Household Finance Review – Q4 2019

In this review we look at activity in UK households' finances in the fourth quarter of 2019, and reflect on annual outturn for 2019.

There are 28 million residential properties in the UK and over a million sales a year. Mortgages support nine million homeowners and a further 200,000 landlords in the private rented sector. Unsecured credit products allow households to manage their spending, with over 60 million personal credit cards (more than two per household), while personal current accounts are used for holding deposits due to their immediate access and overdraft facilities.

Only 1.23 million adults do not currently operate a bank account, down from 1.71 million in 2014.

Eric Leenders, Managing Director, Personal Finance comments:

"Last year saw a slight fall in levels of mortgage activity for home purchases, largely driven by increasing affordability pressures. Meanwhile the remortgage market remains competitive, although the shrinking number of customers coming to the end of their fixed rate deals will start to impact volumes in this segment.

"While borrowers are benefitting from relatively low rates on unsecured credit, levels of borrowing remain somewhat muted with some people instead opting to increase their mortgage borrowing as a more cost-effective way of managing their finances.

"The same low rates have also led to consumers keeping cash in instant access accounts, with demand for longer-term savings products constrained."

HIGHLIGHTS

- **Although modest in size, 2019 saw the first annual fall in gross mortgage lending since 2010.**
- **Affordability limited purchase activity across the country.**
- **New homeowners in Northern Ireland and Yorkshire & Humberside, and homemovers in Scotland have benefitted from relative affordability advantages**
- **The Buy-to-let (BTL) market, whilst still contracting, is levelling off with some growth in the North.**
- **Prospects for growth in remortgaging markets are limited, both as a result of lengthening deal rates and fewer mortgages on Standard Variable Rates (SVR).**
- **Regulation on affordability has increased consumer protection but constrained the ability of lenders to offer certain borrowers mortgage credit to get on or move up the housing ladder.**
- **Credit card borrowing growth continues to decline and is at its lowest point since 2013.**

UK economic context and outlook

The UK economic outlook over the next year or so is being shaped by three related factors.

First, Brexit – while the UK formally left the EU in January, there is still much to be decided about the future relationship. Businesses still do not know what shape the final trade deal will take and whether it will be agreed by the end of this year. This is likely to continue to weigh on investment decisions, even if there has been a recovery in sentiment following a decisive election result last year. Moreover, there remain reasons to be cautious about the extent to which the global economy will support growth, including the still uncertain economic effects of the spread of COVID-19.

The second factor shaping the UK economic outlook is the government's aspiration to 'level up' incomes and opportunities across the country by tackling regional disparities in growth and productivity. At a broad regional level, average household incomes are highest in London and lowest in the North East, Wales and Northern Ireland, a picture that has changed little over the past two decades.

Given the long-term nature of these differences, there will no doubt be challenges to making much progress in a short space of time without a concerted effort to shift resources to the regions. A new regional agenda could bring significant opportunities but this will also require local areas to make effective decisions on how best to deploy additional resources for maximum benefit.

The final factor shaping the outlook is the government's fiscal policy and how it manages the balance between spending and taxation. The March Budget has been widely expected to be focused on the 'levelling up' agenda, which is likely to include commitments to invest more in skills and infrastructure throughout the country. In addition to the task of increasing public investment quickly, high employment and capacity constraints in sectors, may add to the difficulty of implementing ambitious public investment plans quickly. Furthermore, the wider economic benefit of any big public spending rises will also take time to be felt.

More recently, the developing situation with respect to COVID-19 now looks set to reshape the contents of the Budget, with economic resilience and political de-risking likely to feature significantly.

What do these three factors imply for the way the economy will develop over the next year or two? Private sector investment looks set to continue to be weak amidst continuing uncertainty but this will likely be offset by stronger public sector investment. The labour market remains tight and the slight softening observed through 2019 is not expected to gain pace. The unemployment rate remains at 3.8 per cent and the number of vacancies has stabilised at historically high levels. As a result, wage growth has been robust and is expected to stabilise at 3-4 per cent this year. With inflation remaining low, real incomes are growing, providing support for consumer spending. This points to GDP growth of about 1.5 per cent per annum over the next two years.

At the moment, financial market and credit conditions continue to support UK businesses and households in a low growth and below-target inflation environment (*Table 1*). All of which points to more of the same in terms of recent trends, both in the macro economic outlook and in those highlighted in this Review.

Table 1: key forecast variables

Per cent annual change unless stated

	2019	2020	2021
GDP	1.3	1.3	1.6
of which household spending (%)	0.7	0.7	1.0
Unemployment rate (%)	3.8	3.8	4.0
CPI inflation	1.8	1.8	2.1
Average earnings	3.9	3.7	3.6

Source: NIESR

2019 – a marginally softer housing market

As we look back on 2019, we can summarise activity in the housing market as “gentle moderation” (*Table 2*).

Table 2: 2019 Key Mortgage Figures

	2018	2019	Annual change
Number of house purchase loans:			
First-time buyers	353,000	351,000	-0.6%
Homemovers	351,000	344,000	-2.0%
Buy-to-let landlords	72,200	69,900	-3.2%
Total	776,200	764,900	-1.5%
Number of mortgage refinances			
Residential - external remortgage	456,400	445,900	-2.3%
Residential - internal Product Transfers	1,178,900	1,195,200	1.4%
Buy-to-let - external remortgage	178,800	177,100	-1.0%
House Prices (UK average, Q4)	214,178	215,925	0.8%
Gross mortgage lending (£ billion)	268,720	267,552	-0.4%
Mortgages in arrear (end of year)	82,350	75,280	-8.6%
Mortgage possessions	6,900	8,000	15.9%

Source: UK Finance, Nationwide BS, Bank of England

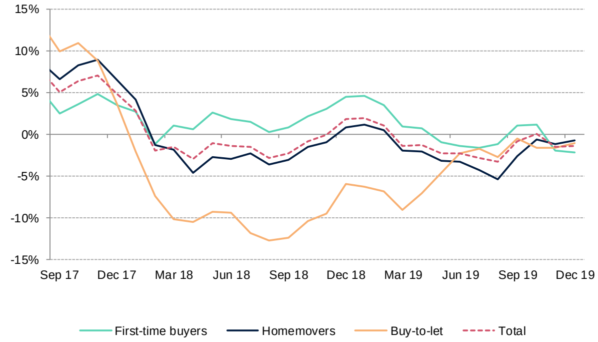
Throughout the year the UK saw a modest decline in the number of new loans in both the residential and BTL purchase markets. This is, in fact, a continuation of the trends seen in 2018. However, price increases have more than offset these declines, resulting in a continuing positive cash advance increase in gross mortgage lending, a trend that has been consistent since 2011.

Whilst homemover and BTL numbers have been in retreat since late 2017, one difference last year was a modest decline in first-time buyer (FTB) numbers, which decreased by 0.6 per cent for the year as a whole.

It should be noted that this decline is marginal – 2,000 fewer loans than the ten-year peak of 353,000 seen in 2018, and well within the margin of routine statistical variation. Effectively then, 2019 saw FTB activity stabilise around the ten-year high levels seen in the previous year.

However, as *Chart 1* demonstrates, growth rates in FTB lending had in fact been moderating since late 2018, becoming modestly negative from the early 2019.

Chart 1: Number of mortgages for house purchase (3-month moving average, year-on-year change)



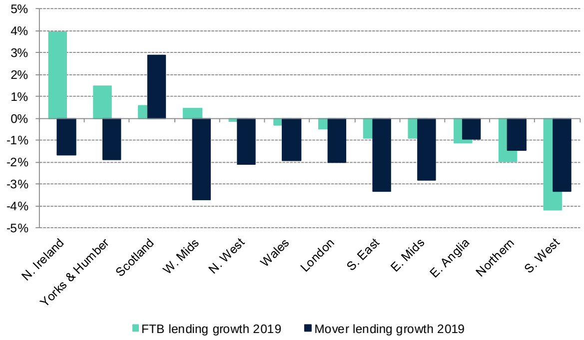
Source: UK Finance

This trend chimes with our December 2019 forecasts, which point to affordability pressures – particularly in the South but now rippling out to other regions – moderating lending growth.

FTB numbers weaken in almost all regions

As *Chart 2* shows, FTB numbers fell on an annual basis in all but two of the English regions (Yorkshire and Humberside and the West Midlands), with the larger declines mostly seen across the Southern regions.

Chart 2: Annual change in new house purchase mortgages, UK nations and English regions



Source: UK Finance

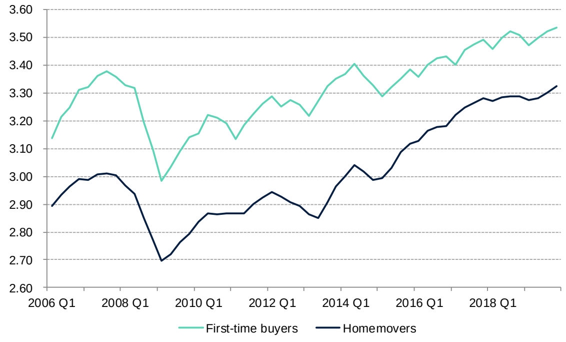
This decline in FTB numbers, albeit marginal, comes despite the various support schemes aimed at boosting demand amongst FTBs. As *Chart 2* shows, the only part of the UK showing material growth in FTB activity last year was Northern Ireland, where Help-to-Buy, arguably the most significant element of support, does not exist.

However, what does exist in Northern Ireland are comparatively forgiving affordability metrics. The typical FTB in Northern Ireland borrowed just over three times income in Q4 2019, compared to over three and a half times across the wider UK.

Affordability and lack of equity both bearing down on homemover activity

As we noted in our Q3 Review, the weakness in homemover activity (which, as seen in Chart *1,* has been seen since the start of 2018), is driven in part by increasing affordability pressures. Whilst average income multiples are at their highest recorded levels for all home purchase mortgages, they have risen faster for homemovers, who in Q4 2019 borrowed on average 3.32 times income, some 10 per cent higher than at the pre-crisis peak in 2007 (*Chart 3*).

Chart 3: First-time buyers and homemovers, UK, average income multiple

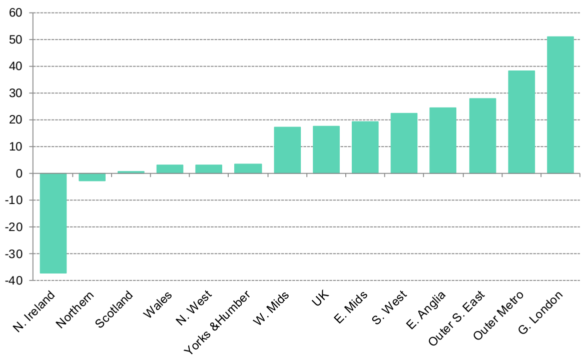


Source: UK Finance

The weakness in homemover activity is replicated across almost all UK geographies. This includes Northern Ireland, where the same comparative affordability advantage which helped support growth in FTB numbers did not have the same effect on homemover activity. In fact, there were 1.7 per cent fewer homemover loans last year than in 2018.

A key difference in Northern Ireland, which helps explain this, lies in the historic path of house prices. *Chart 4* shows the position of house prices now, relative to their pre-crisis peak in 2007 Q4. This shows that, whilst prices across the UK as a whole are now 17 per cent higher than they were at that point, they remain some 37 per cent *below* those levels in Northern Ireland.

Chart 4: House prices Q4 2019, per cent change from 2007



Source: Nationwide Building Society

This means that existing homeowners – most significantly those who bought at the peak – have not benefitted from a build-up of housing equity in the same way that most other areas of the UK have done.

The lack of equity accumulation is not a problem in and of itself. However, it becomes important when assessing the ability of existing homeowners to leverage that equity, the conventional path of financing subsequent moves up the housing ladder.

Overall, we estimate that some 9 per cent of existing mortgaged homeowners in Northern Ireland currently have less than 10 per cent equity, and almost half of that 9 per cent are in negative equity (that is, the value of their mortgage exceeds the value of the property). By contrast, less than 3 per cent across the UK have less than 10 per cent equity, and only one quarter of one per cent are in negative equity. This is then reflected in declining homemover numbers in Northern Ireland, despite the easier affordability.

Overall, this combination of rising income multiples and constrained equity has led to contraction in homemover numbers in every UK region and country with the sole exception of Scotland. There, the housing market saw a more moderate house price downturn, followed by a more measured return to those levels by the end of 2019. Together with the relatively easier affordability metrics that are a feature of the Scottish housing market, this facilitated growth of around 3 per cent in home mover activity last year.

Buy-to-let lending – King in the North

Affordability considerations, albeit of a different type, have also led to significant regional variation in the BTL market.

Overall, tax and regulation changes in this sector have continued to dampen activity levels, with the value of new BTL purchase lending falling 4.7 per cent last year. Whilst still significant, this represents an easing in the rates of decline from those seen in 2017 and 2018 and, as shown earlier in *Chart 1*, this easing continued throughout last year.

Within the UK total, the regional pattern shows a picture of a return to growth in Scotland and the North, with annual rates of change moving progressively negative the further South we look.

As a business investment, BTL demand is driven by yield – specifically the rental yield. With strong rental demand and relatively low property prices, the Northern regions and Scotland offer comparatively attractive returns.

Even in the current challenging environment for BTL then, these regions have seen a return to growth as landlords collectively increase their portfolios to cater for the regional demand.

Chart 5: BTL purchase lending value growth, 2019

Source: UK Finance

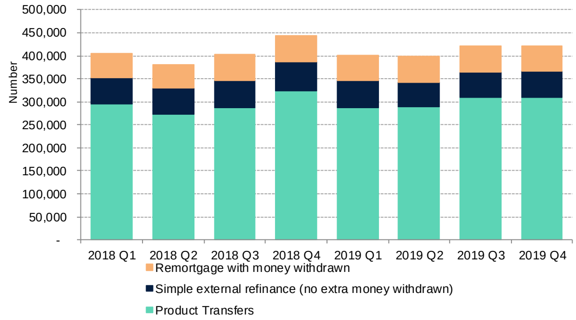
A refinancing market constrained on multiple fronts

Following a year of strong growth in 2018, external remortgaging (i.e. to another lender) activity shrank last year. The 445,900 homeowner remortgages represented a 2.3 per cent decline compared to the ten-year high seen in the previous year. However, that contraction was more than offset by continuing growth in internal Product Transfers (PTs).

As the FCA has observed (in its Mortgages Market Study), the UK mortgage market has a high level of customer engagement, which is providing a competitive environment for borrowers. Perhaps the strongest reflection of this is that almost three quarters now refinance internally, most commonly as their existing deal rate comes to an end, with lenders proactively offering their customers a new deal.

Just under 1.2 million customers took out a PT last year, a relatively modest increase of 1.3 percent on 2018, but more than enough to offset the decline in the external remortgage market. Overall, 1.6 million homeowners took out a new deal last year, 0.4 per cent up on 2018 (*Chart 6)*.

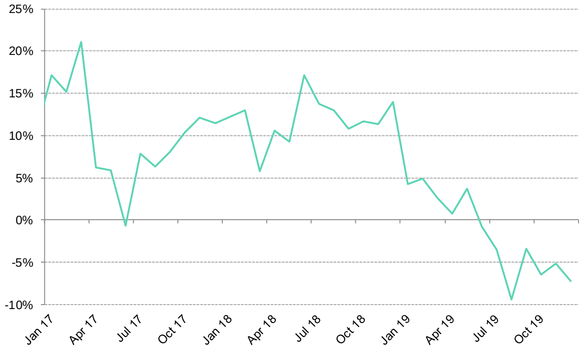
Chart 6: Number of residential remortgages and internal product transfers



Source: UK Finance

In recent months however, remortgage activity has started to soften (*Chart 7*). In line with our forecasts, this is an expected result of the increasing preference for longer-term fixed rate deals (mostly for five years), which is now beginning to bear down on the number of mortgages becoming available to refinance.

Chart 7: Number of homeowner remortgages (3-month moving average, year-on-year change)



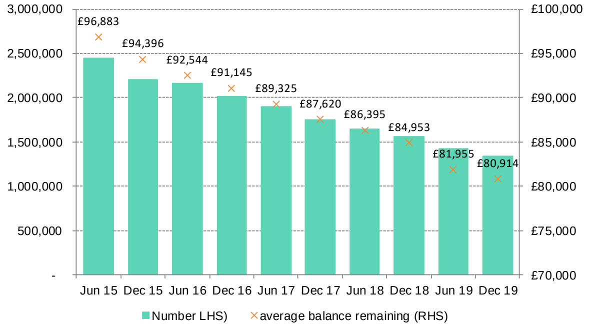
Source: UK Finance

This dampening effect of longer fixed rate deals is expected to continue to bear down on activity through this year and beyond.

An additional material brake on refinancing demand comes from a shrinking pool of mortgages that are currently on lenders' Standard Variable Rates (SVRs), and therefore free to move without incurring an Early Repayment Charge (ERC).

The stock of mortgages on SVR has been reducing significantly over recent years. As at December 2019 there were around 1.3 million homeowner loans on SVR, over 1.1 million fewer than the number just four years previously (*Chart 8)*. SVR mortgages now make up 16 per cent of the outstanding stock, compared to 30 per cent in 2015.

Chart 8: Homeowner mortgages currently on Standard Variable Rates



Source: UK Finance

The significant contraction of the SVR stock in recent years reflects positive action from both mortgage lenders and their customers to refinance onto better rates.

In the years following the financial crisis, many customers remained on SVR for some time, and some are still on these rates.

Broadly speaking there are three types of customer within the SVR book. The first are beneficiaries of mortgages contracts written in those peak years. A number of these reverted onto SVRs which were – and in some cases still are – favourable compared to new refinancing rates available on the market.

A second group reflects customer inaction, with borrowers not keen to incur the perceived hassle factor of taking out a new mortgage.

A third, much smaller, cohort contains borrowers who remain on SVR because they believe, either rightly or wrongly, that they do not qualify for a new mortgage since the FCA's new affordability rules came into force.

However, since 2018 when UK Finance announced its Industry Voluntary Agreement (IVA), active lenders have contacted customers eligible for a new deal in all three of these groups, to ensure that all are aware of the deal options available to them via an internal PT. Whilst most lenders were already running these contact programmes as part of their customer retention strategies, the IVA reinforced and accelerated these processes.

This proactive approach has accelerated the contraction in the SVR book. As *Chart 8* shows, the remaining SVR book is now both 1.1 million loans smaller, and those remaining SVR loans have significantly smaller outstanding balance.

This reflects rational consumer behaviour – those with larger balances have more to gain from switching, with those remaining on SVR having lower potential benefit from switching products.

The overall result of all of this is that we now have a potential remortgage market which is smaller, with more mortgages on longer deal rates, fewer borrowers remaining on SVR, and those who do remain having less to gain from switching. These factors will continue to constrain this market through 2020 and beyond.

A note on "trapped borrowers"

Whilst the IVA has ensured that almost all customers with active lenders are offered a new deal (so long as they are not in arrears and would see benefit from the switch), this programme does not extend to borrowers in closed books.

These closed books are held by inactive firms who do not offer new mortgage products. Many of these firms are not authorised for mortgage lending by the FCA and therefore fall outside the regulatory perimeter.

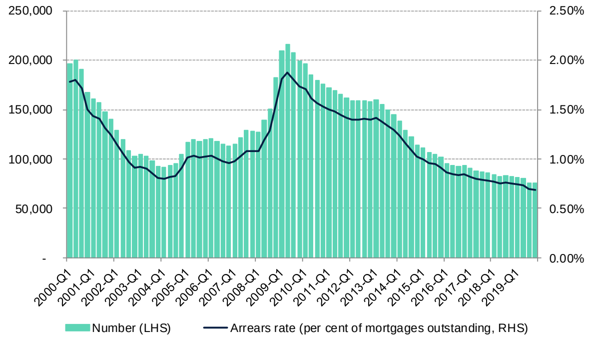
The borrowers within these books – sometimes referred to as "mortgage prisoners" – are therefore trapped in terms of getting a new deal from their existing lender. Neither the IVA, nor the new FCA rules designed to allow these customers to switch more easily, permit active lenders to reach out to customers in another firm's book to offer them a new deal.

Around 40 active lenders are working together to address the challenges, both around product design and how to reach these borrowers. Even under the new rules, not all of an estimated 250,000 closed book customers will be eligible to remortgage. However, the mortgage lending industry and intermediary firms are working with the FCA to find practicable solutions that allow more of these closed book customers to switch.

Arrears falling, but does consumer protection trump housing opportunity?

Last year ended with 75,000 mortgages in arrears. This is the lowest on record, both in absolute terms and as a proportion of the total stock (*Chart 9*). The combination of the low interest rate environment and equally benign unemployment figures have continued to drive down the incidence of payment problems, even for those mortgages taken out in the pre-crash years.

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

More recently, since FCA rules on responsible lending came into force in 2014 (and in fact well before this as the industry evolved to anticipate the new regulatory environment), all new loans have been underwritten with a built-in affordability cushion. This protects borrowers against a material degree of income, expenditure or interest rate shock.

Additional requirements from the Financial Policy Committee stipulate a minimum stress rate at which affordability must be assessed, and a cap on the number of mortgages that can be granted at higher income multiples to borrowers with better income prospects. Layered on top of the existing FCA rulebook, these factors present a "triple lock" on the market.

Clearly, this provides a significant level of consumer protection. Although record low unemployment and interest rates play a major part, the regulatory environment is also helping drive arrears numbers to beyond historic lows. They also ensure that, should the macroeconomic environment turn less benign, any effect on mortgage arrears will be minimised.

However, this "triple lock" also constrains the extent to which the industry is able to offer loans for home ownership, whether to get onto or move up the housing ladder, or to access the wealth held in consumers' housing equity.

The net effect of this is perhaps best encapsulated in the headline figure for mortgage lending; with tightening affordability driving weaker transaction numbers, and constrained refinancing activity, gross lending in 2019 fell by 0.4 percent to £268 billion.

Although modest – like most of the other declining mortgage market trends we saw last year – this was the first annual decline in overall mortgage activity since 2010.

In the current lower-for-longer interest rate environment, this layering of regulation will continue to bear down on lending volumes below those which the central range of interest rate predictions might otherwise allow firms to make available.

The current environment, including that for interest rates, creates increased protection against individual consumers experiencing harm from arrears, and ensures lenders are, by definition, limited naturally in the amount of risk they take through new mortgage lending decisions. At a macro-prudential level it also limits the potential for consumers financing greater spending by taking on more mortgage debt.

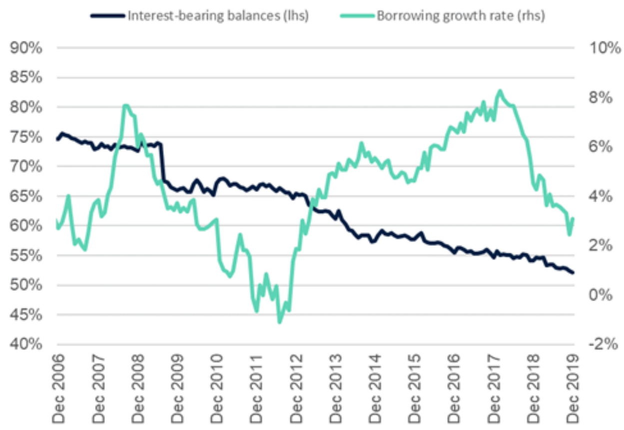
However, this environment will continue to have consequences, both for individual consumers who are unable to access the mortgage market, and at a wider societal level.

As a number of recent commentators have observed, including in the recent Hometrack report and the FCA's own sector views, homeownership levels are falling, and most significantly amongst younger generations. How far the lending industry can help to address these issues depends, to a large extent, on the level of flexibility provided by the regulatory framework to allow those firms that have greater risk appetite.

Unsecured Borrowing – Credit Cards

Around half of all unsecured credit provided by banks and building societies comes from credit card borrowing. With a long period of benign interest rates and strong market competition, annual growth in card borrowing started to expand in 2013 and peaked in early 2018 at over eight per cent. Since this time, it has been declining and now stands at under half that annual rate at 3.1 per cent (***Chart 10***). Over the past decade, the proportion of card balances bearing interest has fallen from three-quarters to a half, as more credit card customers pay off balances immediately.

Chart 10: Annual growth in card borrowing and proportion of balances bearing interest



Source: UK Finance

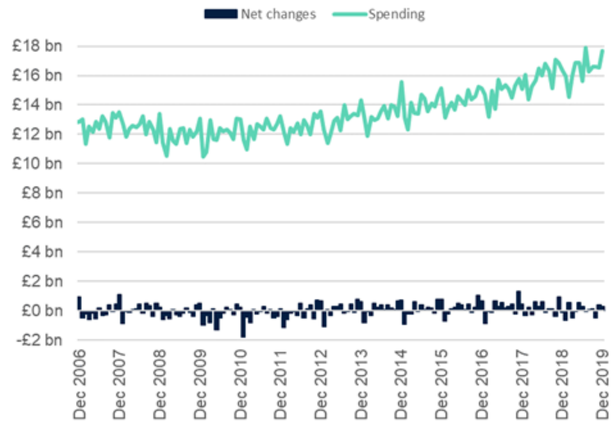
Since 2013 the aggregate amount of monthly spending on credit cards has been trending upwards and is now a third higher. The removal of the credit card surcharge from January 2018, along with cardholders benefiting from spending rewards, loyalty points or legal protection of goods and services purchased has contributed to increased usage. The average credit card transaction value has fallen by 3 per cent over the past year. This has been driven by more contactless credit cards being in issue and greater use of these cards, with credit card contactless transactions increasing by 22 per cent over the past year. Credit card use for travel increased by 18 per cent over the past year. This can be attributed to people using their contactless cards for travel, as well as the removal of the surcharge.

While credit card spending has increased this is, for the most part, largely offset by bill payments from cardholders managing their spending effectively. This is evident through increased numbers of cardholders using Direct Debits to pay more than the minimum amount.

This trend is partly due to the success of the persistent debt remedies introduced as a result of the FCA's Credit Card Market Study. Consumers have responded positively to encouragement from their card providers to increase repayments above contractual minimum amounts and so reduce their overall cost of borrowing.

This has resulted in the annual net change in amounts outstanding being significantly lower in the year to 31 December 2019 than in the previous two years periods (***Chart 11***).

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

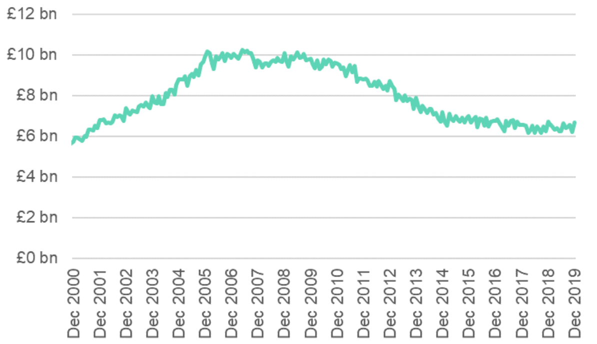


Source: UK Finance

Unsecured borrowing – Overdrafts

Borrowing through personal current account overdrafts with banks and building societies was at a steady peak of around £10 billion between late 2005 and 2009. Since then the level of overdraft borrowing has gradually fallen to just over £6 billion at end Q4 2019 (***Chart 12***).

Chart 12: Overdraft borrowing



Source: UK Finance

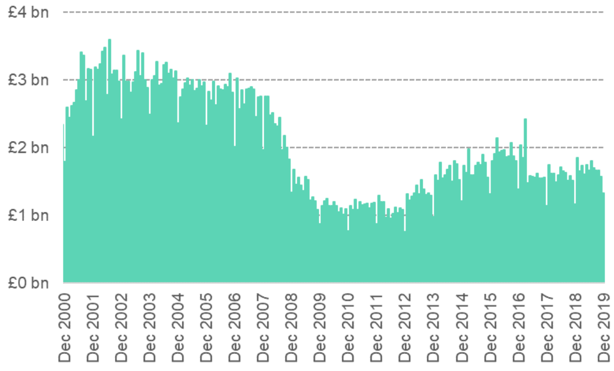
Unsecured borrowing – Personal Loans

Demand for personal loans from banks and building societies has not recovered to levels seen before the financial crisis and, during 2013-2019, has been subdued, in part because of consumers choosing the popular alternative of personal car finance plans (PCPs) provided by dealerships rather than applying for traditional bank loans (***Chart 13***). For homeowners, another attractive borrowing option has been to increase their mortgage borrowing, taking advantage of the historically low rates that remain available in that market.

Around half of all external remortgagors last year took out extra money when they refinanced, borrowing on average an additional £50,000. Additionally, further advances (increasing borrowing without switching lender) accounted for a little over 3 per cent of gross mortgage lending last year.

Taken together, this provides evidence that homeowners are making rational decisions and accessing attractively-priced mortgage credit where possible as part of the overall management of their household finances.

Chart 13: Amounts of new personal loans from banks



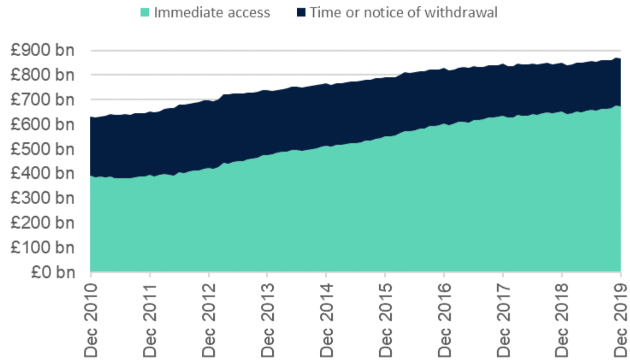
Source: UK Finance

Deposits

The lower use of overdrafts and reduced demand for personal loans has been associated with a build-up in savings. Total deposits increased by 2.4 per cent over the past year. This increase was down to growth in immediate-access accounts which grew by 3.5 percent over the past year compared to a small reduction in time or notice of withdrawal accounts of 1.4 percent.

In recent years, this growth in deposits has been driven by reduced consumption and a return to real earnings growth. Households are typically holding their money in immediate-access accounts which account for just over three-quarters of all deposits. The other quarter is held in notice or savings accounts (***Chart 14***) and, while low investment returns play a part, quick access to disposable income in uncertain economic times is the driving force for individuals when managing household budgets.

Chart 14: Personal deposit account balances



Source: UK Finance

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