Market Overview - Contents

Key Figures

Monthly Index (seasonally adjusted) Q1 1993=100	304.1
Monthly change (seasonally adjusted)	-0.4%
Annual change	15.3%
Average price in October	£152,159

Headlines

- First decline in UK property prices for three years
- UK property prices flat over last three months
- Strength of labour market suggests housing market to tread water

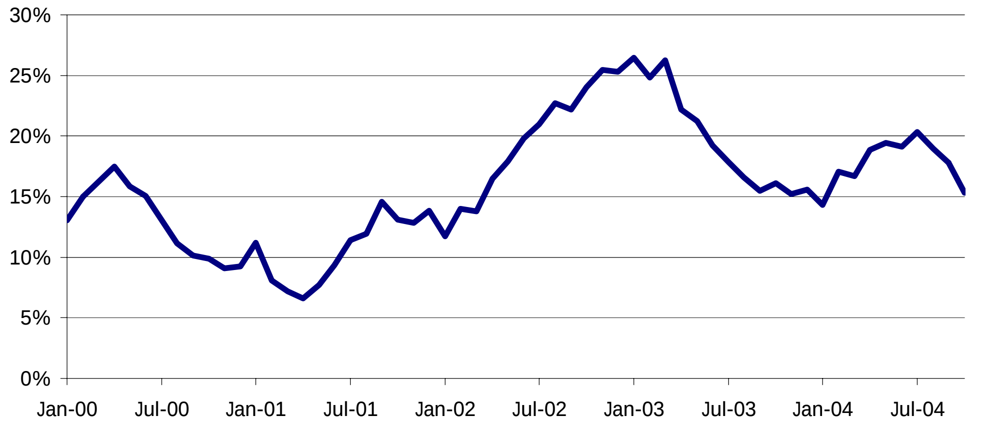
Analysis

Following subdued house price growth in the last two months, house prices fell by 0.4% during October. This was the first monthly fall since October 2001 and the largest decline since February 2001. As a consequence, the annual rate of house price inflation slowed sharply from 17.8% last month to 15.3% in October. The price of the typical house now stands at £152,159, down from the peak of £154,299 in July 2004. Late summer/early autumn is normally a weaker period for house price growth and £1,970 of the £2,140 fall can be explained by normal seasonal movements in price. That means just £170 of the fall is due to underlying price falls.

Nevertheless, this has been a period of marked deceleration in house price growth and is in part a result of 'real' factors, such as weak real take-home pay growth, rising interest rates and stretched affordability, acting as a drag on the market. Our surveys of homeowner sentiment on house prices, conducted over the last few months, clearly show a change in property price expectations. In June, 64% of consumers believed that house prices would be higher over the following six months. Now that figure is around 40%. In addition, the proportion believing house price declines are on the way has increased from 7% in June to just over 15%. This moderation in expectations combined with a deterioration in affordability for both first-time buyers and existing homeowners, who are now facing a tough time trading up, will have played a major part in slowing the market.

Despite price growth over the last three months being slightly weaker than we had expected, developments remain consistent with our view that over the coming years, house prices are more likely to grow at a very subdued rate rather than fall sharply. This does not mean that prices will not fall in isolated months. In fact there have now been seven monthly declines in house prices since the start of 1999; a period which saw house prices more than double.

Annual % Change in House Prices



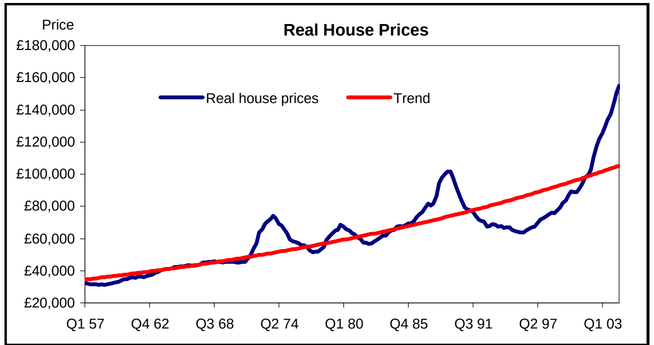
Commentary

Our forecast for annual house price inflation in December 2004 remains at 15%. If prices remain static from now on, the price of an average UK property would end the year 12% up on a year earlier – 3% below our forecast made in March of this year and 3% higher than our original forecast made in December 2003.

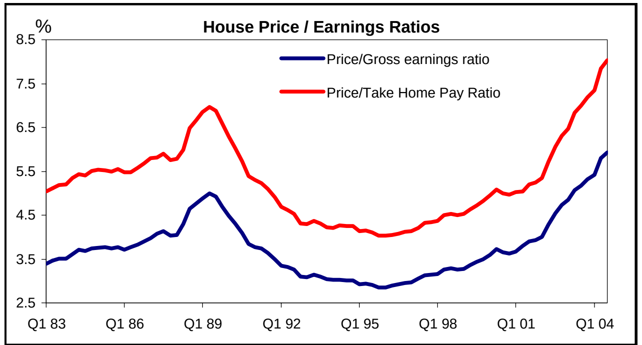
House Price Indices

Month	House price index 1993 = 100 s.a.	Monthly Change %	House price index 1993 = 100 n.s.a.	Annual Change %	Average Price £	Property Transact'ns[1] s.a. 000s
2000	164.9	avg. 0.7	164.0	9.3	82,188	1,431
2001	187.4	avg. 1.1	186.6	13.8	93,544	1,457
2002	234.4	avg. 1.9	233.8	25.3	106,192	1,586
2003 Oct	263.7	1.8	263.2	16.1	131,947	108
Nov	267.1	1.3	266.1	15.2	133,388	109
Dec	271.5	1.6	270.2	15.6	135,444	116
Jan	273.3	0.7	268.9	14.3	134,806	142
Feb	280.8	2.7	276.8	17.1	138,730	164
Mar	285.1	1.5	284.4	16.7	142,584	142
Apr	290.7	2.0	291.1	18.9	145,918	150
May	295.6	1.7	297.3	19.5	149,020	152
Jun	298.1	0.9	302.3	19.1	151,524	161
Jul	304.5	2.1	307.8	20.3	154,299	154
Aug	304.7	0.1	306.7	18.9	153,743	147
Sep	305.4	0.2	306.7	17.8	153,727	152
2004 Oct	304.1	-0.4	303.5	15.3	152,159	-

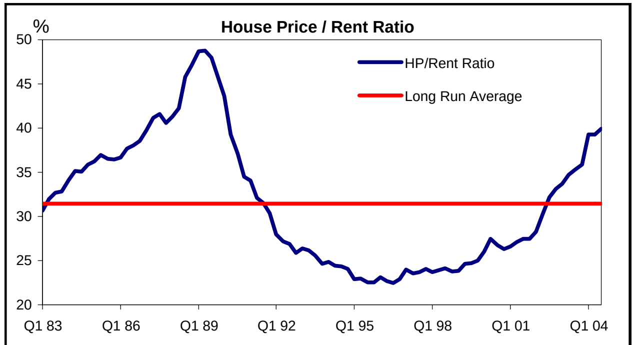
[1] Source: Inland Revenue



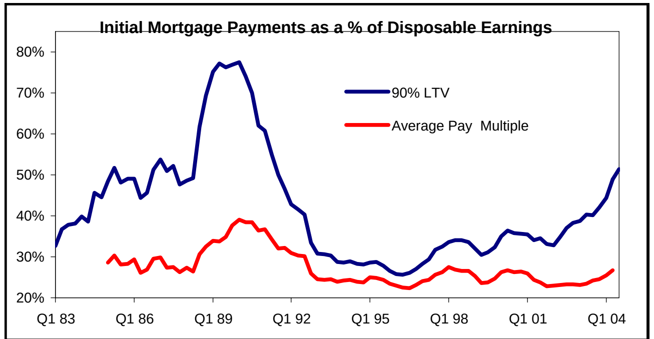
Over the long term the trend growth rate in house prices (after allowing for inflation) has been 2.3% per annum.



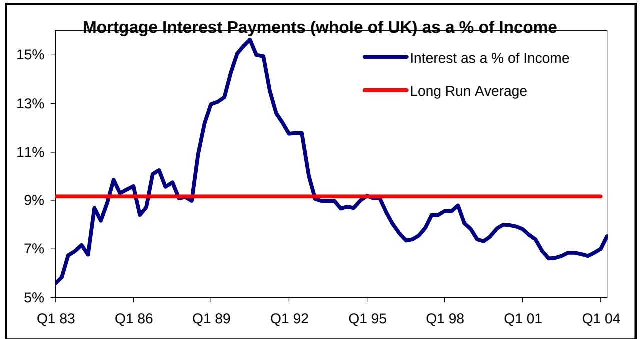
House price to earnings ratios are currently at record high levels...



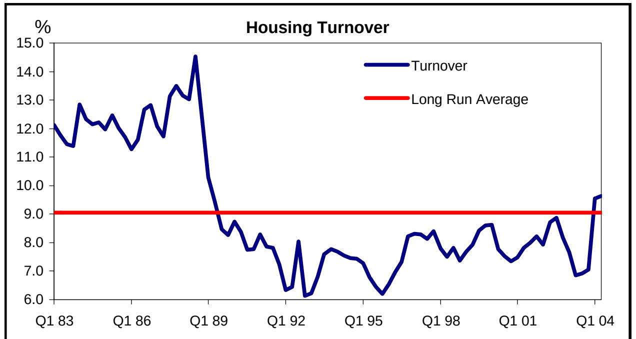
... but affordability is only just above the long run average and well below the level seen in the late 80's.



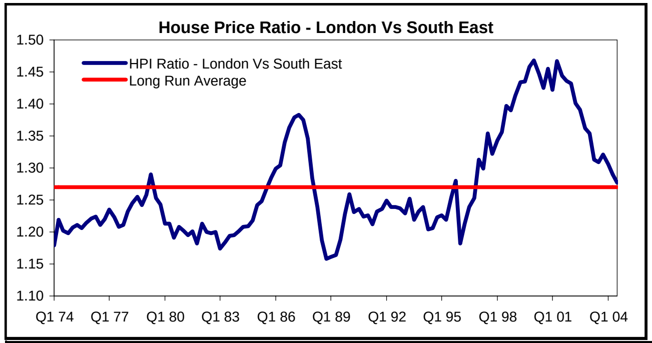
At current rates, payments on a typical mortgage look affordable when compared to the late eighties peak.

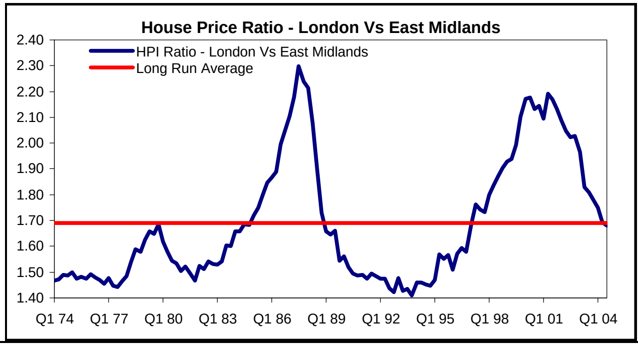


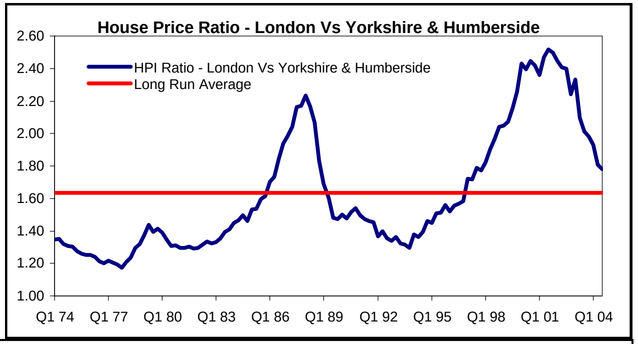
Mortgage interest payments for the economy as a whole remain low relative to income.



Housing Turnover is the proportion of the stock which changed hands per quarter







The ratio of prices in London to prices in other regions is heading back towards its long run average. However, in contrast to the early 90's this is happening due to regions away from London "catching up" as opposed to prices falling in London.

Overview

The start of the housing market slowdown, which has been widely commented on, has resulted in a sharp decline in both the number and value of house purchase approvals for the third consecutive month. The seasonally adjusted number of monthly house purchase loans was 89,000 – lowest since July 2000. The continuing downward trend in equity withdrawal contributed to the decline in the value of approvals. Approvals for remortgage declined slightly, 4% lower than a year ago, but still above £11bn. Preliminary market data suggests that approvals in October will be similar to September at around £25.5bn.

Market gross advances in September were £25.0bn, 3.0% lower than Sept-03 and the first year-on-year fall since November 2000. This was not unexpected as the pattern of approvals have also seen year-on-year falls since July. Lending for house purchase is 8.6% weaker than this time last year having had been strong over the previous few months. Remortgage lending recovered slightly and still remains reasonably strong at £11.4bn.

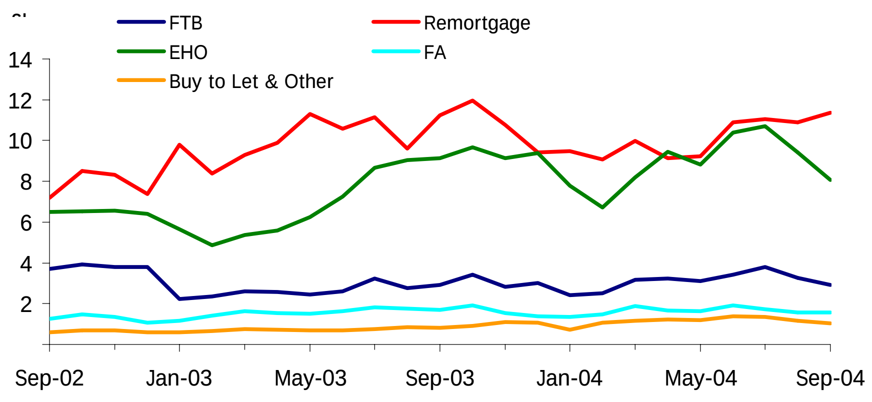
Outlook

We are unlikely to see a significant return in the number of first-time buyers to the market as prices relative to earnings are set to stay high. However, net lending volumes are likely to reduce from the highs of 2003/4 primarily due to a gradual decline in mortgage equity withdrawal as borrowers react to rising interest rates (see chart bottom right).

£m	Gross Approvals	Total Gross Advances	G.Adv. for Housing	G.Adv. for Remortgage	Principal Repaid	Net Advances
2002/03	264,609	230,095	121,328	94,173	149,074	81,021
2003/04	322,495	285,185	130,633	124,431	181,517	103,668
Sep-03	29,165	25,786	12,049	11,245	16,092	9,694
Oct-03	30,971	27,875	13,097	11,946	17,047	10,828
Nov-03	27,979	25,356	11,958	10,762	15,957	9,399
Dec-03	23,506	24,264	12,420	9,404	16,617	7,647
Jan-04	20,863	21,755	10,209	9,481	13,072	8,683
Feb-04	25,282	20,833	9,230	9,063	14,068	6,765
Mar-04	32,936	24,398	11,387	9,968	16,096	8,302
Apr-04	28,487	24,688	12,653	9,130	15,663	9,025
May-04	29,292	24,029	11,948	9,240	15,772	8,257
Jun-04	31,723	28,003	13,808	10,901	17,544	10,459
Jul-04	28,817	28,618	14,499	11,053	18,525	10,093
Aug-04	26,194	26,290	12,665	10,889	17,538	8,752
Sep-04	25,315	25,009	11,011	11,364	16,742	8,267
% YoY	-13.2%	-3.0%	-8.6%	1.1%	4.0%	-14.7%

Source: Bank of England, Survey of Mortgage Lenders

Market Gross Advances

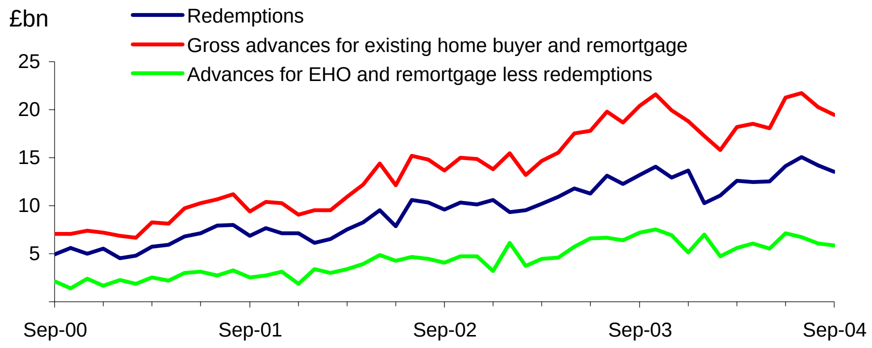


Source: Survey of Mortgage Lenders

Commentary

House purchase lending fell in September and is forecast to decline further for the remainder of the year given the assessment that the housing market is slowing. Remortgage lending recovered slightly but is expected to stay between £9.8-11.4bn a month.

Equity withdrawal starting to decline



Commentary

The difference between the level of redemptions and the total advances for existing home buyers and remortgages is one element of mortgage equity withdrawal. For this group there has been an increase in equity withdrawal over time. However, as seen in the chart, mortgage equity withdrawal remains fairly strong but has slowly declined for the last three consecutive months and is forecast to continue to fall during 2004/05 as borrowers react to rising interest rates.

Overview

Flows & Outlook

Market savings balances rose £8.1bn in September, which was slightly less than forecast. We estimate that around £6bn of this was due to net receipts. On a seasonally adjusted basis net receipts totalled £3.8bn.

The retail deposit market has come off from the peaks seen towards the end of 2003. Our full year forecast for market change in balances has been revised down as a result of the slowdown in equity release from the housing market and the recovery in the recent strong

Pricing

With no base rate change since August the variable rate retail deposit market has taken a bit of a breather. The exception has been the upward movement in average announced e rates. In contrast, fixed rates have tracked swap rates lower since August. This is likely to have meant a shift in focus within the retail deposit market away from fixed rate products back to variable rate products such as e. Two-year fixed rate bond rates averaged 5.32% in August compared to 4.65% on e accounts. At the end of October, two-year fixed rates averaged 5.02% compared to an average of 4.77% on e.

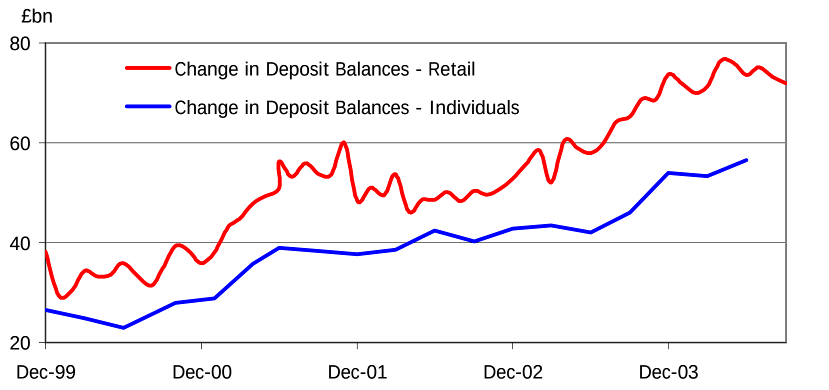
Market Data

	Stock (£bn)			Announced Market Rates (%)#			
	Cash ISA*	Total Market	Total H'Hold	Notice	Postal	ISA	E accounts
2002/03	-	-	-	1.90	2.97	3.94	3.63
2003/04	-	-	-	1.77	2.60	3.67	3.63
Sep-03	80.7	788.5	698.1	1.53	2.35	3.38	3.25
Oct-03	81.2	793.2	-	1.53	2.39	3.38	3.25
Nov-03	81.6	802.2	-	1.65	2.55	3.57	3.46
Dec-03	81.9	809.6	719.5	1.71	2.54	3.63	3.51
Jan-04	82.5	807.9	-	1.71	2.54	3.63	3.51
Feb-04	83.1	811.6	-	1.81	2.63	3.73	3.74
Mar-04	86.8	822.9	729.2	1.95	2.65	3.85	3.95
Apr-04	92.5	833.6	-	1.95	2.72	3.85	3.95
May-04	93.7	837.5	-	2.12	3.02	4.01	4.09
Jun-04	94.2	845.4	746.7	2.33	3.22	4.15	4.36
Jul-04	94.5	846.4	-	2.45	3.30	4.32	4.41
Aug-04	94.7	851.7	-	2.64	3.38	4.46	4.65
Sep-04	127.0	859.8	759.6	2.73	3.51	4.54	4.70
Oct-04	-	-	-	2.73	3.51	4.54	4.77

Source: Bank of England, Nationwide Estimates *** Ex National Savings**

 # Recorded rates at end of month

Market Performance - Rolling 12 Month Periods



Commentary: The gap between individual's holdings of retail deposits and total retail deposit holdings increased further in the year to the second quarter of 2004. The difference between the two series relates to corporate, charity and non-profit organisation's holdings of retail deposits.. In the 12 months to June 2004, a quarter (almost £20bn) of the increase in retail deposits was due to non-individual sector.

Retail Spreads & Margins

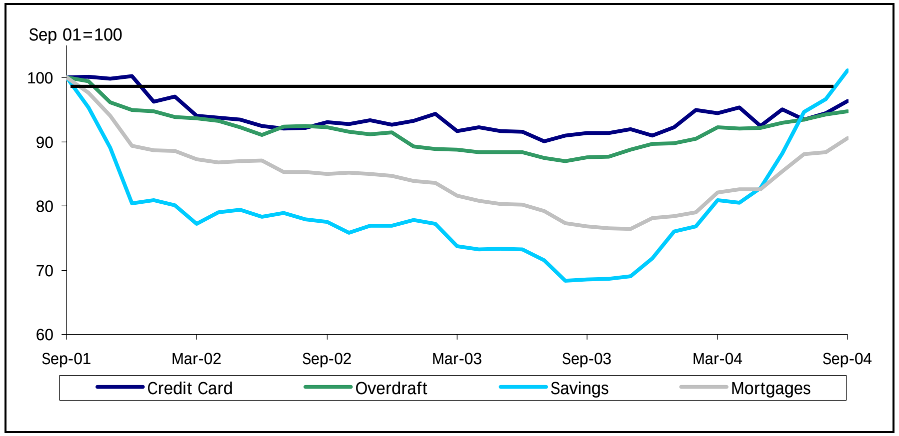
Market trends

Over the last year book rates have moved significantly as a result of movements in LIBOR and base rates, high levels of competition and continued book churn. The market mortgage book rate stood at 5.5% in September 2004 compared to 4.65% in October last year. Over the same period the market savings book rate has risen from 2.36% to 3.48%. Consequently the market retail spread has declined sharply from 2.29% in October 2003 to just 2.03% in September 2004. With competition set to remain intense further declines in the retail spread look likely.

Market Book Rates							
	Base Rates	LIBOR	Mortgage	Savings	Mort-Sav Spread	Overdrafts	Credit Cards
2000/01	5.96	6.01	6.96	4.14	2.82	10.84	16.29
2001/02	4.63	4.57	5.98	3.28	2.71	10.20	15.13
2002/03	3.96	3.99	5.21	2.63	2.57	9.54	14.22
Oct-03	3.50	3.80	4.65	2.36	2.29	9.16	13.98
Nov-03	3.75	3.98	4.64	2.38	2.26	9.28	14.08
Dec-03	3.75	4.02	4.75	2.47	2.27	9.37	13.92
Jan-04	3.75	4.06	4.76	2.62	2.14	9.38	14.13
Feb-04	4.00	4.17	4.80	2.64	2.15	9.45	14.53
Mar-04	4.00	4.29	4.99	2.79	2.20	9.64	14.46
Apr-04	4.00	4.39	5.01	2.77	2.24	9.62	14.59
May-04	4.25	4.53	5.02	2.85	2.17	9.63	14.16
Jun-04	4.50	4.79	5.18	3.03	2.15	9.71	14.55
Jul-04	4.50	4.86	5.35	3.26	2.09	9.77	14.31
Aug-04	4.75	4.99	5.37	3.33	2.04	9.85	14.46
Sep-04	4.75	4.95	5.50	3.48	2.03	9.90	14.75

Source: Bank of England & Nationwide estimates

Book rates since the base rate was last at 4.75%



Commentary: Prior to August 2004, the base rate last stood at 4.75% in September 2001. The chart above plots various book rates indexed to 100 in September 2001. In September 2004 the base rate stood at 4.75% but despite only the savings book rate had returned to the level it was at in September 2001. Although mortgage lending volumes were high throughout this period, which meant that demand for funding was high, it was the savings book rate that declined the most between September 2001 and September 2003. Part of this fall came about at a time when libor was running below the level of the base rate, making wholesale funding particularly attractive. However, with the demand for funding remaining high, libor rising sharply and regulatory limits constraining demand for wholesale funding, savings rates have risen sharply over the last year.

With around a third of the mortgage book on fixed rate deals, the impact of the falling base rate on the book rate was dampened. Working in the opposite direction was the impact of mortgage churn. The increased propensity for borrowers to remortgage to cheaper deals has put downward pressure on the book rate. As a consequence of both these factors the mortgage book rate is now standing significantly below the level when the base rate was last 4.75% and importantly the gap between mortgage and savings rates is now much smaller than it was three years ago.

Rates on other forms of debt (credit card and overdrafts) did not show the same downward pressure over the period when the base rate was falling nor have they moved up as quickly since November 2003.

Interest Rates

Interest rate outlook

As at November 2004, the market appears to be no longer pricing in any further base rate increases during this cycle. However, our view remains that the next move in rates is likely to be up. Prior to the publication of the November inflation report our expectation was that this would happen in February. However, the inflation report was more 'dovish' than we had been expecting and whilst we still see rates rising, this could now be pushed back later in 2005.

Concerns about the global outlook (e.g. US imbalances) represent downside risks to the rate outlook. But, providing these don't materialise in the near term, we perceive there to be upside risks to the Bank's inflation outlook (which already has CPI rising above target beyond two years out). Contrary to the Bank's view, our central view is that house prices will stagnate rather than fall. Although there is a risk that the Bank's comments could dampen confidence in the housing market. On the supply side of the economy, we are not as confident as the Bank that rising producer prices, fuelled by the weakening currency, will not feed through to prices on the high street. Furthermore, it is by no means certain that wage inflation will not be ignited by the tightness of the labour market.