PROPERTY BAROMETER

Residential Market Activity Conditions

Ramaphoria subsides and life goes "back to normal" in a stagnant economy for the Residential Market, according to the 2nd quarter survey

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MARKET ANALYTICS AND SCENARIO FORECASTING UNIT

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Although disappointing, given the raft of poor economic news recently we were not too surprised to see our 2nd quarter 2018 FNB Estate Agent Survey pointing to the excitement of a change in the country's President passing on, and a return to "normal" for the Residential Market in what remains a stagnant domestic economy.

The 1st quarter FNB Estate Agent Survey had seen a noticeable jump in the FNB Residential Activity Rating. It was believed that much of this had to do with a significant improvement in sentiment that was strongly linked to key political leadership changes, most notably the change in the country's President early in the year. We saw bounces in the FNB Consumer Confidence Index and the RMB Business Confidence Indices at the same time, and the Rand performed relatively strongly at the time too.

But leadership changes take sentiment only so far, and as the novelty wears off, the Household Sector continues to experience recessionary economic conditions, rising tax burdens and rising fuel prices as Oil prices rise. That key sentiment driver, the Rand, has begun to come under pressure once more. And more estate agents are beginning once again to perceive "General Pessimism/Economic Stress, while those who perceive "Positive consumer Sentiment" have diminished in number in the 2nd quarter survey.

KEY POINTS

- After a 1 quarter "spike" in the FNB Residential Activity Rating in the 1st quarter of 2018, we believe driven largely by a sentiment jump on the back of key political leadership changes early this year, ongoing economic weakness and rising costs of living appeared to resume their key influence on the housing market, with the Rating falling back from 6.18 in the 1st quarter of 2018 (5.81 on a seasonally-adjusted basis) to 5.28 (5.37 on a seasonally-adjusted basis) in the 2nd quarter of 2018.

- Agent perceptions of Economic Stress/General Pessimism" have bounced back significantly, while those experiencing "Positive Consumer Sentiment" have declined sharply.

- While declines in the Activity Rating are broad-based regionally, Gauteng remains at stronger levels than the Major Coastal Regions of South Africa, while Namibia still has the weakest Activity rating within the broader Rand Area.

- Estate agents in Lower Income/Priced areas still provide stronger Activity Ratings than those at the High End of the market. This is understandable given the variety of tax and tariff increases in recent years, which have been biased more against high income earners and higher priced homes.

AFTER A SIGNIFICANT IMPROVEMENT IN THE 1ST QUARTER, RESIDENTIAL ACTIVITY COMES DECLINES NOTICEABLY IN THE 2ND QUARTER

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More recently, the 2nd quarter FNB Activity Rating has merely moved back to a level almost exactly the same as that of the 4th quarter 2017 survey's "Pre-Ramaphoria" level, suggesting a return to "business as usual" in a weak economy after a brief period of excitement.

Residential Activity subsides

Certain of our Residential Indicators are "leading" ones not only regarding the housing market's future performance, but also with regard to the broader economy and business cycle?

Disappointingly, the 2nd quarter FNB Estate Agent Survey appears to point to the likelihood of a weaker housing market (and perhaps economy too) in the near term, after a brief but very significant improvement in the 1st quarter of the year.

In the survey, the sample of agents questioned is asked to rate Activity Levels in their areas on a scale of 1 to 10, with 10 being a very strong level of activity and 1 being very weak.

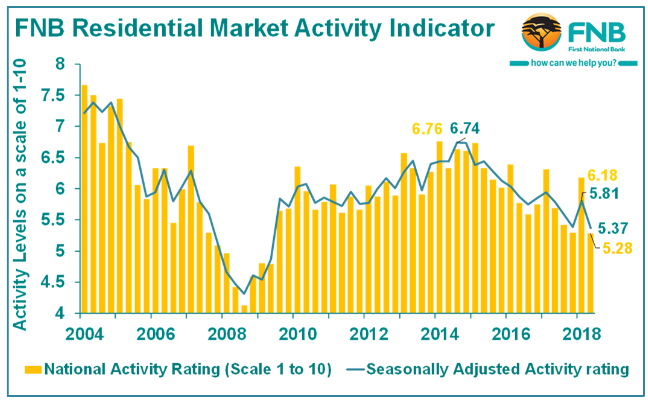
From this, we have compiled the FNB Residential Market Activity Rating for South Africa, and more recently for Namibia too, and this Activity rating has shown itself to be a useful leading economic indicator much of the time.

After a few years of broad decline, from 2015 to late-2017, the 1st quarter of 2018 had shown a significant increase in the Activity Rating, both on an actual as well as a seasonally-adjusted basis.

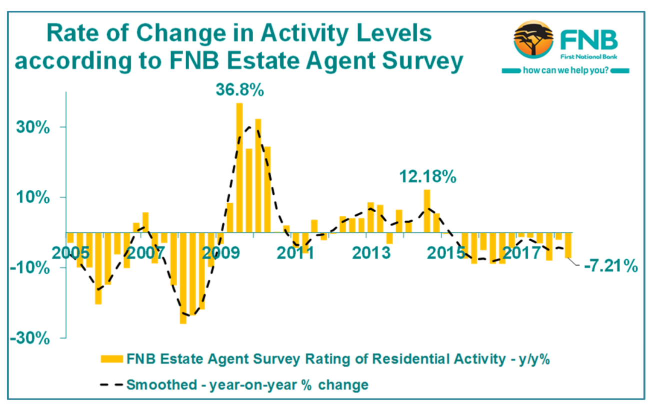
From a multi-year low of 5.29 (5.38 on a seasonally-adjusted basis) in the 4th quarter of 2017, the Activity Rating had jumped to 6.18 in the 1st quarter of 2018 (and to 5.81 on a seasonally-adjusted basis).

The increase was perceived to be the result of a national sentiment jump largely driven by major changes in the country's political leadership, most notably President Cyril Ramaphosa taking over as the country's new President.

But South African households continue to live in a stagnant economy with very little growth to speak of, and as the novelty of the leadership change wears off it is seemingly back to "business as usual", with The 2nd quarter FNB Residential Activity Rating falling back to a lowly 5.28 (5.37 on a seasonally-adjusted basis), erasing the apparent "1st quarter Ramaphoria" gains.



This renewed quarter-on-quarter decline meant that, on a year-on-year basis, the indicator went back deeper into negative rate of change territory, to the tune of -7.21%, noticeably worse than the –2.1% of the 1st quarter and similar to the -8% year-on-year decline of the 4th quarter of 2017.



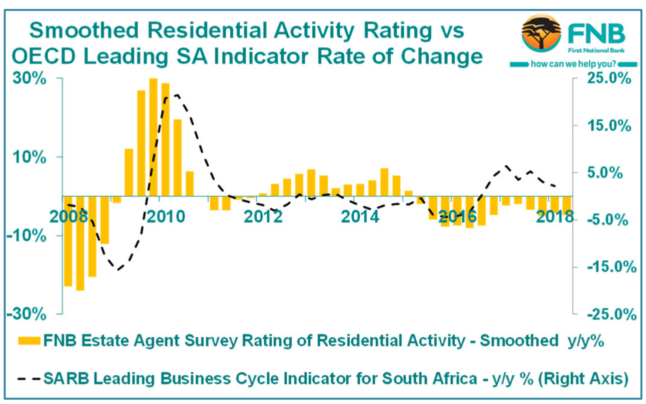
Declining Residential Activity seems to reflect an economy under continued pressure

The direction in the rate of change in the Residential Activity Rating correlates reasonably, though not perfectly, with the direction in the rate of change of the SARB Leading Business Cycle Indicator, sometimes even leading the SARB Leading Indicator with directional changes.

Late in 2017 and early in 2018, the year-on-year rate of change in the SARB Leading Business Cycle Indicator was slowing, broadly in line with an accelerating year-on-year rate of decline in the smoothed Residential Activity Rating in the 3rd and 4th quarters of 2017.

A brief lessening in the smoothed version of the Activity Rating's year-on-year rate of change in the 1st quarter had created some expectation that the SARB Leading Indicator's growth may begin to strengthen in the near term too, which would mean both indicators pointing to likely near term strengthening in economic growth to come.

But a greater magnitude on the rate of decline in the smoothed Residential Activity Rating appears to reflect an economy still in the doldrums.

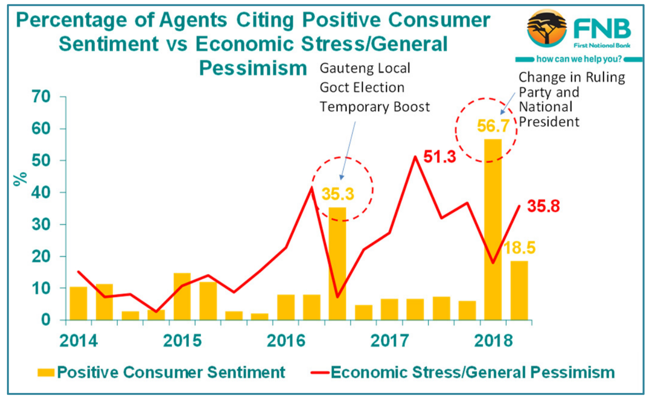


Agents point to renewed deterioration in market sentiment

Sentiment is key to improved economic growth performance, driving businesses to invest more and consumers to spend more. Weak sentiment in both groups has been a major drag on investment and economic performance in recent years.

In the survey, we ask agents for their near-term expectations of Residential Activity. This answer is of limited use due to seasonal factors in the sector. However, as a follow up we ask them to cite reasons for why they expect what they expect with regard to activity levels.

They are free to provide any influencing factors that they wish. Back in the 1st quarter of 2018, 19% of respondents cited "Economic Stress/Pessimism" as a perceived factor, which represented a significant drop from 36.7% in the previous quarter, a significant improvement.



By comparison, those that cited "Positive Consumer Sentiment" in the 1st quarter of 2018 were a far greater 56.7% of survey respondents, a percentage which had risen sharply from a mere 6% in the final quarter of 2017.

Now to the 2nd quarter 2018 survey, and a sharp reversal has taken place. Those respondents pointing to "Positive Consumer Sentiment" have dropped back to 18.5% of total respondents, while those pointing to "Economic Stress/General Pessimism" have increased noticeably to a more significant 35.8%.

Delving a little deeper into the detail of the survey results, we find that the 39.3% of respondents pointing to the change in the country's President as the factor behind their perceiving positive consumer sentiment, in the 1st quarter survey, had largely fallen away in the 2nd. quarter. Agents surveyed put the rebound in General Pessimism/Economic Stress down to a variety of factors including economic weakness (recently confirmed by the 1st quarter economic growth rate which indeed did show a weaker economy early in the year), effective personal tax and VAT hikes recently, and petrol prices rising noticeably as global oil prices have risen.

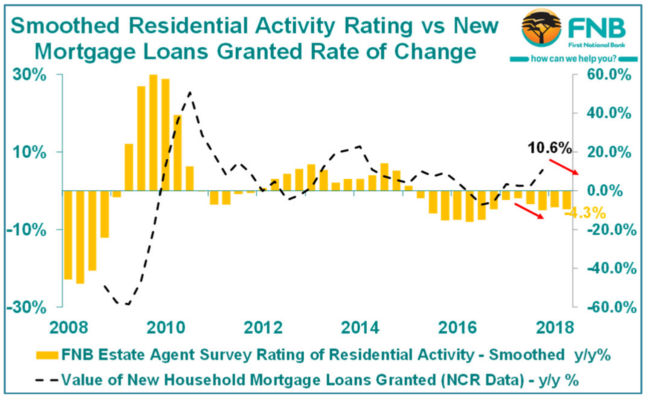
Therefore, in the 2nd quarter we've quickly moved back to a situation where more agents point to "General Pessimism/Economic Stress" than those who point to "Positive Consumer Sentiment", in an economy that remains under pressure.

Potential implications for new mortgage lending

For new mortgage lending, this can all have implications with a considerable lag. Residential activity starts to change when households begin to plan the home buying decision, viewing homes first for a considerable length of time, in many cases, before starting the home purchasing process.

Therefore, trend changes in growth in value of Household Mortgage Loans Granted (NCR Data) can often lag trend changes in the Activity Rating by as much to 4 quarters.

This could mean that in the near term, after a recent acceleration, the stronger year-on-year growth rate in New Mortgage Loans Granted could come under pressure once more in the 2nd half of 2018.

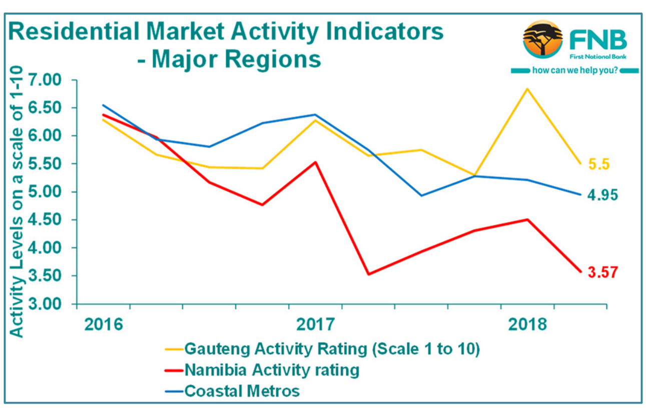


Regional Activity Ratings

Gauteng appears to be the region where Residential Activity improved most noticeably early in 2018 on the back of "Ramaphoria", and it is Gauteng which has seen the most noticeable drop in its Activity Rating in the 2nd quarter of 2018, from 6.84 back down to 5.5.

Gauteng's Activity Rating, however, remains higher than the 3 Coastal Metros' 4.95 combined Activity Rating, and we believe its superior activity level has much to do with its superior housing affordability (house prices relative to income), something that has for a while been reflected in very strong 1st time buying levels in that province (1st time buyers with their financial constraints being more sensitive to home affordability levels)

Namibia weakened once more in the 2nd quarter of 2018, and remains the weak region in the Rand Area, with a lowly 3.57 Activity Rating.

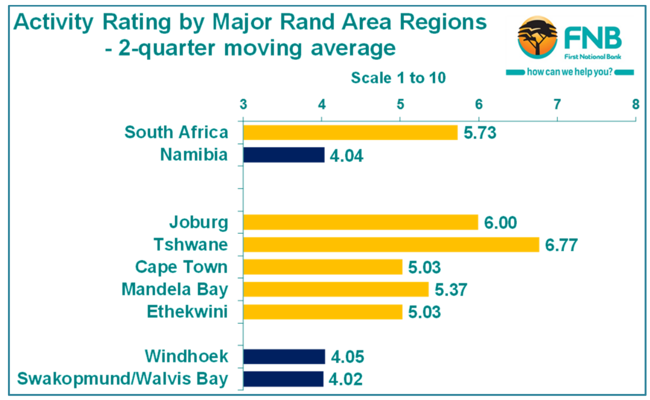


Namibia has recently been experiencing a recession, while its strong housing market run up until around 2015 was far stronger in recent than that of South Africa, creating a significantly greater home affordability challenge in that country. These 2 factors are believed to be largely behind its lowly Activity Rating in recent times.

When breaking the survey results down into smaller regions, we must always caution that sample size becomes smaller and results may thus be less accurate.

In order to address the sample size problem, we evaluate the major South African/Namibian regions on a 2-quarter moving average basis.

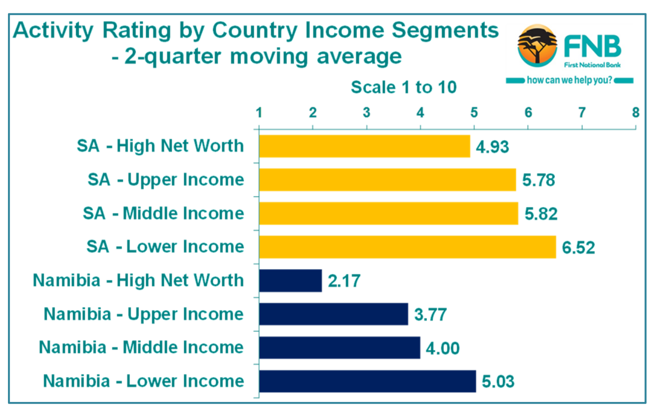
For the 1st half of 2018, the Namibian Average Residential Activity Rating still came in well lower than South Africa at 4.04 (SA averaged 5.73), and lower than any of the major South African cities. The Gauteng Metro Regions were noticeably stronger than any other major region.



Segmenting by Income Area – The Lower End outperforms

Viewing the 4 different Income Areas (as self-defined by the agents, we see both South African and Namibia having their strongest Activity Ratings at the Lower Income Area end of the area spectrum.

This has come to be expected in recent years, given a weak economic growth rate constraining household income growth, rising personal tax rates biased against the higher income groups, and with sharp increases in municipal rates and tariff bills which also work more against the higher end. All of these factors have caused a search for relative home affordability, resulting in a stronger performance at the lower end of the market.



CONCLUSION

In short, given the generally good correlation between the FNB Residential Activity Rating and the Leading Business Cycle Indicators for South Africa, the return to a more significant year-on-year rate of decline in the FNB Residential Activity Rating points not only towards renewed weakness in the housing market performance to come in the near term, but is also likely reflective of an economy remaining under pressure.

Of the estate Agents surveyed, there has been a major decline in the percentage of them experiencing Positive Consumer Sentiment, and a significant increase in those perceiving Economic Stress/General Pessimism in the market. It appears that much of this turnaround, after a brief 1st quarter improvement in agent perceptions, is merely due to the brief excitement of a political leadership change wearing off, while the country's Household Sector continues to grapple with a weak economic environment, and a rising cost of living. Positive political leadership changes can change economic fortunes for the better, depending on the policy measures introduced, but such impact is likely only to be felt in the much longer term.

Notes:

1. **The FNB Residential Activity Rating** is compiled from FNB Estate Agent Survey. This survey, of a sample of estate agents in South Africa's major metropolitan regions, asks the respondents to provide a rating of residential market activity levels on a scale of 1 to 10, 10 being the strongest and 1 the weakest activity level rating.

   "Activity", in an estate agent's world does not only refer to the demand-side. It does include demand-related activity such as enquiries and appointments made by aspirant home buyers, along with the level of show house viewing, but also refers to supply-side activities such as listings or enquiries related to selling of homes.

   For much of the time, trends in the Activity Rating are strongly linked to trends in housing demand, which in turn leads to similar trends in the growth in new mortgage lending and in overall residential transaction volumes with something of a lag. However, at times supply-side issues such as a lack of housing stock available, or unrealistically priced homes for sale, can hamper the level of activity in the market.

   The Activity Rating has shown itself to be something of a Leading Business Cycle Indicator over its relatively short history. The year-on-year rate of change in this indicator tracks other Leading Business Cycle Indicators, such as the SARB and OECD Composite Leading Indicators, fairly well. It often, though not always, leads those 2 leading indicators. It stands to reason that the Activity Rating should lead the business cycle much of the time, due to housing demand's sensitivity to changes in key economic variables. Being a credit-driven market, changes in interest rates have a rapid impact on levels of housing demand, much the same way as they do on new motor vehicle demand. Economic growth rate changes are also quickly felt in the residential market via the impact of growth on employment and household disposable income.

   The highest Activity Rating ever achieved was in the 1st quarter of 2004, measuring 7.66. The lowest Activity Rating every reached was in the 3rd quarter of 2008, measuring 4.13.

   The 1st survey was undertaken in the 4th quarter of 2003, and has been undertaken quarterly ever since. More recently, in late-2015, a Namibian survey was introduced alongside the South African survey. Surveys are done in the middle month of each quarter, i.e. February, May, August and November.

   Seasonal factors have a key influence on quarterly Activity ratings. The 1st quarter survey take place in a typically strong seasonal summer period, while the 3rd quarter is typically the weak winter quarter. In order to eliminate the impact of seasonal factors, we also produce a seasonally adjusted FNB Residential Activity Rating, using an X12 function with which to seasonally adjust the data series.

   There are certain interpretation challenges around the Activity Rating that are important to keep in mind. A key one relates to the entrance and exit of estate agents from the industry over the cycle. The pre-2008 boom period was accompanied by a high number of registered estate agents relative to the post-boom period (many agents exiting the industry during the slump. Therefore, a strong activity rating in the boom period would not be entirely comparable with a similar rating in the post-boom period, because a part of the post-boom strength that agents would be feeling would often be due to there being less competitor agents in their areas following the post-boom "clean out".