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Stuck in the Mud

The Reserve bank's latest decision not to further cut interest rates has disappointed the property market. But weighing more heavily on housing's revival is the difficulty in raising mortgage bond finance.

The decision by the SA Reserve Bank's monetary policy committee to keep the repo rate on hold is particularly disappointing as far as the property industry is concerned.

Prior to the decision there had been a growing upswell of opinion that another half percent cut was on the cards, bringing the repo rate down to 6,5% and reducing the banks' prime interest rate to 10%. This would have brought the cumulative reduction in interest rates to 5,5% since December last year. Alas, we stay at a repo rate of 7% and prime at 10,5%.

However, inflation, which has been a major concern of the Reserve Bank, is gradually declining and the monetary authorities are convinced that the inflation rate will be comfortably within its target range of 3%-6% by the second quarter of next year.

Prices of food and fuel have fallen steadily, contributing to a 3% fall in the consumer price index (CPI) since last year. However, rising electricity and municipal levies have militated against the trend and remain a worry.

The big concern now is the strength of the rand which, while contributing some inflation benefits, is harming our exports. Fortunately, rising commodity prices such as gold and platinum have offset this to some extent. And as a result, the deficit on our worrisome current account of the balance of payments is shrinking.

Although the property market was hoping for a further interest rate cut, there is still an opening for a reduction of 50 basis points before the end of the year. But as usual, economists and analysts

will hedge their bets on this. Nevertheless we still have three more monetary policy committee meetings before year-end.

Arguments in favour of another rate cut within the next few months include the strength of the rand (which has risen 22% against the US\$ this year), the beneficial effect on companies under pressure during the current recession, the possibility of reducing job losses, lower capital inflows and thus a weaker currency, and boost to business confidence generally.

Arguments in favour of keeping the rate on hold at present include concerns that the volatility of the rand could push up inflation if the currency weakens substantially. Since inflation targeting is in essence forward-looking the Reserve Bank had weighed the balance of risks in the 12-18 months ahead and plumped for the status quo; no change.

In terms of the outlook for residential property, there has been an improvement in activity levels since the start of the year. But Absa's current home loans report shows that nominal house prices fell 3,4% year-on-year in August. However, Absa has noted that the pace of house price deflation is slowing.

Dr Andrew Golding, CE of the Pam Golding Property group, reports that the group's volume of transactions has increased. Sales have also risen in the past six months, with each month reflecting an improvement on the month before, in particular July and August. "Generally we are seeing signs of renewed interest and increasing activity across all sectors of the market, with some areas experiencing a shortage of stock. Even within the challenging

market conditions there continue to be highlights, including record house prices being achieved in areas such as Cape Town's Atlantic Seaboard, the northern suburbs in Johannesburg, and Grahamstown and Stellenbosch, to name a few."

He also notes that developers are slowly coming back into the residential market.

Dr Golding stresses that the lack of finance availability is the single, biggest factor holding back the housing market. To some extent, the impact of interest rate cuts has yet to be felt. Not only do lower interest rates take time to flow through to the economy, but consumers' confidence has taken a hammering. From a statistical point of view these cuts have reduced the debt burden on consumers, but the ratio of household debt to disposable income remains an unacceptable 76%.

At present mortgage seekers – particularly first-time buyers – are finding it extremely difficult to get bond finance. Even if they can comply with banks' rigorous lending criteria, they face high deposit requirements and bond interest rates much higher than in the past.

Some of the banks have stated that they are relaxing their lending criteria but, as Dr Golding says: "The evidence of this occurring in a meaningful way remains limited."

The need for financial institutions to loosen the pursestrings to support the housing market is not confined to South Africa. Policymakers in the UK and the US, for instance, have been pondering on how this can be achieved. Former Federal Reserve chairman Paul Volcker disclosed recently that he had been sent a political position paper prepared for the presidential advisory board, which he chairs, which concluded that something had to be done to support housing and mortgages – especially spurring mortgage creation.

The problem with this view is that to magically create some sort of artificial stimulus to boost housing – or car sales, or retail throughput, or whatever – implies boosting the old bad habits of consumption and credit behaviour. So we don't want to kick-start another unsustainable credit boom.

Hopefully relief will come naturally. The firmer rand will help suppress inflation which will in turn lead to further interest rate cuts. Capital inflows will increase and help lower government bond yields and prime a booming stock market, which in turn will improve household purchasing power, reviving incomes and stemming job losses.

All this would provide impetus to renewed risk-taking all round, including mortgage lending.

