PROPERTY INSIGHTS

FNB House Price Index

3 December 2018

A key expected "theme" for 2019 is ongoing real property price "correction". House price growth appears to have found a "range" not far from 4% year-on-year, which continues to reflect gradual decline in real terms.

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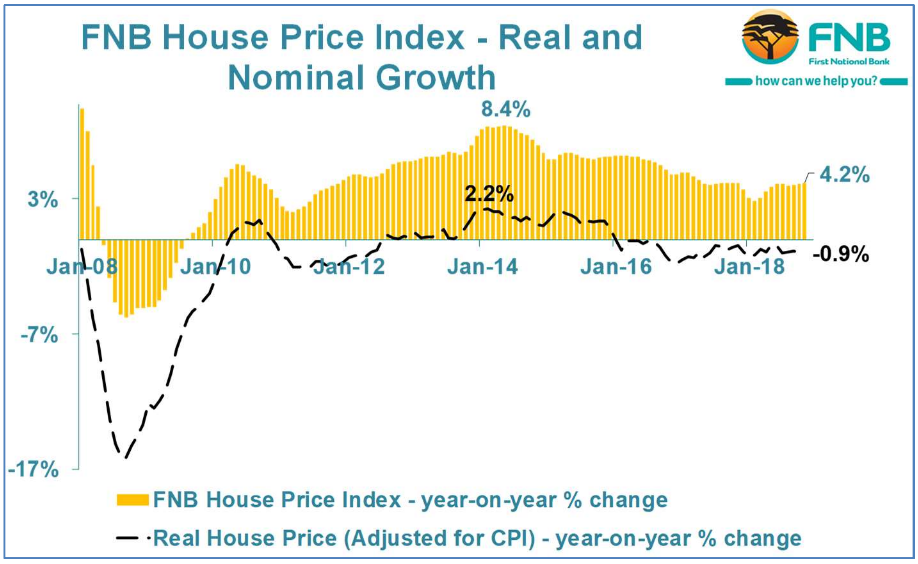
FNB HOUSE PRICE INDEX RESULTS FOR NOVEMBER 2018

One of our expected property "themes" for 2019 is ongoing gradual real property price correction.

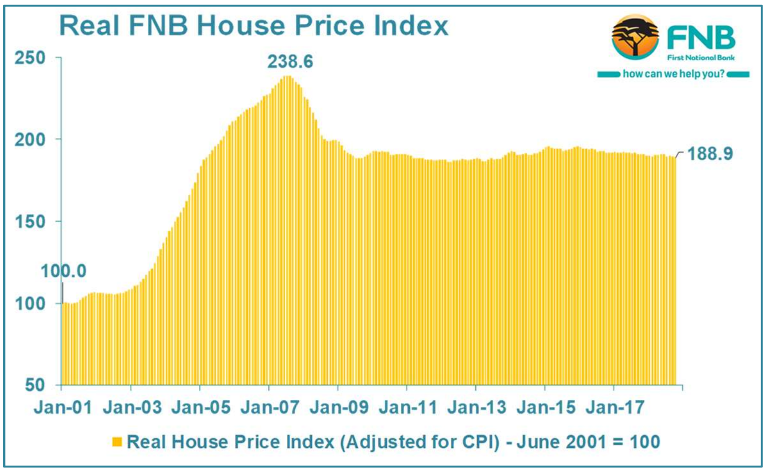
The FNB House Price Index continues to hover in low single digit growth territory not too far from 4% year-on-year. On a year-on-year basis, the Index's growth rate accelerated slightly to 4.2% in November, from a slightly lower revised 4.1% rate in October.

The low single-digit growth in nominal terms continues to translate into a year-on-year price decline in "real" terms, when adjusting for CPI (Consumer Price Index) inflation. This means that the gradual housing market price "correction" continues, as it has since early-2016.

As at October 2018 (November CPI not yet available) real house prices declined year-on-year by -0.9%, with CPI inflation at 5.1% and house price growth at 4.1% in that month.



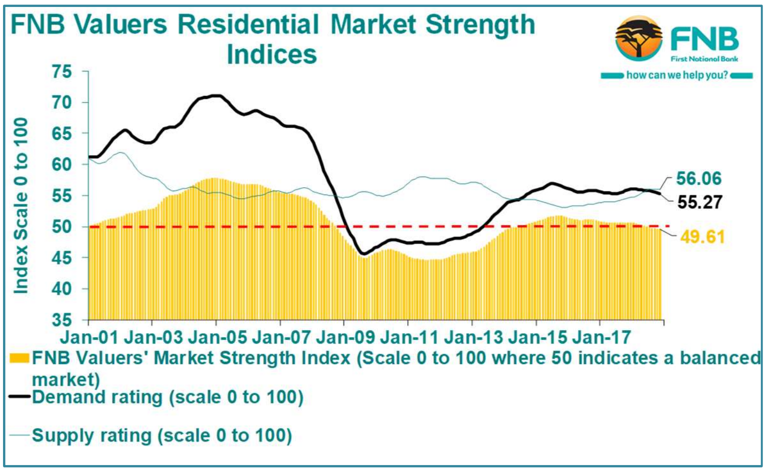
LONGER RUN REAL HOUSE PRICE PERFORMANCE



Examining the longer run performance of the FNB House Price Index in real terms, we still see it at relatively high levels, 88.9 up on the January 2001 "pre-boom" index level, having risen sharply in that pre-2008 boom period.

The cumulative real decline since the peak of that pre-2008 boom period, reached in August 2007, has been -20.8%. We don't, however, believe that this cumulative real price correction to date has been sufficient to bring real home values back into line with what are now very weak economic fundamentals.

FNB VALUERS PERCEIVE THE BROAD MARKET SLOWING TREND TO BE CONTINUING



FNB's valuers continue to point to housing demand weakening, and with it the demand-supply balance as reflected in a declining FNB Valuers' Market Strength Index (explanatory notes at the end of the report).

This appears to explain the ongoing house price decline in real terms.

The FNB Residential Demand Rating declined by -1.2% on a year-on-year basis in November 2018.

The FNB Housing Supply Rating has been rising year-on-year, recording a +2.6% rate as at November.

These movements in demand and supply translate into a further decline in the FNB Market Strength Index by -2.1% year-on-year, to reach a reading of 49.61, keeping it below 50 for the 6th consecutive month. This below-50 reading means that valuers now rate residential supply as stronger than demand.

CONCLUSION – 2018 WAS LIKELY A SLOWER HOUSE PRICE GROWTH YEAR THAN 2017, AND MORE REAL PRICE DECLINE EXPECTED IN 2019

Nearing the end of 2018, and with one month's house price data remaining, it appears likely that the average house price growth rate for 2018 will be slower than that of 2017, and be the 4th consecutive year of average price growth slowdown.

The year-to-date average growth rate for 2018 is 3.7%, which is slower than the 4.3% of 2017, and noticeably slower than the 6.8% high reached in 2013, just before that start of interest rate hiking early in 2014.

Turning to 2019, we project nominal average house price growth to be 3.7% for next year too, i.e. very similar to the 2018 likely outcome. Given an FNB CPI inflation projection of 5.3% for next year, this would translate into another year of house price decline in real terms.

FNB does foresee slightly better (but still weak) economic growth of 1.4% in 2019, compared with 0.7% for 2018. Against this, however, a further interest rate hike is projected in 2019 after the late-2018 hike. This is expected to cause slightly more conservative property spending in 2019 in what is always a highly credit-dependent market.

Mild rate hiking, therefore, is expected to offset the mild support for the housing market coming from a slightly stronger economic growth forecast next year.

ADDENDUM - NOTES:

Note on The FNB House Price Index:

The FNB Repeat Sales House Price Index has been one of our repertoire of national house price indices for some years, and is based on the well-known Case-Shiller methodology which is used to compile the Standard & Poor's Case-Shiller Home Price Indices in the United States.

This "repeat sales approach" is based on measuring the rate of change in the prices of individual houses between 2 points in time, based on when the individual homes are transacted. This means that each house price in any month's sample is compared with its own previous transaction value. The various price inflation rates of individual homes are then utilized to compile the average price inflation rate of the index over time.

The index is compiled from FNB's own valuations database, thus based on the residential properties financed by FNB over the past 18 years.

We apply certain "filters" and cut-offs to eliminate "outliers" in the data. They main ones are as follows:

- The maximum price cut-off is R15m, and the lower price cut-off is R20,000.
- The top 5% of repeat sales price growth rates, and the bottom 5% of growth rates are excluded from the data set.
- Repeat transactions that took place longer than 10 years after the previous transaction on the same home are excluded, as are repeat transactions that took place less than 6 months after the previous transaction on the same home.
- The index is very lightly smoothed using a Hodrick-Prescott smoothing function with a Lambda of 5.

Note on the FNB Valuers' Market Strength Index: *When an FNB valuer values a property, he/she is required to provide a rating of demand as well as supply for property in the specific area. The demand and supply rating categories are a simple "good (100)", "average (50)", and "weak (0)". From all of these ratings we compile an aggregate demand and an aggregate supply rating, which are expressed on a scale of 0 to 100. After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating, add 100 to the difference, and divide by 2, so that the FNB Valuers' Residential Market Strength Index is also depicted on a scale of 0 to 100 with 50 being the point where supply and demand are equal.