UK FINANCE

Household Finance Review – Q4 2023

This review explores trends in consumers' financial behaviour through the final 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.

Q4 2023 HIGHLIGHTS

- Household confidence was volatile in the latter half of 2023, with uncertainty as to the direction of travel for the economy feeding though into weak consumer spending figures.
- Mortgage borrowing was very weak in Q4, as it had been throughout 2023. Despite the welcome downward movement seen in swap rates in the early part of 2024, new mortgage rates remain much higher than in recent years and, combined with cost-of-living pressures, continue to present significant barrier to mortgage affordability.
- Forward indicators suggest an uptick in lending in Q1, although from a very low base. Notwithstanding this, we expect another challenging year for the mortgage market, dominated by affordability constraints.
- The rapid increase seen in borrowing over longer terms levelled off overall but, within this, the proportion at the longest terms is still increasing. Even with stretching to the maximum terms, however, affordability looks to be still out of reach for many who would previously have been able to borrow.
- External remortgage activity was also weak but internal Product Transfers, where affordability tests are not required, was the only area of growth in activity last year.
- With cost and rate pressures continuing, households are drawing down on their savings to meet higher expenses. As yet, however, there is no sign that households are using credit cards or other more expensive unsecured credit to finance higher outgoings.
- Mortgage arrears rose for the fifth consecutive quarter, in line with expectations. However, the level of arrears remains very low by historic standards. Q1 is likely to show a lower increase, but we still expect continued pressure on mortgage payments through 2024.
- Possessions numbers were broadly unchanged in Q4 and remain at very low levels. With the backlog of historic cases largely cleared we expect a return to more normal timelines for those very few arrears cases where possession is, unfortunately, the only available option. However, numbers are expected to remain low through this year and next.

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UK economic context and outlook

The backdrop to this quarter's Household Finance Review continues to be a struggling UK economy, hamstrung by elevated inflation, the effects of recent interest rate rises and an equally weak international environment. Despite this challenging backdrop, the labour market has proved resilient and some of the headwinds that the global economy has faced into since emerging from the pandemic are expected to fade in the year ahead.

The UK economy experienced a second consecutive quarter of contraction in the final months of 2023, according to the latest estimates from the Office for National Statistics (ONS). GDP fell by 0.3 per cent in Q4, the weakest performance since 2021 Q1 when Covid lockdowns were in force. This follows a 0.1 per cent contraction in the three months to September, giving growth of just 0.1 per cent across 2023 as a whole. The fall in Q4, which was slightly greater than many economists and indeed the Bank of England had predicted, was broad-based across all parts of the economy.

Services output fell by 0.2 per cent, marking the third consecutive quarter of contraction. Within this, there was a particularly marked fall in wholesale and retail trade. Consumer-facing services had a very tough time in the second half of 2023 (falling by one per cent and 0.7 per cent in Q3 and Q4 respectively) as cost-of-living pressures bore down on demand.

There is plenty of other supporting evidence for this weakness – the festive spending period was rather subdued. There was the usual boost to sales from Black Friday discounting, but outside of reports of decent food sales, December spending disappointed according to official statistics and retailers' trading statements. This was what consumers were predicting, with nearly half reporting to the ONS public opinion and social trends survey, that they planned to spend less on food and gifts in the run up to Christmas.

Elsewhere in the economy, production and construction activity fell by one per cent and 1.3 per cent respectively in Q4, with the latter seeing large falls in private house building.

While commentators have declared that the falls in GDP in the second half of last year essentially mean the UK is in recession, there are a couple of points to note. Firstly, the downturn is mild and, as we've seen with previous provisional estimates, the contraction in one or both of those quarters could be subject to revision. This wouldn't change the big-picture narrative of stagnation. However, a more pertinent data point in the ONS release is the recent trend in GDP per head – a better gauge of how economic trends feel on the ground. This contracted by a more substantial 0.6 per cent at the end of 2023 and hasn't posted any growth since the start of 2022.

A key challenge for households and policy makers has been the rapid rise in inflation, which started as the global economy was getting back to normal after the pandemic and further accelerated by the conflict in Ukraine. The good news is that double-digit rates of consumer price inflation are now behind us, with CPI registering four per cent at the end of 2023, (down from a peak of over 11 per cent) and holding there in January 2024.

One of the main pressure points for household has been the significant rise in food prices – which peaked at over 19 per cent last March, but latest readings show the rate of increase continued to ease in January. The other big pain point has been energy prices. Here the outlook is more positive, a mild winter and European gas inventories above seasonal averages will drive a material fall in the energy price cap in April, which will help speed CPI's return to close to the Bank of England's two per cent much sooner than previously expected.

This was front and centre in the Bank of England's February Monetary Policy Report forecasts. However, its analysis also shows that the current conditions will be temporary, and CPI will rise again, remaining above target over the next two years. The Bank has not declared victory in its battle against inflation, noting that risks of persistent domestic inflationary pressures remain. Indeed, the latest inflation data continue to show that core CPI hasn't budged from over five per cent in the past three months and services inflation also remains uncomfortably high at 6.5 per cent. Geopolitical tensions, which could lead to prolonged disruption in Red Sea trade routes further, add to the upside risks to inflation.

There will, however, be some comfort from the continuing signs of labour market cooling. Wage growth continued to moderate at the end of last year and vacancies across the economy registered their 19th consecutive month of decline. The unemployment rate, however, has remained very low by historic standards, making this a somewhat unusual recession. Nevertheless, if surveys pointing to plans for more subdued pay increases play out in the months ahead, this could help build the case for interest rate cuts sooner rather than later.

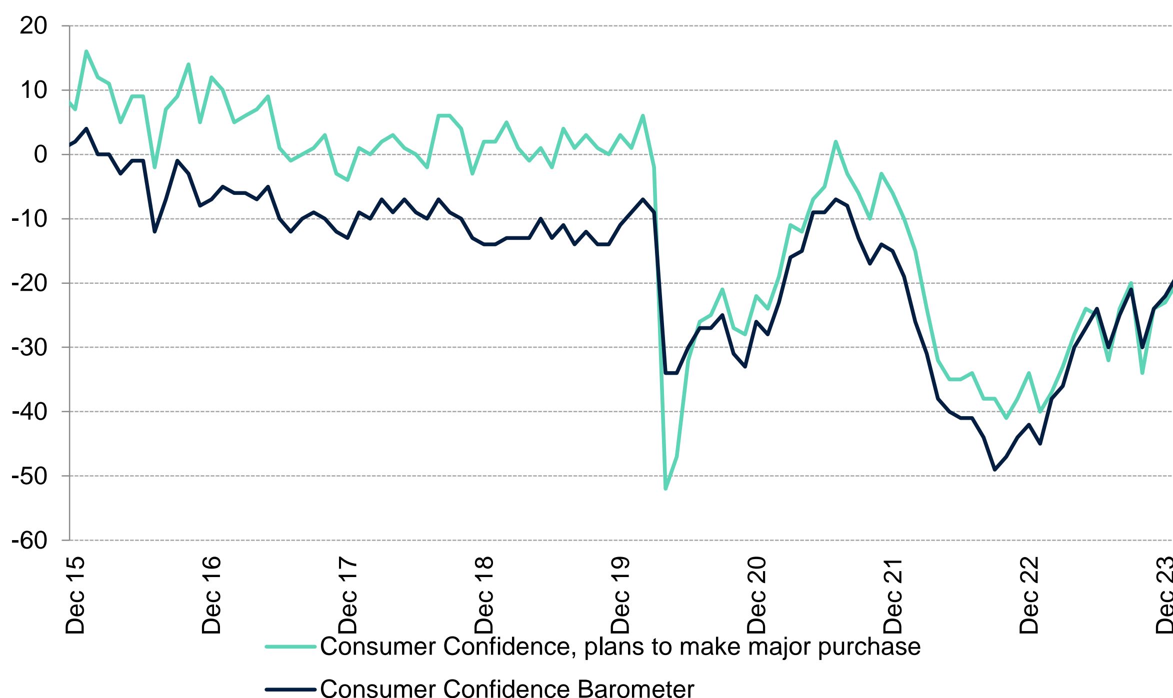
Lower borrowing costs would support an improvement in confidence across consumers and businesses through this year. As inflationary pressures ease and households see growth in real disposable incomes return this year, the expectation is for the economy to start moving again in 2024. Indeed, survey indicators, such as the purchasing managers' index, point to a pickup in activity at the start of the year.

Whether we manage to get out of first gear is another question. The Bank of England expects only muted growth in 2024 (around 0.3 per cent) and, with a fair wind, the UK may hit one per cent in 2025. Stronger and more sustainable growth will require more than interest rate cuts and a recovery in consumer demand. A turnaround in investment and improved productivity also need to happen and this will need to be a focus in not only the fiscal events we see this year, but the next parliament.

Household confidence volatile amidst uncertainty

Since plunging to an all-time low in September 2022, consumer sentiment had been on solid upward trajectory through the first half of 2023. However, in the second half of last year confidence indicators followed an erratic path, reacting to positive and negative news stories on inflation, interest rates and other events from month to month, with no clear trend in either direction (***Chart 1***).

Chart 1: Consumer confidence



Source: GfK

Whilst monetary policy is working to bring down inflation, the lingering impact of the significant price rises already seen, as well as the considerable uncertainty on both the domestic and global fronts, appear to have consumer confidence in a state of flux.

Although the final months of 2023 showed positive movements, consumer confidence indicators, including households' intentions to make major purchases, remained in a net negative position by the end of the year, as they have been through most of the pandemic and post-pandemic years.

More recently, January has shown a further positive movement, with sentiment likely buoyed by falling inflation figures and wage growth starting to erode some of the pressure on household finances. As we move through the year, developments in the UK and across the world are likely to continue to buffet the recovery path of household confidence as the country navigates – and ultimately emerges from – the cost-of-living crisis.

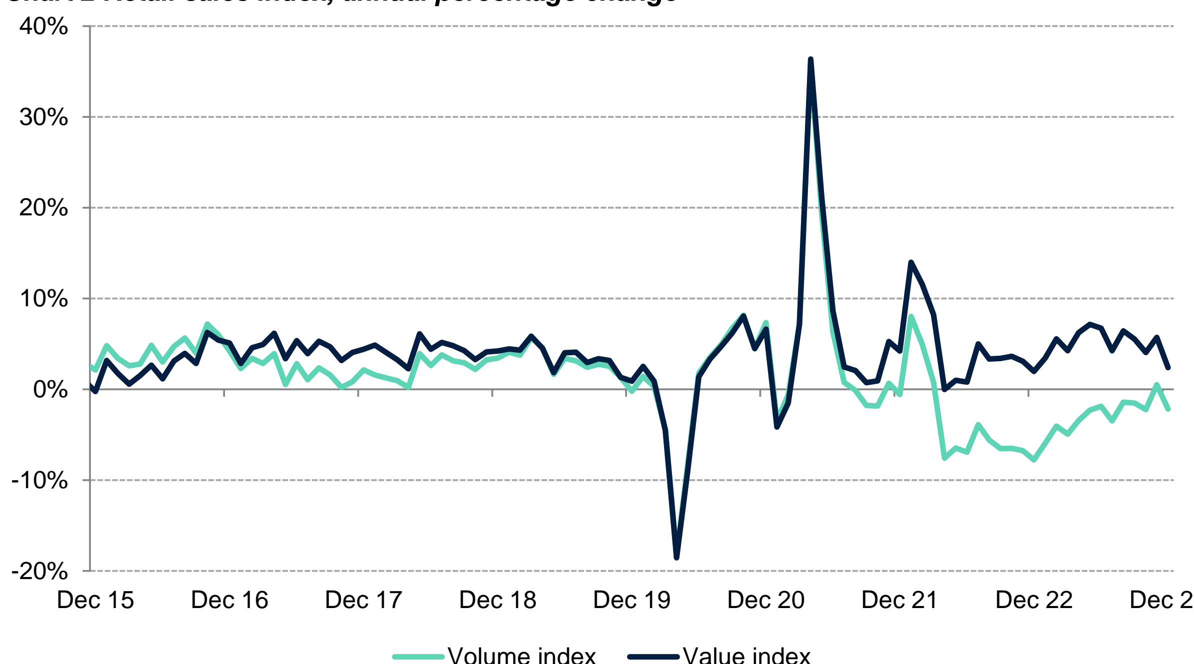
Uncertain conditions led to a weak Christmas for retailers

Perhaps reflecting the fragility of consumer confidence, retail sales were relatively weak in the final quarter.

In the run-up to the festive season, spending patterns had been muted, with public commentary divided between whether this would set the scene for a similarly disappointing Christmas or if consumers were holding back spending through the Autumn, so that they could then have “a proper Christmas.”

As it turned out, those in the former camp were proved right; even with the seasonal “Black Friday bump” supporting greater activity in November, households look to have been restrained in their spending over the festive season, although the drop off in activity was relatively modest (***Chart 2***).

Chart 2 Retail sales index, annual percentage change



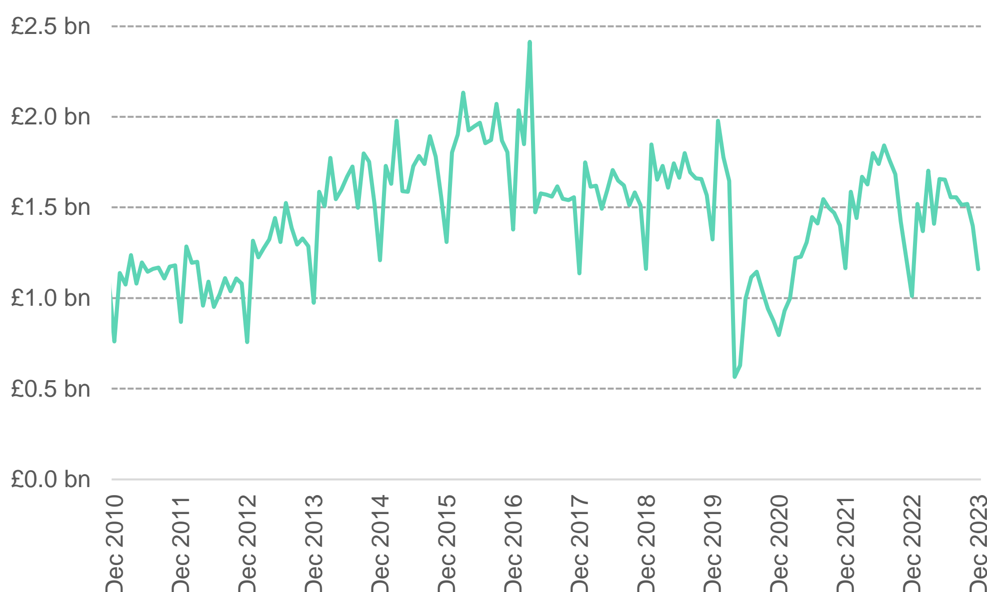
Source: ONS

Throughout 2023, in the face of increased costs, the value of spending was up year on year but down in terms of the number of transactions, with households’ spending power more limited.

Further evidence of the constraints on consumer spending in Q4 was seen in card spending data, with weakness throughout the quarter, particularly in the retail sector and most significantly for household goods and clothing. Spending via debit cards was also weaker than via credit cards, across all sectors but most noticeable in those areas mentioned above. One possible reason for the comparative weakness in debit card activity could be due to an increased reliance on unsecured credit as household costs rise. However, as we explore later in this Review, there is little evidence of this at present.

Echoing the trends in spending, borrowing for personal loans fell away Q4, although activity was up on the same period in 2022 (***Chart 3***).

Chart 3: Amounts of new personal loans from banks



Source: UK Finance

In part, the drop off in personal loan borrowing reflects seasonal patterns, and the year-on year growth also needs to be viewed in the context of an unusually large fall in the fourth quarter of 2022, as pricing spiked in the market turmoil following the mini-budget. Notwithstanding this, the path of personal loan activity – often used to fund larger purchases – looks to have followed the path of consumer sentiment, suggesting the general uncertainty as to what lies ahead may be translating to reluctance to take on more debt right now.

2023: a weak year for mortgages, hampered by affordability pressures

Looking back on 2023, we can see that affordability pressures drove a sharp contraction in all sectors of new mortgage lending. Overall, first-time buyer (FTB) numbers were down 22.4% and movers by 26% (***Table 1***).

Table 1: Key Annual Mortgage Figures

	2019	2020	2021	2022	2023	Annual change
Number of residential purchase loans:						
First-time buyers	351,000	304,000	405,000	370,000	287,000	-22.4%
Homemovers	344,000	310,000	444,000	339,000	251,000	-26.0%
Total	695,000	614,000	849,000	709,000	538,000	-24.1%
Number of residential refinances						
Residential - external remortgage	446,500	352,500	321,900	382,300	311,600	-18.5%
Residential Product Transfers	1,203,200	1,169,100	1,248,100	1,274,200	1,491,800	17.1%
Total	1,649,700	1,521,600	1,570,000	1,656,500	1,803,400	8.9%
House Prices (UK average, Q4)	215,925	229,819	253,113	265,195	259,157	-2.3%
Gross mortgage lending (£ million)	269,006	245,716	308,058	313,176	223,528	-28.6%
Mortgages in arrear (end of year)	80,570	89,310	85,660	81,230	107,250	32.0%
Mortgage possessions	7,990	2,620	2,250	3,920	4,620	17.9%

Source: UK Finance, Nationwide BS, Bank of England

On the face of it, it is perhaps surprising that FTBs – who typically face the tightest affordability constraints – saw a less significant fall in numbers than home movers. However, there are factors supporting FTB activity that are likely to have contributed towards this lower – but still significant – annual contraction.

Firstly, the vast majority of FTB transactions are exempt from Stamp Duty, although a greater proportion still have to pay it in London and the South East, given the much higher house prices there. Second, a sizeable proportion of FTBs will be receiving help in raising a deposit, most commonly from the "Bank of Mum and Dad." In the previous slowdown during the Global Financial Crisis, it was estimated that around half of FTB transactions nationally were getting this help, rising to around 80 per cent in London. As we discuss later in this Review there are still considerable excess savings held by the household sector, and this is likely to be supporting a greater degree of FTB activity than in recent years in the form of funding deposits. However, despite help from various sources, FTB numbers in 2023 were still the lowest since 2013.

In contrast, home movers have neither any additional Stamp Duty exemption beyond the standard £250,000 nil-rate threshold, nor do they typically get cash injections from family to help them buy their next house. As such, the constrained affordability through last year saw just 251,000 home mover loans advanced, the lowest number since 1974.

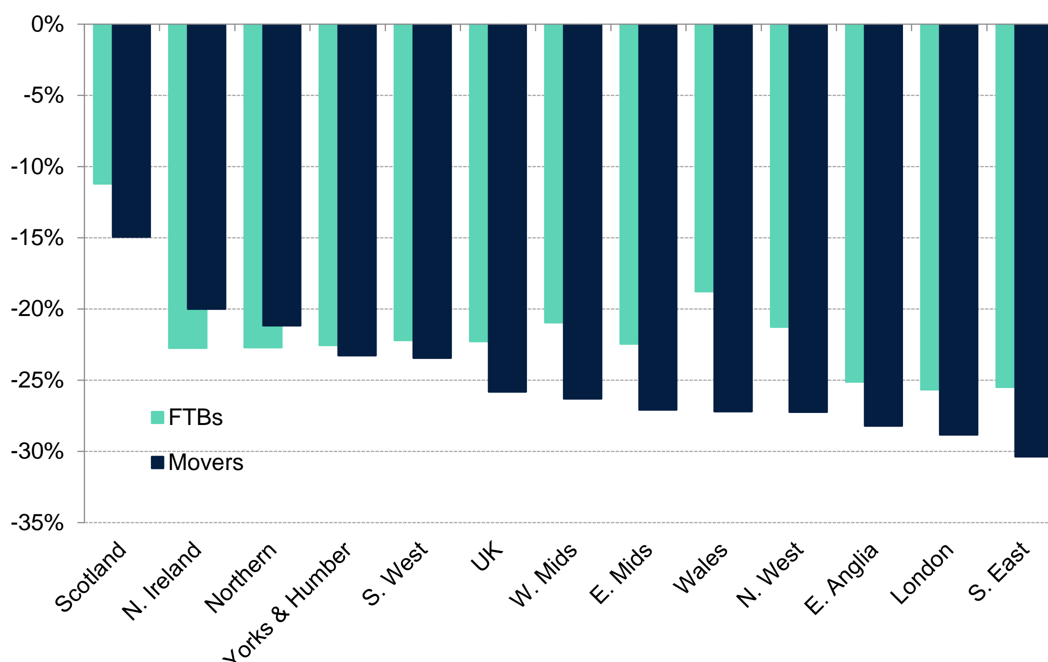
Affordability pressures also came to bear on mortgage refinancing activity. External remortgaging – which theoretically had a sizeable market last year with 1.5 million customers' fixed rate loans set to mature – fell by 18.5% compared with 2022. However, with the widespread availability of internal Product Transfers (PTs) which do not require affordability tests, virtually all customers were able to refinance their loans.

As a result, refinancing activity shifted even further towards retention deals, and the PT market saw annual growth of 17.1%, the sole area of mortgage business growth last year.

2023 market weakest in and around London

The significant contraction in the mortgage market last year was widespread, and every region of the UK saw a double-digit percentage fall in lending volumes. However, some regions were particularly hard hit – most notably London and the South East (***Chart 4***).

Chart 4: Loans for house purchase, UK countries and regions, 2023 annual change



Source: UK Finance

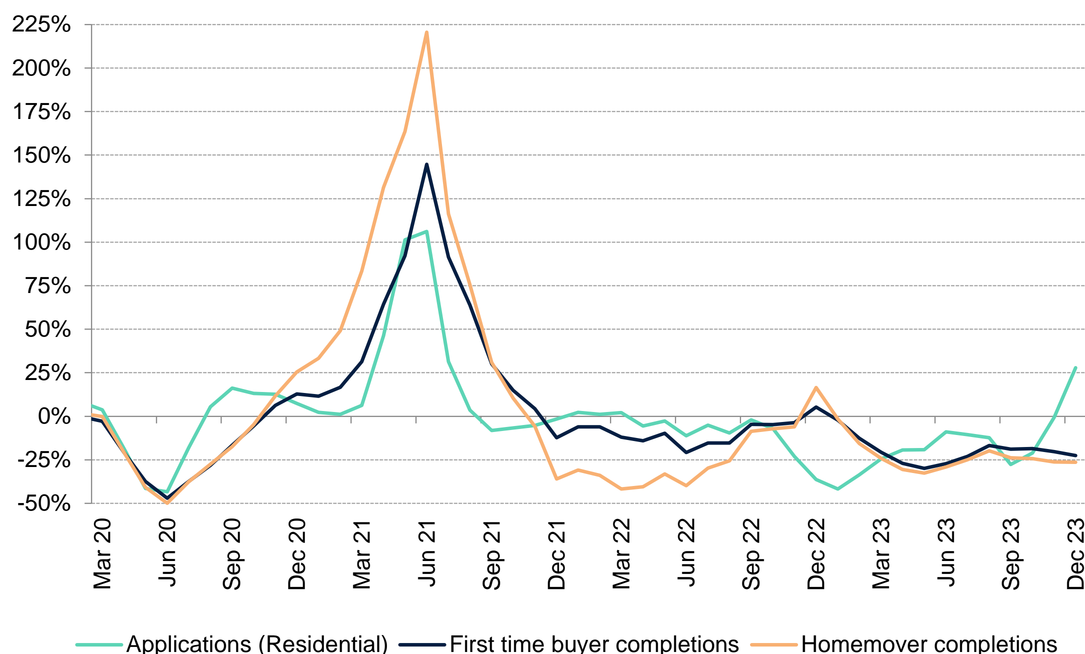
This aligns with the particularly acute affordability constraints in those geographies. Whilst higher rates have tightened affordability everywhere, with the much higher prices in the South FTBs in 2023 needed almost one quarter of their gross income to cover initial mortgage payments.

However, in Scotland, where mortgage payments took up materially less – around one fifth of income – lending contracted by around half of that seen in the South East.

Mortgage lending fell sharply again in Q4, but some resilience expected in Q1

2023 ended as it had begun for the mortgage market, with significant double-digit percentage fall in lending numbers, compared with those seen in 2022 (***Chart 5***).

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



Source: UK Finance

FTB numbers were down some 23 per cent year-on year in Q4, and movers by 26 per cent, as higher interest rates and wider cost of living pressures kept affordability out of reach for many would-be buyers.

With continuing strength in the labour market, there are few forced sellers in the market. As a result, despite the considerably smaller pool of prospective buyers for properties for sale, last year was a market of low transaction volumes but only modestly falling prices.

Indeed, more recent data suggest house prices are currently rising again. This is a positive for prospective sellers, but also means a slower adjustment process for affordability to come back into reach for more buyers.

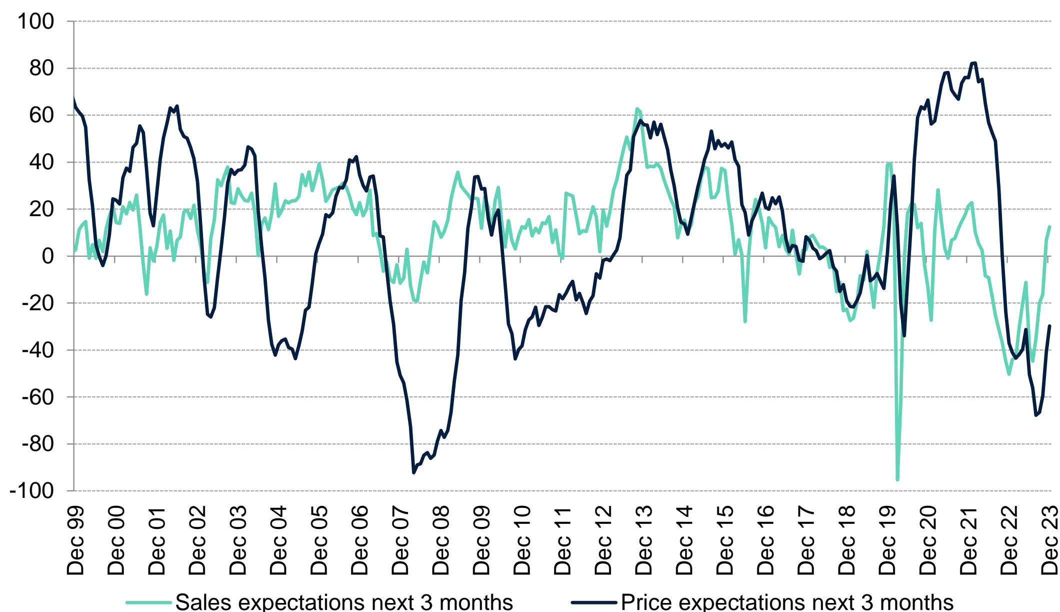
Looking ahead, mortgage applications in Q4 are significantly up compared with a year previously, suggesting we will see some growth in early 2024.

A stronger Q1 expected, but overall picture remains subdued

In addition to the positive year-on year readings from our applications data and price indices, the Royal Institution of Chartered Surveyors (RICS) survey provides another forward-looking view of housing market activity.

Surveyors' sentiment gives slightly mixed messages; a net balance of respondents to the RICS survey expect an increase in sales over the first quarter, which represents a significant turnaround from the negative expectations for the final quarter of 2023. However, whilst price expectations have also risen, they remain firmly in a net negative position (***Chart 6***).

Chart 6: surveyors' expectations for property market



Source: RICS

Taken together with our applications data this suggests the early months of 2024 will show some improvement in activity, as downward pricing of new mortgages brings mortgage affordability into the reach of more prospective buyers.

But, with affordability still far tighter than it has been for some time, market conditions remain challenging. Although these forward indicators suggest Q1 will show annual growth, the first quarter of 2023 was exceptionally weak, and a rebound will still leave lending numbers low compared with historic norms.

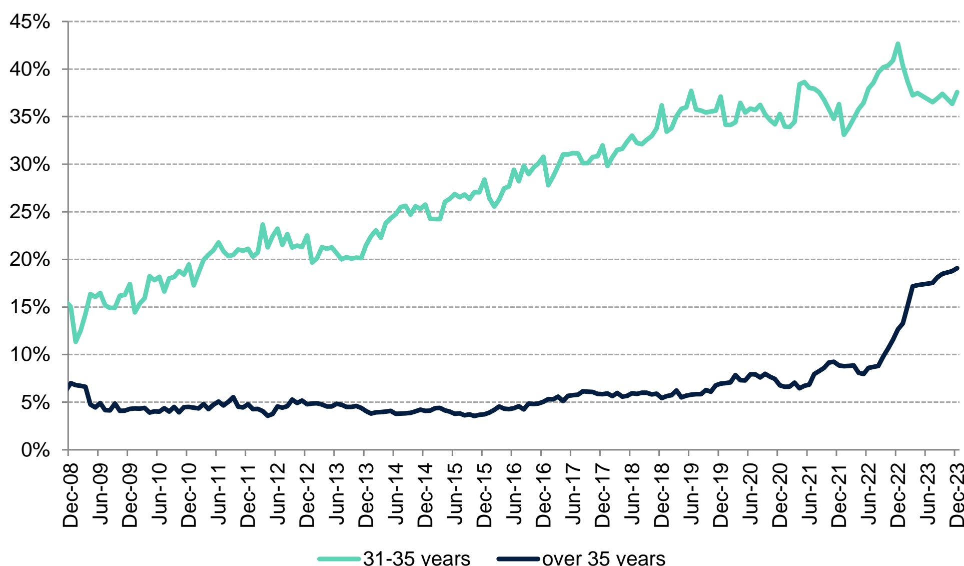
Overall, our expectations remain for a soft market this year with affordability pressures – whilst now gradually receding - still holding back borrowing capacity.

Borrowing over a longer term is becoming borrowing over an even longer term

In previous Reviews we have highlighted he rapid increase in borrowers taking out mortgages over longer terms. For previous generations, borrowing over a 25-year term was very much the norm. However, as the housing market gathered pace over the past decade, affordability pressures have ratcheted up. And the FCA lending rules in place since 2014 have ruled out most means of stretching affordability that had previously been common, including borrowing on an interest-only basis.

Amidst these pressures borrowing over a longer term, which lowers initial mortgage payments, became increasingly common. Throughout 2022 with high house prices, inflation and rising interest rates all bearing down on mortgage affordability, we saw longer term borrowing increase much more rapidly (***Chart 7***).

Chart 7: proportion of new FTB mortgages taken out with over 30-year term



Source: UK Finance

In 2023 the proportion of borrowing at over 30-year terms began to level off, suggesting that perhaps the extent to which this could be used to stretch affordability was reaching its limit.

Borrowing at over 30-year terms remained broadly static for home movers in the fourth quarter, and ticked up for FTBs, but at nowhere near the pace seen through 2022. However, this does not tell the full story: within this we are seeing a continued, more rapid, increase in borrowing for more than 35 years. In other words, where customers are using term stretch to improve affordability, they are needing to lengthen the term even further.

By the end of 2023, almost one in five FTBs were borrowing with a term of over 35 years, compared with fewer than one in ten a year before.

When does term stretch cease to be effective?

As more customers look to borrower over an increasingly long mortgage term, the question arises as to the point at which this loses its effectiveness, in terms of improving the affordability calculation.

To model this, we look at a "typical" FTB borrowing in 2022 – a year of relative stability in the mortgage market, both in terms of rates available and wider affordability pressures. In 2022, the average mortgage term for a FTB was 30 years

Rolling forward the average change in house prices, mortgage rates and incomes to the middle of 2023, for that buyer to achieve the same affordability - as measured by their mortgage payments compared to income - they would have needed to borrow over a 50-year term.

As rates rose through 2023 this calculation increased further. Towards the end of 2023 we started to see some easing off in new mortgage rates, as lenders were able to reduce pricing in response to an easing of market swap rates used to fund fixed rate mortgages. However, the rates on completed new mortgages, which reflect deals agreed typically one to two months previously, look to have peaked in the final quarter of 2023.

Based on rates for loans completed in December last year, the same borrower from 2022 would now need a term of 72 years to have achieved that 2022 level of affordability on their initial payments.

A 50-year term, let alone 72 years, sits outside even the most generous of lender underwriting criteria. This does, however, demonstrate why we have seen such a significant increase in much longer-term borrowing (where this falls within lending policy limits). But, even with this level of term stretch enabling some lending, many borrowers were still unable to pass affordability tests, driving the significant contraction in lending volumes that we saw last year.

As we move through the first few months of 2024, we are likely to see the downward pricing that began late last year to start to feed through into some stimulus in mortgage completions. As observed earlier, applications data suggest Q1 will indeed show something of an uptick. However, as we have shown here,

affordability remains sufficiently stretched that many would-be customers may still not be able to access mortgage credit, even if they borrowed at a much longer term.

Taking the example above, and assuming borrowing at a 40-year term (commonly the maximum allowed under lending policies), a reduction in mortgage pricing of around 80 basis points beyond those on offer at the end of 2023 would bring payments as a proportion of income back into line with 2022 levels. However, without that term stretch, rates would need to fall by some 180 basis points to get back to 2022 affordability levels.

How far lenders will be able to continue to price down through this year remains to be seen. For now, however, we can see that affordability remains extremely tight and, for many, out of reach even with the longest possible mortgage terms.

A steady path to "normal", but expect the unexpected

Our central view for the year ahead is for challenging conditions for the mortgage market, with affordability constrained both for prospective and existing borrowers. We do, however, expect conditions to gradually improve, as falling inflation allows for some easing in Bank Rate and further cuts in mortgage rates, whilst wages relative to house prices also see some normalisation.

Crucially, that gradual improvement assumes no unexpected shocks. In that respect, there are factors well beyond the control of the UK that have the potential to derail things. In particular, the crises in Ukraine and the Middle East continue to loom large, and both have already made negative impacts on global supply chains. Should these worsen, this could trigger another period of higher inflation and a potential monetary policy response, as well as other negative economic and political impacts. This then represents a set of downside risks to the market which could be considerable.

On the domestic front it is possible that policy announcements in the run up to a general election, both in the upcoming spring budget and the second fiscal event later in the year, include ones that stimulate demand, both in the housing market and wider household sector.

Consumer spending and lending: summary

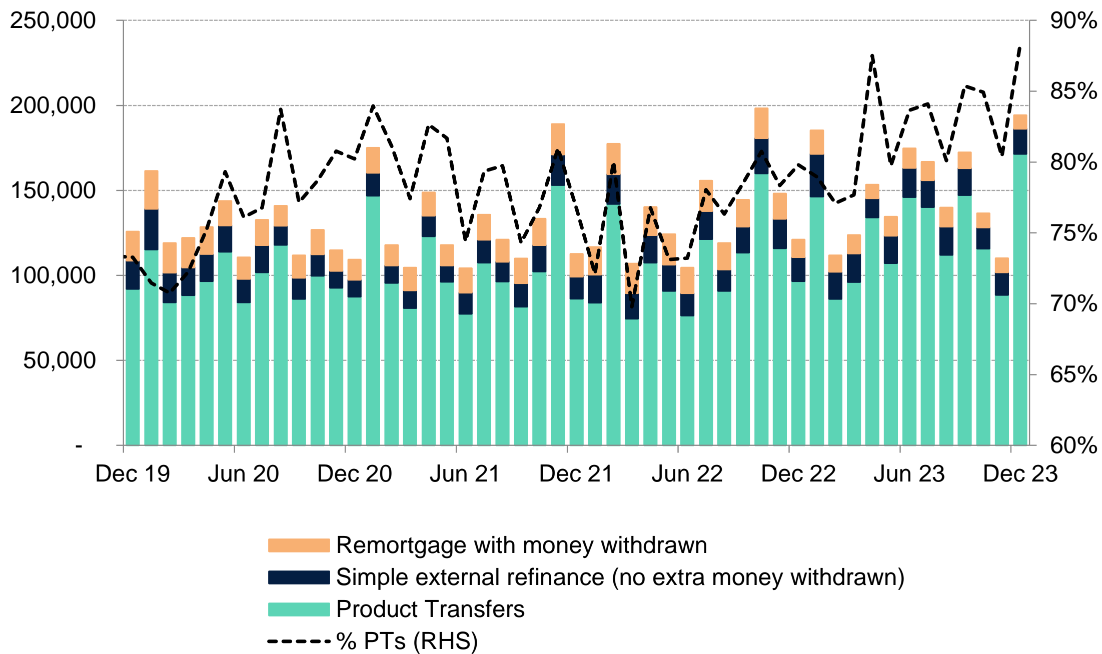
In the final quarter of 2023 cost of living pressures manifested in weak spending and even weaker borrowing. Whilst there are indications that early 2024 will be better, the underlying picture for this year is of cost and rate pressures continuing to hold back activity as household budgets and mortgage affordability gradually improve through this year and next.

External remortgaging weak as affordability constraints drive even more towards internal refinancing

As observed earlier, the 1.5 million maturing fixed rates through 2023 supported strong refinancing. But, with affordability constraints limiting customers' options on the open market, activity shifted even more towards customers refinancing with their existing lender, commonly called Product Transfers (PTs).

The lack of affordability tests for PTs, as well as competitive pricing for retention deals, has meant that more customers than ever remained with their existing lender last year. In December almost nine in ten customers chose a PT deal, a higher proportion even than during the lockdowns in 2020, when the ease of arranging a PT online boosted volumes whilst the country was largely stuck at home (***Chart 8***).

Chart 8: number of residential remortgages and internal product transfers



Source: UK Finance

Although the significant increase in rates, compared with those from two and five years ago, means that customers are typically paying more on their new deals, the affordability stress tests on that initial lending have ensured that customers are able to cope with the increase in payments; as we have shown in previous Reviews, those new rates remain well below the stress rates used to assess affordability on their previous loans.

A further 1.6 million fixed rate mortgages are set to end through 2024. It is likely that, after peaking in 2023, the "payment shock" for customers refinancing their fixed rate loans this year will ease a little this year. However, the increase in payments will still be significant, with PTs continuing to take most of the refinancing business.

December rise in savings follows eleven months of contraction

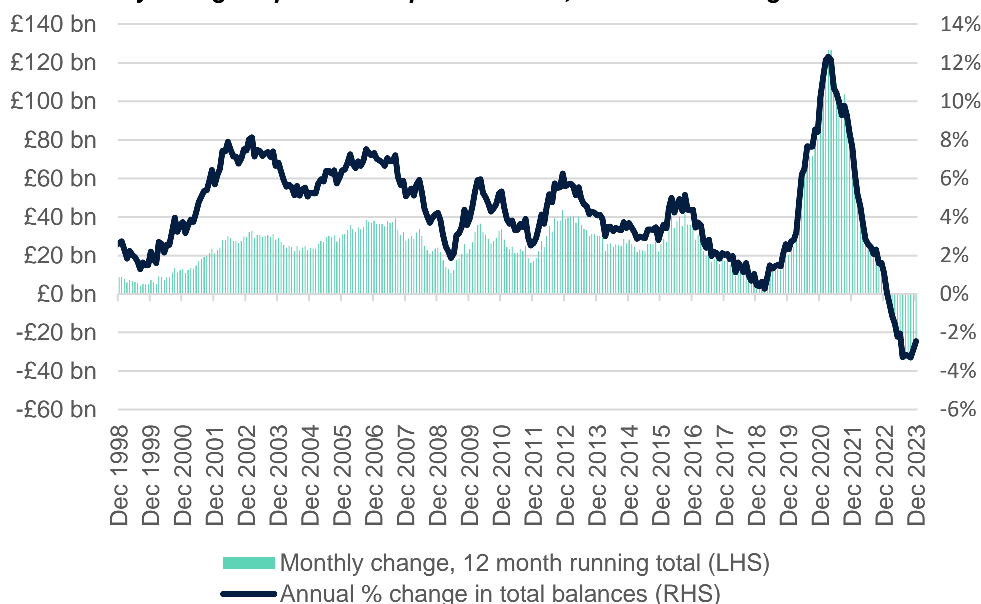
For most of 2023, data on retail deposits have provided one of the clearest demonstrations of the cost pressures facing households. Deposit levels can fluctuate, falling for a month or even two. However, the underlying trend has always been one of a gradual increase in deposit levels, driven in large part by natural inflation.

Last year, however, we saw a sustained fall, each month, in the total level of personal account deposits held in retail banks. This has not previously been seen for at least 25 years, as far back as our data are available.

Simply put, the decumulation in savings last year reflects the fact that, at the aggregate level, household incomes were insufficient to cover household costs. Obviously, this situation can and does happen at the individual household level for any number of reasons, but has never before been widespread enough to be shown aggregate data for the whole sector.

The running down of savings began in January and continued through to November. And, whilst December saw an uptick, the total amount of personal deposits ended the year two per cent lower than a year previously (***Chart 9***).

Chart 9: monthly change in personal deposit account, 12 month running total



Source: UK Finance

This clearly demonstrates the strain that cost-of-living pressures continue to exert on the household sector. However, it remains the case that, following the build-up of savings through the period of pandemic-related social restrictions, aggregate deposit levels are still well above trend.

But, whilst it is obviously a good thing that households have these additional savings that they can draw upon now they are needed, this does mask the fact that not all households were able to build up these buffers. Many, particularly those lower down the income scale, do not have these additional reserves or will have already run them dry, and will now be in the position of either having to cut back on expenditure or find other ways to finance their monthly outgoings.

With inflation coming down and wage growth starting to close the gap between household income and expenditure, it is possible that the household sector overall will be able to weather the storm that is the cost-of-living crisis, although as above, some households are facing much greater challenges. However, as with affordability in the mortgage market, the path back to “normal” remains fragile and the downside risks, particularly from inflation, have far from receded.

Household refinancing and savings: summary

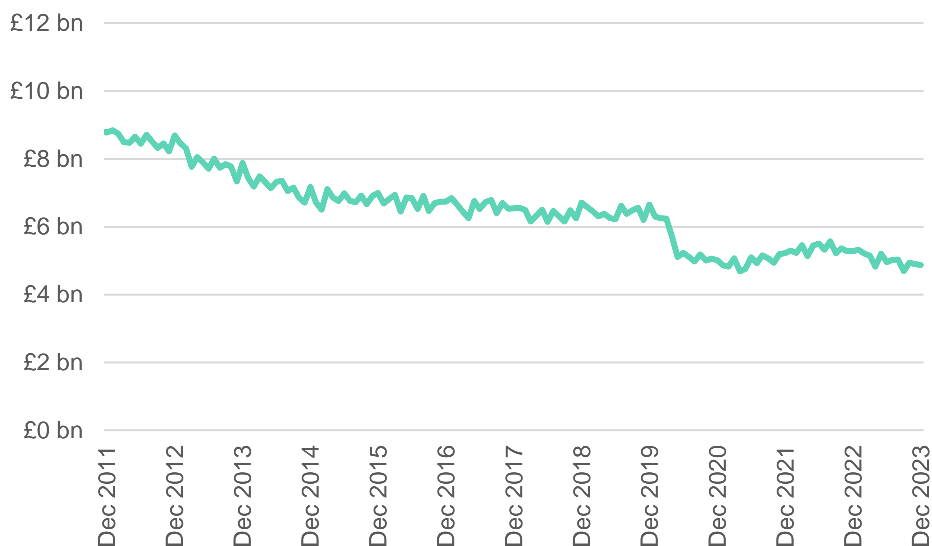
Continuing affordability pressures and competitive retention pricing by lenders meant that the fourth quarter of 2023 saw more customers than ever electing to stay with their existing mortgage provider when they chose a new deal. Even with the significantly higher rates available compared with when their previous loans were arranged, industry stress tests are ensuring that customers can now afford these higher rates.

Meanwhile, household continue to dip into their savings as they negotiate the challenges from both higher interest rates and general price levels, with aggregate deposits ending the year lower than a year ago for the first time on record.

Overdraft levels still trending gently down

It is perhaps surprising that, after a year of households drawing down their savings, we have not seen any build-up of overdraft debt. In fact, outstanding overdraft debt continued the gradual downward trend seen since the middle of 2022 (***Chart 10***).

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



Source: UK Finance

As we observed earlier, there are still substantial surplus savings held by the household sector, but not all households have these buffers. In fact, the ones who do not are likely to be on lower incomes and, therefore, more likely to be struggling to cope with higher costs.

Logically, if those with savings are now drawing them down to cover higher costs, those without - who are also more likely to now be facing household budget shortfalls - will have been the ones facing those tough choices in what they spend and how.

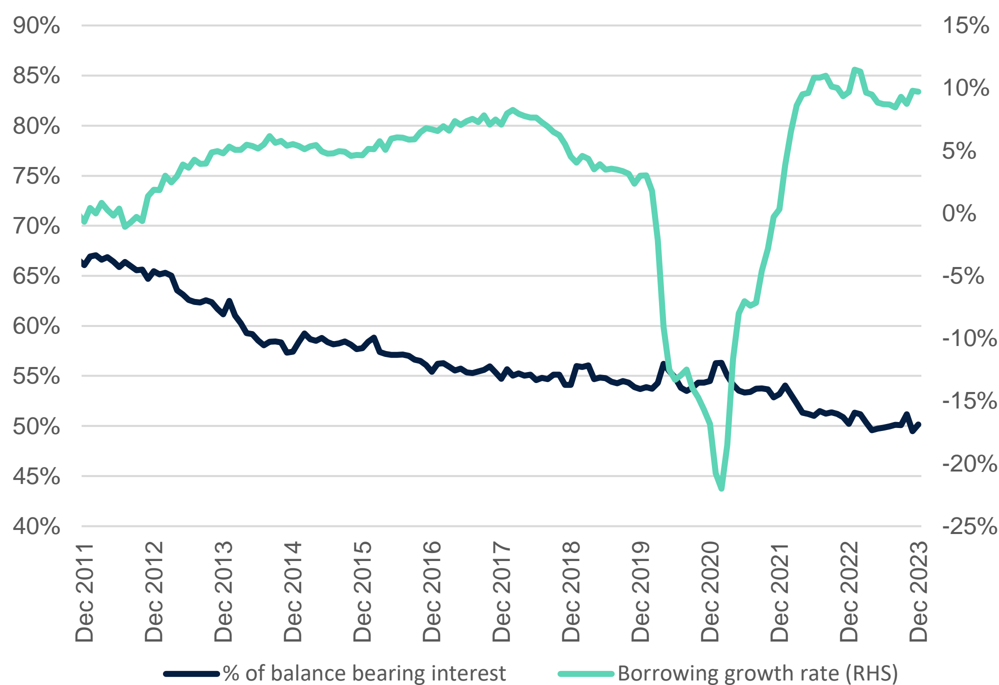
As we set out previously, consumer spending has been weaker through 2023, so it is quite likely then that cutbacks in spending were disproportionately seen amongst those (largely lower income) households with little no savings to make up the deficit.

However, where households have been looking to maintain spending over and above their income – whether this is discretionary spend or simply food and energy bills (which have seen particularly sharp price increases) - it has not been through use of overdrafts, nor from personal loans.

Credit card debt on a stable path

In Q4 credit card debt continued to show the strong year-on-year growth seen since the pandemic-related spending restrictions ended in 2021, and in December was around ten per cent higher than at the end of 2022 (***Chart 11***)

Chart 11: credit card balances outstanding



Source: UK Finance

However, total card debt is still around seven per cent below its peak (following widespread paying down of card debt through the pandemic), whilst gross lending on cards is broadly back to trend levels. So the strong percentage growth figures reflect "normal" gross lending compared against a lower total level of debt, rather than any increased reliance on unsecured credit in the face of higher costs.

Additionally, the proportion of overall debt that is interest bearing has stabilised since the first quarter of 2023. Half of all credit card balances are currently interest-bearing, which is the lowest proportion since at least 1995, as far back as these data are available.

Whilst other factors can affect whether interest is charged on a card balance, it most commonly reflects the balance not having been fully paid off at the end of the month. With interest-bearing card debt at this record low and new borrowing broadly at trend levels, there is still no sign that households are relying more on credit cards to cover shortfalls.

Overall, there are no signs in our data that cost pressures are driving any increase in unsecured borrowing, nor of payment stress in this sector. However, we will continue to closely observe developments, as in previous downturns unsecured debt problems have been a precursor to more widespread financial stress for households, including in the mortgage sector

It is possible that, in the face of continuing elevated costs, household spending has been supported by greater use of Buy Now, Pay Later products, however we do not have sight of data for this sector.

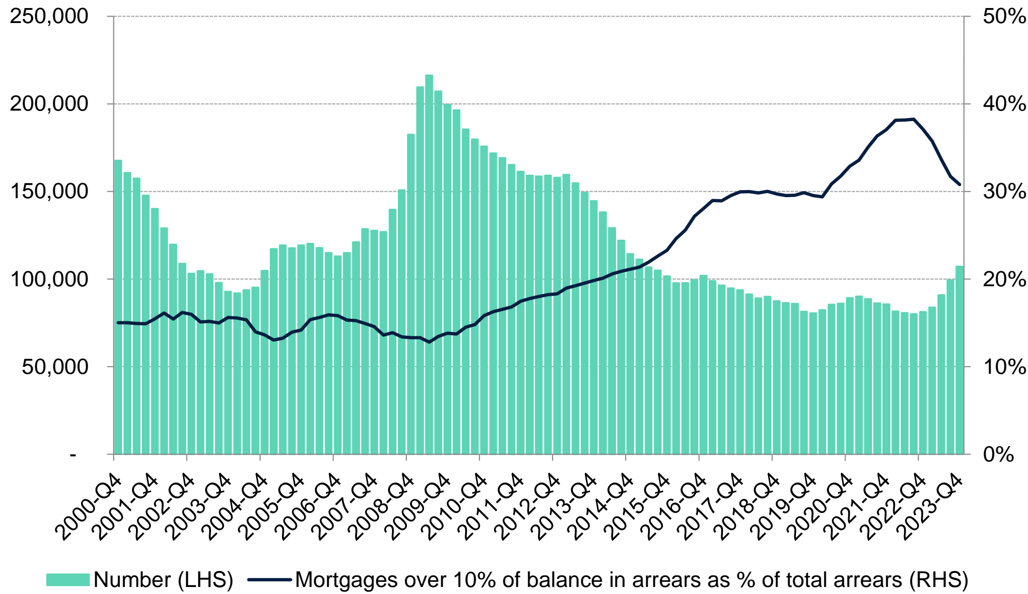
But mortgage arrears continued to trend upwards

Although we have yet to see signs of financial stress manifesting in the unsecured borrowing space, the situation is different in the mortgage market.

For households with a mortgage, this is typically their largest credit commitment, if not the largest element of their overall monthly spending. With interest rates rising as the Bank moved to combat inflation, borrowers have come under increasing strain that the sector has not experienced through the previous twelve years or so of ultra-low Bank Rate.

As a result, we have seen mortgage arrears – which had fallen to record low levels - start to build. From the end of 2022 the number of customers in arrears has risen, at an increasing rate, through last year. This continued in the last quarter of 2023, and in December there were some 107,250 mortgages with arrears representing 2.5% or more of the outstanding balance (***Chart 12***).

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

Arrears levels are currently still very low by historical comparisons, but the number in Q4 nevertheless represents an eight per cent increase on that seen in the third quarter, and a 32 per cent increase compared with the figure in December 2022, when arrears first started to rise.

A key factor mitigating the pressure on mortgage customers is the affordability stress tests that have been in place since 2014. These have worked well to ensure that, even as rates have risen sharply, most customers on variable rates, as well as those coming off fixed rates and looking to refinance, have been able to cope with the increase in their payments.

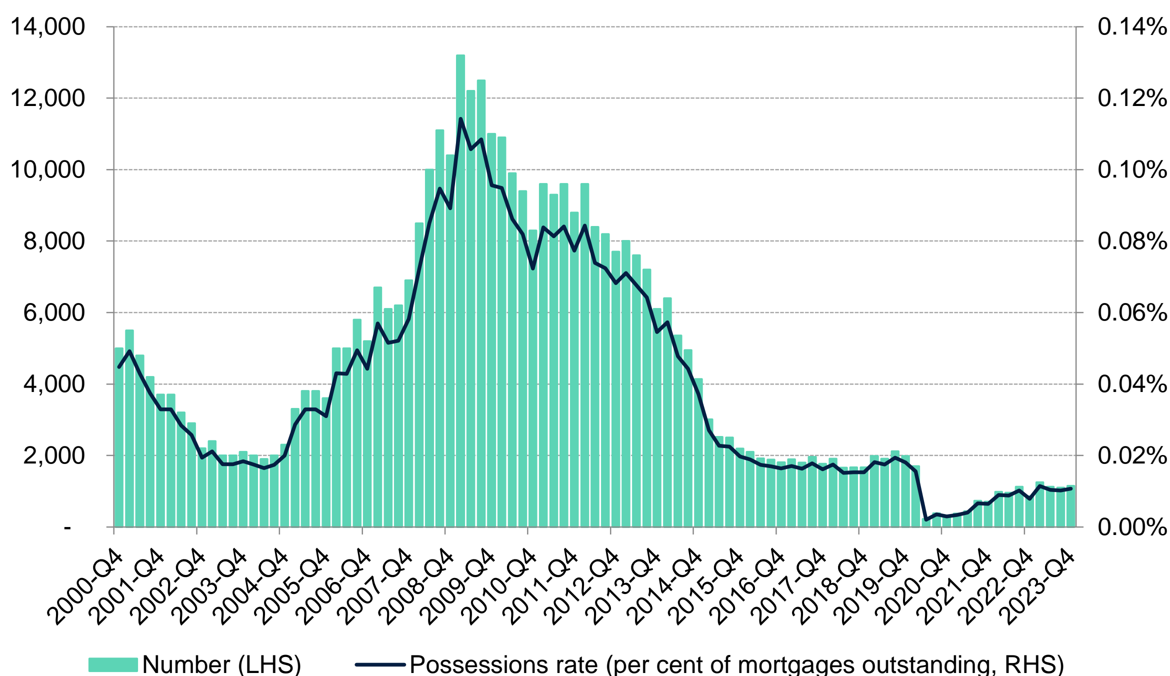
Looking ahead, early arrears (those just below the 2.5 per cent threshold for our headline measure) were more stable in Q4 than in previous quarters, suggesting this will feed through into a smaller increase in headline arrears in Q1. Notwithstanding this, we expect arrears to continue to increase through 2024. However, with existing cost and rate pressures persisting but, currently, no additional stressors anticipated, we do not expect the rate of increase to continue to build as it did in 2023.

For those borrowers who are experiencing difficulty, lenders' extensive tailored forbearance programmes are helping them negotiate this period of increased costs in the best way to suit each customer. But lenders cannot provide this help until the conversation with the customer begins. So, it remains absolutely critical that customers worried about their finances speak to their lender at the earliest opportunity. That initial conversation does not impact a customer's credit file, and lenders can then work with the customer to develop the best solution, tailored to the borrowers' specific circumstances.

Possessions flat in Q4, and remain well below pre-pandemic norms

In contrast to the material increase in mortgage arrears, we have not seen any corresponding increase in possession activity. Q4 saw 1,150 mortgage possessions, and this number has barely changed through the whole of 2023 (***Chart 13***).

Chart 13: Mortgage possessions in period



Source: UK Finance

The 4,620 possessions taken through last year was, excluding the suppressed activity during the pandemic, the lowest number since 1980, when the market was half the size it is now. It was, however, an 18 per cent increase compared with the 2022 figure, but it is important to put this increase in context.

2022 saw artificially suppressed possession numbers, following the moratorium and issues relating to constrained court capacity. So the increase in those numbers last year does not signal a change in market conditions. Rather, it is a timing issue as possessions which, under normal conditions, would and should have taken place in previous years, eventually went through that process.

Another important point to note is that the possessions last year do not relate to mortgage arrears that arose last year. In fact, given the substantial backlog, the cases that have been through the process over the last few years relate to mortgage arrears built up some years previously.

Under normal circumstances possession, whilst only ever a last resort after all other options to repay have been exhausted, should then take place as quickly as possible in the best interests of the customer. This is done to maximise the amount of equity that can be realised for the customer, upon sale of the property and settlement of the mortgage debt

Now that the historic backlog is largely cleared, we expect a return to more normal timelines from the emergence of arrears through to possession. This can be affected by several factors but tends to be around 18 months to two years, and so the possessions this year will still largely relate to cases which pre-date the cost-of living crisis.

In this cycle, with unemployment set to remain low and extensive lender forbearance helping the vast majority of customers in arrears to recover their position, we expect possessions to remain very low by historic comparisons. For the small minority who are unable to do so, this will not feed through into possession numbers until next year.

Household debt: Summary

Through the cost-of-living crisis, there has been little, if any, sign that households are running up higher levels of unsecured debt. However, mortgage customers continue to feel the strain of higher interest rates and wider cost pressures, and arrears in this sector continue to build. We expect pressure on mortgage payments to continue through this year. But, with a benign employment picture and extensive, tailored forbearance, the industry will be able to help vast majority of struggling customers to get back on track, keeping possessions to an absolute minimum.

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