

Changing circumstances but solid foundation

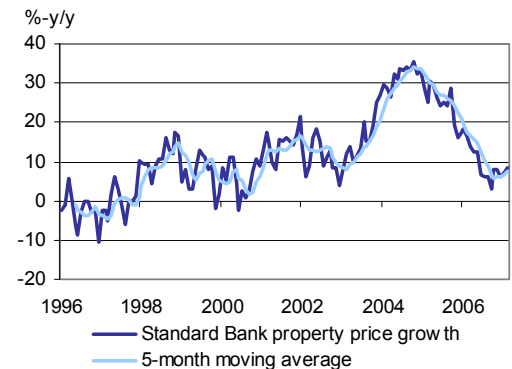
The median house price remained at R570 000 in February, recording 0% month-on-month growth. However, given a relatively base value from which year-on-year growth is calculated in February 2006, house price growth rose marginally to 8.6% in February from 6.9% in January. The five-month moving average rate, which is one of the measures that can be used to represent trend growth, rose 7.6% y/y from 6.4% y/y in January. In addition to fading momentum following frenzied growth earlier and the absence of fresh stimulus, which have been responsible for a generally downward trend in house price growth since the end of 2004, monetary and fiscal policy have more recently joined forces to curb the consumer spending boom and, by extension, house price growth. Furthermore, waning demand from buy-to-let investors on the back of falling yields is aggravating the slowdown in the housing market.

Even though the macroeconomic setting is generally very constructive, characterised by strong economic growth and continued employment expansion, the prolonged consumer boom is being curbed by the concerted effort of monetary and fiscal policymakers to stem the spending spree. The 200 basis points' rise in interest rates last year has rendered households' record-high debt burden increasingly expensive, with them having to fork out at least R14bn per year more at these interest rates to service their debt. At the same time, income tax relief fell by about 40% from last year's (R8.4bn in 2007/08 from R13.9bn in 2006/07). Indeed, with personal income tax expected to grow by almost 12% y/y in the 2007/08 fiscal year, it is likely to exceed the growth in households' income, in which case their tax burden will rise.

Given these and other curtailing factors impacting negatively on households' finances, there is some concern about their financial health, which, if it were to deteriorate markedly, will have severe consequences for the residential property market. The concerns are fuelled by the fact that only around a third of the current outstanding debt has been incurred prior to the monetary policy easing cycle starting in mid-2003 (see Figure 3). In other words, the bulk (about 60%) of the outstanding household debt has been acquired when interest rates were lower than what they currently are. Furthermore, for many households this was the first time that they had access to credit and their first experience with rising interest rates.

Indeed, indications that some households are having difficulty financing their record-high debt have emerged. In December, the value of credit card and mortgage debt in arrears three months or more rose by 71.5% y/y and 18.5% y/y respectively, but this should be seen in the context of the strong growth in credit extension: credit card debt in arrears three months or more rose to 5% of total outstanding credit card debt from a recent trough of 4.3% in November 2005 while the equivalent measure for mortgage advances rose to 1.9% in December 2006 from a near-term trough of 1.5% in May 2006 (see Figure 4). The number of summonses for debt of individuals has been rising since early 2006 to 117 000 (seasonally adjusted) in November (it subsequently dipped in December) – the highest since March 2004. The number of

Figure 1: House prices – Standard Bank



Source: Standard Bank Group

Table 1: Stats at a glance

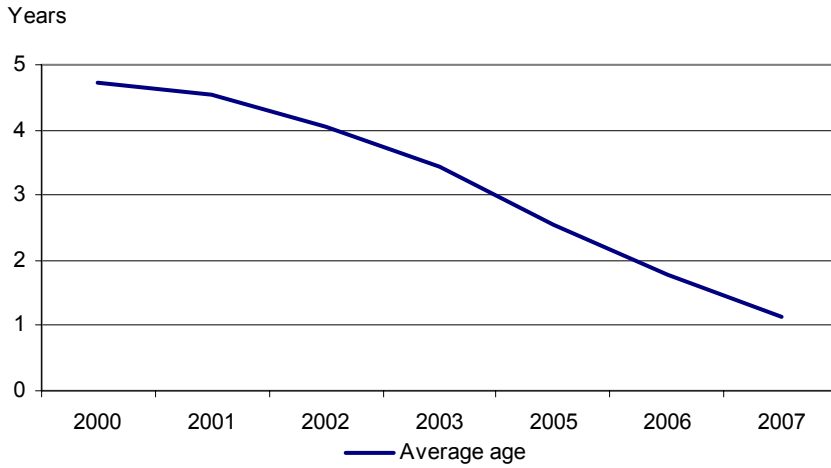
| Indicator | Period | Data |
|-----------------------------------|--------|-----------|
| Median house price | Feb 07 | 8.6% y/y |
| Median house price | 5m ma | 7.6% y/y |
| Median house price | Feb 07 | R570 000 |
| Mortgage advances | Jan 07 | 30.1% y/y |
| Private sector credit extension | Jan 07 | 24.8% y/y |
| Ratio of household debt to income | Q3 06 | 73% |
| Prime rate | Feb 07 | 12.5% |

Source: Standard Bank Group, SARB



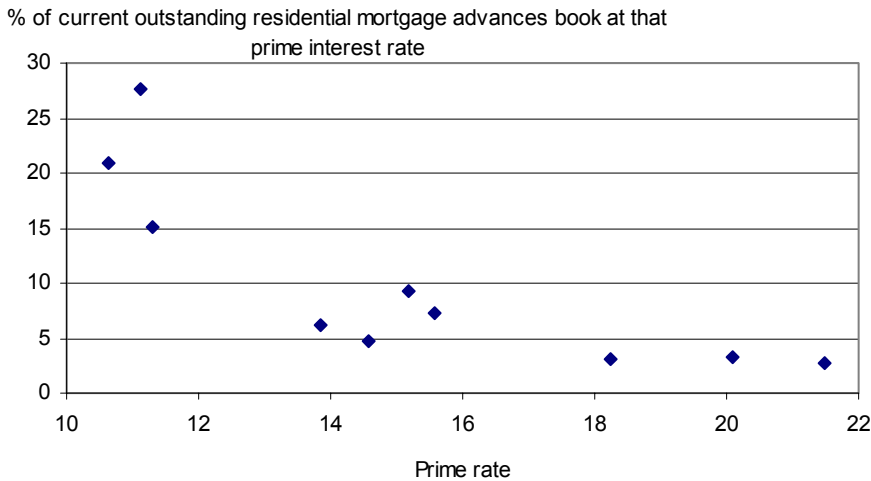
insolvencies of private persons and partnerships declined to 91 in November 2006 (it rose marginally to 103 in December, which is still below the 105 recorded in October), but this indicator obviously trails the other warning signs.

Figure 2: Average age of residential mortgage advances



Source: Standard Bank Group, SARB

Figure 3: Interest rates prevailing when debt was acquired

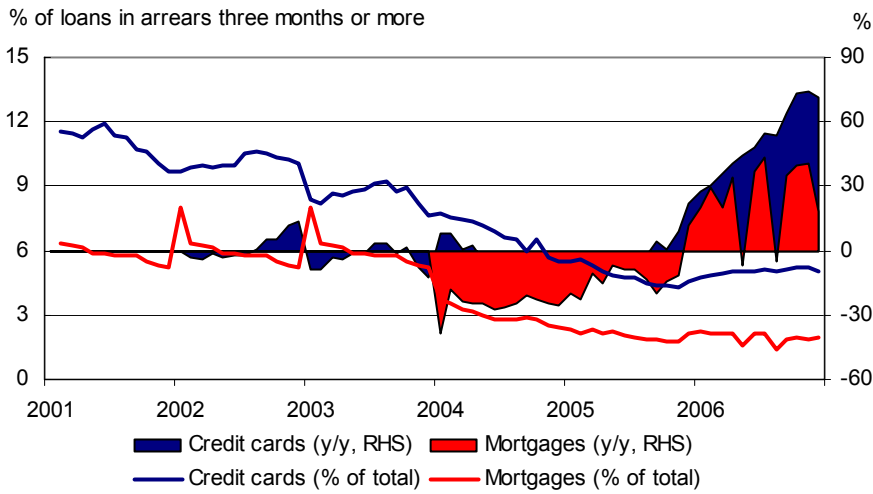


Source: Standard Bank Group, SARB

The bulk of the outstanding household debt has been acquired when interest rates were lower than what they currently are



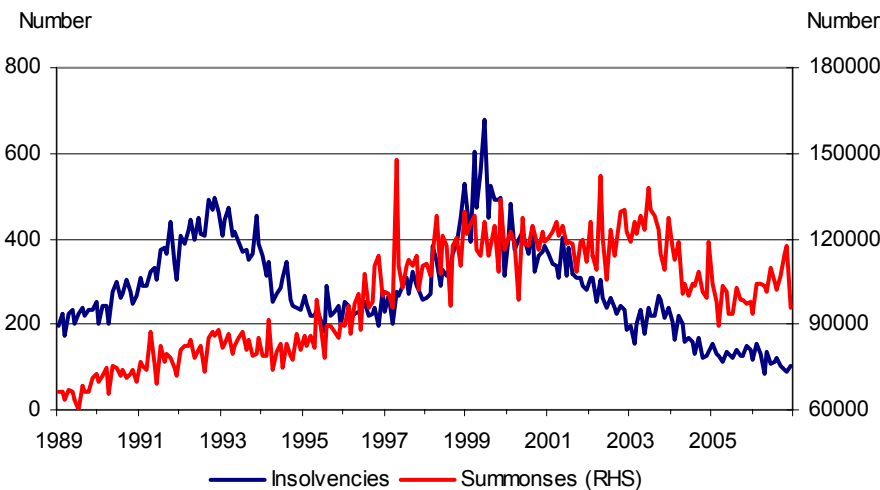
Figure 4: Non-performing loans



Source: Standard Bank Group, SARB

The proportion of loans that are in arrears three months or more has reached a trough and has been rising modestly

Figure 5: Seasonally adjusted number of insolvencies¹ and summonses²



Source: Standard Bank Group, SARB

By and large, the available indicators seem to suggest that households' financial position has been deteriorating but the prognosis remain quite favourable. This, combined with a constructive macroeconomic setting, bodes well for the property market, supporting our view that nominal house prices are unlikely to fall. We still foresee essentially stagnant aggregate house prices in the short-term, with a pickup in house price growth in the medium to long term.

Bottom line

The housing market, along with other indicators of household activity, continues to show signs of moderation. Despite the restraints on households' cash flow, their financial situation compares reasonably favourable with historical settings, which supports our view that nominal house prices are unlikely to fall. Aggregate house prices are expected to show very little, if any, growth in the near term, but growth is expected to pick up towards year-end, especially if the SARB cuts interest rates in the final quarter of the year and early next year as we expect it to.

House price growth will be constrained in the short term

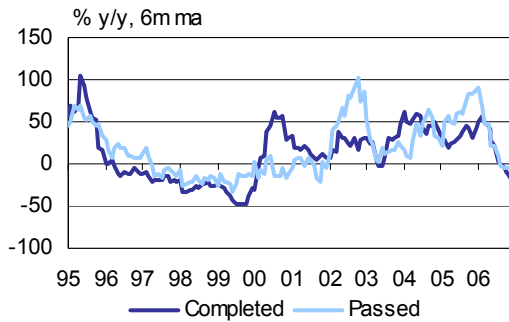
¹ Private individuals and partnerships.

² To private individuals.



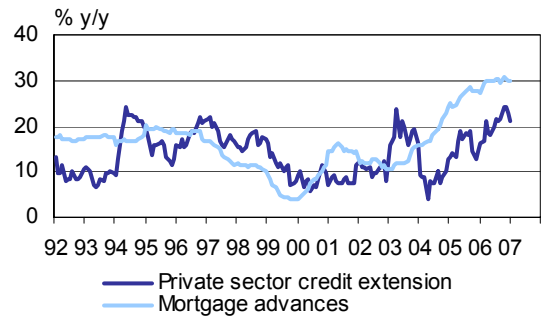
Picture Gallery

Figure 1: Buildings: Flats & townhouses



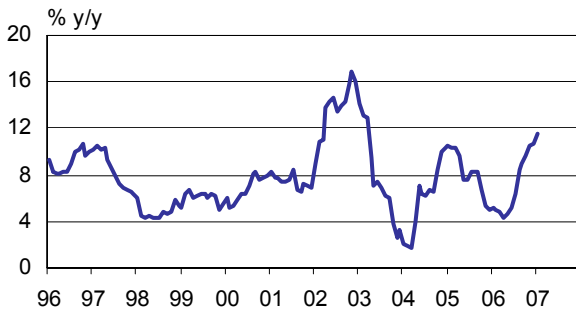
Source: StatsSA

Figure 2: Private sector borrowing



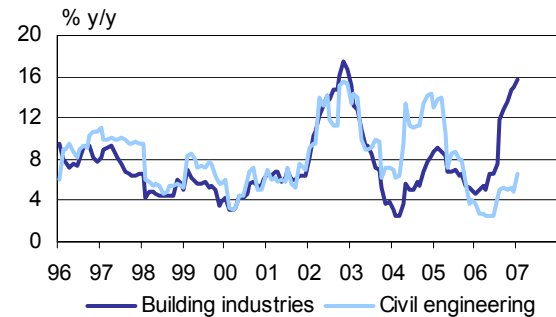
Source: SARB

Figure 3: Building cost: Building and construction



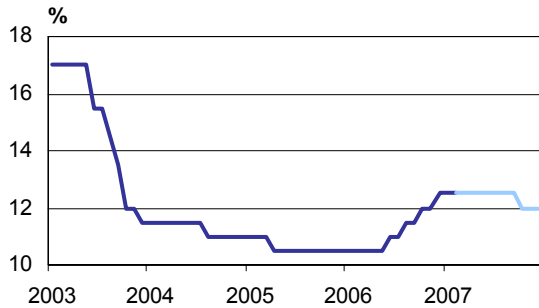
Source: StatsSA

Figure 4: Building cost: Building industries and civil engineering



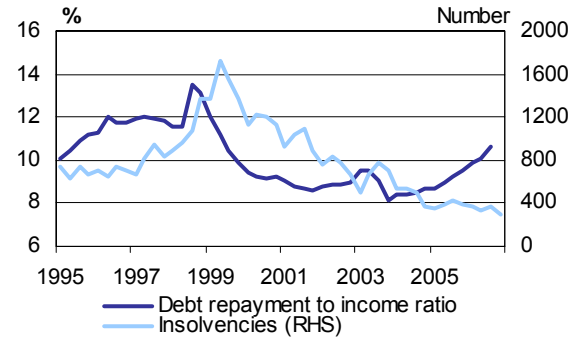
Source: SARB

Figure 5: Prime interest rate



Source: SARB, Standard Bank Group

Figure 6: Debt affordability vs insolvencies



Source: StatsSA, Standard Bank Group

Note on the methodology used in calculating Standard Bank's house price index

The way in which house prices are measured means that they are inherently volatile, not unlike many other economic indicators. Measuring house prices is complicated by the fact that the available data usually stem from the properties sold during a particular period, rather than from a well-designed sample that is representative of all houses. This is aggravated by the heterogeneity of houses. Changes in the measured prices may be the result of actual changes in the general price level; or changes in the distribution of the houses being sold, for example more sales of luxury houses may push up the measured house prices even without changes in general prices; or the changes may simply be random.

Given these data challenges, the international best practice is to use the median or middle price, rather than, say, the average house price. The median is the price such that half of all houses are more expensive and half less expensive than that price. It is substantially less volatile and less sensitive to the typical problems found in house price data. Standard Bank's data are therefore based on the median house price of the full spectrum of houses. Furthermore, national data from the Deeds Office are available only with a relatively long lag of up to nine months, so data from Standard Bank, which has a market share of about 27.7%, and whose data are generally highly correlated with those of the Deeds Office, are a good proxy for the national market.



Table 1: Standard Bank house price data

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|-------------|------|------|------|------|------|------|------|------|
| Jan | 8.3 | 12.8 | 13.6 | 8.0 | 29.6 | 28.6 | 18.5 | 6.9 |
| Feb | 5.3 | 17.5 | 6.4 | 12.0 | 28.6 | 25.1 | 16.6 | 8.6 |
| Mar | 11.1 | 15.0 | 8.7 | 14.0 | 26.3 | 30.6 | 13.8 | |
| Apr | 11.1 | 10.0 | 15.9 | 9.8 | 32.1 | 29.7 | 12.5 | |
| May | 4.4 | 8.1 | 18.2 | 11.5 | 31.0 | 26.3 | 12.5 | |
| Jun | -2.5 | 15.7 | 15.2 | 13.5 | 33.9 | 24.1 | 6.5 | |
| Jul | 2.6 | 15.0 | 8.7 | 20.0 | 33.3 | 25.0 | 6.0 | |
| Aug | 0.7 | 16.2 | 11.1 | 15.4 | 34.0 | 24.4 | 6.0 | |
| Sept | 2.6 | 15.0 | 13.0 | 15.4 | 33.4 | 28.8 | 2.9 | |
| Oct | 7.7 | 14.3 | 8.3 | 19.2 | 35.5 | 19.0 | 8.0 | |
| Nov | 10.5 | 16.8 | 8.3 | 25.0 | 32.3 | 16.3 | 8.0 | |
| Dec | 9.0 | 21.4 | 4.0 | 26.9 | 33.3 | 17.5 | 6.4 | |



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