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MARKET ANALYTICS AND  
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## PROPERTY BAROMETER

### FNB House Price Index

*While Year-on-year house price growth accelerated further in July, month-on-month growth has begun to slow as non-price market indicators generally point to renewed market weakening.*

July 2018 saw the FNB House Price Index growing by a faster 4.1%, year-on-year, up from the previous month's revised 4.0%, and from a February 2018 revised low of 2.8%. This is the 5<sup>th</sup> consecutive month of house price growth acceleration. However, signals from the FNB Estate Agent Survey and FNB's Valuers suggest that a loss of price growth momentum is approaching.

#### FNB HOUSE PRICE INDEX RESULTS FOR JULY 2018

On a year-on-year basis, the FNB House Price Index's growth rate continued to accelerate mildly in July 2018, reaching 4.1%, up from a revised 4.0% in June, and the 5<sup>th</sup> consecutive month of growth acceleration since the revised 2.8% low point reached in February.

However, while the growth accelerates mildly in nominal terms, price growth remains negative in "real" terms, when adjusting for CPI (Consumer Price Index) inflation. This in effect means that the gradual housing market price "correction" continues, a slow real price decline that has been in place for most of the time since early-2016.

But while real house prices have only been in decline since 2016, the signs of market growth slowdown can be traced even further back to 2014, where real price growth peaked at +2.4% year-on-year in May 2014, and where-after a broad growth slowdown commenced on the back of interest rate hiking at the time, along with a broad economic growth stagnation from around 2012.

As at June 2018 (July CPI not yet available) real house prices declined year-on-year by -0.5%, with CPI inflation at 4.6% in that month and house price growth at 4.0%.



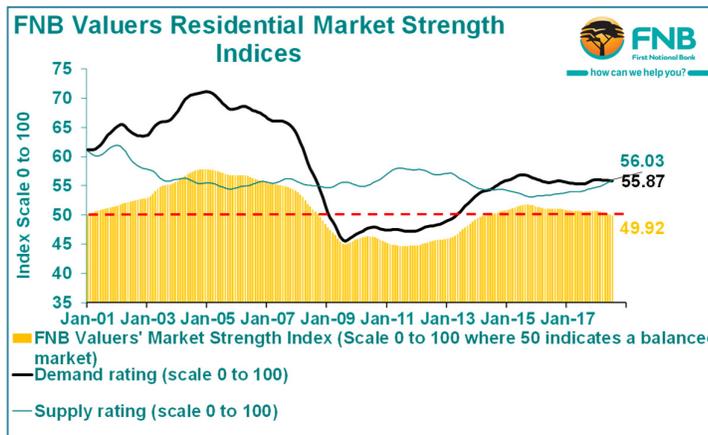
## MONTH-ON-MONTH HOUSE PRICE GROWTH STARTS TO LOSE STEAM AGAIN



In order to better evaluate recent house price growth momentum, we examine month-on-month house price growth on a seasonally-adjusted basis. Month-on-month growth direction leads year-on-year growth direction, and here we have already seen 2 consecutive months of month-on-month house price growth slowdown.

From a high of 0.66% month-on-month growth in May, this rate has slowed to 0.48% as at July 2018

## FNB VALUERS PERCEIVE A RECENT RETURN TO BROADER MARKET SLOWING TREND

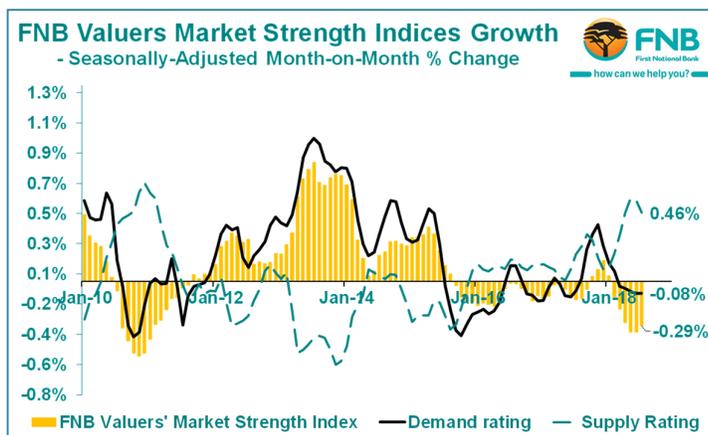


FNB's valuers have been indicating that a mild housing demand strengthening took place late in 2017. This briefly curbed supply growth, according to the valuers, and translated into a slight increase in the FNB Valuers' Market Strength Index (explanatory notes on page 7) late in 2017 and very early in 2018.

With something of a lag, this appears to explain the short uptick in nominal house price growth more recently.

However, the valuers have more recently begun to report weakening home demand, the Seasonally-Adjusted FNB Residential Demand Rating declining by -0.08% in July 2018, and significant growth in the FNB Housing Supply Rating, to the tune of +0.46% at the same time. This translates into a July 2018 month-on-month decline of -0.29% in the FNB Market Strength Index, the Market Strength Index reflecting the balance between supply and demand.

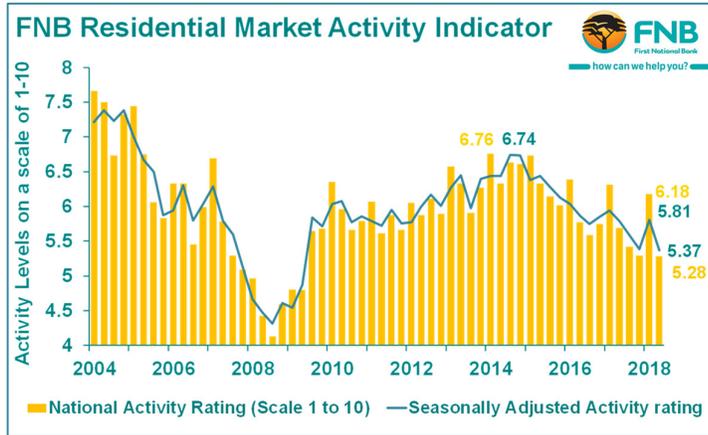
In addition, July 2018 was the 1<sup>st</sup> month since May 2014 that the FNB Market Strength Index dipped below 50, to 49.9, which means that the valuers now rate residential supply as slightly stronger than demand.



The broader multi-year weakening in the FNB Market Strength Index began after a multi-year high of 51.8 reached in September 2015.

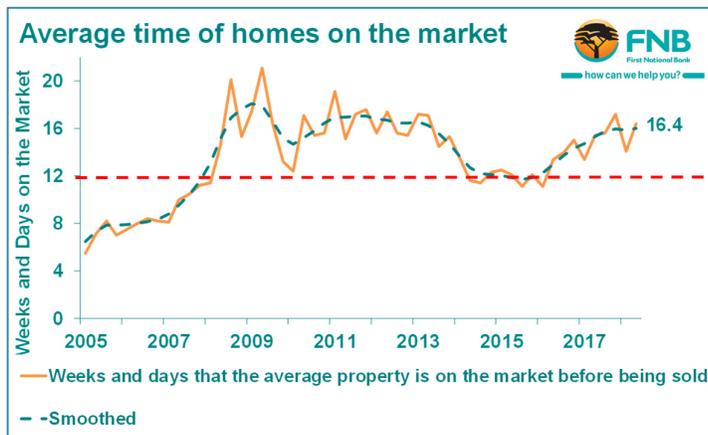
## FNB ESTATE AGENT SURVEY ALSO INDICATES A RECENT RETURN TO BROADER MARKET SLOWING TREND

The FNB Estate Agent Survey provides support to the FNB Valuers' perceptions of a resumption in the market weakening trend.



A resumption of a multi-year weakening trend was witnessed in the 2<sup>nd</sup> Quarter 2018 FNB Estate Agent Survey, with agents reporting a significant drop in residential market activity in the May 2018 quarterly survey, after a “once-off” 1<sup>st</sup> quarter “spike”.

In the survey, we ask respondents to provide a rating of market activity in their areas, a subjective rating on a scale of 1 to 10. The 1<sup>st</sup> quarter 2018 FNB Activity Rating jumped noticeably from 5.29 in the previous quarter to 6.18, a jump that we believed to have been “Ramaphoria”-related, a reference to the change in Presidents in South Africa early this year. Even on a seasonally adjusted basis, the jump was the most noticeable in over 3 years, from 5.4 in the prior quarter to 5.79. But this 1<sup>st</sup> quarter 2018 uptick, like the slightly earlier FNB Valuers Market Strength Index uptick, was quickly reversed in the 2<sup>nd</sup> quarter, the Activity Rating falling back sharply to 5.28 (5.37 on a seasonally adjusted basis).

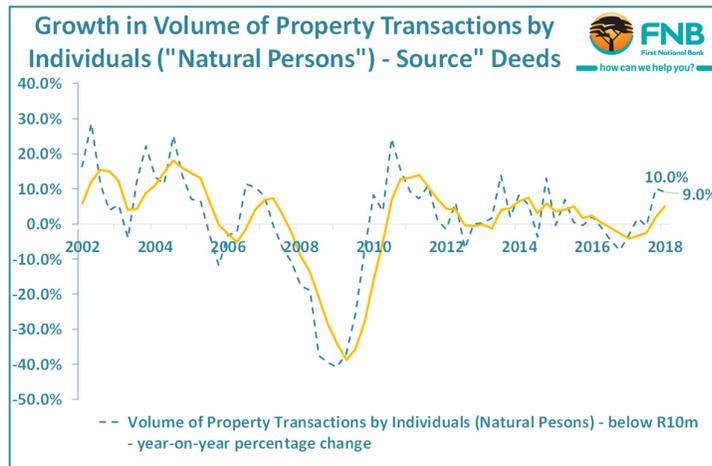


The broad multi-year weakening trend in the Residential Activity Rating started in 2015.

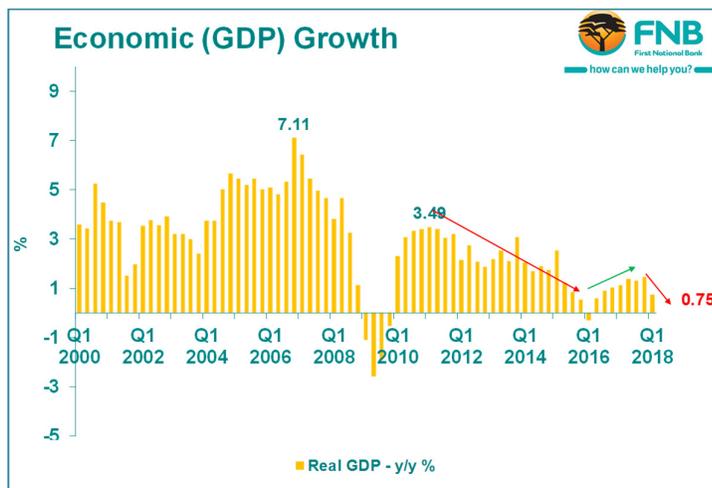
Further support for the perception of a weakened Housing Market in the 2<sup>nd</sup> quarter of

2018 was provided by a renewed lengthening in the estimated average time of homes on the market prior to sale, from 14 weeks and 1 day in the prior quarter to 16 weeks and 4 days in the 2<sup>nd</sup> quarter, according to the Estate Agent Survey. A broad multi-year increase in the average time of homes on the market started in 2016.

## WHAT DOES ALL THIS MEAN FOR MARKET TRANSACTION VOLUMES?



The brief late-2017 market strengthening, according to the FNB Valuers, and the mild strengthening in house price growth early in 2018, appears to have been reflected in housing market transaction volumes late in 2017 and early-2018. Using deeds office property transfers by individuals ("Natural Persons") below R10m, which we believe will be residential-dominated, we saw a year-on-year growth acceleration in transaction volumes late in 2017, from negative territory to a positive +10% year-on-year growth rate in the final quarter of the year. The 1<sup>st</sup> quarter was slightly slower but still saw solid growth to the tune of 9%.



What could we possibly ascribe that brief late-2017/early-2018 relative market strength to? 2017 saw slightly better economic growth, assisted by the end of drought conditions in many parts of the country and a major surge in Agriculture production.

From a negative rate of -0.3% year-on-year in the 1<sup>st</sup> quarter of 2016, real GDP (Gross Domestic Product) growth slowly recovered to 1.5% by the final quarter of 2017. This may have had some impact on the housing market strengthening in the summer 2017/18 quarters, along with a brief "Ramaphoria" bounce in sentiment after the major political leadership changes late in 2017

and early in 2018.

However, 1st quarter GDP growth receded to 0.75% year-on-year, and with it our valuers saw demand weaken once more, followed by agents seeing market activity decline in the 2<sup>nd</sup> quarter of 2018.

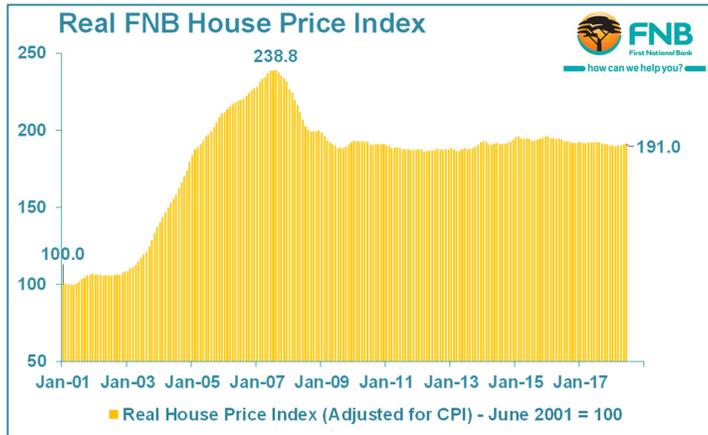
## THE HOUSING MARKET OUTLOOK

While periodic fluctuations in economic growth could see transaction volumes growth turn positive from time to time, the consistently negative real house price growth since early-2016 leads us to believe that economic growth rates of 1%-1.5%, along with very little interest rate stimulus, are not sufficient to create the level of housing demand that can mop up oversupplies, balance the market and lead to positive real house price growth.

With 7 months' worth of house price data available for 2018, it appears increasingly likely that average house price growth for the entire 2018 will come in slower than 2017's 4.3%, and we now forecast an average price growth of 3.5% for this year. This is based on a GDP forecast of 1.3% for 2018, which is unchanged from 2017. The Firstrand Economics team sees slightly faster economic growth in 2019, to the tune of 1.6%, translating into a slightly faster average house price forecast of 3.7%.

But given what we have said about economic growth being insufficient to balance the housing market better, the theme through our forecast period is one of low single-digit house price growth, underperforming CPI inflation, which will translate into further real house price decline.

## LONGER RUN REAL HOUSE PRICE PERFORMANCE



Examining the longer run performance of the FNB Repeat Sales House Price Index in real terms, we still see it at relatively expensive levels, 91% up on the January 2001 “pre-boom” index level. This is despite significant cumulative “post-bubble correction”, the “bubble” referring to the pre-2008 housing bubble.

The “post-bubble correction” to date has come in 2 phases. The 1<sup>st</sup> phase of correction was a sharp decline in real house prices of -21.2% from August 2007’s all-time high to July 2009.

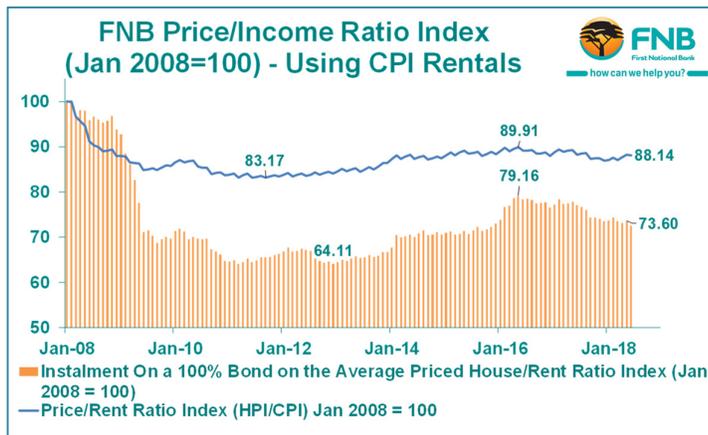
From August 2009 to February 2015, we saw a period of mild recovery, with cumulative real

house price growth of 4%. This “mini-recovery” came on the back of massive monetary and fiscal stimulus packages both globally and locally, aimed at ending the 2008/9 recession and Global Financial Crisis. In South Africa, the SARB implemented major interest rate cuts at the time, Prime Rate dropping all the way from 15.5% late in 2008 to 8.5% by mid-2012. The global and local stimulus helped the economy to recover moderately, and the stimulus helped economic growth recover to a 3.3% post-2008 recession peak.

However, from 2012, the stimulus began to wear off, economic growth began a broad stagnation, and then interest rates started to rise from early-2014 to early-2016.

These events led to the start of the “2<sup>nd</sup> phase” of the post-bubble correction, with real house prices having to date declined cumulatively by -2.5% since February 2015.

Real house price correction in recent years has been slow going, with CPI inflation also being very low.



The other key “real” house price measure which we watch is our House Price-Residential Rental Ratio Index. This is an important ratio, because if house prices rise too far above rentals, ultimately a relatively cheap rental market would become more attractive relative to home buying, thereby reducing home buyer demand as more households choose the rental option.

Progress in lowering what we believe to still be a relatively high Price-Rent Ratio has also been slow going, with the rental market also mired in mediocrity in a weak economy. Nevertheless, there has been some decline in our Price-Rent

Ratio Index, to the tune of -2% since a post-recession high reached in May 2016, and the index is 11.86% down on January 2008.

## Monthly FNB House Price Index (Jan 2001 = 100)

Date	Index	y/y % change	Date	Index	y/y % change	Date	Index	y/y % change	Date	Index	y/y % change
Jan-01	100.0		Jul-05	243.9	28.8%	Jan-10	325.8	3.2%	Jul-14	412.20	8.4%
Feb-01	100.8	-1.7%	Aug-05	247.8	27.9%	Feb-10	328.0	4.0%	Aug-14	413.42	8.1%
Mar-01	101.0	-0.7%	Sep-05	251.9	26.9%	Mar-10	329.4	4.7%	Sep-14	414.74	7.8%
Apr-01	101.1	-0.4%	Oct-05	256.1	25.7%	Apr-10	330.2	5.2%	Oct-14	416.06	7.4%
May-01	101.7	-0.5%	Nov-05	259.9	23.9%	May-10	330.8	5.5%	Nov-14	417.86	6.9%
Jun-01	102.7	0.7%	Dec-05	263.0	21.7%	Jun-10	330.5	5.4%	Dec-14	420.11	6.3%
Jul-01	104.0	3.0%	Jan-06	265.8	19.8%	Jul-10	329.8	4.9%	Jan-15	422.98	5.9%
Aug-01	105.5	5.9%	Feb-06	268.8	18.4%	Aug-10	329.8	4.7%	Feb-15	426.41	5.9%
Sep-01	106.8	8.6%	Mar-06	271.9	17.6%	Sep-10	330.6	4.4%	Mar-15	429.93	6.2%
Oct-01	108.1	10.5%	Apr-06	275.2	17.3%	Oct-10	331.3	4.1%	Apr-15	432.74	6.4%
Nov-01	109.2	11.5%	May-06	278.6	17.3%	Nov-10	331.8	3.6%	May-15	434.68	6.4%
Dec-01	110.4	11.8%	Jun-06	282.0	17.3%	Dec-10	332.4	2.9%	Jun-15	436.07	6.2%
Jan-02	111.5	11.5%	Jul-06	285.5	17.0%	Jan-11	333.1	2.2%	Jul-15	437.01	6.0%
Feb-02	112.8	11.9%	Aug-06	288.9	16.5%	Feb-11	334.1	1.9%	Aug-15	438.02	6.0%
Mar-02	113.9	12.8%	Sep-06	291.9	15.9%	Mar-11	335.5	1.8%	Sep-15	439.27	5.9%
Apr-02	115.0	13.8%	Oct-06	294.8	15.1%	Apr-11	337.3	2.1%	Oct-15	441.38	6.1%
May-02	116.1	14.1%	Nov-06	297.3	14.4%	May-11	338.8	2.4%	Nov-15	443.90	6.2%
Jun-02	117.1	14.0%	Dec-06	299.8	14.0%	Jun-11	340.0	2.9%	Dec-15	446.57	6.3%
Jul-02	118.1	13.6%	Jan-07	303.2	14.1%	Jul-11	340.9	3.4%	Jan-16	449.85	6.4%
Aug-02	119.3	13.1%	Feb-07	307.4	14.4%	Aug-11	341.8	3.7%	Feb-16	453.44	6.3%
Sep-02	121.0	13.2%	Mar-07	312.7	15.0%	Sep-11	343.0	3.7%	Mar-16	456.89	6.3%
Oct-02	122.7	13.6%	Apr-07	318.5	15.7%	Oct-11	344.0	3.8%	Apr-16	459.66	6.2%
Nov-02	124.4	13.9%	May-07	324.0	16.3%	Nov-11	345.0	4.0%	May-16	461.55	6.2%
Dec-02	125.8	14.0%	Jun-07	328.8	16.6%	Dec-11	346.4	4.2%	Jun-16	462.32	6.0%
Jan-03	127.3	14.1%	Jul-07	332.1	16.3%	Jan-12	348.2	4.5%	Jul-16	462.84	5.9%
Feb-03	129.2	14.6%	Aug-07	333.8	15.6%	Feb-12	350.0	4.7%	Aug-16	463.00	5.7%
Mar-03	131.5	15.4%	Sep-07	334.4	14.5%	Mar-12	351.7	4.8%	Sep-16	463.32	5.5%
Apr-03	133.7	16.2%	Oct-07	333.9	13.3%	Apr-12	353.1	4.7%	Oct-16	463.70	5.1%
May-03	136.0	17.1%	Nov-07	333.1	12.1%	May-12	354.3	4.6%	Nov-16	464.84	4.7%
Jun-03	138.5	18.3%	Dec-07	333.0	11.0%	Jun-12	355.8	4.6%	Dec-16	467.43	4.7%
Jul-03	140.8	19.3%	Jan-08	332.7	9.7%	Jul-12	357.3	4.8%	Jan-17	471.40	4.8%
Aug-03	143.5	20.3%	Feb-08	332.0	8.0%	Aug-12	359.4	5.1%	Feb-17	475.10	4.8%
Sep-03	146.8	21.4%	Mar-08	329.7	5.5%	Sep-12	361.8	5.5%	Mar-17	477.48	4.5%
Oct-03	150.8	22.9%	Apr-08	326.3	2.4%	Oct-12	363.5	5.7%	Apr-17	479.15	4.2%
Nov-03	155.0	24.7%	May-08	322.5	-0.5%	Nov-12	364.9	5.8%	May-17	479.92	4.0%
Dec-03	159.6	26.9%	Jun-08	319.3	-2.9%	Dec-12	366.4	5.8%	Jun-17	480.85	4.0%
Jan-04	164.5	29.2%	Jul-08	316.4	-4.7%	Jan-13	368.6	5.9%	Jul-17	482.12	4.2%
Feb-04	169.5	31.2%	Aug-08	314.9	-5.7%	Feb-13	371.0	6.0%	Aug-17	483.22	4.4%
Mar-04	174.0	32.3%	Sep-08	314.8	-5.9%	Mar-13	373.1	6.1%	Sep-17	483.63	4.4%
Apr-04	178.0	33.2%	Oct-08	315.2	-5.6%	Apr-13	374.5	6.0%	Oct-17	483.85	4.3%
May-04	181.7	33.7%	Nov-08	316.1	-5.1%	May-13	375.8	6.1%	Nov-17	484.40	4.2%
Jun-04	185.3	33.9%	Dec-08	316.1	-5.1%	Jun-13	377.9	6.2%	Dec-17	484.78	3.7%
Jul-04	189.3	34.4%	Jan-09	315.9	-5.1%	Jul-13	380.4	6.5%	Jan-18	485.77	3.0%
Aug-04	193.8	35.1%	Feb-09	315.3	-5.1%	Aug-13	382.6	6.5%	Feb-18	488.34	2.8%
Sep-04	198.5	35.2%	Mar-09	314.7	-4.6%	Sep-13	384.8	6.4%	Mar-18	491.80	3.0%
Oct-04	203.8	35.2%	Apr-09	313.9	-3.8%	Oct-13	387.4	6.6%	Apr-18	495.76	3.5%
Nov-04	209.8	35.3%	May-09	313.4	-2.8%	Nov-13	390.9	7.1%	May-18	498.37	3.8%
Dec-04	216.1	35.4%	Jun-09	313.6	-1.8%	Dec-13	395.2	7.9%	Jun-18	500.31	4.0%
Jan-05	221.9	34.9%	Jul-09	314.3	-0.7%	Jan-14	399.6	8.4%	Jul-18	501.75	4.1%
Feb-05	227.0	33.9%	Aug-09	315.1	0.1%	Feb-14	402.8	8.6%			
Mar-05	231.3	32.9%	Sep-09	316.5	0.6%	Mar-14	404.8	8.5%			
Apr-05	234.6	31.8%	Oct-09	318.4	1.0%	Apr-14	406.6	8.6%			
May-05	237.5	30.7%	Nov-09	320.4	1.3%	May-14	408.5	8.7%			
Jun-05	240.4	29.7%	Dec-09	322.9	2.2%	Jun-14	410.6	8.7%			

## **ADDENDUM - NOTES:**

### **Note on The FNB House Price Index:**

The FNB Repeat Sales House Price Index has been one of our repertoire of national house price indices for some years, and is based on the well-known Case-Shiller methodology which is used to compile the Standard & Poor's Case-Shiller Home Price Indices in the United States.

This "repeat sales approach" is based on measuring the rate of change in the prices of individual houses between 2 points in time, based on when the individual homes are transacted. This means that each house price in any month's sample is compared with its own previous transaction value. The various price inflation rates of individual homes are then utilized to compile the average price inflation rate of the index over time.

The index is compiled from FNB's own valuations database, thus based on the residential properties financed by FNB over the past 18 years.

We apply certain "filters" and cut-offs to eliminate "outliers" in the data. They main ones are as follows:

- The maximum price cut-off is R15m, and the lower price cut-off is R20,000.
- The top 5% of repeat sales price growth rates, and the bottom 5% of growth rates are excluded from the data set.
- Repeat transactions that took place longer than 10 years after the previous transaction on the same home are excluded, as are repeat transactions that took place less than 6 months after the previous transaction on the same home.
- The index is very lightly smoothed using a Hodrick-Prescott smoothing function with a Lambda of 5.

**Note on the FNB Valuers' Market Strength Index:** \*When an FNB valuer values a property, he/she is required to provide a rating of demand as well as supply for property in the specific area. The demand and supply rating categories are a simple "good (100)", "average (50)", and "weak (0)". From all of these ratings we compile an aggregate demand and an aggregate supply rating, which are expressed on a scale of 0 to 100. After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating, add 100 to the difference, and divide by 2, so that the FNB Valuers' Residential Market Strength Index is also depicted on a scale of 0 to 100 with 50 being the point where supply and demand are equal.