Household Finance Review – Q2 2021

This review explores trends in household financial activity through a quarter where optimism increased as the country began to reopen ahead of a return to a new normal in early Q3 on the back of the ongoing vaccination programme. Although many households have seen their finances come under pressure, the financial services industry has worked with government to support those who have found themselves in difficulty. Here we look in detail at how the mortgage and unsecured lending markets have performed as the country continues to emerge from the upheavals of the past 18 months.

Eric Leenders, Managing Director, Personal Finance comments:

"There was unprecedented demand in the housing market in Q2 2021 as people sought to take advantage of the Stamp Duty holiday, with changes to working and living patterns encouraging more homeowners to use their existing equity, either to move further afield or to fund additional house purchases for themselves or family. With the holiday now in its final tapering phase, demand was expected to decline, however applications towards the end of the quarter and into Q3 remain higher than before the pandemic began, as we continue to witness the "race for space".

"As Covid restrictions lifted the boost in consumer optimism was evident through modest increases in card spending and in unsecured borrowing.

"The continuing support provided by government and the banking sector for households' impacted by the pandemic has prevented significant increases in arrears. As the UK emerges from lockdown and these schemes end most households will be able to resume normal payments. However, for those who are not

HIGHLIGHTS

- **House purchase lending volumes in June reached the highest monthly level on record, with Q2 2021 house purchase the highest quarterly figures in 13 years.**
- **Credit card spending and personal loan take-up have increased as the hospitality and entertainment industries reopened & consumer confidence was boosted. However, levels remain relatively supressed as some consumers displayed caution and international travel remained restricted.**
- **While loan-to-income ratios for new house purchases have increased, new borrowers remain in a strong position in the event of further economic stress, with record low monthly payments fixed for longer periods and responsible lending rules ensuring loans remain affordable.**
- **Total levels of savings increased but show signs of slowing as the country reopens and savers start to spend larger proportions of their salaries on travel/leisure.**
- **Although arrears levels remain at low levels, the winding down of the Covid Job Retention Scheme & withdrawal of the temporary increase to Universal Credit in Q3 may cause some customers who do not return immediately to full employment to encounter increased payment difficulties.**

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immediately able to return to full employment, lenders stand ready to help with tailored support to best suit customers' situations."

UK economic context and outlook

There has been a significant improvement in the economic context to this quarter's Household Finance Review (HFR). Following the contraction in the economy of 1.6 per cent in the first three months of the year, GDP rebounded in the second quarter, posting growth of 4.8 per cent. This meant that, in June, the gap with pre-pandemic levels of output had narrowed to just over two per centage points. This economic turnaround was underpinned by the ongoing rollout of the vaccine, which in turn ensured that government was largely able to stick with its roadmap to reopen the economy. While we did not see the end of all restrictions in June, large swathes of activity were able to re-start and most sectors began to return to something closer to pre-Covid norms.

In Q2 2021 the largest contribution to growth came from household consumption, which contributed 4.1 percentage points to the 4.8 per cent increase following the easing of coronavirus restrictions compared with the previous quarter. Nevertheless, household consumption was still some seven per cent lower than before the pandemic. Further analysis from Office for National Statistics (ONS) showed large contributions to consumption from spending in restaurants, hotels and transport – all benefitting from the lifting of restrictions.

This, in turn, fed through to strong growth in consumer facing sectors, such as the wholesale and retail trades, accommodation and food services, and education, which provided the largest quarterly contributions to services output growth. There has also been significant movement in the proportion of businesses now open and trading in these sectors, particularly hospitality and leisure. As businesses re–open, the number of employees on furlough has declined – to 1.9 million at the end of June, a drop of over half compared with the end of Q1 2021.

In addition to employees returning from furlough, there are a number of other positive signals emerging. Continued recovery in labour market prospects since the start of the year can be seen in the fall in the unemployment rate to 4.7 per cent in Q2 2021 from 4.9 per cent in Q1 2021. Redundancy rates have returned to the low levels seen pre-pandemic and vacancies hit a record high in the three months to July, with all sectors contributing to the rise and notable year-on-year growth seen in consumer-facing services. While average earnings, which accelerated by nearly nine per cent in the year to the three months to June, are affected by the fall in wages during the first lockdown a year ago and compositional effects relating to a lower share of lower income employees in the sample, the underlying picture is nevertheless robust.

Improvements in the economy have further increased consumer confidence with the GfK index posting its highest reading since the onset of the pandemic. While consumers remain cautious about the outlook over the next year, there was a sizeable jump in the major purchase component of the index signalling the potential release of pent-up demand as retail sectors reopen. With a large accumulation of savings over the past year, the conditions remain for a continuation of the consumer driven recovery seen in Q2 2021.

Pertinent to the HFR are recent trends and the outlook for house price growth. The ONS house price index increased by over 13 per cent in the year to June, the fastest growth rate since 2004. At least part of this rise has been supported by the government's Stamp Duty holiday, but also changes in working patterns driven by the pandemic (discussed in the Q1 2021 HFR). As the Stamp Duty concession will be removed at the end of September, house price growth should moderate through 2022.

There are, however, some clouds on the horizon. When the furlough scheme closes in Q3, this has the potential to create uncertainty in the labour market, due to the mismatch between sectors with large numbers still on furlough and those likely to continue recruiting. This is expected to lead to a pick-up in job losses in the latter part of this year and the unemployment rate is forecast by NIESR to peak at 5.4 per cent in the final quarter of 2021.

In addition, inflation has been on the rise in recent months, posting its fastest pace of increase in June since mid-2018. While the Consumer Price Index including owner occupiers' housing costs (CPIH) moderated in July due to base effects, its upward trajectory is expected to resume in August. Many of the contributors to rising inflation reflect the downward trajectory in many elements of the index a year ago, when the economy was still in the first lockdown. There was a significant upward contribution from transport costs in the year to June due, in large part, to rising fuel costs, which were declining this time last year. Similar base effects can also be seen in restaurants and clothing, which also pushed inflation higher. Further upward pressure came from owner-occupied housing costs (included in CPIH), notably the increase in the energy price cap in April. Further increases are expected in the coming months, and while much of this is predicted to be temporary, there will still be an impact on real income growth, particularly for those on lower incomes.

However, with inflation expectations remaining anchored and the economic recovery still taking root, the Bank of England is not expected to move quickly to raise interest rates. Market expectations are currently for the first rate rise to come in later 2022.

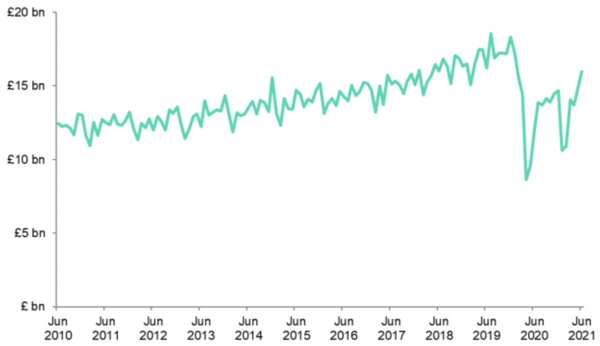
Forecasters have continued to upgrade their outlook for GDP growth this year. The National Institute for Economic and Social Research (NIESR) now expects the UK economy to expand by 6.8 per cent this year up, up from its forecast of 5.7 per cent in the Spring. There will be momentum going into next year and the economy is expected to return to pre-Covid levels of output at the start of 2022, with GDP increasing by 5.3 per cent next year.

Consumer spending: credit card spending bounces back

Following 12 months of on-and-off social restrictions, consumer confidence started to recover from the end of Q1 2021. There are two key drivers: the continued success of the vaccination rollout in the UK (3 in 5 people aged over 18 had received their first jab by the start of Q2 2021, rising to 85 per cent by the end of the quarter) and the subsequent reopening and lifting of restrictions across all UK nations.

The mood of increasing optimism brought about a boost in spending, as shown in Chart 1. With non-essential retail and outdoor hospitality reopening at the start of April 2021 and indoor hospitality reopening in mid-May, consumers returned to the high street in greater numbers.

Chart 1: Credit card spending in month



Source: UK Finance

As covered in previous reviews, credit card spending declined significantly at the start of the Covid-19 pandemic as national lockdowns prevented spending within the hospitality, entertainment, and travel sectors.

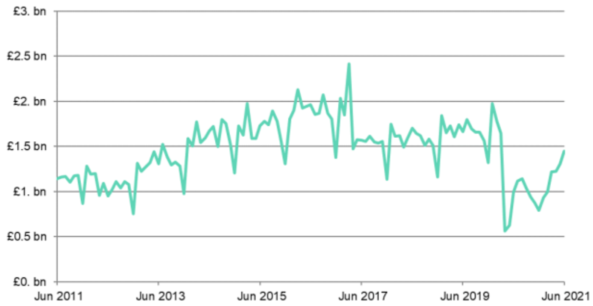
Spending has increased in line with lockdowns being lifted, with levels in Q2 2021 reaching their highest point since the start of the pandemic, an increase of 25 per cent in spending on the previous quarter.

Although this reflects consumers returning to hospitality and entertainment venues as they reopen, spending remains lower than would be expected in 'normal' or pre-pandemic circumstances. This is due in part to lower spending on travel for work as some offices remain closed and, on the leisure side, international travel remains subject to significant restrictions. Additionally, despite the more buoyant national mood, not all consumers are comfortable resuming former patterns of social interaction, and this continues to act as a brake on spending, albeit far less so than before.

Consumer spending: personal loans see start to recover

Personal loans have largely followed the same trends as credit card spending since the start of the pandemic, with consumer confidence being a key driver in new loan uptake. This has continued into Q2 2021, as shown in Chart 2, with a significant boost in borrowing.

Chart 2: Amounts of new personal loans from banks



Source: UK Finance

Banks' lending on personal loans was 26 per cent higher in Q2 2021 than Q1 2021, but remains lower than levels prior to the beginning of the pandemic. This is reflective of the continuing increase in consumer confidence in 2021 but, as with card spending, there is still a little way to go in a full return to pre-pandemic levels.

Another factor in volumes of unsecured lending is supply. [The Bank of England Q2 2021 credit conditions survey] showed that lenders reported increases in both supply and demand in Q2 2021. While the improving economic outlook is clearly a factor in demand, lenders looking to increase business and improve their market share in the sector may also be driving supply, which could continue to be a factor going forward.

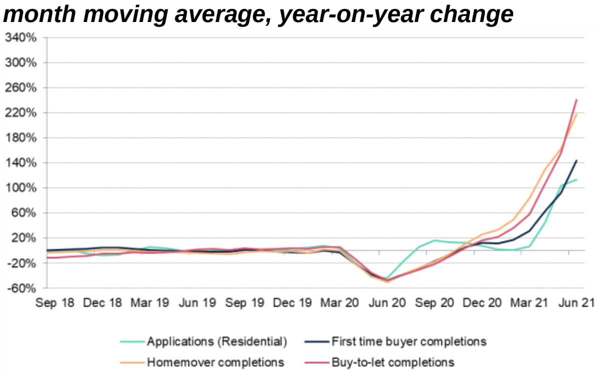
House purchase lending sets new records

The Stamp Duty Land Tax (SDLT) concession, introduced in July 2020, was designed to stimulate demand following the collapse in activity in Q2 2020 when housing markets were largely closed as part of the first Covid-19 national lockdowns. The concession was extended from its original 'cliff-edge' end date in March 2021 to instead taper off with an interim reduction taking place at the end of June 2021 before returning to normal levels at the end of September 2021.

In this regard, the SDLT concession has been a success, with both demand and purchase activity increasing to new highs. There were 124,520 homeowner purchases in June 2021, the highest volume of purchase for one month since 2005 (when comparable records began).

This follows a previous peak in March, when the SDLT concession was originally expected to cease. As Chart 3 demonstrates, the comparison in purchases in H1 2021 to previous months is unprecedented.

Chart 3: Mortgage applications and completions, 3-month moving average, year-on-year change



Source: UK Finance

While homemovers have seen some of the biggest increases in activity in recent months as homeowners leverage their existing equity to move to bigger homes, purchase activity has been significant across all borrower types. Buy-to-let landlords completed the largest monthly volume of purchases since 2016, while first-time buyer numbers were also strong as the help-to-buy equity scheme (in its new form) was extended to the end of May. The Governments mortgage guarantee scheme has also had an impact, encouraging lenders to launch new products at higher loan-to-values for first-time buyers.

In total, Q2 2021 saw the highest levels of homeowner purchase activity since Q3 2007. It's important to note that, despite the very high levels of purchase in the months of March, June (and more generally since August 2020) it is unlikely that this level of lending will be sustained in the medium to long term.

More recent lending has been driven in large part by the SDLT holiday – a combination of purchases brought forward to take advantage of the tax break, and some level of additional activity that might not have taken place, at least in the short term, were it not for the holiday. Increased levels also reflect delayed purchase activity from when the housing market was put on pause in the first set of lockdowns in Q2 2020.

With most delayed purchases now likely to have completed and the SDLT holiday now in its final tapering phase, demand was expected to decline; with lending volumes in H2 forecasted to be considerably lower than in H1 2020.

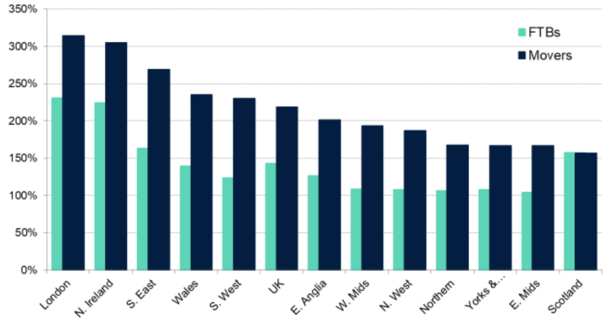
However, applications towards the end of Q2 and into Q3 remained at levels higher than before the pandemic began. This suggests that, while a key driver, the SDLT holiday is not the only factor in play. However, the true level of underlying demand will not be clear until October when the current tax break no longer applies.

Consumer lending: London leads house purchase surge

The regional narrative around house purchase markets through the pandemic has been relatively clear: homeowners are moving out of city centres and into larger houses in the suburbs and beyond, referred to frequently as the "race for space". This has meant that areas such as London have seen many homeowners seek properties in the wider South East region (and beyond), as they trade the city for a more rural location.

However, Chart 4 does show a slightly different picture in Q2 2021. London led the growth in homemover purchase activity, with volumes 300 per cent higher than those seen a year earlier. Strong growth was seen in London, both across the city and its suburbs. Activity in the wider south of England remained popular, as did Wales and Northern Ireland, all seeing between 200-300 per cent increases in mortgages granted for new homemovers.

Chart 4: Number of new house purchase loans, annual percentage change, Q2 2021



Source: UK Finance

While these percentage growth figures are amplified by the initial declines in purchase seen across the country in Q2 2020, it is important to note that house purchase levels in the first two quarters of 2021, across the regions and nations, have either returned to, or are significantly higher than, levels prior to the pandemic. This underlines the strength in the rebound in lending across the country and across first-time buyers and movers.

Consumer spending & lending: summary

Consumer confidence has been a key driver in behaviours for both unsecured and secured spending and borrowing, with the potential for spending to increase further as restrictions on international travel unwind further and workers able to return to the office.

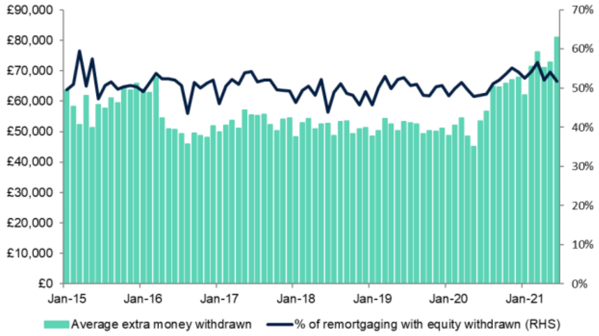
While the SDLT holiday is now in its final tapering stage, demand remains strong for now.

Overall, the outlook for the second half of 2021 is a more optimistic one, however as the furlough scheme ends, optimism has to be tempered with the as-yet-unknown extent of job losses following the end of furlough.

Household refinancing: homeowners continue to leverage equity for additional property purchase

As covered in previous Reviews and above, homemover activity has been exceptionally strong since last summer. Alongside this, one of the less conventional trends to emerge in recent months has been the growing popularity of withdrawing equity through remortgages in order to purchase further properties.

Chart 5: Average value of equity withdrawal through residential remortgages



Source: UK Finance

As Chart 5 shows, this is a continuing trend, with Q2 levels remaining at the new highs in equity withdrawn through remortgage seen over the past year. The significantly higher average values of equity withdrawn point towards this money being used for holiday homes, properties to let for first-time landlords or deposits for relatives to purchase their first homes.

We have also seen this trend in the buy-to-let market, where landlords are leveraging equity from their existing properties to expand their portfolios.

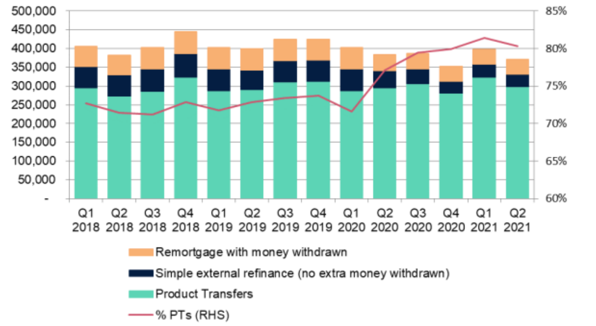
Driven by the same factors as the overall market strength, this wave of re-leveraging is underpinned by the same responsible lending rules as purchase activity, ensuring that customers expand their property wealth without overextending their finances.

Household refinancing: switching activity remains supressed due to popularity of five-year fixed rates

Refinancing continued to move at a steady pace through Q2 2021, following an initial boost in January, with product transfers remaining very strong in Q2 2021 following their increase in popularity since the start of the pandemic.

As Chart 6 shows, total levels of refinancing from 2020 onwards are somewhat muted compared to previous years. While the Covid-19 pandemic could be a factor in this, it is more likely that declines in refinancing are due in larger part to the relatively recent increase in popularity of five-year fixed rate mortgages.

Chart 6: Number of residential remortgages and internal product transfers



Source: UK Finance

Five-year fixed rate mortgages have become the most popular product on the market since 2018, due to the historically low rates of interest. Borrowers locked into these cheaper rates for longer, to guarantee paying lower amounts.

As five-year fixes overtook two-year fixes as the most popular product type in 2018, the dampening impact of this on the refinancing schedule began two years later - in 2020. The shift away from two-year fixes was a roughly ten percent decline, and the overall decline in 2020 for homeowner refinances was commensurate.

While rates have declined further since 2018, five-year fixes remain popular as borrowers continue to value the security of fixing payments at low rates for longer.

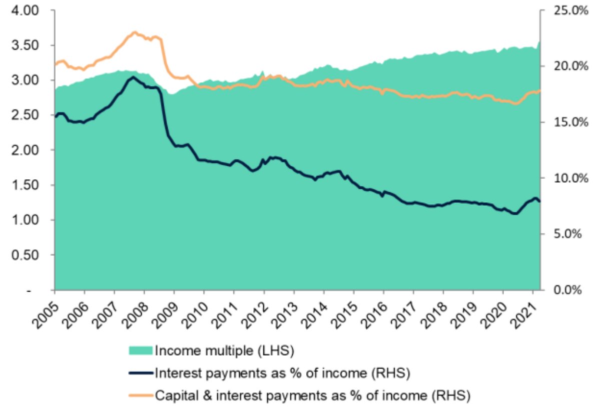
Household refinancing: future impact of LTIs

Since the country began to emerge from the housing market downturn in the late 2000s, we have seen a steady increase in loan-to-income (LTI) ratios for new house purchases. As a result, average LTI ratios now are at record highs.

However, while constantly rising LTIs may, when taken in isolation, suggest borrowers are increasingly stretched, this metric alone can give a misleading picture. Chart 7 shows that recent increases in LTI have been in tandem with declining initial average monthly payments, driven in part by strong competition and lower funding costs driving down rates.

Equally importantly, all new lending is accompanied by responsible lending rules, including an affordability test that ensures the mortgage is affordable even allowing for potential adverse economic disturbance in the future.

Chart 7: Average LTI and initial payments for new residential house purchase



Source: UK Finance

While loan-to-incomes are higher than they have been historically, lower interest rates and initial monthly payments and more stringent affordability rules means that borrowers are in a much stronger starting position than borrowers were in 2007 during the global financial crisis (GFC), and their overall finances are more resilient in the event of adverse income or payment shocks.

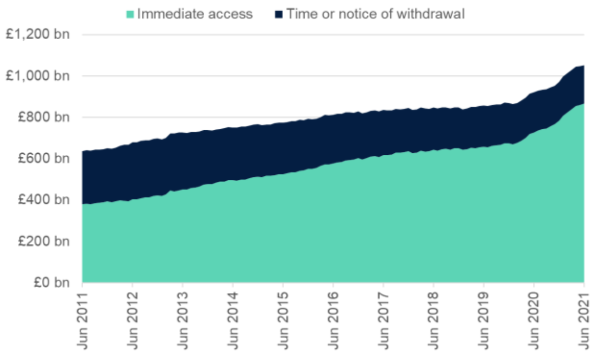
Additionally, these low interest rates and monthly payments overlap with the increased popularity of five-year fixed rate mortgages, giving borrowers certainty of payment over a longer period.

While there has been a slight increase in average payments for new mortgages more recently, they remain very low by historic comparisons and significantly below those seen prior to the GFC.

Household saving: deposits continue to grow but modest signs of slowing

Savings deposits from consumers reached record levels over the pandemic, as many avenues for spending were restricted due to national lockdowns and demand subdued as consumer confidence was weak. Total deposits have continued to grow since April 2020, reaching over £1 trillion in Q1 2021 for the first time on record.

Chart 8: Personal deposit account balances



Source: UK Finance

As Chart 8 demonstrates, deposits have continued to grow upon these record levels in Q2 2021. While lockdown measures were lifted and the country looked on track to reopen fully at the start of Q3 2021, savings continued to grow as some opportunities for spending remained curtailed and consumers continued with some precautionary saving.

While total deposits have increased, it's worth noting that the rate of growth has slowed somewhat. Quarterly growth of deposits increased by two per cent (£23bn) in Q2 2021 compared with Q1 2021, while deposits grew by 6 per cent (£58bn) in Q1 2021 when compared to the end of 2020. This demonstrates that consumers are likely willing to dip into savings or are starting to spend larger amounts of their pay on recreation, travel or large one-off purchases including house purchase). This is again reflective of the increased consumer confidence seen in the quarter.

Another indicator of a pivot from saving to spending for many consumers is the continued decline in popularity in time or notice of withdrawal accounts. The total level of deposits for these accounts has been consistently declining since the start of 2021 (following modest fluctuation in levels in 2020) and has reached a record low at the end of Q2 2021. As we covered in previous reviews, these have become less popular as record low interest rates have meant that there is little difference between these and immediate access accounts, and many consumers now see a clear return to spending in the near future so will not be depositing money into time or notice of withdrawal accounts.

Household refinancing & savings: summary

Homeowners are continuing to lock in their mortgage payments at historically low rates and for longer and are well shielded against modest economic turbulence should it arise.

The recent phenomenon of homeowners leveraging equity in their homes to facilitate further housing purchases is also continuing.

Savings through personal deposits have continued to grow but show signs of slowing as the economy begins to reopen and consumer confidence ticks upwards.

Household debt: Payment deferrals successful across products

The payment deferral (PD) schemes coordinated across the banking industry gave borrowers up to 6 months respite from regular payments on mortgages, personal loans and credit cards through the worst of the pandemic. PDs allowed consumers to prioritise other financial commitments through a time of crisis and not fall behind on payments for these products.

Table 1: Payment deferrals across product types

Type of payment deferral	Total number granted	Number in place at the end of 2020
Mortgage	2.9 million	0.1 million
Personal loan	0.9 million	0.1 million
Credit card	1.3 million	0.1 million

Source: UK Finance

Table 1 shows the scale of uptake for the PD schemes. Millions of borrowers were able to offset the early impacts of the pandemic and manage their finances through the use of these schemes. As demonstrated by the low volumes in place at the end of 2020, PD were in less use in 2021. This was due in part to the financial impacts of the pandemic being less prominent as the country started to reopen, but also because many borrowers had already used the full six months of PDs available in 2020.

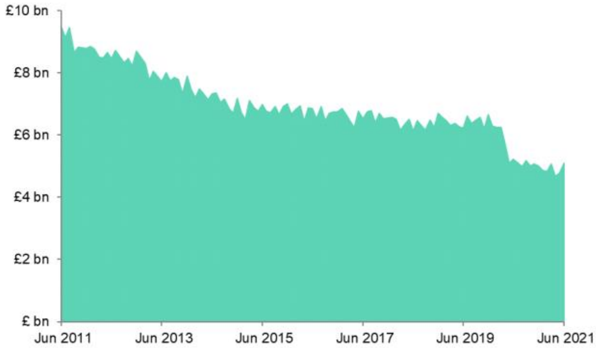
The PD scheme has now ended, with the final deferrals coming to an end on July 31st 2021. For those borrowers who still need help meeting payments, firms are continuing to offer forbearance and tailored support. This can take many forms, such as reduced payments in the short-term or refinancing or restructuring the loan.

Lenders continue to encourage customers who are in financial difficulty and are concerned about meeting regular payments to make contact with them and discuss how they can be assisted as the industry stands ready to help.

Household debt: Overdraft balances remain supressed

Total overdraft balances started to decline at the start of the Covid-19 pandemic as spending declined and borrowers paid off overdraft debts with savings. Overdraft balances have remained at these levels since the initial decline in April 2020, likely because overdrafts are generally seen as a comparatively expensive option for borrowing.

Chart 9: Overdraft balances outstanding



Source: UK Finance

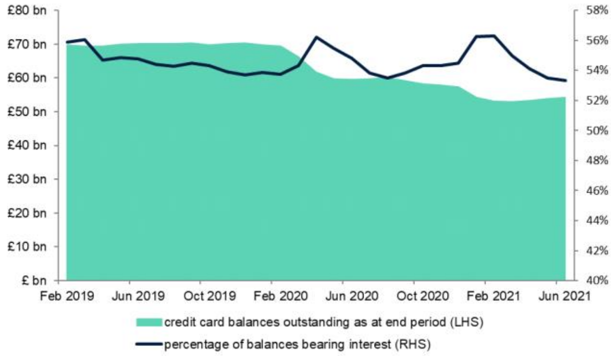
While spending has increased, we may not see an increase in overdraft balances outstanding until there is a full reopening and lifting of restrictions for the nations.

As mentioned in previous Reviews, in addition to credit card PDs, many organisations provided customers with personal current account fee-free, interest free overdraft buffers up to £500. Just over 27 million personal current account holders had this borrowing relief applied to their account in 2020. While the interest-free overdraft buffers scheme ended in October 2020, many lenders are continuing to offer support for customers struggling to pay off overdrafts.

Household debt: Credit card balances outstanding also remain stable despite increase in spending

In a similar vein to overdrafts, credit card balances outstanding declined at the start of the pandemic as lower spending, including on travel and leisure activities, were again used to pay off outstanding debts.

Chart 10: Credit card balances outstanding



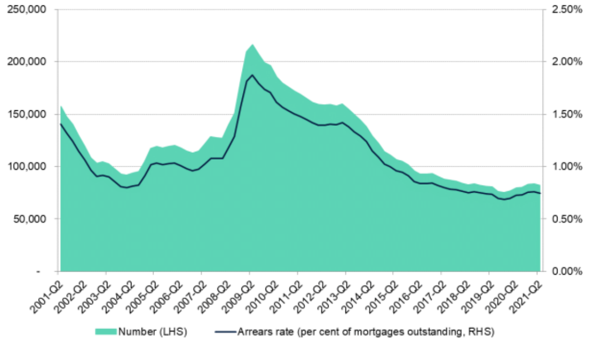
Source: UK Finance

There has only been a very slight rise in balances in Q2 2021 back to levels seen at the end of January 2021. This demonstrates that borrowers have continued to pay off credit card debts alongside the additional spending in the quarter. This is further evidenced by the proportion of balances bearing interest, which declined significantly in Q2 2021 to the lowest percentage since the start of the Covid-19 pandemic.

Household debt: Mortgage arrears decline further but heavier arrears continue to increase

Mortgage arrears saw a transitory rise in the total number of mortgage accounts in arrears in Q2 2020, driven largely by COVID-related payment issues prior to PDs being granted. Since the PD scheme was introduced, we have seen a continuous decline in early arrears (those representing less than 5 per cent of the total outstanding balance). PDs have allowed those already in early arrears, as well as those newly at risk of falling behind due to the pandemic, to delay mortgage payments for a short period, allowing them to pay down previous shortfalls or avoid entering an arrears position altogether.

Chart 11: 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

While early arrears have continued to decline in Q2 2021, due in part to PDs and the Coronavirus Job Retention Scheme (CJRS), later arrears (those 10 per cent or more of total outstanding balance) have gradually increased. This cohort consists largely of borrowers who were in payment difficulties before the pandemic, where their economic situation has worsened even with PDs and/or lender forbearance.

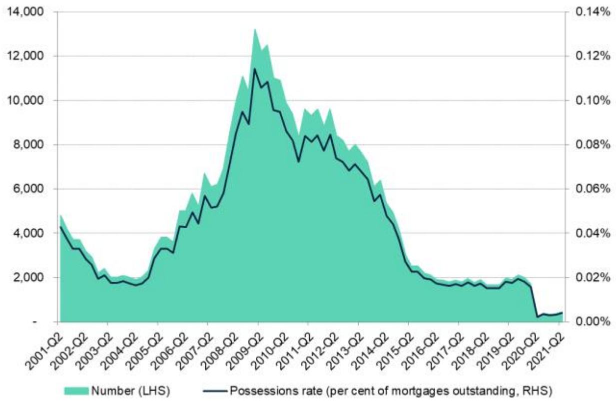
While early and later arrears are currently on opposite tracks, it is expected that early arrears will start to increase as lender and government support schemes are wound down and some proportion of the mortgaged population find themselves in more prolonged positions of income disruption.

Again, tailored help remains available to borrowers who need it from their lender, and it is as important as ever that borrowers who find themselves in financial difficulty talk to their lenders.

Household debt: Mortgage possessions remain low as restrictions are lifted

Possessions essentially halted after March 2020, as government and lenders agreed a moratorium for the majority of 2020, subsequently stretching into 2021. This meant that during this period it was largely only voluntary possessions that took place.

Chart 12: Number and proportion of 1st charge mortgages taken into possession in period



Source: UK Finance

Government restrictions on rental evictions remained in place until 31 May 2021 in England and 30 June 2021 in Wales, so the volume of non-voluntary possessions will have remained very low. This is evidenced in Chart 11, which shows that there were only 80 more possessions cases in Q2 2021 than in the previous quarter.

It is expected that possessions will increase moderately throughout 2021 and 2022, as lenders begin to re-submit possessions claims and the court backlog unwinds. Ministry of Justice data supports this, showing that possession claims have only increased modestly in Q2 2021, demonstrating a slow and considered approach from lenders. Possession is always a last resort after tailored support options are explored (and exhausted) and a thorough, court-based, process has carefully considered the borrower's individual circumstances.

Household debt: Summary

The payment deferral scheme was a success, allowing millions of borrowers crucial breathing room on their credit commitments in response to a national crisis affecting household finances. This scheme has now ended as the country works towards a full reopening, but lender support is still available to those borrowers who need it.

The economy has started to recover with a momentum that is expected to be sustained in the latter part of this year and into next, with a relatively stable outlook across debt indicators. Mortgage arrears, credit card debt and overdraft debt have remained at historic lows, with the majority of borrowers continue to make monthly payments in full and on time.

Looking ahead, the most immediate challenge to household finances is the winding down of the CJRS. For those who do not immediately return to full employment following furlough, maintaining credit commitments may be a challenge, and more so for those who were already in existing financial difficulties prior to the pandemic. Lenders remain ready to help where these borrowers need assistance.

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