

Article

Early assessment of the impact of the coronavirus pandemic on the UK's financial accounts

The impact of the coronavirus (COVID-19) pandemic on the UK balance sheet of the financial account in Quarter 1 (Jan to Mar) 2020.

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1 . Main points

- The coronavirus (COVID-19) pandemic had a very significant impact on financial markets from the month before the government lockdown measures ensued (23 March); this was reflected in the large unprecedented movements in the balance sheet of the financial account observed in the UK.
- Stock market volatility, which mirrored the same movement seen during the 2008 to 2009 financial crisis, was the main driver in all sectors' steep, unprecedented falls in the value of listed shares in their balance sheets, resulting in the biggest fall since records began in 1987.
- For some instruments (equities and securities), the changes have been driven by revaluations (the effects of changes in asset prices), which vary by instrument but are predominantly driven by foreign exchange rates and/or the market price; however, for deposits and loans, the effects of price changes are limited and are explained by a high volume of transactions between sectors.
- Both financial and non-financial corporations saw record increases in deposits and loans in Quarter 1 (Jan to Mar) 2020; this is consistent with the narrative of the "dash for cash".
- The degree of cash holdings by corporations and households was unprecedented, and the highest liquid holdings since records began was observed for both households and private non-financial corporations (PNFCs).
- These figures capture the initial impact of the lockdown on corporations' and households' cash holdings, not accounting for the government's coronavirus pandemic liquidity policies, which will feature more in Quarter 2 (Apr to June) 2020.
- On the assets side of their balance sheet, monetary financial institutions (MFIs) issued the largest value of short-term loans since Quarter 1 2007.
- Movements in the non-financial account were not as extensive this quarter in comparison to Quarter 4 (Oct to Dec) 2019.

Analysis of financial balance sheets

Most of the early impacts of the pandemic can be seen in the financial accounts balance sheets, which is the estimated market value of institutional sectors' financial assets and liabilities. Balance sheets are largely affected by transactions and price changes. Transactions show the market value of a sector's trading of an instrument, while price changes show a change in the valuation of the instrument, for example, because of movements in the stock exchange or the foreign exchange market.

2 . Introduction

The impact of the coronavirus (COVID-19) pandemic has brought major changes in the UK institutional sector financial accounts for Quarter 1 (Jan to Mar) 2020. This article focuses on the balance sheet of the financial account, where a great deal of volatility was observed in a variety of financial instruments. The balance sheet captures revaluations ("price changes") and other changes in volume, which although not directly observed in the financial account explain the difference between the balance sheet and recorded flows ("transactions"). Volatility on the levels seen in the balance sheet is not observed in the income and expenditure of these sectors in Quarter 1 2020, meaning that the non-financial account presents a comparatively steady picture of the early impacts that the coronavirus pandemic has had on the UK's institutional sectors.

More about coronavirus

- Find the latest on [coronavirus \(COVID-19\) in the UK](#).
- All ONS analysis, summarised in our [coronavirus roundup](#).
- View [all coronavirus data](#).
- Find out how we are [working safely in our studies and surveys](#).

3 . The value of listed shares across all sectors

Listed shares are shares that are listed on the stock exchange market or a secondary market where parties negotiate a price at which to exchange an asset and facilitate the exchange of listed shares.

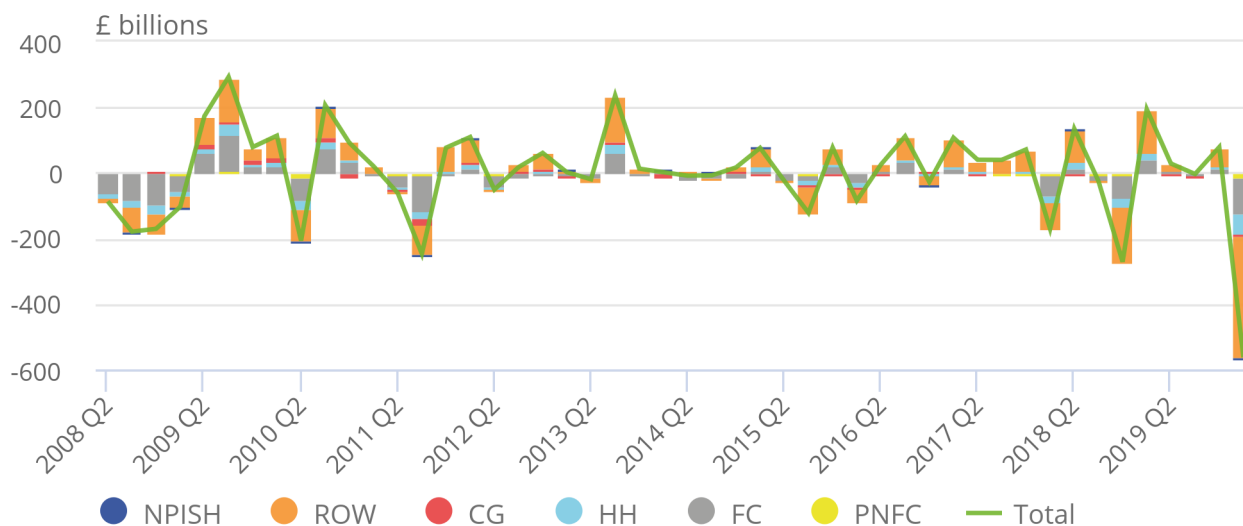
The fall in the value of listed shares was the result of increased investor concerns of the coronavirus (COVID-19) pandemic, which led to increased market volatility. Globally, UK equities were the weakest of the major regional equity market indices because of a 25% fall in the FTSE 100 index, an index showcasing the share price of the largest public companies on the London Stock Exchange, which suffered its worst quarter in three decades, with UK company shares also falling by 25% despite hitting a record high in January.

Figure 1: All sectors experienced a record simultaneous fall in the value of listed shares

Value of listed shares, non-seasonally adjusted, Quarter 2 (Apr to June) 2008 to Quarter 1 (Jan to Mar) 2020

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Value of listed shares, non-seasonally adjusted, Quarter 2 (Apr to June) 2008 to Quarter 1 (Jan to Mar) 2020



Source: Office for National Statistics – Early assessment of the impact of the coronavirus pandemic on the UK's financial accounts

The fall in the value of companies' shares filters through to all sectors, seeing falls in the market value in both shares held and shares issued; this is only the second time all sectors have simultaneously seen a fall, with the other occurring during Quarter 1 (Jan to Mar) 2016. At the same time, there was very little change in the transactions, which means comparatively few shares changed hands in the latest quarter.

At a sector level, this was felt most by the rest of the world where assets fell by £368 billion, approximately 25% of total asset value; this is a dramatic fall following Quarter 4 (Oct to Dec) 2019's listed share increase of £52 billion.

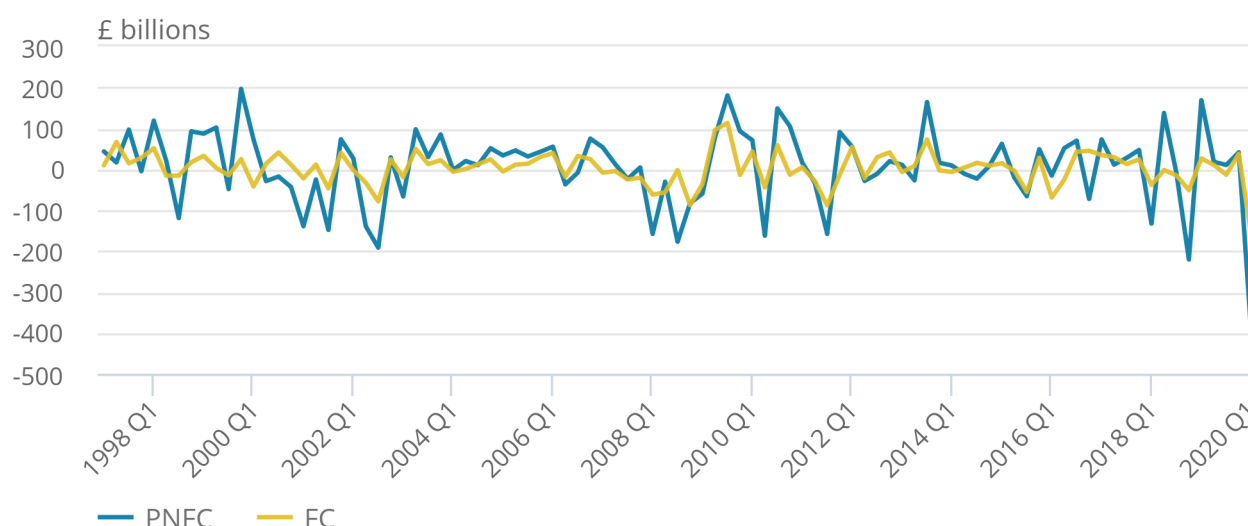
On the liability side, corporations also experienced a record drop in their listed share liabilities.

Figure 2: PNFCs were vulnerable to falling share prices because they comprise of sectors that were most negatively impacted by the lockdown

Listed share liabilities of private non-financial corporations and financial corporations, non-seasonally adjusted, Quarter 1 (Jan to Mar) 1997 to Quarter 1 2020

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Private non-financial corporations (PNFCs) were vulnerable to falling share prices because they comprise of sectors that were most negatively impacted by lockdown restrictions in the UK and overseas such as airlines, leisure and hotels. The substantial change in the market value of shares is almost entirely because of price changes that knocked £401 billion off the worth of PNFCs' listed shares. This is the highest quarterly fall on record, nearly double the Quarter 4 2018 fall of £221 billion.

In Quarter 1 2020, the impact of the pandemic has been different to other financial crises in the sense that there has been a reduction in both supply and demand. The coronavirus-induced restrictions in activity wiped out revenues for companies in several industries, most notably tourism and travel and the energy sector. The pandemic has hit blue-chip companies in Quarter 1 2020 particularly hard because of a combination of the fall in demand in tourism and travel brought on by a global lockdown, the fall in the supply of oil because of the [price war between Russia and Saudi Arabia](#), and reduced exporting of large firms because of affected operations.

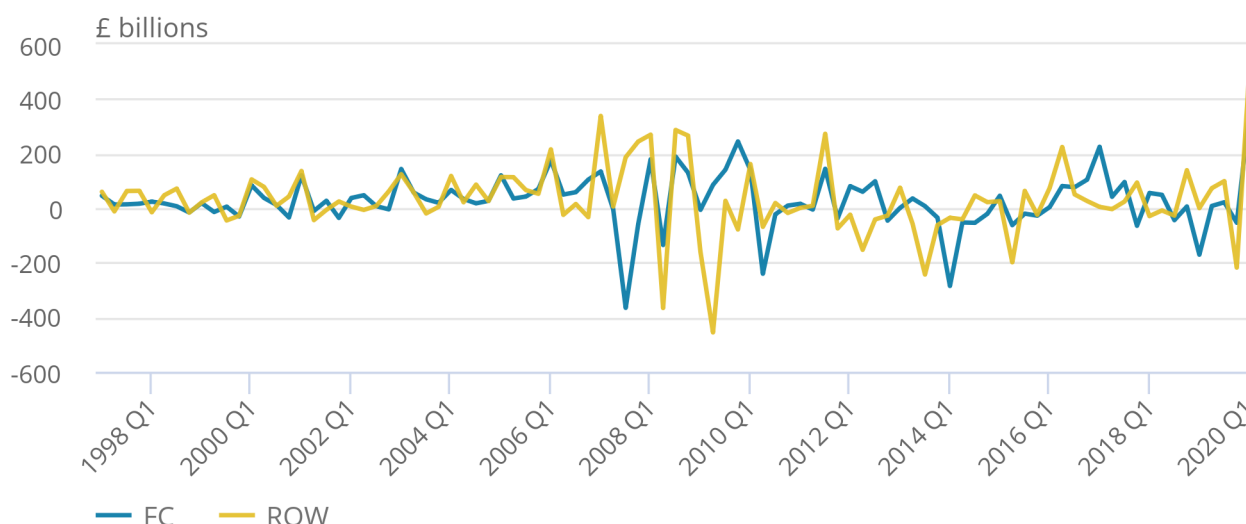
4 . Accumulation of liquid assets among UK financial corporations and rest of the world

Figure 3: The behaviour of UK financial corporations and the rest of the world are similar during periods of uncertainty and market volatility

Financial corporations and the rest of the world deposits (including both Sterling and foreign currency) with UK monetary financial institutions, non-seasonally adjusted, Quarter 1 (Jan to Mar) 1997 to Quarter 1 2020

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The behaviour of UK financial corporations and the rest of the world are similar during periods of uncertainty and market volatility. This is evident in the large increase in deposits and loans activity in Quarter 1 (Jan to Mar) 2020, the Bank of England’s so called “dash for cash”. Along with government securities (“Gilts”), currency and deposits are popular when the outlook of the economy and the stock market is perceived to be poor, since these investments carry relatively little risk.

Looking back at Quarter 4 (Oct to Dec) 2019, improved investor sentiment and reduced political uncertainty decreased financial corporations' and the rest of the world's balance sheet deposits with UK monetary financial institutions (MFIs) by £54 billion and £218 billion respectively.

However, in Quarter 1 2020, financial corporations increased their assets of Sterling and foreign currency deposits with UK MFIs by £343 billion on their balance sheet; deposits with rest of the world MFIs also increased by a similar amount. Such a substantial influx of deposits has never been seen before. To further bolster their balance sheet, several firms in this sector have cancelled dividends and suspended share buyback programmes, retaining earnings to provide additional liquidity.

At the same time, the rest of the world sector saw their Sterling and foreign currency deposits increase by £472 billion on the balance sheet.

The rise in assets is matched on the liability side of the financial corporations and rest of the world balance sheet where they increased the deposits they took to unprecedented levels. Deposits placed with UK MFIs for financial corporations on the liability side increased by £885 billion, compared with an increase of £343 billion for the rest of the world.

These movements are consistent with the Bank of England's findings that there is a "flight to safety" in financial markets and an extreme "dash for cash" in mid-March as the prices of riskier assets (such as equity) fell, which led to a surge in the demand for safer and more liquid assets, such as deposits.

The sudden demand for liquidity was alleviated by central banks around the world that intervened through a series of policy measures and coronavirus (COVID-19) schemes beyond the existing quantitative easing to increase liquidity. However, most of these liquidity measures were implemented in late March and will be reflected in Quarter 2 (Apr to June) 2020 data. As of Quarter 1 2020, the surge in loans to support firms' liquidity can be attributed to the private sector. This is shown in the record £361 billion quarterly increase in the short-term loans issued by UK MFIs and the subsequent take up of these loans by private non-financial corporations (PNFCs).

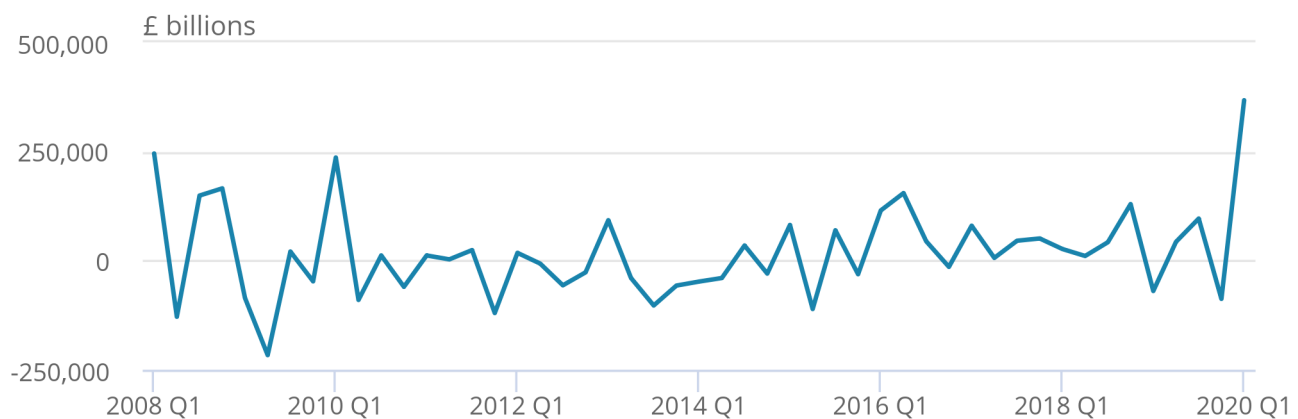
5 . Loan issuance of monetary financial institutions

Figure 4: While the pandemic was beginning to take shape in Quarter 1 (Jan to Mar) 2020, the economy was contracting and company shares were falling

The change in the loans given out by monetary financial institutions, non-seasonally adjusted, Quarter 1 (Jan to Mar) 2008 to Quarter 1 2020

Figure 4: While the pandemic was beginning to take shape in Quarter 1 (Jan to Mar) 2020, the economy was contracting and company shares were falling

The change in the loans given out by monetary financial institutions, non-seasonally adjusted, Quarter 1 (Jan to Mar) 2008 to Quarter 1 2020



Source: Office for National Statistics – Early assessment of the impact of the coronavirus pandemic on the UK's financial accounts

While the pandemic was beginning to take shape in Quarter 1 (Jan to Mar) 2020, the economy was contracting and company shares were falling. Meanwhile, private non-financial corporations (PNFCs) continued to request loans and monetary financial institutions (MFIs) were happy to oblige.

6 . PNFC deposits with UK MFIs

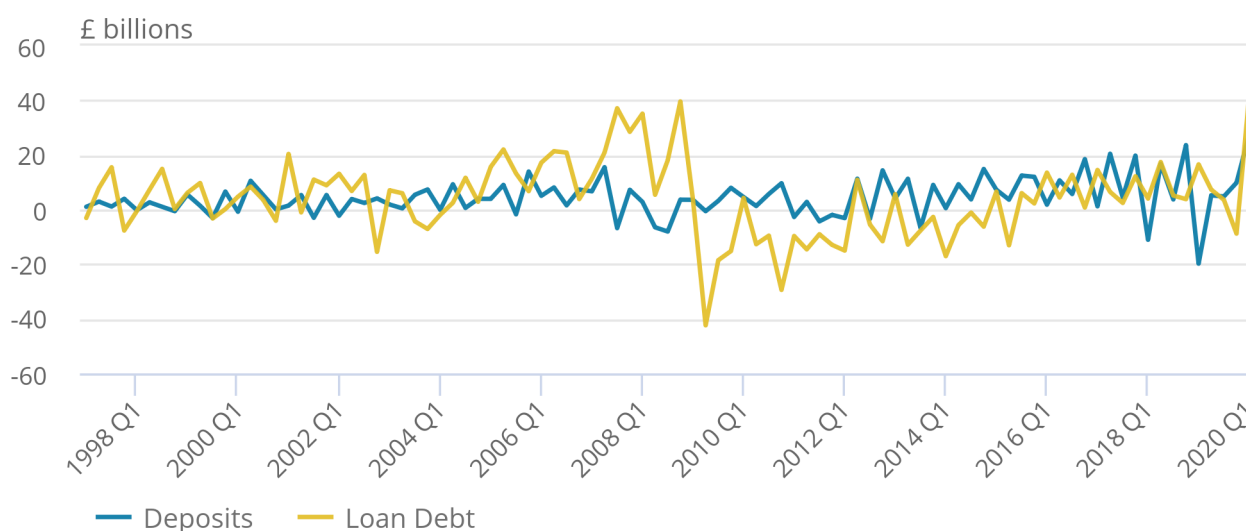
Although the movement was small relative to other market moves, private non-financial corporations (PNFCs) were a major recipient of loans issued by monetary financial institutions (MFIs) in comparison to their past activity.

Figure 5: In Quarter 1 (Jan to Mar) 2020, when GDP fell by 2.2%, the FTSE plunged but PNFCs increased their loans from UK MFIs

Private non-financial corporations' deposits (including both Sterling and foreign currency) with UK and rest of the world monetary financial institutions, non-seasonally adjusted, Quarter 1 (Jan to Mar) 1997 to Quarter 1 2020

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In Quarter 1 (Jan to Mar) 2020, when gross domestic product (GDP) fell by 2.2%, the FTSE plunged and PNFCs borrowed more money from MFIs in a single quarter than ever before. The amount of loans PNFCs took out from UK MFIs increased by £35 billion. The amount they then deposited with UK MFIs increased by £27 billion, which is also a record high.

The “dash for cash” suggests that these sectors are taking the loans from the MFIs and depositing the cash instantaneously. It is evidenced in the close convergence in loans and deposits in the latest quarter; this coming together was last seen in Quarter 2 (Apr to June) 2000 (as seen in Figure 5). This is consistent with findings from the Bank of England's [Agents' summary of business conditions](#), which noted there to be widespread reports of cash flow problems as a range of sectors saw their revenues decline sharply.

7 . Balance sheet movements in derivatives

In Quarter 1 (Jan to Mar) 2020, UK monetary financial institutions' (MFIs') assets saw an increase of £1,554 billion and liabilities of £1,533 billion, the third largest change on record. Derivatives are often referred to as “hedging instruments” as they are mostly used for hedging against risk in uncertain times and, here, MFIs exchanged in financial derivatives because their financial profile might make it vulnerable to losses from changes in the underlying security, and in the case of 2020, the underlying securities were interest rate changes.

In 2020, MFIs traded using a type of interest rate swap, and they exchanged future interest payments based on a pre-agreed amount or vice versa. For example, another MFI will agree to exchange a fixed rate of interest for the floating rate, which is usually the LIBOR (London Inter-Bank Offered Rate) to reduce interest-rate exposure to the affected assets or liabilities. This leads the value of the assets to move more in tandem with the value of its liabilities as rates change, thus helping to “immunise” against rate movements as the gains or the losses will help to match the gains or losses on the liabilities.

8 . Financial corporations balance sheet: more leveraged but more liquid

The increased deposits have improved the liquidity position of financial corporations in Quarter 1 (Jan to Mar) 2020, even without government intervention coming through the financial account. The improvement in liquidity is reflected in Figure 6.

For financial corporations, a decrease in the liquidity ratio is evident in Quarter 1 2020, which means that there is a recent drop in short-term liabilities relative to liquid assets. This suggests that financial corporations hold more cash relative to short-term debt and have a better liquidity position.

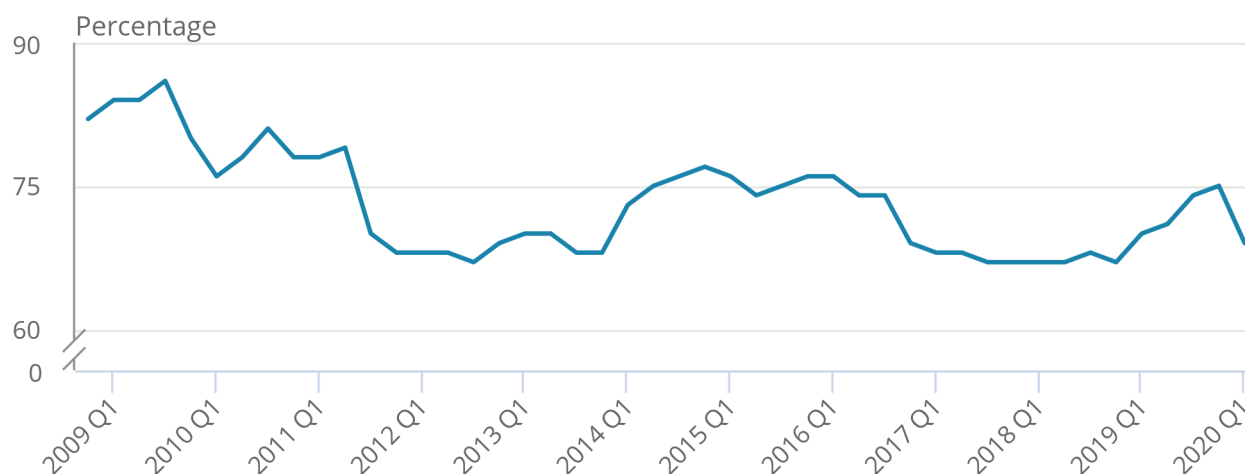
High liquidity levels (denoted by a relatively low liquidity ratio) mean financial corporations are better suited to face challenges arising from the current economic downturn. Looking back at 2008 to 2009, the liquidity ratio was very high, which means that financial corporations were relying on short-term liabilities to cover their liquid assets and were less equipped to deal with the economic downturn.

Figure 6: The increased deposits have improved the liquidity position of financial corporations in Quarter 1 (Jan to Mar) 2020

Liquidity ratio of financial corporations, non-seasonally adjusted, Quarter 4 (Oct to Dec) 2008 to Quarter 1 (Jan to Mar) 2020

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Notes:

1. Liquidity transformation is a type of transformation that involves the use of short-term debts like deposits to finance illiquid assets. A corporation or businesses' liquidity refers to the speed in which an asset can be quickly converted to cash. Thus, it is a tangible asset. The opposite would be intangible assets such as pensions or real estate, which are illiquid assets. There are a few ways of defining liquidity.
2. Liquidity transformation is calculated by dividing short-term liabilities by liquid assets.
3. Liquid assets are currency and deposits, as it is a short-term asset that is liquid. Other financial assets, such as equities, can also fit this spectrum.
4. Short-term liabilities are loans or debt securities liabilities that are short-term, that is less than one year in duration.

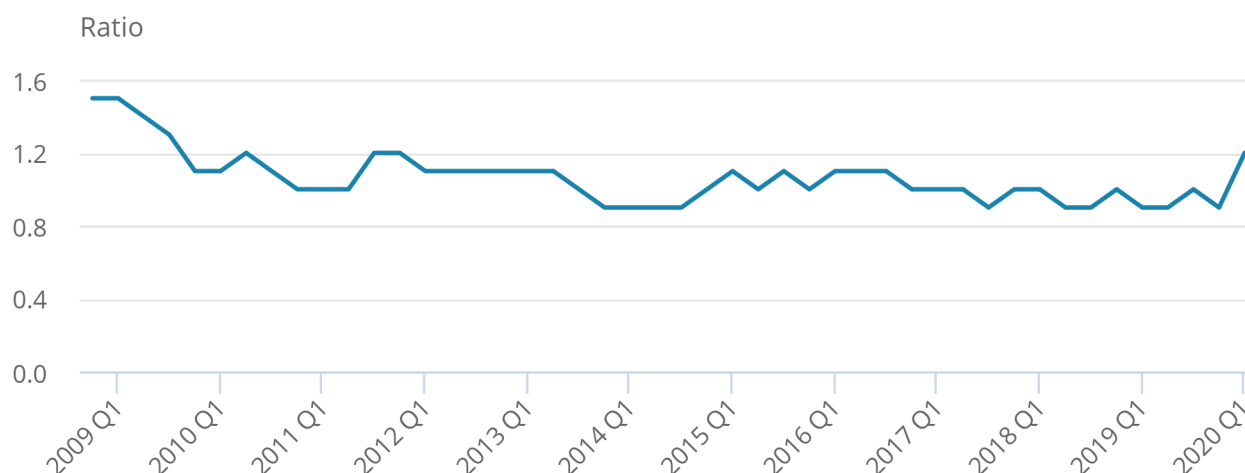
The build-up of liquid assets in Quarter 1 2020 comes at a cost with higher borrowing and debt causing a higher leverage (debt to equity ratio). In Quarter 1 2020, both non-financial and financial corporations saw a sharp spike in the leverage ratio; this spike coincides with eased lending conditions. However, the magnitude of the spike is small compared to the 2008 to 2009 peak levels when credit lending was also eased. This is shown in the uptick in the latest quarter for the non-financial and financial corporations sectors in Figures 7 and 8.

Figure 7: In Quarter 1 (Jan to Mar) 2020, non-financial corporations saw a sharp spike in the debt-to-equity ratio

Leverage ratio (debt-to-equity) of private non-financial corporations, non-seasonally adjusted, Quarter 4 (Oct to Dec) 2008 to Quarter 1 (Jan to Mar) 2020

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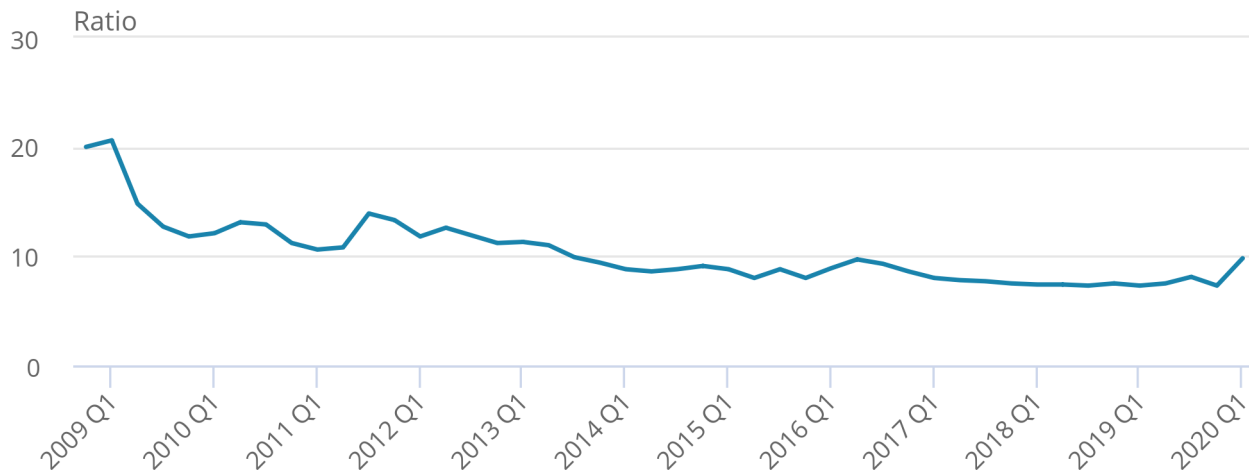
1. Leverage ratio is a measure of a corporation sector's financial leverage. It shows to which degree corporations finance their activities with debt or with equity. It is calculated by dividing the total amount of debt or financial liabilities by the total amount of equity liabilities.
2. Debt is the sum of the following financial liabilities: currency and deposits, debt securities, loans, insurance, pension, and standardised guarantee schemes and other accounts payable.
3. The ratio also measures a corporation's indebtedness. A higher debt to equity ratio indicates that the sector has been increasing its relative share of debt in external financing to finance growth rather than equity.

Figure 8: Financial corporations see their leverage ratio spike in the latest quarter

Leverage ratio (debt-to-equity) of financial corporations, non-seasonally adjusted, Quarter 4 (Oct to Dec) 2008 to Quarter 1 (Jan to Mar) 2020

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Additionally, corporations are currently more reliant on borrowing because of current circumstances, so they are calling on debt rather than issuing equity (which can damage a company's long-term investment and growth prospects). However, according to the Bank of England's summary report, investment is not a current concern for businesses as "sectors most impacted by the COVID-19 virus have put investment plans on hold to preserve cash". Those particular sectors happen to be leisure, travel and hospitality.

9 . Conclusion

This analysis captures the early impact of the coronavirus (COVID-19). Only the last eight days of the quarter were in lockdown, yet there was evidence that it stirred panic as the global stock market plummeted towards the end of February 2020. This has resulted in extreme volatility in the UK institutional sector financial accounts, leading to many sectors experiencing a sudden fall in their revenues and the value of shares. However, financial corporations have entered this current crisis in a more resilient position as their liquidity position and balance sheet appears stronger by historical standards. The extent to which the coronavirus crisis will affect the accounts next quarter is still uncertain, as by the end of Quarter 2 (Apr to June) 2020, the UK will have been in lockdown for the entire quarter.