

## Financial market turmoil poses risks for the housing market

- House prices are unlikely to be significantly hit by market turmoil in the short term
- But dependence of UK economy on financial services poses a longer term risk
- Unexpectedly low inflation and financial market unrest has reduced the risk of a Bank Rate rise to 6%

Headlines	August 2007	July 2007
Monthly index * Q1 '93 = 100	365.7	363.5
Monthly change*	0.6%	0.1%
Annual change	9.6%	9.9%
Average price <sup>1</sup>	£183,898	£184,270

\* seasonally adjusted

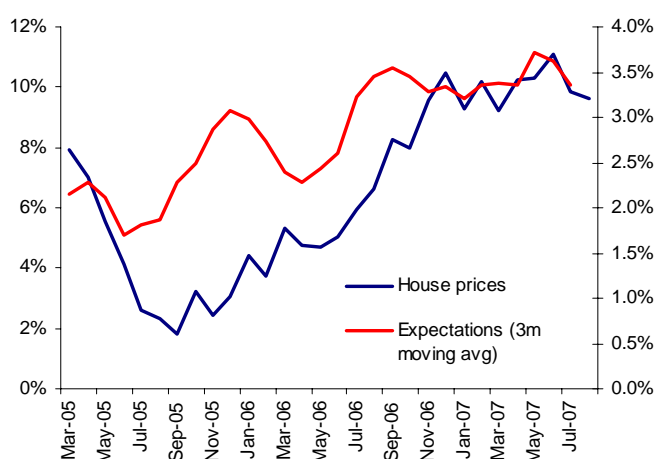
Commenting on the figures Fionnuala Earley, Nationwide's Chief Economist, said:

"The rate of house price growth lifted a little during August, but the annual rate continues to moderate. Prices increased by 0.6% during the month, but the annual rate fell to 9.6% down from 9.9% in July. A typical UK property cost an average of £183,898 in August, £16,177 more than one year ago.

**Financial market volatility unlikely to affect UK house prices in the short term...**

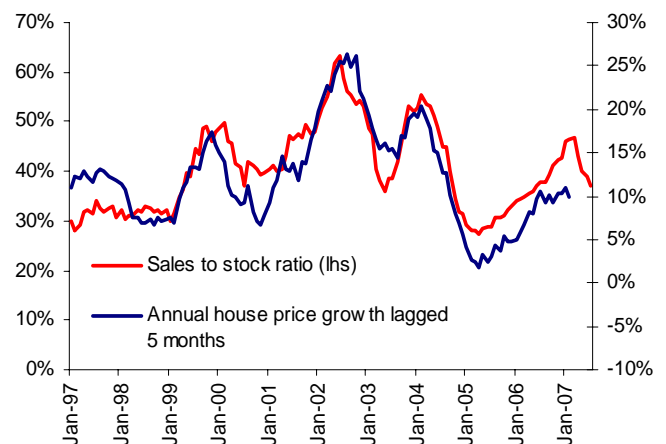
"The US sub-prime crisis has created turmoil in international financial markets, but this is unlikely to have a significant additional effect on the rate of growth of house prices in the UK in the short term. We still expect house price growth in 2007 to come in close to the middle of our forecast range of between 5% and 8%. The expected slowing results from three main factors, each of which have been around for some time. First, weaker affordability, as house prices continue to grow more quickly than earnings; second the effect of higher interest rates and inflation on consumers' pockets; and third lower house price expectations.

House prices and house price expectations



Source: Nationwide

Sales to stock ratio and house prices, %



Source: Nationwide, RICS

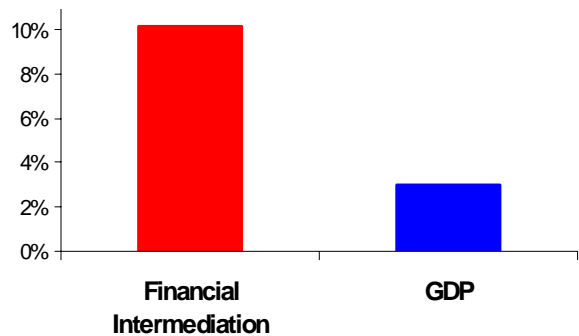
<sup>1</sup> Actual average house prices are lower even though the monthly index shows a rise because of seasonal adjustment. It reflects that prices in August did not fall as much as we would have expected them to given the seasonal pattern in prices.

"While it has taken some time for these factors to bite, there are now clearer signs of slower demand in the market reflected in the collapse in new buyer enquiries. In addition, the stock-to-sales ratio, which leads house price inflation by five to seven months, predicts a continued slowing in the annual rate of house price inflation.

### ...but there are risks

"Whether the fall out from the US sub-prime crisis will have a more severe impact on the housing market longer term will depend on how long it takes for market jitters to settle. A prolonged financial market downturn would be uncomfortable for the overall economy given the importance of this sector to economic growth over several years. Such a downturn would not only affect investment bankers, but would also have negative knock-on effects for legal, accountancy and other professional services that have benefited from the structured credit boom. On top of this, jobs in restaurants, cafes and other services catering for city workers would also be affected. The impact on London property prices can only be negative compared to the current situation, particularly at the top end, but employment generated from Olympic and other infrastructure investment along with supply issues will remain positive factors for the mainstream market.

Growth of financial intermediation output in Q1 2007



### After the floods, out come the doves

"The overall extent of any damage to economic growth and hence the housing market will depend on the length of the credit crunch and the monetary policy response by the Bank of England. August's Inflation Report signalled that a rise in the Bank Rate to 6% was pretty much a certainty. But the Bank's forecast of inflation did not predict a dip below the 2% target at any point over the next two years, even based on market rates rising to 6%. So, the fall in inflation to a sub-target 1.9% in July will have come as a surprise. On top of this, news from Europe suggests that the economies of the UK's main trading partners are weakening, while the likelihood of a slowdown in the States is rising all the time. The MPC has been highlighting the strength of global and Eurozone growth as a factor supporting its tightening campaign. This, together with the softer tone of the last set of MPC minutes, which revealed that most Committee members "had no firm views on whether rates would need to rise further", has led us to believe that rates will now remain at 5.75%.

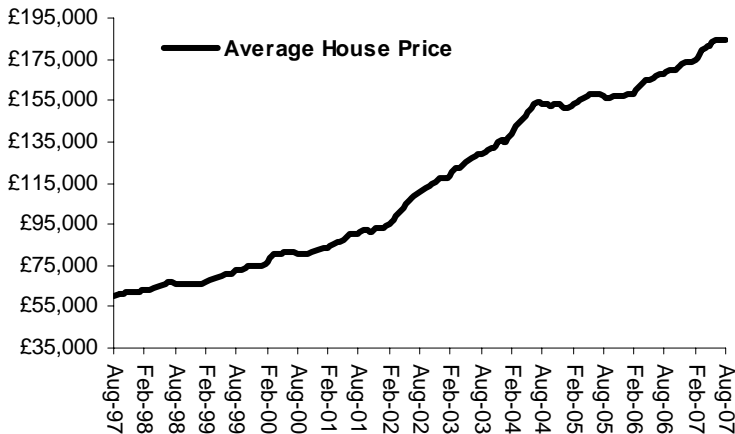
"The turmoil in credit markets strengthens the case of the doves on the Committee as the MPC will be reluctant to do anything to add uncertainty while the markets remain volatile. The Bank of England's reluctance to intervene in the markets in the same way as the Fed and the ECB suggests that at the moment it is fairly sanguine about the lasting effects of the credit crunch. But the longer the squeeze continues, the more likely it is to have a dampening effect on the wider economy and hence the outlook for house price growth next year."

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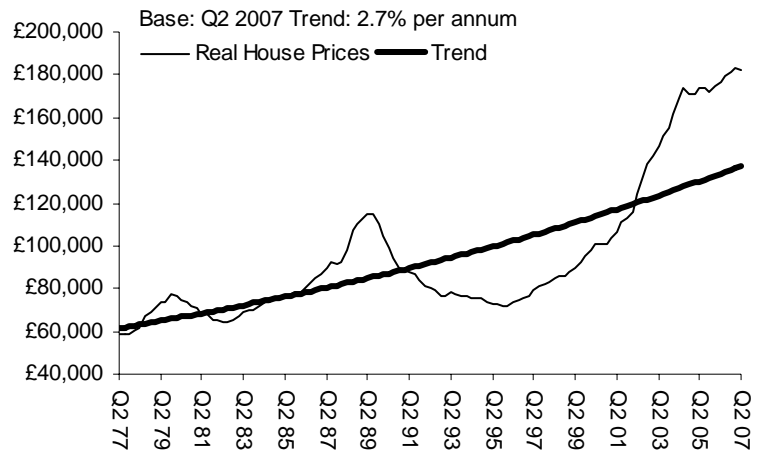
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\*\*\* STRICTLY EMBARGOED UNTIL 7.00AM THURSDAY 30<sup>TH</sup> AUGUST 2007 \*\*\*

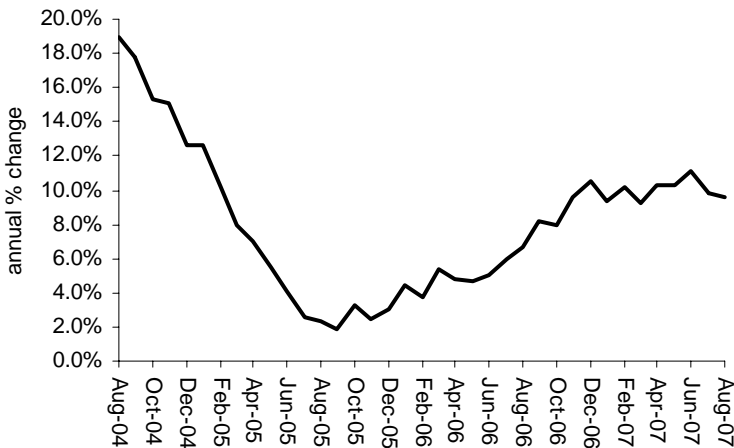
### Average UK House Price



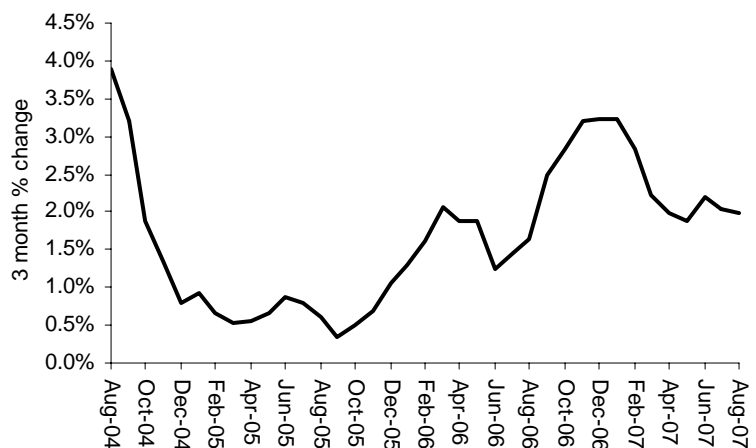
### Long Term Real House Price Trend



### Annual % Change in House Prices



### 3 months on previous 3 months % change



### Historical Data

Month	Monthly Index Q1 93 = 100 seasonally adjusted	Monthly Change %	Latest 3 months on previous 3 months % change	Monthly Index Q1 93 = 100 not seasonally adjusted	Annual Change %	Average Price £
2006 Aug	333.3	0.8	1.7	334.6	6.6	167,721
Sep	337.6	1.3	2.5	338.0	8.2	169,413
Oct	340.1	0.8	2.8	338.4	8.0	169,623
Nov	344.7	1.3	3.2	343.5	9.6	172,185
Dec	348.8	1.2	3.2	346.6	10.5	173,746
Jan	350.0	0.3	3.2	345.6	9.3	173,225
Feb	352.5	0.7	2.8	348.5	10.2	174,706
Mar	354.2	0.5	2.2	353.3	9.3	177,083
Apr	357.5	0.9	2.0	359.7	10.2	180,314
May	359.3	0.5	1.9	362.2	10.3	181,584
Jun	363.2	1.1	2.2	367.2	11.1	184,070
Jul	363.5	0.1	2.0	367.6	9.9	184,270
2007 Aug	365.7	0.6	2.0	366.9	9.6	183,898

## Notes:

Indices and average prices are produced using Nationwide's updated mix adjusted House Price Methodology which was introduced with effect from the first quarter of 1995. Price indices are seasonally adjusted using the US Bureau of the Census X12 method. Currently the calculations are based on a monthly data starting from January 1991. Figures are recalculated each month which may result in revisions to historical data.

The Nationwide Monthly House Price Index is prepared from information which we believe is collated with care, but no representation is made as to its accuracy or completeness. We reserve the right to vary our methodology and to edit or discontinue the whole or any part of the Index at any time, for regulatory or other reasons. Persons seeking to place reliance on the Index for their own or third party commercial purposes do so entirely at their own risk. All changes are nominal and do not allow for inflation.