PROPERTY MARKETS

- The GOOD the BAD, and the UGLY of March's economic and other news related to property

FNB PROPERTY MARKET ANALYTICS

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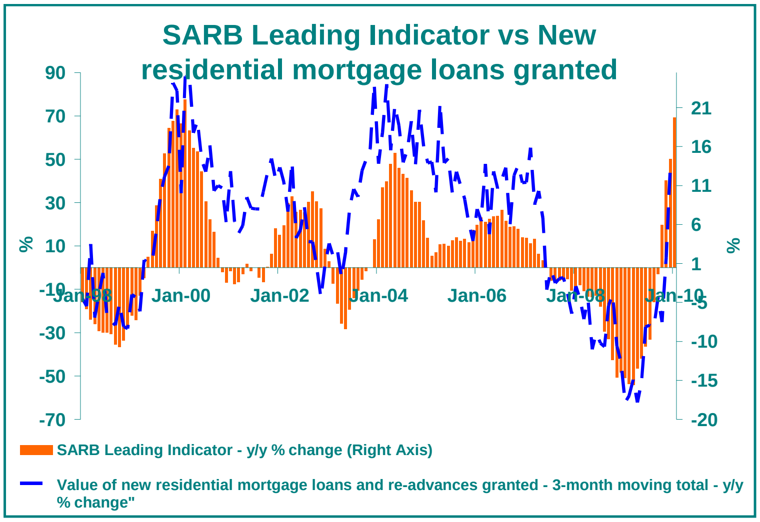
OVERVIEW

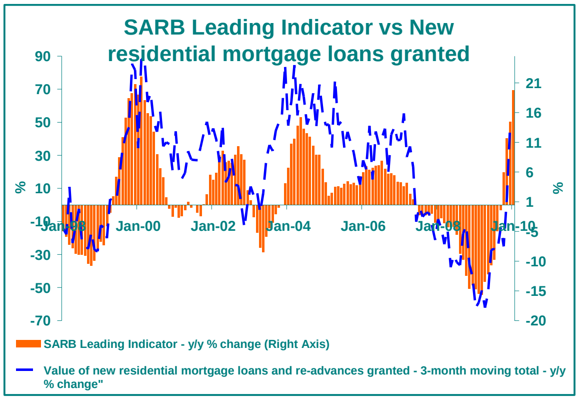
"The Good news is that data releases in March generally point to further strengthening in the economy, while consumer price inflation data improved, arguably precipitating a further 50 basis point interest rate cut

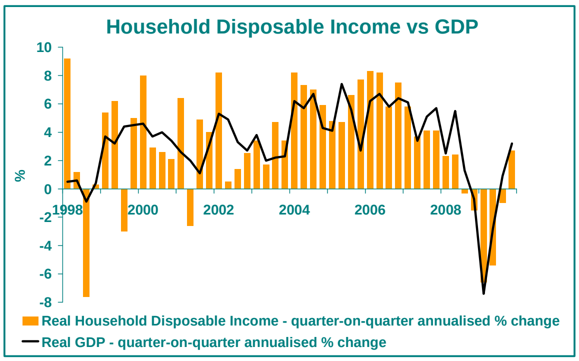
"The bad news regarded the ongoing high level of household indebtedness, which keeps the household sector highly vulnerable to any untoward shocks.

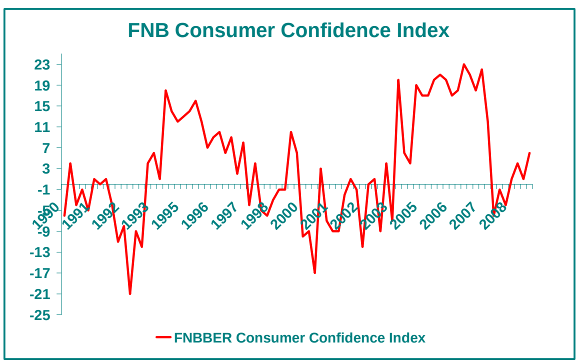
"The "Hate speech" issue has hit the headlines, posing some risk to sentiment in certain residential market segments, and this can lead to a renewed move to higher rates of emigration selling.

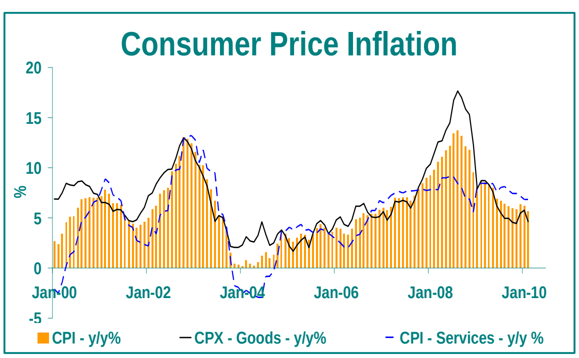
- *THE GOOD: Economic data releases and events were the shining light for property in March. The SARB's renewing of interest rate cutting was the most noticeable economic event, taking mortgage rates to the lowest level since a few decades ago. This rate cut came on the back of a drop in the February CPI figure, released last week too, to 5.7%. However, arguably a more important indicator was the SARB January Leading Business Cycle Indicator, whose growth rate actually accelerated, suggesting further economic growth improvement in the near term. And then, of course, we saw the release of the SARB Quarterly Bulletin, which showed a return to positive quarterly growth in real household disposable income, all very positive for residential property demand.*
- *THE BAD: The SARB Quarterly Bulletin also showed us that, despite improving economic indicators, the household sector's finances are still far from healthy. Nominal disposable income growth was too weak to exceed mediocre household credit growth, meaning an increase in the already-high household debt-to-disposable income ratio, as well as the household debt-service ratio (which is a good predictor of default rates on home loans). Patience is required, as reducing the debt ratio is normally a multi-year process, but for as long as the ratio remains so high the household sector remains at high risk to any unwanted shocks.*
- *THE UGLY: Political events have turned nasty, and SA's racial past has come back to haunt it in the form of renewed focus on the "hate speech" issue. For residential property, the risk is that emigration selling of property starts to rise again, shortly after having subsided since the 2008 emigration selling surge.*











THE GOOD: MARCH ECONOMIC INDICATORS GENERALLY BODE WELL FOR PROPERTY

SARB Leading Indicator jumps: Arguably the most positive economic news to be released last week was the SARB Leading Business Cycle Indicator, whose year-on-year growth rate accelerated to +19.3% for January. There is a very good correlation between new mortgage loans granted and the Leading Indicator, implying the probability of further growth acceleration in residential mortgage demand in the coming months.

New mortgage loan grants growing strongly: As it was, the SARB Quarterly Bulletin showed a large jump in the value of new mortgage loans and re-advances granted in December to 46.6% year-on-year, from November's +4.6%.

Real disposable income growth recovering: The SARB Quarterly Bulletin showed real disposable income growth, at least on a quarter-on-quarter annualised basis, returning to positive growth of +2.7%, after 5 consecutive quarters of decline as a result firstly of the big inflation surge to 2008 and then due to the economic recession.

Disposable income is tracking the economic growth recovery back into more solid territory, and it is thus not surprising that the 1st quarter FNB Consumer Confidence Index also rose .

Consumer Price Inflation plays ball: The consumer price index (CPI) for February showed a decline in year-on-year inflation from 6.2% in the previous month to 5.7%, implying that the rate is back in the SARB's target range of 3% to 6%.

The decline was the result of a decline in the CPI sub-index for goods. The contributors to the decline were "food and beverages", "clothing and footwear", and most significantly a decline in the transport sub-index's contribution as petrol price inflation declined in February.

The services index, by comparison, made no positive contribution, remaining at an unchanged inflation rate of 6.8% year-on-year, and the housing sub-index makes a major contribution to the "downward stickiness" of the overall services sub-index of the CPI..

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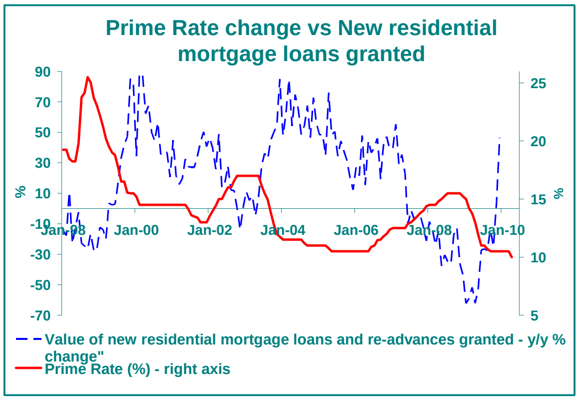
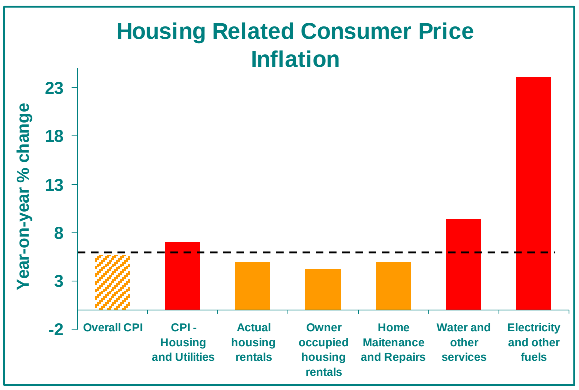
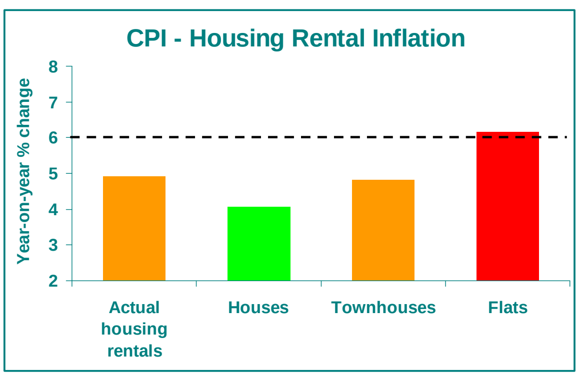






And down go interest rates again: Reacting on a good February inflation number, and citing improved inflation expectations, rand strength, greater certainty regarding electricity tariff hikes, and favourable food price developments, the SARB reduced its policy repo rate by a further half a percentage point, bringing prime rate down to 10%. This level was last seen almost 3 decades ago.

The cut makes a very small difference to bond repayments, but may well prove to be a significant confidence and sentiment booster for home buyers.

Sticking point – the CPI sub-index for housing: A less positive data release was the CPI – Housing sub-index. While the residential property sector relies heavily on interest rate cuts for stimulus, it is also very much part of the problem in the sense of working against lower interest rates. This, however, is not due to the housing market itself, but overwhelmingly due to utilities providing services to the housing market, most notably Eskom, along with cash-strapped municipalities eager to hike assessment rates on housing.

The rental market has been relatively weak in recent years, with many tenants under financial stress, and arguably an oversupply of buy-to-let property on the market (a hangover from the boom years where buy-to-let buying was very strong). As a result, the actual rentals sub-index of the CPI for housing recorded an inflation rate of 4.9% year-on-year in February (along with a low inflation rate in owner occupied rentals), which in turn helped to moderate the overall CPI - Housing inflation rate.

Nevertheless, the Housing index still recorded 7% year-on-year inflation as a result of sharp rates and utilities tariff increases. Leading the pack was the "electricity and other fuels" sub-index of the CPI-Housing Index, inflating by 24.1% year-on-year, while also troublesome was the "Water and other services" Index which was inflating at 9.4%.

The recent recession-driven financial stress can arguably be seen in a split in rental inflation by unit type, with Flats rental inflation at 6.2% being stronger than the larger-sized townhouse and house indices.

Box 1: Knight Frank sees SA "Prime" Property as one of the top performers globally.

The Knight Frank Prime International Residential Index results 2009

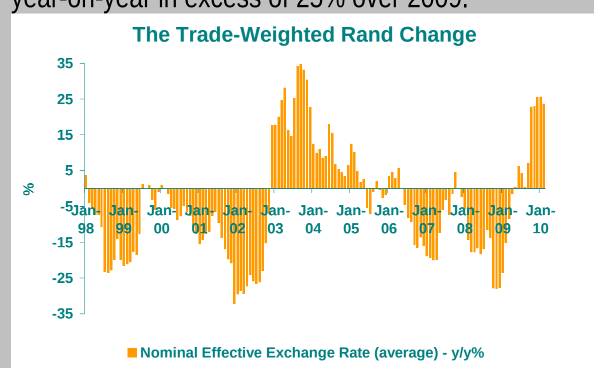
Rank	Country	Location	Annual % change, 12 months to December 2009
1	China	Shanghai	52.0%
2	China	Beijing	47.0%
3	China	Hong Kong	40.5%
4	South Africa	Johannesburg	17.0%
5	Singapore	Singapore	17.0%
6	Indonesia	Jakarta	14.0%
7	India	Mumbai	11.0%
8	Brazil	Rio de Janeiro	10.0%
9	UK	London	6.1%
10	USA	Washington DC	5.6%
11	Brazil	Sao Paulo	5.6%
12	Thailand	Bangkok	4.6%
13	South Africa	Cape Town	4.3%
14	UK	Home Counties	1.4%
15	Switzerland	Zurich	0.0%
16	Canada	Toronto	-0.5%
17	Australia	Sydney	-0.5%
18	Malaysia	Kuala Lumpur	-1.8%
20	Italy	Italian Lakes	-6.1%
21	Russia	Moscow	-6.3%
22	France	Cap Ferrat	-7.5%
23	France	Valbonne	-7.5%
24	France	St Tropez	-7.5%
25	Portugal	Central Algarve	-7.5%
26	France	Val d'Isere	-8.0%
27	Russia	St Petersburg	-8.9%
19		Cayman Islands	-10.0%
28	Switzerland	Geneva	-10.0%
29	UAE	Abu Dhabi	-10.0%
30	France	Megeve	-10.0%
31	France	Cannes	-10.0%
32	France	Provence	-10.0%
33	Mustique	Mustique	-10.0%
34	USA	The Hamptons	-11.0%
35	France	Paris	-12.0%
36	USA	Los Angeles	-12.1%
37	France	Courchevel	-12.4%
38	Japan	Tokyo	-12.5%
39	USA	Manhattan	-12.5%
40	France	Meribel	-12.6%
41	Italy	Umbria	-14.0%
42	Monaco	Monaco	-15.0%
43	USA	San Francisco	-15.7%
44	Italy	Tuscany	-16.0%
45	Ukraine	Kiev	-16.0%
46	France	Chamonix	-17.0%
47	France	Gascony	-17.0%
48	Spain	Mallorca	-17.0%
49	Italy	Florence	-18.0%
50	France	Bordeaux	-18.1%
51	France	Dordogne	-19.5%
52		Barbados	-20.0%
53	Spain	Palma	-22.0%
54	Ireland	Dublin	-25.0%
55	Portugal	Western Algarve	-30.0%
56	UAE	Dubai	-45.0%

While there exists a theory that a weak rand may be a quick fix for an uncompetitive export sector, this doesn't necessarily apply in the real world, and doesn't apply to SA's property sector.

Knight Frank's Prime International Residential Index results to end-2009 were launched last week, and showed Johannesburg (4th) and Cape Town (13th) high on a list of 56 prime international property markets in terms of capital growth performance. Knight Frank's definition of "prime property" is "the most desirable, and normally most expensive, property in a defined location. Commonly, but not exclusively, prime property markets will be areas where demand has a significant international bias."

The 17% inflation rate for the 12 months to December in Johannesburg's prime market should be largely due to rand strengthening over the period, making Joburg's returns impressive in major currency terms, while in times of widespread global price decline even Cape Town's 4.3% inflation rate impresses.

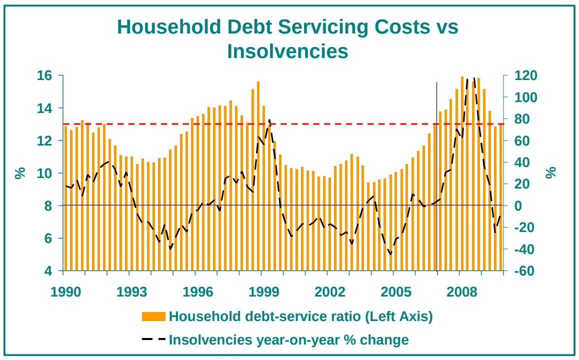
In trade-weighted terms, the rand has strengthened year-on-year in excess of 25% over 2009.

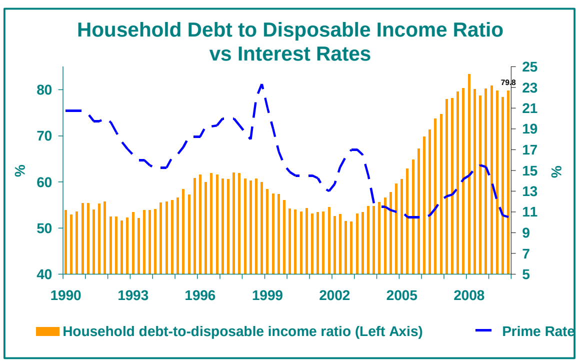


Why else would a strong rand performance be good for domestic property? A strong rand reflects strong net capital inflows, which are positive in easing the ability to raise capital for domestic investment necessary for economic growth, while a stronger currency drives more positive sentiment within the country. What's good for the economy is good for property.

Finally, a stronger currency can weaken net skilled labour "exports", curbing emigration selling of property, and slowing the "brain drain". For property performance, therefore, there are thus many good reasons to desire a solid rand performance.

"The stubbornly high household debt-to-disposable income ratio needn't imply a crisis, but it does mean that the household sector has very limited ability to deal with any unwanted and unexpected economic events at present"





THE BAD: HOUSEHOLD DEBT-RELATED INDICATORS STILL POINT TO FRAGILE HOUSEHOLD SECTOR FINANCES

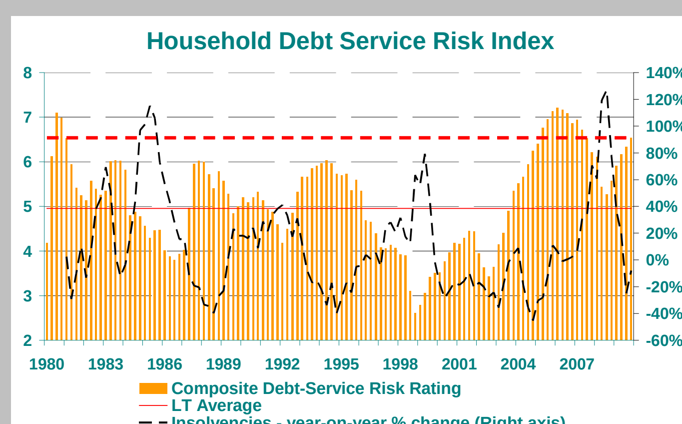
Household debt-service ratio still on "the edge": *While an appropriate upper limit for the debt-service ratio (the cost of servicing the household debt burden – interest + capital – expressed as a percentage of household sector disposable income) is debatable, it would appear that things started going "pear-shaped" early in 2007 when the ratio rose to above 13%, and we believe this level to be a good benchmark..*

The bad news of the 4th quarter of 2009 statistics released in the latest SARB Quarterly Bulletin was that the household sector debt-to-disposable income ratio rose again, with household sector credit growth exceeding disposable income growth in the quarter. From 78.4% in the previous quarter, the ratio rose to 79.8% in the 4th quarter, taking the debt-service ratio slightly higher to 13%, our idea of an appropriate upper limit.

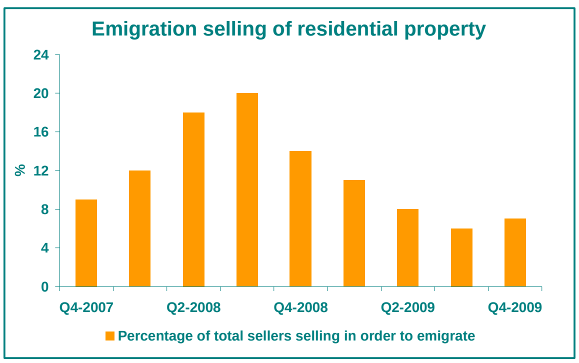
This is a cause for concern, because it implies very little room to absorb any negative events such as interest rate hikes, and any return to higher interest rates unexpectedly in the near future would mean a swift return to high levels of pain in terms of bad debt. While such events may not happen, the current high level of debt-service ratio, at a time when interest rates are probably at or near to their low point, continues to place the household sector, and thus the housing market, at huge risk.

Box 2: The Household Sector Debt-Service Risk Index – Still in the Danger Zone

Our Household Sector Debt-Service Risk Index has risen further in the 4th quarter of 2009 to 6.5 (scale of 1 to 10). The Index takes into account the level of debt-to-disposable income, the direction of this debt ratio, and the level of interest rates relative to longer term inflation. Low interest rates pose a greater risk because the risk of the next move in rates being upward is higher. The combination of high debt ratio, a rise in the debt ratio, and cyclically low interest rates, places the household sector in a relatively high risk position, as shown by the high risk rating.



"For the time being, sentiment appears positive in the residential market. But recent political developments, in the form of the "hate speech" issue rearing its ugly head, pose risks for sentiment, and such events can lead to a renewed rise in the prominence of emigration selling.



THE UGLY:THE RACIAL HATE SPEECH ISSUE REARS ITS UGLY HEAD.

Estate agents surveyed in recent FNB Property Barometer surveys have been citing improving household sector sentiment as a key reason for their more upbeat expectations regarding the near term residential property market performance.

Sentiment is extremely important for the property market. Just let's go back to the negative sentiment so pervasive in the suburban markets in 2008, leading to agents surveyed telling us that emigration selling reached as high as 20% of total selling by the 3rd quarter of that year. . It is believed that the emigration selling surge of 2008 had much to do with major political change at the ANC's Polokwane congress late in 2007, along with the Eskom crisis of early-2008. These events may have served to demonstrate just how sensitive many of SA's suburban residents can be to any perceived heightened political or policy uncertainty, or to an event such as an electricity shortage which could be a sign of a looming crisis.

Since then, agents surveyed have pointed to a decline in emigration selling, as a percentage of total property sales. This is a very positive development, as at 20% of total sales at the peak in 2008, emigration selling was a key contributor to oversupplies of property on the market at the time

However, March saw some potentially damaging rhetoric, regarded in certain quarters as "hate speech", rearing its ugly head, first, allegedly by a political leader and then supposedly by a supporter on a fan site, although it seems questionable as to whether the actual supporter exists. While it will take some time to resolve the issue, or to get to the bottom of "who said what" and whether it was hate speech or not, the reality is that such events that stir up a lot of hype do have the potential to dampen sentiment in some of the country's major residential markets. When this happens, the risk is that emigration selling increases once more.

This was definitely the "ugly" news from a residential market point of view. Whether it will prove damaging of not is tough to tell. For the time being, though, sentiment appears positive.

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