August 2020

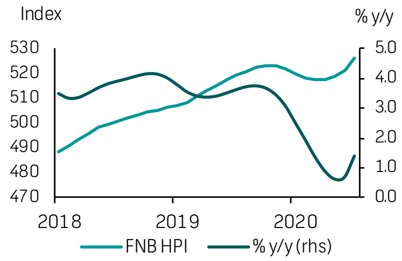
Property Barometer.

1.4%
y/y FNB HPI

1.1%
m/m FNB HPI

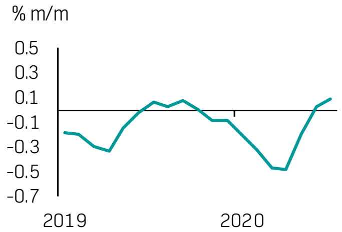
48.29
FNB Valuers' Market Strength Index

Figure 1: FNB HPI rebounded in July



Source: FNB Economics

Figure 2: FNB Valuers' Market Strength Index: – Signs of recovery



Source: FNB Economics

Buying activity resurging, supporting prices

Annual house price growth rebounded to 1.4% y/y in July, down from an upwardly revised 0.7% in June and 0.6% in May. We note, however, that April and May's house price indices are based on significantly lower volumes of mortgage transactions, which affected the stability of our price index (this can be seen from the unusually large revisions). Nevertheless, volumes have since normalised and the index stabilised.

The bounce back in prices reflects the unexpectedly rapid recovery in market activity since the easing of lockdown restrictions. Our initial expectations were for the pandemic to have a more chilling and lingering impact on activity, with pent-up demand filtering through only later this year. In contrast, the volume of new mortgage applications has rebounded beyond the pre-lockdown levels, and across the price spectrum. This is also supported by the volume of buyer leads, derived from web traffic to property portals (Figure 4), which has risen above expectations.

FNB valuers are seeing a compression of demand-supply gap

The FNB Market Strength Index, compiled from property valuers' database (see appendix for methodology), suggests that supply remains stronger than demand, but the gap has started narrowing from the recent weakest (lockdown-induced) level in May (Figure 2). Data also shows that demand collapsed during level 5 lockdown, but gradually recovered as restrictions eased. The pace of supply, on the other hand, appears to have spiked around April, but swiftly retreated thereafter (Figure 3). Currently, the overall level of supply rating appears to be moving sideways. Disaggregation by price categories shows that much of the retreat in supply came from higher price categories, presumably as sellers reassess their decisions amid a challenging macroeconomic environment. Thus, while home shoppers are looking for bargains, homeowners are weighing selling versus refinancing (given the historically low interest rates), and this appears to be supporting prices.

It is important to note that at this rating, market strength (according to FNB valuers) is still 15% above (i.e. stronger than) the lowest rating during the Global Financial Crisis (in June 2009). Thus, the pandemic does not appear to have had as much of a chilling effect as we might have feared, at least at this stage. In fact, results from the FNB Estate Agents Survey showed that while overall activity plummeted in 2Q20, the pandemic had not yet led to exceptional market discounts. The average discount (difference between the final sale price and sellers' initial asking price) was estimated at 12% in 2Q20, relatively unchanged from 13% in 1Q20.

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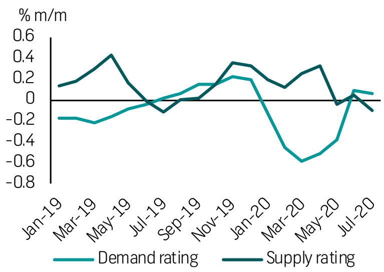
So, where to? Is it a "V" or a "W"?

The rebound in activity reflects several factors. First, it reflects pent-up demand from the lockdown period, where buying decisions were taken before the commencement of the lockdown. Some of these are delayed purchases, on the back of significantly lower transfer duties announced in the February 2020 Budget (which came into effect in April this year). Second, the record low mortgage rates are incentivising renters to buy and first-time buyers to front-load their purchasing decisions as monthly mortgage payments have come down significantly. In other words, sales that would otherwise have taken place some time in future are happening now, with some buyers looking to fix mortgage rates while they are at record lows, fearing that they might increase in the near future. Lastly, there are early signs of behavioural shifts, as homeowners reassess their housing needs and preferences as a result of life in lockdown. Anecdotal evidence shows rising demand for bigger properties (mainly freestanding homes), notably in less crowded "second-tier" cities. That is, the growth of working from home is creating demand for bigger homes which can offer additional features such as home gyms, and conducive environments for home-schooling.

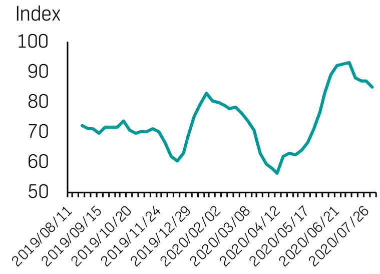
Looking ahead, the historically low interest rates and lower transfer duties (particularly in the middle-priced segment) will continue to support activity, and by extension, house prices in the very near term. However, there is still a great deal of uncertainty around the lasting impact of the pandemic. In particular, our expectation of a significant weakening in labour market conditions implies a greater downward pressure on house prices in the medium term. Thus, while a "V-shape" recovery is apparent in the data, labour market tailwinds could have a more chilling effect ahead, leading to another drop in activity and thus a likely "W-shape" recovery. In our view, the current pent-up demand will likely not be sustained, and is unlikely to replace the demand lost due to very weak labour market outcomes.

Figure 3: Demand vs supply rating – Demand pacing up, while supply slowing



Source: FNB Economics

Figure 4: Buyer interest has surpassed pre-lockdown levels (4-week moving average)



Source: Google Trends, FNB Economics

Monthly FNB House Price Index (% y/y)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2001		-1.7	-0.7	-0.4	-0.5	0.7	3.0	5.9	8.6	10.6	11.6	11.8
2002	11.6	12.0	12.8	13.8	14.2	14.0	13.6	13.1	13.2	13.5	13.8	13.8
2003	14.0	14.5	15.3	16.2	17.1	18.2	19.3	20.3	21.4	22.9	24.7	27.0
2004	29.4	31.3	32.4	33.2	33.7	33.9	34.5	35.1	35.3	35.2	35.3	35.4
2005	34.8	33.8	32.9	31.8	30.7	29.7	28.8	27.9	26.9	25.7	23.9	21.7
2006	19.9	18.5	17.6	17.3	17.3	17.2	16.9	16.5	15.8	15.1	14.4	14.0
2007	14.0	14.3	14.9	15.7	16.3	16.6	16.3	15.5	14.5	13.2	12.0	11.0
2008	9.7	8.0	5.5	2.5	-0.4	-2.9	-4.7	-5.6	-5.8	-5.6	-5.1	-5.1
2009	-5.0	-5.0	-4.5	-3.8	-2.8	-1.8	-0.7	0.0	0.5	0.9	1.2	2.0
2010	3.0	3.9	4.6	5.2	5.6	5.5	5.0	4.7	4.5	4.1	3.7	3.1
2011	2.4	2.1	2.0	2.2	2.5	2.8	3.3	3.6	3.8	3.9	4.1	4.4
2012	4.7	4.8	4.8	4.7	4.6	4.7	4.9	5.2	5.6	5.7	5.8	5.8
2013	5.9	6.0	6.1	6.1	6.1	6.3	6.5	6.4	6.3	6.5	7.0	7.7
2014	8.2	8.3	8.2	8.3	8.4	8.3	8.0	7.8	7.6	7.2	6.8	6.2
2015	5.8	5.9	6.3	6.5	6.6	6.4	6.3	6.2	6.1	6.2	6.3	6.3
2016	6.3	6.2	6.1	6.0	5.9	5.8	5.7	5.6	5.4	5.1	4.8	4.8
2017	4.7	4.6	4.5	4.3	4.2	4.1	4.1	4.2	4.2	4.2	4.0	3.8
2018	3.5	3.3	3.4	3.5	3.7	3.8	3.9	4.0	4.1	4.2	4.1	4.0
2019	3.8	3.6	3.4	3.4	3.4	3.5	3.6	3.7	3.8	3.7	3.5	3.1
2020	2.5	2.0	1.4	0.9	0.6	0.7	1.4					

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 fromthe 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 previoustransaction 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.