Consumer Debt and Money Report

Q4 2011

Q4

cebr
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CONSUMER CREDIT Counselling Service
A Registered Charity

CCCS introduction

This is the first in a series of quarterly reports from Consumer Credit Counselling Service (CCCS) based on research carried out by Cebr, which will provide a useful tool for policy-makers and those grappling to understand and confront the rising problem of household debt.

The report is based on data compiled from CCCS activities in support of more than 7,500 clients every week and provides a unique picture of recent developments and future trends in respect of household debt.

At a time when personal finances continue to be hit by economic uncertainty, low wage growth and rising unemployment, the independent Cebr analysis shines a light on the problems facing individuals and households across the UK. Crucially it introduces a new method of understanding the financial pressures felt by families. The CCCS Interest Burden Index shows us how much money an average household spends on interest payments every month and how this reduces the amount they have available to live on.

Debt is a significant problem for the UK today and the CCCS seeks to play a part both in dealing with its effects and proposing solutions to the wider causes. CCCS is the UK's leading debt charity, providing free, independent and impartial advice to people with financial problems.

Last year, the CCCS helped more than 400,000 people with services ranging from household financial advice to specialist insolvency support, from welfare benefit help to assistance to the self-employed.

The CCCS is the largest specialist provider of independent debt advice and the country's only major charitable provider of non-statutory debt management plans (DMPs).

Executive Summary

This first Cebr analysis of the unique data which CCCS receives through its vital work with consumers struggling with debt reveals some significant patterns and, combining them with use of our own economic modelling tools, enables us to forecast some important future trends for the UK. Among our principal results we find:

- The CCCS Interest Burden Index shows that households are spending 24 percent of their discretionary income – £199 per month – on interest payments.
- The demand for debt advice is forecast to remain high and rise in the coming years as unemployment rises across the UK.
- Demand for debt advice is expected to hit another peak in 2014, indicating the lasting distress caused by the financial crisis (bearing in mind that economic projections in the current economic environment are highly uncertain as the eurozone crisis rumbles on).
- Middle-aged and older people will be increasingly affected by debt problems severe enough for them to need to seek help, highlighting the challenging financial situation that older households face.
- We predict CCCS's share of clients over the age of 45 to rise from a historic 28 percent in January 2005 to a projected 47.6 percent by December 2014. Currently 30-44 year olds make up the largest CCCS client group. Younger households add up to about one in five clients counselled.
- The fastest increasing areas of debt help need are Wales, Yorkshire and the Humber which have seen double-digit increases in demand for advice. The areas with the highest actual demand for counselling are London and the North West.
- Concerned households are battling to shed their debt levels as quickly as they can, which we predict will push the debt to net income ratio down about a quarter by late 2014 compared with its peak.
- However, debt deleveraging slowed in 2011 due to the real disposable income squeeze caused by high inflation and low wage growth. This has been compounded by the increased cost of key essentials such as petrol, utilities and housing with many turning to loans to smooth consumption over this tough time for family budgets.

These factors will continue to put pressure on households as they try to rebuild their balance sheets following the financial crisis and recession.

Cebr Economic Overview

Tim Ohlenburg,
Senior Economist

2011 was a difficult year for many households. The optimism about growth prospects for the UK economy widely felt at this time last year has evaporated and it has become clear that the days of consistent pre-crisis economic growth have passed for a long time. Both the public and private sector are now dealing with the aftermath of debt-driven consumption that turned out to be unsustainable. The UK economy now faces a prolonged period of deleveraging resulting in public sector spending cuts and weak household consumption. With the hope of an export-led recovery hit by the eurozone crisis and business investment low due to limited credit availability and an uncertain profit outlook, the economy is unable to generate sufficient employment.

Mainly driven by public sector retrenchment, the unemployment rate has been rising from 7.7 percent in the three months to April to 8.4 percent in the three months to November. Labour productivity remains low and we expect that many companies will now shed staff to reduce their capacity as they realise that the recovery is not unfolding as expected. The economy contracted in the last three months of 2011 and a recession looks increasingly likely. As a result, we expect unemployment to keep rising gradually, climbing above nine percent in the first months of 2013. With rising unemployment, employees have limited bargaining power and wage growth will therefore be low. Fortunately, inflation is coming down from the very high level of 2011, when it outpaced wage growth and thus ate into households' real purchasing power. This trend should continue and ease some pressure on squeezed household budgets, with 2012 seeing a modest increase in disposable incomes.

A positive effect of the weak economy for indebted households is that interest rates are set to remain at very low levels for several years into the future. The light blue line in Figure 1 shows that the Base Rate of the Bank of England - the economy's key interest rate - dropped steeply during the financial crisis. However, the graph reveals that the falling cost of credit was not fully passed on to consumers. The rising lines show the spread, or difference, between the Base Rate and the actual cost of various forms of consumer credit. The spread for all unsecured forms of credit rose by more than the Base Rate fell, meaning that many credit products actually became more expensive. Only the mortgage interest rate spread rose by less than the Base Rate fell, making mortgages less burdensome. This is the main form of credit for many but not all households and means that those without a mortgage face more challenging credit conditions than before the financial crisis despite the record low of the Bank of England's Base Rate.

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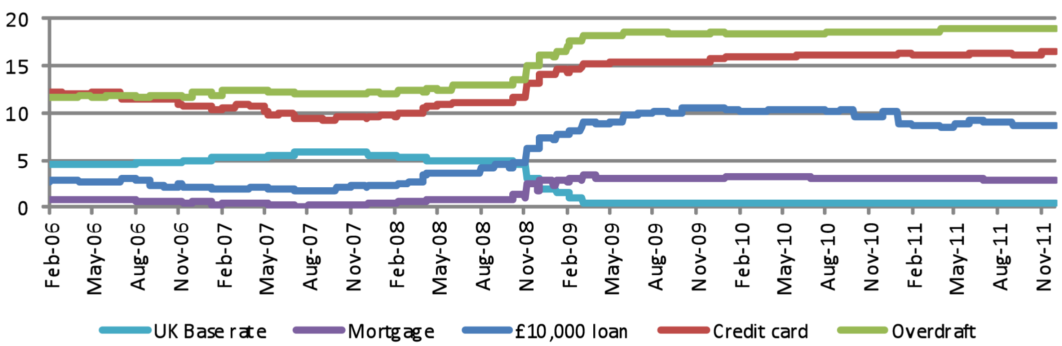
Figure 1: UK Bank Rate and typical interest rate spreads to consumer credit products, percent



Source: Bank of England

The UK's precarious fiscal position and the risk of a credit rating downgrade mean that the Chancellor of the Exchequer has limited fiscal space to reduce the financial pressure bearing down on many households. As a result, the spring budget is likely to contain few policy innovations. A mooted accelerated increase in the income tax-free allowance could raise disposable income for lower income households, although the distributional impact will depend on the details of the change. The uprating of benefits by the September annual consumer price inflation level – right at last year's 5.2 percent peak – means that some households dependent on benefits may see their household finances improve by more than the working population. For a small fraction of households, the £26,000 benefit cap to be introduced in 2013 will outweigh the large rise in benefit payments. Overall, government policy aimed at containing public debt means that there may be little support for borrowers from the public purse. This report shows that the demand for debt advice spiked during the financial crisis and has remained high since. As outlined on the coming pages, we expect the elevated and rising unemployment level alongside challenging credit conditions to keep debt advice in strong demand.

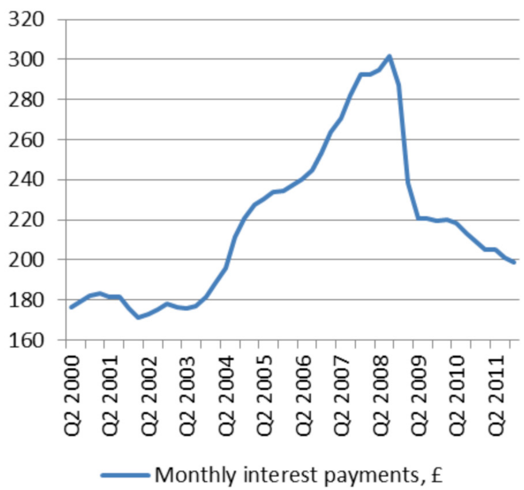
CCCS Interest Burden Index shows that interest payments consume a major chunk of household budgets despite low Base Rate

Interest payments are a heavy burden on household finances. With payment necessary regardless of economic circumstances, they pose a major threat to the solvency of many families. As a major spending component that must be met on time, the need to service debt is posing a significant challenge in the current economic downturn when household heads lose their jobs and income sources dry up. The loose monetary policy of the Bank of England has brought some relief to hard-pressed household budgets, but the CCCS Interest Burden Index shows that the average household is still paying nearly £200 per month in interest.

From 2003 onward, household debt rose amid interest rate increases aimed at keeping the economy from overheating. The pound sterling amount that the average household had to pay on its debt crept up – see Figure 2 for a graphical illustration – rising from about £180 to a peak of £300. The following sections of this report outline how the mounting debt servicing burden had a strong impact on debt distress. With plunging interest rates in the wake of the financial crisis, the average monthly payment fell back sharply and has since been declining due to a deleveraging effort explained in more detail in the following section. However, at £199 per month in Q4 2011, the regular interest burden remains high compared with pre-2003 levels.

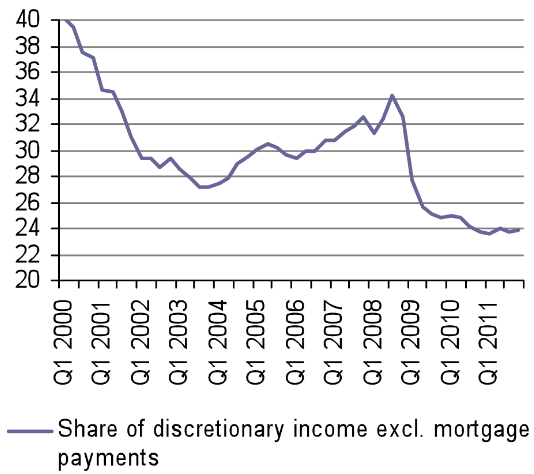
About one in four pounds of discretionary income available, i.e. after essential spending such as utilities and food, goes to servicing debt. This ratio crept up to about one in three during the financial crisis as households piled on debt and then unexpectedly faced a deteriorating labour market. Since the second half of 2009, the share of discretionary income going towards interest payments has been roughly stable (Figure 3). The interest burden as a share of discretionary income should remain largely stable in coming months. On one hand, further household deleveraging is expected to gradually ease the debt burden faced by families and interest rates should remain fairly stable for the foreseeable future. On the other hand, the reason that this is not projected to lead to a lower interest payment burden is that a weak labour market will limit wage increases to less than inflation. With a persistently high average interest burden, those affected by rising unemployment will struggle financially.

Figure 2: CCCS Interest Burden Index of average monthly payment per household, £



Source: Bank of England, Office for National Statistics, Cebr analysis

Figure 3: Interest payments as share of discretionary income excl. mortgage payments, percent



Source: Bank of England, Student Loan Company, Cebr analysis

UK households remain highly indebted despite deleveraging effort

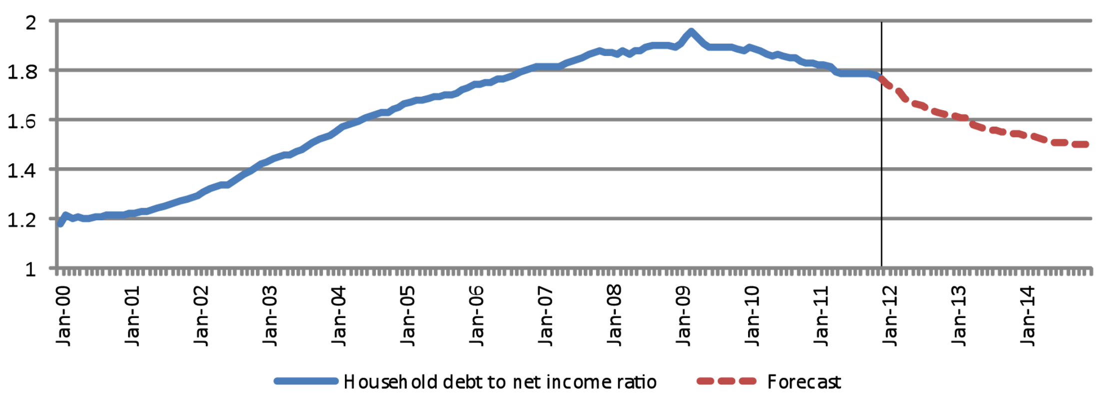
This section introduces an indicator that measures household debt in relation to repayment ability, the Debt to Income (DTI) ratio. It expresses the average level of debt per household as a proportion of net take-home pay. This allows an evaluation of the debt burden over time as household debt can be more affordable if incomes rise at a faster rate and vice versa. By looking at both the debt burden and the income available to service the debt load we can judge the actual financial burden.

A parallel measure for public finances is the debt to GDP ratio, which is currently much discussed in relation to the eurozone debt crisis. As with a country as a whole, household capacity to service debt is best expressed in relation to income generation. The rising leverage shown in Figure 4 initially contributed to the high rates of economic growth and supported house prices, but is now having the opposite effect of undermining domestic demand as consumers attempt to lower their debt burden. A rising savings rate has resulted in a gradual fall in the DTI ratio from a peak of 196.1 percent reached during the height of the financial crisis. It currently stands at 176.5 percent, with the pace of decline slowing markedly during the last months of the year as rising costs of essential items ate into household budgets and reduced their ability to repay debt.

With the property carousel grinding to a halt, the decline has been partially driven by reductions in secured lending, which makes up the bulk – around 85 percent - of household debt. A reduction in non-credit card unsecured debt (such as overdrafts and bank loans) has also played a role in bringing down the DTI ratio, while credit card debt has stayed relatively stable as a proportion of net income at about seven percent. Looking ahead, low transaction volumes in the property market and stagnant house prices mean that households will keep paying off their mortgages at a faster rate than secured credit is taken out. This is projected to result in a fall of the mortgage DTI ratio from 152.3 percent at the end of 2011 to 134.9 percent by the end of the forecast horizon in December 2014. We also expect the public to reduce unsecured debt further, with the ratio falling gradually from the current level of 15.7 percent to about 14.4 percent in late 2013.

Overall, households are expected to keep reducing their high debt burden amid an uninspiring macroeconomic environment that offers little hope of the high pre-crisis wage increases. Nevertheless, the debt burden remains at about the high level of 2006 and imposes a significant strain on many households. With rising unemployment, this means that the demand for debt advice should stay strong in the coming years.

Figure 4: Household debt to net income ratio, percent



Source: Bank of England, Office for National Statistics, Cebr analysis

High mortgage debt puts household finances under pressure

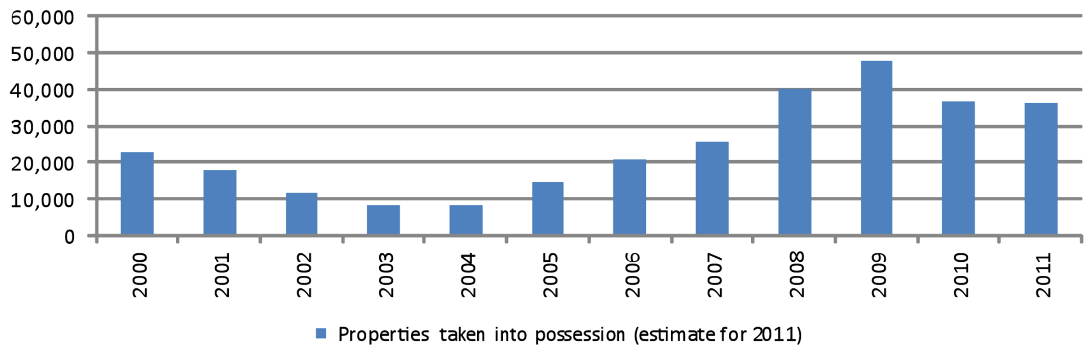
Housing plays a key role in the UK's household finances. On the one hand, it makes up the bulk of borrowing and thus represents the major financial burden that the average family faces. On the other, mortgage debt finances peoples' homes and the underlying asset thus has much more than mere financial importance. Significant monetary as well as emotional investment has gone into most of our homes and the loss of them due to financial reasons is a major disruption with wide-ranging implications from changes to daily life, to organising alternative accommodation, to retirement planning. For these reasons, mortgage debt is crucial for personal finances and is becoming an increasingly important area of debt advice.

The numbers underline the growing importance of mortgage debt in household finances. In the pre-crisis property boom, average mortgage debt ballooned from about £20,000 per household at the beginning of the 2000s to £47,000 per household in December 2011. This accompanied a run-up in house prices from an average of £85,000 to £160,000 over the same time period. Another factor contributing to the importance of secured debt to UK households relates to the high rates of home ownership. About 66 percent of UK households live in their own four walls, compared with just 42 percent in Germany. A supply-demand imbalance in the housing market – household numbers grow much faster than the housing stock – suggests that house prices will keep rising steadily in the medium to long-term. With incomes set to grow at a slower pace and first time buyers hard-pressed to get on the property ladder, rates of home ownership may well decrease gradually in the coming years and decades.

With rising property prices and rising borrowing, mortgage debt has grown in importance compared with other areas of household finances. This development is evident in the growing share of mortgage debt as a proportion of total household debt. This has risen from 80.3 percent in January 2000 to 86.3 percent by the end of last year. The increase of six percentage points is even more noteworthy considering the large increase in the DTI ratio outlined in the previous section. With rising levels of debt have come rising levels of financial difficulty.

The number of properties taken into possession due to non-payment of mortgages is the most tangible measure of secured debt distress. In the years before the financial crisis, unemployment was at very low levels and consumer confidence riding high amid steady wage growth and optimism about UK economic prospects. Property repossessions began to increase in 2005, rising by 77 percent from their low of 8,200 in the previous year, which signalled that households were already getting into mortgage financing difficulties despite the strong economy. The number of repossessions then kept climbing until 2009, when it reached 47,900. The last two years have seen some easing to about 36,500 but, apart from the middle of the crisis, they remain at the highest level since 2000. As explained below, a substantial level of distress linked to both secured and unsecured debt is likely to persist.

Figure 5: Properties taken into possession in England and Wales



Source: Ministry of Justice

The demand for debt advice surged during the financial crisis and has remained high since

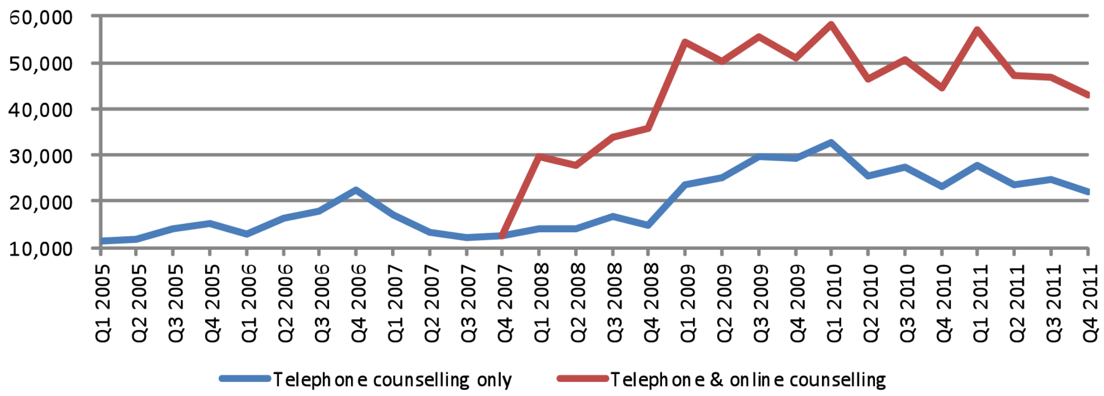
As the largest debt advice charity, the volume of client contacts of CCCS offers direct evidence of the prevalence of financial distress in the United Kingdom. Figure 6 reveals that the economic recovery of 2010 brought little relief to UK households facing a significant debt burden. Looking at development of counselling volumes offers other insights.

The demand for debt advice from CCCS was at a structurally lower level prior to the financial crisis. An initial peak of 22,600 telephone counselling sessions in Q4 2006 followed a rise in unemployment that began in late 2005 and took about a year to feed through to more financial distress. The pattern of changes in employment having a delayed effect on the demand for debt counselling is evident again in a spike of telephone counselling sessions during the first quarter of 2009, about nine months after the financial crisis began to raise the unemployment rate. From here on, volumes remain high, with the Q4 2011 level only 8.7 percent below that of a year before.

The persistence of financial distress becomes more obvious when online counselling sessions are taken into account. Debt Remedy accounts for half of client contacts and averaged 24,000 per quarter in 2011. This is just 2.7 percent below the 2010 level and still 91.9 percent of the demand for debt advice during the 2009 peak. The 23,804 client contacts in Q4 2011 show that many households are suffering financial hardship. As the following section outlines, we expect this trend to continue for an extended period.

The high volume of demand for CCCS's services means that it has been able to help a large number of households to deal with the debt. The total number of contacts - via the telephone or online – amounted to 369,500 in 2011. In early 2012, CCCS was administering 120,000 Debt Management Plans (DMPs) for its clients, covering a volume of unsecured debts of £3.7 billion. The advice provided helped households to pay back £312 million of their unsecured debt last year. The trend towards debt management plans is also evident in more severe cases of financial distress where insolvency is the only option. Data from the Insolvency Service shows that managed insolvencies that include Debt Relief Orders and Individual Voluntary Arrangements (versus bankruptcy orders) now account for about two thirds of insolvencies. This underlines that CCCS work is part of a wider movement to help households manage unsustainable finances.

Figure 6: Counselling sessions per quarter, including and excluding online counselling



Source: CCCS

Worsening job market forecast to push demand for debt advice back towards financial crisis levels

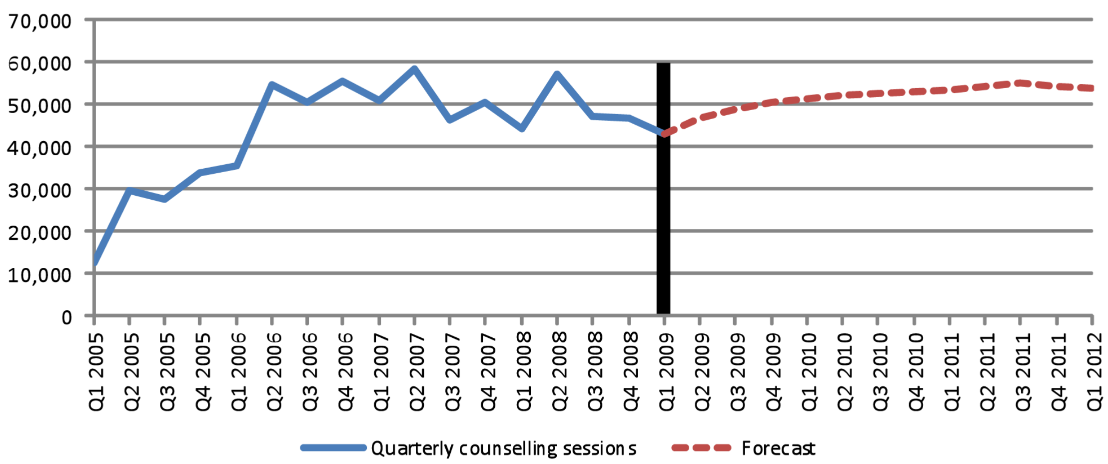
In this section we use information on the expected path of the economy until the end of 2014 to construct a forecast of the demand for debt advice. The result of the forecasting exercise is the quarterly counselling session volume per quarter. The forecast, shown in Figure 7, assumes a stable CCCS share of total debt advice activity. A changing proportion of UK-wide debt advice handled by CCCS would have a distinct impact on the number of counselling sessions projected here.

Our analysis suggests that demand will fall slowly in the first half of 2012 as falling inflation reduces the financial strain for some households. Stable earnings growth amid lower price rises means that many will have additional resources available, although the overall effect of this shift to lower inflation is likely to be limited. By mid-year, counselling volumes are expected to bottom out at 41,630 per quarter, representing a reduction of 3.5 percent from the current level. In the second half of the year, we anticipate rising unemployment to become the main driver of call volumes. A deteriorating labour market that is projected to see the unemployment rate rise above nine percent in 2014 is expected to lead to financial hardship for a growing number of households. From a bottom in mid-2012 onwards, we forecast an average increase in monthly counselling sessions of about 3.6 percent per quarter. By the end of 2014, we expect about 55,200 sessions per month, a level only slightly below that recorded at the peak level of Q4 2009. From the second half of 2014, an improving labour market is expected to lead to a slow decline of the need for debt advice even though rising interest rates may put additional pressure on heavily indebted households.

The risk factors to our forecast are probably more concentrated on the downside than the upside. A significant deterioration of the eurozone debt crisis would lead to an extended recession for the UK economy and push unemployment even higher, likely resulting in more need for debt advice. A related risk is that of a renewed banking crisis brought on by sovereign default in the eurozone periphery that would undermine bank balance sheets and raise the risk of another credit crunch. Such an event would cut the availability of credit and push up borrowing costs, thereby affecting household finances at the credit side at the same time that a worsening labour market cuts incomes.

The forecast of high demand for debt advice implies difficult times for many UK households, households that lose their source of income are severely affected. Unfortunately, our analysis suggests that the weak economy will continue to impact many.

Figure 7: Quarterly CCCS counselling sessions, historical data and forecast



Source: CCCS, Cebr analysis

Older households are increasingly suffering financial hardship

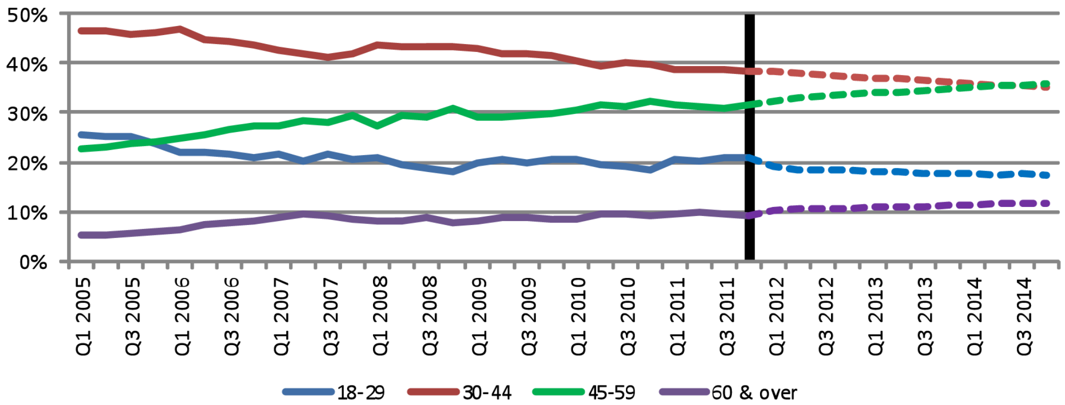
In this section we look at demographic and financial trends apparent in the data. For the Q4 2011 edition, we focus on the age profile of CCCS clients. We have segmented clients into four age groups to show how the shares of these groups have shifted over time (see Figure 8). From the beginning of 2005 to the end of 2008, the data draws on telephone records only. With the introduction of online counselling data in 2008, there is a minor shift in client profiles, but the general trends remain unchanged.

Mid-career workers between the ages of 30 and 44 make up the largest share of CCCS clients. The large number of callers in this age group is related to the high debt burden taken on when founding a household, including the purchase of a house financed by mortgage debt that exposes the households to a high risk of financial distress when incomes fall unexpectedly. The share of this group has been declining, falling from 46.4 percent in Q1 2005 to 38.3 percent in Q4 2011. However, with the uptrend in financial distress, total counselling sessions for this group have increased by nearly 150 percent between 2005 and 2011. **Younger households** have fallen from 25.6 percent in Q1 2005 to 20.9 percent in Q4 2011, possibly because they have been less able to take on debt due to tight lending standards and have thus had the benefit of a lower debt burden while the employment outlook for young workers gets worse.

Rising debt advice demand from households of **late-stage professionals** between the ages 45-59 is the main reason for a shift in client profile. There has been a gradual rise in counselling demand from this group, with its share rising from 22.8 percent in 2005 to 31.7 percent by Q4 2011. The other group that has seen an increase in their share of contacts are **older households**. These have nearly doubled as a share of total contacts, going from 5.2 percent in 2005 to 10 percent in Q2 2011. A major factor for the increase in financial distress of older households is that they have benefitted relatively less from a reduction in mortgage costs due to a lower burden of secured debt. At the same time, the financial crisis brought large investment and pension losses for many older households.

The macroeconomic variables affecting household debt sustainability are expected to keep moving in a similar direction as in the recent past. Low interest rates should provide some relief for holders of mortgage debt, while rising unemployment and volatile financial markets can be expected to hit incomes. At current trends, 45-59 year olds are projected to become the largest CCCS client group by Q3 2014, with their share growing to 35.5 percent at that time. Those 60 and over are expected to keep rising as a share of those counselled, increasing their share about 12 percent by late 2014. Younger households are expected to fall slightly as a share of those counselled as limited credit availability hinders their ability to accumulate a large debt burden. Illustrating the shift of financial distress amid demographic change and a new economic environment, at current trends older households will make up nearly half (47.6 percent) of CCCS clients by the end of 2014, up from 28 percent in early 2005.

Figure 8: Share of CCCS clients by age group, percentage points



Source: CCCS, Cebr analysis

Demand for debt advice rising in nearly half the regions

Local economic conditions vary greatly across the UK, with some areas much more affected by financial distress than others. This section looks at regional developments to give an insight into the changing demand for debt advice across the UK. There are striking differences and large changes over time that are illustrated graphically in Figure 9. This graph shows the number of client contacts to CCCS per 10,000 households of a given region in order to show demand on a population-adjusted basis. The size of the circles represents contact volumes in Q4 2011 compared with Q4 2010, based on data from telephone counselling sessions for which locational information is available. The annual comparison with a previous fourth quarter is most meaningful because it eliminates seasonal variation. It should be noted that regional variation in the number of contacts is related to CCCS share of debt advice given as well as to underlying economic conditions.

With their large urban populations, London, the North West and the West Midlands are the regions with the highest volume of contacts per 10,000 households. Urban centres have higher unemployment rates and there is a wider discrepancy of incomes, resulting in a bigger need for credit counselling. With 4.64 client contacts per 10,000 households, London is the region with most advice activity.

In the last three months of 2010, the East Midlands saw by far the largest number of contacts – 5.93 – on a population-adjusted basis, but this has fallen by an enormous 47.6 percent over the course of 2011. The East of England saw a similarly large decrease in call volumes, with volumes falling 47.1 percent to 2.17 per 10,000 households. In both regions, improvements in the local labour market that lasted until the middle of the year appear to have been the main cause for the improvement in household finances. Looking ahead, this unfortunately suggests that these parts of the UK will again see more need for debt advice as they, too, have been affected by rising unemployment.

With a high dependence on the public sector, Wales has suffered significantly from public sector austerity measures. This has resulted in an increase of 25.1 percent in call volumes in Q4 2011 compared to Q4 2010. The other heavily affected areas are mainly those with already-high rates of financial distress, with London, the West Midlands and Yorkshire and the Humber reporting large increases of about 12 percent each. This illustrates that a worsening economy will lead to further difficulties for highly-affected areas.

Figure 9: Fourth quarter contacts per 10,000 households, by region

Source: CCCS, Office for National Statistics

Data sources and methodology

The main source for this report is anonymous client data from the CCCS client database. The database goes back to 2005 and includes information from the online advisory service, Debt Remedy, from 2008 onwards. The telephone and online counselling information provides the inputs for the sections on the volume of counselling sessions provided, on demographic variables of clients seeking advice and the base data for forecasting the average monthly level of telephone counselling sessions.

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. The forecast series relies on Cebr projections of income growth and household savings.

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. 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 forecasting section is based on a multivariate time series regression that draws on various variables affecting household debt sustainability. The independent variables that offer the best statistical model include a lagged dependent variable, seasonal dummies and current and lagged values of differenced average weekly earnings, unemployment and the savings rate. Cebr forecasts are then used to derive a projected series, with the result shown in Figure 4 representing a smoothed series that represents the central tendency of the forecast values.

Foundation for Credit Counselling
Registered Office: Wade House, Merrion Centre, Leeds LS2 8NG
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