

Residential market expected to remain in upswing

Our review of prospects for the residential market includes forecasts for house prices as well as flat rentals, both on a national basis. The house price movements are based on Rode's House Price Index, whilst the flat rentals are for two-bedroom units.

House prices

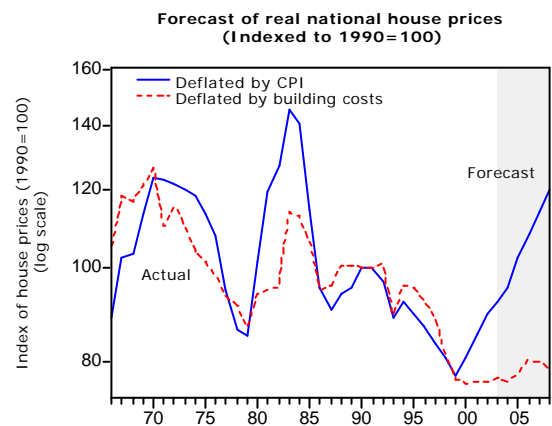
National nominal house prices are predicted to show average *nominal* growth of almost 11% p.a. over the forecast period, which equates to an inspiring annual *real* growth rate of 5,1% when deflated by the Consumer Price Index (CPI). The stimulus for growth is expected to come from lower interest rates, further income tax cuts, as well as healthy GDP growth. Another factor that could possibly stimulate continued growth is the likelihood that in many cities the manufacture of new stands cannot keep up with booming demand for new housing as a result of bureaucratic incompetence and red tape.

By deflating nominal house prices with building costs, an average *real* growth rate of only 0,6% is forecast. The reason for the big difference in the two real growth rates is that building costs are forecast to grow in excess of the CPI, which implies that the house-building construction sector is expected to perform better than the economy as a whole. The upbeat performance in the home-building construction sector is, of course, fuelled by the steady growth in nominal house prices, underpinned by buoyant demand for new residential units.

Furthermore, readers must take note that our forecast for house prices is for all price classes combined. The historic trend in the different price classes, however, shows a distinct difference in performance, with upper-priced suburbs doing much better than

the average for all price classes. Middle-priced suburbs' performance was more or less on par with the average for all price classes, whilst lower-priced suburbs performed weaker than the average for all price classes. More detail of the different price classes' performance is given in the chapter on the Property Cycle.

The building costs used in deflating *nominal* national house prices, are the Bureau for Economic Research's (BER's) building cost index (BCI) before 1980 and for the forecast period (2003-2008), and the Absa home-building cost index from 1980-2002.



Source: Rode's House Price Index; Stats SA; Absa; BER

The forecasts in this publication are based on economic fundamentals and historic relationships. The econometric model's forecasts assume that these relationships will continue.

The base year for Rode's House Price Indices is 1990. In other words, all prices were given the value of 100 in 1990. For interpretation purposes, it is therefore

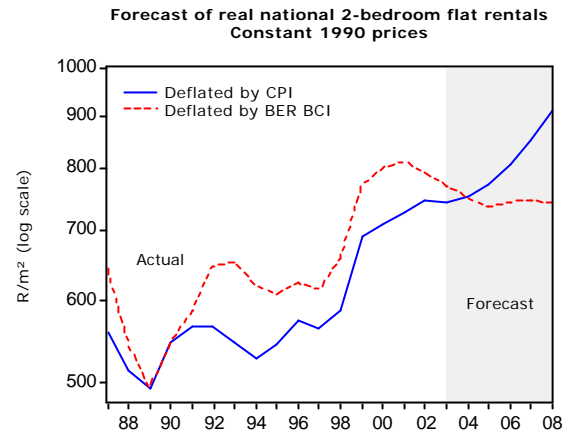
important to remember **an index does not reflect true levels**. It reflects the variable's level compared to that of the base year (the growth since 1990, in this case). Hence, interpretation should focus on trends and not actual values.

The accompanying table summarises the forecast performance in national house prices from 2003-2008.

Flats market

The flats market has been in a 'consolidation' phase since the end of 2002, and it is expected that this will continue for the next year or so. The main reason for this is the growing oversupply of rental stock (flats, townhouses and houses), which to a large extent is the result of growing investor interest in the buy-to-let market. Furthermore, the rental market could also start to experience growing competition from the market for lower-priced owner-occupied houses, which will become increasingly competitive with the expected decline in interest rates over the next year or so.

Real flat rentals (CPI deflated) are predicted to put in a better performance over the forecast period than real rentals (BER BCI deflated), for the same reasons mentioned above in the section on houses.



Source: Rode's Time Series; Stats SA; BER

The reason for deciding on the BER BCI — which mainly measures movements in pre-contract non-residential prices — as the building cost deflator, is that both flat and office buildings are normally multi-storey; hence the same building contractors tend to operate in this industry.

Despite the pressure on rentals from excess rental stock, the flat rental market should still benefit from the expected expansion in the economy, as well as further increases in employment numbers. Non-agricultural employment rose notably in the last three quarters of 2002, after declining for five years.

Forecast of house prices: national			
% change on previous year			
	Nominal	Real (deflated by CPI)*	Real (deflated by building costs)**
2002	14,1	4,4	0,0
2003	12,0	3,3	0,9
2004	8,0	3,3	-0,8
2005	12,5	7,0	2,2
2006	11,9	6,2	2,8
2007	10,4	5,1	-0,2
2008	10,8	5,5	-1,6
Average 2003-2008	10,9	5,1	0,6

* Deflated using panel of economists' survey forecast of the CPI
 ** Deflated by BER BCI before 1980 and from 2003-2008 and the Absa house-building cost index from 1980-2002.

Forecast of 2-bedroom flat rentals: national
% change on previous year

	Nominal	Real (deflated by CPI)*	Real (deflated by BER BCI)
2002	12,2	2,7	-2,6
2003	8,0	-0,4	-2,7
2004	6,0	1,4	-2,6
2005	8,0	2,7	-2,0
2006	10,0	4,5	1,1
2007	11,0	5,7	0,4
2008	12,0	6,7	-0,6
Average 2003-2008	9,2	3,4	-1,1

* Deflated using panel of economists' survey forecast of the CPI

The accompanying table sets out the forecast for national 2-bedroom flat rentals from 2003-2008. Nominal flat rentals are predicted to average 9,2% p.a. over the next six years, which equates to 3,4% p.a. when deflated by the CPI and -1,1% p.a. when deflated by the BER BCI.

In sum...

On average, house prices are forecast to put in a moderate performance over the next six years, with positive *real* growth expected in terms of both CPI and building costs. House prices are set to benefit from further interest rate drops, more income tax breaks as well as better economic growth forecasts.

Flat rentals are forecast to show positive *real* growth in terms of the CPI over the forecast period. However, in the case of nominal flat rentals deflated by building costs (BER BCI), negative average *real* growth is forecast. Real flat rentals are expected to feel the pressure from the increase in rental stock, especially over the initial stages of the forecast period. However, on the positive side, rentals should find some support from higher expected economic growth as well as higher employment figures.

This concludes our section on the residential market. ■