# Real estate is an effective way of storing value during stagflation

By Antonie Goosen

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The current increased levels of inflation, high interest rates, stagnant global and local economic growth combined with high unemployment have led to deliberations between experts that South Africa might be heading towards a period of economic stagflation. If this is the case, it is good to keep in mind that real estate is an effective way of storing value.

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The slowdown that accompanies stagflation would mean that there are less people involved or participating in the economy. That means GDP numbers go down and, more importantly, earnings numbers are affected through corporate profits. From an investment perspective, that places pressure on the equity market and this is where real estate will store value. This asset has traditionally been effective in the long term. Inflation causes the cost of raw materials, goods, or labour to rise, meaning that there will be more expensive homes on the market.

During periods of stagflation, building contractors will continue to expand their construction of homes to meet consumer demand. The need for real estate is constantly increasing, given a more significant population. Stagflation does not decrease demand for homes; however, it causes supply to stagnate and reduces the affordability of completed houses. The physical number of completed buildings slows down because of the prohibitive cost of construction and persistent supply chain problems. It is a disadvantage for contractors and potential homeowners; however, it is an advantage for existing homeowners. These variables mean that their homes are in greater demand and will appreciate.


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## Stagflation related to interest rates

The inflation that comes with stagflation is related to the interest rates in the country. Consumers looking to purchase a home in 2022 are significantly affected by the money supply in the economy. There are fewer prospective home buyers as the government attempts to slow down inflation. Given the effects of the Covid-19 pandemic, many building materials have increased in cost while wages have remained constant. This feature makes it difficult for new homes to be priced affordably.

The South African Reserve Bank (Sarb) will try to rein in inflation by increasing interest rates. Higher interest rates mean less money supply in the economy. Consumers and businesses are unlikely to borrow when the interest payments are high. This measure leads to reduced economic spending and can cause a recession.

The Sarb this month increased the interest rate with a further 75 basis points, giving us a repo rate of 6.25%, which brings us back to pre-Covid levels. With the prime lending rate now at 9.75%, homeowners might have to look at ways to minimise the effect on their bond repayments. Property pegged at a fixed-rate mortgage is safer because it is immune to inflation. The price for homes often appreciates as time passes, while the mortgage prices remain the same.

Consumers without a fixed-rate mortgage will have to pay a higher home fee. Real estate owners who buy homes with mortgages will gain value through the high inflation experienced during stagflation. It also allows homeowners to charge higher rentals regardless of the stagnating economy. A higher valuation in inflation-adjusted terms may stagnate at first, but after five years, the home will return to its actual market value.


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## Property not yet in full stagflation cycle

There are positive economic data that would indicate that the property market is not yet in a full stagflation cycle. One of the economic indicators that needs to be considered is property inflation and this needs to be looked at in conjunction with national consumer inflation average. According to [https://www.lightstoneproperty.co.za/ *Lightstone Property's Residential Property Indices Report*]] at the end of August 2022, the national year-on-year house price inflation is at 3.67%, having decreased consistently since early 2021. This is well below the consumer inflation average we currently see at 7.8% as at the end of July 2022.

The report by Lightstone Properties goes on to say, annual property inflation remained steady in the Free State, Limpopo, and the Northern Cape, increased in the Eastern Cape and Mpumalanga, and decreased in Gauteng, KwaZulu-Natal (KZN), North West and the Western Cape. Annual property inflation in the low value segment was once again much higher than that in other segments - inflation for properties in low value markets was 9.8%, compared to 4.3% for properties in mid value markets.

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## Industry remains resilient

According to the September 2022 FNB Property Barometer, the steeper-than-expected interest rate hikes suggest a less supportive environment for homebuying activity. Our data concurs with this in the lower- and middle-income market.

In addition, the South African economy has been impacted in the second quarter of 2022 (Q2:2022) by Stage 6 load shedding, global political unrest and the looming possibility of a global recession, backed by slowing growth. Nevertheless, the real estate industry remains resilient. According to Stats SA, the real estate, finance and business services industries made the biggest positive impact on GDP growth in Q2:2022, rising by 2.4%. Stats SA goes on to say that in Q2:2022, the real estate industry is one of only four industries that has recovered to pre-pandemic levels and that the real estate industry only took two quarters to recover to Q4:2019 levels, post Covid.

The FNB property barometer also shows that the economy created approximately 648,000 jobs between Q1:2022 and Q1:2022, an increase of 4.3% quarter on quarter. This has resulted in stronger post-pandemic household balance sheets (in non-labour income) for higher income households. The report also mentions competition and innovation in the mortgage market making buying a home easier.

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## Accessible home loan finance

The Ooba Q2:2022 data shows that competition between banks for home loans in Q2:2022 has allowed potential homeowners to benefit from more accessible home loan finance at attractive interest rate discounts. The Q2:2022 statistics show that the average approved bond size of R1,320,225 (up by 2.4% from Q2:2021), grew at a higher rate than that of the average purchase price, indicative of sturdy lending confidence.

At the moment, property stock shortages continue, but high demand across the spectrum of properties has started to ease slightly as interest rates have risen. However, this is not to the levels that one might have expected. We see that the high-end market is impacted less by changes in the interest rate. Sellers can wait to get the price they want, and buyers have less stock to choose from but are prepared to pay the asking price. We are seeing continued demand in the high-end market and in properties purchased as part of the high-end semigration trend.

We are not yet in a situation of stagflation in the property market in South Africa. True stagflation in real estate happens when buyers are not able to buy and sellers are unable to sell or unwilling to sell at lower prices. The property market has proved to be resilient in times of economic turmoil and should continue on its current trajectory for the remainder of the year, albeit more in the higher end property market.

### ABOUT THE AUTHOR

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