HOUSEHOLD FINANCE REVIEW - Q3 2023

December 2023

Written by:

Lee Hopley
Director, Economic Insight and Research

James Tatch
Principal, Head of Analytics

This review explores trends in consumers' financial behaviour through the third quarter of 2023. With consumer confidence fragile amidst ongoing cost pressures and global tensions, we look how the wider landscape is impacting on patterns of spending, borrowing and saving by the household sector.

Q3 2023 HIGHLIGHTS

- Household confidence recovered through Q3 but remained downbeat overall. More recently, we have seen confidence fall away sharply in October.
- Retail sales saw a larger than expected contraction at the end of Q3 but card spending held up, with ongoing strength in the travel sector.
- The contraction in house purchase lending continued, with cost-of-living pressures and higher interest rates presenting a significant barrier to mortgage affordability. Indications are that Q4 will show a further contraction.
- Mortgage lending is weak in almost every segment of the market, but this can be seen most acutely in the tighter end of affordability, in particular lending at higher LTVs and income multiples. Customers with lower incomes are currently putting down deposits equal to twice their annual income in order to meet affordability requirements.
- Mortgage refinancing remained strong in Q3. Within this, the same affordability pressures, as well as competitive retention deals, drove yet more customers to take a Product Transfer with their existing lender.
- Households continued to run down savings to cover increased monthly bills. At this stage, however, there is no sign of increased reliance on overdrafts or credit cards to cover any shortfalls in budgets.
- Arrears saw an expected larger rise in Q3, with signs that more increases lie ahead. Cost and rate pressures have pushed more customers into a payment shortfall and increased the pressure on those already in arrears. However, arrears cases continue to be mainly older mortgages, with very few mortgages underwritten since FCA-mandated stress tests came into force now entering arrears.
- Possessions fell slightly and remain at historically very low levels, as the industry works through the historic backlog of cases. No possessions related to arrears newly arising amidst cost-of-living and interest rate pressures are expected until the end of 2024 at the earliest.

UK ECONOMIC CONTEXT AND OUTLOOK

In the three months to September – the period covered by this latest Household Finance Review, the economic story was technically one of no economic growth at all in the UK, with GDP unchanged from 2023 Q2. While the UK's economic performance in the first half of this year could best be described as sluggish, this latest data on the state of the economy cements expectations for very little, if any, expansion in activity in the second half of 2023.

Looking at Q3 GDP numbers in more detail, those parts of the economy which had been providing some modest support to growth in the first six months of this year, namely some resilience in household spending and increased investment, completely fell away in the third quarter, according to the Office for National Statistics (ONS). Notably, household spending contracted by 0.4 per cent, the fastest pace of decline for a year. Only net trade provided any contribution to growth, but only because of imports declining faster than exports compared with the previous quarter.

Weakness seen in consumer spending over the quarter aligned with fragile consumer confidence, which we will turn to in more detail in the next section. In addition, the effects of increasingly cautious households are evident in particularly weak reading for consumer-facing services activity. Output of these industries, which include retail and hospitality, fell by 0.7 per cent on the quarter and, moreover, declined in each month in the quarter.

While some of the weakness in retail was attributed to unseasonably warm weather in September delaying purchases of autumn clothing the underlying picture is, nevertheless, broad-based weakness.

The prolonged period of persistently high inflation and the impact of past interest rate rises does now appear to be having a more significant dampening effect on demand. The Bank of England, in its November Monetary Policy report, reiterated the lagged impact of higher interest rate with the full effects of past rate rises on GDP expected to be fully felt only in 2025.

Monetary tightening does also appear to be tackling the challenge of high inflation. CPI inflation fell to 4.6 per cent in October – good news for the Bank of England as it is getting closer its two per cent target, good news for the government – it has met its own commitment to halve inflation by the end of 2023 – and good news for consumers – as it signals cost-of-living increases are starting to ease.

However, the main contributor to October's fall was a reduction in the energy price cap. Other inflation measures, which may be better indicators of persistence, for example, core inflation and services inflation did not see falls of the same magnitude, posting annual increases of 5.7 per cent and 6.6 per cent respectively.

While headline inflation may be heading in the right direction, it will likely be some time before households really feel like the pressure is off. Food prices, for example, were still up by around ten per cent in the year to October, and have risen by more in the last two years than in the preceding fifteen.

The latest public opinion and social trends survey from the ONS supports this, with around half of households surveyed reporting an increase in their cost of living in the previous month – down from over three-quarters reporting a rise a year ago – but still a sign of ongoing pressure on household budgets.

This all speaks to the household spending outlook remaining pretty weak for the next year. In the near term, firms in the services sector report activity in contractionary territory at the start of Q4, citing cost of living pressures, high interest rates and weak consumer confidence as factors holding back customer demand.

A still-resilient labour market is one positive for households. The latest data suggests the unemployment rate has held steady at 4.2 per cent over the third quarter, and wage growth has remained robust. That said, a softer demand outlook and weaker business confidence across all three broad economic sectors – services, construction, and production, is reducing demand for labour, which should take some heat out of wage growth.

The Bank of England has revised down its expectations of the UK's economic prospects, and it now predicts no GDP growth through 2024. A key contributor to this downgrade is the expectation that any resilience we saw in consumers earlier this year will continue to fade in the year ahead. And with that, the MPC is likely to hold rates at current levels in the near term. The committee voted to retain Bank Rate at 5.25 per cent at both its September and November meetings, though the decisions were not unanimous. Some MPC members still question whether policy is sufficiently restrictive, but the overall message was that consideration of interest rate cuts were still some way off.

Alongside the autumn statement, the Office for Budget Responsibility gave a slightly less downbeat assessment of the UK's economic prospects. At 0.7 per cent, its forecast for growth next year is stronger than the Bank's but still subdued and a significant downgrade to its March forecast.

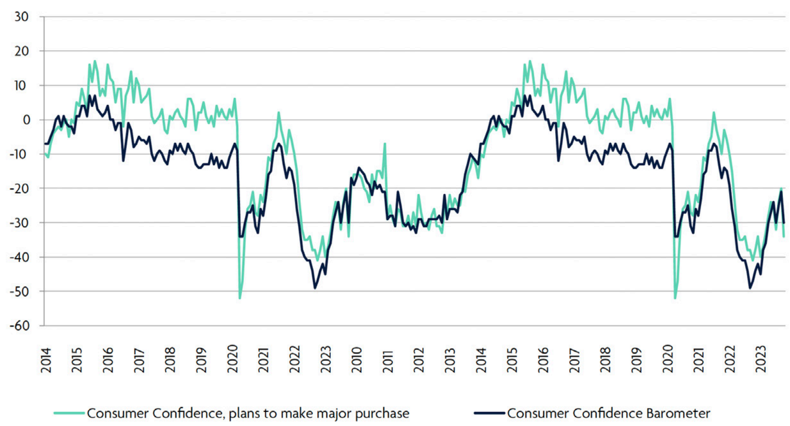
The bigger news in the Autumn statement was the Chancellor's additional spending and tax cuts, amounting to around £17 billion per year over the forecast period. Higher nominal tax revenues and falling inflation provided some leeway for a few big giveaways for households and businesses. The main measure for households was a 2p cut to the main rate of employee National Insurance contributions. There were several smaller scale measures, including extending the mortgage guarantee scheme to June 2025, uprating working age benefits by inflation and further support for job seekers.

HOUSEHOLD CONFIDENCE RECOVERED THROUGH Q3 BUT HAS FALLEN SHARPLY MORE RECENTLY

Q3 saw consumer confidence continuing to build from the historic low last September following the Truss administration's mini-budget but, even with this continuing recovery, remained in a significant negative net position (**Chart 1**).

Within this, households' intentions to make major purchases followed a similar path to overall confidence, recovering but still a distance away from the modest net positive position seen briefly in early 2021.

Chart 1: Consumer confidence



SOURCE: GfK

In part, the recovery in confidence is due to the receding impact of the deep fall in the indicator readings following the mini-budget. It also likely reflects the steady fall in inflation through Q3 (with a sharper than expected fall in more recent data). Whilst inflation appears now on a solid trajectory back down towards the two per cent target, price increases seen through the cost-of-living crisis are largely baked-in (excluding energy costs which remain volatile and subject to fluctuation in both directions). Robust wage growth will have eased cost pressures to an extent, although the continuing negative confidence readings suggest these were still weighing relatively heavily in the quarter.

More recently, however, October saw a very significant fall in confidence, most particularly in households' intention to make major purchases. A range of explanations have been offered for this, including energy cost uncertainty and global events such as the situation in the Middle East.

Whatever the underlying reasons, however, this reinforces our observation in previous Reviews that, in the current uncertain economic and geopolitical environment, confidence remains fragile and subject to negative shocks.

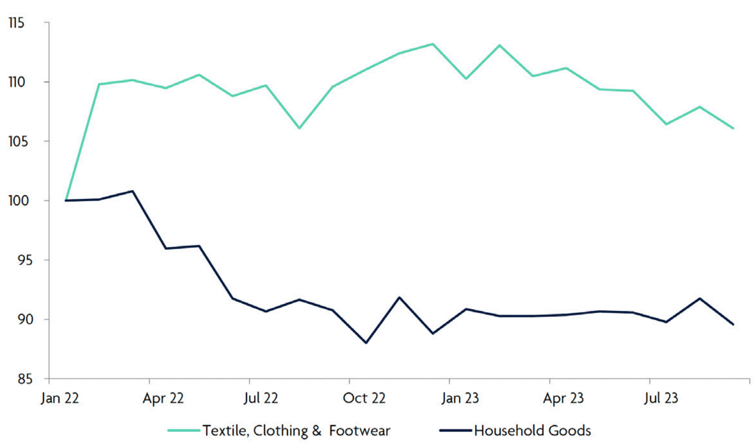
INFLATION MASKING UNDERLYING WEAKNESS IN RETAIL SALES, BUT TRAVEL SPEND REMAINS STRONG

When looking at how weak confidence and cost pressures are impacting on consumer spending, the data gives some mixed signals. Whilst the value of retail sales rose through Q3, much of this growth was driven by continuing price growth. Underlying sales numbers have, in fact, been falling for the past two years as prices have risen.

This divergence – rising sales value but falling underlying volume of sales – is seen across most categories of retail sales, however the timing has varied.

For example, sales volumes for household goods fell from early 2022, echoing the weak "major purchase" consumer confidence indicator. In contrast, sales in clothing and footwear stores held up relatively well but this too has begun to fall away in recent months (**Chart 2**).

Chart 2: Retail sales volume index (2022 =100)



SOURCE: ONS

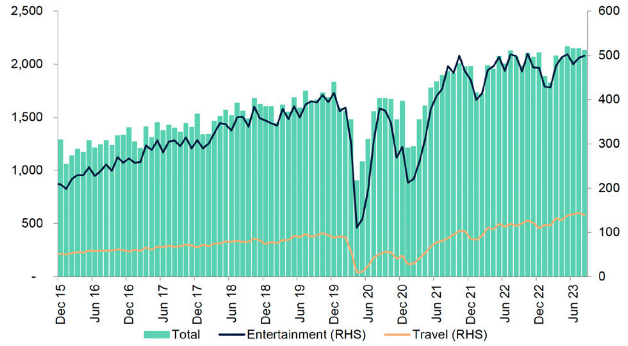
Notes: index scaled to 2022 for ease of interpretation

The savings built up in the household sector through the early months of the pandemic are likely to have supported consumer spending through the cost-of-living crisis. However, recent weakness in retail activity overall could be a sign that increasing numbers have run through their savings and no longer have the ability to maintain their spending patterns at previous levels.

On the other hand, data on spending via cards indicates relative strength in service sectors, for example in the travel industry, where sales have continued to rise even through 2023 as cost-of-living pressures accelerated (**Chart 3**).

This continued strength in the travel sector, even as many other categories of discretionary spend have fallen away, has been a consistent feature amidst the cost-of-living pressures of the past two years.

Chart 3: Card spending – number of transactions (000s)



SOURCE: UK FINANCE

In part this may reflect a continuing rebound following the absence of opportunity for holidays through the pandemic. However, whether the strength comes from households making up for lost holiday time or from elsewhere it appears that, at least for some, holidays away are an expenditure that trumps cost of living pressures.

Retailers are braced for the possibility of muted activity over the run-up to Christmas, compared to normally elevated spending patterns through December. However, there has also been some speculation that the recent weakness in retail sales is due to households reining in their spending now, in order that they can then afford "a proper Christmas."

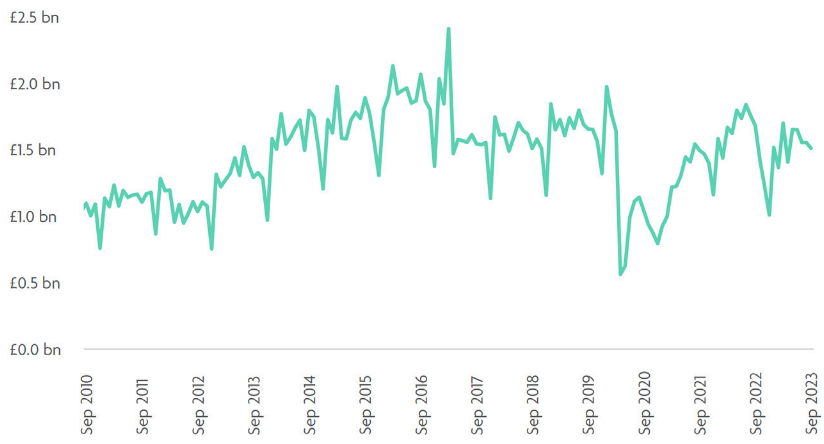
It remains to be seen whether Christmas spending, like holidays, is an area where households are prepared to stretch their wallets even amidst cost-of-living pressures, possibly at the expense of drawing back in other areas so they can afford to do so.

FALL IN PERSONAL LOAN BORROWING ECHOES RETAIL SALES

Until late 2022 household borrowing via personal loans, which are often used to fund purchases of larger items, had been recovering from the depressed levels seen through the early months of the pandemic. Following a sharp contraction after last Autumn's mini-budget, levels have again been on an upward trend towards pre-pandemic levels, despite the upwards pricing as Bank Rate has risen (**Chart 4**).

In Q3, however, personal loan borrowing fell away. Although we have noted above some areas where spending has proved more resilient, this contraction in personal loan borrowing likely reflects the widespread weakness in retail sales.

Chart 4: Amounts of new personal loans from banks



SOURCE: UK FINANCE

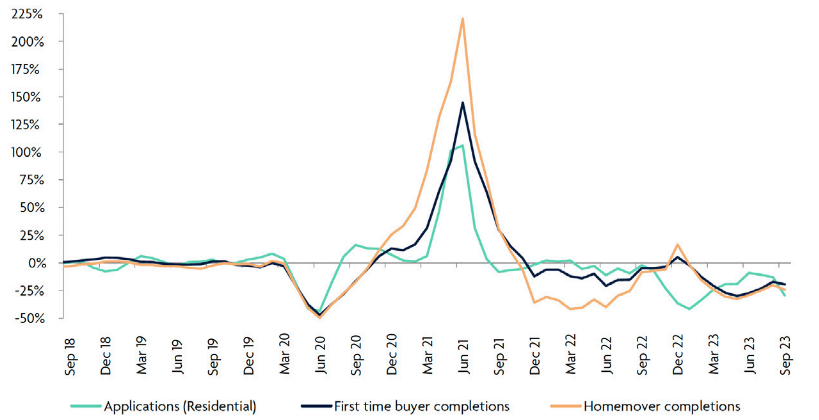
CONTRACTION IN HOUSE PURCHASE LENDING CONTINUED, AND INDICATIONS ARE FOR MORE WEAKNESS TO COME

Mortgage lending for house purchase continued to fall sharply through the third quarter. Lending to both first time buyers and home movers has now fallen, year on year, in every month since December 2022. Although the rate of decline moderated through the third quarter, first-time buyer (FTB) activity was still down almost one fifth, and movers by one quarter, compared with Q3 last year (**Chart 5**).

Mortgage borrowing capacity is currently constrained on multiple fronts. Since the country emerged from the Global Financial Crisis (GFC) a decade ago, house prices have consistently - and significantly - outpaced wage growth. Prices peaked at a little over nine times earnings last year, up from around seven times income a decade ago.

However, even as prices continued to rise beyond incomes mortgage affordability remained relatively benign, because competitive pricing through the continuing ultra-low rate environment meant mortgage payments remained low. Although not the only factor, this was a major contributor to continuing robust activity in the mortgage and wider housing market, feeding into further price growth.

Chart 5: Mortgage applications and completions, 3-month moving average, year-on-year change



SOURCE: UK FINANCE

With the Bank Rate increases seen since the end of 2021, we are now in a situation where prices remain elevated relative to average incomes, but mortgage payments have moved sharply up from the abnormally low levels seen through the era of ultra-low Bank Rate.

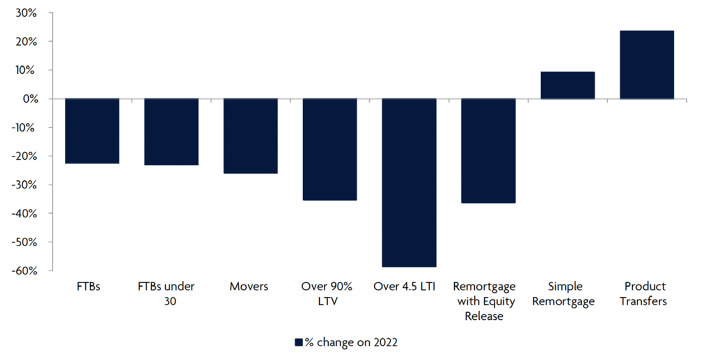
Whilst new mortgage rates now are broadly in line with those seen prior to the financial crisis, the combination of these rates and the much higher house prices faced by prospective borrowers presents a dual affordability challenge to prospective borrowers to pass FCA-mandated affordability tests to buy the house they want. Layered on top of this, the cost-of-living pressures affecting all households have also brought the scales down heavier on the outgoings side of these income-expenditure tests, further raising the affordability bar.

MORTGAGE LENDING WEAK IN ALMOST EVERY SEGMENT

The significant contraction in lending this year has been widespread with few, if any, areas of new lending seeing growth. However, looking within the overall figures we can see some areas of particular weakness, which speak to the affordability constraints facing borrowers and where these are biting most severely.

Perhaps surprisingly, given the drivers of weakness, first-time buyer numbers have not been hit disproportionately hard. In the year to date, FTB activity is currently 22 per cent down compared with the first nine months of 2022, slightly less in fact than the 26 per cent decline in homemover numbers. Even amongst younger FTBs, who might be expected to be more sensitive to affordability-related pressures, numbers have fallen by slightly less than the wider house purchase market (**Chart 6**).

Chart 6: Number of mortgage loans, year-to-date comparison, market segments



SOURCE: UK FINANCE

However, we can also see that the affordability challenges arising from the rise in interest rates have borne down more significantly on borrowing at both higher LTVs and, even more significantly, at higher income multiples.

Over the past couple of years, significantly more customers have borrowed over a longer term to reduce initial payments, which makes it possible to borrow the same amount at a higher multiple of income and/or with a smaller deposit. But, as we have observed in previous Reviews, this looks to have reached its limit in the current higher rate environment, meaning that those with smaller deposits or needing to borrow more relative to income are facing much greater challenges in meeting affordability rules.

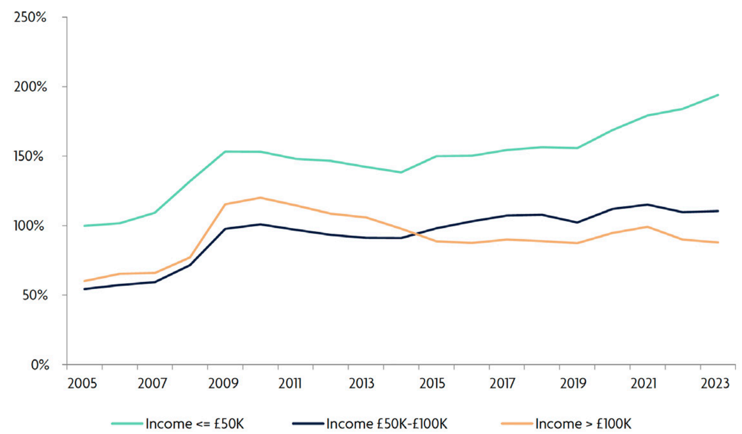
BORROWERS IN LOWER INCOME DECILES NEED LARGE CASH INJECTIONS TO MEET AFFORDABILITY REQUIREMENTS

Inevitably, the households facing the greatest affordability challenges in accessing mortgage credit are those on lower incomes, and this is a theme that we have seen throughout cost-of-living research across almost every aspect of household finances.

In general, increasing house prices mean that incomes of households looking to buy will necessarily need to rise over time. However, this combination of rapid price growth and, more recently, rate increases, has restricted borrowing significantly for those with what would have been quite adequate incomes for a mortgage until the past couple of years. As recently as 2021, some 57 per cent of FTBs had a declared household income of less than £50,000 when they took out their mortgage. But by 2023, this had fallen to 46 per cent.

In order to get a mortgage, these households on lower incomes - who still make up nearly half of all FTBs - have needed to put down much larger deposits, and this has accelerated over the past few years. For those with higher incomes, the typical deposit put down has not changed dramatically, and stands at around one year of gross income, or a little lower for those in the highest income brackets.

Chart 7: FTB Deposit-income ratio, new borrowers



SOURCE: UK FINANCE

In stark contrast, however, borrowers with less than £50,000 gross income are now typically putting down deposits of nearly two times their gross household income. This is a particularly difficult hurdle given those on lower incomes typically have less free disposable income to put away each month, and this pressure on disposable income has, as we know, has been accentuated for lower income households throughout the cost-of-living crisis (**Chart 7**).

This underlines the much greater challenges facing prospective borrowers in the current environment. Although house prices have been softening in recent months, the rate of decline remains relatively modest, and the affordability challenge remains significant for many.

With wage growth now running ahead of inflation, employees are seeing real income growth. This, combined with softer house prices will help to bring affordability back within reach of more customers in due course, although this adjustment is likely to take some time.

In the near term, applications data – a forward looking indicator of final market outturn – had suggested the rate of decline in lending was moderating through the year but this has turned more sharply negative through Q3, suggesting that the fourth quarter will see a further, deeper contraction in mortgage completions.

CONSUMER SPENDING AND LENDING: SUMMARY

Whilst some areas of consumer spending continue to show resilience, cost pressures are acting as a brake on spending overall, with inflation masking the underlying weakness. In the housing market, higher cost-of-living and interest rates are material obstacles to obtaining mortgage credit. Wage growth is now moving in the right direction to alleviate these constraints, but there is some way to go until the combination of incomes, prices and interest rates adjust to bring affordability back to levels that open up the market to many more households. As such, transaction levels remain significantly down on recent years, with further weakness expected until these affordability constraints ease.

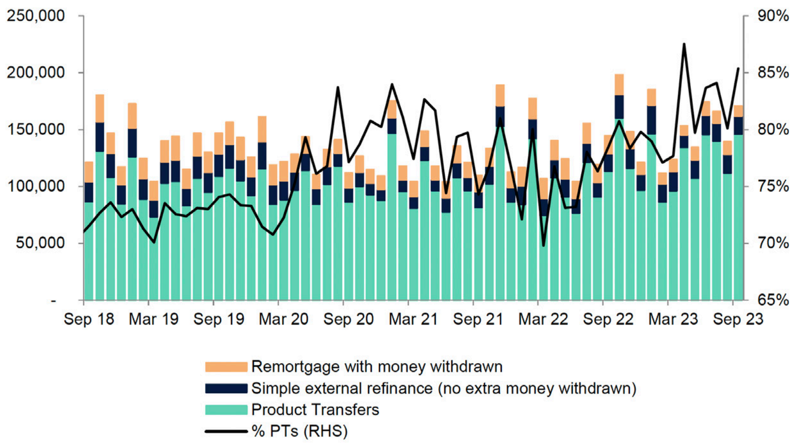
INTERNAL REFINANCING CONTINUES TO DOMINATE THROUGH THE "YEAR OF REMORTGAGING"

As shown earlier in **Chart 6**, remortgaging activity is the only area of the mortgage market which has shown strength through 2023. This is in line with our **forecasts**, driven by the strong numbers of fixed rates coming to maturity through the year, in particular those taken out two and five years ago.

However, the strength continues to be in simple refinancing, both external remortgage and, more significantly, internal Product Transfers (PTs). Remortgaging where additional money is taken out has actually fallen by more than house purchase activity in the year to date (**Chart 8**).

Around 1.5 million borrowers will have reached the end of their fixed rate deals through 2023. In the year to date we have seen about 1.3 million pound-for-pound refinances, nearly nine in ten of which were internal Product Transfers.

Chart 8: Number of residential remortgages and internal product transfers



SOURCE: UK FINANCE

The same affordability challenges facing prospective buyers also limit the options for those looking to remortgage away from their existing lender, and particularly so when looking to increase the size of loan at the same time. This has driven more customers towards the internal PT route, where lenders offer competitive rates to retain customers without the need for new affordability tests or a long application process.

Due to the historic pricing of fixed rates scheduled to expire, borrowers refinancing this year – in particular those who took out their previous loan in 2021 when rates were at their lowest - are likely to have experienced the largest rate shock. However, as we explored in our previous **Review**, even though these rates are significantly higher, new deal rates are still comfortably below those at which their previous loans were stress-tested. Next year the rate differential for borrowers refinancing looks to be a little less, but still significant compared with recent years.

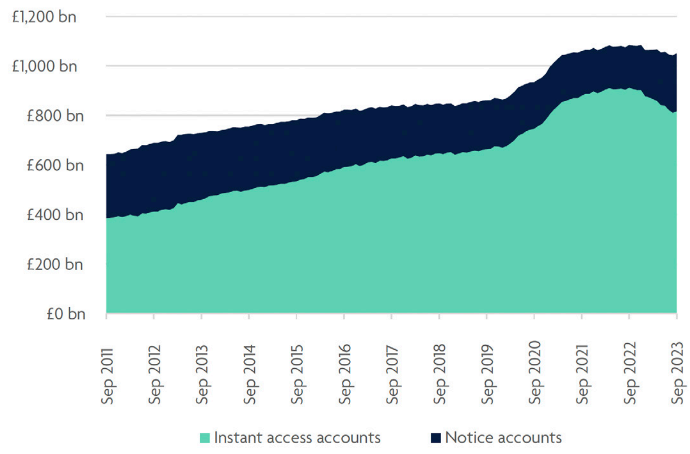
This suggests existing customers will continue to face some affordability challenges when looking to remortgage on the open market next year, and so we are likely to see a continuing preference for PTs through the remainder of this year and into 2024.

HOUSEHOLDS SAVINGS BUFFER REDUCING BUT FAR FROM DEPLETED

In Q3 we continued to see a decumulation of household deposits held with retail banks. Overall, deposit levels at the end of the quarter were some three per cent below those seen a year ago (**Chart 9**). This represents a further acceleration on the two per cent annual contraction in deposit levels seen in Q2, as households continue to run down their savings to cover higher household costs.

Since the end of last year, when deposit levels with high street banks peaked at £1.085 trillion, balances in current accounts and other instant access savings have reduced by nearly £100 billion. And although this has been offset by a significant increase in deposits in notice accounts - due to the now much better rates of return to be found in the savings market since Bank Rate began to rise - there has been a net reduction in overall deposit levels of some £37 billion in the nine months since the start of 2023.

Chart 9: Personal deposit account balances



SOURCE: UK FINANCE

As cost and rate pressures continue, we are likely to see a further decumulation of savings. At this stage, however, overall deposit levels are still significantly elevated above trend levels, due to the sums built up through the periods of pandemic-related social restrictions in 2020 and 2021.

It is difficult to precisely gauge the overall level of additional savings built up due to the pandemic, as other factors will have also affected household savings rates over the same period. However, a ballpark approximation indicates that the value of deposits held by retail banks is currently around £110 billion higher than it would have been had savings grown in line with the trend over recent years.

This would suggest that, even with the current rate of decumulation, households still have a significant cushion of savings to draw upon. Although this is a reassuring finding, it is important to bear in mind that savings are not held evenly across households. The National Institute for Economic and Social Research, amongst others, has published **research** showing that the additional savings built up over the pandemic were concentrated strongly amongst those in higher incomes deciles, whilst the lowest deciles actually ran down savings over the same period. And now, with cost of living and interest rate pressures coming to bear, these have also hit hardest on those lower income households, who are much less likely to have these additional savings to draw on.

As set out above, inflation is now falling back, and wage growth is beginning to ease some of the cost pressures. For the time being however the combination of higher prices and interest rates means that more households need to tap into their savings to cover their monthly outgoings. At the same time increasing numbers, particularly those lower down the income scale who do not have this savings buffer, will either need to make additional cuts to spending or look to other ways to finance their higher spend.

HOUSEHOLD REFINANCING AND SAVINGS: SUMMARY

The continuing strong maturity schedule has kept mortgage refinancing activity buoyant through the third quarter. However, affordability pressures and competitive retention rates have meant that most of the refinancing business is currently via internal Product Transfers. Whilst customers are facing much higher new deal rates than their previous ones, stress tests applied by mortgage lenders are ensuring that, even where the new rate is significantly higher, mortgage payments remain affordable for existing customers. Meanwhile, those households who still have excess savings built up over the pandemic continue to draw on these to cover higher monthly expenditure.

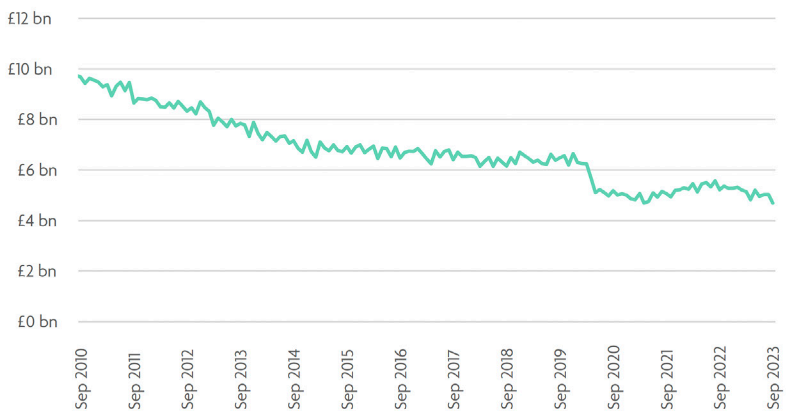
DESPITE CONTRACTION IN SAVINGS, OVERDRAFT LEVELS ARE STILL TRENDING DOWN

After nine months of continuous savings decumulation, we still have yet to see any sign that households are also drawing on overdrafts to cover higher household costs (**Chart 10**).

As we move forward, the extent to which overdraft debt remains at these subdued levels depends on how long the pressure on real household incomes persists. As we observed earlier, wage growth is now beginning to catch up with prices, albeit that previously it lagged inflation for some time and, as a result has, some way to go before real incomes are fully adjusted.

Should wages and inflation normalise relatively quickly, it may be possible that a build-up of overdrafts and other unsecured debt is largely avoided. However, the longer the imbalance between incomes and household expenditure remains, the more likely it is that we will see these indicators of household stress start to rise.

Chart 10: Household sector overdraft debt outstanding at end of period



SOURCE: UK FINANCE

INCREASE IN CREDIT CARD DEBT STABILISED IN Q3

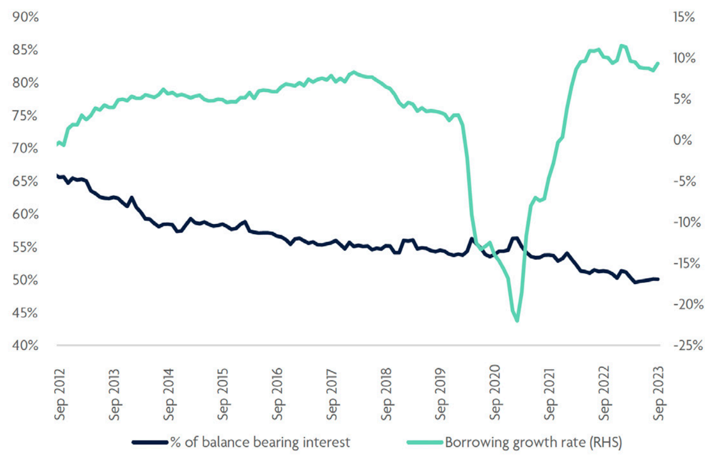
Growth in credit card debt continued to run at historically high levels through Q3, after falling away in Q2 (**Chart 11**).

Much of this growth is driven by higher prices; total card debt is still around nine per cent below its pre-pandemic peak, as significant amounts of card debt were paid down through the early months of the pandemic).

Whilst overall card debt is remains well below its trend level we did see modest increase over the quarter in the proportion of balances that are interest-bearing. This can be affected by a number of different factors, including the availability of interest-free balance transfers. However, an increase in interest-bearing balances is a broad indicator that larger proportion of balances are not fully paid off each month (and therefore attract interest).

It is dangerous to over-interpret data, and one quarter of increase in this proportion does not constitute a trend. However, should this continue increasing into the fourth quarter and beyond it would suggest there is some increased pressure on unsecured debt payments.

Chart 11: Credit card balances outstanding



SOURCE: UK FINANCE

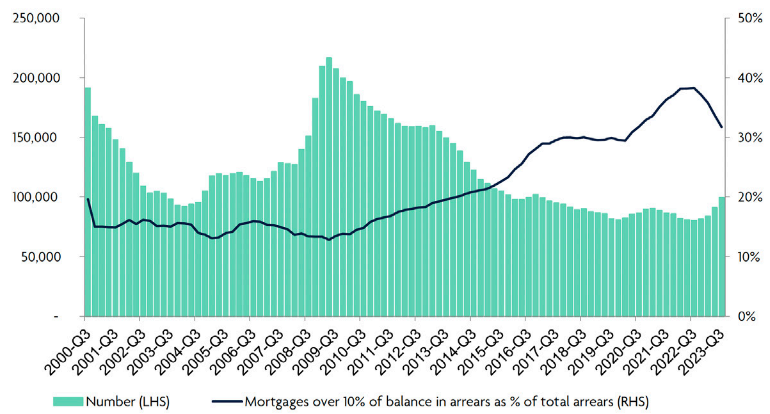
ARREARS ACCELERATED IN Q3, BUT LEVELS STILL VERY LOW

Since Q4 2022, when arrears numbers first showed a marginal increase, each consecutive quarter of data has shown a further, and more material increase in borrowers behind on their mortgage payments. This trend continued in Q3, and at the end of the quarter there were some 99,480 mortgages in arrears representing over 2.5 per cent of their mortgage balance. This represents an increase of nine per cent compared with the figure at the end of Q2 (**Chart 12**).

This increased build up in arrears was expected, with Q2 having shown a larger increase in the numbers in arrears of between 1.5 and 2.5 per cent of balance - so just below the threshold for our headline measure. The numbers in these less material arrears positions are more volatile, with a greater tendency to cure in the short term compared to more entrenched payment problems. Notwithstanding this, movements in this band of pre-headline cases are a good indicator of likely feed-through to headline arrears in the following period.

Arrears numbers have risen in all bands, from the lightest through to the heaviest cases, although the largest percentage increases remain in the lower bands.

Chart 12: 1st charge mortgages in arrears[1]



SOURCE: UK FINANCE

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

As with the previous three quarters, early arrears (below 2.5 per cent of balance) showed a greater increase in Q3, pointing towards another larger increase in Q4 data. Whilst inflation is coming down and market expectations are that we are at, or near, the peak of the interest rate cycle, these are still exerting pressure on household budgets and, at the margins, more customers are having difficulty meeting higher mortgage payments.

However, whilst the data suggest we are not yet at the peak of the arrears cycle, arrears levels remain very low by historic comparisons. Overall, less than one per cent of all mortgages are in arrears, less than half of the proportion seen at the height of the previous downturn through the Global Financial Crisis and less than a quarter of the rate seen in the early 1990s.

The rising arrears landscape, whilst expected, is a concern for lenders, whose priority is to help any customers who are struggling to get back on track, with the most appropriate help and forbearance measures. However, it is also important, at the aggregate level, to consider both the historic context and the factors which have - and will continue - to mitigate the extent of payment problems as we move through this cycle.

Over the past two years, both inflation and interest rates have risen to levels above the range of most public forecasts prior to 2021. However, the data - both from the rising, but still low, arrears numbers, and typical affordability for borrowers refinancing this year - points to the affordability tests in place since 2014 working effectively. Specifically they are, demonstrably, protecting the vast majority of mortgage customers' ability to pay, even in a negative scenario that is beyond previous expectations.

The flipside of this, however, is that most of both existing and newly arising arrears cases relate to mortgages taken out before these affordability rules became standard practice, particularly in those pre-GFC years. Many of the loans written in those years were – and still are – on interest-only terms. When an interest-only mortgage falls into arrears some forbearance options, including those set out in the government's Mortgage Charter, cannot help the customer's situation. In these cases, the tailored forbearance and help offered by all lenders becomes even more important, and so it is vital that customers facing difficulty speak to their lender at the earliest opportunity, in order that the best option to help can be identified and deployed.

POSSESSIONS STATIC IN Q3, AND REMAIN WELL BELOW HISTORIC NORMS

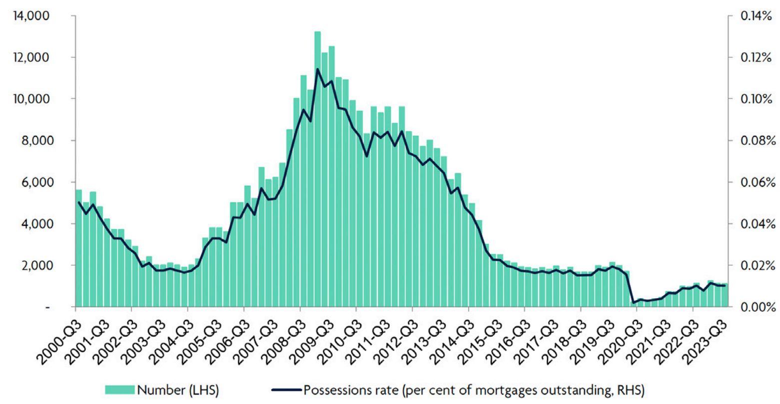
Mortgage possessions were static in Q3, with 1,100 cases, compared with 1,120 in the first quarter (**Chart 13**).

Although arrears have risen broadly in line with expectations, possession activity remains incredibly low by historic comparisons, and is still well below even the very low activity levels seen immediately before the pandemic took hold.

The typical timeline from the emergence of arrears until all help and forbearance options have been exhausted and possession, as a last resort, becomes the best option for the borrower is well over twelve months, and often considerably longer. This means that the current adverse conditions for mortgage payments are not expected to result in any increase in possessions in the near term.

The low number of possessions still largely relate to a backlog of customers in long-term, unrecoverable arrears positions. Since the possessions moratorium in place during the pandemic came to an end, the industry has been working through this backlog and is still doing so.

Chart 13: Mortgage possessions in period



SOURCE: UK FINANCE

Whilst possession is always a last resort, it is important that when it does become necessary, the process is as efficient as possible, so that the customer is able to exit the mortgage with as much equity as possible. This becomes even more time-sensitive in the current environment where higher mortgage payments, as well as a softening of house prices, mean that customers in arrears can see their equity eroded at a much faster rate than has been the case in recent years.

Going forward we expect possessions to remain muted into early 2024, with any increase still leaving numbers very low. The current cycle of increasing arrears cases will not result in any material possessions activity in the short term, as lenders will work with customers to help them through this period of higher costs and mortgage payments. The very small proportion of customers who are unable to get back on track with the help of lender forbearance, and ultimately work through to the possession stage, will not start to emerge until late 2024.

HOUSEHOLD DEBT: SUMMARY

Whilst households continue to rundown their savings to cover higher monthly expenditure and bills, we have still yet to see any confirmed signs of payment stress in the unsecured space. However, arrears on mortgages, typically the largest credit commitment for households, have continued to increase as those (mostly older) mortgages on variable rates have seen payments rise significantly through the past two years.

Despite this, the affordability tests carried out by all lenders since 2014 are keeping the emergence of new arrears to a minimum. As such, whilst arrears will see further increases, we expect these to remain relatively low and to peak well below the levels seen in any of the previous market downturns. Likewise, possessions will remain at very low levels in the short term, and any eventual increase in possession activity relating to new arrears cases will be similarly modest.

As always, the industry stands ready to help its customers when they experience financial difficulties, and we strongly urge anyone worried about their situation to talk to their lender at the earliest opportunity.