The UK’s household debt problem: Is there one, and if so, who’s at risk?

For the typical household, debt problems are not as bad as is often painted despite the increase in debt levels, but for low income families, access to high quality credit remains a problem.

Household debt now exceeds one trillion pounds in Britain. With buoyant consumer spending over Christmas, debt-financed consumer spending is commonly perceived to be out of control. But does this picture fit the facts, and which households are most at risk of debt problems? A talk by Richard Disney (Nottingham) delivered on 24th January at the IFS will provide some aggregate economic data and then focus on updating research, published by IFS in 2004, which examined the debts of low income households in the late 1990s, updating the picture to the recent past.

The talk illustrates how aggregate consumer debt has grown substantially in recent years – both secured on houses (primarily mortgages and remortgaging) and unsecured debt (such as finance loans and credit cards). But, alongside debt, the value of household disposable income and household asset values have also grown strongly. Data from the Bank of England for the last 13 years (Chart 1) show that unsecured debt as a fraction of household disposable income has been roughly constant for the last five years, despite the rapidly increasing number of credit cards in the economy. In fact, use of most types of unsecured credit instruments other than credit cards has fallen over the last 5 years. What the chart does show is that debt secured on housing wealth has risen – not surprising given the rise in the value of houses over the period.

Aggregate data do not show which households are at risk from ‘excessive’ debt. Research published by the IFS in 2004 examined the debt position of households with children in 1999. It showed that poorer households tended to use more easily accessible methods of purchase such as mail order and catalogue purchases rather than credit cards. Although a minority of families reported problems paying off loans from finance companies and credit and store card bills, by far the greatest prevalence of arrears took the form of unpaid utility bills and council taxes.

The research updates these results by tracking the sample of households five years on. Have these households changed their use of credit instruments, and have their debt problems worsened? Among the findings of this analysis of a panel of households, Professor Disney shows that:
• Whereas almost 60% of our poorer families with children were tenants in 1999, nearly 50% were homeowners by 2004.

• The individuals studied are much more likely to use credit cards than 5 years before, with a corresponding decline in the use of almost all other kinds of credit: store cards, bank loans, loans from finance companies, mail order and catalogues and various kinds of ‘informal’ and sub-prime lending. (Chart 2)

• For example, among the 21% of tenants who purchased houses between 1999 and 2004 in the sample, 57% had credit cards in 2004 compared to only 26% in 1999. Credit card access rose among all groups, even those who remained tenants. (Chart 2)

• Conversely use of mail order and catalogues fell sharply among all household types. Use of store cards has risen slightly among tenants but fallen among owners.

• These trends reflect the growth of home ownership, which is associated with access to ‘better’ forms of credit, the longer credit histories of our sample five years on, which gives them positive credit scores, and the greater sophistication of credit scorers in identifying ‘good’ risks.

Despite the growth of credit cards, the research finds no evidence of growing financial difficulties among the sample. On every criterion of financial difficulties, there is a lower risk of repayment difficulties as these individuals have grown older. (Chart 3 illustrates the most pervasive form of arrears). This almost certainly illustrates growing real incomes over the life cycle and access to better forms of credit, especially as individuals acquire collateral such as housing equity.

Tenants, and lower income households generally, maintain a greater risk of running into difficulties with repayment. High and rising utility bills provide a continued threat to household finances, and slowing growth of real incomes may prove a problem for such families. In addition, poor or non-existent credit scores also lock poor families into debt with high APRs which pose major difficulties in repayment.

These conclusions suggest that policy should especially focus on two concerns:

• Minimising major adverse shocks to household finances such as the rising costs of ‘essentials’ such as utilities and housing costs;

• Addressing the problems faced by those consumers who only have access to ‘bad’ credit instruments with high APRs, rather than consumers with good credit records and access to credit in the competitive prime market.
Chart 3: Proportion in arrears on at least one utility bill or council tax by household type 1999 & 2004

Notes to editors:

1. Richard Disney is a Research Fellow of the Institute for Fiscal Studies and Professor of Economics and Co-Director, Centre for Finance and Credit Markets, University of Nottingham.
2. The author will present these findings at a briefing on Wednesday 24th January at 12.30 at the Institute for Fiscal Studies.