# MORTGAGE BAROMETER –HOUSING MARKET FINANCIAL PRESSURE

*At this stage there is little cause for major concern at levels of financial stress in the Housing and Mortgage Market, but there has been some mild increase in financial pressure, and we would expect some more to follow*

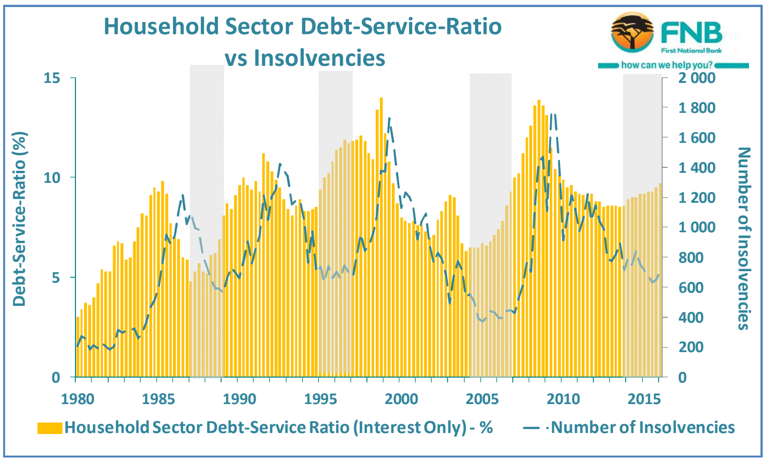
19 July 2016

**KEY POINTS**

- The past 2 and a half years of interest rate hiking have been mild, with only 2 percentage points' worth of rate hiking by the SARB (Reserve Bank) in total. However, under the FNB "Base Case" economic forecast, some mild increase in Household Sector Mortgage Non-Performing Loans through the 2016-2018 forecast period is still expected to come.
- Various indicators in the Home Owner market have for a while pointed to mounting financial constraints or in some cases, more recently, a small rise in financial stress. But no indicators yet point to "severe" financial stress". The softening indicators include a decline in estimated percentage of sellers upgrading, slower levels of home maintenance and upgrades, and a slight lift in the percentage of sellers selling in order to downgrade due to financial pressure.
- In the Housing Rental Market, a noticeable signal of some build in financial pressure was also seen in 1st Quarter 2016 TPN stats. From a high of 86% of total tenants back at a stage of 2014, the percentage of tenants in good standing has declined to 82.2% by the 1st quarter of 2016, the 1st quarter's quarter-on-quarter decline being the most noticeable in this current cycle to date.

## 1. MORTGAGE CREDIT HEALTH OUTLOOK – BEWARE OF LAGS. STILL SOME IMPACT FROM PAST INTEREST RATE HIKES TO COME

**The past 2 and a half years of interest rate hiking have been mild, with only 2 percentage points' worth of rate hiking by the SARB (Reserve Bank) in total. However, under the FNB "Base Case" economic forecast, some mild increase in Household Sector Mortgage Non-Performing Loans through the 2016-2018 forecast period is still expected to come.**



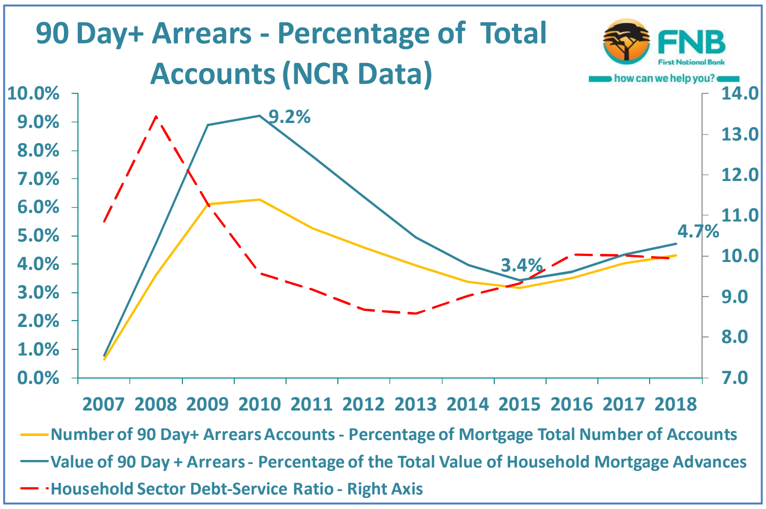

Long before banks begin to see the impact of a weakening economy or rising interest rates in their arrears and non-performing loan levels, there are quite a number of leading indicators in the Household Sector, as well as in Residential Market data, of building financial constraints that can provide "early warnings"

The best single "macro-predictor" of Residential Mortgage Arrears levels/trends is the Household Sector Debt-Service Ratio. The Debt-Service Ratio indicates the Total Interest Paid on all outstanding Household Sector Debt per quarter, expressed as a ratio of Household Disposable Income per Quarter.

The level of this ratio is thus determined by the level of Household Disposable Income, the amount of outstanding Household Debt, and the average borrowing rate on that debt.

The Debt-Service Ratio began to rise noticeably from early-2014, as a result of the start of SARB interest rate hiking. From 8.5 late in 2013, the ratio has risen to 9.7 by the 1st quarter of 2016. The magnitude of the rise has been limited by further decline in the Household Sector's Debt-to-Disposable Income Ratio. So, whereas the average quarterly Prime Rate had risen by almost 2 percentage points from the 1st quarter of 2014 to the 1st quarter of 2016, the Debt-Service Ratio had risen by a lesser 1.2 percentage points.

Nevertheless, with a traditional lag which could typically last up to around 2 years, consumer credit health should ultimately deteriorate somewhat, and mortgage arrears would ultimately increase as a percentage of volume or value of total accounts open. This typical lag drives our current forecast of a mild increase in "Non-Performing" Mortgage Loans in the near term.




In our forecasting we define "non-performing" loans as those in arrears for longer than 90 days, using NCR data. From what we believe to have been the low point in 2015, 2 years after the Debt-Service Ratio bottomed in 2013, we project the value of non-performing mortgage loans to rise moderately through our forecast period from 2016 to 2018, from 3.4% of the value of total mortgage loans in 2015 to 4.7% by 2018.

This projection is based on a forecast of mild further interest rate hiking, to where Prime Rate peaks at 10.75% later this year, taking the Debt-Service Ratio to just above 10%.

Through the outer forecast years of 2017 and 2018, the Debt-Service Ratio is projected to move sideways next year and then to decline very slightly, the decline being due to further slight decline in the level of Household Debt relative to Disposable Income ("Debt-to-Disposable Income Ratio), while interest rates are forecast to move sideways through both years.

However, the considerable lag time from when the Debt-Service Ratio begins to decline until when the Non-Performing Loan percentage begins to decline implies that we don't yet see the start of a decline in this percentage during the forecast period to 2018, but one would assume that such a decline could begin to take place by 2019.

A 4.7% high in the Non-Performing Loans percentage, however, would reflect a modest outcome in a weak economic environment with a rising interest rate cycle. In 2010, 2 years after the 2008 interest rate and Debt-Service Ratio peak, the Value of Non-Performing Loans as a Percentage of Total Mortgage Loans Outstanding peaked at a very high 9.2%.

This time around, the ratio is contained by significantly less interest rate hiking, along with a lower level of household indebtedness compared with 2008.

| **HOUSEHOLD MORTGAGE ARREARS AND KEY DRIVERS FORECAST** | | | | **Forecast Period** | | |
|---|---|---|---|---|---|---|
| | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** |
| Nominal Disposable Income (R'm) - % change | 7.9% | 7.2% | 6.3% | 6.8% | 7.2% | 7.1% |
| Debt to Disposable Income (%) | 79.5% | 78.2% | 77.4% | 76.5% | 75.1% | 74.4% |
| Debt Service Ratio | 8.6 | 9.0 | 9.3 | 10.0 | 10.0 | 9.9 |
| Real Disposable Income - % change | 1.8% | 1.3% | 2.2% | 0.1% | 0.8% | 1.2% |
| | | | | | | |
| Mortgage Arrears >90 days (Volume as % of Total Accounts) | 3.9% | 3.4% | 3.2% | 3.5% | 4.0% | 4.3% |
| Mortgage Arrears >90 days (Value as % of Total Accounts) | 4.9% | 4.0% | 3.4% | 3.7% | 4.3% | 4.7% |

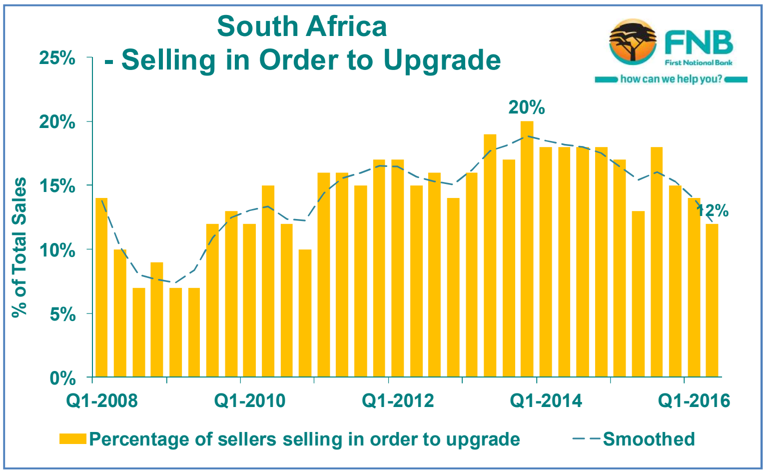
The Household Sector Income, Debt and Mortgage Arrears model projections rest on "benign" FNB Macro-Economic forecasts which include weak albeit slightly improving economic growth in 2017 and 2018, Prime Rate peaking at 10.75% late in 2016 and moving sideways through 2017, and Consumer Price inflation averaging 6.6% in 2016 before slowing back into the 3-6% target range in 2017 and 2018.

| KEY DOMESTIC ECONOMIC PROJECTIONS | | | | Forecast Period | | |
|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| **Domestic Economy (2005 Prices)** | | | | | | |
| Gross Domestic Product (R'm - 2005 Prices) - % change | 2.3% | 1.6% | 1.3% | 0.2% | 1.0% | 1.6% |
| **Prices** | | | | | | |
| Consumer Price Index (2005=100) - % change | 5.8% | 6.1% | 4.6% | 6.6% | 5.9% | 5.5% |
| **Interest Rates (%)** | | | | | | |
| Prime Interest Rate (Annual Average) | 8.50 | 9.07 | 9.39 | 10.53 | 10.75 | 10.75 |
| Government Long Bond Yield (Annual Average %) | 7.72 | 8.25 | 8.17 | 9.52 | 10.36 | 10.54 |
| **Currency** | | | | | | |
| US Dollar/Rand Exchange Rate (Annual Average - Cents per | 9.65 | 10.84 | 12.75 | 15.31 | 15.61 | 16.02 |

## 2. INDICATORS OF BUILDING FINANCIAL CONSTRAINTS AND PRESSURE IN THE HOME OWNER MARKET

Various indicators in the Home Owner market have for a while pointed to mounting financial constraints or in some cases, more recently, rising financial stress. But no indicators yet point to "severe" financial stress".

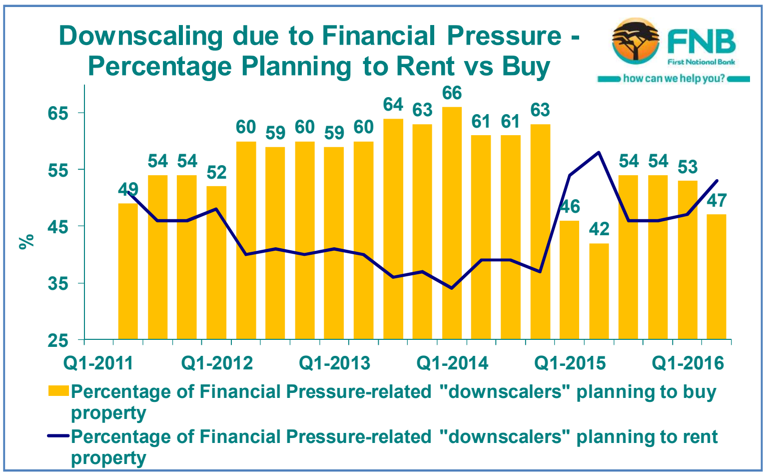
- **Estimated selling in order to upgrade to better homes is on the decline**




One such indicator emanates from the FNB Estate Agent Survey question relating to the percentage of sellers "selling in order to upgrade to better homes. Much of this upgrading is non-essential, so can be "shelved" in tougher times. That is indeed what has happened, and this estimated percentage went into a broad declining trend starting early in 2014.

After a peak of 20% of total selling as at the final quarter of 2013, the estimated percentage of sellers selling in order to upgrade slowed all the way to 12% by the 1st quarter of 2016.

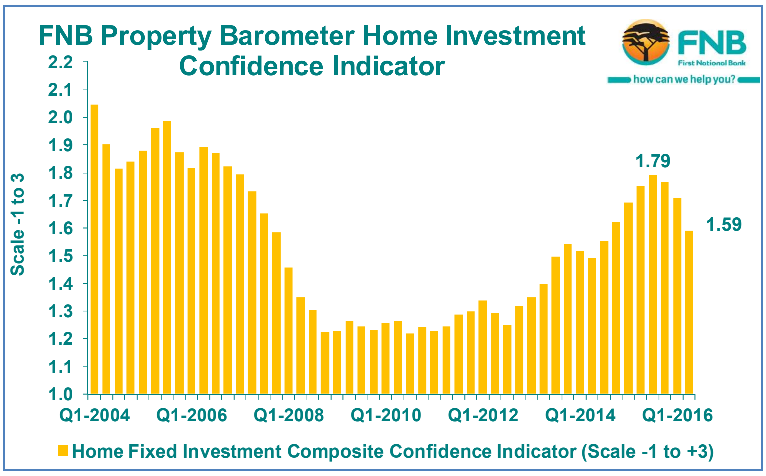
- **More financially stressed home sellers are believed to be opting for the cheaper rental option**




A 2nd sign of financial "constraints" starting to mount in the Household Sector came in the form of an increase in the estimated portion of financially pressured home sellers who were to downscale into a rental property versus those who would buy a cheaper home. Whereas at the end of 2014 it was estimated that 37% of sellers downscaling due to financial pressure would choose the cheaper rental option, by the 2nd quarter of 2016 this had risen to 53%

- **Levels of home maintenance and upgrades estimated to be moderating**

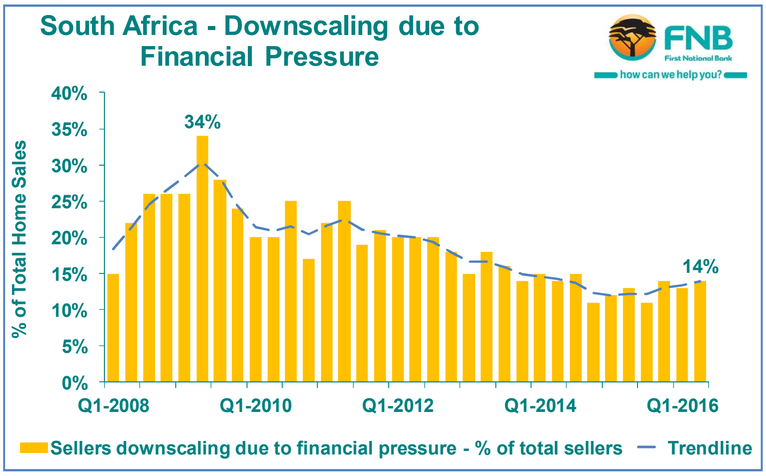
From the FNB Estate Agent Survey, we also see a recent perception of moderation in the levels of home maintenance and upgrades.



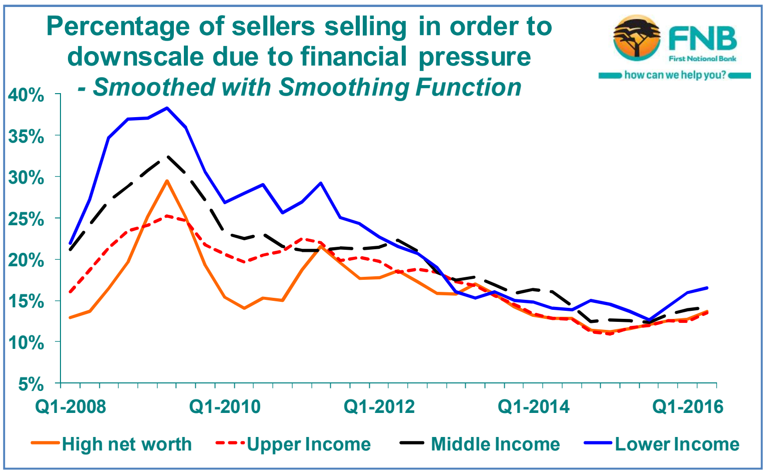

The estimated decline in the highest 3 categories of home investment, “Value adding upgrades”, “Maintaining and making some improvements”, and “Not Spending but still maintaining homes”, in recent quarters has contributed to a 3-quarter decline in the FNB Home Investment Confidence Indicator.

This indicator is represented on a scale of -1 to +3. From a multi-year high of +1.79 in the 3rd quarter of 2015, the Indicator has declined to +1.59 by the 2nd Quarter of 2016.

- **Financial stress-related home selling mildly up off 2014/15 lows**




Estate agents in the survey have also, in recent times, perceived a mild rise in financial stress-related selling. Hovering between an estimated 13-14% of total selling, the percentage of sellers believed to be “selling in order to downscale due to financial pressure” is mildly up off prior lows of 11% reached at times in 2014/15.



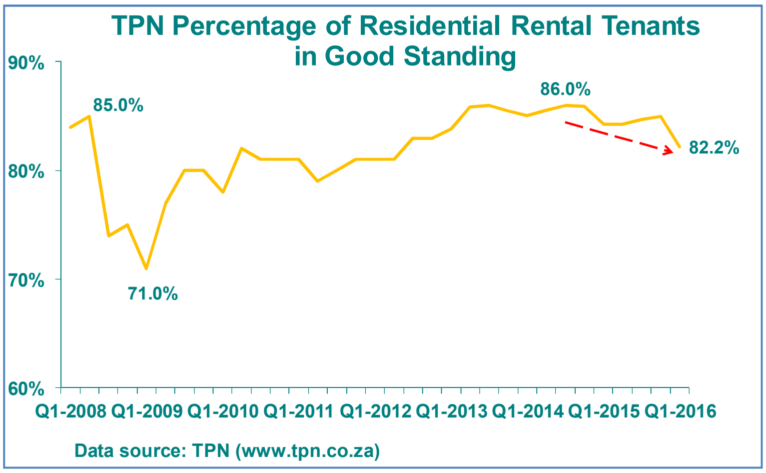

And as should be expected in time of rising interest rates and credit health deterioration, the estate agents surveyed perceived a lightly more noticeable rise in financial pressure-related downscaling in the Low Income Areas compared to higher priced areas. Lower Income Areas’ inhabitants are typically more sensitive to the economic cycle, being less well-resourced to ride out tougher economic and interest rate times.

It must be emphasized, however, that the most recent percentages of financial stress-related downscaling remain low relative to 2008/9 peak levels.

## 3. INDICATORS OF FINANCIAL PRESSURE IN THE HOUSING RENTAL MARKET

- **TPN data regarding rental tenants in good standing shows a more noticeable weakening in Q1 2016**

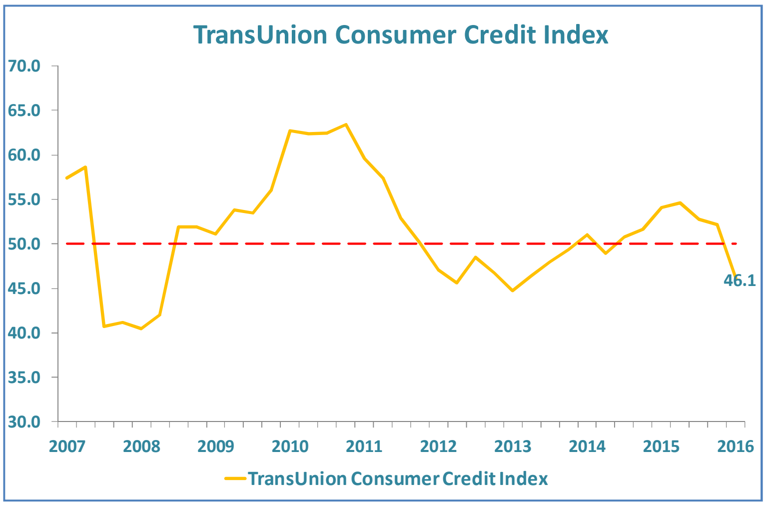
In the Housing Rental Market, a more noticeable signal of rising financial pressure was seen in 1st quarter 2016 TPN stats regarding the percentage of rental tenants "in good standing" with their rental payments to the landlord.




From a high of 86% of total tenants back at a stage of 2014, the percentage of tenants in good standing has declined to 82.2% by the 1st quarter of 2016, the 1st quarter's quarter-on-quarter decline being the most noticeable in this current cycle to date.

This percentage too, though, remains reasonably good compared with a 71% low back in the last recession of 2008/9.

## 4. TRANSUNION CONCUMER CREDIT INDEX, TOO, POINTED TO A NOTICEABLE DETERIORATION IN CREDIT HEALTH IN THE 1ST QUARTER OF 2016

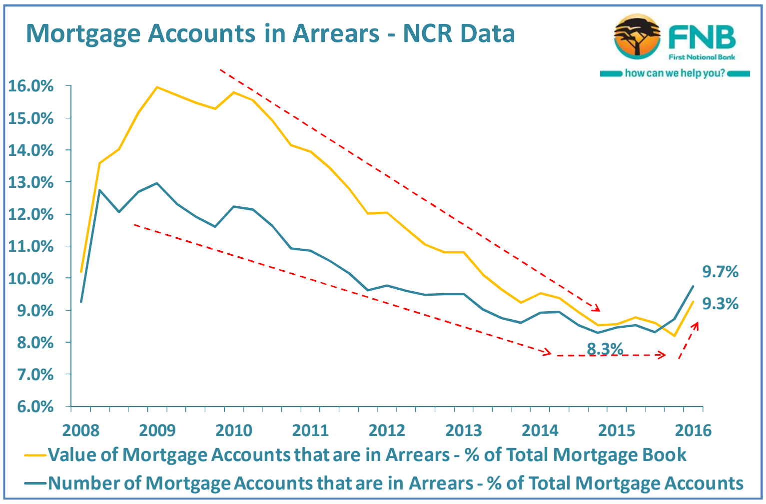



In the last 2 quarters of 2015, the TransUnion Consumer Credit Index began to point to consumer credit health still improving, but at a diminishing rate, its 1st signal of the start of a credit health deterioration looming.

Then, in the 1st quarter of 2016, this index's level dropped to a level of 46.1, below the crucial level of 50 which signals the onset of a deterioration in credit health.

## 5. NCR DATA FOR MORTGAGE ARREARS – A NOTICEABLE RISE EARLY IN 2016

National Credit Regulator (NCR) data for Household Sector Mortgage Arrears expressed as a percentage of total accounts also showed a more noticeable rise in the 1st quarter of 2016, after having earlier gone from a broad declining trend pre-2015, to more-or-less sideways through last year. The Value of Arrears Accounts expressed as a Percentage of the Value of All Accounts rose to 9.3% in the 1st quarter of 2016, up from the previous quarter's 8.2%.




By comparison, the Total Number of Accounts in Arrears as a Percentage of The Total Number of Accounts rose from a previous 8.7%, to 9.7%.

## 6. CONCLUSION

Based on a benign macroeconomic forecast for 2017 and 2018, the level of Household Sector Non-Performing Mortgage loans (90 Day + Arrears) is projected to peak at a moderate 4.7% of Total Mortgage Loans in 2019, which is around half of the 2010 peak percentage that followed the Global Financial Crisis of 2007/8.

The forecast increase is driven by a rise in the Household Sector Debt-Service Ratio since late-2013/early-2014, with SARB interest rate hikes being the key driver.

Typically, there is a considerable lag time between increases in the Debt-Service Ratio and resultant increases in Mortgage Arrears, so it is realistic to expect a some further increase in Non-Performing Loans levels even after the expected end of interest rate hiking late this year.

Examining our set of indicators related to financial constraints and financial stress in the Household and Residential Mortgage Market, all of these have pointed to rising financial pressure in the early stages of 2016, although not yet to "severe" financial pressure.

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