Modest deterioration in outlook for SA house prices

PAM GOLDING PROPERTIES

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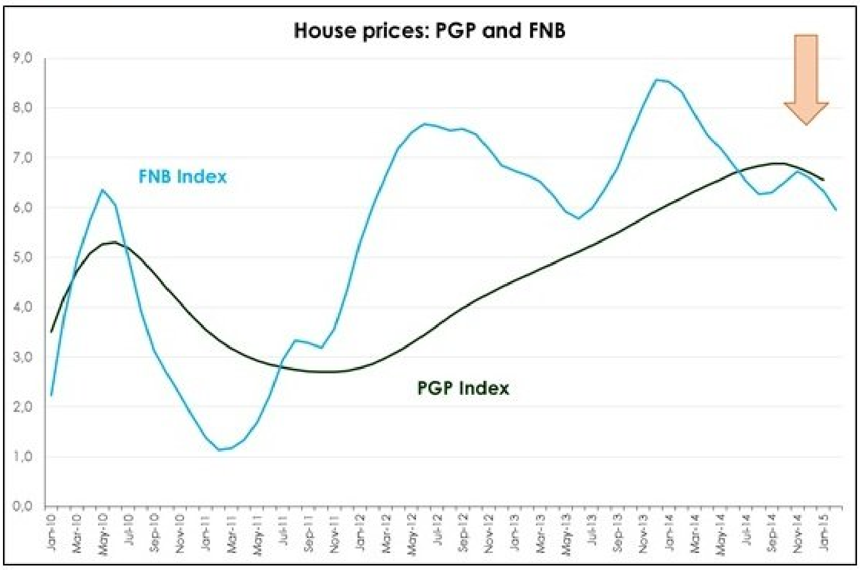
The disappointing economic growth prospects and the first increase in personal taxes in two decades has prompted analysts to downgrade their house price forecasts for 2015.

> "While initial optimism regarding a potential windfall for the residential property market from the collapse in global energy prices is beginning to fade, the local macro-economic environment remains fundamentally supportive for house prices and a further real (inflation-adjusted) increase in prices remains likely."

One of the first indicators of the underlying trends prevailing in the local residential property market to be released each month is the First National Bank (FNB) House Price Index. In early March, the **FNB house price index** (HPI) was released, showing a 5.9% increase in average house prices in February. The latest reading confirms that, although house prices continue to increase, the pace at which prices are rising is beginning to lose momentum.

This slowing trend is confirmed by the less volatile **PGP Residential Property Index**, which is released later each month. The PGP Index has also begun to lose momentum since peaking at 6.9% in September and October last year (see chart below). In January, the PGP Index recorded an increase of 6.6% in national house prices, the start of a gradual - but distinguishable - downward trend.

Figure One



SOURCE: Pam Golding Properties Residential Property Index and FNB Property Barometer, Feb 2015

At the start of the New Year, it seemed that the collapse in global energy prices would give the domestic residential property market an unexpected, but welcome, boost in 2015. Tumbling global oil prices, coupled with a relatively resilient Rand exchange rate, had allowed government to announce several substantial cuts in the local petrol price. Lower petrol prices, coupled with an easing in global food price pressures, prompted analysts to revise their inflation forecasts downwards. With inflation now set to remain comfortably within the Reserve Bank's target range all year, it seemed likely that the series of interest rate hikes than had been anticipated during the course of 2015 would be delayed – possibly until 2016. There was even, briefly, speculation that the Bank may consider cutting interest rates in response to these positive developments.

However, as the first quarter of 2015 progressed, a number of these positive developments began to reverse, forcing market commentators to review their initial optimism. In late January, international oil prices rebounded from their lows, in recent weeks persistent drought conditions in much of South Africa's maize growing regions has fuelled fears of higher food prices, while the Rand is losing ground against the surging US Dollar. Together, these trends, suggest that the marked easing in local inflationary pressures will prove to be short-lived.

Furthermore, the increase in the overall personal tax burden announced in the 2015/16 Budget - including higher marginal tax rates, increased "sin" taxes, a hefty increase in the fuel levy and a temporary levy on electricity prices - suggest that the anticipated recovery in household disposable incomes, which provide a crucial underpinning for the residential property market, is likely to be more subdued than initially anticipated. Not only do households now face an increased tax burden, but the likely reversal in the inflation rate will begin to erode household disposable incomes as the year progresses.

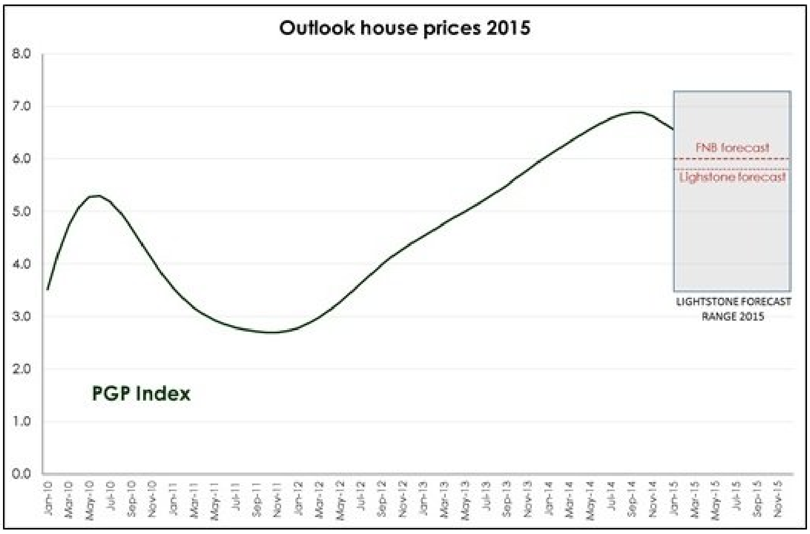
Despite the deterioration in a number of the factors that had previously appeared to be providing the local residential market with an unexpected boost, the local macro-economic environment remains fundamentally supportive for house prices in 2015. The pace of economic activity looks set to strengthen this year, after recording a disappointing average growth rate of just 1.5% in 2014. Admittedly, at just 2% the growth forecast for 2015 is still subdued but it does at least signal the start of a modest economic recovery. Furthermore, the rebound in global oil prices has stalled and local interest rates are still likely to remain unchanged, at close to current 40-year lows, for much of the year. Finally, the modest recovery in building activity anticipated during the course of this year suggests that the current shortage of housing stock will ease only gradually during the months ahead – providing a further underpinning for house prices.

Nonetheless, the deterioration in the inflation outlook, the disappointing economic growth prospects and the first increase in personal taxes in two decades has prompted analysts to downgrade their house price forecasts for 2015.

Earlier this month, FNB announced a downward revision in its average house price growth forecast for 2015 from an average of 8%-9% to a more modest 6%. This would, however, still translate into a real increase in house prices, as inflation is forecast to average 4.2% this year. This would translate into the second consecutive year in which South African home owners have enjoyed a real increase in the value of their residential properties.

Similarly, **Lightstone** is forecasting house price inflation of just 5.8% for 2015. Given the unusually high level of uncertainty surrounding the economic outlook this year, Lightstone has included a forecast range as well. Should the economic growth rate exceed current estimates of 2% this year, Lighstone suggests house prices could rise by an average of 7.3% for the year as a whole. However, in the event that the economy suffers further bouts of labour unrest, or indeed unexpectedly severe load shedding, then house price inflation could slow to just 3.5% for the year as a whole (see chart below).

Figure Two



SOURCE: PGP Residential Property Index, FNB Property Barometer and Lightstone House Price inflation Forecast

While the outlook for house prices nationally may have deteriorated marginally in recent weeks, these forecasts disguise starkly divergent trends within different regions and price bands. For example, in contrast to the gradual slowdown evident at a national level, house prices in **KwaZulu-Natal** are clearly gathering momentum and look set to out-perform other major provinces this year. Similarly, prices in the lower price band **(under R1 million)** are also strengthening steadily and may well register double digit increases during the first half of this year. This section of the market looks set to receive a further boost from the announcement in the 2015/16 Budget that no transfer duties will be payable on properties under R750 000. Given that the majority of home sales in South Africa fall within this price band, this should provide a welcome boost to the residential property market.

Thus even though the local housing market faces a range of economic headwinds in 2015, macro-economic environment remains supportive and opportunities within certain regions and price bands within the local residential property market look set to register strong growth rates during the year ahead.

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