Consumer Debt and Money Report

Q3 2012

making business sense

Executive summary & commentary

The StepChange Debt Charity Consumer Debt and Money Report Q3 2012 **expands on previous reports to build a nuanced picture of financial difficulty in the UK. Analysis by the Centre for economic and business research (Cebr) shows that continuing economic uncertainty has resulted in fragile livelihoods for many, leaving them in a precarious position.**

Key findings:

- **Level of interest burden varies dramatically across the UK:** A breakdown of the StepChange Debt Charity Interest Burden Index (IBI) shows the financial pressure on people living in different areas of the UK. Those in the South East appear to be under the most pressure, spending 30 percent (£315) of their disposable income on interest payments. On average, individuals in Yorkshire, the South West and East Midlands spend over 25 percent of disposable income on interest payments.

  Interest payments are lowest, both in cash terms and as a proportion of disposable income, in Wales (£150) and Scotland (£168).

- **Self-employed struggling:** Analysis of the StepChange Debt Charity data warehouse shows the downturn may have hit the self-employed particularly hard. Large mortgages and high levels of secured borrowing, possibly taken out to keep businesses afloat, mean that self-employed people advised by the charity in Q3 owed on average almost £300,000. Poor economic conditions appear to have contributed to gradually worsening financial hardship, with self-employed clients in a deficit budget, spending, on average, £211 more than they earn each month.

  StepChange Debt Charity clients in part-time or full-time employment have an average debt load of 4.1 time their income. This rises to 18.6 times income for the self-employed.

- **Family budgets under pressure:** As wages have stagnated, prices have continued to inflate, leaving many families in an increasingly precarious position. Since January 2009, earnings growth has been only 1.5 percent per year. Over the same period, rents have been rising at 2.2 percent year on year, food by an average of 4.5 percent, utilities by 3.9 percent and transport by five percent.

  Overall, a basket of essential spending items increased by £48 from January 2009 to September 2012 whereas average weekly earnings over this period have only grown by £29.

About this report:

This report has been compiled by the Centre for economic and business research (Cebr) for StepChange Debt Charity. It is based on data compiled from StepChange Debt Charity activities in support of more than 7,000 clients every week and provides a unique picture of recent developments and future trends in respect of household debt.

Economic Overview

by Tim Ohlenburg, Cebr Senior Economist – UK recession ends, but challenges remain

Economic growth of 0.9 percent quarter on quarter between July and September brought an end to recession, but UK output remains three percent below its pre-crisis peak and fourth quarter GDP may disappoint. Making up about 77 percent of the economy, services are where most value and wealth is created and an upturn in this dominant section of output would promise economic progress if sustained. However, the recent PMI services index from Markit/CIPS indicated activity in the service sector is falling. It should be noted that in the areas where the service industry is most productive, i.e. London and the South East, this report shows the debt burden is substantially higher.

In line with growing output, the labour market has strengthened, although unemployment still remains high. The unemployment rate fell from a peak of 8.4 percent at the end of 2011 to 7.8 percent in the three months to September. That is an important development from a consumer finance perspective because unemployment is often a primary reason households fall into debt distress, with the last edition of this report showing the impact income shocks have on financial sustainability. Monetary policy is expected to be loose for an extended period, meaning that mortgage interest rates should stay near current levels beyond 2015. However, a snapshot survey carried out by StepChange Debt Charity with its clients in Q3 2012 (results in Appendix), shows a mixed message about confidence. Around 60 percent of those surveyed feel their personal finances will be in a better position in six months,15 percent feel it may get worse.

The number of employed persons in the UK reached an all-time high in August, moving slightly above the level of early 2008 when the financial crisis started to be felt. However, it should be kept in mind that the UK population is growing and so an employment record would be expected at some point even if the job market lacks momentum. In addition, much of the rise in employment has been in part-time work and self-employment. Due to lower earnings in the former case and more uncertain ones in the latter both these categories result in more fragile livelihoods. The rising cost of essential items such as rent, fuel and heating bills only adds to this. Table 1 shows key priority arrears statistics for all StepChange Debt Charity clients. The number of people seeking help with arrears on basic living expenses has increased since 2009. It is particularly noticeable that the proportion of clients with Council Tax, fuel and rent arrears appears to have increased sharply over the first three quarters of 2012.

Figure 1 shows that the rate of personal insolvencies has remained high in England and Wales and even higher in Scotland. Inflation has exerted major pressure and the weak economy means that many suffer declining incomes. This report evaluates how inflation has affected financial sustainability and describes wider debt advice trends.

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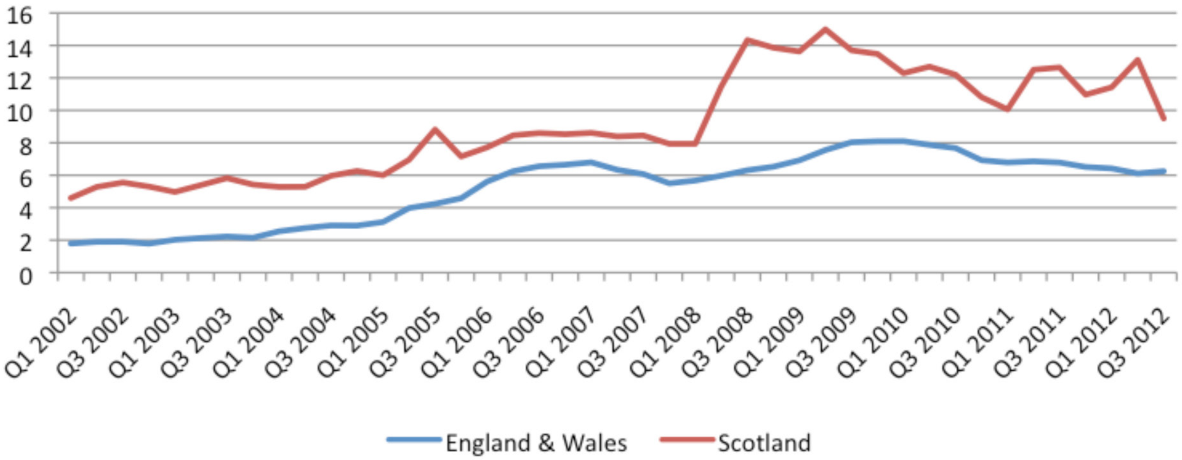
Table 1: Levels of arrears, StepChange Debt Charity clients, 2009-2012

	2009	2010	2011	2012 Q1-3
% with Council Tax Count arrears	7%	6.7%	8.9%	13%
Council Tax Arrears Balance	£633	£675	£717	£798
% with fuel arrears	6.8%	7.1%	8.2%	11%
Fuel arrears balance	£537	£596	£592	£664
% with rent arrears	4%	4%	5%	9%
Rent arrears balance	£712	£725	£760	£808

For England and Wales, the rate of personal insolvencies is falling towards the level of the early 2000s. While still at an elevated level of roughly six per 10,000 people in England and Wales, this rate has fallen from the peak of about eight per 10,000 during the height of the financial crisis.

Figure 1: Personal insolvencies per 10,000 of the working age population



Source: Department for Business, Innovation and Skills

Large difference in interest burden across UK regions

The StepChange Debt Charity Interest Burden Index (IBI) stayed stable in Q3 2012, with an interest payment of £189 for the average UK household. As a share of discretionary income, interest payments take up about 22 percent of available funds after subtracting spending on essentials, such as food and transport, from the average after tax income. Looking ahead, changes to the uprating of benefits will put additional pressure on those receiving social security payments.

But the average household is a statistical construct that corresponds with few actual families. A more disaggregated look at the debt situation is needed. Figure 2 shows the amount of average monthly interest payment by region and an estimate of the proportion of household income with which this corresponds.

The IBI for Wales of £150 per month is the lowest for the regions of Great Britain (Northern Ireland is excluded due to lacking data). Scotland and the North East follow shortly after with values of £168 and £174 respectively. Other regions are similar until we reach the East of England where monthly payments jump to £209. Given high house prices, it's little surprise that the average London household has to pay more to service its debt, namely about £286 per month. The highest interest burden is reported for the South East, facing £315 of financial obligations per month. Table 2 lists the interest burden by region across the UK.

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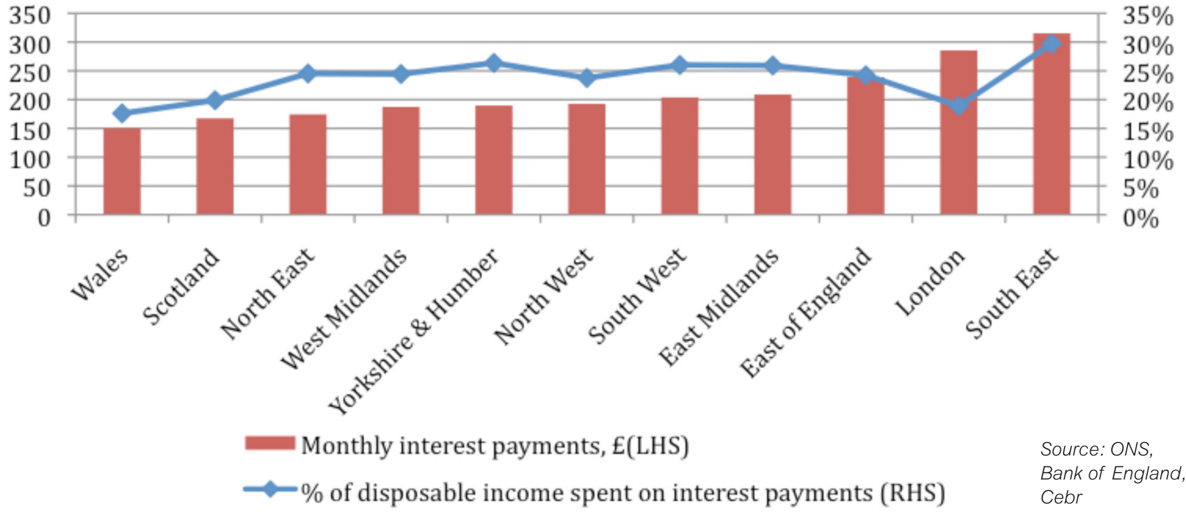
Figure 2: Interest Burden Index in proportion to discretionary income, by UK region (excl. Northern Ireland)



Source: ONS, Bank of England, Cebr

Table 2: Average monthly interest burden by UK region (excl. Northern Ireland)

	Wales	Scotland	North East	West Midlands	Yorkshire & Humber	North West
Monthly interest payments	£150	£168	£174	£187	£190	£193

	South West	East Midlands	East of England	London	South East
Monthly interest payments	£204	£209	£239	£286	£315

Source: ONS, Bank of England, Cebr

The share of discretionary income consumed by interest payments generally rises with the amount of interest payments, but there is no strict relationship. Also Figure 2 shows that Wales and Scotland have a share below 20 percent, which rises to a fairly consistent 25 percent for most regions in England. The share is similar, despite different interest payment obligations, because households with more income take on more debt on average and for most of England they do this in a fairly even pattern. The two outliers are London and the South East. Households in the South East face by far the highest interest burden per month and this is reflected in the share of disposable funds going to service debt: they spend about eight percent more of their disposable income on interest payments than the UK average. A large average mortgage debt resulting from high house prices has forced many in the South East to allocate more of their money to servicing debt. Judging from the amount of interest payments, one may expect London to be in a similar situation, but this isn't the case as the income of the average London household is higher than elsewhere in the UK. In fact, the higher earnings of the average London household reduces the share spent on servicing debt to a level more similar to that of Wales and Scotland than to the rest of England.

To supplement the analysis we can look at the type of debt that households across the UK have accumulated. Figure 4, in which regions are ordered according to their share of mortgage debt (rather than by interest burden as above)

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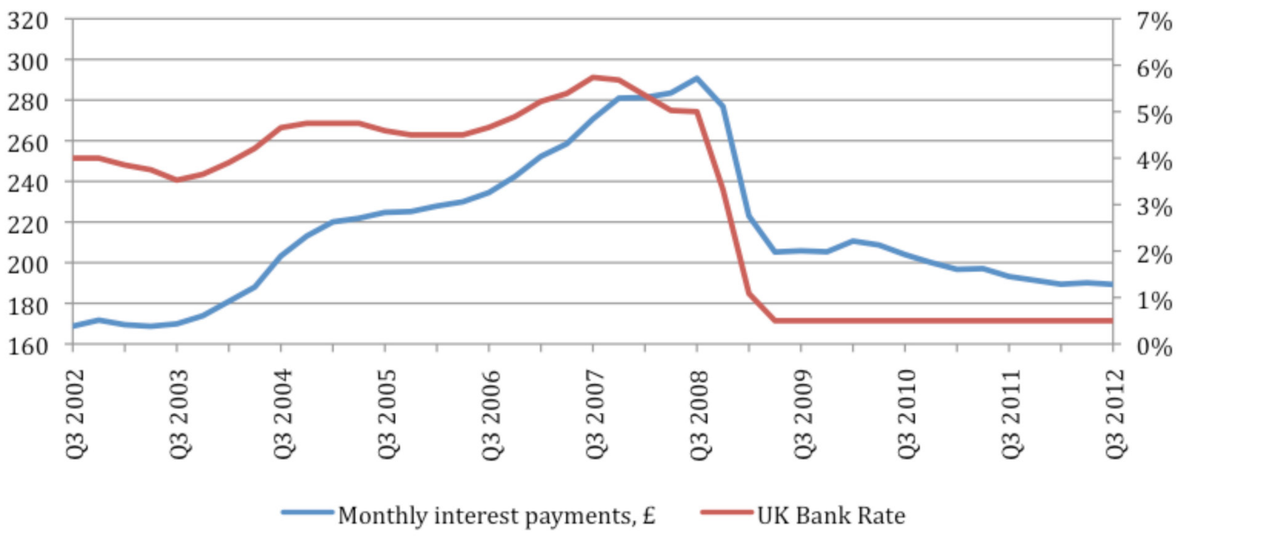
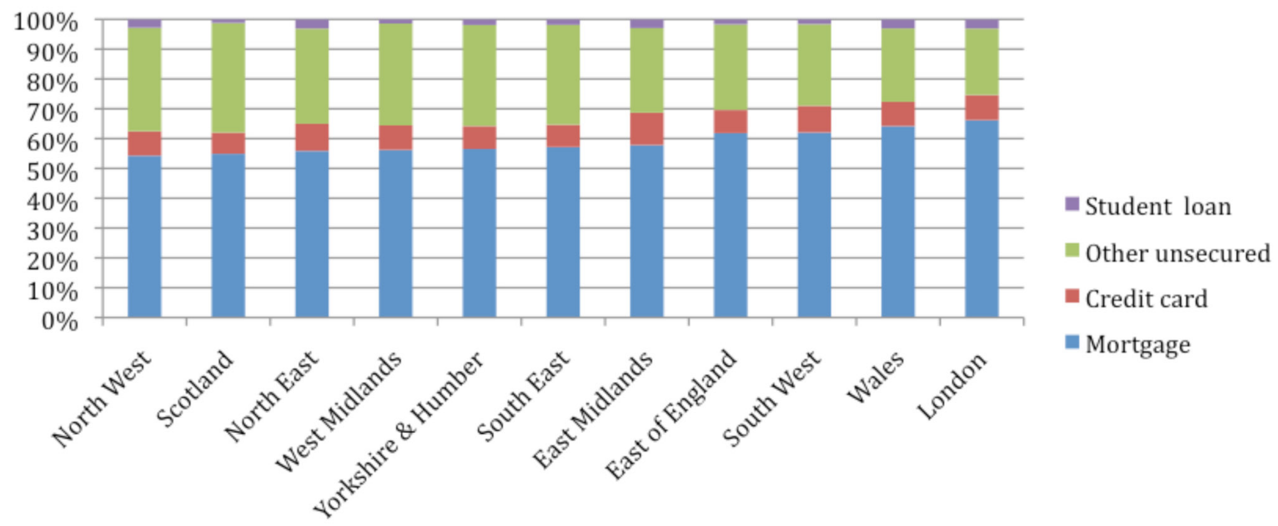
Figure 3: Interest Burden Index of average monthly payment per household, £



Source: Bank of England, Student Loans Company, Cebr

Figure 4: Debt proportions of total household debt, by UK region (excl. Northern Ireland)



Source: ONS, Bank of England, Cebr

shows differences in the debt profile of UK regions. Mortgage debt is the dominant type across all parts of the UK, with its proportion of total debt rising from 55 percent in the North West to 66 percent in London. Other unsecured debt, consisting of store card, mail order and hire purchase debt, overdrafts, and commercial or bank loans, accounts for much of the remaining difference. From a maximum of 37 percent in Scotland it falls to just 22 percent in London.

The two main factors in explaining the regional differences stem from house prices and wages. The average house in the UK costs about £164,000, compared with £200,000 for the South East and £301,000 for London. With similar loan to value ratios being granted to mortgage borrowers across the UK, this results in much higher secured lending in the more expensive regional housing markets. To an extent, some Londoners may be able to afford more expensive houses as gross wages in London are about 40 percent higher than in the rest of the country. However, even in the capital the cost of living and house prices are rising faster than incomes. The next section examines this point in more detail.

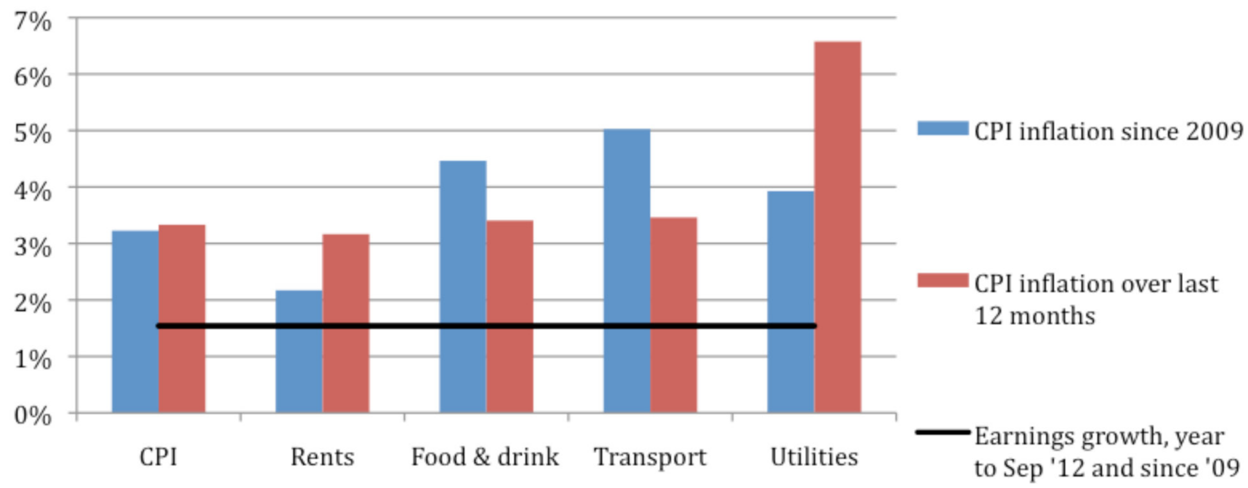
Family budgets suffer as price of essential items outpace wages

In this section we look at the issue of purchasing power. Purchasing power consists of two elements. One is income, especially earnings from regular employment. The other is the price level, which determines what goods and services can be bought with household incomes.

Earnings growth has slowed by nearly two thirds since the recession. In the 2000s until the end of 2008 average weekly earnings rose by an average of 4.2 percent per year. That rate suggests a doubling of earnings in about 17 years, a considerable rise in available financial resource. A break occurred in 2009 and the black line in Figure 5 shows the average level of earnings growth since then: 1.5 percent, which is also the rate over the twelve months to September 2012.

While incomes rose by 6.6 percent in nominal terms since 2009 the price level went up by 13.6 percent, meaning that households lost an average of about 1.7 percent per year in real purchasing power. Because non-discretionary spending categories saw rising prices, households were in many cases unable to avoid rising costs. Rents have been rising at 2.2 percent year on year since 2009 and over the past year have picked up to 3.2 percent as the lack of house building combined with a rising population, pushes up the value of living space. Energy sources, such as oil and gas, and agricultural items have seen large price rises, pushing up domestic inflation. Food and beverage prices have risen by an average of 4.5 percent annually since 2009, transport costs have gone up by five percent and utilities have added 3.9 percent. High gas prices have been pushing up utilities costs even more over the past twelve months, rising by an annual average of 16.4 percent between September 2011 and September 2012. In sum, wage rises have been more than outweighed by rising costs, meaning that household finances have suffered purchasing power declines. Overall, a basket of essential spending items as measured by the ASDA income tracker has increased by £48 from January 2009 to September 2012 whereas average weekly earnings of this period have only grown by £29.

Figure 5: CPI inflation versus annual weekly earnings growth since 2009 and over the past year



Source: Office for National Statistics

Self-employed face highest debt burden

UK business insolvencies remain elevated. Even though the statistics show a decline in the share of firms being liquidated, the overall number of liquidations this year is expected to be higher than at any point since records began apart from during the financial crisis. As 77 percent of UK companies have at most one employee, in many cases business finances are closely tied to the owner's fortunes, meaning that company insolvency can often result in personal distress. In this section we look at evidence from StepChange Debt Charity clients to analyse the position of self-employed individuals seeking debt advice.

The level of income is a crucial determinant of debt sustainability. The average self-employed client (£1,321 net) earns about 14 percent less per month than part- or full-time employees (£1,542 net) as Figure 6 shows. Considering that they will have often invested considerable sums in their companies, this is somewhat concerning and indicates that a low return on investment is a major reason for debt distress among the self-employed. An income level below that of other employed clients suggests many firms are either very small or face a difficult operating environment. And while incomes are lower than for the self-employed, monthly expenditure is higher, resulting in an average deficit of £211. By contrast, clients in full- or part- employment have an average monthly surplus of £74.

But the key difference from a debt advice perspective relates to the level of debt. As Figure 7 shows, the self-employed have nearly four times more debt than those in employment. Mortgages make up the bulk of the difference, amounting to an average of £206,500 for the self-employed versus £54,600 for others. Secured loans that are not mortgages and unsecured debt (credit cards, overdrafts etc.) is also much higher for the self-employed group; they owe £42,500 more on secured loans and £24,200 more on unsecured loans. As an example, the self-employed have accumulated £16,100 of credit card debt, 2.3 times as much as other employed clients.

The much higher debt level combined with a lower income means that the average self-employed person seeking debt advice is in a more difficult financial situation. The high mortgage

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Figure 6: Monthly income, expenditure and surplus/deficit, self-employed vs. part/full-time employed

Source: StepChange Debt Charity

Figure 7: Debt levels, self-employed vs. part/full-time employed

Source: StepChange Debt Charity

and secured debt levels indicate a substantial investment of funds in the business that the self-employed are personally liable for. The lack of return on the investment evident from the income level makes servicing debts problematic in many cases and lead to financial distress. The figure that best indicates the scale of the issue for the self-employed is the ‘gearing’ of debt to income. Clients in part- or full-time employment have an average debt load of 4.1 times their annual income as reported to StepChange Debt Charity. The ratio rises to 18.6 times income for the self-employed. Even at current low interest rates such a situation is unsustainable for this group.

In the current tough economic climate, for many business owners the operating environment of weak demand and rising costs appears to have reduced incomes to a point where the debt load has become too heavy to bear.

Persistent demand for debt advice belies economic recovery

Over the previous 12 months, StepChange Debt Charity has completed 197,500 advice sessions. That number is roughly the same as the 12 months prior, up a marginal one percent. Compared with last quarter there was also little change, with the flat annual growth line in Figure 9 showing just how persistent the issue of unsustainable household debt is. Over a longer time period we can see that there has been very little movement in the number of advice sessions since late 2010 (see Figure 8). The volume of advice sessions over the past year still amounts to over 90 percent of the financial crisis peak. It is nearly four times as high as before the deep recession that resulted in rising advice sessions from 2008 onwards. The balance between telephone advice and the online Debt Remedy platform remains roughly balanced. About 53 percent of clients receive advice from StepChange Debt Charity via the phone.

Going from the national to the regional level we can see some divergence in demand for advice from StepChange Debt Charity across the regions. Measured per 10,000 of population to have a comparable basis across the UK, the demand for debt advice has risen in five regions, stayed largely unchanged in another five regions and fallen in two over the past year. This underlines the overall assessment there has there has been little change in advice sessions over the past quarters and Q3 2012 is no exception. The clearest decreases in activity were in the West Midlands (-7.0 percent) and in London (-2.9 percent). However, the capital continues to have the highest demand for debt advice from StepChange Debt Charity when adjusted for population, as shown in Figure 10 overleaf.

The high and stable demand for debt advice is a clear indicator that the income squeeze resulting from high inflation and a weak labour market continues to take a toll on household finances.

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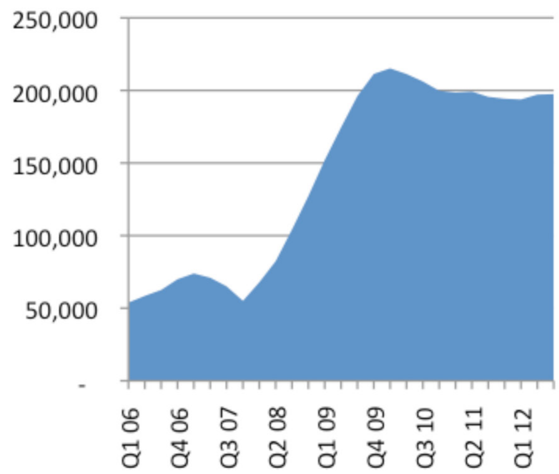
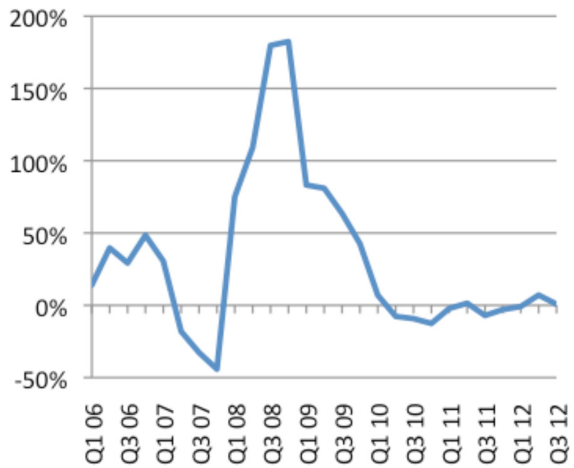
Figure 8: Telephone and online counselling sessions, rolling four quarter figure



Source: StepChange Debt Charity

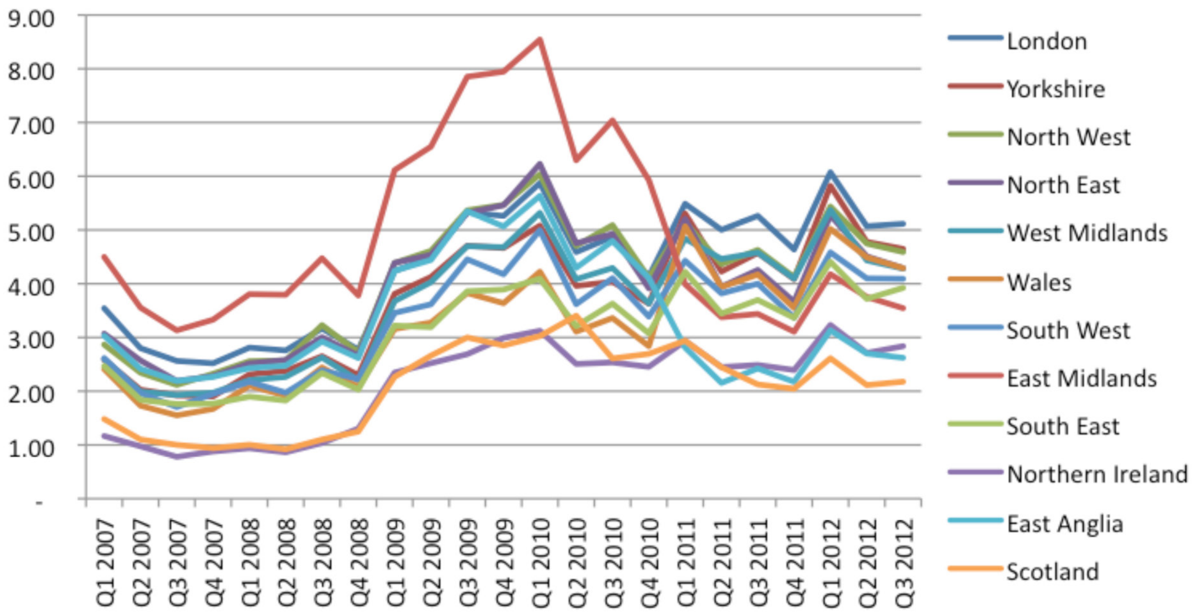
Figure 9: Year-on-year growth in telephone counselling sessions



Source: StepChange Debt Charity, Office for National Statistics, Cebr

This may be obscured by relatively upbeat labour market figures, but the numbers presented here are clear evidence of a stressed financial situation for many. That the demand for debt advice remains near crisis levels despite record-low official interest rates is a cause of concern for the future. Although full-time employment and wage growth should have picked up by the time mortgage rates – the major debt-relate expenditure – rise again, the legacy of the pre-crisis consumer debt boom in the form of over-indebted borrowers will be with us for years to come.

Figure 10: Contacts per 10,000 households by UK region



Source: StepChange Debt Charity, Office for National Statistics

Appendix

n=122	Better	Worse	I don't know
1. How do you feel your personal finances (including debts, arrears and mortgage obligations) are now, compared to six months ago?	77.0%	13.1%	9.8%
2. Looking forward six months, do you expect personal finances will be:	59.8%	14.8%	25.4%

n=122	Easier	More difficult	I don't know
3. Compared to six months ago how are you finding keeping up with essential expenditure (such as food, housing and transport)?	65.6%	28.7%	5.7%
4. Looking forward six months, do you expect keeping up with essential expenditure to be:	48.4%	24.6%	27.0%

n=122	Higher	Lower	About the same
5. Thinking about your income (from wages, benefits etc), what is it now compared to six months ago?	10.7%	21.3%	68.0%
6. Still thinking about your income, looking forward six months do you expect it to be:	14.8%	6.6%	78.7%

n=122	Improved	Got worse	Stayed the same
7. How do you think addressing your financial situation via CCCS has affected your family life compared with six months ago?	87.7%	2.5%	9.8%
8. Looking forward six months do you expect your family situation to be:	45.9%	3.3%	50.8%

Results based on responses from 122 StepChange Debt Charity clients, who were nine-months into a Debt Management Plan. Clients were surveyed in October 2012.

Data sources and methodology

The main source for this report is anonymous client data from the StepChange Debt Charity client database. The database goes back to 2005 and includes information from the newly introduced online advisory service from 2008 onwards. The telephone and online advice information provides the inputs for the sections on the volume of counselling sessions provided and on demographic variables of clients.

To compute the average level of debt of UK households in relation to the average household income, we draw on a variety of economic variables. The Bank of England provides lending volumes while household figures are based on data from the Department for Communities and Local Government. Income figures rely on a Cebr model that draws on a variety of data sources supplied by the Office for National Statistics and the Bank of England.

Bank of England Lending to Consumers data on the stock of secured and unsecured debt as well as lending interest rates are used to estimate the average household's amount of monthly debt payments. For credit card data, the stock of loans is adjusted for non-interest bearing balances with figures from the British Bankers' Association. Credit card debt and student loans are excluded from the stock of unsecured debt. The interest rate applied to the remaining unsecured debt is based on a simple arithmetic average of the overdraft, £5,000 loan and £10,000 loan interest rates as no detailed breakdown of the loan portfolio is available. Interest on student loans is calculated based on information from the Student Loan Company, with monthly figures estimated on a straight line basis from published annual amounts and including principal repayment. Household numbers are based on the figures published by the Department for Communities and Local Government.

The interest payments share of discretionary income is calculated using an income tracker. This is put together using Office for National Statistics data on family spending and incomes and modelled on a monthly basis using price and wage data. Essential spending is a subset of total spending and includes spending on food, rent and utilities for instance.

The regional breakdown of interest payments and the Interest Burden Index is based on household level data by region from the Office for National Statistics' Wealth and Asset Survey. The distribution of different debt types across the country was brought in line with the national total as measured by Bank of England figures outlined above and interest payments are estimated according to the Bank of England's published average interest rates. For the regional derivation of the discretionary income part ONS Family Expenditure Survey was used to model both income and expenditure profiles across the United Kingdom, in line with the method set out above.