

Over-indebtedness Monitoring Paper Q1 2005

Introduction

As part of the strategy outlined in 'Tackling Over-indebtedness: Action Plan 2004'¹, the DTI is committed to monitoring levels of over-indebtedness in the UK. This paper aims to provide a high level balanced summary of information on, factors that may lead to changes in, or provide evidence on the level of over-indebtedness. Information is drawn primarily from publicly available sources, although where appropriate we also refer to specific research. The paper will be updated quarterly to reflect the most recent information.

Summary

Whilst the level of consumer indebtedness continues to rise, there is little evidence that consumers are facing additional difficulties. Surveys in the latter part of 2004 by funded by the Bank of England and the DTI show that the number of borrowers who declared their debt a 'heavy burden' has remained relatively constant over the past decade. Low interest rates and a healthy labour market reduce the likelihood that those already in debt will experience difficulty. However, the situation is not entirely benign. The levels of personal insolvency continue to rise across the UK but as yet no single factor can conclusively be proven to be driving this trend.

This Report presents the evidence in three sections:

- 1. Macroeconomic Environment**
- 2. Objective Measures of Over-indebtedness**
- 3. Subjective Measures of Over-indebtedness**

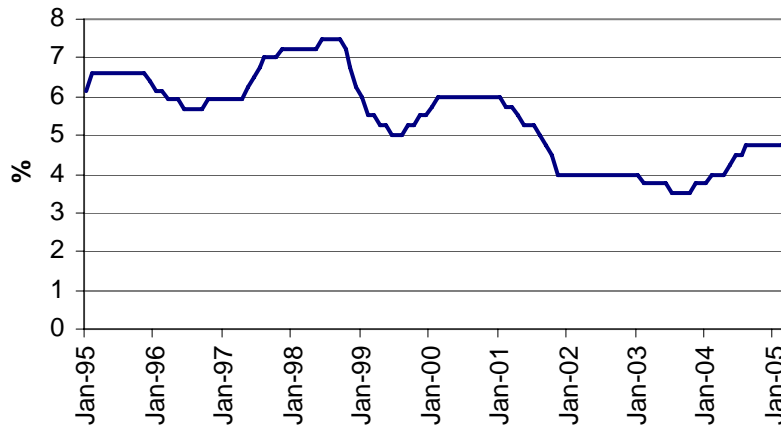
¹ Available at <http://www.dti.gov.uk/ccp/topics1/pdf1/overdebt0704.pdf>

1. Macroeconomic Environment

1.1 Interest Rates

The Bank of England has maintained the base rate at 4.75% since August 2004. Prior to this rates had risen by 1.25% since autumn 2003. Whilst the cost of borrowing is relatively low by historic levels there are indications that the rate increases throughout the first half of 2004 are beginning to affect consumers.

Figure 1: Base Rate

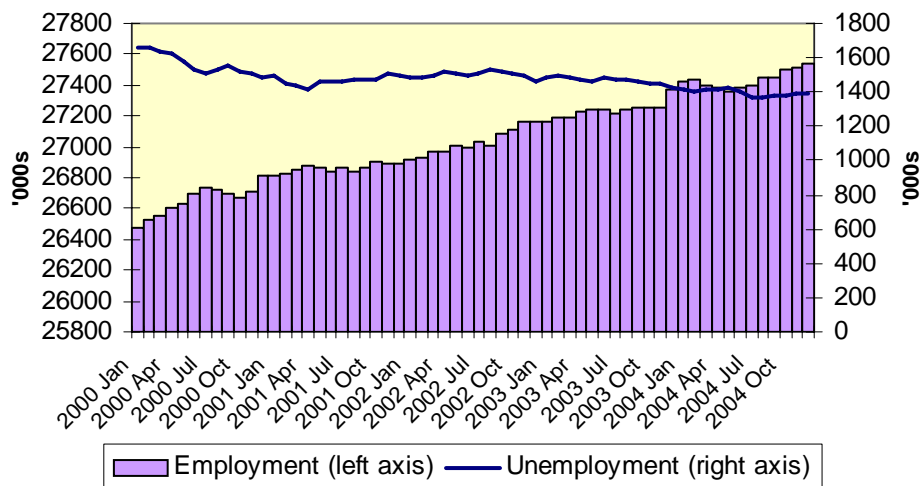


Source: Bank of England: Monetary & Financial Statistics Interactive Database

1.2 Labour Market

The latest figures from the ONS show the continued strength in the UK labour market. Measures of unemployment were fairly static over the last two quarters of 2004 but still remain at a 20-year low. Levels of employment recovered markedly during the latter half of 2004 the following their dip in over the first two quarters. The employment rate for people of working age was 75.0 per cent for the three months ending in February 2005, rising from 74.8 per cent the previous quarter. The average number of job vacancies for the three months to March 2005 was 631,800. This was down 16,200 on the previous quarter but up 15,400 over the year. The risk to consumer over-indebtedness from forces in the labour market therefore remains low.

Figure 2: Employment and Unemployment ('000s)



Source: ONS Labour Market trends

Figure 3: Employment and Unemployment Rates

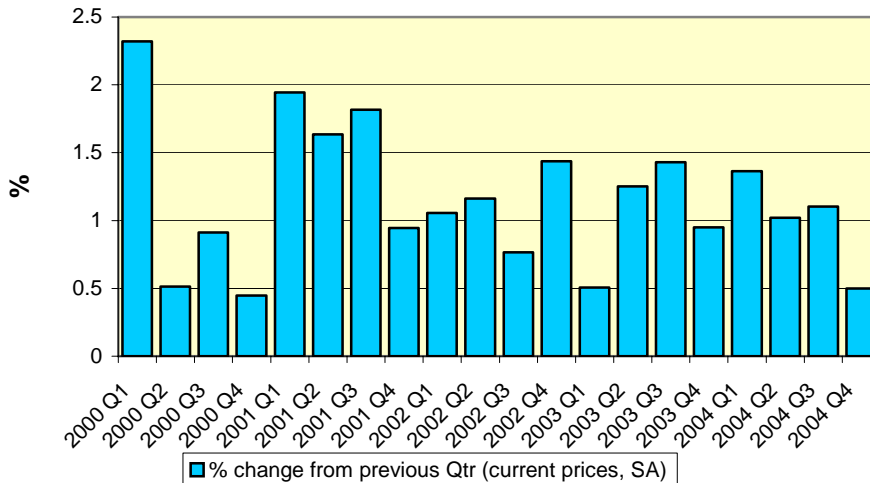


Source ONS: Labour Market trends

1.3 Consumer spending

Growth in Household Final Consumer Expenditure dipped markedly in Q2 2004 in line with low retail sales growth. Consumers may also be feeling the first effects of the increase in interest rates over the first half of 2004. There is evidence to suggest that weak consumption growth has continued in Q1 2005.

Figure 4: Growth in Household Final Consumer Expenditure



Source ONS: Consumer trends: Quarterly change in ABJO

1.4 Consumer lending

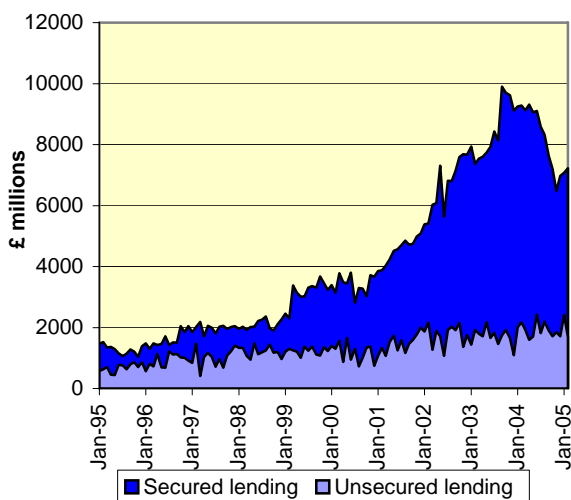
Whilst absolute levels continue to grow, relative levels of lending has fallen. Bank of England figures show a relative decline in secured lending over Q4 2004 whilst that of unsecured lending has remained relatively static.

Growth in total net lending to individuals was weaker in February than in January and also weaker than the previous six-month average. Growth in secured lending was stronger than the increase in January but slightly weaker than the previous six-month average. The value of all loans approved was slightly higher than in January, as was the

number of loans approved for house purchase. But the number of loans approved for remortgaging and for other purposes fell.

Growth in consumer credit slowed from January's strong outturn. Underlying this, both net credit card lending and net other loans were weaker than their respective strong January outturns and their previous six-month average outturns.

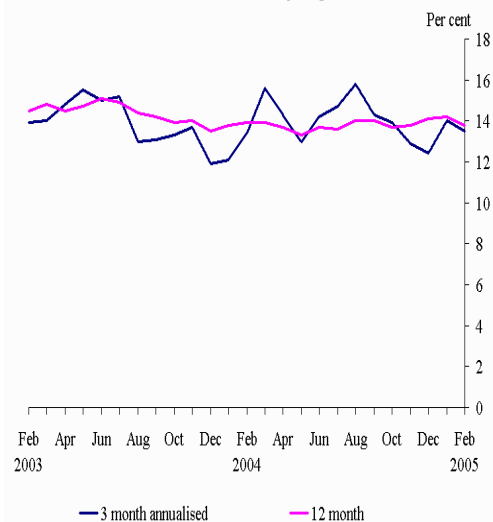
Figure 5: Monthly changes to net lending £ millions



Source: Bank of England: LPMRLMH and LPMVTVJ

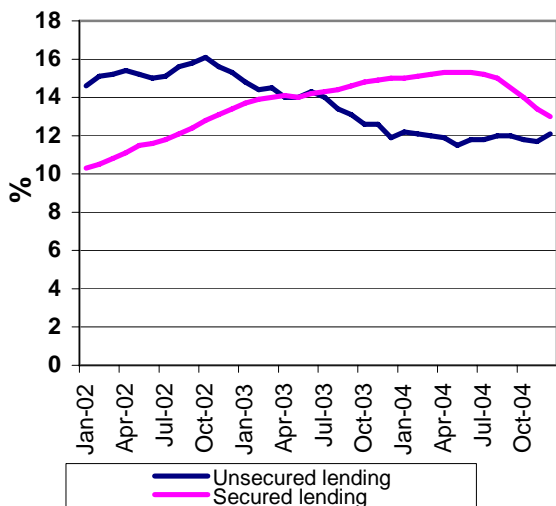
Figure 6: Growth in unsecured lending

Chart 2: Growth rates of seasonally adjusted consumer credit



Source: Bank of England: Monetary & Financial Statistics Interactive Database

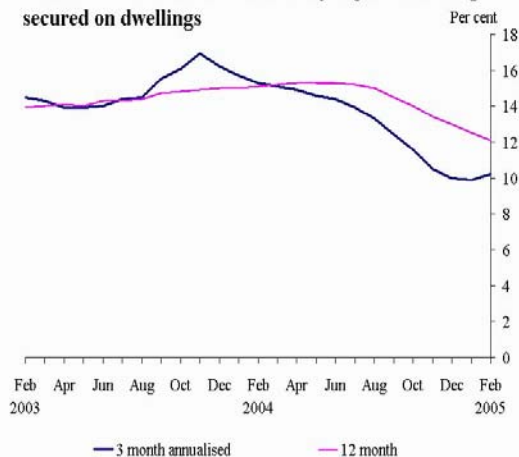
Figure 7: 12 month growth rate of Net Lending



Source: Bank of England: LPMVTYO and LPMVTYJ

Figure 8: Growth in lending secured on dwelling

Chart 1: Growth rates of seasonally adjusted lending secured on dwellings



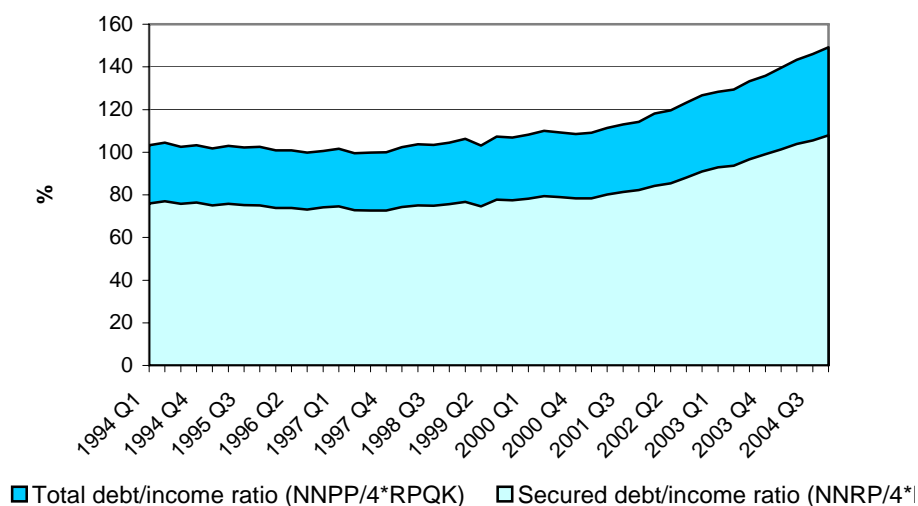
Source: Bank of England: Monetary & Financial Statistics Interactive Database

2. Objective measures of debt

2.1 Debt/Income Ratios

The growth rate of borrowing continues to outstrip that of earnings, pushing up the total debt to income ratio to just under 150% of annual income, a series high. Average earnings growth has remained relatively static at around 4.5% so we can expect debt-income ratios to continue to rise in the short term.

Figure 9: Total Household Sector Debt / Income Ratios

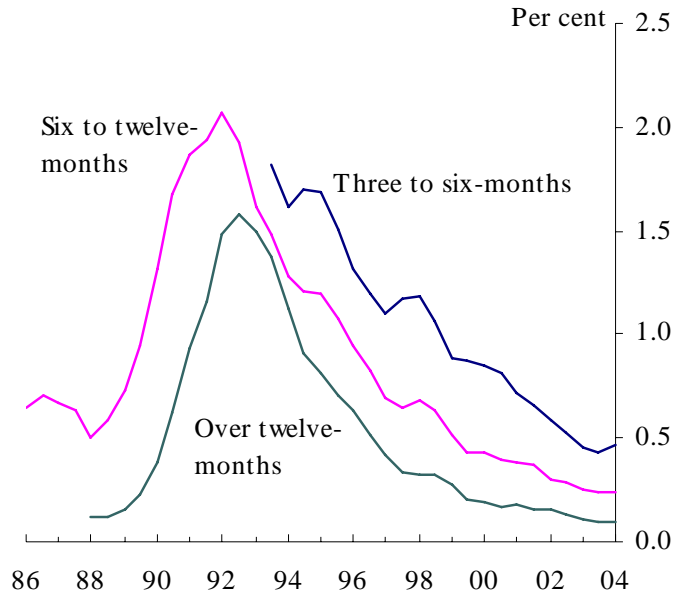


Source: ONS

2.2 Mortgage Arrears

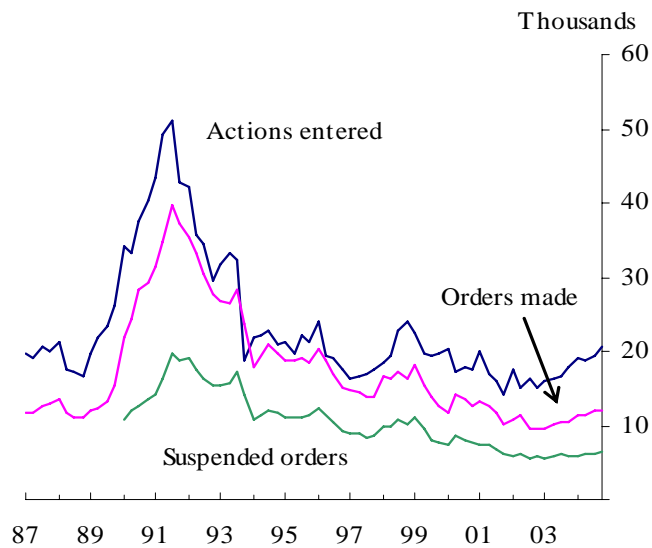
Mortgage arrears of one to three months rose in the second half of 2004 for the first time in 6 years. However, this rise may be related to the introduction of the new FSA mortgage regulation regime rather than indicative of genuine repayment problems. Mortgage arrears figures are still historically low and longer-term mortgage arrears measures have remained static. Mortgage possession actions continued to rise over the past quarter whilst the number of properties taken into possession fell over the same period. Both series are still relatively low by historic standards.

Figure 10: Mortgage arrears^(a)



(a) Percentage of outstanding stock of mortgages.
Source: Council of Mortgage Lenders.

Figure 11: Mortgage possession orders^(a)



Source: Department of Constitutional affairs
 (a) Orders made by local authorities and private lenders.
 (b) Orders made include suspended orders.
 Source: Department for Constitutional Affairs.

2.3 Those over-indebted accessing professional services as a result of over-Indebtedness

2.3.1 Personal Insolvency

The 13,013 individual insolvencies in England and Wales during the fourth quarter of 2004 took the total number of personal insolvencies to 46,650 for 2004. This represents 25% more than the previous peak of 36,800 in 1992. Both bankruptcies and Individual Voluntary Arrangements (IVA's) rose on a seasonally adjusted basis over the last quarter. Bankruptcies rose to 9,803, an increase of 6.3% on the previous quarter and 28.9% on

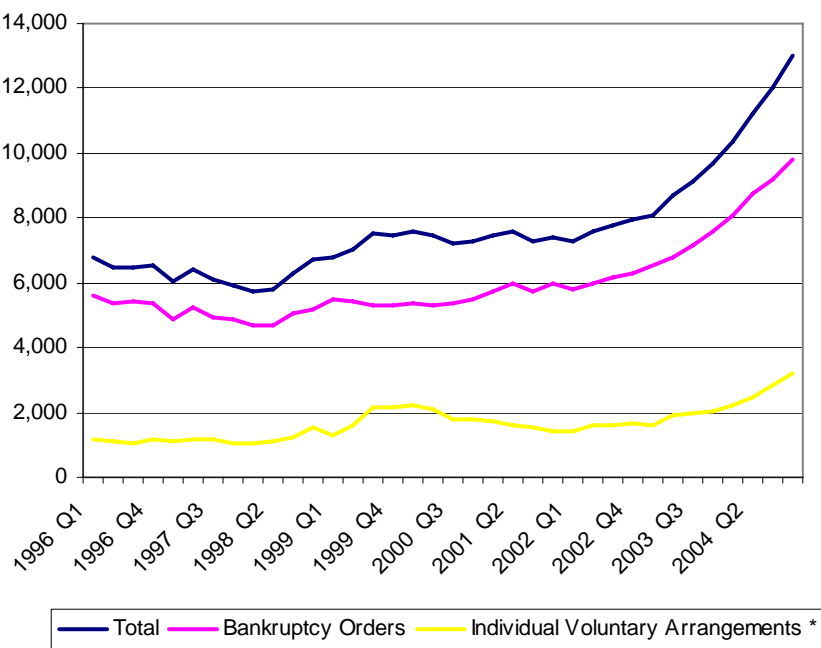
the corresponding quarter of last year whilst IVA's grew by 11.8% on the previous quarter and an increase of 55.7% on the corresponding quarter of the previous year.

There are a number of factors which may be contributing toward to the increasing trend in personal insolvencies, but the evidence is not conclusive in supporting a single driver. Contributing factors could be the increased levels of consumer borrowing or a reduction in the social stigma attached to bankruptcy.

The Enterprise Act 2002 made significant changes to bankruptcy law, including the fact that from 1 April 2004, the honest majority of bankrupts would be discharged from bankruptcy after a maximum of 1 year (prior to the Enterprise Act this was generally three years). However, it is too early to say what impact, if any, the changes to the law have had on bankruptcy numbers. The Insolvency Service is evaluation of the change in legislation includes: economic modelling of business start-up rates; details of lending policies from a panel of mainstream financial institutions set up by the British Bankers Association; surveys of stakeholders to ascertain satisfaction levels with the various provisions of the Enterprise Act 2002; and academic research regarding corporate provisions.

Bankruptcy levels can and do fluctuate. Research generally attributes changes in bankruptcy numbers to economic factors, principally the availability and levels of credit but also asset/debt ratios, interest rates and employment levels rather than change to the insolvency law.

Figure 12: Individual Insolvencies in England & Wales ('000s)

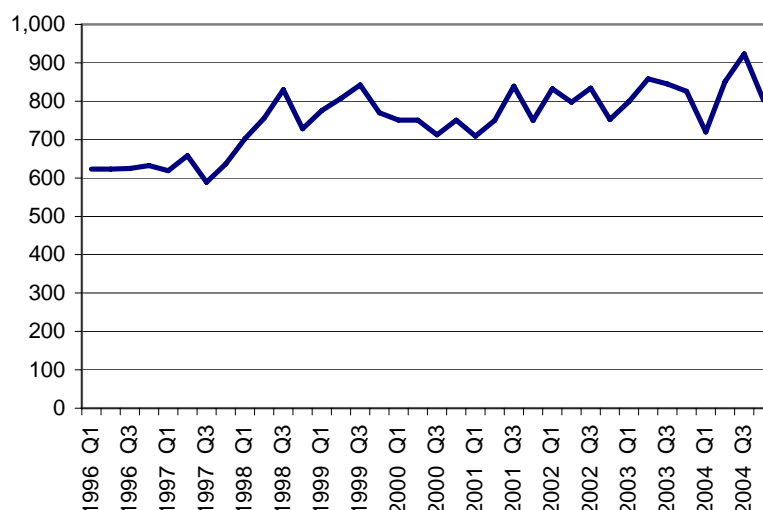


Source: Insolvency service, DTI

*Includes deeds of arrangement

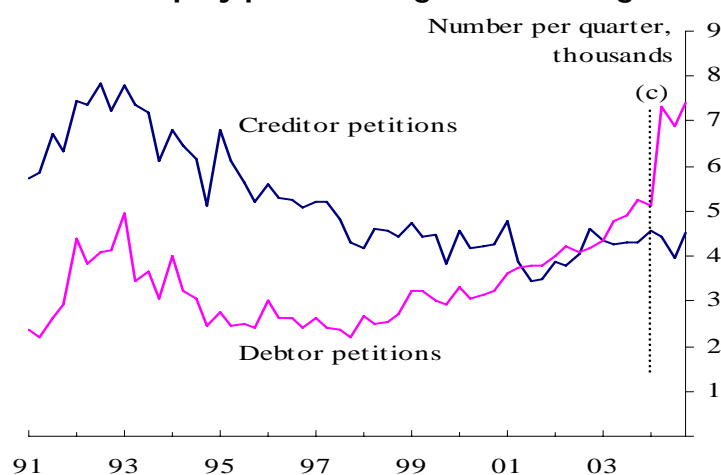
Q3 2004 data provisional

Figure 13: Sequestrations in Scotland



Source: Insolvency service, DTI

Figure 14: Bankruptcy petitions registered in England & Wales



Source: Department for Constitutional Affairs.

(c) Introduction of new bankruptcy regime under Enterprise Act 2002.

2.3.2 Debt Advice

Figures from debt advice lines are often quoted to illustrate changes in the level of consumer over-indebtedness. However, these figures should be treated with considerable caution for a number of reasons:

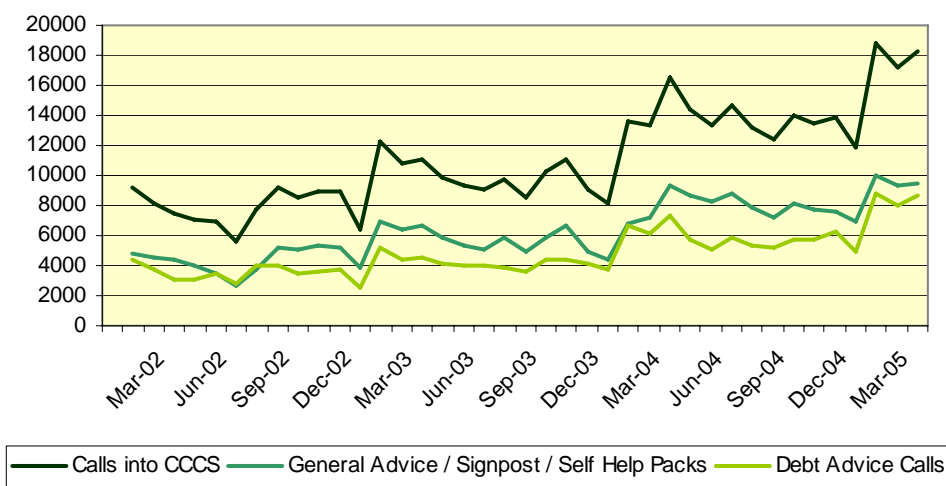
- **Over-indebtedness versus Awareness.** Most fundamentally, the difficulty lies in interpreting whether a change in the figures relates to a change in the level of over-indebtedness or a change in consumers' awareness of the availability or value of debt advice.
- **Demand for debt advice is split over many agencies.** The debt advice sector is serviced by a vast number of agencies and operators, so it is possible for a trend from one agency to be contradicted by another.
- **The most useful unit of measurement varies from agency to agency.** Some agencies may only be able to service a fraction of calls they receive, so callers may have to call back many times before their call is answered – in this

case looking at total calls received would be misleading. Other agencies deal with their callers over several phone calls - in this case we would be interested in the number of clients rather than the number of calls. These differences make it difficult to collate data for the debt advice sector as a whole.

- **Changes in resources impact on the numbers.** The ability of the debt advice agencies to service demand depends on its resources, which change over time. An increase in the amount of calls may therefore be due to an investment in advisers rather than an increase in the level of indebtedness.

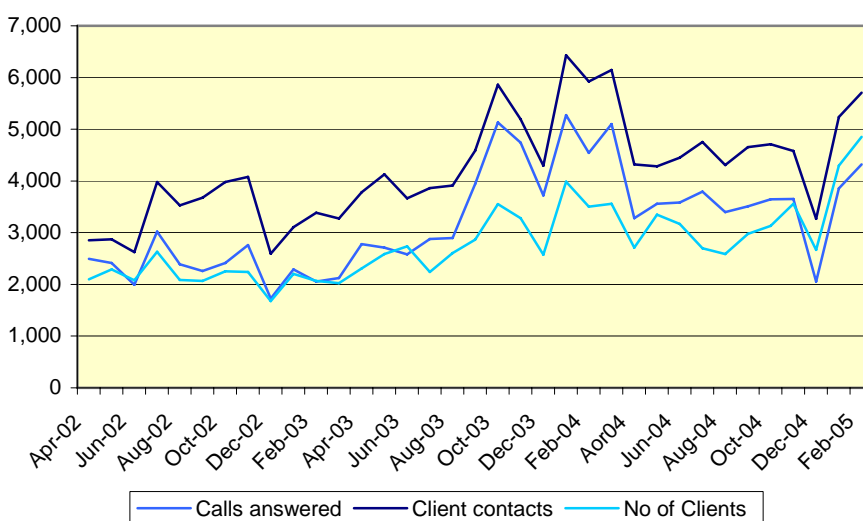
The most recent figures from Consumer Credit Counselling Service (CCCS) and the National Debtline illustrate some of these problems. The figures from CCCS show debt advice calls at a series high, whilst the figures from the National Debtline are lower than those experienced at the same time last year.

Figure 15: Calls/General Advice/Debt Advice calls to the CCCS



Source: CCCS

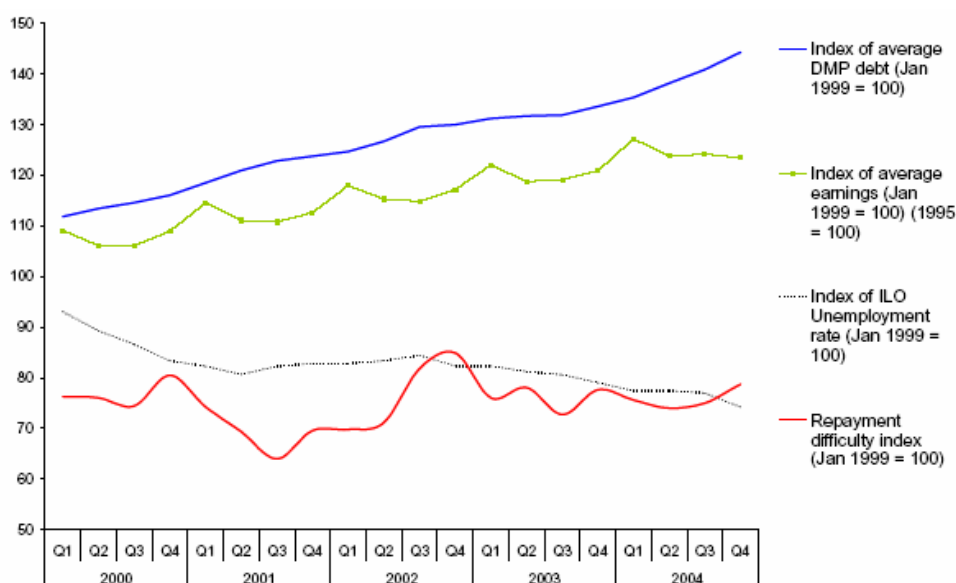
Figure 16: Calls/Clients/Client contacts to the National Debtline



Source: National Debtline

The Consumer Credit Counselling Service's repayment difficulty index increased slightly over the latter half of 2004, indicating that consumers are finding it more difficult to make repayments.

Figure 17: CCCS repayment difficulty index



3. Subjective measures of debt

To monitor the current situation on consumer over-indebtedness in more detail, the DTI commissioned MORI Financial Services to undertake a survey over the last five months of 2004. The survey allowed several measures of consumer over-indebtedness and showed that the number of individuals taking on a high level of debt service has increased over the past two years, reflecting the strong growth in consumer borrowing. However, the evidence also suggests that this increasing debt service is not causing significant problems at present.

Table 1: Results from DTI Report on the MFS 2004 survey

Over-indebtedness Indicator	% of total sample
Individuals with monthly repayments on unsecured borrowing > 25% of gross income	8%
Individuals with monthly repayments on secured and unsecured borrowing > 50% of gross income	9%
Individuals finding their household's debt repayments a 'heavy burden'	4%
Individuals currently in arrears on at least one credit commitment/ domestic bill for more than 3 months	4%

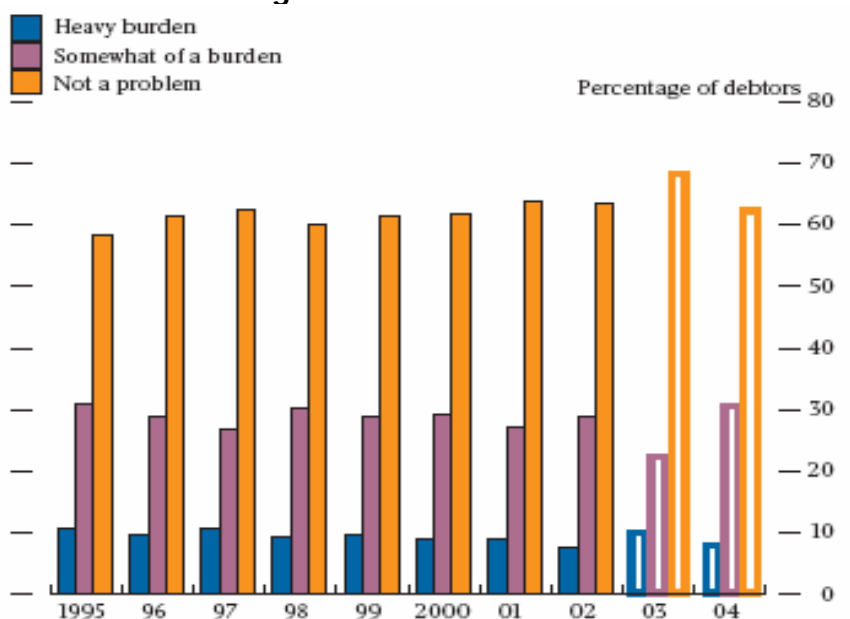
The survey also indicated that unsecured borrowing repayments are causing more problems than secured borrowing repayments. The relative performance of individuals was worse on the unsecured debt service-income indicator than on total debt service-income indicator. Half of those spending over 50% of their income servicing total

borrowing repayments were also spending over a quarter of their income servicing their unsecured borrowing alone.

The survey identified several characteristics that are disproportionately associated with over-indebtedness. Amongst those who are over-represented on the over-indebtedness indicators are those who; earn less than £9,500 a year; are in their 20's or 30's; are single parents; are renting accommodation or have savings less than £1,000.

The conclusions from the MFS survey support the most recent figures from the Bank of England. The Bank sponsored survey carried out by NMG Research showed that the number of borrowers who declared their debt a 'heavy burden' has remained relatively constant over the past decade.

Figure 18: Burden of Debt



Note: Figures up to 2002 are calculated using the BHPS, 2003 and 2004 figures are from the NMG Research surveys.

Sources: BHPS, NMG Research and Bank calculations.

Note: Figures are given as a percentage of borrowers