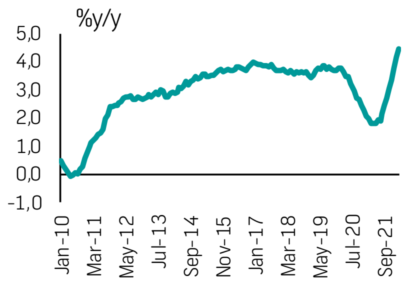
Economics
weekly

6 May 2022

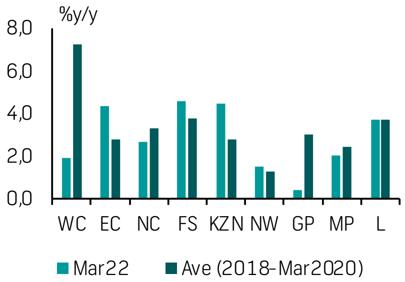
Rental inflation is climbing in the US but SA's dynamics differ materially

Figure 1: US rental inflation



Source: FRED, FNB Economics

Figure 2: Provincial rental inflation



Source: Stats SA, FNB Economics

Following the easing of lockdown and improved mobility, people have reverted to the cities. This has broadly resulted in rising rental inflation. While the latest rental inflation reading of 4.4% y/y in the US has outpaced the longer-term average of 2.9% (since 2010), rental inflation in SA remains muted. SA rental inflation has increased from the lockdown-induced trough of 0.6% y/y in March 2021 to 1.9% in March 2022. However, rental inflation in SA remains well below the pre-pandemic average of 3.9% (since 2018 when housing inflation started to moderate broadly in line with structurally slowing headline inflation).

While average rental inflation in urban areas remains subdued, delving deeper into the provincial data provides a few observations worth highlighting. There are provinces where current inflation is well below the pre-pandemic average, such the Western Cape (5.3ppt below), Gauteng (2.6ppt), Northern Cape (0.6ppt) and Mpumalanga (0.4ppt). Limpopo's rental inflation has recovered to its pre-pandemic average, but the remainder of the provinces have surpassed their pre-pandemic averages: KwaZulu-Natal (by 1.7ppt), Eastern Cape (1.5ppt), Free State (0.8ppt) and North West (0.3ppt). This, in part, reflects both supply and demand fundamentals i.e. good quality rental unit shortages in the Eastern Cape as well as rising demand in mining areas in North West.

The national vacancy rate as measured by TPN has declined from pandemic highs of 13.3% to 8.3% in 1Q22 but remains above the pre-pandemic average of 7.5%. This is in line with the theme of a gradual recovery in the rental market as households still face several headwinds, such as weak employment growth and an elevated cost of living, that should keep demand subdued and contain rental escalations. It is likely that rental demand around business districts will improve as the economy recovers, employment prospects improve and more people return to the office. For now, vacancy rates in selected cities remain elevated at 13.1% in Durban, 12.7% in Johannesburg, 11.6% in Cape Town and 9.6% in Pretoria—all above their pre-pandemic averages.

The innovation of lockdowns to curb the spread of Covid-19 has generally resulted in a shift in demand from services to goods, and relative price changes have reflected

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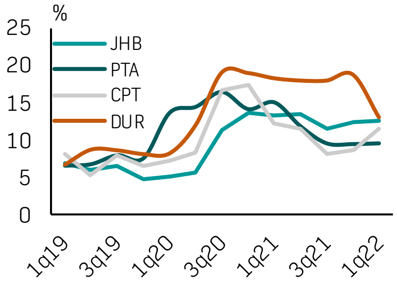
Figure 3: Selected vacancy rates



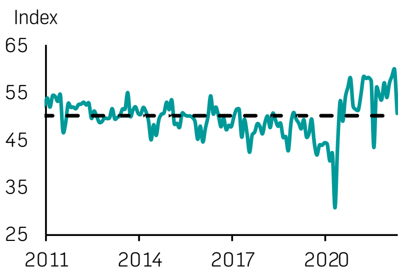
Source: Rode's and Associates, FNB Economics

this. Housing makes up a large proportion of consumer baskets in both the US (32.7%) and SA (16.5%) and is important in explaining services inflation trends. The divergence between US and SA rental inflation highlights the varying experiences of households following the easing of lockdown. On the demand side, US households have been supported by unemployment benefits that have largely resulted in labour shortages (in addition to frictional labour issues) and rising wage growth. On the supply side, housing construction has been slow to adjust, due in part to pandemic-induced supply chain disruptions, resulting in significant housing stock shortages. This supply/demand imbalance will likely keep rental escalations elevated. SA differs drastically, suffering from record-high unemployment and excessive stock in some areas. In addition to demand lost because of job losses, the currently high cost of living may prolong the financial strategy of sharing space to contain individual costs. Elevated inflation should also make tenants sensitive to excessive rental escalations.

As such, we expect the gradual normalisation of rental inflation to continue as the economy recovers and the improvement in investments as well as intentions to hire materialise. However, the ongoing economic recovery is precarious, threatened by the Russia-Ukraine war and its impact on trading partner growth, persistent loadshedding, the recent KwaZulu-Natal floods and other export capacity constraints, as well as rising prices dampening household spending. We anticipate rental inflation will recover to the pre-pandemic average only by the end of 2024.

Week in review

Figure 4: Absa PMI

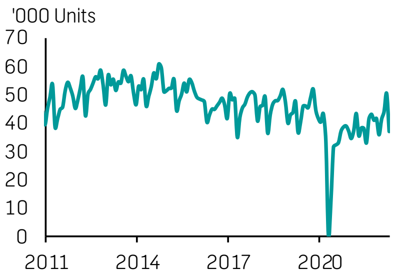


Source: Absa, BER, FNB Economics

Following three consecutive months of expansion, the seasonally adjusted Purchasing Managers' Index (PMI) fell sharply to 50.7 index points in April, from 60.0 in March. This is the lowest level of the PMI since the July 2021 unrest. This time, the sharp decline is on the back of devastating flooding in parts of KwaZulu-Natal, that has disrupted real economic activity. The decline in the headline PMI reflected a sharp drop in the business activity and new sales orders indices. The business activity index plunged to 39.6 index points in April from 60.5 previously, while the new sales orders index fell to 43.6 from 61.7 in March. This suggests a likely sharp monthly contraction in manufacturing output at the start of the second quarter. Surprisingly, however, the employment index increased by 3 index points in April. This may suggest that the declines in activity and demand may be regarded as temporary and producers may not need to shed further jobs. This is corroborated by the index tracking expectations of business conditions in six months' time, which improved slightly to 55.7 index points.

New domestic vehicle sales continued to outperform expectations, growing by 4.3% y/y in April. This is despite the devastating floods in KwaZulu-Natal, which caused significant supply chain disruptions in port, rail and road traffic, as well as the temporary closure of Toyota South Africa Motors. In addition, there were number of public holidays in April, which tends to slow sales. The continued recovery is spearheaded by the strong demand in the passenger car segment, which recorded 12.5% y/y sales

Figure 5: New vehicle sales



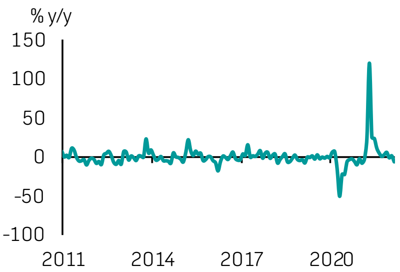
Source: Naamsa, FNB Economics

growth - supported by the car rental industry. All other vehicle segments (commercial vehicles) saw a decline in volumes, while export sales increased, by 16.0% y/y in April. Factors such as greater mobility, a low interest rate environment, pent-up demand from the tourism industry, some improvement in business confidence and replacement cycle pressure have all supported domestic demand in recent months. However, stock availability remains a constraint, exacerbated by the supply chain disruptions due to the floods, the ongoing Russia-Ukraine war and lockdowns in China. This will limit the potential upside from strong domestic demand.

Week ahead

On Monday, data on **foreign exchange reserves** for April will be released. The SARB's foreign gross reserves amounted to $58.16 billion in March, reflecting an increase of $470 million from February's level of $57.69 billion. Government's foreign borrowings to the value of $750 million from the World Bank and the increase in the dollar price of gold contributed to the increase in gross reserves. The accumulation of gross reserves bodes well for South Africa's import cover level, which measured 5.6 months at the end of December 2021, from 5.5 months at the end of September 2021.

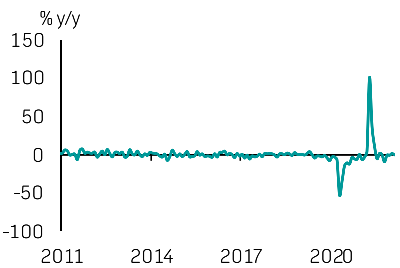
Figure 6: Mining production



Source: Stats SA, FNB Economics

Next week's release of the production dataset will provide further clarity on how the economy likely played out in the first quarter of the year. **Mining production** for March will be released around midday on Thursday. We expect non-seasonally adjusted mining output to have contracted by between 3.2% and 6.4% in March (following a 6.0%y/y contraction in February), mainly on a statistically higher base of the same month last year. Growth in the seasonally adjusted mining production could be modestly robust at around 4.1% m/m following a sharp 6.4% m/m contraction in February. The forecast risk is higher, and mine workers' unrest over higher wages would have affected output in some mining subdivisions. Frequent rains during March would have also impacted open cast coal mining.

Figure 7: Manufacturing production



Source: Stats SA, FNB Economics

Also important will be the release of **manufacturing production** on Thursday afternoon. The Manufacturing PMI reading for March suggested that monthly output increased faster in that month relative to February. We expect seasonally adjusted manufacturing production to have posted growth of 1.0% m/m following an unexpected contraction of 1.1% in February. Meanwhile, non-seasonally adjusted manufacturing production is expected to have modestly declined by 1.4% y/y in March, following growth of 2.0% y/y and 0.2% y/y in January and February respectively. Growth in manufacturing production is likely to have been constrained by higher input (and transportation) costs and the prevalent raw material shortages from supply chain pressures amid Covid-19 and Russia's invasion of Ukraine.

Tables

The key data in review

Date	Country	Release/Event	Period	Act	Prior
3 May	SA	Manufacturing PMI	Apr	50,7	60,0
	SA	Naamsa Vehicle Sales y/y	Apr	4,3%	16,2%
5 May	SA	Electricity production y/y	Mar	-1,1%	-0,4%

Data to watch out for this week

Date	Country	Release/Event	Period	Survey	Prior
9 May	SA	Gross Reserves	Apr	--	$58.2b
	SA	Net Reserves	Apr	--	$55.4b
12 May	SA	Mining Production m/m	Mar	--	-6,4%
		Mining Production y/y	Mar	--	-6,0%
	SA	Manufacturing Production m/m	Mar	--	-1,1%
		Manufacturing Production y/y	Mar	--	0,2%

Financial market indicators

Indicator	Level	1 W	1 M	1 Y
All Share	69 682,65	-2,6%	-7,4%	3,5%
USD/ZAR	15,99	-0,3%	9,0%	11,3%
EUR/ZAR	16,86	0,2%	5,4%	-2,3%
GBP/ZAR	19,75	-1,1%	3,0%	-1,2%
Platinum US$/oz	986,00	7,0%	1,5%	-19,7%
Gold US$/oz	1 877,18	-0,9%	-2,4%	5,1%
Brent US$/oz	110,90	3,1%	4,0%	60,8%
SA 10 year bond yield	9,97	-0,2%	4,5%	9,2%

FNB SA Economic Forecast

Economic Indicator	2020	2021	2022f	2023f	2024f
Real GDP %y/y	-6,4	4,9	1,7	1,6	1,5
Household consumption expenditure %y/y	-6,5	5,7	2,1	1,3	1,2
Gross fixed capital formation %y/y	-14,9	2,0	2,0	3,6	3,2
CPI (average) %y/y	3,3	4,5	6,0	5,0	4,6
CPI (year end) % y/y	3,1	5,9	5,5	4,5	4,6
Repo rate (year end) %p.a.	3,50	3,75	5,25	5,75	5,75
Prime (year end) %p.a.	7,00	7,25	8,75	9,25	9,25
USDZAR (average)	16,60	14,80	15,30	16,00	16,70

Source: FNB