ARBUTHNOT BANKING GROUP PLC

PERSPECTIVES

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Record household savings in 2020: ready to boost the economy when lockdown lifted

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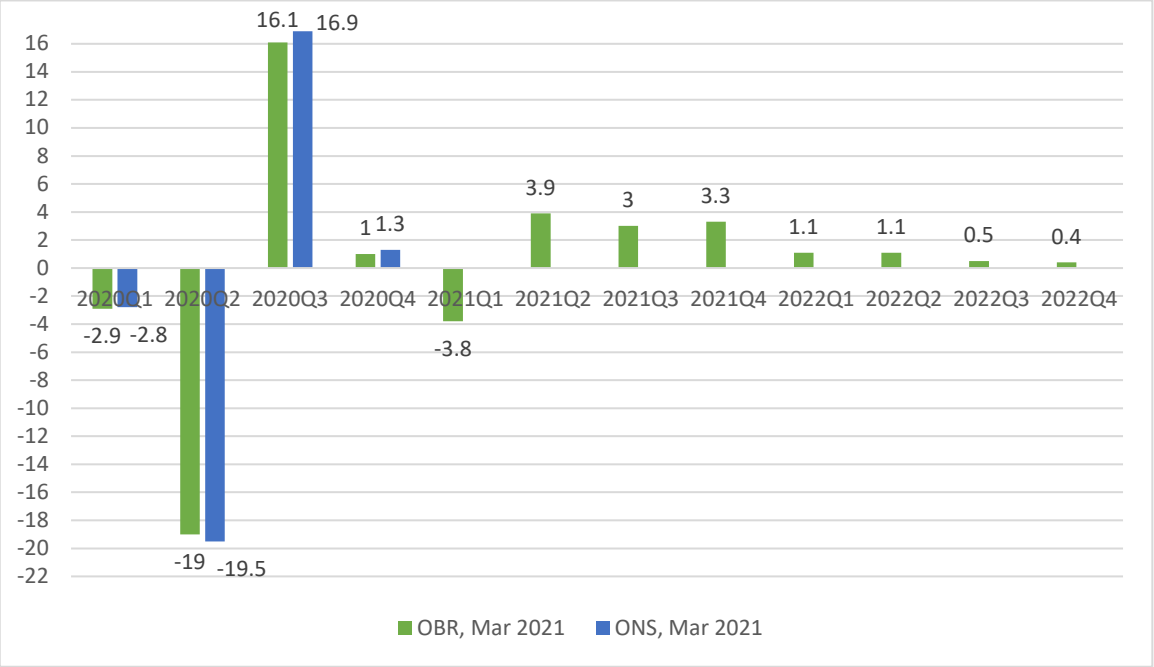
Introduction: GDP fall in 2020 little changed at 9.8%...

The ONS's revision to GDP for 2020 was very modest. They now estimate a fall of 9.8% (YOY), marginally less than the initial estimate of 9.9%, but still the largest fall on record.[1-3] There were, however, some more substantial revisions to the quarterly data, which now read -2.8% for 2020Q1, -19.5% for 2020Q2, +16.9% for 2020Q3 and +1.3% for 2020Q4. The data released in February 2021, and incorporated into the OBR's March 2021 Budget forecasts, read -2.9% for 2020Q1, -19.0% for 2020Q2, +16.1% for 2020Q3 and +1.0% for 2020Q4 (see chart 1).

Within the total, the three major output sectors all provided strongly negative contributions to GDP growth for 2020, as previously indicated. On the revised data, services output fell by 9.0% (YOY), within which accommodation & food services decreased by 42.5% (YOY), education by 16.4%, health by 8.2% and "other services" (including the arts) by 25.8%. Total production output decreased by 8.0%, within which manufacturing output fell by 9.5%, whilst construction output decreased by 14.0%.

Turning to the expenditure measure of GDP, all components were strongly negative, except the trade balance. On the revised data household consumption contracted by 10.6% (YOY), whilst Government consumption fell by 6.5% (YOY). Gross fixed capital formation (GFCF) fell by 8.8% (YOY), within which business investment decreased 10.2% (YOY), and there was major destocking in 2020, after modest stock-building in 2019. However, the trade deficit narrowed in volume terms, as exports fell by 15.8% whilst imports fell by 17.8%. This would have supported GDP.

Chart 1 OBR forecast, ONS outturns, quarterly GDP growth profile (%)



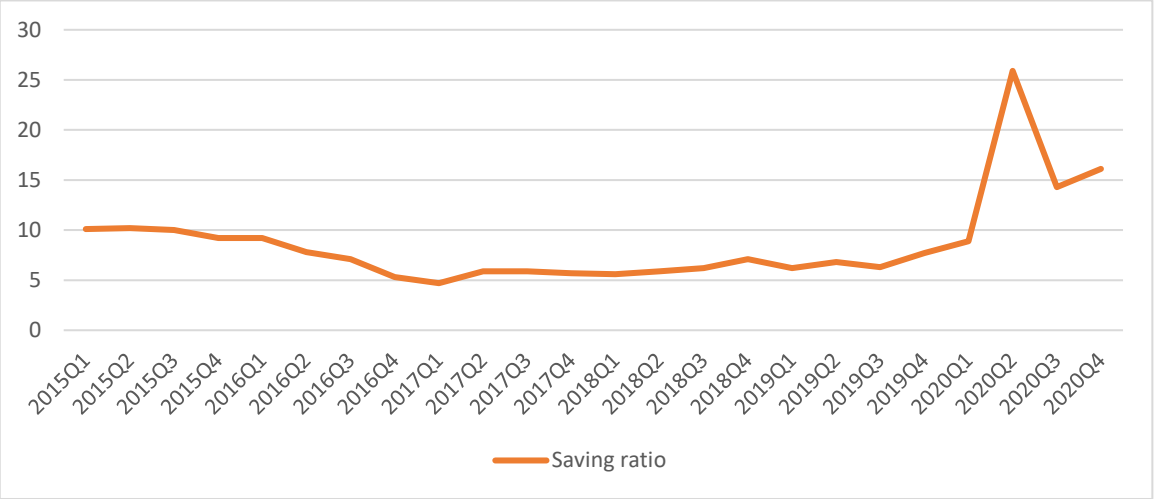
Sources: (i) *OBR*, "Economic and fiscal outlook", CP387, March 2021, table 2.3; (ii) *ONS*, "GDP quarterly national accounts, UK: 2020Q4", 31 March 2021.

…whilst saving ratio reached record high in 2020

Perhaps the most interesting feature of the latest set of UK national accounts related to the newly released households' saving ratio for 2020.[4-5] The saving ratio rose sharply in 2020, reaching a record high of 16.3%, as household incomes outstripped spending reflecting lockdown restrictions, compared with 6.8% in 2019. Chart 2 shows the quarterly data since 2015Q1. The ratio almost tripled between 2020Q1 (8.9%) and 2020Q2 (25.9%) but fell back in 2020Q3 to 14.3% (revised) as households resumed spending following an easing in lockdown restrictions (household consumption rose over £50bn in 2020Q3). It was, nevertheless, still very high by historical standards in 2020Q3. The ratio then increased in 2020Q4 to 16.1%, as lockdown restrictions were reimposed and household consumption fell back (by £5bn). Households saved nearly £240bn in 2020, compared with £100bn in 2019.[6]

Suffice to say, the Bank's Chief Economist, Andy Haldane, has recently pointed out that much of the increased household savings is likely to be spent (when lockdown is lifted) and, therefore, boost household consumption and hence GDP.[7-8] This, coupled with Government support, should lift the economy. His comments are equally apposite to the large increases in money holdings over the past 12 months by the household sector and companies and we will return to his comments when discussing the Bank's latest data on the money supply (below).

Chart 2 Households' saving ratio (%)



Source: *ONS*, "Quarterly sector accounts, UK, 2020Q4", 31 March 2021.

The current account widened in both 2020Q4 and the year 2020

The ONS has also released the latest data for the balance of payments, the main current account data of which we record here.

Concerning 2020Q4, the current account deficit widened quite significantly to £26.3bn (from £14.3bn in 2020Q3), mainly reflecting a worsening goods balance (annex table 1a).[9-11] The goods deficit widened to £41.7bn (£30.8bn in 2020Q3), with higher imports, in particular, reflecting evidence of stockpiling in preparation for EU exit after the end of the transition period on 31 December 2020. The services surplus increased a tad to £28.4bn (£26.8bn in 2020Q3), with the ONS noting that services trade (both exports and imports) continued to be impacted by the pandemic, especially in transport and travel services. The primary income (mainly investment income) deficit narrowed a tad £5.0bn in 2020 (from £5.3bn in 2020Q3), with the marginal improvement reflecting the slightly larger recovery in UK earnings on foreign investments than the recovery in payments to foreign investors on their UK investments. The secondary income deficit, however, widened to £8.1bn (£5.0bn in 2020Q3), reflecting a significant increase in payments to the EU. Concerning the geographical EU/non-EU split, there were deteriorations in the balances with both the EU and the non-EU.

Turning to the current account for the year 2020, there was a modest deterioration in the deficit to £73.9bn in 2020, compared with £68.6bn in 2019, a deterioration of just £5.3bn (annex table 1b). The goods deficit narrowed to £115.0bn (from £130.8bn in 2019), as imports fell more than exports, whilst the services surplus rose a tad to £107.4bn (from £103.3bn in 2019). But the primary income (mainly investment income) deficit widened to £38.2bn in 2020 (from £14.7bn in 2019), with the ONS commenting "…credits fell more sharply than debits as earnings on investments abroad were more impacted by economic uncertainty because of the coronavirus pandemic". The secondary account (current transfers) deficit also widened to £28.2bn (£26.4bn in 2019), with the ONS commenting "…payments to EU institutions increased as the UK reached the final year of the Multiannual Financial Framework (MFF) and to support the EU's coronavirus response." Concerning the geographical EU/non-EU split, there was a major improvement in the balance (deficit) with the EU, which was more than offset by the deteriorating balance with the non-EU.

The Bank: continued consumer credit repayments in February, but mortgage market still strong…

The Bank of England's latest data on net consumer credit, showed that households continued to making net repayments of consumer credit in February (£1.2bn), which was, however, a slightly smaller net repayment than the average of £1.8bn since March 2020.[12] As a result of the further repayment, the annual growth rate fell to -9.9%, a new series low since it began in 1994. Within consumer credit, the weakness on the month reflected net repayments on credit cards (£0.9bn) with some repayments of other forms of consumer credit (£0.3bn). The annual growth rates of both components fell further, to -21.0% and -4.8%, respectively. Both represent new series lows.

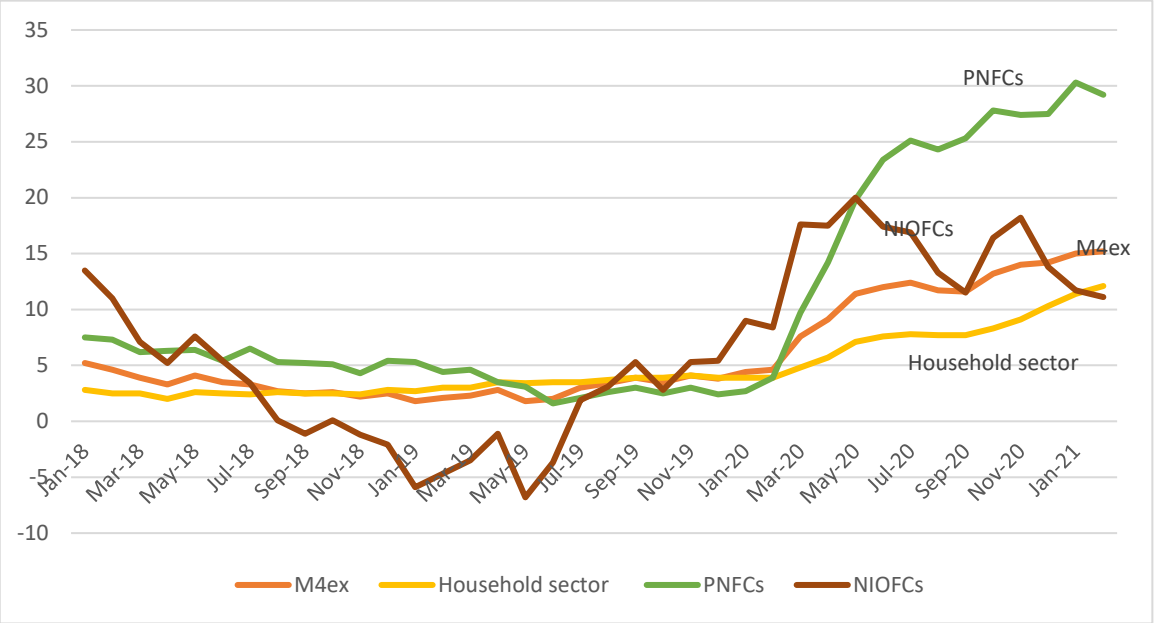
The mortgage market, however, remained strong in February. Net mortgage borrowing was £6.2bn in February, the strongest since March 2016 and the annual growth rate for mortgage borrowing picked up a tad to 3.2% (3.1% in January). Borrowing was supported by the expected ending of the temporary stamp duty tax relief at the end of March, which was extended to end of June in the March 2021 Budget. The pick-up in borrowing has followed high levels of mortgage approvals for house purchase seen in recent months and February was no exception. Mortgage approvals for house purchase were still as high as 87,700 in February, though down on January's 97,350 and down on the recent peak of 103,700 in November 2020. By comparison, the monthly average in the six months to February 2020 was 67,900. Approvals for re-mortgage (which only capture re-mortgaging with a different lender) were 34,300 in February.

…and the money supply continues to expand rapidly

M4ex is the Bank's favoured measure of the money supply (broad money, excluding intermediate other financial corporations (IOFCs)), which comprises the money holdings of households, private non-financial corporations (PNFCs) and non-intermediate other financial corporations (NIOFCs). Money holdings include notes and coin and deposits with monetary financial institutions (MFIs, including the Bank and the commercial banks). The growth of M4ex and its three constituent component sectors are shown in chart 3 (and see annex box 1 for more on the money supply definitions).

The Bank's latest data show that M4ex increased by a significant £15.8bn in February, though this was down on January's £31.1bn.[13] Households continued depositing significant amounts, with an additional £17.1bn placed in February. Private non-financial companies (PNFCs) placed just £1.2bn, whilst Non-Intermediate OFCs actually decreased their holdings by £2.5bn. The M4 growth rate was 15.2% (YOY) in February, after January's 15.0% (chart 3, orange line).

Chart 3 M4ex and component sectors, January 2018-February 2021, YOY growth (%)



Source: (i) *Bank of England*, "Money and credit: February 2021", 29 March 2021; (ii) Bank's website for time series.

Chart 3 also shows the rapid growth of money holdings over the past 12 months of the household sector and PNFCs, both of which have been large contributors to the growth of M4ex, as table 1 below demonstrates. The stock of M4ex increased by nearly £337bn between February 2020 and February 2021, of which the household sector and PNFCs contributed the lion's share. The household sector's money holdings increased by nearly £180bn, whilst PNFCs increased their money holdings by over £125bn, reflecting the effects of QE as well as the large increase in bank lending.[14] The net contribution of NIOFCs has been modest by comparison.

These rapid increases in money holdings by the household sector and companies are partly behind the recent upbeat comments by the Bank's Chief Economist, Andy Haldane. He wrote in a February article "…the rapid rollout of the vaccination programme across the UK means a decisive corner has been turned in the battle against Covid. A decisive corner is about to be turned for the economy too, with enormous amounts of pent-up financial energy waiting to be released, like a coiled spring".[15-16] And he noted "…so come the Spring, we can expect the UK economy to be firing on all three cylinders – households, companies and government".

Table 1 M4ex and money holdings by sectors, amounts outstanding (£bn)

	Feb 2020	Jan 2021	Feb 2021	Change	
				Feb 2021-Feb 2020 (YOY)	Feb 2021-Jan 2021 (MOM)
M4ex, of which:	2,258.3	2,579.9	2,595.0	336.7 (rounding)	15.8 (summed from components)
Household sector	1,488.3	1,650.6	1,667.7	179.4	17.1
PNFCs	432.0	557.8	557.9	125.9	1.2 (rounding)
NIOFCs	338.0	371.5	369.3	31.3	-2.5

Sources: (i) *Bank of England*, "Money and Credit: February 2021", 29 March 2021; (ii) Bank of England website.

Other indicators

Recent indicators have also included Nationwide's house prices index for March and the SMMT's February car production data.

According to the Nationwide house prices fell 0.2% (MOM) in March on a seasonally adjusted basis, to be 5.7% higher (YOY), after February's YOY rise of 6.9%.[17] The Nationwide commented that March's slowdown "…probably reflects a softening of demand ahead of the original end of the stamp duty holiday before the Chancellor announced the extension in the Budget". Moreover, they were more sanguine about the near future, saying "…recent signs of economic resilience and the stimulus measures announced in the Budget, including the extension of the furlough scheme and the stamp duty holiday, as well as the introduction of a mortgage guarantee scheme, suggest that housing market activity is likely to remain buoyant over the next six months." Of the UK's four countries in 2021Q1, Northern Ireland saw a price increase of 7.4% (YOY), followed by Wales (7.2%), Scotland (6.9%) and England (6.4%). There was considerable disparity in the English regions for prices increases in 2021Q1, ranging from the North West (8.2%), West Midlands (7.6%), South West (7.2%), North (7.2%), Outer SE (7.2%), Yorkshire and Humberside (7.0%), East Anglia (6.1%), East Midlands (6.0%), Outer Metropolitan area (5.6%) to, finally, London (4.8%).

Following on from weak car registrations for February, the SMMT confirmed there was also weak car production in the month.[18-19] Production was down 14% (YOY) in February, comprising a fall of nearly 35% for the home market and a fall of 8% for the export market; 83% of output was destined for the export market, with the EU remaining the largest market. The YOY fall marked the weakest February performance in more than a decade as the impact of the coronavirus pandemic, in particular shuttered UK showrooms, new customs processes and global supply chain constraints continued to drag on output.

References

1. *ONS*, "GDP quarterly national accounts, UK: 2020Q4", 31 March 2021.
2. *ONS*, "GDP first quarterly estimate, UK, 2020Q4", 12 February 2021.
3. Ruth Lea, "GDP falls nearly 10% in 2020 but, after first quarter weakness, should recover well in 2021", *Arbuthnot Banking Group*, 15 February 2021, for discussion of the first estimates of GDP for 2020.
4. The saving ratio is the percentage of disposable income that is saved. Total savings = disposable income – household consumption.
5. *ONS*, "Quarterly sector accounts, UK, 2020Q4", 31 March 2021.
6. *ONS*, "UK economic accounts, 2020Q4: institutional sector – households and non-profit institutions serving households", 31 March 2021, table 6.2.6.
7. Andy Haldane, "Britain to fire on all cylinders after year to forget", *Daily Mail*, 12 February 2021.
8. *BBC*, "UK economy poised like a coiled spring, says Bank economist", 12 February 2021.
9. *ONS*, "Balance of payments: 2020Q4", 31 March 2021.
10. *ONS*, "UK trade: December 2020", 12 February 2021.
11. Ruth Lea, "GDP falls nearly 10% in 2020 but, after first quarter weakness, should recover well in 2021", *Arbuthnot Banking Group*, 15 February 2021, discussed the trade figures for 2020Q4.
12. *Bank of England*, "Money and Credit: February 2021", 29 March 2021.
13. *Bank of England*, "Money and Credit: February 2021", 29 March 2021.
14. Ruth Lea, "The coronavirus crisis: the Bank's projections improve, but cannot disguise the economic damage to date", *Arbuthnot Banking Group*, 10 August 2020, explains QE.
15. Andy Haldane, "Britain to fire on all cylinders after year to forget", *Daily Mail*, 12 February 2021.
16. *BBC*, "UK economy poised like a coiled spring, says Bank economist", 12 February 2021.
17. *Nationwide*, "UK annual house price growth slows in March as North West sees strongest growth in 2021Q1", 31 March 2021.
18. *SMMT*, "New car registrations drop 35.5% as lockdown depresses demand ahead of "new reg" month", 4 March 2021.
19. *SMMT*, "February UK car production falls 14% as sector grapples with multiple issues", 26 March 2021.

Annex

Table 1a Current account of the balance of payments, balances (£bn), 2020Q3 and 2020Q4

	2020Q3	2020Q4	Change
Total balances:			
Goods (total, including precious metals)	-30.8	-41.7	-10.9
Services	26.8	28.4	+1.6
Goods & services	-3.9	-13.2	-9.3
Primary income	-5.3	-5.0	+0.3
Secondary income	-5.0	-8.1	-3.1
Current account	-14.3 (2.6% of GDP)	-26.3 (4.9% of GDP)	-12.0
Of which:			
CA balance with the EU	-15.1	-22.5	-7.4
CA balance with non-EU	+0.8	-3.8	-4.6
Addendum:			
GDP (market prices, nominal, £bn)	534.2	538.8	…

Table 1b Current account of the balance of payments, balances (£bn), 2019 and 2020

	2019	2020	Change
Total balances:			
Goods (total, including precious metals)	-130.8	-115.0	+15.8
Services	103.3	107.4	+4.1
Goods & services	-27.5	-7.6	+19.9
Primary income	-14.7	-38.2	-23.5
Secondary income	-26.4	-28.2	-1.8
Current account	-68.6 (3.1% of GDP)	-73.9 (3.6% of GDP)	-5.3
Of which:			
CA balance with the EU	-113.1	-72.2	+40.9
CA balance with non-EU	+44.5	-1.7	-46.2
Addendum:			
GDP (market prices, nominal, £bn)	2,203.7	2,073.9	…

Source: *ONS*, "Balance of payments: 2020Q4", 31 March 2021. Some non-addition due to rounding errors.

Box 1 Money supply, some definitions

Some institutional definitions

The private sector (excluding Monetary Financial Institutions (MFIs)) comprises three groups:

- Households.
- PNFCs (private non-financial corporations).
- Other financial corporations (OFCs).

The Bank distinguishes two types of OFCs:

- Intermediate other financial corporations (IOFCs).
- Non-intermediate other financial corporations (NIOFCs).

IOFCs provide intermediation services to banks and building societies and are defined as:

- Non-bank credit grantors.
- Mortgage and housing credit corporations.
- Bank holding companies.
- Securitisation special purpose vehicles.
- Other activities auxiliary to financial intermediation.
- 'Other financial intermediaries' belonging to the same financial group.

Monetary Financial Institutions (MFIs) are central banks and other institutions (commercial banks and building societies in the UK) whose business include taking deposits.
M4 definitions
M4 is defined as the private sector's (excluding monetary financial institutions (MFIs)) holdings of: • Sterling notes & coin (cash in circulation with households & non-bank corporate sector). • Sterling deposits, including certificates of deposit. (In other words, private-sector retail & wholesale bank and building society deposits.) • Commercial paper, bonds, FRNs (floating rate notes) & other instruments of up to and including five years' original maturity issued by UK MFIs. • Claims on UK MFIs arising from repos (from December 1995). • Estimated holdings of sterling bank bills. • 35% of the sterling inter-MFI difference (added to OFC deposits, within wholesale M4).
M4ex, excludes the money holdings of IOFCs in order to obtain a better measure of those money holdings that are likely to be used as a medium of exchange. M4ex, therefore, comprises the money holdings of households, PNFCs and NIOFCs.
Monetary base
The monetary base (or M0) is the total amount of a currency that is either in general circulation in the hands of the public or in the form of commercial bank deposits held in the central bank's reserves. This measure of the money supply is not often cited since it excludes other forms of non-currency money that are prevalent in a modern economy.
Velocity of circulation
This is based on an identity known as the equation of exchange, which relates money to the transactions it is used to settle: MxV=PxT. M denotes the money stock, Vis the number of times the money stock circulates through the economy during a given period of time (the velocity of circulation), P is the price level and T is the number of transactions undertaken during that period.

Main source: Bank of England website.