

The subprime crises

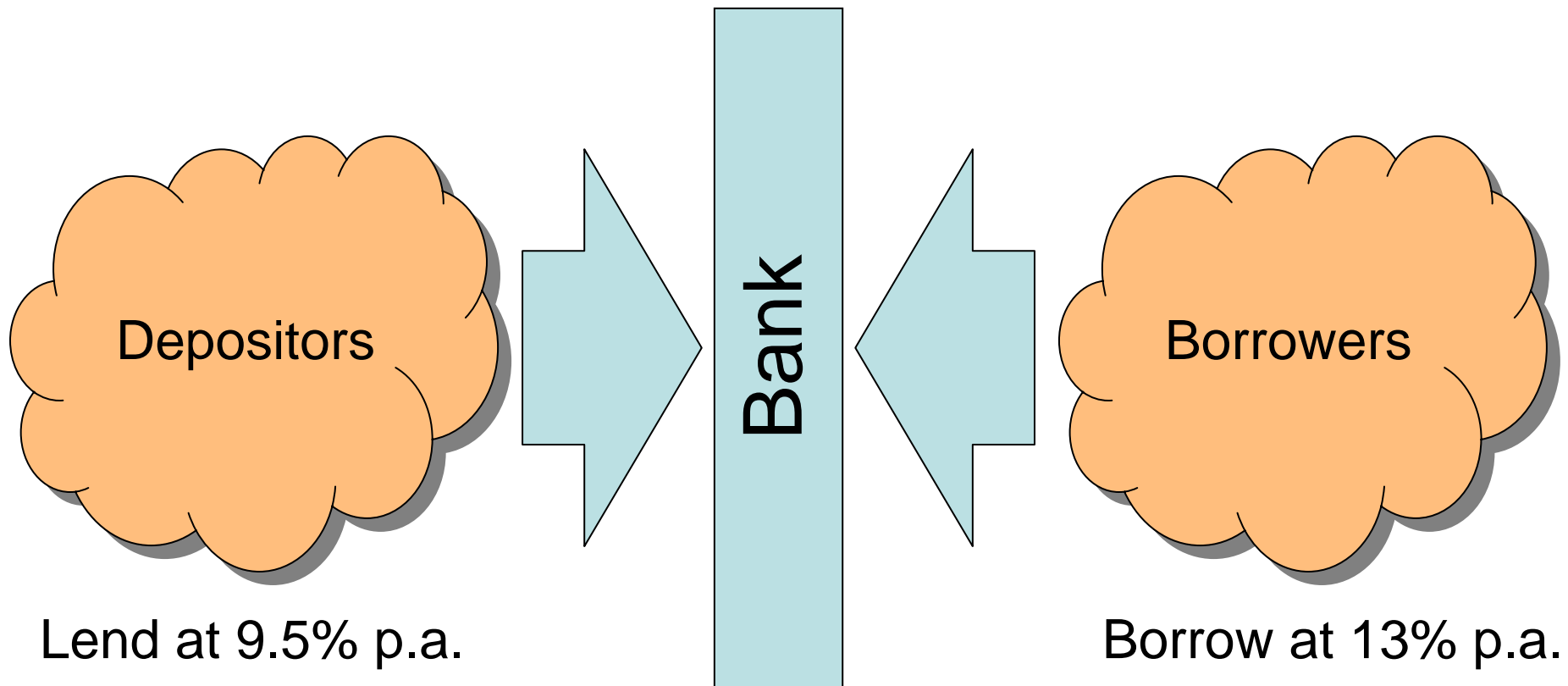
Impact on the SA property market



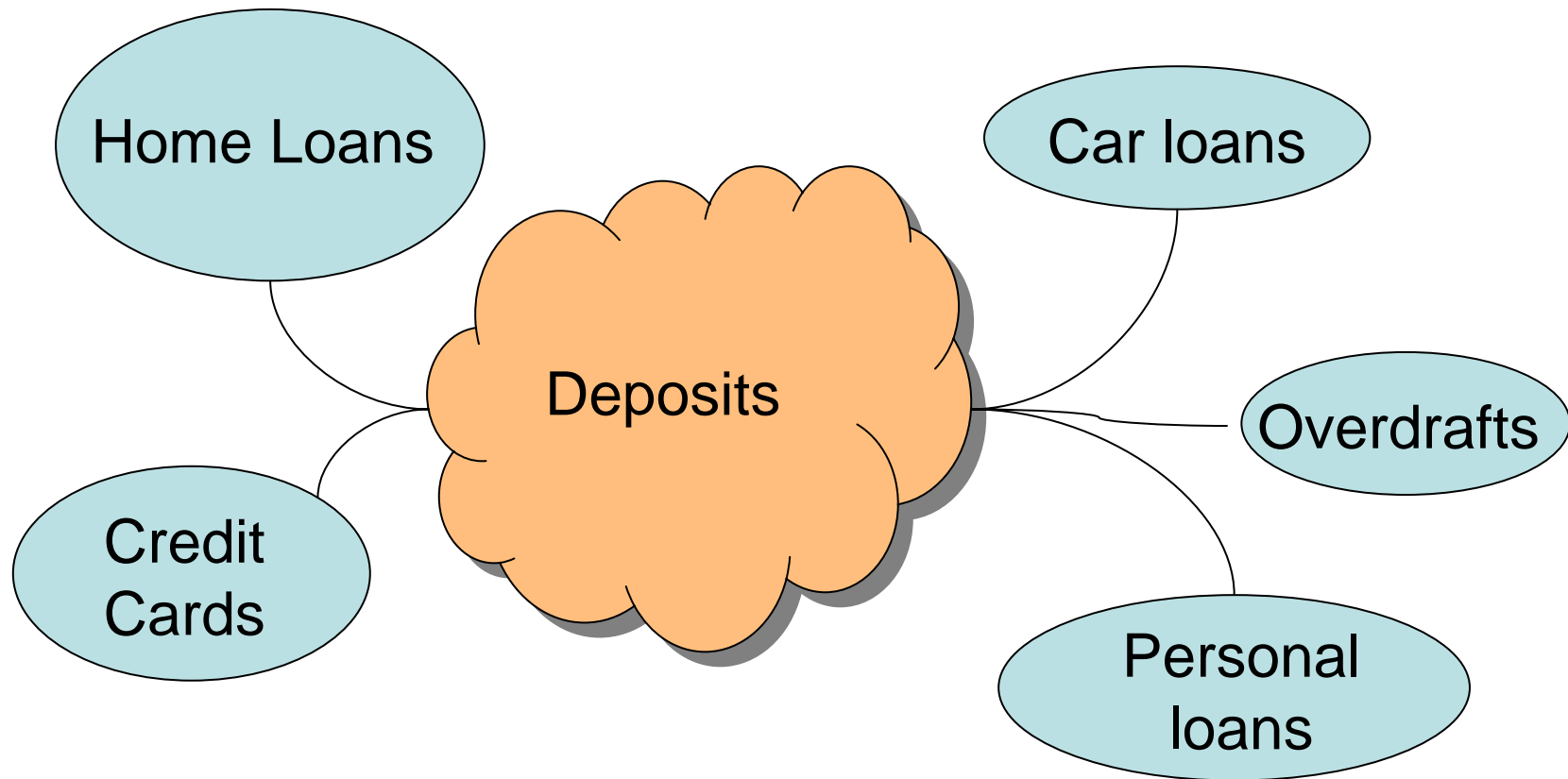
Overview

- Banking today
- Causes of the subprime crises
- Impact on South Africa

Traditional banking model

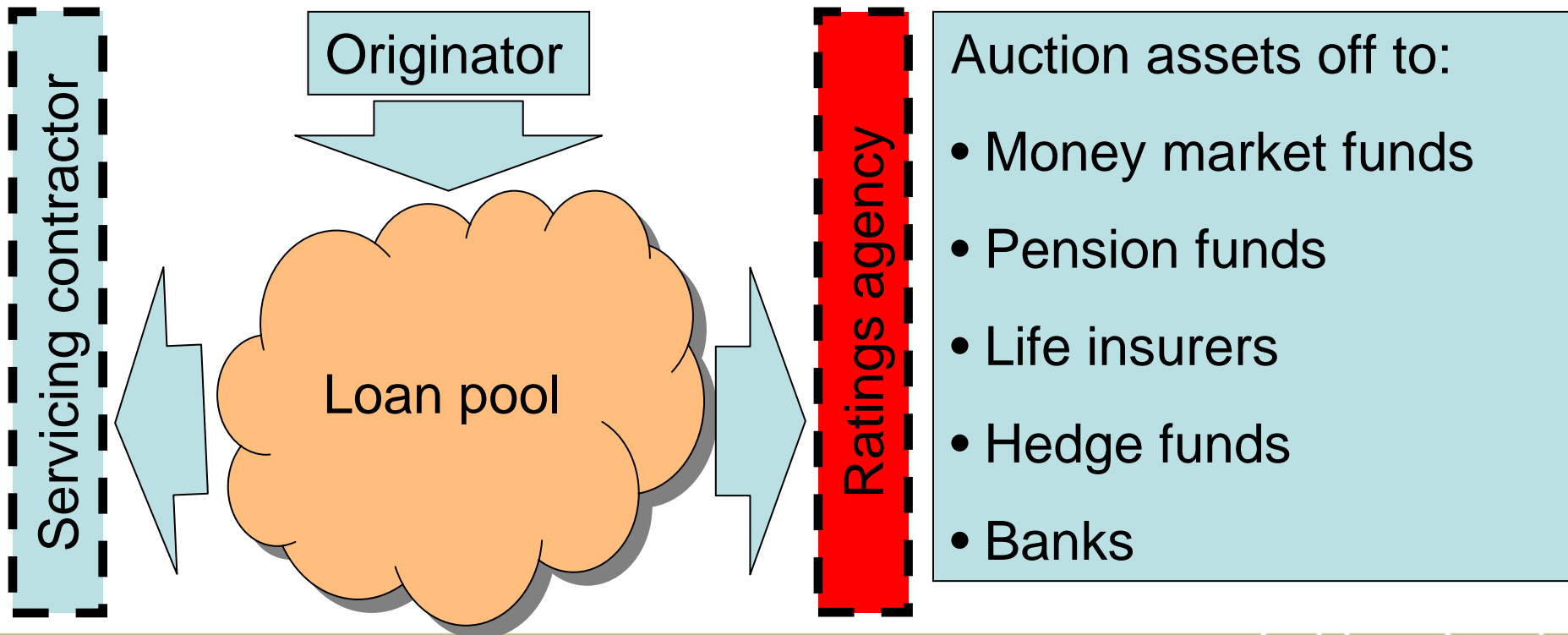


Deposits are used to fund all lending activities



Funding through securitisation

Forbes Magazine: ***“Securitisation is the process of taking illiquid assets and, through financial engineering, transforming them into tradable securities.”***



Both models are necessary

Traditional banks

Securitisation

Advantages

- Deposits guaranteed
- Regulated by SARB
- Large, stable companies
- Use own client's money when granting loans

- Low barrier to entry
- Spurs innovation
- More choice for consumers
- High interest to investors

Risks

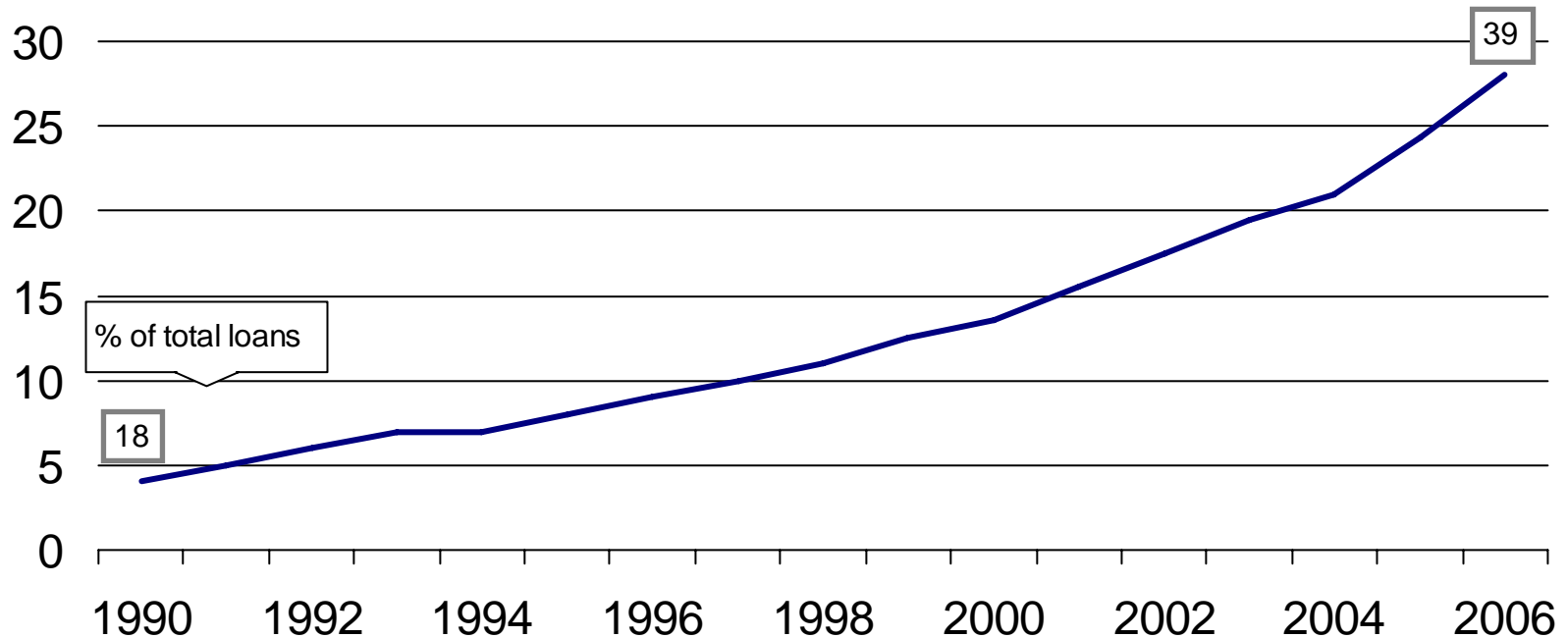
- Huge barriers to entry (R250m in capital for banking license)
- Low interest on deposits
- Mediocre service
- No innovation

- Regulator (ratings agency) is appointed by borrower
- No one knows who the risk ends up with
- Use of other people's money

Off-balance sheet financing has fast been winning market share



Securitised loans outstanding, \$trn



Sources: Federal Reserve; NERA Economic Consulting

The subprime crises is really a crises of securitisation

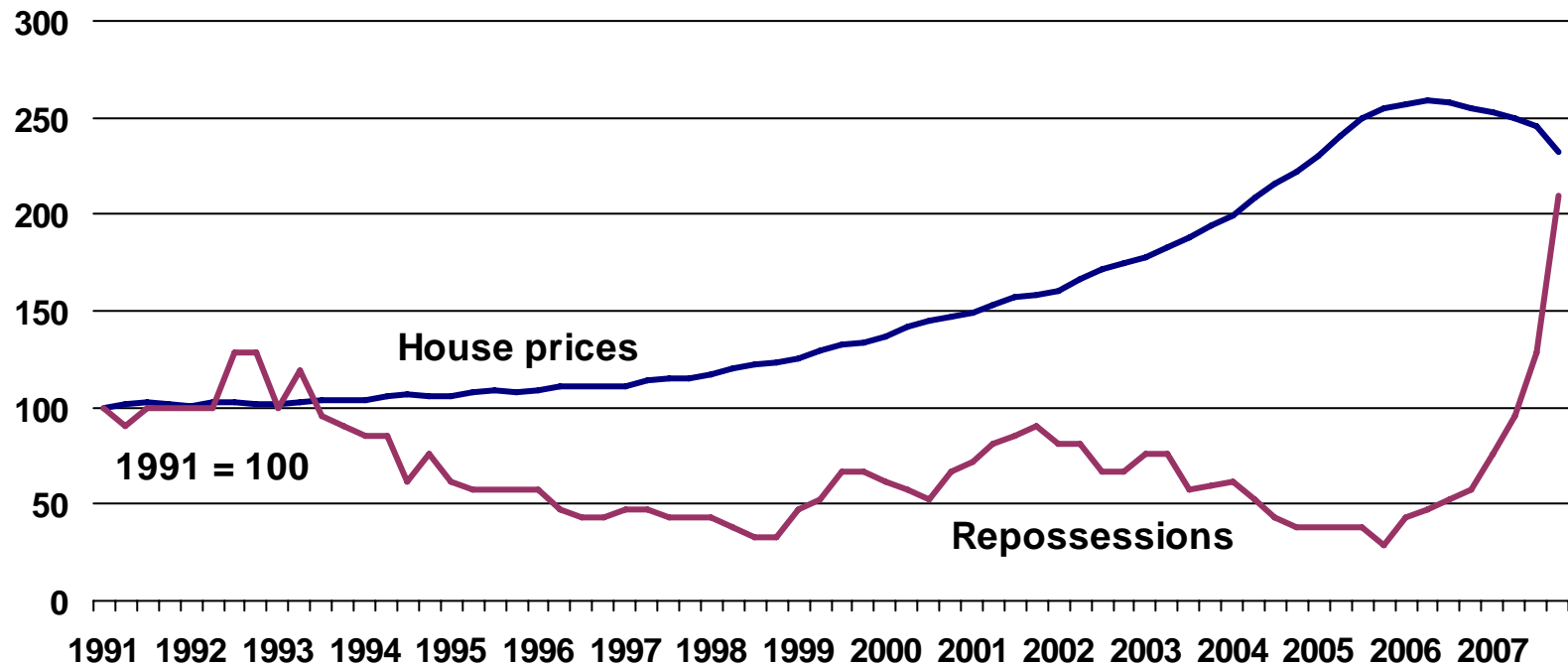


- Use of other peoples money resulted in lax lending standards
 - Assume rising house prices will last forever
 - No verification of information (“Liar’s loan”)
 - No deposits, ‘teaser’ interest rates
- Ratings agencies paid by issuers of securitized debt, not investors
- Risks dispersed through the financial system

Low interest rates and easy credit led to rapid house price growth in the US

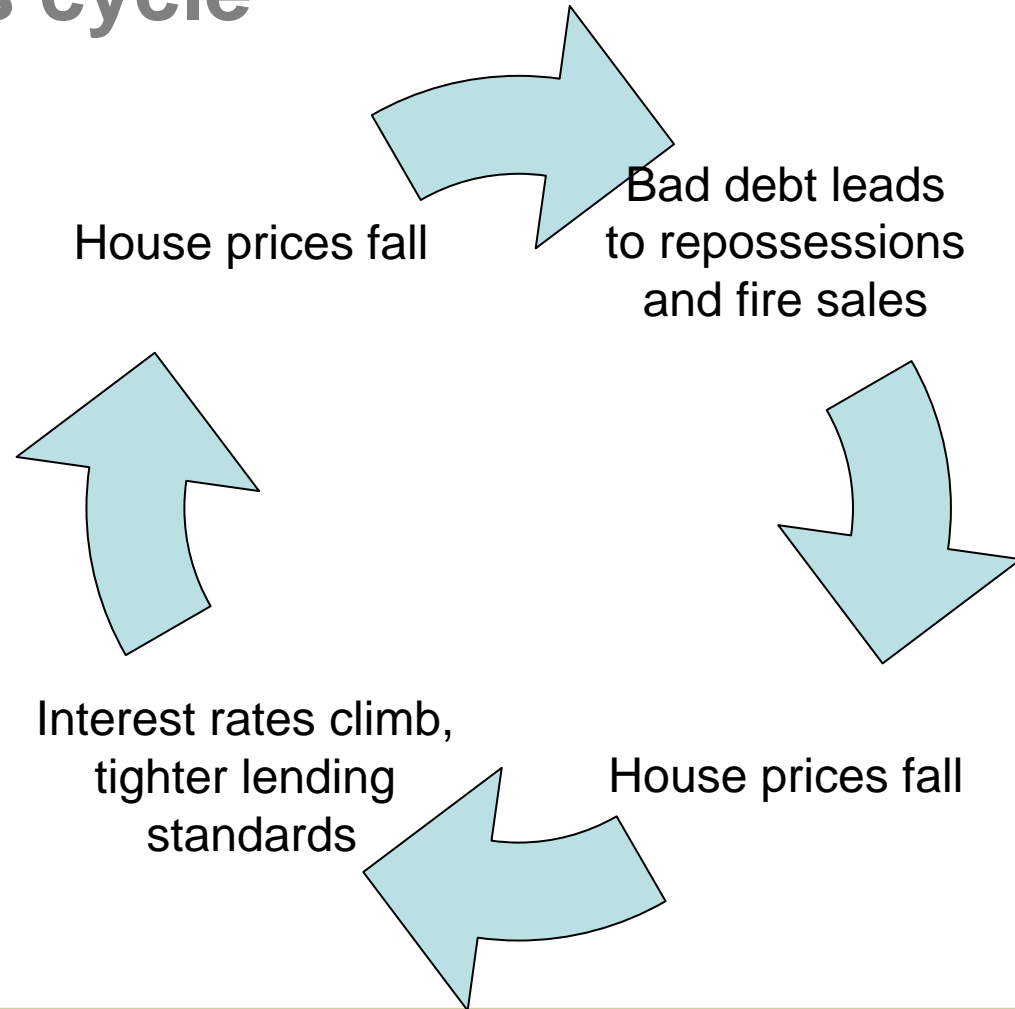


Case-Schiller US national home price index



Sources: Standard & Poor's, Federal Reserve

Falling house prices cause a vicious cycle



The crises has shaken the world's financial system



- Write-off's totaling \$160bn and counting
- Giant institutions under severe pressure
 - Northern Rock
 - Countrywide
 - US bond insurers
- Banks stop trusting each other



South Africa's property industry is being hit by a perfect storm



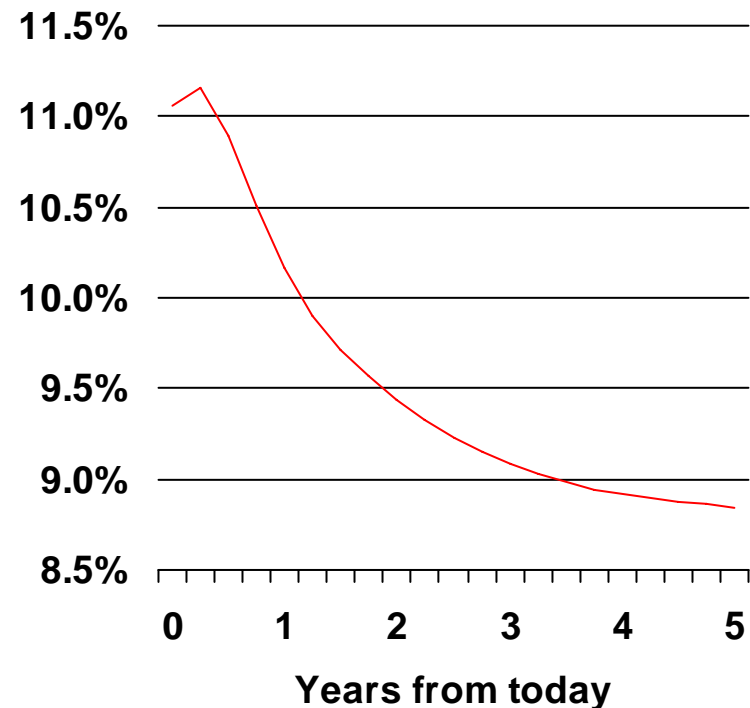
- US subprime crises
- National Credit Act
- Rising inflation and interest rates
- Stagnating house prices
- Eskom



But our fundamentals are strong

- Little exposure to US subprime
 - Strict lending standards
 - Well capitalised banks
 - Less reliance on capital markets
- Peaking inflation
- Huge pent-up demand for housing

South African yield curve



Source: South African Bond Exchange

Conclusion

- The world has not seen the last of the subprime mess
 - Full extent of the bad news has yet to emerge
 - Structural problems with oversight and conflict of interest
 - World economy taking strain
- Securitisation is a wonderful tool that allows for more competition and innovation
- South African fundamentals are strong