PROPERTY BAROMETER – Residential Activity Ratings

Given the apparent usefulness of the FNB Residential Activity Rating as leading economic indicator, a renewed 2-quarter decline in the Rating may point to some near term economic growth weakening approaching. Ethekwini Metro economy’s huge exposure to the underperforming Manufacturing Sector may explain why it has the weakest Residential Activity Rating of the major city regions.

26 September 2017

While South Africa’s economic growth rate has accelerated marginally in recent quarters, on a year-on-year basis, to a still-weak 1.1% in the 2nd quarter, a mild acceleration in the year-on-year rate of decline in the FNB Residential Activity Rating suggests the possibility of renewed weakening in economic growth in the 2nd half of 2017. We say this because the Residential Activity rating appears to be a useful leading economic indicator, and so it should be given the housing market’s high sensitivity to economic events.

Neighbouring Namibia, in the grip of recession, recorded the worst Residential Activity rating in the broader Rand Area. In South African itself, however, it seems to be the Ethekwini Metro whose housing market is most under pressure of the major city regions of late. We suspect that this has to do with that metro’s high exposure to Manufacturing, which is one of the underperforming sectors of an already-underperforming economy.

THE FNB RESIDENTIAL ACTIVITY RATING CONTINUES THE BROAD MULTI-YEAR DECLINING TREND

Although the FNB Residential Activity Indicator, emanating from the quarterly FNB Estate Agent Survey, is not strictly an indicator of housing demand only, but rather of all activity in an estate agent’s world (see notes on page 6-7), we believe that its direction does reflect housing demand conditions most of the time. We believe, therefore, that it can be used as a useful demand-side indicator. And the fact that it has shown a decline in the past 2 quarters suggests to us that there has been some decline in housing demand levels of late, resuming a broad multi-year declining trend that started early in 2015, after a brief 2-quarter strengthening in the summer of 2016/17.

From a reading of 5.69 in the 2nd quarter of 2017 (on a scale of 1 to 10), the Residential Activity Rating dropped further to 5.42 in the 3rd quarter, the lowest reading since the 2nd quarter of 2009.

It is important, however, to acknowledge the existence of seasonal factors in the housing market. In order to eliminate these, we use a statistical seasonal adjustment to compile our Seasonally-Adjusted Residential Activity Rating. This index, too, has declined from 5.79 in the 2nd quarter of 2017 to 5.56 in the 3rd quarter.

It would thus appear that the latest decline in the Activity Rating is more than just about seasonal factors.
THE ESTIMATED NUMBER OF SHOW HOUSE VIEWERS REMAINS “DEPRESSED” COMPARED WITH 2013 HIGHS

A further FNB Estate Agent Survey question supports our view that the broad decline in recent years in the Residential Activity Rating is largely due to demand-side factors in the housing market.

This question asks survey respondents for an estimate of how many “serious viewers” per show house they experience or perceive. In the 3rd quarter of 2017, this estimate was 10.29 serious viewers per show house.

These quarterly estimates have been trending broadly sideways through 2017-17, having previously fallen noticeably through 2014-15 during much of the last interest rate hiking period, from a mid-2013 high of 16.69 viewers per house.

RENEWED ACCELERATION IN YEAR-ON-YEAR DECLINE IN THE RESIDENTIAL ACTIVITY RATING MAY BE POINTING TO RENEWED ECONOMIC GROWTH WEAKENING IN THE NEAR TERM

On a year-on-year percentage change basis, the negative growth rate has persisted since mid-2015.

The rate of decline did diminish through 2016 up until the 1st quarter of 2017.

However, in the 2nd and 3rd quarters the rate of decline has accelerated slightly, from -1.25% in the 1st quarter of 2017 to -3.04% year-on-year decline by the 3rd quarter.

The direction of activity in the Residential Market is very swiftly influenced by economic factors, and thus often proves to be one of the more “leading sectors” in the direction of the economy.

The Residential Activity Rating, therefore, can be useful as a leading indicator of near term direction of the economy.

The gradual diminishing in the year-on-year rate of decline in the Residential Activity Rating, until early-2017, was accompanied by a broad gradual improvement in Real GDP (Gross Domestic Product) growth, from -0.6% decline in the 1st quarter of 2016 to a +1.1% positive rate by the 2nd
quarter of 2017. However, the renewed acceleration in the rate of decline of the Residential Activity Rating may suggest that the recent improvement in GDP growth is set to end, and renewed weakness about to set in.

Given the apparent usefulness of the Residential Activity Rating as an indicator of economic direction much of the time, it may be possible to gain some idea of differences in the economic strength of South Africa’s major regions when breaking the Activity Rating down to according to the country’s major metro regions.

NEIGHBOURING NAMIBIA’S LOWLY ACTIVITY RATING APPEARS “RECESSIONARY”….AND INDEED IT IS

But before we do that, as a “test” of its usefulness we compare the South African Residential Activity Rating with that of neighbouring Namibia. While both countries’ Residential Activity Ratings have declined in recent years, Namibia’s decline has been more severe, dropping to a very low 3.93 reading by the 3rd quarter of 2017 compared to SA’s less severe 5.42.

Does this country differential reflect Real GDP growth differentials? The answer appears to be “yes.

Whereas South Africa has had weak, but slightly positive, economic growth over the past 5 quarters, Namibia has experienced GDP contractions (negative growth) in 4 of the past 5 quarters. By the 2nd quarter of 2017, Namibia’s GDP was declining by -1.66% year-on-year compared to SA’s positive +1.1%

The differential in economic growth between the 2 countries thus appears reflected in significant differentials in their Residential Activity Ratings.

IS ETHEKWINI METRO IN KZN BEGINNING TO FEEL THE IMPACT OF WEAKNESS IN THE MANUFACTURING SECTOR?

With the apparent link between the Residential Market Activity Rating and the economy in mind, we compare major metros within South Africa, to find the Ethekwini Metro region of KZN Province having had a noticeably weaker Residential Activity Rating than the other 4 major regions of late, those other regions being Greater Joburg (includes City of Joburg, and Ekurhuleni Metros),
Tshwane, Cape Town and Nelson Mandela Bay.

Using a 2-quarter moving average to address the small sample size issue at regional levels, Ethekwini recorded a Residential Activity Rating of 5.05 for the 2 winter quarters in 2017.

This is noticeably weaker than the next weakest Activity Rating, which is that of Cape Town on 5.47.

The 2 Gauteng regions had the strongest Residential Activity Ratings in the same 2 quarters, Tshwane on 5.80 and Greater Joburg with a reading of 5.67.

Ethekwini Metro’s Activity Rating weakness compared to the other metros has become quite noticeable in 2017.

After an Average Activity Rating that exceeded the national average in 2016 (6.05 compared to the national 5.88 2016 average), its 2017 year-to-date average has dropped markedly, recording 5.34 compared to a national average 5.81.

We suspect that this may be reflective of severe Manufacturing Sector weakness, and Ethekwini’s, as well as KZN Province’s, greater exposure to the Manufacturing Sector than the exposure of the country as a whole.

SA’s Manufacturing Sector remained mired in recession in the 1st half of 2017, its GVA (Gross Value Added) contraction of -2.05% year-on-year in the 2nd quarter of 2017 being the 3rd consecutive quarter of GVA contraction.

The regions more exposed to the Manufacturing Sector, therefore, may have seen their economies underperforming the overall National Economy by some margin in 2017, and this in turn may have exerted additional pressure on such regions’ housing markets.

According to IHS Markit estimates, Manufacturing makes up 18.2% of KZN’s GDP (over 20% in the Durban sub-region, a major part of Ethekwini Metro), while nationally Manufacturing accounts for a lesser 13.4%.

We suspect, therefore, that the Manufacturing recession of late-2016/2017 may be exerting some additional pressure on the Ethekwini Residential Market, while the less cyclical and more Services Sector dominant Gauteng Metros may be less exposed in 2017 to date.
CONCLUSION

After 2 prior quarters of increase during last summer, the FNB Residential Activity Rating has returned to its declining ways in the 2\textsuperscript{nd} and 3\textsuperscript{rd} quarters of 2017, pointing to housing market weakening even when seasonal factors are removed from the numbers.

This should not be too surprising, given the recent weak economic growth, and given the fact that surveys of both consumer and business confidence remain very low, pointing to major concerns regarding the country’s economic future. The lack of positive economic policy announcements, at a time when the spectre of further widely publicized sovereign ratings downgrades lingers and social tensions rise, is a recipe for weak confidence levels. This should thus be a time when households on average become more conservative in their spending and borrowing patterns, and such an environment is not conducive to national housing market strength.

Given that the Residential Activity Rating appears useful as a leading economic indicator, its recent movement suggests that the recent improvement in real economic growth in South Africa may have been short-lived, and renewed weakening may be at hand in the near term.

Of SA’s major metros, Ethekwini has the weakest Activity Ratings in 2017 to date. We suspect that this has to do with that city’s huge exposure to the ailing Manufacturing Sector, a sector that has been in contraction for the past 3 quarters when measuring its GVA growth on a year-on-year basis. This Manufacturing weakness may be exerting pressure on the Ethekwini Residential Market over and above the pressure from the weak economy that the rest of the country experiences.

Ethekwini, aside, however, the nationwide Residential Activity Rating of 5.81 average for 2017 to date is still slightly down on the 5.88 average for 2016, suggesting that the country’s economic performance for 2017 as a whole will not be too dissimilar from the stagnant performance of 2016 (2016 having recorded only 0.3% GDP growth)

Finally, the Activity Ratings also show that the high end of the market remains the soft spot, as should probably be expected in times of economic and financial weakness.

<table>
<thead>
<tr>
<th>Activity Rating by Country Income Segments - 2-quarter moving average</th>
<th>Scale 1 to 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>SA - High Net Worth</td>
<td>4.75</td>
</tr>
<tr>
<td>SA - Upper Income</td>
<td>5.19</td>
</tr>
<tr>
<td>SA - Middle Income</td>
<td>5.55</td>
</tr>
<tr>
<td>SA - Lower Income</td>
<td>6.11</td>
</tr>
<tr>
<td>Namibia - High Net Worth</td>
<td>2.17</td>
</tr>
<tr>
<td>Namibia - Upper Income</td>
<td>3.27</td>
</tr>
<tr>
<td>Namibia - Middle Income</td>
<td>4.40</td>
</tr>
<tr>
<td>Namibia - Lower Income</td>
<td>3.79</td>
</tr>
</tbody>
</table>

The areas are “self-defined by survey respondents. So-called High Net Worth Areas (average price = R 7.07m) returned a 2-quarter average Residential Activity Rating of 4.75 for the 2 winter quarters of 2017, Upper Income Areas (average price = R3.44m) a slightly better 5.19, Middle Income Areas (average price = R1.60m) a 5.55 rating, and Lower Income Areas (average price = R1.26m) the highest average Activity Rating of 6.11.
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 ever 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. 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”.

2. **The estimate of the number of “serious” viewers per show house** is obtained from the FNB Estate Agent Survey. This survey, of a sample of estate agents in South Africa’s major metropolitan regions, asks the respondents to provide an indication of how many viewers per show house they receive who are perceived to be “serious” viewers, i.e. seriously intend on buying a home.
We believe that this survey response can often, though not always, prove to be a useful indicator of residential demand trends, more viewers per showhouse pointing towards stronger demand and vice versa.

We say that it is not always going to point towards stronger demand, should it rise, or vice versa, because in certain instances a decline in the average number of “serious viewers” could come at a time when demand increases, because buyers could conceivably be “speeding up” their decision-making process and viewing less homes before buying.

But much of the time it has tended to be higher during stronger market periods, such as that period from around 2011 to 2013, before broadly declining through 2014-15 as interest rates gradually rose and the economy gradually slowed.

Over the past decade, the highest estimated number of serious viewers was reached in the 1st quarter of 2011, measuring 18.03, while the lowest estimated number was reached as the country was last headed towards recession, measuring 8.01 viewers in the 2nd quarter of 2008.

3. **The FNB Valuers’ Demand Strength Index:** *When an FNB valuer values a property, he/she is required to provide a rating of demand for property in the specific area. The demand rating categories are a simple “good (100)”, “average (50)”, and “weak (0)”.*

Therefore, a reading below 50 points towards a greater number of valuations citing demand as “weak” compared to those returning a “good” rating, and vice versa.

The Valuers’ Demand Strength Index tends to be more of a “co-incident” indicator than a “leading” indicator, confirming a trend rather than providing a very early indication.