

Over-indebtedness Monitoring Paper Q1 2006

Introduction

As part of the strategy outlined in 'Tackling Over-indebtedness: Action Plan 2004'¹, the DTI committed to monitoring over-indebtedness in the UK. This paper aims to provide a high level balanced summary of the evidence on the level of over-indebtedness. Information is drawn primarily from publicly available sources, although where appropriate we also refer to specific research. This paper covers information on the situation up to March 2006. The paper will be updated on a 6 monthly basis in future to reflect the most recent information.

Summary

Whilst growth in consumer lending is lower than in 2004, growth rates of borrowing remain high in Q1 2006 due mainly to increases in secured lending, which have offset significant reductions in the growth of unsecured lending. Whilst most consumers are able to keep up with all of their borrowing commitments there is a relatively small but growing number of consumers who are increasingly showing signs of financial distress². Mortgage arrears and mortgage possession orders continue to rise, albeit from low bases, and personal insolvencies across the UK continue their increasing trend. Having said this, fewer people on repayment plans reported difficulties with their repayments over the course of 2005, compared to 2004. Low interest rates and a healthy labour market continue to lower the risk that those already in debt will experience difficulty in the short term, although the labour market position has weakened slightly.

Longer-term vulnerabilities such as the high debt-to-income ratio for the household sector continue to cause concern. These factors may leave UK consumers vulnerable to future macroeconomic shocks, although there is currently no reason to believe that such events will occur.

Notable changes since Q4 2005:

- The UK labour market weakened slightly again in Q1 2006. Unemployment now stands 0.5 percentage points higher than the same period a year earlier.
- Growth in secured lending continued the long term downward trend witnessed since 2004 in Q1 2006, curtailing a slight increase over 2005. Growth now stands at just below 11%.
- The growth rate of unsecured lending continues on its downward trend, and now stands at approximately 5% on a three month annualised basis.
- Personal insolvencies in England and Wales for Q1 2006 increased 12.9% on the previous quarter and 73.4% on the same period a year ago.
- Total debt write-offs to individuals in Q1 2006 increased by 83% compared to the same period a year ago and 23% compared to the previous quarter³.

This Report splits the evidence into four 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>

² This is consistent with the FSA Financial Risk Outlook 2006

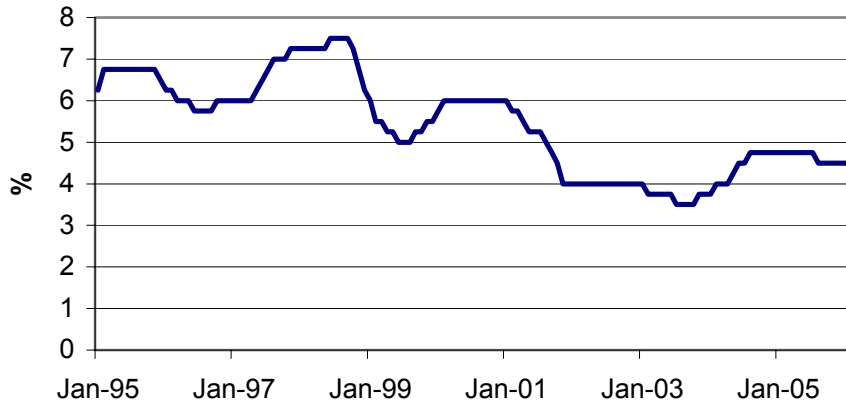
³ The data series are variable because some lenders wait for their write-offs to consolidate before declaring them.

1. Macroeconomic Environment

1.1 Interest Rates

During the third quarter of 2005 the Bank of England reduced the base rate by 0.25% to its current level of 4.5%. This is the first change to the base rate since August 2004. The cost of borrowing has remained unchanged since then and continues to stay relatively low by historic levels.

Figure 1: Base Rate⁴



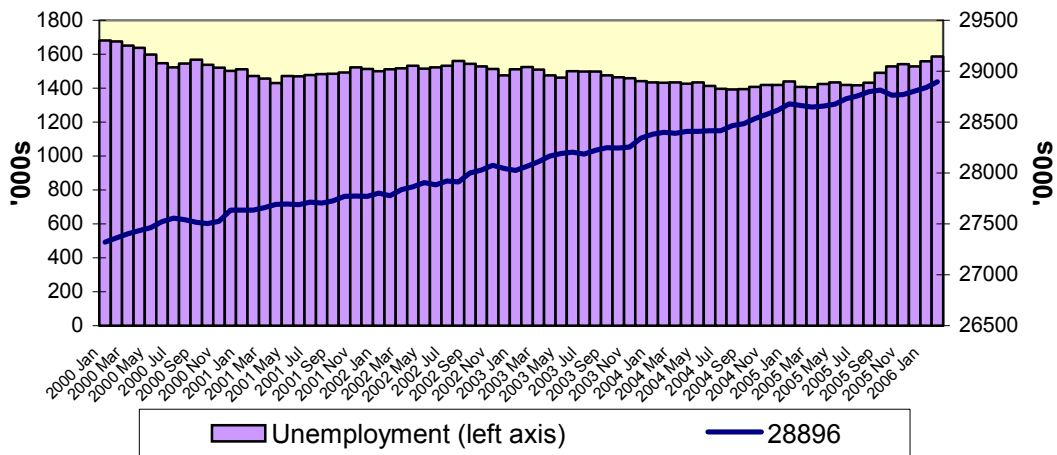
Source: Bank of England: Monetary & Financial Statistics Interactive Database

1.2 Labour Market

The risk to consumer over-indebtedness from forces in the labour market remains low. Measures of unemployment have remained reasonably static throughout 2005 and are at their lowest points for 20 years.

However, data shows that the unemployment rate rose to 5.2% in February, and now stands 0.5 percentage points higher than the same period a year earlier. This represents a slight weakening of the UK labour market in Q1 2006.

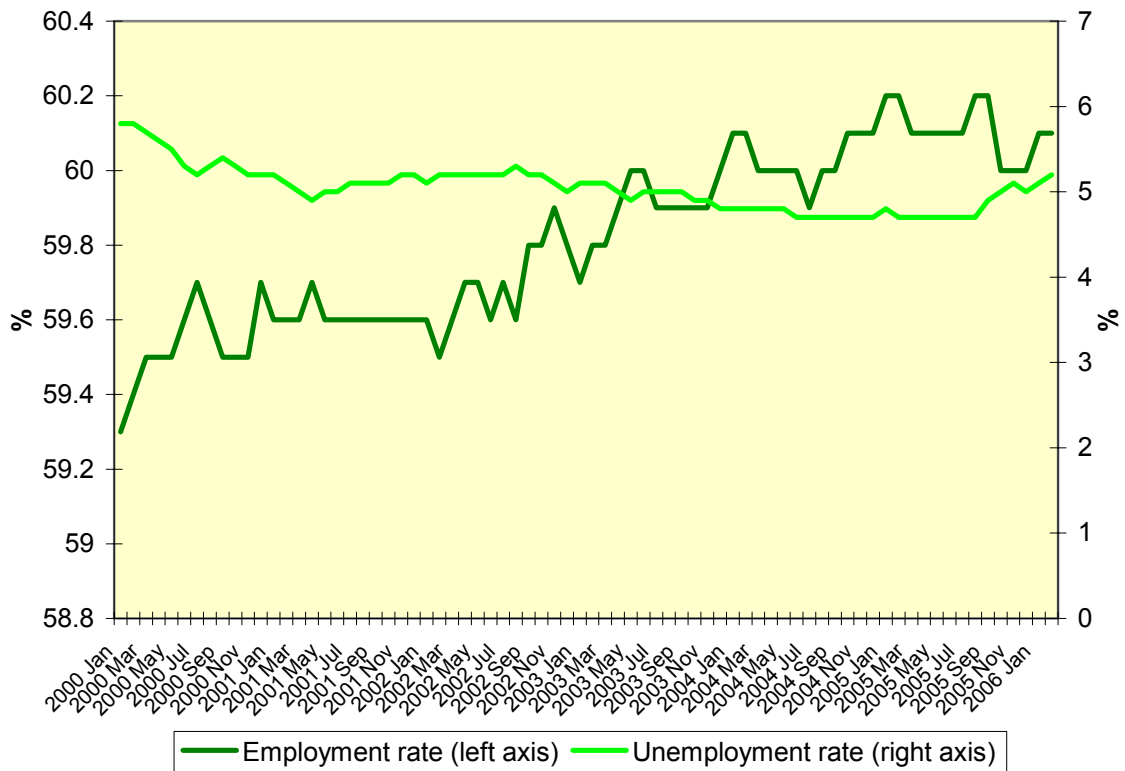
Figure 2: Employment and Unemployment ('000s)



Source: MGRZ and MGSC, ONS Labour Market trends

⁴ IUMBEDR- End Month, Bank of England Repo Rate

Figure 3: Employment and Unemployment Rates

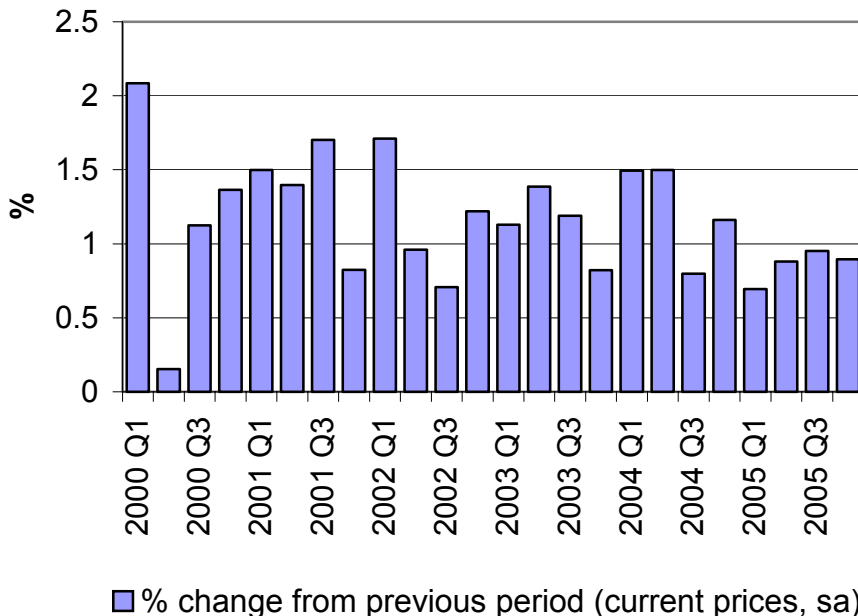


Source: MGSR and MGSX, ONS Labour Market trends

1.3 Consumer spending

Data on consumption growth for the fourth quarter of 2005 show a slight decrease in the rate of growth to 0.89%, although this is still higher than the four year low of 0.7% in Q1 2005. Growth in household consumer expenditure continues to be lower than average over the last five years. Data is not yet available for Q1 2006.

Figure 4: Growth in Household Final Consumer Expenditure



Source ONS: Consumer trends: Quarterly change in ABJQ

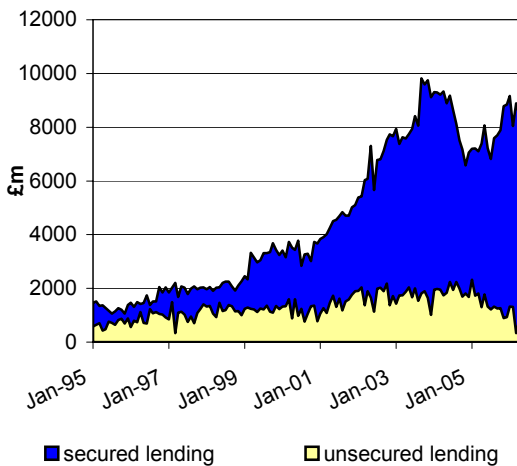
1.4 Consumer lending

Lending to consumers continues to grow in to 2006 and the rate of growth is higher than that of a year ago.

This increase is primarily due to increases in secured lending. The rate of growth in secured lending increased steadily in 2005 after a sharp drop off at the end of 2004, although 2006 figures indicate that growth may be slowing again. Growth in secured lending now stands at approximately 11% on a 3 month annualised basis.

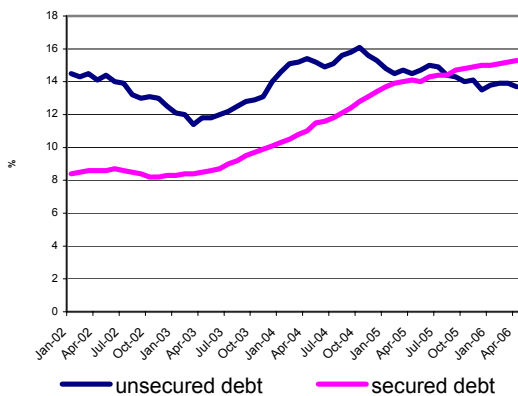
Conversely, the rate of growth of total consumer lending fell steadily in 2005 and continues to follow a downward trend in 2006. Growth in unsecured now stands at just over 5% on a 3 month annualised basis, compared to a high of around 14% in early 2004.

Figure 5: Monthly changes to net lending £ millions



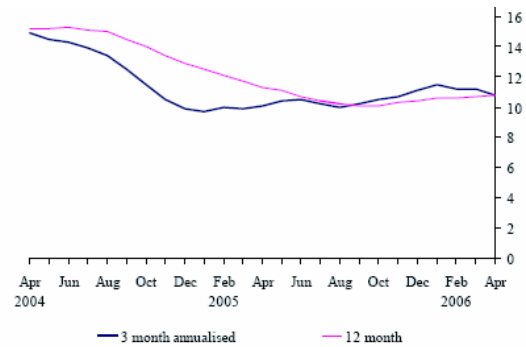
Source: Bank of England: LPMRLMH and LPMVTVJ

Figure 6: 12 month growth rate of net Lending



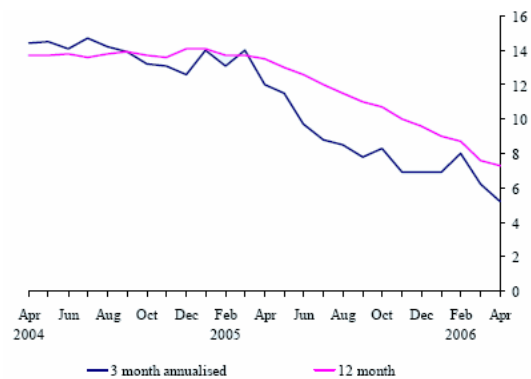
Source: Bank of England: LPMVTYO and LPMVTYI

Figure 7: Growth in secured lending



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

Figure 8: Growth in unsecured lending

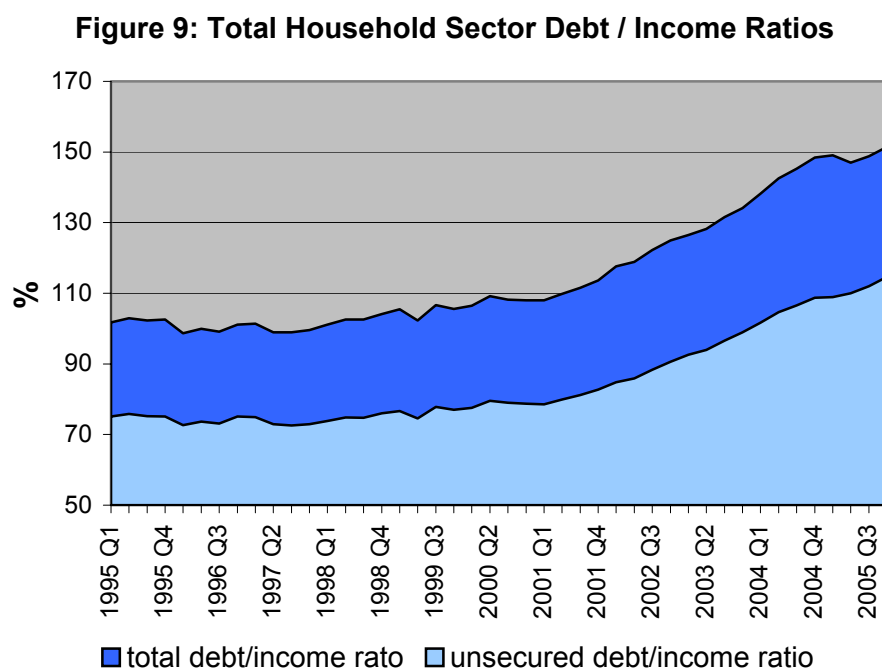


Source: Bank of England: Monetary & Financial Statistics Interactive Database

2. Objective measures of debt

2.1 Debt/Income Ratios

The growth rate of borrowing has continued its long run trend of outstripping growth in earnings in Q4 2005, pushing up the total debt to income ratio to over 150%⁵ of annual income. The debt/income ratio in Q4 2005 rose by 2.6% against Q3 2005 levels due to increases the rate of growth of secured borrowing. Data is currently unavailable for Q1 2006.



Source: ONS

2.2 Debt Write-offs

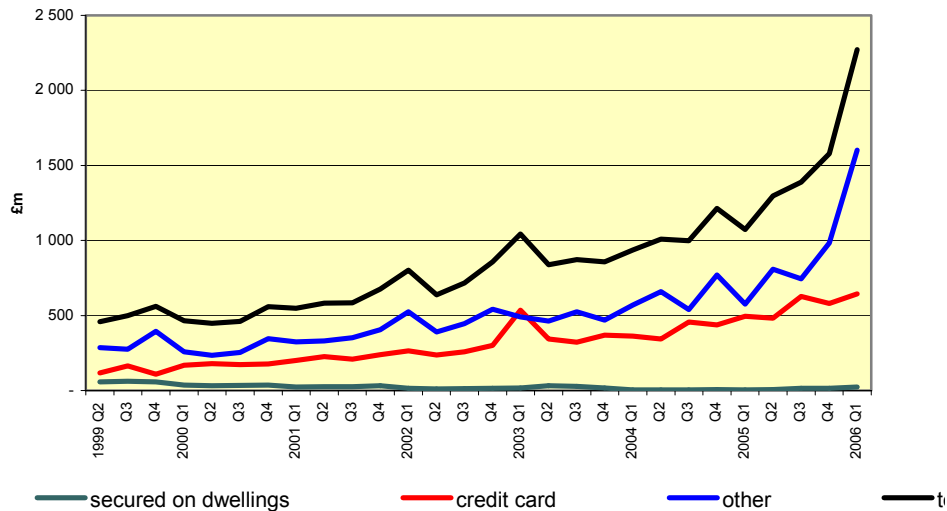
Figures for overall debt write offs for individuals, show a sharp increase over the past few years. Total write-offs to individuals in Q1 2006 increased by 83% compared to the same period a year ago and 23% compared to the previous quarter⁶. Unsecured lending to UK households accounts for the largest domestic contribution to UK bank write-offs in recent years and have seen by far the most significant increases in the last quarter.

Such an increase could be expected as a result of the recent rise in personal insolvencies, although Figure 11 shows that growth in household write-offs has not matched that of personal insolvencies in recent years.

⁵ Based on ONS provisional results

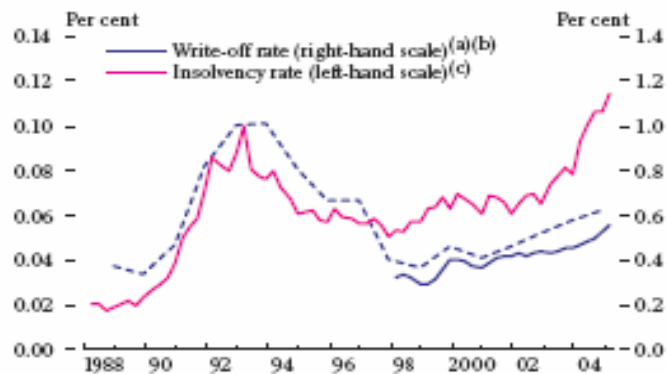
⁶ The data series are variable because some lenders wait for their write-offs to consolidate before declaring them.

Figure 10: Debt write-offs for individuals



Source: Bank of England. Monetary & Financial Statistics August 2005, Table C2.1

Figure 11: Household write-offs versus Insolvency rates



Sources: ONS, DTI and Bank of England.

- (a) Solid line shows annual write-off rate for UK-owned banks, dotted line the rate for all UK-resident banks (interpolated annual data).
- (b) Data are for individuals; unincorporated businesses excluded.
- (c) Data are for England and Wales, and are annualised.

2.3 Mortgage Arrears

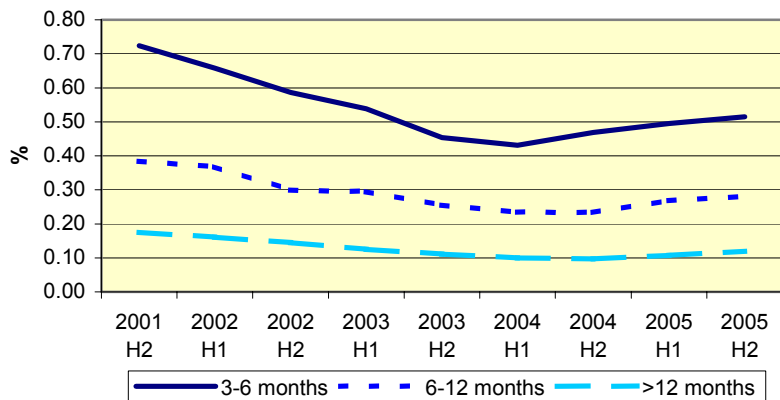
Mortgage arrears and mortgage possession orders continue to stay at a very low level by historic standards.

During the first quarter of 2006, 33,442 mortgage possession actions were entered in to. This represents a rise of 29% from those in the first quarter of 2005. For the same period, figures show a rise of 57% in orders made.

The number of mortgages in arrears of 3-6 months rose to 59,700 in the second half of 2005 - up 3% compared with the end of the first half of the year, and up 11% on the end of 2004. The number of 6-12 month arrears cases rose to 32,470 - 3% higher than in the first half of the year, and 21% higher than at the end of 2004.

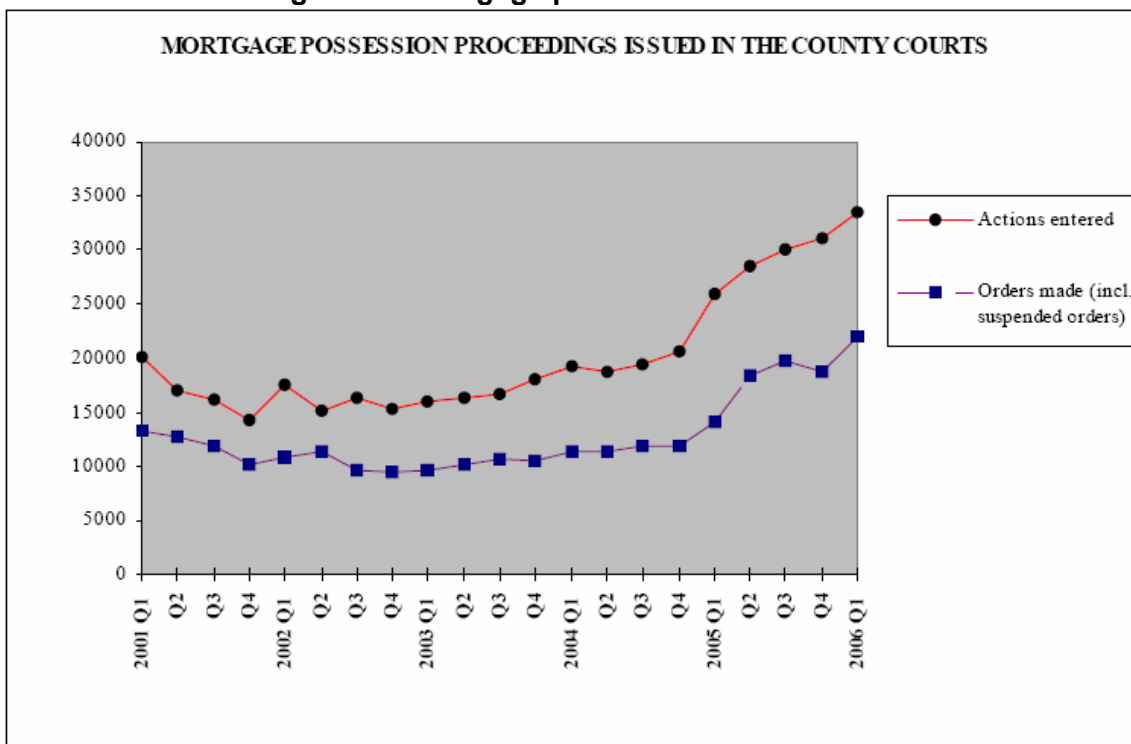
According to the Council of Mortgage Lenders, the main factor pushing arrears higher appears to have been rising mortgage service burdens. This reflects the rise in interest rates between late 2003 and the summer of 2004, slower growth in household incomes and robust growth in mortgage borrowing.

Figure 12: Mortgage arrears *



*Percentage of outstanding stock of mortgages.
Source: Council of Mortgage Lenders.

Figure 13: Mortgage possession orders

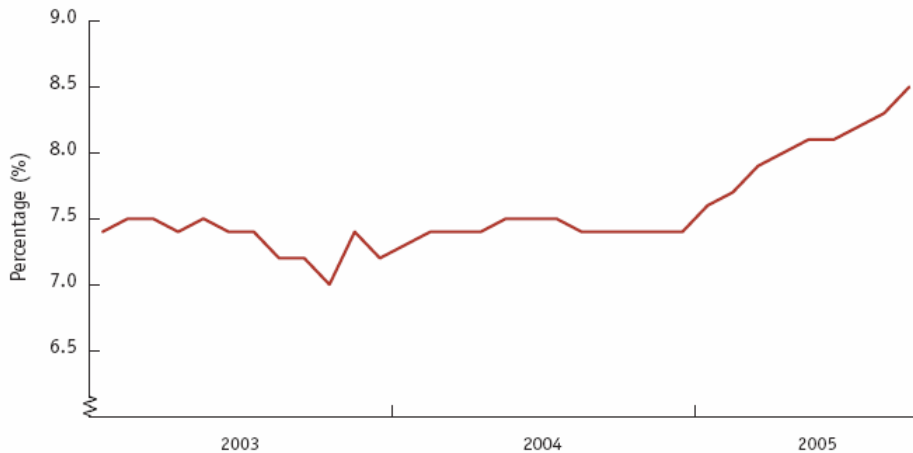


Source: Department of Constitutional affairs
Orders made by local authorities and private lenders.
Orders made include suspended orders.

2.4 Credit card arrears

Credit card arrears rose consistently throughout 2005. The proportion of balances more than three months in arrears increased to 8.5% in September 2005 from 7.4% nine months earlier. This represents an increase of 14% over 2005.

Figure 14: proportion of UK credit card balances more than three months in arrears



Source: APACS

2.5 Those over-indebted accessing professional services as a result of over-indebtedness

2.4.2 Personal insolvency

A number of statutory insolvency instruments are available to individuals facing serious financial difficulty, including bankruptcy, county court administration and individual voluntary arrangements. Individuals also have the option of non-statutory options, such as debt management plans, re-mortgaging, and debt consolidation.

There were 23,351 individual insolvencies in England and Wales in the first quarter of 2006 on a seasonally adjusted basis. This was an increase of 12.9% on the previous quarter and an increase of 73.4% on the same period a year ago.

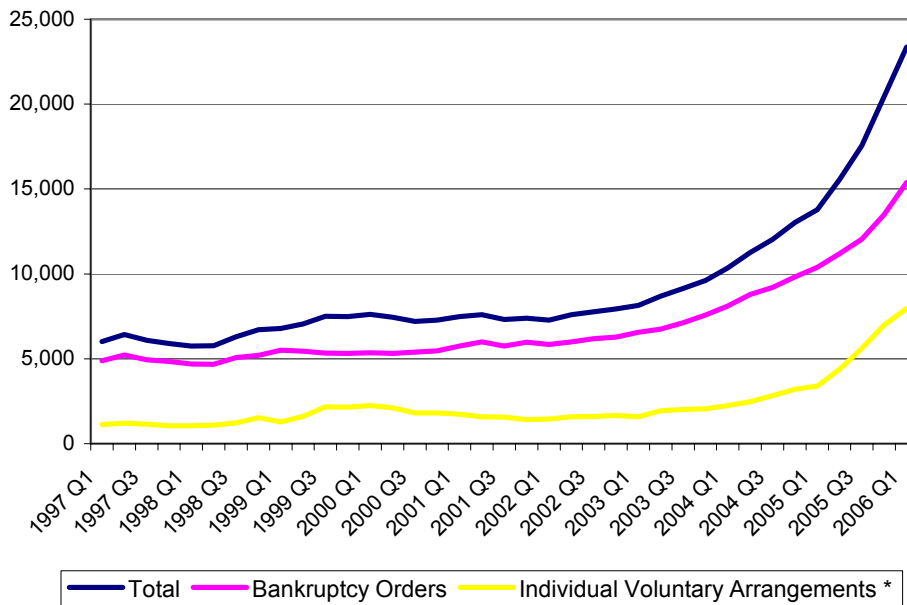
This was made up of 15,389 bankruptcies, an increase of 12.5% on the previous quarter and an increase of 51.2% on the corresponding quarter of the previous year, and 7,961 Individual Voluntary Arrangements (IVA's), an increase of 13.7% on the previous quarter and an increase of 141.9% on the corresponding quarter of the previous year.

Since 1998 there has been a decline in the number of self employed individuals entering bankruptcy. Currently, around 75% of bankrupts are non-traders⁷. Of those who provided information on their occupation to the Bankruptcy Courts Survey 2005, 40% were employed, 27% unemployed and 4% self-employed⁸.

⁷ Bankruptcies in England and Wales – Industrial Analysis
<http://www.dtistats.net/sd/insolv200602/table5.htm>

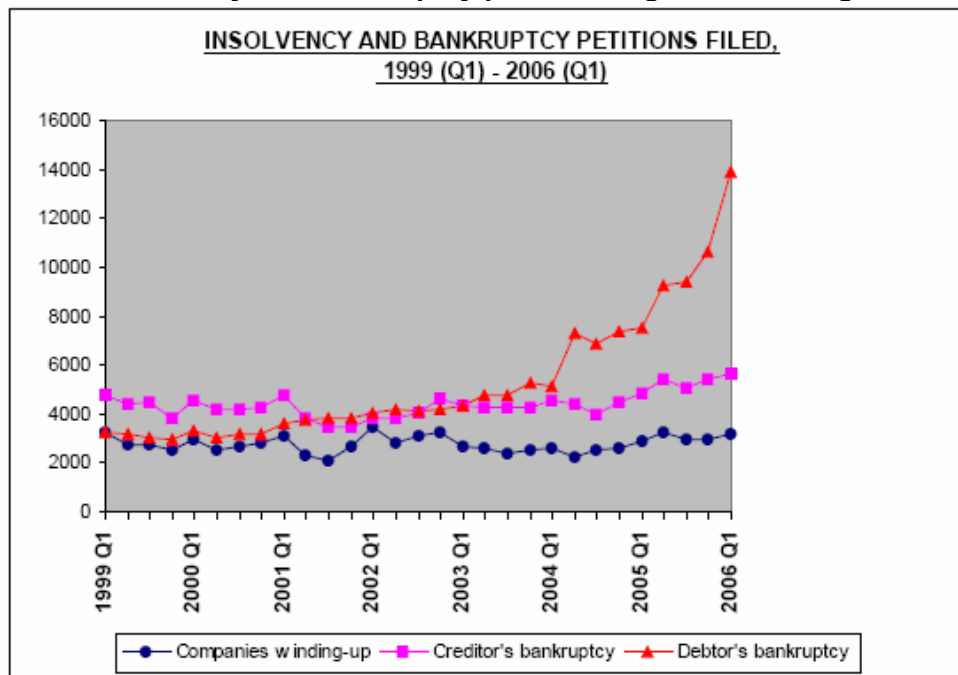
⁸ Bankruptcy Courts Survey 2005 – A Pilot Study :John Tribe
<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/personaldocs/BankruptcyCourtsSurvey.pdf>

Figure 15: Individual Insolvencies in England & Wales ('000s)



Source: Insolvency service, DTI
*Includes deeds of arrangement

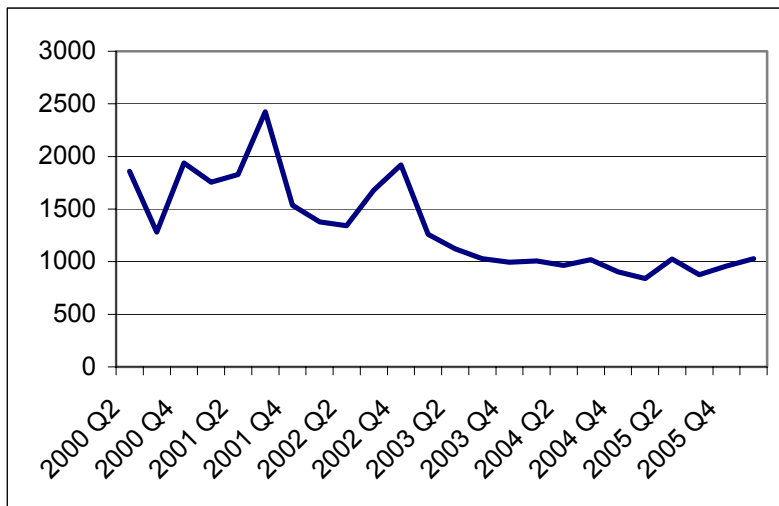
Figure 16: Insolvency and Bankruptcy petitions registered in England & Wales



Source: Department for Constitutional Affairs.

Information on the number of County Court Administration Orders (AO's) indicates that numbers are low by historic standards. This is due entirely to the current debt limit (£5k), which is set in statute, and means AO's are not relevant for most consumers. In Q1 2006 1026 AO's were made.

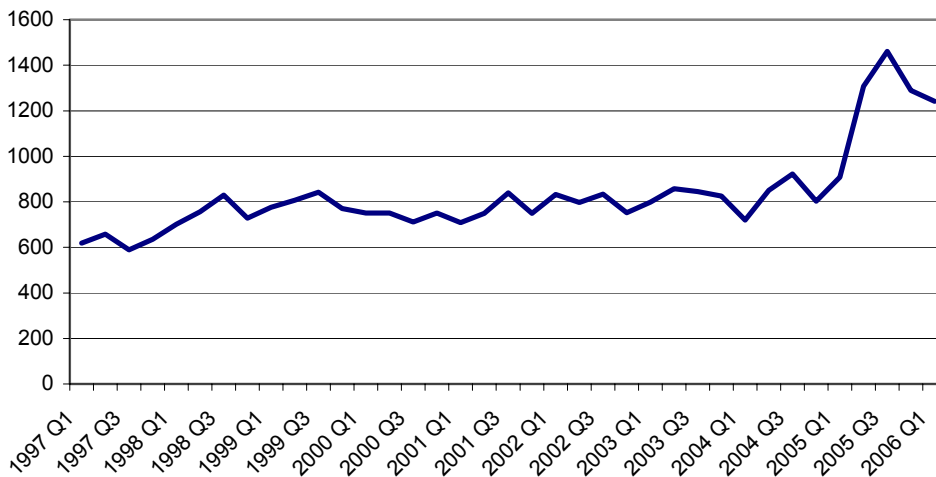
Figure 17: County Court Administration Orders in England & Wales



Source: Department for Constitutional Affairs.

Figures for sequestrations in Scotland increased markedly in 2005. In Q3 2005 numbers peaked at 1,461, an increase of 58% year on year. This is explained by a rapid rise in creditor petitions since April following a crack down by Scottish councils on individuals with persistent council tax arrears beginning in the second quarter. The number of sequestrations fell slightly in Q4 2005 and again in Q1 2006 to a level of 1,241.

Figure 18: Sequestrations in Scotland



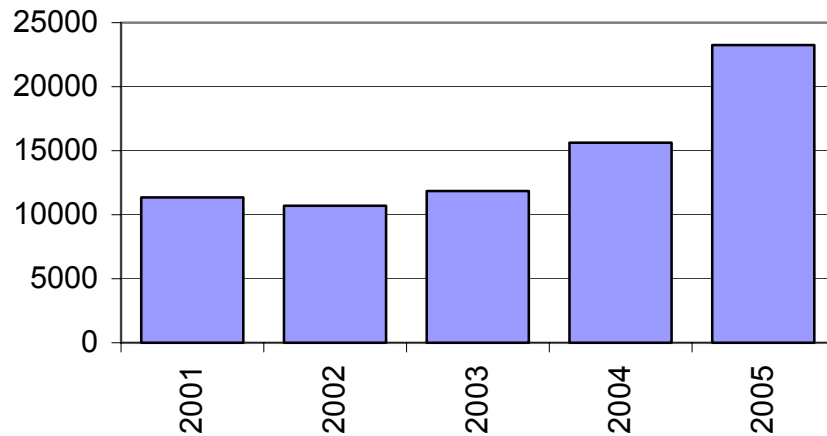
Source: DTI Statistics

The situation is less clear in relation to Debt Management Plans (DMPs), due to the fact that they are non-statutory and not provided by a single source.

Evidence from National Debt Line (NDL) indicates that the number of DMPs, as a proportion of the total client base, has been stable for a number of years at about 3.5-4% (200-250 per year). This number is low as most of NDL's clients set up informal plans with their creditors, which are not included in the figures above. It is likely to be higher as a proportion of insolvencies.

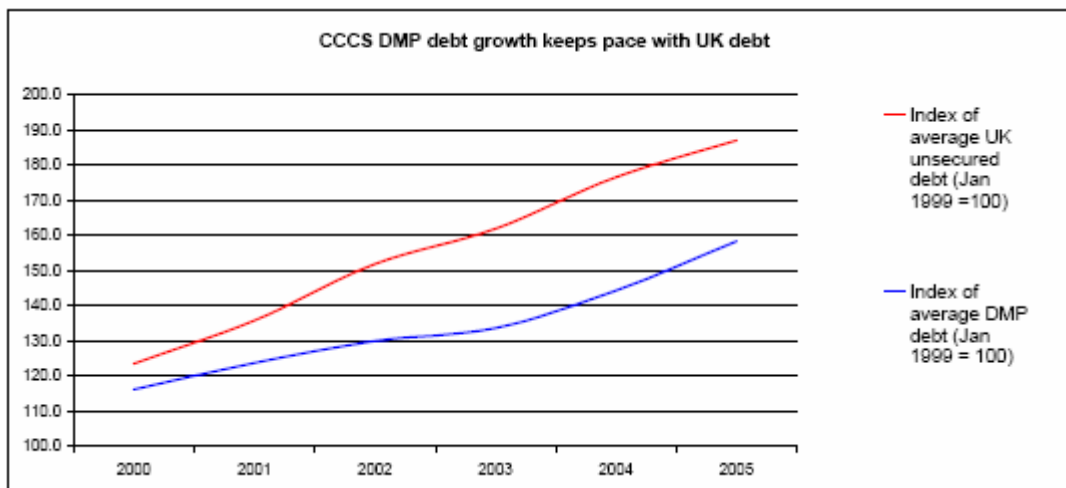
However, figures provided by the Consumer Credit Counselling service (CCCS) indicate a sharp rise of 48% in the number of DMP's in 2005. The average debt owed on DMP's has also continued to rise throughout 2005, according to the CCCS. In 2005 the average unsecured debt of a client starting a debt management plan with CCCS increased by 10.5 per cent from £26,630 in Q4 2004 to £29,400 in Q4 2005. Total outstanding unsecured debt in the UK increased by 5.9 per cent in the same period. This superior increase in DMP debt suggests that a greater proportion of the money being lent by banks and credit card companies became "problem debt" in 2005 than would be expected. This is in line with recent retail banking results which show a rise in the percentage of lending which has been written off as bad debt.

Figure 19: CCCS DMP's (annual)



Source: CCCS

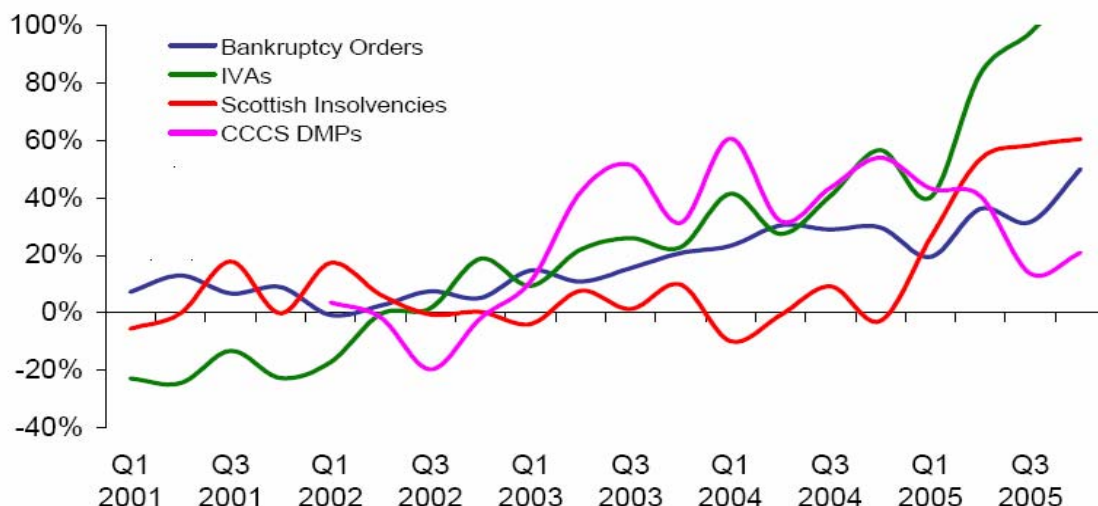
Figure 20: CCCS DMP debt growth rate



Source: CCCS

Figure 21 provides information on the year on year increases of various variables set out within this section. As can be seen the general trend of problem debt is one of growth at a steadily increasing rate over the last two years. The rate of growth in problem debt is greater than that of overall unsecured debt, indicating that a greater proportion of the unsecured money being lent became "problem debt" in 2005.

Figure 21: Year on year increases



Source: CCS

2.4.2 Key drivers of insolvency

Personal insolvency levels can and do fluctuate. There is no definitive evidence of a single driver that might be contributing to the overall increase in personal insolvencies, although research generally attributes changes in bankruptcy numbers to economic factors, in particular availability and levels of credit, although asset/debt ratios, interest rates and employment levels all play a part.

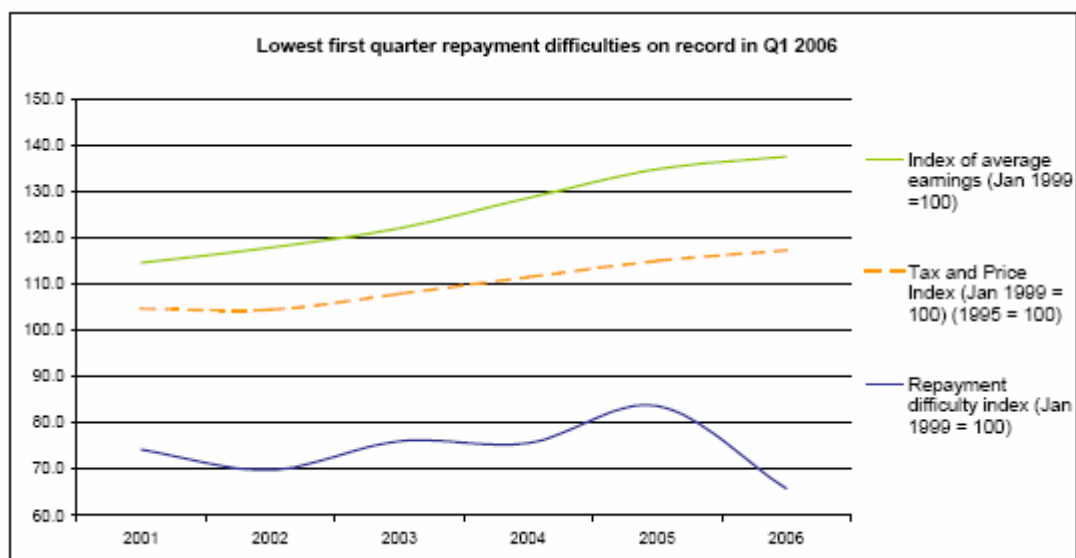
The data presented within this paper indicates that increases in debt, and subsequent rises in the debt income ratio since 2003, have impacted upon the number of insolvencies over the last two years. This is a trend that can be expected to continue, unless growth in debt lessens substantially.

As previously reported, the Insolvency Service is continuing to evaluate the effect of the changes to the personal insolvency regime brought about by the Enterprise Act 2002, but it appears that the changes in legislation have had little if any effect on the number of people becoming bankrupt. The continued rise in the number of individual voluntary arrangements, where there has been no legislative change, and which is in percentage terms is greater than the increase in bankruptcy numbers, suggests that the increases in personal insolvency levels are being influenced by factors other than changes in the law.

2.5 Debt repayment

In terms of the difficulty of repayment, the CCCS index remained at a historically low level in Q1 2006. The index fell by approximately 15% year on year from 2005. It has now reached its lowest level.

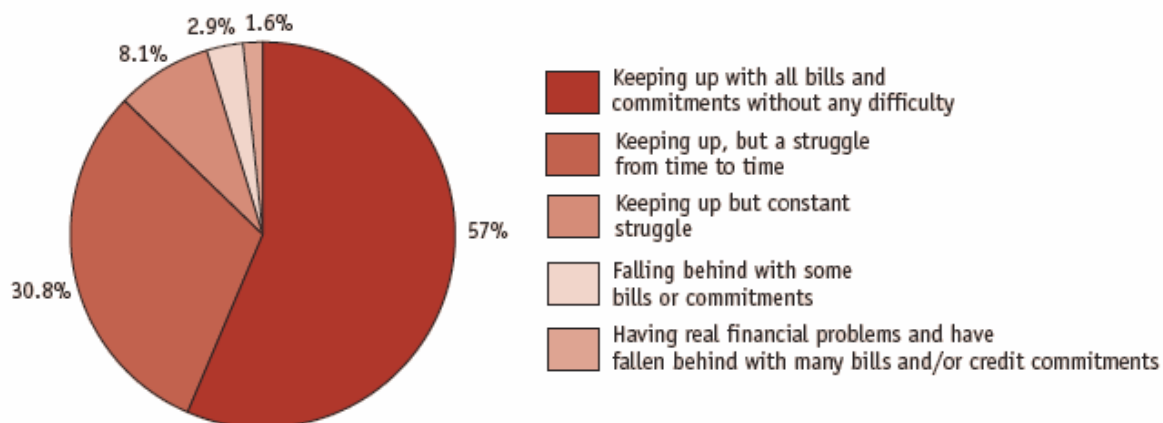
Figure 22: CCCS repayment difficulty index



3. Subjective measures of debt

According to recent FSA research 96% of consumers with debt say they were keeping up, either without difficulty (57%) or with some degree of struggle (39%). Only 1.6% of individuals indicated that they were having real financial problems as a result of bills and/or credit commitments.

Figure 23: The degree to which consumers with debt are able to cope with bills and credit commitments



Note: Based on a sample of consumers with debt, including mortgages. Figures may not add up to 100% due to rounding.
Source: FSA/BMRB, 2005

This evidence is consistent with survey results from the DTI commissioned MORI Financial Services survey of 2004, which showed only a small proportion (5%) of debtors consider their debt repayments a heavy burden, which is one measure of over-indebtedness.

Evidence collected by the BoE in 2004, also indicated that a small proportion of individuals considered unsecured debt to be a 'heavy burden', with a figure of 8%⁹.

⁹ <http://www.bankofengland.co.uk/publications/quarterlybulletin/qb040401.pdf>

Annex A: List of Data Sources relevant to Consumer Over-Indebtedness

The release date of each data series varies according to publication, to find out the release date of a specific series it is best to check the relevant link. In general, monthly data are available at the end of the following month and quarterly data as follows; Q1= Early April, Q2= Early July, Q3= Early October, Q4= Early Jan.

Frequency key: D= Daily, M= Monthly, Q= Quarterly, A= Annual.

Measure	Source	Frequency	When available	Weblink
Base Rate (Underlying Interest Rate)	Bank of England: Monetary & Financial Statistics Interactive Database	D, M, Q, A	1 st week of every month.	http://213.225.136.206/mfsd/iadb/Index.asp?first=yes&SectionRequired=I&HideNums=-1&ExtraInfo=true&Travel=NIx Click 'Wholesale Interest and Discount Rates' then 'Bank of England repo rate (base rate)'
Employment (MGRZ) and Unemployment (MGSC) Employment rate (MGSR) and Unemployment Rate (MGSX)	Office for National Statistics: Labour Market trends Seasonally Adjusted figures	M, Q, A	Check: http://www.statistics.gov.uk/statbase/tsdreleasedata	http://www.statistics.gov.uk/statbase/tsdtimezone.asp Select 'Labour Market stats' then 'Unemployment by age and duration' and 'Employment by age'
Growth in Household Final Consumer Expenditure	Office for National Statistics: Consumer trends: Quarterly change in ABJQ	Q	Check: http://www.statistics.gov.uk/statbase/tsdreleasedata	http://www.statistics.gov.uk/statbase/tsdtimezone.asp Select 'Consumer Trends then '0.CS: Household Final Consumer Expenditure'
Monthly changes to net lending £ millions	Bank of England: LPMRLMH and LPMVTVJ	M	End of following month	http://213.225.136.206/mfsd/iadb/NewIntermed.asp Search for 'LPMRLMH' and 'LPMVTVJ'
Growth in unsecured lending	Bank of England: Monetary & Financial Statistics Interactive Database	M	End of following month	http://213.225.136.206/statistics/li/current/index.htm

12 month growth rate of Net Lending	Bank of England: LPMVTYO and LPMVTYI	M	End of following month	http://213.225.136.206/mfsd/iadb/NewIntermed.asp Search for 'LPMVTYO' and 'LPMVTYI'
Growth in lending secured on dwellings	Bank of England: Monetary & Financial Statistics Interactive Database	M	End of following month	http://213.225.136.206/statistics/li/current/index.htm
Total Household Sector Debt / Income Ratios	Office for National Statistics: Total Debt / Income Ratio (NNPP/4*RPQK) Secured Debt / Income Ratio (NNRP/4*RPQK)	Q	Check: http://www.statistics.gov.uk/statbase/tsdreleasedataes.asp	http://www.statistics.gov.uk/statbase/tsdtimezone.asp Select 'Financial Consistent' and go to table 12.1N for NNPP, table 9.1M for NNRP and table 14.8D for RPQK
UK Bank Write-offs	Bank of England. Monetary & Financial Statistics August 2005, Table C2.1 (TFHD, TFHE, TFHF, TFHG)	A		http://www.bankofengland.co.uk/statistics/ms/current/index.htm - c
Mortgage arrears	Council of Mortgage Lenders.	A, Half- Yearly		http://www.cml.org.uk/servlet/dycon/zt-cml/cml/live/en/cml/stats_free Mortgage arrears, by number of months in arrears Mortgage arrears, by percentage of total balance in arrears
Mortgage possession orders	Department for Constitutional Affairs.	Q		http://www.dca.gov.uk/statistics/cjust.htm
Individual Insolvencies in England & Wales ('000s)	Insolvency service, DTI	Q		http://www.dti.gov.uk/statistics/index.htm Scroll down to Insolvency statistics
Sequestrations in Scotland	Insolvency service, DTI	Q		http://www.dti.gov.uk/statistics/index.htm Scroll down to Insolvency statistics

Bankruptcy petitions registered in England & Wales	Department for Constitutional Affairs.	Q		http://www.dca.gov.uk/statistics/cjust.htm
Calls/General Advice/Debt Advice calls to the CCCS	CCCS	M	End of following month	Not publicly available.
Calls/Clients/Client contacts to the National Debtline	National Debtline	M	End of following month	Not publicly available.
CCCS debt repayment/repayment difficulty index	CCCS	Q		http://www.cccs.co.uk/media/media.aspx Link usually embedded in press releases. Look for Debt Dashboard Q4 2004 (PDF)
Burden of Debt	MFS survey, Bank of England	Varies.	Bank of England Autumn 2005 DTI Survey Autumn 2006	MFS Study available: http://www.dti.gov.uk/ccp/topics1/overindebtedness.htm Check publications for 2005 update. http://213.225.136.206/publications/index.htm