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PROPERTY BAROMETER

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Foreign home buying still appears weak – no wonder given the recent foreign currency-denominated price boom in South African property

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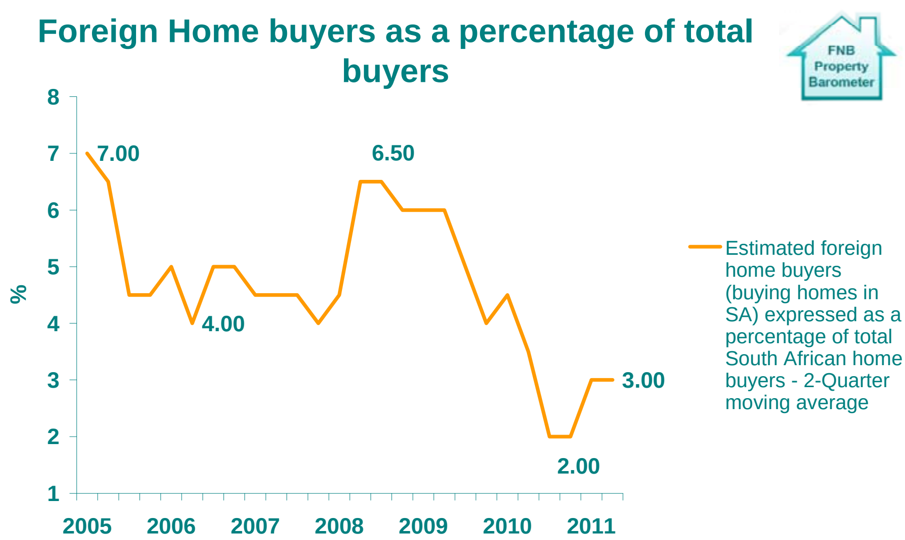
Some may see a lack of foreign buying of residential property in South Africa as a sign of negative sentiment towards the country. We believe otherwise. While the FNB House Price Index has shown very weak growth in rand terms, significant rand strengthening in recent years implies that it has shown massive growth in foreign currency-denominated terms in recent years. Rather than citing weak sentiment, a more likely reason is that South African property has become far more expensive for foreigners from 2009 onward, at a time when household sectors in some of our main foreign buyer nations are under significant financial pressure. In addition, residential property is arguably not the favoured global asset class at present.

1. FNB ESTATE AGENT SURVEY POINTS TO WEAK FOREIGN BUYING CONTINUING IN THE 1ST HALF OF 2011

The FNB Estate Agent Survey for the 2nd quarter continued to point to agents surveyed perceiving an anaemic pace of buying of South African residential property by foreigners.

Using a 2-quarter moving average, the percentage of foreign buying for the 2nd quarter of 2011 was an estimated 3% of total local residential buying. This is slightly up from the estimated 2% in the latter half of 2010.

These percentage estimates are a far cry from the 7% of early 2005 (when total market volumes were also far higher than at present), as well as from the 6.5% reached at a stage in 2008.

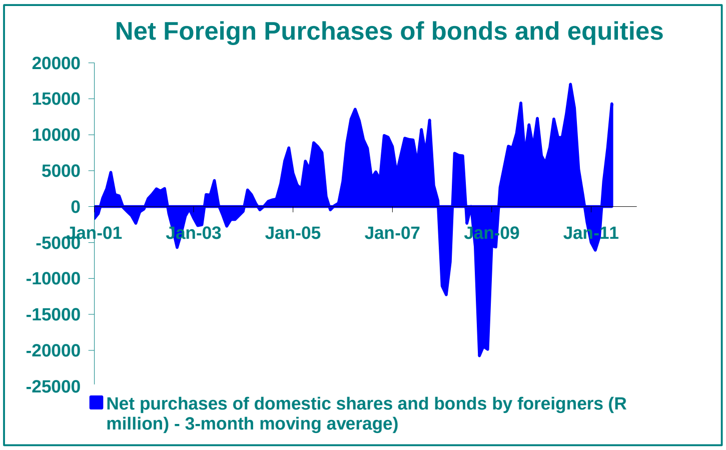


2. IRONICALLY, WE THINK THAT WEAK FOREIGN PROPERTY BUYING MAY BE DUE TO POSITIVE RELATIVE SENTIMENT TOWARDS SA

Some would draw the conclusion that the slow estimated foreign buying is a reflection of foreigner nervousness surrounding South Africa's longer term stability, or possibly uncertainty regarding foreigners' property rights in future (pronunciations regarding possible future limits on foreign ownership do take place periodically).

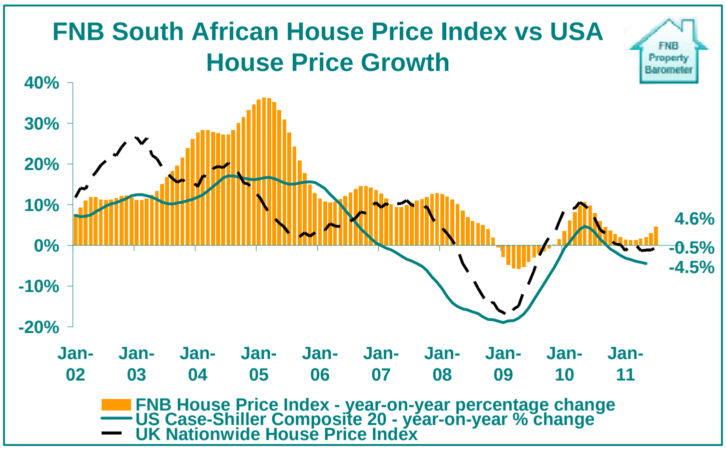
However, we don't believe that poor sentiment towards SA is currently a key issue. Rather, weak foreign buying is more likely to be related to a combination of ***improved*** *foreign sentiment towards South Africa in recent years, but a deterioration in sentiment towards the property asset class globally. This must sound somewhat ironic at first, but is explained as follows.*

Investment flows between countries fluctuate according to perceived changes in the attractiveness of one country relative to another. So, in recent years, while South Africa's economy may have not shown much in the way of absolute improvement, its growth still ticking along at pedestrian pace, its position "on the global log" may well have improved in the eyes of many investors. This is because of the deterioration in the fortunes of many, mainly western, developed countries. So when those "risk free" assets that are US treasury bills are offering very low yields (and a rating downgrade is being mooted), while many European countries' debt situations are almost catastrophic and their growth prospects weak, why not look at higher yielding (and perhaps not as high a risk as thought) and more rapid growth emerging economies?.



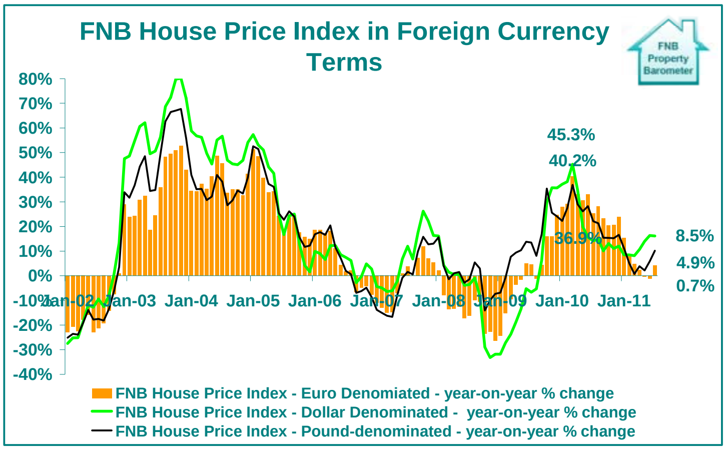
That appears to be what a portion of the world's investors have been doing. The result has been strongly positive share and bond net purchases by foreign residents through most of 2009/10, and after a brief dip late in 2010 a resurgence in 2011 (as seen on the graph to the left).

Foreigners have thus contributed to solid net capital inflows into South Africa, which have in turn contributed to a relatively strong performance of the rand against the major currencies (the rand arguably being the "share price" of the country).



Now if we compared the FNB house price index with the US Case Shiller and the Nationwide UK Index, denominated in their own currencies, we see that all 3have recently been fairly well synchronized, all showing a very mild recovery out of house price decline in 2010, all 3 cooling off late in 2010, and all 3 currently showing low or no growth. This can arguably be explained by economic cycles in all 3 countries being very similar in recent years, and all 3 countries' household sectors being under very significant pressure too.

However, if we depict the FNB House Price Index in foreign currency terms, we see how would-be foreign buyers view our market, i.e. as one with recent rampant price growth, created by significant weakening of some of the major global currencies in recent years. In dollar terms, the FNB House Price Index's growth recovery of 2010 peaked at a massive 45.3% year-on-year in the 1st quarter of last year, in Euro terms at 40.2%, and in UK Pound terms at 36.9%.



Small wonder our panel of agents estimated foreign buying to have hit a low point during last year. Perhaps the slight reported increase in the percentage of foreign buyers has to do with foreign-denominated SA house price growth having cooled off in 2011.

But the fact that the estimated percentage remains relatively low may still be largely due to the dramatic increase in SA home values in 2009/2010, when viewed in foreign currency terms.

Since the beginning of 2009, as the global and local economy began to emerge from recession, the rand-denominated FNB House Price Index has risen by a meager +8.5% to July 2011. Over the same period, the FNB House Price Index in UK Pound terms has risen by a massive +47.5%, in Euro terms by +50.6%, and in US Dollar terms by +59.9%.

Is it any wonder that potential foreign buyers aren't piling into the local market? It has become rather expensive at a time when the household sectors in Europe, UK and the US also experience significant financial pressure.

But why, when the prices of other South African asset classes have also risen dramatically in recent years in foreign currency terms, has foreign buying of those assets remained solid? Here, we believe the answer lies more in the reality that residential property in many countries is not the "flavour of the month" following the end of huge booms during last decade.

3 CONCLUSION

Therefore, our view is that relative sentiment towards South Africa at the present time is fairly positive. Perhaps the successful World Cup played something of a role, but more significant has been years of good macroeconomic management, containing the national debt and preventing debt crises such as those taking place in Europe currently, while our financial system has held up well through the crisis too.

As a result, more favoured assets such as equities and bonds have experienced good foreign demand in recent years, assisting solid capital inflows and a significantly stronger rand. This positive effect on the rand implies that net foreign demand for non-property assets has driven up the foreign currency-denominated prices of SA property dramatically, creating something of an affordability challenge.

Significantly higher local property prices for foreigners, along with property not being a hugely popular global asset class at present, are what we believe have conspired to curb foreign demand in SA property.