What to do with £200 billion

Economic commentary

2 March 2021

Key points

- As the UK economy re-opens during the next few months, one of the big questions is: what will consumers do with the roughly £200 billion of additional savings that they have accumulated?
- HSBC's revised forecasts assume that around £20 billion of this will be spent on current consumption by the end of next year, helping to lift GDP growth to around 5% both this year and next.
- But it is also possible that households will avail themselves of this unforeseen opportunity to reduce their burden of debt, which has remained stubbornly high since the financial crisis. There has already been a marked reduction in consumer finance indebtedness, especially credit card balances. And in the longer term, lower levels of household debt will make it easier for the Bank of England to lift interest rates off the floor.

After nearly a year of living under restrictions of one sort or another, households across the UK are sitting on a growing mountain of cash. With Covid infection rates now falling sharply, and with the Government pledging to offer at least one dose of a vaccine to all adults by the end of July, on 22 February the Prime Minister outlined plans for a gradual easing of restrictions in England during the coming months. Before this, on 13 February, the Bank of England's Chief Economist, Andy Haldane, described the economy as being "like a coiled spring, ready to release large amounts of pent-up financial energy". It's therefore tempting to look ahead to a boom in spending as people make up for all the things that they've missed during the long months of lockdown, especially leisure, hospitality, and travel. But it's worth pausing to consider what proportion of this money will actually be splashed out on exotic holidays, fine dining, fast cars, and such-like; or might people, in fact, opt to put the money to other (and arguably better) uses?

It's become clear over the past year that the impact of the pandemic has not been evenly spread. In terms of job losses and reduced incomes, the impact of lockdown restrictions has fallen hardest upon the young and on people doing low-skill jobs. And meanwhile the large numbers of (mostly) low-paid workers toiling away in hospitals, care homes, supermarkets, and warehouses have been at greater risk of catching Covid compared to the army of professional and office workers who have been able to work safely from the comfort of their own homes. So, the pandemic has brought obvious hardship for some segments of the population, with many people in mortgage and rent arrears, and struggling to keep up payments on other loans. But, across the economy as a whole, the pandemic has resulted in a considerable build-up of financial resources.

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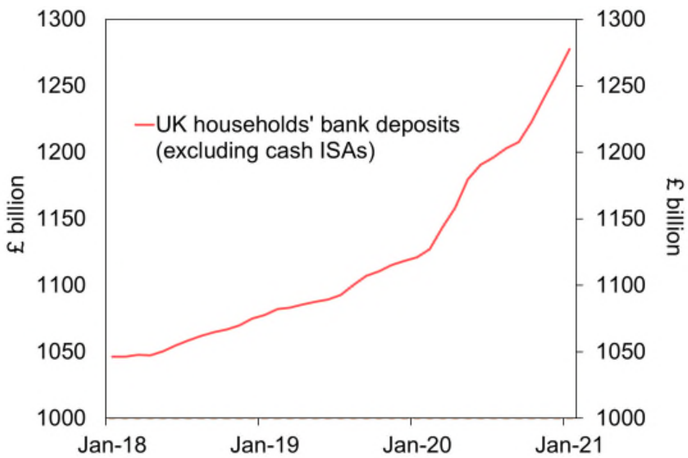
Spending power sustained by the government

In the past year, the incomes of households have been topped up to a considerable extent by the furlough scheme, by several rounds of payments to the self-employed, and by extra Universal Credit payments. At the time of last November's Spending Review, the Office for Budget Responsibility (OBR) put the cost of the Covid Job Retention Scheme (CJRS), to give the furlough scheme its formal title, at a staggering £54 billion in the current financial year. The scheme is currently slated to end in April, but is likely to be extended further, possibly to the end of August. Meanwhile, the three rounds of payments under the Covid Self-Employment Support Scheme are reckoned to cost £20 billion, with the increase in Universal Credit and other enhancements to benefits costing a further £8 billion.

The upshot is that, across the economy as a whole, there has been no appreciable reduction in the total financial resources, and hence the spending power, of households. Aggregate wages and salaries received in the first nine months of last year were still 1.4% higher than they had been the year before, and after taking account of all the other sources of income that households received, and allowing for the taxes they have to pay, disposable income (measured on a 'cash basis') was still 1% higher. Assuming that this trend was maintained through the fourth quarter, then the amount available for households to spend was £12 billion more in 2020 than in 2019. But with consumers forced to stay at home, their spending fell off the proverbial cliff in the months following the imposition of the first national lockdown last March: in the second quarter of 2020, the amount spent was 30% lower than in the same months of 2019. Assuming that expenditure in the final quarter of 2020 held at the same level as in the third quarter, then over the year as a whole, households would have spent £158 billion less than in 2019.

This enforced saving, which has extended into the opening months of 2021, means that households have been accumulating cash in their bank accounts. Over the year to the end of January, households added £157 billion to their stock of bank deposits (excluding funds held in cash ISAs). In the past few months, the pace of accumulation has not been quite as frenetic as it was during the first national lockdown last spring. Even so, households have still been adding to their bank deposits at a rate of £19 billion a month since October. So, even though businesses have adapted to lockdown conditions and evolved new ways to continue serving their customers, the stock of households' bank deposits is likely to climb further until social distancing restrictions are eased, hopefully from June. It's likely that by then the amount added to bank balances will top £200 billion.

Involuntary savers?



Source: Bank of England

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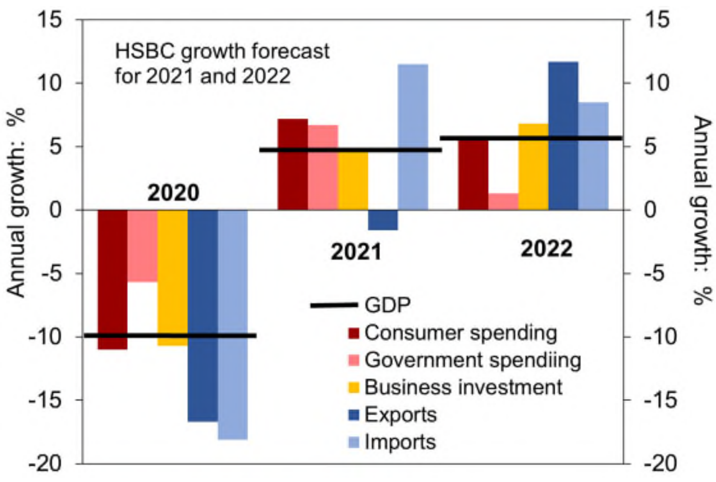
Spend, spend, spend ?

As the economy starts to revive for a second time, the big question is: how much of this money will be spent? How quickly will it be spent, and on what? This build-up of savings has been a feature in many countries, with the money that has been accumulated being viewed by economists and policymakers as another recovery fund that will help get economies back on to their feet, alongside the stimulus provided by both governments and central banks. And since the UK suffered a sharper fall in GDP, and a bigger fall in household spending, Andy Haldane's metaphorical spring may be a little more tightly-coiled than elsewhere: by the time restrictions ease, the build-up of deposits is likely to amount to almost a fifth of one year's normal expenditure.

The hope in the beleaguered hospitality, leisure and tourism sectors, as well as among those parts of the retail sector that have been forced to close, is that some of this money will quickly find its way into a surge of pent-up demand for going to pubs, eating in restaurants, getting fit, getting dressed up, enjoying live music and theatre, and taking holidays. All of that will certainly happen, but maybe not immediately.   Experience from last year suggests that many people may be initially cautious about venturing out until they feel safe. It will be an impressive feat if the government succeeds in rolling out vaccines to all over 50s by the middle of April, but that still implies that it will be the middle of June before this entire cohort has had second jabs. It was very noticeable during last summer's re-opening that footfall at hospitality and leisure venues was slower to revive in the UK than in other major European countries.   In particular, foreign holidays will be problematic until there is an agreed approach to the vaccination and/or testing required for international travel. There will also be losers from the re-opening process, as consumption habits return to something like what they were before the pandemic struck. This will apply especially to the supermarkets, garden centres, DIY stores, and other retailers who have been permitted to remain open.

With the vaccine roll-out going well and take-up being high, HSBC has revised up its expectations for UK economic growth this year and next year. GDP is now expected to expand by 4.7% this year (slightly above our previous forecast of 4.3%) and by 5.4% in 2022 (previously forecast at 4.5%). Spending by households will be the key driver of this growth, with some support also coming from business investment. On the other hand, the government's contribution will abate as the various support schemes are wound down, while net trade (the difference between exports and imports) will act as a drag, partly due to the new trading relationship with the EU.

Consumer spending will drive a broader recovery



Source: HSBC Global Research

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What else to do with so much money?

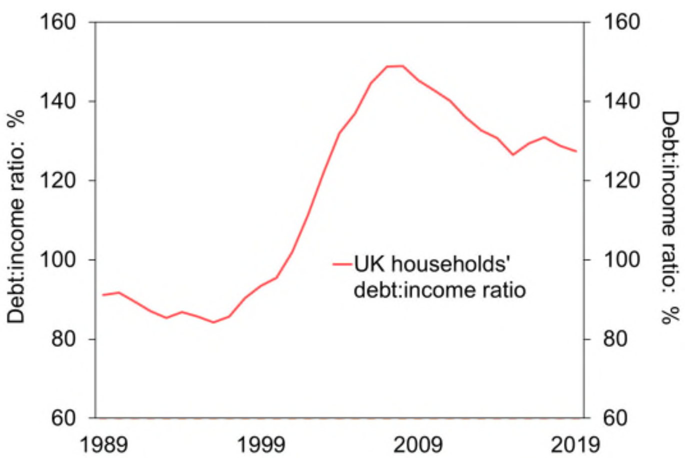
With consumer spending slated to revive by more than 7% this year, and by more than 5% next year, the total level of spending is forecast to return to its pre-pandemic level early in 2022. It's assumed that after a gradual re-opening in the second quarter of this year, most activities (with the exception of international travel) will return largely to normal during the third quarter. The gradual re-opening of close contact services and the cushioning effect of the furlough scheme should mean that the unemployment rate peaks later this year at around 6%, as against the previous forecast of closer to 7%.

Expectations of a strong revival of household spending are therefore driven by a more upbeat assessment of labour market conditions, which will give households the confidence to spend around £20 billion of their accumulated savings by the end of 2022. That means that by then the savings rate (the proportion of incomes that aren't spent) will be back at around 5%, as against 6.5% for 2019 as a whole. At that rate, getting all the extra savings spent is going to take many years. It should be acknowledged though that gauging the appetite of consumers to spend this money, and how quickly, will make economic forecasting somewhat tricky, both in the UK and elsewhere, during the coming years.

There are, moreover, other things that households can do with the money that they've accumulated, instead of splurging it on a consumption binge. Some of it may find its way into higher-yielding investments, whether that be equities or even Bitcoin, and some might end up – as has already happened to some extent – in the residential property market, though this option may look less attractive when the present Stamp Duty reduction comes to an end. And given the erosion of pension entitlements in recent years, as defined benefit schemes have given way to less certain returns from defined contribution schemes, many people may also opt to make lump sum payments into their pension pots.

But one of the most tantalizing prospects of the post-Covid world, albeit not one that will excite the futurologists, is the possibility that households could use this once-in-a-lifetime opportunity to reduce their burden of debt. It has long been a nagging worry for economists that UK households remain highly leveraged. They took on large amounts of borrowing during the decade of frothy house prices before the financial crisis, but haven't done much to repair their balance sheets in the years since. This has left them potentially vulnerable when interest rates eventually rise again.

Household debt is still high



Source: ONS

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Seizing the opportunity

By 2008, households were carrying a debt burden equivalent to 150% of their annual incomes, this figure having climbed rapidly from 85% ten years earlier. The ratio fell back in the immediate aftermath of the crisis, but has been fairly stable in recent years, standing at 127% just before the pandemic struck. In cash terms, these debts in their various guises amounted to just over £1.8 trillion at the end of 2019. Needless to say, the bulk of this is accounted for by mortgages on residential properties, which amounted to more than £1.4 trillion.

There are already signs that households are taking the opportunity of pandemic-induced saving to repay some debts, especially the more expensive varieties. The amount outstanding on consumer finance (excluding student loans) has fallen by just over a tenth during the pandemic, from £225 billion at the end of 2019 to £199 billion at the end of January this year, with people being especially keen to run down credit card balances. In the meantime, the amount owed on mortgages has continued to increase, albeit at a sluggish pace, with no clear evidence so far that people are looking to make more repayments. Given the very low interest rates that still prevail, that's perhaps not a surprise.

It's also likely that households will deploy their additional resources to avoid or reduce new borrowing in the future. The next new car may be bought outright, instead of being acquired via a Personal Contract Plan (PCP). And parents (or grandparents) may opt to fund children through higher education, rather than taking out Student Loans. Meanwhile, those who have fixed rate mortgages may wait until their deal expires, especially given the prevalence of early repayment charges, and then make a lump sum repayment. So, while some of us might be planning to spend our accumulated savings in the pub, and others are planning lavish foreign holidays, in reality much of the windfall is likely to be used to reduce indebtedness, albeit over a period of several years.

Maybe this would be no bad thing. After all, the government has borrowed hundreds of billions of pounds to pay for the slew of support measures that have been put in place to mitigate the pandemic, and it wouldn't be ideal if this resulted in an economy-wide build-up of debt. Far better if households, in particular, were able to achieve some overdue deleveraging. The recession of 2008-09 was followed by a decade of anaemic growth, during which the Bank of England never felt brave enough to lift interest rates off the floor: if the Covid pandemic is to be the start of "building back better" in its widest sense, then that must include finally restoring financial conditions to something like their historic norm. That process will be greatly helped if interest rates can be raised without causing financial stress to borrowers. An opportunity to get rid of some household debt may never come again; and indeed after the last year of Covid restrictions, let's hope that it doesn't.

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