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FNB Commercial Property Finance

Property Insights

The Property Sector won't necessarily notice the short term impact of interest rate cutting, with negative economic growth forces being more dominant. But an important rate cutting impact will be present, possibly more on the supply-side of the market than the demand side.

Yesterdays SARB repo rate cut of 50 basis points brings the cumulative repo rate reduction in the current rate cutting cycle to 3 percentage points.

We don't expect to see any meaningful property demand boost emanating from interest rate cutting specifically, but we still believe it to be an important source of support for the property market. In the current deep recession, with business confidence at multi-decade lows, the support from interest rate cutting comes more in the form of financial relief for current property owners, which can be important in curbing the extent of growth in property supply on the market, by slowing the rate of financial pressure-related property selling by businesses.

SARB rate cutting stimulus not expected to boost property demand meaningfully...

The SARB (South African Reserve Bank) 50 basis point interest rate cut yesterday brought the cumulative repo rate reduction in the current interest rate cutting cycle to 3 percentage points (starting in July 2019), yesterday's cut being from 4.25% to 3.75%. This will take Prime Rate lower from 7.75% to 7.25%.

The Bank sees no significant inflationary pressure build up at present, with its CPI inflation forecast of 3.4% for 2020 being near the lower limit of the 3-6% target range.

Despite very significant interest rate reductions, however, we would not expect to see any visible signs of a commercial property demand "jump" taking place that could be ascribed to interest rate reductions.

Any increase in property demand later in 2020 will merely be the effect of the country coming out of lockdown, and normal property trading being possible once again. But we would still expect total property trading volume for 2020 to be significantly lower than 2019, and new mortgage lending also experiencing a significant decline for this year compared to 2019.

We've also projected a drop of -7% in the MSCI All Property Value/Square Metre Index in 2020, which will not be a sufficient valuation decline to restore the demand-supply balance during this year, the market thus expected to be oversupplied in the near term.

Our expectations are based on the perception that the Commercial Property Market is influenced to a great extent by economic growth conditions and Business Confidence, and while the SARB forecasts low inflation, justifying major rate cuts, it also forecasts a -7% contraction in GDP (Gross Domestic Product) for 2020 (The FNB forecast being an even more severe -8%.

So it isn't that we don't believe that interest rate cutting stimulus would have any impact on the property market. It will, just that the negative GDP shock is so severe that it is expected to over-ride any property demand stimulus received from interest rate cutting.

The economic shock has dented already-weak business confidence so severely that few will be looking to take advantage of rate cuts to purchase property.

....but rate cutting is seen as crucial relief for owners, containing the growth in supply of property on the market

However, we do see aggressive interest rate cuts as having an important function in the property market, but perhaps more on the supply side of the market.

Rather than bolstering property demand, the key role of rate cuts at present will be in providing relief to current property owners. Many property owners are likely to be under intense financial pressure in the near term, either as a result of their own business pressures or as a result of a larger part of the business tenant population's financial squeeze and resultant battle to pay rent. Cutting costs on property owner debt is thus crucial. And this may impact more significantly on the supply-side of the property market than on the demand side, containing the number of property owners being pressured into selling their properties due to financial pressure, to lower levels than would otherwise have been the case. Severe business financial pressure risks "flooding" the market with properties, but aggressive rate cuts can curb the growth in such property supply.

The rate cuts probably won't be sufficient to prevent a significant oversupply of property in this economic environment, but we believe the supply glut may have been headed for far higher levels had there hypothetically been no rate cuts.

At the same time, rate cutting can relieve the financial pressure on the beleaguered tenant population who often have other forms of debt, supporting rental payment performance, thus making a difference, but again not necessarily being enough to fully offset the impact of lockdown and recession on tenant income.

Conclusion

In short, the 300 basis points' worth of interest rate cuts in the current interest rate cutting cycle has likely provided significant support for the property market, and the SARB macroeconomic model suggests more rate reduction is possible. However, in this severe recession, the stimulus impact will go largely un-noticed, overshadowed by the negative recession impact.

Interest rate cuts will not likely be a meaningful property demand stimulus at the current time. Their impact is more one of relief for current property owners, curbing the level of property supply that could be driven onto the market by financial pressure. It is thus on the supply-side (containing supply growth) of property where their role may currently be more meaningful for the property's market's balance.

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