UK FINANCE

Household Finance Review – Q3 2020

The third quarter review captures the latest data on household activity and finances as the Covid-19 pandemic continues to dominate the landscape. Whilst the UK economy has recovered some of the lost output from the Q2 lockdown, many households are still feeling the major financial and social disruptions caused by the pandemic, with incomes coming under considerable pressure. Throughout the pandemic the financial services industry has worked with government to provide tailored support to households who have found themselves in financial difficulty. Here we look in detail at how the mortgage and unsecured lending markets have shifted as Covid-19 continues to impact on the UK.

Eric Leenders, Managing Director, Personal Finance comments:

"In third quarter of 2020 the economic and logistical impacts of lockdown receded somewhat, facilitating a strong rebound in the housing market, yet recent further regional lockdowns and tighter restrictions may dampen this to some extent.

"As the stamp duty holiday and current Help-to-buy schemes come to a close at the end of Q1 2021, demand for mortgages is likely to be inflated over the next couple of months - beyond that the outlook is uncertain.

"Unsecured borrowing continued to recover but, with consumer confidence still fragile and reduced day to day spending generating savings for some households, levels remain considerably below those seen before the pandemic.

"Payment deferral schemes have helped millions struggling with Covid-related income shocks. These will now remain in place into 2021, but with the uncertain employment outlook, there may be further pressure on households' ability to maintain existing credit commitments. Where customers still need support, lenders stand-by ready to help as required."

HIGHLIGHTS

- **House purchase lending in Q3 recovered strongly from the collapse in Q2 and, by September activity was nearly back to the levels seen a year ago.**
- **Applications data point to a possible return to annual growth in Q4, but the recent second wave of lockdowns may impact this.**
- **Purchase activity is likely to be strong in Q1 2021 as households seek to take advantage of lending support such as the Stamp Duty holiday and current Help-to-Buy scheme before their end-March closure; but beyond this point demand is likely to come under pressure.**
- **With industry and government support measures in place, including a moratorium on court possession proceedings, Q3 saw static arrears and minimal possessions and this is set to continue in Q4.**
- **Further demand for lender support is anticipated to increase next year as employment and incomes come under strain, but the fundamentals behind lending, together with lenders' forbearance tools, should help to mitigate payment problems.**
- **Unsecured borrowing has recovered somewhat in Q3, but with households still cautious against an uncertain economic outlook, levels remain well below those seen before the pandemic struck.**

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UK economic context and outlook

Economic activity in 2020 has been severely affected by the Covid-19 pandemic globally. With the UK and several other European countries re-imposing forms of lockdown in the autumn as the rates of infection have risen, the pandemic will be the key factor determining the economic outlook for the coming year.

The pandemic is not the only factor that will shape the economic outlook. At least three other factors will be of great importance for the UK economy – Brexit; decisions made about the public finances and how the labour market develops.

The pandemic, government policy and the public response to it have shaped UK economic activity in 2020. The lockdown and social distancing from late March led to an unprecedented fall in UK GDP of 20.4 per cent in the second quarter of the year. The lifting of the first national lockdown – but with continuing social distancing – resulted in a similarly unprecedented rise in GDP of 15.5 per cent in the third quarter. Even with this increase, however, the level of GDP was 9.7 per cent below that of the final quarter of 2019.

The UK has, of course, not been alone in suffering a massive drop in output, but it has seen the largest fall amongst the G7 economies. One factor in this has been the dependence on the service sector, which has been particularly hard hit by social distancing and lockdown measures.

Monetary and fiscal policy measures have been taken to support the economy, as they were in the 2007/08 financial crisis. Compared to that period, the scope for reducing interest rates was severely restricted, with Bank Rate at just 0.75 per cent at the end of 2019. Therefore, fiscal policy has played a larger role both in terms of the scale of the support and in the types of support given.

The National Institute of Economic and Social Research (NIESR) projects the fiscal deficit to rise from 0.6 per cent of GDP to over 14 per cent this year, an increase of over £250 billion. This will push the public sector debt-to-GDP ratio above 100 per cent for the first time since 1960-61. A considerable part of the increase in borrowing has been to fund furlough payments in order to maintain the attachment of employees to companies and prevent an even sharper increase in redundancies and unemployment.

At the same time, grants loans and guaranteed lending schemes have been made available to companies, loan payment deferrals arranged for individuals facing potential financial difficulties because of the pandemic and a Stamp Duty ‘holiday’ announced until the end of March 2021.

The extent of the recovery in economic activity over the next two years will depend on the pandemic and responses to it. For example, the late autumn lockdown is likely to turn what was an anticipated continuation of GDP growth in the final quarter of the year into another fall in output. Consequently, GDP is likely to fall by between 2 and 2.5 per cent in the quarter. When the lockdown ends there will be scope for a further rise in GDP, and recent news on the development of vaccines provide some basis for optimism about economic activity in 2021.

Even so, it is likely that it will be mid-2023 before UK GDP reaches the level it was at the end of 2019, and the unemployment rate is likely to rise once the furlough scheme ends at the March 2021. With considerable uncertainty about how the pandemic will develop, especially if the National Health Service (NHS) is put under acute pressure by the ‘flu season’ in the winter months, rising GDP in 2021 of around 6 per cent is likely but the economic picture will be a more complex one with rising unemployment.

The final negotiations over a trade agreement with the EU, post-Brexit transition period, are

being completed at the same time as several European economies, including the UK, have re-imposed lockdown measures in the face of increases in the number of Covid-19 cases. There is still considerable uncertainty about whether an agreement will be reached or whether the UK will move to World Trade Organisation (WTO) rules (a 'no deal' Brexit) for 2021.

Estimates from NIESR indicate that in the event of a 'no deal' Brexit UK GDP would be 1.5 per cent lower in the long run compared with a Free Trade Agreement (FTA), with most of this adjustment occurring relatively quickly (within three years). The difference may appear relatively small, but this highlights that most of the adjustment to exit from the EU single market is already taking place under a de facto FTA.

Combined with the uncertainty about Covid-19, this situation has led many businesses to continue to defer major investment decisions. Firms are investing in processes for trading in the new trading environment outside the EU but, in many instances, there remains a lack of clarity about the precise requirements.

There is scope and demand for increased public sector infrastructure spending on a range of projects, including green investment and those aimed to boost productivity and incomes in northern regions as part of the government's 'levelling up' agenda. As the economy is now operating below capacity, boosting public sector investment would be unlikely to draw resources away from the private sector by pushing up wages, prices and interest rates.

However, the need for increased spending on public investment now comes at a time when the position of the public finances has deteriorated dramatically. After almost a decade of fiscal policies that reduced the deficit and debt (as a share of GDP), the position has more than reversed within a year. With output expected to be below its pre-pandemic level in 2021 and 2022, the 'levelling up' agenda still at the forefront, and relatively high unemployment, fiscal policy will need to continue to provide support. However, continued low long-term market interest rates for government borrowing, and a list of skills and infrastructure projects, provide scope for such support.

At the same time, a debate has already started about the possibility of tax increases in the medium-term, aimed at reducing the debt ratio. With further resurgences of the pandemic possible, the government is unlikely to want to set early targets for any future fiscal consolidation. By March 2021, however, if a vaccination programme has begun and the outlook on Covid-19 is more optimistic, the government may need to consider a programme for moving towards restoring the public finances over the medium-term.

How the labour market develops over the next couple of years will also be a critical factor. While it is widely expected that unemployment will rise once the furlough payments cease, the implications for different age groups, skill levels and geographies will be critically important.

One additional uncertainty concerns how consumers will behave once lockdowns (of varying severity and geographical coverage) end. Voluntary social distancing, reduced public transport usage, increased online purchasing and the high level of working from home could continue. This could lead to protracted difficulties for the 'High Street' retail sector and changes in skill requirements to adapt to a changed economic environment.

Consequently, despite recent positive news on vaccines, the UK economy's recovery from the pandemic is expected to be fragile, with downside risks from a resurgence of the virus, the uncertain result of trade negotiations with the EU and the possibility of premature withdrawal of economic policy support.

After a particularly sharp fall in consumer spending this year of around 14 per cent,

NIESR predicts a rebound next year of around 8 per cent, with about 5 per cent growth in 2022 as the effects of the pandemic shock dissipate.

In view of the continuing uncertainty, a weaker rebound in private sector investment is anticipated, but public sector investment growth is set to remain strong.

The damage from the pandemic is likely to be felt most keenly in the labour market, with NIESR projecting unemployment to rise to around 2.6 million people, twice as many as in 2019. This translates to the unemployment rate rising to 7.5 per cent in 2021 before easing as the economy starts to recover.

With increased risks of both higher and lower inflation, the base NIESR forecast is for annual CPI inflation to pick up towards 2 per cent from just below 1 per cent this year. In such an economic environment, Bank Rate is likely to hold at its all-time low of 0.10 per cent.

However, for both households and companies, the key aspect of the financial environment is not the all-time low level of Bank Rate but the uncertainty over prospects for incomes and revenues, respectively. Many individuals have been supported by government schemes, but those in the service sector who have been severely restricted in their trading opportunities are finding further lockdown restrictions very damaging for their business prospects.

In summary, the broad short-term outlook for the economy is for a return to output growth in 2021 but with the likelihood of rising unemployment as government support schemes end. Issues around how the pandemic will develop and how people will react in the event of either further increases in the infection rate or the successful and widespread use of a vaccine make the economic outlook particularly uncertain.

Q3 2020 – predicted rebound in mortgage lending played out

As we observed in our previous Review, the mortgage market in the second quarter of 2020 was – like most elements of the UK economy – profoundly impacted by the pandemic. With the housing market closed through much of Q2, the path of house purchase mortgage completions changed abruptly from the broadly flat trend seen since early 2019, plunging over 50 per cent compared to levels seen a year previously.

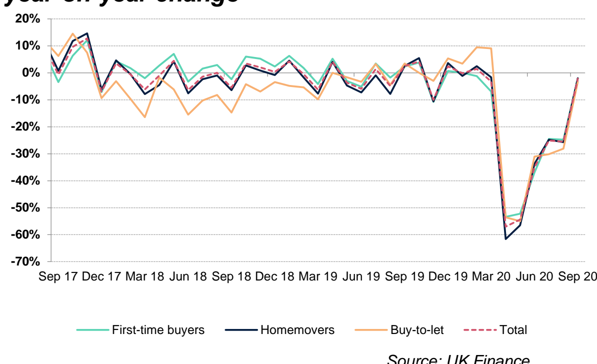
However, we also pointed to a very strong V-shaped pattern in our forward-looking mortgage applications data through the quarter. In April and May, with housing markets closed across most of the UK, demand for mortgages collapsed by between 60 and 70 per cent year on year. The reopening of the housing market in England in May triggered a surge in activity back to modestly positive annual growth in June.

Wales, Scotland and Northern Ireland, having reopened their housing markets some weeks after England, started to rebound commensurately later, and June's applications data in these geographies still showed significant double-digit annual declines.

In any given period not all applications will complete, for a variety of reasons. Nonetheless, the strength of the June applications numbers pointed to at least a partial if not complete recovery to the previous stable trend in mortgage completions in Q3.

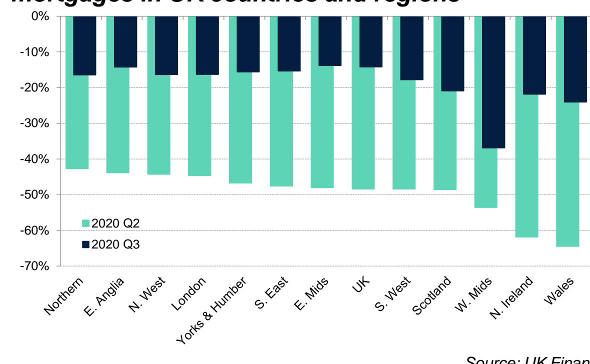
As ***Chart 1*** shows, the V-shaped path of applications fed through to a partial recovery which gained momentum through Q3. By September, despite the continuing widespread income and employment shocks caused by Covid-19 and the necessary social distancing measures, completions had recovered to just shy of the levels seen a year previously.

Chart 1: Number of mortgages for house purchase, year-on-year change



Source: UK Finance

Chart 2: Year-on-year change in new house purchase mortgages in UK countries and regions



Source: UK Finance

This recovery represents a strong and rapid return to trend – albeit a broadly flat one. However, this does not yet recover the lost activity that we might have seen.

Were we to assume that, absent of the pandemic, 2020 would have continued the stable pre-Covid-19 trend, a ballpark estimate suggests some 130,000 purchase loans did not take place between April and September, compared to the number that might have otherwise completed in those six months.

Of course, this does not mean that all of those transactions would have taken place, but it is useful to temper any "return to trend" observations with the point that, regardless of the Q3 rebound, total house purchase mortgage activity for the first nine months of 2020 is nearly a quarter lower than in the same period in 2019.

Extent of rebound consistent across most of the UK

As volumes recovered through Q3, most English geographies saw broadly similar rebounds. However, as the profile of applications through Q2 suggested, the later re-openings of housing markets in Wales, Scotland and Northern Ireland meant that the resumption of mortgage activity came later, and has not yet flowed through to completion to the extent we have seen in England (***Chart 2***).

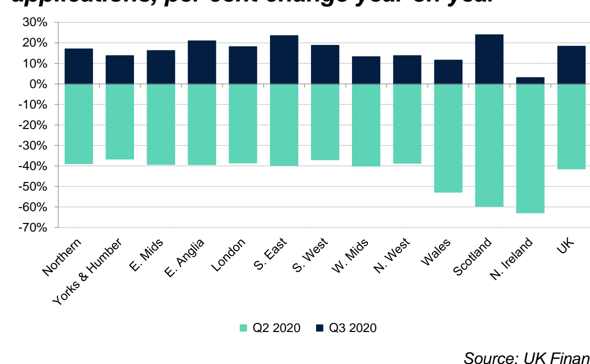
One exception to this consistent picture is the West Midlands, which saw a slightly deeper decline in Q2 than other English regions and has also seen a weaker path to recovery thus far. Residential house purchase completions in the region were 37 per cent down year on year in Q3, following a greater-than-average 54 per cent decline in Q2.

Birmingham and the surrounding geographies have been hit particularly hard by both Covid-19 and its economic impacts, and the weakness in the housing market there reflects this.

Prospects for Q4

The path of mortgage applications data for Q3 points to Q4 continuing the recovery path seen since housing market restrictions were lifted. (***Chart 3***).

Chart 3: Number of residential mortgage applications, per cent change year on year



Source: UK Finance

In Q3 overall, mortgage applications indicated robust demand in every region and country in

the UK. Northern Ireland, which as we observed previously, experienced the largest contraction in Q2 (63 per cent) and reopened its housing market later, had recovered to a marginal 2 per cent increase in Q3. Otherwise, all regions saw double-digit annual growth.

Of particular note is the growth in applications in the South East and in East Anglia (24 and 21 per cent respectively). This chimes with reports of increased demand for properties further out in the commuter belt and beyond which are well-suited to a substantial period of social distancing and homeworking.

Following the path from applications to completions that we saw from Q2 into Q3, we could expect that Q4 will see a consolidated return to completions growth across most if not all of the UK. However, as we noted in the Q2 review, further outbreaks of Covid-19 and associated lockdown measures have the potential to disrupt any potential return to growth.

The localised lockdowns, including those in Liverpool and Leicester, and the subsequent national lockdown across England in November, are a materialisation of exactly these risks. At the same time as England entered this new regime, Wales was emerging from its own "firebreak", whilst Scotland and Northern Ireland were also operating tighter social distancing restrictions.

Against this disruptive backdrop, the paths of the regional housing market recoveries are likely to be further delayed and distorted. Even though housing markets remain open, the economic and social aspects, both of the rise in the infection rate and the associated lockdown measures, are likely to have negative impacts on household finances and confidence that bear down again on activity levels.

Notwithstanding this we anticipate Q4 showing a return to annual growth in completed mortgages, as the backlog of paused transactions unwind further. Additional stimuli, in the form of the stamp duty holiday and the approaching end of the current Help-to-buy scheme have increased demand to complete mortgages before the end of March next year.

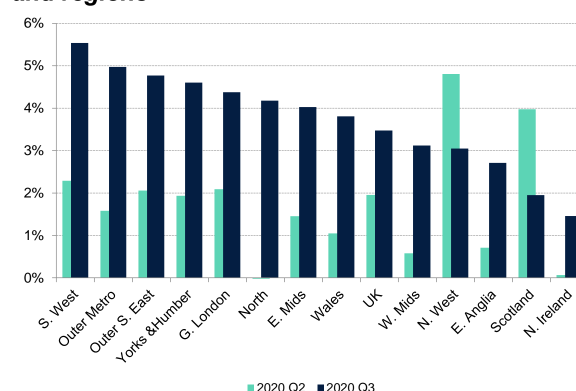
House prices have remained strong through the crisis

One perhaps unexpected feature of the housing market through this year is that, despite massive disruption to activity, volatile levels of confidence and significant strain on household incomes, house prices have been remarkably resilient.

In Q2, prices were showing modest annual growth – 2 per cent or less in most regions. However, increased demand in Q3 from the factors set out above has driven price growth upwards in all regions apart from the North West and Scotland. The southern English regions, in particular, have all seen around a doubling of the rate of price growth to between 4 and 5 percent in Q3 (***Chart 4***).

The strength in these southern regions may be, in part, due to the "race for space" effect as homebuyers with resources to do so compete for "lockdown-friendly" properties.

Chart 4: House prices, annual change, UK countries and regions



Source: Nationwide Building Society

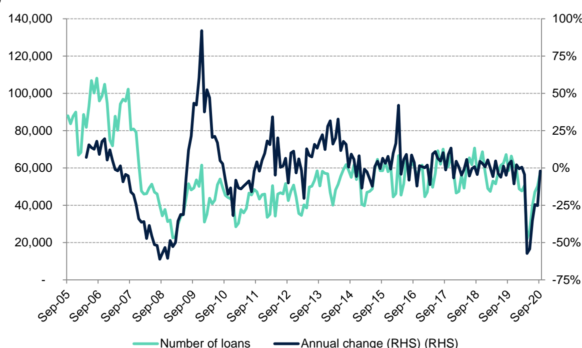
A comparison with the Global Financial Crisis

When assessing the impact of these unprecedented events or their potential impact on the shape of the market going forwards,

historical comparisons can only be of limited use as there is no comparable period in living memory. However, a comparison with the market downturn following the Global Financial Crisis (GFC) does draw out some points which may be useful, if only as a guide for what not to expect.

Chart 5 below shows residential house purchase activity from before the GFC through to the present day. This shows that the collapse in lending as the credit crunch took hold was not instant. Lending turned negative (year on year) in March 2007, but this did not reach its nadir until August 2008.

Chart 5: Number of new loans for residential house purchase



Source: UK Finance

By contrast, the collapse in lending earlier this year was from effectively zero annual growth to around the same percentage contraction as seen in the GFC, but it took just one month to reach that point, as the housing market closure effectively brought purchase activity to a near-standstill.

The subsequent recovery path is equally contrasting. Through the GFC, lending showed annual contractions for 26 straight months from May 2007 through to June 2009 whereas, should current trends continue, lending growth may recover back to the previous flat trendline by the end of the year.

Clearly, the current situation is very different from the credit crunch, as are the market fundamentals in the period leading up to the lending collapse. However, the relevant point is that what we have seen this year *is not a downturn and its subsequent recovery*.

Rather, at this stage at least, it reflects a market interruption. In large part this is a mirror image of the pattern we typically see in the run-up to a change in house purchase or mortgage taxation.

For example, when a Stamp Duty holiday nears its end date we typically see a surge in brought-forward activity, followed by an immediate drop-off in volume following the end of the holiday, as the activity that would normally have happened in those months has already taken place.

What we saw in Q2 and Q3 is largely the reverse of this – delayed activity from Q2 taking place instead in Q3, along with the "normal" activity we would have seen in the quarter.

However, this is not the whole story; whilst the numbers show an almost complete recovery (to flat trend) by September, this reflects only that immediate effect of the reopening of housing markets, allowing those delayed transactions that were still in a position to complete to do so.

What is unclear is the extent to which the approximate 130,000 fewer transactions so far this year will subsequently become completions in the coming months as the backlog fully unwinds, and how much is entirely lost volume, from those consumers who have been adversely affected by the health, social or economic impacts of the pandemic.

This unknown element presents a significant obstacle to assessing future market prospects. These impacts were felt through the first national lockdown in March and beyond, and the second wave of lockdowns are likely to exacerbate this. However, with continuing government support schemes –most notably the Job Retention Scheme (JRS) –supporting incomes and minimising permanent job losses,

the underlying market impacts of the crisis have been mitigated.

How permanent this mitigation – and therefore how fully the market will recover the activity lost due to market closure and other Covid-19 related factors – depends heavily on the extent to which job losses following the end of the JRS early next year are recovered.

Whatever the trajectory of the labour market, it looks likely that 2021 will see muted levels of house purchase activity. A positive scenario would see Covid-19 and lockdown-related unemployment spiking in Q4 this year or Q1 2021, then fading rapidly as furloughed employees return to work and redundancies are reversed with compensating recruitment within each industry, if not from the same firms. Given this path, the fall in activity levels would be modest, potentially limited to 2021 with return to trend the following year.

However, in a less optimistic scenario unemployment may prove more widespread and persistent, with firms and/or industries, including those that were already struggling pre-Covid-19 not recovering swiftly after the profound income shocks of 2020.

In such a scenario, purchase activity would be more constrained, with a smaller pool of households able to enter or move in the housing market. However, the areas of the mortgage market most impacted depends on which segments of the labour market are hit hardest.

What lies ahead for First-time buyers?

A key feature of the mortgage market in recent years has been the consistent relative strength of FTBs, who have been the principal beneficiaries of demand stimuli. By contrast, Buy-to-let (BTL) investment has been constrained by a series of tax and regulatory measures, whilst homemover numbers remain around half the peak levels seen prior to the GFC.

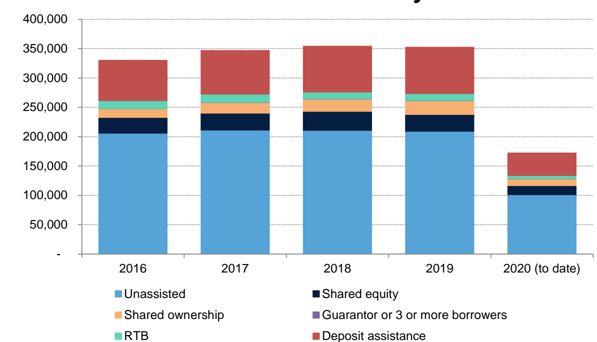
As we look forward to the possible shape of things beyond the current turmoil, it is useful to look in a little more detail at the composition of FTBs within overall numbers, to better evaluate future borrowing prospects.

Chart 6 below sets out the relative importance of different FTB segments.

It is important to note that this is partly illustrative – in particular the identification of unassisted buyers versus those buying with deposit assistance (most commonly a gift or loan from family) is based on a calculation of whether the size of deposit put down is one which that borrower could reasonably have saved in their working lifetime.

In each year – including this year, even as the pandemic has dominated all other market considerations – around six in ten FTBs look to have been able to buy without needing help from either an assistance scheme or the 'Bank of Mum and Dad'.

Chart 6: Breakdown of first-time buyers



Notes:
1. *Shared equity and shared ownership include both Help-to-buy and private schemes*
2. *Unassisted and assisted borrowers are based on a comparison of deposits versus plausible lifetime savings.*
3. *Both unassisted and assisted borrower segments exclude any accessing any of the other schemes shown in the chart*

Source: UK Finance

However, the flipside of this is that four in ten buyers have help, either from a government or private scheme or from direct deposit assistance.

This is not to say that any assistance taken is always necessary; research suggests that at

least some using Help-to-buy could have bought outside the scheme and were perhaps using the scheme to buy “bigger, and sooner.”

However, it is likely that the majority of FTBs taking assistance of whatever kind could not have made the same purchase, or potentially not been able to buy at all, without that help.

Looking forward to next year then, a number of factors may impact on the profile of FTBs in the market. Firstly, the current Help-to-buy scheme comes to an end in March, and the follow-on scheme is more restrictive in terms of regional house price caps which, apart from in London, are lower than in the current scheme.

Second, there is the disproportionate economic impact of Covid-19 on younger working cohorts. Younger workers, particularly those on lower incomes, are more likely to have been furloughed or lost their jobs.

As set out above, the path of unemployment as we emerge from lockdown and, eventually, from the pandemic itself, remains to be seen. However, even if the labour market recovers quickly, many will have seen a material loss of income through the pandemic. This is likely then to bear down on the numbers of would-be FTBs who might have been looking to buy without assistance over the next year and possibly beyond.

Although young workers may have felt the economic impacts of Covid-19 most acutely, the effects have been widespread and many amongst older cohorts will have found their own finances more stretched. This in turn may well impact the ability of parents and grandparents to gift or lend deposit sums to their children or grandchildren.

The extent of these factors is, at this stage, unknown and will remain so until Covid-19 and social distancing requirements start to recede more fully. Regardless of this, however, these factors are likely to combine to subdue FTB activity levels to some degree next year.

A further observation on the outlook for younger households relates to the BTL market. The rental market is often thought of as being somewhat countercyclical; that is, when households are not in a position to buy they will need to rent, which leads to a buoyant Private Rented Sector (PRS) and, within this, the BTL mortgage market.

However, in a more pessimistic employment scenario, this has the potential to break down. In the example of the 1990s downturn, a significant number of households disappeared entirely rather than demand shifting to the PRS. In other words, people moved in with other households – typically family members – as incomes could no longer support either rent or a mortgage.

In such a scenario, both FTB and BTL demand are more severely constrained, reducing two key elements of liquidity at the bottom of the housing market. This in turn hampers the formation of housing chains, constraining the ability of potential homemovers to sell.

Added to all of this, although less front-and-centre than the same time last year, is the fast-approaching new year, when the UK will have a new trading relationship with the EU.

At the time of writing, the shape this will take remains unclear. However, it is likely that any new relationship will come with greater frictions and costs than we have today. To the extent that this puts downward pressure on employment and incomes, this may reduce demand in the housing market.

The outlook then, whilst very uncertain in magnitude, points towards a more muted purchase market, with any declines seen more acutely within the FTB sector.

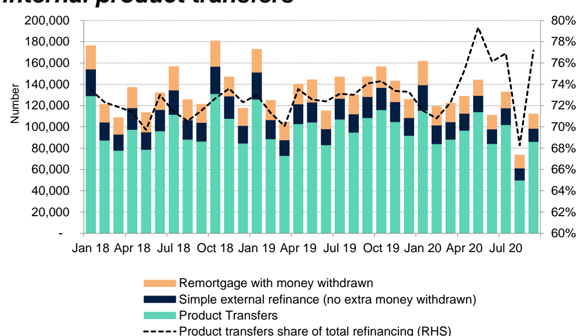
Internal Product Transfers continue to dominate refinancing

In contrast to house purchase activity, refinancing had held up relatively well in Q2, with significant falls in external remortgaging

largely offset by modest growth in internal Product Transfer (PT) activity.

PTs then continued to increase year on year in October, but then also turned sharply negative (year-on-year) through the rest of Q3, although less so than the decline in external remortgaging. Overall, refinancing activity fell by 25 per cent in Q3, compared to the same quarter last year. ***(Chart 7*)**.

Chart 7: Number of residential remortgages and internal product transfers



Source: UK Finance

The relative resilience of refinancing activity through 2020 stems largely from the fact that its principal driver is the schedule of mortgages currently on an incentivised deal rate (mostly fixed) coming to an end, when customers typically shop around for a new deal.

The notable difference this year, which has persisted in Q3, has been this increasing trend towards internal PTs which, as we observed in the Q2 review, are particularly well suited to the socially-distanced UK of 2020, given they can be carried out with minimal effort and person-to-person interaction.

Another driver of the relative strength in PTs is the industry agreement to permit PT transactions for customers currently on a mortgage payment deferral. This has allowed many customers whose incomes have taken a hit through the pandemic to put one of their most (if not the most) significant credit commitments onto a new deal rate.

Since the start of the first lockdown, PTs have accounted for 76 per cent of all refinancing transactions.

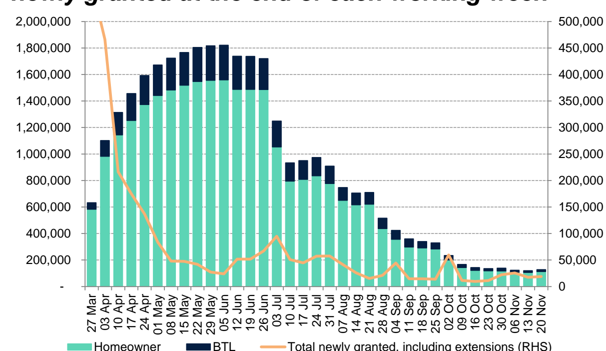
Covid-19 related payment deferrals

At the start of the first lockdown, the mortgage payment deferral (PD) scheme dominated activity in the mortgage market, with over a million deferral applications processed and granted within the first two weeks of the scheme's commencement on 19 March. The pace of take-up lessened after that point, reaching a peak of a little over 1.8 million mortgages – some 17 per cent of all mortgages outstanding – by early June.

Since then this has followed a downwards "sawtooth" pattern, with the number of PDs in place rising modestly through each month as some PDs reach their end date but more are taken out or extended. A more significant fall takes place at month-end, when many lenders' systems are set up to take mortgage Direct Debits (and so marks the expiration of greater volumes of PDs).

In the Q2 Review we noted the potential for a final spike in the number of PD applications as the original 31 October scheme end date approached. In fact, we saw only a modest pick-up in requests and, as at 20 November, only an estimated 127,000 PDs remained in place (***Chart 8***).

Chart 8: Number of payment deferrals in place and newly granted at the end of each working week



Source: UK Finance

As we also noted in the Q2 Review, any significant spikes in the infection rate and associated local or regional lockdowns have the potential to trigger further material increases in customers requesting PDs before the scheme ended.

With the second lockdown in England coming into effect in early November (and subsequent financial support for impacted local businesses), the end date of the PD scheme has now been extended. This will provide important financial help for customers impacted by the continuing spread of Covid-19 through lockdown and beyond, with the scheme currently remaining open for new applications and extensions until the end of March 2021.

However, borrowers will still only be eligible for a maximum of six months-worth of PD, which will likely limit the reach of the scheme extension.

It is reasonable to assume that those who most needed help with their mortgage payments during the first wave of infections and lockdown are likely to be impacted in similar ways now but, as per regulatory guidance, will not be able to take a further scheme PD if they have already taken the full six months.

There will be borrowers who were able to cope without needing help through the earlier lockdown but have since used up whatever "rainy day" financial resources they had, and the extension of the scheme will help these customers, as well as any whose incomes have only now been adversely affected. However, considering the scale of the initial wave of take up we do not anticipate a surge in PDs to the extent that we saw in early Q2.

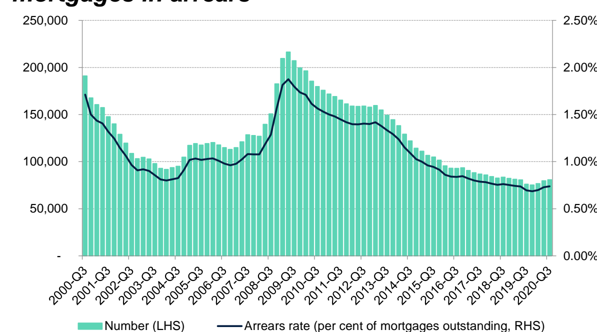
For those borrowers who have already taken six months of deferrals under the scheme, lenders will look to their existing range of Business-As-Usual (BAU) forbearance measures, as agreed with the FCA, to identify the best way to help each customer on a case-by-case basis.

Support for customers ensures arrears remain near historic lows

As we saw in Q2, the extent of Payment Deferrals granted to customers, in conjunction with the JRS, has ensured that what would otherwise likely have been very significant increases in mortgage arrears did not materialise. In Q3, with both schemes still in place, this continued and there was only a modest rise in arrears cases ***(Chart 9)***.

Overall, there were some 80,270 mortgages in arrears at the end of Q3, a rise of just 420 from the figure at the end of Q2, and 4,130 increase (5 per cent) compared to Q3 2019.

Chart 9: 1st charge homeowner and buy-to-let mortgages in arrears[1]



Source: UK Finance

Notes: 1. Arrears measured as those representing more than 2.5 per cent of outstanding mortgage balance

Any increase of customers in arrears is a concern. However, following a decade of almost uninterrupted declines from the previous peak in summer 2009, arrears rates remain very close to historic lows. At such low levels, any increase is liable to appear more significant, but only in percentage terms.

Within the overall rise in Q3, the vast majority was concentrated in the BTL sector, with total homeowner arrears essentially static. However, we did see shifts in the profile of arrears within the homeowner sector.

Less entrenched arrears cases fell by a little over a thousand in the quarter, offset by an almost identical rise in the more serious arrears bands. Therefore, although overall

homeowner arrears are currently not rising, the profile has been shifting incrementally towards customers experiencing longer arrears periods.

As with all other aspects of the mortgage market, the path of employment and incomes as we emerge from the worst of Covid-19 and the support measures come to an end, will play a key role in determining the path of arrears.

Some increase in unemployment next year is almost inevitable, but its extent or duration are very difficult to predict until after the support measures end. However, there are some factors which are likely to help to mitigate the transmission from unemployment to mortgage payment problems.

Firstly, following a protracted period of ultra-low Bank Rate and strong competition in the market, most mortgage customers are on low rates.

Additionally, the more stringent affordability assessments in place since 2015 ensure borrowers have a buffer against unexpected shocks to income or outgoings.

This buffer will help those customers whose income has taken a partial hit to maintain their mortgage payments. For those who have been more severely impacted the continuation of the PD scheme, together with lenders' own BAU forbearance measures, will further help to mitigate payment stress.

Taken together, these factors should help temper any employment-related rise in payment problems and keep arrears levels lower than they might otherwise have been, had the pandemic struck in a previous housing market cycle.

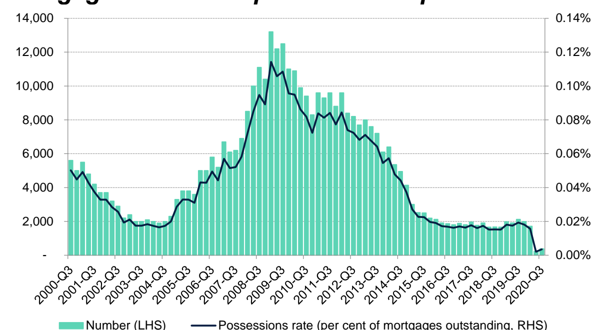
However, there are significant downside risks to this. Should unemployment prove more significant and/or protracted, many more customers could find themselves in difficulty.

In contrast to the previous downturn, Bank Rate is already barely above zero. Further rate cuts (potentially into negative territory) would not help the majority of mortgage customers who are currently on fixed rates. Additionally, even if rates were to go negative, the extent of a cut would be unlikely to be of material benefit to the minority of borrowers on variable rates.

Possessions activity remains close to zero

The moratorium on court possession proceedings, which came into effect in March 2020, remained in place through the entirety of Q2 and Q3. The result is that we have seen two full quarters of virtually no possessions ***(Chart 10).***

Chart 10: Number and proportion of 1st charge mortgages taken into possession in period



Source: UK Finance

There were a total 390 mortgage possessions in Q3, the majority of which were in the BTL sector. With the moratorium in place, virtually all possessions that occurred have been voluntary – at the borrower's request.

At the time of writing a new moratorium on evictions was set to come into force along with the extension of the PD scheme. However, even with the courts now open for possession proceedings, almost none have been brought by lenders at this stage, barring exceptional circumstances.

Additionally, UK Finance has been able to confirm that its members have agreed to continue the industry's long-standing practice of ceasing possession activity in the run-up to Christmas, ensuring that December will continue to see minimal possessions through to 11 January 2021.

These measures ensure that very few borrowers lose their home as a result of mortgage payment difficulties in this year of social and economic crisis.

However, this also means that next year, there will be a backlog of possessions that had been paused in the crisis. After the emergency measures are lifted, we are likely to see elevated numbers of houses being repossessed, as the possession activity that would otherwise have occurred since March 2020 unwinds.

Whilst some of these cases will have been able to either repair their position or exit their mortgage via a different route in the intervening period, this is unlikely to be a significant number. As such, we are likely to see increased possession numbers in 2021 which largely do not relate to payment problems triggered by Covid-19, but were already in the pipeline before the pandemic struck.

Looking further out, the path of possessions is likely to follow that of mortgage arrears, but with a lag as lenders will only take possession from a customer in arrears as a last resort. once all other options have been exhausted.

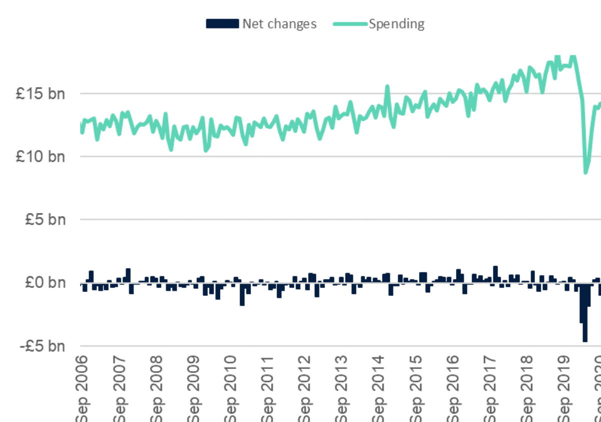
So, to repeat a theme peppered throughout this Review, much depends on the future path and shape of the labour market through the next couple of years.

Unsecured Borrowing – Credit Cards

Credit card borrowing accounts for around half of all unsecured credit provided by banks and building societies. As reported in our previous Review, spending on credit cards contracted by 25 per cent in Q2 compared to the previous year as lockdown restrictions resulted in a sharp drop in spending in many sectors, including hospitality, entertainment and travel.

As lockdown restrictions eased, towards the end of that quarter and more parts of the economy began to open up, new borrowing started to increase again. In Q3 this trend continued, with borrowing reaching £14.2 billion at the end of Q3, compared to £8.7 billion at the peak of lockdown in April (***Chart 11***).

Chart 11: Credit card spending and net changes in balances outstanding



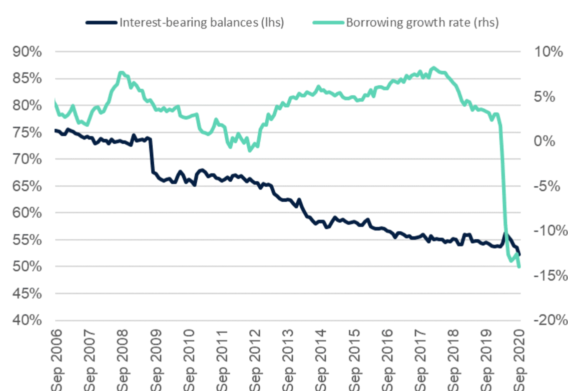
Source: UK Finance

Overall credit card borrowing in Q3 2020 was 17 per cent lower than a year previously. While still at low levels, credit card spending has increased by 17 per cent compared to the end of Q2. This reflects lockdown restrictions easing as well as some tentative signs of improving consumer confidence.

Chart 12 illustrates the changes in borrowing on cards – with the initial drop in April mirroring the fall in spending, and also the proportion of interest-bearing credit cards. Over the past decade, the proportion of card balances bearing interest has halved as more credit card customers pay off balances in full when they receive their monthly statements. There has also been a rise in the number of customers using direct debits to pay off their balances in full each month, lowering the level of outstanding balances.

At the start of Q2 there was a small increase in the percentage of credit cards bearing interest. Since then this metric has fallen and now sits at 52.3 per cent as at the end of Q3, the lowest level on record. This decline indicates that consumer repayments are continuing to outstrip new lending, with many customers opting, because they had significantly reduced outgoings, to pay down debt in the current environment.

Chart 12: Annual growth in card borrowing and proportion of balances bearing interest



Source: UK Finance

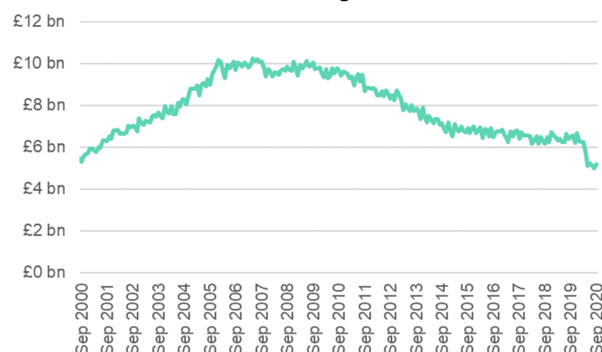
Echoing the extension for the mortgage payment deferral scheme, the end-date for the credit card PD scheme has also been pushed back (new applications and extensions to current deferrals to end March 2021 with a long stop date of 31 July), as the second English national lockdown was put in place. Since the start of the scheme, 1.17 million credit card PDs have been granted. However, echoing the downward path seen in mortgage PDs since June, as of 19 November only 58,000 remained in place.

Unsecured borrowing – Overdrafts

Borrowing through personal current account overdrafts with banks and building societies had fluctuated around a peak level of around £10 billion between late 2005 and 2009. Since then, the level of overdraft borrowing gradually decreased to just over £6 billion by the end of 2015 and remained at similar levels until early this year (***Chart 13***).

However, in Q2 2020 overdraft borrowing fell sharply to £5.2 billion, and was still at this level at the end of Q3 2020. The initial fall in overdraft borrowing in Q2 can be attributed to some customers flexing their household budgets in the face of an uncertain Covid-19-dominated backdrop, to repay borrowing in conjunction with the lower spending we have observed.

Chart 13: Overdraft borrowing



Source: UK Finance

Due to lockdown some customers will have had lower expenses, including reduced travel costs, as well as less opportunity to spend on non-essential retail or social events. Some may have opted to use these additional savings to pay off any outstanding debts. Whilst other forms of borrowing such as personal loans increased in Q3 compared to the previous quarter, overdrafts have remained stable. This suggests that overdraft borrowing is often seen as a final option when compared to that on credit cards and loans.

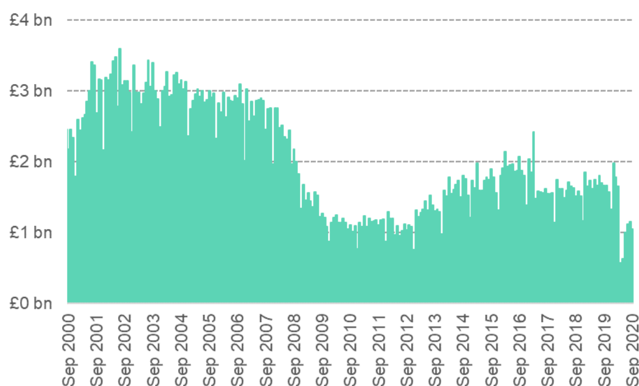
It should also be noted that, in addition to credit card payment deferrals, many organisations have provided customers with personal current account fee-free, interest-free overdraft buffers up to £500. Just over 27 million personal current account holders have had this borrowing relief applied to their account.

Unsecured borrowing – Personal Loans

Demand for personal loans rebounded in Q3 2020 after a steep fall the previous quarter, with gross lending up by 51 per cent (***Chart 14***). The Q2 decline was largely driven by the adverse economic environment, with lower levels of consumer confidence and fear of rising unemployment seeing consumers cautious in taking on additional debt. While this has rebounded as the first lockdown restrictions lifted and economic sentiment increased, it should be noted that gross lending was still just a third (36 per cent) of

what it was a year previously. This suggests that, despite the increase over the previous quarter, consumers remain cautious of taking on additional debt as the effects of the pandemic play out.

Chart 14: Amounts of new personal loans from banks



Source: UK Finance

As with credit card borrowing, new applications and extensions to current Covid-19 payment deferrals have been extended for personal loans until the end of March 2021 with a long stop date for deferrals of 31 July 2021. Since the start of the scheme, 823,000 million personal loan PDs have been granted but, again, the number in place has dropped away significantly since peaking in the summer. As at 19 November only 27,000 PDs remained in place.

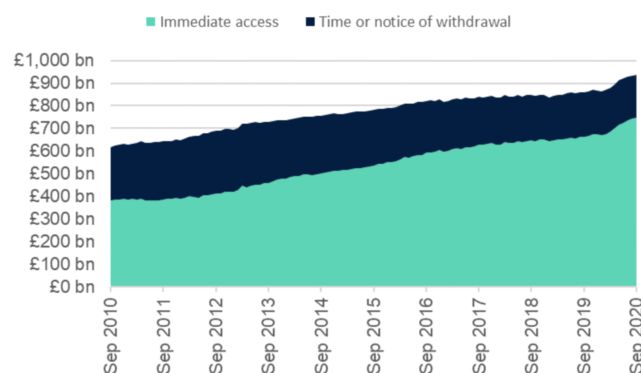
While this is likely to translate into an increase in amounts outstanding in Q4, it will take some time to see how the various payment deferrals on mortgages and unsecured lending interact at the individual customer level. It will also be important to understand how customers have chosen to use the flexibility of these support measures to manage their personal finances through the current crisis.

Deposits

Recent years' data have signalled a build-up of savings by households. However, these savings have largely been held in easy access accounts, with the low interest-rate environment (both current and expected future rates) dampening demand for term products.

Chart 15 shows that over the third quarter of this year deposits continued to grow. During the first half of 2020 many households saw their regular outgoings substantially lower because of COVID-related restrictions, but have also looked with increased uncertainty at their future finances and employment prospects and postponed or forgone spending, resulting in a steep rise in savings of 5 per cent over this time.

Chart 15: Personal deposit account balances



Source: UK Finance

In Q3 as the economy showed signs of improvement this rise slowed, though total personal deposits still grew by 1.9 per cent. This suggests that households remain cautious, which tallies with recent consumer confidence indices that indicate increased plans to save, and with economists' expectations of a growth in the savings rate during the pandemic.

Deposit growth in Q3 was again confined to immediate-access accounts, with time deposits actually falling by 2.7 per cent. Households have chosen to prioritise the ease of access of savings in these accounts in uncertain times over the rates of returns held in fixed accounts such as ISAs, with the total amount of savings held in in ISAs declining by £1.6 billion over the quarter.

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