ARBUTHNOT BANKING GROUP PLC

PERSPECTIVES

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Cautious households continued to save in July, whilst borrowing no additional consumer credit

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The Bank's latest Money and Credit data…

The Bank of England's latest *Money and Credit* data confirmed that households remain financially cautious. They were reluctant to borrow consumer credit in July, whilst saving another £7.1bn.[1]

Specifically, the Bank's data showed that, overall, households borrowed no additional consumer credit in July. Within this, they borrowed an additional £0.1bn of "other" forms of consumer credit (such as car dealership finance and personal loans), but this was offset by net credit card repayments of £0.1bn. In comparison, £1.2bn of consumer credit was borrowed on average, per month, in the 2 years to February 2020. The annual growth rate for all consumer credit remains extraordinarily weak. It was -2.7% in July, compared with -2.2% in June (annex table 1, data tracker). The annual growth rates of credit cards and other forms of consumer credit also remained weak at -8.3% and -0.3% respectively in July.

In addition, the Bank's data showed that individuals repaid £1.4bn of mortgage debt (net) in July. The Bank commented that net repayments were relatively rare, with only one other repayment made (in April 2020) in the past decade. But it should be emphasised that July's net repayment followed record borrowing in June (£17.7bn), which was probably boosted by the tapering of the stamp duty holiday. The Stamp Duty Land Tax (SDLT) nil rate threshold (for England and Northern Ireland) was reduced from £500,000 to £250,000 on 1 July (and will revert to £125,000 on 1 October), whilst the tax holiday ended on 31 March 2021 in Scotland and on 30 June 2021 in Wales. The Bank's other data relating to the housing market were also probably influenced by the change to the stamp duty regime. Approvals for house purchases fell to 75,200 in July, compared with June's 80,300 and May's 86,200. July's figure was the lowest since July 2020, though it remained above pre-February 2020 levels. Approvals for re-mortgage (which only capture re-mortgaging with a different lender) rose to 37,400 in July, from 35,800 in June.

Even though cautious households' money holdings continued rising in July, with net flows of £7.1bn, sterling money (known as M4ex, excluding Intermediate Other Financial Corporations (IOFCs), annex box 1) increased by just £6.7bn, after June's £19.6bn (table 1).[2] This was the weakest since August 2020, reflecting a fall of £7.1bn in private non-financial corporations' (PNFCs) holdings (the weakest on record). Non-Intermediate OFCs (NIOFCs) increased their holdings by £6.7bn.

As can be seen in table 1, the stock of M4ex increased by nearly £395bn between February 2020 and July 2021, of which the household sector and PNFCs have contributed the lion's share. The household sector's money holdings increased by nearly £230bn, whilst PNFCs increased their money holdings by nearly £130bn, reflecting the effects of QE as well as the large increase in bank lending. The net contribution of NIOFCs has been modest by comparison.

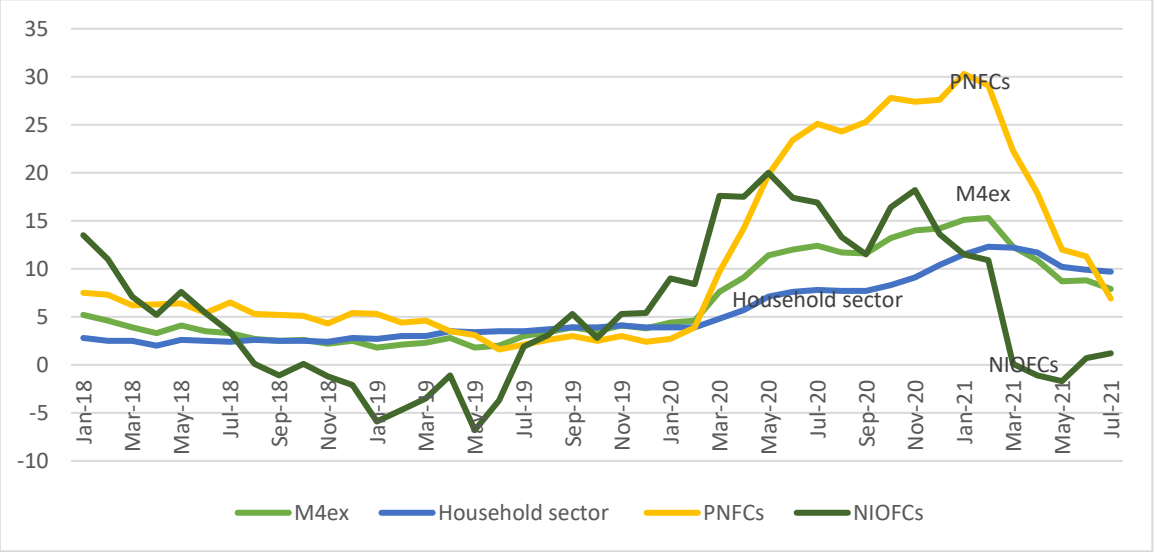
Table 1 M4ex and money holdings by sectors, amounts outstanding (£bn)

	Feb 2020	June 2021	July 2021	Change	
				July 2021-Feb 2020 (sic)	July-June 2021 (MOM)
M4ex, of which:	2,256.9	2,643.3	2,649.9	393.0	6.7
• Household sector	1,488.1	1,710.9	1,718.0	229.9	7.1
• PNFCs	431.7	567.5	560.3	128.6	-7.1
• NIOFCs	337.1	364.9	371.5	34.4	6.7

Sources: (i) *Bank of England*, "Money and Credit: July 2021", 31 August 2021; (ii) Bank of England website. Data revisions from April 2021. There are rounding errors.

Nevertheless, the growth of M4ex has slowed quite significantly in recent months, it was 7.9% (YOY) in July, after June's 8.8% (YOY), after the extremely rapid growth in 2020. Chart 1 (covering the growth of M4ex and its three constituent component sectors) clearly shows the rapid growth of money holdings since pre-pandemic February 2020 of the household sector and PNFCs, both of which have been large contributors to the growth of M4ex. It also shows the recent slowdown, especially for PNFCs.

Chart 1 M4ex and component sectors, January 2018-July 2021, YOY growth (%)



Source: (i) *Bank of England*, "Money and credit: July 2021", 31 August 2021; (ii) Bank's website for time series. Data revisions from April 2021.

…and the Bank of England appoints a new Chief Economist…

The Bank of England announced on 1 September that their new Chief Economist and Executive Director for Monetary Analysis would be Huw Pill, beginning in post on 6 September.[3] He will also be a member of the MPC. It has been reported that Mr Pill is seen as "hawkish", backing limits on QE, and there is speculation that his appointment may be a sign that the Governor is keen to rein in QE.[4-5] The outcome of the September MPC meeting will be released on 23 September.

…whilst the Nationwide reports house prices rose in August

Somewhat surprisingly, the Nationwide reported that house prices rose by 2.1% (MOM, seasonally adjusted) in August to be 11.0% higher YOY after July's annual growth of 10.5%.[6] In addition, they calculated that prices were around 13% higher than when the pandemic began.

The Nationwide commented "…the bounce back in August is surprising because it seemed more likely that the tapering of stamp duty relief in England at the end of June would take some of the heat out of the market. The strength may reflect strong demand from those buying a property priced between £125,000 and £250,000 who are looking to take advantage of the stamp duty relief in place until the end of September. Lack of supply is also likely to be a key factor behind August's price increase, with estate agents reporting low numbers of properties on their books". Concerning the outlook, they were fairly bullish, saying "…underlying demand is likely to remain solid in the near term. Consumer confidence has rebounded in recent months while borrowing costs remain low. This, combined with the lack of supply on the market, suggests continued support for house prices."

Eurozone inflation has picked up…

Eurozone HICP (Harmonised Index of Consumer Prices) inflation picked up by more-than-expected in August to 3.0%, after July's 2.2%, and was the highest since November 2011.[7-8] The price increases were driven by the economic rebound from the impact of the pandemic, higher energy costs, the reversal in last year's German cut in VAT and bottlenecks in supply chains. They also partly reflected last year's delayed start to summer clothing sales in France and Italy, which were on time this year.[9] In other words, there are significant "base effects" operating that have been driving up the CPI inflation rate. For the individual countries, Germany's rate increased to 3.4% in August, France's rate rose to 2.4% whilst Italian inflation increased to 2.6% (chart 2a).

As already indicated, one of the key drivers of the higher inflation rate was the price of energy, which was 15.4% higher (YOY) in August. Excluding energy, inflation was 1.7% in August, though up from July's 0.9% (chart 2b). Core inflation, excluding energy, food, alcohol and tobacco, rose to 1.6% in August, from 0.7% in July. The inflation rate for food, alcohol and tobacco was just 2.0% in August, compared with 1.6% in July.

Chart 2a Eurozone HICP inflation (%), EU19, key countries, January 2020-August 2021

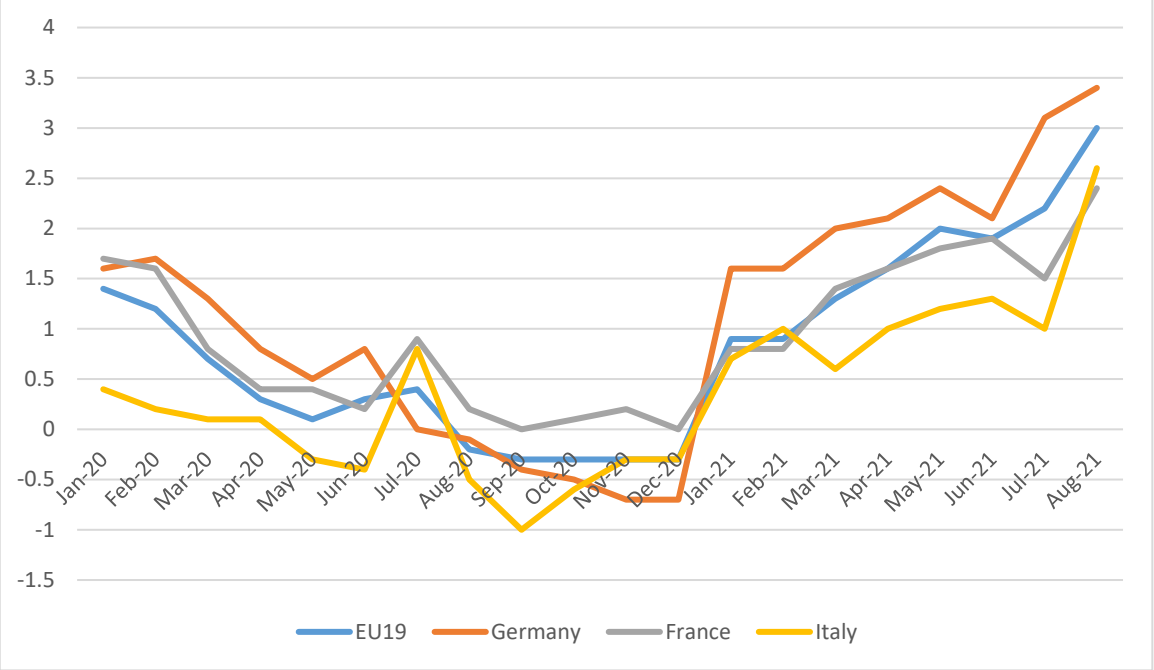
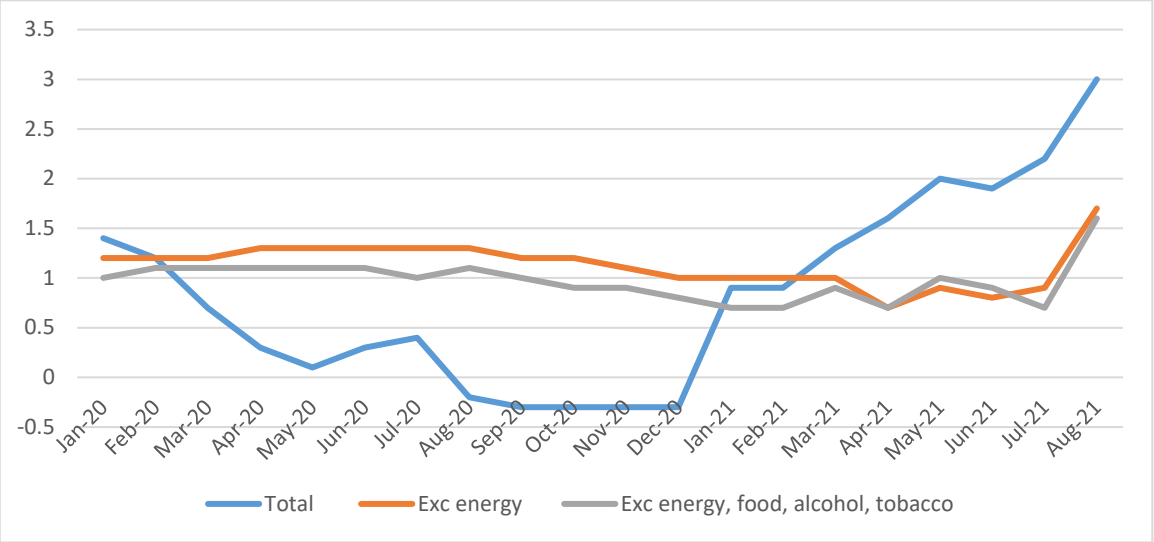


Chart 2b Eurozone HICP inflation (%), EU19, total, excluding energy, excluding energy, food, alcohol & tobacco, January 2020-August 2021



Sources: *Eurostat*, "Euro area annual inflation up to 3.0%, flash estimate, August 2021", 31 August 2021, and Eurostat database.

…ahead of this week's ECB meeting

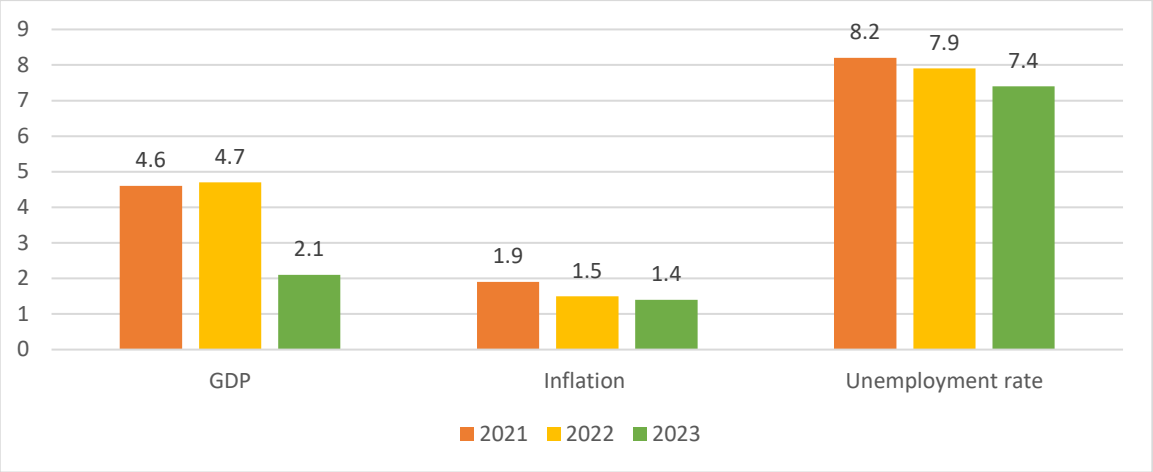
The decisions of the September meeting of the ECB's Governing Council will be announced on 9 September. At the 22 July meeting a dovish ECB said that it acted in order "…to underline its commitment to maintain a persistently accommodative monetary policy stance to meet its inflation target". There were no policy changes and there was no indication that they intended to significantly tighten monetary policy in the near term. Specifically, interest rates were unchanged, net asset purchases under the pandemic emergency purchase programme (PEPP, with a total envelope of €1,850bn) would continue until at least the end of March 2022 and net purchases under the asset purchase programme (APP) would continue at a monthly pace of €20bn.[10-11] However, there is increasing speculation that the ECB will start setting the stage for winding down the PEPP (reducing asset purchases, "tapering"), especially in the light of the higher inflation data, with a possible announcement of intention as early as this week.[12]

It should be noted that the ECB loosened its inflation target on 8 July 2021, just prior to the July meeting.[13-14] The ECB announced that "…the Governing Council considers that price stability is best maintained by aiming for a 2% inflation target over the medium term. This target is symmetric, meaning negative and positive deviations of inflation from the target are equally undesirable. When the economy is operating close to the lower bound on nominal interest rates, it requires especially forceful or persistent monetary policy action to avoid negative deviations from the inflation target becoming entrenched. This may also imply a transitory period in which inflation is moderately above target". Previously the inflation target was framed as "close to but below 2%", so the new framework implies looser monetary policy with some tolerance of above 2% inflation.

The ECB will provide revised forecasts this week (chart 3). In June, they judged that consumer prices inflation (HICP) was expected to spike at 1.9% in 2021, driven by "temporary upward factors", before returning to rates of 1.5% and 1.4% in 2022 and 2023, as demand pressures remained muted and as oil prices were assumed to decline.[15-16] Significantly, the projections for 2022 and 2023 remained below the ECB's old target of "a level sufficiently close to, but below, 2%". And, clearly, they remained below the ECB's revised symmetric target of "2% inflation over the medium term". Given the recent pick-up in inflation, it is highly probable that the ECB will revise up its inflation forecasts.[17] Interest will also be focused on whether the ECB still regards the higher inflation as mainly driven by "temporary upward factors", or whether they believe there are more permanent factors at work. The minutes from the ECB's

last meeting suggested that some members believed the bank's stance was underestimating the risk of higher inflation.[18]

Chart 3 ECB forecasts, June 2021, GDP, HICP inflation and the unemployment rate



Source: *ECB*, "Eurosystem staff macroeconomic projections for the euro area", 10 June 2021.

References

1. *Bank of England*, "Money and Credit: July 2021", 31 August 2021.
2. M4ex is the Bank's favoured measure of the money supply (defined as broad money, excluding intermediate other financial corporations (IOFCs)). It 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).
3. *Bank of England*, "Huw Pill appointed Chief Economist of the Bank of England", 1 September 2021.
4. *Daily Telegraph*, "Hawkish economist lands at Bank of England", 2 September 2021.
5. *FT*, "New BoE chief economist backs limits on quantitative easing", 1 September 2021.
6. *Nationwide,* "August upturn as UK house price growth increases to 11%",
7. *Eurostat*, "Euro area annual inflation up to 3.0%, flash estimate, August 2021", 31 August 2021.
8. *CNBC*, "Eurozone inflation hits 10-year high ahead of key central bank meeting", 31 August 2021.
9. *FT,* "Eurozone inflation rises to a decade high of 3%", 31 August 2021.
10. *ECB*, "ECB Governing Council press conference", 22 July 2021.
11. Ruth Lea, "Public sector borrowing: debt interest payments jump in June", *Arbuthnot Banking Group*, 26 July 2021, discussed the ECB's July meeting.
12. *FXSTREET*, "Week ahead: tapering high on the agenda as ECB, BoC and RBA meet", 3 September 2021.
13. *ECB*, "ECB's Governing Council approves its new monetary policy strategy", 8 July 2021.
14. Ruth Lea, "CPI inflation picks up further in June, increasing concerns over rising inflationary pressures", *Arbuthnot Banking Group*, 19 July 2021, discussed the ECB's new monetary strategy.
15. *ECB*, "Eurosystem staff macroeconomic projections for the euro area", 10 June 2021.
16. Ruth Lea, "Recovery continued in April, with 2.3% rise in GDP", *Arbuthnot Banking Group*, 14 June 2021, discussed the ECB's June forecasts.
17. *Daily Telegraph*, "Rising inflation puts pressure on ECB", 1 September 2021.
18. *CNBC*, "Eurozone inflation hits 10-year high ahead of key central bank meeting", 31 August 2021.

Annex

Table 1 UK economic data tracker

Date	Release	Source	Quarter, year	Outcome
2 Aug	Manufacturing PMI (Jul)	Markit	2021Q3	Index: 60.4 (Jul), 63.9 (Jun)
4 Aug	Services PMI (Jul)	Markit	2021Q3	Index: 59.6 (Jul), 62.4 (Jun)
4 Aug	Composite PMI (Jul)	Markit	2021Q3	Index: 59.2 (Jul), 62.2 (Jun). Weighted average of services PMI & manufacturing output index.
5 Aug	Construction PMI (Jul)	Markit	2021Q3	Index: 58.7 (Jul), 66.3 (Jun).
12 Aug	GDP (2021Q2)	ONS	2021Q2	GDP: 4.8% (QOQ)
12 Aug	GDP, industrial breakdown (2021Q2):	ONS	2021Q2	
12 Aug	• Services	ONS	2021Q2	5.7% (QOQ)
12 Aug	• Production	ONS	2021Q2	0.5% (QOQ); manufacturing: 1.8% (QOQ)
12 Aug	• Construction	ONS	2021Q2	3.3% (QOQ)
12 Aug	GDP, expenditure breakdown (2021Q2):	ONS	2021Q2	
12 Aug	• Household consumption	ONS	2021Q1	7.3% (QOQ)
12 Aug	• Govt consumption	ONS	2021Q1	6.1% (QOQ)
12 Aug	• GFCF	ONS	2021Q1	-0.5% (QOQ); business investment: 2.4% (QOQ)
12 Aug	• External trade	ONS	2021Q1	Exports: 3.0% (QOQ), imports 6.5%(QOQ), negative external trade contribution (volume)
12 Aug	GDP, monthly (Jun)	ONS	2021Q2	GDP: 1.0% (MOM)
12 Aug	GDP, industrial breakdown (Jun):	ONS	2021Q2	
12 Aug	• Services	ONS	2021Q2	1.5% (MOM)
12 Aug	• Production	ONS	2021Q2	-0.7% (MOM); manufacturing: 0.2% (MOM)
12 Aug	• Construction	ONS	2021Q2	-1.3% (MOM)
12 Aug	Total trade in goods & services (2021Q2):	ONS	2021Q2	
12 Aug	• Goods	ONS	2021Q2	Deficit: £32.8bn (2021Q2), £29.9bn (2021Q1)
12 Aug	• Services	ONS	2021Q2	Surplus: £28.3bn (2021Q2), £28.2bn (2021Q1)
12 Aug	• Goods & services	ONS	2021Q2	Deficit: £4.4bn (2021Q2), £1.8bn (2021Q1)
12 Aug	Total trade in goods & services (Jun):	ONS	2021Q2	
12 Aug	• Goods	ONS	2021Q2	Deficit: £12.0bn (Jun), £9.6bn (May)
12 Aug	• Services	ONS	2021Q2	Surplus: £9.5bn (Jun), £9.4bn (May)
12 Aug	• Goods & services	ONS	2021Q2	Deficit: £2.5bn (Jun), £0.2bn (May)
17 Aug	PAYE payroll employees (July)	ONS	2021Q3	+182,000 (MOM, Jul) to 28.9mn
17 Aug	Employment (3 months to Jun)	ONS	2021Q2	+95k (QOQ, -329k (YOY)
17 Aug	Employment rate (3 months to Jun)	ONS	2021Q2	75.1%, +0.3pp (QOQ), -0.7pp (YOY)

17 Aug	Total weekly hours worked (3 months to Jun)	ONS	2021Q2	1bn, +50.9mn (QOQ), +50.8mn (YOY)
17 Aug	Unemployment (3 months to Jun)	ONS	2021Q2	-53k (QOQ), +193k (YOY)
17 Aug	Unemployment rate (3 months to Jun)	ONS	2021Q2	4.7%, -0.2pp (QOQ), +0.6pp (YOY)
17 Aug	Redundancies (3 months to Jun)	ONS	2021Q2	99k, -52k (QOQ), -35k (YOY)
17 Aug	Vacancies (3 months to Jul)	ONS	2021Q3	Total vacancies: 953k, +290k (QOQ), +578k (YOY). Record levels.
17 Aug	Pay (3 months to Jun):	ONS	2021Q2	
17 Aug	• Total pay (inc. bonuses)	ONS	2021Q2	Nominal: 8.8% (YOY); Real: 6.6% (YOY)
17 Aug	• Regular pay (exc. bonuses)	ONS	2021Q2	Nominal: 7.4% (YOY); Real: 5.2% (YOY)
17 Aug	Productivity (output per hour), 2021Q2	ONS	2021Q2	-0.5% (QOQ), +3.1% (YOY)
17 Aug	Productivity (output per worker), 2021Q2	ONS	2021Q2	4.5% (QOQ), 23.4% (YOY)
18 Aug	CPI (Jul)	ONS	2021Q3	YOY inflation: 2.0% (July), 2.5% (June)
18 Aug	CPIH (Jul)	ONS	2021Q3	YOY inflation: 2.1% (July), 2.4% (June)
18 Aug	PPI (output) (Jul)	ONS	2021Q3	YOY inflation: 4.9% (July), 4.5% (June)
18 Aug	PPI (input) (Jul)	ONS	2021Q3	YOY inflation: 9.9% (July), 9.7% (June)
18 Aug	Sterling effective exchange rate index (EERI) (Jul)	ONS	2021Q3	-0.1% (MOM), +6.5% (YOY)
18 Aug	Crude oil prices (Jul)	ONS	2021Q3	+3.1% (MOM), +52.7% (YOY)
18 Aug	House prices (Jun, official)	ONS	2021Q2	YOY growth: 13.2% (June), 9.8% (May), 9.6% (Apr)
18 Aug	House prices (Jun, official)	ONS	2021Q2	+4.5% (MOM, non-seasonally adjusted), +4.2% (MOM, seasonally adjusted)
20 Aug	Public Sector Net Borrowing (PSNB) (Jul)	ONS	2021Q3	£10.4bn (July 2021), compared with £20.4bn (July 2020)
20 Aug	PSNB, FY2021 cumulative (4 months to Jul)	ONS	2021Q3	£78.0bn (FY2021), compared with £139.7bn (FY2020)
20 Aug	Public sector net debt (PSND) (end-July)	ONS	2021Q3	£2,216.0bn (end-July 2021, 98.8% of GDP), compared with £1,993.7bn (end-July 2020, 94.6% of GDP)
20 Aug	Public sector debt interest/revenue ratio (DIR) (July)	ONS	2021Q3	2.9% (12-months to July 2021)
20 Aug	Retail sales (July)	ONS	2021Q3	Volume: -2.5% (MOM), 2.4% (YOY)
20 Aug	Retail sales (3 months to July)	ONS	2021Q3	Volume: +5.2% (QOQ), +11.1% (YOY)
20 Aug	Retail sales, online sales proportion (July)	ONS	2021Q3	Online sales/total: 27.9% (July), 27.1% (June)
23 Aug	Flash composite output index (Aug)	Markit-CIPS	2021Q3	Index: 55.3 (Aug), 59.2 (July). COI comprises services business activity index & manufacturing output index
31 Aug	Unsecured credit (Jul)	BoE	2021Q3	Growth rate (YOY): -2.7% (July), -2.2% (June)
31 Aug	Net mortgage borrowing (Jul)	BoE	2021Q3	Monthly change: -£1.4bn (July), net repayment
31 Aug	Mortgage approvals for house purchase (Jul)	BoE	2021Q3	75,200 (July), 80,300 (June)

31 Aug	Net bank lending to non-financial businesses (Jul), of which:	BoE	2021Q3	These data include the public sector.
31 Aug	• SMEs	BoE	2021Q3	Growth rate (YOY): 2.9% (July), 6.2% (June)
31 Aug	• Large businesses	BoE	2021Q3	Growth rate (YOY): -3.1% (July), -6.1% (June)
31 Aug	Sterling money (M4ex) (Jul)	BoE	2021Q3	Growth rate (YOY): 7.9% (July), 8.8% (June)

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), excluding banks (MFIs).
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 whose business is to take deposits and/or close substitutes for deposits from entities other than MFIs and, for their own account (at least in economic terms), to grant credits and/or make investments in securities.
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, includes the money holdings of households, PNFCs and NIOFCs.

Source: Bank of England website.