HOUSEHOLD AND CONSUMER SECTOR – WILL RESIDENTIAL PROPERTY "PRESSURE" CONSUMER SECTORS FURTHER?

While far from booming, a mildly recovering residential property market, and growing residential stock constraints, may just pose some further "downside risk" for already-slowing consumer sectors' growth rates, as the household need for greater residential fixed investment gradually grows.

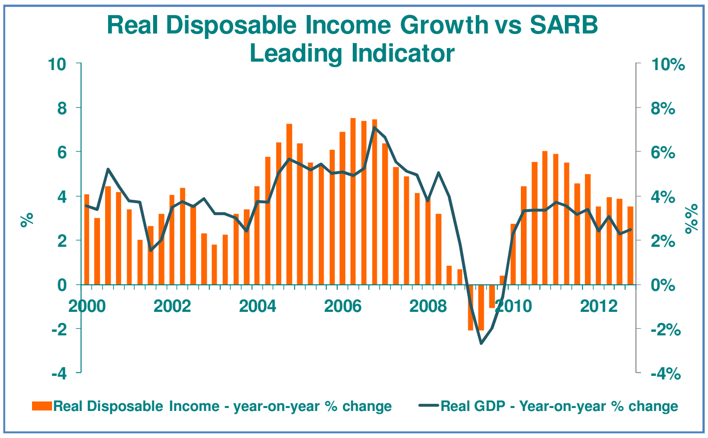
10 April 2013

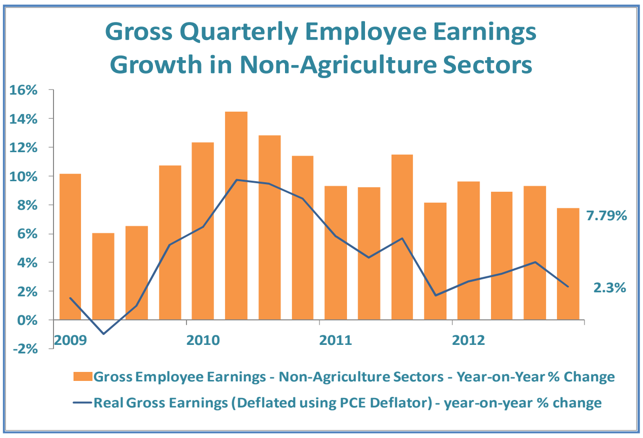
In recent weeks, the question has begun to arise as to why it would be that the household sector's consumer spending growth has become increasingly constrained, while simultaneously it would appear that residential property demand has been noticeably picking up. This would appear surprising to some, as it is the same household sector with the same frail financial situation that spends both on consumer goods and services as well as on housing. And a "partial reprioritization" in household spending may just mean that a gradually rising need for new residential properties further constrains already pressured consumer spending growth further.

Indeed, the slowing growth in real household consumption expenditure makes sense, slowed by the tapering off in real household disposable income growth since a peak of above 6% at the end of 2010, and this is expected to lead to a slower 2013 growth rate in the country's retail sector.

Real household disposable income growth has been growing well-above real economic growth since 2010, buoyed by sharp rises in employee discretionary remuneration, and income on investments, from a very low base created during the 2008/9 recession. Unlike wage remuneration growth, which is far less cyclical, companies can ratchet back discretionary rewards and dividend payouts far more extremely when their performances deteriorate during recessions and economic slowdowns, and the converse thus holds true when performance improves. In addition, average wage inflation has often been significant over the post-recession period, helping the cause of the household.

But by 2012, many of the upward "normalizations" were coming to an end, and we have seen a narrowing of the gap between real disposable income growth and real economic growth. By the 4th quarter of 2012, year-on-year growth in real disposable income was down to 3.5%, with still a way to go to aligning more with real economic growth of nearer to 2.5%.

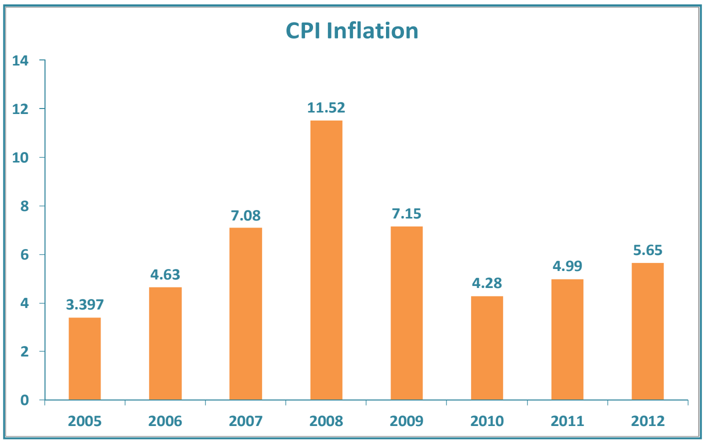


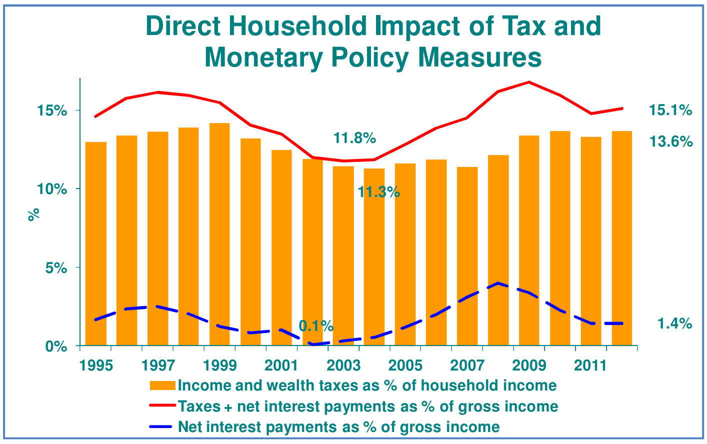


Further constraining factors on real disposable income growth in recent times have been:

- *a rising annual average consumer price inflation rate since a 2010 low,*
- *while the personal income tax-to-household income ratio looks set to increase again in 2013 after the Minister of Finance offered very little in the way of income tax bracket creep adjustments.*
- *And then, the likelihood that interest rates will stay stable for most of 2013 points to little likely improvement in household net interest payments.*

Whereas personal tax and net interest payments of households (net implying interest payments on debt minus interest received on deposits) were as low as 11.8% of household income in 2003, they were 15.1% in 2012, and this percentage was slightly up on 2011 after some prior decline.





So the tide has gradually been turning against the consumer in recent times. And with the gradually mounting downward pressure on real disposable income growth, we have seen real household consumption expenditure growth, with the strongly cyclical durable consumer demand slowing the fastest off the highest base.

Still more downward pressure may be being exerted on real consumer expenditure growth due to the end of the "normalization" of some maintenance and replacement cycles:

- *The FNB Estate Agent Survey points to a gradual increase in the average levels of home maintenance following the financial pressure of the 2008/9 recession and the interest rate peak in 2008. This was reflected in sharp growth in sales of retailers of hardware, glass and paint products in 2011/12, but this growth has since subsided.*
- *Similarly, after a few years of very strong new vehicle sales growth, the recent growth figures are weak. In a country weak on public transport, reliable motor vehicles can often be ahead of homes on the shopping list, but large part of the replacement cycle may now have run its course.*

And now, enter higher residential property fixed investment to exert some additional pressure on consumer-related sectors?

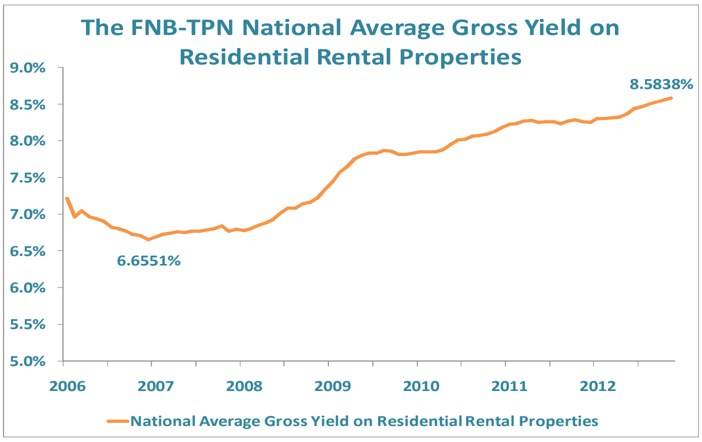
Plausible? *Firstly, one has to consider the set of pressures on lending institutions. In 2012, concerns were expressed from National Treasury, amongst others, regarding the pace of growth in consumer-related unsecured lending. While consumer-related credit is still growing rapidly, this "verbal intervention" may be starting to have the effect of causing the lending industry to pull back a bit in this area of lending. The same pressures to pull back are not prevalent in the residential mortgage lending industry, which has been growing its lending far more slowly for a number of years now.*

That's not to say that residential mortgage lending will start to grow rapidly. That's unlikely at this time, but some strengthening in growth is possible, not only because of a lack of pressure to pull back but also because a couple of key events have quietly been unfolding in the residential sector:

- *Firstly, the pace of establishment of new households has increased significantly since 2008/9, as reflected in FNB Estate Agent Survey estimates of 1st time home buying which is significantly higher nowadays. Initially, though, there was enough existing stock on the market to easily satisfy this gradually growing demand.*
- *But recently there has also been a significant increase in the percentage of agents surveyed citing "stock constraints" (i.e. stock available to sell).*

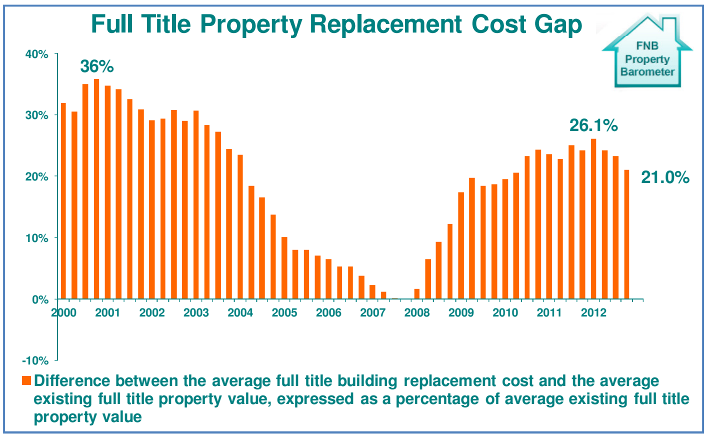
- *Couple this to the FNB-TPN Yield Index which estimates the national average income yield on property to have been rising, implying that it is becoming less advantageous from a cash flow point of view to rent versus buying a property. TPN points to a significant number of letting agents also citing stock constraints in the rental market, plausible given very low levels of buy-to-let investment in recent years.*

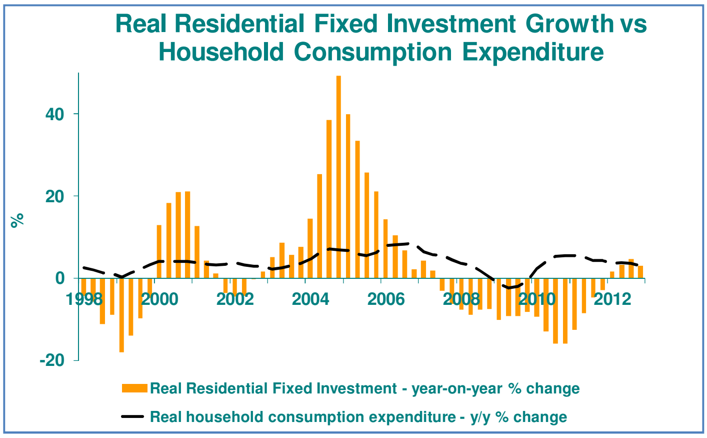
No wonder that the FNB Estate Agent Survey also reports a decline in the percentage of sellers, selling in order to downscale due to financial pressure, indicating that they will be moving into rental properties, and a rise in the percentage intending to buy a cheaper home.



Yes, while real consumer expenditure growth only paused for a very short period during the 2008/9 recession, real residential fixed investment has experienced far more of a decline, and as this includes new residential building activity, it implies a sharp throttling back in residential supply growth over a lengthy period. The SARB estimates real levels of residential fixed investment as at end-2012 to be as low as levels last seen in mid-2004, having only returned to mild positive growth in 2012 following 4 and a half years of constant decline. StatsSA building stats show a return to slight growth in square metreage of buildings completed in 2012 to the tune of 2.8%, after some years of sharp decline, also supportive of SARB figures indicating mildly positive growth in real residential fixed investment in 2012.

In 2013, this growth could conceivably be a little better, given the indications of mounting stock constraints in the existing home sector, and given that the residential replacement cost gap appears to be shrinking (i.e. the difference between the average cost of replacing an existing home with a new one and the average existing home cost, expressed as a percentage of the existing home value), from 26.1% late in 2011 to 21% by end-2012, making it gradually easier for the development sector to bring competitively priced stock to the market.





In summary, therefore, there already exist numerous downward pressures on real household disposable income growth which are expected to bring it down more into line with real economic growth in 2013, i.e. a growth rate between 2.5% and 3%. This in turn could be expected to reduce real household consumption expenditure growth in a similar fashion, from 3.5% in 2012 to an expected 2.5-3% in 2013.

However, these expectations are based on slowing real disposable income growth alone. A downside risk to forecasts may be emanating from growing residential property demand, and increasing supply constraints. While not expected to lead to a residential building boom, a growing shortage in the existing home market could be expected to lead to mildly stronger new building growth.

With not much savings with which to fund such investment, the household sector either needs to up its dismal savings rate, implying an additional constraint on consumption, or alternatively fund the investment from increased credit. Given the very high debt-to-disposable income ratio, stronger growth in residential mortgage credit may begin to partially crowd out the growth in other forms of household credit, also constraining consumption expenditure growth. So one may then see non-mortgage household credit growth thus slowing and residential mortgage credit growth rising mildly.

Either way, the time to get a little more "balance" between residential fixed investment spend and consumer spend may have arrived, after some years of very low residential fixed investment and strong consumer spend growth.

In different times, this balance may have merely been achieved through stronger residential mortgage borrowing growth as well as ongoing strong consumer-related credit growth. Currently, things may be different however. While I do expect the overall household debt-to-disposable income ratio to rise through 2013, given already very high levels of overall household sector indebtedness achieving that balance may also require a significantly slower period for consumer credit growth, in order to "make some space" for mildly residential mortgage credit growth.

We're in an era of tight finances and "trade-offs".

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