

Some huff and puff, but not falling down

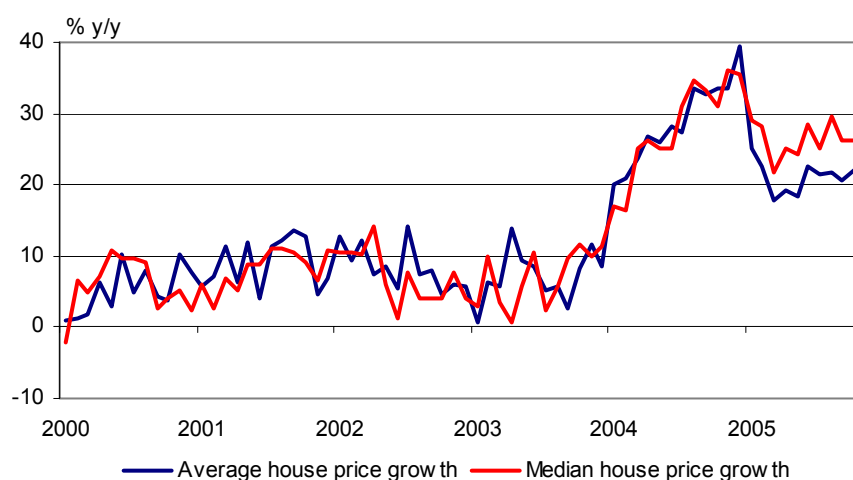
The residential property market continues to be buoyant, although the growth in house prices have softened substantially from last year's peak. This deceleration is most evident in the upper price range, while activity and prices of properties in the middle price ranges are still outpacing the growth in other price bands.

The macroeconomic environment and consumers' relatively sound balance sheets remain supportive of a firm housing market. However, the anticipated consolidation in house prices has crept in. The slowdown in the property market is echoed by anecdotal evidence which suggests an increase in the average number of days that a property is on the market before being sold, and a rising gap between asking and selling prices. This is the result of recent above-trend growth that created a high base from where future growth rates will be calculated; the reduction in pent-up demand after several years of brisk buying; and the fading impact of previous interest rate cuts.

In this report we analyse these and other trends in the domestic residential property market. In the next section, we unpack national house prices across different price segments. Section 2 takes a closer look at the property market dynamics in the main cities. In sections 3 and 4 the demand for housing by owner-occupants and investors, respectively, are analysed. Section 5 presents the outlook for the property market. A description of the definitions used, as well as a comparison between house prices recorded by Standard Bank and the Deeds Office, is presented in Appendix A.

In November, house prices grew by 21.5%.

FIGURE 1: MONTHLY NATIONAL HOUSE PRICES: STANDARD BANK



The median house price is the price such that half of all houses are cheaper than that price.

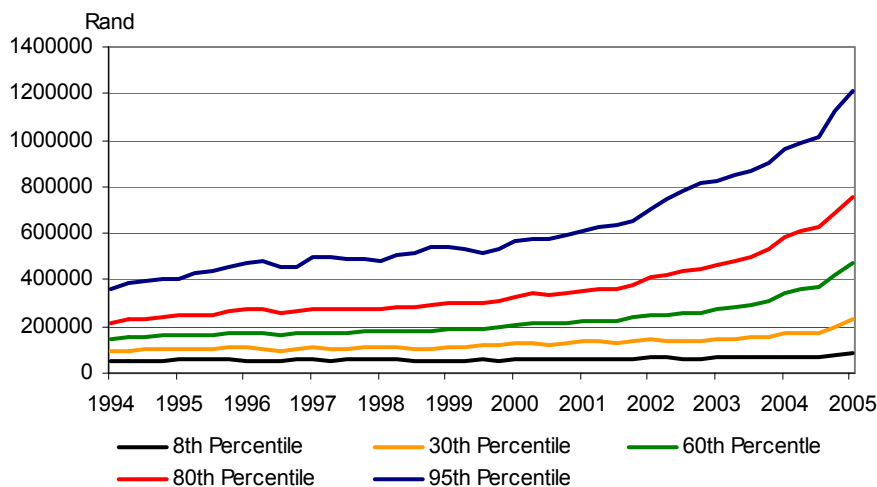
Source: Standard Bank Group

1. Residential property prices

Even though growth in house prices across the board are slowing down, there are noticeable differences in the various price segments. Prior to 2003, luxury houses' prices generally outpaced those of less expensive houses, while the least expensive houses generally grew the slowest (see Figures 2 and 3). This is important from an affordability point of view, especially for the less affluent whose cost of housing has increased less than proportionately most of the time.



FIGURE 2: HOUSE PRICES IN DIFFERENT PRICE CATEGORIES¹

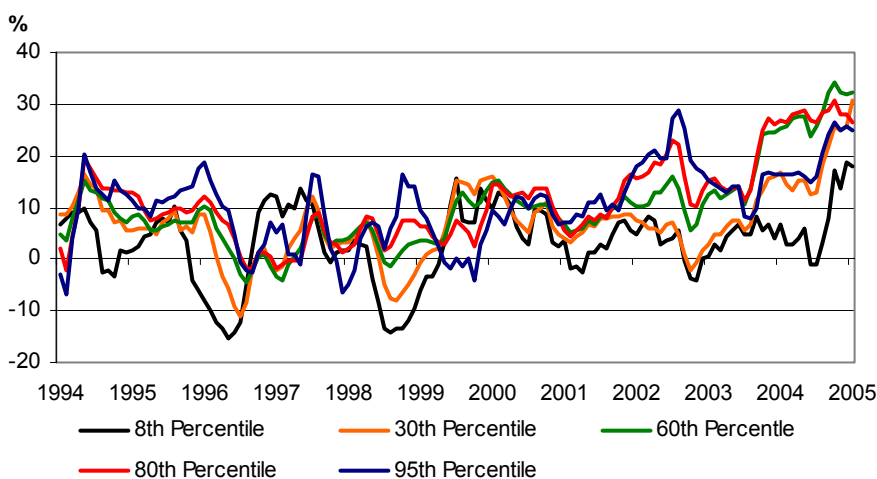


Source: Standard Bank Group, Deeds Office

Over the long term the price growth of luxury houses generally outpaced those of less expensive houses...

More recently, faster growth has been recorded in the middle price ranges than among the most expensive houses (see Figure 3). This is attributable to two factors. Firstly, increasing property prices have been stimulating the demand for more affordable property, with townhouses and flats gaining popularity relative to houses (see Figure 4). According to Statistics South Africa, the number of houses completed this year was almost 20% lower than in the corresponding period last year, while the number of townhouses and flats completed has grown by 68% in the year to date. While this reflects a rising supply of townhouses and flats, the continuous price growth in this segment implies that the demand for this type of accommodation still exceeds supply.

FIGURE 3: HOUSE PRICE GROWTH IN DIFFERENT PRICE CATEGORIES



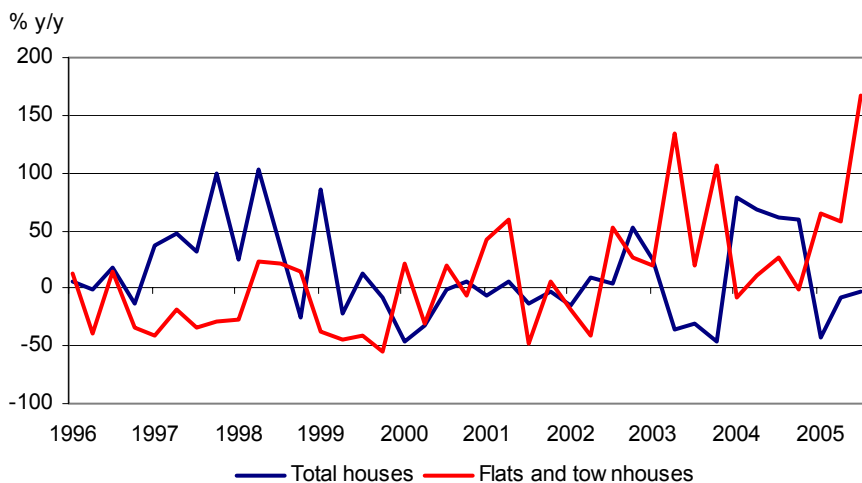
Source: Standard Bank Group, Deeds Office

...but recently, faster growth was recorded in the middle price ranges

¹ Percentiles divide all house prices into 100 portions of equal size. For example, a house price falling in the 8th percentile means that 8% of all houses are less expensive.



FIGURE 4: THE NUMBER OF HOUSES, TOWNHOUSES AND FLATS COMPLETED

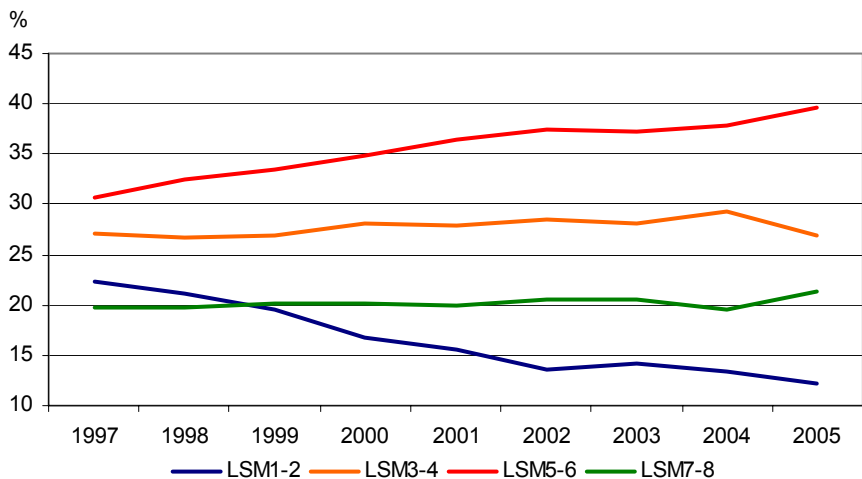


Source: Stats SA

Secondly, the relative performance of different house price segments concurs with the dynamics in different income groups. The favourable macroeconomic environment and national redistributive policies are underpinning an upward income migration of the population, with a rising proportion entering the middle-income groups from the low-income group (see Figure 5). The proportion of the population that falls in the highest income group remains more or less constant, and amid a growing total population, this implies that the number of people in this group increased. The rising proportion of the population (and number of people) in the middle-income groups boosted demand for middle-priced properties, while the stagnant proportion of high-income earners explains why rises in the most expensive houses were less buoyant than in middle-priced houses. The relatively low inflation in the cheapest houses is at least partly attributable to the shallowness of a secondary market for houses in this price segment.

More affordable accommodation, such as townhouses and flats, are gaining popularity.

FIGURE 5: UPWARD INCOME MIGRATION²



Source: SAARF

² The South African Advertising Research Foundation (SAARF) LSM is a unique means of segmenting the South African market, which groups people according to their living standards using criteria such as degree of urbanisation and ownership of cars and major appliances. The average monthly household income for the LSM groups in 2004 were as follows: LSM 1 R879; LSM 5 R2 427; LSM 6 R4 075; LSM 7 R6 455; LSM 8 R8 471; LSM 9 R11 566 and LSM 10 R18 649.

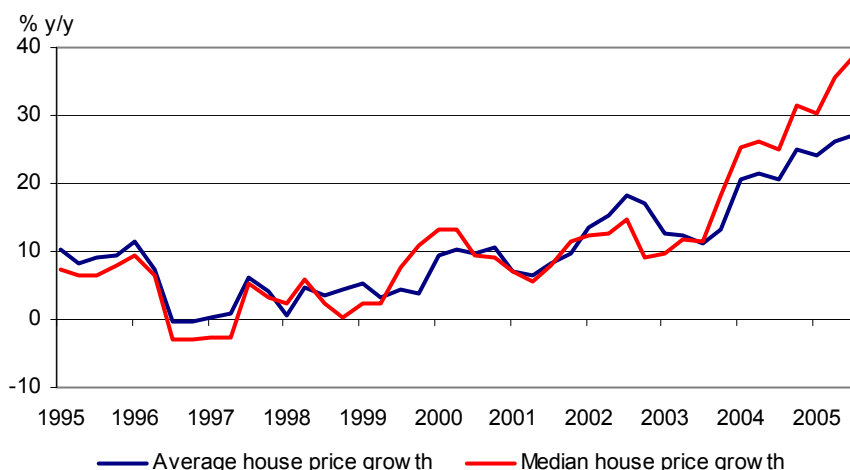


The relative performance of different price categories has important implications for the aggregate growth in house prices. Only a couple of exceptionally expensive houses need to be sold to have a material influence on the *average* value of house prices transacted in a particular period, so that it no longer accurately represents the general trend. It is therefore more appropriate to analyse the *median* house price, which is the price such that half of the houses are more expensive and half of them cheaper. If relatively expensive (or cheap) houses don't have an exceptional influence on the aggregate data, the mean and median should be similar.

Prior to 2003, the growth in the mean house price usually exceeded that of the median house price (see Figure 6). This is consistent with a scenario where the selling prices of the most expensive houses have grown significantly faster than most other houses, or an unusually large number of expensive houses have been sold, and hence skews the picture portrayed by the mean. The shift of activity in the property market from higher to middle price categories, combined with superior price growth in middle-price categories, means that a sharp divergence between the growth in the average and median house prices is appearing (see Figure 6). In the second quarter of this year, for example, the average and median house prices recorded by the Deeds Office rose by 26% and 36% respectively, from the year before.

Prior to the current boom in the housing market, the growth in the mean house price usually exceeded that of the median house price.

FIGURE 6: MEAN AND MEDIAN HOUSE PRICES: DEEDS OFFICE



Source: Standard Bank Group; Deeds Office

The recent slowdown in domestic house price growth means that South Africa no longer has the fastest growing property prices. According to The Economist, house prices in Hong Kong are now outpacing those in South Africa (see Table 1).



TABLE 1: GROWTH IN INTERNATIONAL HOUSE PRICES

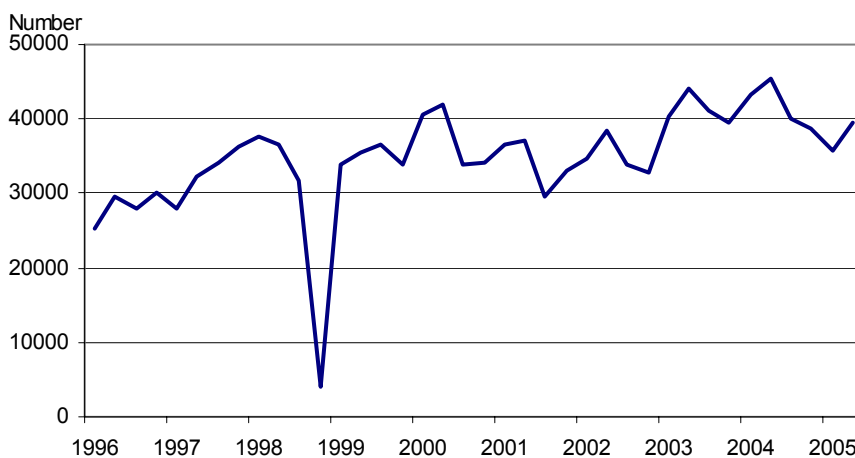
%	2005 Q2 ³ (y/y)	1997-2005
Hong Kong	22.1	-44
South Africa	21.4	26.3
Spain	13.7	171
US	13.4	79
Italy	8.5	76
China	8.0	NA
Ireland	6.2	196
Canada	4.3	48
Britain	2.3	155
Australia	-0.1	113
Japan	-5.4	-28

Source: *The Economist*

The recent deceleration in house price growth means that South Africa no longer has the fastest rising property prices.

The deceleration in house price growth is echoed by anecdotal evidence. For example, Jigsaw recorded an increase in the average time that a house is on the market from 39 days during the period August to October 2004 to 48 days in the corresponding months this year. Further, on average properties sold for 4% below the asking price between August and October this year, compared with 3.7% in the corresponding period last year. Despite the slowdown in house prices, the residential property market remains lively, with more properties sold in the second quarter of 2005 than in the previous two quarters (see Figure 7).

FIGURE 7: NUMBER OF HOUSES SOLD



Source: Standard Bank Group; Deeds Office

2. House prices in different areas

Driven by increasing demand, low property prices and social trends, the inner city residential property market in South Africa has started showing signs of rejuvenation. These inner cities are developing into prosperous areas for growth in both activity and prices in the residential property market.

The government is facilitating the plans to regenerate the inner cities of South Africa with the implementation of key initiatives to attract both residents and investors. Current infrastructure projects and

³ Or latest available.



funding plans suggest that growth in the inner cities will be strong and steady. Supporting this revival is the growing middle-income population migrating into the working areas of the CBDs.

All four of the major inner cities of South Africa – Johannesburg, Pretoria, Durban and Cape Town – have seen more transfers and higher property prices. In line with this strong growth, there is higher activity in rental stock demand in these areas as the younger generation seek improved social and economic lifestyles. With a higher demand for rental stock, specifically flats and townhouses, supply has begun to narrow against demand, thus providing opportunities for both investors and developers in the market (regional differences are explored in more detail in Appendix B).

The growth in activity and property prices in select suburbs of the four major inner cities are analysed below.

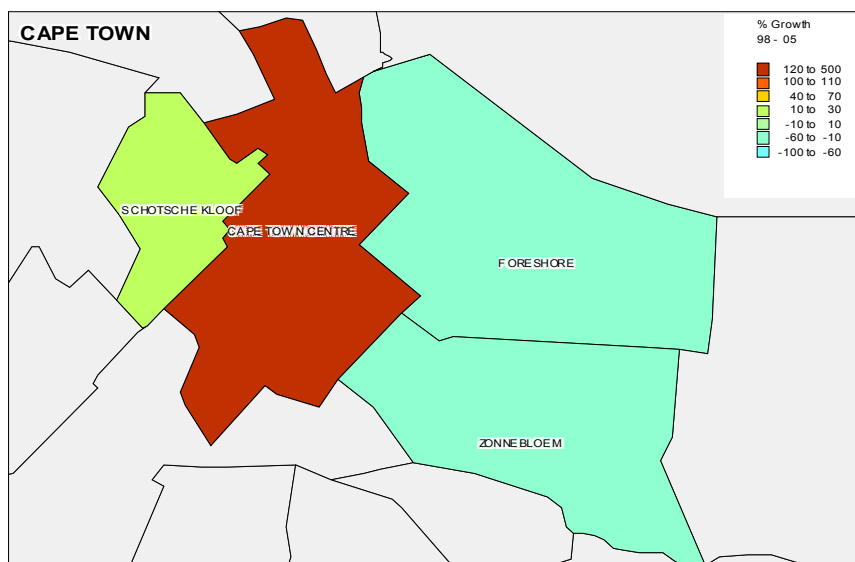
2.1 Cape Town

Cape Town’s CBD experienced less public and private infrastructure deterioration than, for example, Johannesburg during the 1990s. This is probably attributable to the fact that the inner city of Cape Town is small, lying between the harbour and a series of upmarket suburbs. Also, tourism has ensured that the CBD maintains a higher standard than that of the other inner cities, with strong municipal support.

Holding title to being the oldest and most established of all inner cities, strong rejuvenation continues to take place. Cape Town is recognised as a city of strong historical and cultural content and with the CBD a source of “high-street” shopping, entertainment and business, one can expect to observe even stronger growth in the near future.

Cape Town Centre has experienced high growth in both the number of properties being sold and average property prices (157% and 137% between 1998 and 2005 respectively). This impressive growth will hopefully have a spillover effect on the surrounding suburbs of Zonnebloem and Foreshore. However, despite the fact that sales volume growth in the remaining suburbs of Cape Town is low, the growth in property prices is robust. Plans to improve the surrounding areas of the CBD on a continuous basis have been put in place by the Cape Town municipal government, and the effects on the surrounding suburbs can be seen in Schotsche Kloof.

FIGURE 8: GROWTH IN THE NUMBER OF RESIDENTIAL PROPERTIES SOLD: CAPE TOWN INNER CITY (1998-2005)

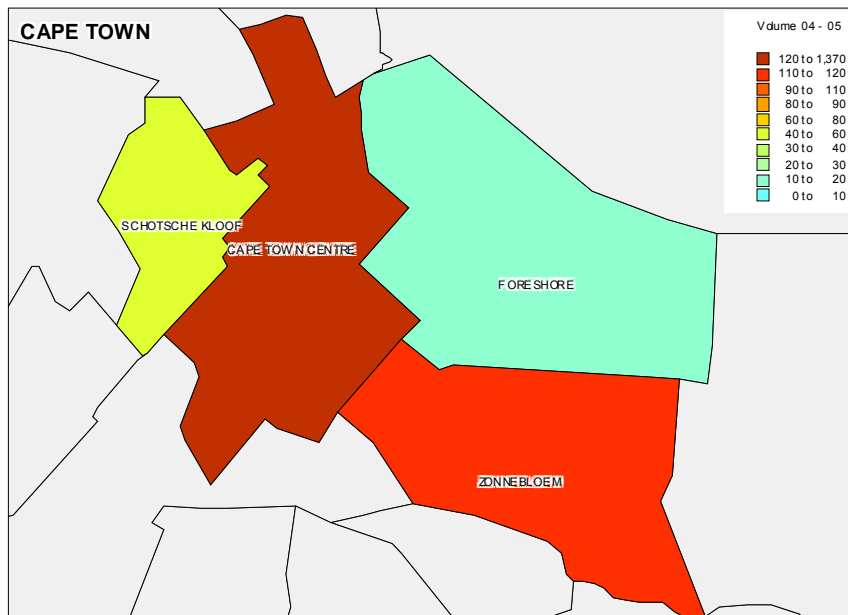


Tourism is boosting the residential property market of Cape Town’s inner city.

Source: Standard Bank Group, Deeds Office



FIGURE 9: NUMBER OF RESIDENTIAL PROPERTIES SOLD: CAPE TOWN INNER CITY (2005)



Source: Standard Bank Group, Deeds Office

2.2 Durban

The inner city of Durban has experienced high property price growth, a rising number of transfers and increasing rental stock. Durban could be in for even stronger growth in the next few years, particularly as it has lagged the other areas. For example, where Johannesburg began experiencing higher levels of growth in 1998, Durban only followed this trend approximately two years later. Similar to Johannesburg, Durban's CBD is home to some of the major companies and businesses in the city, thus facilitating a strong need to upgrade and revive the standard of living. Additional land developments near the CBD, such as uShaka Marine World, have provided a revival to those suburbs on its border, particularly the CBD.

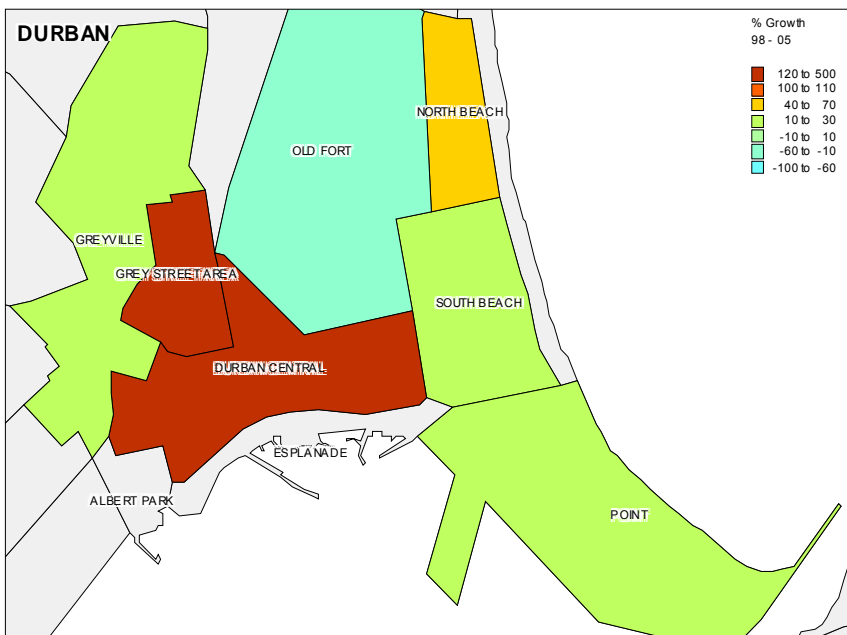
Given the positive outlook for the CBD, the municipality has geared itself to support the upgrading of weathered properties as well as redeveloping rundown buildings. Further motivating the current renewal are plans to follow Johannesburg's fiscal incentives. A major challenge faced by Durban's CBD is the shortage of two- and three- bedroom apartments to accommodate families. The demand for bachelor flats is also robust and consistent, due to the need for student accommodation.

All major suburbs in Durban's CBD have experienced growth in both activity and prices of residential property. However, some areas noticeably outperform others. Interestingly, the highest growth in transfers has been in the Grey Street Area (168% between 1998 and 2005) and Durban Central (125%), while the highest growth in property prices has been in Point (190%), North Beach (138%) and Greyville (141%). It is interesting to note that the suburbs in the centre of the city – Grey Street Area and Durban Central - have experienced the most movement with less price impact. This could signify a surplus of supply in the inner centre of the city. Conversely, the outer lying suburbs have experienced less activity, but somewhat constrained supply, thus increasing the prices of these properties.

The inner city of Durban is experiencing a rising number of transfers and property prices.



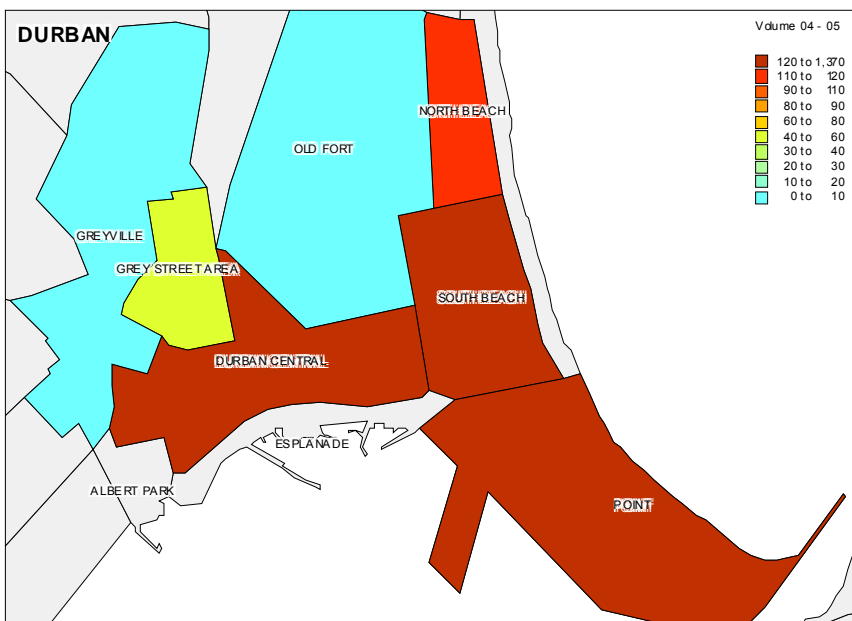
FIGURE 10: GROWTH IN THE NUMBER OF RESIDENTIAL PROPERTIES SOLD: DURBAN INNER CITY (1998-2005)



Durban's inner city has a lively residential property market.

Source: Standard Bank Group, Deeds Office

FIGURE 11: NUMBER OF RESIDENTIAL PROPERTIES SOLD: DURBAN INNER CITY (2005)



Source: Standard Bank Group, Deeds Office

2.3 Johannesburg

Gauteng sets the trend for future inner city development in South Africa. With tax incentives and being labelled the future mega city of South Africa, Johannesburg's CBD shows high levels of activity beginning to take place.

The percentage growth in the number of transfers of property within selected suburbs of Johannesburg's CBD from 1998 to 2005 is illustrated in Figure 12. High levels of activity have been experienced, mainly

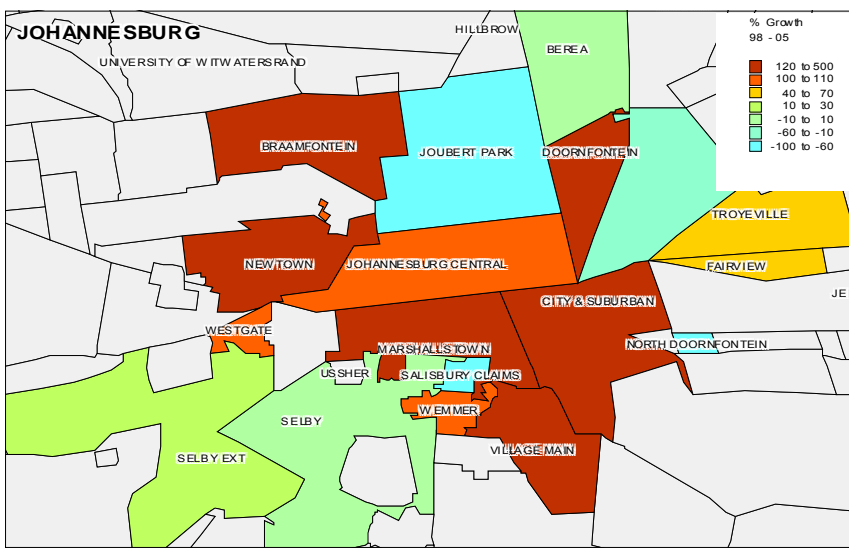


toward the inner core of the city. Buoyant levels of development in Newtown, Braamfontein and Johannesburg Central, confirm the general opinion that levels of activity within Johannesburg’s CBD are increasing continuously.

Joubert Park has shown high average price growth between 1998 and 2005. Despite it having experienced less activity over this period (volume growth of – 65.8%), the average property price growth has partly compensated for this loss in volume with gains in value. Highest growth occurred in the most inner centre of the CBD – Doornfontein (500%), Braamfontein (210%), Newtown (200%), Village Main (150%), City & Suburban (123%) and Marshalltown (150%) (see Figure 12).

Such indicators clearly illustrate that not only is property in the inner city of Johannesburg gradually becoming more actively traded, but that its value is increasing at a rapid rate.

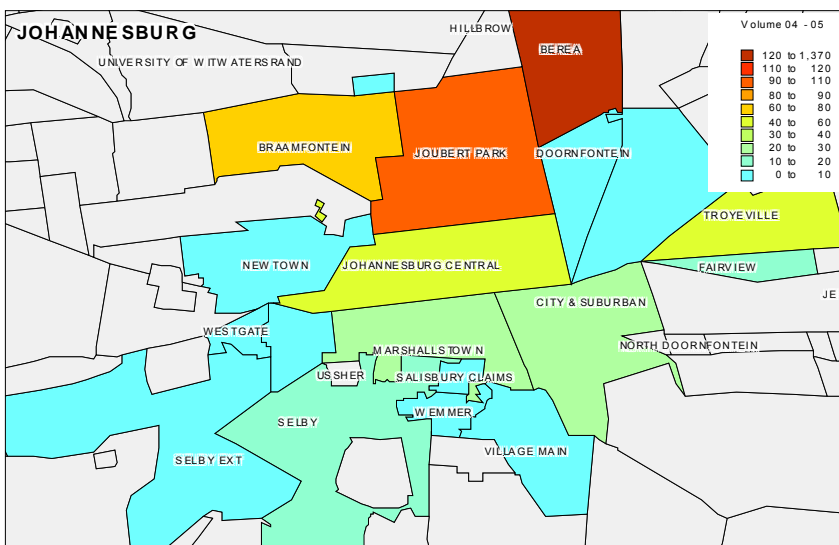
FIGURE 12: GROWTH IN THE NUMBER OF RESIDENTIAL PROPERTIES SOLD: JOHANNESBURG INNER CITY



The residential property market in the inner city of Johannesburg is gradually becoming more active.

Source: Standard Bank Group, Deeds Office

FIGURE 13: NUMBER OF RESIDENTIAL PROPERTIES SOLD: JOHANNESBURG INNER CITY (2005)



Source: Standard Bank Group, Deeds Office



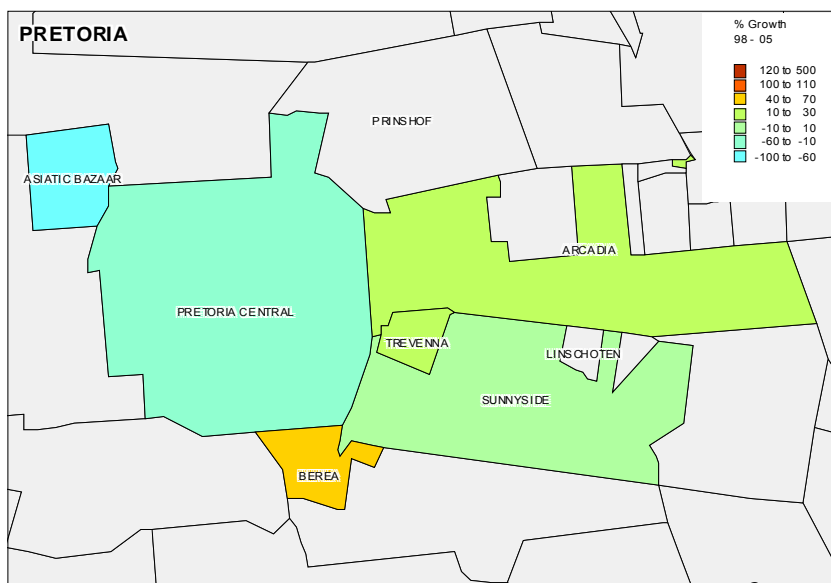
2.4 Pretoria

The city of Pretoria is interesting to compare with the other inner cities. Strongly related to Johannesburg's CBD as both make up the mega city of Gauteng, Pretoria's CBD continues to experience high but consistent levels of activity. With an R18-billion development plan in place to renovate the CBD, it is expected that the continued stable levels of high activity will begin to increase gradually as more infrastructure improvements take place.

Average property prices have experienced healthy and, thus far, sustainable growth. Pretoria Central, although dropping off slightly in the volume of transfers, has nonetheless seen an increase in average property prices of approximately 202.9% between 1998 and 2005. All major inner city suburbs have experienced similar price increases, with the number of transfers taking place increasing in every suburb except Pretoria Central.

Pretoria Central showed the highest property price growth for the period 1998 to 2005, 203%, despite having experienced the lowest volume growth, -15.6%. This may signify that although the level of activity taking place is consistent with that of the other suburbs in the area, the demand for property in Pretoria Central has increased dramatically. All inner city suburbs of Pretoria, although experiencing low levels of volume growth have shown healthy and increasing property price growth. This is most likely due to the lack of supply of properties in the suburbs, signifying that current owners are more eager to hold on to their properties than to sell – this could be a reliable indicator of increasing rentals.

FIGURE 14: GROWTH IN THE NUMBER OF RESIDENTIAL PROPERTIES SOLD: PRETORIA INNER CITY (1998-2005)

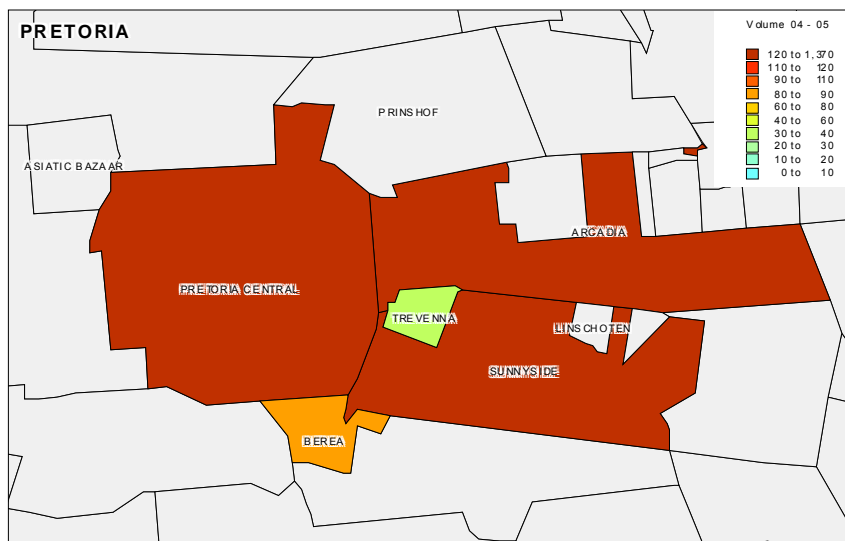


Pretoria's inner city is characterised by buoyant, although relatively slow growing, activity.

Source: Standard Bank Group, Deeds Office



FIGURE 15: NUMBER OF RESIDENTIAL PROPERTIES SOLD: PRETORIA INNER CITY (2005)



Source: Standard Bank Group, Deeds Office

The growth rates in house prices not only differ across price categories but also across locations.

3. Consumers and the housing market

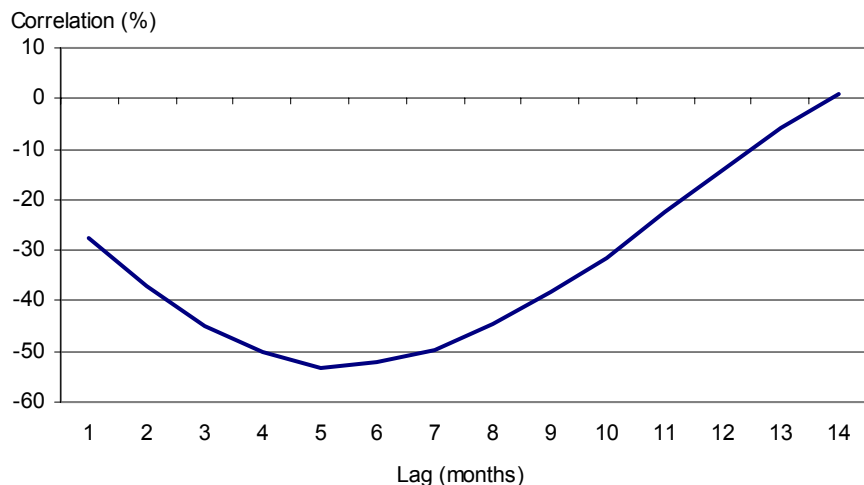
The housing market, along with the demand for other consumer goods and services, continues to benefit not only from cyclical but also structural factors. Firstly, 6.5 percentage points reduction in interest rates since mid-2003 continues to be a key driver of property prices. Even though the last cut in April 2005 (of 0.5 percentage points) was relatively small compared with the cumulative 600 basis points reduction between June 2003 and August 2004, it has had a positive impact and has underpinned the uptick in house prices since April (see figure 1).

April's interest rate cut is still stimulating the property market, albeit only moderately.

The rate cut is likely to continue to support house prices, since statistical analysis has shown that changes in interest rates have a maximum impact on house prices after about five months, with the full impact materialising only after about 14 months (see Figure 16). This is reflected in the house price growth rates recorded by Standard Bank (see Figure 1), which continued to rise in the first five months following the interest rate cut in April this year. Thereafter, the market remained lively, but the growth in house prices has decelerated since then.



FIGURE 16: CORRELATION BETWEEN HOUSE PRICES AND DIFFERENT LAGS OF THE PRIME RATE⁴

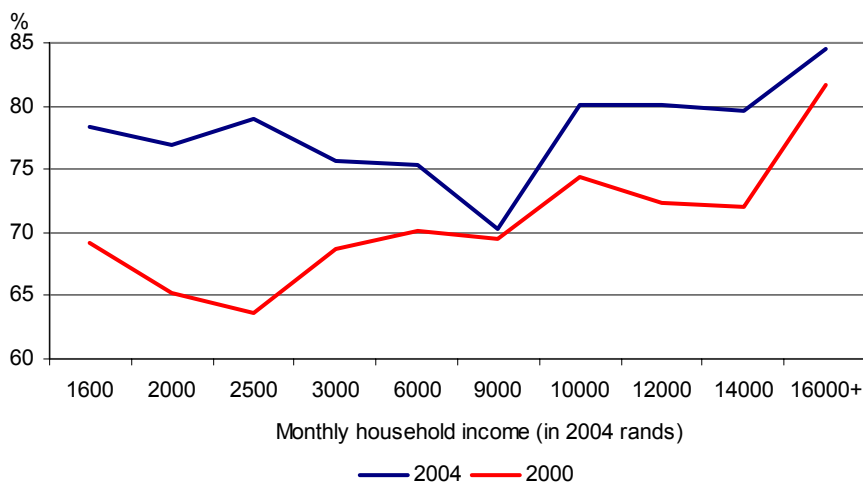


Source: Standard Bank Group

Interest rate movements have a maximum impact on house prices after about five months, with the full impact materialising only after about 14 months.

Secondly, households' disposable income continues to benefit not only from higher economic growth, but also from consecutive years of income tax cuts, including about R6.8bn in income tax relief announced in the 2005/06 National Budget. In addition to continuous growth in real wages, disposable income and employment, the housing market also benefited from the upward income migration of households. This has enabled a larger section of the population to buy property (see Figure 17). With consumer confidence indices near record-highs, households are optimistic enough about future prospects to make long-term commitments such as purchasing property.

FIGURE 17: PERCENTAGE OF HOUSEHOLDS OWNING PROPERTY



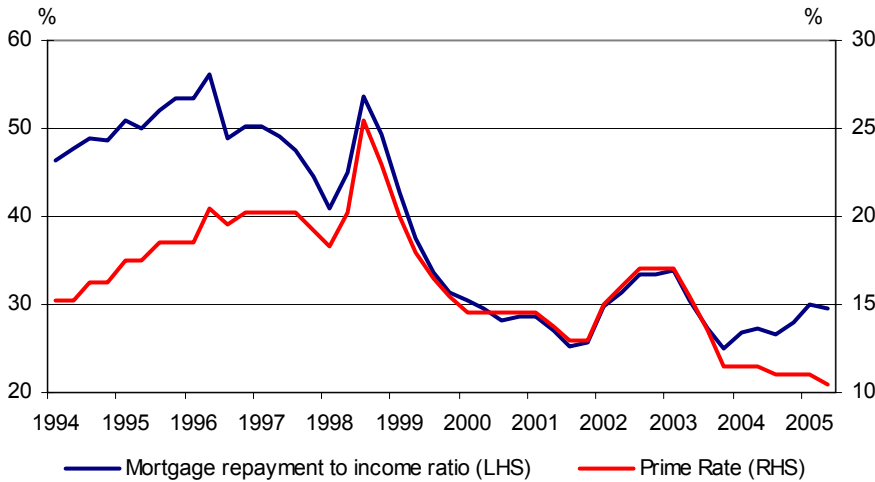
Source: SAARF, Standard Bank Group

A larger proportion of the population, especially middle-income earners, owns property.

⁴ A correlation of 100% (-100%) indicates a perfect positive (negative) correlation, while a correlation of 0% indicates no relationship. The negative correlation between interest rates and house prices reflects their inverse relationship. The correlation between interest rates (lagged one month) and house price growth is less than 30%, while the correlation between interest rates lagged five months and house prices exceeds 50%.



FIGURE 18: HOUSING AFFORDABILITY AND INTEREST RATES



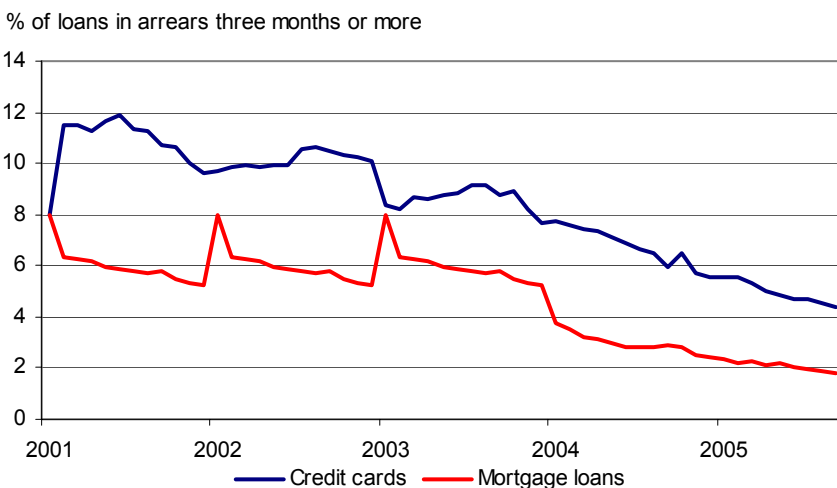
An increase in the affordability index signals that the instalment to income ratio is rising so that the affordability of houses is seen to be deteriorating

Source: Standard Bank Group, Deeds Office

Finally, households' balance sheets remain relatively healthy, which enables them to continue to repay and expand their debt. There is some concern about the impact of the brisk rises in house prices on the affordability of property. However, despite the deterioration since late last year, the national mortgage instalment to income ratio is still relatively low compared with that for most of the 1990s (see Figure 18). The deterioration since late 2003 can in part be ascribed to soaring house prices, and also faster debt takeup relative to the pace of interest rate decline.

Nevertheless, the sustainability of the buoyant conditions in the residential property market depends not only on the affordability of houses, but also - almost more crucially - on households' total indebtedness and the affordability of their total debt burden. This will determine whether they can continue to increase their indebtedness and, hence, afford to buy more expensive houses/new houses and sustain their spending, which has partly been financed with credit.

FIGURE 19: NON-PERFORMING LOANS



Measures such as the number of insolvencies and non-performing loans are not yet signalling that households are having difficulty financing their loans.

Source: SARB, Standard Bank Group

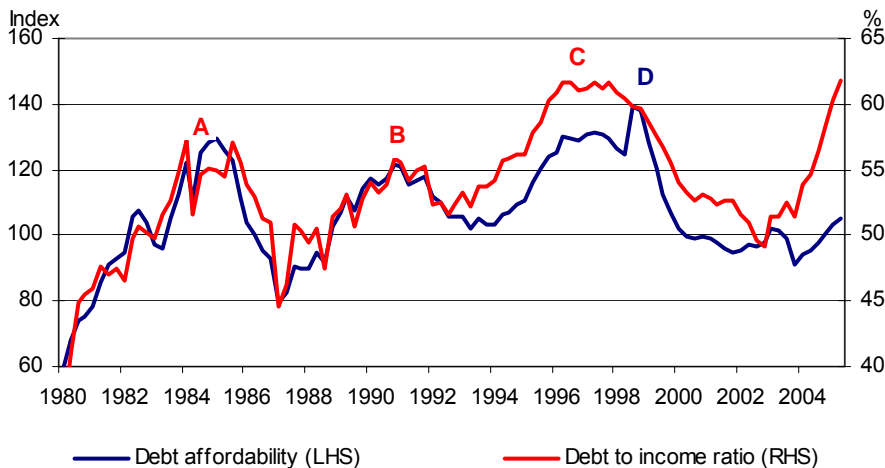
Consumers' record-high debt to income ratio of 61.8% (Q2 2005) is raising some concern regarding their financial position. However, the reduction in interest rates over the past two years also means that, despite the rise in households' indebtedness, the proportion of their income spent on debt financing rose more gradually. There are some encouraging signs regarding the health of households' finances. Non-performing loans, as proportion of total loans, is still relatively low (see Figure 19). This is not only the



case for mortgage loans, but also with, for example, credit cards, which usually shows signs of distress earlier. Indicators such as the number of insolvencies are also still favourable.

Although the debt repayment to income ratio assists in evaluating the affordability of households' debt burden, it is still difficult to gauge when households' indebtedness will become problematic, which will have a profound impact on the property market. One approach is to compare it with historical peaks. In recent history, households' indebtedness was subject to three cycles, with upper turning points in 1985, 1990, 1997 and 1998 (labelled A, B, C and D respectively, in Figure 4)⁵.

FIGURE 20: DEBT AND DEBT REPAYMENT TO INCOME RATIOS



Source: SARB, Standard Bank Group

Table 2 shows the combinations of debt to income and prime rate needed to get to the affordability index (that is debt repayment to income ratio) in each of the four stress periods discussed above. Row 4 illustrates the extent to which interest rates must rise, given households' current indebtedness, to reach the affordability index at each of the four highlighted periods. For example, at a debt to income ratio of 61% the prime rate must rise to 22% before households are spending as much on debt repayment as a proportion of income as in the second quarter of 1997. Likewise, row 3 illustrates the debt to income ratio at which households' debt repayment to income reaches the level that prevailed at each of the four stress phases if prime remains at 10.5%. For instance, with prime constant at 10.5%, households' debt to income ratio must rise to 85% to reach the level of debt affordability recorded in the third quarter of 1998.

Table 2: Combinations of prime and debt-income ratio needed to reach the affordability levels at which debt-income ratios peaked historically

		1985 Q1	1990 Q4	1997 Q2	1998 Q3
Actual parameter at historical turning point	Debt-income ratio (%)	55	55.9	61.6	59.8
	Prime rate (%)	25	21	20.25	24
Parameters needed to reach historical turning point	Debt-income ratio at current prime rate (10.5%)	74	73	79	85
	Prime rate at debt-income ratio of 61%	22	19	22	24

Source: SARB, Standard Bank Group

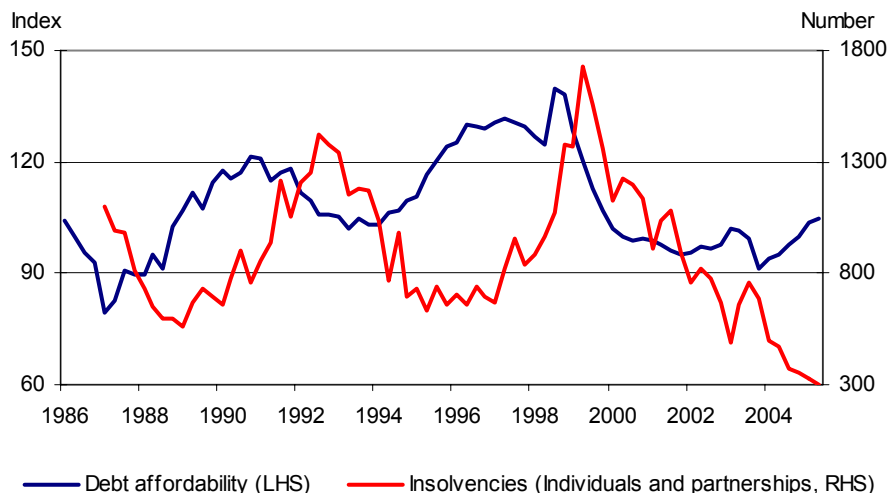
Interest rates and/or households' indebtedness must increase substantially before nearing historical peaks in debt affordability. However, debt default is likely to have risen noticeably by then.

⁵ While households reduced their debt to income ratio from 1997, the interest rate shock in 1998 spawned by the emerging markets crises caused a surge in debt repayment to income. For completeness, the three peaks in indebtedness (1985, 1990 and 1997) as well as the 1998 spike in the affordability index (labelled D in Figure 20) will be analysed as "acute stress" periods.



This analysis suggests that interest rates and/or households' debt to income ratio must rise appreciably before nearing historical levels where debt affordability was unsustainable, thereby forcing a reduction in aggregate household indebtedness. Unsurprisingly, these periods occurred alongside high and rising insolvencies (Figure 21). It is therefore as important to know when households will begin to have difficulty repaying their debt. For example, it would be helpful to understand when the number of insolvencies is likely to *start rising*, rather than when it is likely to reach its *peak*. To further this analysis, the number of insolvencies was modelled econometrically to establish its determinants and to model several scenarios to understand the likely future course of consumers' financial situation.

FIGURE 21: HOUSEHOLDS' INDEBTEDNESS



Households' debt repayment to income ratio leads insolvencies by up to two years.

Source: StatsSA, Standard Bank Group

According to the econometric model (see Appendix B), the number of insolvencies is determined by the affordability of households' debt (lagged two years); the proportion of private sector credit extension (PSCE) comprising mortgage loans (lagged eight months); house and share price growth (lagged nine months); interest rates (lagged nine months); household savings; and a calendar effect, such that certain months are traditionally characterised by a higher number of insolvencies. (See Appendix C for more detail.)



TABLE 3: INTERPRETATION OF REGRESSION RESULTS OF INSOLVENCIES

Driver		Impact on insolvencies
1 pp ⁶ ↑ households debt repayment to income ratio _{t-24}	⇒	3 more insolvencies
1pp ↑ in mortgage advances as % of total PSCE _{t-8}	⇒	29 fewer insolvencies
1pp ↑ house price growth _{t-9}	⇒	0.0003 fewer insolvencies
1pp ↑ share price growth _{t-9}	⇒	1.4 fewer insolvencies
1pp ↑ in prime rate _{t-9}	⇒	25 more insolvencies
R1m ↑ household savings	⇒	0.02 fewer insolvencies

Households' savings and wealth, and the composition of their debt are significant in determining their likelihood of becoming insolvent.

"Dummy" variables were included to allow for calendar effects (see Appendix C). For example, in August, on average 93 more insolvencies were being recorded than in December, all else being equal. All months usually register more insolvencies than December and January. August and November are the months with the highest occurrence of individuals becoming insolvent.

These results show that, in addition to the obvious drivers of debt default (income, indebtedness and interest rates), households' savings and wealth, and the nature of the composition of their debt are also significant in determining their likelihood of becoming insolvent. The bigger the unsecured proportion of households' debt, the more likely they are to become insolvent. Intuitively, the bigger consumers' need to finance their consumption expenditure rather than wealth accumulation with debt, the more likely they are to over-extend themselves. Despite households' brisk rate of debt accumulation, it is therefore consoling that mortgage advances make up the biggest and growing chunk of these loans.

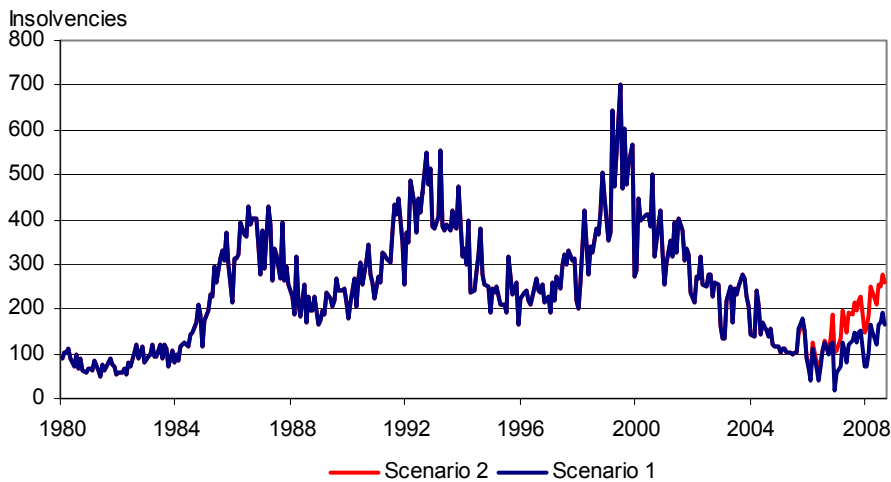
However, the results also highlight the importance of households' declining buffer provided by access to savings. Further, it emphasises the significant role played recently by the wealth effect of rising house and equity prices in keeping consumers' balance sheets sound.

Generally, the macroeconomic setting is gradually becoming less favourable for consumers, and many of the factors underpinning multi-decade low insolvencies are being eroded as the windfalls of strong asset price growth, for example, subside. However, due to the lags with which these factors impact on consumers' solvency, there will be a delay in the potential rise in insolvencies. Figure 22 illustrates that insolvencies are likely to remain relatively low, albeit rising, under a relatively conservative scenario (scenario 1) and even a less benign scenario (scenario 2). In scenario 1, house and equity prices are assumed to grow by 10% and 12% respectively in 2006 and 1.5% and 7% respectively in 2007; the prime lending rate is expected to remain at 10.5%; the household debt to income ratio is expected to rise to 76% and 86% in the final quarter of 2006 and 2007 respectively; with a constant savings ratio. In scenario 2, house and equity prices are assumed to experience no growth in 2006 and 2007; the prime lending rate is expected to rise to 12.5% early in 2006; the household debt to income ratio is expected to rise to 76% and 86% in the final quarters of 2006 and 2007 respectively; and household savings is expected to decline to zero.

⁶ Percentage point (pp).



FIGURE 22: INSOLVENCIES – 2 SCENARIOS



Source: Standard Bank Group, StatsSA

Insolvencies are likely to start rising from the latter part of 2006, although remaining at relatively low levels.

Both scenarios pencil in a rise in insolvencies from the latter part of 2006, although remaining at relatively low levels. This lends further support to our argument that house price growth will continue to decelerate as households' balance sheets gradually deteriorate.

A slowdown in property price growth, in turn, will dampen other types of consumer spending and hence economic growth by reducing the wealth effect seen during the property boom. In 2004, for example, households withdrew about R50bn from their mortgage equity on the back of higher house prices. (This is equivalent to about 6% of the value of total household consumption expenditure in 2004.) The amount is likely to be substantially higher in 2005. With house price growth expected to half in 2006 from 2005, a significant stimulus to households' spending will therefore be withdrawn.

This partly explains why mortgage advances are still soaring despite the slowdown in property prices. Of course, mortgage advances are also rising because of the rise in the number of transactions. Nevertheless, the anticipated decline in mortgage equity withdrawal will dampen the growth in mortgage advances, and in turn total private sector credit extension and money supply growth. This money is likely to have been spent mostly on durable goods and home improvements. Surveys of Australian consumers, for example, indicate that 76% of survey respondents spent the money on home improvements while 22% bought new goods for the property and 7% spent it on cars. While 65% of households spent the money within six months, 20% paid off other debt.

4. Residential property investment

The important role of investors in the property market is particularly pronounced once price increases start to decelerate and even more so when prices start to fall. Generally, investors are more likely than homeowners to sell their property when they expect (or see) a fall in house prices, or even when the slowdown in property price growth dampens the prospects of further capital gains. The simultaneous sell-off by investors to escape or limit capital losses aggravates the decline in property prices. A larger presence of investors therefore gives the property market more momentum and fuels the trend in house prices in either direction.

The earlier acceleration in house prices was at least partly attributable to increased activity in the residential property market by investors⁷, spurred largely by the substantial decline in interest rates since mid-2003. Interestingly, the proportion of property owners that are investors (rather than owner-

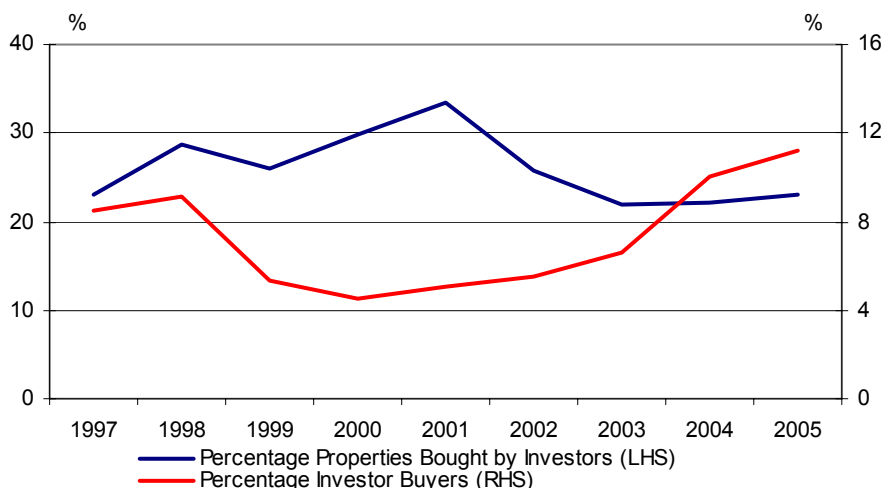
The recent acceleration in house prices is at least partly attributable to increased activity in the residential property market by investors.

⁷ A person owning more than one property is regarded as an investor.



occupants) has been rising steadily over the past four years, while a smaller proportion of properties are owned by investors. In other words, there are more investors participating in the property market but on average each of them holds fewer properties (see Figure 23). This could be attributed to a rise in the number of new entrants in this market who are buying their first investment properties.

FIGURE 23: INVESTOR PARTICIPATION IN THE RESIDENTIAL PROPERTY MARKET



The proportion of property owners that are investors (rather than owner-occupants) has been rising steadily over the past four years.

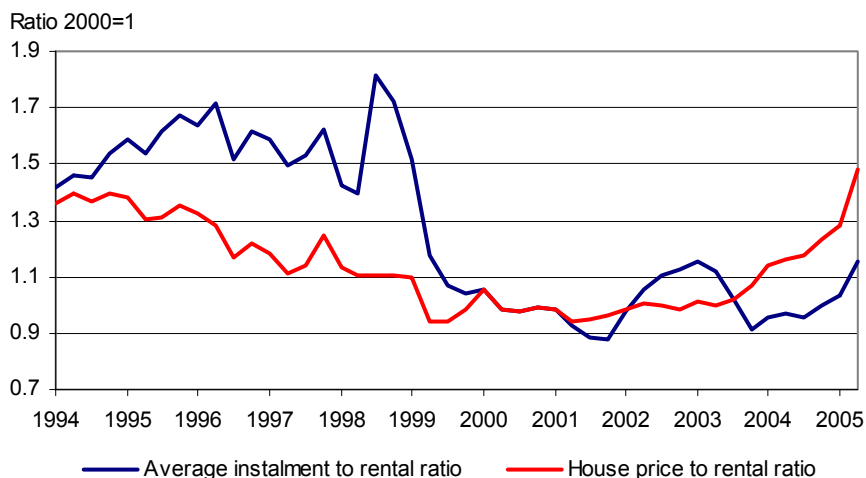
Source: Standard Bank Group, Deeds Office

Previously, investors were lured into the market by the prospects of healthy capital gains offered by continuous acceleration in house prices and attractive rental yields. These yields have generally improved since 1998 even though the rising vacancy rate since 2003 slowed rental growth somewhat as investors settled for lower increases rather than have unoccupied properties. However, the sharp rises in house prices, combined with a slowdown (albeit still expansion) in rental income as net demand for rental properties declines, is eroding the rental yield. Figure 24 illustrates the rise in the mortgage income and house price to rental income ratios⁸, which are both deteriorating and suggest declining attractiveness of residential properties as investments. Even though lower interest rates have mitigated the impact on the mortgage instalment to rental income ratio, slower growth in house prices, and hence low capital gains, will further reduce the attractiveness of residential property to investors.

⁸ The ratio of house prices to rents is often seen as an approximation of the price-earnings ratio for the property market. In the same way that a share price should equal the discounted present value of future income (dividends), the price of a house should reflect the income that it will generate (either in terms of rental income received by an investor or the rental saved by an owner-occupier).



FIGURE 24: MORTGAGE INSTALMENT AND HOUSE PRICE TO RENTAL INCOME RATIOS



Source: Standard Bank Group, Rode, Deeds Office

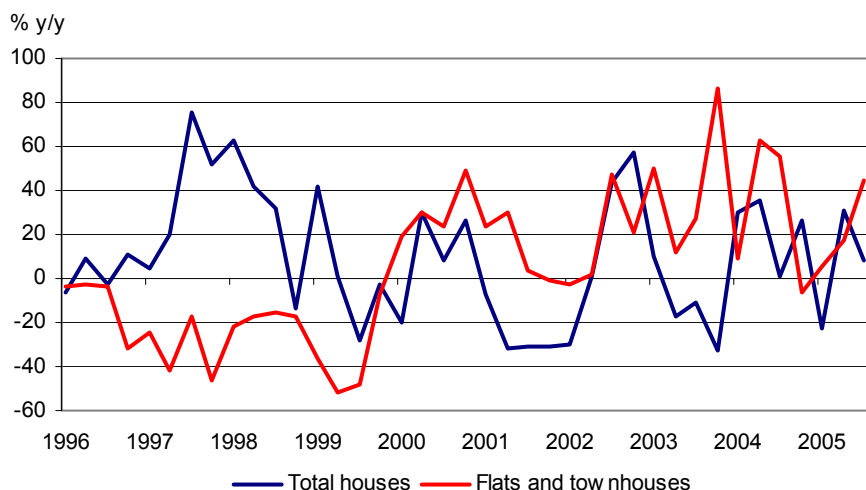
The sharp rises in house prices, combined with a slowdown (albeit still expansion) in rental income is eroding the yield earned by property investors.

5. The outlook

The key house price drivers are expected to be sustained and hence support positive, albeit slower, growth in residential property prices. Inflation prospects, the key determinant of interest rates in an inflation-targeting regime, suggest that low interest rates should remain intact and hence supportive of the housing market. The target-friendly inflation outlook is largely attributable to a strong rand, which mitigates the effect of high oil prices on domestic fuel prices; the suppression of domestic businesses' ability to increase prices due to excess production capacity locally; relatively low global inflation; competition from low-cost production in countries such as China and India; and relatively low inflation expectations, which weigh on general price setting in the economy. Based on this benign inflation outlook, monetary policy is unlikely to be tightened substantially, if at all, over the short to medium term.

The outlook for house prices continues to be supported by persistent low inflation and interest rates, accelerated economic growth and healthy consumer fundamentals

FIGURE 25: BUILDING PLANS PASSED



Source: SARB, Stats SA



House prices are therefore expected to continue to grow, although growth is likely to fall noticeably from last year's phenomenal rates. Indicators such as the number of building plans passed (see Figure 25), which are growing at positive but softer rates, concur with this outlook.

Bottom line

House prices continue to be supported by relatively sound consumer fundamentals and a benign economic outlook. Despite a rise since the end of 2002, South Africa's household debt repayment to income ratio is still not punishingly high, which suggests that households have some scope to further increase their exposure to the housing market. However, their rate of debt accumulation could slow. Further consolidation in house price growth is expected next year as a result of the reduction in pent-up demand after several years of brisk buying; the fading impact of previous interest rate cuts; and recent above-trend growth that created a high base from where future growth rates will be calculated. It is also encouraging that from an offshore contagion viewpoint, the United Kingdom and Australian residential property markets, which experienced expressly exuberant growth in recent years, appear to have "soft landed".

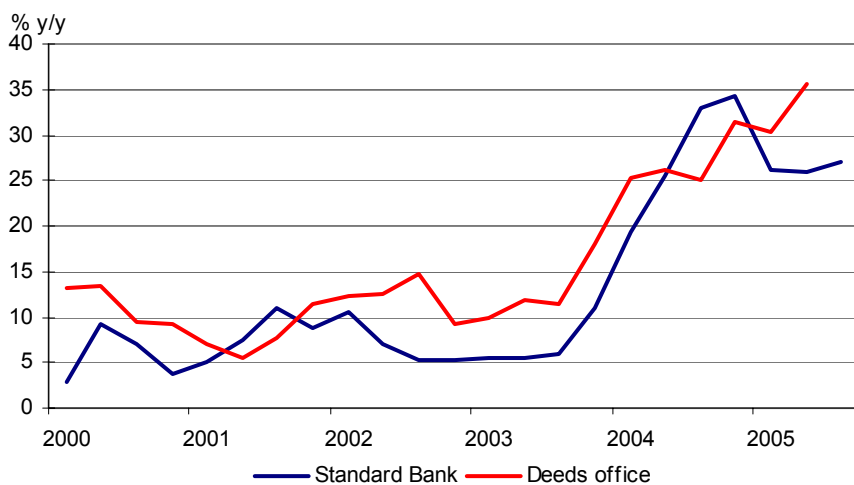
The outlook for house prices hinges largely on the affordability of houses, the role of investors and the macroeconomic setting



Appendix A Methodological issues

It is crucial that an analysis of the residential property market be based on reliable and consistent data, which is representative of the spectrum of property in South Africa. Ideally, the analysis should be based on data from the Deeds Office, which include all transfers of properties. However, the usual delay of about six months with which this data is available necessitates the use of alternative sources. Prices of houses financed by Standard Bank, which has about 29% share of new business in the mortgage market, show the same trends as the Deeds Office's data but is more recent and therefore suitable for use in this type of analysis (see figure 2).

FIGURE A1: STANDARD BANK AND DEEDS OFFICE'S HOUSE PRICE GROWTH



House prices captured by Standard Bank and the Deeds Office move largely in tandem

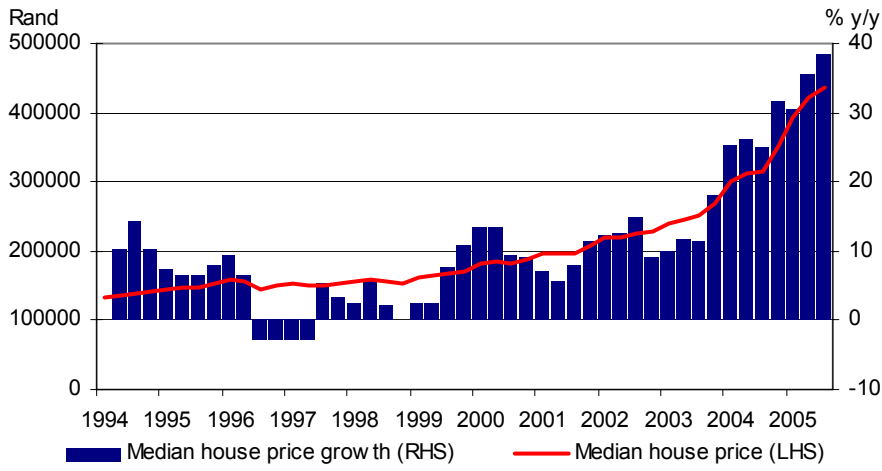
Source: Standard Bank Group, Deeds Office

Despite similar trends there are some differences in absolute prices and growth rates. This inconsistency may occur when cheaper houses are bought with cash, for example, by investors, and are therefore not included in banks' samples. One of the reasons for the very high growth rate in the deeds data national property price index is that there are certain property values that occur far more regularly than other values. For example, properties often sell for prices such as R400 000, R450 000 and R500 000, rather than the amounts in between, as sellers often round their offering prices for simplicity sake. As a result of this, in an increasing property price environment, the median will tend to get stuck on these frequently occurring property prices and skip through the prices that don't occur as frequently. With the national property price index calculated using data from the Deeds Office, the median has been moving towards the value of R450 000, where it is likely to remain for a considerable period of time. This has had the effect of a quickly increasing median property price as the median moved through those values that don't occur frequently, and hence resulted in a higher growth rate.

Throughout this analysis the Deeds Office's data is used unless specified otherwise.



FIGURE A2: QUARTERLY NATIONAL HOUSE PRICES: DEEDS OFFICE



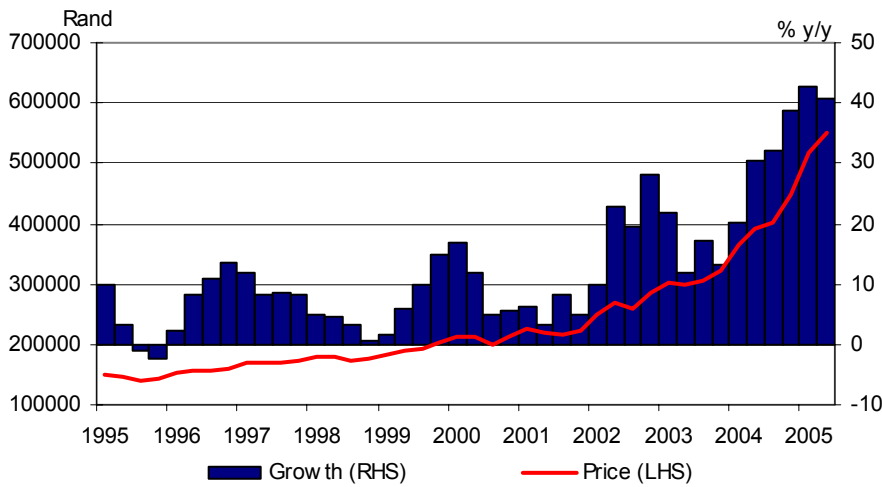
Throughout this report the Deeds Office's data is used unless specified otherwise

Source: Standard Bank Group, Deeds Office



Appendix B Residential property prices in selected areas

FIGURE B1: MEDIAN RESIDENTIAL PROPERTY PRICES: CAPE TOWN



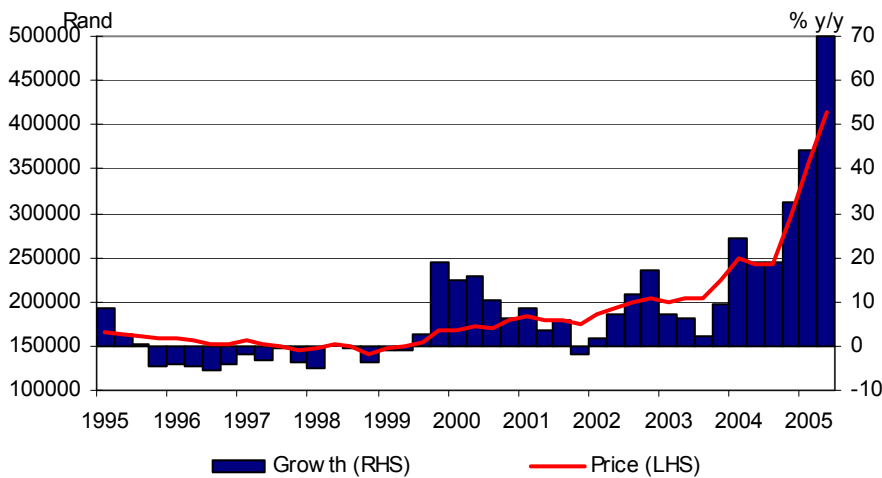
2005 Q2 DATA:

**Median house price:
R547 500**

Growth: 39.8% y/y

Source: Deeds Office, Standard Bank Group

FIGURE B2: MEDIAN RESIDENTIAL PROPERTY PRICES: DURBAN



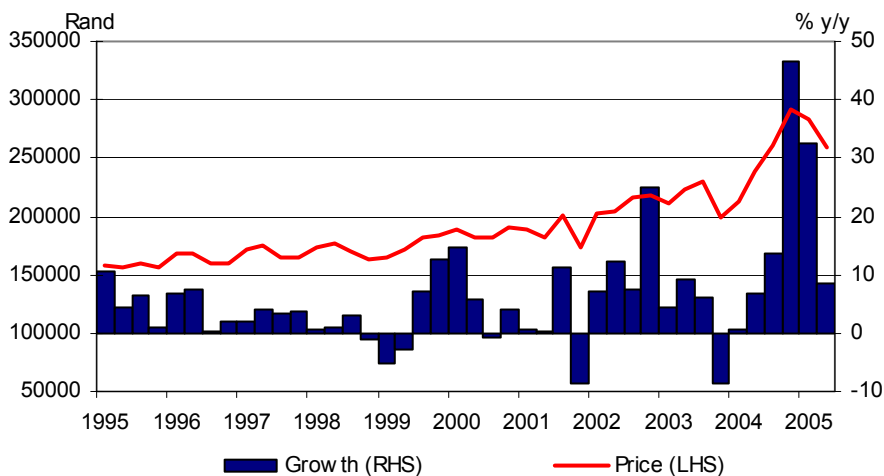
**Median house price:
R405 000**

Growth: 66.44% y/y

Source: Deeds Office, Standard Bank Group



FIGURE B3: MEDIAN RESIDENTIAL PROPERTY PRICES: EAST LONDON

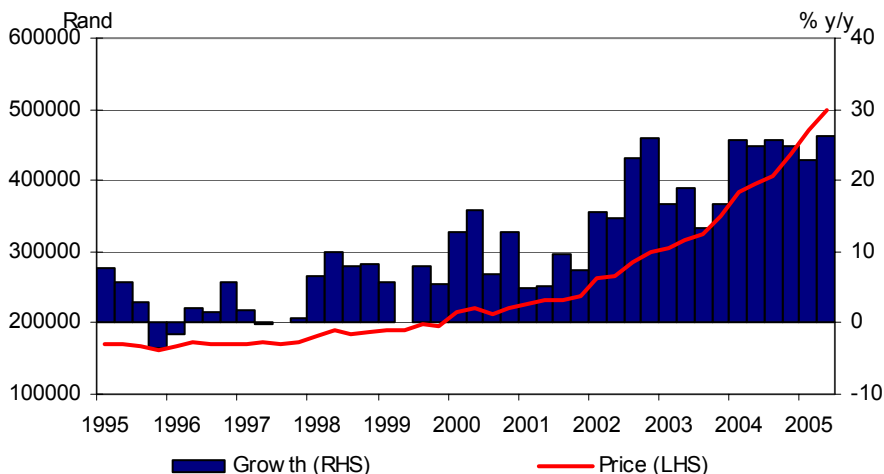


**Median house price:
R242 500**

Growth: 13.4% y/y

Source: Deeds Office, Standard Bank Group

FIGURE B4: MEDIAN RESIDENTIAL PROPERTY PRICES: JOHANNESBURG



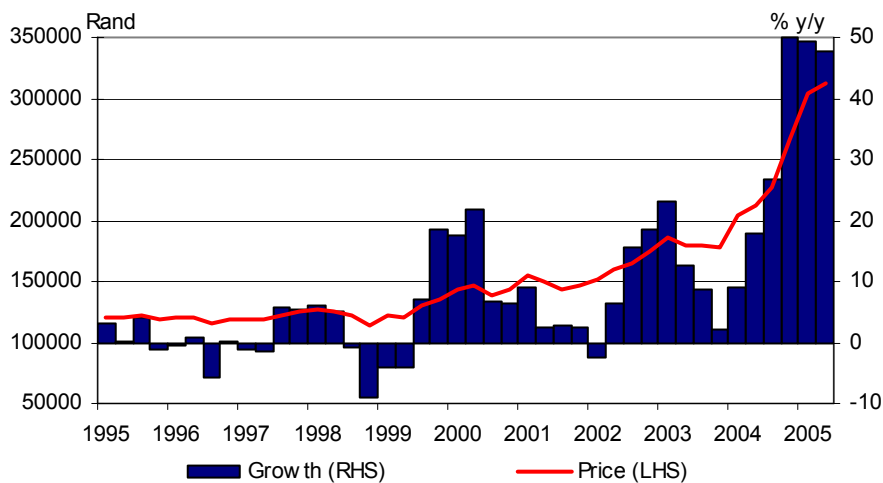
**Median house price:
R497 500**

Growth: 25.95% y/y

Source: Deeds Office, Standard Bank Group



FIGURE B5: MEDIAN RESIDENTIAL PROPERTY PRICES: PORT ELIZABETH

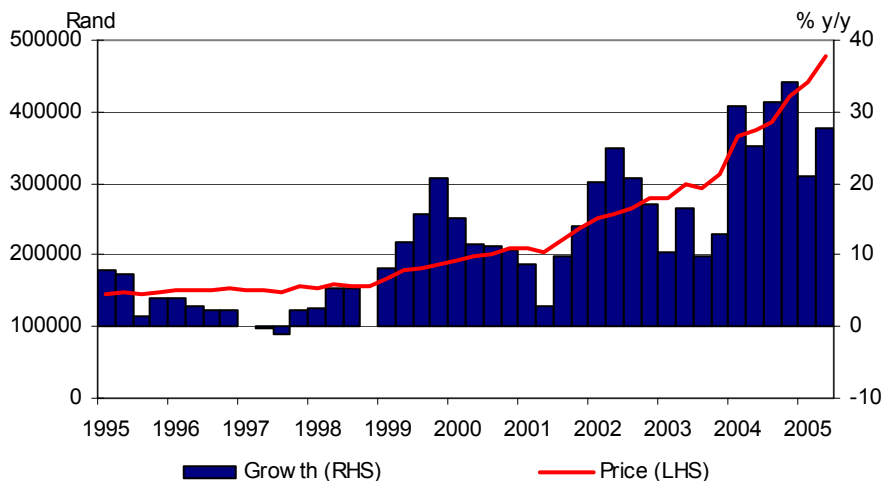


Median house price:
R311 500

Growth: 32.81% y/y

Source: Deeds Office, Standard Bank Group

FIGURE B6: MEDIAN RESIDENTIAL PROPERTY PRICES: PRETORIA



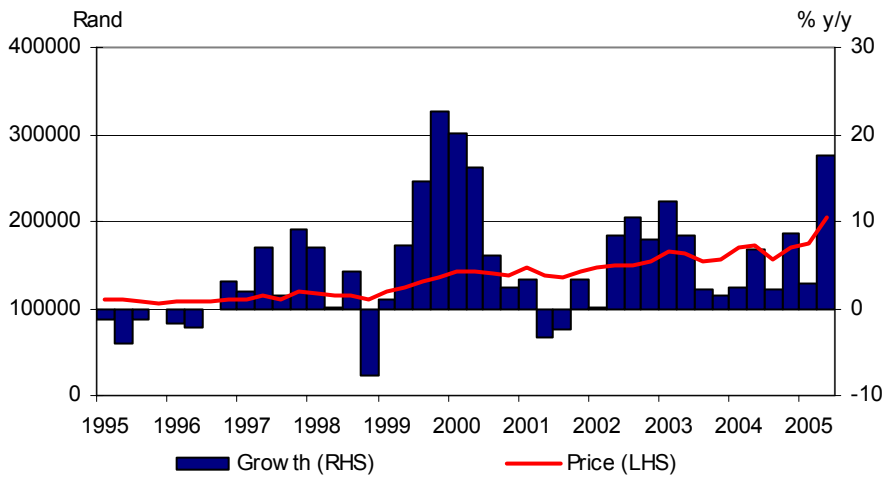
Median house price:
R477 500

Growth: 27.67% y/y

Source: Deeds Office, Standard Bank Group



FIGURE B7: MEDIAN RESIDENTIAL PROPERTY PRICES: FREE STATE



**Median house price:
R200 000**

Growth: 18.4% y/y

Source: Deeds Office, Standard Bank Group



Appendix C Regression model of insolvencies

TABLE C1: REGRESSION RESULTS OF INSOLVENCIES ⁹

Variable	Coefficient	t-value
Constant	829.731	5.846
Affordability of households' debt _{t-24}	2.839	4.992
Mortgage advances (% of total PSCE _{t-8})	-28.776	-10.314
House price growth _{t-9}	-0.0003	-1.961
Share price growth _{t-9}	-1.425	-1.848
Prime rate _{t-9}	24.754	10.748
Household savings	-0.023	-5.009
February dummy ¹⁰	25.014	1.518
March dummy	85.181	3.182
April dummy	61.706	3.049
May dummy	32.380	1.491
June dummy	71.566	2.859
July dummy	73.096	3.098
August dummy	92.956	4.081
September dummy	61.878	3.084
October dummy	84.951	4.730
November dummy	87.074	3.908
R^2	84.95%	
Adjusted R^2	82.52%	

Insolvencies are determined by the affordability of households' debt, the proportion of PSCE comprising mortgage loans, asset price growth, interest rates, household savings and calendar effects.

⁹ These variables explain 85% of the variation in the number of insolvencies, confirming the close correlation between actual insolvencies and that predicted by the model (Figure 6). Additional test results confirming that this model is adequate from a statistical perspective are presented in Appendix A. It also shows that the unexplained variation in insolvencies is random, and therefore it is unlikely that any important variables have been omitted from the model. The results are interpreted in Table 3.

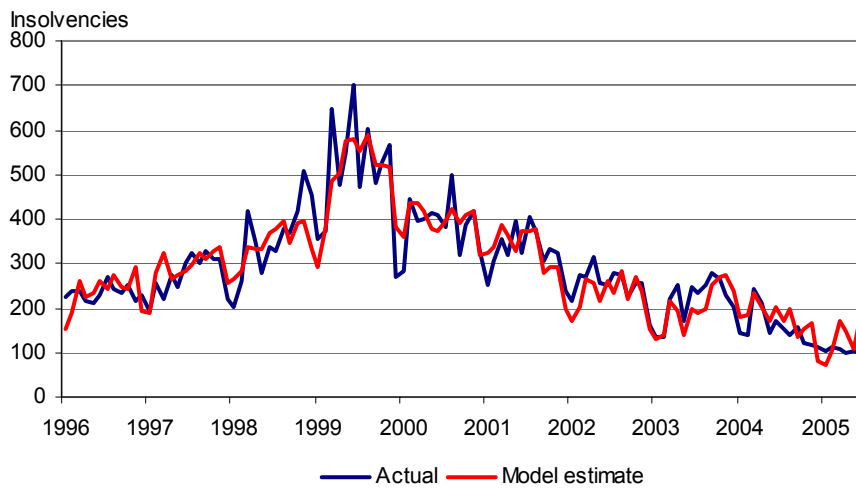
¹⁰ The "dummy" variables for the various months measure the occurrence of insolvencies relative to that experienced in January and December, which are used here as benchmark months. This choice is arbitrary and doesn't impact on the results. January's and December's results were not statistically different from each other. For example, in August, on average 93 more insolvencies were recorded than in December, all else being equal. Since all the dummy variables have positive coefficients, all months usually register more insolvencies than December and January. August and November are the months with the highest occurrence of individuals becoming insolvent.



TABLE C2: DIAGNOSTIC TESTS OF INSOLVENCY MODEL

Test	Statistic	Conclusion ¹¹
Durbin-Watson	1.75	No serial correlation of order 1
Breusch-Godfrey (2)	4.22	No serial correlation of order 2
ARCH (1)	0.72	No ARCH-type heteroscedasticity of order 1
ARCH (2)	1.14	No ARCH-type heteroscedasticity of order 2
White	36.44	No heteroscedasticity
Ramsey RESET	1.08	No specification error
Jarque-Bera	5.10	Residuals are normally distributed

FIGURE C1: ACTUAL AND MODELLED INSOLVENCIES



Source: StatsSA, Standard Bank Group

¹¹ At a 1% level of significance.



Group Economics

Goolam Ballim – Group Economist

+27-11-636-2910 goolam.ballim@standardbank.co.za

South Africa Research

Monica Ambrosi

+27-11-636-5323

monica.ambrosi@standardbank.co.za

Johan Botha

+27-11-636-2463

johan.bolha2@standardbank.co.za

Shireen Darmalingam

+27-11-636-2905

shireen.darmalingam@standardbank.co.za

Rashika Lalla

+27-11-636-6242

rashika.lalla@standardbank.co.za

Elna Moolman

+27-11-631-2018

elna.moolman@standardbank.co.za

Africa Research

Robert Bunyi

+27-11-631-1279

robert.bunyi@standardbank.co.za

Jan Duvenage

+27-11-636-4557

jan.duvenage@standardbank.co.za

Anita Last

+27-11-631-5990

anita.last@standardbank.co.za

Yvonne Mhango

+27-11-631-2190

Yvonne.Mhango@standardbank.co.za

Home loans

Leon Barnard – Director

+27-11-636-0247 leon.barnard@standardbank.co.za

Matthew Cook

+27-11-636-9801

matthew.cook@standardbank.co.za

Lasath Punyadeera

+27-11-636-1292

lasath.punyadeera@standardbank.co.za

Gina Schoeman

+27-11-636-7952

gina.schoeman@standardbank.co.za

Kindly email brenda.landsberg@standardbank.co.za should you wish to be included on our research distribution list.

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