MAY FNB HOUSE PRICE INDEX

- The short term impact of late-2010 interest rate cuts continues to keep house price growth in mildly positive territory

FNB Property Barometer

FNB PROPERTY MARKET ANALYTICS

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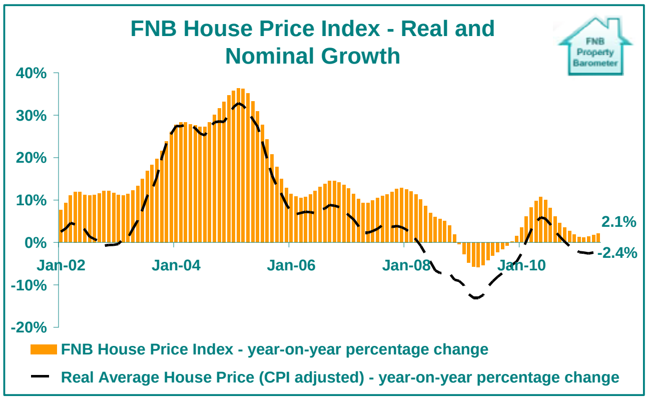
FNB HOUSE PRICE INDEX YEAR-ON-YEAR GROWTH REMAINING POSITIVE BUT PEDESTRIAN

The May 2011 FNB House Price Index once again shows an FNB House Price Index just managing to defy gravity to remain in low positive growth territory, and has in recent months shown a very slight acceleration in year-on-year growth. From a 2011 low point of 1.2% year-on-year as at February, The price growth rate rose to 2.1% in May, up from a revised 1.7% rate in April.

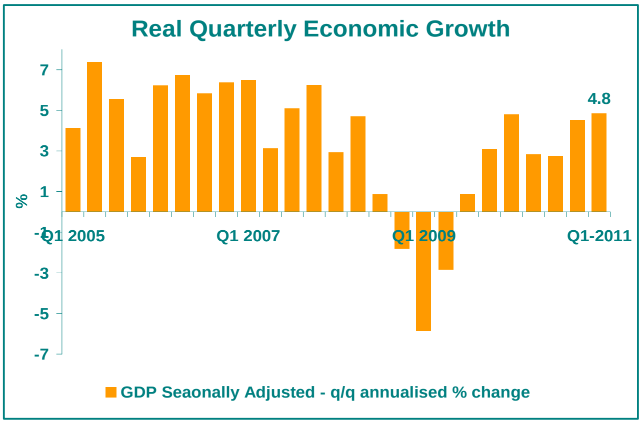
We ascribe this very slight acceleration in price growth to the lagged positive impact of the 2 further 50 basis point interest rate cuts late in 2010, along with the effects of the 2nd round of US Quantitative Easing (QE2) late in 2010, which supported the global economy mildly and led to a slight uptick in residential demand in the summer months..

The recent period of improved house price growth, however, looks far less impressive than the market response to the more significant interest rate cutting of 5 percentage points between December 2008 and August 2009, which was accompanied by massive developed country stimulus packages, including the US' "QE1". That stimulus had led to an earlier "mini-cycle" price growth peak of 10.8% year-on-year in May 2010.



*As yet, though, this 2nd "mini-recovery" of early-2011 has been too mild as to translate into any house price growth in **real** terms. If one adjusts the average house price index with the consumer price index, the April real house price growth rate remained negative to the tune of -2.4%, with consumer price inflation having risen to 4.2% year-on-year in that month.*

As mentioned above, the stabilizing, and slight acceleration, in house price growth can arguably be explained by global and local economic factors, and indeed yesterdays release of the 1st quarter GDP (Gross Domestic Product) estimate for South Africa showed a further slight acceleration in seasonally adjusted quarter-on-quarter annualized growth, from a previous quarter's 4.5%, to 4.8%. The solid performance in economic growth in the 2 summer quarters, after some weakness during the winter, can also arguably be ascribed to the further global stimulus along with the late-2010 domestic interest rate cuts.



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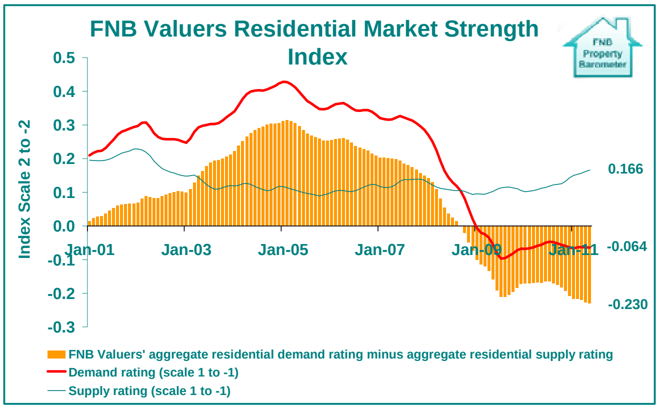

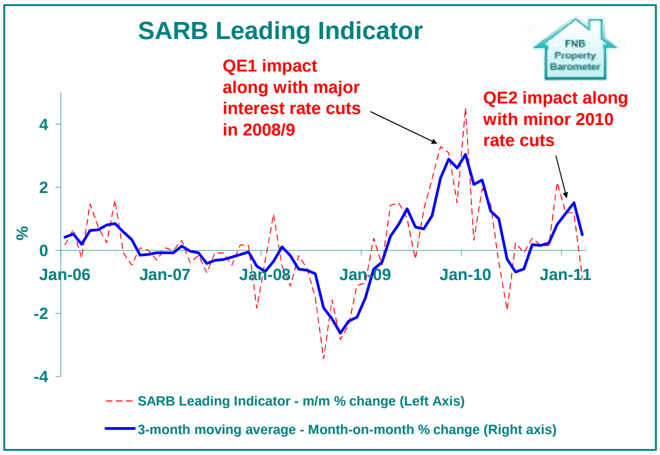

Unfortunately, however, the FNB Valuers panel continues to report very weak demand relative to supply of residential property, suggesting that we should continue to keep our expectations regarding the property market modest in the near term. The upward trend in the valuers' supply rating has continued in the initial months of 2011, while there has also been some very mild weakening in the demand rating, with the net result having been a further small weakening in the FNB Valuers' Residential Market Strength Index (Aggregate Demand rating minus aggregate supply rating) in May to -0.23, from April's revised -0.226. The Market Strength Index therefore remains un-balanced in favour of supply, and this arguably explains real house price decline along with still very low nominal price growth.*

In addition, both the domestic SARB Leading Business Cycle Indicator, as well as the US and G7 Leading Indicators, point towards a likely near term slowing in global and local economic growth. Such leading business cycle indicators tend to correlate well with local residential property demand, suggesting a slowdown to come in the housing market too.

On a month-on-month basis, the SARB Leading Indicator showed negative month-on-month growth in March, whilst the 3-month moving average had also started to see slowing month-on-month growth after some increase in the summer months.

Such indication of possible near term slowing in economic growth as well as in housing demand should not be surprising. Oil prices remain stickily high at around $115/barrel (Brent Crude), which is sure to impact negatively on global and local economic growth while locally we have seen some increase in inflation pressures, with consumer price inflation having risen to 4.2% in April.

At this stage, despite some rise in inflation, it is far from a foregone conclusion that interest rate hiking will take place this year. While our group expectation is indeed for a 250-300 basis point interest rate hiking cycle commencing in the 2nd half of 2011, the possibility does exist that the global economy slows quickly enough for global inflationary pressures to be dampened before the SARB gets to interest rate hiking. However, whether it is rising interest rates or significantly slower economy, the negative impact on our residential property market should be much the same.

PROPERTY OUTLOOK

In short, therefore, our indicators suggest that residential demand went through a very mild "mini-recovery" in the summer months, and that, with a lag, this appears to have translated into a slight acceleration in year-on-year nominal (though not real) house price increase, as estimated in the FNB House Price Index..

Looking forward, however, the spectre of high oil prices, and higher consumer price inflation, could lead to possible interest rate hiking later in 2011, while economic growth slowdown is expected in the near term. Our valuers continue to suggest weak demand relative to supply, and this even after huge interest rate reductions since late-2008. This reflects the very weak financial and debt position of the household sector following the 2008/9 recession. As such, we remain of the opinion that, if the residential market cannot achieve respectable house price growth after such a huge interest rate stimulus, a period of house price decline would be the likely outcome of a possible phase of interest rate hiking, or of slowing economic growth, or both.

*Note: *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)". From all of these ratings we compile an aggregate demand and an aggregate supply rating, which are expressed on a scale of -1 to +1. After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating to obtain the FNB Valuers' Residential Market Strength Index.*

***The FNB House Price Index is a fixed-weighted average of its sub-indices, which are split by room number and by sectional title versus freehold properties. The index is lightly smoothed using a Hodrick-Prescott smoothing function. An index month commences 7 days prior to the end of the previous month to 7 days prior to the said calendar month.*