

Over-indebtedness Monitoring Paper Q2 2006 (URN 06/401b)

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 June 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 Q2 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 show 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. Relatively 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. However, the labour market position has weakened slightly in Q2 2006, and interest rates have since started to rise, leading to an increasing risk for the future.

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 severe shocks will occur.

Notable changes since Q1 2006:

- The UK labour market weakened slightly again in Q2 2006. Unemployment now stands at its highest point for six years.
- Growth in secured lending continued the long-term stable trend witnessed since 2004 in Q2 2006. Growth now stands at around 11.5%.
- The growth rate of unsecured lending continues on its downward trend, and now stands at approximately 6% on a three month annualised basis.
- Personal insolvencies in England and Wales for Q2 2006 increased 12.5% on the previous quarter and 51.2% on the same period a year ago.
- Total debt write-offs to individuals in Q2 2006 increased by 15% compared to the same period a year ago.

This Report splits the evidence into 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/files/file18559.pdf>

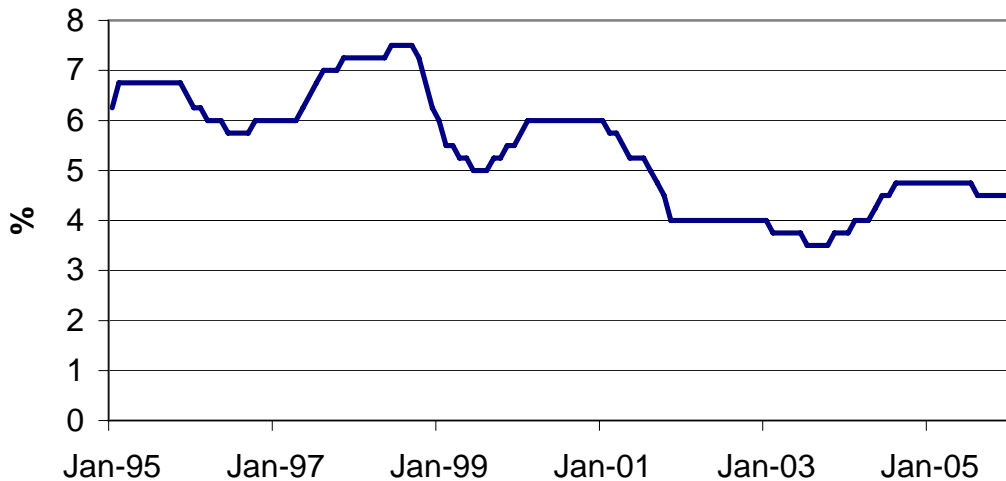
² This is consistent with the FSA Financial Risk Outlook 2006

1. Macroeconomic Environment

1.1 Interest Rates

The Bank of England continued to keep interest rates at their long-term rate of 4.5% in Q2 2006. This means that the base rate has not changed since the second quarter of 2005. The cost of borrowing continues to stay relatively low by historic levels.

Figure 1: Base Rate³

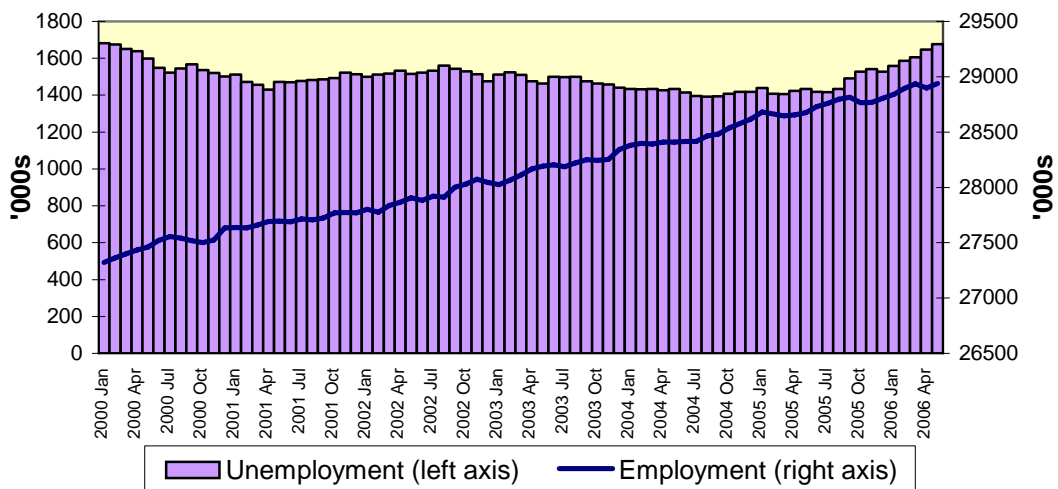


Source: Bank of England: Monetary & Financial Statistics Interactive Database

1.2 Labour Market

The overall risk to consumer over-indebtedness from forces in the labour market remains relatively low. However, data shows that the unemployment rate rose to 5.6% in May, a six-year high. This represents a weakening of the UK labour market in Q2 2006.

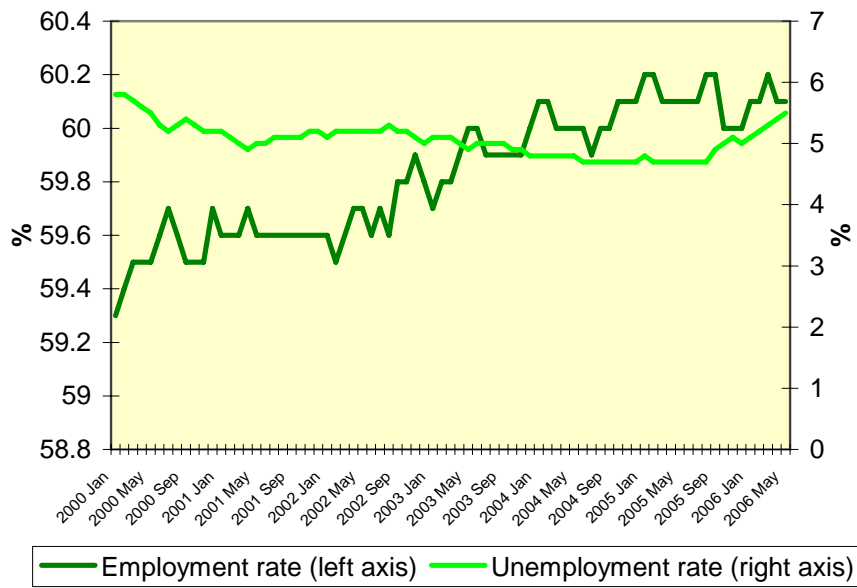
Figure 2: Employment and Unemployment ('000s)



Source: MGRZ and MGSC, ONS Labour Market trends

³ IUMBEDR- End Month, Bank of England Repo Rate

Figure 3: Employment and Unemployment Rates

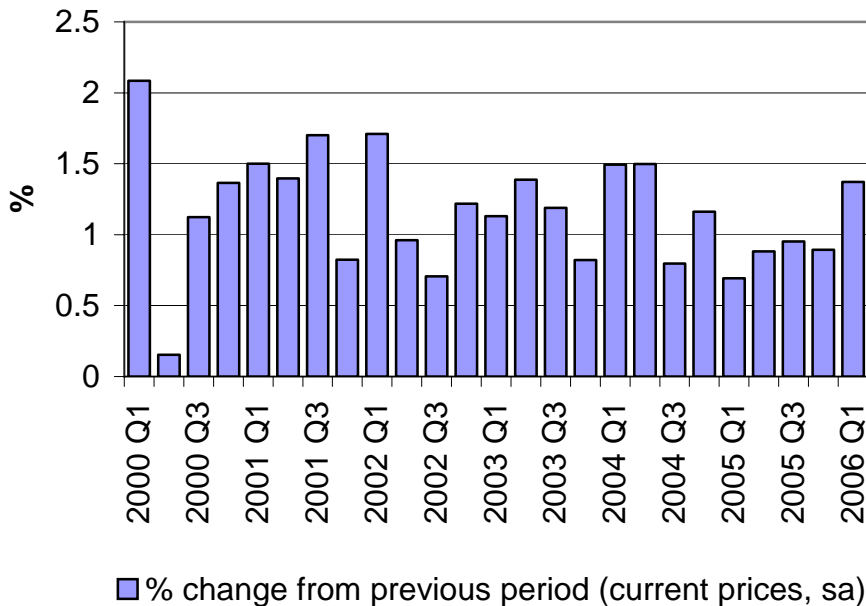


Source: MGSR and MGSX, ONS Labour Market trends

1.3 Consumer spending

Data on consumption growth for the first quarter of 2006 shows an increase in the rate of growth to 1.37%, higher than the same period last year but lower than that of 2004. Growth in household consumer expenditure continues to be lower than average over the last five years. Data is not yet available for Q2 2006.

Figure 4: Growth in Household Final Consumer Expenditure



■ % change from previous period (current prices, sa)

Source ONS: Consumer trends: Quarterly change in ABJQ

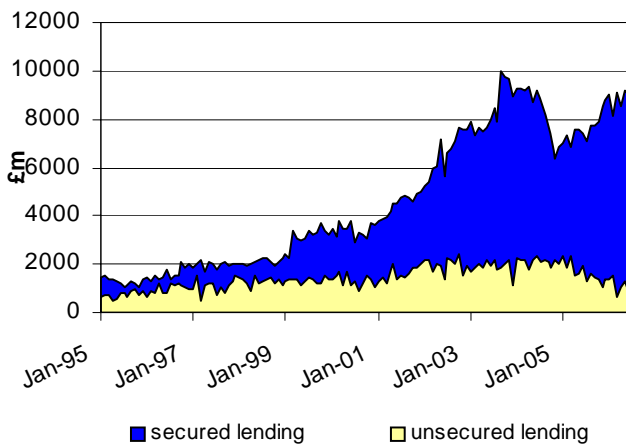
1.4 Consumer lending

Lending to consumers continues to grow in 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. The latest figures indicate that June growth is above the six-month average. Growth in secured lending now stands at approximately 11.5% on a 3 month annualised basis.

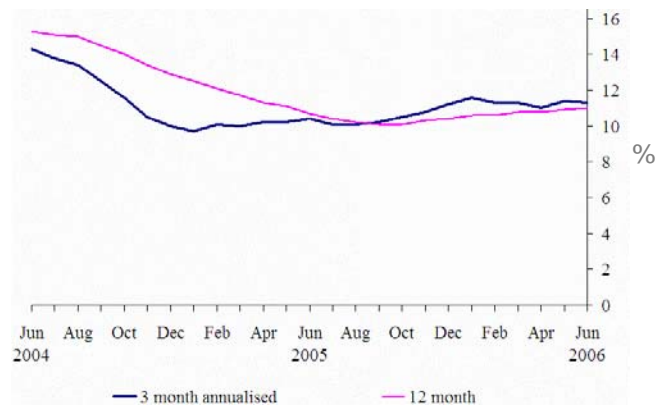
Conversely, the rate of growth of total consumer lending fell steadily in 2005 and continues to follow a downward trend in 2006. Growth in unsecured lending now stands at just around 6% on a 3 month annualised basis, compared to a high of around 14% in early 2004.

Figure 5: Monthly changes to net lending £ millions



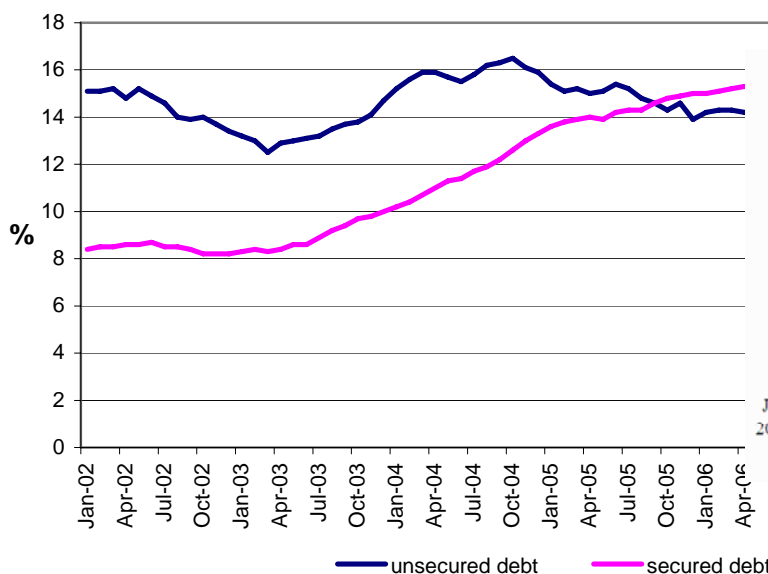
Source: Bank of England: LPMRLMH and LPMVTVJ

Figure 7: Growth in secured lending



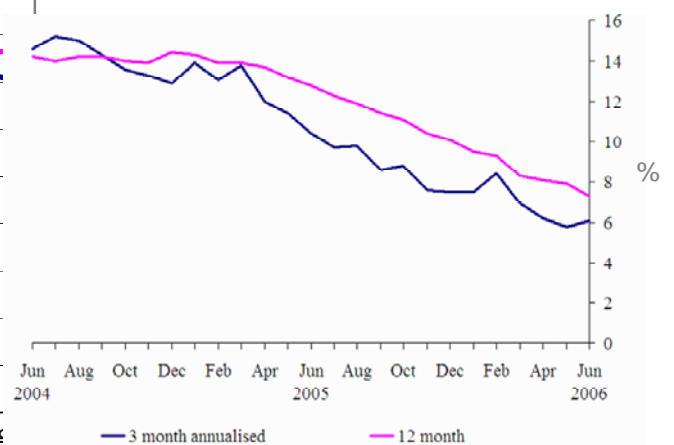
Source: Bank of England: Monetary & Financial Statistics Interactive Database

Figure 6: 12 month growth rate of net Lending



Source: Bank of England: LPMVTYO and LPMVTYI

Figure 8: Growth in unsecured lending

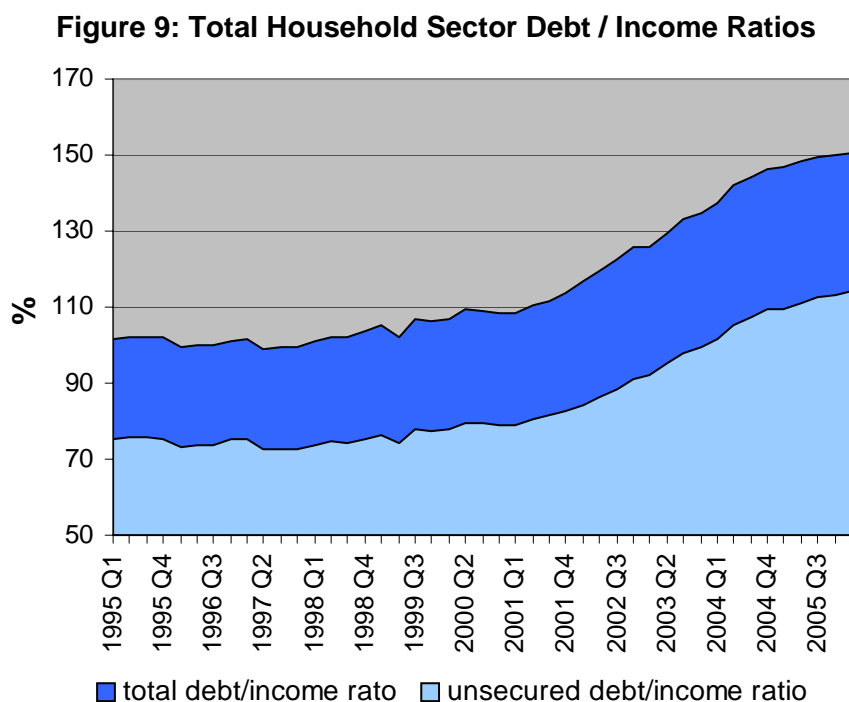


Source: Bank of England: Monetary & Financial Statistics Interactive Database

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 Q1 2006, pushing up the total debt to income ratio to over 150%⁴ of annual income. The debt/income ratio in Q1 2006 rose against Q4 2005 levels due to increases in the rate of growth of secured borrowing. Data is not available for Q2 2006.



Source: ONS

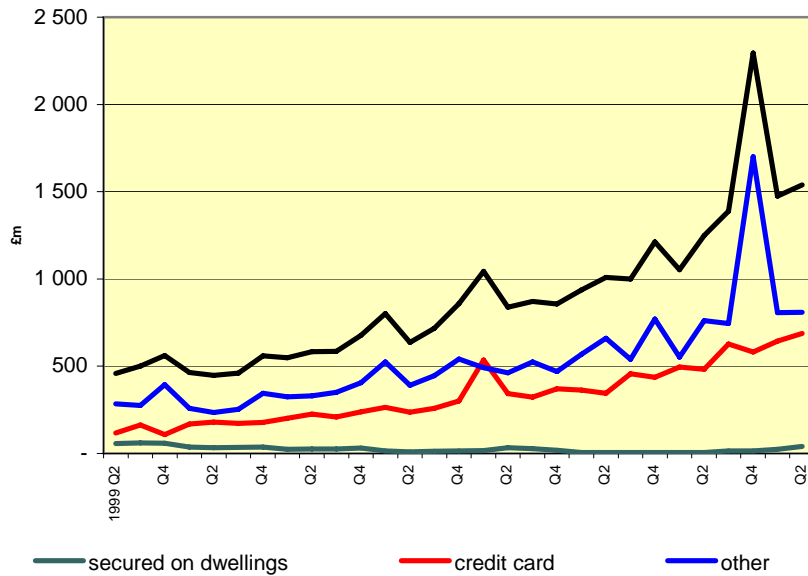
2.2 Debt Write-offs

Figures for overall debt-write offs for individuals show a sharp increase over the past few years. Total write-offs to individuals in Q2 2006 returned to their long run trend level after sharp increases in Q4 2006 due to one-off increases in debt write-offs reported by a number of banks, possibly due to seasonal factors. Total write-offs increased by 15% compared to the same period a year ago. Unsecured lending to UK households accounts for the largest domestic contribution to UK bank write-offs in recent years and has 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 Figures 11 and 15 show that growth in household write-offs has not matched that of personal insolvencies in recent years.

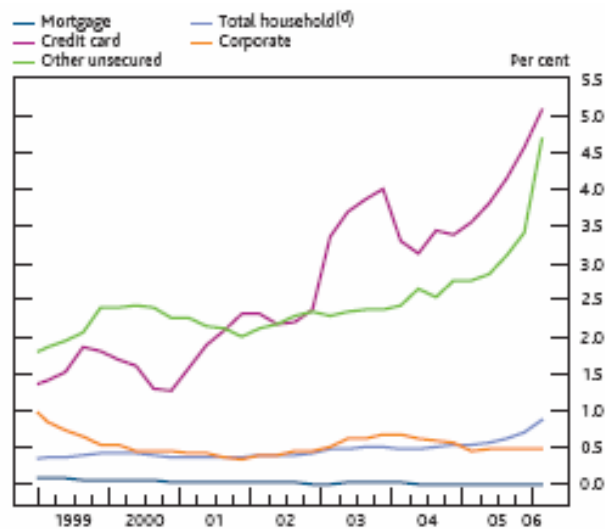
⁴ Based on ONS provisional results

Figure 10: Debt write-offs for individuals



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

Figure 11: Household write-off rates



Source: Bank of England.

- (a) Data exclude Nationwide.
- (b) Write-off rates are dependent on specific bank policies, which may vary over time.
- (c) Write-off rates on lending to UK residents.
- (d) 'Total household' is the sum of mortgage, credit card and other unsecured.

2.3 Mortgage Arrears

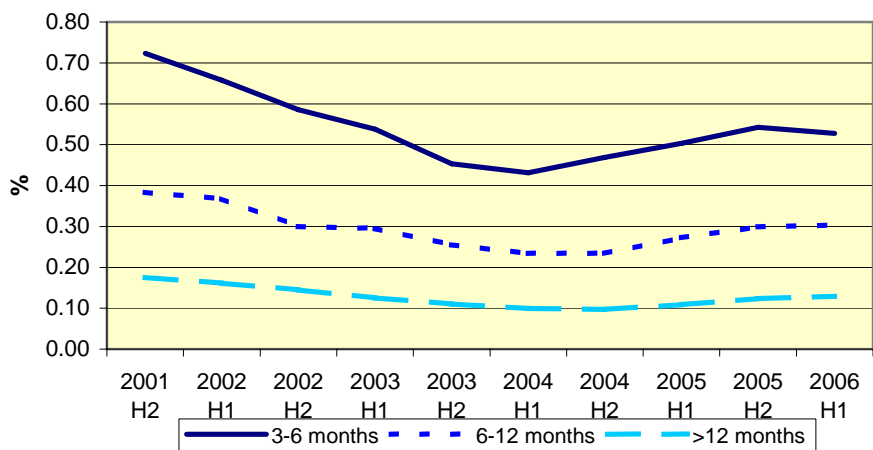
Mortgage arrears and mortgage possession orders continue to stay at a low level by historic standards.

During the first quarter of 2006, 33,180 mortgage possession actions were entered in to. This represents a rise of 17% from those in the second quarter of 2005. For the same period, figures show a rise of 21% in orders made.

The number of mortgages in arrears of 3-6 months fell slightly to 61,470 in the first half of 2006 - down 2.3% compared with the end of the second half of 2005, but up 5.8% on the first half of 2005. The number of 6-12 month arrears cases rose to 35,320 - 2% higher than in the second half of 2005, and 12% higher than the first half of 2005.

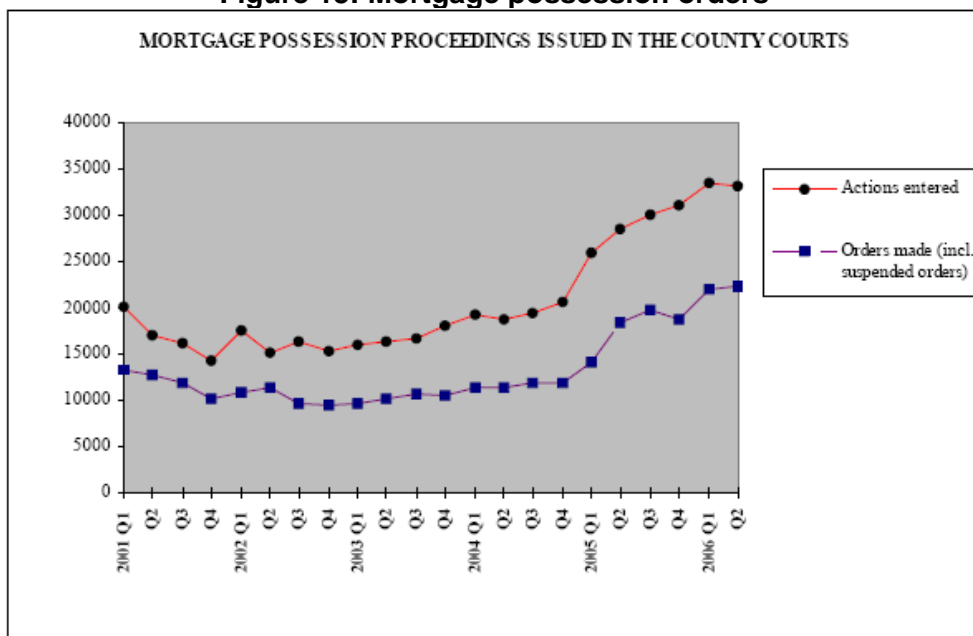
According to the Council of Mortgage Lenders, the modestly less favourable interest rate background will raise mortgage interest payments relative to income, associated with rising arrears a few quarters later. However, the Council predicts that arrears and possessions are set to remain at historically low levels⁵.

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.

⁵ <http://www.cml.org.uk/cml/filegrab/ForecastsJun2006.pdf?ref=4836>

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

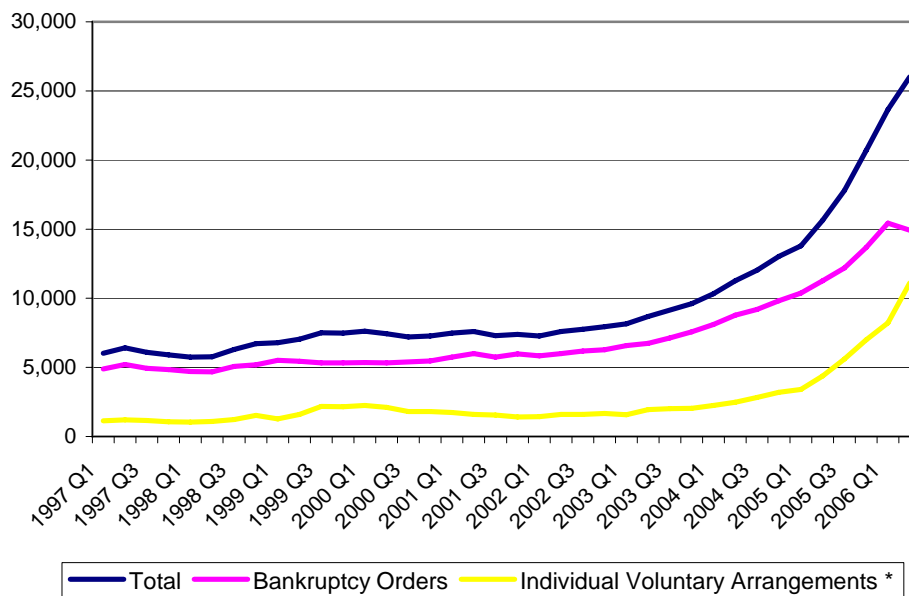
2.4.1 Personal insolvency

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 26,021 individual insolvencies in England and Wales in the second 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.

Figure 14: Individual Insolvencies in England & Wales ('000s)



Source: Insolvency service, DTI
*Includes deeds of arrangement

Figure 15: Insolvency rates

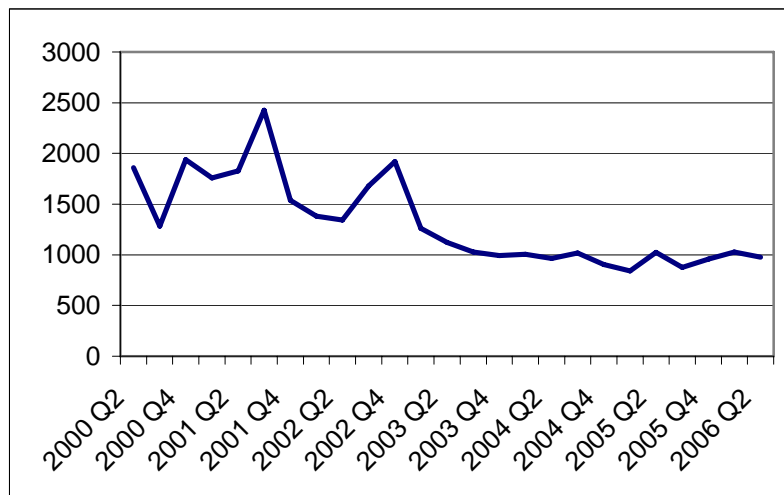


Sources: DTI, ONS and Bank calculations.

- (a) 2006 Q1 figures provisional from DTI
- (b) Figures for England and Wales only.
- (c) Ratio of annualised insolvencies in the quarter to active registered companies in the last month in that quarter.

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 Q2 2006 977 AO's were made. (Please note that data for June 2006 is provisional and subject to revision.)

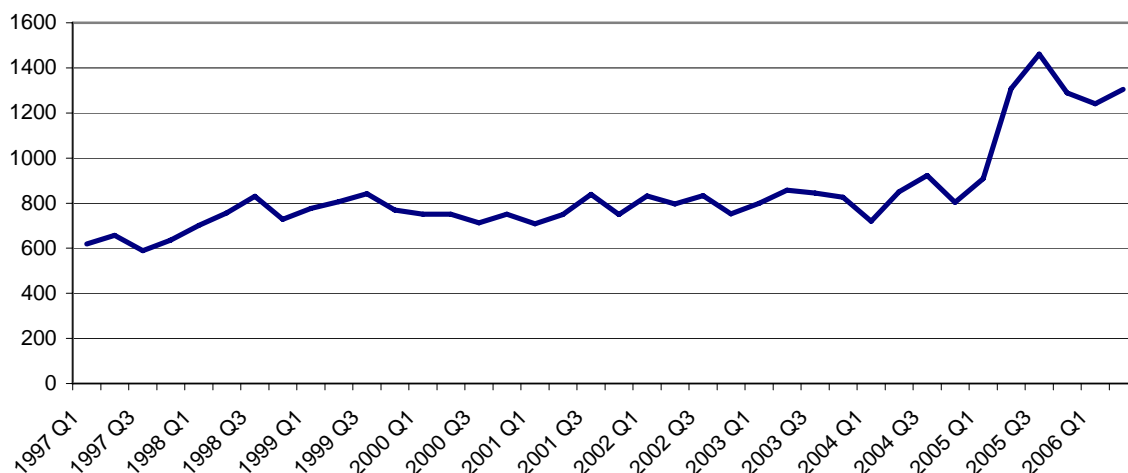
Figure 16: County Court Administration Orders in England & Wales



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 Q1 2006, but seems to be starting to rise again in Q2 2006, currently at a level of 1,305.

Figure 17: Sequestrations in Scotland



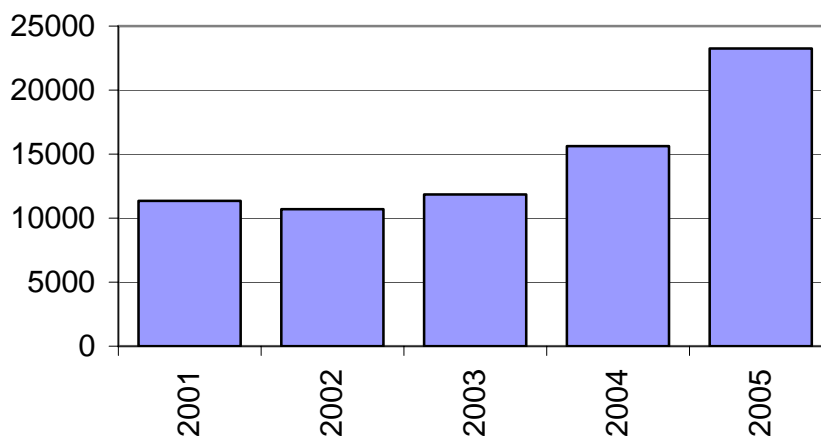
Source: DTI Statistics

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, with a new peak in Q2 2006 of 8953. The average debt owed on DMP's has also continued to rise throughout 2005 and into 2006, according to the CCCS. In Q2 2006 the average unsecured debt of a client starting a debt management plan with CCCS increased by nearly 10 per cent to £30,800. Total outstanding unsecured debt in the UK increased by just over 2 per cent in the same period.⁶ 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 Q2 2006 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.

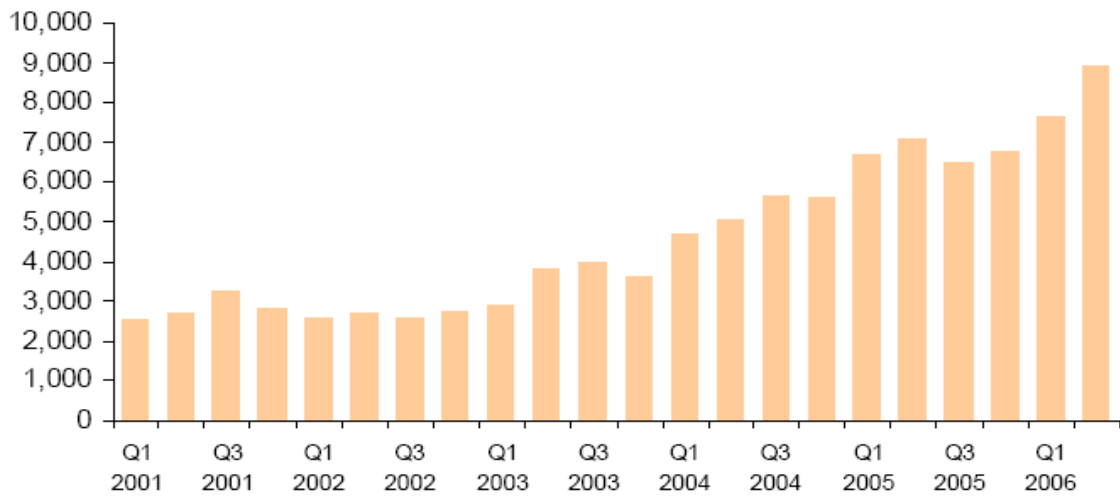
Figure 18: CCCS DMP's (annual)



Source: CCCS

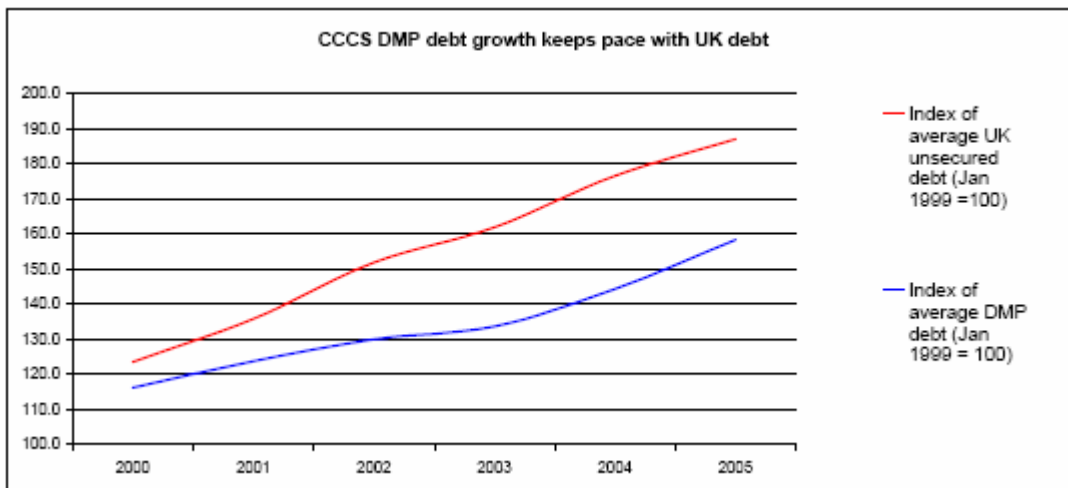
⁶ CCCS Debt Dashboard Q2 2006

Figure 19: CCCS DMP's (quarterly)



Source: CCCS

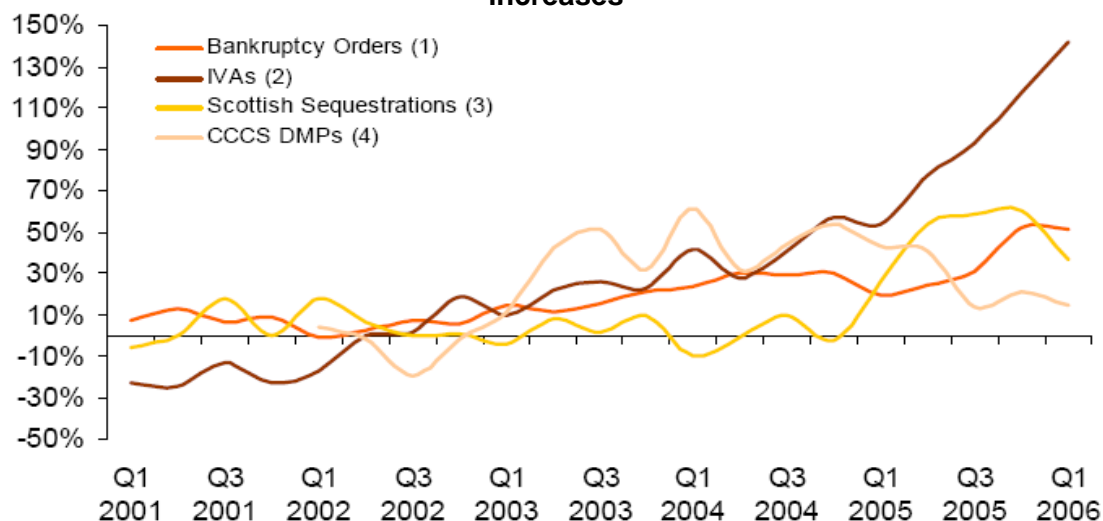
Figure 20: CCCS DMP debt growth rate



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. This is particularly the case for IVA's, which saw substantial year on year increases during 2005 and in to 2006.

Figure 21: Year on year increases



Source: CCCS

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.

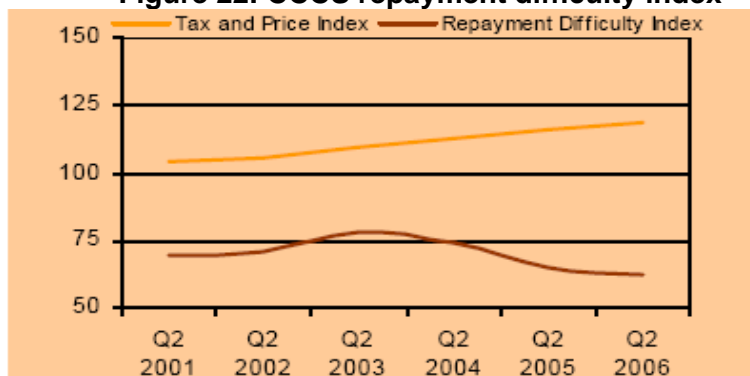
The data presented within this paper indicates that increases in debt, and subsequent rises in the debt income ratio since 2003, have impacted upon the number of insolvencies over the last two years. This trend is expected to continue over the next year to 18 months unless growth in debt lessens substantially, as changes to debt-to-income ratio and employment levels feed through with a lagged effect.

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 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 Q2 2006, lower than the same quarter last year. It has now reached its lowest level.

Figure 22: CCCS repayment difficulty index



3. Subjective measures of debt

According to recent FSA research (the FSA Financial Risk Outlook 2006, also cited in the Q1 2006 over-indebtedness monitoring paper), 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.

This is consistent with evidence collected by the BoE in 2006 which indicates that 9.8% of individuals consider unsecured debt to be a “heavy burden” (a small deterioration from 8% in 2004)⁷. It is also consistent with survey results from DTI-commissioned MORI Financial Services survey of 2004.

⁷ Bank of England, “The distribution of assets, income and liabilities across UK households: results from the 2006 NMG Research survey”, Quarterly Bulletin – Spring 2006 (as quoted in the Annual Report 2006 on Tackling Over-indebtedness)

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=Nlx 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/tsdreleasedates.asp	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/tsdreleasedates.asp	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	Bank of England:	M	End of following month	http://213.225.136.206/mfsd/iadb/NewIntermed.asp

Lending	LPMVTYO and LPMVTYI			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	Q		http://www.insolvency.gov.uk/otherinformation/statistics/insolv.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/consumers/consumer-finance/over-indebtedness/index.html Check publications for 2005 update. http://213.225.136.206/publications/index.htm