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UK LOCKDOWNS - LESSONS FROM MONEY AND CREDIT DATA

Berenberg Macro View

Note: This report includes corrections from the initial version published on 1 February 2020 in which household M4 had been reported as non-financial businesses M4 and vice versa.

Policy continues to support businesses and households

Bank of England data on money supply and credit provide important insights into how businesses and households are reacting to the ongoing wave of the COVID-19 pandemic and national lockdowns since November. From the December money supply data we make some tentative comparisons between the ongoing lockdown and the initial one from March to June 2020:

- While deposits held by UK households are rising sharply again, non-financial business deposits are rising much more slowly this time around – Chart 1. Businesses operating in the parts of the economy that are temporally shut have borrowed heavily since March 2020 to make up for the shortfall in revenues by raising their liquid balances. To buffer against the severe cash-flow crunch, and incentivised by policymakers' generous loan guarantees and cheap credit, businesses have drawn from their available credit facilities and now have the liquidity buffers necessary to manage short-term cash flow problems.
- Households are increasing their liquid balances sharply once again. This reflects a rise in involuntary saving while major parts of the UK economy are under lockdown – thereby limiting the opportunity to spend. Crucially, however, households have partly adjusted to restrictions by now – they now spend more online when the shops are shut. After slumping by around c23% during the spring lockdown, retail sales ex-auto fuel were 4.9% higher in December 2020 than their pre-pandemic peak. Jobs and incomes remain well supported by the furlough scheme. As a result, households report a strong financial situation even though overall confidence remains weak - this reduces the urge to save for precautionary reasons.
- The trends in money supply and credit during 2020 differ sharply from those of the financial crisis. Whereas growth in M4 for households and businesses has accelerated strongly since March 2020, growth in household deposits slowed dramatically in 2008/09 while businesses deposits contracted sharply – see Chart 2. The big difference between the COVID-19 pandemic and the financial crisis is simple – policymakers mostly got it right this time around. With a suitably aggressive policy response to make sure credit is available to those who need it, policymakers have prevented a major economic shock from developing into a serious financial crisis.

Highlights from the December data

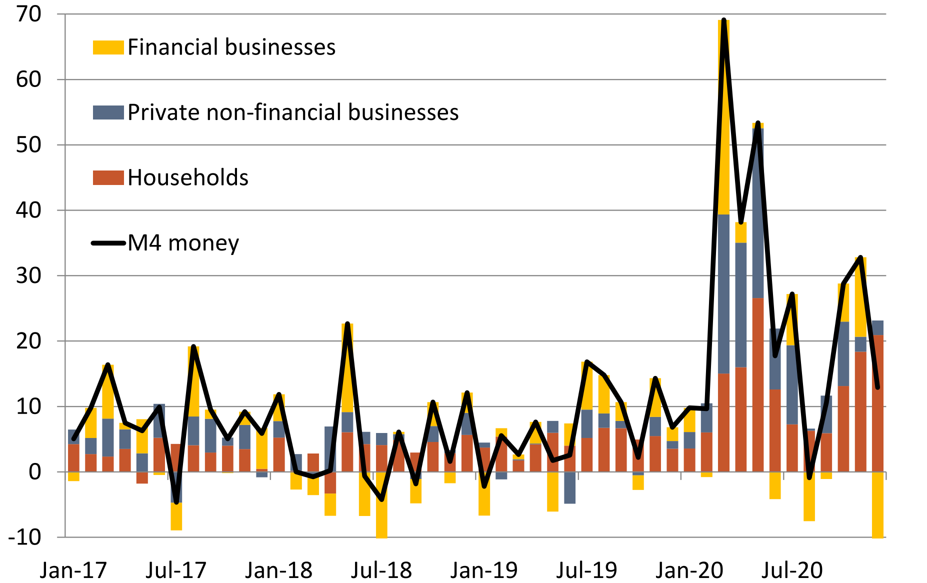
- Liquid balances held by households and businesses rose further in December. Although the £12.9bn monthly rise was below the £30.8bn average for October and November and well below the £69.1bn peak in March, the monthly drop-off was due to a decline in money held by financial businesses. The aggregate balance for households and non-financial businesses increased at a similar rate to recent months.

- While households added £20.9bn to their liquid balances – the second highest monthly gain during the pandemic (May 2020 was the highest at £26.5bn), non-financial businesses added just £2.2bn – in line with the November increase but well below the pandemic average of £11.1bn. Much-less-affected financial businesses reduced their liquid balances by £10.2bn – that remains within the range of normal monthly volatility, however.
- While businesses continued to borrow in December, households continued to pay down debt at a modest rate using some of their excess cash balances – Chart 3. This is in line with trends for 2020 overall – households paid down £16.6bn of consumer credit. Businesses borrowed £3.6bn in December via a combination of bonds (£2.0bn) and equity issuance (£1.6bn).
- As current restrictions do not impair housing market activity as severely as earlier lockdowns, the market remained firm during the first half of winter. The robust performance follows the V-shaped recovery in housing demand and supply during H2 2020 after the initial pandemic shock. The number of loans for house purchase remained broadly unchanged on a monthly basis at 103.4k December – well above the 67.9k pre-pandemic six month average – Chart 4. Re-mortgaging activity remained subdued at 33.8k loans in December – roughly 32% below the pre-pandemic monthly average.

Positive outlook

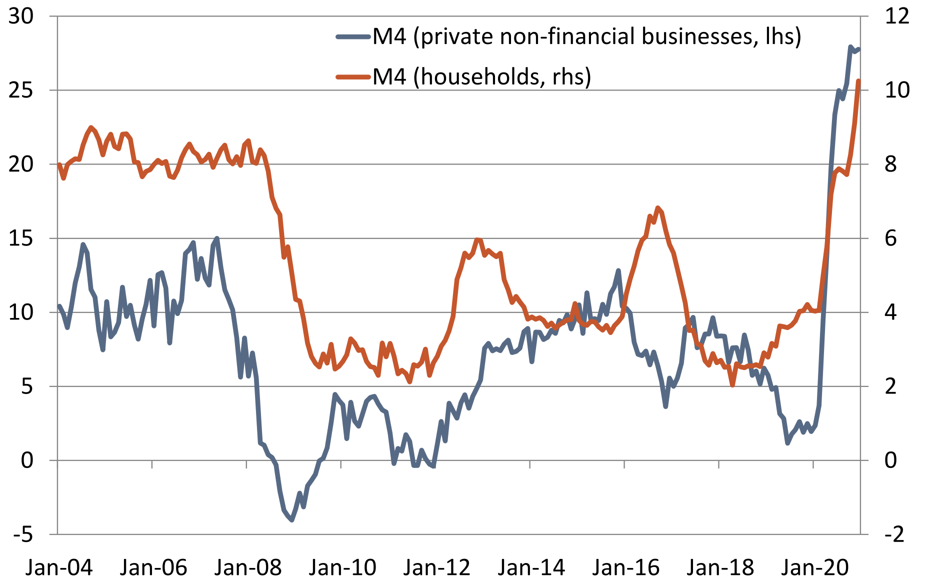
The money and credit data support our positive medium-term outlook for the UK. Driven by a rapid rebound in broad consumer spending and upturn in business investment and hiring, we expect the UK to reach its pre-pandemic level of GDP by Q3 2022 - see here for more detail. The note includes a detailed analysis of excess savings, the housing market rebound and the consequences of higher private debt.

Chart 1: Broad money by sector (monthly change, £ bn)



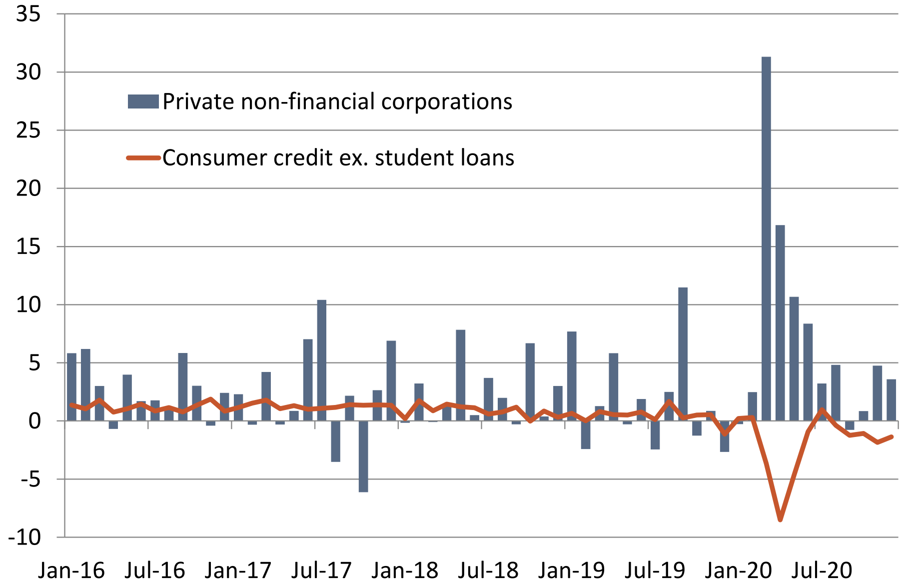
Monthly amounts outstanding of UK resident monetary financial institutions' sterling M4 liabilities to private sector excluding intermediate other financial corporations. Source: Bank of England

Chart 2: Annual change in broad money by sector (%)



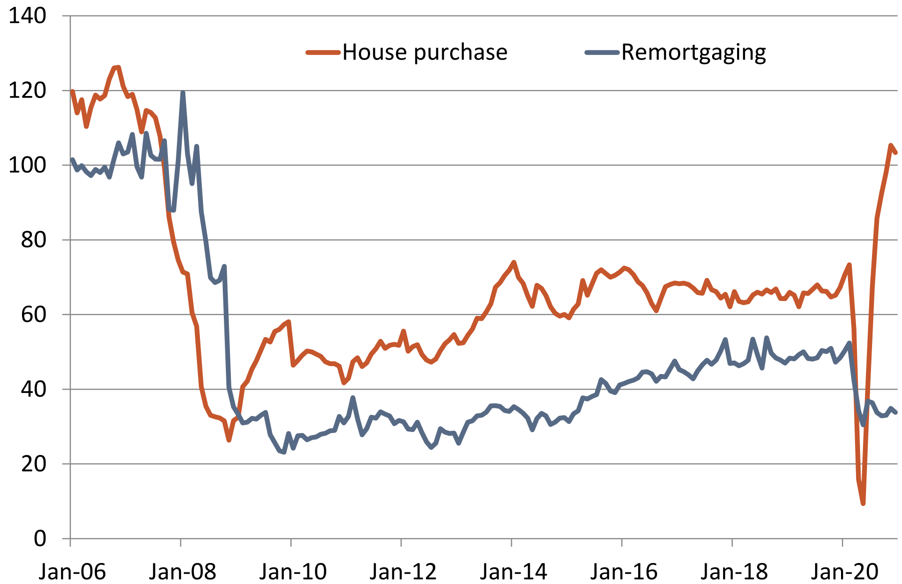
Annual change in outstanding amount of financial institutions' sterling M4 liabilities to the household and private non-financial sectors. Monthly data. Source: Bank of England

Chart 3: Monthly net lending (£ bn)



Monthly data. Source: Bank of England

Chart 4: Mortgage approvals (thous)



Monthly data. Source: Bank of England