PROPERTY BAROMETER
Mortgage Barometer

The Residential Mortgage Market could still see a decline in levels of mortgage arrears in the near term...Rand and Interest Rates permitting

In the initial stages of 2017, the Residential Mortgage Market has remained one of very low growth. However, while this can be ascribed to recessionary economic conditions and low levels of consumer confidence, the levels of financial stress in the market remain moderate, and it is conceivable that mortgage arrears levels could even decline in the near term should interest rates continue to move sideways.

KEY POINTS

• Total Mortgage Arrears, according to NCR (National Credit Regulator) data, remain at moderate levels and resumed their decline as a percentage of total mortgage loans in the 2nd half of 2016, after the SARB had stalled on interest rate hiking since March 2016.

• The positive contributor to the mortgage arrears situation has been a major decline in the Household Sector Mortgage Debt-to-Disposable Income Ratio and the total Household Debt-to-Disposable Income Ratio since 2008.

• If our FNB forecast of interest rates moving sideways through 2017 and into the years beyond, and the Debt-to-Disposable Income Ratio continues to decline, it is conceivable that we can see further decline in mortgage arrears levels during 2017 and even beyond.

• Economic forecasts these days are even more full of risks than normal though. Mortgage Lending Sector competition level changes, and the “fragile” Rand and its potential impact on interest rates, remain key risks to mortgage credit repayment performance in the next few years.
FOCUS: THE MORTGAGE ARREARS OUTLOOK

WITH THE RAND HOLDING, WE COULD STILL BE ON TRACK FOR SOME IMPROVEMENT IN MORTGAGE ARREARS

The most relevant indicators point to the level of Household Sector Mortgage Arrears likely being on track for further near term decline (improvement). Total Arrears, according to NCR (National Credit Regulator) data, had risen mildly early in 2016, from a low of 8.2% of the value of total mortgage loans outstanding in the final quarter of 2015, to 9.4% in the 2nd quarter of 2016. However, following a SARB (South Africa Reserve Bank) stalling of interest rate hiking after March 2016, this percentage receded once more to 8.8% of total mortgage loans by the final quarter of last year.

The quick recovery (return to decline) in Household Sector Mortgage Arrears levels, in these times of weak economic growth, may come as a surprise to many, but it shouldn’t. It is arguably explained by ongoing slow (and good quality) new mortgage lending growth, which translates into steady decline in the Mortgage Debt-to-Disposable Income Ratio, which in turn contributes to the declining trend in the Household Sector Debt-to-Disposable Income Ratio.

From a high of 49.2% as at the 1st quarter of 2008, the Household Sector Mortgage Debt-to-Disposable Income Ratio has declined all the way to 33.9% by the final quarter of 2016.

This massive improvement has been key in driving the Overall Household Sector Debt-to-Disposable Income Ratio down from an all-time high of 87.8% in the 1st quarter of 2008 to 73.4% by the end of 2016.

This has greatly reduced the vulnerability of the Household Sector to events such as recessions interest rate hikes since 2008.

Looking at our most recent Deeds data extracts for bonded property transactions by individuals (“Natural Persons”), we saw a continuation of year-on-year decline in the 1st 3 months of 2017 to the tune of -4.5% in terms of volume of such transactions, and a lesser decline of -0.6% in terms of the value of such transactions.
With that weak estimate of this proxy for new residential mortgage lending growth early in 2017, the value of Mortgage Advances growth ticking along slowly to the tune of only 3% year-on-year as at April 2017, and Nominal Disposable Income growth expected to be in a significantly higher 6-7% range, it is highly likely that the declining trend in the Mortgage Debt-to-Disposable Income Ratio continued into the early stages of 2017. The same is likely for the overall Household Sector Debt-to-Disposable Income Ratio, with overall Household Sector Credit growth measuring a lowly year-on-year rate of 2.9% as at April 2017.

A declining Household Sector Debt-to-Disposable Income Ratio has meant that, as soon as interest rates stopped rising after March 2016, the all-important Household Sector Debt-Service Ratio (The interest cost on Household Debt expressed as a ratio of Disposable Income) began to decline mildly once more. This ratio is arguably the best predictor of the direction of mortgage arrears. We believe that its return to a state of decline, implying declining interest costs as a percentage of Household Sector Disposable Income in the 2nd half of 2016, was key in reversing the short-lived increased in mortgage arrears early last year.

For the Debt-Service Ratio to remain in a state of decline through 2017 and beyond depends on Household Sector Credit growth under-performing Household Disposable Income growth, and for interest rates to remain moving sideways.

Given the very weak state of consumer Confidence, as reflected in the negative readings of the FNB-BER Consumer Confidence Index, we expect a relatively cautious consumer in 2017 and even the few years beyond, lifting their savings rate mildly and going slowly on borrowing growth in a weak economic and employment environment.
BUT CAN INTEREST RATES PLAY BALL? YES, BUT MUCH DEPENDS ON THE RAND’S BEHAVIOUR

a key question is whether interest rates will be able to remain moving sideways, or will further increases be required. Key to rates continuing to move sideways will be a relatively well-behaved Rand. Any policy announcement of political event that dents investor sentiment severely and knocks the Rand sharply weaker can lead to renewed interest rate hiking. That will remain a key risk to mortgage debt repayment performance through the next few years of likely political and policy uncertainty.

The Firstrand Base Case, however, is for the SARB to maintain interest rates at current levels where Prime Rate is 10.5% through to 2019.

Right now, there is even speculation of a rate reduction in some circles, with the Rand reasonably stable and food price inflation coming off strongly as drought conditions are alleviated in many parts of the country.

The Producer Price Inflation Rate for Agriculture reflects the drought alleviation, having slowed from 20.7% as at June 2016 all the way to -4.4% year-on-year deflation as at April 2017.

This is normally a lead indicator for the direction of the Consumer Price Index (CPI) for food, whose inflation rate has also declined from a high of 11.4% as at December 2016 to 6.75% in April 2017.

This is a material drop in what is one of the major sub-indices within the overall CPI

With Food a key influence, the Overall CPI inflation rate itself has slowed from 6.7% year-on-year in December 2016 to 5.3% by April 2017.

This brings the inflation rate back within the SARB’s 3-6% target range, which bodes well for stable interest rates in 2017 (Rand permitting)

Under these benign inflation and interest rate circumstances, it is conceivable that the Household Debt-Service Ratio could decline further, as could Household Sector Mortgage Arrears and Non-Performing Loans (Mortgage Loans 90 days and more in arrears).

CAN MORTGAGE LENDING SECTOR COMPETITION LEVELS HEAT UP?

A 2nd risk to any Mortgage Sector forecast has to do with possible changes in competition levels within the Mortgage Lending Sector, which may or may not lead to changes to lenders’ risk “appetites” and pricing of home loans.

At present there is not much more than a vague hint of change in this regard, coming in the form of slight increases in the Effective Home Loan Approval Rate according to Ooba data, and a slight reduction in the average differential...
above Prime Rate on home loans in recent months. In addition, we have estimated some slight increase in the Average Loan-to-Purchase Price (LTP) Ratio for the industry, using Deeds Data.

But for the time being these changes are too little and too soon to draw conclusions regarding any major move in industry-wide competition levels.

**CONCLUSION**

Mortgage Lending Sector competition level changes, and the Rand and its potential impact on interest rates, remain key risks to mortgage credit repayment performance in the next few years.

However, based on the FNB base case forecast, where CPI inflation remains within the target range, interest rates remain at current levels through the forecast period to 2019, and economic growth shows slow but positive annual averages (the recent 2-quarter recession being short in duration), our projection is for anaemic Mortgage and overall Household Credit growth to sustain the decline in the Household Debt-to-Disposable Income Ratio, and thus the Debt-Service Ratio. This would cause the value of Non-Performing Household Sector Mortgage Loans (Loans 90 days and more in arrears) to decline as a percentage of the value of Total Mortgage Loans outstanding in 2017 from 3.3% of the value of total mortgage loans outstanding in 2016 to 3.1% for 2017.

Perhaps ironically, tough economic times and resultant weak consumer confidence levels can do a lot of good in terms of promoting more cautious financial behavior and a decline in indebtedness relative to disposable income. This reduces vulnerability of households to interest rate hikes.

<table>
<thead>
<tr>
<th>FORECAST SUMMARY</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Growth (%)</td>
<td>1.3</td>
<td>0.3</td>
<td>0.7</td>
<td>1.4</td>
</tr>
<tr>
<td>Prime Rate Average (%)</td>
<td>9.4</td>
<td>10.4</td>
<td>10.5</td>
<td>10.5</td>
</tr>
<tr>
<td>CPI Inflation (%)</td>
<td>4.6</td>
<td>6.3</td>
<td>5.7</td>
<td>5.2</td>
</tr>
<tr>
<td>Household Credit Growth (%)</td>
<td>4.6</td>
<td>3.8</td>
<td>4.4</td>
<td>3.3</td>
</tr>
<tr>
<td>Nominal Disp. Income Growth (%)</td>
<td>6.6</td>
<td>7.3</td>
<td>6.6</td>
<td>7.4</td>
</tr>
<tr>
<td>Debt-to-Disposable Income Ratio (%)</td>
<td>76.9</td>
<td>74.5</td>
<td>72.9</td>
<td>70.1</td>
</tr>
<tr>
<td>Debt-Service ratio (%)</td>
<td>9.33</td>
<td>9.63</td>
<td>9.43</td>
<td>9.07</td>
</tr>
<tr>
<td>Non-Performing Mortgage Loans (%)</td>
<td>3.4</td>
<td>3.3</td>
<td>3.1</td>
<td>2.8</td>
</tr>
</tbody>
</table>

*“Non-Performing Mortgage Loans” refer to those mortgage loans that are 90 days or more in arrears. This variable is expressed as a percentage of Household Sector Mortgage Loans Outstanding in the forecast table
NEW LENDING GROWTH

• Growth in New Loans Granted vs the FNB Residential Market Activity Rating

In recent quarters, growth in the value of new mortgage lending has been in negative territory. In the final quarter of 2016, the rate of decline was -5.79% year-on-year according to NCR (National Credit Regulator) data for the value of new mortgage loans granted.

However, the smoothed FNB Estate Agent Survey Activity Rating is usually a good leading indicator for new mortgage lending. With its year-on-year rate of change turning slightly positive in the 1st quarter of 2017, it points to some likely near term return to positive growth in new mortgage lending to households.

• Deeds data for bonded property transaction by individuals (“Natural Persons”)

Deeds data regarding Bonded Transactions registered by individuals (“Natural Persons”) has also pointed to negative growth for most of the period since May 2016. For the 1st 3 months of 2017, the volume of bonded property transactions registered by individuals (“natural persons”) declined year-on-year by -4.5%, and the value of these transactions by -0.6%.

However, these most recent rates of decline had diminished a little, possibly hinting at a near term move back to positive growth.

• Deeds data for bonded property transaction by individuals (“Natural Persons”)

As household finances have gradually become more constrained by interest rate hiking since 2014, and with income growth having slowed with a slowing economy, so we have seen a broad slowdown in the rate of growth in the average value of bonded property transactions.

From a high of +12.4% year-on-year growth in the 3 months to February 2013, the rate of increase in the average value of bonded transactions by individuals has broadly slowed to 4.1% year-on-year by the 1st 3 months of 2017.

Growth in the Average Bonded Property Transaction Value for Individuals (“Natural Persons”)

Bonded Property Transaction Value vs Volume Growth - by Individuals (“Natural Persons”)
• Ooba data for the average bond amount

Oobarometer data (Source: Ooba), too, has shown some tapering in growth in the average value of bond amounts through its own business, from 9.9% year-on-year in the 3 months to November 2015 to 4.5% in the 3 months to April 2017.

The recent rate of growth is significantly down from a post-recession high of 11.3% year-on-year for the 3 months to August 2013.

THE BONDED TO UNBONDED TRANSACTIONS MIX

• The Bonded-to-Un-bonded Transaction Ratio

One of the 1st signs of the impact of the big interest rate cuts around 2008/9 wearing thinner was to be found in a trend change in the Bonded-Un-bonded Transactions Ratio for Individual property buyers. This ratio increased significantly from late-2009 to early-2012 as bonded transactions outpaced un-bonded transactions on the back of interest rates having fallen sharply. But after rate cutting had come to an end, and then rates started to increase from early-2014, the Ratio of Bonded-to-Unbonded transactions (Value of Transactions) broadly declined from a 2.62 high in the 3 months to January 2012 to 1.65 by the 3 months to April 2017.
MORTGAGE LENDERS’ BROAD LENDING STANCE

- Mortgage loan decline rates mildly down, according to Ooba data

There appears to have been a trend change in rates of declined home loan applications since around late-2016, following a broad rising trend from around late-2015 to late-2016, to one of a declining ratio of applications declined.

From a high of 48.1% by the 3 months to October 2016, the Average Home Loan Application Decline Ratio receded to 44.8% by the 3 months to April 2017.

This has translated into a rise in the so-called Effective Approval Rate on mortgage loan applications (which includes approvals plus applications declined by one bank and approved by another), from 66.4% for the 3 months to September 2016 to 68.5% for the 3 months to April 2017.

This rising effective approval rate may have to do with some deliberate credit criteria relaxation by banks as a group, as they attempt to drive sales growth a little more in the face of a lack of economic and “natural” market growth. However, it is a bit early in the recent upward move in the Effective Approval Rate to conclude the existence of any strong trend.

- Estimated average Loan-to-Purchase Price (LTP) Ratio

Using Deeds data in order to estimate our own average Mortgage Loan-to-Purchase Price (LTP) Ratio, we see a slight rise in recent months.

From an estimated 87.7% as at December 2016, the average LTP has risen to 89.7% for April 2017. The 3-month moving average has also risen slightly.
MORTGAGE MARKET PRICING

- Ooba data shows very slight recent pricing “squeeze”, but not yet significant

In recent months, Ooba data has just started to point to a slight renewed decline in the average rate differential above Prime Rate on new home loans. From a high of +0.50 of a percentage point above Prime Rate (Prime currently 10.5%) in July 2016, the average differential has declined slightly to +0.31 of a percentage point above Prime in April 2017. This comes after a prior increase in the differential between November 2015 and July 2016. Pricing squeezes can point to competitiveness among mortgage lenders heating up.

BONDED HOME AFFORDABILITY

Using Deeds data for bonded property registrations by individuals (Natural Persons), we calculate the affordability on the average priced bonded property in terms of Bond Instalment Value on the Average Priced Bonded Property at Prime Rate/Per Capita Disposable Income Ratio Index.

Due to a combination of 200 basis points’ worth of interest rate hikes from January 2014 to March 2016, along with house price growth outpacing Per Capita Disposable Income growth over much of the period, the Instalment/Per Capita Disposable Income Ratio Index rose by a cumulative 16.1% from the 3rd quarter of 2012 to the 4th quarter of 2016.

This probably explains the mild decline in transaction volumes in recent times.
THE MIX OF MORTGAGE LOAN TYPES

- Further loans and Switching levels don’t show much sign of increasing mortgage lender drives to boost sales in a flagging market

One threat to market profitability and risk can stem from certain lenders attempting to boost sales through mortgage loan switching and further loans, when the “natural growth” in the market starts to fade.

To date, however, we see little sign of this.

Further loan registration volume was 20% of total mortgage loans registered by individuals for the 3 months to April 2017, according to our deeds data estimates, down from 23.2% for the 3 months to January 2017. The percentage is far below estimates above 30% around 2012.

Switched loans, expressed as a percentage of total loans registered, also remain relatively moderate compared to pre-2008 boom times. For the 3 months to April 2017, the estimated volume of switched loans was 9.2% of total registered loans. This was up from 7.3% in November 2016, but such multi-month fluctuations are normal, and the 9.2% remains in the range which the switching percentage has moved in since 2010. The most recent percentage remains well-below the early-2008 “end-of-boom-time” high of 15.3%

- Home Loan Cancellation Risk remains low in a financially constrained housing market

Over-exuberance in the market can lead to a higher frequency of home buying and re-selling, which can be costly for mortgage lenders due to the cost of putting new home loans on the books each time. We refer to this as “home loan cancellation risk”

Monitoring for any signs of speculative activity or “over-exuberant” behavior in the market, we find that a good indicator to watch is the frequency of repeat sales transactions on homes. To this effect, we compile estimates of the number of bonded homes being sold in a given month that were bought within 12 months or less prior to this sale, expressed as a percentage of total transactions in that month.
We repeat the exercise for properties having been purchased 24 months prior to the sale, 36 months prior as well as 48 months prior.

At 1.98% of total sales as at April, homes that were purchased within less than 12 months of the recent sale remained very low compared to pre-2008 boom time levels peaking at 12.85% in August 2005.

The 24, 36 and 48 month series, too, remain low by pre-2008 boom levels, and have even showed some slight decline in recent months

- **Financial stress in the mortgage market diminishes once more after brief early-2016 rise**

  Total Arrears, according to NCR (National Credit Regulator) data, had risen mildly early in 2016, from a low of 8.2% of the value of total mortgage loans outstanding in the final quarter of 2015, to 9.4% in the 2nd quarter of 2016. However, following a SARB (South Africa Reserve Bank) stalling of interest rate hiking after March 2016, this percentage receded once more to 8.8% of total mortgage loans by the final quarter of last year.

- **Total Mortgages Outstanding remain in low single-digit growth territory, and continued decline in real terms**

  In the early months of 2017, we saw further low single-digit nominal year-on-year growth in the value of Household Sector Mortgage Debt Outstanding, measuring 3.05% in April.

  In real terms, adjusted for consumer price inflation (as per the PCE Deflator), year-on-year decline continued in the 1st 4 months of the year, measuring -2.2% in April.

  Since the post-boom peak in January 2009, the real value of Household Sector Mortgage Debt has declined by -18.7% as at April 2017.
And the Mortgage Debt-to-Disposable Income Ratio continues the declining trend

From a high of 49.2% as at the 1st quarter of 2008, the Household Sector Mortgage Debt-to-Disposable Income Ratio has declined all the way to 33.9% by the final quarter of 2016.

This massive improvement has been key in driving the Overall Household Sector Debt-to-Disposable Income Ratio down from an all-time high of 87.8% in the 1st quarter of 2008 to 73.4% by the end of 2016.