PROPERTY BAROMETER

Residential Market Vulnerability Risk Review

Residential Market vulnerability risk improved (declined) in the 4th quarter of 2017

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MARKET ANALYTICS AND SCENARIO FORECASTING UNIT

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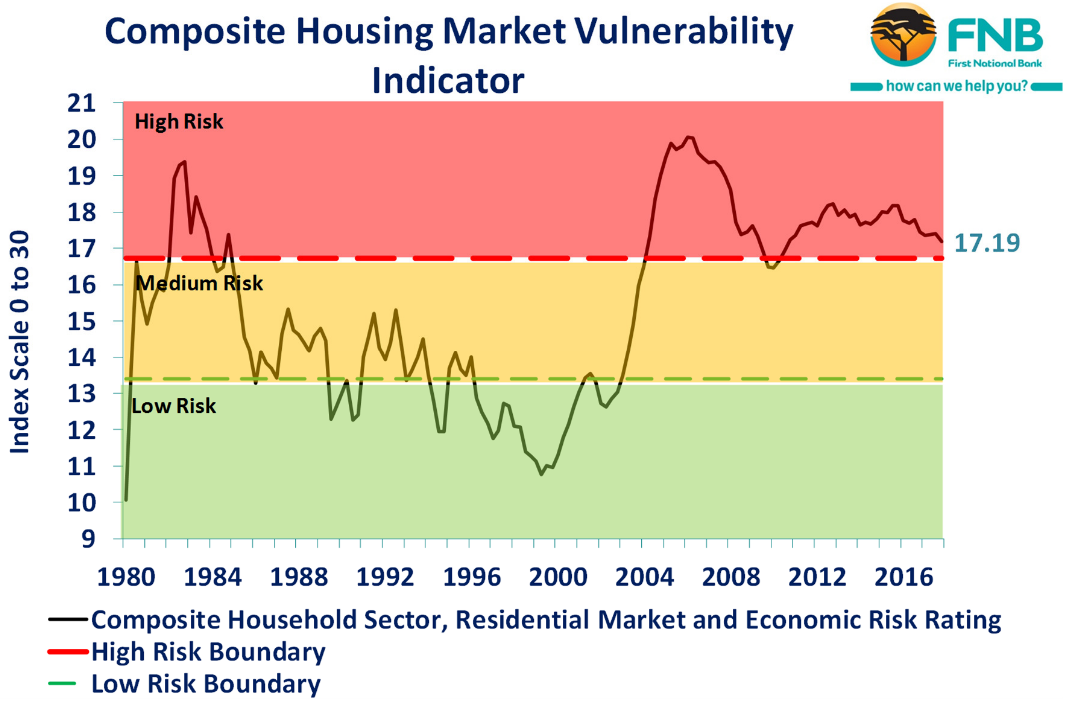
The final quarter of 2017 saw a mild improvement (decline) in Residential Market Vulnerability, resuming a broader improving (declining) trend that has taken place from 2015 onward.

The 4th quarter improvement is due to a slight decline in housing market-specific risks as well as due to a decline in broader economy-wide risks.

KEY POINTS

- Overall risk to the future stability of the housing market more-or-less moved sideways in the 1st 3 quarters of 2017, after some prior years of noticeable improvement, but resumed the broader declining trend in the final quarter.
- On the Household Sector side, the ongoing decline in the Household Sector Debt-to-Disposable Income Ratio remains a positive development in terms of lowering Housing Market vulnerability.
- Very weak Household Savings remains a long term negative for Housing Market Risk, however, despite savings having improved mildly in recent years.
- House prices remain relatively high by historic standards, and the Housing Affordability Risk Index remains in the "High Risk" zone.
- A key positive is that there exists a low risk of speculation and "over-exuberance" in the market, due to interest rates that are higher than the relatively low house price inflation rates, along with moderate Household Disposable Income growth.
- Putting all of the key Household Sector and Housing Market-specific indicators together to form the Composite Household Sector and Housing Market Risk Index, we see that the Housing Market itself is greatly improved (lower) since a decade or more ago. This Composite Housing Market Risk Index is now well-within what we call "Medium Risk" territory at 31.8 (scale of 0 to 60).
- The state of the country's broader economy is what continues to poses significant risks to the Housing Market, however, with big Macroeconomic imbalances having built up. These include a relatively high Government Debt burden, and already-low real interest rate levels at a time when the economy hardly grows.
- Therefore, our Composite Housing Market Vulnerability Index, the over-riding risk index which incorporates Household Sector, Housing Market and Macroeconomic Risk, remains in the High Risk zone (due to Macroeconomic Risks), although it is on a gradual improving (declining) path..

SUMMARY GRAPH: COMPOSITE HOUSING MARKET VULNERABILITY INDEX – RATING: 17.19 – HIGH



SUMMARY TABLE: INDICES MAKING UP HOUSING MARKET STABILITY RISK

	Q4 2017	Prev.	Yr Ago
Debt Service/New Lending Risk (0-10)	5.07	5.16	5.07
Household Savings Risk (0-10)	8.93	8.85	8.97
Disposable Income Windfall Risk (0-10)	3.98	3.87	3.48
Over-investment/Speculative Risk (0-10)	3.41	3.43	3.55
Affordability/Price Competitiveness Risk (0-10)	7.59	7.64	7.62
Building Oversupply Risk (0-10)	2.82	2.99	3.24
Household and Housing Market Risk (0-60)	**31.80**	**31.95**	**31.93**
Economy-Wide Vulnerability Risk (0-10)	7.36	7.45	7.45
Current Economic Pressures Risk (0-10)	5.48	5.80	5.99
Composite Housing Market Vulnerability Index (0-30)	**17.19**	**17.39**	**17.44**
Low Risk			
Medium Risk			
High Risk			

OVERVIEW: PROGRESS IN THE LOWERING OR RESIDENTIAL MARKET VULNERABILITY IS SLOW, BUT IT HAS BEEN HAPPENING

The risks to the future stability of the housing market improved (declined) mildly during the 4th quarter of 2017, resuming a gradual declining trend that has been taking place since 2015.

Household Sector and Housing Market-specific risk declines (improves) slightly

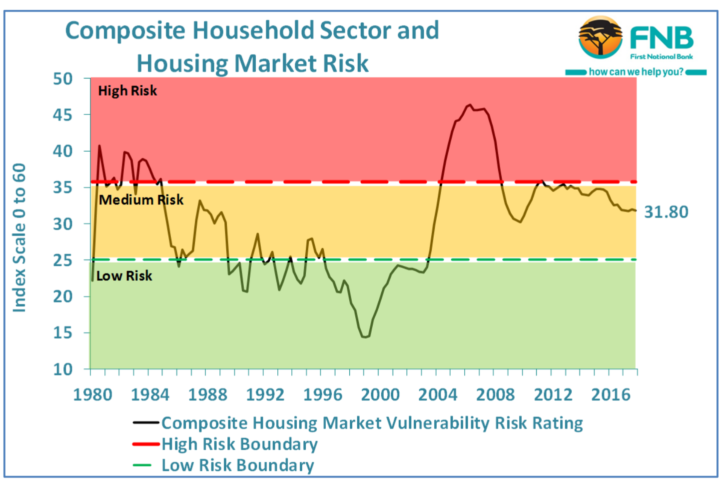
On the Household Sector side, the ongoing decline in the Household Sector Debt-to-Disposable Income Ratio remains a positive development in terms of lowering the Household Sector's and Housing Market's vulnerability to unwanted economic and interest rate shocks. The Debt-to-Disposable Income Ratio has declined all the way from 87.8 as at the 1st quarter of 2008 to 71.2 by the 4th quarter of 2017. Given that much of this overall indebtedness decline is due to a decline in the Household Mortgage Debt-to-Disposable Income Ratio too, this contributes significantly to lower residential market vulnerability.

Largely as a result of this multi-year decline in the Debt-to-Disposable Income Ratio, the all-important Household Debt-Service Risk Sub-Index is down in "Medium Risk" territory, from being well up in the High Risk zone a decade ago (each risk index having a "High Risk", Medium Risk"' and Low Risk" Zone).

Within the Household Sector and Housing Market, there are certain sub-indices which remain in "High Risk" territory. Notable here is the ongoing dismal state of Household Sector Savings, which although improved from a few years ago remains at very low levels not conducive to building up strong financial "buffers". In addition, Housing Market Affordability Risk remains high, with real house price levels in South Africa still high by historic standards.

However, key positive (low) risk contributors relate to constrained new housing supply and a lack of any risk of speculative or "over-exuberant" behavior in the market. Speculators try to take advantage of cheap credit and a strong price growth trend. There is little of the latter, with house price growth firmly rooted in single-digit territory and, importantly, well-below the mortgage borrowing rate. Disposable Income growth remains moderate too, despite some recent strengthening, so there is little risk of "over-exuberant" home buying and investment that can often arise in times of major household income "windfalls".

With regard to new housing supply, a positive risk factor is that the Residential Development Sector remains subdued due to the cost of building new homes being significantly higher than the average price of existing homes.



Overall, taking the above factors into account, the Composite Household Sector and Housing Market Risk Index is placed firmly within the "Medium Risk" Zone.

It declined (improved) slightly in the 4th quarter of 2017 to 31.80 (scale of 0 to 60), from 31.95 in the prior quarter, but for all intents and purposes has moved sideways through 2017, ending the year at the same level that it recorded at the start.

Despite no improvement from start to finish of 2017, the index level remains sharply improved since the all-time high (worst) risk level of 46.389 reached in mid-2006 at the height of the pre-2008 housing bubble.

But the broader economy is where the big risks still lie

The state of the country's broader economy is where the very significant risks to the Housing Market still linger, despite a noticeable improvement in sentiment in the country following the change in Presidents of both the ruling party and of the country.

Economic growth has improved mildly from early-2016 to late 2017, but remains stagnant at 1.5% year-on-year as at the final quarter of 2017. More positive sentiment since early in the year is welcome, but the country's policy direction remains uncertain, and with weak economic growth continuing, this sustains the risk of elevated social tensions, greater instability and economic disruption. We have witnessed steadily rising Government indebtedness over the past decade, with the Government Debt-to-GDP Ratio reaching 53% in the 4th quarter of 2017, its highest level in the

3-and-a-half decades over which the risk indices are compiled. This, along with relatively low real interest rates, points to limited fiscal and monetary stimulus potential for the economy at present. One macro-economic risk improvement in recent times has come in the form of a noticeable narrowing in the Current Account Deficit on the Balance of Payments, from as wide as -6.9% of GDP in the 3rd quarter of 2013 to -2.9% in the 4th quarter of 2017. This reflects a country living less beyond its means of late. However, the most recent deficit remains significant.

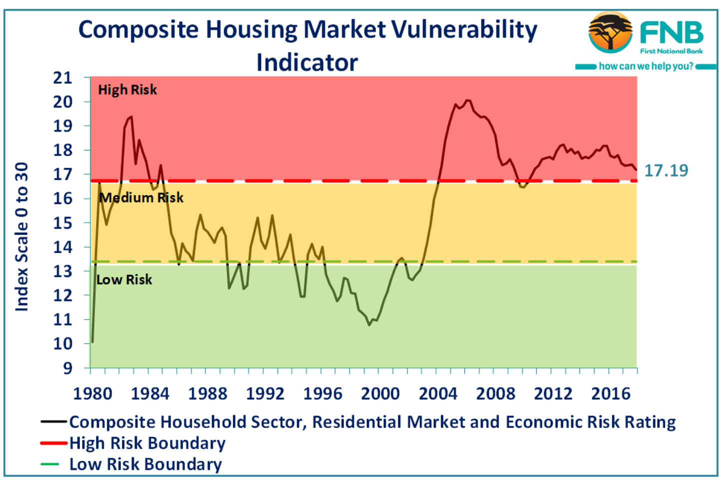
This weak growth economy therefore remains a "high risk" one, and these broader macroeconomic risks still pose a key risk to the level of future residential demand and thus the housing market's health and stability. The Macroeconomic Risk Index did decline in the 4th quarter of 2017 from 7.45 previous to 7.36, but it remains rooted firmly in the "High Risk" zone.

Current Economic Pressures Risk subsides (improves) in the 4th quarter of 2017

Although economic growth remains weak, the SARB and OECD Leading Business Cycle Indicators for South Africa have recently been rising, pointing to the possibility of slightly better economic growth to come in the near term. This has meant that our Current Economic Pressures Risk Index subsided in the 4th quarter of 2017, thus making it a mildly positive contributor to the broader Housing Market Risk picture. Therefore, while the big Macroeconomic imbalances, as reflected in the Macroeconomic Risk Index, are a key negative to overall Housing Market stability, near term cyclical economic risks appear to have been alleviated somewhat, and remain in "Medium Risk" territory at a level of 5.48 in the 4th quarter of 2017, down from 5.80 in the prior quarter.

With Global economic performance still reasonably solid, improved growth performance for South Africa is plausible. It is especially possible given that we have seen some improvement in sentiment in and towards South Africa, feeding into an improved 1st quarter RMB-BER Business Confidence Index. The political leadership change recently has been key in boosting sentiment.

Against this, however, the Western and Eastern Cape droughts remain intact, and can hamper economic performance in those regions especially via the impact on Agriculture.



Nevertheless, we do project an economic growth rate of 1.8% for 2018, slightly above the 1.3% actual number for 2017, therefore stronger than last year but still weak.

The Composite Housing Market Vulnerability Index thus declined (improved) in the 4th quarter of 2017, thanks to quarterly declines in the Composite Household Sector and Housing Market Risk Index, in the Macroeconomic Risk Index as well as in the Current Economic Pressures Risk Index.

The Index saw a decline (improvement) from 17.39 (Scale of 0 to 30) in the previous quarter to 17.19 in the 4th quarter of 2017. This level is now noticeably lower (better) than the multi-year high of 18.18 reached at the end of 2016, and well down on the all-time high of 20.06 reached at a stage of 2006.

In short, there has been gradual progress in lowering risk as reflected in the Composite Housing Market Vulnerability Index, since 2015. This index remains vastly improved since the all-time high (worst) of 20.06 reached at a stage early in 2006, due to major improvements within the Household Sector and Housing Market since then. But it could be significantly lower today if not for high levels of Macroeconomic Risk. The Macroeconomic Risk Index, has started to move slightly lower (better) recently, but remains in the High Risk Zone, implying that the most significant risks to the housing market thus emanate more from outside of the market, and relate to the broader economy

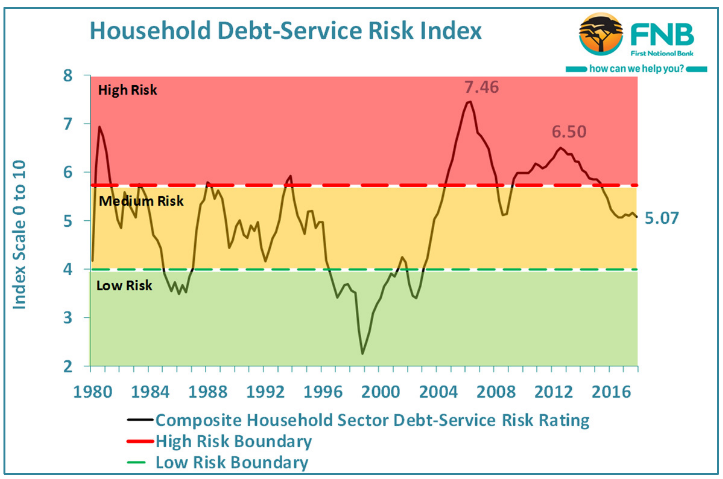
1. HOUSEHOLD DEBT-SERVICE/NEW LENDING RISK– RATING: 5.07 - MEDIUM

The rationale: The Household Debt-Service Risk Index attempts to look at the vulnerability of the Household Sector in terms of its future potential ability to service its debt.

The compilation of the Index: The index is compiled from 3 variables, namely, the debt-to-disposable income ratio of the household sector, the trend in the debt-to-disposable income ratio, and the level of interest rates relative to long term average (5-year average) consumer price inflation.

The higher the debt-to-disposable income ratio, the more vulnerable the household sector becomes to unwanted "shocks" such as interest rate hikes or downward pressure on disposable income. An upward trend in the debt-to disposable income ratio contributes negatively to the overall risk index (i.e. exerts upward pressure on the index) and vice versa for a downward trend. Then, the nearer prime rate gets to the "structural" inflation rate (using a 5-year average consumer inflation rate as a proxy), i.e. the lower this estimate of real interest rates becomes, the more vulnerable the household sector becomes, the reasoning being that the nearer we may be getting to the bottom of the interest rate cycle and the end of rate cutting relief, the more the risk of the next rate move being upward becomes, or at least the less the chance becomes of further cuts. In addition, households tend to make poorer borrowing and financial decisions on average, while it is tougher for lenders to assess aspirant borrowers, when money is cheap, so better borrowing/lending decisions are arguably made when interest rates are relatively high. Therefore, we view low interest rate periods as ones where risk generally builds up, and vice versa for periods of relatively high interest rates.

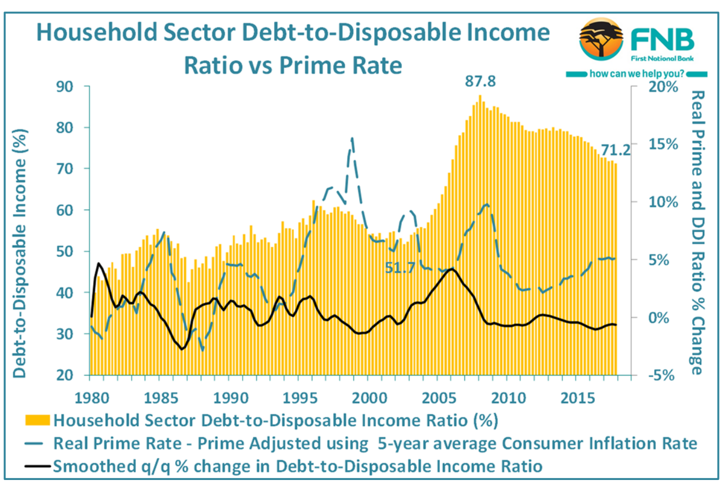
The Index: The Household Debt-Service Risk Index resumed its broader improving (downward) movement in the 4th quarter of 2017 after prior stalling. It remains firmly within the "Medium Risk" zone.



After some prior quarters of increase (deterioration) through earlier-2017, the 4th quarter of 2017 saw a resumption in improvement (decline) in the Household Debt-Service Risk Index, from the 3rd quarter's 5.16, to 5.07 (on a scale of 0 to 10).

This index remains firmly within the "Medium Risk" Zone.

The Key Drivers of the Index's Recent Movement:



The key cause of the quarterly decline was a further decline in the Household Sector Debt-to-Disposable Income Ratio.

The Debt-to Disposable Income Ratio remained on its declining path in the 4th quarter, from 72 in the previous quarter to 71.2, further lowering Household Sector vulnerability to interest rate hiking or adverse economic conditions.

2. HOUSEHOLD SECTOR SAVINGS RISK– RATING: 8.93 - HIGH

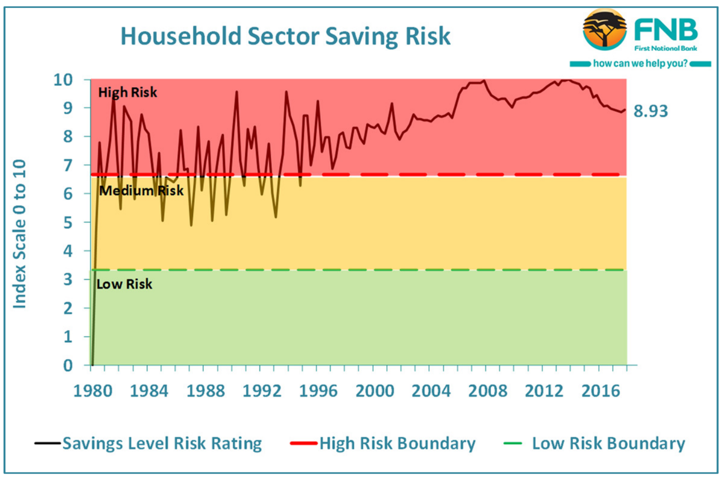
The rationale: We view the level of Household Sector savings to be important in understanding housing market risk. The Household Sector adjusts its consumption and saving habits as economic times change. The lower the savings rate at the time of some significant economic shock, the higher the risk of a more significant increase in savings and reduction in spending by households. Households could raise savings due to perceived job insecurity, or to compensate for a slowing growth in Net Wealth due to slower asset price growth.

This can be negative for both economic growth and housing demand in the short run. On the other hand, a high rate of savings already in place at the time of an economic shock may lower the risk of a dramatic reduction in already-low household spend.

The compilation of the Index

The index is compiled from 1 variable only, namely the Household Sector Net Savings Rate expressed as a percentage of Household Sector Disposable Income. This net savings rate refers to the gross savings rate adjusted for depreciation in fixed assets owned by the Household Sector. The weaker the net savings rate, the higher the risk rating and vice versa, on a scale of 0 to 10.

The Index: Household Sector Savings Risk remains extremely high, but improved since 3-4 years ago after a mild improvement in the country's dismal savings rate.

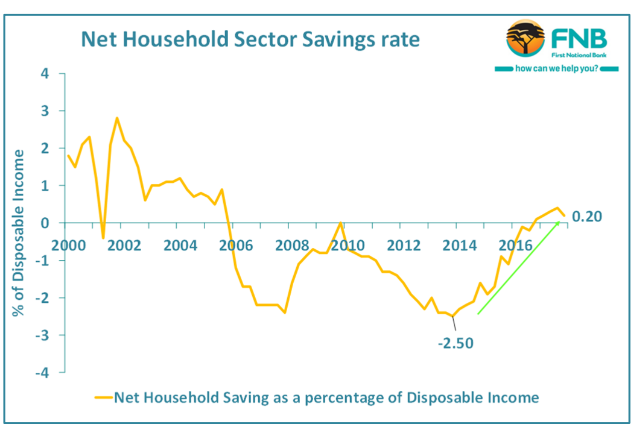


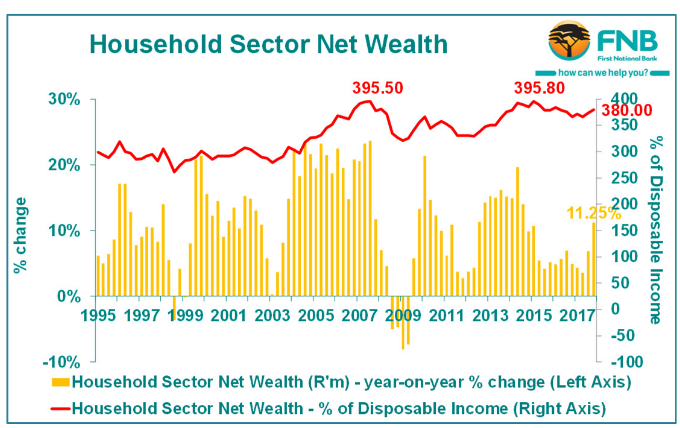
The Household Sector Savings Risk Index remains extremely high, with a rating of 8.93 in the 4th quarter of 2017 (on a scale of 0 to 10). This is slightly higher (weaker) than the previous quarter, after some mild multi-year improvement (decline) from mid-2013 to 2017, with this risk index having declined in those years due to the Net Dissavings Rate improving slightly.

The Key Drivers of the Savings Risk Index's Recent Level:

The Net Savings rate (Gross Saving net of Depreciation on Fixed Assets) remains very weak. However, off a very low base it improved mildly, from negative territory at a multi-year low of -2.5% of Disposable Income as at the 4th quarter 2013, to a slightly positive rate of +0.4% of Disposable Income in the 3rd quarter of 2017, before slipping slightly to +0.2% of Disposable Income in the 4th quarter.

Growth in the value of Net Wealth of the Household Sector accelerated to 11.25% year-on-year in the 4th quarter of 2017, from 6.8% in the previous quarter. However, by-and-large asset price growth has been mediocre in recent years, which would arguably justify a higher household savings rate to compensate for this.





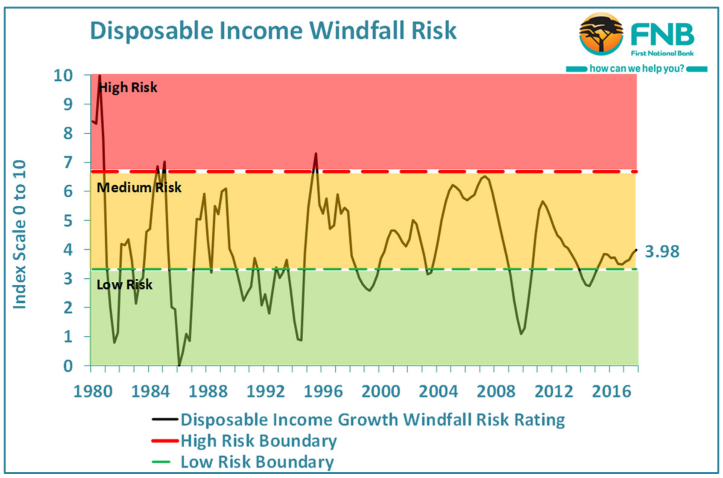
3. DISPOSABLE INCOME WINDFALL RISK– RATING: 3.98 MEDIUM

The rationale: Household spending and borrowing behavior can tend to become more aggressive, or even reckless and highly risky, in times of "economic windfalls". When abnormally big new job offers, bonuses, salary increases and dividend payments are the order of the day, such as in economic boom times, the big risk is that households begin to assume that these windfalls will continue forever, set their spending and borrowing commitments accordingly, and end up over-committed or over-indebted. Times of abnormally high disposable income growth thus pose a high "Disposable Income Windfall" Risk, which can lead to "over-investment" in, and ultimate de-stabilisation of, the residential market.

The compilation of the Index

The index is compiled using long term Real Household Disposable Income growth. We calculate the 4-quarter average year-on-year growth rate in Real Disposable Income (our feeling is that a "windfall needs to be sustained for a while before it leads to recklessness, hence the 4-quarter average), and then calculate the differential between it and the long term Real Disposable Income growth average since 1970. The higher the 4-quarter average growth rate is relative to the long term average, the higher the risk rating is, and vice versa.

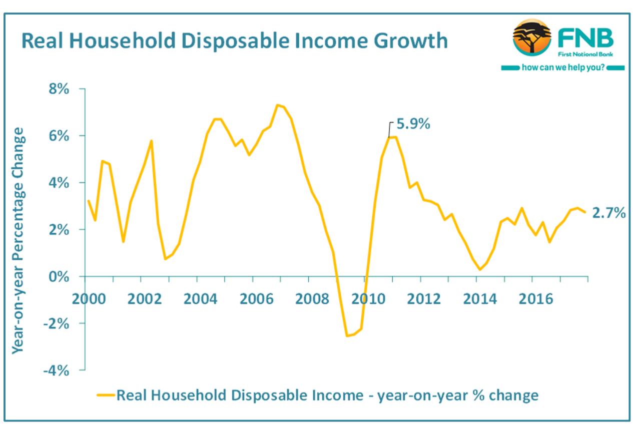
The Index: The Disposable Income Windfall Risk hovers near the borderline between "Medium Risk" and "Low Risk", and poses little threat in a weak economic environment despite a recent rise.

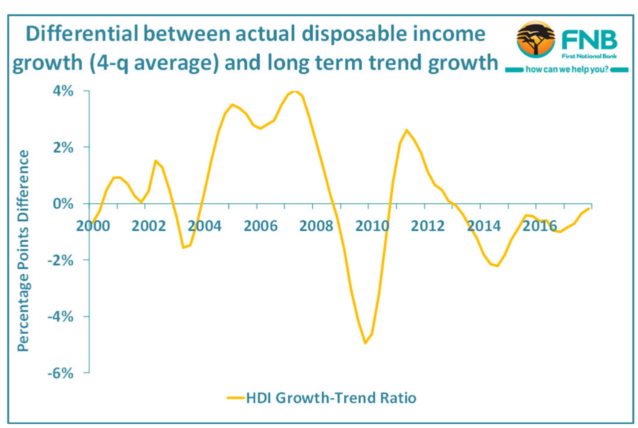


The Household Disposable Income Windfall Risk Index has risen recently, but remains at the low end of the "Medium Risk" Zone, at a 4th quarter 2017 level of 3.98. This is mildly higher (worse) than the 3.87 level for the previous quarter, but poses no significant threat at present.

Key Drivers of recent movement in Disposable Income Windfall Risk

Real Household Disposable Income growth recorded 2.7% year-on-year growth in the 4th quarter of 2017. This is slightly lower than the 2.9% of the prior quarter, and still far below the 5.9% post-recession peak in early-2011. Since 2013, the 4-quarter moving average growth rate has been consistently below the long-term average, implying little threat of "Windfall Madness" in the current environment.





4. RESIDENTIAL PROPERTY SPECULATIVE, PANIC AND OVER-EXUBERANCE RISK – RATING: 3.41 - MEDIUM

The rationale: The combination of strong house price growth and cheap credit can drive buying frenzies on an extreme scale. This can lead to market "overshoots", and financial over-commitment on a large scale.

It makes sense to speculate in such an environment, borrowing cheap credit to make quick capital gains before selling the property for a handsome profit. In addition, less seasoned investors see times of strong capital growth as the time to invest, seeing recent price growth as a predictor of future growth, often ignoring the rental yield. Big buy-to-let investment sprees thus often take place in such an environment.

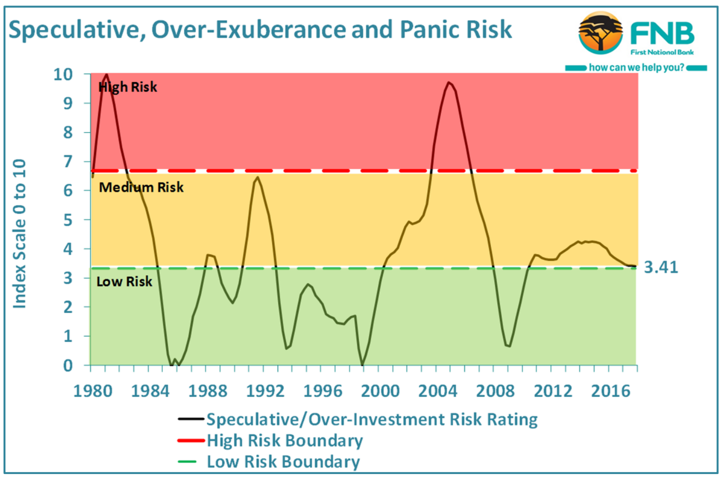
Then there is the issue of 1st time "buyer panic", where aspirant 1st time buyers fear that if they don't buy quickly they won't ever be able to afford a home in future. This can also spark a stampede.

House price growth relative to the interest rate level is thus crucial in determining the risk of such behaviour emerging.

The compilation of the Index

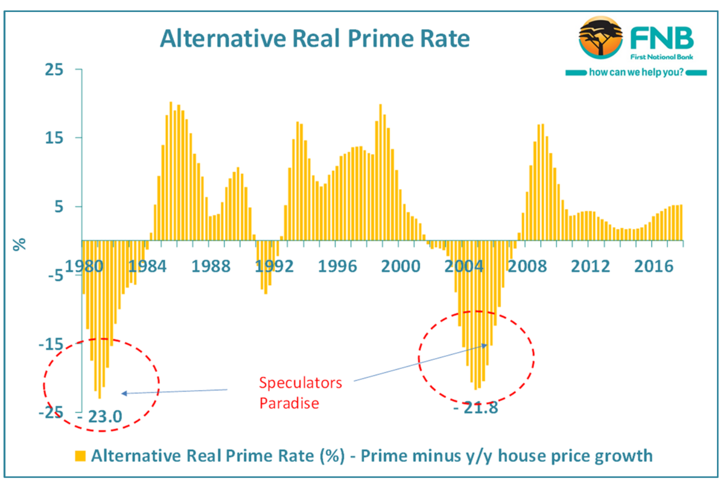
The index is compiled using the FNB Long Term House Price Index year-on-year inflation rate, for its long term history, and a SARB Prime Mortgage rate time series. We calculate the "Alternative Real Prime Rate" which is the difference between the Prime Mortgage Rate and House Price Inflation. When house price inflation far exceeds the Prime Rate percentage, an environment conducive to widespread speculation, over-exuberance and buyer panic emerges. A lower risk situation prevails when the Alternative Real Prime Rate is positive.

The Index: Speculative, Over-Exuberance and Buyer Panic Risk is near to the border between the Medium and Low Risk Zones.



The Speculative, Over-Exuberance, and Buyer Panic Risk Rating declined further in the 4th quarter of 2017 to 3.41 (scale of 0 to 10), from a previous level of 3.43. This revised level is just within the Medium Risk Zone, but bordering on Low Risk as it continues to decline (improvement). It is now far below the multi-decade high (worst) point reached in late-2004.

Key Drivers of recent trends in Speculative, Over-Exuberance and Panic Buying Risk Index



Single-digit average house price growth since 2008 (using the FNB Long Term House Price Index), coupled with interest rate hiking from 2014 to 2016 to lift Prime Rate to above 10% (where it remains despite last July's lone rate cut), has served to maintain a positive Real Alternative Prime Rate continuously over the past 10 years. This has contained any risk of widespread speculation, over-exuberance and 1st Time Buyer Panic buying.

5. HOME AFFORDABILITY RISK – RATING: 7.59 - HIGH

The rationale: The risk of downward pressure on house prices, in the event of an economic shock or interest rate hiking, is heightened the less affordable a residential market becomes. We consider 3 main types of affordability. Firstly, the average house price relative to disposable income is important. Secondly, house prices relative to rental costs are important, because if home values are very high relative to rental, rental may become an attractive option, lowering home buying demand. Thirdly, house prices relative to prices of consumer items are also important, because these compete with housing for a slice of the household income pie, and housing needs to be "competitively priced" in this regard. The higher the house prices relative to these other variables, the less price competitive housing becomes and the higher the Affordability Risk.

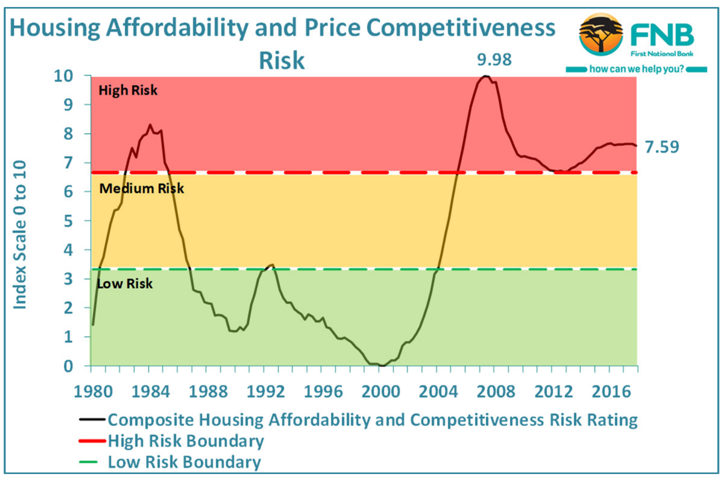
The compilation of the Housing Affordability Risk Index

The Housing Affordability Risk Index is compiled from 3 affordability indices:

- The Average House Price/Per Capita Disposable Income.
- The Average House Price/Average Rental Index
- The Average House Price/Consumer Prices Index

In all 3 sub-index cases, the higher the index level, the worse the affordability, or the less price competitive housing is, and the higher the affordability risk becomes.

The Index: Home Affordability Risk remains high, but may be peaking

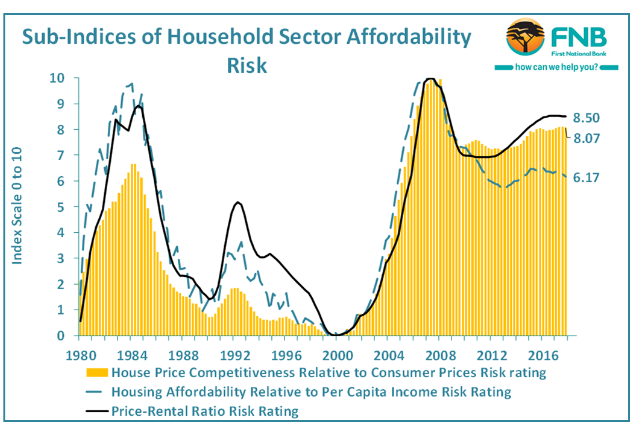


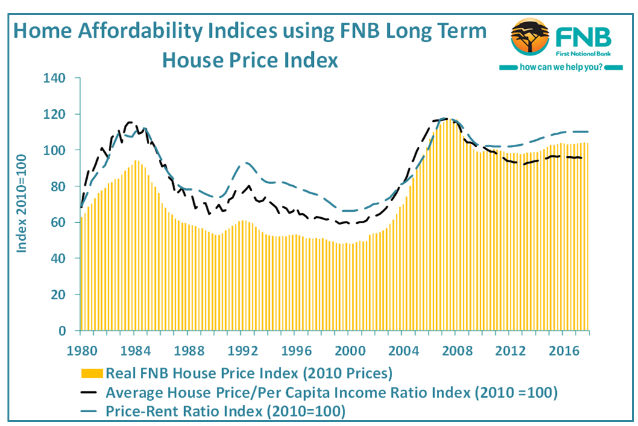
The Composite Home Affordability Risk Index was on a broadly rising (deteriorating) trend from 2012 to 2016, but this may have peaked.

From late-2016, the index began to "level out", and in the 4th quarter of 2017 we saw a very slight decline (improvement) from 7.64 previous, to 7.59.

The key drivers in Home Affordability Risk

The Average House Price/Per Capita Disposable Income Index is the lowest of the 3 affordability sub-indices, due to significant average wage inflation over recent years, which outpaced rental and consumer price inflation for much of the time since 2008. This index recorded a level of 6.37 (scale of 0 to 10) in the 4th quarter of 2017. The Price-Rent Ratio Risk Index at 8.5, and the Real House Price Risk Index at 8.07, keep the Affordability and Price Competitiveness Risk firmly in the "High Risk" zone though.





6. NEW BUILDING OVERSUPPLY RISK – RATING: 2.82 - LOW

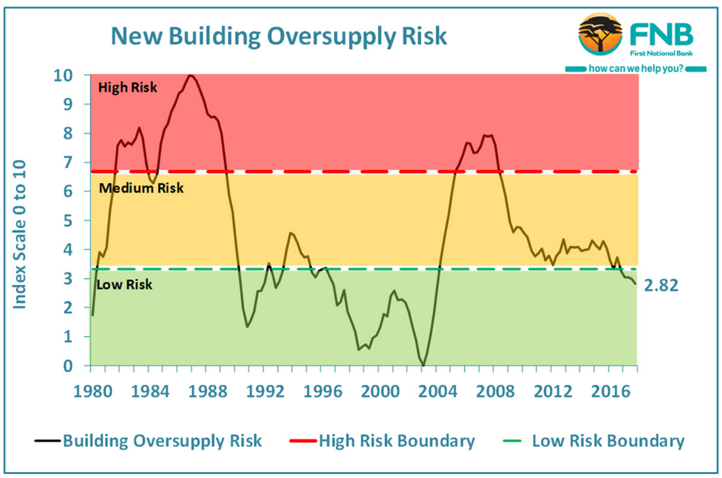
The rationale: Key to future market balance is the supply of new residential stock to the market. The cost of building new residential stock relative to the prices of existing homes is key to the level of constraint on new residential supply. When the cost of a new home is significantly above that of an existing home, it is relatively challenging to bring "competitively priced" new homes to the market, and vice versa if there is not price gap between the two or new home costs are lower than existing homes. This implies that the risk of housing oversupply is greater the less that new home prices are relative to existing home prices.

The compilation of the New Building Oversupply Risk Index

Due to the temporary discontinuation of the Absa housing market data, the New Building Oversupply Risk Index is compiled using a historic Absa time series depicting the percentage difference between the average new house price and the average existing house price (Source: Absa house price data), up until 2007, and thereafter the FNB Full Title Replacement Cost Gap time series (The percentage by which the average full title home replacement cost differs from its existing home value.

The higher the percentage by which the average new house price exceeds the average existing house price, the more difficult it becomes for the Residential Development Sector to bring new homes to the market than can compete price-wise with existing homes. This constrains the level of new residential development activity and thus new supply. The higher the average new home price is above the average existing house price, therefore, the lower the risk of creating oversupplies, which would lower the New Building Oversupply Risk Index, and vice versa. The Index is on a scale of 0 to 10.

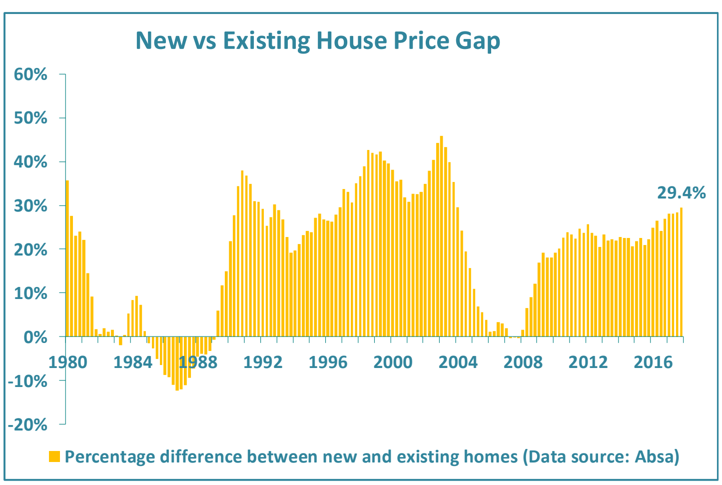
The Index: Building Oversupply Risk has moved back into the "Low Risk" zone



The New Building Oversupply Risk Index moved back into the "Low Risk" zone at the end of 2016, and declined further from the previous quarter's 2.99, to 2.82 in the 4th quarter of 2017.

This is the lowest of all sub-index risk ratings.

Key Drivers of recent trends in New Building Oversupply Risk



The residential market does not appear at great risk of creating a "major" oversupply of new residential units at present. Examining the FNB Full Title Replacement Cost Gap, the average replacement cost of a Full Title home was 29.4% higher than the existing home value by the 4th quarter of 2017. This gap has widened in recent quarters too, implying building cost inflation having been faster than existing house price inflation, and keeps it challenging for the Development Sector to bring competitively priced new housing stock to the market.

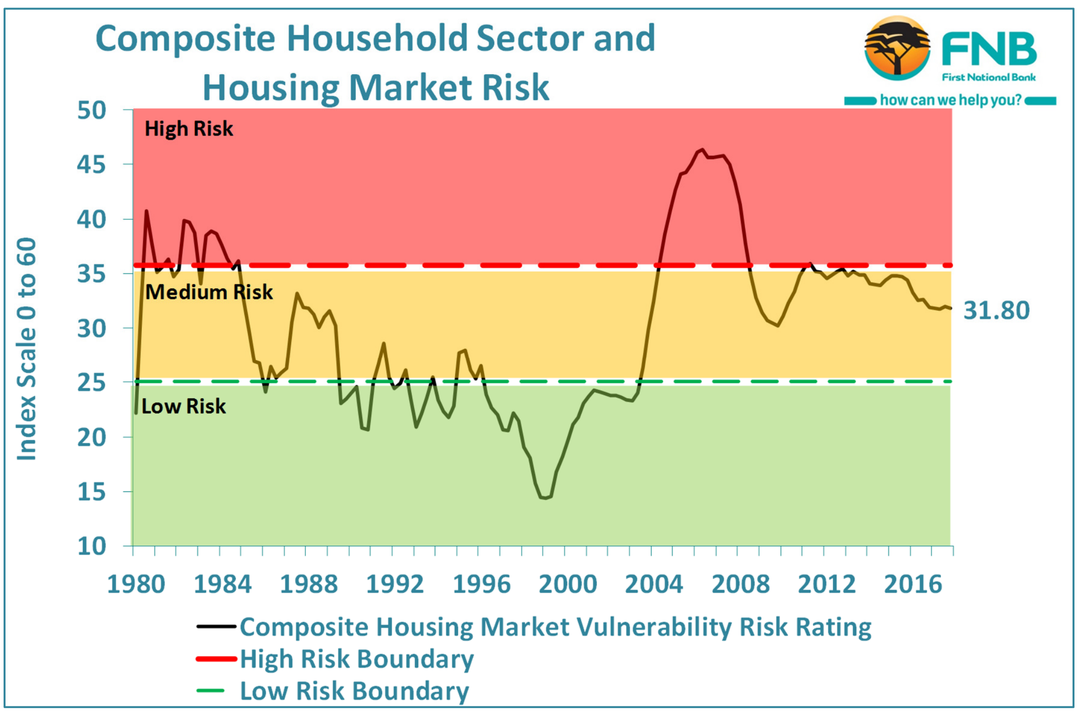
COMPOSITE HOUSING MARKET RISK– RATING: 31.8 - MEDIUM

The Composite Housing Market Risk Index includes the following risk sub-indices:

- Household Debt-Service Risk Index
- Household Sector Savings Risk
- Disposable Income Windfall Risk
- Residential Property Speculative, Over-Exuberance and Panic Risk
- Housing Affordability Risk
- New Building Oversupply Risk

This Composite Index attempts to capture Household Sector Financial and Housing Market-specific conditions and risks, excluding broader economic risks which are later captured in the Macroeconomic and Current Economic Pressures Indices.

The revised Composite Household Sector and Housing Market Risk Index has lacked "downward progress" in recent quarters. It did show a slight improvement (decline) in the 4th quarter of 2017, from 31.95 in the 3rd quarter of 2017 to 31.8 in the 4th quarter, but it ended the year on the same level that it started 2017 on. The Index remains firmly within the "Medium Risk" zone.



7. MACRO-ECONOMIC RISK– RATING: 7.36 - HIGH

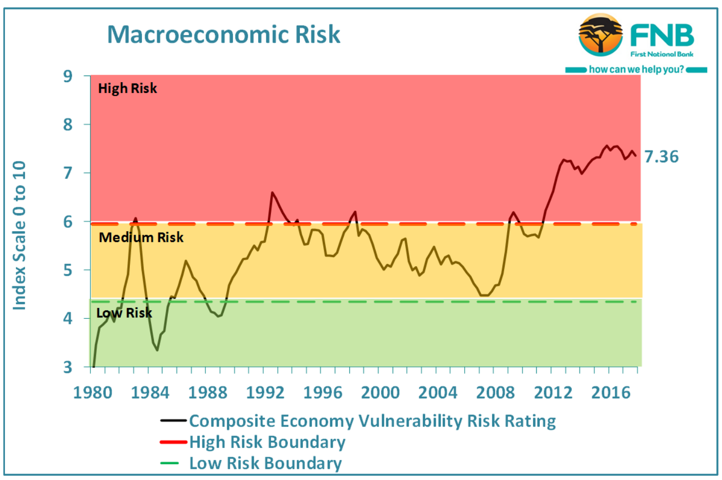
The rationale: Risks to Macroeconomic performance are key to the housing market, as it is the economy that drives employment and household income growth. The risks are very much determined by to what extent the country is living, or not living within its means, as reflected in the Current Account Balance. They are further determined by the scope that the Monetary and Fiscal Authorities have for future stimulus. This is determined by the current level of real interest rates (low implying less scope than high current real rates) and the Government Debt-to-GDP Ratio. Finally, current economic growth is key, as low growth has the potential to dent investor confidence (and thus future growth) as well as to fuel social tensions and economic disruptions in future. As a key Global Risk indicator we've included US 10-year Government Bond Yields, the lower the yield the higher the global risk.

The compilation of the Macroeconomic Risk Index

The Macroeconomic Risk Index is compiled from 5 key economic indicators:

- Real year-on-year GDP growth (smoothed)
- Current Account Balance as a percentage of GDP (smoothed)
- Real Interest Rates (as per our Prime Rate adjusted with the 5-year average consumer inflation measure)
- General Government Debt-to-GDP Ratio
- US 10-year Government Bond Yields

The Index: Macroeconomic Risk remains extremely high, but has shown some recent decline

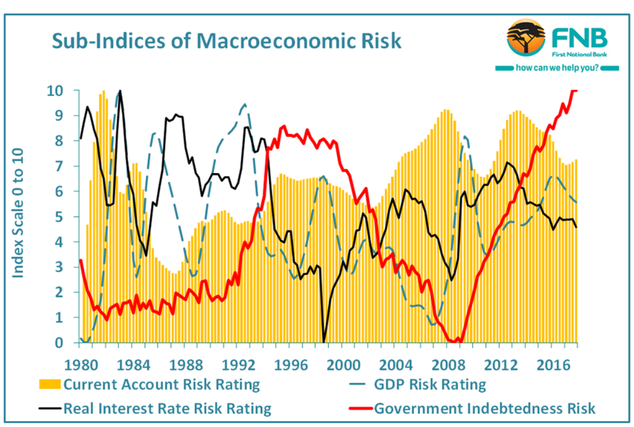


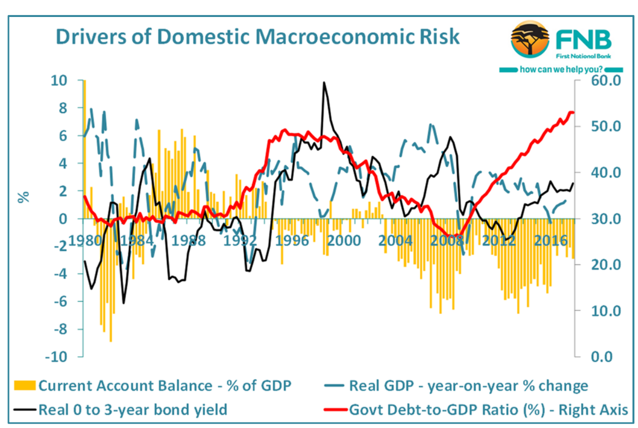
The Macroeconomic Risk Index remains at extremely high levels. However, in the 4th quarter of 2017, this Risk rating declined (improved) from a 7.45 previous quarter's level to 7.36, and is off its multi-decade worst (highest) of 7.56 reached late in 2015

However, it remains in the High Risk Zone.

Key Drivers of Macroeconomic Risk

The key driver of The Macroeconomic Risk Index's rise to such high levels in recent years has been a steadily rising General Government Debt-to-GDP Ratio, which reached 53% in the 4th quarter of 2017, the highest level over the past 3-and-a-half decades over which the risk indices are constructed. This variable, coupled with still moderate real interest rate levels, means very limited scope for monetary and fiscal stimulus. In addition, the continued stagnant rate of GDP (Gross Domestic Product) growth keeps this risk rating high. The longer that growth remains stagnant, so the risk of weak investor confidence, as well as rising social tensions and economic disruption, increases (although recent change of President has brought about some sentiment improvement of late). One positive development, however, has been a noticeably narrower Current Account Deficit on the Balance of Payments compared to a few years ago around 2013/14, where it went wider than -6% of GDP at a stage. But at -2.9% of GDP in the final quarter of 2017 the deficit issue remains significant. This implies a country still living beyond its means, albeit to a lesser extent than a few years ago.





8. CURRENT ECONOMIC PRESSURES – RATING: 5.48 - MEDIUM

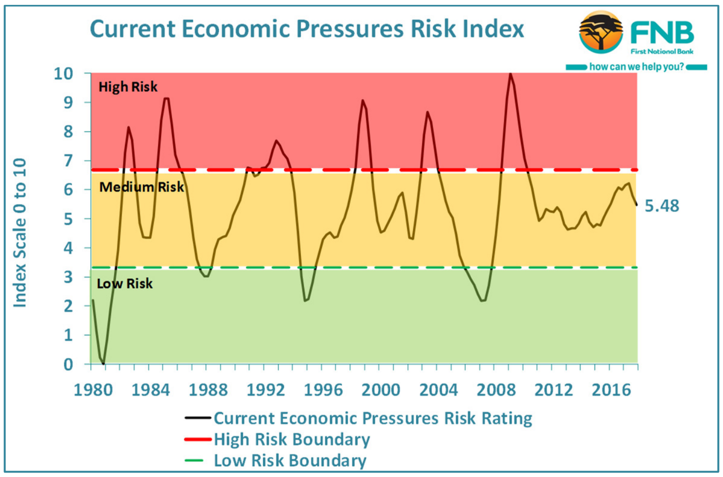
The rationale: Finally, we add current economic pressures, which may not necessarily be due to the imbalances mentioned in the previous section, but rather often due to cyclical forces such as global economic strength/weakness or commodity prices.

These pressures nevertheless need to be taken into account, as they can exert near term influence on the residential market

The compilation of the Current Economic Pressures Index

The Current Economic Pressures Index uses one variable, namely the OECD Leading Business Cycle Indicator for South Africa.:

The Index: Current Economic Pressures improve to remain in the "Medium Risk" zone



The Current Economic Pressures Index has moved towards the middle of the Medium Risk Zone recently, the most recent reading in the 4th quarter of 2017 being 5.48. This was down on the prior quarter's 5.80, pointing to some mild alleviation in near term economic growth pressures as the Leading Business Cycle Indicator has risen.

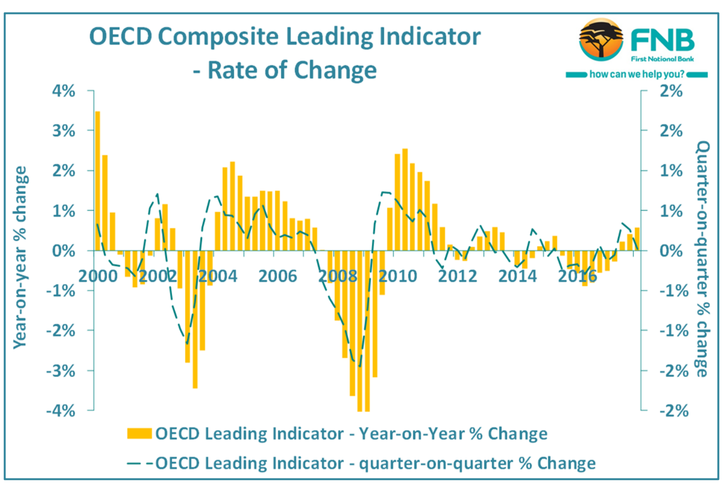
Key Drivers of Current Economic Pressures

The OECD Leading Business Cycle Indicator, a useful leading indicator of likely near term economic performance, shifted to positive year-on-year increase in 2017.

This has caused the improvement (decline) in the Current Pressures Risk Index in recent quarters, and indeed we did see mild strengthening in economic growth as 2017 progressed.

The other South African Leading Business Cycle Indicator, that of the SARB, has also been rising recently, the 2 indicators thus pointing to a possible improvement in economic growth performance as we move into 2018.

With Global economic performance reasonably solid in recent times, improved growth performance for South Africa is plausible. However, general confidence in the economy remains much dependent on policy and politics. The leadership changes in Government recently appear to have had some positive impact on sentiment for the time being, but much now depends on what policy reforms will be introduced.



In addition, the small but important Agriculture Sector remains at the mercy of the weather patterns, with drought conditions still intact in certain parts of the country, notably the Western and Eastern Cape.

Nevertheless, we do project an economic growth rate of 1.8% for 2018, slightly above the 1.3% expected number for 2017, therefore stronger than last year but still weak.

COMPOSITE HOUSING MARKET VULNERABILITY INDEX – RATING: 17.19 - HIGH

Finally, we compile the Composite Household Sector, Residential Market and Economic Risk rating. This index rolls up all 3 of the Major Composite Sub-Indices, namely the Composite Household Sector and Housing Market Vulnerability Risk Index, the Macroeconomic Risk Index and the Current Economic Pressures Index, into one overall risk rating for the Residential Market.

This Composite Index has shifted noticeably lower since late-2015. It declined (improved) in the 4th quarter of 2017, from 17.39 in the prior quarter to 17.19, but remains in the "High Risk" zone, albeit drastically improved (down) on the all-time highs reached around 2006.

The key contributor to the multi-year improvement (decline) in this Composite Index since 2006, of the 3 Major Composite Sub-Indices, has been the Composite Household and Housing Market Risk Index, which is very significantly lower (improved) since back then and hovers down in "Medium Risk" territory. The Current Economic Pressures Index also finds itself in the "Medium Risk" zone. However, the negatives are the large macroeconomic imbalances, as captured in the Macroeconomic Risk Sub-Index, that are keeping the Composite Housing Market Vulnerability Index in the "High Risk" zone.