



It was the excess supply over faltering demand that exerted downward pressure on UK house prices in the final months of 2010

Sluggish activity and monthly price volatility with a gentle downward drift characterised the UK housing market in the second half of 2010. We expect activity to remain weak and house prices to follow a flat underlying trend as supply conditions weaken while buyer demand falters against a backdrop of increased economic uncertainty and limited mortgage lending.

The UK housing market continues to be characterised by sluggish activity and overall stagnant house prices. The volatility seen in the monthly data is typical of a market where the number of transactions is low and where even small movements in underlying supply and demand can tip the balance either way.

Nationwide reports that house prices fell by 0.3% in November 2010 but then rose by 0.4% in December. Calculated on a quarterly basis, seasonally adjusted house prices fell by 1.3% in 2010q4. Thus, despite a rally in the second half of 2009, house prices are still falling three years after the bottom dropped out of the market in late 2007. Clearly, the housing market has suffered a prolonged period of weakness and conditions still remain depressed. This is confirmed by **Halifax** which reported a monthly fall of 1.3% in December 2010 and an overall fall of 0.9% in 2010q4.

The recent fall in prices can be attributed to a greater supply in the

market as sellers, attracted by higher prices in 2009 and early-2010, returned to the market. This happened as buyers were pulling out of the market, discouraged by a generally weaker economic conditions and difficulties in obtaining mortgage credit. According to the **RICS survey**, the number of new enquiries has been declining since June 2010 while, in contrast, the average number of properties on surveyors books has picked up. In the final months of 2010, it was the excess supply over weak demand that exerted downward pressure on house prices.

To gauge the path house prices are likely to follow in the next few quarters, a useful exercise is to examine underlying trends in housing supply and buyer demand. The renewed decline in house prices is likely to discourage sellers from entering the market and we expect the supply conditions to weaken. On the demand side, buyers are being held back by a second renewed weakness in the labour market, where falls in

HOUSE PRICE GROWTH (%) - non-seasonally adjusted				
	2010Q4	2010Q3	2009Q4	2010Q4 £
UK	-2.5	-0.8	1.2	163,244
Scotland	-1.3	-3.3	0.1	137,491
Wales	-3.5	-1.4	0.8	133,688
Northern Ireland	-4.0	1.6	-6.3	125,637
South West	-3.4	-0.3	0.7	183,242
Outer South East	-3.3	0.1	1.4	195,392
Outer Metropolitan Area	-3.2	0.6	2.2	238,767
Greater London	-3.4	1.1	2.7	283,511
East Anglia	0.2	-0.7	0.5	166,026
East Midlands	-2.0	-0.2	1.9	138,973
West Midlands	-2.7	-0.3	1.2	145,752
North West	-1.6	-1.1	1.4	137,969
North East	-0.1	-1.5	0.1	117,082
Yorkshire & the Humber	-3.1	-3.0	2.0	132,633

Source: Nationwide

Supportive factors to buyer demand, such as better affordability and low interest rates, are being offset by weakness in the labour market and heightened economic uncertainty

employment and real wages affects buyers' ability and willingness to enter the market. Two factors supportive to buyer demand are improved affordability due to generally lower house prices and low interest rates. However, the full benefits of low rates are felt by only a proportion of buyers (those already in the property market on tracker mortgages). Otherwise, for new entrants, spreads between Bank rate and mortgage rates still remains high. Given the unexpected surge in inflation in January 2011, the risk that the Bank of England may hike rates sooner than anticipated is heightened. This increased risk will affect buyer sentiment making them less likely to enter the market for fear that such a move will put further pressure on their already constrained budgets.

Arguably, the biggest constraint to housing market activity is the lack of mortgage finance. Bank lending is still at historically low levels. Recent data

from the **Council of Mortgage Lenders** shows that UK mortgage lending fell to its lowest level in nine years in 2010. The value of mortgages advanced, which has now fallen for three consecutive years, declined by 5% in 2010. **Bank of England** data reveal mortgage approvals in November 2010, although marginally higher than in October, were worryingly low at only 48,000. The proportion of loans with a loan-to-value ratio exceeding 90% is just 2% compared with over 16% in 2007, according to Nationwide.

With supply and demand both expected to weaken in the first half of 2011, and the market operating in an environment of stringent lending, it is evident that the level of activity in the market will remain depressed for some time yet. We expect little movement in house prices although a volatile monthly pattern is likely to conceal a flat underlying trend.

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