

2008: a difficult year for the housing market

- House prices fall by 2.5% in December
- Annual rate of fall reaches 15.9%
- Continuing uncertainty means forecasts can be misleading
- Outlook for 2009 subdued, but low supply will play a part in recovery

Headlines	December 2008	November 2008
Monthly index * Q1 '93 = 100	308.9	316.8
Monthly change*	-2.5%	-0.4%
Annual change	-15.9%	-13.9%
Average price	£153,048	£158,442

* seasonally adjusted

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

"The price of a typical house fell by 2.5% in December, a stark contrast with the modest fall of 0.4% in November. This brings the annual rate of fall over the last twelve months to 15.9%. However the three-month on three-month rate, which smoothes the volatility often seen in the monthly numbers, shows a fall of only 4.2% in December. This is its slowest pace since May 2008. The price of a typical house is now £153,048, around the same level as of spring 2005, but still over £17,500 more than five years ago.

2008 has been a difficult year for the housing market...

"2008 has been a year of turmoil in the UK housing market. The disruption in the financial markets worsened throughout 2008 and had larger implications for the real economy than we anticipated a year ago. This time last year we expected the housing market to cool quickly as affordability was poor and economic conditions looked set to weaken, but we did not anticipate the speed of house price falls or the extent of the global and domestic economic slowdown. While we underestimated the speed and size of the fall, with the benefit of hindsight, the path of prices in 2008 is understandable. Three main factors have been behind the sharp fall in prices: credit conditions, expectations and affordability.

"Even in 2007 it was clear that affordability was beginning to act as a brake on activity and on the rate of house price growth in the market. The reduced access to credit resulting from wholesale market turmoil provided a catalyst for further declines in housing market activity. Finally, a combination of the initial price falls, widespread reports of financial market turbulence and the slowdown in the real economy prompted households to expect further price declines. As house price expectations turned negative, the incentive to enter the market evaporated and buyer demand fell accordingly. As a result, housing market activity plunged to the lowest levels ever recorded and house prices fell sharply.

...and conditions remain too volatile to produce a meaningful forecast for 2009 now ...

"Conditions remain highly volatile going into 2009, making it more difficult than usual to arrive at a specific forecast for house prices. In these unsettled times a forecast subject to frequent change could itself add to greater uncertainty.

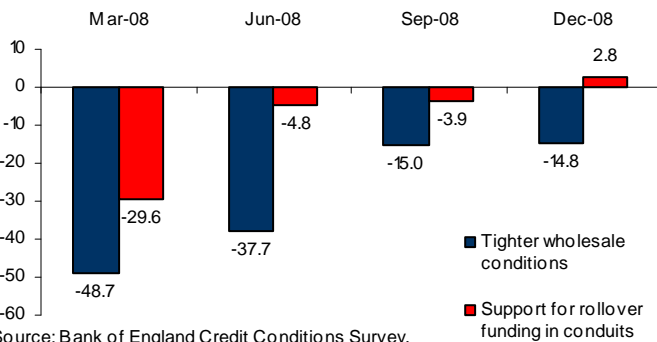
...but general trends are clearer

"However the outlook for the economy, and consequently the housing market, can be described in more general terms. The UK and various other economies slipped into recession in the final quarter of 2008 and there is little sign that this trend will be reversed in 2009. These conditions have already prompted the MPC to cut the base rate by 3.5 percentage points, and are likely to lead to further falls in 2009 in an effort to prevent a deeper recession. It looks like 2009 will be a bumpy year for the UK economy.

Credit availability will remain an issue

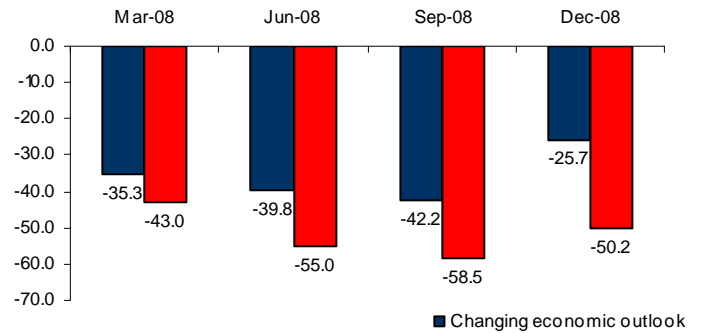
"A great deal of uncertainty surrounds the matter of credit criteria and how much this is likely to continue to be an issue in 2009. The latest Bank of England Credit Conditions survey shows how credit conditions have been tightening at a slower rate over the last year. This may suggest that we are past the most severe phase of tightening and may mean some stabilisation or even relaxation in criteria in 2009. However, it is unlikely that conditions will relax to the levels seen in early 2007. While banks still felt that difficult wholesale market conditions led to a tightening in credit criteria over the three months to December, this was less important than earlier in the year. However, they felt that the weaker economy and the expectation of further falls in house prices continue to be an important factor. This illustrates that the more traditional underwriting criteria are coming into play, and will continue to act as a constraint for some borrowers, particularly those at the riskier end of the spectrum.

How wholesale conditions affected the availability of household secured credit over previous 3 months (net balance %)



Source: Bank of England Credit Conditions Survey.

How economic and housing market conditions affected the availability of household secured credit over previous 3 months (net balance %)

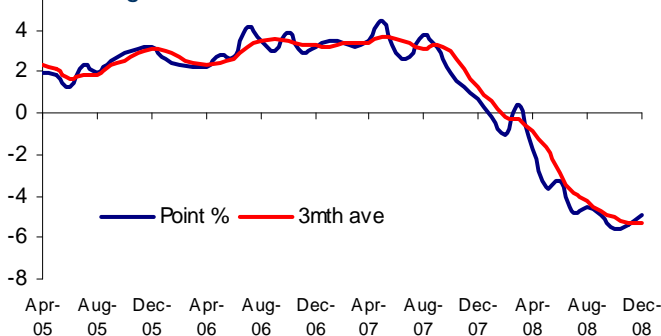


Source: Bank of England Credit Conditions Survey. ■ Expectations for house prices

"Weaker demand from borrowers is also likely to be a more important factor in 2009. In terms of house price expectations, current sentiment of borrowers and lenders is still fairly low. Until the economy and the labour market stabilise, it is hard to imagine households becoming upbeat about the immediate future for house prices and this will hinder the pace of recovery. In addition, the wider economic recession also impacts negatively on household expectations of future incomes. With job security and income growth less certain, households are likely to be less willing to take on more debt.

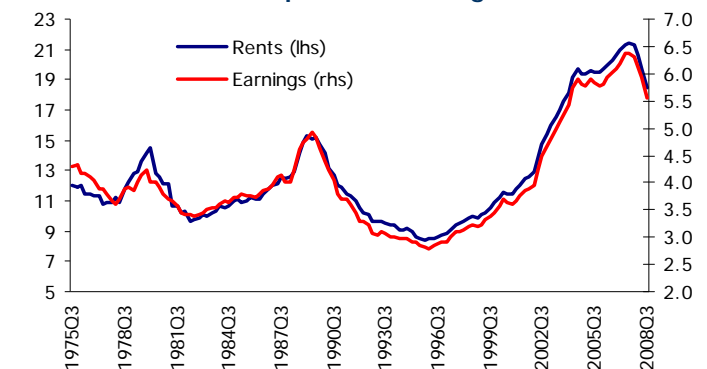
"While house price falls are helping to improve affordability and the steep drop in interest rates will provide some further support, all of the typical affordability measures are still above their long-run averages. This suggests that prices have further to fall before significant numbers of buyers will be willing to return to the market. But, as the market adjusts, property will start to look cheaper and this will encourage more activity.

Consumer House Price Expectation, 6 months % change



Source: NCCI

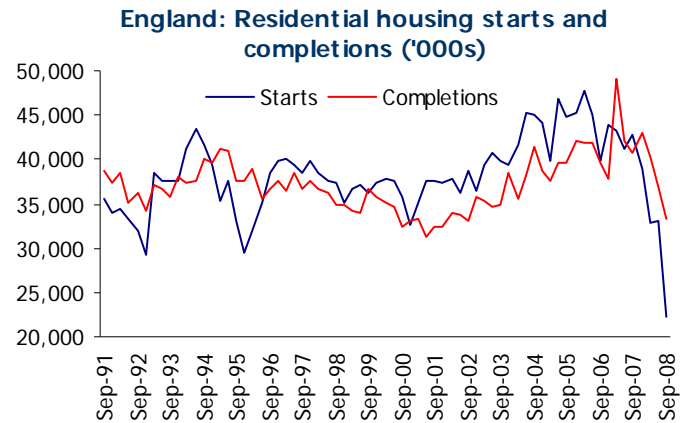
Ratio of house prices to earnings and rents



Source: ONS, Nationwide, IPD

Pent up demand likely to play a part in recovery

"An important underlying factor which we expect to play a part in the recovery of the market is the likely build-up in pent-up demand since 2003. Since then, first-time buyers have made up only 33% of transactions, compared to an average of 46% since 1979. If one assumes that the same proportion of first time buyers would have liked to have entered the market, it is possible to work out how many have been "locked out". This adds up to about 750,000 buyers over the 2003-7 period, which is more than the total number of house purchase transactions expected in 2008. Clearly this estimation is fraught with uncertainty and sensitive to assumptions, but it does appear likely that a substantial pool of pent-up demand has been building up, which could make its way back into the market when affordability improves and economic conditions and house price growth expectations stabilise. Moreover, the severe cuts in house building activity since late 2007 suggests that once housing market activity does begin to rise again, the longer term supply pressures highlighted in the Barker Review¹ could re-emerge relatively quickly. This in turn could help prices to recover more quickly.



Source: DCLG

Forecasts surrounded by uncertainty

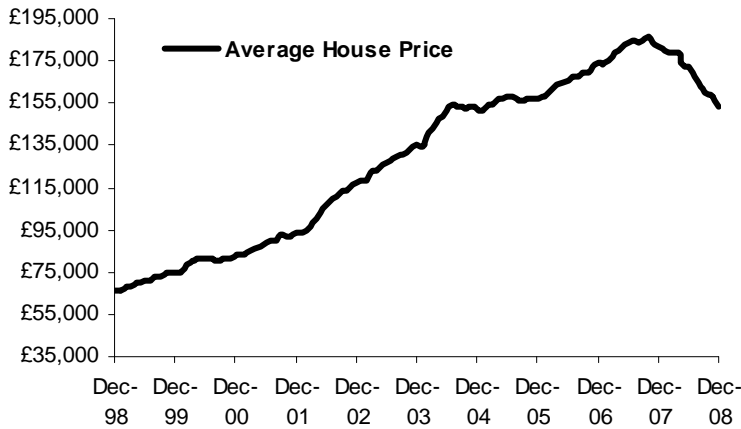
"In these turbulent times the uncertainties around all forecasts are greater than usual. If the economy goes into a deeper recession we should expect to see a slower recovery in the cycle. However, if the economy recovers more swiftly, we may expect a faster turnaround in the housing market. Nevertheless, the short-term outlook for the housing market is fairly weak. This should not be surprising given the economic and labour market conditions we expect to face. Sharp cuts in interest rates will provide support to existing and potential homeowners and pave the way for the improvement in affordability which will eventually encourage buyers back into the market."

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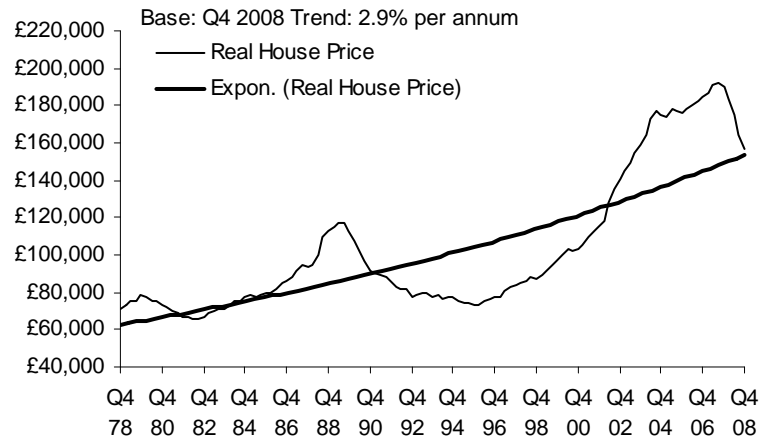
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¹ http://www.hm-treasury.gov.uk/barkerreview_land_use_planning_index.htm

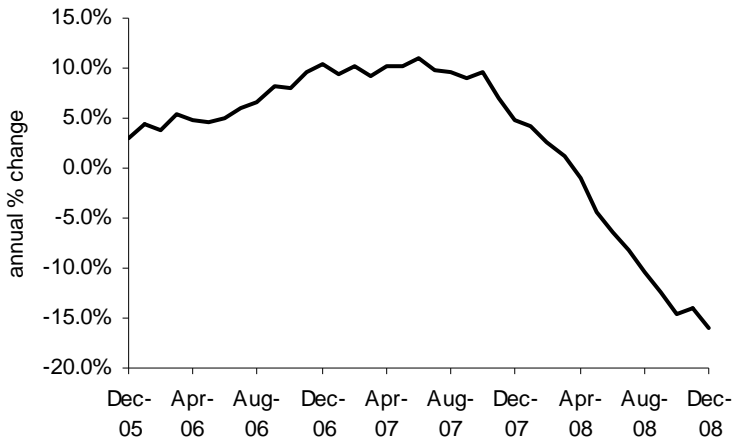
Average UK House Price



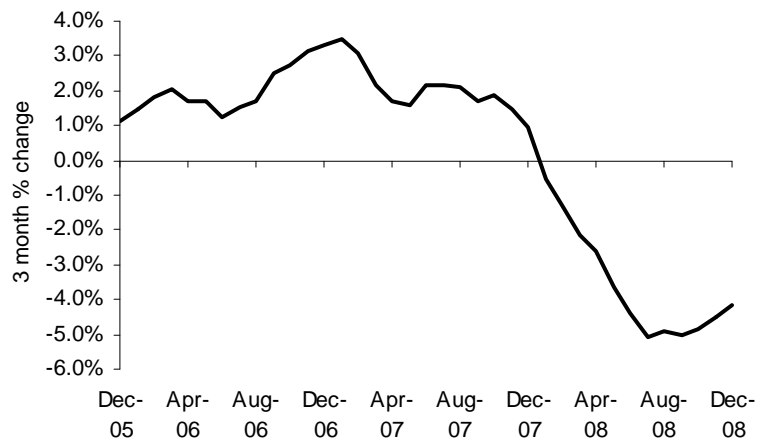
Long Term Real House Price Trend



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 £
2007 Dec	367.3	-0.2	1.0	363.2	4.8	182,080
Jan	365.1	-0.6	-0.5	360.0	4.2	180,473
Feb	361.8	-0.9	-1.3	357.8	2.7	179,358
Mar	357.4	-1.2	-2.1	357.3	1.1	179,110
Apr	353.0	-1.2	-2.6	356.2	-1.0	178,555
May	343.7	-2.6	-3.7	346.3	-4.4	173,583
Jun	340.1	-1.1	-4.4	343.9	-6.3	172,415
Jul	334.2	-1.7	-5.1	337.8	-8.1	169,316
Aug	327.9	-1.9	-4.9	328.5	-10.5	164,654
Sep	322.5	-1.7	-5.0	322.8	-12.4	161,797
Oct	317.9	-1.4	-4.9	316.9	-14.6	158,872
Nov	316.8	-0.4	-4.5	316.1	-13.9	158,442
2008 Dec	308.9	-2.5	-4.2	305.3	-15.9	153,048

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 series 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.

More information on the house price index methodology along with time series data and archives of housing research can be found at www.nationwide.co.uk/hpi

Photographs of our economists are available at: www.nationwide.co.uk/mediacentre/economist.asp