DECEMBER FNB HOUSE PRICE INDEX

- House price inflation remains unchanged from previous month, as house price inflation averages an estimated 6.7% for 2010 as a whole

FNB Property Barometer

FNB PROPERTY MARKET ANALYTICS

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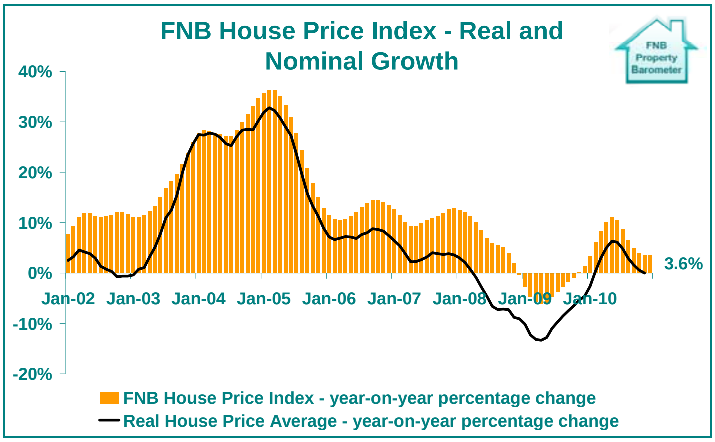
FNB HOUSE PRICE INDEX AVERAGED 6.7% GROWTH FOR THE YEAR 2010

The December 2010 FNB House Price Index completes the picture for last year, a year which proved to be hard work for those in the property industry, although it was significantly better than 2009.

For December, the year-on-year rate of increase in the FNB House Price Index was 3.6%, which was unchanged from the November revised rate of growth of 3.6%. In real terms, i.e. adjusting for a November Consumer price inflation rate of 3.6% year-on-year, this means that November saw zero percent real change.

Examining 2010 as a whole, though, the picture was better than what the weak year-end figures suggest. The average price level was estimated to be 6.7% higher than the 2009 average price level, which translates into a real price average that was 2.3% higher in 2010 than in 2009, when taking the 1st 11 months of 2010 into account (We still await December CPI stats).

It must be said, though, that 2010 was a "tale of 2 halves", with the 1st half of the year showing an acceleration in average price growth, in response to massive interest rate cuts in 2008/9, while the 2nd half of the year showed a de-celeration in price growth in response to the SARB putting the brakes on the pace of interest rate cutting from late-2009.

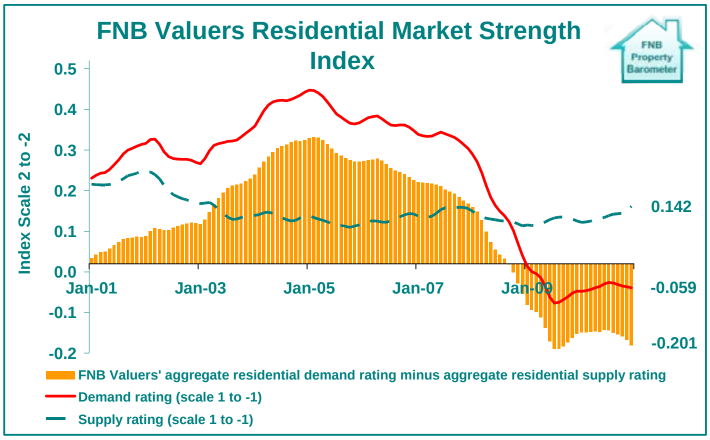


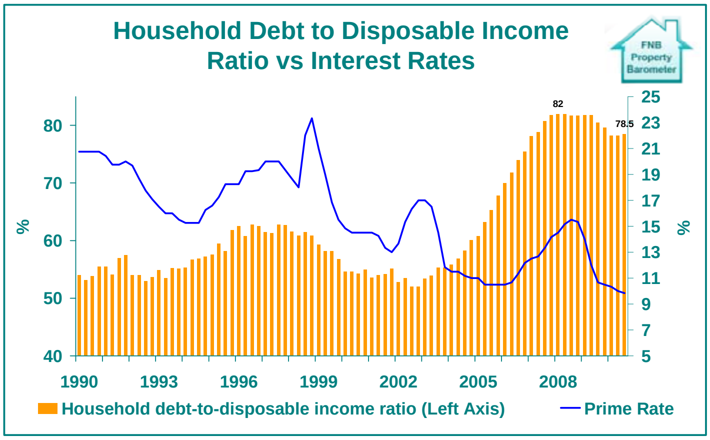
And then, right at the end of 2010, there were hints at some stabilization in nominal price growth, albeit at a very low rate of price increase.

It is too early to say whether the stabilization in the rate of price increase is any sign of a turnaround in the price trend, and at this stage we think probably not. Rather, we believe it possible that the 2 successive interest rate cuts in September in November may have given the market a slight bit of impetus (on top of any seasonal factors) through the summer months, but that this will fade should there be no further interest rate cutting.

And so, the market enters 2011, with its fundamentals still mediocre at best.

It is important to accept that the broader property cycles (excluding the "mini-recoveries" such as that of the 1st half of 2010) are generally long in duration, and the slow times following booms can last for a good number of years while the market slowly battles to eliminate past "excesses". Certain indicators suggest that 2011 will probably be another year of hard work for the residential property-related industries. FNB's valuers, as a group, certainly appear to believe that the situation of weak demand relative to supply continues.





The FNB Valuers' Market Strength Index weakened further in December. 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)".

The aggregate supply rating was slightly higher at +0.142, while the aggregate demand rating weakened from -0.057 (revised) previous to -0.059 in November.

After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating. The collective opinion of the valuers is that demand relative to supply has weakened further from -0.19 in November to -0.2 in December, the continuation of a weakening trend in the Market Strength Index.

The ongoing weakness in valuers' perceptions of the market continues to be of little surprise, with the country's household sector still experiencing a high level of indebtedness. In December, the SARB Quarterly Bulletin showed the household sector debt-to-disposable income ratio to have been 78.5% as at the 3rd quarter of 2010, which remains only marginally lower than the 82% all time high recorded at the beginning of 2008. The household sector, therefore, remains constrained with regard to the extent by which it can grow its borrowing of this very high base (a high base by SA standards, at least).

In addition, 2011 looks set to provide little in the way of additional interest rate stimulus to the market. Already, 2010 proved to be a year of far slower interest rate cutting by the SARB, compared with 2009. And recently, we have seen 2 consecutive months of mild increase in the consumer price inflation rate, from a September low of 3.2% to 3.6% by November. Factors suggesting a further near term increase in consumer inflation include upward pressure on global food prices, rising oil prices and some increase in domestic petrol price inflation recently, as well as mildly rising home rental inflation as measured in the CPI.

A 3.6% consumer price inflation rate is by no means a problem, however, and we do not expect interest rate hiking until 2012 (although the performance of the rand this year is probably the wildcard from an inflation point of view, and another year of solid performance by the currency would be crucial to this view). But it is important emphasise that the stimulus to the market comes from interest rate cutting, not from rates moving sideways, and given the SARB's inflation focus, it would be unlikely to cut rates should inflation be rising..

And so, after starting the year with some of the mild stimulus from late-2010 interest rate cuts still to feed through into house prices, a year of expected sideways movement in interest rates, leads us to believe that 2011 will see further de-celeration in the rate of increase of the FNB House Price Index following perhaps an initial few months of relative stability.