PROPERTY BAROMETER – THE RAND AND RESIDENTIAL PROPERTY

Rand weakness has become a significant "downside risk" to residential property market performance.

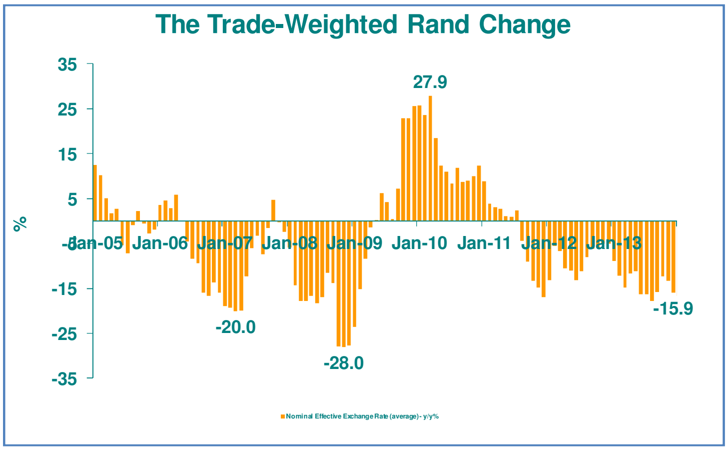
29 January 2014

2013 ended with various residential property numbers looking positive. In the FNB Estate Agent Survey for the 4th quarter, the residential activity rating was up once more, and a significant number of agents reported residential stock constraints in their areas. Early in 2014 our perception is that there has been a noticeable increase in media attention and "hype" around residential property.

Initially, this media attention was generally positive, focusing on a rather upbeat residential market at a time when the rest of the economy has not been doing that wonderfully, and repeatedly asking the question as to whether now is "the time to buy", either for own residence or for letting purposes.

In recent days, however, renewed rand weakness may have started to erode general sentiment in South Africa, on top of its depreciation being in part driven by a deterioration in sentiment (along with other key factors such as US Federal Reserve "tapering" or the prospect thereof).

POTENTIAL IMPACT ON SENTIMENT



Yes, the Rand is seen by many as the "share price" of South Africa, and radical depreciations can bring about an air of "gloom" in the country. The most recent bout of broad Rand depreciation has been a sustained one too, lasting all the way back to 2011, and it may be starting to "wear us down".

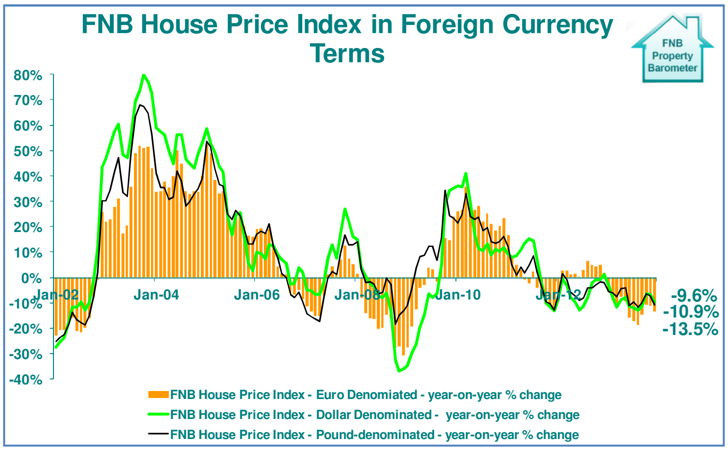
This brings about the 1st possible impact of a weak Rand on residential property, when sentiment has a possible dampening effect on domestic home buying, although it is near impossible to determine at what point this may or may not happen.

POTENTIAL IMPACT ON INFLATION AND INTEREST RATES

More significant, however, is a 2nd potential impact that the weakening Rand can have via its impact on imported inflation, and thus on interest rates, because the residential market is a highly credit-dependent one. And in recent days, some economists have been openly debating the possibility of interest rate hikes being brought forward in 2014 (our recent expectation had been only for a 2015 start to interest rate hiking), a possible SARB response to the additional imported inflation that a weakened rand brings.

Does the mere heightened speculation of earlier interest rate hikes make home buyers more cautious? Possibly, but if not, then actual interest rate hiking almost certainly would. Now the Rand is certainly not the only driver of inflation and interest rate hikes, but recently it has threatened to become an important one.

POTENTIAL IMPACT ON FOREIGNER BUYING

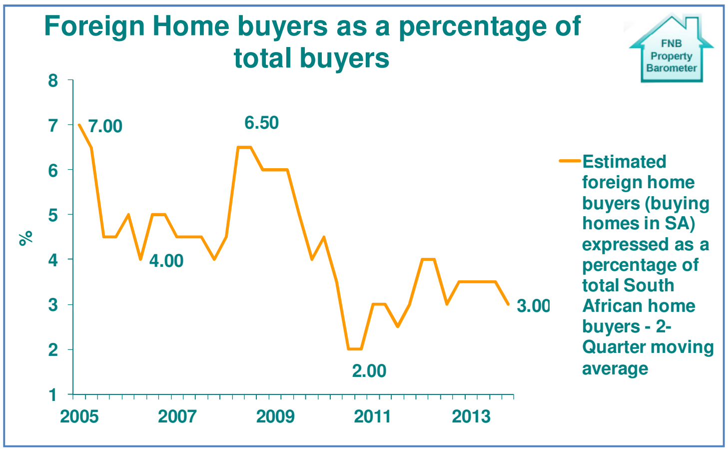


The potential impacts go further, and one must consider what the Rand depreciation has done to the price of residential property in foreign currency terms. While our FNB House Price Index in Rand terms has shown respectable, if not extreme, growth through 2012/13, the picture is very different in "hard currency" terms.

In dollar terms, the year-on-year drop in the FNB House Price Index for December was -9.6%, in Pound terms -10.9%, and -13.5% in Euro terms.

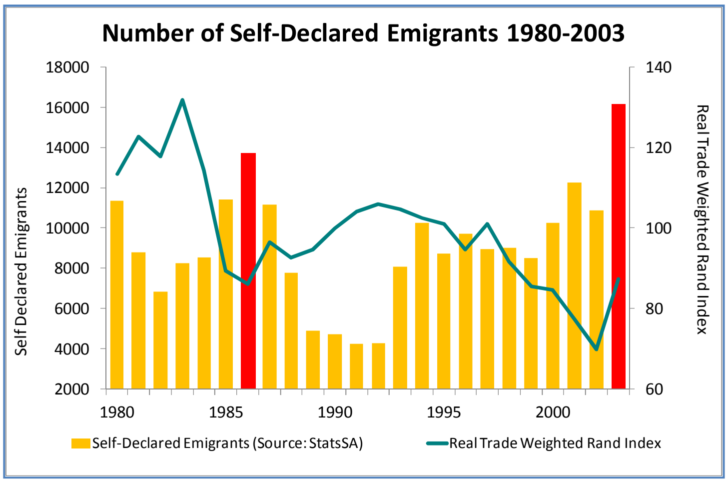
The cumulative drop since as recently as July 2011 has been quite extreme , -19.7% in Euro terms, -22.9% in Dollar terms and -24% in Pound terms. So, for a foreign property investor these days, the SA market is far cheaper.

Does this bring the foreign buyers rushing in large numbers? It is possible that some may take advantage of "bargains", but we doubt whether it would have a significant impact, in the same way that SA's goods and services exports never seem to be boosted dramatically by a weaker Rand.

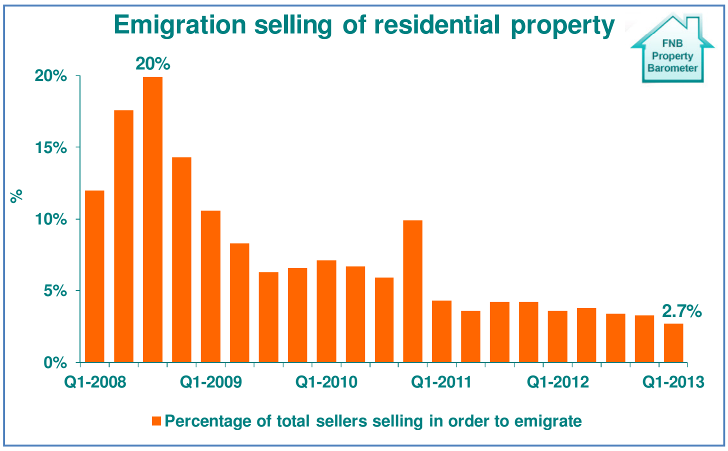


There was some rise in estimated levels of foreign buying, according to the FNB Estate Agent Surveys, since lows of 2010. But from 2% of total buying at a stage of 2010 to recent levels hovering round 3-3.5%, still well-down on the 6.5% peak of 2008, any possible response has not been extreme. Furthermore, much of the 2011/12 rise in the foreign buyer percentage may merely be the result of some global recovery of the popularity of residential property as an asset class, a lagged response to the passing of the 2008/9 recession.

POTENTIAL IMPACT ON EMIGRATION



The 4th potential impact point of a weak Rand on residential property is via a possible impact on the levels of emigration, and thus on emigration-related home selling. From the days where SA still compiled emigration data, i.e. on the number of "self-declared emigrants", we see that the 2 periods of extreme Rand weakness, i.e around 1985/6 and 2001/2, were accompanied by or closely followed by surges in the numbers of self-declared emigrants. Once again, one can't necessarily blame all of this on the weak Rand. But in that a weak Rand is not only driven by poor sentiment but also becomes a driver of weak sentiment, it is conceivable that the Rand depreciation has something to do with this, as people see the value of their wealth being eroded steadily.



By 2008, the StatsSA emigration data had been discontinued. However, enter our FNB Estate Agent Survey regarding "reasons for selling", which showed a major surge in the percentage of home sellers believed to be selling in order to emigrate.

Perhaps it is no co-incidence that 2008 was also a period of noticeable Rand depreciation, although we could also potentially blame specific incidents such as the electricity load shedding "crisis" of early that year.

And it is far from an exact science, because more recently, in 2011/12, there has been no apparent response of emigration-related selling levels to Rand weakening. In fact, the 4th Quarter FNB Estate Agent Survey shows an estimated emigration selling percentage (of total sellers) of 2.7%, still lower than the prior quarter's 3% and the lowest percentage since the survey question started late in 2007.

Admittedly, this could mean that our view that the Rand may have an impact on emigration rates is flawed. One can't discount this possibility. However, we believe that this time around South Africa has the "good fortune" of global unemployment levels being relatively high, thus causing traditionally attractive emigration destinations not to offer great job prospects for prospective SA emigrants. The result? Far more people staying put this time around.

CONCLUSION

We have identified 4 potential ways in which the Rand's slide can impact on the domestic residential property market. They are:

- *In that the Rand is seen as the country's "share price", and thus often causes a deterioration in sentiment, it is possible that this general sentiment deterioration can cause a more cautious residential property investment approach*
- *A weaker Rand potentially exerts upward pressure on domestic inflation via the prices of imports. Given the SARB's 3-6% consumer inflation target, this may have implications for interest rates, and speculation of earlier-than-previously expected interest rate hiking has indeed arisen as a result.*
- *The weaker Rand has made domestic property values substantially cheaper on average in key foreign currency terms. Does this have a potential positive spin-off though boosting foreign buying? Perhaps, although we don't see anything more than a moderate rise in foreigner buying in our survey since 2011.*
- *In that the Rand drives a domestic sentiment deterioration, as well as making the earning of foreign currency in a foreign country that much more attractive, it may assist in boosting emigration-related home selling, a negative for the local residential market. Admittedly, though, this time around we have yet to see it in our Estate Agent Survey, but some of the great Rand slides of previous decades have indeed been accompanied by major emigration surges.*

Which of the 4 potential impacts do we currently believe to pose the greatest risk to the residential market? *Undoubtedly the 2nd one, i.e. the potential upside risk to interest rates that it poses. Recent speculation in this regard alone may be damaging to residential demand, although it remains to be seen whether Rand weakness does indeed lead to actual earlier interest rate hiking. Important too, is to understand that this week is the SARB's MPC meeting, a week in which interest rate hype and speculation is indeed heightened in the media, and it is possible that this subsides once more from next week onward. But potential impacts of the Rand on interest rates are a risk that can't be ignored.*

On the subject of the Rand's impact on emigration selling, we believe this to currently be less of risk due to mediocre job prospects elsewhere in the World. The weak global economy of recent years has thus brought about something of a window of opportunity for SA to acquire the skills to "fix things that don't work". It is questionable *as to how well we've used this opportunity, but it won't around forever. When the global economy one day booms again, attracting and retaining skilled labour will become far more challenging once more. But that's another matter.*

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