FNB AUGUST HOUSE PRICE INDEX

- The decline in year-on-year inflation begins to gather steam, and what happens in the US in the near term is crucial to our market's well-being

FNB Property Barometer

FNB PROPERTY MARKET ANALYTICS

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SUMMARY

The FNB House Price Index continued its trend of slowing year-on-year price growth, from a July revised rate of 10.1% to an August rate of 7.2%. While the declining price growth trend was expected, the pace of the decline has been slightly faster than our expectations. Base effects do play a role, with the base in the 2nd half of 2009 having begun to rise once more. However, the weakening also has much to do with a slowing global and domestic economy as well as a lack of further interest rate stimulus over the past 12 months (only one further rate cut in March 2010). The positive impact of the 5 percentage points' worth of rate cuts from December 2008 to August 2009 has thus started to wear thin.

A lack of interest rate cuts aside, we are increasingly concerned with events playing themselves out in the world's largest economy, the United States. Massive monetary and fiscal stimulus packages in recent years have seemingly done very little to boost that country's economy, which has been slowing again in recent times, its unemployment remains high, its consumer confidence low, and the risk of the so-called "double-dip" recession must surely be seen as very high at present.

This has implications for our own economy and housing market. Already, we have seen a slowing month-on-month growth rate in the SARB Leading Business Cycle Indicator since late-2009, and more recently SA's 2nd quarter economic growth slowed too. By how far our economy, and thus our housing market, will slow will depend much on the global economic situation, with the US being key. But domestic housing and household sector fundamentals make us vulnerable, and this to will also be a major factor. The FNB Valuers' Market Strength Index for July continues to point to an imbalance between demand and supply, with the aggregate supply rating by our valuers still being stronger than their demand-side rating. The FNB estate Agent survey estimates average time of a property on the market to be a lengthy 17 weeks and 1 day, supporting the valuers' view that demand is weak relative to supply despite a 2009/early-2010 "mini-recovery".

In addition, the household sector debt-to-disposable income ratio at 78.4% is high by our historic standards, which has prevented the household sector from responding strongly over the past year-and-a-half to lower interest rates.

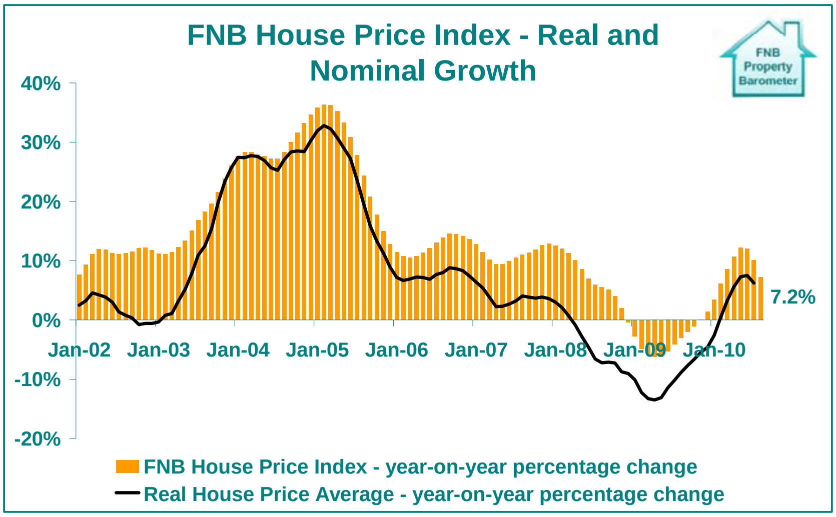
The reality is, therefore, that our housing market starts its slowdown off a very weak base. It may still be in a better position than the US Housing Market at present, because unlike the US, where interest rates are almost zero, the SARB does have ammunition in store to cushion the blow of a global economic slowdown.

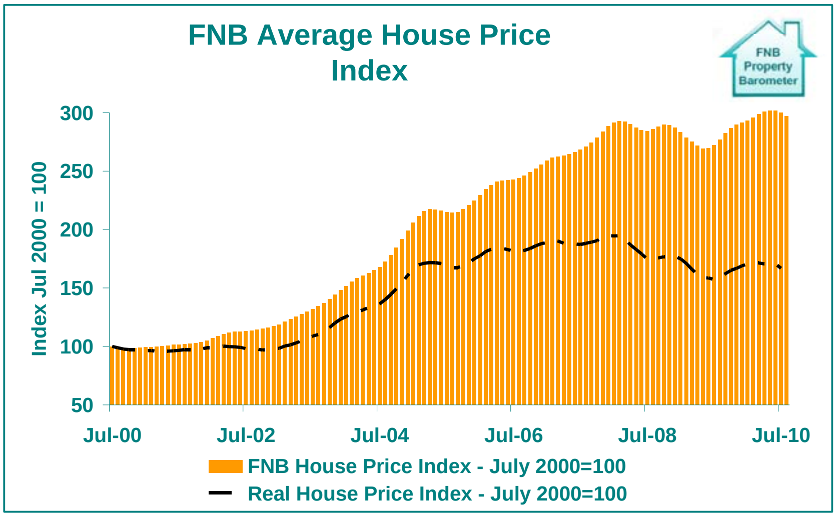
However, a disappointing US economic performance, the very real risk of a double-dip, and all the while our own weak domestic housing fundamentals, have led us to a downward revision of our house price growth forecast, and we "pencil in" some renewed decline in the FNB House Price Index in 2011 after an average projected growth rate of +6.4% in 2010.

As yet, there isn't reason to believe that the decline need to be extreme, such as was the case in the US during the last slump, with that country's national house price deflation rate bottoming at near to -19%, because the likelihood of some renewed SARB interest rate cutting in September can provide some support. But it is the unfortunate reality that SA is an open economy, highly exposed to global economic events, and the magnitude of the housing market slowdown does very much depend on the magnitude of the global slowdown.

YEAR-ON-YEAR HOUSE PRICE INFLATION SLOWS FURTHER

The August FNB House Price Index recorded a year-on-year inflation rate of 7.2%, significantly lower than the previous month's revised 10.1%, the 3rd successive month of decline from a revised peak of 12.2% in May 2010.





On a month-on-month basis the index declined by -1%, following a -0.7% revised decline in July. One does get seasonal factors playing a role in the month-on-month rate, though, so one should be careful about drawing conclusions regarding month-on-month decline. The average price for August was R777,491.

In real terms, the latest house price estimate translates into further year-on-year increase due to a very low consumer price inflation rate of 3.7% for July. The year-on-year house price increase for July was therefore +6.2%. this also reflects a decline from the previous months' +7.5%, the 1st quarter of decline in the real rate of increase in the current "mini-cycle".

Examining the cumulative index growth since July 2000, the date that the FNB data starts, we have seen a cumulative increase of 197.1%, and 70.5% in real terms to July (adjusted for CPI).

Most of this cumulative increase, however, was between the years 2000 to 2007, with very limited upward movement since.

HOUSING, HOUSEHOLD SECTOR AND ECONOMIC FUNDAMENTALS ARE VERY WEAK, AND THE THREE ARE INTERLINKED.

As indicated in previous reports, we are of the opinion that the recent declines in house price inflation are the start of a slowing trend in the residential property market. The big question is how far does the slowdown go? Part of the answer lies in the reality that both the local property market and the domestic household sector are currently not standing on a "solid platform". The 2nd part of the answer lies in a deteriorating global economic environment, with the World's largest economy, the USA, in a very fragile position to put it politely, and the risk of a double-dip recession for that country being very high.

Local property fundamentals remain mediocre at best,...

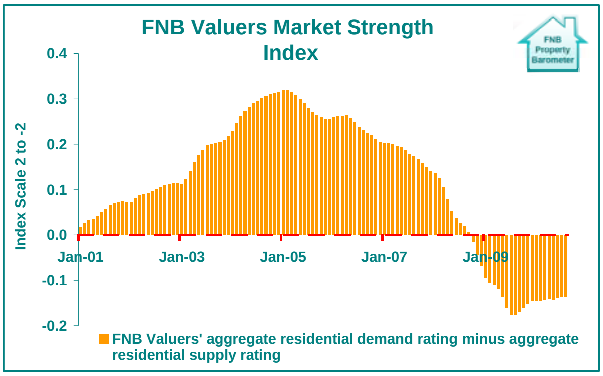
The 2nd data series to be released today along with the House Price Index is the FNB Valuers Market Strength Index.

When an FNB valuer values a property, he/she is required to provide a rating of demand as well as supply for property in the specific area. The demand and supply rating categories are a simple "good (+1)", "average (0)", and "weak (-1)".

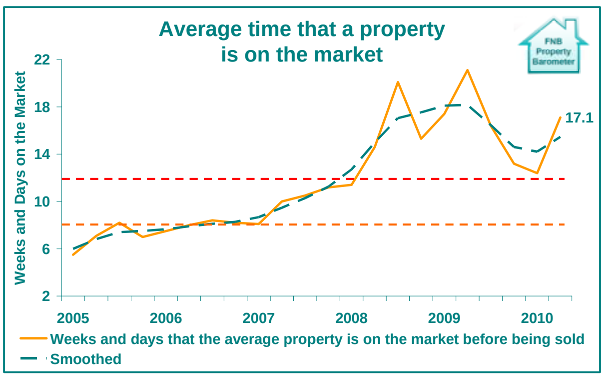
We aggregate all of these individual demand and supply ratings, and subtract the aggregate supply rating from the demand rating.

The collective opinion of the valuers is that demand relative to supply has remained weak throughout the recent mini-recovery cycle, never having got back to anywhere near the incredibly strong levels of 2004/5 at the peak of the boom.

The August reading of the Market Strength Index (scale of +2 to -2) was -0.137, which is virtually unchanged from the previous month's reading. The overall improvement in this index since its worst level of -0.177 in July 2009, has been marginal at best, and the index continues to show a very poor demand level relative to supply when compared to the best reading on record of +0.319 in February 2005.



A totally separate indicator, from a separate source is the FNB Estate Agent Survey, is the estimated average time of a property on the market, which reached 17 weeks and 1 day in the 2nd quarter. This, too, points to a weak demand-supply balance situation, with the early-2005 average time on the market having been far lower at around 6 weeks.



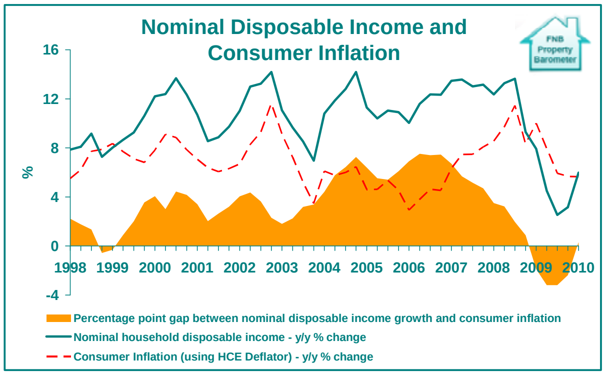
And so, the residential market, therefore, goes into a demand slowdown, starting from a very weak base, with indications that oversupplies in the market are still in abundance in many areas.

...local household sector fundamentals are fragile despite some mild improvement,...

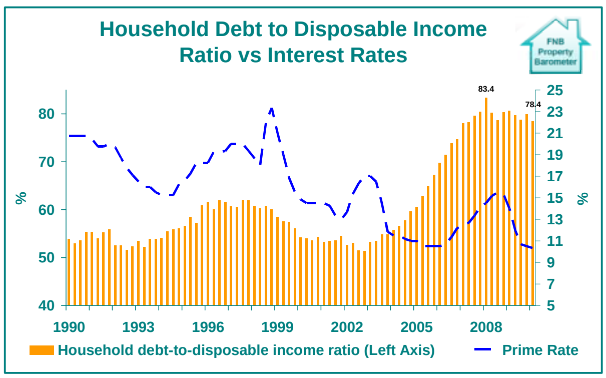
A key reason why the property market did not strengthen impressively during the "mini-recovery" from early 2009 to early-2010, despite huge interest rate cuts, was due to poor household sector financial fundamentals following a very severe recession.

The recession had a hugely negative impact on nominal disposable income growth, and as a result the household sector made far lass progress in reducing its debt-to-disposable income ratio than it would have made should SA have experienced a more "normal" economic growth situation in recent years.

In 2009, nominal disposable income growth dropped all the way from above 13% year-on-year growth as at the 3rd quarter of 2008 to 2.5% growth a year later. The graph below shows that through the entire 2009 the nominal disposable income growth rate was lower than consumer price inflation, translating into a decline in disposable income in real terms. While this situation was busy turning for the better by early 2010, and the negative gap between the 2 variables had been all but wiped out, there was little in the way of positive real disposable income growth.



The result of severe pressure on disposable income growth has been only limited progress in lowering the household sector debt-to-disposable income ratio from a record high of 83% at the beginning of 2008, to 78.4% in early-2010. While the decline in the ratio to date is welcome, 78.4% ratio remains very high, and off this high base the household sector has been unable to grow its new borrowing in response to interest rate cuts. Hence the muted recovery in home buying through 2009, which was to a certain degree mistakenly blamed on banks' tight lending criteria (though this is not to say that banks aren't conservative lenders at present).



How can we help you?

And so, the property slowdown also begins from a very fragile household sector financial platform.

...and across the ocean, the risk of a so-called "double-dip" is high.

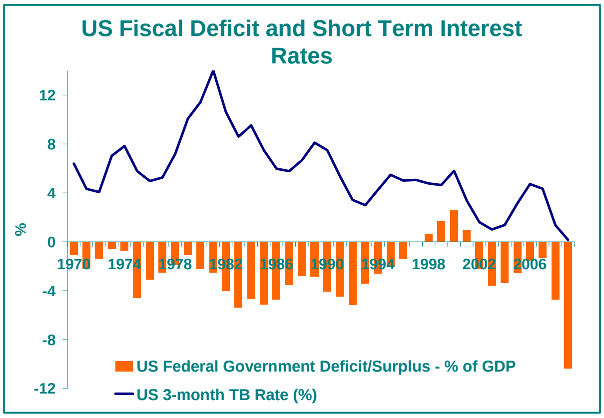
The world's largest economy, the United States' fortunes are crucial for our own economic performance as well as that of our own housing market..

Last week, an announcement of a large drop in housing sales in the US increased concerns of a so-called double-dip recession in that country. However, ominous signs have been around for quite some time.

The reality is that the impact of huge monetary and fiscal stimulus packages in recent years in the US has to date been disappointing.

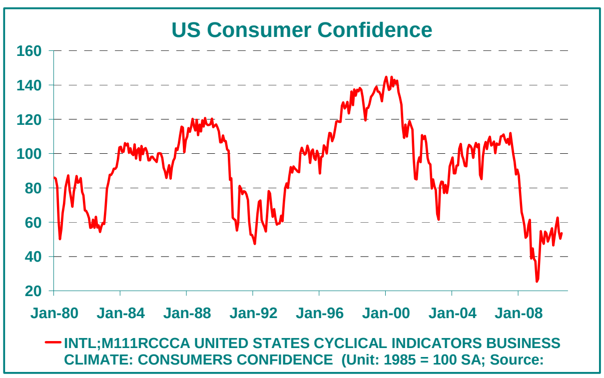
Whereas, in response to the 2001 recession, the US could breathe life back into its economy by cutting its fed Funds Target rate to 1%, and allowing a fiscal deficit to run up from a 2000 surplus to a moderate deficit of -3.6% of GDP (gross domestic product), the response to the 2007/08 financial and economic crisis had to be far more extreme and with far less impressive results.

This time around, the fed Funds Target rate was lowered to just short of zero percent, and by 2009 the fiscal deficit was running at a massive -10.3% of GDP, or not far short of $1.5 trillion.



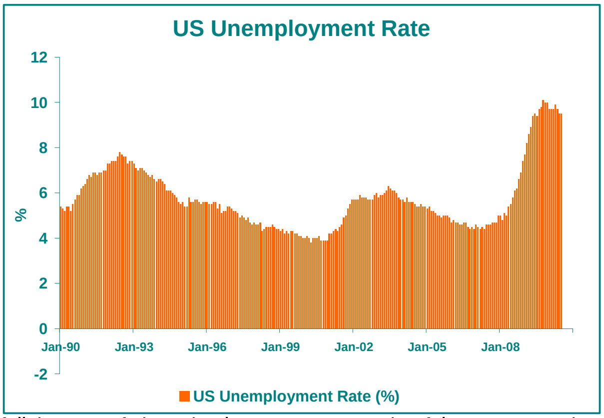
The pattern thus appears to be one of increasingly extreme policy stimulus measures with decreasingly extreme responses, a function of an increasingly over-indebted nation.

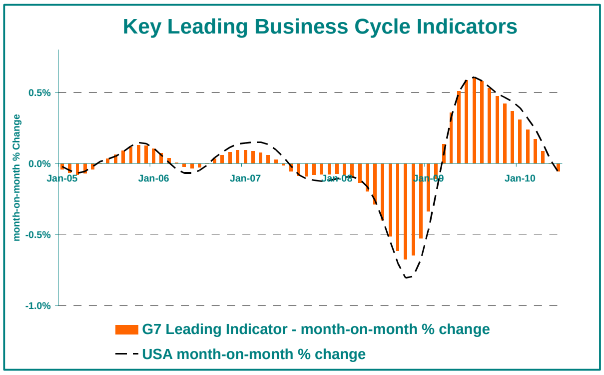
The Conference Board Consumer Confidence Index measured a level of 53.5 in August, slightly up from the previous month's 51 level, but still dismal compared to the July 2007 cyclical peak of 111.9, and even less impressive compared to the previous cycle's May 2007 peak of 144.7.



One reason why US Consumer Confidence remains weak is the high level of unemployment by US standards, currently languishing at 9.5%. While slightly down from the October 10.1% peak, these levels still remain at high levels last witnessed in the early-1980s after the big oil shock.

No problem, some might say, we just need to wait a little longer for the US economic growth recovery to take effect, and for the full impact of the stimulus measures to be felt. However, the reality is that US economic growth has already begun to slow for 2 successive quarters (1.6% quarter-on-quarter annualised in Q2, down from 5% in Q4 2009), and both the US and G-7 Leading Indicators' declining growth rates suggest that there's probably more slowdown to come in the near term





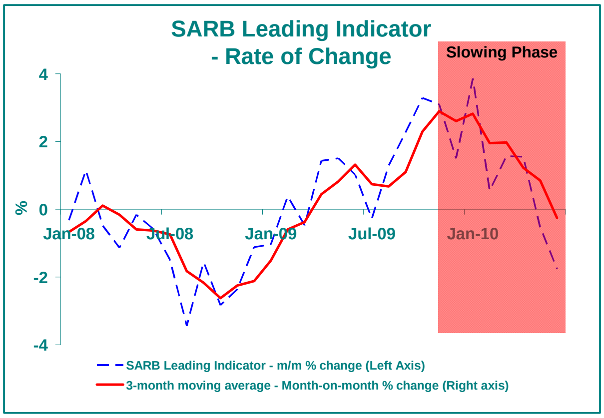
This comes at a time when US policymakers are running thin on ammunition, with interest rates already near zero.

So that's the precarious nature of the US economic situation at present, a fragile platform off which to enter an economic growth slowdown, making the risks of a 2nd recession in a matter of a few years a very real possibility.

CONCLUSION – ALL OF THE ABOVE LEAVES THE SOUTH AFRICAN HOUSING MARKET VULNERABLE AS 2011 APPROACHES

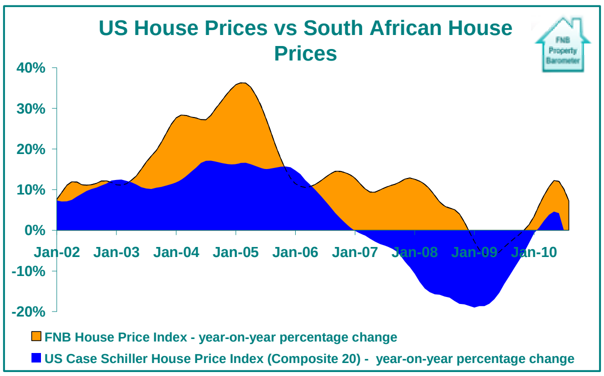
Where does this leave South Africa's housing market? Vulnerable to say the least. As mentioned in previous sections, we start our own housing market slowdown off a fragile base, and then have to contend with the US and its even more fragile situation too.

Already, SA's own Leading Business Cycle Indicator has been showing slowing month-on-month growth since late-2009, and actual economic growth has also begun to slow in the 2nd quarter.



The growth slowdown was to be expected, given the impact on our own economy (via our exports) of slowing global growth. In addition, there has been a distinct slowdown in the pace of interest rate cutting by the SARB since a year ago. After a massive 5 percentage points worth of cutting up until August 2009, we have had only one further half a percentage point cut since. Good inflation numbers in recent months make another cut likely in September, which could provide some support, but this is unlikely to fully offset the negative impact arising from the wearing off of last year's big rate cutting stimulus.

So, is the South African Housing Market in the same weak position as that of the US? Looking at the past decade, represented on the graph below, SA appears to have outperformed the World's largest housing market by far, experiencing far higher price inflation through most of the decade as well as far less price deflation through the slump.



The main reason for this "outperformance" by SA was that SA ended the 1990s with relatively low levels of indebtedness and extremely high interest rates. We then experienced a "once-off structural adjustment" to interest rates, in lagged response to a long term downward adjustment in consumer price inflation since the 1980s. Our less-indebted household sector could respond aggressively with a home buying spree not witnessed in our recorded history, resulting in a major upward price adjustment.

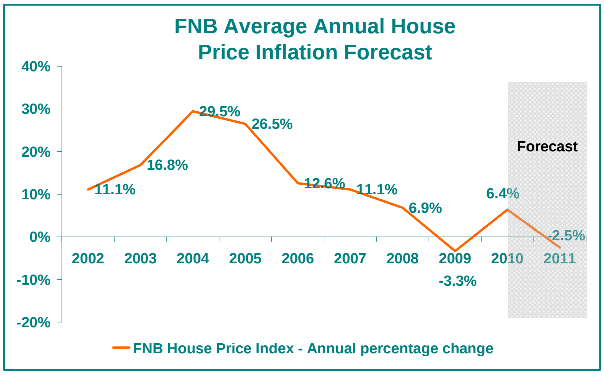
But despite our outperforming of the US market, we cannot get away from the reality that there is still a broad correlation between our own housing market performance and that of the US. Good economic times in the US, back earlier in the last decade, helped SA to 5%+ economic growth rates and strong disposable income growth. The US crash from 2007 ultimately brought about recession in SA and house price deflation by 2009. The difference was that our own housing downturn was less extreme than the US case, but downturn it was nevertheless.

Going into the next economic growth downturn, is SA still in a better position than the US housing market? Probably, because unlike the US case, SA still has a repo rate of 6.5%, meaning that the SARB can still cut interest rates to cushion the global blow.

But the extent of our advantage has diminished over the last decade, as we now have a far more highly indebted household sector, and our residential market doesn't yet have a healthy demand/supply balance following the 2008 slump.

As such, while we may yet again not be required to experience as extreme a housing market downturn as what the US may yet witness, the likelihood of a significant slowdown in SA economic growth in the near term, with the US response to stimulus packages having disappointed, lead us to believe that we should "pencil in" some average house price decline for 2011. This is an adjustment from our previous projection of a lowly +3% positive average house price growth rate in 2011.

The slightly faster-than-expected decline in the FNB House Price inflation rate in recent months has also led to a downward revision for 2010 average house price growth to +6.4%.



Monthly FNB House Price Index (July 2000 = 100)

Date	Index	y/y % change	Date	Index	y/y % change	Date	Index	y/y % change	Date	Index	y/y % change
Jul-00	100.0		Feb-03	121.0	11.1%	Sep-05	215.1	20.8%	Apr-08	290.1	10.1%
Aug-00	99.2		Mar-03	123.4	11.4%	Oct-05	217.5	17.8%	May-08	287.3	8.6%
Sep-00	98.6		Apr-03	125.8	12.3%	Nov-05	220.7	15.0%	Jun-08	284.9	7.0%
Oct-00	98.4		May-03	127.7	13.4%	Dec-05	224.9	12.8%	Jul-08	284.2	6.0%
Nov-00	98.6		Jun-03	129.8	15.0%	Jan-06	229.6	11.5%	Aug-08	285.8	5.5%
Dec-00	98.9		Jul-03	132.2	16.8%	Feb-06	234.4	10.8%	Sep-08	288.1	5.1%
Jan-01	99.3		Aug-03	134.4	18.3%	Mar-06	238.3	10.5%	Oct-08	289.8	4.0%
Feb-01	99.6		Sep-03	136.9	19.7%	Apr-06	240.9	10.8%	Nov-08	289.5	2.0%
Mar-01	99.7		Oct-03	140.3	21.6%	May-06	241.9	11.3%	Dec-08	287.3	-0.4%
Apr-01	100.0		Nov-03	144.1	23.9%	Jun-06	242.2	12.1%	Jan-09	283.3	-2.8%
May-01	100.7		Dec-03	148.0	26.1%	Jul-06	242.8	13.0%	Feb-09	278.6	-4.8%
Jun-01	101.4		Jan-04	151.7	27.7%	Aug-06	244.1	13.8%	Mar-09	275.0	-5.9%
Jul-01	101.8	1.8%	Feb-04	155.3	28.3%	Sep-06	246.4	14.5%	Apr-09	271.9	-6.3%
Aug-01	102.2	3.0%	Mar-04	158.3	28.3%	Oct-06	249.0	14.5%	May-09	269.5	-6.2%
Sep-01	102.5	4.0%	Apr-04	160.8	27.9%	Nov-06	252.1	14.2%	Jun-09	269.8	-5.3%
Oct-01	102.9	4.5%	May-04	163.0	27.6%	Dec-06	255.5	13.6%	Jul-09	272.4	-4.2%
Nov-01	103.7	5.1%	Jun-04	165.2	27.2%	Jan-07	258.9	12.8%	Aug-09	277.1	-3.1%
Dec-01	105.1	6.2%	Jul-04	168.1	27.2%	Feb-07	261.3	11.5%	Sep-09	282.4	-2.0%
Jan-02	106.9	7.6%	Aug-04	172.4	28.3%	Mar-07	262.6	10.2%	Oct-09	286.7	-1.1%
Feb-02	108.9	9.3%	Sep-04	178.0	30.0%	Apr-07	263.5	9.4%	Nov-09	289.7	0.1%
Mar-02	110.7	11.1%	Oct-04	184.6	31.6%	May-07	264.6	9.4%	Dec-09	291.4	1.4%
Apr-02	112.0	11.9%	Nov-04	191.9	33.2%	Jun-07	266.2	9.9%	Jan-10	293.1	3.5%
May-02	112.6	11.9%	Dec-04	199.3	34.6%	Jul-07	268.2	10.5%	Feb-10	295.8	6.2%
Jun-02	112.8	11.2%	Jan-05	206.0	35.8%	Aug-07	270.9	11.0%	Mar-10	298.6	8.6%
Jul-02	113.1	11.1%	Feb-05	211.6	36.3%	Sep-07	274.2	11.3%	Apr-10	301.0	10.7%
Aug-02	113.7	11.2%	Mar-05	215.6	36.2%	Oct-07	278.6	11.9%	May-10	302.5	12.2%
Sep-02	114.4	11.6%	Apr-05	217.4	35.2%	Nov-07	283.8	12.6%	Jun-10	302.2	12.0%
Oct-02	115.4	12.1%	May-05	217.2	33.3%	Dec-07	288.4	12.9%	Jul-10	300.0	10.1%
Nov-02	116.3	12.2%	Jun-05	216.1	30.9%	Jan-08	291.4	12.5%	Aug-10	297.1	7.2%
Dec-02	117.4	11.8%	Jul-05	214.8	27.8%	Feb-08	292.8	12.0%			
Jan-03	118.8	11.2%	Aug-05	214.4	24.3%	Mar-08	292.2	11.3%			

Cumulative Percentage Change in the FNB House Price Index

From Date	Cumulative % change to July 2010	From Date	Cumulative % change to July 2010	From Date	Cumulative % change to July 2010	From Date	Cumulative % change to July 2010
Jul-00	197.1%	Feb-03	145.6%	Sep-05	38.1%	Apr-08	2.4%
Aug-00	199.6%	Mar-03	140.8%	Oct-05	36.6%	May-08	3.4%
Sep-00	201.4%	Apr-03	136.3%	Nov-05	34.6%	Jun-08	4.3%
Oct-00	201.8%	May-03	132.7%	Dec-05	32.1%	Jul-08	4.5%
Nov-00	201.2%	Jun-03	128.9%	Jan-06	29.4%	Aug-08	4.0%
Dec-00	200.3%	Jul-03	124.8%	Feb-06	26.7%	Sep-08	3.1%
Jan-01	199.3%	Aug-03	121.1%	Mar-06	24.7%	Oct-08	2.5%
Feb-01	198.3%	Sep-03	117.0%	Apr-06	23.4%	Nov-08	2.6%
Mar-01	198.1%	Oct-03	111.8%	May-06	22.8%	Dec-08	3.4%
Apr-01	197.0%	Nov-03	106.2%	Jun-06	22.7%	Jan-09	4.9%
May-01	195.2%	Dec-03	100.7%	Jul-06	22.4%	Feb-09	6.7%
Jun-01	192.9%	Jan-04	95.9%	Aug-06	21.7%	Mar-09	8.0%
Jul-01	191.8%	Feb-04	91.4%	Sep-06	20.6%	Apr-09	9.3%
Aug-01	190.8%	Mar-04	87.8%	Oct-06	19.3%	May-09	10.2%
Sep-01	189.8%	Apr-04	84.8%	Nov-06	17.9%	Jun-09	10.1%
Oct-01	188.8%	May-04	82.3%	Dec-06	16.3%	Jul-09	9.1%
Nov-01	186.6%	Jun-04	79.9%	Jan-07	14.7%	Aug-09	7.2%
Dec-01	182.8%	Jul-04	76.7%	Feb-07	13.7%	Sep-09	5.2%
Jan-02	178.0%	Aug-04	72.3%	Mar-07	13.2%	Oct-09	3.6%
Feb-02	172.9%	Sep-04	66.9%	Apr-07	12.8%	Nov-09	2.6%
Mar-02	168.4%	Oct-04	61.0%	May-07	12.3%	Dec-09	2.0%
Apr-02	165.4%	Nov-04	54.8%	Jun-07	11.6%	Jan-10	1.4%
May-02	163.8%	Dec-04	49.1%	Jul-07	10.8%	Feb-10	0.5%
Jun-02	163.4%	Jan-05	44.2%	Aug-07	9.7%	Mar-10	-0.5%
Jul-02	162.6%	Feb-05	40.4%	Sep-07	8.3%	Apr-10	-1.3%
Aug-02	161.4%	Mar-05	37.8%	Oct-07	6.7%	May-10	-1.8%
Sep-02	159.7%	Apr-05	36.6%	Nov-07	4.7%	Jun-10	-1.7%
Oct-02	157.6%	May-05	36.8%	Dec-07	3.0%	Jul-10	-1.0%
Nov-02	155.5%	Jun-05	37.5%	Jan-08	1.9%		
Dec-02	153.0%	Jul-05	38.3%	Feb-08	1.5%		
Jan-03	150.1%	Aug-05	38.6%	Mar-08	1.7%		