HOUSEHOLD FINANCE REVIEW - Q1 2023

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This review explores trends in household spending, saving and borrowing through the first quarter of 2023. Cost-of-living pressures, which began in 2022 and have continued into 2023, are shaping households' spending and borrowing behaviour. Here we look in more detail at the developing impact of these pressures and changing consumer behaviours.

Q1 2023 HIGHLIGHTS

- Households' confidence remains weak, particularly in their own positions. However, notwithstanding a seasonal drop-off, spending continued to hold up in Q1 as consumers took advantage of January sales.
- Q1 saw an expected, pronounced, contraction in house purchase lending, as cost-of-living pressures and higher interest rates have further raised the bar for affordability, bearing down significantly on effective demand. Looking ahead, housing market activity may see a modest improvement in Q2 but is likely to remain relatively weak.
- Borrowing over a longer term as a means of stretching affordability may be reaching its limit, which may place an additional constraint on the extent to which borrowers can access mortgage credit under current conditions.
- Mortgage refinancing was robust and tighter affordability does not appear to be limiting refinancing options as yet, but this may now be a brake on the appetite and ability of customers to withdraw equity at remortgage.
- As cost pressures continued to build, Q1 saw the first contraction in the aggregate level of deposits as households accessed savings built up through the Covid-19 era of restricted consumption activity to cover higher monthly spend.
- Following a small rise in Q4, mortgage arrears rose further in Q1, as cost pressures continued to build. While further increases are expected, levels remain low by all historic comparisons.
- Although higher rates are a driver of payment stress for many, this is not the only factor and, for some, cost-of-living alone appears to be pushing customers into arrears positions. Depending on where the stressors are, different customers will benefit from different kinds of help, and the best way to help is not always via the mortgage payment itself. This underlines the key importance of the mortgage industry's tailored approach to helping its customers, and the value of more holistic forbearance and help across other sectors where households are currently stressed.
- Like arrears, possessions continued to rise from a low base, as lenders continue to work through the backlog of cases built up pre-pandemic.

UK ECONOMIC CONTEXT AND OUTLOOK

The UK economy remained in first gear in the first three months of this year, expanding by 0.1 per cent compared with the previous quarter – the same rate of expansion as the final quarter 2022. Despite the relatively flat picture over much of the past year, the latest GDP numbers were actually good news relative to previous expectations.

Concerns, as we have discussed in previous Household Finance Reviews, have centred on the continuing pressure households face from high inflation, and materially higher energy costs than they saw before. Although wholesale energy prices have fallen in recent months, they are not expected to fall back to levels seen before 2022, so households will continue to face higher bills than they have seen in previous years. However, consumer sentiment, which we'll discuss in a bit more detail in the next section, has mounted something of a recovery, though from a low base, since the turn of the year.

Compared with the record lows seen just after the Autumn fiscal event, households are feeling somewhat less downbeat about their own financial outlook and prospects for the economy, although confidence indicators remain weak. Measures announced in the spring budget, such as the extension of the energy price guarantee, will likely have helped lift confidence. In aggregate therefore, consumers have proved somewhat more resilient than expected even as inflationary headwinds persisted at the start of 2023 contributing to household spending making a small positive contribution to Q1 growth.

Against the resilience of household spending, were another tranche of exceptional factors which weighed on growth in the early months of the year. Key among these was the ongoing impact of industrial action across health, education, and transport sectors.

Provisional data from ONS (Office for National Statistics) suggest that more than one million days were lost to strike action in the first three months of the year, and this flowed through to output declines in industries such as transport and storage, and public administration. In addition, bad weather was blamed for a drop in retail sales in March. Moreover, we'll see more 'one-off' impacts on growth from the coronation Bank Holiday and ongoing strikes in the Q2 data.

Consumers' confidence is also likely to be shored up by continued strength in the labour market. Unemployment has edged up to 3.9 per cent, but this is still low by historic standards and there remain over a million vacancies in the economy. Wage growth also remains firm, with total pay growth running at 5.8 per cent in the three months to April and, notably, public sector pay growth closing the gap (up 5.5 per cent, excluding financial services, over the same period).

While this might be a positive for consumers, relative tightness in the labour market is still a source of concern for the Bank of England as it acts to bring inflation sustainably back to target. That job is proving tricky as inflation in April was still running at 8.7 per cent. While energy price inflation dropped back sharply, upward pressure from sharply rising food prices is one of the key contributors to persistently high inflation and the most cited driver of cost-of-living pressures in the ONS regular public opinions survey. Additionally, second round effects from faster wage growth are keeping inflation in the services sector at nearly seven per cent.

Against this backdrop a majority of MPC (Monetary Policy Committee) members considered that a further 25 basis point increase in Bank Rate to 4.5 per cent was necessary in May. There remains a large degree of uncertainty about how these inflation pressures will play out in the coming months, with the MPC noting that risks are still skewed to the upside.

Some recent surveys add weight to concerns about persistence; the services PMI (Purchasing Managers Index), for example, noted a faster pace of output price inflation in April on the back of stronger demand, higher salaries, and still-elevated energy costs. Financial markets are currently expecting further increases in Bank Rate.

In terms of the growth outlook, activity is likely to remain subdued in the coming quarters – notwithstanding some data volatility due to the additional bank holiday. With prices still rising, notably food price inflation, together with the increase in interest rates, there is not yet light at the end of the tunnel for the squeeze on household budgets. While we have seen some resilience, many lower income households will have reached or be approaching the limits of their ability to manage further cost increases. This will constrain any real recovery in consumer spending for most of this year.

Forecasters have stepped back from their predictions of recession this year and the latest Bank of England forecast expects UK GDP to expand by around 0.3 per cent this year, up from its expectations in February of a 0.5 per cent contraction. Within this, the Bank sees household spending expanding by around three-quarters of a per cent, significantly weaker than seen in the decade prior to the pandemic. And positively, unemployment is expected to end this year at a similar level to where we are now. While the avoidance of recession has to be seen as positive, for many households, it will still feel like one.

RECOVERING CONFIDENCE DOES NOT YET EXTEND TO CONSUMERS' OWN POSITIONS

As 2023 began, consumer confidence continued to recover from the historic low seen in the wake of the September mini-budget, when households' confidence in the economy had plunged to an all-time low, below even that seen during the height of the Global Financial Crisis (GFC).

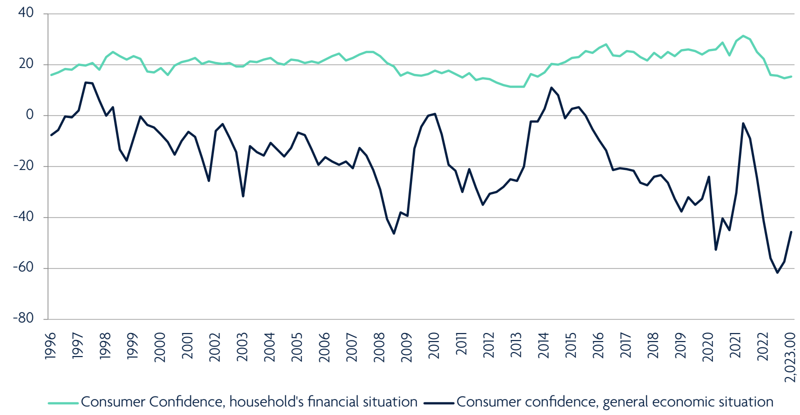
Confidence had, in fact, been on a downward trajectory since late 2021, this trend accelerating through 2022 as warnings of cost pressures – from energy costs, wider inflation and then interest rates as the policy response – increased through the year.

The swift reversal of most of the mini-budget measures and the announcement of continued support for energy bills in the spring Budget, did see confidence recover somewhat. However, with these cost pressures persisting, levels remain lower than those through the credit crunch (**Chart 1**).

Reflecting the same factors, households' confidence in their own financial position, which had fallen very sharply as inflation and Bank rate increases through 2022 increased the pressure on household budgets, had seen no recovery in late 2022. This indicator flatlined in the first quarter of 2023, as Bank Rate continued to rise and inflation remained stubbornly in double-digit territory, but looked like it turned a corner at the start of Q2.

While labour market conditions remain benign for the most part, the new high-inflation, high interest rate environment (relative to the norms for over a decade) present a new set of concerns for households across the country. While both persist, this is likely to act as a brake to households' confidence, and on their ability and willingness to make financially stretching decisions.

Chart 1: Consumer confidence



SOURCE: GfK

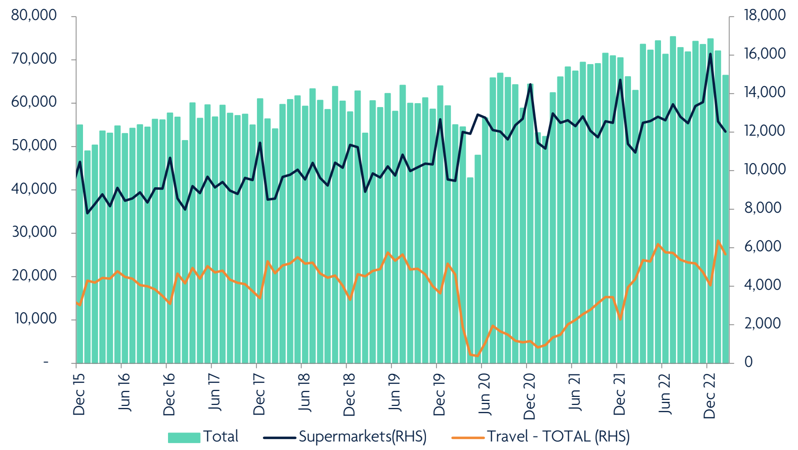
NEW YEAR SALES BARGAIN HUNTERS SUPPORT CARD SPENDING

Consumer spending typically sees a dip in the early months of the year, as households look to pull back on consumption following elevated levels during the festive season. 2023 started in similar fashion, with spending in supermarkets and other regular spend items seeing a contraction. However, this was partly offset by buoyant activity elsewhere, with a significant uptick in spending on travel, including with airlines (**Chart 2**).

In the first half of 2022, as the world reopened its doors to tourists following the lifting of most remaining Covid-19 restrictions, we saw very significant growth in spending on travel as consumers flocked back to that market after a two year absence. However, this travel spending fell away in the latter half of the year; in our Q4 Review we suggested that, as cost pressures built, consumers may have decided that holiday spending - a relatively expensive non-essential item - was an area where they could cut back as their finances came under greater pressure. However, the strength in travel spend as the new year began suggests that both capacity and appetite for foreign holidays remain.

Amidst ongoing cost pressures and the downbeat nature of consumer sentiment, it is perhaps surprising that demand for more expensive items such as foreign holidays remains robust. However, part of the particular strength in January is likely consumers taking greater advantage of the sales offered by many airlines and other travel companies (and as well as retailers of other bigger-ticket items) in the January sales.

Chart 2: Card spending in month, £m



SOURCE: UK FINANCE

On that basis, it could be that the drop off in travel spending through late 2022 was more a reflection of “wait for a bargain” than “not this year” on the part of households. The particularly strong jump in activity in January may then also reflect another cost-of-living driven behaviour, that of increased bargain-hunting when paying full price has become a stretch for more households.

Following this through, it may be that certain elements of spending, including travel, were disproportionately concentrated in January during the sales. This may then result in compensating lower levels of activity through the coming months, analogous to the drop off we see in house purchase activity following the end of every Stamp Duty holiday as purchases are brought forward to take advantage of the savings available.

REBOUND IN PERSONAL LOAN BORROWING ECHOES THAT FOR SPENDING ON TRAVEL

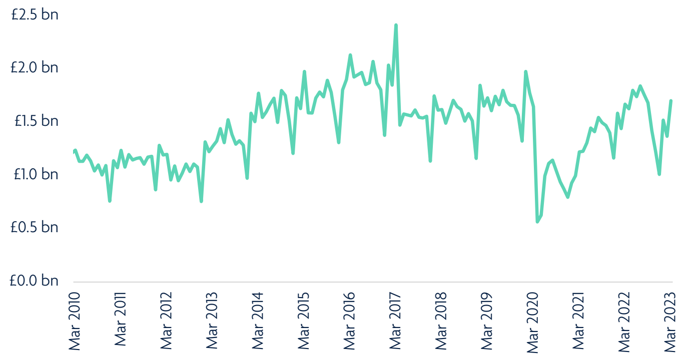
Following a drop off in the second half of 2022, borrowing for personal loans saw a significant bounceback in the first quarter of 2023 (**Chart 3**).

Although growth in borrowing is generally seen at the start of each year, this was stronger than expected, particularly given the higher borrowing costs currently compared with a year ago, as Bank Rate increases fed through to personal borrowing rates.

It is possible that some of this strength is linked to the growth in spending on discounted bigger-ticket items in the January sales, as the pattern of decline through late 2022 and subsequent rebound in Q1 2023 is broadly in line with that for spending on travel. However, regardless of the underlying drivers, spending on (and borrowing for) more expensive consumer items was relatively robust as the year began.

Like card spending on these more expensive items, it is possible that personal loan borrowing may fall away somewhat in Q2, should the growth in the first quarter reflect the same bringing forward of purchase decisions during the sales.

Chart 3: Amounts of new personal loans from banks



SOURCE: UK FINANCE

HOUSE PURCHASE ACTIVITY FELL AWAY SHARPLY IN Q1, WITH FURTHER WEAKNESS EXPECTED

In our Q4 Review we observed a significant drop off in mortgage applications submitted to lenders, which pointed towards a similarly significant year-on-year decline in mortgage completions in Q1.

In line with this, lending for house purchase did indeed see a significant contraction as the year began, with the rate of decline increasing through the quarter (**Chart 4**).

For Q1 as a whole, lending to both first-time buyers (FTBs) and home movers fell to the lowest level since Spring 2020, when the housing market was largely closed during the first national Covid-19 lockdown. Further, excluding that period of closure, FTB numbers were the lowest since 2015 and movers the lowest since 2009 during the GFC.

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

SOURCE: UK FINANCE

This decline in activity is in line with our expectations, as set out in our **Market Forecasts**; cost-of-living and interest rate increases seen over the course of 2022 are now baked into household budgets and, therefore, affordability calculations, and this is bearing down on effective demand for mortgage credit.

Looking ahead to Q2, applications data suggest the rate of contraction has moderated. However, volumes were still 25 per cent lower than in Q1 2022, indicating the softer lending market is set to continue at least over the coming months.

AFFORDABILITY STRETCH BY EXTENDING TERM MAY HAVE PEAKED

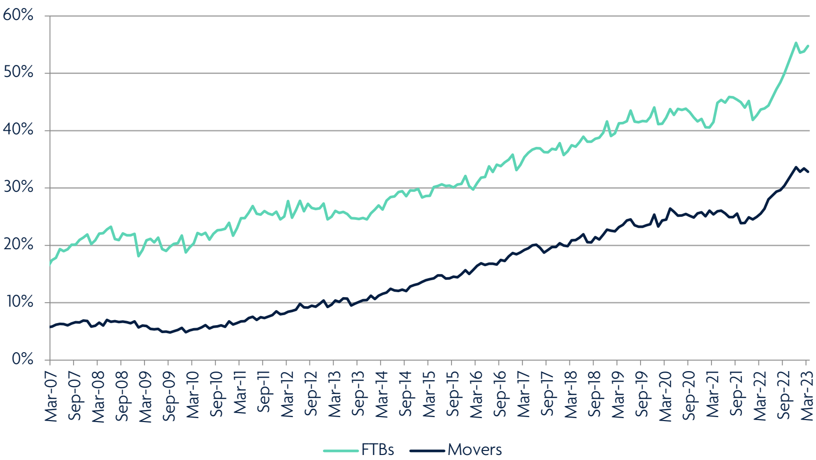
Since the housing and mortgage market began to emerge from the GFC in 2010, house prices have resumed more or less uninterrupted growth, while wages have lagged well behind. This is not a new phenomenon in the UK – for as long as demand for housing exceeds supply there is long-term, structural upward pressure on prices and many borrowers, particularly first-timers, need to stretch their finances for a period in order to obtain a mortgage to buy a home. However, with the more robust underwriting criteria operated by lenders post-GFC, and subsequently enshrined in FCA responsible lending rules from 2014, many well-trodden avenues to stretch affordability have been unavailable to prospective borrowers.

In order to lower monthly payments and, thereby, improve their affordability calculations, we have seen customers increasingly take out mortgages over longer terms, an option still permitted by most lenders and within the FCA's responsible lending rules (**Chart 5**).

While this has been a long-term trend seen since 2010, the growth in borrowing over a longer term accelerated rapidly through 2022 as rising market interest rates and wider cost-of-living pressures combined with still-rising house prices to further raise the bar for meeting FCA-mandated income-expenditure affordability tests.

This is an effective method of improving affordability without putting pressure on a borrower's month-to-month finances. But it does mean that, if that mortgage were to run for its full term, the overall cost of borrowing would be higher. For example, a customer borrowing £200,000 over 33 years at a typical market rate today would lower their monthly payment by around £143, compared to borrowing over 25 years. However, they could pay around £50,000 more in interest over this longer term.

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



SOURCE: UK FINANCE

As 2023 began, alongside the drop-off in lending, we have also seen the growth in longer term borrowing level off. Although tentative at this stage, this may signal that the extent to which this option can be used to stretch affordability and meet underwriting requirements is reaching its limit. This may then act (or indeed, already be acting) as a brake on lending while affordability remains stretched.

INDICATORS GIVE MIXED SIGNALS BUT POINT TO WEAKNESS FOR THE MONTHS AHEAD

As an indicator of overall market sentiment and direction of travel, house prices are useful, but reading the runes can sometimes be difficult.

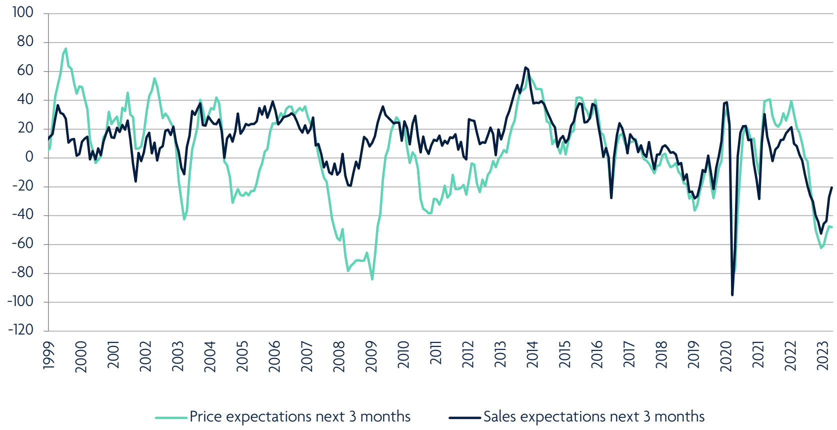
House price indices are perpetually open to different interpretations. Depending on whether considering month-to-month movements, year-on-year, seasonally-adjusted or unadjusted levels, each data point could be interpreted in very different ways. As such it is often possible – especially in an uncertain market – for one index to be reported as indicating rising, falling, or static prices by three different commentators.

At the time of writing, most of the indices were still showing annual growth. However, all have been showing rapidly slowing growth rates or were already in negative territory.

Although not a price index as such, the Royal Institution of Chartered Surveyors (RICS) data provides a useful forward-looking view as to the future path of housing market activity. Like the price indices, this shows that, for both sales and prices, surveyors' expectations of future movements have been trending sharply down since early 2022, and negative since the middle of 2022 (**Chart 6**).

RICS data point to a smaller contraction in Q2 than we saw in Q1, echoing the movements seen in our own forward-looking data for mortgage applications. The pace of the immediate contraction as the year began may have eased but, overall, our forecast for a weaker housing market in the face of much tighter affordability constraints looks set to continue to play out over the next few months at least.

Chart 6: Surveyors' expectations of housing market activity



SOURCE: RICS

CONSUMER SPENDING AND LENDING: SUMMARY

As 2023 began, consumers' spending held up surprisingly well even as their mood and their finances came under increasing pressure. However, cost of living and interest rate rises appear to have now come to bear on the willingness and ability of households to borrow for house purchase. Mortgage affordability, already stretched for many before the year began by rapidly rising house prices, looks to have become a barrier for increasing numbers, and this is likely to continue as we move through the year.

STRONG MATURITY SCHEDULE SUPPORTS REFINANCING BUT EQUITY WITHDRAWAL CONSTRAINED

As at the end of 2022, there were an estimated 1.5 million residential mortgages set to come to the end of their fixed rate deals through 2023. This strong fixed rate maturity schedule underpins our expectations of a robust refinancing market this year.

However, Q1 actually saw a year-on-year contraction in external remortgaging, falling by nine per cent compared with the first quarter of 2022 (**Chart 7**).

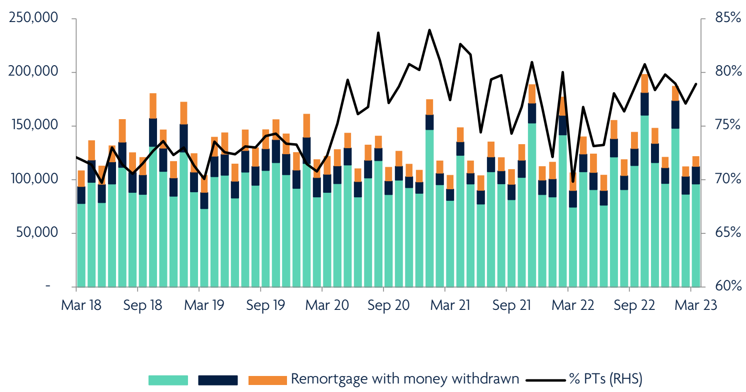
Within this, however, remortgaging where money is taken out (equity withdrawal) contracted very sharply while simple, pound-for-pound external remortgaging (with a new lender) saw growth. Meanwhile, the internal Product Transfer (PT) market also grew, but by a smaller amount than external pound-for-pound remortgaging.

In our market forecasts we observed that, while the fixed rate maturity schedule would support strong refinancing numbers through the year, the same affordability pressures bearing down on demand for house purchase had the potential to also act as a brake on external remortgaging. If so, this would drive more customers to take an internal Product Transfer (PT) to refinance their mortgage, since lenders do not generally carry out affordability tests for these simple pound-for-pound internal switches.

PT volumes tend to be volatile, with the absolute number and share of overall refinancing dependent on when individual lenders' tranches of fixed rate deals are set to end. Because of this, it is easy to over-interpret month-to-month movements. However, the relative strength of simple external refinancing suggests that, at present, affordability pressures are not driving higher volumes of customers towards internal refinancing. At the same time, though, the same pressures may now be impacting adversely on the ability of customers to withdraw equity at remortgage.

The stretch in refinancing is likely to continue through the year as borrowers reach the end of their fixed rates. Within this, however, cost and interest rate pressures still have the potential to constrain the extent to which borrowers access external refinancing options, whether just for a new deal or to withdraw equity.

Chart 7: Number of residential remortgages and internal product transfers



SOURCE: UK FINANCE

HOUSEHOLDS BEGINNING TO RUN DOWN SAVINGS IN THE FACE OF HIGHER COSTS

Throughout 2022, rapidly rising prices and (for borrowers) interest rates have progressively increased monthly outgoings and reduced the capacity to save. As such, household deposits, which saw elevated growth through the Covid-19-era as social restrictions reduced spending on many activities, including travel and leisure, ground to a standstill.

In Q1, the level of overall household savings fell by one per cent compared with the same point in 2022, as the number of households now running down those savings as monthly costs escalated outnumbered those still able to put away monthly income (**Chart 8**).

While not unexpected, given the significant increased costs now faced by all households, compared with a year ago, this is the first time in at least a decade and a half that the household sector, in aggregate, has seen year-on-year contraction in the level of savings.

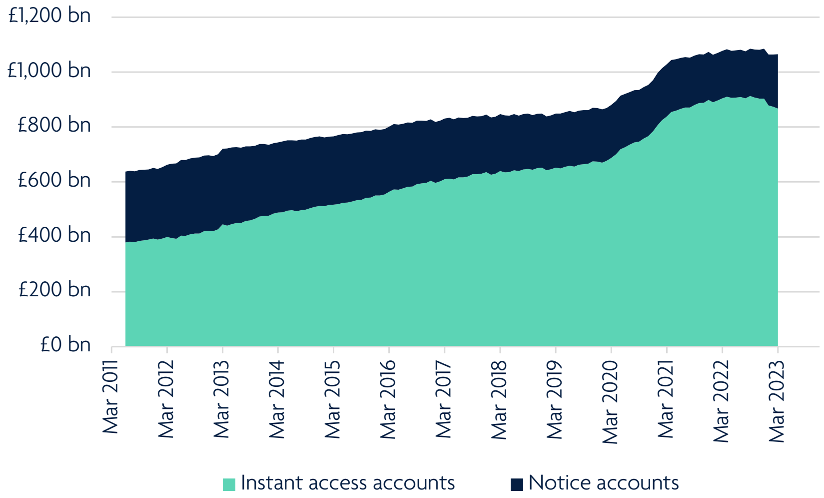
Although the rate of inflation may now have passed its peak, the price increases seen to date are now baked into household expenditure and, for now, increased mortgage and other loan payments from the rate increases seen to date will continue to weigh more heavily on finances.

As such, we are likely to see some further decumulation in savings levels until current cost pressures ease, whether through real wage growth or elsewhere.

However, for those households still able to put away monthly income, the significantly higher rates on longer-term savings products have led to a sustained reversal, since September 2022, of the longer-term decline seen in term deposits though the era of ultra-low Bank Rate.

Although those rates continue to lag well behind inflation, many deposit rates are now well above those of the typical rate on an existing fixed rate mortgage. As with many aspects of the cost-of-living challenges faced by the UK, we are likely seeing a divergence of experience, with lower income households running down their savings, while those on higher incomes, still able to build up their savings levels, finally seeing material returns on those savings.

Chart 8: Personal deposit account balances



SOURCE: UK FINANCE

HOUSEHOLD REFINANCING AND SAVINGS: SUMMARY

As cost and rate pressures build, households are feeling additional strain on their monthly finances. Following a year of stagnant savings growth, it appears that these pressures have now led to the start of a decumulation of the additional savings that the household sector built up through the Covid-19 era.

On the secured side there is, as yet, no sign that the customers coming to the end of their fixed rate deals are seeing their refinancing options limited by the tighter affordability constraints from these cost pressures when simply moving to a new deal. However, these pressures may now be tempering the willingness and ability to borrow more against their home.

As cost-of-living pressures persist through 2023, we may well see a further decumulation of savings by the household sector. Should these pressures escalate further, we may also see some sign that this is constraining customers' refinancing options.

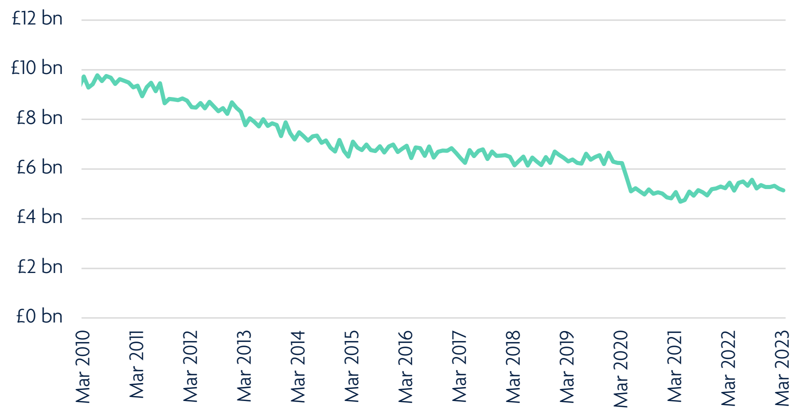
OVERDRAFT DEBT REMAINS LOW

Although the household sector in aggregate appears now to be running down its savings to cover increased costs, there has not yet been any associated rise in use of overdrafts (**Chart 9**).

This is likely due to the fact that, at present, households still have those additional funds accumulated over the Covid-19-era on which to draw. The existence of this buffer has likely prevented many from running up relatively expensive overdraft or other unsecured debt to cover their increased monthly outgoings.

Covid-19 effects have, to some extent, contributed to the current cost-of-living squeeze, with supply chain dislocations and other factors contributing to higher prices and, in response to this, higher interest rates. At the same time, however, social restrictions through the pandemic have also allowed many households to build up a rainy day fund for exactly such a situation as this.

Chart 9: Overdraft balances outstanding



SOURCE: UK FINANCE

As we move through this period of higher household costs, there is the question around the extent to which households can continue to run down these savings buffers given the distribution of deposits across the household income spectrum. As savings become more depleted, more households will increasingly face choices as to whether to cut back on household expenditure and/or look for ways to finance their higher monthly costs.

CREDIT CARD DEBT GROWS BUT TOTAL OUTSTANDING STILL LOW

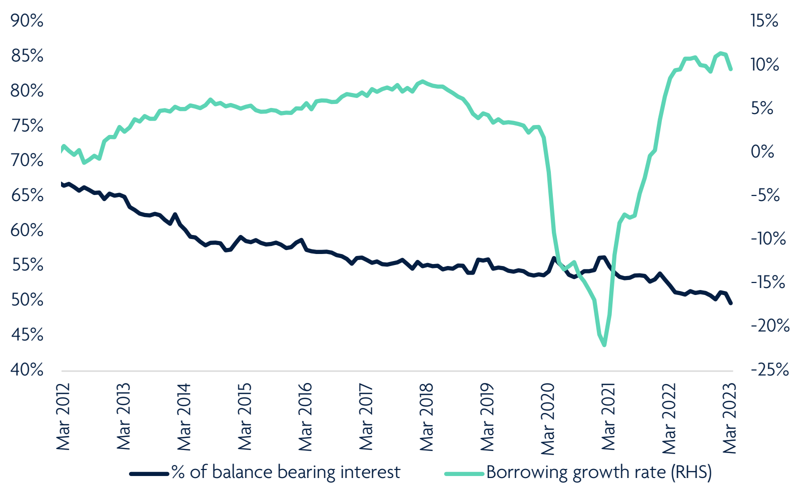
Following an increase in the rate of growth in credit card borrowing in Q4, due in part to seasonal spending patterns through the festive period, growth fell back a little in Q1 of 2023 (**Chart 10**).

Although growth in card debt is still relatively elevated, the absolute levels of card debt remain some 14 per cent lower than that seen prior to the pandemic.

Additionally, the proportion of total card debt that is interest bearing continued to trend down in Q1, meaning fewer card holders are not paying off their bill at the end of the month (and therefore accumulating relatively expensive interest-bearing card debt).

Like overdraft debt then, there is no sign as yet, at the aggregate level, that cost-of-living pressures are feeding through into payment in stress the unsecured space. However, this is likely facilitated, for now, by the ability of households to draw on accumulated savings. If the current pressures prove more persistent, more households are likely to use up this savings buffer, at which point we may see greater signs of payment stress start to emerge.

Chart 10: Credit card balances outstanding



SOURCE: UK FINANCE

Additionally, there are other finance obligations that we do not have visibility of within our own data sources, such as PCP car finance. Insight from the Finance and Leasing Association notes a six per cent decline in the flow of new car finance to consumers in Q1 2023, compared with the same quarter last year, but the sustained growth in this type of financing in recent years may be a further source of pressure for some households.

FOLLOWING A MARGINAL RISE IN Q4, ARREARS ROSE FURTHER IN Q1 AS EXPECTED

As cost of living and interest rates pressures built over the course of 2022, mortgage customers had begun to show early signs of payment stress by the third quarter, but at that stage increases were concentrated in cases where arrears account for less than 2.5 per cent of the mortgage balance, and so fell beneath the threshold for our long-running headline measure of arrears.

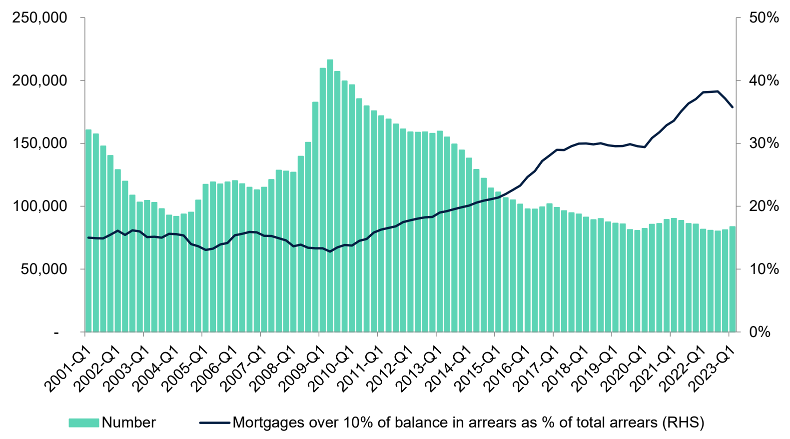
We signalled at that point the likelihood that headline arrears would begin to tick up in subsequent reporting periods, and in fact there was a small rise (1,050 more customers in arrears) in the final quarter. Following on from this, Q1 2023 showed a larger increase (of 2,530 cases), bringing the total to 83,760 mortgages in arrears (**Chart 11**).

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

In addition to the rise in headline figures, earlier arrears (between 1.5 and 2.5 per cent of balance) saw a more material increase in Q1, which is likely to translate into a similarly larger increase in headline arrears in the Q2 figures.

Overall, these increases are broadly in line with our forecast for arrears to reach 98,500 by the end of the year. Although this would represent a significant (21 per cent) percentage increase on the number at the end of 2022, it is important to keep in mind that the current picture for mortgage arrears is incredibly benign by historic comparisons, and the current low volumes necessarily make any increase appear large in percentage terms. Should our forecast increase play out, this would take levels to somewhat less than those seen in 2016, and less than half those seen at the peak of the downturn during the GFC in 2009.

Chart 11: 1st charge homeowner and buy-to-let mortgages in arrears[1]



SOURCE: UK FINANCE

Notes:

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

CUSTOMERS IN ARREARS FACE DIFFERENT CHALLENGES...

However, any increase in arrears, even a modest one from a low base, is of concern and the industry is focused on helping customers navigate periods of increased financial stress. Lenders have a range of tools, including forbearance measures, which can be offered to customers to help them cope when times get tougher. However, mortgage customers are not a homogeneous group, and each customer will have different circumstances which have led to their current position.

It is important, therefore, to understand the challenges faced by customers falling behind, to better inform what help is likely to be most beneficial in the long run.

In our latest **Trends in the Economy and Lending** (TEAL) publication, we used our loan level data to examine the characteristics of borrowers newly falling behind last year, separately from those with pre-existing arrears positions, and also compared headline arrears with earlier, lighter shortfalls.

This report identified key differences between different cohorts of arrears customers. Associated with these differences, there appear to be different drivers of arrears for the different cohorts.

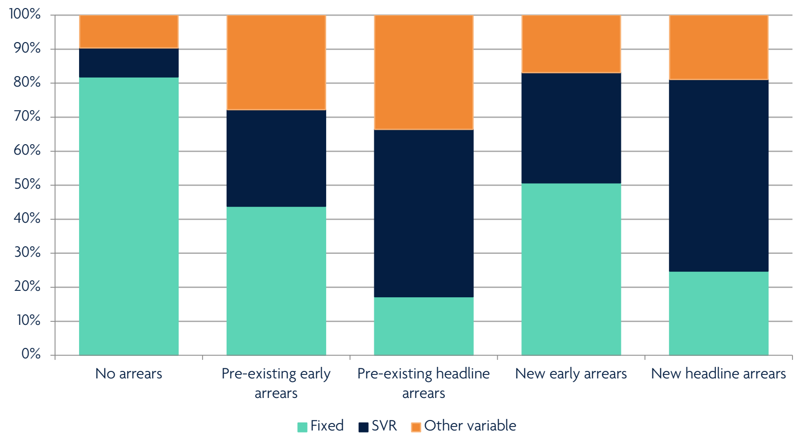
Overall, around 80 per cent of all arrears customers are on variable rates, which is in stark contrast to the wider mortgaged population, where 80 per cent are on fixed rates, reflecting the strong preference for fixed rates amongst new borrowers dating back well over a decade. The corollary to this is that, given almost all new lending is on fixed rates, the vast majority of arrears cases are much older mortgages.

However, this leaves 20 per cent of arrears customers who are on fixed rates and, amongst early arrears cases (those under the 2.5 per cent threshold for "headline arrears"), around half are on fixed rates (**Chart 12**).

These customers are on low rates - around 2.5 per cent on average, which is not materially different to fixed rate customers not in arrears. Their current payment difficulties are unlikely, therefore, to be related to their mortgage rate. Rather, in the absence of any rise in unemployment, the cost-of-living squeeze is most likely to be the key stressor. These customers may, therefore, benefit most in the long term from help or advice in navigating these wider cost pressures.

In the last 12 months, lenders have proactively contacted customers who are worried about their finances a combined total of 16.5 million times to offer support, and expect a further 20.5 million contacts over the next 12 months. This includes via post, telephone, email, SMS, website and app messaging, with individuals often contacted more than once to ensure that they know that help is available. This is in addition to the business-as-usual tailored forbearance that lenders deploy, on a case-by-case basis, where this forbearance will best help the borrower through difficulties.

Chart 12: mortgages in arrears by rate type



SOURCE: UK FINANCE

Notes:

1. Headline arrears defined as cases representing over 2.5 per cent of the outstanding balance

2. New cases are those where arrears first arose in 2022; pre-existing cases are those where arrears began before this.

...AND REQUIRE CUSTOMER FOCUSED SOLUTIONS

Elsewhere within the stock of arrears cases, those on variable rates are mostly much older mortgages, often with pre-existing arrears, and are on SVR (standard variable rates) or tracker rates which were written before the GFC. These products were, typically, very competitively priced (by reference to Bank Rate) compared with those on the market today.

Following a decade or more of these mortgages tracking ultra-low Bank Rate (whether directly or indirectly) these customers have seen the cost of their mortgage payments rise significantly through 2022, exacerbating their problems. However, given market rates have risen through this year as well, many would not see their pre-existing problems eased significantly were they to move to a new market rate.

Table 1 below shows the average costs faced by those customers on variable rates taken out in those pre-GFC years, for a representative £100,000 balance (which is broadly typical for this group of customers). As seen here, although monthly interest payments for these customers have increased by some £271 over the course of 2022, for a customer on those historic SVRs that interest payment is only around £85 higher than a customer taking out a new five-year fix at the end of 2022. And, for a customer on a tracker product from the same period, they are actually paying less on that tracker than a new fixed rate borrower.

Table 1: mortgage costs, variable rate customers in arrears vs new fixed rates

	December 2021		December 2022	
	Average rate	Monthly interest payment	Average rate	Monthly interest payment
Customer in pre-existing arrears on SVR	2.82%	£235	6.07%	£506
Customer in pre-existing arrears on tracker rate	1.67%	£139	4.92%	£410
New five year fixed rate	1.59%	£133	5.05%	£421

SOURCE: UK FINANCE, BANK OF ENGLAND

Notes:

1. New fixed rate pricing based on Bank of England average quoted rates for new lending

2. Rates for customers in pre-existing arrears based on the average rates paid as at December 2022 by customers who borrowed in pre-GFC period

The key point from this analysis is that customers in arrears are not a homogeneous group – they are individuals, with individual problems which require an individualised approach to helping them. Some may benefit from advice on how best to manage their budgets in the face of rising wider costs, while others may need more formal forbearance for a period.

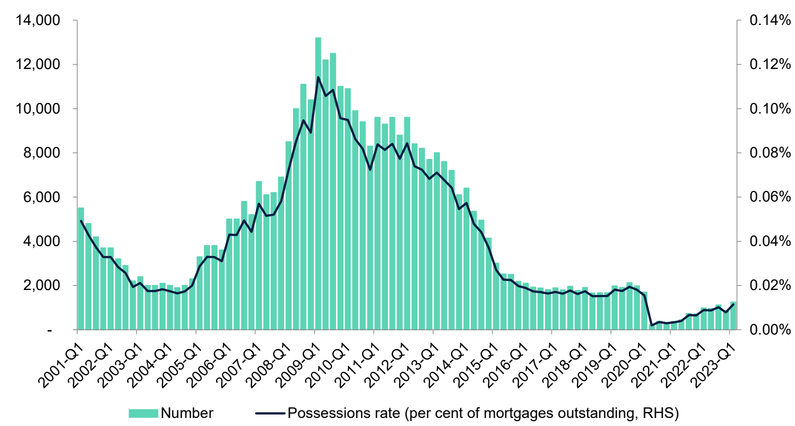
This then underlines the importance of the tailored approach to forbearance that the industry operates, not just in the current climate but for many years now. Lenders are alert to the challenges facing their customers through this period and will continue to deploy the forbearance tools available to them to suit customers' individual circumstances. As always, however, 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 will not, in themselves, affect customers' credit scores.

FOLLOWING FESTIVE PAUSE IN Q4, POSSESSIONS CONTINUE TO RISE SLOWLY

Possessions figures saw an expected dip in Q4 of 2022, as the industry paused enforcement activity through the festive season. Following the resumption of activity from January, possessions numbers resumed their gradual increase in Q1. There were 1,250 mortgage possessions in the previous quarter, up from 860 in the previous quarter and 28 per cent up from the 960 possessions seen in the first quarter of 2022 (**Chart 13**).

Like arrears numbers, although the annual percentage increase is relatively large, it is important to remember that the starting point is an artificially low base, with the industry still slowly increasing possession activity and working through the accumulated backlog of cases from the Covid-19 moratorium. We expect this gradual increase

Chart 13: Number and proportion of 1st charge mortgages taken into possession in period



SOURCE: UK FINANCE

in numbers to continue through the year, with activity still reflecting those cases that pre-date both the current cost-of-living squeeze and the pandemic before it.

As we have set out above, many customers in arrears - particularly those in deeper arrears - have been behind on their mortgage for quite some time on variable rates which, until last year, were typically low.

The rate increases seen though last year and into 2023 reinforce the importance of working through this backlog sensitively, but with appropriate speed, to limit the additional debt that these customers will build up in these cases. Possession of a property only takes place after a strict process has been followed, and where all other options to help the customer to repay their arrears have been exhausted.

We expect possessions numbers to continue to rise through 2023, as the industry works through these backlog cases. However, our forecast 7,300 for the year would represent a very low figure by historic comparisons and represents delayed activity from previous years, rather than any new cases arising from either the current cost pressures facing households or any lingering impacts from the Covid-19 era.

HOUSEHOLD DEBT: SUMMARY

As 2023 began, the additional savings built by the household sector through the Covid-19 era provided a buffer against rising costs, and this has, thus far, helped households avoid building up more expensive unsecured debt. However, at the same time, the cost of living and rate pressures built up since early 2022 began to show in more material increases in mortgage arrears.

As we move through the year these pressures - although they may be near their peak - are unlikely to ease rapidly, and we expect this to be reflected in rising arrears. Additionally, should households run through their savings buffer, we may see some increase in unsecured debt levels as household finances continue to be pressured.

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.