May 2020

Property Barometer.

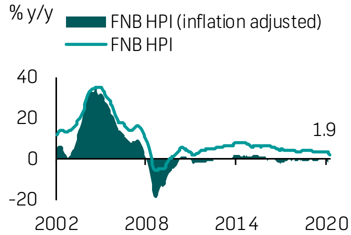
+1.9% y/y FNB HPI

0.4% m/m FNB HPI

48.1 FNB Valuers' Market Strength Index

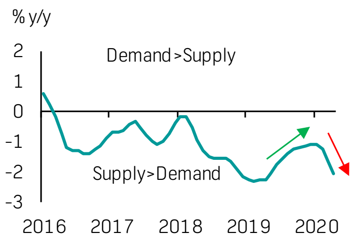
FNB HPI reaches lowest level in over 10 years

Figure 1: FNB HPI



Source: FNB Economics

Figure 2: Market strength index – Demand-supply gap widening again in 2020



Source: FNB Economics

Impact of lockdown yet to fully reflect

Annual house price growth fell to 1.9% in April, down from 2.5% (revised from 2.8%) in March – the slowest pace since December 2009 (just over a decade ago). The sharp drop is consistent with other high-frequency data, such as passenger car sales, which plunged 98% y/y in April. While this month's data gives early indications, the impact of lockdown on the housing market is not yet fully reflected in the data. This is because our index is constructed using mortgage approval data, and there is generally a lag between mortgage applications being submitted and approved. Approximately 60% of the April sample relate to applications that commenced prior to the lockdown.

Since the implementation of lockdown, market activity has almost grounded to a halt. Preliminary data shows that volumes plummeted by around 60% y/y in April (or 62% compared to the last twelve months' average monthly volumes). This is consistent with our view that the pandemic will have a larger impact on transaction volumes than on price. A lack of transactions will, unfortunately, make gauging house price trends difficult in the coming months.

So, where to?

Economic activity is set to contract significantly in the near term, mainly as a direct result of the (necessary) measures adopted to suppress the spread of the virus. While the outlook remains highly uncertain, our estimates suggest that GDP could contract by between 7% and 10%. This implies employment loss of at least 750 000. Nevertheless, the raft of policies adopted to support the economy could help limit long-term damage to the economy and set the stage for a rebound once the shock passes.

Commensurately, we expect, as a base case, that house prices will decline by around 5% and transaction volumes by around 45% this year. In comparison, prices declined by an average 1.5% (according to the FNB HPI) and transaction volumes by around 40% in 2009 during the global financial crisis. We expect a deeper contraction this year because of the nature of the shock, and the magnitude of the impact on labour markets. Recovery will likely be drawn out, due to pre-existing weaknesses in consumer fundamentals. Historically low interest rates, a decline in house prices and lower transfer duties (particularly in the middle-priced segment) will eventually support purchasing activity and facilitate a house price rebound in 2021.

We expect pressure to reverberate across all price segments, although higher-end and luxury markets will likely be the hardest hit this year. This is partly due to pre-

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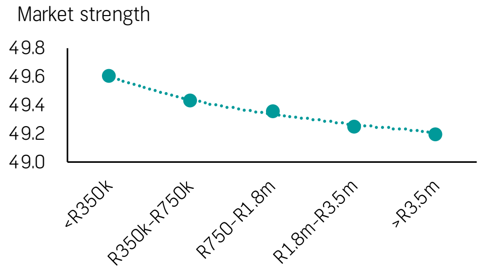
existing supply-demand imbalances (excess supply) and depressed sentiment. In contrast, we expect a relative resilience in the affordable market, partly due to a structural supply deficit (i.e., demand is higher than the available stock). Further, demand in the lower end will partly be supplemented by the middle segments "buying down", which is common in such weak economic environments.

While we await the country's Phase 3 response to Covid-19, which will focus on structural reforms to reignite growth, measures announced so far could help ensure that the impact on the housing market will ultimately be much less than would normally be associated with an economic shock of this magnitude. In the short term, however, these will likely be outweighed by heightened uncertainty and second-round effects on the labour market.

Figure 3: Market strength index (April) – Lower priced segments associated with stronger demand



Source: 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	4.9	4.9	4.7	4.4	4.2	4.1	4.1	4.2	4.2	4.2	4.2	3.9
2018	3.3	3.1	3.3	3.6	3.9	4.1	4.1	4.0	4.1	4.2	4.2	4.2
2019	3.9	3.3	3.4	3.4	3.3	3.5	3.6	3.7	3.8	3.7	3.5	3.5
2020	3.3	3.1	2.5	1.9								

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.