



Still waters run deep

The housing market continues to slow, even though the strong downward trend is, from time to time, masked somewhat by volatility in the monthly data. House price growth has, despite an uptick in October and November to 8% year-on-year, clearly decelerated from the double digits registered in the first half of the year, and the rates of around 20% clocked up last year. Residential property prices are virtually stagnating, with the median price stuck at R530 000 from July to September this year, with a slight increase in October to R540 000 where it stayed at in November. Thus, despite still registering reasonable year-on-year growth rates (that are substantially lower than before), recent movements in house prices have been in line with our expectation of very little, if any, growth going into next year. This corroborates the slowdown in consumer activity reflected in other indicators such as retail and car sales, even though strong income growth and continued employment creation are supporting a remarkably resilient consumer force.

The slowdown, like the boom preceding it, is not being experienced in the same way across different market segments. Generally, the price growth of luxury houses is slowing down faster, while the more affordable housing segment is still quite robust. In this report, apart from unpacking the headline housing-related data in more detail, a closer look is taken at the lower price segments. In particular, the housing market in Soweto is analysed for a better understanding of the dynamics in this part of the market.

1. Unpacking the housing market data

Some methodological issues

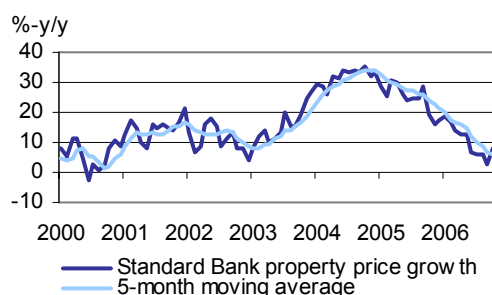
Since we have dealt with the construction of house price indices extensively in previous reports (see *Residential Property Gauge* 12 July 2006 and 1 November 2006), this report will not comprehensively cover the challenges faced when constructing such indices. However, the recent volatility in the monthly data justifies a brief mention of the key complications of housing market data. While a national house price index would ideally track changes in the values of all houses, the data to do so are not available, which necessitates the use of data based on housing transfers or bonds. Therefore, the data are impacted by any changes in the segments with the most activity. For example, if more activity starts taking place in the upper price segments, this will put upward pressure on aggregate house price measures.

Furthermore, since national data from the Deeds Office are available only with a relatively long lag of up to nine months, current indicators of the housing market are usually based on a particular institution's experience. In this report, data from the Deeds Office are used wherever possible, and are supplemented by data from mortgages granted by Standard Bank, which has a market share of about 24%.¹ The data from these two sources are generally highly correlated over time. Nevertheless,

IN THIS ISSUE:

- Challenges inherent in house price data add to the volatility, which masks a strong downward trend in house price growth (p 1)
- The demand for houses from owner-occupants (p 3) and investors (p 4) is moderating
- More affordable housing segments: A closer look at Soweto's property market (p 6)
- While constrained in the short term, house price growth is expected to pick up in the medium to long term (p 15)

FIGURE 1: House prices – Standard Bank



Source: Standard Bank Group

TABLE 1: Stats at a glance

Indicator	Period	Data
Median house price	Nov 06	8% y/y
Median house price	5m ma	6.2% y/y
Median house price	Nov 06	R540 000
Mortgage advances	Oct 06	30.9% y/y
Private sector credit extension	Oct 06	27.5% y/y
Ratio of household debt to income	Q2 06	70%
Prime rate	Nov 06	12%

Source: Standard Bank Group, SARB

¹ Graphs based on data from the Deeds Office will have both the Deeds Office and Standard Bank quoted as sources, whereas those based on Standard Bank's data will only credit Standard Bank Group as the source.

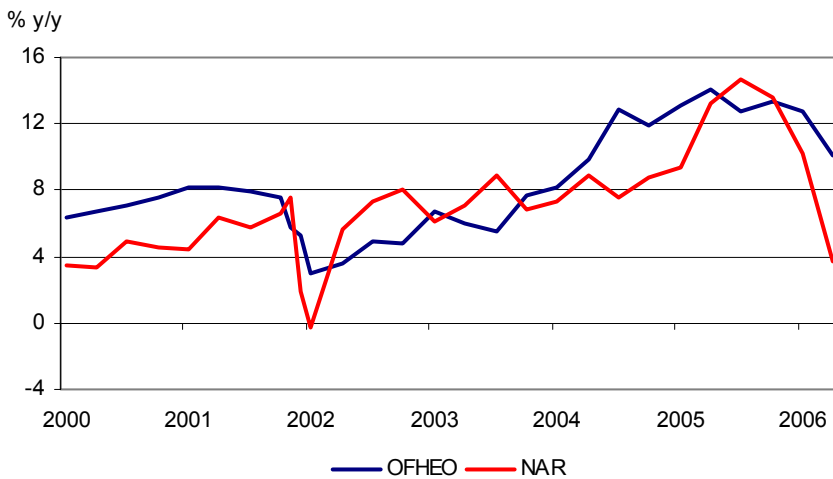


it should be kept in mind that the data are representative of Standard Bank’s client base, and may therefore differ from the data of other institutions.

Changes to the mix of houses sold in a particular period impact on any aggregate measures, albeit less so when the median² rather than, say, the average is used. The substantial impact that this caveat has on house price indices is aptly demonstrated by a comparison between two indices of national house prices in the US. The index constructed by the National Association of Realtors (NAR), like most international house price indices, is not adjusted for the mix of houses included. The index of the Office of Federal Housing Enterprise Oversight (OFHEO), on the other hand, is one of the rare exceptions that adjust the index for the type of houses included. Figure 2 illustrates how the OFHEO house price index is growing almost twice as fast as that of the NAR. In this case, the change in the mix of houses sold is subtracting around six percentage points off the aggregate growth rate.

The distribution of houses transferred is not expected to fluctuate wildly from month to month and rather impacts on house price indices over a somewhat longer term. Nevertheless, Figure 2 highlights how the distribution can have a marked impact even over a relatively short period, with the gap between the two US indices’ price growth measurements rising from zero to six percentage points over just two quarters.

Figure 2: US house prices



The type of houses sold in a particular period has a substantial impact on aggregate house price measures

Source: OFHEO, NAR, Bloomberg

In the local housing market, the data necessary to make the adjustments for the mix of houses included in every period are not available, but it is well known that activity has shifted from the upper end of the price spectrum towards the more affordable segments (see Table 2), which is generally pulling aggregated measures of house prices down (albeit less so in the case of the median house price than, say, the average, as explained in previous reports). This distortion should be kept in mind when interpreting changes in house price indices, and it emphasises the importance of focusing on the trends rather than the volatile monthly numbers. We are currently undertaking a project that attempts to estimate the magnitude that this distortion has on local house price data; the findings will be reported in next year’s *Residential Property Gauges*.

² As explained in detail in the Residential Property Gauge of 12 July, the median house price is used in Standard Bank’s house price index. The median house price is one of the most common measurements used globally to calculate house price indices. Examples of where the median is used to measure house prices include: Rode Property Economists, Consultants & Valuers (South Africa); the Real Estate Institute of Australia (www.reiaustralia.com.au); the Commonwealth Bank (www.commbank.com.au/propertyvalueguide) (Australia); the Real Estate Institute of New Zealand; and the US National Association of Realtors (www.realtor.org). Essentially, the median house price is the midpoint that separates the top 50% of house prices from the lowest 50% of house prices. In other words, half of all the houses are more expensive than the median price and the other half of the houses are cheaper. The median price is therefore representative of the typical house price.



Table 2: House price growth

Price segment:	Low	Low-Middle	Middle	Middle-Upper	Upper
Percentile ³	8	30	60	80	95
2002	3.02	4.98	12.25	17.22	20.71
2003	3.41	8.59	14.77	16.46	13.20
2004	5.79	18.19	27.17	26.19	15.77
2005	25.83	35.49	31.37	22.84	13.37
2006 Q1	18.10	21.58	19.21	12.19	8.90

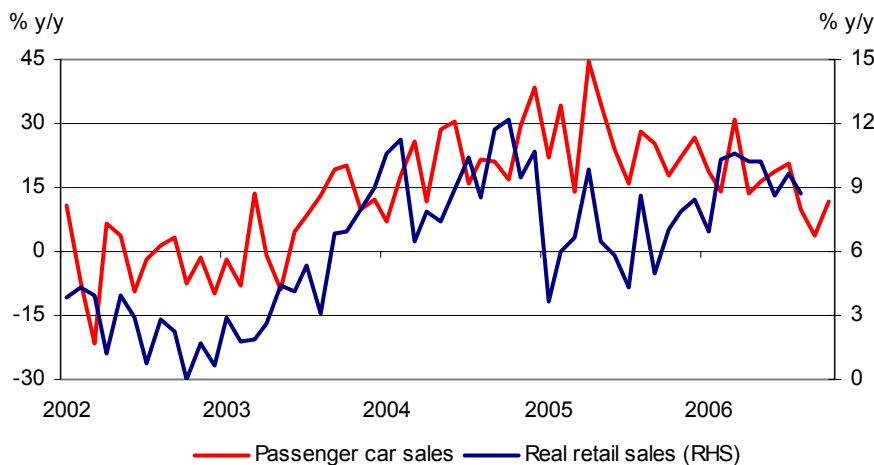
Source: Standard Bank Group, Deeds Office

The slowdown in owner-occupants' demand

Despite the uptick in house price growth in October and November from September's 2.9% y/y, there are several indicators pointing towards a continued slowdown in the housing market and also more broadly in consumer activity. For example, even though total mortgage advances continue to grow at around 30% y/y, the rate around which they have been hovering since February this year, this masks a shift from individual to corporate borrowing. A careful scrutiny of the Reserve Bank's DI900 data reveals that the growth of mortgages granted to individuals dropped from 31% y/y in February to 22.1% y/y in August – the slowest growth since May 2004. In contrast, the growth of mortgages extended to corporates rose to 59.3% y/y in August from 29% y/y in January.⁴ This, along with the trends in indicators, such as vehicle and retail sales, and the slowdown in households' total debt already evident prior to the onset of the rising interest rate cycle, corroborates our view that consumer activity is slowing down. At the same time, the supply side of the economy seems to be gaining pace.

Strong growth in private sector credit extension masks a shift from household to corporate borrowing

Figure 3: Passenger car and real retail sales growth



Source: Naamsa, Stats SA

³ The xth percentile is the price such that x% of all houses are cheaper than that price. For example, the 80th percentile will be the price such that 80% of all houses are cheaper, and 20% more expensive, than that price. The advantage of defining different price segments in this way, rather than working with pre-determined price bands, is that it isn't necessary to change the price limitations a priori, which could impact on any statistics based on the data, such as the average price.

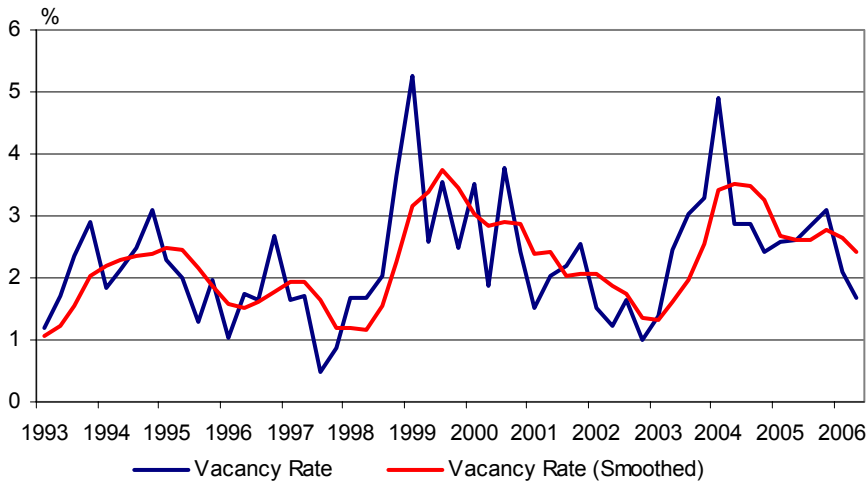
⁴ These calculations may be influenced by mortgages extended to closed corporations. Furthermore, changes to the ways in which banks classify different types of loans may, from time to time, influence the aggregate data. In particular, a classification change by one of the large financial institutions earlier this year is impacting on the magnitudes of some of these calculations. However, the trends are robust to this specific disruption.



Buy-to-let investors' loss of enthusiasm

Apart from the impact of owner-occupants' constrained finances, restrained by higher living costs and interest rates in particular, further downward pressure is being put on the housing market by the loss of investors' enthusiasm for purchasing buy-to-let properties. Unfortunately the data on investor activity are somewhat stale, since it relies on data from the Deeds Office, which lag up to three quarters. The available data, however, already show that fewer investors entered the market in 2005 (40 882) than in 2004 (52 018). The strong rise in activity in the buy-to-let market during the recent property market boom strengthened concerns that the higher supply of rental units would suppress the rental income. Indeed, vacancy rates have been rising since the end of 2004 (see Figure 4) to levels last seen more than five years ago. Since the end of 2005, however, vacancy rates have generally been dropping as investors have accepted lower rentals or lower rental growth rather than be left with vacant properties.

Figure 4: Vacancies in residential sectional title units



Vacancy rates have been moderating, since buy-to-let investors lowered their rental costs' escalation rather than have vacant properties

Source: Standard Bank Group, Rode

Consequently, the growth in rental costs has been moderating since early 2005 from close to 15% y/y to around 10% y/y by the end of 2005. This year, the growth in rental costs has moderated quite sharply, and, by some measures, rental income is lower than a year before (see Figure 5). As usual, we hasten to add that, like most aggregate numbers, these mask vast differences in different market segments. According to data collated by Rode, the rental market is still relatively buoyant in, for example, Pretoria and Germiston, but less so in, for example, East London (see Table 3). The deceleration in rental growth, combined with solid house price growth in recent years and higher interest rates more recently, has caused a deterioration in the average instalment to rental ratio (see Figure 6) and the rental yield earned by investors. This will deteriorate even further following the expected continuation in monetary policy tightening.

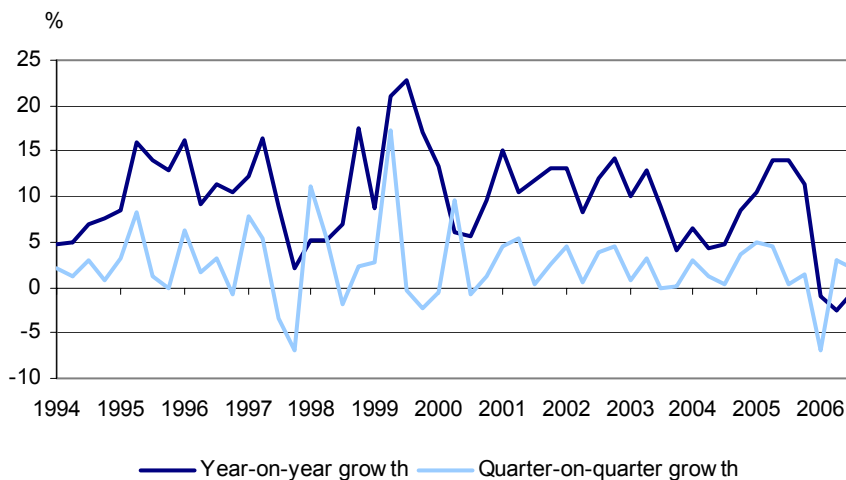


Table 3: Rental costs

City	Property	Average rent (Rand, 2006 Q2)	% y/y (2006 Q2)	% y/y (2006 H1)
Johannesburg	Bachelor	1 632	-7.11	-0.15
Johannesburg	1-bedroom	2 066	-5.23	2.48
Johannesburg	2-bedroom	2 759	2.19	6.55
Johannesburg	3-bedroom	3 473	-4.27	4.86
Germiston	Bachelor	1 111	11.77	20.61
Germiston	1-bedroom	1 479	12.73	20.88
Germiston	2-bedroom	1 899	16.65	22.57
Germiston	3-bedroom	2 303	17.98	20.23
Pretoria	Bachelor	1 497	9.03	14.02
Pretoria	1-bedroom	1 819	6.81	9.80
Pretoria	2-bedroom	2 503	8.31	7.79
Pretoria	3-bedroom	3 153	0.61	2.13
Durban	Bachelor	1 738	12.64	14.77
Durban	1-bedroom	2 119	5.63	5.86
Durban	2-bedroom	2 735	3.91	3.64
Durban	3-bedroom	3 412	4.76	-0.36
Cape Town	Bachelor	1 752	11.24	11.43
Cape Town	1-bedroom	2 104	6.37	6.56
Cape Town	2-bedroom	2 836	7.06	5.89
Cape Town	3-bedroom	3 804	6.44	3.85
Port Elizabeth	Bachelor	1 364	12.73	7.77
Port Elizabeth	1-bedroom	1 610	3.94	5.98
Port Elizabeth	2-bedroom	2 175	12.75	10.16
Port Elizabeth	3-bedroom	2 613	9.15	9.55
Bloemfontein	Bachelor	1 036	7.69	-2.98
Bloemfontein	1-bedroom	1 437	0.28	0.24
Bloemfontein	2-bedroom	1 968	-1.99	4.82
Bloemfontein	3-bedroom	2 518	-10.39	-4.05
East London	Bachelor	1 357	4.95	10.45
East London	1-bedroom	1 692	3.30	9.71
East London	2-bedroom	2 098	-4.55	1.23
East London	3-bedroom	2 514	-1.68	3.76

Source: Standard Bank Group, Rode

Figure 5: Rental rates



The growth in rental costs has been moderating since early 2005

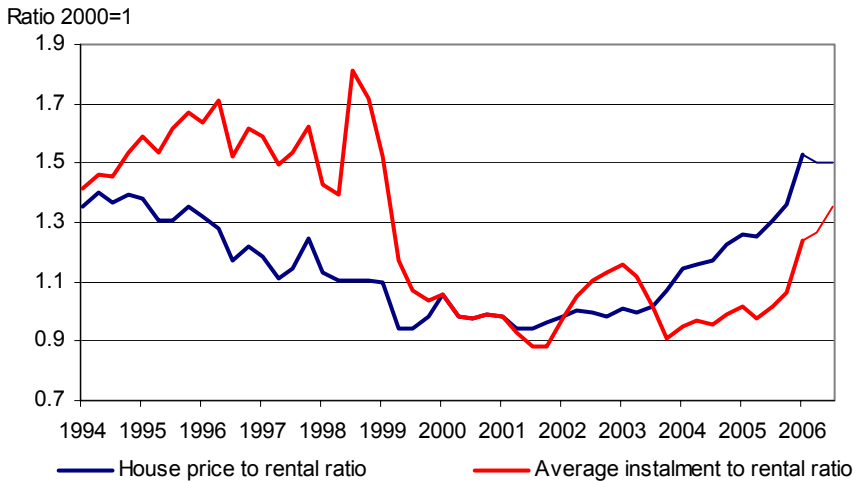
Source: Standard Bank Group, Rode

Figure 6 illustrates the instalment to rent ratio, incorporating the decelerating rental and house price growth and higher interest rates. A lack of data prohibits an analysis of the proportion of the instalment



that an investor can cover with his rental income on a buy-to-let property, but he/she would have been about 12% worse off with a new investment at the end of 2005 than at the beginning of 2004. In other words, an investor who was able to repay his/her full mortgage instalment from rental income at the beginning of 2004 would only have been able to repay 88% of the instalment on a new purchase at the end of 2005 and, based on the abovementioned assumptions, only about 67% in the second quarter of 2006. These calculations are based on house prices and rents in each quarter. In other words, they represent the situation faced by new investors, which will, of course, be different from that of investors who bought their properties earlier at lower prices.

Figure 6: Mortgage instalments and house price to rental income ratios



Investors' returns on buy-to-let properties have been declining

Source: Standard Bank Group, Rode

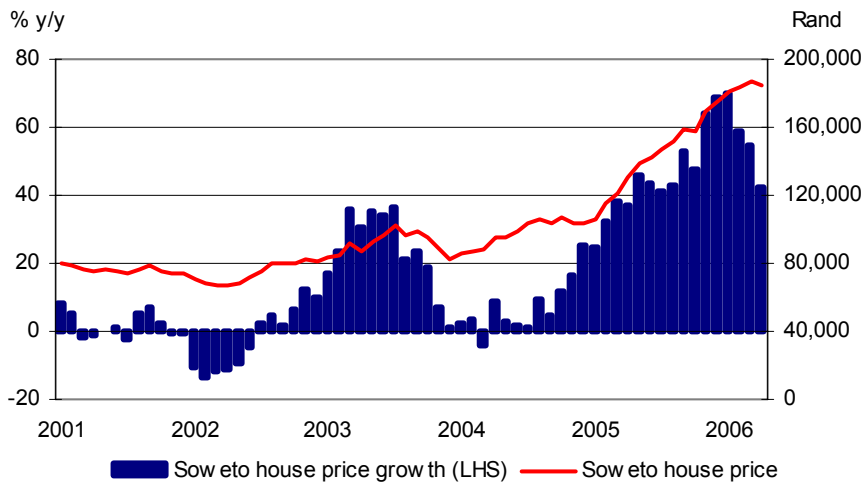
2. The more affordable housing market – Soweto

A far cry from being simply an outer area of Johannesburg that it was once thought to be, Soweto and the Soweto housing market is flourishing. From what once were 'matchbox' houses, built by the apartheid government as welfare housing, the sight of affluent housing is now not uncommon. Social programmes, such as the Greening Soweto Campaign (which plans to plant 300 000 trees throughout Soweto by 2010), together with commercial projects, such as the Baralink project (which aims to turn the Baragwanath Precinct into a major commercial hub), add to the upcoming prosperity of this city.

The trickle-down effect of the recent property boom throughout the country has been vast. The boom touched on the majority of areas within South Africa, and lately also on Soweto; this is in line with the uptick in more affordable housing throughout the country (see Table 2). Occasionally, when house prices experience large increases, this may limit the ability of individuals to migrate between lower-priced and higher-priced regions. As a result, those who once would have moved out of Soweto, in light of increasing income, may now choose to remain in Soweto (in exchange for not paying higher prices) and, instead, may enhance their current living standards in light of their improving financial circumstances.



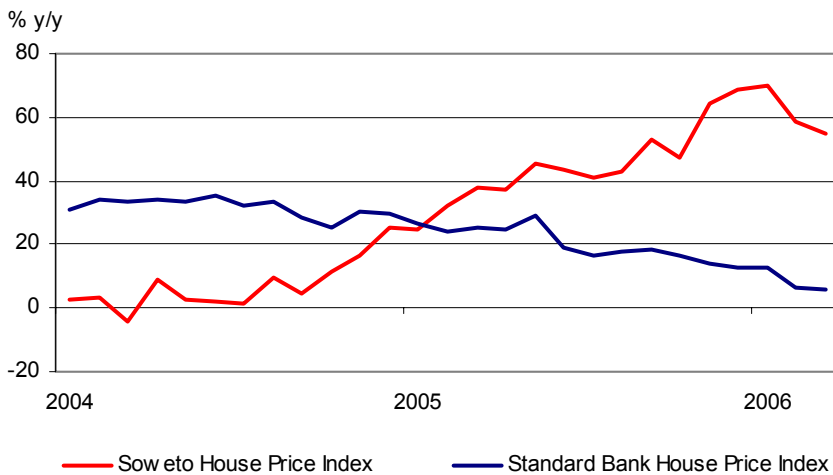
Figure 7: House prices (Soweto)



Source: Standard Bank Group

The house price growth experienced in Soweto has, until recently, lagged behind that of national house prices. Soweto's house price growth lagged the growth in national house prices until the start of 2005, when Soweto's house prices grew in excess of 30% on average for that year, and continued to grow strongly into 2006 (see Figure 8). Table 4 below illustrates the differences in the median house prices in Soweto and the national residential property market, together with the differences in their respective growth rates.

Figure 8: National and Soweto house prices



Source: Standard Bank Group

Since early 2005, Soweto's house price growth has been outpacing that of the national aggregate house price

Table 4: Median house prices and house price growth

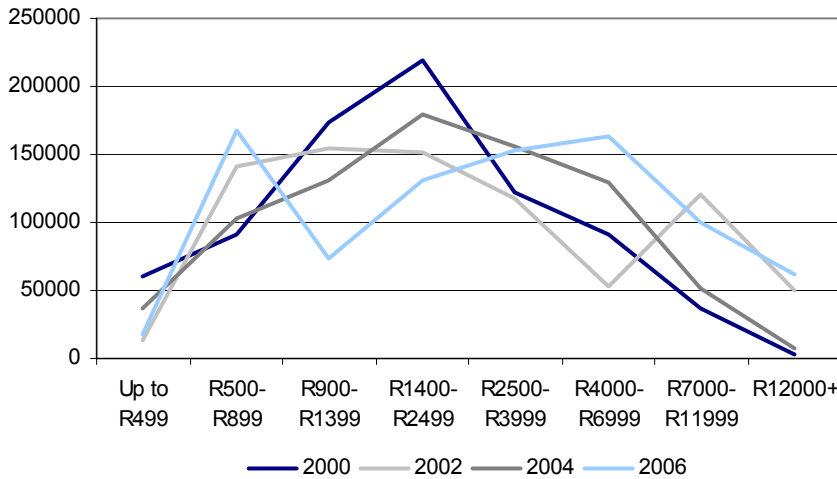
	Median House Prices		Median House Price Growth	
	Soweto (Rand)	National (Rand)	Soweto (% y/y)	National (% y/y)
August 2004	112,280	402,018	8.95	32.90
August 2005	145,000	500,000	36.95	25.83
August 2006	180,000	530,000	42.09	8.65

Source: Standard Bank Group



The property market boom currently under way in Soweto has to some extent been the consequence of national housing dynamics alluded to above, but it has also been driven by changing socio-economic features. The income distribution of Soweto's population has been catching up with that of the rest of the country, narrowing the sizeable gap that prevailed earlier. For example, in 2000, only 4.6% of Soweto's adult population earned between R7 000 and R12 000 per month, compared with 8% of the total population. By 2006, this had increased to 11.5% in the case of Soweto, compared to 10.7% nationally. This implies a noticeably larger demand in Soweto for properties selling for between R190 000 and R330 000; 60 000 more Soweto residents can afford such houses now than in 2000.⁵

Figure 9: Income distribution (Soweto)



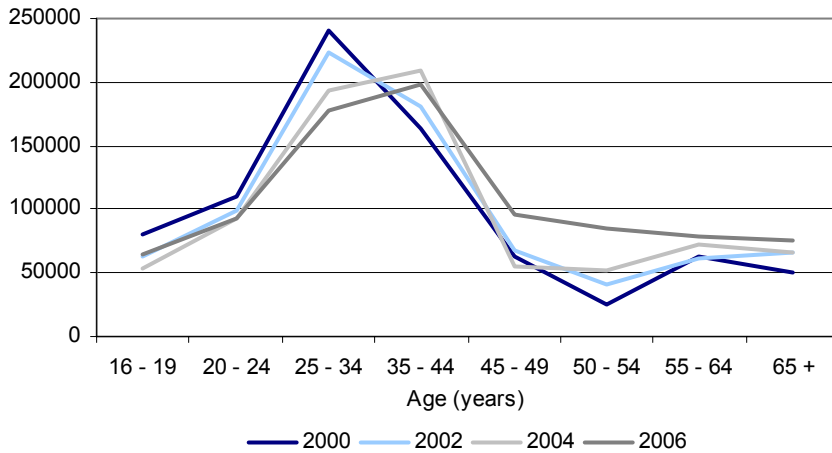
Source: Standard Bank Group, SAARF

The income distribution of Soweto's population has been gaining on that of the rest of the country

Along with the higher incomes, the average age of Soweto's residents has also been rising (see Figure 10). For example, between 2004 and 2006, the proportion of the adult population in Soweto aged 45 to 49 rose from 6.8% to 11%, while the proportion of people between 50 and 54 years of age increased to 9.8% from 6.5% of the adult population. Indeed, over this period, the proportion of the population in each of the age groups from 45 years and older increased. In contrast, the opposite occurred in the age groups younger than 45 years (bar the 16-19 year cohort). Generally, these trends have prevailed since 2000 (the first data available).

⁵ The income data used here have not been adjusted for inflation. They therefore aren't indicative of standard of living, but do reflect individuals' ability to pay higher house prices.

Figure 10: Age distribution (Soweto)



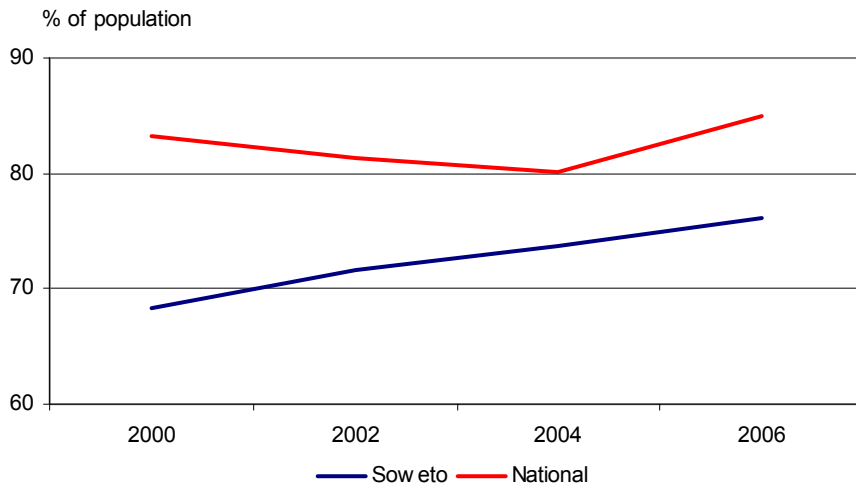
Source: Standard Bank Group, SAARF

Furthermore, better education also may have contributed to the favourable income and property market trends, with more people in Soweto now having tertiary qualifications than before. For example, the proportion of the adult population in Soweto with a university degree rose from less than 1% in 2002 and 2004 to 1.9% in 2006. Figure 11 illustrates how the proportion of Soweto’s adult population with secondary or tertiary qualifications rose not only in absolute terms but also at a faster rate than that of the total South African population.

Despite these pleasing trends, though, the general level of education in Soweto is still inferior to that of the rest of the population. For example, only 7.4% of Soweto’s adult population has a tertiary qualification, compared to a national level of 10.4%. If Soweto catches up with the rest of the population in this regard, it could provide further stimulus to the property market in the medium to long term.

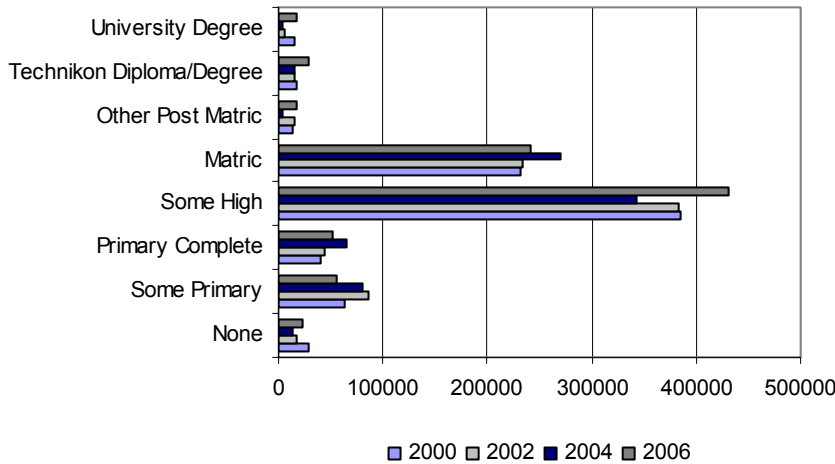
Despite vast improvements, the general level of education in Soweto still lags that of the rest of the population

Figure 11: Population with secondary or tertiary qualification



Source: Standard Bank Group, SAARF

Figure 12: Education (Soweto)



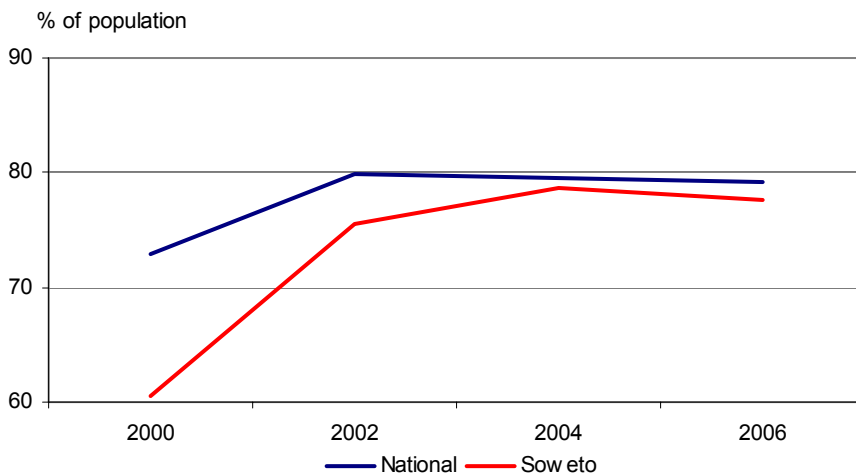
Source: Standard Bank Group, SAARF

Nonetheless, the socio-economic trends described above could support Unilever’s findings, in research done last year, that people prefer the vibrant township life, close to their families and friends, and hence do not move to the city, even when they can afford to do so. Alternatively, people’s decision to stay in Soweto may stem from the fact that it is still cheaper than in the nearby cities. Interviews with estate agents in Soweto, however, seem to be pointing towards the former.

Soweto’s catching up in terms of the economic indicators has clearly filtered through to the property market. The proportion of Soweto’s adult population owning their dwellings has increased from around 60.5% in 2000 to 77.6% in 2006 (see Figure 13). Consequently, the gap between the ownership ratio in Soweto and the rest of the country has shrunk, and Soweto’s ratio (77.6%) compares quite favourably to the national ratio (79.2%) in 2006, from 60.5% and 72.9% respectively in 2000.

Socio-economic upliftment has contributed to growth in Soweto’s residential property market

Figure 13: Adult population owning their dwellings



Source: Standard Bank Group, Stats SA

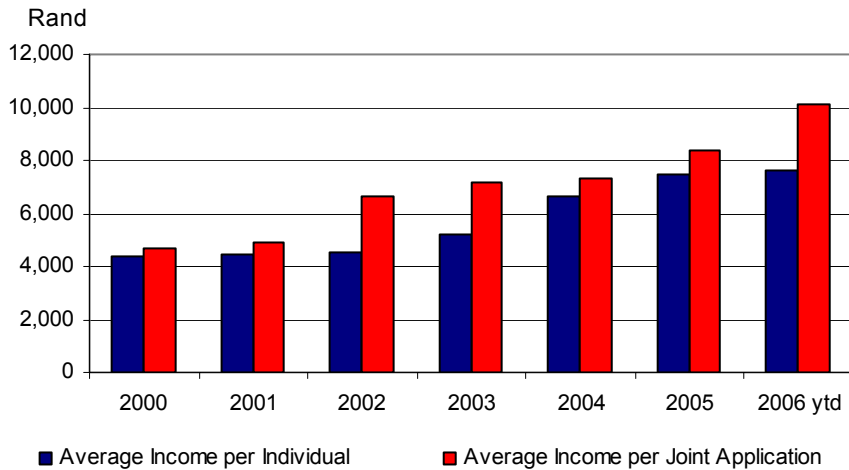
The exposition above centred around the dynamics of the demand for residential property in Soweto, which clearly played an important part in boosting the property market – prices in particular – recently. However, supply-side constraints certainly supported the lift in prices. While data supporting this are not readily available, the importance of supply-side constraints clearly shows up in anecdotal evidence and was highlighted during individual interviews with stakeholders in Soweto’s property market.

The data above referred to the total population in Soweto; to further the analysis, more data on the population that owns properties in Soweto are unpacked below.



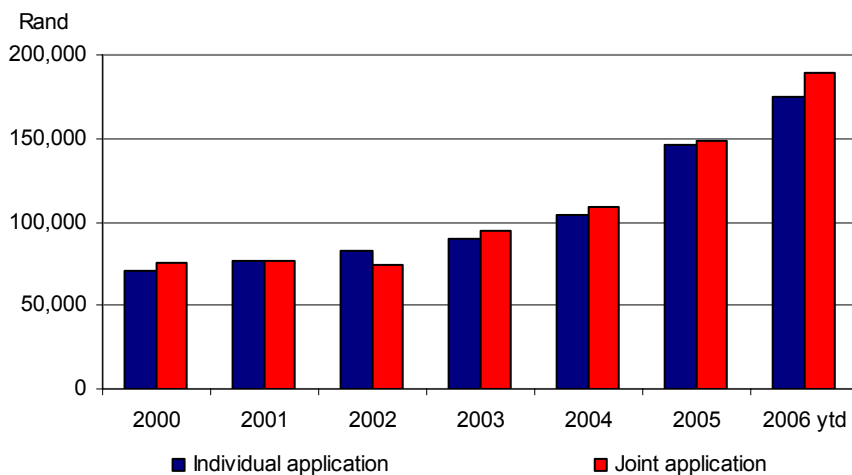
When considering mortgage applications from Soweto, a comparison between those made on single and joint incomes (in other words, where houses are mortgaged premised on a single individual's income or the joint income of, say, a couple) highlights interesting differences and similarities. Figure 14 indicates that the average income of applications based on a single income doesn't differ substantially from the combined income in the case of applications based on joint incomes. In other words, the primary reason for applications based on joint incomes does not seem to be the desire to purchase an above-average house, but is rather merely to afford an average house. This is corroborated by the fact that, generally, the values of houses bought on combined or individual incomes are quite similar (see Figure 15).

Figure 14: Average income per mortgage application (Soweto)



Source: Standard Bank Group

Figure 15: Average loan amount (Soweto)

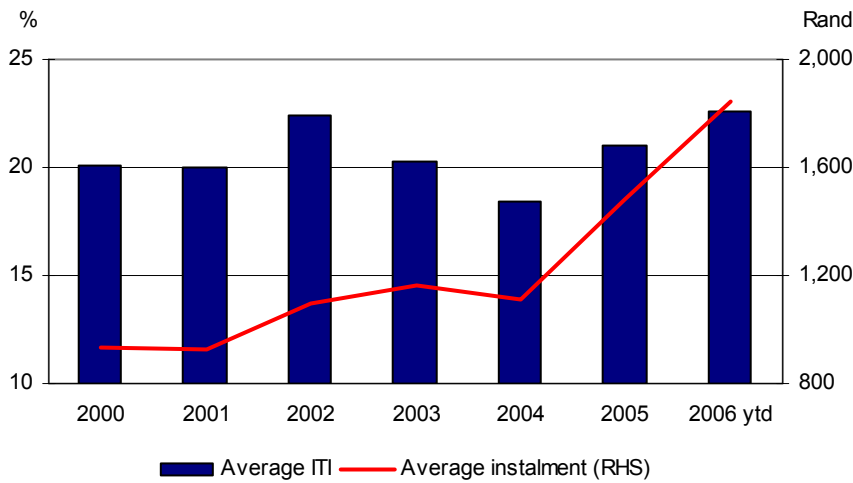


Source: Standard Bank Group

Figure 16 indicates the difference between the average instalment and the instalment to income ratio (ITI) used by banks as an affordability indicator. The rule of thumb is that ITI should not exceed 30%; in other words, the instalment being paid on a home loan should not be more than 30% of gross monthly income. In 2000, the average ITI among Soweto homeowners was approximately 20%, which is 10 percentage points below the maximum contractual threshold. Therefore, with the average income at R5 000, and R1 000 being set aside for mortgage repayment, a remaining R4 000 is available for all other expenses. This could be attributable to the individuals at that time being sensitive to their cash flow. As a result, mortgage repayments were kept below the maximum contractual threshold so that other expenses, such as food, clothing and transport costs, could be afforded.



Figure 16: Instalment and instalment to income (ITI) (Soweto)



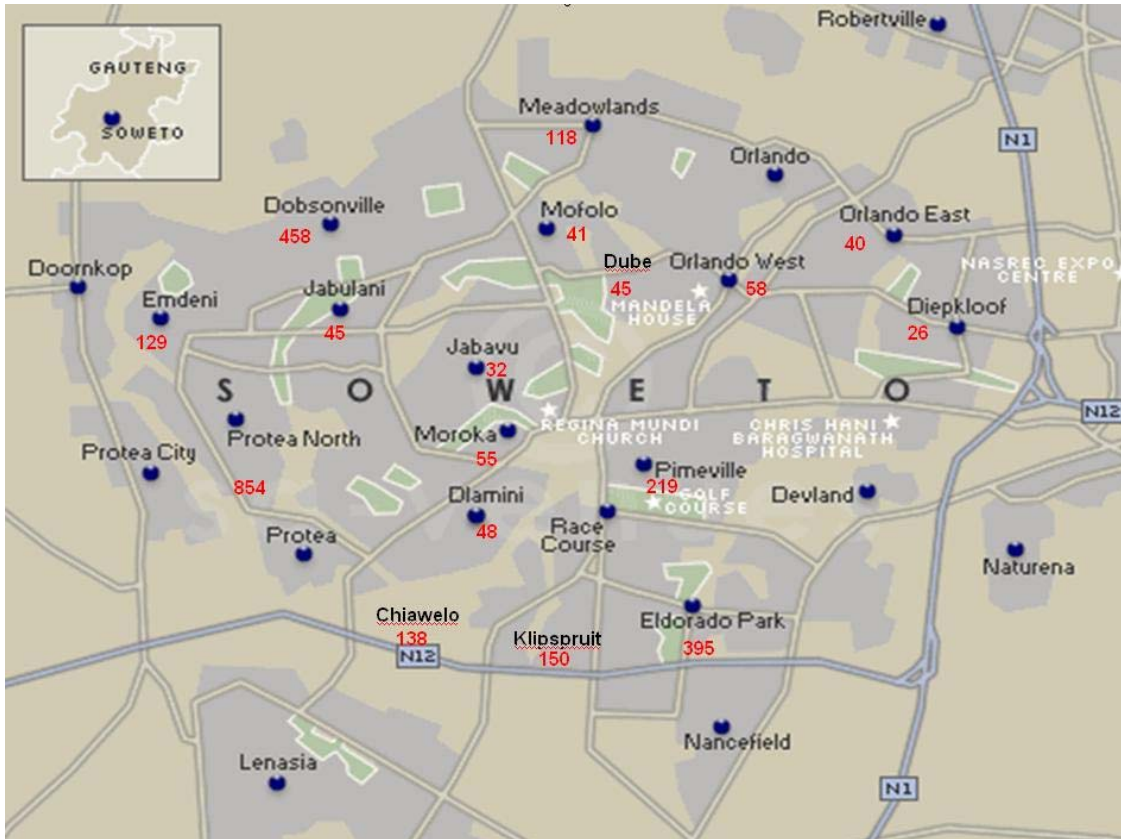
Source: Standard Bank Group

In 2006, although the average ITI has increased gradually towards the maximum contractual threshold, the average instalment has increased significantly, most likely as a result of rising house prices and strong income growth, suggesting strong upward economic migration taking place in Soweto.

Between 2004 and 2006, an average of 145 bonds per month were registered at the Deeds Office in Soweto, most of which came from Dobsonville, Protea Glen, and Protea North. Furthermore, according to Deeds Office data, the majority of these properties fall within a R50 000 to R250 000 price range, with a growing number of properties migrating into a price range of between R250 000 and R500 000.

The map below illustrates those areas of Soweto where the highest house price growth has taken place between 2004 and 2006. Examples of this growth include 55% growth in the combined Protea suburbs, over 100% growth in the Orlando region, and approximately 80% growth in Dobsonville. The map clearly illustrates that most of the growth over recent years has taken place in those suburbs situated on the border of Soweto. This supports the trickle-down effect theory that the trend in the growing property market is steadily affecting all areas, and one would expect that, soon enough, other areas such as Dlamini and Mofolo (also with proactive social initiatives) will begin seeing signs of property price growth.

Figure 17: Property market activity (Soweto)



Source: Standard Bank Group

Figures 18 to 21 portray some of the houses on sale in Soweto. They aptly illustrate the price differences between different areas, with the houses in Figures 18 and 19 having similar specifications, yet a 20% price difference. They also illustrate the breadth of the market, which includes not only relatively affordable houses, but also houses such as the one in Figure 21, selling for about R680 000.

Figure 18: House in Diepkloof



Specifications: 2 bedrooms, 1 bathroom
For sale price: R350 000
Estimated gross income required⁶: R12 846 p.m.

Figure 19: House in Meadowlands



Specifications: 2 bedrooms, 1 bathroom
For sale price: R290 000
Estimated gross income required: R10 644 p.m.

Figure 20: House in Protea Glen



Specifications: 2 bedrooms, 1 bathroom
For sale price: R270 000
Estimated gross income required: R9 910 p.m.

Figure 21: Diepkloof



For sale price: R680 000
Estimated gross income required: R24 958 p.m.

The potential of the property market in Soweto has already been recognised by most real estate agencies. With smaller agencies already established in the area for some time now, such as Mashingo Properties (in collaboration with Wendy Machinik Properties), larger agencies such as Pam Golding and Remax have recently established a presence in this area. This real estate agency presence would usually be indication enough of expected growth in Soweto and its surrounding areas' property markets.

The change taking place in the individuals residing in Soweto, in respect of income and spending habits, is not the only factor driving the potential of this property market. Apart from the growing presence of real estate leaders that is a clear indication of the increasing popularity of Soweto as a desirable area to live in, there is also the entry of Soweto's first large regional shopping centre, Maponya Mall. The consequent influx of prominent retail brands is expected to provide further impetus for future residential property market growth.

⁶ These calculations are based on 20 year mortgages at an interest rate of 12%, assuming that no deposit is paid.



3. Outlook for the residential property market

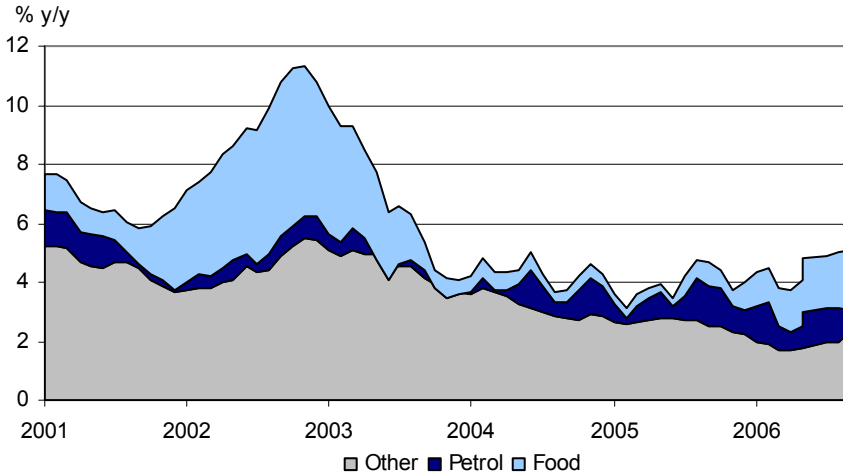
The residential property market remains remarkably buoyant, despite a firmly entrenched slowdown. The key to individuals' resilience is the continued strong growth in their income and employment. Over the past three years, one million new jobs (to quote Finance Minister Manuel) have been created, while annual income growth per capita averaged almost 8%, which means that the surge in the property market was not merely cyclical and had support beyond the 40% drop in finance costs (interest rates). Therefore, the upward cycle in interest rates currently under way will certainly dent the momentum in the market and dampen price growth, but the solid macroeconomic prospects will mitigate this somewhat.

House price growth is clearly no longer at its earlier heights

Inflation and interest rates

The rising interest rate cycle is expected to be relatively modest – a cumulative 200 to 250 basis points' rise is currently envisaged – and probably short lived. Structurally, inflation remains quite low, and over the past three years pressure has mainly emanated from food and energy costs (see Figure 22), even though more recently there has also been a mild increase in inflation excluding fuel and food costs. Nevertheless, the subdued level of inflation excluding fuel and food costs underpins our expectation that, after the current upswing, inflation, and eventually interest rates, will moderate. The recent drop in oil prices, from \$74/bl in July to below \$60/bl in October and November, has an important impact on the inflation and interest rate prognosis. Figure 23 illustrates, for example, that if oil prices had remained at \$70/bl, CPIX inflation would probably have breached the inflation target ceiling for several months (represented by scenario 2 in Figure 23), in which case interest rates would probably have risen much more than currently envisaged – not necessarily as a reaction to the first round impact of petrol prices on inflation, but to contain inflation expectations and wage pressure, the indirect consequences of higher fuel costs. (Figure 23 also illustrates CPIX inflation projections under the assumptions of an average oil price of \$60/bl (scenario 3) and an average oil price of \$55/bl (scenario 1).)

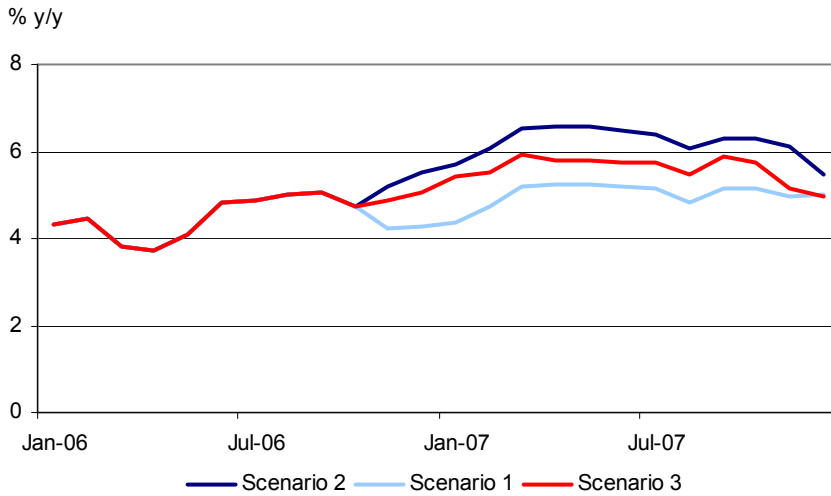
Figure 22: Impact of fuel and food costs on CPIX inflation



Source: Standard Bank Group, Stats SA



Figure 23: Impact of different oil price assumptions on CPIX inflation



Source: Standard Bank Group, Stats SA

Standard Bank is of the view that CPIX inflation could remain target friendly in the short to medium term, even though it is likely to come very close to the inflation target's ceiling and it may remain in the upper part of the inflation target band for a prolonged period. Any factors putting unexpected pressure on inflation, such as a rise in the oil price, even if it is short lived, could push inflation beyond the upper limit of the inflation target. There are, however, several risks associated with this generally benign outlook. The lift in global inflation, albeit modest, as well as rising inflation expectations and labour cost pressure will in particular need to be monitored closely, as they can ignite broader price pressure. Standard Bank expects the SARB to hike interest rates only once more, by 50 basis points in December, during the current interest rate cycle. Unless incoming data confirm a moderation in domestic demand, and movements and oil prices and the rand exchange rate remain relatively favourable, the possibility of an additional hike in February cannot be ruled out completely.

Table 5: Impact of interest rate change on mortgage payments

Prime rate:	10.5%	11%	12%	12.5%	13%
Loan amount	Mortgage payment				
100 000	998	1 032	1 101	1 136	1 172
200 000	1 997	2 064	2 202	2 272	2 343
300 000	2 995	3 097	3 303	3 408	3 515
400 000	3 994	4 129	4 404	4 545	4 686
500 000	4 992	5 161	5 505	5 681	5 858
750 000	7 488	7 741	8 258	8 521	8 787
1 000 000	9 984	10 322	11 011	11 361	11 716
1 250 000	12 480	12 902	13 764	14 202	14 645
1 500 000	14 976	15 483	16 516	17 042	17 574
1 750 000	17 472	18 063	19 269	19 882	20 503
2 000 000	19 968	20 644	22 022	22 723	23 432

Source: Standard Bank Group

Households' debt burden

Following the substantial decline in interest rates from mid-2003 to 2005, households have rapidly increased their utilisation of bank credit, so that total household debt in relation to disposable income has grown significantly. Rising property values are contributing to the solid growth in total household debt as is evident from the rise in the proportion of mortgage debt in relation to total debt to a record high. Not only have higher house prices contributed directly to households' growing debt exposure through new purchases, but they have also allowed existing home owners to "cash in" on higher values by increasing

Total household debt in relation to income has grown substantially



their outstanding mortgage amounts in line with higher valuations. The prevalence of this phenomenon is expected to moderate as house price growth softens, but the deceleration in mortgage equity withdrawal could be more protracted than the deceleration in house price growth, since not all homeowners would have taken advantage of the additional equity in their houses immediately. Therefore, even though further equity growth will be subdued, many households probably haven't used their available equity and can do so long after house price growth has halted. This could moderate the immediate impact on consumer activity following the reduced wealth effect from slower house price growth.

Nevertheless, household finances are taking some strain following various onslaughts, including higher living costs and interest rates in particular. The first two interest rate hikes in the current cycle, in June and August this year, represent a 9.5% increase in the prime lending rate, which is not substantially higher than households' income growth this year. However, the consecutive interest rate hikes would have started to eat into consumers' discretionary income and hence are expected to hit a bit harder than the initial hikes.

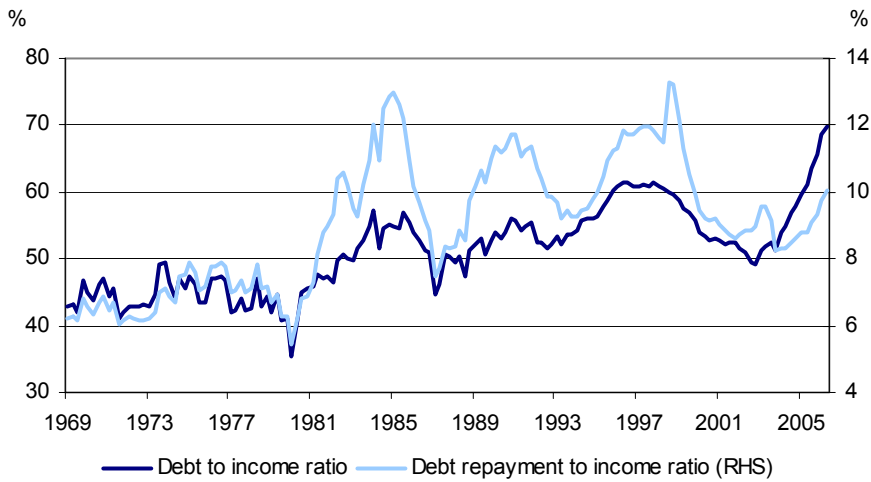
We still maintain that the outlook for the residential property market depends primarily on households' ability to continue repaying and expanding their total debt. Despite households' debt to income ratio being at a record-high level of almost 70% in the second quarter, and probably even higher by now, their debt repayment or instalment to income ratio still compares quite favourably with historical peaks (see Figure 24). According to the Reserve Bank, South Africans spent on average less than 8% of their after-tax income on debt servicing, which is noticeably lower than the peak of 12% in 1998.

The graph below illustrates Standard Bank's calculations of households' debt repayment to income ratio; one of the differences between these and the SARB's calculations is that Standard Bank's include the capital as well as interest payments, whereas the SARB's quoted numbers only refer to the interest component. Admittedly, several assumptions have been made in these calculations, and they should therefore be interpreted as mere approximations. Nevertheless, the trends in Standard Bank's and the SARB's calculations are similar.

Meaningful historical and global comparisons are complicated by socio-economic changes and differences. Specifically, income distribution and relative poverty play important roles. Generally, lower income groups spend a larger proportion of their income on necessary goods, such as food, and can therefore afford to spend a relatively smaller proportion of their income on debt repayment. For example, in their consumption baskets, food constitutes 51.4% and 15.82% respectively of the very low⁷ and very high expenditure groups. Interest rate payments on mortgages, on the other hand, constitute 0.37% and 13.61% respectively of the very low and very high expenditure groups' spending baskets.

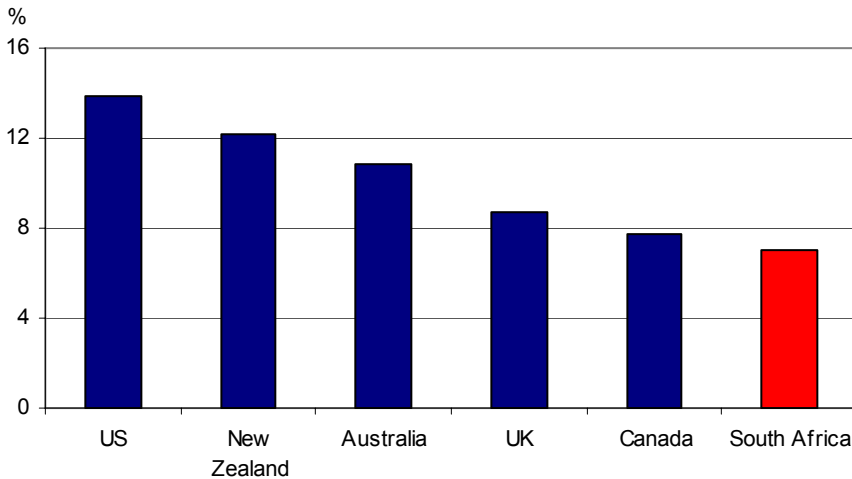
⁷ According to Stats SA, the very low expenditure group includes households that spend less than R8 070 per year (in 2000-rand), while the very high expenditure group includes households that spend more than R55 160 per year (in 2000-rand).

Figure 24: Households' finances



Source: SARB, Standard Bank Group

Figure 25: Households' debt repayment to income ratio⁸



Source: SARB, Standard Bank Group

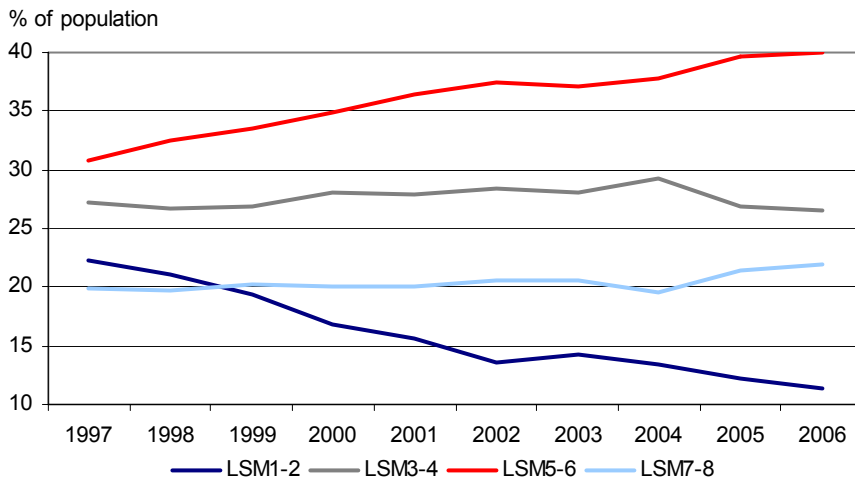
South Africa's household debt repayment to income ratio is approaching international levels

In light of the above, for South Africans the debt repayment to income ratio is expected to be generally lower than in developed countries with higher proportions of their populations in upper-income groups (see Figure 25). And the sustainable debt repayment to income ratio will rise, albeit gradually and only marginally, as the middle- and upper-income groups expand, as has been the case locally (see Figure 26). It is therefore very difficult to make a meaningful interpretation of the global and historical comparisons: the global comparison seems to suggest limited scope for South Africans to expand their debt, yet the historical comparison suggests that the crisis levels reached in, say, 1998 are still some way off.

⁸ Latest data available.



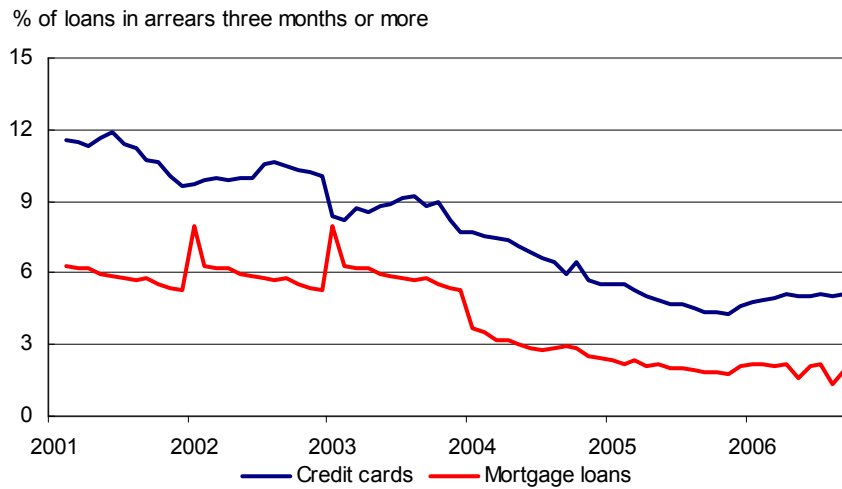
Figure 26: Income distribution



Source: SAARF, Standard Bank Group

Looking at other indicators of households' financial health may therefore assist in evaluating the current situation. Indeed, there has been a marginal deterioration in some of these indicators, although they remain relatively benign when compared historically. The non-performing proportion of loans, for example, is still relatively low, although it has probably bottomed out and is expected to continue rising. This is the case not only for mortgage loans but also for credit cards, which usually show signs of distress earlier. Figure 27 illustrates the proportion of mortgage loans and credit cards in arrears three months or more – the trends for those in arrears one month or more are similar.

Figure 27: Non-performing loans



Source: SARB, Standard Bank Group

In a nutshell, then, the absence of a national house price bubble makes a decline in house prices quite unlikely, bar any shocks and provided that income growth remains solid. The onslaughts on consumer finances, rising interest rates in particular, will continue to limit the scope for house price growth; reduced yields on buy-to-let properties and investors' enthusiasm will further constrain the demand for and prices of residential properties. In the medium to long term, house price growth should again be in line with the nominal income growth of between 8% and 10%, but in the short term there will be limited growth in house prices.

**Table 6: Standard Bank house price data**

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

Bottom line

The domestic property boom is over, despite temporary spikes in monthly housing data caused by data imperfections and volatility. Owner-occupants' finances are constrained by several onslaughts, in particular increases in living costs and interest rates, but strong income growth should keep them somewhat resilient. Buy-to-let investors' demand for properties is dented by declining yields on the back of a moderation in rental growth and rising interest rates. House prices are therefore not expected to rise much in the near term, but they aren't expected to fall on a national basis.

House price growth will be constrained in the short term

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

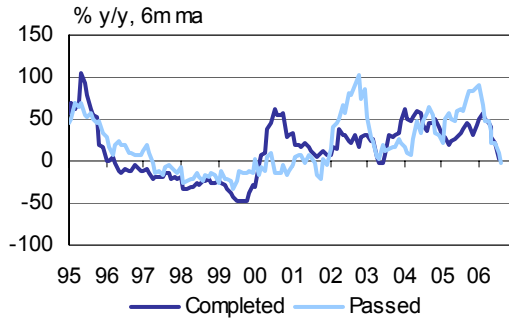
The way in which house prices are measured means that they are inherently volatile, not unlike many other economic indicators. Measuring house prices is complicated by the fact that the available data usually stem from the properties sold during a particular period, rather than from a well-designed sample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

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



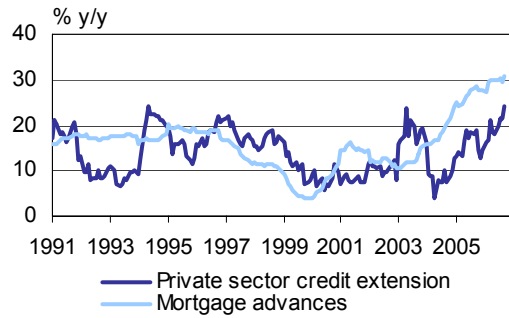
Picture Gallery

Buildings: Flats & townhouses



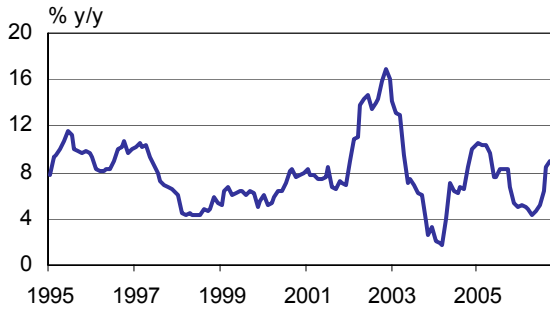
Source: StatsSA

Private sector borrowing



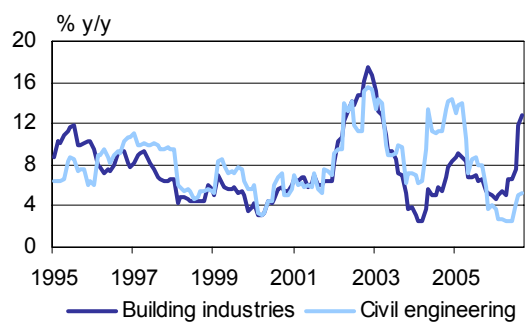
Source: SARB

Building cost: Building and construction



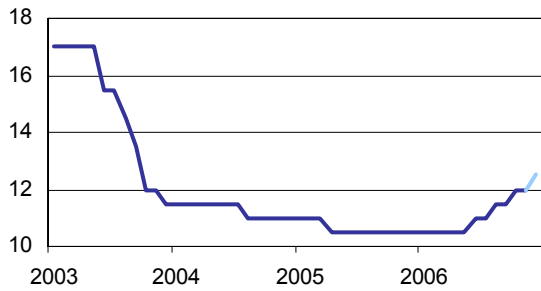
Source: StatsSA

Building cost: Building industries and civil engineering



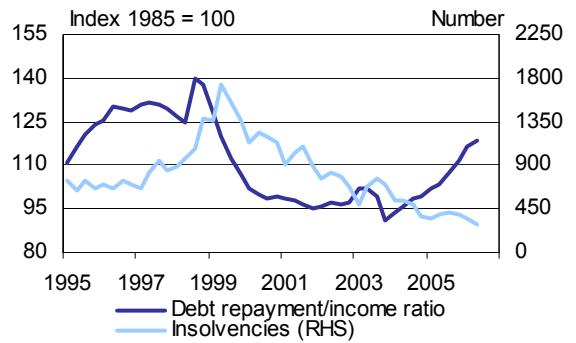
Source: SARB

Prime interest rate



Source: SARB, Standard Bank Group

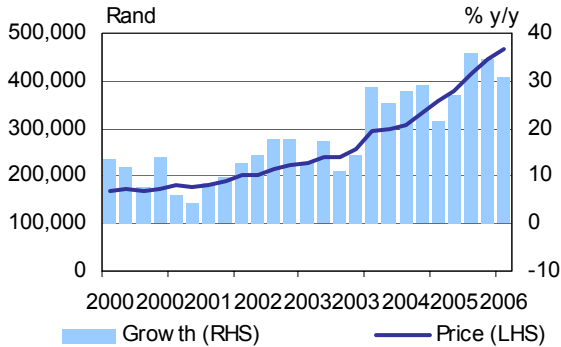
Debt affordability vs insolvencies



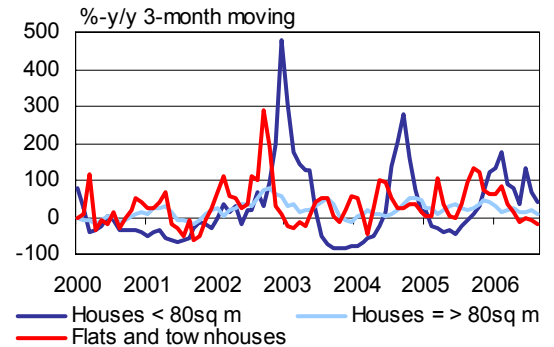
Source: StatsSA, Standard Bank Group



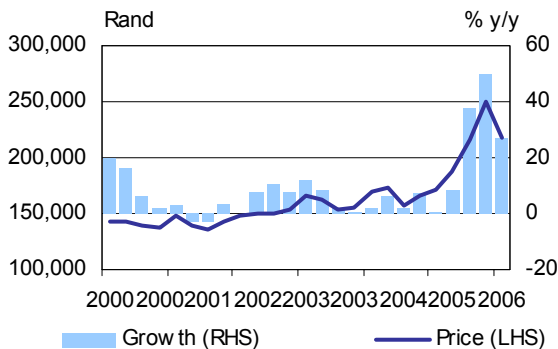
Gauteng: House prices



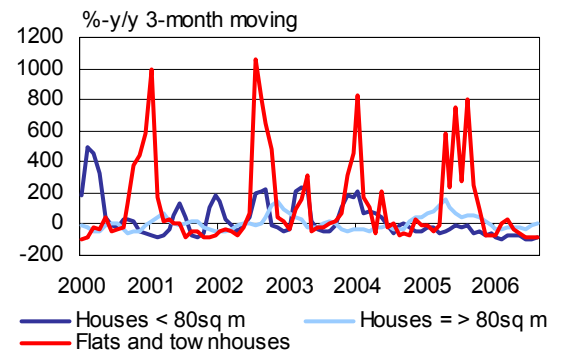
Gauteng: Building plans



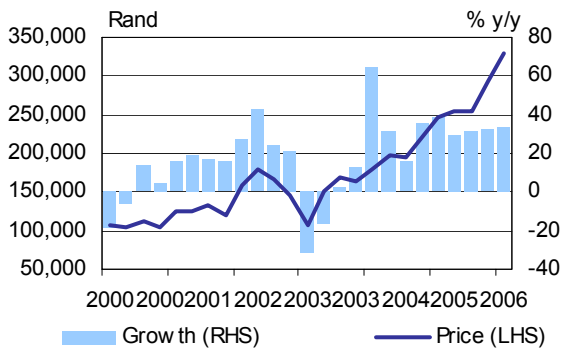
Free State: House prices



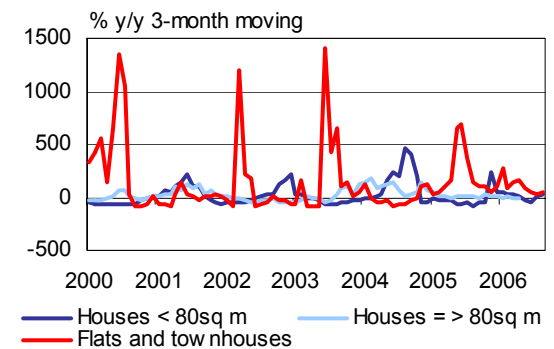
Free State: Building plans



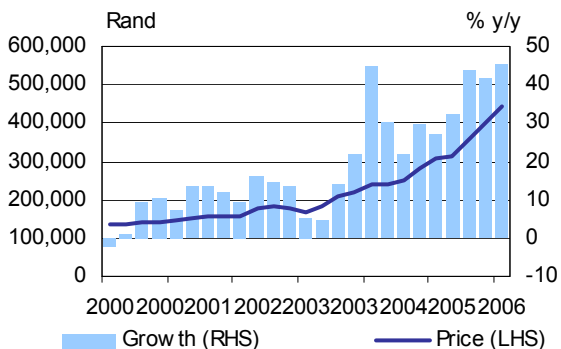
Eastern Cape: House prices



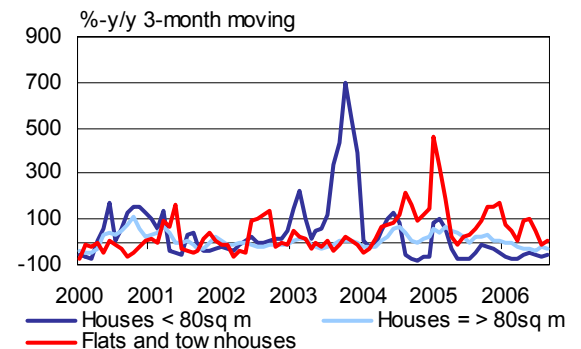
Eastern Cape: Building plans



KwaZulu-Natal: House prices

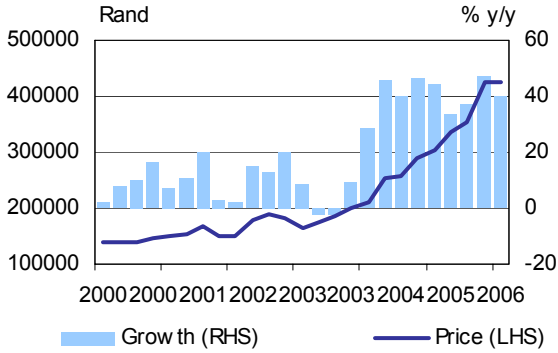


KwaZulu-Natal: Building plans

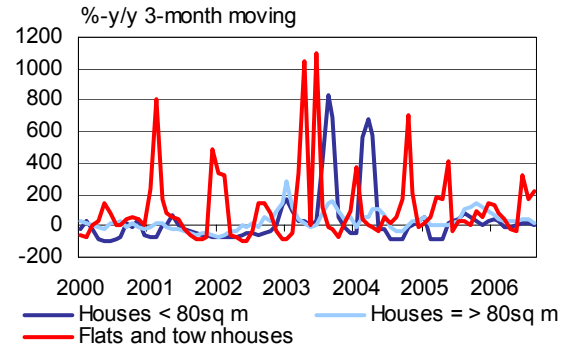




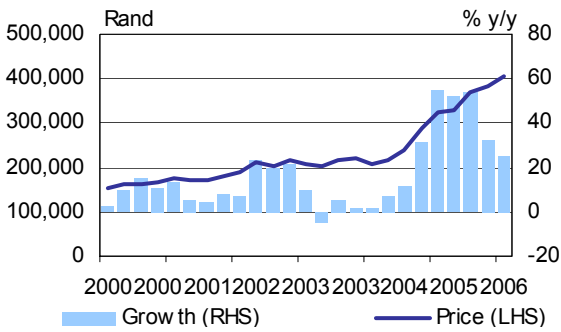
Limpopo: House prices



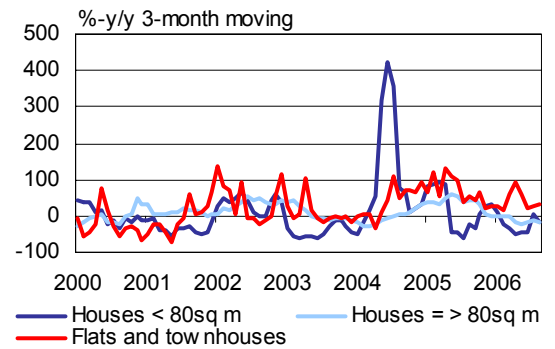
Limpopo: Building plans



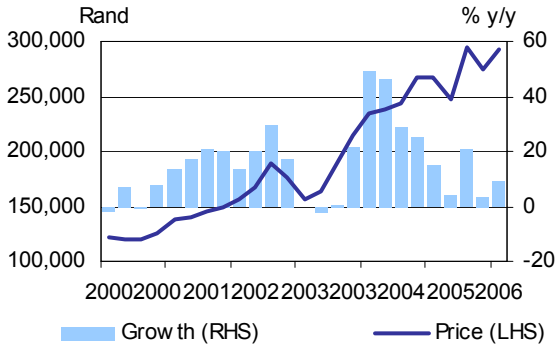
Western Cape: House prices



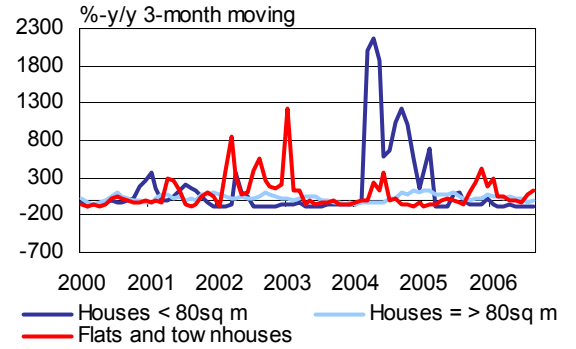
Western Cape: Building plans



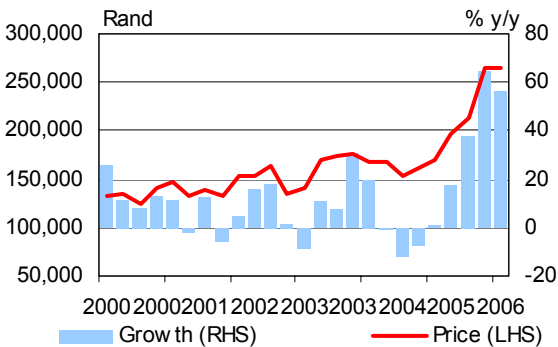
North West: House prices



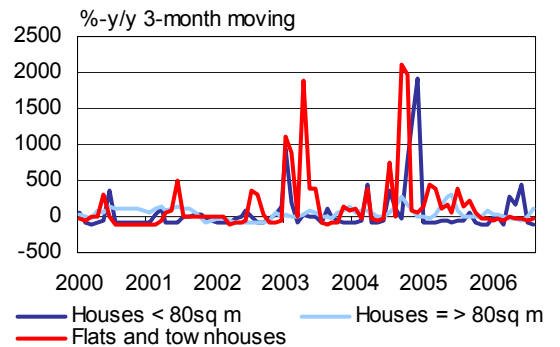
North West: Building plans



Northern Cape: House prices



Northern Cape: Building plans



Source: Standard Bank Group, Deeds Office, Stats SA



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