PROPERTY BAROMETER

FNB Estate Agent Survey - Price Realism and Market Balance

The national residential market continued to move away from equilibrium late in 2016.

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FNB HOME LOANS: MARKET ANALYTICS AND SCENARIO FORECASTING UNIT

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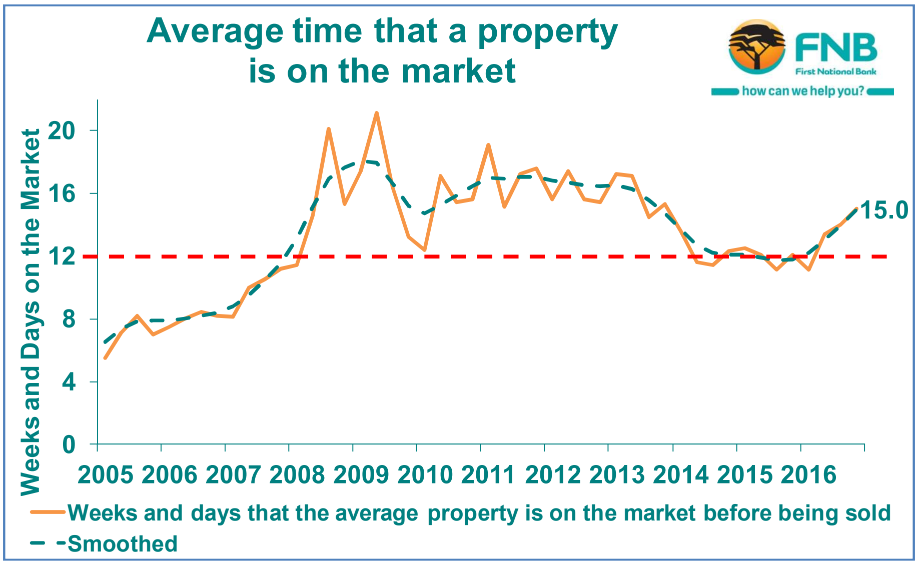
ESTIMATED AVERAGE TIME OF HOMES ON THE MARKET INCREASES

It is important to understand that, due to significant resistance by home sellers to house price declines, in times of economic and residential demand slowdown the residential market often moves away from market equilibrium price.

Therefore, the average market house price level, as depicted by a house price index, is not necessarily the "market equilibrium" price level. Often, in times of market weakness, part of the weakness is reflected in the average transaction price, or its inflation rate, and part of it will be reflected in a longer average time that it takes to sell a home.

The key question around the estimated average time of properties on the market is what would be the average time on the market that reflects market equilibrium? The answer to this is a subjective one, but our view is that the level is not far from 3 months average time on the market. From 2014 to early-2016, the estimated average time had been moving broadly sideways at levels around 12 weeks, i.e. slightly less than 3 months, and this was a time with very mild average house price growth in real terms (zero average house price growth in real terms theoretically reflecting a well balanced market)

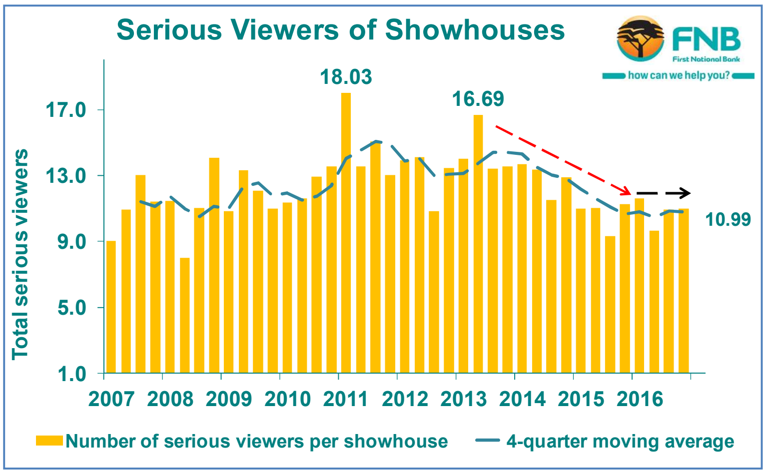
In 2016, we appear to have seen a move away from that equilibrium, the 4th Quarter of 2016 survey showing still further movement in this regard. From a solid 1st quarter 11 weeks and 1 day estimated average time on the market, the 2nd Quarter 2016 estimate rose noticeably to 13 weeks and 4 days, increasing still further to 14 and 15 weeks for the 3rd and 4th quarters respectively.



RISING AVERAGE TIME ON MARKET A DELAYED RESPONSE TO SLOWER HOUSING DEMAND

The start of a noticeable increase in the national average time on the market early last year was arguably the lagged response to a slowing in housing demand through 2014 and 2015. Those were the 2 years of rising interest rates (up until early-2016), and we saw one of key the demand indicators from the survey declining noticeably.

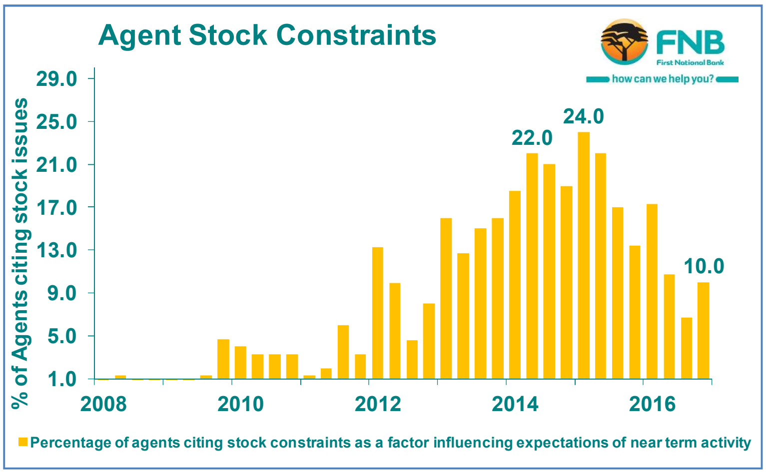
This residential “demand-side” question that is asked to the survey respondents, in the FNB Estate Agent Survey, is to give an estimate of how many serious viewers per show house they get before making the sale.



From a multi-year high average 14.42 estimated serious viewers per show house for the 4-quarters of 2013, we saw a noticeable decline to 10.66 average for the 4 quarters of 2015. Hereafter, the broad movement was sideways, averaging 10.79 viewers for the 4 quarters of 2016.

But it mattered not that the decline in demand may have slowed or stopped in 2016. At these levels it was too weak to keep the market in a good balance between demand and supply.

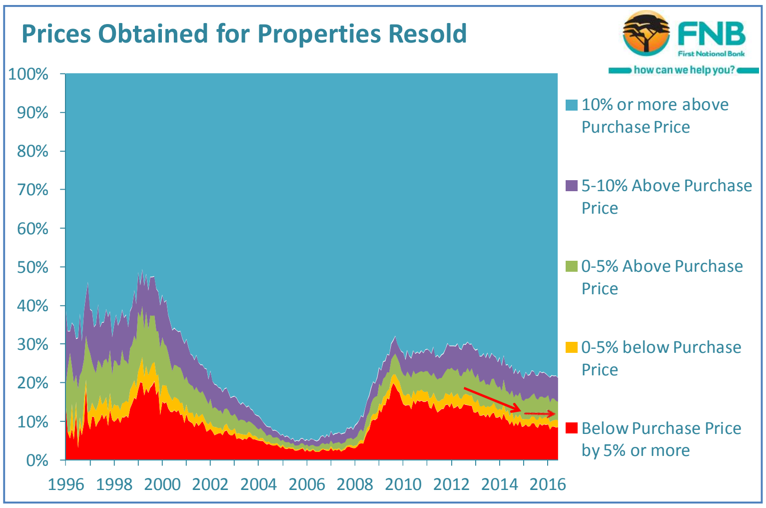
It is difficult to gauge the strength of supply of residential stock through asking survey respondents for their opinion. But when asking agents about their market expectations in the near term, we allow them to provide a list of factors that influence their expectations, both in a positive and a negative way



After the percentage of agents citing “stock constraints” as a key factor had intensified noticeably from 2012 to early-2014, assisted by relatively low levels of residential building activity since the end of the building boom in 2008, they began to diminish through 2015, as one would expect in most slowing demand environments.

10% of agents cited stock constraints in the 4th quarter 2016 survey, well down from the 24% high back in the 1st quarter of 2015. In addition, this percentage is very much boosted by a far higher percentage in the Western Cape, perhaps the only region in South Africa still known for its very strong market.

BUT HOUSE PRICE DEFLATION DOESN’T APPEAR TO HAVE BECOME MORE WIDESPREADY JUST YET



Key now is to look for signs that a longer average time on the market is beginning to exert greater downward pressure on house price levels, as sellers are ultimately forced to accept reality? On a national average basis, that may have already begun to happen, with the FNB house price year-on-year inflation rate having slowed to a mere 1.3%

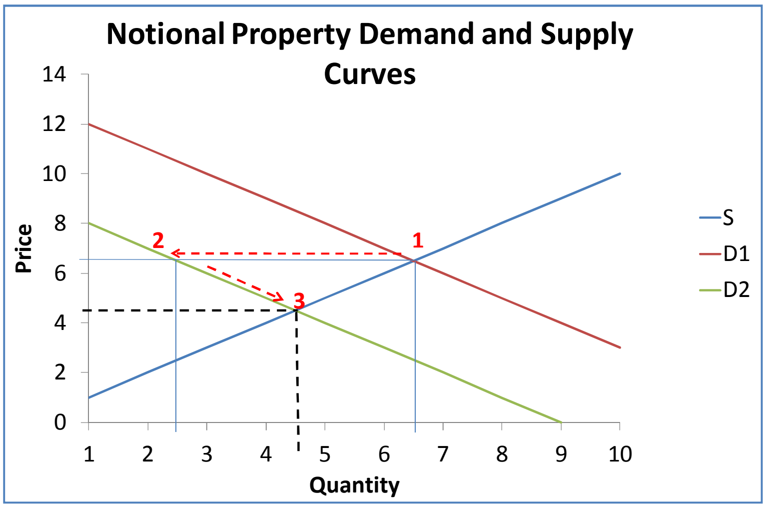
However, using Deeds data for property transactions by individuals, we have yet to see any noticeable increase in the percentage of properties being sold at a transaction price below that of their previous transaction price. Just after the last recession and interest rate cycle peak, back in September 2009, the percentage of properties transacted by individuals ("natural persons"), that were sold for a value below that of their previous transaction price, spiked to 22.1% of total property transactions in that month.

As economic recovery and interest rate cuts sparked a housing market recovery thereafter, this percentage slid to 10.6% by the end of 2014. From there onward, however, this trend turned from declining to more-or-less sideways, estimated at a similar 10.9% by November 2016.

As yet, therefore, a tougher selling environment, as reflected in a longer average time on the market, does not appear to have led to more widespread cumulative price deflation on homes in between transactions. But the rising trend in the average time on the market, should it not be reversed any time soon, can ultimately be expected to lead to such an increase in this percentage.

A THEORETICAL REPRESENTATION OF THE MARKET SHIFT AWAY FROM EQUILIBRIUM

A very simple representation of the theory on a demand-supply graph below, of a shift away from market equilibrium, appears as follows. Let's assume a sudden sharp interest rate hike. As this is not a house price-related residential demand-driver, the Housing Demand Curve would shift to the left from D1 to D2.Given home owner resistance to dropping prices, the average price may not immediately decline, however. Therefore, the market initially shifts from point 1 to point 2 on the graph, the average price initially remaining unchanged but quantity demanded and transacted declining from a 6.5 to 2.5. Initially, however, the supply of homes remains at 6.5, and the market is oversupplied. This move to an oversupplied situation would be witnessed in an increase in the average time of homes on the market. The prices now getting transacted in the market at position 2 are above the market equilibrium prices. Only over a significantly longer period, would the market then gradually make its way to position 3 on the graph, as real prices gradually adjust down, resulting in a partial recovery in demand compared with that at Position 2. The market eventually finds a new demand-supply equilibrium at a lower transaction volume level than prior to the demand shift (Position 1), i.e. 4.5, but higher than straight after the initial demand drop.



We thus always view the full extent of market weakness through average house prices along with average time of homes on the market

Given the market's ability to move away from equilibrium price for lengthy periods, especially in times of economic weakening, it is important not only to focus house price trends. A sizeable part of the market weakness in such times can be seen in the estimated average time of homes on the market prior to being sold, with this average time often lengthening in periods where demand weakens but prices don't fall "sufficiently".

This is all very important for both mortgage lenders and that group of borrowers who become financially stressed. That's because, in cases of mortgage stress, homes need to be "offloaded" quickly in order to settle debt and avoid big holding costs. Often, in order to quickly trade out of the property, the financially-stressed home owners have to go to a level considerably below market equilibrium price to do this, and this may be a "negative equity" situation where the price fetched is insufficient to settle the debt outstanding.