Property market remains well-balanced despite weak economy

The FNB House Price Index for September 2015 rose by 6.8% year-on-year. This is up from a revised 6.4% for August, effectively meaning a 'stalling' in the broader slowing price inflation trend that started back early in 2014, after house price growth had hit a multi-year high of 8.6% at the end of 2013.

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In real terms, when adjusting for Consumer Price Index (CPI) inflation, the rate of house price growth accelerated to 1.7% year-on-year in August (September CPI data not yet available), with CPI inflation of only 4.6% in that month. This August Real House Price Inflation rate was also up on the prior month's revised 0.9%. The average price of homes transacted in September was R1,026,725.

Examining the longer term real house price trend (house prices adjusted for CPI inflation), we see that despite some rise in recent years (+4.8% since the October 2011 low), the average real house price level remains -18.6% below the high reached in December 2007 at the back end of the residential boom period.

Real house price levels

Looking back longer though, the average real price remains 66.3% above the January 2001 level, a time back just before boom-time price inflation started to accelerate rapidly. Real house price levels thus remain at 'boom time' levels in our view, despite having lost some ground since the end of 2007.

In nominal terms, when not adjusting for CPI inflation, the average house price in July 2015 was 280.9% above the January 2001 level.

According to FNB's valuers as a group, the residential market remains very well balanced, so it should not be too surprising to see short up and down fluctuations in house price inflation for the time being, despite a broadly deteriorating economy.

The level of the Residential Demand Rating remains relatively solid at 56.14 on a scale of 0 to 100 in September. Simultaneously, the valuers as a group rate supply at a lower level of 53.21, and they still see supply as weakening, which is supportive of house price growth.

Strong demand

With the supply rating being lower than the demand rating, this translates into a Market Strength Index above the crucial 50 level at a 51.32 reading for September. Above a 50 level in Market Strength implies demand still being stronger than supply in the eyes of FNB's valuers as a group.

Examining the Market Strength Index's growth rates may provide an interesting explanation for the renewed rise in average house price inflation. The revised figures, when viewed on a month-on-month seasonally adjusted basis (to eliminate seasonal factors), still point to very mild decline in the demand rating.

However, they continue to point to a more significant rate of decline in the supply rating, which has caused a slight rise in the month-on-month growth rate of the overall seasonally adjusted Market Strength Index.

The Market Strength Survey is by no means an exact science, but it suggests that ongoing supply constraints at current levels of residential demand are key to sustaining mildly positive real house price growth (i.e. house price inflation higher than CPI inflation) at a time when there is little support from economic factors for residential demand growth.

Short-term fluctuations

The mild uptick in average house price growth in the revised September data comes slightly unexpectedly, but FNB valuers' surveys regarding demand and supply suggest that short-term up and down fluctuations should not be too surprising given a still very well-balanced residential market.

The valuers continue to see residential supply as constrained, and this plays a key support role for house price inflation at a time when they don't perceive much in the way of further residential demand strengthening.

We believe that this uptick will be short-lived, and remain of the view that house price inflation will resume its broad and gradual slowing trend towards lower single-digits. The multi-year deterioration in economic growth, along with a gradual rise in interest rates, remains likely to constrain demand growth, while we have seen recently positive growth in residential building completions. We expect that the supply side constraints will, therefore gradually begin to ease, which would be the catalyst for slower house price inflation.

But it is a slow process. For the first nine months of 2015, the average year-on-year house price inflation was 5.7%. That is moderately slower than the 7.1% for 2014.