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DEVELOPMENTS IN THE ECONOMY AND THEIR IMPACT ON HOUSING DEVELOPMENT

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ENVIRONMENTAL SCANNING: DEVELOPMENTS IN THE GLOBAL AND LOCAL ECONOMY AND THEIR IMPACT ON HOUSING DEVEKLOPMENT

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Compiled by: Governance Frameworks, Research Directorate

Postal Address:
Private Bag X644, Pretoria, 0001

Physical Address:
240 Justice Mohamed Street, Govan Mbeki House, Sunnyside, 0002

Call Centre: 0800 14 6873
Telephone: 012 421 1762
Fax: 012 444 5001
Email: gilbert.khathi@dhs.gov.za
Website: www.dhs.gov.za
Fraud and Corruption: 0800 701 701

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1. INTRODUCTION

The human settlements environmental scanning report is a quarterly publication focusing on developments in the global and local economy, building sector as well as residential property market and their potential impact on housing development. This report is compiled by Governance Frameworks, Research Directorate of the Department of Human Settlements using various sources that comprise Statistics South Africa, Bureau for Economic Research, building material retailers, document analysis, surveys and interviews with key players in the construction industry. The publication is intended for practitioners and stakeholders in the human settlements sector. It provides an analysis of trends relating to developments in the global and local economy, the state of the building industry, the residential property market and how these affect the mandate of the Department of Human Settlements.

The impact of global economic developments in South Africa is analysed using variables such as GDP growth, inflation, interest rates, access to credit, credit defaults and rate of unemployment. Analysis of developments in the building industry includes comparative analysis of the cost of building materials, building plans passed, etc. An analysis of developments in the residential property market is also discussed focusing mainly on the affordable market.

Furthermore business and consumer confidence indices are utilised to determine future developments in the economy and construction industry. Implications are drawn on how these could weaken or strengthen the implementation of policies and programmes of the Department of Human Settlements.

2. GLOBAL ECONOMIC DEVELOPMENTS

According to the International Monetary Fund's (IMF), world growth accelerated to 3.8% in the third quarter of 2014 from 3.3% in the second quarter, with growth that remained largely divergent among the major economies. Oil prices in US dollar terms have dropped sharply since September 2014, putting huge downward pressure on inflation over a wide front, with oil exporting countries facing significantly lower levels of revenue as a result of the lower oil prices. Economic growth in the US has picked up during the course of 2014 after a contraction in the first quarter on the back of severe weather conditions, with labour market conditions improving as the year progressed and inflation remaining low as a result of dollar strength and declining oil prices.

In the euro area, economic growth was still very much subdued up to late last year, while inflation continued to decline to a point where the region is on the brink of falling into a state of widespread deflation. The European Central Bank has announced a package of substantial quantitative easing in January 2015, related to the purchase of financial assets in an attempt to revive economic activity and inflation in the European economy.

The Japanese economy technically experienced a recession in the third quarter of 2014, with inflation on a downward trend. Lower economic growth was also evident in China, impacted by subdued investment growth, while the Russian economy weakened markedly on the back of the significantly lower oil prices and ongoing geopolitical tensions that caused economic sanctions to be imposed against the country by some prominent Western countries.

As a result of these trends and developments, monetary policy has remained largely accommodative in advanced economies in 2014, whereas currency weakness in emerging and developing economies has caused interest rates to be raised in some of these countries that are heavily reliant on commodity exports (South African Reserve Bank).

3. SOUTH AFRICAN ECONOMIC OUTLOOK

3.1 Economic Performance

According to Statistics South Africa, the annualised South Africa’s economy grew by 1.5% in 2014, down from 2.2% in 2013. The industry that grew the fastest in 2014 was agriculture, expanding by 5.6%, with government services coming in second place at 3.0%.

Economic activity within the mining and electricity industries decreased by 1.6% and 0.9% respectively, while manufacturing showed very little change for the entire year. The mining industry was interrupted by widespread strikes during the first half of 2014, resulting in a decline of -22.8% in mining activity in the first quarter and -3,0% in the second quarter. This was followed by positive growth during the second half of the year, with mining expanding by 3.9% in the third quarter and 15.2% in the fourth quarter. The increased mining activity in the fourth quarter was due to higher production in the mining of other metal ores (including platinum) and other mining and quarrying (including diamonds).
South Africa's GDP for 2014 was R3.8 trillion (STATSSA, 2015).

3.2 Developments in energy prices

The energy prices and in particular petrol price in South Africa is linked to the price of crude oil in international markets and is quoted in US dollars (US$) per barrel. Crude oil prices combined with the Rand/Dollar exchange rate therefore have a major impact on petrol prices. In order for a refinery to make a profit, the price for the product manufactured from crude oil has to be higher than that of the crude oil price. Therefore, if crude oil prices increase, the petrol price has to increase so that crude oil refineries are able to cover their costs.

Crude oil fell from a high of $115 a barrel in June to a low of $45 in January 2015. The lower prices have generated ripple effects throughout the global economy. The primary reasons for the low prices include demand for oil in the industrialised world and ever advancing technological change in the extraction and use of oil (Department of Energy, 2014).

The average international product prices of petrol, diesel and illuminating paraffin decreased during the review period of 28 November 2014 to 01 January 2015. The average Rand/US Dollar exchange rate weakened when compared to the previous period. The average Rand/US Dollar exchange rate during the review period of 28 November 2014 to 01 January 2015 was 11.4749 compared to 11.0969 during the previous period. The weakening of the Rand against the US Dollar increased the contribution of the basic fuels price on petrol, diesel and illuminating paraffin by 17.92 c/l, 19.43 c/l and 19.75 c/l respectively. The weakening of the Rand/US Dollar exchange rate led to further increased contribution to the basic fuels price on petrol, diesel and illuminating paraffin by 54 c/l, 0.56 c/l and 0.57 c/l respectively during the 30 January to 26 February 2015 review period (Department of Energy, 2014).

3.3 Inflation[1] movements and its impact

The Consumer Price Index (CPI) and Producer Price Index (PPI) are the two primary measures of inflation for South Africa. The CPI tracks the rate of change in the prices of goods and services purchased by consumers. Thus, the headline CPI is used as the inflation target measure which guides the South African Reserve Bank (SARB) on the setting of interest rates. The PPI tracks the rate of change in the prices charged by producers of goods.

According to Statistics South Africa, the headline CPI (for all urban areas) annual inflation rate in February 2015 was 3.9%. This rate was 0.5 of a percentage point lower than the corresponding annual rate of 4.4% in January 2015. On average, prices increased by 0.6% between January 2015 and February 2015.

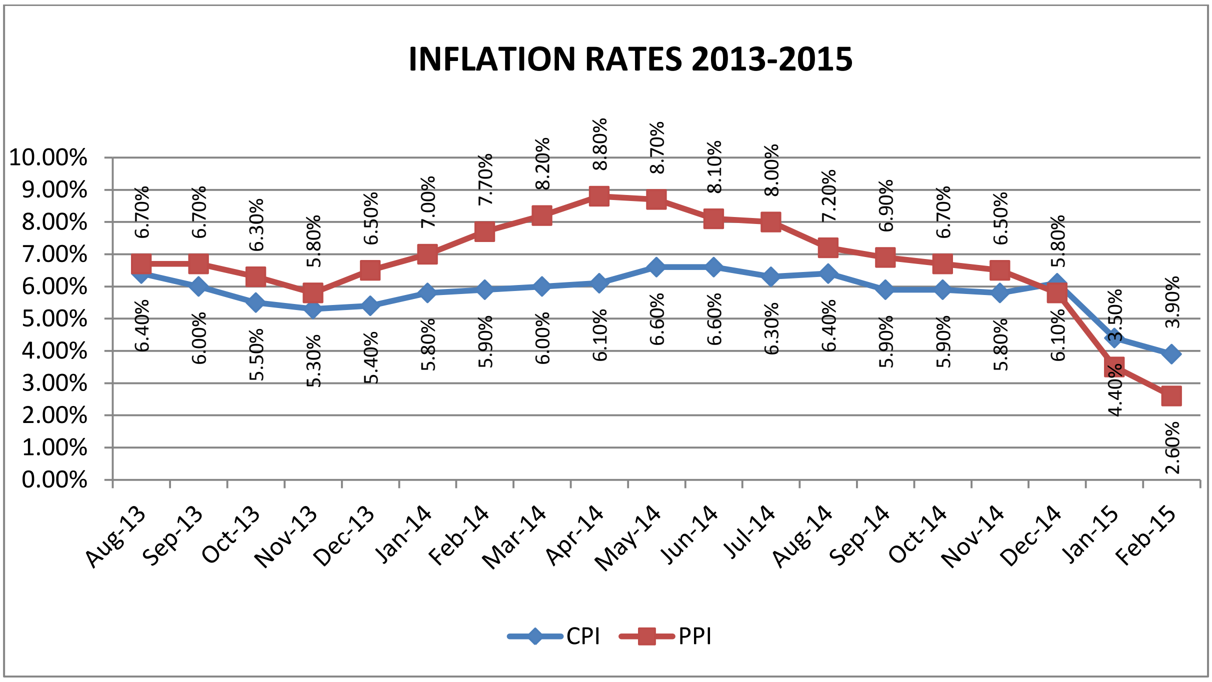
The food and non-alcoholic beverages index increased by 0.4% between January 2015 and February 2015. The annual rate decreased to 6.4% in February 2015 from 6.5% in January 2015. The alcoholic beverages and tobacco index increased by 1.0% between January 2015 and February 2015. The annual rate increased to 8.2% in February 2015 from 7.4% in January 2015.

The transport index decreased by 2, 5% between January 2015 and February 2015, mainly due to a 93c/litre decrease in the price of petrol. The annual rate decreased to -6.3% in February 2015 from -2.5% in January 2015. The restaurants and hotels index increased by 0.2% between January 2015 and February 2015. The annual rate decreased to 7.0% in

[1] Inflation is the rate at which prices are increasing

February 2015 from 7.4% in January 2015. The miscellaneous goods and services index increased by 5.2% between January 2015 and February 2015, mainly due to a 9.0% increase in health insurance. The annual rate increased to 7.8% in February 2015 from 7.3% in January 2015 (STATSSA, 2015).

FIGURE 1: INFLATION RATES



Source: STATSSA, Jan 2015

The annual percentage change in the PPI for final manufactured goods was 2.6% in February 2015 (compared with 3.5% in January 2015). From January 2015 to February 2015 the PPI for final manufactured goods increased by 0.4%. The main contributor to the annual rate of 2.6% was food products, beverages and tobacco products (7.0% year-on-year and contributing 2.3 percentage points).

Though PPI is also on a declining trend, the cost of production is still expensive. For housing specifically, if costs of production are still high, it means that the value capital investments made for housing development will consistently decline. The result is that it will cost a little more to build the same size of a house. These developments together with high prices of essentials like food and clothing for instance does indicate that households will find it more challenging to provide shelter for themselves and therefore will require some form of assistance from government.

3.4 Interest Rates

At its Monetary Policy Committee (MPC) meeting in March, the South African Reserve Bank left the repo rate unchanged at 5.75%. The prime interest rate asked by commercial banks also remained unchanged at 9.25% (SA Reserve Bank, 2015). This decision meant that the pressure on disposable income for individuals with mortgages and other forms of credit exposure also remained unchanged.

In its previous statement the Committee noted that the more favourable inflation path allowed for some room to pause in the process of domestic monetary policy normalisation. The deterioration in the outlook suggests that this scope has narrowed. The uncertainties related to US policy normalisation and the weak state of the domestic economy prompted the MPC to keep the repurchase rate unchanged for now (SA Reserve Bank, 2014).

3.5 Unemployment

According to the labour force survey of Statistics South Africa, the number of employed people increased by 203 000 between third and fourth quarters of 2014. Employment increases were observed in all sectors, with 68 000 in the formal sector and 41 000 in the informal sector. The agricultural and private households industries also observed increases in employment of 56 000 and 38 000 respectively.

During this period the labour force decreased by 39 000, while the number of unemployed people decreased by 242 000. This resulted in unemployment rate decreasing by 1.1 percentage points to 24.3%, absorption rate increasing by 0.4 of a percentage point and the labour force participation rate decreasing by 0.3 of a percentage point. The number of discouraged work-seekers decreased by 111 000 and the other (not economically active) group increased by 305 000, resulting in a net increase of 194 000 among the not economically active population (Statssa, 2014).

The high levels of unemployment means people will still be dependent on State assistance programmes. For the Department of Human Settlements it means more people will require housing assistance and this will add to the already existing backlog

3.6 Access to credit

According to du Toit (ABSA, 2015) growth in the total value of outstanding credit balances in the South African household sector slowed down to 3.4% year-on-year (y/y) at the end of December 2014. This is the lowest level since early 2010. Growth in household unsecured credit balances dropped further to a level last seen around mid-2010, while growth in secured credit balances was largely stable at a low level in the last four months of 2014.

Household secured credit balances saw growth of 2.9% y/y at the end of December, unchanged from November. Secured credit includes instalment sales, leasing finance and mortgage loans.

Growth in household unsecured credit balances amounting to R335,7 billion tapered off further to 4.7% y/y at the end of December 2014. The largest component of unsecured credit balances with a share of 60.4%, are general loans and advances (largely personal loans and micro finance), registered growth of 2.1% y/y at end of December.

The value of total outstanding private sector mortgage balances, including both commercial and residential mortgage loans, saw growth of 4.3% y/y at end of December, showing a gradual upward trend since a recent low in growth of 3.3% y/y at the end of September 2014. This was the result of mainly accelerating year-on-year growth in corporate mortgage balances during this period, while growth in household mortgage balances remained muted.

Growth in outstanding household mortgage balances was only marginally up to 2.3% y/y at end of December last year from 2.2% y/y and 2.0% y/y at end of November and end of October respectively. The value of outstanding mortgage balances is the net result of all property transactions related to mortgage loans, including additional capital amounts paid into mortgage accounts and extra monthly payments above normal mortgage repayments.

Economic developments, and the consequential impact on household finances and consumer confidence, will remain important driving factors of household credit and its various components. Although economic growth is forecast to pick up in 2015 from last year, with inflation expected to be lower on the back of sharply lower international oil and domestic fuel prices, and interest rates projected to rise only later in the year, growth in household credit balances, including mortgage balances, is forecast to remain in single digits this year.

3.7 Credit Defaults

According to du Toit (2015), in the third quarter of 2014 a total of 10.05 million credit active consumers, or 44.7% of a total of 22.5 million, had impaired credit records, up from 9.95 million (45.0%) in the second quarter. The number of consumers in good standing came to 12.45 million (55.3%) in the third quarter compared with 12.17 million (55%) in the second quarter. A total number of 81.18 million consumer credit accounts were active in the third quarter of last year, of which 59.55 million (73.3%) were in good standing and 21.64 million (26,7%) were impaired.

Consumer financial vulnerability, as measured by the Bureau of Market Research (BMR), improved somewhat in the third quarter of 2014 from the second quarter. But still, consumers' credit-risk profiles severely restrict the access to credit and adversely affects household consumption expenditure against the background of the continued low level of household savings.

4. CURRENT DEVELOPMENTS IN THE BUILDING INDUSTRY

According to ABSA, building activity in the South African market for new housing, as reflected by the number of building plans approved and the number of buildings completed, started 2015 on a relatively low note, with both the planning and the construction phases recording a decline in volumes in January from a year ago. In the third quarter of 2014, there were more than 6 million residential properties in South Africa with a total value of almost R4.3 trillion, of which 2.1 million with a total value of R2.3 trillion were bonded and 3.9 million with a total value of R2 trillion were non-bonded.

ABSA further highlights that the General Household Survey 2013, published by Statistics South Africa in June this year shows that 77.7% of a total of 15.107 million households were living in formal housing; 13.6% of households were living in informal housing; 15.3% of households were living in RDP or state subsidised housing; 13.6% of households had at least one member on a waiting list for state-subsidised housing and 13. 3% of households were receiving a housing subsidy from the state.

4.1 Building plans completed

The number of building completed reflects the level of building activities that occurred during the specified period. According to Statistics South Africa (2014d), the value of buildings reported as completed at current prices decreased by 13.3% (-R478.1 million) in January 2015 compared with January 2014. Decreases were reported for additions and alterations (-34.6% or -R267.3 million), non-residential buildings (-17.1% or -R162.3 million) and residential buildings (-2.6% or -R48.4 million).

4.2 Building Plans Passed

According to Statistics South Africa, the building plans passed provide an indication of the level of building activities that is expected to take place in the near future. According to the Statistics South Africa, the value of recorded building plans passed at current prices decreased by 6.2% (-R381,4 million) in January 2015 compared with January 2014. Non-residential buildings fell by R750.4 million (55.8%), mainly as a result of decreases in industrial and warehouse space (-R364,6 million) and office and banking space (-R347,1 million).

Table 2: Comparative Analysis of Building Plans Passed and Completed by Province

Province	% Change in Buildings Completed Between January to September 2013 and January to September 2014	% Change in Building Plans Passed Between January to September 2013 and January to September 2014
Eastern Cape	-1.3	0.1
Free State	-0.8	-2.1
Gauteng	3.2	-0.7
KwaZulu-Natal	-3.2	-1.1
Limpopo	-0.7	0.8
Mpumalanga	-0.1	0.1
Northern Cape	-0.4	-2.8
North West	0.8	-0.6
Western Cape	-10.7	6.3
Total	**-13.3**	**-6.2**

Source: Stats SA, 2015

Out of the nine provinces, seven reported a year on year (y/y) negative value of buildings completed in January 2015. The Western Cape dominated the decrease with a -10.7 followed by KwaZulu Natal and Eastern Cape with -3.2 and -1.3 respectively. Gauteng recorded a figure of 3.2 followed by North West with 0.8. In terms of building plans passed, four provinces reported y/y increases in the value of building plans passed. Western Cape lead the positive figure with a 6.3 followed by Limpopo with 0.8. The rest of provinces are having a decreased number of building plans passed in January 2015.

Residential building activity continues to be influenced by conditions and trends in the economy, household finances, consumer and building confidence, as well as factors related to the demand for and supply of new housing. These will remain the main driving factors of residential building activity.

4.3 Building Costs

According to ABSA (2015), the cost of having a new house built increased by 6.8% y/y in the fourth quarter of 2014, down from an increase of 7.8% y/y in the third quarter and 8.6% y/y in the second quarter, but remained above the average consumer price inflation rate of 6.1% y/y in these quarters. Despite the continued upward trend in building costs, the growth in the average price of a new house has been slowing down up to the end of 2014. Building costs showed an increase of 7.5% in 2014 after rising by 7.1% in 2013.

Factors impacting building costs and ultimately the price of new housing include building material; transport; equipment and labor costs. The cost of developing land for residential purposes also contributes extensively to the escalation of building costs.

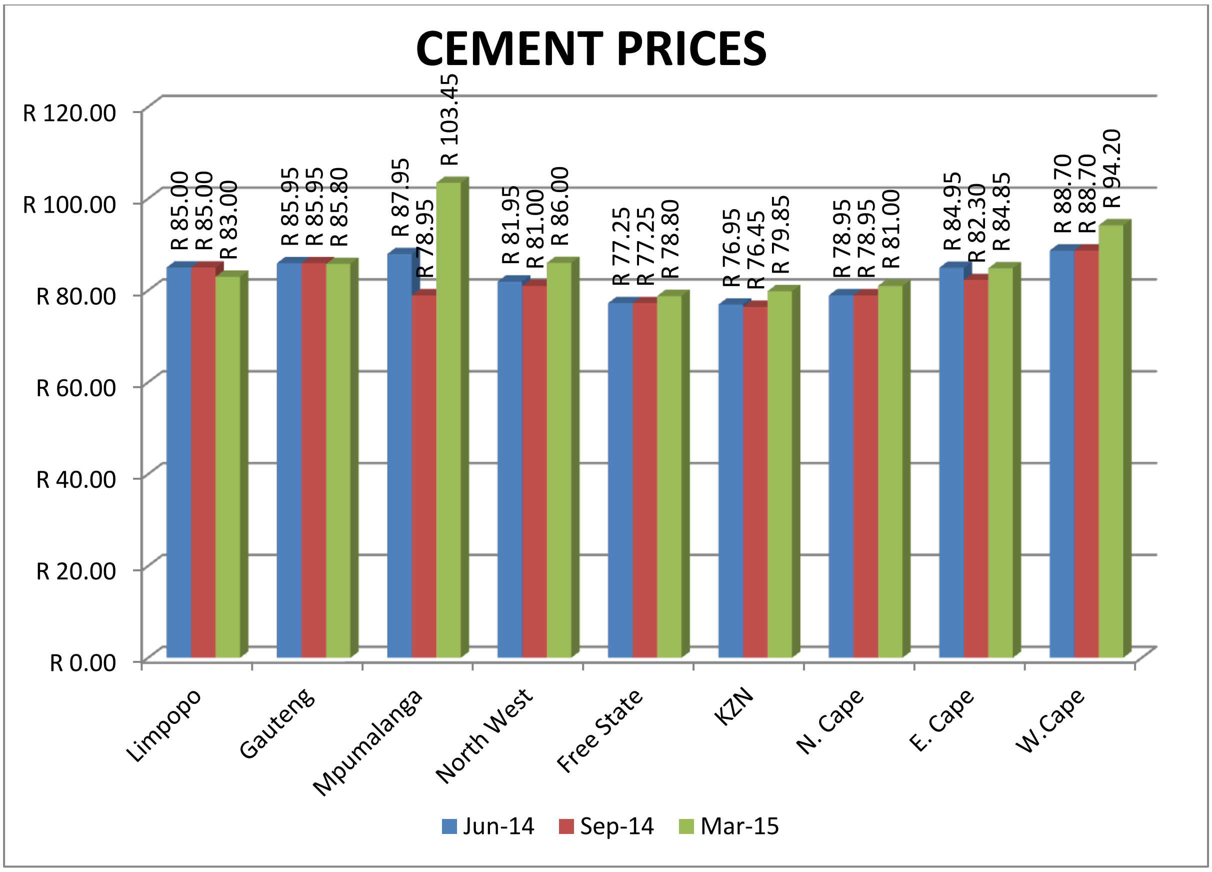
Global economic growth rates seem to be recovering gradually. BER business survey data reflect an improved business confidence levels. BER building survey respondents have become optimistic about business conditions for the first time in six and a half years.

These building costs developments suggest that input costs continues to increase going forward and therefore they should be adequately accommodated in the subsidy quantum.

4.4 Cement Prices

Cement is one of the major products utilised in the building industry particularly in government-subsidised housing. Therefore, increases in the cement price impact significantly in the delivery of government subsidised housing and the total building costs. A telephonic interview with Cash Build Hardware was conducted to establish the cement prices in all Provinces. According to the data obtained from them, it was evident that the cement prices vary. These varying prices might be due the transport costs associated with delivering products different provinces within the country.

FIGURE 2



Source: Department of Human Settlements, 2015

In trying to track trends in cement prices, most provinces experienced there haven't been major changes in the cement prices between July 2014 and March 2015. It should be noted that in provinces such as Mpumalanga, Free State, KwaZulu Natal and Eastern Cape, the Cashbuild hardware don't stock the PPC cement. They only sell the NPC, LaFarge, Afrisam and Sephaku. This might be the reason for the difference in prices. In terms of the most expensive prices, Mpumalanga reported an alarming R103.45 followed by R94.20 for Western Cape. (Human Settlements, 2014).

These figures are indicating that the transport costs from the harbour to the inland could be a major factor that affects prices for goods in the inland provinces.

5. OVERVIEW OF THE RESIDENTIAL PROPERTY MARKET

Trends in house prices is a reflection of the property market conditions and related factors which are affected by a combination of macroeconomic developments, the state on household finances and the level of consumer confidence.

According to ABSA, House price growth in the middle segment of the market remained largely resilient throughout 2014, despite some challenging economic conditions impacting households over a wide front during the course of the year. In both the categories of affordable and luxury housing nominal price growth was higher last year compared with 2013, with prices also increasing in real terms in these two segments of the market. A situation of a normalisation of and more balanced housing demand and supply conditions have largely contributed to house price growth in 2014 (ABSA, 2015).

5.1 Residential Property Prices

The affordable segment (houses with the size of 40m^2 to 79m^2 and priced up to R545, 000 in 2014), increased by 7.4%, with an average price of about R381 000 in the fourth quarter of 2014, after rising by 8.2% in the third quarter. Real price inflation of 1.6% y/y was recorded in the fourth quarter from the 1.9% recorded in the third quarter (du Toit, 2015).

The average nominal price of a homes in the middle segment of the market (homes of 80m^2 to 400m^2 and priced at R4million or less in 2014) increased by 9.4% y/y to more than R1 315 000 in the fourth quarter of 2014 (9.8% y/y in the third quarter). Real price inflation in this category of housing came to 3.6% y/y in the fourth quarter of the year, down from 3.4% y/y in the third quarter (du Toit, 2015).

In the fourth quarter of 2014 the average price of luxury housing (homes priced at between R4 million and R14.6 million in 2014) rose strongly by a nominal 15.7% y/y to a level of about R5 935 000, after prices had risen by an equally strong 11.9% y/y in the third quarter. In real terms, the average price in this category of housing was up by 5.3% y/y and 9.7% y/y in the third and fourth quarters respectively.

5.2 Land Values

The value of land for new housing in the middle and luxury segments of the market for which Absa received applications and approved mortgage finance, increased by a nominal 8.9% y/y to an average of about R588 500 in the fourth quarter of 2014, after having risen by 7.9% y/y in the third quarter. In real terms residential land values were up by 3.1% y/y in the fourth quarter of last year, after rising by 1.6% y/y in the preceding quarter.

Residential land values increased by a nominal 6.1% and a real 0.1% in 2014 after nominal and real growth of 7.6% and 1.8% respectively in 2013. The average price of land for new middle-segment and luxury housing came to 26.7% of the total value of a new residential property in these categories in the fourth quarter of 2014, with this ratio averaging 27.1% last year (du Toit, 2015).

6. CHALLENGES

6.1 Poor prospects of economic performance

World economic growth slowed down in the first half of 2014 compared with the second half of 2013. It indicates that growth in real world output was down to an annualised rate of 2.7% in the first half of the year from 3.9% in the last six months of 2013.

6.2 High rate of unemployment

The third quarter saw an increase in employment of 22 000 from 8 666 000 in June 2014 to 8 688 000 in September 2014. This resulted to a slight decrease in the unemployment rate from 25.5% in the second quarter of 2014 to 25.4% in the third quarter. Though a slight improvement was seen, more South Africans will still rely on government for assistance including housing.

6.3 Vulnerability of the low income earners

High level of indebtedness and high level of impaired credit record presents evidence of vulnerability of low income earners to access mortgage loans which is the main form of funding housing development for ownership currently. This suggests that incremental housing should be the preferred approach for housing development for low income earners. Information from Credit Regulator provides evidence that low income earners are continually opting for short term loans to fund their housing development as opposed to mortgage loans.

6.4 Increasing input cost

Cost escalations for new house construction continue to outstrip the cost of buying an existing house. Increasing land cost is also expected to continue to contribute significantly to the costs of housing development. This means that more funding will be required to ensure that the level of housing development is not affected.

6.5 Subdued property market

The property market is expected to continue to reflect conditions of poor economic performance, struggling consumer sector due to declining values of disposable income (owing to inflation and increasing costs of living) and limited access to funding due to indebtedness, impaired credit record and risk aversion by financial institutions. This is more prevalent in the affordable segment of the market which registered real price deflation of 2.6% y/y in the first quarter.

7. FUTURE ECONOMIC PROSPECTS AND IMPACT ON THE RESIDENTIAL PROPERTY MARKET

Confidence indices are the key leading indicators which points the direction for the future economic performance. Business confidence and building confidence indices provides indication of future investments by businesses while consumer confidence is critical to point the direction of spending by the general public.

The **Business Confidence Index**[2] (BCI) which measures the confidence levels of prevailing business conditions in the manufacturing, building, retail trade, wholesale trade and new vehicle trade sectors increased by 5 points to 51 points in the fourth quarter of 2014.

This is the first time since early 2013 that confidence is back in net positive territory. A reading of 51 indicates that slightly over half of the respondents are satisfied with prevailing business conditions.

After reaching lows of 25 and 28 in the second and third quarter respectively, manufacturing confidence bounced back to 42 index points as the adverse impact of the labour strikes dissipated. Retailers deteriorated slightly with the index falling by five points, to a still high 55. Except for clothing, sales volumes generally accelerated in the fourth quarter. Wholesalers essentially unchanged, with the index stabilising at about 60. As for new motor dealers, confidence remained depressed at around 30 index points in the fourth quarter.

According to RBM/BER, the **Consumer Confidence Index**[3] **(CCI)** consumer confidence index rebounded from the very low levels of between -6 and -8 index points recorded during the third and first quarters of 2014 to a high of +4 in the second quarter of 2014. It then slipped back to -1 index point in the third quarter of 2014 as economic realities once again exerted downward pressure. The CCI edged up to a level of zero in fourth quarter of 2014. Although the latest index number is still below the long-term average reading of the CCI (+5 since 1994), consumer confidence is now considerably higher compared to the very low CCI reading of -7 index points recorded during the 2013 festive season.

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[2] Business Confidence Index (BCI) is determined from a survey of five major sectors of the economy namely manufacturing, building, retail trade, wholesale trade and new vehicle trade. BCI measures whether investors in these sectors rate prevailing business conditions as satisfactory or not.

[3] **Consumer Confidence Index** is a FNB/BER survey of consumers based on three questions, namely the expected performance of the economy, the expected financial situation of households and the rating of the appropriateness of the present time to buy durable goods (such as furniture, appliances, electronic equipment, and motor vehicles) (BER, 2011c).

The **Building Confidence Index**[4] increased up jumped to 60 points (15 points increase) in the fourth quarter of 2014. The current level of the index indicates that more than half of the respondents are satisfied with prevailing business conditions. The pace of growth in residential building activity quickened unexpectedly during the quarter, boosting work across the rest of the building value chain. Main contractor confidence jumped to 66 index points in the fourth quarter, from 53 last quarter. Sub-contractor confidence rose by 3 index points to 50. The confidence of retailers of hardware was unchanged at a high 74 index points

[4] **Building confidence Index** measures the level of performance as well as possibility for future investments in all sectors of the building industry. The index measures the business confidence of all the major role players and suppliers involved in the building industry, such as architects, quantity surveyors, contractors, sub-contractors, wholesale and retail merchants, and manufacturers of building materials (BER, 2011f). The index can vary between zero (indicating an extreme lack of confidence) and 100 (indicating extreme confidence).

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