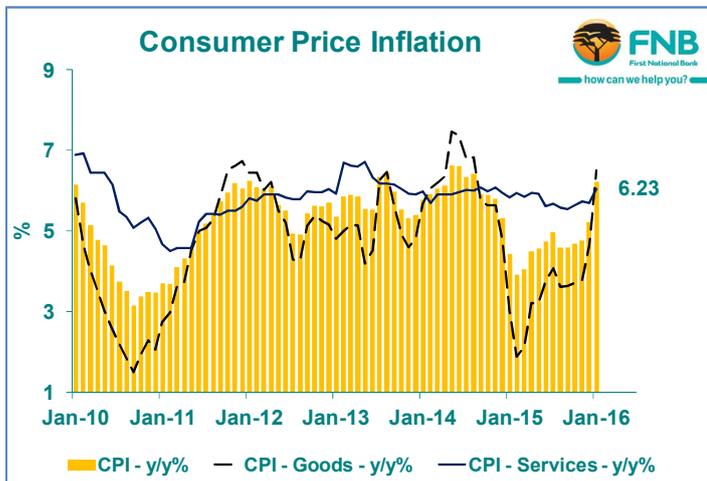


PROPERTY BAROMETER – JANUARY CPI INFLATION

While drought-induced food price inflation has become more troublesome, it was the petrol price and thus the Transport CPI that was mostly responsible for a significant jump in CPI inflation in January. Concerns remain for low income groups, and a dampening impact on residential demand is likely.

THE HEADLINE NUMBERS

The January CPI (Consumer Price Index) inflation rate accelerated, from 5.2% year-on-year in the previous month to 6.2%. This is a very significant jump, and takes the inflation rate to above the SARB's (Reserve Bank) upper inflation target limit of 6%.

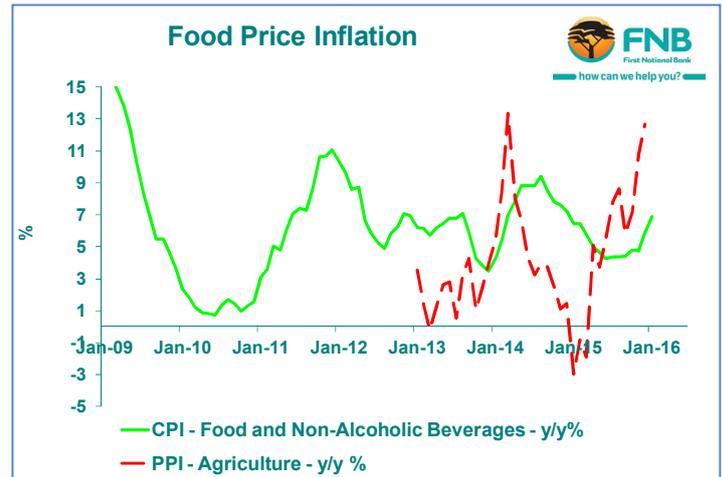


Accelerating food price inflation is big CPI news of late, driven in part by a severe drought, but also by a sharply weaker Rand since late last year.

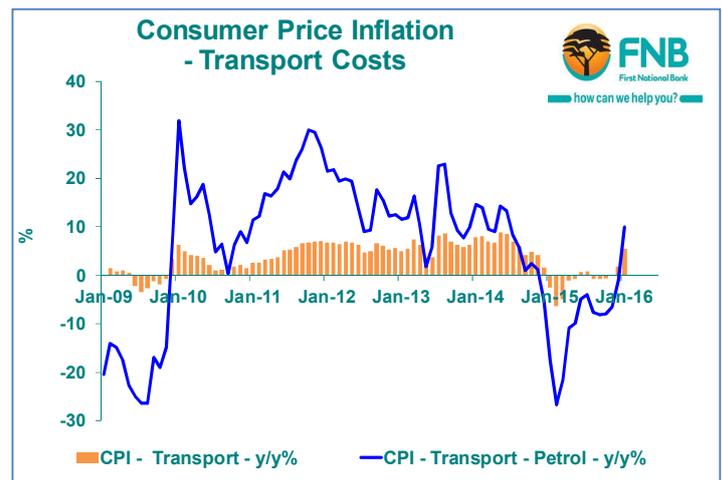
Already, we had seen the year-on-year inflation rate of the Producer Price Index for Agriculture outputs accelerate dramatically from -3% deflation in January 2015 to +12.7% inflation by December of last year. With a lag, this was always going to take the major Food and Non-Alcoholic Beverages CPI sub-index to a higher inflation rate.

Indeed, from 4.3% in June 2015, the Food and Non-Alcoholic Beverages CPI inflation rate has accelerated to 6.9% by January 2016, a further acceleration from the previous month's 5.9%.

This has meant that the Food and Beverages CPI's contribution to overall year-on-year CPI inflation has risen from 0.9 of a percentage point in December 2015 to 1.1 percentage points in January 2016.



However, rising food inflation was not the major cause of an overall CPI inflation acceleration. Rather, it was the Transport CPI inflation rate's acceleration from a 1.9% year-on-year rate in December to 5.5% in January, taking this sub-index's contribution to overall inflation up from 0.3 of a percentage point to 0.9 of a percentage point.

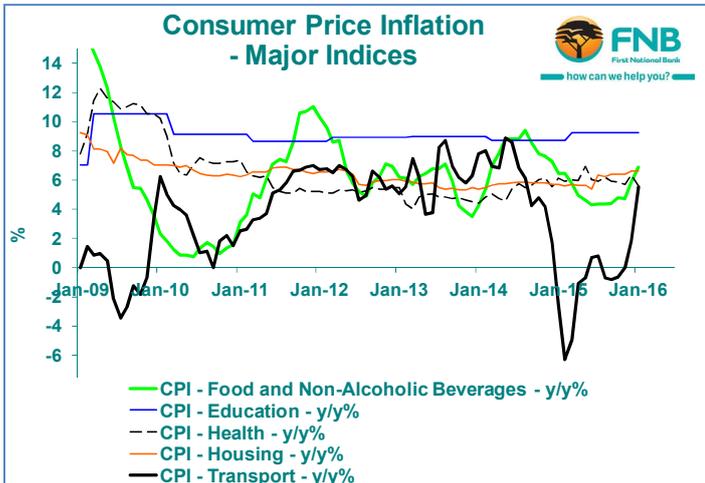


Key to this was a significant acceleration in petrol price inflation in January, which begins to reflect the impact of a sharply weaker Rand since late last year. The Petrol sub-index of the Transport CPI saw its year-on-year inflation

accelerate sharply from -1.2% deflation in December to +10% inflation in January.

Examining the major sub-indices of the CPI, the Education Sub-Index remains the one with the highest inflation rate of the major sub-indices, at 9.3% year-on-year, but was not surveyed in January, and so remained unchanged. Although the Food and Non-Alcoholic Beverage CPI has just overtaken the Housing CPI's inflation rate, to date the Housing CPI (6.6% year-on-year inflation) remains the most troublesome one, contributing 1.6 percentage points to overall CPI inflation due to it having the largest weighting in the CPI.

The Housing Index's major source of trouble is in the area of Municipal Rates and Utilities Tariffs. Not many of the Housing CPI's components were surveyed in January, but based on the most recent surveys, the Electricity CPI inflates at a massive 11.2% year-on-year, while the Water and Other Services CPI inflates at 9.8%.



Following on the Housing CPI's 1.6 percentage points contribution to overall CPI inflation comes Food and Non-Alcoholic Beverages with 1.1 percentage points and Transport with 0.9 of a percentage point.

IMPLICATIONS FOR INTEREST RATES

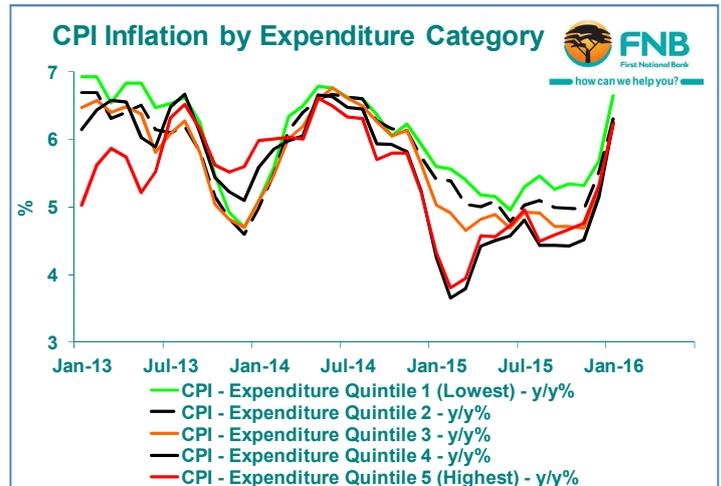
The more significant rise in CPI inflation in January to a level outside of the 6% SARB target range keeps the pressure on the SARB to gradually lift interest rates further, we believe.

We thus remain of the expectation that the bank will continue with its "upward normalization" in interest rates in 2016. However, we continue to expect the hiking to remain of a gradual nature, against the backdrop of a fragile economy, the next hike expected to be 25 basis points (which would lift Prime Rate to 10.5%) at the May 2016 MPC meeting.

CPI INFLATION STILL TILTED AGAINST THE POOR, BUT HIGH INCOME GROUPS' INFLATION RATES CATCHING UP

Examining the CPI Indices by "Expenditure Quintile", Expenditure Quintile 1, i.e. the lowest spending level group, which more-or-less correlates to the lowest income group, continues to have the highest CPI inflation rate of 6.6%. The next quintile up, i.e. Quintile 2, had a slightly lower rate of 6.3%.

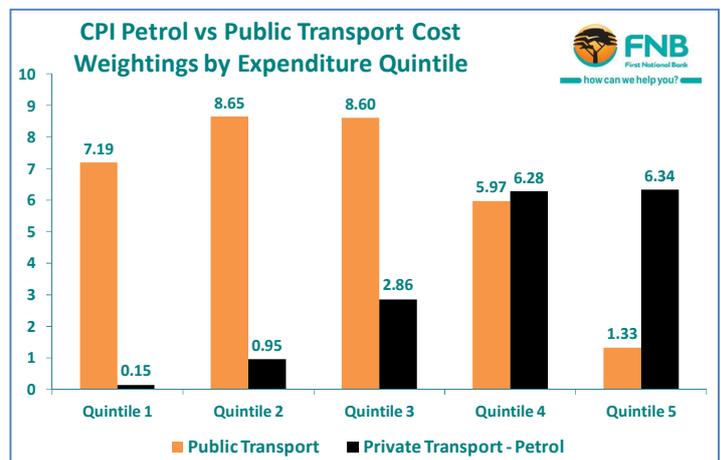
At the lowest end of the inflation spectrum is Quintile 5, the highest Expenditure Quintile, with a 6.22% inflation rate, while Quintiles 3 and 4 both have slightly worse inflation rates of 6.23% and 6.25% respectively.



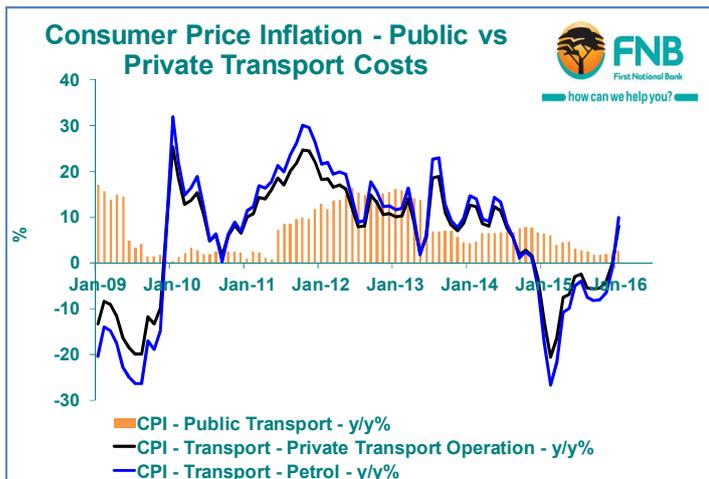
However, while the lowest expenditure/income groups have the highest CPI inflation rate, the gap has narrowed significantly.

This is because, while the lowest income groups suffer at the hands of accelerating food price inflation, recently the more significant rise in the petrol price has worked against the higher income groups more.

The reason is the high Public Transport Weighting in the expenditure basket of the lower income groups, along with their low Private Transport weighting.



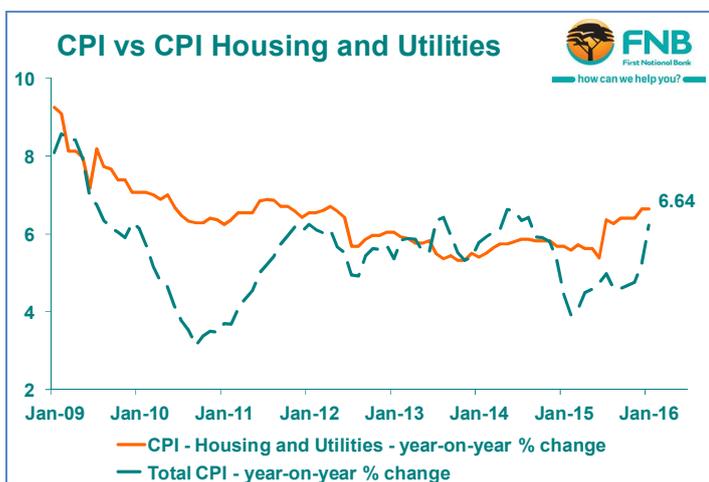
This difference in weightings becomes important when one considers the difference between the inflation rate for the CPI – Private Transport Operation, which inflated year-on-year by 8.1% in January, versus the CPI for Public Transport, which inflated by only 2.7%. The heavier dependence by the lower expenditure groups on public transport, and less on private transport, means that they have benefited relatively due to public transport operators not immediately passing the full impact of a fuel price increase onto the public (this works against them when petrol prices decline, and public transport doesn't immediately pass the full impact of such decline either).



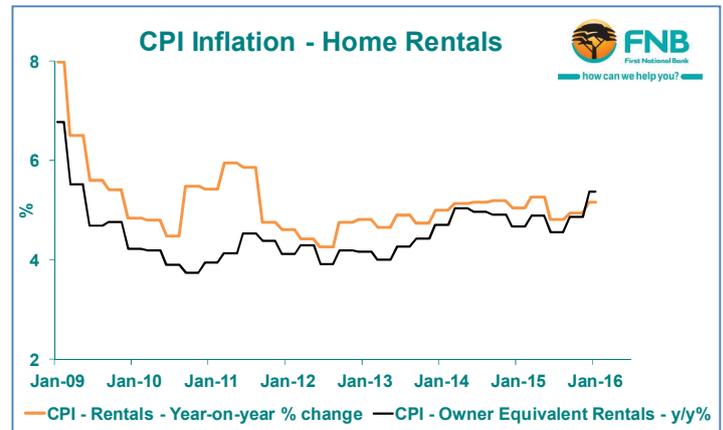
In short, the high income groups' inflation rates have recently been driven up more significantly, off a lower base, by a petrol price inflation acceleration. But the low income groups' inflation rates remain marginally higher, and also still accelerating, with their vulnerability being to rising food prices.

HOUSING CPI REMAINS TROUBLESOME

While not contributing to the overall CPI inflation acceleration in January, the Big Ticket Housing CPI remains the ongoing troublesome component of the overall CPI, with a year-on-year inflation rate of 6.6% in January.

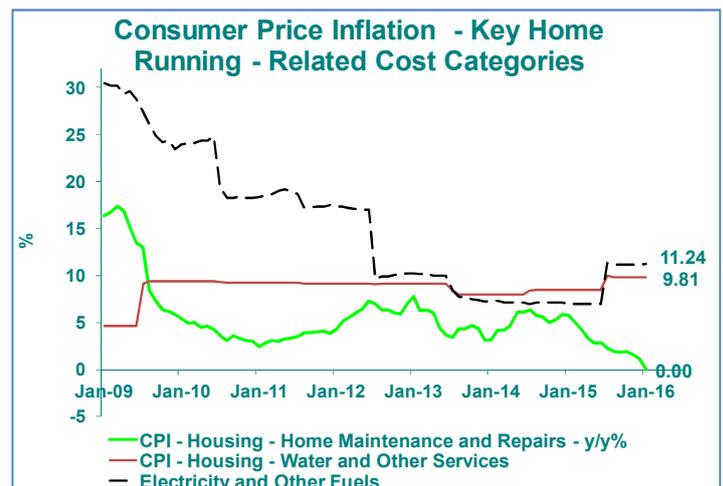


The Rental Market doesn't play the major role in this (rentals were not surveyed in January). Actual Rental inflation is 5.2% (From December survey), while Owner Equivalent Rental inflation is 5.4% (Also from December survey).



As these rental inflation rates are now lower than the accelerating overall CPI inflation rate, they can no longer be seen as exerting upward pressure on it. In addition, these rental inflation rates remain within the 3-6% target range of the SARB, so cannot be seen as troublesome from an inflation targeting point of view either.

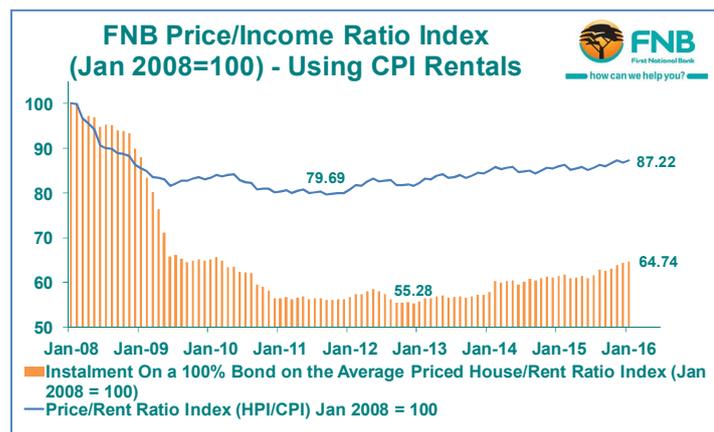
The key sources of upward pressure, however, are in the area of Municipal Rates and Utilities' tariffs. The Electricity CPI is currently inflating at 11.2% on the back of ongoing extreme Eskom tariff hikes, while the "Water and Other Services CPI (which includes municipal rates) is not far behind at 9.8%.



Working partly against these big housing-related cost increases is a very benign inflation rate in the CPI for Home maintenance and Repairs, which had declined to a zero percent year-on-year by January.

RENTALS AND THE HOUSE PRICE-RENT RATIO

The CPI for Rentals was not surveyed in January, only being surveyed every 3 months. But based on the December CPI Rental Index (whose value is used in the January CPI), there was a further rise in the Residential Average Price-Rental Ratio Index in January. Whereas the year-on-year Actual Rental Inflation rate was 5.2%, the Average House Price Inflation Rate in the FNB House Price Index was considerably higher at 6.8%.



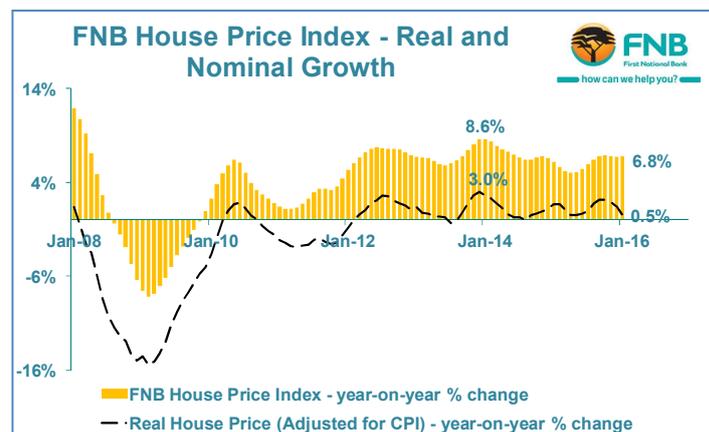
Therefore, the most recent CPI Rental figures continue to show the residential rental option becoming more attractive compared to the relatively expensive home buying option. At an index level of 87.22 (Jan 2008 = 100), the Residential Price-Rent Ratio in November was a mere 12.78% below the January 2008 level, and the January 2008 level was believed to have been at or near to the all time high. The Price-Rent Ratio therefore remains high, and this index has risen by 9.4% on its September 2011 Post-Recession low point.

What keeps time home buyer numbers relatively solid high at this stage then? A relatively low prevailing interest rate level, which translates into a far lower level in the Instalment Repayment on the Average Priced Home/Rent Index. In January, this index was 35.26% lower than the level at January 2008, having been driven sharply down by big interest rate cuts around 2009.

However, this Index has also risen, by 15.6% since a low at September 2011, thus also making the home buying option gradually less attractive relative to the rental option.

REAL HOUSE PRICE GROWTH SLOWS

The CPI inflation rate of 6.2% year-on-year in January, coupled with our FNB House Price Index inflation rate of 6.8%, implies that house prices continued to rise in real terms (when adjusted for CPI inflation). However, this real house price inflation rate has slowed to 0.5% year-on-year in January, from December's 1.4% and a high of 2.1% as at September 2015.



CONCLUSIONS AND OUTLOOK

The January CPI inflation rate showed a more noticeable jump compared to prior months' accelerations. Suddenly, therefore, the rate finds itself above the SARB's upper target limit of 6%. This reflects the sharp weakening in the Rand late in 2015, along with a drought-induced food price inflation surge.

This continues to lead us to believe that the SARB will continue to raise interest rate gradually, by another percentage point in total, to where Prime Rate reached 11.25% early in 2017.

Rising inflation is thus expected to have a dampening impact on housing demand in the near term, due in part to its impact on interest rate hiking, but also due to the expectation that higher consumer inflation will lead to still-slower real household disposable income growth.

The CPI inflation rate is likely to rise further in the near term, with the full impact of a food price inflation surge not yet having been seen in the CPI numbers.

The food price inflation remains of particular concern, due to its upward pressure on the inflation rate for the lower income groups at the current time. This is undesirable due to the current situation of high social tensions, which can manifest themselves in activity that can be disruptive to the economy (aggressive strike action, service delivery protests and the like)

In addition, we saw the year-on-year inflation rate in the Gauteng Petrol Price accelerate further from +9.7% in January to +20.4% in February. This means that we should expect the Transport CPI's contribution on the overall CPI inflation to rise further in the short term.

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Consumer Inflation - Key Components

	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16
Key CPI Inflation Measures						
CPI - All Urban Areas	116.1	116.1	116.4	116.5	116.8	117.7
Y-o-Y % Change	4.6	4.6	4.7	4.8	5.2	6.2
CPI - All Goods	114.9	114.3	114.7	114.8	114.9	116.3
Y-o-Y % Change	3.6	3.6	3.7	3.8	4.6	6.5
CPI - All Services	117.3	117.9	118.0	118.2	118.6	119.2
Y-o-Y % Change	5.6	5.6	5.6	5.7	5.7	6.0
CPI - Very low expenditure group	115.9	116.1	116.4	116.8	117.2	118.800
Y-o-Y % Change	5.5	5.3	5.3	5.3	5.7	6.643
CPI - Low expenditure group	115.4	115.6	115.9	116.2	116.7	118.100
Y-o-Y % Change	5.1	5.0	5.0	5.0	5.5	6.301
CPI - Middle expenditure group	115.4	115.5	115.7	116.0	116.4	117.700
Y-o-Y % Change	4.9	4.7	4.7	4.7	5.2	6.227
CPI - High expenditure group	115.6	115.6	115.8	115.9	116.3	117.300
Y-o-Y % Change	4.4	4.4	4.4	4.5	5.2	6.250
CPI - Very High expenditure group	116.3	116.3	116.6	116.7	117.0	117.800
Y-o-Y % Change	4.5	4.6	4.7	4.8	5.3	6.222

Consumer Inflation - Key Product and Service Categories

	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16
Key CPI Product and Service Categories						
CPI - Housing and Utilities	117.0	118.0	118.0	118.0	118.9	118.9
<i>Y-o-Y % Change</i>	6.3	6.4	6.4	6.4	6.6	6.6
CPI - Food and Non-Alcoholic Beverages	115.4	115.5	116.1	116.8	117.5	119.7
<i>Y-o-Y % Change</i>	4.3	4.4	4.8	4.8	5.9	6.9
CPI - Alcoholic Beverages and Tobacco	122.8	122.9	123.1	123.3	122.8	125.2
<i>Y-o-Y % Change</i>	8.8	8.7	7.4	7.0	6.6	8.3
CPI - Clothing and Footwear	113.2	113.6	113.9	114.4	114.7	115.1
<i>Y-o-Y % Change</i>	5.3	5.0	4.6	4.5	4.5	4.4
CPI - Household Contents and Equipment	108.4	108.8	108.9	108.9	109.4	109.6
<i>Y-o-Y % Change</i>	2.7	2.7	3.0	3.1	3.5	3.4
CPI - Health	116.7	116.8	117.4	117.2	117.3	117.1
<i>Y-o-Y % Change</i>	6.2	5.9	5.9	5.7	6.3	5.6
CPI - Transport	111.8	110.0	110.5	109.9	110.1	110.7
<i>Y-o-Y % Change</i>	-0.7	-0.8	-0.6	0.0	1.9	5.5
CPI - Communication	99.7	99.7	99.6	99.6	99.6	99.7
<i>Y-o-Y % Change</i>	-0.8	-0.7	-0.7	-0.7	0.2	0.3
CPI - Recreation and Culture	108.1	108.0	108.7	109.2	108.8	112.8
<i>Y-o-Y % Change</i>	2.4	2.3	2.9	3.1	2.6	6.0
CPI - Education	129.5	129.5	129.5	129.5	129.5	129.5
<i>Y-o-Y % Change</i>	9.3	9.3	9.3	9.3	9.3	9.3
CPI - Restaurants and Hotels	119.6	120.1	120.8	122.1	122.2	123.1
<i>Y-o-Y % Change</i>	5.5	5.0	5.2	5.2	5.0	5.7
CPI - Miscellaneous	122.4	122.3	122.4	122.3	122.3	123.2
<i>Y-o-Y % Change</i>	7.0	7.0	7.0	6.8	6.7	6.9