# HOUSEHOLD FINANCE REVIEW - Q4 2022

In collaboration with: accenture

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This review explores trends in household spending, saving and borrowing through the final quarter of 2022. The escalating cost-of-living squeeze gripping the country has dominated both the headlines and, increasingly, households' financial decisions. Here we look at how these pressures, exacerbated by the aftershocks of the Truss government's September fiscal event, shaped consumer spending and borrowing patterns as the year drew to a close.

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This Q4 2022 Household Finance Review clearly reflects the continued tough conditions facing consumers, especially those on lower incomes. Amid ongoing cost-of-living pressures, inflation – while starting to ease – remains at historically high levels, and the uptick in interest rates has contributed to a significant drop in personal borrowing and mortgage applications during the quarter.

Overall, the picture is relatively subdued. Where consumer confidence in the general economic situation is concerned, there's been a slight recovery following the unwinding of the fiscal measures announced in September 2022. That said, it remains well below previous lows – including those seen during the global financial crisis of 2008-2009.

As 2022 drew to a close, the flow of mortgage applications submitted to lenders dropped away sharply, to considerably below the numbers seen in the final quarter of 2021. Looking ahead, although anecdotal evidence pointed to something of a recovery in January, borrower interest in house purchases is not expected to come close to the buoyant levels of the past two years.

Refinancing activity is likely to strengthen further through 2023, with some 1.8 million fixed rate mortgage deals set to expire. However, against the backdrop of tighter affordability, it's likely that internal product transfers – which are not subject to affordability tests – will continue to take a greater share of overall refinancing.

We're also seeing an increase in mortgage terms, with over a third of new loans to movers extending beyond 30 years. This means the average mover will be well into their 70s before their loan is paid off. While there will be a limit to the extent to which borrowers are able to use longer-term borrowing to meet affordability requirements, the rapid increase in mortgage terms showed no signs of slowing through the final quarter of 2022.

Overall, unsecured debt stress indicators were stable, but headline mortgage arrears saw a modest increase as cost-of-living, and interest rates rises start to feed through.

As cost-of-living pressures persist through 2023, more households may need to draw upon their savings to cover higher monthly bills. For now, however, the higher levels of savings accumulated over the pandemic remain unchanged.

Against this backdrop, priorities for banks include working ever more closely with their customers, with the emphasis on providing support through clear and open communication. The quality of customer experience and engagement banks can provide – not least via digital interactions and apps – will assume ever greater importance.

## Q4 2022 HIGHLIGHTS

- Despite continuing weak consumer confidence, overall spending on credit and debit cards held up. But changes in patterns of spending within this indicate a shift away from luxuries towards essentials and cheaper options, as cost-of-living pressures bear down.
- Personal loan borrowing fell sharply, suggesting the "make hay whilst the sun shines" effects seen in first half of 2022 have come to an end.
- Borrowing for house purchase remained broadly on trend with pre-Covid levels but weakness is expected ahead. Amidst cost-of-living and interest rate increases, more borrowers have been choosing longer mortgage terms to reduce initial payments and satisfy affordability requirements. Although borrowing volumes are holding up for now, there is a limit to the extent that these factors can continue to support market activity.
- Refinancing remains strong by virtue of strong numbers reaching the end of their deal rates, but prospects are challenging for the 1.8 million fixed rate loans set to mature through 2023, which may drive business further into the internal (non-affordability tested) Product Transfer market.
- Unsecured debt stress indicators were stable, but headline mortgage arrears saw a modest increase as cost-of-living and interest rates rises begin to feed through, although numbers were down compared to the end of 2021. Whilst we expect further increases in arrears through 2023, in the absence of unexpected adverse shocks we expect numbers to peak at relatively low levels, and well below previous cycle highs.

## UK ECONOMIC CONTEXT AND OUTLOOK

After a year of economic and political ups and downs, 2022 ended more or less where it began, in GDP terms. Despite a headline of four per cent growth in 2022 compared with 2021, the economy was fractionally smaller in December 2022 than the same month the previous year. Even with the stuttering performance in the last three quarters of last year, the UK economy nevertheless avoided falling into a technical recession – two consecutive quarters of declining GDP.

However, this is a mere technicality. While there were a few nuggets of positive news in the final months of 2022 – growth in construction output and a boost to the hospitality sector from the World Cup final in November – offsetting factors such as industrial action weighing on sectors such as transport and postal services, stagnant industrial activity and falls in sports and recreation (the disadvantage of a winter World Cup delaying sporting fixtures) resulted in a bigger than expected decline in GDP in December.

In addition, the ONS retail sales data were weak, although less so than expected, in the run up to the key Christmas trading period. While the value of food sales rose, volumes were down – a reflection of rising prices, but both non-food volumes and values were down in December, a likely consequence of some caution amongst consumers as concerns build about their own financial situation.

The underlying and persistent weakness in the economy, illustrated by the flat GDP in Q4 2022 was consistent with private sector survey indicators. The S&PGlobal/CIPS purchasing manages' indicators across services and manufacturing remained in contractionary territory at the end of 2022, with more of the same in the early months of this year. There were also signs that some businesses were easing back on hiring plans against ongoing uncertainty about the outlook.

A key theme of our Reviews throughout 2022 was the impact of inflation on consumers. This continued to be a key component of the economic backdrop to our latest report. It does appear that CPI inflation peaked at just over 11 per cent in October and edged down in the following months. However, food price inflation continued to accelerate in December although this was partially offset by an easing in price rises across transport and clothing.

Moreover, the ONS public opinion and social trends survey continues to show that inflation and cost of living pressures remained the most cited issue facing the UK economy and more than nine in ten respondents consistently report that their cost of living had increased compared with a year ago.

The downward trend in inflation is expected to continue, not least by the Bank of England in its latest Monetary Policy Report. The impact of energy price hikes will fall out of the headline CPI calculation in the coming months, in addition to a softening in commodity and goods prices. However, still rising services inflation, partially driven by higher wage costs, presents a risk of more persistent inflation.

Together with the continued tightness in the labour market - with vacancies still elevated, unemployment low and private sector earnings growth running at around seven per cent at the end of 2022 - these were amongst the factors convincing a majority of MPC members at the February 2023 meeting that a further 50 basis points increase in Bank Rate to four per cent was necessary to get inflation sustainably back to target.

However, the Bank also forecast a further deterioration in the economic outlook. GDP is expected to fall by 0.5 per cent in 2023, though the latest forecasts are conditioned on a lower peak for Bank Rate compared with those in the November report. As such, predictions for the depth and severity of the recession have moderated somewhat. And alongside this, expectations for the labour market this year are also improved, with unemployment expected at around 4.3 per cent at the end of 2023.

The uncertainties to the UK outlook that have been discussed in previous Reviews remain in place. The key one is how the conflict in Ukraine evolves, and what this means for global inflation. The final reopening of the economy in China also presents some upside risks to the global outlook this year. Closer to home, labour market developments will be the thing to watch – notably the pace of pay growth and whether the trend towards post-Covid-19 increases in inactivity start to reverse.

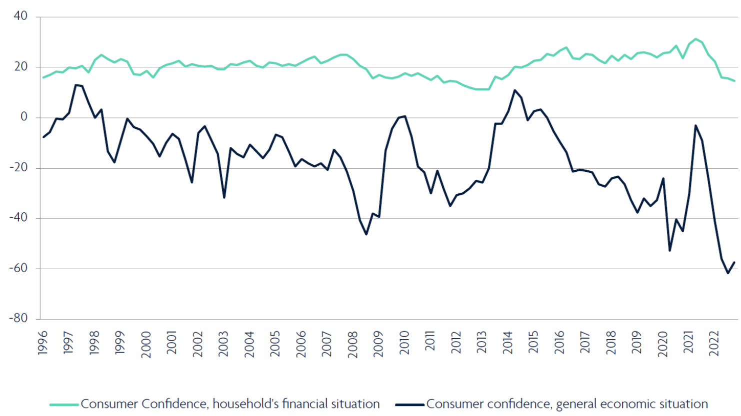
Given these factors, the next moves on Bank Rate are not clear cut. In addition, we have another fiscal event in the calendar. With early indications that the cost of the government's energy support packages will cost less than originally forecast, will the Chancellor bring forward any further support for hardest hit households? While inflation may be set to fall, it will be some time before wage growth begins to compensate for recent price rises, so for many households, and especially lower income ones, managing budgets will continue to be challenging in 2023.

## HOUSEHOLDS INCREASINGLY WORRIED ABOUT THEIR OWN POSITION

As we observed in our previous Review, the market reactions to the fiscal event of September 2022, including the spike in mortgage interest rates, drove consumer confidence indicators down below their already-depressed levels, reaching the lowest level on record at the end of Q3.

The subsequent rapid unwinding of most of the announced measures did much to restore market confidence, which was reflected in gilt yields and mortgage rates in particular moving back towards the levels seen before the fiscal event. However, households' confidence in the economy saw only a modest uptick in Q4 and remains well below previous lows (**Chart 1**).

**Chart 1: Consumer confidence**




**SOURCE: GfK**

Perhaps more tellingly, households' confidence in their own financial position continued to decline. This divergence may reflect the reality of the situation catching up with broader, less personally tangible, sentiment from the media and elsewhere, as cost-of-living pressures, both from inflation and Bank Rate increase in November of 0.75 per cent (the largest since the late 1980s), impacted more on borrowers' household budgets through the final quarter.

While households are less pessimistic about their own finances than they were as the Global Financial Crisis (GFC) unfolded in 2008, this indicator has already fallen by the same amount (but from a higher base) and in less than half the time seen through the GFC.

## WITHIN STRONG OVERALL SPENDING, SOME ACTIVITY MOVING TO CHEAPER OPTIONS AMID COST-OF-LIVING SQUEEZE

Despite the increasing pessimism of households as to their own position, overall consumer activity, as measured by card spending, continued to hold up reasonably well, fluctuating around the monthly levels seen throughout 2022. However, within the total (and as explored further in our latest **TEAL report**), there are some patterns of behaviour suggestive of consumers increasingly making choices driven by cost-of-living considerations.

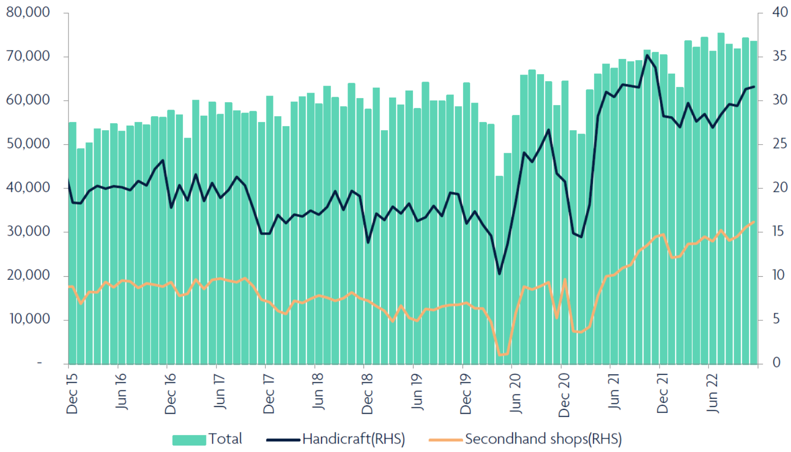
Spending on travel - and particularly air travel, which had seen significant growth in the early months of 2022 as households returned in numbers to take the foreign holidays which Covid-19 had prevented for the previous two years - continued to fall away sharply. Other elements of leisure-related travel expenditure saw similarly pronounced falls.

While many households consider holidays away to be an essential component of their lives, they are nonetheless discretionary. As the squeeze accelerated through the year, it does appear that increasing numbers decided that, at least for now, this was a luxury they would need to forego.

However, spend in other areas has seen a marked increase through 2022. In particular, spending in second hand shops, handcraft stores and, to a lesser extent, DIY stores, saw sustained, sharp increases (both in value and the number of transactions) which continued in Q4 (**Chart 2**).

This partly signals a gradual societal shift towards recycling and upcycling, as awareness of environmental issues broadens and households increasingly adjust their consumption behaviours in response. However, is likely that the recent sharp increase in these sectors also reflects cost considerations as consumers look to make the most out of their (and others) still-usable clothes and household goods rather than buy new, where possible.

**Chart 2: Card spending in month, £m**




SOURCE: UK FINANCE

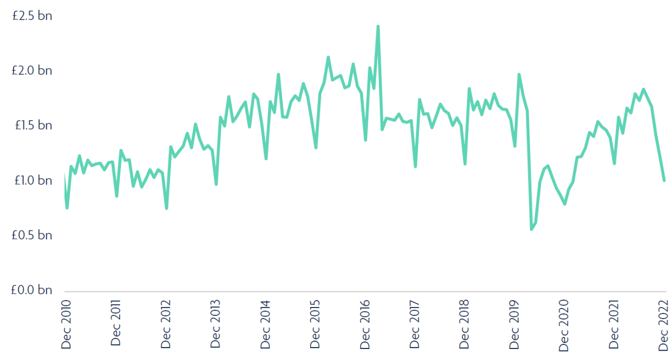
## ACCELERATING DECLINE IN PERSONAL LOAN BORROWING POINTS TO FURTHER SOFTENING IN 'LUXURY SPEND'

In our Q3 review we noted a slight easing of the strong personal loan borrowing (often used to fund more expensive consumer purchases), seen in the first half of 2022. We suggested that this may indicate the end of the 'make hay while the sun shines' behaviour we had seen in those earlier months – that is, consumers buying more expensive items before the price of these goods, as well as overall cost-of-living pressures, could make them unaffordable within their wider household budgets.

The pronounced further decline in personal loan borrowing in Q4 looks to support this, with levels now trending sharply down towards the trough in activity seen through the Covid-19 lockdowns in 2020 (**Chart 3**).

It is highly likely that the higher interest rates from late Q3, following the September fiscal event, exacerbated this decline, with the higher cost of borrowing putting these purchases more firmly out of reach for many.

**Chart 3: Amounts of new personal loans from banks**




SOURCE: UK FINANCE

Taken together, these data point towards a degree of belt-tightening on the part of consumers, as cost-of-living pressures lead household to think harder about how they spend available income, what constitutes an element of essential spend and whether cheaper alternatives are acceptable. While overall inflation is likely to support still-strong levels of spending in pound terms, the mix within this is likely to continue to reflect such cost-of-living driven choices.

## WEAKER HOUSE PURCHASE ACTIVITY THROUGH 2022 OFFSET BY PRICE GROWTH AND STRONG REFINANCING

Overall, the mortgage market saw relatively subdued growth in 2022. Gross lending rose by 1.9 per cent compared to 2021, a year which was fuelled by exceptionally strong purchase activity and double-digit price growth as a result of the Stamp Duty holiday, as well as Covid-19-related societal changes in demand for housing (**Table 1**).

Following the end of the Stamp Duty holiday the volume of purchase transactions softened, as expected, and particularly so for home movers (who had benefitted most from the temporary tax break). However, weaker transaction numbers were offset by still-healthy price growth and the expected strong market in refinancing, with an estimated 1.3 million customers coming off fixed rates and looking to arrange a new mortgage deal.

Compared against 2019 (the last year of "normal" before the pandemic), transaction levels grew modestly. However, this growth was largely concentrated in the first half of 2022, with the economic backdrop of cost-of-living pressures, interest rate increases and declining consumer confidence increasingly bearing down on activity as the year progressed.

Meanwhile, the number of customers behind on their mortgage ended the year lower than the year before, defying expectations in this increasingly cost-pressured environment. This improvement was helped significantly by a benign labour market and lenders' tailored, customer-focused approach to forbearance, working with borrowers in difficulty to identify the most appropriate option to help them maintain payments.

Possessions activity increased modestly in absolute terms as the industry and courts continued to work through the backlog of cases that largely predated the pandemic. While the number of possessions (3,920) was up 74 per cent compared to 2021, that previous year's number was itself abnormally suppressed as a result of the moratorium and closure of the courts though the early months of the pandemic. The subsequent increase in 2022 reflected a gradual unwinding of the backlog of cases that would, under normal market conditions, have taken place through the previous two years of pandemic-interrupted market conditions (by way of comparison, the number seen in 2019 was over twice that seen last year).

**Table 1: Annual key mortgage figures**

| | 2019 | 2020 | 2021 | 2022 | Annual change |
|---|---|---|---|---|---|
| **Number of house purchase loans:** | | | | | |
| **First-time buyers** | 351,000 | 304,000 | 405,000 | 370,000 | -8.6% |
| **Homemovers** | 344,000 | 310,000 | 444,000 | 339,000 | -23.6% |
| **Buy-to-let landlords** | 75,167 | 66,649 | 114,782 | 104,006 | -9.4% |
| **Total** | 770,167 | 680,649 | 963,782 | 813,006 | -15.6% |
| **Number of motgage refinances:** | | | | | |
| **Residential - external remortgage** | 446,500 | 325,400 | 321,800 | 192,400 | -39.6% |
| **Residential Product Transfer** | 1,203,200 | 1,169,100 | 1,247,700 | 1,272,200 | 2.0% |
| **Buy-to-let external remortgage** | 189,653 | 164,637 | 158,836 | 204,389 | 28.7% |
| **House Prices (UK average, Q4)** | 215,925 | 229,819 | 253,113 | 265,195 | 4.8% |
| **Gross mortgage lending (£ million)** | 269,000 | 245,716 | 308,058 | 313,885 | 1.9% |
| **Mortgage in arrear (end of year)** | 80,570 | 89,310 | 85,660 | 81,230 | -5.2% |
| **Mortgage possessions** | 7,990 | 2,620 | 2,250 | 3,920 | 74.2% |

SOURCE: UK FINANCE, NATIONWIDE BS, BANK OF ENGLAND

## HOUSE PURCHASE ACTIVITY HELD UP IN Q4 BUT SOFTER MARKET EXPECTED IN Q1

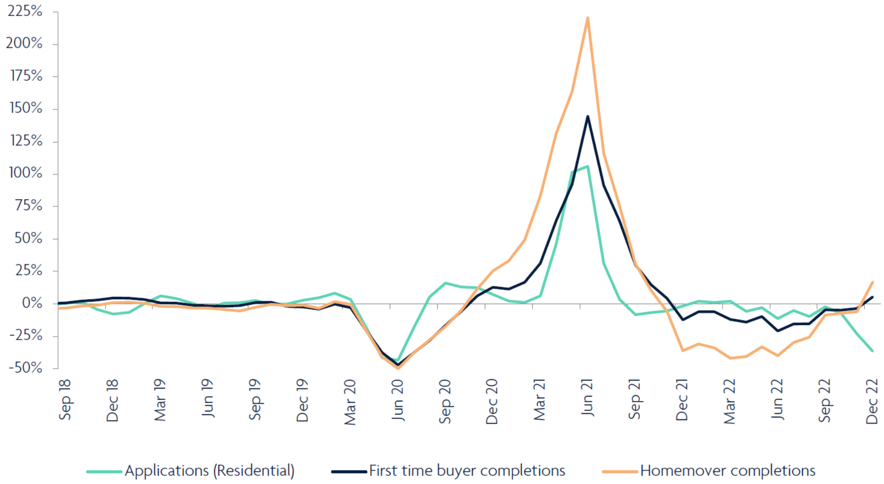
Throughout the first nine months of 2022, house purchase activity was weaker than the same month of 2021.

These year-on-year contractions were in line with expectations; the elevated levels seen during the Stamp Duty holiday were not expected to continue as many purchases had been brought forward from 2022 (and possibly beyond) to take advantage of the tax break. As such, a compensating drop-off in activity has been seen following the end of every Stamp Duty holiday over the years.

However, by the end of Q3, activity had recovered to approach the levels seen in 2021 and, by December, was showing modest year-on-year growth (**Chart 4**).

At the same time, however, as the year drew to a close the flow of mortgage applications submitted to lenders dropped away sharply, to considerably below the numbers seen in the final quarter of 2021 – levels which were themselves artificially depressed, as they immediately followed the end of the Stamp Duty holiday.

**Chart 4: Mortgage applications and completions, 3-month moving average, year-on-year change**




**SOURCE: UK FINANCE**

Both our applications data and the approvals data published by the Bank of England for December point towards a weak start to 2023 for mortgage lending as measured by completions data (which measures actual, final lending amounts). This weaker short-term outlook is echoed by other external data, including the Royal Institution of Chartered Surveyors (RICS) survey, which shows surveyors' expectations of both house sales and prices at their lowest levels since the start of the first Covid-19 lockdown in March 2020.

A softer purchase market is in line with UK Finance forecasts, with the cost-of-living and interest rate increases seen over the course of 2022 now baked into both household budgets and affordability calculations, and so bearing down on effective demand.

Anecdotal evidence suggests that January may have seen something of a recovery in borrower interest for both house purchase and remortgage, although the extent to which any such recovery translates into borrowing activity remains to be seen. Notwithstanding this, a softer market is expected through the year, particularly compared with the buoyant levels of the past two years.

## AFFORDABILITY STRETCH BY EXTENDING TERM CONTINUED THROUGH THE FINAL QUARTER

As we observed in our Q3 Review, with house price growth considerably outstripping wage growth over the past two years, affordability has become ever more constrained, and customers face increasing obstacles to satisfy the FCA-mandated affordability requirements for accessing mortgage credit.

Bank rate increases through 2022 have exacerbated these affordability constraints, and the regulatory rules now limit many options previously used to stretch affordability. Despite this, we have seen house purchase lending hold up reasonably well, albeit at pre-pandemic levels this year, as opposed to those elevated levels seen through the Stamp Duty holiday.

One result of this is that we have seen incomes rise for new borrowers, most significantly for FTBs, so that increasingly, a greater proportion of households entering the market are in higher income brackets.

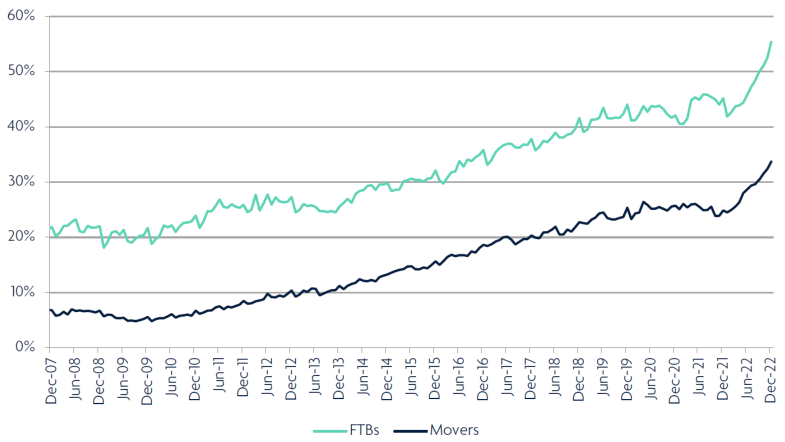
Alongside this, we have seen a marked increase in the proportion of borrowers – both FTBs and movers, borrowing over a longer term, a means of stretching affordability which is not directly constrained by FCA rules.

Whereas in previous generations (and as recently as 2005) borrowing over 25 years was the norm, the average term for a new FTB loan is now almost 31 years. And well over 50 per cent of FTBs now borrow over a term longer than 30 years, which would put the average buyer entering the market now approaching their retirement age by the time they had paid off their first mortgage (**Chart 5**).

In practice most FTB mortgages are redeemed well before their actual term end, as households move up the housing ladder and redeem their mortgages as they do so. However, this phenomenon of increasing mortgage terms is also seen for home movers; over a third of new loans to movers are for a term of more than 30 years, which would see the average mover well into their 70s before the loan was paid off.

While there will be a limit to the extent to which borrowers are able to use longer-term borrowing as a means of lowering initial payments to meet initial affordability requirements, the rapid increase in this showed no signs of slowing through the final quarter of the year, supporting still-robust levels of borrowing even as cost-of-living and interest rate increases place additional constraints on mortgage affordability.

**Chart 5: Proportion of new house purchase mortgages taken out with over 30-year term**




**SOURCE: UK FINANCE**

## CONSUMER SPENDING AND LENDING: SUMMARY

The early months of 2022 saw the cost-of-living squeeze bear down on consumer sentiment but with little resulting impact on aggregate market data. As the year drew to a close, however, this began to shift. While consumer spending still looks to be holding up relatively well overall, there are shifts in the mix of spending which point to an increasing impact from cost-of-living pressures, away from luxuries and towards cheaper options, where possible.

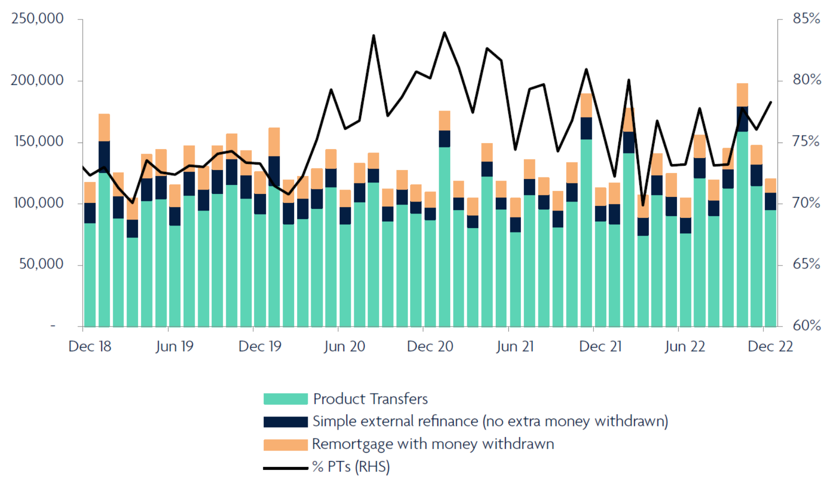
Meanwhile, house purchase borrowing has also held up well as the year ended, but activity is likely to soften in the early months of 2023, as the same cost pressures exert downwards pressure on affordability and, therefore, on effective demand.

## REFINANCING STRONG IN Q4, BUT INCREASED PREVALENCE OF PRODUCT TRANSFERS AND USE OF BROKERS POINTS TO TIGHTER AFFORDABILITY

Refinancing activity saw a pronounced peak in October, likely reflecting borrower activity to refinance their mortgages in September ahead of expected rate rises. Levels then fell back sharply through the remainder of Q4, in part a reflection of activity that was brought-forward in October (**Chart 6**).

In our **Q3 Review** we looked at the tighter affordability constraints facing customers looking to refinance, both for external remortgage deals and Product Transfer rates. Increases in Bank Rate have inevitably led to a shift upwards in the price of all new deal rates and borrowers who took out their previous mortgage through an era of record low mortgage rates will typically face higher mortgage rates than before. The market remains competitive, however, and we have seen pricing trend downwards since the post-fiscal event spike in October.

**Chart 6: Number of residential remortgages and internal product transfers**




**SOURCE: UK FINANCE**

On the other side of the affordability equation, inflation has increased the household spend that forms part of FCA-mandated affordability tests. Both increased mortgage costs and expenditure reduce the amount of "wiggle room" left over from borrowers' income. As we set out in our Q3 Review, while most borrowers would still have a good proportion of spare income, post-refinancing, some - particularly those with lower incomes - are likely to find themselves with little left over.

As we have seen since the end of Q1, internal refinancing has seen an increasing share through 2022, again likely reflecting the increased affordability constraints when sourcing a deal on the open market. A further increase in the use of brokers to arrange refinancing deals (both external and internal) through the quarter also points to these greater challenges.

We expect refinancing activity to strengthen further through 2023, with some 1.8 million fixed rate mortgages set to reach the end of their deal period. However, against the backdrop of tighter affordability, it is likely that internal product transfers – which are not subject to affordability tests – will continue to take a greater share of overall refinancing, with external remortgage likely to show less pronounced (but still robust) activity levels.

## HOUSEHOLD SAVINGS REMAINED STAGNANT THROUGH Q4, BUT TERM ACCOUNTS FINALLY SHOWED GROWTH

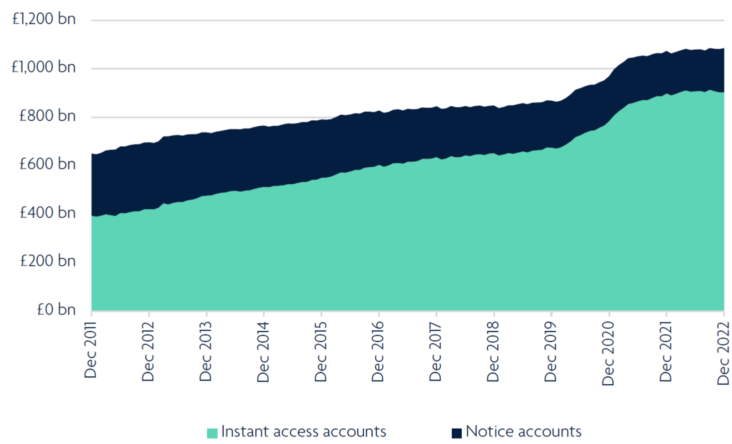
Household deposit levels remained essentially flat in Q4, as they have done since early in 2022.

This overall static picture likely masks a continuing divergence of behaviour with some, concentrated amongst higher income households, still able to put away savings, even against the backdrop of increasing cost pressures and those now depleting them to maintain spending and meet financial obligations.

This is reflected in a growth in the stock of savings held in notice accounts. Following nearly a decade of uninterrupted decline in longer-term savings through the era of ultra-low interest rates, the Bank Rate rises through 2022, reflected in savings rates, have finally begun to attract increased demand (**Chart 7**).

Savings rates remain below the rate of inflation, keeping real rates of return firmly negative. However, it is now possible to get a rate of return on savings that does exceed that of many customers' fixed rate mortgages, particularly those that were taken out in 2020 and 2021. This can, for some, change the equation when balancing out whether to put away spare monthly income or use it to pay down their mortgage debt.

**Chart 7: Personal deposit account balances**




SOURCE: UK FINANCE

At the same time, however, cost-of-living pressures mean other households are having to draw upon their "rainy day" money stored away (and in increased amounts over the early months of the pandemic). At present these two opposite forces on household balance sheets appear to be balancing each other out, keeping the overall level of household deposits stable.

## HOUSEHOLD REFINANCING AND SAVINGS: SUMMARY

With large numbers of borrowers coming to the end of their fixed rate mortgage deals, 2022 was a strong year for refinancing and 2023 is set to be even more so, with particular strength in the Product Transfer market amid tighter affordability considerations.

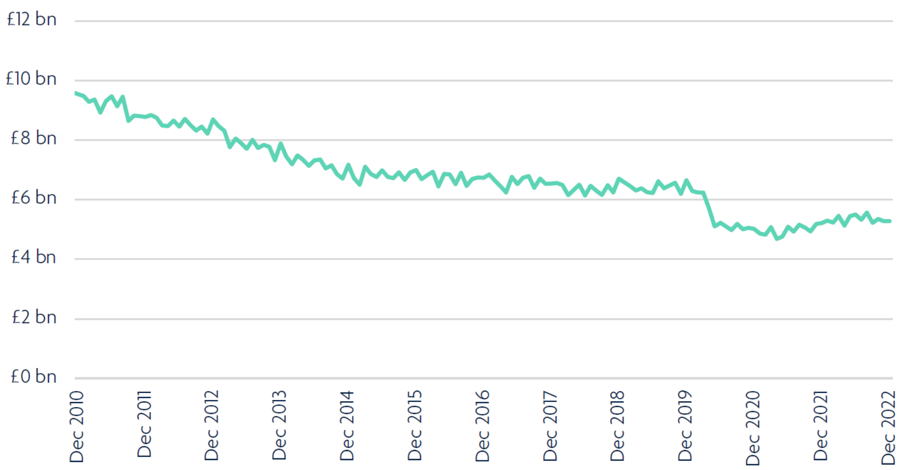
As cost-of-living pressures persist through 2023, more households may need to draw upon their savings to cover their higher monthly bills. For now, however, the overall level of savings remains unchanged at the elevated levels accumulated over the pandemic, providing a cushion for many against cost pressures through the year.

## DESPITE STATIC SAVINGS, NO CONFIRMED EVIDENCE OF OVERDRAFTS INCREASING

Although it is likely that a proportion of households are drawing on previously accumulated savings to cope with increased household costs, we have yet to see any signs of household payment stress reflected in an increased use of overdrafts. We observed a modest uptick in overdraft balances in Q3; however, this reversed in Q4 and, as at December, balances were almost exactly at the level seen at the start of the year (**Chart 8**).

The year ahead will inevitably be challenging for many households as they look to balance their budgets in the face of increased prices and (for many) increased mortgage payments. However, levels of overdraft debt remain low, and have not materially grown since the significant pay-down seen over the early pandemic months. This means the household sector, in aggregate, begins the year in a good position with respect to its level of (relatively expensive) overdraft debt.

**Chart 8: Overdraft balances outstanding**




**SOURCE: UK FINANCE**

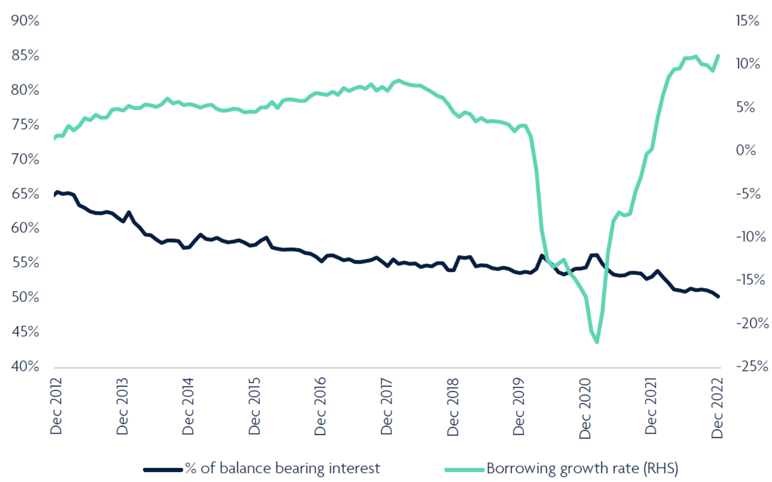
## CREDIT CARD DEBT CONTINUES TO GROW BUT REMAINS BELOW PRE-PANDEMIC LEVELS

Growth in credit card debt, having eased off through the early part of 2022, accelerated again in the final months of the year. Much of this likely reflects seasonal patterns of increased spending around the Christmas period. But, despite growth levels remaining higher than historic norms, the level of total credit card debt outstanding remains substantially below that seen prior to the pandemic (**Chart 9**).

Additionally, the marginal uptick we saw in Q3 for the proportion of card balances that attract interest reversed in Q4, resuming its long-term trend downwards.

Like overdraft debt, the low (and still decreasing) proportion of card debt that is not paid off in full each month means that – in aggregate – customers are in a good position overall with respect to more expensive means of borrowing, as we begin the year.

**Chart 9: Credit card balances outstanding**




**SOURCE: UK FINANCE**

## MORTGAGE ARREARS SAW EXPECTED MODEST UPTICK

Through a year of Bank Rate rises and escalating cost-of-living pressures, the incidence of mortgage payment problems defied expectations, with total numbers falling in each of the first three quarters of 2022.

Contributing to this positive movement, almost 80 per cent of mortgage customers are currently on fixed rates, meaning the vast majority were shielded from the immediate impact of rate rises through the year. The remaining 20 per cent that are on variable rates are, for the most part, much older mortgages with commensurately smaller balances, so that the impact of rate rises translated to a lower rise in absolute terms in their mortgage payments. Additionally, a continuing benign picture on unemployment has not added pressure from job losses on borrowers' ability to pay, at the aggregate level.

Nonetheless, the cumulative impact of these rate rises, as well as the wider cost-of-living pressures bearing down significantly on wider household finances, were expected to place some upwards pressure on customers. Those facing greater pressure include both those on variable rates and the 1.3 million coming off fixed rate deals last year, looking to refinance onto what would typically have been materially higher rates (although in most cases, lower than the reversion rate following on from their previous deal).

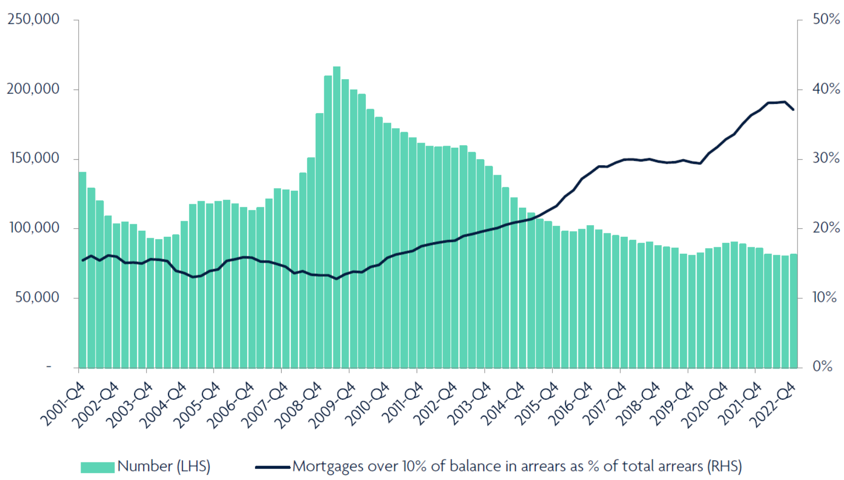
Although it takes several months of missed payments to build into reportable arrears (representing over 2.5 per cent of the outstanding mortgage balance), we expected to start to see signs of increased payment stress in the latter part of last year.

In Q3, although reportable arrears fell marginally, we did see a modest increase in early arrears (which fall below the 2.5 per cent threshold for our headline measure). These early cases fed through, as expected, into a similarly modest rise in headline arrears number in Q4. However, the rise – of just over 1,000 cases – only brought the total to 81,000 – almost exactly the number seen at the beginning of the year (**Chart 10**).

A key factor that has mitigated the incidence of mortgage arrears has been the range and extent of lender forbearance. Through the GFC, followed by a decade of austerity and sluggish wage growth, a global pandemic temporarily shutting down vast swathes of the economy and, now, a new epidemic in the form of a cost-of-living squeeze, the lending industry has deployed and continually improved its range of options available to help customers struggling with their mortgages.

Lenders are alert to the challenges facing their customers through this period and will continue to deploy the forbearance tools available to them to suit customers' individual circumstances. As such, it remains crucial that customers worried about their position speak to their lender at the earliest possible opportunity, so that they can work together to maximise their ability to maintain payments. These discussions do not, in themselves, affect customers' credit scores.

**Chart 10: 1st charge homeowner and buy-to-let mortgages in arrears[1]**




**Notes:**

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

**SOURCE: UK FINANCE**

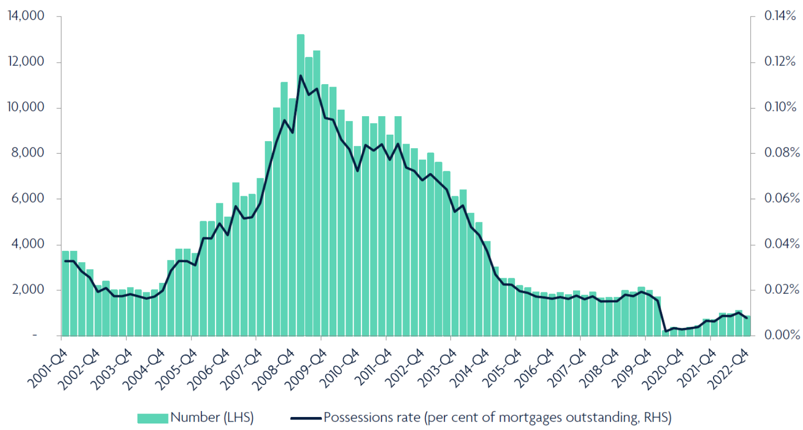
## CHRISTMAS PAUSE IN POSSESSIONS INTERRUPTS GRADUAL INCREASE IN ACTIVITY TO CLEAR THE BACKLOG

Following the virtual cessation of activity through the early months of the pandemic, mortgage possessions have been slowly increasing since the end of 2020. This gradual rise continued through the first three quarters of 2022, but Q4 saw possessions numbers drop away (**Chart 11**).

This drop in activity was expected, as the industry announced a voluntary pause on possession activity over the festive season. The 860 possessions in Q4 brought the total to a little under 4,000 over the whole of 2022. While up from the artificially-suppressed volumes of the previous two years, this is still lower than in any other year since 1980, when the overall stock of mortgages was a little over half the size it is today.

As we move through 2023 we expect the gradual increase in possessions activity to resume, however the 7,300 we have forecast for this full year would remain very low by all comparisons over the past 40 years, excluding the pandemic. This low level of activity reflects the industry working through the mostly pre-pandemic backlog of the most serious arrears cases where all other options had been exhausted, with possession being the final option in the best interests of the customer.

**Chart 11: Number and proportion of 1st charge mortgages taken into possession in period**




**SOURCE: UK FINANCE**

The anticipated cost-of-living related increase in mortgage payment problems is only now beginning to show in our figures, and we expect arrears numbers to rise only relatively modestly to reach around 110,000 by the end of 2024. As such we do not expect "new" possessions activity – arising from the small minority of these cases where the customer cannot ultimately recover their position – to feed through to possessions figures until the back end of 2024 in most cases. Reflecting the relatively constrained forecast rise in arrears, we expect any increase in possessions numbers after that point to be similarly modest.

Although there are downside risks – including an adverse labour market shock and further unexpected economic fallout from the ongoing war in Ukraine – our current outlook for arrears and possessions would see increases, but for both to peak well below the levels seen in the downturns of the 1990s and 2000s.

## HOUSEHOLD DEBT: SUMMARY

Although cost-of-living pressures are widespread and, for some, acute, there remains little sign of stress in the unsecured borrowing space at the aggregate level. Both overdraft utilisation and payments on revolving card debt appear stable. Rather, households are shifting spending patterns, as expected, cutting down on non-essentials and choosing cheaper options where possible.

Meanwhile, while mortgage payments have increased significantly for many, we are only now seeing a modest rise in customers unable to meet their monthly payments. And, while we expect these numbers to rise, lender forbearance will help minimise the extent of mortgage arrears and, ultimately, possessions, and keep both low by historic comparisons.