

Trend in price growth remains steady

- Prices rose 1.7% in January to leave annual increase above 26%
- Low mortgage rates to sustain house prices and borrowing
- Bigger deposits leaves households better insulated from negative equity

Headlines January 2003

Monthly index (seasonally adjusted) Q1 '93 = 100	239.2
Monthly change (seasonally adjusted index)	1.7%
Annual change	26.5%
Average price in January	£117,905

Commenting on the figures Alex Bannister, Nationwide's Group Economist, said:

“House price growth remained steady at 1.7% in January close to the average 1.8% increase over the last 3 months. Given that house prices rose at a more modest pace a year ago the annual rate of inflation rose to 26.5%. With the current trend in growth very stable and strong we would expect the annual inflation rate to remain around 25% for the next couple of months. However, in the six months between April and September last year house prices rose by a cumulative 15.5% - or an annualised rate of 33%. We do not expect to see this strength repeated this year and the annual rate of inflation should decline significantly over this period. A similar pattern is likely to be followed by house sales and lending although these tend to lag 1-2 months behind our house price figures. December house sales remained at a high level, up 7% on a year earlier, meaning that during 2002 nearly 1.6 million properties (or 1 in 10 homes) changed hands – the highest level of transactions for 14 years. There appears to be little sign of a slowdown in mortgage lending. December was a strong month for gross lending taking the total for 2002 to £216bn, of which £43bn was lent to first time buyers, £77bn to existing home owners, £83bn was remortgage business and £13bn was further advances.

Whilst our outlook for the housing market remains positive we believe households are more insulated from the effects of falling house prices than in the past. The main reason for this is the trend towards buyers putting down larger deposits. In 1989 almost 300,000 first time buyers (or almost half of the total) put down a deposit of 5% or less. In fact, 25% of first time buyers (or 150,000) put down no deposit and a further 23% (or 140,000) put down just 5% deposit. We estimate only 125,000 put down a deposit of 5% or less in 2002 meaning that fewer people lack a buffer against falling house prices. In addition, a typical first time buyer is now 27 (considerably older than the average 24 seen in the eighties) and consequently, they tend to be relatively well-heeled. Nevertheless, first time buyers should not be encouraged to over-stretch themselves. Prudent lenders should ensure that they stress test their borrowers' ability to meet repayments should circumstances change. Borrowers should also take a forward-looking stance and check that they could continue to meet their mortgage payments should mortgage rates increase. In addition, it is always prudent for borrowers to put down a sizeable deposit as a buffer against negative equity in the unlikely event of falling prices in their local area.”

Are debt levels sustainable?

Despite the recent slide in equity markets, house price growth has helped dampen the reduction in the level of household net wealth. As a more widespread and fungible form of wealth, this growth in house prices has helped to underpin consumer confidence and borrowing against mortgages. However, the recent rate of debt acquisition has given rise to mixed comment on the sustainability of current debt levels. Our view is that current debt and house price levels are sustainable given record employment levels and low real mortgage rates. In contrast, the current growth rate of borrowing is unsustainable and will slow significantly over the next few years.

There is no doubt that household debts have grown quicker than assets over the last decade. In today's money outstanding mortgage loans amount to £665bn versus around £375bn in 1989. Despite a 57% increase in house prices over the same period the growth in housing wealth (c£2.5tn¹ now compared with c£1.6tn in 1989) has not been so swift. In addition, gross financial wealth is only 44% higher than in 1989 in today's money - largely because of the near 50% fall in stock markets since the end of 1999. Nevertheless, total net wealth is still around 6 times annual disposable income (down from a peak of 6.7 in 2000) - much the same as in 1998 and considerably higher than its average over the last 20 years (5 times).

However, the key to whether debt levels are sustainable comes down to the strength of the labour market and affordability. Although much of the recent employment growth has been part-time and in the typically lower paid public sector it is difficult to say that the labour market is anything other than supportive. Unemployment is below 1 million and continues to decline with employment levels at record highs. The same is true of affordability. While there is a risk that some borrowers have over-stretched themselves the average payments of a first time buyer are currently around 25% of gross earnings compared with 31% in the mid to late eighties (41% in 1989). In addition, the cost of a mortgage over its life in real terms is also lower than during the eighties due to current real post tax mortgage rates being around 3% compared to 4% in the eighties. Looking forward, borrowers must be careful to avoid over-stretching themselves as they will find that their mortgage payments as a proportion of their earnings will remain relatively static or even increase as mortgage rates move higher.

Economic Outlook

The key risks to the current benign housing market conditions are threefold: a sharp rise in interest rates, a significant increase in unemployment or a large fall in consumer confidence. Rate rises in the near term look increasingly unlikely, with the financial markets currently pricing in the possibility of a cut. A weak global outlook explains part of this view on rates and this in turn is likely to have been driven by uncertainty over a potential conflict with Iraq. Although any conflict could also lower consumer confidence we think sentiment will remain relatively robust while unemployment remains on a downward path and the chance of a significant rise in interest rates is small.

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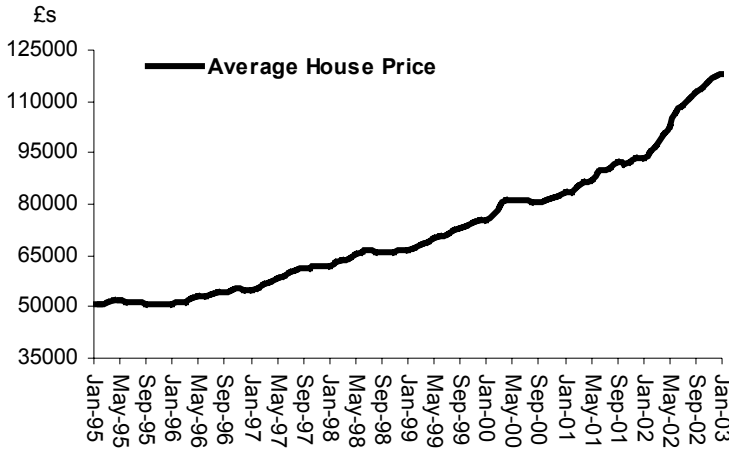
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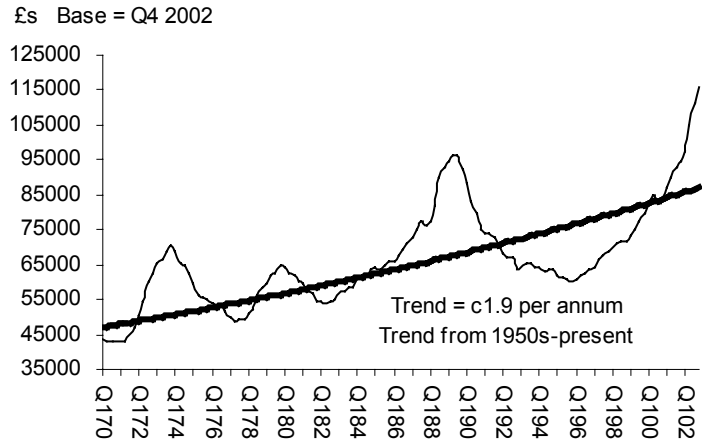
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¹ A thousand billion

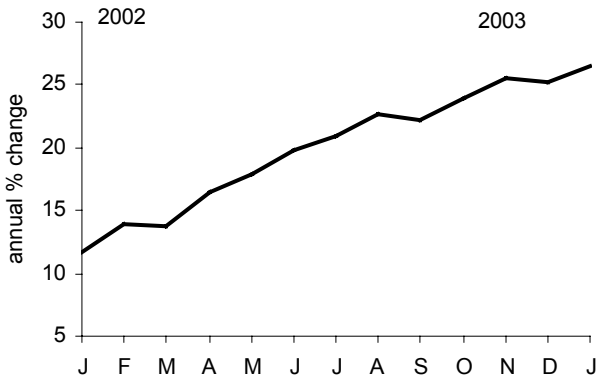
Average UK House Price



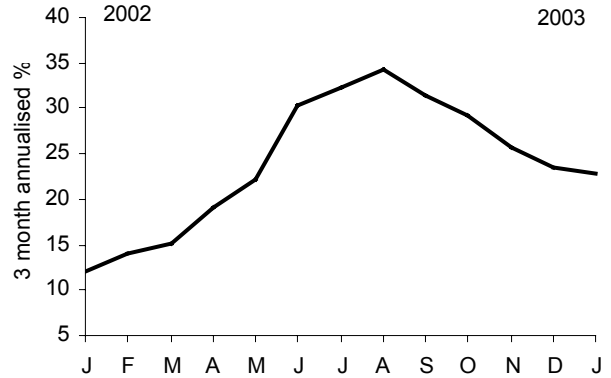
Long Term Real House Price Trend



Annual % Change in House Prices



Trend in House Price Inflation (1)



Historical Data (2)

Month	Monthly Index (3) Q1 93 = 100 seasonally adjusted	Monthly Change (4) % seasonally adjusted	Monthly Index Q1 93 = 100 not seasonally adjusted	Annual Change (5) % not seasonally adjusted	Average Price £ not seasonally adjusted
2002 Jan	189.1	0.7	186.0	11.7	93,231
Feb	192.3	1.7	189.4	14.0	94,965
Mar	193.8	0.8	193.1	13.8	96,792
Apr	200.2	3.3	200.4	16.5	100,473
May	204.3	2.0	205.2	17.9	102,886
Jun	210.0	2.8	212.8	19.8	106,693
Jul	214.6	2.2	217.1	21.0	108,818
Aug	219.5	2.3	221.2	22.7	110,890
Sept	223.8	1.9	225.3	22.2	112,919
Oct	227.0	1.5	226.8	24.0	113,665
Nov	231.3	1.9	230.9	25.5	115,761
Dec	235.2	1.7	233.8	25.3	117,206
2003 Jan	239.2	1.7	235.2	26.5	117,905

Notes:

- 1) Chart shows % change in the 3 month moving average over the last 3 months annualised. Conceptually it is akin to the quarter on quarter annualised % change, but it uses monthly data.
- 2) 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.
- 3) Price indices are seasonally adjusted using the US Bureau of the Census X11 method. Currently the calculations are based on a monthly data starting from January 1991. Figures are recalculated at six month intervals, in June and December.
- 4) % change over previous month.
- 5) % change over same month last year.

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.