Where next for the UK housing and mortgage markets?

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Agenda

- Current state of the market and near term outlook
- The bigger picture and its implications
- Medium-term prospects

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State of the market I - Transactions

- Activity recovered from extreme lows over the course of 2009
- Early 2010 saw the recovery in housing transactions stall
- Still a thin market with turnover well down on pre-crisis levels

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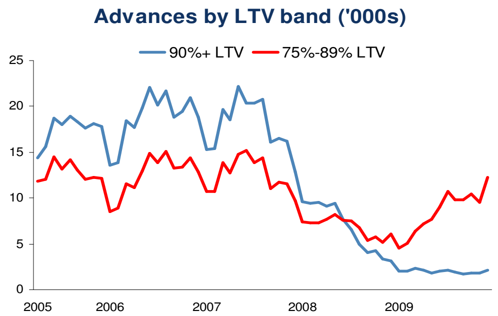
State of the market II – Lending trends

- Lending up to 90% LTV is broadly in line with pre-crisis levels
- Higher risk lending is still limited, reflecting the interplay of funding constraints and uncertainty about the future economic and regulatory environment



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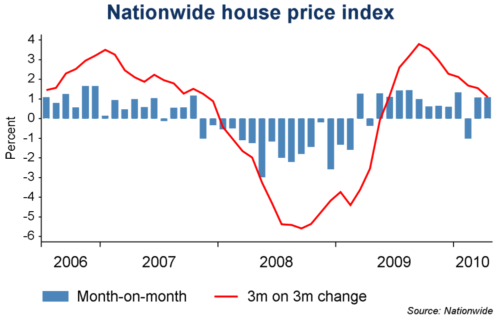
State of the market III – Price trends

- Prices have rebounded by 10% from the early 2009 trough
- Much stronger than expected performance …
- … but early signs that the rebound in prices may be losing some momentum



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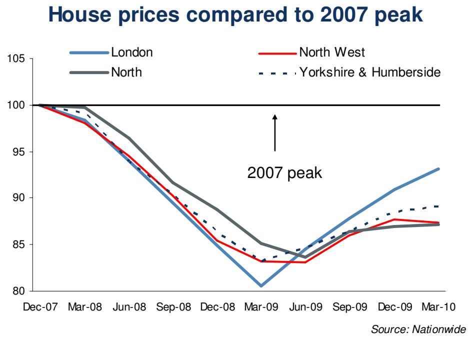
State of the market III – Price trends cont'd

- London and South East have led the rebound
- London only 7% below 2007 peak and still rising
- Northern regions seeing much weaker recoveries



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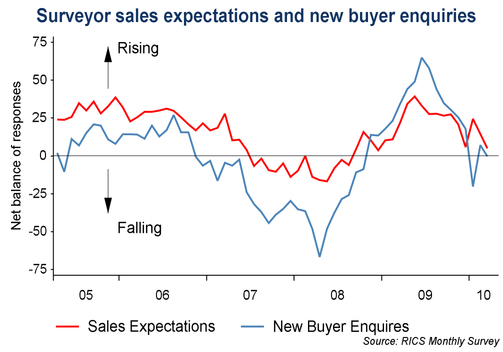
State of the market IV – Demand indicators

- Upstream indicators are consistent with a relatively flat demand picture
- New buyer enquiries rose sharply in 2009 but have lost momentum recently
- Surveyor sales expectations have also flattened out somewhat



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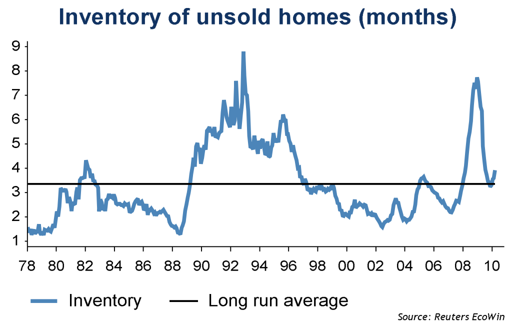
State of the market V - Supply

- Ultra low interest rates have led to a big drop in the supply of property for sale
- Few have been under pressure to sell, despite higher unemployment
- Early signs that supply may be increasing again



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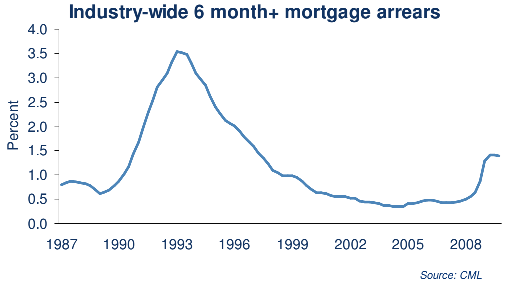
State of the market VI

- Mortgage arrears and possessions appear to be stabilising
- Arrears levels nowhere near the peak of the early 1990s downturn
- Low rates have been the primary support, though ISMI and other measures have helped



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Near term outlook for housing market

- House prices should be broadly flat over the course of 2010, with risks tilted somewhat to the upside given the trend so far this year
- A slow increase in property supply alongside relatively flat demand should lead to less upward pressure on prices
- Purchase transactions appear unlikely to rise much above late 2009 levels

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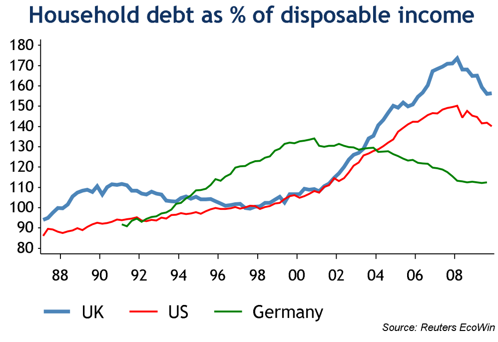
The big picture I – Household debt

- The UK personal sector is carrying a historically large debt burden
- Consumers are still in deleveraging mode
- Sustainable debt-to-income ratio is probably lower than where it is today
- Implies debt increasing at a slower rate than household incomes



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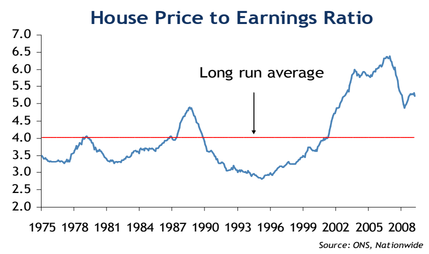
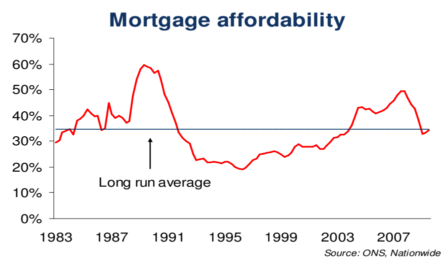
The big picture II – Affordability

- The house price to earnings ratio still looks quite high …
- … but low interest rates have kept mortgages affordable
- Higher interest rates would raise challenges for affordability





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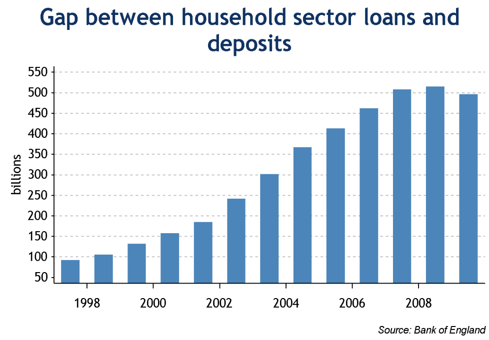
The big picture III - Funding

- Rapid household debt accumulation is reflected in gap between household loans and deposits
- Government funding schemes expire over next 2-3 years
- Wholesale markets are recovering, but aren't what they were in 2006-7



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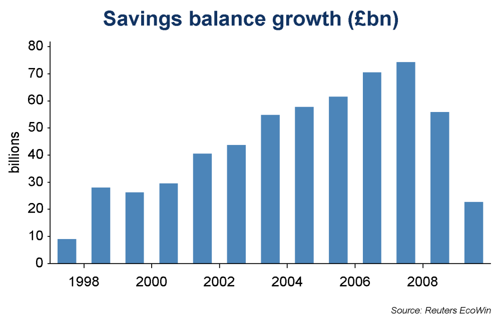
The big picture III – Funding cont'd

- Savings balance growth was £23bn in 2009, down from £74bn in 2007
- Early signs of life have begun to emerge in the savings market
- But balance growth will not be enough by itself over the next few years to close the funding gap



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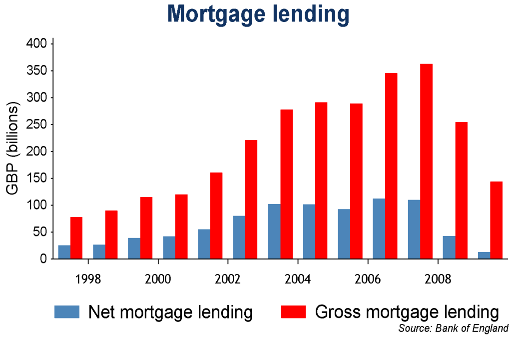
Prospects for mortgage lending I

- Net mortgage lending in 2009 was £10bn compared with more than £100bn in 2007
- Household balance sheet adjustment implies relatively modest net lending for the next few years



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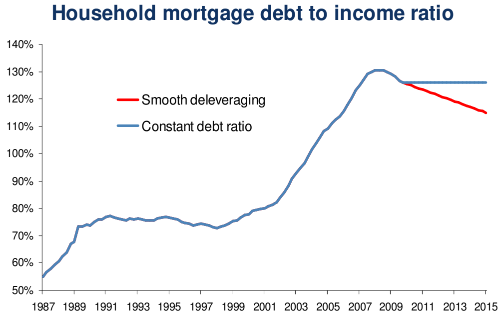
Prospects for mortgage lending II

- Medium term outlook depends on pace of household balance sheet adjustment
- If households continue smooth deleveraging, average net lending of around £10-15bn p.a. looks likely for next couple of years
- If households maintain mortgage debt to income ratio at current high level, average net lending of ca. £40bn p.a. is possible



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Implications for house prices

- 2009 showed that even with a very subdued mortgage market house prices can rise
- Lesson is that supply dynamics for second hand homes are key to the outlook
- Weak mortgage market makes another boom unlikely, and this wouldn't be desirable anyway
- Worst case scenarios for house prices have not materialised and look unlikely to unless interest rates jump sharply higher

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Conclusions

- Housing market has recovered more quickly than expected though price gains may start to slow down
- Household indebtedness and the funding gap suggest that return to a buoyant market is still some way off
- Market likely to be characterised by relatively thin volumes
- Impact on prices to depend on supply trends, particularly for second hand property

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