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PROPERTY BAROMETER –FNB HOUSE PRICE INDEX – AUGUST

August FNB House Price Index shows further year-on-year growth slowing, increasingly reflecting the recent global economic "soft patch"

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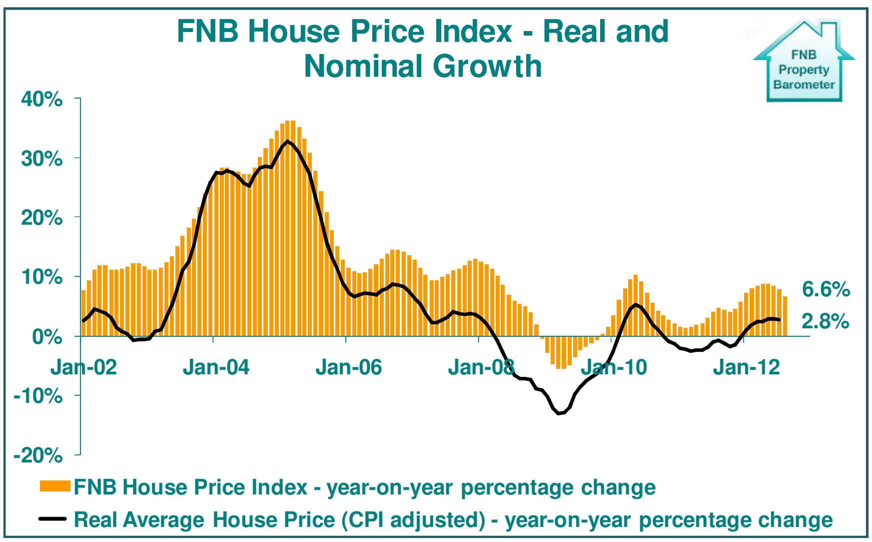
YEAR-ON-YEAR HOUSE PRICE GROWTH SLOWED FURTHER IN AUGUST

The FNB House Price Index showed a further slowing in its year-on-year growth rate in August, from a revised 7.8% rate in July to 6.6% in August. The further slowing in the year-on-year growth rate is more or less in line with our expectations, as we have seen increasing evidence of a "soft patch" in both the global and domestic economy as the year has progressed.

In real terms, adjusted for consumer price inflation, as at July the index showed a slight year-on-year growth slowing from 2.85% in the previous month to 2.76%. The slowing in real house price growth was limited by a significant further decline in consumer price inflation from June's 5.5%, to 4.9% in July.

The Index's average price of homes transacted was R865,900



This means that since the "boom-period" real house price peak reached in February 2008, real house prices (house prices adjusted for CPI inflation over the period) were -13.6% lower at July 2012. In nominal terms prices were +14.2% higher than February 2008, as at August 2012.

However, compared to price levels at the inception of the FNB House Price Index back in July 2000, real prices were still 68.4% higher as at July 2012, while nominal price levels were +230.9% higher in August 2012.

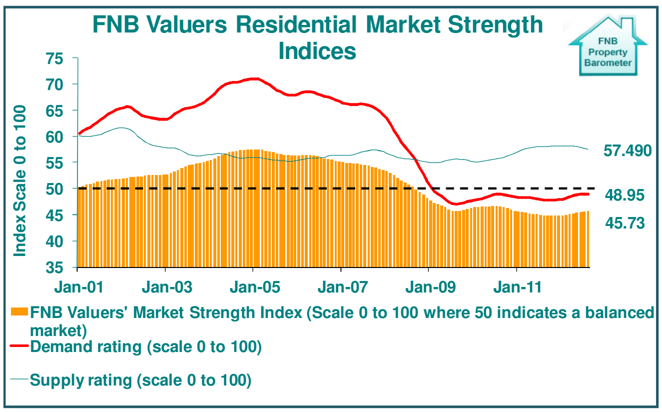
FNB'S VALUERS HAVE RECENTLY BEEN PERCEIVING A SLOWING RATE OF IMPROVEMENT IN THE MARKET

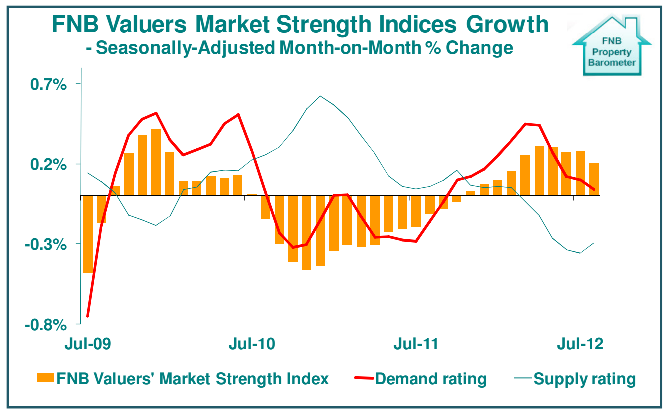
FNB's Valuers' percentions of market strength, as encapsulated in the FNB Valuers' Market Strength Index, are increasingly supportive of the slowing price growth trend as measured by the FNB House Price Index.

In August, the FNB Valuers Market Strength Index (see notes at the end for an explanation of this index) did rise slightly further, from a previous level of 45.64, to 45.73, indicating that the valuers as a group still perceived a slight narrowing of the gap between supply and demand). However, this 45.73 level remains below the crucial 50 level, implying that the Valuers still give a higher average rating to supply than to demand, and this indicates that real house price decline remains a strong possibility.

In addition, the rate of improvement in the Market Strength Index has been broadly slowing since May 2012 on a month-on-month seasonally-adjusted basis, in line with the slowing rate of house price growth in recent months, and August saw a continuing of this recent slowing growth trend.

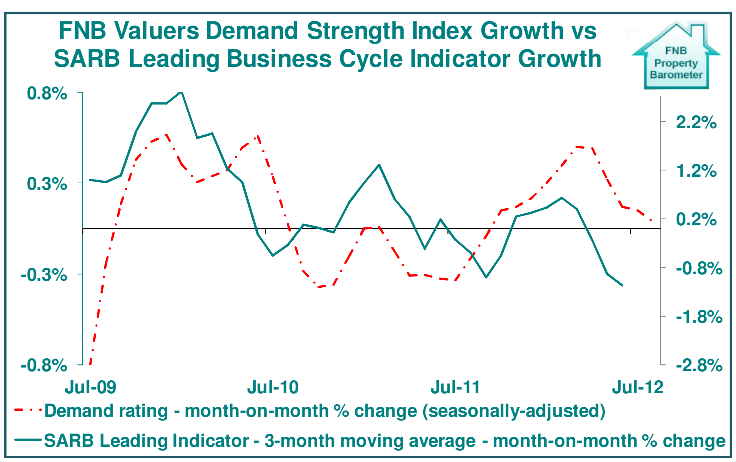
The reason for the slowing pace of improvement in the Market Strength Index in August was twofold. Firstly, the Supply Index saw its pace of decline slow mildly, while there has been a steady slowing in the growth rate in the Valuers' Demand Index.





The FNB Valuers Indices suggest that the short term residential market fluctuations that they perceive continue to track short term South African economic fluctuations. This statement may sound a little contradictory, given the improved real GDP (gross domestic product) growth rate of 3.2% annualized for the 2nd quarter of 2012 (up from 2.7% in the 1st quarter). However, a closer look at 2nd quarter GDP reveals that the improvement was due to a massive increase in mining output in the 2nd quarter, after very weak output in that sector in the 1st quarter due to industrial action disruptions. Excluding the currently volatile mining sector, many of the major economic sectors showed slowing growth in the 2nd quarter, in line signs of recent global economic weakness.

And the latest slowing in growth in the FNB Valuers Demand rating in the winter months of 2012, after a good Summer period, has been very much in line with a slowing month-on-month growth rate in the SARB Leading Business Cycle Indicator.



The recent trend in the SARB Leading Indicator's 3-month moving average has also been significantly down month-on-month, reaching a -1.2% decline for the latest available data point in June. This would suggest economic weakness in the current (3rd) quarter, and the SARB reports that the list of negative contributors to the indicator includes global economic factors.

OUTLOOK

So where too from here? After a few months, it is becoming more evident that the slowing FNB House Price Index inflation rate is something of a short term trend, and not just a "once off". This slowing growth comes as little surprise given signs of global and domestic economic weakness that have been building for some time.

On the labour remuneration front, the SARB has reported mediocre growth rates in the country's nominal wage bill growth, in the order of 7.6% and 8.1% year-on-year for the 1st and 2nd quarters respectively. These growth rates are lower than the 9.6% average wage bill growth in 2011. In addition, 2011's household disposable income growth was boosted by very strong growth in household net income from investments (termed income from "property" by the SARB), to the tune of 16.6%, as dividend income and the like "normalized" last year off a very low base after the 2008/9 recession. This growth in household income from investments is not expected continue at such a rapid pace.

It is quite likely, therefore, that household disposable income growth is currently slowing.

Therefore, in the coming months we anticipate further slowing in the year-on-year rate of increase in house prices, with the FNB House Price Index expected to end the year on lower year-on-year growth of between 3-5%.

Notes:

Note on The FNB Average House Price Index: *Although also working on the average price principle (as opposed to median or repeat sales), the FNB House Price Index differs from a simple average house price index in that it could probably be termed a "fixed weight" average house price index.*

One of the practical problems we have found with house price indices is that relative activity shifts up and down the price ladder can lead to an average or median price index rising or declining where there was not necessarily "genuine" capital growth on homes. For example, if "suburban segment volumes remain unchanged from one month to the next, but former Black Township (the cheapest areas on average) transaction volumes hypothetically double, the overall national average price could conceivably decline due to this relative activity shift.

This challenge of activity shifts between segments is faced by all constructors of house price indices. In an attempt to reduce this effect, we decided to fix the weightings of the FNB House Price Index's sub-segments in the overall national index. This, at best, can only be a partial solution, as activity shifts can still take place between smaller segments within the sub-segments. However, it does improve the situation.

The FNB House Price Index's main features are as follows:

- *The weightings of the 10 sub-segments were determined by their relative transaction volumes over the 5 years from 2003 to 2007. The weightings are fixed (to be revised periodically):*

- *Sectional Title:*

  - *Less than 2 bedroom (Weight – 0.0718)*
  - *2 Bedroom (Weight – 0.2106)*
  - *3 Bedroom (Weight – 0.101)*
  - *4 Bedrooms (weight – 0.0031)*
  - *More than 4 Bedrooms (Weight – 0.0002)*

- *Full Title:*

  - *Less than 2 Bedrooms (Weight – 0.053)*
  - *2 Bedrooms(Weight – 0.1092)*
  - *3 Bedroom(Weight – 0.3561)*
  - *4 Bedroom (Weight – 0.0811)*
  - *More than 4 Bedroom(Weight – 0.0139)*

- *The Index is constructed using transaction price data from homes financed by FNB.*
- *The minimum size cut-off for full title stands is 200 square metres, and the maximum size is 4000 square metres*
- *The maximum price cut-off is R10m, and the lower price cut-off is R20,000 (largely to eliminate major outliers and glaring inputting errors).*
- *The index is very lightly smoothed using a Hodrick-Prescott smoothing function with a Lambda of 5.*

Note on 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 (100)", "average (50)", and "weak (0)". From all of these ratings we compile an aggregate demand and an aggregate supply rating, which are expressed on a scale of 0 to 100. After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating, add 100 to the difference, and divide by 2, so that the FNB Valuers' Residential Market Strength Index is also depicted on a scale of 0 to 100 with 50 being the point where supply and demand are equal.*