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**MARKET ANALYTICS AND  
SCENARIO FORECASTING  
UNIT**

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## PROPERTY BAROMETER

### FNB Estate Agent Survey's "Leading Indicator"

*We usually focus on the impact of economic events on the residential property market, but the residential market can tell us a lot about what may be coming for the economy too*

*There has been a, perhaps mistaken, perception that the Residential Property Market "lags" the economy or the business cycle rather than "leads" it. Nothing could be further from the truth. It is true that residential transaction data releases are far more delayed than, for instance, new vehicle sales data, making its use as a leading indicator limited. But the residential market is very much a leading sector of the economy, or at least the existing home market is. Trend changes in residential activity are highly sensitive to changes in the economic environment, and can even lead some of the most leading business cycle indicators.*

#### KEY POINTS

- *In the 3rd quarter 2015 FNB Estate Agent Survey, our sample of estate agents surveyed appear to have started to point to a more noticeable slowing in activity levels in the residential market. On a year-on-year basis, the FNB Estate Agent Activity rating declined by -7.4%, well down from a high of 12.2% growth in the corresponding quarter a year ago.*
- *While Residential Activity levels may still be fairly solid, the noticeable slowing in its growth is becoming a concern. It is concerning because of what it may be signalling in terms of the near term trend in South Africa's economic growth performance, which is already weak. Such growth movements in the Residential Activity rating can have a "leading indicator" nature with regard to the business cycle and economy.*
- *Comparisons between the growth peaks and troughs of the Residential Activity rating, and both the Leading Business Cycle and GDP growth, generally show the Activity Rating's growth peaks and troughs to lead those of the latter 2 variables*
- *While the residential property market does influence a portion of the economy, its apparent "leading" status is arguably more about it responding swiftly to economic changes than about that influence it has. Interest rate hiking is an obvious impact on the residential market, but it may also be indirectly reflecting a global industrial production growth slowing since early-2014, and a multi-year commodity price slide whose full impacts have probably not yet been felt on the local economy.*
- *A residential property market-related indicator, such as the FNB Activity Rating can potentially be a useful leading indicator of the business cycle or of near term economic growth. While actual levels of residential activity still appear good, it is the direction of this Activity rating's growth rate that may provide important leading insights into the economy's near term direction, and the prognosis doesn't appear good.*

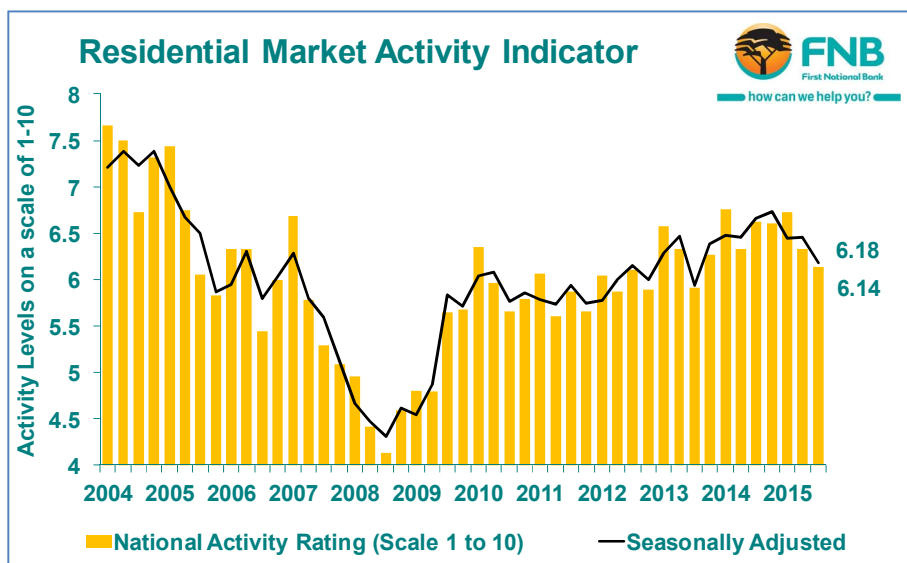
## **AS ESTATE AGENTS POINT TO A SLOWING IN RESIDENTIAL ACTIVITY LEVELS, WHAT DOES THIS SAY ABOUT NEAR TERM ECONOMIC PROSPECTS?**

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*In the 3rd quarter 2015 FNB Estate Agent Survey, our sample of estate agents surveyed appear to have started to point to a more noticeable slowing in activity levels in the residential market. The market still remains “comfortable” and well-balanced, and some of the limits of activity are due to supply (stock) constraints rather than demand constraints. But one gets the feeling that demand-side weakening may be starting to play a role, and being something of a “leading” sector of the economy this activity rating may be pointing to further economic growth weakening in the near term.*

*The FNB Estate Agent Survey is of a sample of estate agents predominantly in SA’s major metro regions. The 1st question asked to agents is with regard to their perceptions of residential market activity in their areas, a subjective question on a scale of 1 to 10, with 10 being the strongest level of activity.*

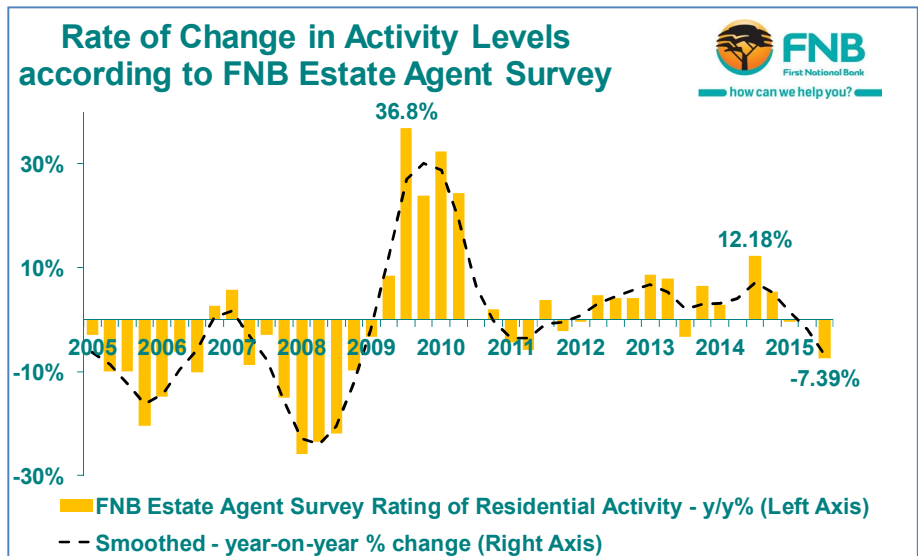
*The 3rd Quarter Residential Activity Indicator declined to 6.14, from the previous quarter’s 6.33. However, when one takes seasonal factors out through a statistical seasonal adjustment, we see that our seasonally-adjusted version of the Indicator declined from 6.46 in the previous quarter, to 6.18 in the 3rd quarter of 2015. Seasonal factors aside, therefore, we still saw a decline in activity levels too.*



*The 3rd quarter Residential Activity Indicator level remains at the upper end of the “stable” bracket (a level from 4 to 6), and not far from the “Positive” bracket of 7 to 8. The 2 other rating brackets are the “not very active (1 to 3), and “very active (9 to 10).*

***While Residential Activity levels may still be fairly solid, the noticeable slowing in its growth is becoming a concern***

*However, while activity levels are still fairly solid, what is becoming concerning is the noticeable slowing in the Activity Rating’s year-on-year growth rate, from a +12.18% positive growth “high” in the 3rd quarter of 2014 to a -7.39% year-on-year decline by the 3rd quarter of this year. Admittedly the data can have some volatility from quarter to quarter, but the smoothed trend line also points to a shift to negative growth in recent quarters.*



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*It is concerning because of what it may be signalling in terms of the near term trend in South Africa's economic growth performance, which is already weak. Real Economic Growth was a mere 1.2% year-on-year in the 2<sup>nd</sup> quarter.*

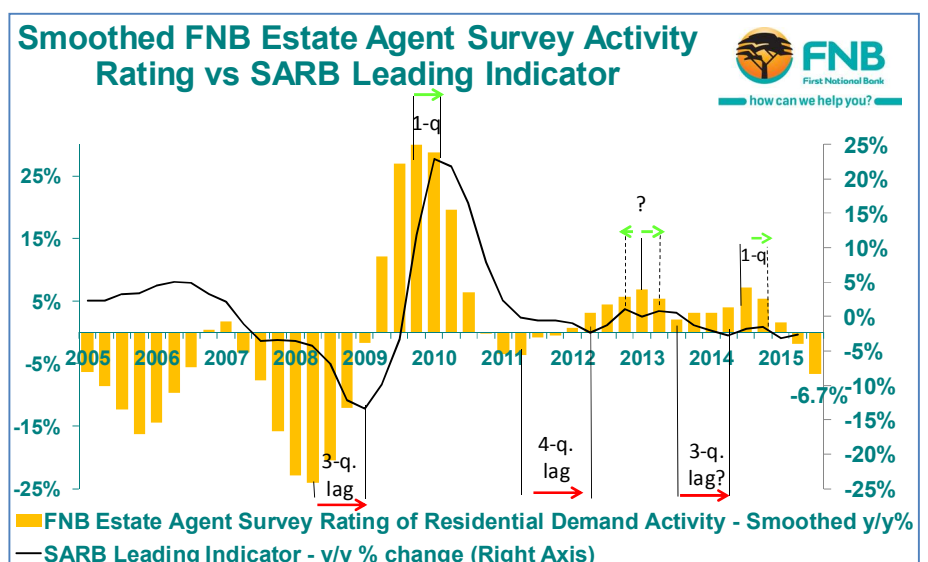
*In the Residential Activity Rating's short 12 year history, the short term trend changes in its year-on-year rate of change appear to have very often led or corresponded with the trend changes in the SARB (Reserve Bank) Leading Business Cycle Indicator as well as those of real economic growth.*

*This should be expected. As is the case with durable consumer goods such as new vehicle sales, residential demand is highly sensitive to interest rate movements as well as disposable income growth trend changes, both items presenting major financial risks to households due to the high cost, while also being highly credit financed.*

*Such growth movement in the Residential Activity rating can have a "leading indicator" nature with regard to the business cycle and economy*

*So, while sentiment in the residential market (due to a home being seen by many as an investment, not just a consumer item) can often keep this market at solid levels of transaction activity until after vehicle sales have already fallen significantly, the growth fluctuations in this activity nevertheless do appear to have a "leading indicator" nature.*

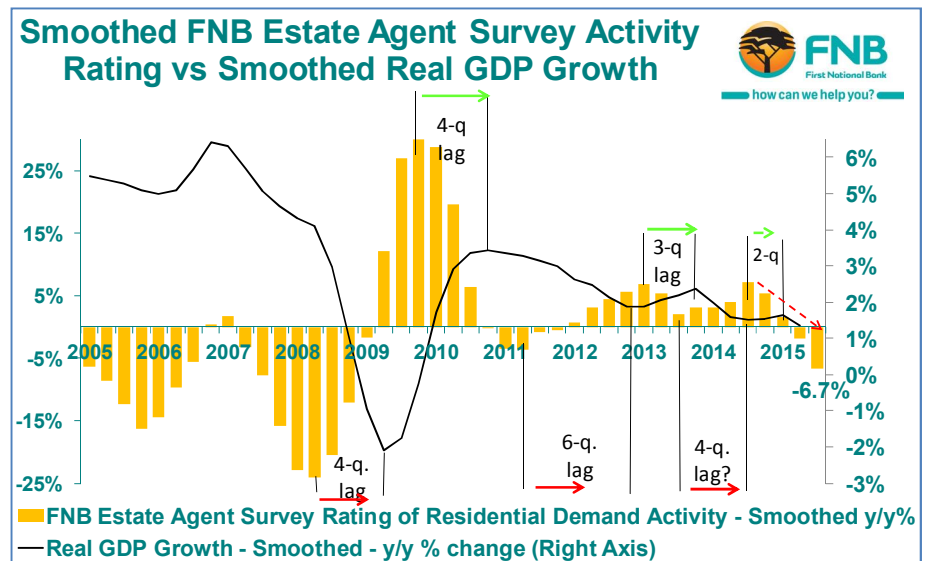
*For analysis purposes we smooth the Activity Indicator very lightly with a Hodrick-Prescott Function), in order to remove some quarter-to-quarter volatility and view the broader multi-quarter movements. A comparison of year-on-year rates of change in the Residential Activity Rating and the SARB*



*Comparisons between the growth peaks and troughs of the Residential Activity rating, and both the Leading Business Cycle and GDP growth, generally show the Activity Rating's growth peaks and troughs to lead those of the latter 2 variables*

*Leading Indicator shows very little lag time between the growth "mini-peak" in the Activity Rating and the Leading Indicator. The growth "mini-peaks" are "relative" peaks, the past one in the Leading Indicator being a slightly diminished negative growth rate in the final quarter of 2014. Comparing the growth troughs of the 2 indicators, however, the Residential Activity Rating appears to have a longer lead time over the Leading Indicator of 3-4 quarters.*

*Comparing the Residential Activity Rating's smoothed year-on-year rate of change with Real Year-on-year GDP (Gross Domestic Product) growth also smoothed in the same way, the lead time between "mini-trend" changes in the Activity Rating growth and GDP growth is a little longer, the growth peak lead-lag time being 1-4 quarters and the troughs being 4-6 quarters.*



*Should this lag time in the troughs continue to hold going forward, the most recent downward move in year-on-year deterioration in the Residential Activity Rating points towards weaker year-on-year growth in Real GDP in the near term.*

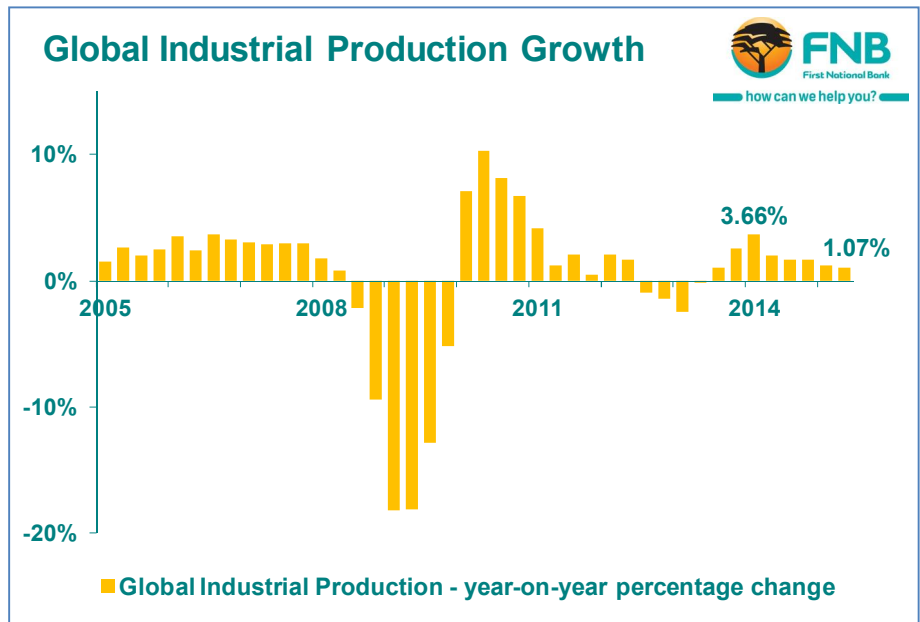
**CONCLUSION - SO WHAT ECONOMIC EVENTS ARE THE ESTATE AGENTS EXPERIENCING?**

*While the residential property market does influence a portion of the economy, its apparent "leading" status is arguably more about it responding swiftly to economic changes than about that influence that it has.*

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*The most obvious event to which the residential market must surely be responding to is the mild interest rate hikes that started back in January 2014. But it probably goes deeper than this. We saw a big drop in 2<sup>nd</sup> quarter Consumer Confidence levels, which may have pointed to consumer concerns over events that may yet have to happened, or are currently unfolding but are yet to be reflected in high frequency economic data.*

*Already we know that global industrial production growth has been slowing since early-2014. The broad shape of the Residential Market Activity Rating's growth trends have indeed resembled that of global industrial production, with an initial sharp recovery in 2010, a dip around 2011/12 followed by a 2<sup>nd</sup> growth recovery and more recent slowing. That suggests that the residential market's key influences are more than just recent interest rate movements.*

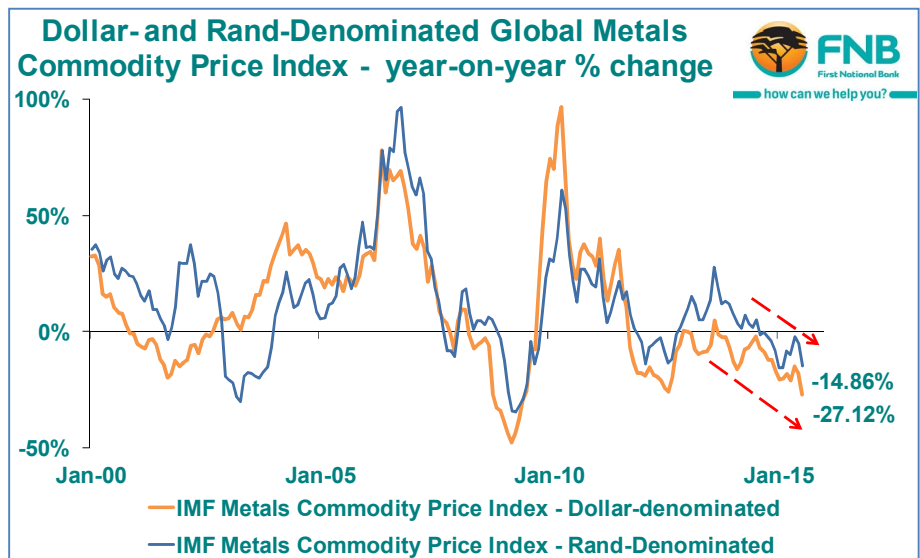


*Interest rate hiking is an obvious impact on the residential market, but the Activity rating's recent year-on-year decline may also be indirectly reflecting a global industrial production growth slowing since early-2014, and a multi-year commodity price slide whose full impacts have probably not yet been felt on the local economy.*

*We also know that global metal commodity prices have virtually halved since around 2011 (according to the IMF Metals Commodity Price Index) in Dollar terms. More recently, exerting arguably more pressure on an economy still heavily dependent on commodity exports, has been a noticeable decline in these commodities in rand terms too.*

*As at July, the IMF Metals Commodity Price Index had declined by -27.1% year-on-year in Dollar terms and -14.9% year-on-year in Rand terms.*

*It is likely that much of this negative impact on the Mining and Manufacturing sectors, and with a lag on the rest of the economy, is still busy filtering through. And as job security deteriorates in this fragile economic environment, households/consumers become less confident and more cautious.*



*It is also likely that this deterioration in confidence, which in turn reflects weakness in certain of these key drivers of the direction of the South African economy unfolding, is what the estate agents are beginning to experience, at the proverbial coal face, in terms of "feet through doors".*

*It is unlikely that the full impact of the China slowdown, the year-and-a-half slowing in global industrial production growth, and the multi-year slide in metals prices, has been felt in South Africa.*

*The recent slowing in the year-on-year rate of change in the FNB Estate Agent Survey Activity Indicator may be suggesting that these impacts along with interest rate hiking are indeed still feeding through.*

*This in turn suggests that economic growth figures may still deteriorate further in the near term.*

*Can a residential property market-related indicator be a useful leading indicator of the business cycle or of near term economic growth? Yes.*

*Can a residential property market-related indicator be a useful leading indicator of the business cycle or of near term economic growth? Yes. It isn't an exact science, but we know that the SARB) already uses residential building plans passed statistics as one of the components in its Leading Business Cycle Indicator. And we would expect the FNB Residential Activity Indicator, which reflects what estate agents on the more "rapidly responsive" existing home market experience too, to be more of a leading indicator than building plans.*

*While actual levels of residential activity still appear good, it is the direction of this Activity rating's growth rate that may provide important leading insights into the economy's near term direction, and the prognosis doesn't appear good.*

*While the actual levels of residential activity still appear good, and certainly don't feel anything near to the pain of the Mining and Manufacturing Sectors at present, it is the direction of this Activity rating's growth rate that may provide important leading insights into the broader economy's near term direction, and the prognosis doesn't appear good at the moment.*