Household Finance Review – Q1 2020

In this review we look at activity in UK households' finances during the first quarter of 2020. This is the first Household Finance Review published since the onset of the Covid-19 pandemic and the data captures some very early signs of the impact on household finance activity, immediately before and after the introduction of lockdown restrictions on 23 March 2020.

The focus of this quarterly Review considers activity in the mortgage market, where there are over nine million mortgages outstanding in a wider housing market of 28 million residential properties in the UK. Other aspects of household finance covered in this review include credit cards, overdrafts and personal loans.

Eric Leenders, Managing Director, Personal Finance comments:

"Following a subdued year in the mortgage market in 2019, any signs we might have seen of improving confidence translating into increased homemover activity at the turn of this year have currently been overtaken by the impact of the Covid-19 pandemic.

"Further evidence of the crisis is evident in unsecured borrowing. The sharp reduction in consumer spending has flowed through to a fall in credit card borrowing. We've also seen further increases in deposits held by households.

"This Review does not capture the various support measures to households that the industry has enacted, such as three-month

HIGHLIGHTS

- **Mortgage lending was flat in the first three months of 2020 compared with a year ago.**
- **An increase in buy-to-let activity was offset by a drop in first-time buyers.**
- **Regional variations in activity are likely a reflection of the market disruption due to the coronavirus pandemic.**
- **Despite cuts to Bank Rate we expect household preferences for fixed rate mortgages to continue.**
- **A modest pick-up in arrears towards the end of the quarter as the Covid-19 pandemic began to impact homeowners still leaves the number of mortgages in arrears lower than a year ago.**
- **Sharp fall in credit card borrowing as consumer spending falls in response to Covid-19 lockdown.**
- **Little movement seen in personal loans and overdraft activity over the quarter.**
- **Growth in instant access deposits continued in Q1.**

payment holidays and a repossession moratorium. By mid-May approximately 1.8 million mortgage payment deferrals had been arranged for customers. Similar payment holidays for personal loans and credit cards were introduced at the end of March and will be reviewed in depth in our next household finance review."

UK economic context and outlook

The outlook for the UK economy is expected to weaken at unprecedented levels as a result of the pandemic crisis. At the turn of the year, we had seen the economy starting to regain some momentum after several years of sluggish growth as business and consumer confidence was weighed down by uncertainty about Brexit and potential changes to the political landscape ahead of the General Election.

The significant public health response to the global pandemic saw swathes of the economy shut down in March. Business activity indicators covering all major sectors of the economy – manufacturing, construction and services – have reported the biggest ever falls in output. Housing market activity, as measured by the Royal Institute of Chartered Surveyors, for example, ground to a halt, with new instructions drying up almost entirely, given the challenges of concluding a property transaction.

The official data we have for the quarter confirms the early impact on economic activity, with GDP contracting some two per cent in the first three months of the year with a 5.8 per cent fall in March alone. However, the most visible impact has been on the labour market. In response to the lockdown, the government's Coronavirus Job Retention Scheme is currently contributing to the wages of over eight million workers. In addition, ONS claimant count figures signalled a 69 per cent rise in benefit applications to over two million in April.

Predictions from independent economists are for a much larger fall in GDP in the second quarter, as many lockdown measures remained in place. Estimates suggest this could be as large as 20 to 25 per cent. The latest independent forecasts published by HM Treasury, for example, show the average full year GDP forecast for 2020 coming in at -8.6 per cent. There are inevitably significant uncertainties around any forecast for the year ahead.

Recovery will hinge on sustained containment of the coronavirus. It will also depend on firms' ability to restart and the sequencing of the restrictions being lifted across the UK. Recent government announcements confirm that a phased lifting of restrictions will begin in June. Business surveys from, for example, the British Chambers of Commerce, point to many, but not all firms, being ready to reopen their doors while conforming to safety guidelines. The confidence of consumers to return to previous spending patterns remains uncertain, not least because labour market prospects will remain fragile for many. April's unemployment expectations index, as reported by the European Commission, rose sharply to its highest level since early 2012.

Continuing assistance from the range of government-supported schemes, such as the Coronavirus Job Retention Scheme, and the extension of payment deferrals agreed with the banking and finance industry, should help alleviate some of the pressure on household and business finances through the transition out of lockdown. This should hopefully underpin a return to growth in UK GDP through the second half of this year with the rebound continuing in 2021.

Significant steps have been taken to support activity and minimise long-term scarring to the UK economy. Coordinated central bank actions will provide a further prop. In March the Bank of England cut the Bank Rate to 0.1 per cent, expanded its asset purchase programme by a further £200 billion – mainly targeted towards purchases of government bonds –

and introduced a Term Funding scheme with additional incentives for SMEs. The package aims to mitigate tightening in financial conditions across the economy. Our Review will touch on how these actions will flow through to households (see page 6).

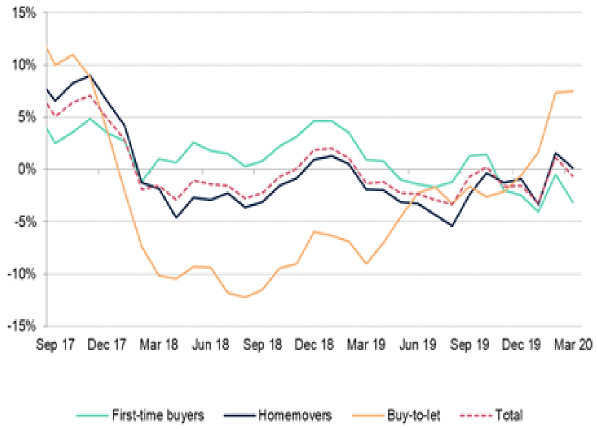
While this latest Household Finance Review concentrates on activity in the first quarter of this year, we also seek to outline how these indicators could evolve in the coming quarters throughout 2020 and into 2021.

Q1 2020 – Benign activity in mortgage market with regional variance

The UK mortgage market in the first quarter of 2020 was relatively flat for both house purchase and refinancing in the residential sector. This is in line with what we have been seeing in the mortgage market over the last few years – flat or declining volumes of new mortgages amid increasingly tight affordability.

However, once we dive deeper into the overall picture for the UK, there is some divergence in trends for the different segments of house purchase activity. This is best shown in **chart 1**, where we can see that, although the picture for total house purchase has been broadly stable over the last two years, there has been significant variance, most significantly between how buy-to-let (BTL) and first-time buyer (FTB) purchasers have behaved.

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



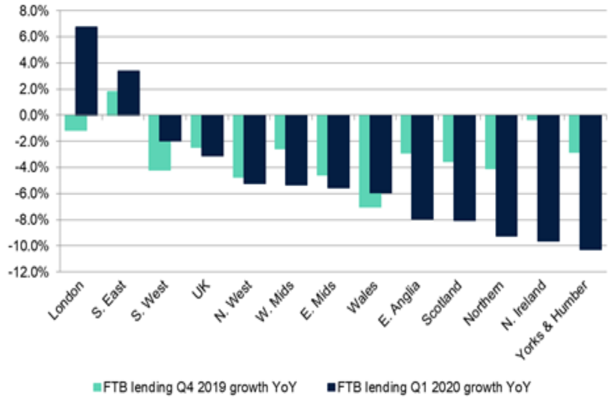
Source: UK Finance

Homemovers volumes picked up in the first quarter of 2020 and have remained broadly in line with overall house purchase movement, as affordability has remained tight and the economy had remained stable.

By comparison, BTL house purchases increased by a comparatively large seven per cent in Q1 2020 relative to the same period a year earlier. While we had seen purchases within this sector improve considerably over the past year, following a decline due to tax and regulatory changes that started in 2016, we had seen material growth in this sector from December 2019 onwards.

This recent growth in BTL purchase has helped to offset FTB numbers, which have been declining slightly since October 2019. While FTB figures have remained subdued in aggregate across the UK, when we look at the regional picture we get a different story.

Chart 2: Quarterly volumes of first-time buyer mortgages in UK counties and regions, year-on-year



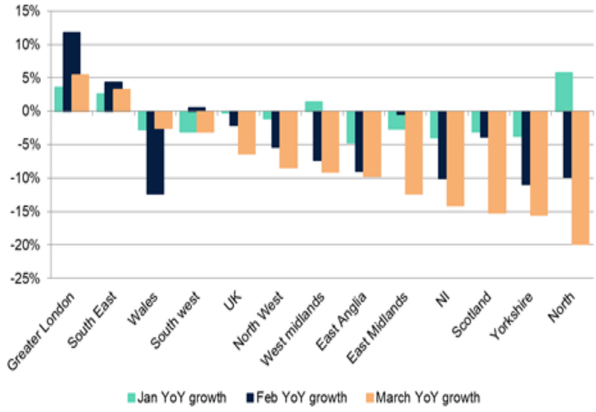
Source: UK Finance

In **chart 2**, we can see that growth in Q1 was much stronger than Q4 2019 for FTB volumes in London and the South East. This differs from the rest of the UK, where there has been a drop-off in growth in Q1 in almost every geography.

This trend is particularly marked in the devolved nations and the North of England, with year-on-year drops in volumes reaching as high as ten per cent. While these negative growth rates have affected the UK's overall growth, the improvement in first-time buyer lending in the South has offset the drop elsewhere, leading to a relatively modest overall decline (of three per cent).

For those regions now showing a year-on-year decline, the rate of decline looks to have accelerated throughout the quarter. As **chart 3** shows, in the majority of regions there was a drop in January followed by more significant falls in February and March in first-time buyer completions.

Chart 3: Monthly volumes of first-time buyer mortgages in UK counties and regions, year-on-year

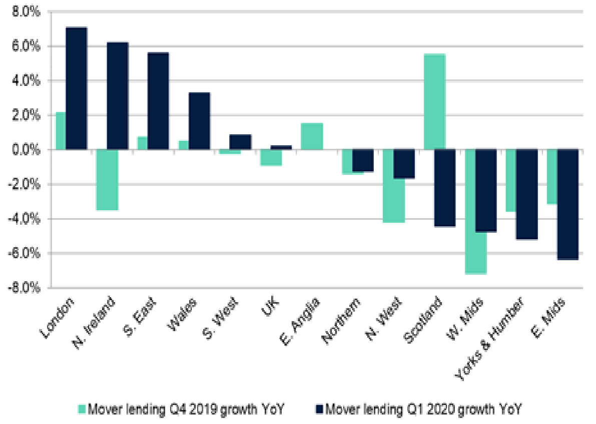


Source: UK Finance

Again, southern England was less affected by this trend, with the most pronounced – and accelerating – declines concentrated in northern England, Northern Ireland and Scotland. In geographies such as Yorkshire, Scotland and Northern Ireland, these declines in activity follow overall FTB growth in 2019, whereas the south of England had declines in FTB activity last year.

Interestingly, as **chart 4** shows, this is not a movement seen across the whole house purchase market. While homemover activity in the south of England is consistent with FTB activity there, homemovers in the rest of the UK have behaved differently to FTBs.

Chart 4: Quarterly volumes of homemover mortgages in UK counties and regions, year-on-year

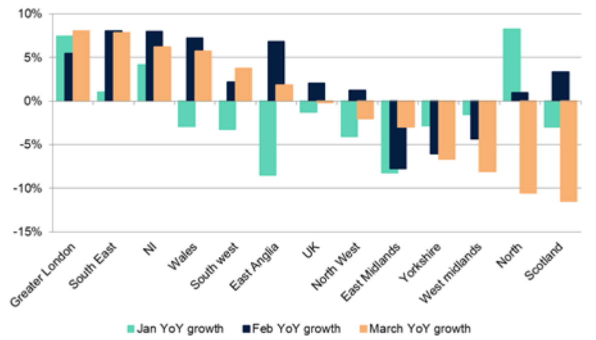


Source: UK Finance

In Northern Ireland, where we saw large declines in FTB activity, we saw strong homemover growth. Likewise, Wales saw homemover growth in both quarters as opposed to drops in FTB volumes in both quarters. In fact, in only four of the 13 regions was lower growth recorded for homemovers in Q4 2019 than in Q1 2020, compared to nine of the 13 geographies where this was the case for FTBs.

These differences in FTB and homemover trends are further exemplified by **chart 5**, where we again see key regional differences in homemover growth as opposed to the clear similarities present in FTB movement.

Chart 5: Monthly volumes of homemover mortgages in UK counties and regions, year-on-year growth



Source: UK Finance

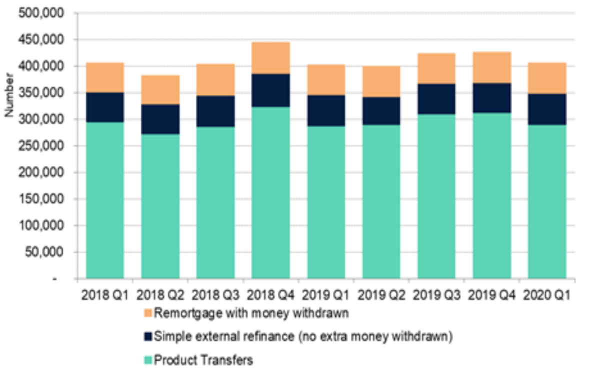
While those big drops in March are present in four geographies, these movements don't necessarily follow a pattern of decreasing homemover growth in January and February. And in every other geography, March saw an improvement in year-on-year growth compared to January and February.

This clearly differs from FTBs where there was a material drop in March growth in every geography outside the south of England.

While there appears to have been a regional divergence in FTB markets, this is not the case for homemovers. It is likely that the significant disruption to activity over the quarter is creating some noise in the data and a clear picture of how trends have evolved in different parts of the country should become more apparent in the coming quarters.

While regional house purchase year-on-year growth shows variances, the picture for the whole of the UK was fairly flat. This is also the case for residential refinancing, as seen in **chart 6**.

Chart 6: Number of residential remortgages and internal product transfers



Source: UK Finance

In the Household Finance Review for Q4 2019, we covered refinancing in detail, in particular the year-on-year decrease in activity in the final months of last year. As we observed then, this drop-off was largely due to the overall refinancing schedule and the number of borrowers coming off a fixed rate mortgage written two or five years ago.

This quarter saw a pick-up in activity as borrowers locked into attractive rates (the majority of borrowers did so for five years as opposed to two years) as their fixed-term ended. Most refinancing is done via product transfer as lenders continue to offer their existing borrowers new deals at historically low rates.

Lenders have committed to continue to offer product transfers to those borrowers who have taken out a Covid-19 related payment deferral. Under normal circumstances, these borrowers would not be able to take out a product transfer while on – or entering into – payment deferral arrngements, however this restriction has been temporarily lifted to ensure that the 1.8 million mortgage holders taking a mortgage payment deferral, as at 21May, are able to switch to a new fixed-rate should their current fixed-rate deal come to an end. This allows customers to continue to manage the cost of their borrowing in a time of financial uncertainty. Borrowers who have been furloughed or have otherwise had their income reduced will also continue to be offered a product transfer.

How Bank Rate has affected borrowers over the past decade

Over the past fifteen years, the Bank of England base rate has declined to record lows as the Bank flexed monetary policy to support the economy, first through the Global Financial Crisis, through Brexit uncertainty and, most recently, to help mitigate the negative economic impacts of Covid-19.

These decreases in Bank Rate have had a large impact on mortgage products and pricing.

Chart 7: Initial interest rates for new mortgages and the Bank of England base rate over time

Source: UK Finance

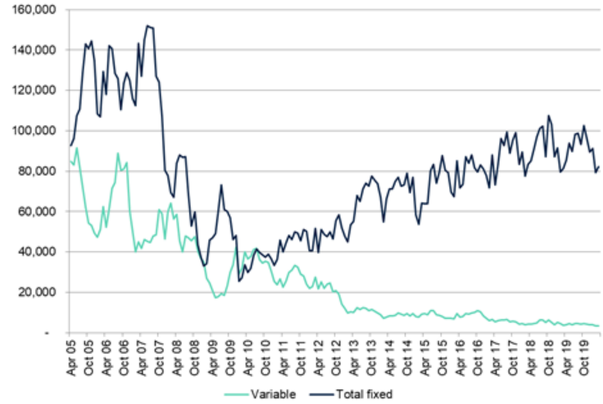
Following the Bank Rate cut in 2009, we saw variable-rate mortgages follow this movement with a similar fall in pricing. It is important to note that while variable rates are linked to Bank Rate, they are also affected by a range of other conditions affecting both lenders' cost of funds and wider supply and demand conditions in the market.

After a series of reductions culminating in the largest cumulative rate cut in 2009 alongside a substantial programme of quantitative easing, Bank Rate then didn't change for another seven years. While Bank Rate remained unchanged, interest rates continued to decline as the market became more competitive, with more lenders entering the market each year.

With rates cut again in March 2020 to 0.1 per cent, in order to mitigate against tightening financial conditions in the economy, variable and fixed-rate mortgage pricing has declined again, albeit to a lesser extent as lenders balance passing on Bank Rate cuts and covering costs.

It's important to note that while variable rates have, for the past decade, been much lower than fixed-rate mortgages, a yield curve reflecting the lower-for-longer rate environment we are now in, together with increasing market competition, has helped to drive fixed-rates to levels as low as variable rates. With this virtual absence of premium for payment certainty, this means that borrower preference in mortgage lending is now almost entirely for fixed-rate products, as borrowers lock in to these historically low rates (**Chart 8**).

Chart 8: Number of new mortgages by type of interest-rate



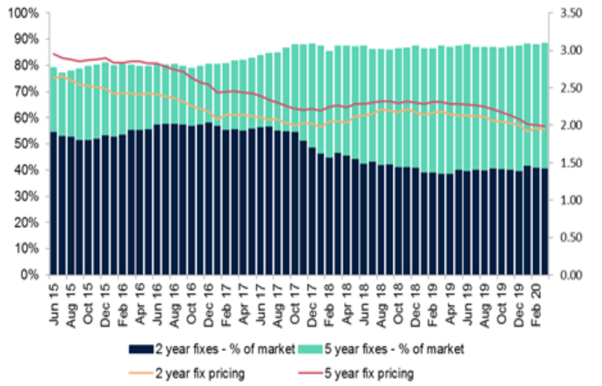
Source: UK Finance

The proportion of residential regulated mortgages outstanding on a fixed-rate now stands at 70 per cent.

As noted in our Q4 2019 Household Finance Review, with more borrowers already on fixed rates – and increasingly their deal periods are for five rather than two and three years – there are fewer variable-rate mortgage holders who are able to switch.

This is further shown in **chart 9**, where it is clear that customers are locking into fixed rates for longer as rates reduce.

Chart 9: Interest rates and proportion of new residential mortgages for two & five year fixed-rates



Source: UK Finance

Again, pricing for these longer-term mortgages has reduced as more lenders enter the market and compete for business. As five-year fixed rate prices have reduced, the proportion of new mortgages that are taken on a five-year fixed rate has increased commensurately, with borrowers keen to take advantage of the favourable rates available now for longer fixed rate products.

As well as the benefit of the low absolute pricing, the predominance of borrowers now on low fixed rates for longer brings welcome surety of payment amid the continuing, and evolving, economic uncertainty that the country has seen over the past few years. This shows rational behaviour from borrowers to manage their finances.

So how will the most recent Bank Rate change affect borrowers? As the majority of borrowers are now on a fixed-rate, only around three in ten borrowers with a residential regulated mortgage will be affected.

Table 1 shows that those borrowers on a variable or tracker rate will on average save between £25 – £40 a month on their monthly mortgage payments. It is important to note that many borrowers on tracker rates are on very low rates already and often have lower balances or time left on the mortgage so these borrowers will have little incentive to move to a different mortgage product. As a result, it's unlikely that the proportion of borrowers on a variable rate mortgage will drop much further.

Table 1: Bank rate change by interest-rate type

	Type of interest rate		
	Fixed rate	Standard variable rate	Bank of England Base rate tracker
Per cent of all new loans (March 2020)	96%	0.2%	2.1%
Number of outstanding loans (December 2019)	5.7 million	1.3 million	0.9 million
Per cent of all outstanding loans (December 2019)	69%	16%	11%
Average monthly payment (December 2019)	£574	£483	£408
Average remaining balance (December 2019)	£151000	£81000	£122000
Average interest rate for new loans (March 2020)	1.98%	3.94%	1.6%
Average interest rate for outstanding loans (December 2019)	2.31%	3.93%	2.17%
Change in monthly payments	£0	-£27	-£39

Source: UK Finance

In addition, the average monthly payment for fixed-rate mortgages is higher in the table above. This is due to a greater proportion of newer mortgages (which therefore have larger average balance) being on a lower fixed rate.

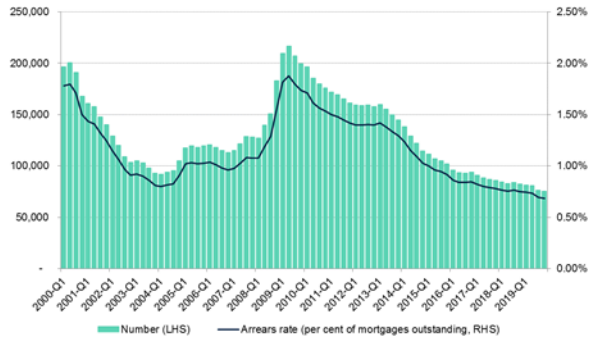
Arrears & Possessions

As the vast majority of borrowers are paying their mortgages on time and in full, mortgage arrears have continued to trend down over the past decade, reaching historic lows for the number of borrowers in arrears.

There was, as we noted in our Q1 2020 Arrears and Possessions release and accompanying blog, a small uptick in arrears at the start of March relating to early issues due to Covid-19 before payment deferrals were introduced.

As **Chart 10** shows, despite this small uptick in arrears from Q4 2019 to Q1 2020, arrears were still much lower than a year previously.

Chart 10: 1st charge homeowner and buy-to-let mortgages in arrears[1]

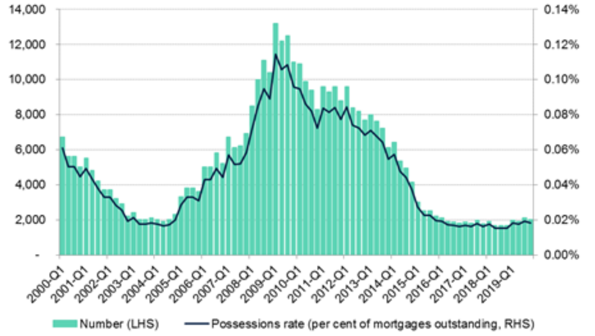


Source: UK Finance

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

In a similar vein, possessions trended downwards and are again at historic lows, as shown in **chart 11**.

Chart 11: Number and proportion of 1st charge mortgages taken into possession in period



Source: UK Finance

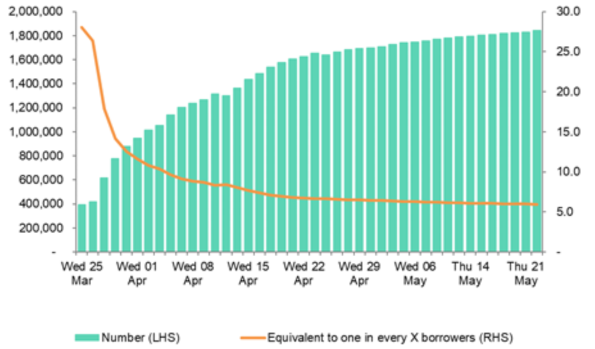
Possessions saw a small uptick in 2019 due to the unwinding of a backlog in cases that were originally paused to ensure that these were processed in line with the latest guidance. With a possessions moratorium now in place in response to the Covid-19 pandemic, no more involuntary possessions can take place before 31 October 2020.

Covid-19 related payment deferrals

Over the last two months, lenders have put a huge effort into ensuring that borrowers are supported as much as possible if they are struggling with payments as a result (either direct or indirect) of Covid-19.

Lenders have (as shown in **chart 12**) granted more than 1.8 million mortgage holidays (which we will subsequently refer to as payment deferrals throughout) since the scheme came into effect in late March.

Chart 12: Number of payment deferrals in place at the end of each working day



Source: UK Finance

This means that one in every six borrowers has taken the option of mortgage payment deferral. This level of support for borrowers is unprecedented, but also shows that, even in a period of large economic uncertainty, the majority of borrowers are still able to meet mortgage payments, and those who are not are able to take advantage of mortgage payment deferrals in order to help them manage their finances in this difficult time. Final FCA guidance, just published, confirms that those customers who need it will be able to access a further three-month full or partial payment deferral

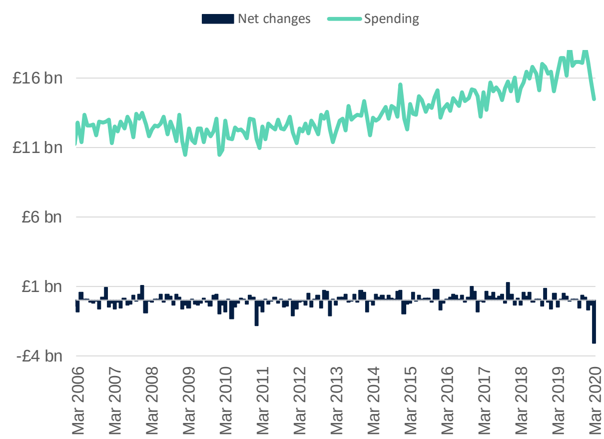
Unsecured Borrowing – Credit Cards

Around half of all unsecured credit provided by banks and building societies comes from credit card borrowing. As reported in the Q4 2019 Review, spending on credit cards has been trending higher in recent years driven by a combination of real income growth and a rise in the number of contactless cards being issued – seen, for example, in the year-on-year growth in credit card transactions for travel. However, over this period growth in credit card spending has been offset by credit card balance repayments.

This quarter the picture looks very different. One of the most immediate effects of the Covid-19 pandemic, seen in both the official retail sales statistics and our own data, is the drop in consumer spending. The lockdown restrictions implemented towards the end of March resulted in a sharp drop in 'non-essential' retail activity, travel and entertainment spending. Indeed, there was evidence of consumer behaviour change in line with social distancing, before the official lockdown guidance was issued by the government.

Chart 13 shows a sharp decline in credit card spending, which contracted by more than 12 per cent in the year to March. This includes a 14 per cent fall in purchases, and cash withdrawals slumping by more than a quarter compared with March 2019. The data confirms the trend in official retail sales data, and our own experience as consumers, of buoyant retail activity in supermarkets and food retailing. This was more than offset by a collapse in card spending on travel (down nearly two-thirds relative to a year ago) and entertainment (down by 27 per cent over the same period). With lockdown restrictions in force for much of the current quarter and an uncertain labour market outlook further weighing on spending activity, we can expect more of the same in the Q2 2020 Review.

Chart 13: Credit card spending and net changes in balances outstanding

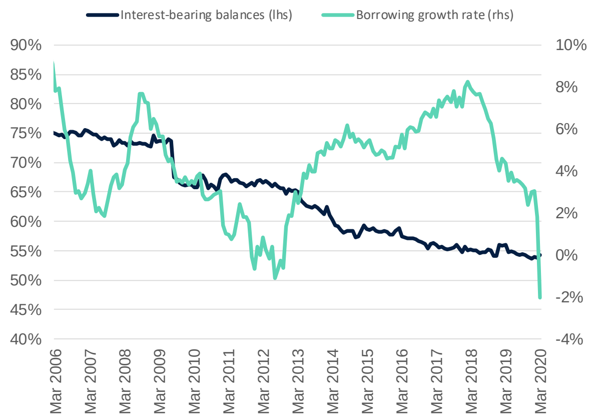


Source: UK Finance

The trends seen in credit card activity are very much a household activity story. **Chart 14** illustrates the changes in borrowing on cards – mirroring the fall in spending, and also the proportion of interest-bearing credit cards. There is little movement on this latter metric. Over the past decade, the proportion of card balances bearing interest has reduced to 54.3 per cent as more credit card customers pay off balances in full when they receive their monthly statements. There has been no change in this consumer behaviour in the first quarter of this year.

In addition to expectations of further declines in card spending over the coming quarters, further measures to support households through the crisis include three-month credit card repayment deferrals. The introduction of this additional support measure came into effect in April and is, therefore, not captured in the Q1 data. However, at time of writing an estimated 878,000 credit card payment deferrals had been agreed, the impact of which is likely to be evident in future Reviews.

Chart 14: Annual growth in card borrowing and proportion of balances bearing interest



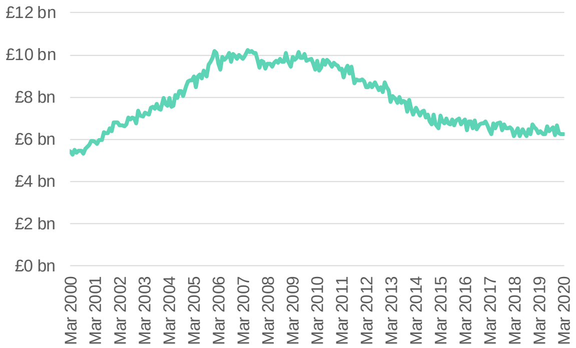
Source: UK Finance

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 Q1 2020 (***Chart 15***). There was little movement in overdraft lending over the quarter, with amounts outstanding at the end of the quarter around one per cent lower compared with the same period a year ago.

We expect this picture to change in coming quarters. This will be driven by the introduction of support measures to bank customers, with personal current account providers offering fee-free overdraft buffers up to £500. Again, the effects of this are not evident in the Q1 data covered in the Review as most banks implemented this additional support in April 2020. With around 27 million additional overdraft facilities in place, next quarter's data will shed more light on how these have been taken up by customers.

Chart 15: Overdraft borrowing



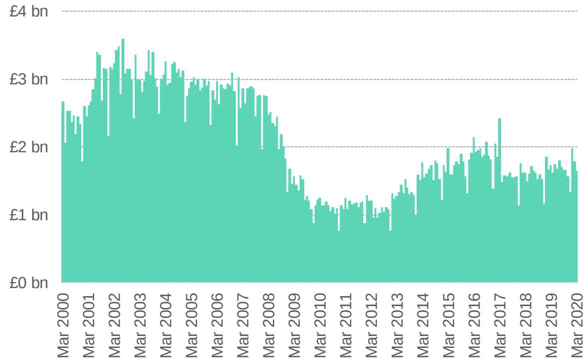
Source: UK Finance

Unsecured borrowing – Personal Loans

Like the largely stable picture over the first quarter on overdrafts, trends in personal loan activity were also flat at the beginning of 2020. We have seen demand for personal loans from banks and building societies subdued in recent years, in part because of consumers choosing the alternative of personal car finance plans (PCPs) provided by dealerships over traditional bank loans (***Chart 16***). And for homeowners, many have opted to increase their mortgage borrowing for some spending that might previously have been funded by personal loans.

There were no shifts in these trends at the start of 2020. The amount outstanding was a modest one per cent higher at the end of Q1 2020 compared with the same time a year ago. Like the other unsecured products discussed, banks' Covid-19 support includes three-month payment deferrals for personal loans. By mid-May some half a million of these had been agreed with customers. While we expect, again, to see this translated in to an increase in amounts outstanding in the next quarter, it will take some time to understand how various payment deferrals on mortgages and other unsecured lending interact and how customers have chosen to use the flexibility of these support measures to manage their personal finances through the current crisis.

Chart 16: Amounts of new personal loans from banks

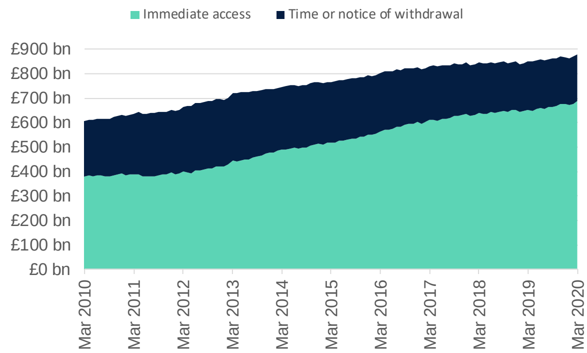


Source: UK Finance

Deposits

In recent years data has signalled a build-up of savings amongst households. In 2019 total deposits increased by 2.4 per cent, mainly through growth in immediate-access accounts (up 3.5 percent in 2019). Households were responding to economic uncertainty by favouring savings accounts with easy access. Lower investment returns from products such as ISAs were also a factor contributing to the balance of savings being held in immediate access accounts.

Chart 17: Personal deposit account balances



Source: UK Finance

Chart 17 shows that over the first quarter of this year there was further growth in deposits and that was, again, concentrated in immediate-access accounts. Limited retail opportunities towards the end of the quarter and a sharp fall in consumer confidence fed through to a 1.3 per cent rise in total deposits at the end of Q1 2020 compared with Q4 2019, with the rise in immediate-access saving coming in at 1.9 per cent over the same period. Many economists expect to see a sharp increase in the savings ratio, at least in the first half of 2020. This should provide something of a cushion for households until the economy starts to emerge from this crisis.

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