

**AN ANALYSIS OF MACROECONOMIC DETERMINANTS OF HOUSE PRICE
VOLATILITY IN NAMIBIA**

**A THESIS SUBMITTED IN PARTIAL FULFILMENT
OF THE REQUIREMENTS FOR THE DEGREE OF
MASTER OF SCIENCE IN ECONOMICS**

OF

THE UNIVERSITY OF NAMIBIA

BY

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201614479

APRIL 2019

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ABSTRACT

The housing sector plays a significant role in the economy however, house prices are presumed to be more volatile than other goods and services, because of their high demand. The aim of this study was to conduct an empirical analysis of the determinants of house price volatility in Namibia. Moreover, the direction of causality between house price volatility and the macroeconomic determinants was examined. The ARCH and GARCH models together with the VAR/VECM approaches were used to analyse quarterly data from 2007 quarter 1 to 2017 quarter 2. The findings show that house prices in Namibia are volatile and the volatility is highly persistent. A long run relationship was established between house price volatility and the macroeconomic determinants. It was further established that volatility itself, GDP and mortgage loans significantly determine house price volatility. In addition, a unidirectional causality from GDP and mortgage loans to house price volatility was found. The IRF analysis showed that shocks to the selected macroeconomic variables, except the prime lending rate magnify volatility. It was also confirmed by the VDC analysis that mortgage loans and current volatility are the most significant variables that explain variation in house price volatility. Policy makers should therefore monitor macroeconomic factors closely and ensure that the economy is growing to mitigate the issues of house price volatility.

Keywords: House Price Volatility, Macroeconomic Determinants, Namibia

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LIST OF ABBREVIATIONS AND ACRONYMS

ADF:	Augmented Dickey Fuller
AHP:	Analytic Hierarchy Process
AIC:	Akaike Information Criterion
APA:	American Psychological Association
ARCH:	Autoregressive Conditional Heteroskedasticity
BoN:	Bank of Namibia
CUSUM:	Cumulative Sum
CRDW:	Cointegration Regression Durbin-Watson
DF:	Dickey-Fuller
DW:	Dubin-Watson
ECM:	Error Correction Model
ECT:	Error Correction Term
EGARCH:	Exponential Generalized Autoregressive Conditional Heteroskedasticity
EIEWS:	Econometric views
FNB:	First National Bank
FPE:	Final Prediction Error
GARCH:	Generalized Autoregressive Conditional Heteroskedasticity
GDP:	Gross Domestic Product

GIRF:	Generalized Impulse Response Function
HPI:	House Price Index
HQ:	Hannan-Quinn
IMF:	International Monetary Fund
IRF:	Impulse Response Function
JFE:	Joint Facility for Electives
KPSS:	Kwiatkowski-Phillips-Schmidt-Shin
LM:	Lagrange Multiplier
LNGDP:	Logarithm of Gross Domestic Product
LNML:	Logarithm of Mortgage Loans
LNPLR:	Logarithm of Prime Lending Rate
LNVOLTY:	Logarithm of Volatility
LR:	Likelihood Ratio
MSAs:	Metropolitan Statistical Areas
NAMFISA:	Namibia Financial Institutions Supervisory Authority
NSA:	Namibian Statistics Agency
NUST:	Namibia University of Science and Technology
OLS:	Ordinary Least Squares

PP:	Phillips and Perron
SIC:	Schwarz Information Criterion
SWARCH:	Switching Generalized Autoregressive Conditional Heteroskedasticity
TGARCH:	Threshold Generalized Autoregressive Conditional Heteroskedasticity
UK:	United Kingdom
UNAM:	University of Namibia
VAR:	Vector Autoregressive
VDC:	Variance Decomposition
VEC:	Vector Error Correction
VECM:	Vector Error Correction Model

ACKNOWLEDGEMENTS

First and foremost, I would like to give thanks to the almighty God for the knowledge and wisdom he has given me during my studies in general, and during the writing of this thesis in particular. Secondly, I would like to extend my sincere gratitude to Doctor Teresia Kaulihowa for her supervision throughout this study, for devoting her time and working tirelessly to ensure that everything ran smoothly and for the valuable comments and advice. Thirdly, I would like to thank all the UNAM and the Joint Facility for Electives (JFE) lectures who participated in my studies. Professor Tafirenyika Sunde of the Namibia University of Science and Technology (NUST), I owe you a stack for always willing to offer a helping hand. To the staff members of BoN, FNB and NSA your quick responses to data requests are highly appreciated. Finally, my heartfelt thanks goes to my friends and family for their undying love and for supporting me throughout my studies.

DEDICATION

This work is dedicated to my living God, my father, my creator and my deliverer, for he has been with me throughout my studies. It was by his grace and mercy that everything worked out well for me as planned. Without him, I would not have reached this stage. It is also dedicated to my parents for supporting me emotionally and financially and pushing me to strive for what is best. The study is further dedicated to all those who believe in working hard to achieve their dreams and never give up.

DECLARATIONS

I, Katrina Namutenya Kamati, hereby declare that this study is my own work and is a true reflection of my research, and that this work, or any part thereof has not been submitted for a degree at any other institution.

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Date

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Until the global financial crisis of 2007 which adversely affected housing among other markets, houses were viewed as a good investment because properties do not depreciate (Sunde & Muzindutsi, 2017). The importance of housing is evident from the various roles it plays in individuals' lives, the economy and society. Firstly, to individuals, housing is a basic need for shelter and forms an important part of their wealth. Secondly, it is an important segment of the economy because of its relation to other sectors such as construction, financial and retail. House prices are, however more volatile than other goods and services, because a house is the most demanded asset whereas real house prices' movements are greater than those of real incomes (Reen & Razali, 2016). Reen and Razali, (2016) stated that volatility is linked to lagged information and since house prices are unstable, any new information would cause volatility in prices. According to Boone and Girouard (as cited in Noord, 2005) supply shocks such as demographic labour supply changes and demand shocks that directly affects income are some of the factors that also contribute to house price volatility.

Furthermore, house prices increase more than what economic fundamentals can support from time to time leading to a bubble in the property market (Pillaiyan, 2015). Prices can however not increase forever; the bubble will have to burst at a point in time leading to a severe fall in prices. For instance, many developed countries experienced a house price boom which was followed by a burst with real house prices falling by more than thirty percent in the late 1990s (Anundsen & Nymoer, 2013). This burst contributed to the world

economy downturn after the Great Depression. According to Anundsen and Nymoer (2013), some countries experienced the highest unemployment rates, especially in the construction sectors, while the United States' housing market and financial system collapsed between 2007 and 2008. The collapse of the US financial system which resulted from a property bubble triggered the 2008 global financial crisis (Pillaiyan, 2015). The 2008 financial crisis proved the fact that there is a very close link between the housing market and macro economy.

In the Namibian context, Sunde and Muzindutsi (2017) stated that the rapid increase of house prices experienced over the years in Namibia may not be sustainable in the long run. Furthermore, International Monetary Fund experts predicted that there is a high possibility of a housing bubble bust and a financial crisis in Namibia if house prices continue to rise ("IMF fears housing", 2016). Although long term solutions such as increased housing supply and short term solutions such as taxation and safety nets are put in place to tackle volatility, there is still a need to investigate the sources of house price volatility for better planning. Hence, it is important to analyse the determinants of house prices volatility in Namibia.

1.2 Statement of the Problem

Being the most demanded and valuable asset and due to its interactions with the entire economic cycle, Case (as cited in Miller & Peng, 2004) stated that the housing market affect the economy through both wealth effects and through its effects on other markets. Therefore, the risks associated with housing market fluctuations are more prevalent than other economic risks (Miller & Peng, 2004).

Moreover, there is a general consensus that economies seeking economic stability should consider maintaining asset price stability. This according to Morley and Wei (2012) is attributed to the fact that persistent volatility in asset price may result in financial instability. From the property market perspective, Wang (2014) stressed that house price volatility may have implications for an economy not only because it threatens financial stability but also because it has significant effects at a macroeconomic level. In the historical context, increasing house prices have been linked to increasing financial and real economic instability, whereas, financial and banking crises have been attributed to volatility in housing prices (Anundsen & Nymoen, 2013).

Poghosyan (2016) stated that the housing market has an impact on aggregate demand and supply. Swings in house prices may affect demand through expenditure on residential construction and wealth effects, whereas it may have implications for labour mobility and property assets of businesses. Furthermore, boom and bust cycles in the housing market may affect an economy through distortion of housing choices, increased risk, increased mortgage debts and repossession rates and affects house building and equity (Stephens, 2011).

The uncertainty surrounding volatility in housing markets negatively affects stakeholders, mainly households. For one thing, Nakajima (2011) stated that with housing being the most important component of households' wealth, changes in house prices greatly affect human lives since it impacts total wealth. For instance, a drop (rise) in the house price generates less (more) earnings for the owner. Pettinger (2012) added that, in as much as rising house prices accumulate wealth for home owners, it reduces living standards for people who do not own houses because it makes housing unaffordable. This makes it

difficult to get home ownership especially when house prices increase more than incomes hence people who would have been able to afford houses in the past may be priced out of the market (Stephens, 2011). Moreover, house price inflation also creates generational inequality. For example, in the United Kingdom, older people who bought in the 1970s and 1980s managed to acquire cheaper housing as opposed to younger ones buying now (Pettinger, 2012).

It is worth mentioning that due to affordability issues or flexibility reasons, many people resort to or prefer renting. However, Stephens (2011) cautioned that although private tenants may be less exposed to house price volatility than homeowners, they risk losing their accommodation if landlords are unable to repay mortgages when house prices fall. Contrary to that, a rise in house prices has an impact on increasing rents as well (Pettinger, 2012).

Additionally, Muellbauer (as cited in Stephens, 2011) explained that expected regional house price and inflation differentials impede movement as individuals from low price areas may not afford to move to high price regions and vice versa for fear of not being able to return. Since mortgage debt is fixed in nominal terms, volatile prices may also be damaging to those who are unable to repay their mortgage due to circumstances beyond their control and would like to sell off their houses during downturns (Stephens, 2011). Not only does house price volatility force households to overextend themselves by buying more expensive houses, but it may also constraints labour mobility. For example in the United Kingdom, about two million households were unable to move at the end of 2008 due to limited equity or lack thereof (“The Current Volatility in House Prices,” 2011). House price fluctuations also put financial systems at risk since it may impose risk on the

banking sector due to its high mortgage exposure, (Nakajima, 2011). This is because, in most cases houses are collateralized by the house itself hence may increase the spill-over effects between house prices and household borrowing. Besides, policy makers usually follow house price movements very closely when evaluating the financial system's vulnerability. This is because it makes planning difficult as planners cannot be sure of what to expect and policy makers may be pressurized to make knee jerk decisions (Nakajima, 2011).

A clear understanding of the macroeconomic drivers of house price volatility is important in understanding and effectively managing the overall economy. While Matongela (2015) and Sunde & Muzindutsi (2017) have looked at the determinants of house prices, no study on volatility has been undertaken in Namibia yet. Hence, there is a need to address the current literature gap.

1.3 Objectives of the Study

The main objective of this study is to analyse the macroeconomic determinants of house price volatility in Namibia. The specific objectives were:

- To analyse the determinants of house price volatility in Namibia;
- To evaluate the direction of causality between house price volatility and its determinants.

1.4 Research Hypotheses

In light of the above objectives, the following hypotheses were tested:

H₀: Prime lending rate, Gross Domestic Product (GDP) and mortgage loans do not determine house price volatility in Namibia;

H₁: Prime lending rate, GDP and mortgage loans determine house price volatility in Namibia.

H₀: There is no causal relationship between house price volatility and prime lending rate, GDP and mortgage loans in Namibia;

H₁: There is a causal relationship between house price volatility and prime lending rate, GDP and mortgage loans in Namibia.

1.5 Significance of the Study

This study is important because identifying the determinants of house prices volatility is crucial in examining the significance of house prices volatility in Namibia. Additionally, the findings of the study are envisaged to benefit various stakeholders of the housing sector including investors and policy makers. On one hand, it will help investors in making informed decisions by being able to estimate the condition of the housing market with respect to price volatility, while it will help policy makers in the policy formulation process on the other hand. It will also create awareness for homeowners and other stakeholders by understanding the explosiveness of house prices, what the contributing factors are and what results to expect when there are shocks to the determinants. Moreover, the study will serve as a contribution to the existing literature and discussions on house price volatility and its determinants, and be serve a starting point for other people who would like to explore the topic further. As mentioned earlier, this study was undertaken due to the fact that although there are studies conducted on the determinants,

no study has been carried out on house price volatility and its determinants in Namibia yet.

1.6 Limitation of the Study

The major limitation of the study is the unavailability of house price index's data for the period before 2007 as the First National Bank (FNB) only started computing it in that year. There is also no monthly GDP data since the Namibian Statistics Agency (NSA) only captures GDP values on a quarterly basis and this limited the number of observations. Additionally, analysing volatility requires very high frequency data, but there is lack of this type of data for most variables in the Namibian economy. The lack of high frequency data could have had implications on the interpretation of results. The study focused on the macroeconomic determinants of house price volatility, but although there are many determinants, only three namely the prime lending rate, GDP and mortgage loans were employed. Inflation for example was excluded from the model since there is a possibility of high correlation between it and the interest rates. The study was also limited in scope due to the fact that the topic of house price volatility has not been studied in the Namibian context.

1.7 Delimitation of the Study

The study focused on the overall market house prices, because some of the chosen variables are only computed for the entire nation and not for individual towns. Additionally, it specifically analysed house price volatility, since subjects such as demand for housing and determinants of house prices in Namibia have been covered by other researchers. In addition, only the Namibian housing market was covered since the researcher is a Namibian and has a better understanding of the market.

1.8 Organization of the Study

The rest of the study is organized as follows: Chapter two discusses the overview of house price volatility and its determinants by looking at their trends over the years. Chapter three explores both the theoretical literature in which three theories namely theory of the user costs of housing and rents, the bubble theory and the Tobin's Q theory are discussed. It further discusses the empirical literature on the drivers of house prices in general and those of house price volatility. Chapter four explains the models employed to answer the study's objectives and details all the steps followed. The conceptual framework explaining the expected relationships between house price volatility and its determinants is also discussed in this chapter. The study's findings are discussed in chapter 5 and chapter 6 gives the main conclusions and policy recommendations.

CHAPTER 2: AN OVERVIEW OF HOUSE PRICES AND MACROECONOMIC VARIABLES

2.1 Introduction

This chapter presents an overview of house prices and the identified macroeconomic variables in Namibia. It analyses trends of the variables of interest through the use of graphs in order to contextualize the study's discussions and findings. It is divided into three sections of which section 2.2 gives a general background of how the Namibian housing market has been performing over the years in terms of house prices. The section further discusses the movements of prime lending rate, GDP and mortgage loans which were used as independent variables, while section 2.3 concludes the chapter.

2.2 An Overview of Housing Market and the Macroeconomic Variables

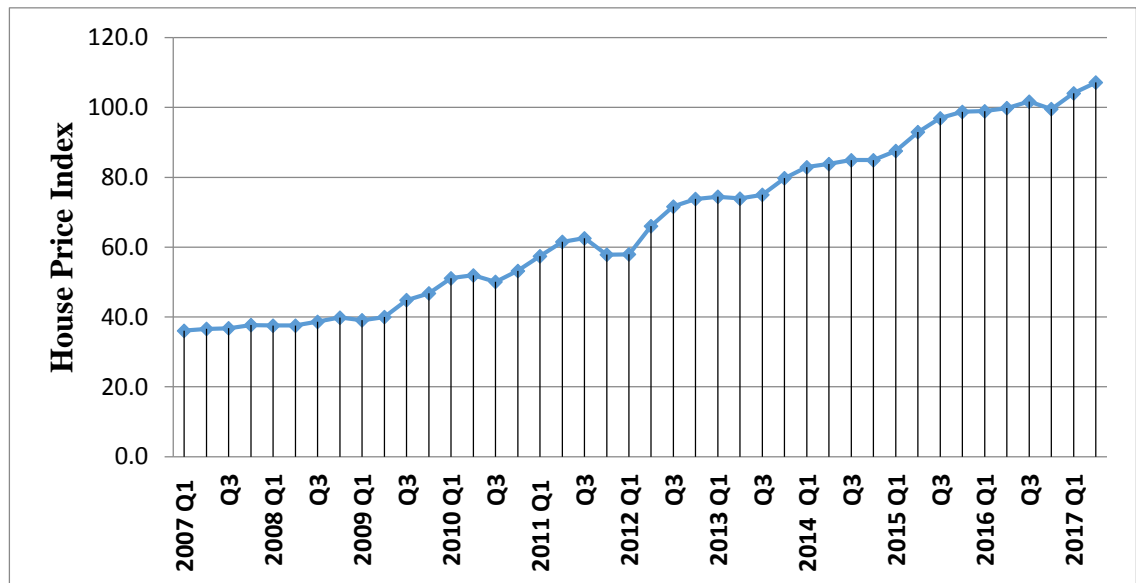
2.2.1 House Price Index (HPI) Trend in Namibia

Prices in the Namibian housing market have been volatile over the years (Sunde & Muzintutsi, 2017). Grobler (as cited in Sunde & Muzindutsi, 2017) noted that on average, up until 2014 house prices have increased by 29 percent annually implying that the housing market may become unsustainable in the long run. This increase can be confirmed by the upward trend in the house price index from 2007 to 2014 as depicted in figure 2.2.1. Furthermore, statistics have shown that the house price index increased by 8.2, 8.5 and 7.2 percent in the central, coastal and northern regions respectively in June 2009 (First National Bank, 2009). However the southern region's index remained subdued during that month due to downward pressure on small and medium houses. Likewise, the housing index fell by 4.5 percent as house prices weakened in the central and coastal property markets in February 2012 as it can again be observed from figure 2.2.1 (FNB,

2012), while it fell by 5.7 percent in March 2013 thereby putting house prices under pressure (FNB, 2013). Towards the end of the third quarter of 2015, property prices rose sharply, with the central region recording an increase of 27 percent and an average price of N\$1.9 million (FNB, 2015). The coastal region experienced an increase of 12 percent and an average price of N\$975,000.00 was recorded by the end of September 2015, whereas the northern regions recorded an overall house prices increase of 22 percent.

However, there was a downturn in the property market between 2015 and 2016, due to the Angolan economic crisis that was caused by a plunge in global oil prices (Nakashole, 2016). Contrary to that, the central region prices tripled during the second quarter of 2016 while those of the coast and north doubled (FNB, 2016). Although house prices in the coastal region continued to increase in the fourth quarter of 2016, they reduced in the central region. Given the economic situation and inability of citizens to afford, prices were expected to go down by the end of 2017 (FNB, 2016).

Figure 2.2.1: The House Price Index Trend



Source: Author's computation

2.2.2 Prime Lending Rate Trend in Namibia

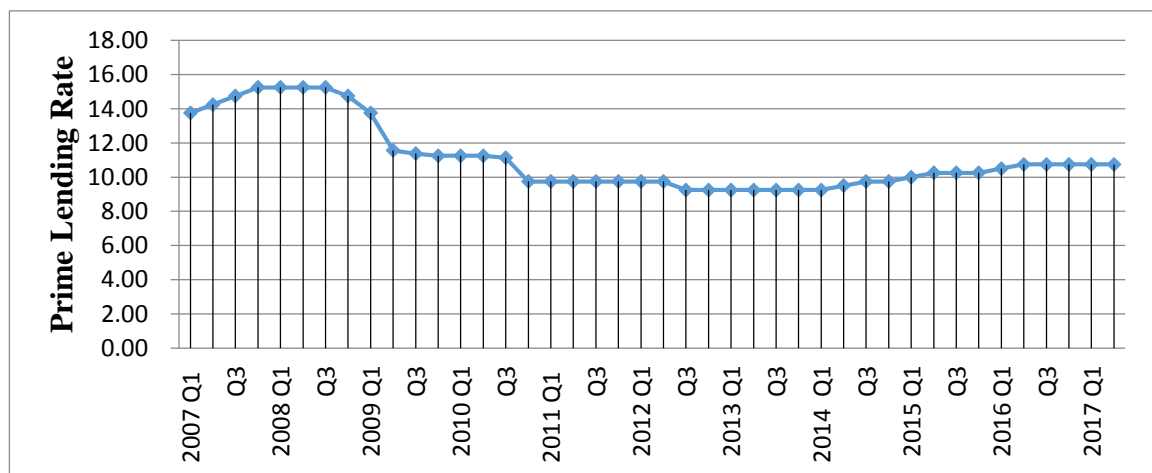
Figure 2.2.2 shows movements in the prime lending rate for the period 2007-2017. The figure shows that the prime lending rate has not been stable over the years. To begin with, due to a directive by the Bank of Namibia to reduce interest rates in order to meet its demand for lower interest rate spread, Bank Windhoek complied by reducing its prime lending rate by 50 basis points to 10,75 percent on 5th July 2010 (Duddy, 2010). Other banks also followed suit and the overall reduction was said to have increased borrowing during that period. This act was deemed necessary for economic development.

Following an announcement by Bank of Namibia to increase its repo rate, commercial banks also raised their lending rates in 2014. Specifically, both the First National Bank and Nedbank increased their prime rates by 0.25 to 9.75 percent per annum (Kaira, 2014).

It was reported that due to this increase, the overall market prime rate was 0.5 percent higher than that of South Africa.

According to the Bank of Namibia (BoN) and the Namibia Financial Institutions Supervisory Authority (NAMFISA), (2017) the downgrade of the Namibian outlook by credit rating agencies from stable to negative in 2017 implied that the country could lose its investment grade status. This was seen as one of the factors that could have had triggered a rise in the general interest rates. Nevertheless, the central bank reduced its lending rate by 25 basis points to 6.5 percent in order to align it to that of South Africa in August 2017 and commercial banks followed suit by lowering their prime lending rates, (Jantze, 2017). This means the overall Namibian prime lending rate reduced by the end of 2017.

Figure 2.2.2: The Prime Lending Rate Trend



Source: Author's Computation

2.2.3 Gross Domestic Product Trend in Namibia

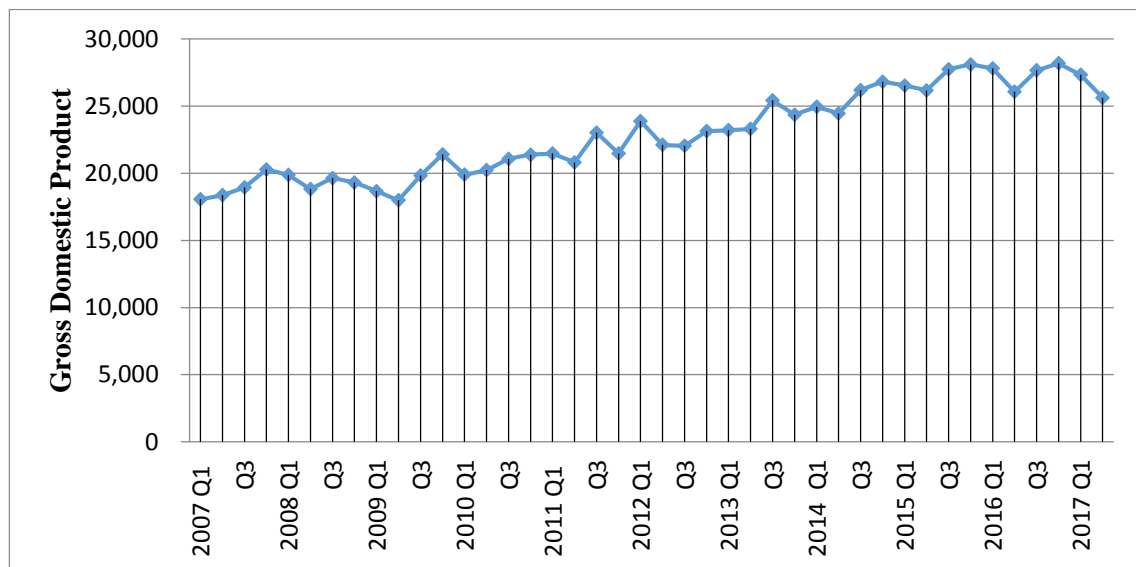
Being a middle income country, Namibia has successfully managed to build a market-oriented economy and stable political environment over the years. This has greatly contributed to the country's economic growth as evident from figure 2.2.3 that is showing a growing trend of GDP. Real output averaged at 4.5 percent between 2003 and 2007 (International Monetary Fund, 2007). Expansions in some of the leading sectors such as construction, mining, transport and communications were said to be behind the growth during that period. Although there was a positive growth rate of 4.3 percent in 2008, the economy faced a recession contracting by 0.7 percent in 2009 following the global economic downturn (Ministry of Finance, 2011). As a result of the global economic recession and consequent fall in demand for and prices of commodities, primary industries experienced a decline. According to the Ministry of Finance (2011), there was a recovery in 2010 with an estimated growth rate of 4.8 percent in GDP which was attributed to an increase in the mining of diamond and uranium.

There was fear that, the agriculture sector which is one of the biggest contributors to overall GDP would not recuperate well if weather conditions did not improve. Drops in electricity supply from South Africa and the fall of Angolan oil prices were also threatening factors to Namibia's growth. Furthermore, Bank of Namibia and NAMFISA (2016) confirmed that there was indeed a fall in the agriculture sector due to the drought that the country experienced in 2015. Despite the prevalent drought conditions and volatile exchange rates among other risk, the overall outlook for economic activities still looked promising. Although, the Bank of Namibia (2015) cautioned that the economy faced a risk of a fall in economic growth due to low trade prices for mine products and bad weather conditions , the real GDP growth rates were recorded at 6.1 and 0.7 percent during 2015

and 2016 respectively (Namibia Statistics Agency, 2017). The growth came as a result of improved performances in both the secondary and treasury sectors joined by a recovery of the primary industry. To be specific, it was reported that growth in private and public construction sectors, a rise in manufacturing output due to new entries and increased electricity production were behind the medium-term growth of GDP for 2015/16.

As depicted in figure 2.2.3 below, real GDP grew slowly during 2016 at a rate of 0.7 percent as opposed to the 6.1 percent growth rate achieved in 2015. This according to BoN and NAMFISA (2017) was a result of contractions in construction and mining sectors, as well as the fiscal consolidation in the public sector (Bank of Namibia & NAMFISA, 2017). The economy however contracted in 2017 with the real GDP growth rate falling by 0.8 percent. This according to the Namibia Statistics Agency (2017) was attributed to the weak performance in the secondary and tertiary sectors.

Figure 2.2.3: The Gross Domestic Product Trend



Source: Author's computation

2.2.4 Mortgage Loans' Trend in Namibia

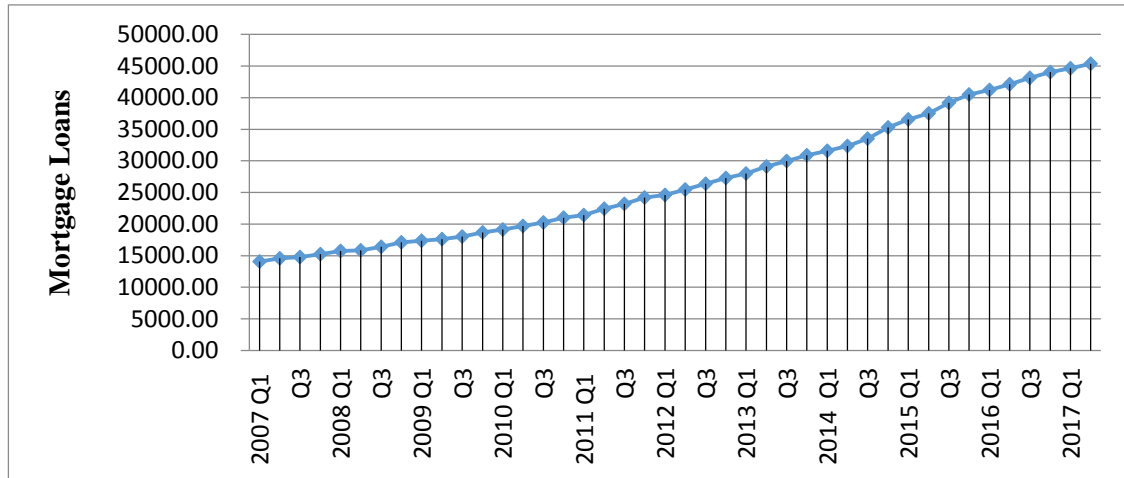
Namibia is considered as one of the countries with a very strong housing finance system and has a mature banking system. According to FinMark Trust (2011), the country has a well-functioning infrastructure to facilitate mortgage lending hence takes the 5th position out of six in terms of the World Bank's depth of credit information index. Mushendami and Kandume (2008) mentioned that the Namibian housing finance has been growing over the years, with mortgage loans taking the biggest chunk of bank loans in Namibia. For instance, mortgage loans covered 52.6 percent (N\$14.0 billion) of the total loans by December 2007, whereas a total of N\$15.2 billion which is 32 percent of GDP was outstanding for the rest of that financial year. 92.2 percent of the total mortgage loans was financed by banking institutions, while the remainder was funded by Agribank and the National Housing Enterprise (Mushendami & Kandume, 2008).

Mortgage loans represent the biggest form of home financing in Namibia. According to Sunde and Muzindutsi (2017), about 800 000 households lived in debt in 2015 with mortgage loans taking the biggest portion. Bank of Namibia and NAMFISA (2016) explained that this led to overall mortgage loans increasing by 0.5 percent to 12.5 percent in 2015 from the 12.0 percent of 2014. Mortgage lending growth however, fell to 9.5 at the end of 2016 but together with non-performing loans increased again by N\$120.6 million in 2017 (BoN and NAMFISA, 2017).

Additionally, mortgage loans on average grew by 8.1 percent on an annual basis and a total of N\$ 47.5 billion was recorded in 2017 of which N\$36.2 billion was for the residential sector (Ngatjiheue , 2018). It was explained that mortgage loans given for residential purposes accounted for 76.2 percent of the total extended to the private sector

and the remainder was for the business sector. Figure 2.2.4 confirms that mortgage loans exhibit an upward trend from 2007 quarter 1 to 2017 quarter 2 as demand for it increased.

Figure 2.2.4: Mortgage Loans' Trend



Source: Author's computation

2.3 Conclusion

By way of conclusion, chapter two presented an overview of the Namibian housing market and the identified macroeconomic variables. To be specific, it looked at the trends of the variables of interest being the house price index, prime lending rate, Gross Domestic Product and mortgage loans. Firstly, it was mentioned that the house price index and prime lending rates have not been stable over the years and it is evident from figure 2.2.1 and 2.2.2 above. Secondly, the overall performance of Namibia in terms of economic growth was said to be impressive although there were certain hiccups that led to a fall in GDP during some years. Lastly, mortgage loans which take the largest share of total household debt have been increasing over the years due to people's appetite for housing.

CHAPTER THREE: LITERATURE REVIEW

3.1 Introduction

This chapter presents a review on the theories related to the study and empirical studies conducted on the drivers of house prices in general and those of house price volatility in particular. The rest of the chapter is structured as follows: section 3.2 discusses three theories related to house price determinants namely theory of the user costs of housing and rents, the bubble theory and Tobin's Q theory. Section 3.3 reviews empirical studies done by other researchers by looking at the models used, periods covered and the main findings, whereas section 3.4 summarizes the chapter discussions.

3.2 Theoretical Literature

3.2.1 Theory of the User Costs of Housing and Rents

User costs can be defined as the annual costs that home purchasers of homes incur when they buy new houses, utilize them for one period and sell them at the end of that period (Nakajima, 2011). The standard Jorgensonian capital theory, states that market rental costs for an identical home are expected to be equal to their ex ante user cost, ceteris paribus, (Garner & Verbrugge 2009). However, Verbrugge (2008) emphasized that not only are housing rents far less volatile than ex ante user costs, but they may also deviate for extended periods of time.

Nakajima (2011) stated that the user-cost theory explains how user costs are established and its relation to rents. These costs include interest cost, property taxes, deduction of mortgage interest payments, maintenance and repair costs, and expectations about future changes in house prices. Hence, according to Verbrugge (2008), a standard annual user

cost formula which excludes special tax treatment given to homeowners may be given as follows:

$$U_t = P_t^h (i_t + \gamma - E\pi_t^h)$$

Where P_t^h denotes home price, i_t denotes nominal interest rate, γ includes maintenance and repair, depreciation, insurance and property tax rates which are all assumed constant. Whereas π_t is the four quarter constant-quality home price appreciation between the current and next period and E denotes expectations.

The user cost components can be used to understand house price dynamics by incorporating the aspect of user cost equivalence to rent (Verburgge, 2008). For instance, if user costs and rents are initially the same but interest rates rise, total user cost will rise as well assuming all else is equal. The rise in user costs (greater than rent) forces homeowners to sell their houses as owning them becomes worthless. This reduces overall demand for housing which further exerts downward pressure on house prices. Hence house prices and user costs would eventually return to their equilibrium level, while user costs and rents will be equalized with a higher interest rate and lower house prices. Contrary to that, when rents are higher than user costs, demand for housing would rise and in turn push house prices up. House prices would go up until user costs and rents are equalized.

As aforementioned, user costs and rents are expected to be equal when houses are rented and purchased. This is because if rent exceeds the costs of owning and maintaining a house, people would find it profitable to buy houses and rent them out Nakajima (2011). When this happens, demand is expected to increase thereby pushing house prices up and

the opposite holds if rent is lower than user costs. It can then be stated that user costs and house prices move in the same direction, i.e. user cost components will be larger if house prices are higher, (Garner & Verbrugge 2009).

In a nutshell, house prices are low when rents are low, interest rates are higher, property tax rates are higher, the tax deduction rate is lower, maintenance and repair costs are higher, and house prices are expected to decline in the future, *ceteris paribus* (Nakajima, 2011).

3.2.2 The Bubble Theory

Sjoling (2012) defines a bubble as a sharp rise in house value that is followed by an equal fall in value. However, the time between a rise and fall in prices should not be longer than two years for it to qualify as a bubble. Lind (as cited in Sjoling, 2012) explained that, if the time lag between the increase and decrease is longer, it would imply that the two events were not influenced by the same factors. In other words, it indicates a rapid increase in house prices in a year for consecutive years and eventually fall just as rapidly in the following years (Mayer, 2011). The literature has indicated numerous explanations of what may cause a bubble. For instance, Case and Shiller (2004) stated that a bubble occurs when excessive public expectations regarding a rise in future prices triggers a temporary rise in current prices. However, Mayer (2011) suggested that a bubble results when house prices are extremely volatile over the cycle, increasing more than fundamentals would suggest in a boom and falling faster than the decline in fundamentals in a recession.

Based on their intensity and influence on the overall economy, bubbles can be classified into three types namely the good, bad and ugly bubble (Duus & Hjelmeland, 2013). Firstly, the good type is the least harmful and considered a healthy bubble since it has little

negative effect on households' demand for consumer goods and has minimal effects on the economy. It is more common in speculative and financial assets. Secondly, the bad type influences the general economy and private households to a certain degree and is common in stock markets. Thus impacts of a burst would be felt more by investors and shareholders rather than the society in general. Lastly, an ugly bubble is the most aggressive type and a burst adversely affects the entire economy. It results when real assets such as housing are overvalued (Duus & Hjelmeland, 2013). Losses from a burst are mostly felt by banks and credit systems, but may spread to firms and households as the banking system weakens, interest rates rise and lending policies become stricter. In an ugly bubble, assets depreciate rapidly and owners lose out immensely and given their illiquid characteristic, individuals may find it difficult to exit the market.

Due to the high transaction costs, illiquidity and heterogeneity aspects of the housing market, a housing bubble influence on the economy can be greater than that of a collapse in the stock market (Chen, Gan, Hu & Cohen, 2013). As aforesaid, the housing market plays a great role in any economy due to its relation to other markets. In this light, a house bubble affects the overall economy and a bubble burst can consequently be followed by a financial crisis (Duus & Hjelmeland, 2013)

When there is a bubble in the housing market, demand increases as buyers view a house that may normally seem expensive to be cheaper due to the gain they expect from increased house value (Case & Shiller, 2004). Economists have pointed out that when prices start rising, players in the housing market become too excited and get carried away, thereby causing house prices to spike in booms (Mayer, 2011). Additionally, when the perception in the economy is that prices will rise in future, it is favourable for new buyers

to buy now than later when houses are more expensive (Sjoling, 2012). However, it is impossible for prices to rise persistently (Case & Shiller, 2004). When home investors notice that prices will eventually decrease, demand would fall and therefore house prices. This fall in prices after a sharp price is what is called a bubble bursts and it discourages sellers from selling houses while owners may lose confidence in the value of their homes (Sjoling, 2012).

There is evidence of aspects of a housing price bubble in the world. For instance rapid price increases were experienced during the 2000s in all developed nations apart from Germany and Japan (Case & Shiller, 2004). This problem has also been experienced in developing countries including Namibia. Sunde and Muzindutsi (2017) stated that the rapid increase of house prices experienced over the years in Namibia may not be sustainable in the long run. Furthermore, International Monetary Fund experts predicted that there is a high possibility of a housing bubble bust and a financial crisis in Namibia if house prices continue to rise (“IMF Fears Housing”, 2016).

3.2.3 Tobin’s Q Theory

The Q-theory, developed by James Tobin in 1969 is an extension to the neoclassical investment theory which assumes that rational market players will continue to invest as long as the net present value remains positive (Duus & Hjelmeland, 2013). It examines the link between the market price and replacement costs of an asset. The theory states that it is valuable to invest in construction when the market price of an asset is greater than the replacement cost, and worthless to do so when the opposite is the case. According to Gathuru (2012), it is based on the notion that investment in housing is influenced by consumer’s arbitrage between new and existing homes. Demand for new homes relative

to existing ones may for example be presumed to rise if new homes are cheaper, thus, suppliers would respond by building new homes. The Tobin's Q can be computed as follows:

$$\text{Tobin's Q} = \frac{\text{Market Price}}{\text{Replacement Cost}}$$

Tobin's Q is based on the marginal q, but the above equation shows the average which is mostly applied in empirical studies as the marginal q is not directly observable. Hayashi (as cited in Duus & Hjelmeland, 2013) defines the marginal q as the market value of an additional unit of capital to its replacement cost whereas the average q is the market value of an existing unit of capital to its replacement cost. Usually, the average and marginal q would be the same when certain assumptions are fulfilled (Duus & Hjelmeland, 2013). The assumptions are that, suppliers in the market are price takers, the production function and installation function are linear homogenous and have constant returns to scale and that capital markets are perfect. When the investment level rises, the marginal q falls.

When applying the Q-theory to housing market analysis, the market price becomes the value at which a house is sold whereas the replacement cost is the total construction cost (Duus & Hjelmeland, 2013). Moreover, the theory signals the state of the housing market (Berg and Berger, 2005). A Q-value less or greater than one indicate excess supply of or demand for houses respectively, while that of one signals an equilibrium in the market. When the q-value is above 1, rational players in the market would find it profitable to undertake more investments (Berg & Berger, 2005). As mentioned above, a q value of one indicates a long-term market equilibrium. According to Brueggemann and Fischer (as

cited in Duus & Hjelmeland, 2013), this merely means that buyers will not be willing to buy houses at a price higher than the replacement cost.

A high q value indicates an increase in supply of housing due to a rise in investment and this may exert a downward pressure on the market price of existing houses in the long run. It should however be noted that if q is persistently high, it shows that market prices are above their fundamental value therefore signals the presence of a bubble in the housing market (Duus & Hjelmeland, 2013).

3.3 Empirical Literature

The housing market has interested a number of scholars due to the role it plays in the economy. The economic literature has explored various aspects of the housing market, with some scholars looking at the macroeconomic determinants of house price volatility while others looked at the determinants of house prices. The following sub-sections discuss empirical views on the macroeconomic determinants of house price volatility, macroeconomic determinants of house prices in general and the determinants of house prices in Namibia.

3.3.1 Empirical Literature on House Price Volatility and its Macroeconomic

Determinants

Despite the importance of the housing market, the area of sources of house price volatility has received little attention in the literature. Existing empirical studies in the literature have used different data, variables, and methodologies to examine the determinants of house price volatility that have produced mixed results. Among the few scholars that addressed house price volatility and its macroeconomic determinants are: Miller and Peng (2004); Lee (2009); Hossain and Latif (2009); Tu and Zhou (2015); Reen and Razali

(2016); and Tupenaite, Kanapeckiene and Naimaviciene (2017)). To begin with, studies by Miller and Peng (2004); Hossain and Latif (2009), and Tu and Zhou (2015) all found evidence of house price volatility and agreed that the volatility was greatly affected by both positive and negative house price appreciations. Miller and Peng (2004) emphasized that, an exogenous increase (decrease) in the home appreciation rate magnifies (mitigates) the volatility. While Hossain and Latif (2009) found the population growth rate to be an insignificant determinant, Lee (2009) and Tu and Zhou (2015) found it to be significant, implying that changes in the population growth rate can result in house price volatility change. However, the findings of Miller and Peng (2004) showed that the impact of population growth rate was complicated as it depended on qualitative characteristics of the change.

Another study by Lee (2009) also concluded that house prices were indeed volatile. The author stated that shocks to inflation produced dynamic responses in housing prices. This result supported some studies in housing price volatility that inflation is one of the most significant determinants of housing price volatility including Hossain and Latif (2009); Reen and Razali (2016); and Tupenaite, Kanapeckiene and Naimaviciene (2017). Lee (2009) also documented that past values of unemployment and income growth rates were the other determinants of house price volatility of which the unemployment rate had a negative impact while income growth had a positive impact. The negative impact of the unemployment rate was also shown in Tupenaite, Kanapeckiene and Naimaviciene (2017).

The level of Gross Domestic product (GDP) in a country can indirectly measure living standards as it determines GDP per capita. When incomes are high, citizens are more able

to afford housing and vice versa. Hence, the level of GDP in a country can affect the rate at which house prices fluctuate. Some studies in the literature found that changes in the Gross Domestic Product (GDP) significantly affected housing prices volatility. Specifically, Hossain and Latif (2009); Reen and Razali (2016); and Tupenaite, Kanapeckiene and Naimaviciene (2017) were some of the scholars who found GDP to be a significant determinant. Hossain and Latif (2009) explained that positive changes in the GDP growth rate magnify volatility, while negative changes mitigate it.

When it comes to the lending rate, it is hypothesized that it plays a big role in any economy as it the cost of borrowing. Both central and commercial banks charge interest when lending money. Usually, the rate set by central banks affects all other lending rates in the financial system. Likewise, many people take out home loans which are paid back with interest because they are financially constrained. Hence, there is no doubt that mortgage loans and lending rates influence house prices. Although Lee (2009) found that mortgage rates had little influence on housing price volatility, studies of Reen and Razali (2016) and Tupenaite, Kanapeckiene and Naimaviciene (2017) identified interest rates as a significant determinant. In addition, the findings of Tupenaite, Kanapeckiene and Naimaviciene (2017) further showed that mortgage loans significantly affect volatility. Other macroeconomic determinants such as house sales growth rate, house price volatility itself and housing stock were documented in the studies of Miller and Peng (2004); Tu and Zhou (2015) and, Reen and Razali (2016) respectively.

Savva and Michail (2017) estimated the dynamics of the housing market price change volatility in Cyprus and found a high and a low volatility states existed in the market and both states showed a high degree of persistence. The high volatility state's probability was

close to one in the beginning but eventually declined around 2008-2010 when the Cypriot housing boom was at the peak. The implication was that booms could be re-enforcing because of the degree of persistence. It was further discussed that higher volatility was a result of increased credit, suggesting that credit expansion attracts investors to the housing market thereby increase speculations.

Contrary to the above, other scholars only examined the dynamics of house prices without identifying the sources. For example, Tsai and Chen (n.d.) found at least two volatility states in the price series suggesting that housing markets are relatively stable and different states do not switch very often in the United Kingdom (UK). The study further discovered that the degree of high price volatility was as high as 4.89 times of low volatility for all housing market and 2.87 times of low volatility for new housing markets. It was however concluded that low volatility was the normal condition in the two markets.

The above empirical literature shows mixed findings by different scholars. Table 3.3.1 summarizes the samples covered, countries studied and the methodologies followed in the studies discussed above that might have led to different findings.

Table 3.3.1: Sample, Country and Methodologies Used by Various Scholars

Author(s)	Sample and Country	Model
Tsai and Chen (n.d)	1955 – 2005 (UK)	ARCH, GARCH and Switching ARCH (SWARCH)
Miller and Peng (2004)	1990 Q3 – 2002 Q2 (United states of America)	GARCH and Panel VAR

Hossain and Latif (2009)	1981 Q1- 2006 Q1 (Canada)	GARCH and VAR
Lee (2009)	1987 Q4 – 2007 Q4 (Australia)	Exponential GARCH (EGARCH)
Tu and Zhou (2015)	1980 Q2 -2014 Q1 (Canada)	ARCH, GARCH, Threshold GARCH (TGARCH) and VAR
Reen and Razali (2016)	2005 Q1 – 2013 Q4 (Malaysia)	ARCH
Savva and Michail (2017)	2001 Q1 – 2016 Q2 (Cyprus)	ARCH and SWARCH
Tupenaite, Kanapeckiene and Naimaviciene (2017)	2005 – 2015 (Lithuania)	Analytic Hierarchy Process (AHP)

Source: Author's Compilation

3.3.2 The Macroeconomic Determinants of House Prices

It is hypothesized that house prices have various characteristics and respond to different factors and this aspect of the housing market has received a lot of attention. Mainly, various scholars in the literature have studied the macroeconomic drivers of house prices. This section discusses a few of these studies and their findings.

Firstly, Borowiecki (2009) studied the determinants of house prices and construction activity in Swiss using annual data for 1991-2007. The Vector Autoregressive (VAR) model analysis discovered that real house price growth and construction activity dynamics are mostly influenced by changes in population and construction prices, while real GDP

had a minor impact in the short run. Furthermore, the study found that shocks to house prices only had short term impacts on housing supply and vice versa. Finally, it was discussed that despite substantial price increases, there were no worries of overvaluation.

Secondly, Mwenje (2015) examined key macroeconomic variables that influence housing prices in South Africa. Impact of shocks to macroeconomic variables on housing prices in the short run and the nature of the relationship in the long run were studied within the VECM framework. Using quarterly data for the period 1978-2014, the study found that real house prices, exchange rate, new mortgage loans and prime interest rates had a long run equilibrium relationship. Household net wealth and household debt were found to be the leading variables explaining variations in of house price. While, shocks to prime interest rates and Rand/US\$ exchange rate showed a negative impact on house prices in the short run.

In Malaysia, Pillaiyan (2015) investigated the key macroeconomic drivers of house prices. Using the VECM technique, inflation, stock market, money supply (M3) and number of approved residential loans were confirmed to be significantly related to the Malaysian housing prices. Gross Domestic Product was not recognized as a determining factor.

Finally, Kim, Mei, Yin and Niap (2016) also examined the fundamental determinants of housing price in Malaysia. Their study employed the Error Correction Model (ECM) over the period 2000 quarter 1 to 2014 quarter 4. It was found that unemployment had a negative relationship, while real GDP had a positive relationship and the lending rate had no significant relationship with Malaysia housing prices in the short run. However, the results further showed that lending rates and house prices were negatively related in the long run.

3.3.3 The Namibian Housing Market and the Determinants of House Prices

In the Namibian context, a few researchers have analysed the housing market. In the first place, Matongela (2015) analysed the determinants of house prices in Namibia for the period 2007-2013 using cointegration and error correction modeling. Land supply was found to be a significant determinant of house prices. The study concluded that, house prices' increase during the reviewed period was due to serviced land shortage in Namibia.

Kgobetsi (2017) looked at the factors influencing housing affordability for the low and middle income households in Windhoek, Namibia and reviewed how various government policies have influenced the Namibian housing market. Using a mixed research strategy which involved close review of the literature and interviews with selected income groups, it was found that housing affordability in Windhoek is influenced by social, economic and political factors. These factors included immigration, education levels, income, taxation, interest rates, preference, construction cost and availability of serviced land. Moreover, the results highlighted that most people were not aware of some existing policies and that the policies have not been effective as house prices still remained high in Namibia.

Lastly, Sunde and Muzindutsi (2017) conducted an econometric analysis of endogenous and exogenous determinants of house prices and new construction activity in Namibia for the period 2000-2014. The study employed a restricted VAR model with a Johansen cointegration approach for analysis. The authors also analysed if there was evidence of an overvaluation of house prices to determine if there was a chance of a housing price bubble. The findings established that the Namibian housing price index was greatly affected by changes in population, mortgage loans and inflation, while house price index and inflation were the major determinants of construction activities. Moreover, the study

found bidirectional causality between the house price index and new construction activity. It was then concluded that there is evidence of overvaluation of house prices which could result to a house price bubble.

3.4 Conclusion

Chapter three discussed both theoretical and empirical views concerning factors influencing changes in house prices and house price volatility. The user cost theory stated that changes in user costs have an impact on house prices. According to the bubble theory, highly volatile house prices are often sources of house price bubbles. Additionally, it was mentioned that the Tobin Q's theory explains the relationship between market prices and replacement costs of an asset. Finally, most empirical studies presented similar views on what influences house price fluctuations and it was observed that house prices and house price volatility are driven by the same macroeconomic fundamentals.

CHAPTER FOUR: RESEARCH METHODOLOGY

4.1 Research Design

A research design is a plan that sets out how a study is conducted and provides a framework for data collection and analysis (Kothari, as cited in Akumu, 2014). It comprises of all steps taken in conducting the research from statement of hypotheses to data analysis and guides the researcher on the appropriate research method to use. There are various types of research designs of which the appropriate type depends on the nature of the research objectives or questions (Walliman, 2011). The most common research designs include; historical, descriptive, correlation, comparative, experimental, simulation, evaluation and ethnological amongst others. Since this study required formulation of hypotheses in order to establish the variables to be tested and how they were measured, the experimental research design was followed. According to Walliman (2011), experimental research tries to control every relevant condition which determines the event that is being examined and observes the effects when this condition is manipulated. Research methods on the other hand are the tools and techniques used for different types of enquiry. There are two types of research methods, namely quantitative and qualitative method. To analyse house price volatility and its determinants in Namibia, the study employed a quantitative method. A quantitative research method follows a numeric or statistical approach to research design approach. Since they build on existing theories, quantitative studies are specific in their surveying and experimentations, (Williams, 2007). Moreover, this approach allows for objectivity, and results can be predictive, explanatory and confirming. The study made use of time series data which was analysed using the Econometrics Views (Eviews) software.

4.2 Procedure

The study used secondary quarterly time series data for the period January 2007 quarter one to 2017 quarter two, yielding a total of 42 observations. The sample period was chosen based on the availability of data for the main variable of interest, house price index. The FNB only began keeping record of the overall market housing price index in 2007 and has only recorded an index based on FNB home loans and not the aggregate house price index prior to that year.

The house price index volatility was used as the regressand, whereas the determinants identified from the literature were regressors. These determinants are interest rates, GDP and mortgage loans. Secondary data for the house price index and GDP at market prices was sourced from First National Bank of Namibia (FNB) and Namibian Statistics Agency (NSA) respectively. Moreover, data for mortgage loans and the prime lending which was used as a proxy for interest rates was acquired from Bank of Namibia. All variables were transformed into natural logarithms so that the data could meet statistical interpretations of the study more closely. Table 4.2 specifies the measurements and definitions of the variables used.

Table 4.2 Measurement and definition of variables

Dependent Variable	Measurement	Definition
House Price Volatility	House price Index volatility series (GARCH variance series)	Logged Quarterly house price index (percentage)
Independent Variables		

Interest Rates	Aggregate Prime lending Rate	Logged quarterly figures of the prime lending rate (percentage)
Gross Domestic Product	Real GDP	Logged quarterly GDP at market prices figures (millions)
Mortgage Loans	Aggregate Nominal Mortgage Credit	Logged quarterly nominal mortgage credit figures (millions)

Source: Author's compilation

4.3 Conceptual framework explaining the determinants of house prices in general and house price volatility

It is hypothesized that house prices in general are influenced by macroeconomic variables as well as the fundamentals of demand and supply. Nakajima (2011) stated that various researches have tried to answer why house prices are highly volatile. On the supply side, some researchers reasoned that unavailability of land and time taken to build a house could be some of the contributing factors, while others concluded that prices respond to unstable land and building materials' prices and to macroeconomic fundamentals. Nakajima (2011) also noted that changes in demographic factors indirectly affect house prices through demand and that housing demand increases when income is more volatile and therefore increases house prices volatility. A number of macroeconomic variables have been identified from the literature as determinants of house prices in general and house price volatility. For example Akumu (2014) mentioned that movements in housing markets

reflect wider changes in Gross Domestic Product (GDP), inflation, interest rates, demographics, mortgage loans, unemployment, money supply and income. Changes in these variables have a close link to variations in house prices. Figure 4.3, demonstrates the determinants of house prices and house price volatility as identified from the literature on which the analysis of the study are be based.

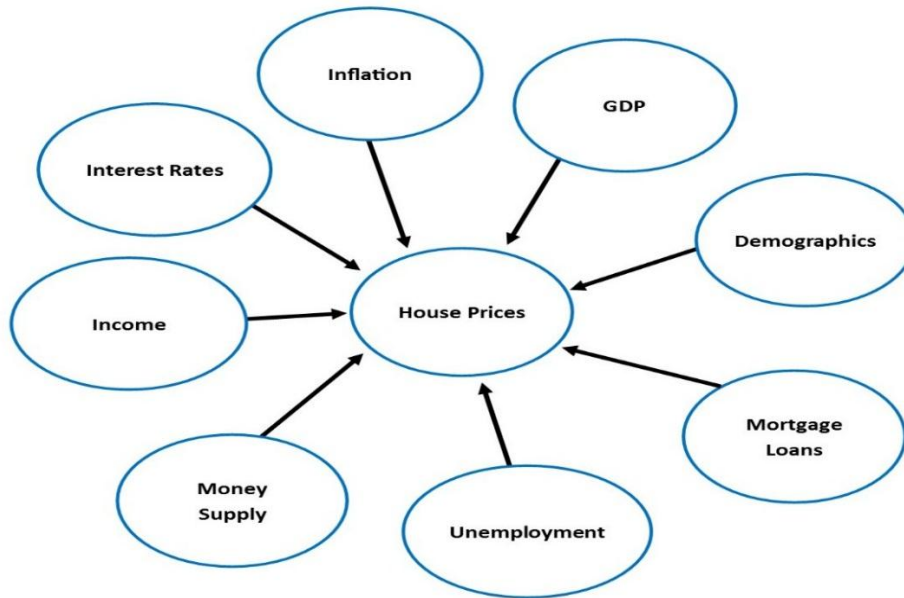
Firstly, it is widely recognised that GDP, which is a measure of economic growth is the main driver of house prices (Pillaiyan, 2015). According to Akumu (2014), there is a positive relationship between house prices and GDP in a sense that if GDP increases, it should be expected that there would be a rise in demand for housing which in turn pushes house prices up, *ceteris paribus*. Hossain and Latif (2009) in a study to determine the drivers of housing price volatility in Canada established that both positive and negative changes in GDP growth rates make housing prices more volatile.

Secondly, prime lending rates are used to calculate mortgages, credit cards and other consumer loan interest rates. Hence the prime lending rate plays a huge role in the housing market and therefore viewed as one of the most important macro-economic factors that influence house prices. Andrews (as cited in Panagiotidis & Printzis 2015) argued that there is a negative relationship between house prices and interest rates. An increase in interest rates for instance means a rise in the cost of borrowing and high mortgage repayments. This discourages home buyers, thereby decreasing demand and prices. Akumu (2014) and Zhu (as cited in Pillaiyan, 2015) both found that there is a negative relationship between interest rates and house prices. When considering the volatility aspect, Reen and Razali (2016) found lending rates to be a significant driver of house price

volatility, while Hossain and Latif (2009) confirmed that an increase in mortgage rates increase house price volatility.

Houses can be acquired either through cash purchase or mortgage. However, since many individuals are cash constrained, mortgage forms the majority of home purchases. Pillaiyan (2015) stated that the sensitivity of mortgage loans once caused a cyclical movement in property prices which was followed by a bubble burst. Moreover, asset price bubbles have often been preceded by rapid expansion of credit. Mansor et al., (as cited in Pillaiyan, 2015) confirmed that bank loans which include mortgage loans have significant impacts on short-run variations in house prices but have a positive long run relationship with house prices. Thus, the conclusion from this is that there is a positive relationship between mortgage loans and house price volatility.

Figure 4.3: Drivers of house prices and house price volatility



Source: Author's computation

Other factors such as income, unemployment, inflation, money supply and demographics are also considered significant factors. Unemployment is viewed to have the same impact on house prices as GDP. Unemployment implies lower or no incomes, hence a rise would mean only a few people will demand housing leading to a fall in their prices and vice versa (Gathuru, 2014). Nguyen as cited in Gathuru (2014) added that, although overlooked,

demographics such as age, race and gender are also significant determinants. Moreover, Goodhart (as cited in Pillaiyan, 2015) explained that an increase in money supply will lead to an increase in house prices and found that money growth has a positive and significant influence on house prices. Inflation has an indirect impact on house prices and it is theoretically expected that a rise in it pushes house prices up due to a higher construction cost. On the other hand, a positive relationship is expected between income and house prices.

To sum up, Tupenaite et al., (2017) in their study established that economic indicators including GDP, interest rates and mortgage loans have significant impacts on housing market fluctuations. Given this background, the following relationships listed in table 4.3 are expected between house price volatility and the selected determinants.

Table 4.3: Expected Relationships

Variable	Expected Sign
Prime Lending Rate	Positive (+)
Gross Domestic Product	Positive (+)
Mortgage Loans	Positive (+)

Source: Author's compilation

4.4 Data Analysis

An approach similar to that of Hossain and Latif (2009) was adapted to examine the study's objectives. The study employed Autoregressive Conditional Heteroskedasticity (ARCH), Generalized Autoregressive Conditional Heteroskedastic (GARCH) models to determine if there is volatility in the Namibian housing market and then extracted a

Domestic Product (LNGDP_t) and mortgage loans (LNML_t). The multivariate Vector Autoregressive (VAR) model took the form:

$$\begin{pmatrix} VOLTY_t \\ PLR_t \\ GDP_t \\ ML_t \end{pmatrix} = \begin{pmatrix} C_1 \\ C_2 \\ C_3 \\ C_4 \end{pmatrix} + \begin{pmatrix} \phi_{11}^1 & \dots & \phi_{14}^1 \\ \vdots & \ddots & \vdots \\ \phi_{41}^1 & \dots & \phi_{44}^1 \end{pmatrix} \begin{pmatrix} VOLTY_{t-1} \\ PLR_{t-1} \\ GDP_{t-1} \\ ML_{t-1} \end{pmatrix} + \begin{pmatrix} \phi_{11}^2 & \dots & \phi_{14}^2 \\ \vdots & \ddots & \vdots \\ \phi_{41}^2 & \dots & \phi_{44}^2 \end{pmatrix} \begin{pmatrix} VOLTY_{t-2} \\ PLR_{t-2} \\ GDP_{t-2} \\ ML_{t-2} \end{pmatrix} + \dots \\ + \begin{pmatrix} \phi_{11}^4 & \dots & \phi_{14}^4 \\ \vdots & \ddots & \vdots \\ \phi_{41}^4 & \dots & \phi_{44}^4 \end{pmatrix} \begin{pmatrix} VOLTY_{t-\rho} \\ PLR_{t-\rho} \\ GDP_{t-\rho} \\ ML_{t-\rho} \end{pmatrix} + \begin{pmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \\ \varepsilon_{4t} \end{pmatrix} \quad \varepsilon_t \sim IN(0, \Sigma) \dots \dots \dots (4)$$

Where the Cs are vectors of constants, ϕ s are vectors of coefficients and ε s are the error terms or impulses. The steps involved in the VAR regression analysis are outlined in the following sub sections.

4.4.2.1 Testing for Stationarity

The first step in VAR models is to investigate the series’ unit root characteristics and determine the order of integration. According to Brooks (2008), testing for stationarity is relevant because a variable’s stationarity properties can have a strong impact on its behaviour and the regression of a nonstationary series on another may produce nonsensical results. Moreover, time series data usually has trends over time, hence they contain unit root (Sheefeni, 2013). The concept of being stationary implies that the variable has constant mean, variance and autocovariances (Brooks 2008). Hence, it’s imperative to investigate its characteristics to avoid problems of misleading results which might imply a significant relationship between variables although such a relationship does not really exist. Sheefeni and Nyambe, (2016) stated that the econometric technique to use for estimation is determined by the unit root test. If the variables are stationary at levels, the

Ordinary Least Squares (OLS) method can be applied for estimations, otherwise they must be differenced until they become stationary and then other methods can be applied. There exist a number of unit root tests namely Augmented Dickey Fuller (ADF), Phillips and Perron (PP), Kwiatkowski-Phillips-Schmidt-Shin (KPSS) and modified Dickey-Fuller (DF) (Sheefeni & Nyambe, 2016).

The order of integration means the number of times a series is differenced before it becomes stationary (Wickremasinghe, 2005). Variables are said to be integrated of order zero if they are stationary in levels and of order one if they only become stationary after the first difference. Gujarati (2003) stated that the null hypothesis for unit root tests is that, the variable under consideration contains a unit root and it is tested against the alternative hypothesis that the variable is stationary. In testing for unit root characteristics of the variables, the study employed the ADF and PP tests. This is because most Dickey Fuller tests have limitations including that of lower power as they tend to accept the null hypothesis more often than necessary, thereby finding that a variable is nonstationary even when it is stationary (Gujarati, 2003). Hence it is important that a confirmatory test, in this case the PP test was conducted.

4.4.2.2 Testing for Cointegration

Once the unit root process is examined, the next step is to test for cointegration. If two or more series are found to be non-stationary but their linear combination is, then they are known to be cointegrated. Variables are said to be cointegrated if a long term relationship exists between them (Gujarati, 2003). This implies that the series move together in the long run, but not at the same rate. Cointegration relationships among variables can be

established by applying either the Engle-Granger Test, the Cointegration Regression Durbin-Watson (CRDW) test or the Johansen cointegration test (Sheefeni, 2013). If cointegration is found among the series, the short-run adjustment to the long run equilibrium can be obtained using the Vector Error Correction Model (VECM), otherwise a VAR Short run analysis is conducted (Sheefeni, 2015). Since this is a multivariate model, the study employed the Johansen cointegration test approach which according to Brooks (2008) is based on two statistics, the Trace and Maximum Eigen. The decision rule is that, if the test statistic is greater than the critical value, reject the null hypothesis and conclude that a long run relationship exists among the variables and the opposite holds when the critical value is greater.

4.2.2.3 Determination of Optimal Lag Length

When running regressions on time series data, it is vital to include lagged values of all variables in the specified model. The determination of a proper lag structure has a great effect on subsequent inferences, whether they are about causality, cointegration or forecasting (Gonzalo & Pitarakis, 2000). Brooks (2008) however indicated that there is often confusion about the proper lag to use in a VAR and the period which variables take to work through the system. Additionally, caution should be taking when deciding on the number of lags because choosing too few lags may result in misspecification and too many lags could result in the loss of degrees of freedom (Gujarati, 2003). However there are ways of choosing an optimal lag, including the information criteria. These criteria are Hannan-Quinn (HQ), Schwarz Information Criterion (SC), Akaike Information Criterion (AIC), Final Prediction Error (FPE) and Likelihood Ratio (LR) (Sheefeni, 2015).

There is often confusion regarding which criterion is most appropriate in determining the optimal lag. Theoretically, SC and HQ lead to the most accurate results in both stationary and non-stationary systems, whereas AIC is characterized by a positive limiting probability of over fitting (Gonzalo & Pitarakis, 2000). Brooks (2008) also noted that although SIC is strongly consistent, it is inefficient while the AIC is inconsistent, but generally more efficient. However, one cannot say for sure which criterion is the best.

4.4.2.4 Testing for the Stability of the model

After estimating the VAR/VECM model, it is imperative that it is post tested for stability and serial correlation issues among others. The essence of this is to determine the authenticity, reliability and validity of the results that will be generated. For the stability test, the sufficient and necessary condition for a model to be considered stable is that all characteristic roots lie inside the unit circle or the moduli should lie within the range -1 and 1.

4.4.2.5 Testing for Causality

Although a long run relationship is found amongst variables implying that there is causality in at least one direction, it still does not prove the exact direction of influence. Therefore, the essence of a causality test is to determine whether one time series is good for forecasting the other or vice versa. The Granger representation theorem states that, if two time series share a long run relationship and they are both integrated of order one, $I(1)$, then either one must Granger cause the other (Gujarati, 2003). The implication of this is that, cointegration and the order of integration need to be established first, otherwise testing for causality would be meaningless. Lin (2006), stated that the Granger causality

test is based on assumptions that the past predicts the future and not the other way around and that a cause has information about an impact that cannot be found anywhere else.

In analysing the causal relationship between house price volatility and its determinants, the study employed the Granger causality test. Gujarati (2003) stated that since the past comes before the future and if A causes B, then changes in A should happen before changes in B. Hence if including lags of A in a regression of B on other variables plus its own lags improves the forecast of B, then it can be concluded that A Granger causes B and vice versa. There are two ways to state what type of causality relationship exist between variables in the system. On one hand, if A Granger causes B, and not vice versa, then it can be said that there is unidirectional causality from A to B (Brooks, 2008). On the other hand, if A Granger causes B and in turn B causes A, then it can be concluded that there is bi-directional causality. Brooks (2008) however cautioned that Granger causality does not mean movements in one variable are responsible for changes in the other. It simply means there is correlation between the current value of one variable and the past values of others.

4.4.2.6 Impulse Response Function (IRF)

The next step in the VAR system is to check for impulse response function since causality tests alone do not give much details about the interaction between variables. It is therefore important to know how one variable responds to shocks in all other variables in the system. Impulse responses trace out the response of the dependent variables to one standard deviation shock to other variables in the VAR (Brooks, 2008). Hence, for each variable in

each equation separately, a unit shock is applied to the error, and the effects over time are noted. Furthermore, if variables are nonstationary and share a long run relationship, then the estimated impulse response function is more consistent and would give best estimates in error correction models than it would in VAR models (Lin, 2006). Hossain and Latif (2009) stated that although variance decompositions indicate how much of the variability in the dependent variable an independent variable is responsible for, it does not show whether the impact is negative or positive or whether it is transitory or permanent. Impulse responses on the other hand show the system's dynamic behaviour. For this reason, the Impulse Response Function Exercise was carried out through the Vector Error Correction Model.

The paper made use of the Generalized Impulse Response Function (GIRF) instead of the Cholesky decomposition. This is due to the fact that Cholesky has an issue of ordering variables from top to bottom but not the other way around. To avoid this, Lin (2006) urged that the GIRF is more reliable since it is not affected by the problem of ordering variables.

4.4.2.7 Forecast Error Variance Decomposition

Hossain and Latif (2009) stated that Granger causality tests do not expose much information on how much a change in a variable contributes to fluctuations in another variable. However the variance decomposition (VDC) analysis shows exactly how a shock to one variable influences changes in another. It separates the total variance in the dependent variable for each future periods and indicates how much of this change each independent variable is responsible for. Hence analysing variance decompositions, which is an alternative method to the impulse response functions for examining the effects of shocks to the dependent variable is the final step in VAR.

Variance decompositions provide information on how much of the forecast variance for any variable in a model is explained by innovations to each independent variable over a period of time (Brooks 2008). It can be noted that own shocks usually explain most of the forecast error variance in the variable, but would also be transmitted to all other variables in the system through the dynamic structure.

4.5 Research Ethics

Research ethics are moral principles that have been laid down, are widely accepted and involve setting rules about how to treat the information gathered for research (Robson, as cited in Adere, 2013). Therefore, researchers are required to take ethical issues into consideration when collecting and analyzing data. For this reason, this study acknowledges all sources of information and data using the American Psychological Association (APA) referencing style. Only sources cited in-text appear in the reference list. For analysis, results are reported as obtained from the regression analysis and no modification took place. Conclusions and recommendations are also only based on the study's findings.

4.6 Conclusion

This chapter discussed the research design, conceptual framework, the models used for estimations and research ethics. It was indicated that due to its nature, the study followed an experimental research design and a quantitative approach. Expected relationships between the dependent and independent variables were also listed in this chapter. It was further specified that ARCH and GARCH models were used to determine if house prices in Namibia are volatile and how persistent the volatility is. All steps followed in VAR to establish the drivers of house price volatility and causal links, from unit root testing to

variance decompositions were outlined. The findings from the regressions are discussed in the next chapter.

CHAPTER FIVE: ANALYSIS AND DISCUSSIONS OF EMPIRICAL FINDINGS

5.1 Introduction

Chapter five discusses the empirical results of the study which are analysed in the following sequence: section 5.2 discusses findings from the ARCH and GARCH models while section 5.3 looks at the findings of the VAR analysis. Section 5.3 is divided into subsection to discuss the findings of unit root tests, Johansen cointegration, optimal lag length, , VECM model, diagnostic tests, Granger causality test, impulse response functions and the variance decompositions.

5.2 Testing for the presence of price volatility and its persistence in the Namibian housing market

Tables 5.2.1 to 5.2.3 present the results of the ARCH (1, 0), GARCH (0, 1) GARCH (1, 1) models. These models were all applied for confirmation and to see which method yields the best results regarding house price volatility and its persistence. From table 5.2.1, the residual term is significant with a p-value of 0.004 suggesting that the null hypothesis of no ARCH effect can be rejected at the 5 percent level of significance. The presence of heteroskedasticity in the model means that house prices are volatile in Namibia. It was alluded to earlier that the GARCH model performs better than the ARCH, hence the GARCH (0, 1) which excludes an ARCH term and the GARCH (1, 1) were modeled. The number of lags in the GARCH model makes no empirical difference, as GARCH (0, 1) and GARCH (1, 1) generate almost identical estimation of volatility. From table 5.2.2, the GARCH term is significant at the 5 percent level, confirming that house prices are indeed volatile in Namibia. These results confirm the findings of Miller and Peng (2004); Hossain and Latif (2009), Tu and Zhou (2015) who tested for the presence of volatility in housing

markets through similar approaches. Table 5.2.3 shows the GARCH (1, 1) results and shows that the summation of alpha (ARCH term) and beta (GARH term) is 0.997 and are both significant at the five percent level of significance. According to Dlamini (2014), the rule of thumb is that this summation should be close to one in order to conclude that volatility is persistent. Hence, the value of 0.997 is close to unity, suggesting that house price volatility is highly persistent or has long lasting effects in Namibia. Given that the presence of volatility was found, the study further employed the VAR/VECM models to identify the determinants of this volatility.

Table 5.2.1: ARCH (1, 0)

Variable	Coefficient	P-Value
Constant	6.459	0.000**
RESID ² (-1)	-0.139	0.004**

Source: Author's compilation and values obtained from Eviews

*Note: ** denote 5% level of significance and resid²(-1) is the ARCH term*

Table 5.2.2: GARCH (0, 1)

Variable	Coefficient	P-Value
Constant	0.586	0.437**
GARCH(-1)	0.917	0.000**

Source: Author's compilation and values obtained from Eviews

*Note: ** denote 5% level of significance and GARCH (-1) is the GARCH term*

Table 5.2.3: GARCH (1, 1)

Variable	Coefficient	P-Value
Constant	0.227	0.675
RESID(-1)^2	-0.214	0.012**
GARCH(-1)	1.211	0.000**

Source: Author's compilation and values obtained from Eviews

Note: resid^2(-1) and GARCH (-1) denote the ARCH and GARCH terms respectively

5.3 VAR Analysis of the Determinants of House Price Volatility in Namibia

5.3.1 Unit Root Tests Results

It was mentioned that the importance of testing for unit root revolves around examining the stationarity of time series data. To identify the order of integration of all the variables, this study employed the Augmented Dickey Fuller (ADF) and Phillips-Perrons (PP) tests. Two different tests were used in order to ensure the robustness of the results. The unit root tests' results are presented in table 5.3.1 below.

Table 5.3.1: Unit root tests: ADF and PP in levels and first differences

Variable	Model Specification	ADF	PP	ADF	PP	Order of Integration
		Levels	Levels	First Difference	First Difference	
	Intercept	-1.210	-1.448	-3.419**	-3.409**	I (1)

Lnvolty_t	Trend and Intercept	-1.737	-1.627	-3.762**	-3.632**	I (1)
Lnplr_t	Intercept	-1.362	-1.412	-1.511	-4.371**	I (1)
	Trend and Intercept	-0.458	-0.672	-4.663**	-4.510**	I (1)
Lngdp_t	Intercept	-0.464	-4.451	-6.446**	-15.825**	I (1)
	Trend and Intercept	-4.366**	-4.373**	-6.352**	-18.673**	I (1)
Lnml_t	Intercept	-0.193	-0.194	-6.137**	-6.136**	I (1)
	Trend and Intercept	-1.748	-1.779	-6.056**	-6.055**	I (1)

Source: Author's compilation and values obtained from Eviews

*Notes: ** denote stationarity at 5% significance level.*

Table 5.3.1 shows that all variables contain a unit root in levels, thus accepting the null hypothesis of non-stationarity. This is however in exception of GDP which shows conflicting results with both ADF and PP statistics showing significance at five percent when regressed with a trend and intercept. It is noteworthy that in order to use the VAR/VECM models, all variables are required to be stationary. Hence, all variables were differenced once and all became stationary at the five percent level of significance, although the ADF statistic for prime lending rate with intercept showed contradicting results that it is not stationary. That is to say that shocks to the variables are not permanent and the effect would disappear and revert to its long run. It can therefore be concluded

that all variables used in the model are integrated of order one and are fit to be estimated through the VECM.

5.3.2 Cointegration Test

Since all variables were nonstationary in levels and are all integrated of the same order, I(1), the Johansen cointegration test based on Trace and Maximum Eigen values test statistics was conducted to test for a long run relationship. From the results presented in table 5.3.2, the Trace test indicates three cointegrating equations, while the Maximum Eigen test indicate one cointegrating equation for the endogenous series during the sample period at the five percent significance level. This is because the statistics are greater than the critical values, therefore rejecting the null hypothesis of no cointegrating variables. It is worth noting that the Trace test give more reliable results than the Maximum Eigen test. Hence, conclusions are based on the Trace test, i.e. there are three cointegrating equations.

In the context of the study, the presence of cointegration imply that house price volatility, interest rates , gross domestic product and mortgage loans share a long term relationship. It means that changes in either variable have a long lasting effect on other variables. Therefore the study further conducted long run analysis through the VECM.

Table 5.3.2: Johansen Cointegration Test Results

Trace Test				Maximum Eigen Test			
$H_0: \text{rank}=r$	$H_a: \text{rank}=r$	Statistic	95% critical value	$H_0: \text{rank}=r$	$H_a: \text{rank}=r$	Statistic	95% critical value
$r=0$	$r=1$	58.934	40.175**	$r=0$	$r \geq 1$	29.561	24.159**

r<=1	r=2	29.372	24.276**	r<=1	r>=2	14.413	17.797
r<=2	r=3	14.959	12.321**	r<=2	r>=3	13.476	11.225
r<=3	r=4	1.483	4.129	r<=3	r<=4	1.483	4.129

Source: Author's compilation and values obtained from Eviews

*Notes: Trace test indicate three cointegrating equations, while Max-Eigen test indicate one cointegrating equation at the 0.05 level (**). The reported results are for the tests with no deterministic trend and intercept.*

5.3.3 Determination of the Optimal Lag Length

According to Sunde and Muzindutsi (2017), estimations of lag orders (p) in a VAR (p) model are built on lag order selection statistics. For this study, the optimum lag length was selected based on various information criteria. Particularly, the lag length criteria was set based on the Log Likelihood Ratio (LR), Final Prediction Error (FPE), Akaike Information Criterion (AIC), Schwarz Information Criterion (SIC) and Hannan-Quinn criterion (HQ). As aforementioned, there is usually confusion regarding which criteria gives most accurate results. However there is an opinion that the Hannan-Quinn and Schwarz criterion perform best.

Table 5.3.3 show the test statistics for the above mentioned criteria, for all of the full VARs of an order less than or equal to three. The LR, FPE, SIC and HQ statistics suggest a lag length of one while the AIC test suggest a lag length of three. However, since the majority tests select a lag of one at the 5 percent significance level including the Hannan-Quinn and Schwarz which are hypothesized to work better, the study uses a lag of one or a VAR (1) model.

Table 5.3.3: Lag Order Selection

Lag	LogL	LR	FPE	AIC	SC	HQ
0	50.217	NA	9.66e-07	-2.498	-2.324	-2.437
1	244.965	336.862*	6.19e-11*	-12.160	-11.289*	-11.853*
2	259.675	22.264	6.86e-11	-12.091	-10.523	-11.538
3	278.323	24.192	6.48e-11	-12.234*	-9.969	-11.436
* indicates lag order selected by the criterion						
LR: Sequential Modified LR Test Statistic (each test at 5% level)						
FPE: Final Prediction Error						
Aic: Akaike Information Criterion						
SC: Schwarz Information Criterion						
HQ: Hanan-Quinn Information Criterion						

Source: Author's compilation and values obtained from Eviews

5.3.4 The Determinants of House Price Volatility in Namibia

Since cointegration was found among the variables, the Vector Error Correction Model (VECM) was estimated. Equation 5 below shows the general VECM model (taken from Eviews) that was estimated to obtain the results presented in table 5.3.4. In the equation, C (1) and C (2) represent the Error Correction Terms (ECT) for each cointegrating equation and give information about the speed of adjustment of volatility to its long run equilibrium, whereas C(3) to C(10) represent the short run coefficients.

$$\begin{aligned}
D(LNVOLTY) = & C(1) \\
& * \left(LNVOLTY(-1) - 3.41597451719 * LNGDP(-1) \right. \\
& + 3.59948790473 * LNML(-1) + C(2) \\
& * \left(LNPLR(-1) - 0.726146587476 * LNGDP(-1) + 0.42130039003 \right. \\
& * LNML(-1) + C(3) * D(LNVOLTY(-1)) + C(4) \\
& * D(LNVOLTY(-2)) + C(5) * D(LNPLR(-1)) + C(6) \\
& * D(LNPLR(-2)) + C(7) * D(LNGDP(-1)) + C(8) \\
& * D(LNGDP(-2)) + C(9) * DLNML(-1) \left. \right) + C(10) \\
& * D(LNML(-2)) \left. \right) \dots \dots \dots (5)
\end{aligned}$$

The estimated parameters of the modelling technique are presented in Table 5.3.4. Interpretations focused on variables that statistically significant affect house price volatility. Particularly, they focus on the dynamic response of house price volatility to exogenous changes in volatility itself, GDP and mortgage loans. The first important finding is that a one percent increase in past volatility would significantly increase current volatility by 0.67 percent. This implies that if house prices are volatile this quarter, people should expect it to even be more volatile in the next quarter. This finding confirm the result of Miller and Peng (2004) and Savva and Michail (2017). The second important, but surprising finding is that a one percent increase in GDP result into a 5.45 percent decrease in the house price volatility. This contradicts the economic theory that there is a positive relationship between the variables but concur with findings by Reen and Razali (2016) and Tupenaite et al. (2017) that GDP is one of the most significant macroeconomic determinant of house price dynamics. The findings suggest that an increase in GDP is

good for the Namibian economy as it reduces volatility in the housing market, which is known to cause uncertainties. Savva and Michail (2017) explained that credit expansion attracts investors to the housing market thereby increasing speculations, hence lead to an increase in house price volatility. This can be confirmed by the third significant finding that, if mortgage loans for the past two quarters increased by one percent, volatility would increase by 15.09 percent. This finding is in line with Mansor et al., as cited in Pillaiyan (2015) that there is a positive and long run relationship between the series and that of Tupenaite et al., (2017) who found housing mortgages significant. The implication is that increased mortgage loans are undesirable because they increase volatility which was said to cause problems at a macroeconomic level. Moreover, banks give loans mainly to finance housing as it alluded to earlier in chapter two. When people are given more mortgage loans, they are able to afford houses which in turn lead to an upward trend in house prices as suggested by the findings. The findings are also in line with Sunde and Muzindutsi (2017), who discovered a positive link between house prices and mortgage loans.

The impact of an increase in the prime lending rate is insignificant although the coefficient shows a positive relationship when lagged twice. These findings are in line with Kim et al. (2011) and Lee (2009) who found that lending rates are not a significant determinant of house prices and house price volatility, but inconsistent with Reen and Razali (2016) and Tupenaite et al. (2017) who found the variable to be a significant determinant.

Additionally, the coefficient of the error correction term for the first cointegrating equation indicates that it takes about 0.31 percent for house price volatility to adjust to its long run equilibrium and it is significant at the 5 percent level. The coefficient for the

second cointegration equation error term is insignificant. Moreover, the adjusted coefficient of determination value of 0.42 percent means that the independent variables account for 0.42 percent of the variations in house price volatility. Both the Durbin Watson (DW) statistic and Lagrange Multiplier (LM) test fail to reject the null hypothesis of no serial correlation. In the same vein, the ARCH probability value indicate the absence of heteroskedasticity among the variables while the cumulative sum (CUSUM) test suggests that the estimated model is stable at the 5 percent level of significance. In a nutshell, the performance of these diagnostic tests imply that the obtained findings are reliable which confirms the rigour of the analysis conducted.

Table 5.3.4 VECM Model Results

Dependent Variable: LNVOLTY		
Variable	Coefficient	P-Value
ECT _{1t-1}	-0.309	0.003**
ECT _{2t-1}	-0.564	0.444
Δ LN _{VOLTY} _{t-1}	0.672	0.003**
Δ LN _{VOLTY} _{t-2}	-0.302	0.874
Δ LN _{PLR} _{t-1}	-1.649	0.406
Δ LN _{PLR} _{t-2}	1.233	0.550
Δ LN _{GDP} _{t-1}	1.349	0.443
Δ LN _{GDP} _{t-2}	-5.448	0.005**
Δ LN _{ML} _{t-1}	10.715	0.168
Δ LN _{ML} _{t-2}	15.087	0.037**

Adjusted R-Square	0.422
Diagnostic Tests	
Durbin-Watson (DW)	1.625
LM-test	11.729 (0.762)
ARCH	-0.112 (0.661)
CUSUM Test	Stable**

Source: Author's own work and values obtained from Eviews

*Note: ** indicate 5% significance level. The figures in brackets on the diagnostic tests are the probability values. The reported results are for the tests with no intercept or trend.*

5.3.5 Post Estimation Diagnostic

It is necessary to analyze the post estimation diagnostic of the whole VECM model to determine whether its results can be trusted or if the model is stable so that it can be corrected if it is unstable to avoid misleading results. To achieve this, the study uses the Lagrange Multiplier (LM) test for autocorrelation and the VECM stability test. If these tests give good results, then it can be concluded that the results of the model can be considered valid and authentic. The results of these diagnostic tests are presented below. To begin with, table 5.3.5.1 summarizes the results for autocorrelation disturbance terms for the whole model. The Lagrange Multiplier test fails to reject the null hypothesis of no autocorrelation of residuals at the five percent level of significance since all the probability values are greater than 0.05. Secondly, the entire model's estimated stability test results are presented in table 5.3.5.2. As per the rule of thumb, a model satisfies the stability

condition if the Eigen-values or the roots lie within the range -1 and 1. The VECM specification used imposes three unit roots and the rest of the roots in the model have moduli that are less than one. The latter results imply that the model estimated is stable and the variables are fit for further regressions.

Table 5.3.5.1 Lagrange Multiplier test for autocorrelation

Lags	LM-Stat	Probability
1	11.729	0.762
2	5.741	0.991

Source: Author's Compilation

Table 5.3.5.2 Roots of Characteristic Polynomial

Root	Modulus
1.000000	1.000000
1.000000	1.000000
1.000000	1.000000
-0.075900 - 0.828607i	0.832076
-0.075900 + 0.828607i	0.832076
0.733770 - 0.084537i	0.738624
0.733770 + 0.084537i	0.738624
-0.664107	0.664107
0.184732 - 0.459150i	0.494919
0.184732 + 0.459150i	0.494919
-0.292900	0.292900

0.275713	0.275713
----------	----------

Source: Author's compilation

Notes: the VECM specification imposes 3 unit roots

5.3.6 Granger Causality Test

In this section, the VEC Granger Causality/Block Exogeneity Wald test was employed to determine the causal relationship between house price volatility and its determinants as per the objectives. Table 5.3.6 reports the results. According to the results, there exist significant evidence of unidirectional causality from GDP and mortgage loans to house price volatility. As noted earlier, Granger causality does not imply that movements in one variable are responsible for movements in another but that there is correlation between lagged values of the independent and future values of the dependent variable. Hence the implication of these results is that, movements in GDP and mortgage loans rates significantly help predict the variations in house price volatility. In other words, it means there is a correlation between past values of GDP and mortgage rates and current values of house prices i.e. changes in the former variables should take place before changes in the later. The causation of GDP on volatility can be confirmed by Hossain and Latif (2009). Moreover, the findings are different from the findings of Tu and Zhou (2015) who find causality between interest rates and house price volatility, but in line with Hossain and Latif (2009) who found no causality between lending rates and house price fluctuations. It can then be concluded that current changes in GDP and mortgage loans can give an indication of what is likely to happen in the housing market in the future.

Table 5.3.6: VEC Granger Causality/Block Exogeneity Wald test

Dependent variables				
Regressors	LNVOLY _t	LNPLR _t	LNBDP _t	LNML _t
LNVOLY _t	0.00	0.989	0.290	0.429
LNPLR _t	0.439	0.00	0.249	0.263
LNBDP _t	0.001**	0.017**	0.00	0.019**
LNML _t	0.089*	0.159	0.000**	0.00

Source: Author's compilation and values obtained from Eviews

*Note: ** and * indicate significance at the 5% and 10% levels respectively.*

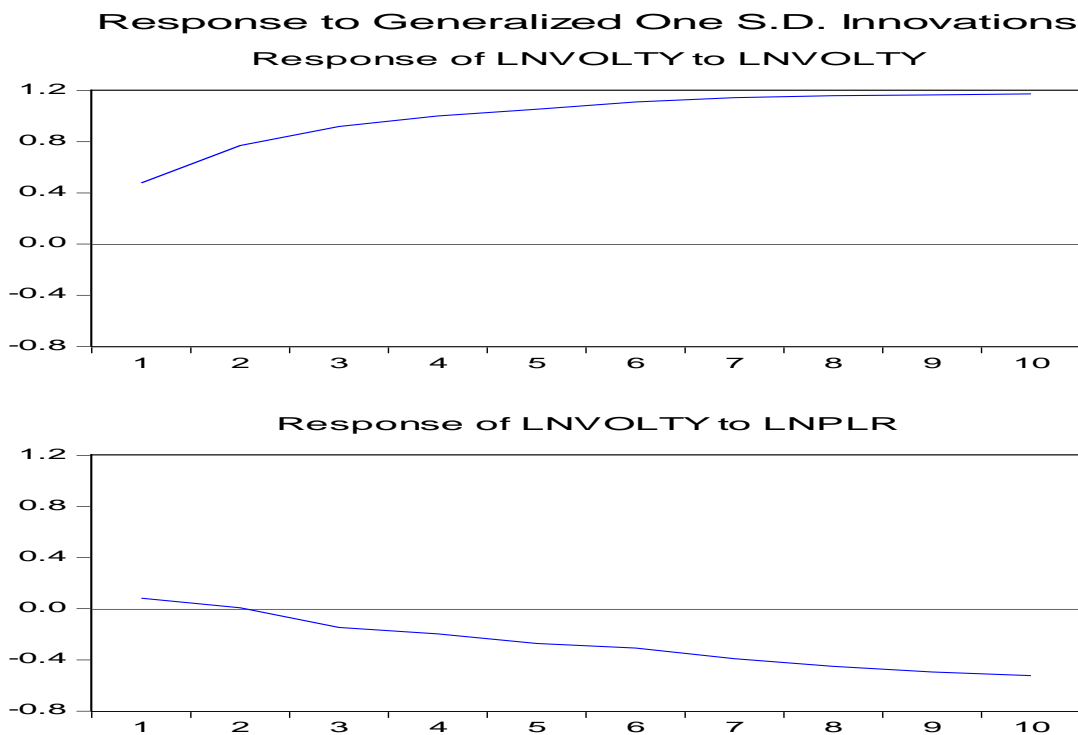
5.3.7 The Impulse Response Functions Analysis

An impulse response function shows how a variable in the VAR system responds to a one standard deviation innovation in other variables of interest (Hossain & Latif, 2009). Since the impulse responses are sensitive to the ordering of the variables, the generalized form was used. Figures 5.3.7.1 to 5.3.7.3 demonstrate the impulse response functions showing the dynamic behaviour of housing price volatility due to random shocks in the volatility itself, prime lending rate, GDP and mortgage loans.

Figure 5.3.7.1 shows how house price volatility responds to an exogenous increase in itself and to an increase in prime lending rates. The upper graph in the figure shows that an exogenous increase in the volatility magnifies the volatility level in subsequent quarters and the impact seems to be permanent as it does not die out. This suggests that if citizens experience house price volatility in the current period, they should also expect it in the next period. This finding confirms that of Miller and Peng (2004). The next observation

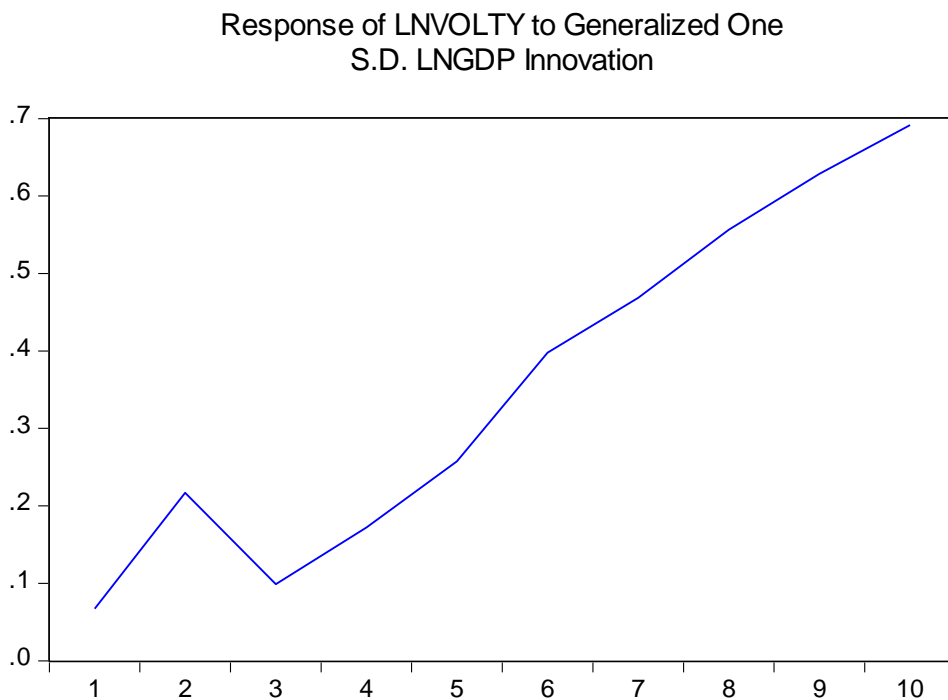
is that an exogenous increase in the prime lending rate mitigates volatility. As figure 5.3.7.1 shows, the volatility begins to decrease immediately after the shock and the impact seems to be permanent as volatility kept on decreasing over the cycle without returning to its normal level. This implies that an increase in in prime lending rate is desirable for the Namibian citizens because it makes house prices less volatile and it was alluded to in chapter one that volatility in the housing market is problematic. Theoretically, there is a positive relationship between the variables, hence this results are contradicting. The results are also inconsistent with the findings of Hossain and Latif (2009) that a positive shock to interest rates increases house price volatility.

Figure 5.3.7.1 Response of house price volatility to a standard deviation shock in volatility and prime lending rates.



Source: Eviews

Figure 5.3.7.2 Response of house price volatility to a standard deviation shock in Gross Domestic Product



Source: Eviews

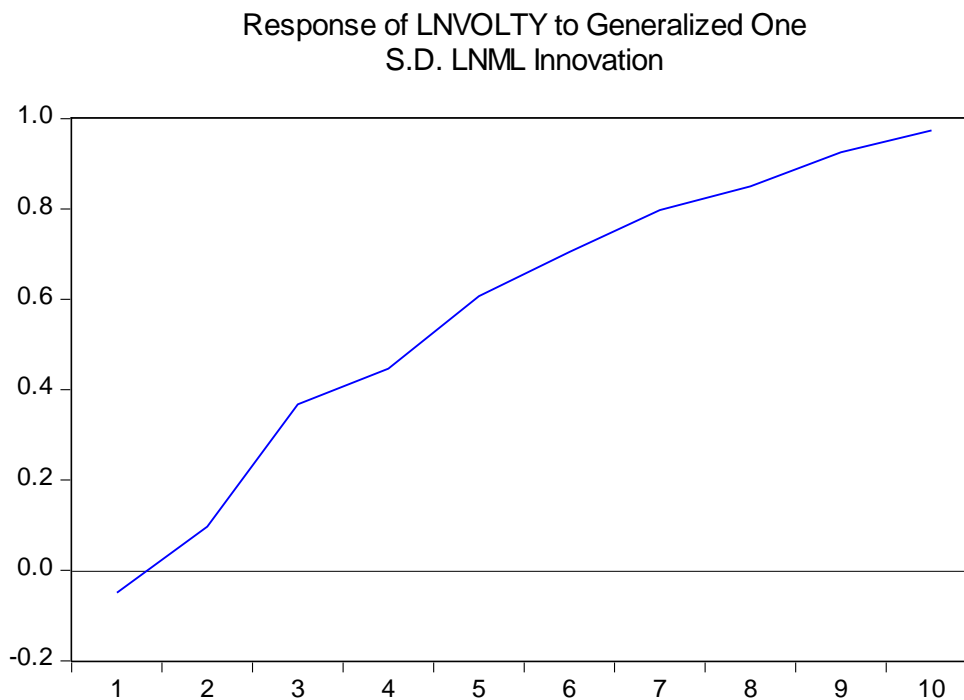
Figure 5.3.7.2 reveals how house price volatility responds to a transitory increase in the gross domestic product. The volatility peaks at about two percent higher than the equilibrium level two quarters after the positive shock. However, starts decreasing until the third quarter, then increases again for the rest of the quarters. This suggest that an increase in GDP can mitigate volatility in the short run but magnifies it in the long run and the effect is permanent. These results are quiet consistent with the findings of Hossain and Latif (2009) who discovered that positive shocks to the GDP growth rate magnify house price volatility, but contradicting at the same time. Hossain and Latif (2009) found that although a positive shock to GDP magnifies volatility the effect is temporary. The implication of this is that inasmuch as a rise in total output is desirable since it increases

GDP per capita, it is still undesirable because it creates another problem of making house prices more volatile.

Figure 5.3.7.3 demonstrates the impact of a positive shock emanating from mortgage loans on house price volatility. The figure shows that a transitory increase in mortgage loans leads to a rise in housing price volatility. The effect appears to be permanent as it does not die out after the shock. This results concur with those of Mansor et al. as cited in Pillaiyan (2015) who discovered that bank loans which include mortgage loans have significant impacts on house prices movements. It is also in line with the economic theory and the findings of Sunde and Muzindutsi (2017) that there is a positive link between house prices and mortgage loans.

In a nutshell, the impulse response function results confirm the cointegration test results that a movement in either variable will have long lasting effects on the others. It should be noted that, since volatility involves both upward and downward swings, the assumption of the study is that a rise in house price volatility signifies a rise in house prices and vice versa.

Figure 5.3.7.3: Response of house price volatility to a standard deviation shock in mortgage loans



Source: Eviews

5.3.8 Variance Decomposition (VDC) Analysis

As aforementioned, a Granger causality test alone does not reveal much information concerning the explanatory power of a variable to the variation in another but the variance decomposition does. The variance decomposition analysis can specifically show how much of the forecast error variance of house price volatility can be explained by exogenous shocks to other variables. It decomposes the total variance of the volatility in each of the future periods and determines how much of this variation each macroeconomic variable can explain. The VDC results are presented in table 5.3.8 for 9 quarters. In this case the variance decomposition indicate exactly how much of the variations in house price volatility that prime lending rate, GDP and mortgage loans explain. The results

demonstrate that the disturbance originating from the mortgage loans explains 16.22 percent of the variation in house price volatility after six quarters. Even after nine quarters, it still explains 18.65 percent of the variation. The results further show that, of the total variation in housing price volatility, the current volatility accounts for 70.76 percent after six quarters and 60.82 percent after nine quarters. Thus, mortgage loans and current volatility appear to be the most important variables that cause changes in house price volatility in Namibia. The same discovery was made in the VECM estimations. These two variables account for 93 percent of the variation in house price volatility after three quarters. The other two variables, prime lending rate and GDP do not account much for changes in volatility. For example, prime lending rates only contribute 5.66 percent, while GDP contributed 1.05 percent to the variations after three quarters. These results are quite consistent with Hosain and Latif (2009) who found that interest rates and GDP do not explain much of the variations in house price volatility. In their case mortgage rates explained a mere 2 percent and 3.5 percent of the variations in the dependent variable. It can however be observed that contributions from current volatility gradually decrease after the third quarter as the other variables' contributions increase. When analyzing the variance decompositions for the rest of the variables in the system, it can be seen that although it decreases with time, most of the variations in the variables are explained by own shocks with the rest of the variables in the system making minimal contributions. In a nutshell, it can be confirmed that macroeconomic variables do play a role in house price volatility analysis.

Table 5.3.8 Variance Decomposition Results

VARIANCE DECOMPOSITION OF LNVOLTY _t				
Period	LNVOLTY _t	LNPLR _t	LNGDP _t	LNML _t
1	100	0	0	0
3	84.286	5.665	1.052	8.997
6	70.769	10.134	2.874	16.222
9	60.816	13.502	7.366	18.653
VARIANCE DECOMPOSITION OF LNPLR _t				
PERIOD	LNPLR _t	LNVOLTY _t	LNGDP _t	LNML _t
1	96.878	3.122	0	0
3	67.376	1.127	28.889	2.607
6	29.788	0.368	67.664	2.180
9	17.821	0.280	80.139	1.683
VARIANCE DECOMPOSITION OF LNGDP _t				
PERIOD	LNGDP _t	LNVOLTY _t	LNPLR _t	LNML _t
1	93.569	1.958	4.472	0
3	72.991	9.519	6.249	11.242
6	68.409	10.270	7.542	13.778
9	67.566	11.015	8.502	13.241

VARIANCE DECOMPOSITION OF LNML _t				
PERIOD	LNML _t	LNVOLTY _t	LNPLR _t	LNGDP _t
1	85.835	1.083	6.486	6.595
3	66.124	2.619	10.539	20.717
6	48.178	2.693	15.651	33.477
9	40.307	2.479	18.124	39.090

Source: Author's own compilation and values obtained from Eviews

5.4 Conclusion

This chapter discussed both the ARCH/GARCH and VAR/VECM models empirical findings of the study. Firstly, the ARCH and GARCH models established that there is volatility in the Namibian housing market and that it is persistent. From the VAR analysis, the unit root test results showed that all variables contained a unit root and were integrated of order one. Moreover, the Johansen cointegration test discovered that there is a long run relationship between house prices and its determinants, hence further analysis were conducted through the VECM approach. An optimum lag of one was chosen based on the LR, FPE, SC and HQ criteria. Estimations of the VECM model revealed that volatility itself, GDP and mortgage loans significantly determine house price volatility. Furthermore, a unidirectional causality was found from GDP and mortgage loans to house price volatility. Finally, the IRF and VDC analysis showed that all selected macroeconomic variables, but interest rates have a long lasting positive impact on house price volatility and that mortgage loans and current volatility are the most important variables that explain the variation in house price volatility.

CHAPTER SIX: CONCLUSIONS AND POLICY RECOMMENDATIONS

6.1 Introduction

The previous chapter discussed the study's findings. This chapter therefore gives a summary of the whole study and recommendations. The chapter is divided into three sections. Firstly, section 6.2 concludes the study, while section 6.3 presents policy recommendations based on the empirical findings and section 6.4 discusses areas for further research.

6.2 Conclusions

This study analysed macroeconomic determinants of house price volatility and attempted to establish the direction of causality between volatility and its determinants using quarterly data for the period 2007 quarter 1- 2017 quarter 2 at the national level for Namibia. It was mentioned that the housing market plays an important role in the economy because of its links to other sectors. Due to its high demand, house prices are hypothesized to be more volatile than any other financial asset. However, house price fluctuations may have implications for an economy as it threatens financial stability and has significant negative effects at a macroeconomic level. It was also noted that house prices in Namibia are highly volatile, and the high housing prices experienced over the years in the country might lead to a price bubble in the future.

From the reviewed literature, empirical studies seemed to agree that house prices are indeed volatile and macroeconomic determinants do play a significant role. Most studies agreed on the macroeconomic determinants, while some findings were conflicting depending on the methodologies used and countries studied.

Furthermore, the ARCH and GARCH models were employed to determine whether house prices in Namibia are volatile and the level of persistence. The house price volatility series was estimated through the GARCH model. The Vector Autoregressive (VAR) model was used to study the dynamic interactions among the volatility and macroeconomic fundamentals namely the prime lending rate, GDP and mortgage loans.

The ARCH and GARCH analysis revealed that there is volatility in the Namibian housing market and it is highly persistent. From the unit root analysis, all variables were found stationary after the first difference through the ADF and PP unit root tests and concluded that they are all integrated of order one. The Johansen cointegration test based on the Trace and Maximum Eigen test statistics found that there is a long run relationship between the variable. Hence, suggesting that further analysis could be modeled through the VECM. A VAR (1) model estimated as suggested as suggested by various optimal lag length criteria. Added to that, the LM test indicated that variables are not serially correlated, whereas the VEC stability test declared the model stable.

Important results were observed from the VECM estimations. Firstly, it was found that volatility itself, mortgage loans and GDP were the most significant determinants of volatility. Surprisingly, GDP was found to have a negative impact, therefore contradicting findings of other researchers. As reviewed in the empirical literature, the prime lending rate was proven to play a minimum role in house price determination.

The Granger causality analysis seemed to confirm the findings of the VECM estimations that only mortgage loans and GDP help predict movement's in house price volatility. Particularly, a unidirectional causality was found from GDP and mortgage loans to house price volatility. Finally, the IRF and variance decomposition analysis were conducted. The

impulse response analysis showed that an exogenous increase in current volatility, GDP and mortgage loans magnify volatility in subsequent periods and the effects were permanent as they do not die out. A standard deviation shock to the prime lending rate however, mitigates house price volatility. It was concluded from the VDC analysis that mortgage loans and current volatility were the most important variables that cause changes in house price volatility in Namibia, while GDP and PLR contributions were minimal.

6.3 Policy Recommendations

The findings of the study have important policy implications which policy makers should pay special attention to and take action on. Firstly, housing is a very sensitive issue in Namibia especially to the households. Many citizens are desperately in need of permanent accommodation but the majority are left out of the market. Hence, policy makers should try by all means to consider the importance of including macroeconomic factors in the formulation of national housing policies. Specifically, they need to keep track of changes of these factors and understand their impacts on the housing sector in order to come up with better policies.

Since house price volatility is known to cause negative implications at a macroeconomic level, it is essential for the macroeconomic fundamentals that are linked to volatility to be closely monitored. For example, a rise in credit expansion implies high price volatility which is undesirable for citizens. The close relationship between mortgage and housing markets therefore has an important policy implication. The central bank, should monitor the growth in mortgage loans closely to ensure that its impact on house price volatility is minimal.

Lastly, the finding that an increase in real GDP has a negative impact on house price fluctuations suggest that the government should find more ways of improving or maintaining economic growth in order to mitigate house price volatility in Namibia.

6.4 Areas of Further Research

To the researcher's knowledge, this study is the first to analyse the macroeconomic determinants of house price volatility in Namibia which is extremely important given the significance of the housing sector in the economy. The study employed the GARCH and VAR/VECM techniques for analysis. The empirical findings are novel and provide a valuable insight into the dynamics of the Namibian housing market. However, it is obvious that the paper experienced challenges. For example, the sample size, the methodology and variables used. Surely, there are other factors that influence housing market dynamics. Henceforth, further research on this topic is highly recommended. Future researchers can include more variables such as income growth rate, unemployment rate, population growth rate and demographic changes.

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