High-street banks will be 'wary' of loan defaults as mortgage rates surge

B
ritain's biggest lenders will shed light on how well they are riding out the economic storm when they unveil their latest quarterly financial results next week.

Lloyds Banking Group, NatWest Group, HSBC and Barclays are all set to tell shareholders where their profits stand amid severe market turbulence and soaring mortgage rates.

Investors will be eager to know how the high-street banks are faring as the average two and five-year fixed-rate mortgage surged above 6% for the first time since 2008 this month.

The UK's biggest lender, Lloyds Banking Group, is expected to reveal slimmer profits compared to last year on Thursday.

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Lloyds will report statutory pre-tax profits of £1.88 billion in the third quarter, a drop from the £2.03 billion posted in the same period last year, according to the market consensus.

The group is expected to have swung to a loss from impairment charges in the latest quarter, with £285 million in losses estimated compared to the £119m it held on to in credit last year.

This could mean that the lender expects to lose more cash from customers defaulting on their loans.

Sophie Lund-Yates, an equity analyst at Hargreaves Lansdown, said: “All banks feel the pinch in the face of economic downturns.

“Lloyds is especially exposed because of its reliance on traditional banking. Classic loans, day-to-day accounts and mortgage lending are the core of the business, unlike other names which have more exposure to trading and investment bank activity.

“So, there will be watch for any impairment charges. Lloyds is likely to take the view that more people are going to default on their loan repayments.

“Higher ‘bad debts’ as they’re known, result in non-cash, but potentially hefty, charges being recognised which can affect profits.

“The scope of any impairments will give an indication of how Lloyds thinks consumers are going to fare in the coming quarter.”

Banks are facing a growing risk of bad debts if rising interest rates hit homeowners with higher mortgage repayment costs that they cannot afford.

However, investors will be keeping an eye out on the banks’ net interest margins – which will indicate whether any losses from loan defaults have been offset by gains from higher borrowing returns.

The Bank of England has been upping the base interest rate in recent months, meaning that banks can charge customers more for lending.

Though the true impact of the cost-of-living crisis won't yet have had a material impact on lending arrears and forward looking guidance is likely to remain cautiously confident, lenders will be entering Q4 wary of what's to come

Tom Merry, managing director in Accenture's UK banking strategy practice, said: "The major UK banks will be entering this earnings season well positioned.

"Strong returns are being driven by further increases to base interest rates, as well as the low pass-through rates to depositors of those increases.

"While management will be relieved that the financials are trending upwards, they will be acutely aware that the rising interest rates which have helped the health of their balance sheets have simultaneously added to the financial pressures felt by many mortgage borrowers.

"Though the true impact of the cost-of-living crisis won't yet have had a material impact on lending arrears and forward-looking guidance is likely to remain cautiously confident, lenders will be entering Q4 wary of what's to come."

In the summer, most high-street lenders reassured shareholders that there have been limited signs of financial stress from customers despite the deepening cost-of-living crisis.

This is largely because many households have been able to fall back on savings amassed during the pandemic and because banks are reaching out to support customers pre-emptively, several banks have said.

It is also because unemployment levels remain low, which is a key decision-maker for the bank in terms of upping its loans provisions, analysts pointed out.

British bank Barclays is also expected to report a dip in profits, from £2 billion last year to £1.8 billion this year.

Investors will be looking out for higher loan provisions from the £341 million it set aside in the previous quarter.

Meanwhile, NatWest Group is set to post pre-tax operating profits of £1.27 billion, an increase from the £1.1 billion it made last year.

But the group is also set to have swallowed up impairment losses of £131 million, compared to posting credit in previous quarters.