The reason(s) why Cape Town house prices boom

By Erwin Rode
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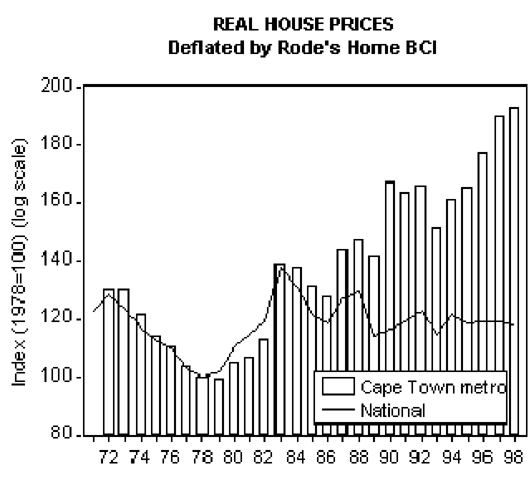
It is common knowledge that throughout the 1990s house prices in South Africa did not keep up with consumer inflation. The exception of course was your favourite metropolis, Cape Town, which bucked this trend quite dramatically.

What is of greater interest is the reason(s) why, because if we knew that, then we would be in a better position to come to a prognosis for the house market in Cape Town.

It is often simplistically claimed that the main reason for Cape Town's better performance was the new South Africa, and that the crime explosion during the 1990s on especially the Witwatersrand led to a strong migration of skilled people to the Western Cape. I think this is only a small part of the truth. Here is my evidence.

The accompanying chart shows that national real house prices only kept up with Cape Town metro prices until 1983. Thereafter, national real prices stagnated or worse, whereas Cape Town real prices set off on a high growth path. The only temporary dents on this high-growth path were periods of business cycle contraction.



Now then, 1983 is a long way off from the 1990s and the new South Africa. So we must look for another main reason for Cape Town's exceptional performance.

In my previous article I explained that one of the important factors that makes house prices grow is economic expansion (for a reread, see previous articles at the bottom of this article). And this is our clue: the Western Cape economy has been outperforming the rest of the country since the early 1980s. Why?

The engine room of the SA economy is the Witwatersrand. This has been the case since the discovery of gold in the 1880s. Gold was later followed by other minerals, which ensured that SA has had a commodity-based economy for more than a century. However, times are a-changing. The world is now in the information or post-industrial era, and real commodity prices have consequently been in a secular decline since 1982. It follows that this must have affected the regional economy of the Gauteng province negatively, apart from the negative effect on South Africa's economic growth rate in general. The broadly-based Western Cape economy, on the other hand, has never relied on metals and minerals, so the Cape must have done better than Gauteng — *relatively speaking* — since 1982. This fundamental reason must be regarded as the main cause of the Cape Peninsula's better house-price performance. And, because this reason is rooted in a megatrend — the information age — it is not going to change for a long time to come.

Furthermore, the Western Cape — as an important fruit-exporting and tourism- generating region — benefited hugely from South Africa's re-entry into the world economy in the 1990s.

It is estimated that the Western Cape economy is now growing between 0,5 and 1,0 percentage point faster than the national economy.

Of course, a peripheral reason since the mid-1990s must have been the migration of skilled people to Cape Town — a phenomenon also known as semigration. The reasons for this migration are the Western Cape's supposedly better lifestyle and lower crime rate in middle-class suburbs. The lifestyle edge will remain but the crime rate in the Cape Peninsula suburbs will in all likelihood soon equal that in other parts of the country.

A last reason that is sometimes listed by economists desperate for reasons to explain the Western Cape's better economic performance is the province's better-educated and trained work force. However, this has always been the case, also before 1983, yet during the decades preceding the 1980s the Western Cape economy was actually lagging the rest of the country. So I discard this as an important reason for the Western Cape's superior performance since the 1980s. Having said this, in the information age high-level education has become crucial to a region's or country's economic performance. Menial jobs will become less plentiful, resulting in huge unemployment among the lesser educated.

To sum up then, the Western Cape will in the long run in all probability keep on outperforming the rest of South Africa. In its wake its house prices will also do better. The fundamental reason for this is the relatively poorer performance of the regional economies in the rest of SA.

However, there is one important caveat to this scenario. In my last article I explained that a house-price bubble develops when prices start exceeding replacement costs. I do not know how close Cape Town house prices are to this level — I wish somebody would commission me to do this research! — but the chart provides a clue. It shows that Cape Peninsula house prices have been outpacing home building costs ever since 1979. Presumably newish-house prices in the Cape Peninsula were in 1979 well below replacement costs, but could we now be all that far from the crossover point? ■