In collaboration with:

HOUSEHOLD FINANCE REVIEW - Q1 2022

June 2022

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This review explores trends in household spending, saving and borrowing through the first quarter of 2022. Confidence dipped again, with the rapid spread of the Covid-19 Omicron variant and rising inflation starting to be felt in wallets. Here we look in detail at how the mortgage and unsecured lending markets fared as the economy moves into a more challenging phase for household finances.

FOREWORD FROM ACCENTURE

Taken in isolation, the Q1 data presents a snapshot of UK household finances in a fairly stable state. Housing activity remained buoyant, alongside robust credit card spending and personal borrowing.

But this benign environment was short-lived. With consumer confidence plunging to an all-time low, forward-looking surveys and early indicators suggest a far bleaker outlook for the rest of 2022. The impacts of rising energy prices and the war in Ukraine are now starting to be felt by business and consumers alike, as soaring inflation puts the UK in the eye of a cost-of-living storm. And with the Bank of England expected to make further increases to interest rates, we anticipate a tightening squeeze on household finances in Q2 to Q4.

The pressure is likely to be most intense for lower-income households, which indicators suggest will see the biggest reductions in their disposable income. Concerns over this effect are being deepened by the prospect of energy prices rising further in the autumn, when the energy cap is raised again.

While the Government's recently announced support package will help to cushion the impacts to a degree, it's clear there are tough times ahead. We're already seeing some retail banks respond by issuing more cautious forward-looking statements and making rising provisions against expected losses – with further provisions anticipated in Q2. However, beyond taking these steps, we believe banks will also need to explain the hard realities of this crisis to households and provide appropriate support to vulnerable customers, blending digital and human-delivered services to help people weather the storm. These efforts could include the restoration of some measures introduced in response to COVID-19, such as more flexible lending criteria and the option of payment holidays.

Meanwhile, consumers will need to keep close tabs on their own household finances – and be ready to discuss and explore solutions proactively with their bank if the pressure becomes too much.

Q1 2022 HIGHLIGHTS

- Despite a sharp fall in consumer confidence, spending on credit cards remained robust, as did personal loan borrowing to fund larger purchases.
- House purchase borrowing dropped sharply year on year, reflecting the unprecedented boom this time last year. However, given relatively strong volumes remain, it is too early to say whether the Covid-driven demand for property better suited to new ways of living and working has yet run its course.
- Cost-of-living pressures are expected to bear down on effective demand for mortgages this year, particularly amongst lower-income households, but are unlikely to start to show materially until Q2.
- Remortgaging is strong and set to remain so through the year. Equity withdrawal at remortgage has fallen away following the end of the Stamp Duty holiday, but the amounts withdrawn for home improvement remain significantly elevated, reflecting inflation in this sector.
- Cost-of-living pressures have so far not fed through to any signs of early stress in the unsecured borrowing space. Similarly, mortgage arrears continue to improve.
- We do expect increases in unsecured debt stress and mortgage arrears as cost-of-living pressures are increasingly felt through this year. As with demand, we expect these arrears pressures to be felt most acutely amongst lower-income households who have less flex in their household budgets.

UK ECONOMIC CONTEXT AND OUTLOOK

The opening quarter of 2022 signals a difficult year ahead for the UK economy, as the rate of inflation continued to rise while economic growth slowed. Although the planned rises to the energy price cap and national insurance contributions took effect in April, UK GDP grew by only 0.8 per cent in the first three months of this year – the lowest quarter-on-quarter growth in the last 12 months.

Initially, the economy bounced back from the contraction in December caused by the emergence of a new Covid-19 Omicron variant, with GDP growth of 0.8 per cent registered for January. However, monthly economic growth subsequently flatlined in February, and turned negative in March. The services sector was the main contributor towards March's negative growth – likely a result of growing concerns among consumers over costs of living. The retail industry contracted 15 per cent in March and activity in the NHS Test and Trace services and vaccination programmes continued to fall, after detracting approximately 1.1 percentage points from GDP alone the month prior.

The various fiscal tightening policies outlined by the Chancellor, as well as the rise in energy prices, will impact economic activity in the second quarter and beyond. On average, forecasters predict GDP growth to be stagnant in the second quarter of 2022, and NIESR now expect the economy to contract in the second half of the year.

Inflation surged to seven per cent in Q1 – the highest rate of CPI in the UK since 1992. Alongside persistent supply chain disruptions, the sanctions imposed on Russia over the invasion of Ukraine have caused increases in global commodity prices. Among these is a near-20 per cent rise in world wheat prices. Together, Ukraine and Russia export more than a quarter of the world's wheat, as well as being key in the export of sunflower oil and corn. This has translated into a five per cent spike in food prices in March compared with the same month last year, with 39 per cent of food and beverage firms reporting they have increased prices in February, according to the ONS.

A recent ONS survey on cost-of-living found that nearly nine in ten adults have seen an increase over the past year, and four in ten of those who pay energy bills stating it was somewhat or very difficult to afford their energy bills in March – a month before the energy price cap rose by over 50 per cent. It is worth noting that there was a difference in response between renters and mortgage holders, with 37 per cent of renters reporting it difficult to pay their usual household bills, compared with 23 per cent of mortgage holders.

Research from the Bank of England indicates most households look to use their savings to cover these costs, as 60 per cent of respondents to a recent survey stated they will save less each month to cope with rising prices. A sizeable proportion of households also intend to use their existing savings, which comes as no surprise as it is estimated UK households accumulated an aggregate £200 billion in excess savings during the pandemic.

However, this may not be the case for lower-income households, who are unlikely to have accumulated significant savings to cushion the rises to living costs. The latest Monetary Policy Report from the Bank suggests the lowest income decile spend ten per cent of total household expenditure on energy, compared with the highest income decile who spend roughly six per cent. The combination of a recent rise in energy prices, with further rises in October, and the rise in wheat prices affecting the price of staple foods, indicates lower-income households are going to particularly struggle in the coming year.

The UK labour market continued to tighten in the first three months of 2022. Job vacancies continued to exceed previous record-levels, with the accommodation and food industry registering a 93 per cent increase in vacancies since Q1 2021 – a period during which the economy was under strict lockdown. However, even as vacancies rise, the level of unemployment falls, returning to pre-pandemic levels by the end of March. Despite this low level of unemployment, the number of those employed has also fallen by over half a million since the start of the pandemic. Economic inactivity has risen over this period by over 480,000, with long-term illness commonly cited as a reason for leaving the workforce. High vacancy numbers coupled with low unemployment has led to the ratio of unemployed person to every vacancy reaching 1.0 in February, a record low. Typically, a tight labour market will lead to increased growth in wages; however, the current level of inflation means growth in regular pay – excluding bonuses – fell by 1.2 per cent in real terms in the last 12 months to March.

As is expected following a decline in real wages, consumer confidence dropped to near record-lows in March. Among the largest contributor to this decline were the public's thoughts on their personal financial situation over the coming year, which has since fallen to levels below that seen during the 2008 Global Financial Crisis.

As a consequence of rising energy and goods prices, and to guard the UK economy from persistent future inflation above target levels, the Bank of England raised the Bank Rate twice in Q1 and has since raised it to one per cent – the highest it has been since 2009. Further rate rises are not out of the question, as the minutes of the latest Monetary Policy Report (MPR) note further tightening may be warranted in the future, with a third of the committee voting already for a larger rise.

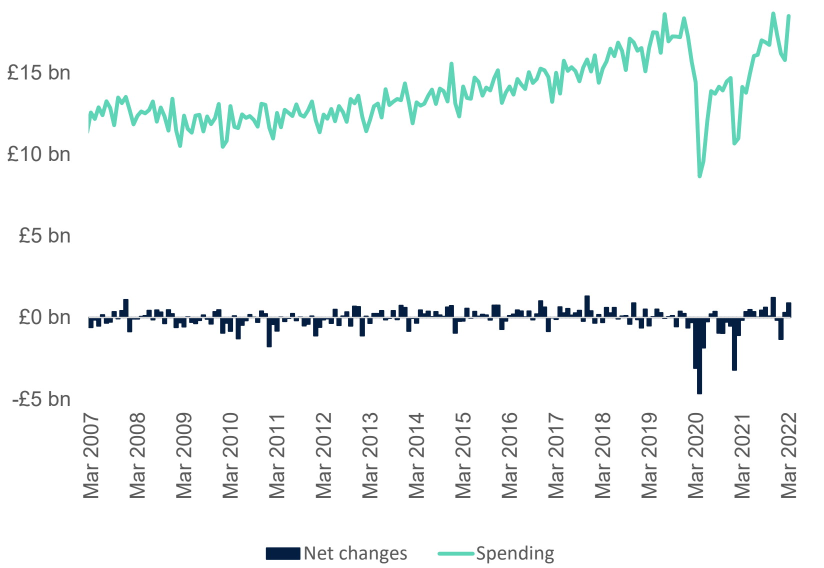
Overall, it is clear the remainder of the year will prove challenging to UK households as they cope with elevated pressures to costs of living, especially those households towards the lower end of the income distribution. In the coming quarter, external forecasters expect a gradual slowdown in economic growth, meanwhile inflation has been continually revised upwards. In comparison, the labour market outlook remains relatively stable, with unemployment projected to rise marginally. For the year as a whole, NIESR forecast annual GDP growth at 3.5 per cent, CPI inflation to increase by 7.8 per cent and the unemployment rate to average at 4.4 per cent.

CONSUMER SPENDING: DESPITE HIT TO CONSUMER CONFIDENCE, SPENDING PATTERNS REMAINED STRONG

Consumer confidence dropped sharply in the first quarter of 2022, following a smaller fall in Q4 2021, amidst the rapid spread of the Omicron variant and rising prices starting to be felt at the checkout. Importantly, confidence levels fell not just with respect to the general economic situation, but also the outlook for household's own positions, where respondents are normally more upbeat. The "own situation" element of the GfK indicator dropped to a reading of 22, below that seen throughout the pandemic and lockdowns.

However, possibly helped by the relatively limited disruption caused by the Omicron variant, this appears to have had relatively limited impact on consumer spending patterns. In fact, card spending saw an uptick in Q1. The final lifting of all Covid-19 restrictions across all parts of the UK will have provided support in some categories of spending, such as entertainment. In addition, whilst some of the growth reflects inflation raising the average spend, the number of purchase transactions also rose (**Chart 1**).

Chart 1: Credit card spending in month



SOURCE: UK FINANCE

Increases in spending were concentrated in services, with travel-related spending particularly strong as households returned to international holidays after two years of disruption. In contrast, retail activity was somewhat weaker over the quarter, with spending in supermarkets down as spending in restaurants rose. These trends are potentially a return to more normal spending patterns as Covid-19 and associated restrictions changed the mix of household spending towards more goods and away from services. Indeed, our data are consistent with the patterns of growth seen in the ONS GDP and retail sales statistics.

Broadly speaking, card spending overall appears to have reverted to its pre-COVID trend. Looking ahead, the combined pressures on households from energy price increases and tax changes will start to be felt from Q2 onwards, adding to the pressures from rising overall inflation which started to emerge in the first quarter. How this will impact on spending remains to be seen; many households will be able to absorb these shocks without needing to change their spending patterns, and their spending is likely to increase, at least in value terms. However, some, particularly in lower income brackets, are likely to scale back on some expenditure items as prices rise. This will bear down on the volume of transactions, although the pound value of spending for these households may move in either direction, depending on the size of the overall shock to their household budgets.

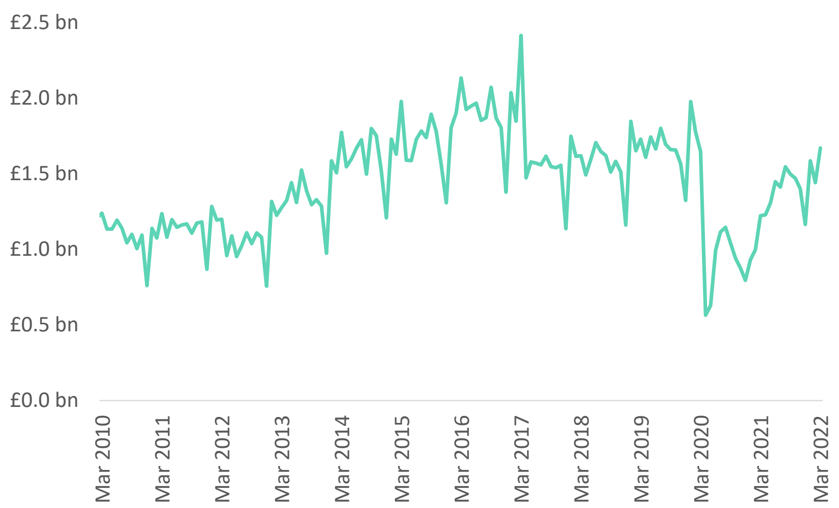
CONSUMER SPENDING: PERSONAL LOAN DEMAND ALSO NEARING PRE-COVID-19 LEVELS

Echoing the trend for card spending, personal loan borrowing also saw growth through Q1, following the normal seasonal drop-off at the end of 2021 (**Chart 2**). Overall, the dip in consumer confidence does not as yet appear to have dampened consumers' appetite to take out unsecured credit to fund larger purchases (excluding car finance).

These robust spending patterns may appear counterintuitive, given rising inflation and the weakness in consumer confidence over the quarter. It is possible that, with borrowing costs still low (albeit rising), the more rapid increases in consumer prices and ongoing supply chain issues limiting the availability of many consumer goods, households may be bringing forward larger purchases, to avoid paying even more later on or finding the items they need are unavailable.

As with card spending, the outlook for take-up of unsecured personal loans is uncertain given the conflicting pressures from rising prices. The downward pressures from inflation and tax changes are likely to reduce demand for larger items, which would feed through to more subdued demand for personal loans as we move through 2022.

Chart 2: Amounts of new personal loans from banks



SOURCE: UK FINANCE

HOUSE PURCHASE ACTIVITY FELL AWAY IN Q1

Following the unprecedented boom in house purchase activity from late 2020 through Summer 2021, mortgage loan volumes have followed a downward trend, which continued in the first quarter of 2022.

Overall, homemover numbers in Q1 2022 were some 42 per cent down on the number seen in the first quarter of 2021, and first-time buyers (FTBs) down a more modest 12 per cent (**Chart 3**).

The greater fall in homemover numbers is largely a result of the unprecedented volumes seen this time last year, as homemovers saw the greatest benefit from the Stamp Duty holiday. Following the end of the Stamp Duty holiday, this drop-off in activity is fully expected, as many transactions that would have normally taken place in 2022 (or beyond) were brought forward to take advantage of the material savings which the holiday offered. The boost to FTB numbers was less pronounced (although still very strong) and, accordingly, the compensating drop off following the end of the temporary holiday was of a lesser magnitude.

Chart 3: Mortgage applications and completions, 3-month moving average, year-on-year change

SOURCE: UK FINANCE

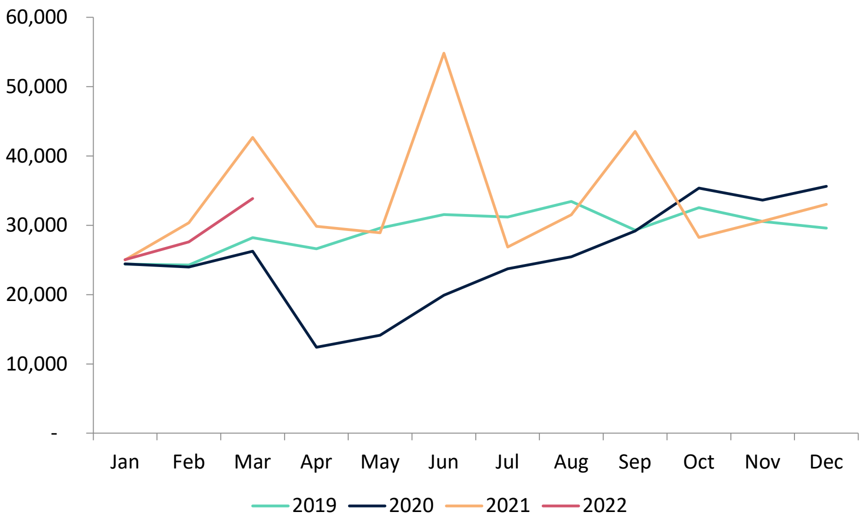
Looking ahead, the volume of mortgage applications submitted in Q1 2022 – most of which will complete in Q2 – was two per cent greater than the same quarter last year. However, it is likely that much of this growth is concentrated in the remortgage market (our applications data includes those for both house purchase and remortgage loans but the two are not separately identified). We expect relatively robust house purchase activity in Q2, but this will almost certainly show a year-on-year decline given the unprecedented surge in Q2 last year as borrowers rushed to beat the Stamp Duty deadline.

DESPITE YEAR-ON-YEAR FALLS, PURCHASE ACTIVITY CURRENTLY APPEARS BROADLY ON PRE-COVID TREND

Overall, FTB activity, whilst down from the extreme highs of 2021, is still currently trending well above 2019 (pre-Covid-19) levels (**Chart 4**). The outlook for FTBs, as we move through 2022 is unclear; typically younger and therefore lower down on the income scale than homemovers, there may be greater downward pressure on FTB numbers as cost-of-living pressures come to bear. However, in Q1, with these cost and income pressures not yet fully felt, there are no signs of a contraction.

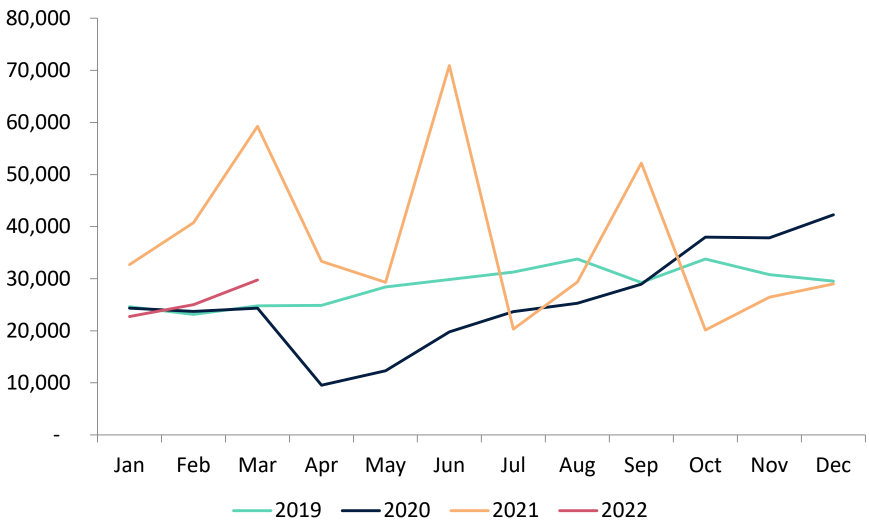
On the face of it, homemover numbers look to have now fallen away dramatically and are almost back down to their 2019 (pre-Covid-19) trend (**Chart 5**). However, a simple reading of trendlines may not tell the full story.

Chart 4: Number of loans to FTBs, 2019 to 2022



SOURCE: UK FINANCE

Chart 5: Number of loans to homemovers, 2019 to 2022



SOURCE: UK FINANCE

Given the volume of transactions likely to have been brought forwards to take advantage of the Stamp Duty holiday, many homemovers buying through the stamp duty holiday period are those who would have normally bought in 2022 or even 2023 but brought their purchases forward. Accordingly, we might have expected to see an even greater year-on-year decline than the 42 per cent fall seen in Q1 2022. It is therefore possible that there is continuing strength in the homemover segment arising from the Covid-triggered changes to living and working patterns, which may outlive the pandemic itself.

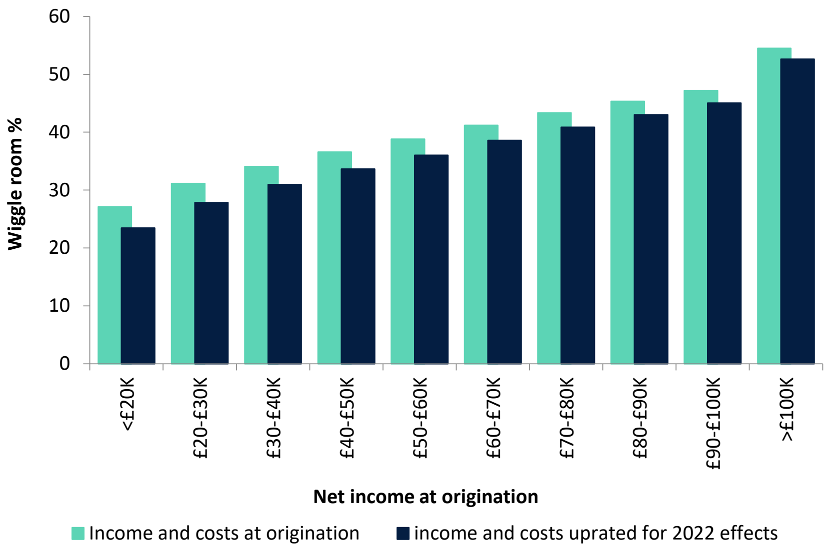
COST-OF-LIVING LIKELY TO HAVE ONLY MODEST IMPACT OVERALL, BUT MAY WEAKEN DEMAND AT THE MARGINS

In our Q4 Review we signalled the headwinds to effective demand for mortgage credit on the horizon, as tax increases and rising inflation combine to put new pressures on households' balance sheets that have not been present for well over a decade. Whilst this has yet to show in mortgage completions data the most material changes – those arising from energy bill increases and tax changes - will not come to bear until Q2.

For further insight into the extent of any dampening of demand, we have looked at our loan-level mortgage data to simulate the combined effect of these pressures on recent borrowers, uprating household expenditure and net income to take account of actual inflation and wage growth to date, as well as that forecast through the rest of 2022.

Chart 6 shows the affordability position of borrowers in 2021, both at the time they took out the loans and then what their positions would look like after these income and price changes come to bear over this year. This analysis takes into account confirmed income changes and inflation forecasts at the time of writing but does not incorporate any subsequent changes. In broad terms, this "wiggle room" metric approximates the income-expenditure test carried out on mortgage applicants.

Chart 6: Wiggle room in mortgagors' budgets, before and after 2022 inflation and disposable income effects, 2021 originations



SOURCE: UK FINANCE

Notes:

1: wiggle room defined as the proportion of net income left after subtracting initial mortgage payments, basic household expenditure and credit commitments.

2: we estimate uprated costs for 2022 using external forecasts for full-year 2022. Confirmed increases to National Insurance Contributions (NICS) are factored into net income. Any confirmed or unconfirmed change after the time of writing are not included.

Overall, the combined impact of price, tax and income changes through 2022 would translate to a little under three per cent less disposable income for the average household borrowing in 2021. This would suggest that there is likely to be only a relatively modest impact on effective demand, as the average affordability assessment would only see a small downwards impact and the average borrower still having more than half of their net income to spare after subtracting all these items.

However, as we have observed previously, the extent of the cost-of-living squeeze now taking place will impact all household budgets materially, but is likely to be felt most acutely amongst lower income brackets.

As Chart 6 shows, the reduction in wiggle room is greatest amongst those in the lower income brackets. In addition, borrowers in these lower brackets had significantly less free income than those in higher brackets, even before these current cost-of-living pressures are factored in, with the lowest brackets having around half the spare income of those in the higher brackets.

Overall, borrowers in all income brackets would have a good proportion of income left even after these cost-of-living pressures come to bear and would therefore still likely qualify for mortgage credit now as they did last year. At the margins, however, there will be some borrowers for whom these combined pressures mean they would not be able to afford the size of loan originally applied for, and so would have to take either a smaller loan or not at all, if a smaller mortgage would not be a viable option.

Therefore, we may see some softening of effective demand as cost and income pressures rise, and these are likely to be felt more acutely in those household segments and regions of the country with typically lower incomes.

CONSUMER SPENDING AND LENDING: SUMMARY

The spread of the Omicron variant and the early pressures on consumer prices dented confidence in Q1 2022, but this did not translate to any drop off in activity, either in spending or borrowing for consumption or house purchase.

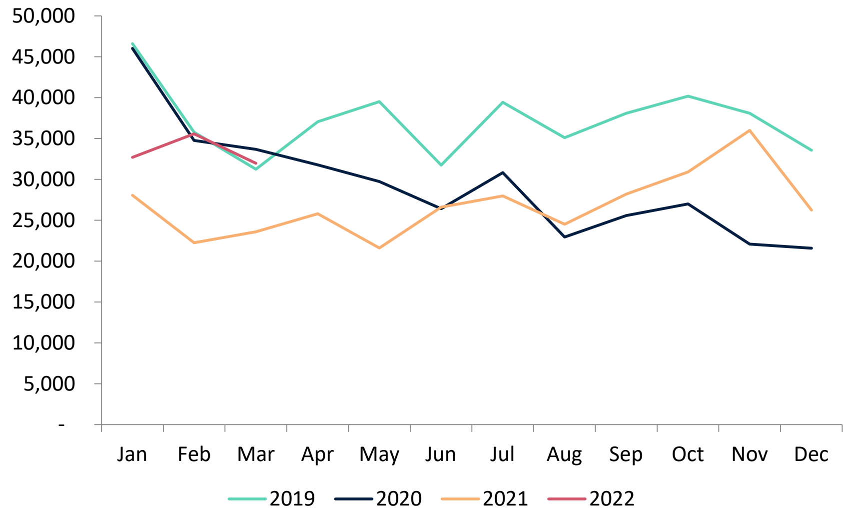
We expect demand to soften as we move through Q2 and as the cost-of-living pressures become more acute and, whilst most households will be able to absorb these, we are likely to see downwards pressure on household spending and borrowing, skewed disproportionately towards lower income households.

REFINANCING ACTIVITY IN Q1 SHOWING STRONG YEAR-ON-YEAR GROWTH, AND SET TO REMAIN STRONG THROUGH THE YEAR

Refinancing activity in Q1 continued to follow the pattern of maturing fixed rate mortgages. With the increase in popularity of longer-term fixes in recent years, the longer average time between origination and the end of deal rate had been bearing down on remortgage demand last year, compared with that seen previously when the most popular choice was a two-year fix. However, strong volumes of five year fixed rate lending taken out in 2017 are due to mature this year, setting expectations of a continuation of the strong growth seen in Q1 through the rest of the year (**Chart 7**).

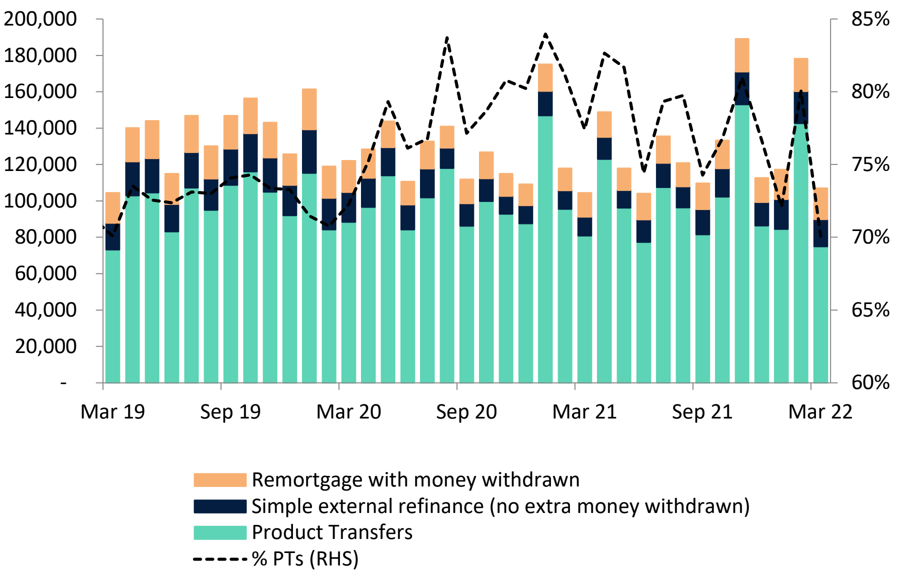
Following an increase in the incidence of equity withdrawal in total remortgaging activity through the past two years, the proportion of total remortgaging where extra money was taken out has reverted back to 50%, the typical split seen since around 2012 (**Chart 8**).

Chart 7: Number of loans for residential remortgage, 2019 to 2022



SOURCE: UK FINANCE

Chart 8: Number of residential remortgages and internal product transfers



SOURCE: UK FINANCE

Within simple refinancing (where no additional money is borrowed), internal Product Transfers (PTs) continue to dominate activity, with over eight in every ten customers taking a PT with their current lender. The split between PTs and external remortgaging is erratic, and heavily influenced by the fixed rate maturity schedules and retention strategies of loans for individual lenders. Notwithstanding this fluctuation, the increased preference through two years of social distancing for PTs, which can be completed simply and quickly by remote channels, appears to be falling back towards pre-Covid-19 levels. However, there still appears to be some increased preference for PTs, and it remains to be seen whether this will fall fully back to pre-pandemic norms over the coming months.

PRODUCT TRANSFERS DOMINATE REFINANCING, BUT DIFFERENT CUSTOMERS HAVE DIFFERENT REFINANCING NEEDS

With the fixed rate maturity schedule set to fuel strong refinancing numbers this year, we can now use new loan-level data available to us since Summer 2021 to compare the characteristics of borrowers accessing different kinds of refinancing products.

Table 1 below sets out some of key data points for external remortgaging, alongside the same data for PTs and further advances on existing lending, both of which are now available within our loan-level data. PTs remain dominant, and account for 68 per cent of all refinancing, and 86 per cent of all simple pound-for-pound refinancing in Q1 2022. However, the characteristics of borrowers taking PTs differ in a number of respects to those remortgaging on the open market.

Table 1: Characteristics of borrowers accessing different types of mortgage refinancing

	External remortgage, no additional borrowing	Product Transfers	Remortgaging with additional borrowing	Further Advances	All refinancing and releveraging transactions
Number of transactions	48890	302120	51140	41450	443600
of total refinancing	11%	68%	12%	9%	100%
Average characteristics					
Loan size	£ 203,089	£ 153,064	£ 220,188	£ 53,038	£ 156,969
Borrower income	£ 83,873	N/A	£ 77,049	£ 85,059	N/A
Term of mortgage	20	19	22	20	20
Borrower age	42	44	43	42	43
Initial interest rate	1.49	1.78	1.66	1.98	1.75
LTV	51	N/A	58	14	N/A
LTI	2.6	N/A	3.0	0.6	N/A

SOURCE: UK FINANCE

Notes:

1. Income, LTI and LTV are not available for Product Transfers.
2. Affordability statistics for Further Advances relate to the new loan only, and do not incorporate the pre-existing loan balance
3. Product transfers are not included in industry figures, including for gross or net lending, as they do not result in a change of lender or aggregate balances outstanding.

In particular, borrowers choosing PTs are typically older, with less time to run on the mortgage, compared with those taking out simple pound-for-pound remortgages with a different lender. Importantly, they also have much lower loan balances.

These lower balances are likely to be the key factor influencing the decision to refinance internally, saving the time and expense of searching the wider market for the best deal. Whether consciously or unconsciously, customers clearly attach a cost to the time and effort taken to source and arrange the best deal. In addition to the actual financial cost of the arrangement fee for an external remortgage (although some deals do not have an associated fee), customers balance out these financial and non-financial costs against the savings made by refinancing on the open market, compared with taking a deal offered by their existing lender.

The average rates presented in Table 1 give only a broad indication of the value customers place on convenience versus cost savings, as rates will vary dependent on individual circumstance for each loan. However, the typical rate on a PT taken out in Q1 2022 was 1.78 percent, 29 basis points more than the average rate amongst borrowers taking a simple pound-for-pound remortgage with a different lender.

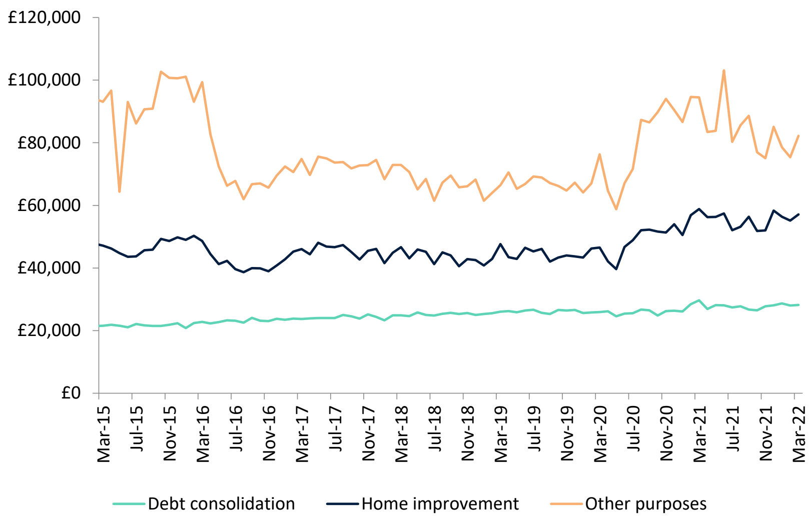
HOUSEHOLD REFINANCING – POST STAMP DUTY HOLIDAY, EQUITY WITHDRAWAL TO FUND PURCHASE FELL AWAY, BUT HOME IMPROVEMENT BORROWING STILL ELEVATED

Whilst we expect mortgage activity to be strong through this year, this is largely driven through increased numbers coming to the end of their fixed rate deals and looking to switch to a better rate. This is in contrast to the activity seen through the last two years, where a significant element of remortgaging activity involved borrowing substantial additional money, in many cases to fund additional property purchases to take advantage of the Stamp Duty holiday.

Following the end of the temporary tax break, the incidence of equity withdrawal is returning to pre-2020 norms. We can see that, alongside this, the amounts taken out where equity is withdrawn for "other purposes (which will include those where the reason was to fund additional purchases) has fallen back towards pre-pandemic levels (**Chart 9**).

However, the average amounts taken out for home improvements remain significantly elevated compared with pre-pandemic levels, reflecting the inflation already seen since 2020 for labour and materials in the residential construction sector. These increased costs are likely to keep the pound values for remortgage activity higher, particularly whilst the current Covid-triggered wave of improving and adapting living spaces persists.

Chart 9: Average value of equity withdrawal through residential remortgages



SOURCE: UK FINANCE

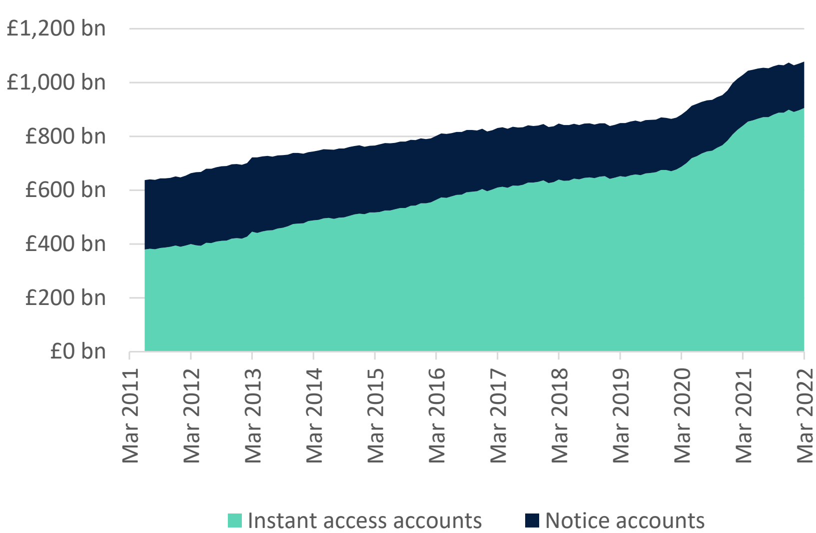
At this stage we have not seen any material increase in money withdrawn to consolidate other (more expensive) debt into the mortgage. These average amounts have been trending very slowly upwards, broadly reflecting general inflation, with no additional increase over and above this over the past two years. This suggests that the cost-of-living increases, the bulk of which will not be felt until Q2, have yet to feed through into a material build-up of unsecured debt (which would feed through to some increase in mortgage borrowing to consolidate this comparatively expensive debt).

HOUSEHOLD SAVING: DEPOSITS CONTINUE TO GROW BUT MODEST SIGNS OF SLOWING

The elevated growth from household savings in deposit accounts through 2020 and 2021, as social restrictions limited avenues for spending, eased off in Q1 2022 and annual growth fell back near to levels seen before the first lockdown in March 2020 (**Chart 10**).

All the growth in retail deposits remains concentrated within sight (instant access) accounts. Despite recent Bank Rate rises leading to higher returns on notice accounts, these rates remain well below inflation and, with further cost pressures set to come through this year, there is currently low (and decreasing) demand amongst households to tie up savings in longer term products whilst the real rate of return on these products remains negative.

Chart 10: Personal deposit account balances



SOURCE: UK FINANCE

HOUSEHOLD REFINANCING AND SAVINGS: SUMMARY

Mortgage refinancing activity was strong through the first quarter of 2022, in line with expectations, and customers continue to choose to refinance either on the open market or internally dependent on which option best suits their own circumstances. Whilst the incidence of borrowing to fund further property acquisition has fallen away, we are likely to see elevated amounts withdrawn to fund home improvements whilst the costs in this sector face material inflationary pressure.

Elsewhere, deposits continue to rise, albeit at a slower rate than seen through the past two years when social restrictions limited the avenues for spending. However, there is no evidence in Q1 that, at the aggregate level, the household sector is either dipping into existing savings or consolidating unsecured debts into their mortgage.

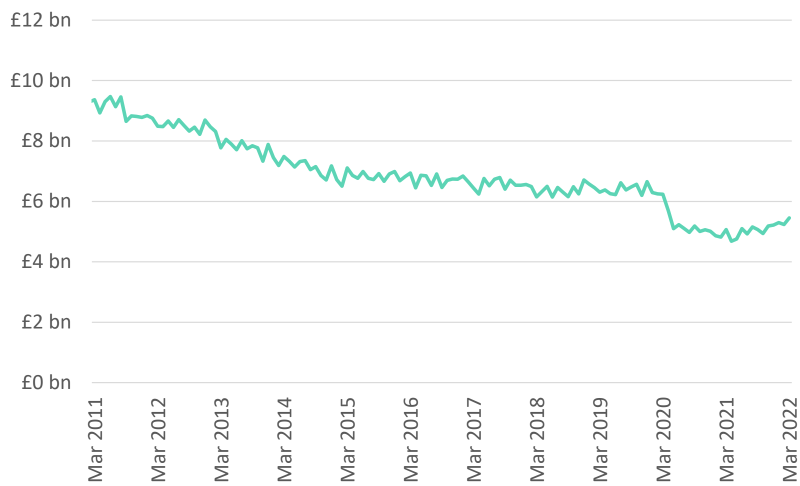
HOUSEHOLD DEBT: OVERDRAFT BALANCES CONTINUE TO RISE BACK TO "NORMAL"

Overdrafts levels continued to rise in the first quarter of 2022, but, following the rapid decumulation of overdraft debt in the early stages of the pandemic, remain well below pre-2020 norms (**Chart 11**). At around £5.5 bn, the total overdraft debt held with high street lenders was still around 15 per cent below the amounts seen in 2019. Households, many of whom had been able to pay down relatively expensive overdraft debt through the period of social restrictions and lower spending, have not yet returned to their previous patterns of overdraft utilisation.

A material increase in overdraft usage may be an early sign of household financial stress from cost-of-living pressures. However, the increases currently seen in aggregate balances primarily reflect a general return to trend.

Whilst there may be some at the margins who are already experiencing financial stress from rising cost-of-living, we would not expect this to feed through to any more widespread pressures until Q2, when energy prices increases and tax changes kick in.

Chart 11: Overdraft balances outstanding



SOURCE: UK FINANCE

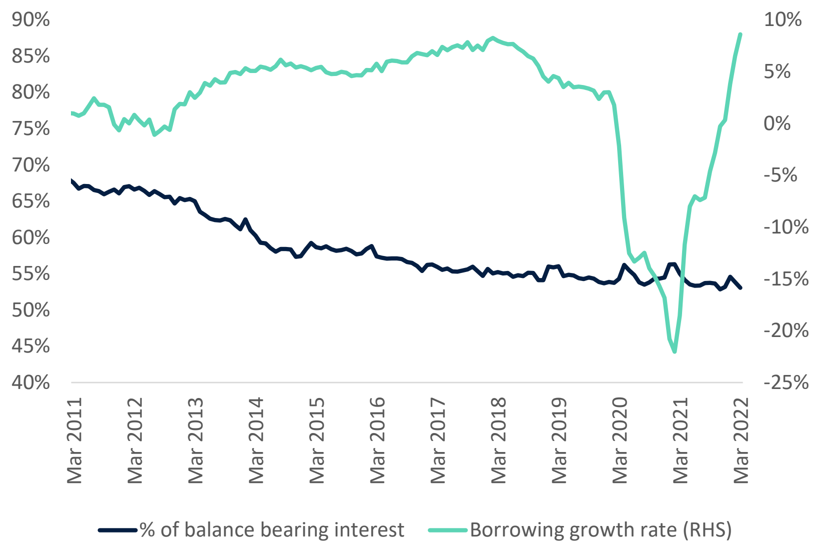
HOUSEHOLD DEBT: MORE CREDIT CARD DEBT PAID OFF EACH MONTH

In the early months of the pandemic, social restrictions significantly limited the avenues for consumer spending and, alongside this, the Covid-19 payment deferral scheme allowed consumers to pay down existing credit card balances. Accordingly, we saw balances fall sharply each month whilst social restrictions were widespread. The level of outstanding credit card debt finally started to increase in December 2021, with almost all sectors of the economy fully open and consumer spending rising in line with this.

This growth has accelerated through Q1 2022, as spending patterns moved closer to previous norms (**Chart 12**).

Whilst higher consumer prices have also contributed towards the strong growth in Q1, the proportion of balances bearing interest, which declined in the early part of the pandemic as households spent less and many paid off balances using spare income, has not shown any signs of returning to pre-covid levels. In Q1, 54 per cent of card balances were interest-bearing, with the remaining 46 per cent paid off each month and therefore attracting no interest.

Chart 12: Credit card balances outstanding



SOURCE: UK FINANCE

Whilst somewhat erratic and affected by seasonal spending patterns, interest-bearing card balances are currently still trending gradually down. This suggests that - at the aggregate level - households' ability to pay for their monthly outgoings has not been negatively impacted by cost-of-living pressures at this stage.

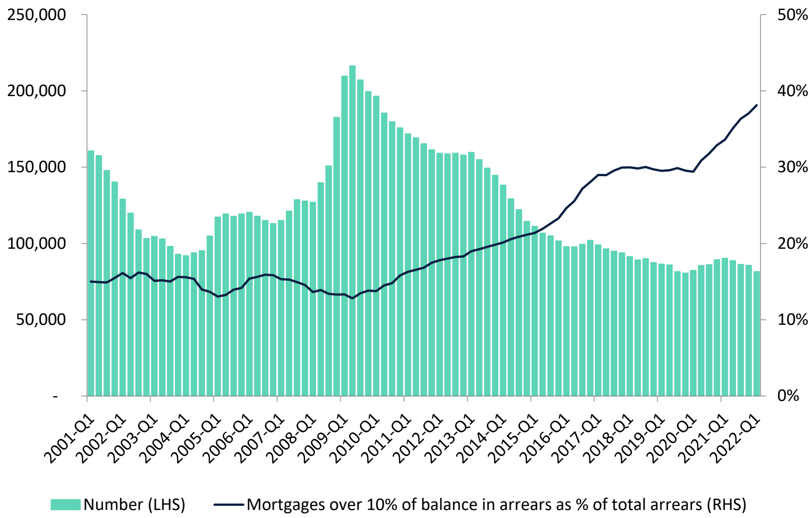
HOUSEHOLD DEBT: MORTGAGE ARREARS IN GOOD SHAPE AS COST-OF-LIVING PRESSURES LOOM

Following the Bank Rate increases in December, February and March, mortgage payments will have risen for those borrowers with variable rates – approximately 2 million borrowers (25 per cent of all homeowner mortgages) - by the end of the quarter. These have yet to translate into any increased incidence of payment stress for mortgage customers. In fact, the number of borrowers in arrears has continued to fall through Q1 and now stands at 81,480, down from the 85,610 seen at the end of Q4 2021 (**Chart 13**).

However, given the time taken to build up reportable arrears, we would not expect these rate increases, nor the subsequent rise to one per cent in May, to start to feed through to arrears until the end of Q2. Even with these rises mortgage rates remain low by historic comparisons.

Within the overall figures, the number of arrears cases has fallen across the board – from early arrears all the way through to those cases with the deepest arrears positions (representing over 10 per cent of the mortgage balance).

Chart 13: 1st charge homeowner and buy-to-let mortgages in arrears



SOURCE: UK FINANCE

The fall in heavy arrears, albeit by a modest amount (down by 650 cases to 31,070), is the first quarterly decrease since Q4 2019. This number had been rising since the start of 2020, driven in large part by the possessions moratorium, which meant that these heavy arrears cases, many of which would have passed through to possession in the best interests of the customer where all other options to repay had been exhausted, have instead remained in arrears and seen those arrears balances increase. This first fall in heavy arrears may be an early indication that the backlog of possession cases, most of which will be in these heavy arrears bands, is finally starting to clear. However, further quarters of arrears data are needed to confirm this.

Looking forward, vacancies data indicate that the strength in the labour market may be easing off a little, at least in some sectors. Although this has yet to lead to any aggregate increase in unemployment, should this emerge in the coming months we would expect this to place additional pressure on mortgage payments.

However the main pressure, as we move through Q2 and beyond, will be the cost-of-living pressures. These will impact on all mortgaged households, regardless of employment and whether or not they are on a variable rate. As we observed previously in this Review, the combined cost-of-living pressures from inflation, income and tax changes would lower the amount of wiggle room (disposable household income left over after mortgage and other household expenditure) by around three per cent on average.

Similar to the impact on new demand, we expect that most mortgaged households will be able to absorb these pressures, given the significant amounts of room after all payments that most mortgage borrowers have in their budgets. Additionally, as we have observed in previous Reviews, current rules require firms to stress-test affordability at a minimum of three per cent above the initial interest rate. This cushion is equally effective against cost-of-living pressures.

However, as shown in **Chart 6**, those with lower incomes to start with, who have significantly less flex in their household budgets, will feel these pressures more. Therefore, we expect these pressures to lead to gradually increasing arrears numbers, with households on lower incomes disproportionately featuring in this. However, the risks also apply to borrowers in higher income brackets, particularly where those households have multiple credit commitments and/or higher necessary expenditure in other areas.

Notes:

1. Arrears as those representing more than 2.5 per cent of outstanding mortgage balance

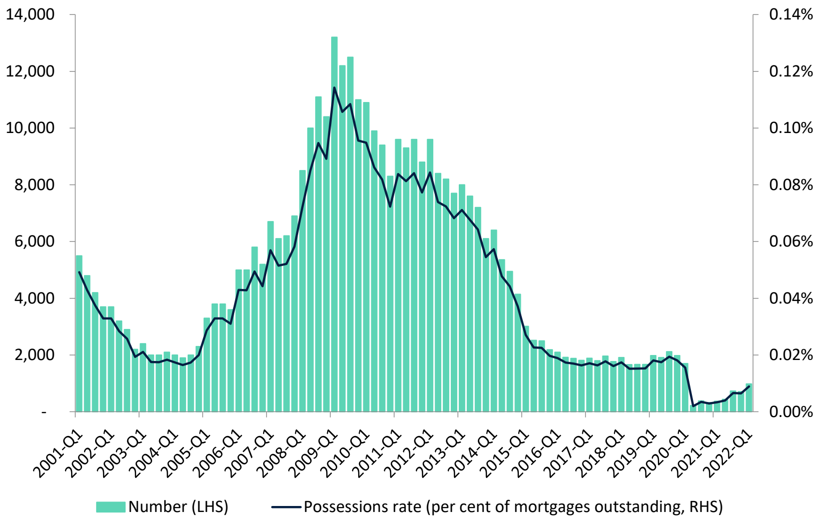
HOUSEHOLD DEBT: POSSESSIONS ACTIVITY INCREASES GRADUALLY

Possessions rose again in Q1 2022, as the industry and courts continue to work through the backlog of paused possession cases from 2020, which we estimated in 2020 to number approximately 5,000-6,000. However the 980 mortgage possessions in the first quarter is still well below typical levels, even at a low point in the cycle (**Chart 14**).

Whilst we expect possessions to rise to 7,700 this year as the backlog is cleared, this would still be a very low annual number of possessions by any historic standards. For example, it would be lower than the 8,200 seen in 2004, which was the low point of the previous possessions cycle.

It is also crucial to keep in mind that these possessions relate to cases which, under normal circumstances, would have proceeded in 2020. Many of these customers will have seen their debt positions deteriorate over the intervening two years and now need this final resolution to prevent further deterioration.

Chart 14: Number and proportion of 1st charge mortgages taken into possession in period



SOURCE: UK FINANCE

Through the pandemic, the support provided to households from government and industry meant that, since 2020, very few new arrears cases emerged. In fact, FCA data indicate that new cases throughout the pandemic era were lower than at any point since 2007, when these data begin. This means that the mortgage stock is in good shape as we move into this higher inflation period.

Although we expect increases in arrears, given the time taken for heavy arrears to accrue - as well the longer processing times for court proceedings seen currently - we would not expect this to translate into any material numbers of new possessions cases until the end of 2023 at the very earliest.

Household debt: Summary

As 2022 began we saw no signs of increasing household payment stress in the aggregate data, despite the beginning of considerable cost-of-living pressures and all Covid-19 specific support measures having ended. Mortgage arrears continued to trend down and early signs of household financial stress in the unsecured space have not materialised. However, inside the aggregate figures there will be some households already feeling the strain and we do expect this to start to feed through to arrears numbers as we move through this year. However, these increases are not expected to feed through to possessions within our current two-year forecast horizon.

As always, any customers facing difficulty meeting their mortgage or other credit commitments are encouraged to talk to their lender at an early stage, as the industry stands ready to help with a range of forbearance tools. Lenders will not put customers on repayment plans that are not affordable for the borrowers' individual circumstances.