House prices on the way up as economy booms

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The rate at which house prices increase should bottom this year, and start increasing next year. It matters little whether you accept Absa Bank senior economist Jacques du Toit's estimate that this year's average year-on-year house price increase will be between 8 and 9%, or FNB Commercial Banking's property strategist John Loos's prediction of 11,6%; the bottom line is that the residential property market is still healthy, and it's getting better.

Loos expects average year-on-year house price inflation to start increasing again in 2008.

He says he was surprised by the average 15,2% increase in 2006, "given that I had been expecting a rate closer to 12% for the year".

"Last year we saw further rises in both the repayment value on an average-priced house/remuneration ratio, while the household debt-service ratio also rose further. However, none of these ratios appear extreme by historic standards."

Loos forecasts "a further slowdown in house price inflation for 2007 to an average 11,6%, before a gradual turnaround in 2008".

Remembering the prophets of doom's dismal forecasts for property, he added: "Certainly this would appear to be another blow for the believers that a house price bubble had developed during the recent boom years. That term implies the probability of a major and possibly sharp downward correction at some future date.

"Yes, the market is slowing but there are no strong indications that some major imbalance is building which could lead to a major slump."

Loos believes house price inflation's recovery from 2008 onwards will be driven by "the severity of looming supply-side constraints, which, along with significant land price inflation, will manifest themselves in rapid building cost inflation over the next few years".

The sector will have to compete with commercial property as well as other infrastructure investment that are placing huge demands on materials and skills.

"It comes as no surprise, therefore, that Industryinsight's residential building cost index rose by 23% year-on-year in October, sharply up from 0,8% at the end of 2005," says Loos. He predicts: "With many new government infrastructure projects commencing, and 2010 preparations beginning in earnest, it is expected that materials and skills supply constraints will get worse before they get better."

Another reason he advances for the price acceleration is "an economy growing at a steady annual pace of between 4% and 5%, which implies steady middle-class growth and thus housing demand growth".

"The housing market is demonstrating that, contrary to the belief of many, interest rates are not the only variables that drive the world. It's the economy that really matters."

He expects rents to rise. "This will be mildly exacerbated," says Loos, "by last year's interest rate hikes, along with some fears of further rate hikes.

"Furthermore, despite a small slowdown in real economic growth, the forecast for 2007 remains above 4%, which implies that as the economy continues to grow (albeit at a less robust pace) the middle-class sector will increase steadily, which should add to a tightening of the supply of new rental stock."

Another reason for the impending shortage of rented accommodation is that the buy-to-let market has slowed down slightly "in lagged response to the weaker rental market and weaker capital growth of recent years following the 2004 peak, as well as the interest hikes of 2006".