

Over-indebtedness Monitoring Paper Q2 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 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 2005. The paper will be updated quarterly to reflect the most recent information with the next paper covering Q3 2005 due to be published in November.

Summary

Whilst the growth in consumer lending continues to fall, there are some signs that consumers are having problems repaying their borrowing. Mortgage arrears and mortgage possession orders continue to rise, albeit from low bases, and personal insolvencies across the UK continue their increasing trend. However, fewer people on repayment plans are reporting difficulties with their repayments, and low interest rates and a healthy labour market reduce the likelihood that those already in debt will experience difficulty in the short term.

The Bank of England acknowledges that whilst unsecured lending to UK households accounts for the largest domestic contribution to UK banks write-offs in recent years, the write-off rate on household lending is still low by historical standards. Of greater concern are the longer-term vulnerabilities such as the high debt-to-income ratio for the household sector.

Notable changes since Q1 2005:

- Personal insolvencies in England and Wales grew by 11.7% year on year. Sequestrations in Scotland increased by 53.6% year on year.
- Mortgage possession actions rose by over 52% year on year in Q2 2005.
- Mortgage arrears continue to rise but by a tiny amount, 0.002% year on year.
- Total Net Lending in June 2005 was down 24% on June 2004.
- The CCCS repayment difficulty index fell 12% year on year.

This Report splits the evidence into three sections:

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

Annex A: List of Data Sources

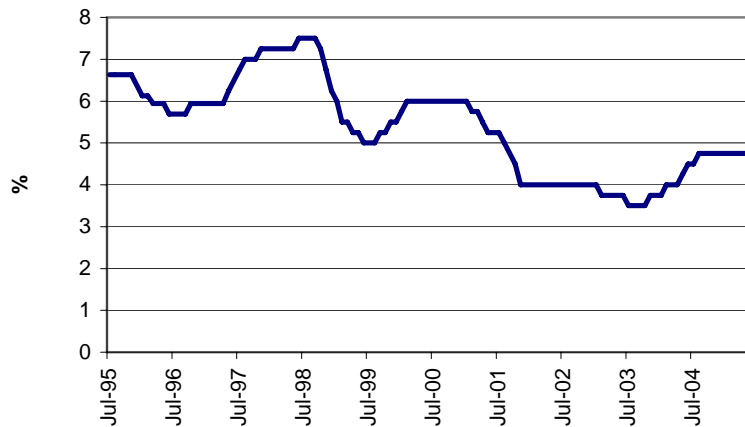
¹ Available at <http://www.dti.gov.uk/ccp/topics1/pdf1/overdebt0704.pdf>

1. Macroeconomic Environment

1.1 Interest Rates

During the second quarter of 2005 the Bank of England maintained the base rate at 4.75%, a level which had been constant 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, the recent decline in borrowing gives an indication that the rate increases throughout the first half of 2004 are beginning to feed through to consumers.

Figure 1: Base Rate²



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

1.2 Labour Market

The UK labour market remains strong despite a slight levelling off in employment growth. Measures of unemployment have remained static over the last two quarters and are at their lowest points for 20 years. Growth in employment has stayed constant in Q2 2005, the employment rate being held at 60.1% for March to June. 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. Despite this, the risk to consumer over-indebtedness from forces in the labour market remains low.

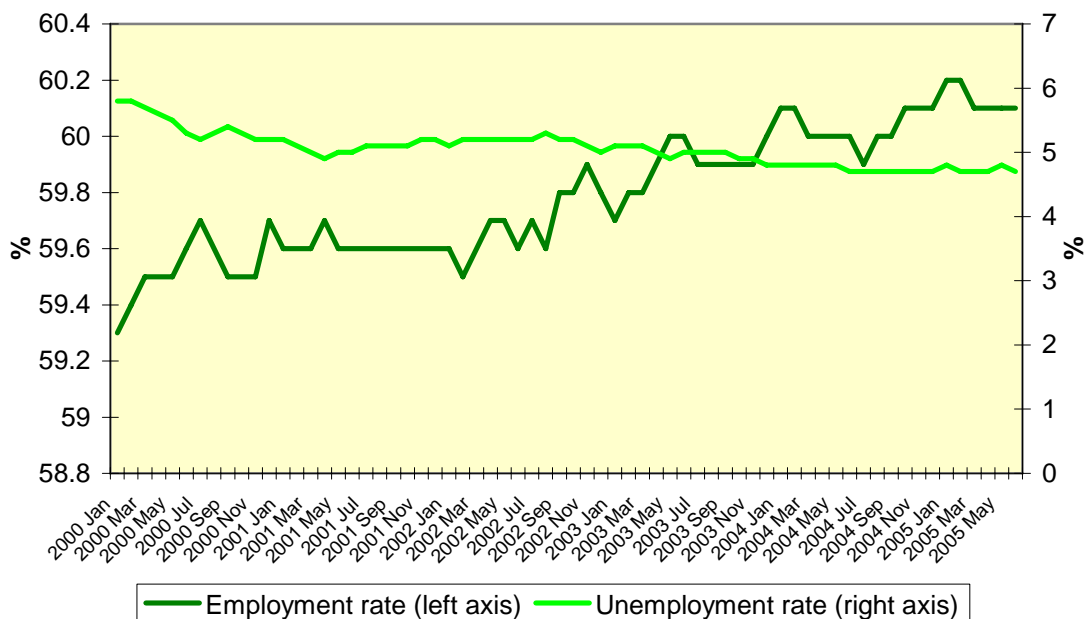
Figure 2: Employment and Unemployment ('000s)



Source: MGRZ and MGSC, ONS Labour Market trends

² IUMBDR- End Month, Bank of England Repo Rate

Figure 3: Employment and Unemployment Rates

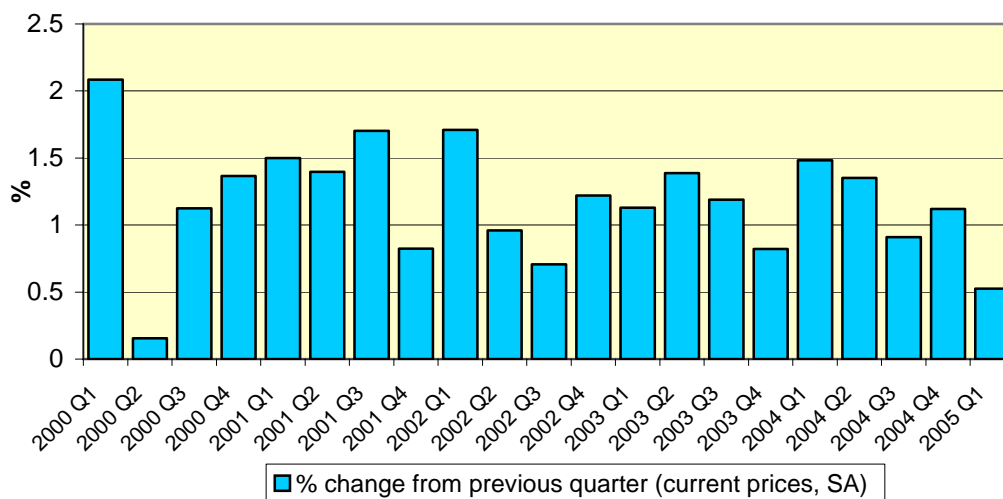


Source: MGSR and MGSX, ONS Labour Market trends

1.3 Consumer spending

Data on consumption growth for the second quarter of 2005 is not yet available. Figures from Q1 2005 showed consumption to be weakening, at just over 0.5%, quarterly growth in Household Final Consumer Expenditure was at its lowest for almost 5 years.

Figure 4: Growth in Household Final Consumer Expenditure



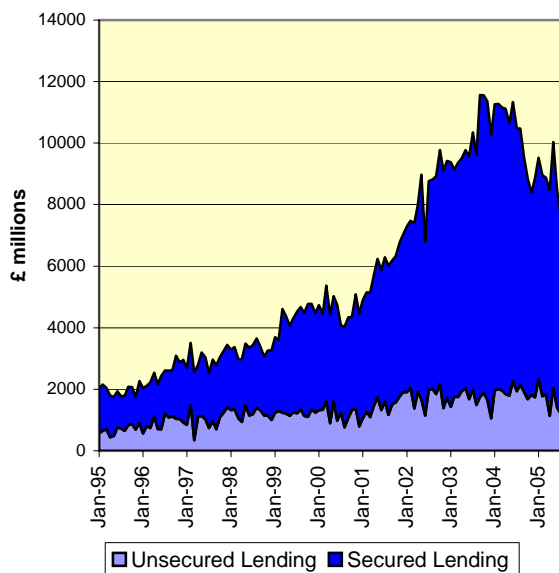
Source ONS: Consumer trends: Quarterly change in ABJQ

1.4 Consumer lending

Lending to consumers continues to grow, but the rate of growth has declined since Q3 2004 on all measures. Total Net Lending in June 2005 was down 24% on June 2004. Figures from the Bank of England show that the fall in growth has been more pronounced in secured lending than unsecured.

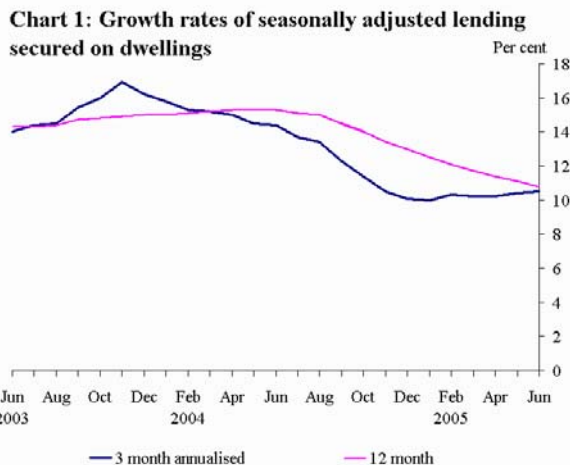
The increase in total net lending to individuals in June (£8.8 billion) was less than in May and weaker than the previous six month average. The increase in consumer credit (£1.3 billion) in June was weaker than May. Within this, both net credit card lending and net other loans were weaker than in May and their respective previous six month averages.

Figure 5: Monthly changes to net lending £ millions



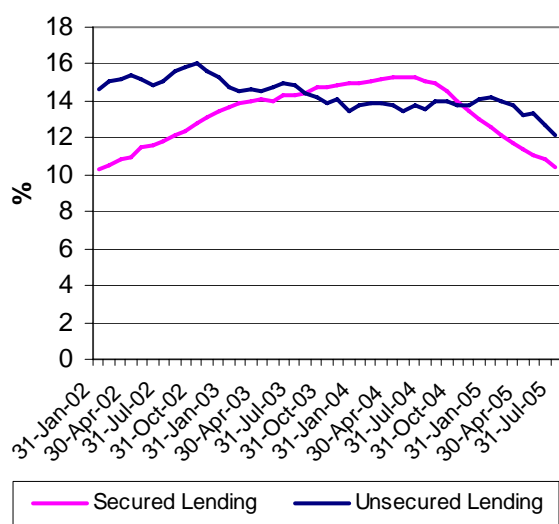
Source: Bank of England: LPMRLMH and LPMVTVJ

Figure 6: Growth in secured lending



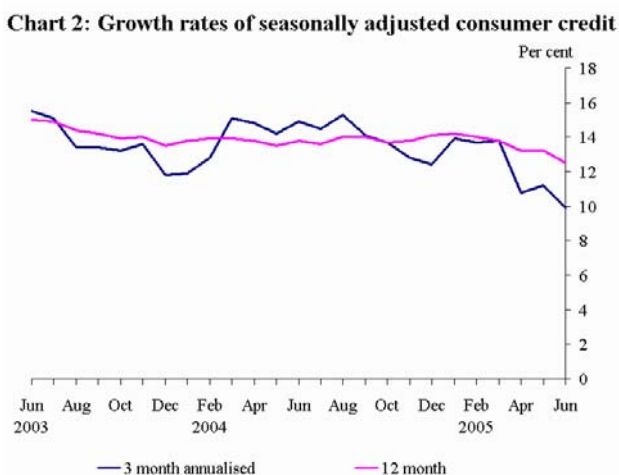
Source: Bank of England: Monetary & Financial Statistics Interactive Database

Figure 7: 12 month growth rate of Net Lending



Source: Bank of England: LPMVTYO and LPMVTYI

Figure 8: Growth in unsecured lending

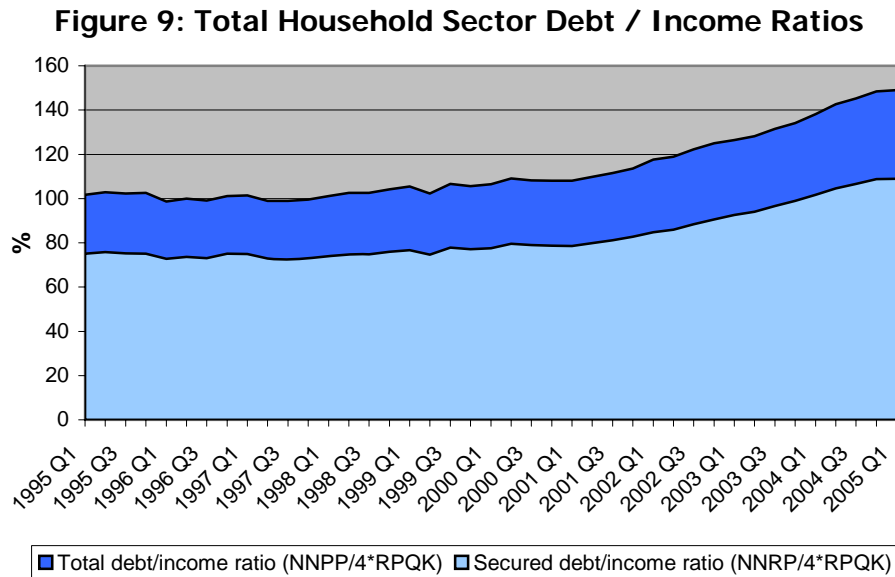


Source: Bank of England: Monetary & Financial Statistics Interactive Database

2. Objective measures of debt

2.1 Debt/Income Ratios

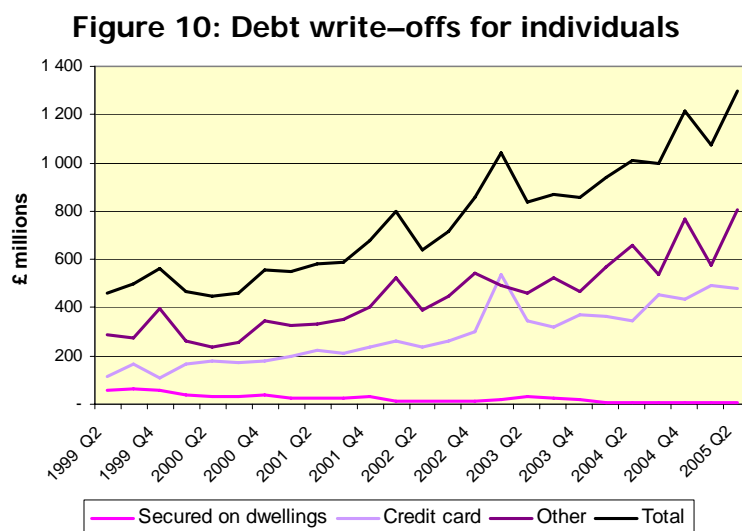
The growth rate of borrowing continues to outstrip that of earnings, pushing up the total debt to income ratio to just under 150% of annual income, a series high. There are signs from the first two quarters of 2005 that this growth is levelling off slightly as the rate of borrowing falls.



Source: ONS

2.2 Debt Write-offs

A number of large UK banks have recently declared an increase in their provisions for bad debt in 2005. However, it is not always the case that bad debt provisions manifest as bad debts, so it is better to consider figures on actual write-offs rather than speculate on provisions.

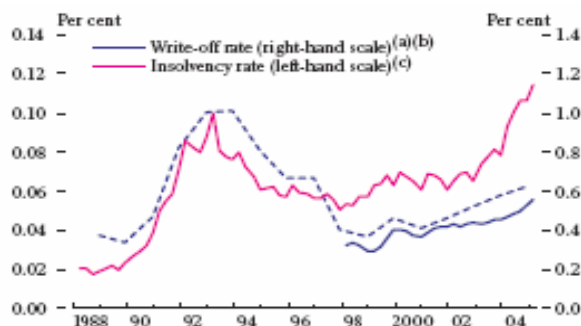


Source: Bank of England. Monetary & Financial Statistics August 2005, Table C2.1

The data series are variable because some lenders wait for their write-offs to consolidate before declaring them. The figures show a gradual increase in write-offs over the past few years. Such an increase could be expected as a result of the recent rise in personal

insolvencies, but Figure 11 shows that growth in household write-offs has not quite matched that of personal insolvencies.

Figure 11: Household write-offs versus Insolvency rates



Sources: ONS, DTI and Bank of England.

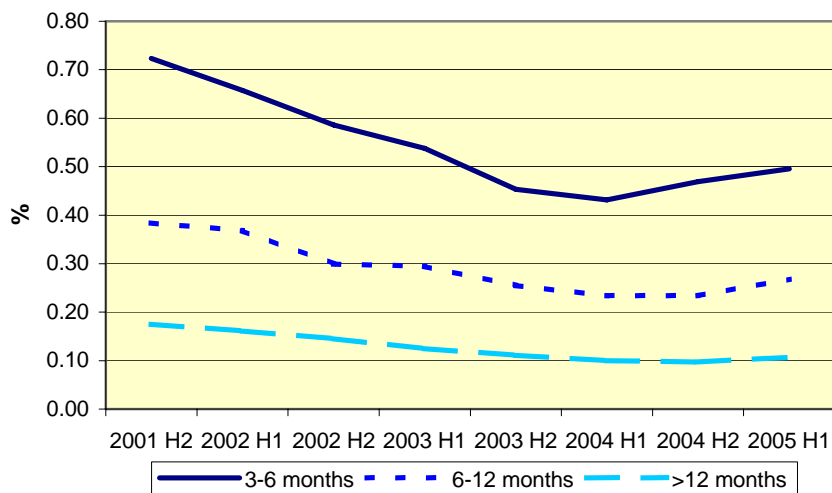
- (a) Solid line shows annual write-off rate for UK-owned banks, dotted line the rate for all UK-resident banks (interpolated annual data).
- (b) Data are for individuals; unincorporated businesses excluded.
- (c) Data are for England and Wales, and are annualised.

Total write-offs to individuals in Q2 2005 increased by 28.7% year on year. Unsecured lending to UK households accounts for the largest domestic contribution to UK bank write-offs in recent years. However, the Bank of England stress in their Financial Stability Review published in June that whilst 'Write-offs on UK household debt have increased... overall, the outlook suggests that major threats to financial institutions from developments in the economic environment are unlikely to materialise in the short term.' They suggest that the main risks to the UK financial system lie in longer-term vulnerabilities, such as the historically high debt-to-income ratios for UK households.

2.3 Mortgage Arrears

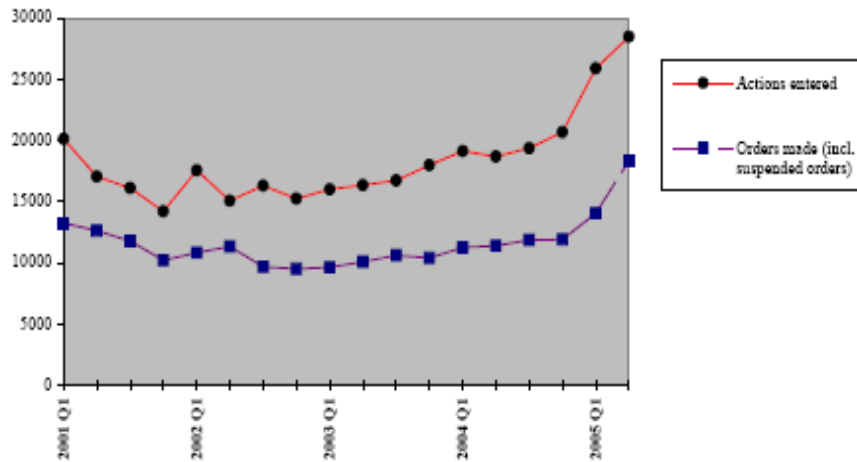
Mortgage arrears increased by a tiny amount, 0.002% year on year, over the first half of 2005, after increasing for the first time in 6 years in the second half of 2004. Mortgage possession actions rose by over 52% year on year in Q2 2005 following a sharp rise in Q1. However, both series are still relatively low by historic standards.

Figure 12: Mortgage arrears*



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

Figure 13: Mortgage possession orders



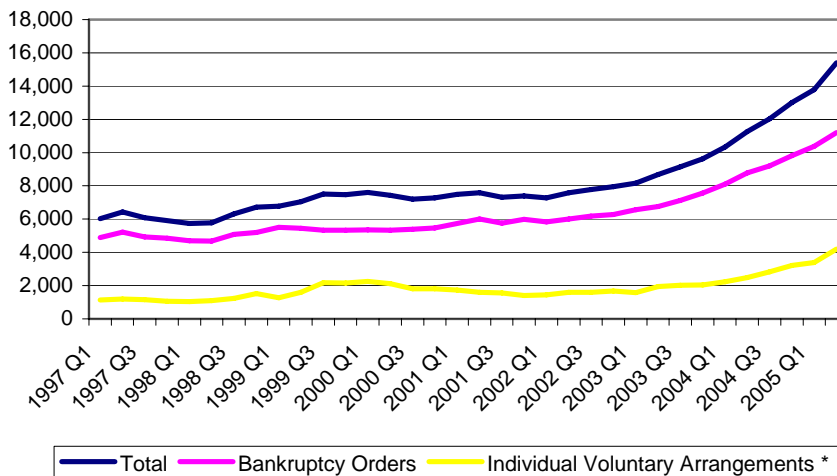
Source: Department of Constitutional affairs
 Orders made by local authorities and private lenders.
 Orders made include suspended orders.

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

2.4.1 Personal Insolvency

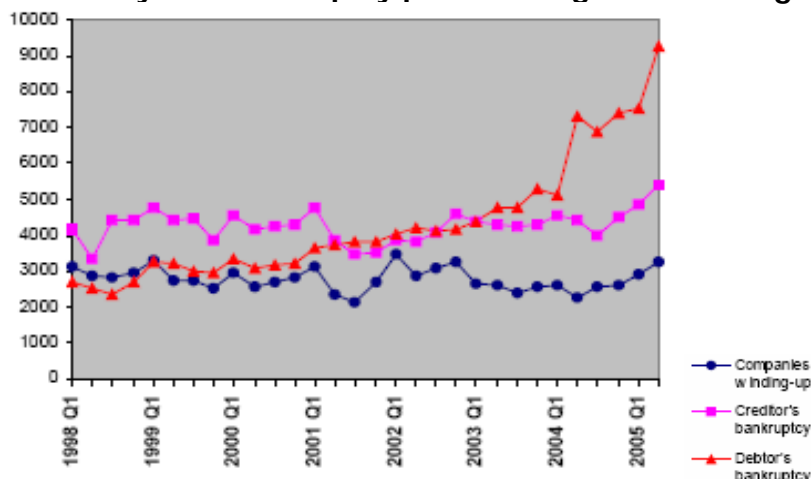
There were 15,394 individual insolvencies in England and Wales in the second quarter of 2005 on a seasonally adjusted basis. This was an increase of 11.7% on the previous quarter and an increase of 36.8% on the same period a year ago. This was made up of 11,195 bankruptcies, an increase of 7.8% on the previous quarter and 27.5% on the corresponding quarter of last year, and 4,199 Individual Voluntary Arrangements (IVA's), an increase of 23.7% on the previous quarter and an increase of 69.6% on the corresponding quarter of the previous year. Bankruptcy petitions also rose during this period, creditor petitions rose by 23% and debtor petitions by 27% year on year.

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



Source: Insolvency service, DTI
 *Includes deeds of arrangement

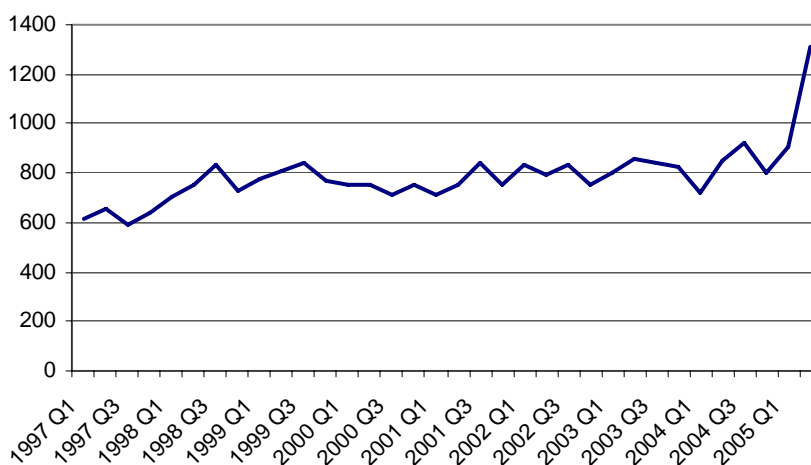
Figure 15: Insolvency and Bankruptcy petitions registered in England & Wales



Source: Department for Constitutional Affairs.

Sequestrations in Scotland increased markedly in the second quarter of 2005 according to provisional figures. Figures released in August cite an increase to 1,305 from 908 in Q1 2005, an increase of 53.6% 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. The councils in question are expected to continue with this harder line on council tax arrears in the near future.

Figure 16: Sequestrations in Scotland



Source: DTI Statistics

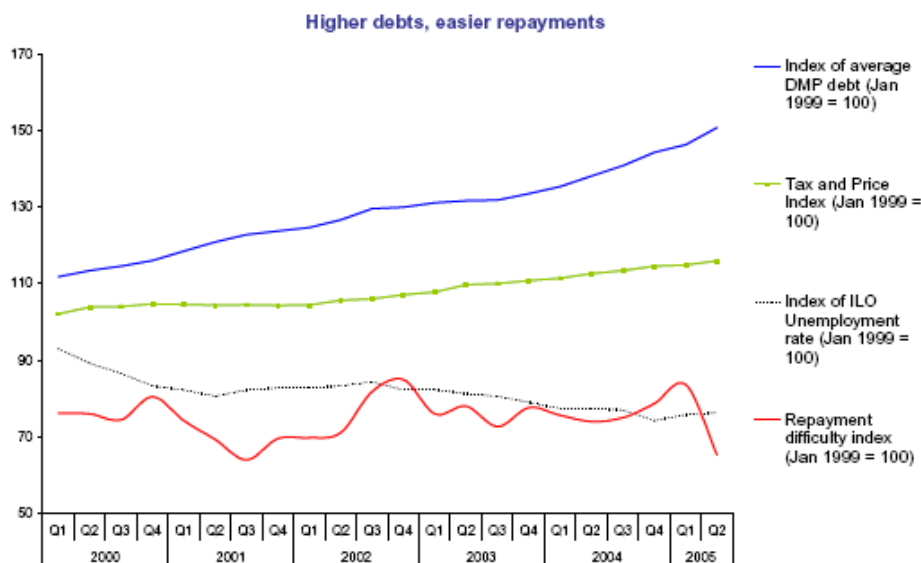
As explained in the last monitoring paper (for Q1 2005) there is no conclusive evidence of a single driver that might be contributing to the overall increase in personal insolvencies, although research generally attributes changes in bankruptcy numbers to economic factors, in particular availability and levels of credit, although asset/debt ratios, interest rates and employment levels all play a part.

The 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 is too early to say whether or not the changes in legislation have had any effect on the number of people becoming bankrupt. The Insolvency Service is also undertaking some detailed work investigating the characteristics of people that become bankrupt including age, gender

and the levels of debt incurred. A full report will be published in due course but preliminary results show that there is an increase in the proportion of female bankrupts and those aged 18 to 29.

Consumers on repayment plans had less difficulty making their debt repayments in Q2 2005. The Consumer Credit Counselling Service's repayment difficulty index, which reflects problems reported by people on repayment plans, fell 12% year on year from quarter two of 2004. It reached the lowest repayment difficulty figure recorded for any second quarter, and the second lowest quarterly figure since the index began.

Figure 17: CCCS repayment difficulty index



Notes
 1) Tax and Price Index measures how much the average person's gross income needs to change to purchase the RPI basket after allowing for the average amount of income tax and national insurance paid on earnings.

3. Subjective measures of debt

The most recent survey results on consumers' own view of the burden of their borrowing repayments are from the DTI commissioned MORI Financial Services carried out over the last five months of 2004. They show only a small proportion (5%) of debtors declaring their debt repayments a heavy burden.

Table 1: Burden of borrowing repayments

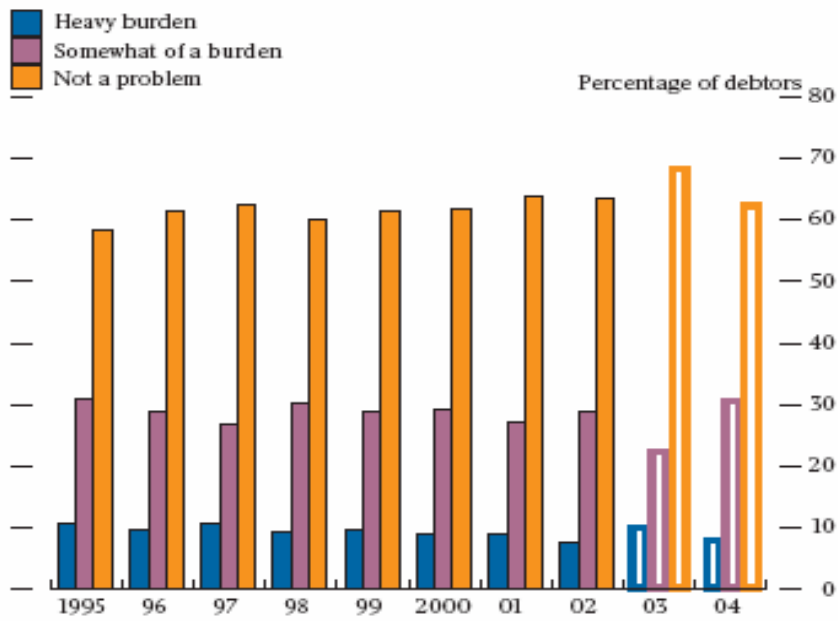
Level of Financial Burden	MFS 2004 % of debtors ³ who find their secured and unsecured borrowing repayments:
Heavy burden	5%
Somewhat of a burden	20%
Not a problem	75%

The results were consistent with the similar research⁴ from the Bank of England. The Bank sponsored survey carried out by NMG Research showed that the number of borrowers who declared their unsecured debt repayments a 'heavy burden' has remained relatively constant over the past decade.

³ Answering sample of 4,106. The question refers to household debt repayments.

⁴ This research looked at the burden of unsecured borrowing repayments whereas the MFS survey took into account of secured and unsecured borrowing repayments.

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

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://www.bankofengland.co.uk/statistics/li/current/index.htm 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 (MG SX)	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://www.bankofengland.co.uk/statistics/index.htm Interactive Database Search for 'LPMRLMH' and 'LPMVTVJ'
Growth in unsecured lending	Bank of England: Monetary & Financial Statistics Interactive Database	M	End of following month	http://www.bankofengland.co.uk/statistics/li/current/index.htm
12 month growth rate of Net Lending	Bank of England: LPMVTYO and LPMVTYI	M	End of following month	http://www.bankofengland.co.uk/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://www.bankofengland.co.uk/statistics/li/current/index.htm
Total Household Sector Debt / Income Ratios	Office for National Statistics: Total Debt / Income Ratio (NNPP/4*RPOK) Secured Debt / Income Ratio (NNRP/4*RPOK)	Q	Check: http://www.statistics.gov.uk/statbase/tsdreleased/ates.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 RPOK
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 &	Department for	Q		http://www.dca.gov.uk/statistics/cjust.htm

Wales	Constitutional Affairs.			
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 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://www.bankofengland.co.uk/publications/index.htm

Department of Trade and Industry
Consumer and Competition Policy Directorate

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