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MORTGAGE MARKET BAROMETER

Household Sector Credit growth slows slightly in December. Is it beginning to respond to ongoing interest rate hiking?

MARKET ANALYTICS AND SCENARIO FORECASTING UNIT

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Growth in Household Sector Credit Outstanding slowed slightly in December, and it may be that further rises in interest rates are just beginning to put the brakes on this previously accelerating growth rate.

We hadn't quite expected a growth slowing yet, and 1 month of slower growth doesn't yet confirm a trend. But ultimately we should expect slower credit growth as interest rates continue to rise and a weakening economy slows employment and income growth.

In the large Mortgage Credit category of Household Credit, slower residential activity growth for some time now suggests that new mortgage lending growth may have already started to slow. While outstanding mortgage credit has not yet begun to slow, an unchanged growth rate in this category, after previous acceleration, suggests that slowing growth may soon be on its way.

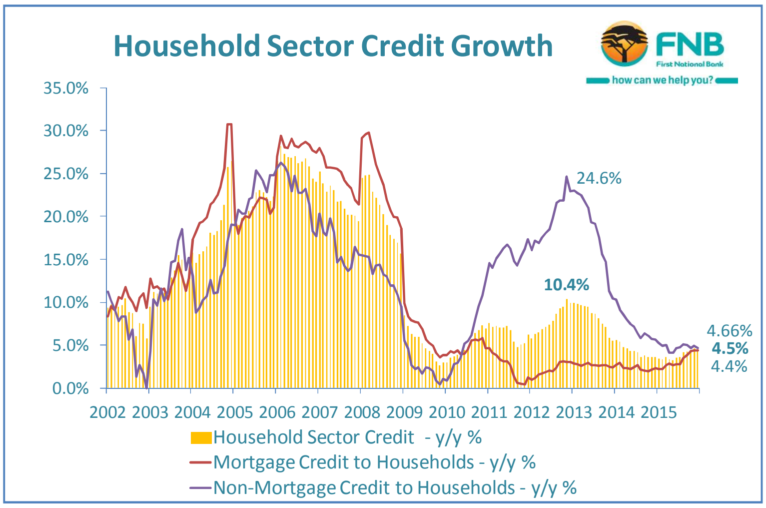
KEY POINTS

- *On a year-on-year basis, the growth in value of Household Sector Mortgage Credit Outstanding remained virtually unchanged at 4.4% in December, after a prior accelerating growth trend.*
- *It was thus the non-mortgage area of household sector credit extension which contributed to a slower Total Household Sector Credit growth rate in December, to the tune of 4.5%, down from 4.6% in November. Non-Mortgage Credit growth slowed from 5% previous to 4.7% year-on-year in December.*
- *Although 1 month's data does not yet confirm a trend change, a slowdown in Total Household Sector Credit growth is welcome news, given the slow pace of household income growth in a weak economy. Slow credit growth is important in order to sustain the multi-year trend towards a lower Household Sector Debt-to-Disposable Income Ratio, a trend we believe to have been a positive development in recent years given a high level of indebtedness.*
- *There new mortgage lending environment may be starting to weaken, given signs of slowing activity levels in the residential market. The Leading Business Cycle Indicator for South Africa normally leads the trend in new mortgage lending growth, and this has been declining for some time. Therefore, in the near term we may begin to see slowing in mortgage book growth starting, which may contribute to further slowing in total Household Sector Credit.*
- *Recent Ooba stats may point to a rising interest rate environment having made it slightly more difficult to get a home loan approved. But to date there is little convincing evidence of a noticeable trend change in the mortgage lending space.*

HOUSEHOLD CREDIT GROWTH SLOWS

Growth in Outstanding Household Sector Credit de-celerated slightly in December, from 4.6% year-on-year in the previous month to 4.5%. This slight slowing comes a little earlier than we had anticipated, but we had nevertheless expected that a prior acceleration in growth would be short lived, and that the SARB's ongoing interest rate hiking would begin to contain credit growth fairly soon.

The de-celeration comes largely as a result of a slowing in non-mortgage credit growth, from 5% year-on-year in November to 4.7% in December. Noticeable here is a now very slow growth rate of 2.3% in Instalment sales Credit, reflecting a slump in vehicle sales growth along with other durable goods, the result of interest rate hiking along with a deteriorating economy's impact on household income growth and consumer confidence.

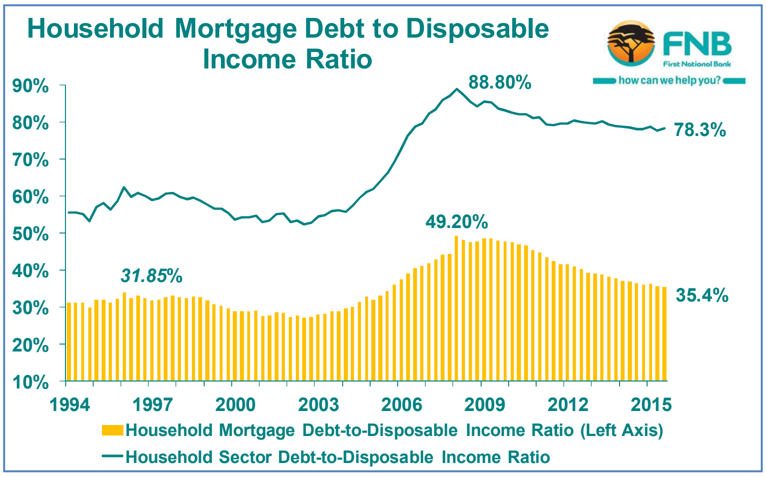


Mortgage credit growth to households treaded water in December, at an unchanged rate of 4.4% year-on-year, after a prior rising growth trend through much of 2015.

We believe that slowing growth will be the order of the day in the coming months, especially given the SARB's further 50 basis point interest rate hike this week, and the rising risk of a domestic recession in 2016.

A SLOWER HOUSEHOLD CREDIT GROWTH RATE IS GOOD NEWS

Although 1 month does not confirm a trend change in Household Credit growth yet, a slower growth rate is positive news. The prior months' acceleration in growth had begun to raise mild concerns with us, because should it have continued to rise, it may have led to an end to the multi-year trend towards a lower and healthier Household Sector Debt-to-Disposable Income Ratio, a positive development in recent years which has reduced Household Sector vulnerability to interest rate hiking considerably since 2008.



It is crucial that Household Sector Credit growth remains pedestrian in order to lower the Debt-to-Disposable Income Ratio further, because in a weak economic environment where the possibility of recession is significant, we can't expect much strength in Household Disposable Income growth in the near term.

Moderate mortgage advances growth since the end of the 2000-2007 Residential Boom/Bubble has been key to the declining trend in the Household Debt-to-Disposable Income Ratio, due to the sheer size of the Mortgage Credit category. From a high of 88.8% in the 1st quarter of 2008, the Household Debt-to-Disposable Income Ratio has declined noticeably to 78.3% by the 3rd quarter of 2015. This declining trend in the ratio has been greatly assisted by a drop in the Household Sector Mortgage Debt-to-Disposable Income Ratio from a 49.2% peak to 35.4% over the same period.

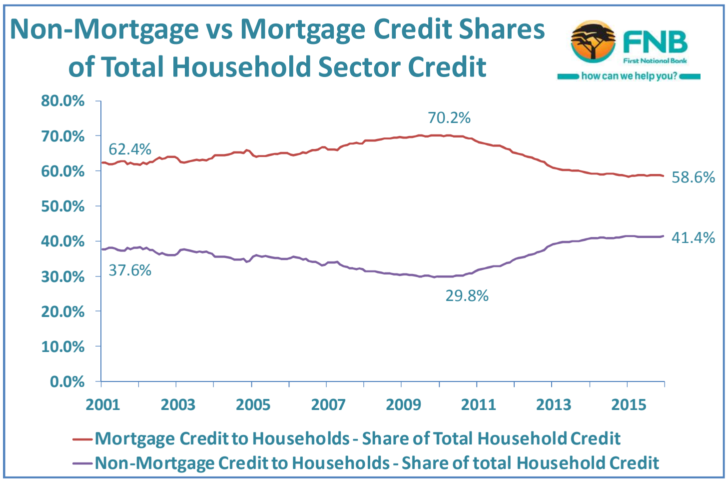
Going forward, however, stagnant economic growth looks likely to keep income growth very slow, in turn requiring very slow household credit growth so as not to increase Household Sector vulnerability.

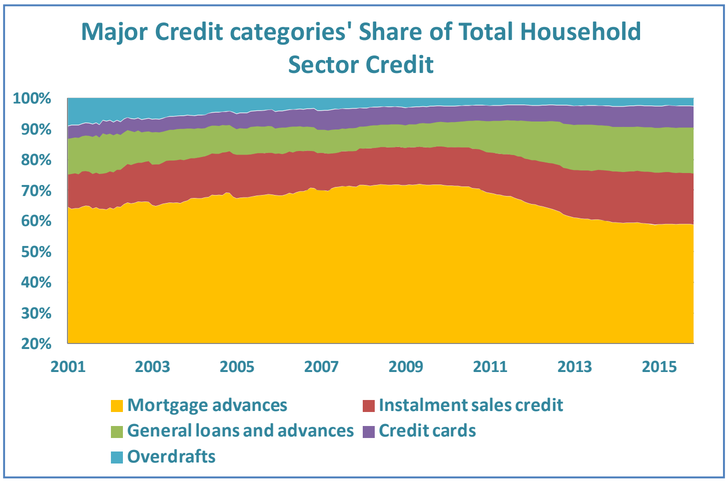
MORTGAGE-TO-NON-MORTGAGE SHARES OF TOTAL CREDIT MOVING ALMOST SIDEWAYS

The years of slow growth in Household Sector Mortgage Credit appear to have largely "normalized" its share of total Household Credit, if we consider pre-boom levels to be "normal.

Whereas Mortgage Credit's share of total Household Credit rose from 62.4% early in 2001 to 70.2% by 2009, this percentage has since dropped back significantly to 58.6% by December 2015. In recent months, however, the percentage is moving more-or-less sideways, with both Non-Mortgage and Mortgage Credit growth rates fairly similar these days.

Of the main categories of credit extended to the Household Sector, the highest growth rate was shown in December by the General Loans and Advances" category, to the tune of 7.1%, followed by Overdrafts with 7% year-on-year. Credit Card Debtors was next with 5.7%. Only the Overdraft category was still on an accelerating growth trend, however.





THE NEW MORTGAGE LENDING ENVIRONMENT

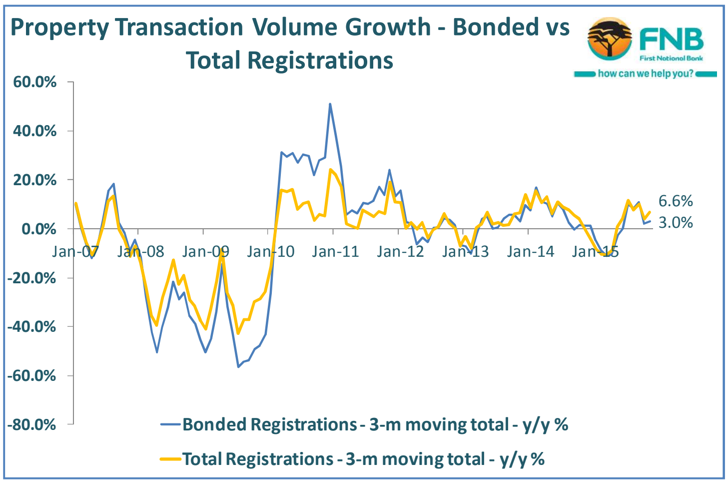
After 4 years of economic growth deterioration, and a 5th year of "slide" looking likely in 2015, and with interest rates having risen for 2 years to date, we will be looking for signs of a more conservative lending approach by mortgage lenders this year. To date, though, there has been little strong evidence of such moves in the market of late, although home loans approvals may "automatically" have become slightly tougher to obtain given ongoing interest rate hiking..

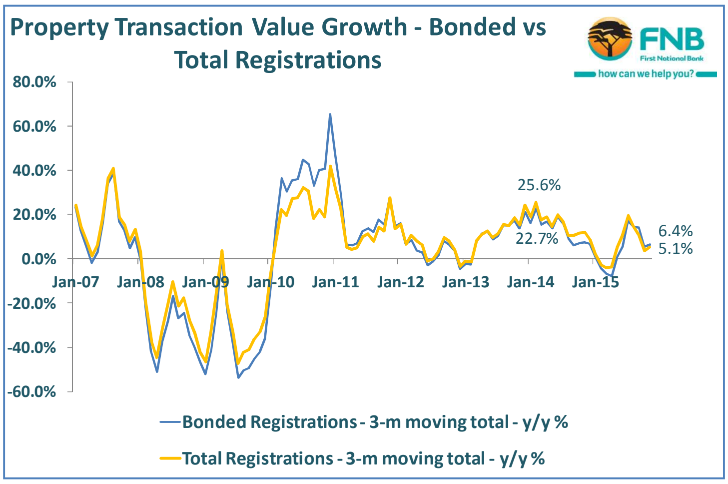
Growth in New Bond Registrations

We attempt to identify all bonded transaction registrations by individuals (natural persons) with the Deeds Office in order to estimate growth in what should be largely residential new mortgage lending.

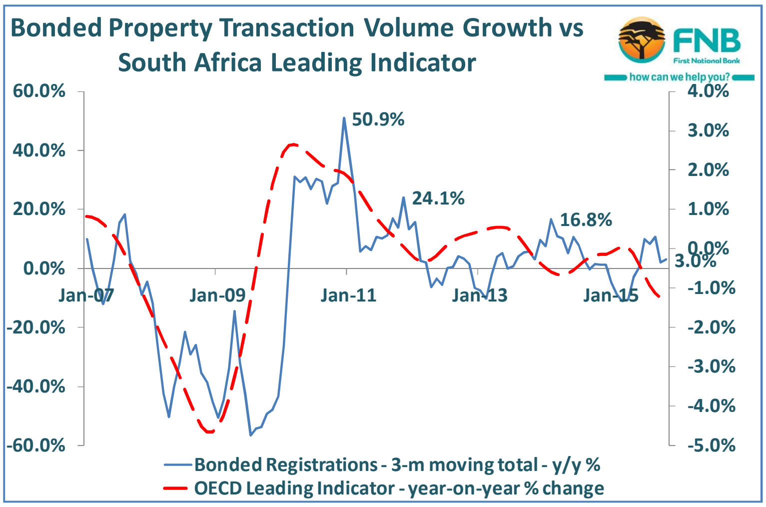
As was the case with NCR data for new mortgage loans to Households, we saw something of a mini-surge in bonded registrations growth around mid-2015, after a lull earlier in the year. This appears very much the lagged impact of a mild surge in Residential Activity being witnessed in the latter half of 2014 according to our FNB Estate Agent Survey.

More recently, in 2015, however, we have seen agents reporting a decline in residential activity in the Survey, while FNB's valuers have also reported perceived weakening in demand in recent months. We would thus expect to begin to see bonded registrations year-on-year growth slowing in the near term. As at November, the year-on-year growth in the 3-month moving average in the volume of bonded registrations recorded 3%, slightly above the 1.7% for the 3 months to October, but significantly slower than the 10.7% in the 3 months to September.



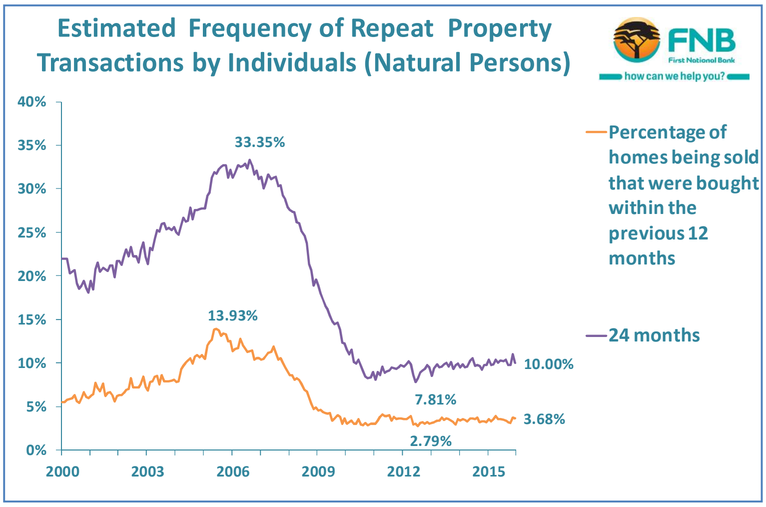


It is possible that November data is not yet quite complete yet, implying possible revisions as more data gets added in coming months. But it would appear that growth in new lending had begun to slow late in 2015, after something of a positive "bump" around mid-year.



While bonded registration data is somewhat rough, broadly speaking the growth fluctuations in lending track the growth direction of the Leading Business Cycle Indicator with something of a lag. The recent "speeding up" of the rate of decline in the South African Leading Indicator (OECD version), thus suggests that the growth in volume of bonded registrations should indeed have started to slow, and could turn negative as the country's economy looks set to go into an even weaker period in 2016.

Home Loan Cancellation Risk – still low



The weak economic environment keeps the pace of housing "turnover" slow, as a high percentage of home owners stay in the same home for longer, and speculative activity remains muted.

This remains reflected in the relatively low percentage of properties, currently being sold by individuals, which were purchased within the past 2 years. Whereas this level was an extreme 33.35% of all properties traded by individuals (Natural Persons) back in July 2006 at the height of the boom, in December 2015 it remained a lowly 10%, albeit having risen marginally from a post-Boom low of 7.81% at a stage of 2012.

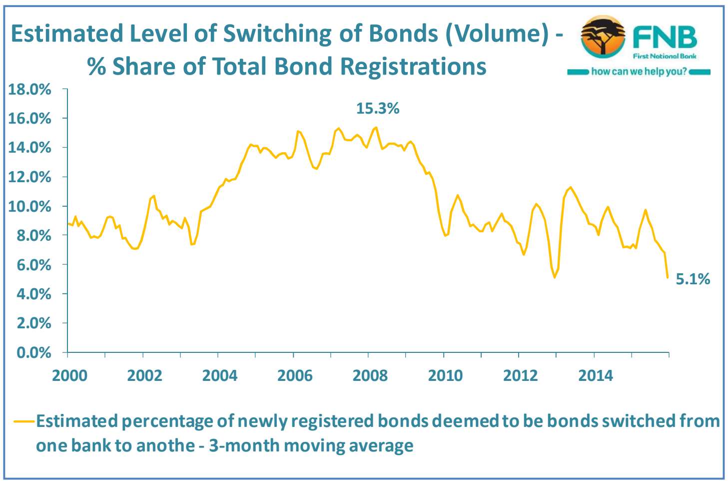
This slow pace of turnover is a key positive for mortgage lenders' profitability, as it increases the possibility of home loans remaining on their books for longer. This is important because, given a significant cost of putting a home loan on the books, it can take a considerable time before one reaches "break even" on a home loan and starts to make money.

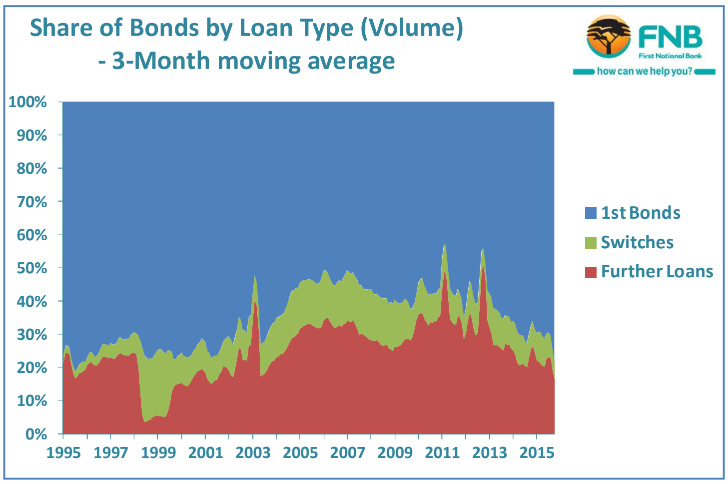
Given the likelihood of a slowing economy and residential market in 2016, the pace of turnover could begin to slow again.

A lower home loan cancellation risk since the end of the boom years has also been reflected in less aggressive drives by mortgage lenders to "switch" home loans from rival banks.

Examining deeds data for bond registrations, we estimate that as for the 3 months to December 2015, 5.1% of all bond registrations for individuals (natural persons) were "switches". This estimate has slowed mildly since 9.8% for the 3 months to May 2015, and remains very subdued since the 15.3% high back in March 2008, which was right at the end of the "Market Share War" of the boom years. The timing of the peak of boom time switching suggests that switching activity can become more aggressive towards the end of a strong growth period, as mortgage lenders try to sustain their sales growth where "natural" market growth is starting to slow. To date, we haven't seen signs of a noticeable re-emergence of such actions yet.

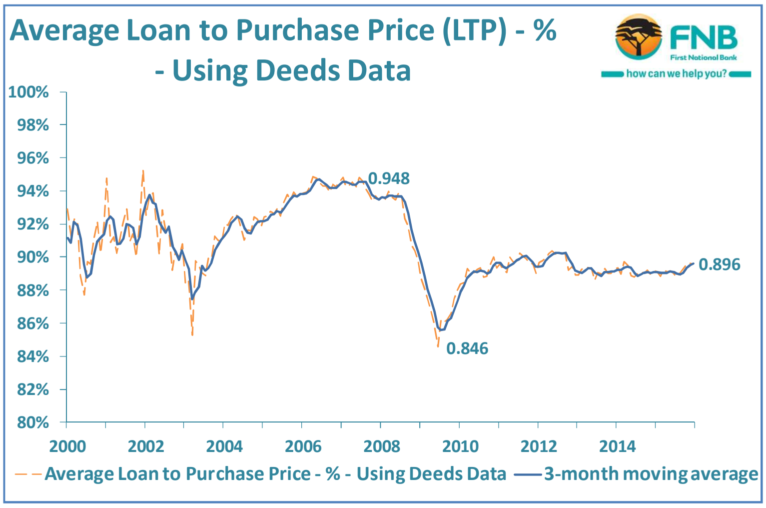
The other potential indicator of "market madness", i.e. Further Loan registrations, also remains relatively subdued at an estimated 16.7% of total registrations in the 3 months to December 2015, down from a relative high of 23% in the 3 months to September. This remains a far cry from being consistently above 30% in the last years of the boom period around 2005-7.





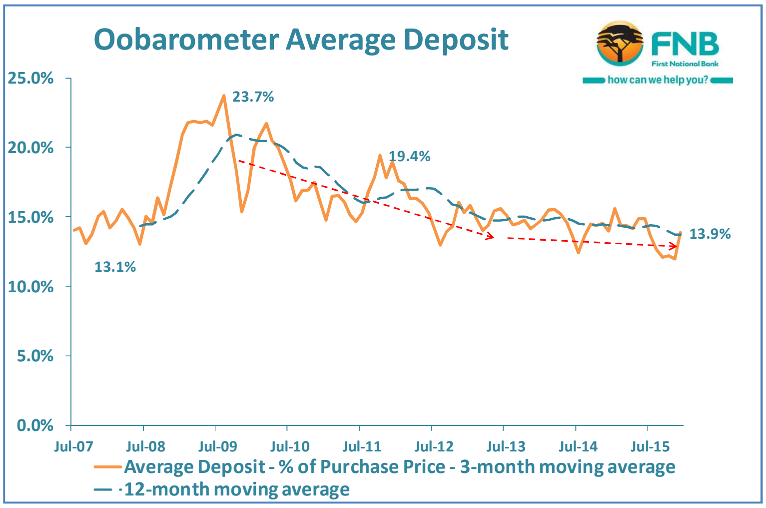
Therefore, the Mortgage Market continues to appear largely "rational", overwhelmingly dominated by 1st Bonds registrations. These made up 78.2% of total bond registrations by individuals in the 3 months to December 2015, far above the estimated 50.7% reached in March 2007 at the back end of the boom.

Lending Stance of Mortgage Lenders



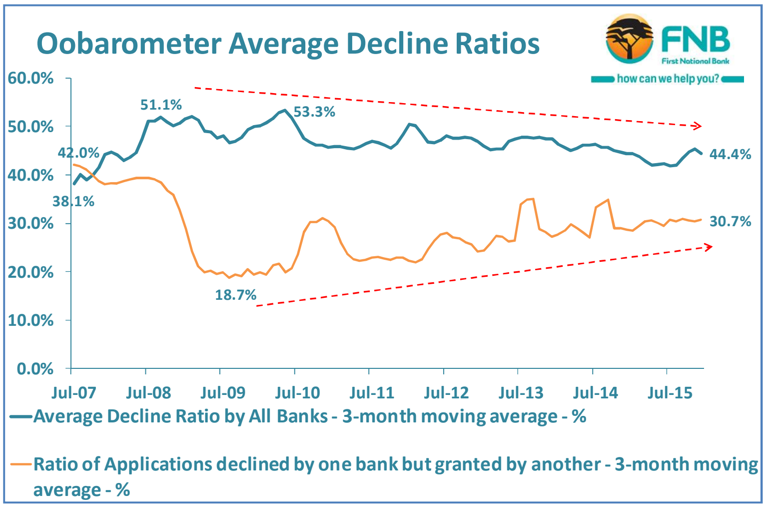
One did still get the feeling for a while in the 2nd half of 2015 that mortgage lenders as a group did want their lending to grow a little faster, within the bounds of "responsible lending", at a time when natural market growth was starting to "battle".

Using deeds data, our estimated Loan-to-Purchase Price Ratio was 0.896 as at December 2015. This was mildly up from 0.888 in July, but the broader trend has been sideways since around 2011, after a prior noticeable rise from a low of 0.846 in mid-2009. At the current level, the average LTP remains well below the 0.948 boom time high in June 2007.



In the 2nd half of 2015, Oobarometer data hinted at a slightly easier credit environment if one looked at average deposit size. Although the average deposit as a percentage of purchase price did "jump" higher in December to 13.9%, from November's estimated 12%, one should accept that month to month movements can be volatile. Examining the 12-month moving average, we actually saw further decline in the average deposit percentage through the 2nd half of 2015, from 14.3% for the 12 months to June to 13.7 for the 12 months to December.

Data source: Ooba

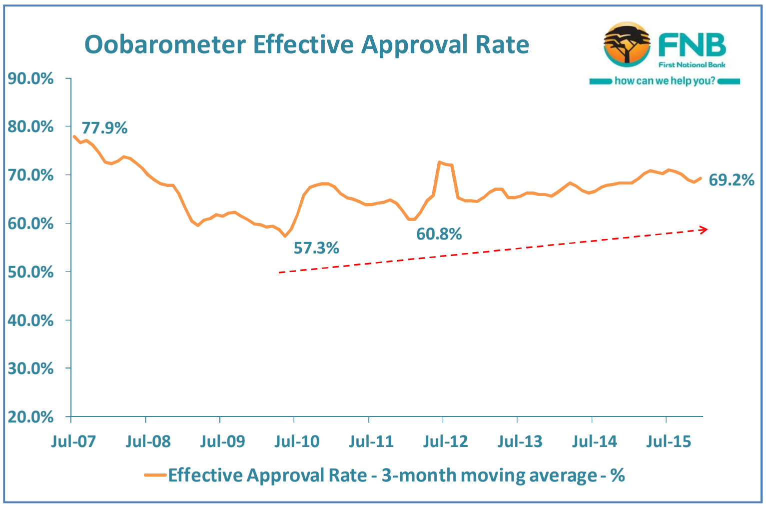


There wasn't a noticeable improvement in bank approval rates in the late stages of 2015, however.

As at December, the 3-month average decline ratio by all banks measured 44.5%. This is a little higher than the 2015 low of 41.8% for the 3 months to July, which is plausible given further interest rate hiking and economic weakness late in the year.

The Ratio of applications declined by one bank but approved by another, however, has shown little movement in recent months, recording 30.7% for the final 3 months of 2015.

Data source: Ooba

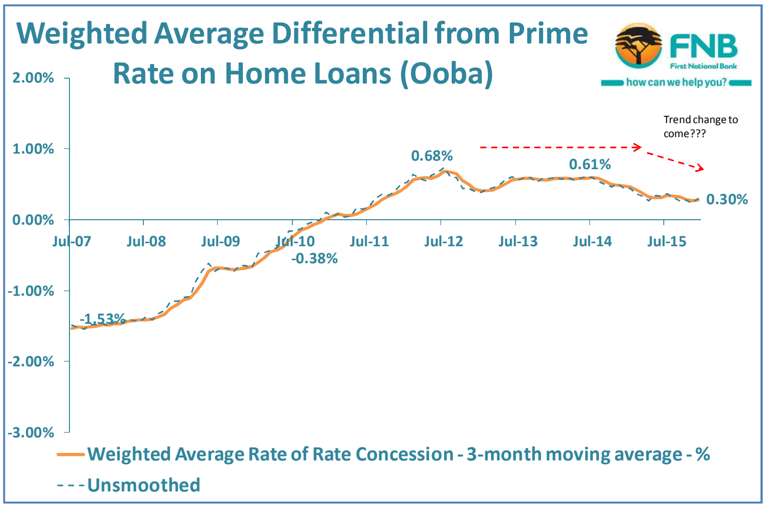


Putting 1st and 2nd bank approvals together, Ooba's "Effective" Approval Rate of 69.2% in the 3 months to December is a little down on 71% for the 3 months to July.

It is possible that rising interest rates and weak household income growth are a constraining factor in this regard, but we will need a few more months to determine whether this signals a trend change from the broad upward trend in the Effective Approval rate, all the way from 57.3% in mid-2010 to recent levels.

Data source: Ooba

Average Home Loan Pricing



Where we saw an apparent mild increase in competition levels through the 2nd half of 2014 and early-2015 was in the area of home loans pricing. According to the Ooba data, from mid-2014 to October 2015, the average differential above Prime Rate had declined from 0.61% to 0.27% by April 2015.

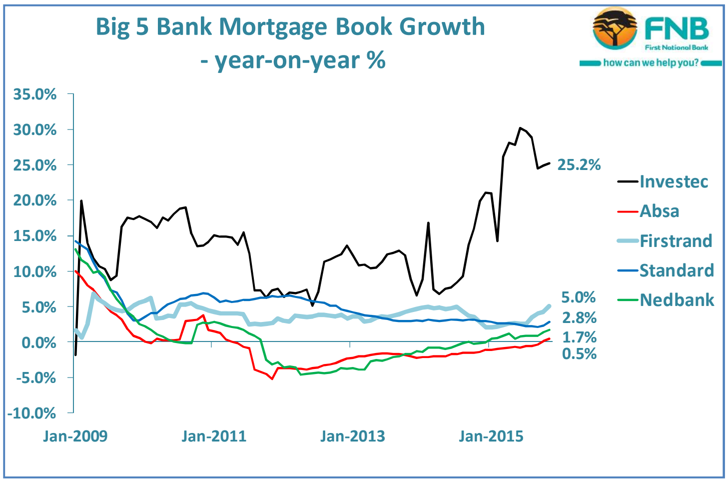
However, ending 2015 at 30%, we have not seen any further meaningful "squeezing" in this average pricing level.

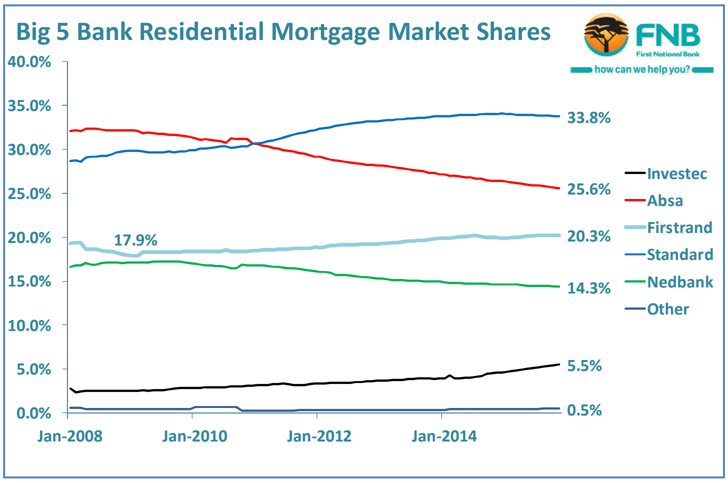
Data source: Ooba

Market Shares and Individual Lenders' Residential Mortgages Growth

The largest mortgage lender, Standard Bank, has seen its market share decline very slightly, from 34% at the beginning of 2015 to 33.8% by November. Of the "Big 4", Firstrand was the only one showing a mild market share gain through 2015, from 19.9% in January to 20.3% by November. In terms of book growth rates, Firstrand's year-on-year residential mortgage advances growth measured 5% in November, noticeably higher than 2.1% at the start of last year, while Standard Bank was next of the Big 4 with 2.8%

The most aggressive lender in 2015 by a long way appears to be Investec, with its residential mortgage book growth at 25.2% year-on-year at November.

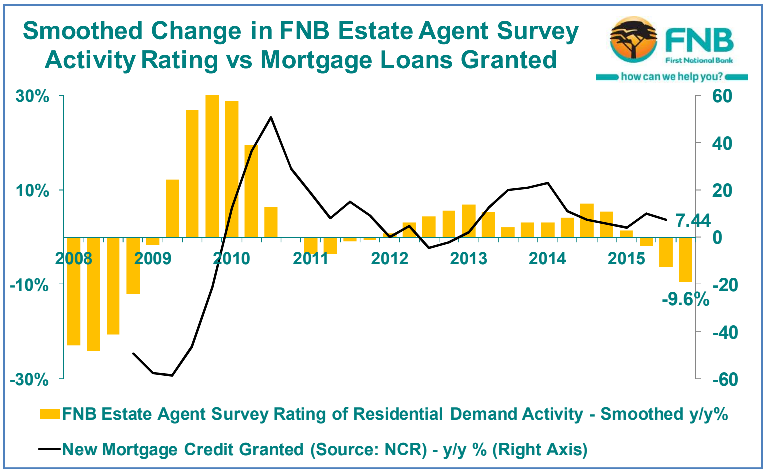




OUTLOOK

The slight December slowing in Household Sector Credit growth comes perhaps a little sooner than we had expected, but 1 month does not yet confirm a trend change. We expect this growth to be contained well within single digit territory, as we anticipate a tapering in **new** lending growth in the near term. Such a slowdown in new lending growth is to be expected on the back of rising interest rates and slowing economic growth.

Key Leading Indicators suggest that **NEW** mortgage lending growth is set to slow in the near term, which should lead to a containment outstanding mortgage loans growth.



One of the national measures of new residential mortgage Loans granted comes from the National Credit Regulator (NCR) in the form of Value of New Residential Mortgage Loans Granted. After a slowing rate of growth through much of 2014 and into early-2015, the 2nd quarter saw year-on-year growth in the value of new mortgage loans granted pick up briefly from 3.9% in the prior quarter to 10%. The 3rd quarter, however, showed a slight slowing in growth to 7.4% once more.

The 3rd quarter slowing in growth, we believe, is the start of a broader slowing trend going into 2016. Such expected slowdown is in lagged response to a slowing pace of growth, and more recently a decline, in Residential Activity Levels as perceived by estate agents taking part in the FNB Estate Agent Survey.

By the 4th quarter of 2015, the smoothed year-on-year rate of change in the Residential Activity rating from the survey reached a -9.6% year-on-year decline. Trend changes in new mortgage loans approvals growth can lag this activity rating by up to 4 quarters.

We thus believe that slowing new mortgage lending growth is now due, and may increasingly be seen in the mortgage numbers early in 2016. This in turn should lead to growth in mortgage credit outstanding starting to slow in the near term, helping total household credit growth to lower levels.

***Under such currently constrained circumstances a slowing in Household Sector Credit growth can arguably be seen as positive news. With Household Sector Disposable Income weak, it is important to have very slow credit growth so as to sustain the declining trend in the all-important Household Debt-to-Disposable Income Ratio. December's slower credit growth rate is thus encouraging, and we expect that it will slow further in the coming months on the back of further SARB rate hiking since December*.**