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PROPERTY BAROMETER –FNB HOUSE PRICE INDEX – FEBRUARY 2013

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Slower year-on-year house price growth in February 2013 is perhaps still reflective of the lagged impact of a briefly slower economic period late in 2012.

FEBRUARY HOUSE PRICE INDEX FINDINGS

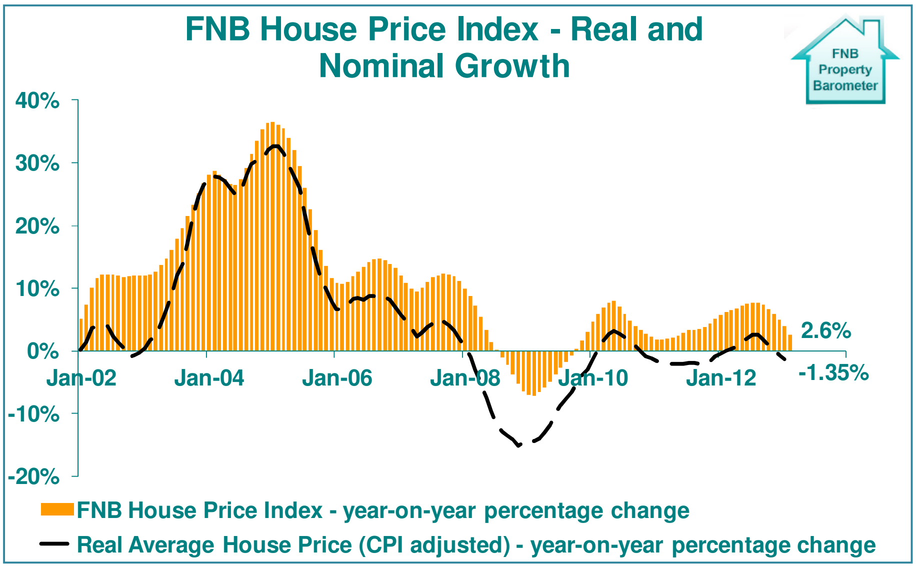
We have undertaken our 5-yearly exercise of re-weighting of the FNB House Price Index's sub-segments, in order to keep up with longer term changes in the composition of housing stock that gets traded. New sub-segment weightings have led to some backdated changes in the FNB House Price Index. For explanation, see notes at the end of the report.

The FNB House Price Index for February 2013 showed further slowing in its year-on-year inflation rate, from a revised 3.9% in January to 2.6%. This continues a mild slowing growth trend from a "mini-peak" of 7.7% growth reached in July and August 2012.

The average value of homes transacted in the FNB House Price Index was R846,172 in February.

This slowing year-on-year house price growth, to levels back below consumer price inflation, implies a recent return to declining house prices in inflation-adjusted real terms. As at January (February consumer price inflation data not yet available), the combination of a CPI inflation rate of 5.4% year-on-year, and a 3.9% nominal house price growth rate in that month, translated into a real year-on-year decline of -1.35% in the FNB House Price Index.

Monitoring longer term performance of the index, we see that in real terms, as at January the FNB House Price Index was still 58.7% higher than in July 2000 when the index started. However, since the revised real price peak reached in November 2007, real price levels have declined by -19.5%. In nominal terms, the index is 216.9% higher than July 2000, but only 9.5% above November 2007.



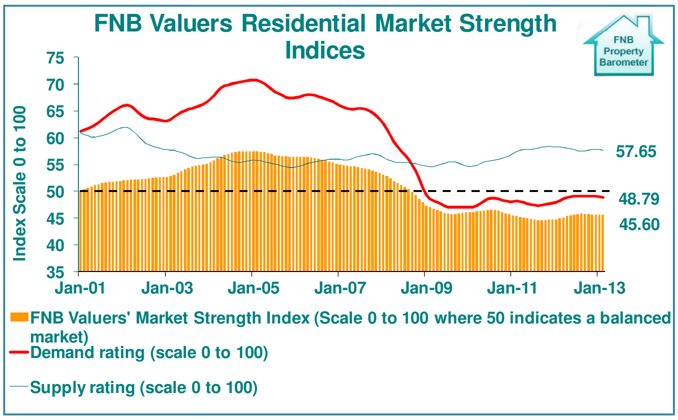
FNB'S VALUERS HAVE ALSO POINTED TO THE BEST PACE OF MARKET IMPROVEMENT HAVING BEEN EARLIER IN 2012

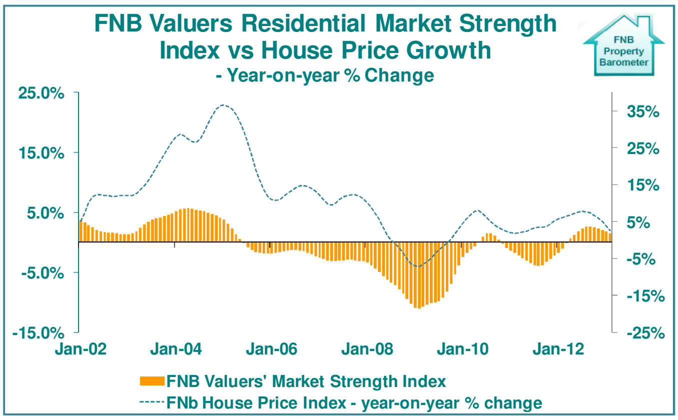
What movements in house price growth suggest over the past year to year-and-a-half is that the best rate of improvement was to be found back in the 1st half of 2012, around the time when the economy was going through a relatively strong growth period. The slowing growth more recently perhaps reflects the slower economic growth period of the 2nd half of the year.

The FNB Valuers' Market Strength Index (Explanatory notes on page 4) has also pointed to year-on-year improvement over the course of 2012, and like price growth it also pointed to an accelerating rate of improvement earlier in 2012, and a slowing pace of improvement in the 2nd half of 2012.

Trend changes in the Market Strength Index often lag price growth trend changes a little, but this indicator nevertheless serves as something of a "confirming indicator" for recent price trends.

In addition, despite some rise in the Market Strength Index through 2012, the fact that it remains below the crucial level of 50 implies that the valuers still rate supply as better than demand. This should probably imply further broad house price decline in real terms for the foreseeable future, and this is what the FNB House Price Index is recording once again.

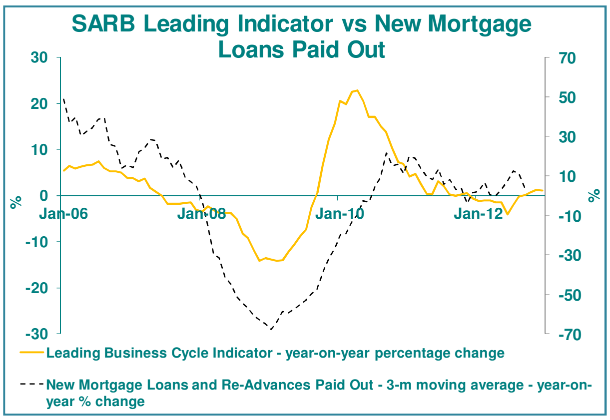




OUTLOOK…..

Where too from here? It was a relatively strong economic period through the summer of 2011/12 to mid-2012 that aided a noticeable improvement in the housing market and house price growth. During the 2nd half of 2012, however, a slower domestic economy, hampered by widespread industrial action disruptions to production (the most extreme being in the mining sector), was arguably instrumental in causing a slower pace of price growth in the 2nd half of 2012 and early-2013.

However, recently we have started to see the economic growth situation "normalize". From a lowly 1.2% quarter-on-quarter annualized growth in real gross domestic product (GDP) in the 3rd quarter of 2012, the 4th quarter rate accelerated mildly to 2.1% in the 4th quarter. More recently, the February Manufacturing Purchasing Managers' Index, a very useful current indicator of economic direction, rose to above 50, signaling renewed expansion in manufacturing after a late-2012 slump.



The Reserve Bank Leading Indicator, too, has recently pointed to slightly better economic times in the near term. After a period of negative year-on-year growth through much of 2012, its growth rate returned to positive territory from September through to the end of the year, suggesting that we were probably headed for better economic growth at the start of 2013.

Therefore, we would expect the recent slowing in year-on-year growth to come to an end soon, as the lagged impact of mildly improved economic times takes effect on the housing market.

However, the expectation that house price growth will remain in lower single-digit territory for the year, below consumer price inflation and thus negative in real terms, still holds. This mediocre expectation is on the back of our forecast for no further interest rate reduction in 2013, and although economic growth is expected to be better than it was late in 2012, a 2.7% 2013 forecast growth rate remains weak, constrained by global economic mediocrity as well as a highly-indebted household sector.

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 short term 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.

With our 2013 re-weighting exercise, we have begun to segment not only according to room number, but also to segment according to building size within the normal segments by room number, in order to further reduce the impact of activity shifts on average price estimates.

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

- *The weightings of the sub-segments are determined by their relative transaction volumes over the past 5 years, and will now change very slowly over time by applying a 5-year moving average to each new price data point. The sub-segments are:*

- *Sectional Title:*
    - *Less than 2 bedroom – Large*
    - *Less than 2 bedroom – Medium*
    - *Less than 2 bedroom – Small*

    - *2 Bedroom – Large*
    - *2 bedroom – Medium*
    - *2 bedroom – Small*

    - *3 Bedroom and More - Large*
    - *3 Bedroom and More - Medium*
    - *3 Bedroom and More - Small*

- *Full Title:*
    - *2 Bedrooms and Less - Large*
    - *2 Bedrooms and Less - Medium*
    - *2 Bedrooms and Less - Small*

    - *3 Bedroom - Large*
    - *3 Bedroom - Medium*
    - *3 Bedroom - Small*

    - *4 Bedrooms and More - Large*
    - *4 Bedrooms and More - Medium*
    - *4 Bedrooms and More – Small*

The size cut-offs for "small", medium" and "large" differ per room number sub-segment. "Large" would refer to the largest one-third of homes within a particular room number segment over the past 5 year period, "Medium" to the middle one-third, and "Small" to the smallest one-third of homes within that segment.

- *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.*