Consumer Debt and Money Report

Q1 2012

Q4

making business sense

CONSUMER CREDIT Counselling Service

A Registered Charity

Executive Summary & Commentary

This second in a quarterly analyses of key trends in the financial well being of households in the UK focuses on the plight of young people, who are being disproportionately affected by the deteriorating state of the economy. This is particularly true for men, for the very youngest and in certain parts of the country, including northern England and the West Midlands.

Factors impacting on the young include:

1. **Unemployment:** one in four men and one in five women aged under 25 are unemployed. The situation is even more dire for 16 and 17 year olds where 44 percent of males and one in three women have no jobs. For all those aged 18 to 24, one in four have been out of work for a year and one in ten for over two. Under 25s now make up the largest proportion of unemployed people in the UK.

2. **Stagnating incomes:** even when employed, the young no longer have the same expectations as previous generations that their incomes will rise, while their spending power will be considerably reduced by increases in the cost of living. In the five years to end of 2012, prices are set to rise by 21 percent while earnings will have gone up by 12 percent.

3. **Debt:** every day CCCS helps about 40 people under the age of 25. Unsecured debt levels are relatively low, averaging £5,800, but because of low incomes and high unemployment, the average take home pay for clients under 25 is £980 compared with £1,380 for the average client.

4. **Tuition fees:** with two out of five young people aged 18-22 attending university, tuition fees will add roughly £9,500 to the debt burden of the average British citizen of future generations, meaning less money available for savings.

5. **Regional variations:** those parts of the UK which are struggling financially show a higher ratio of young people contacting CCCS per 100,000 population with Yorkshire & the Humber, the North West and the West Midlands generating significantly more calls from young people.

This combination of factors coupled with an ageing population and changes in pensions makes this an unusually challenging time for the young. At the same time, unemployment in youth casts a long shadow over subsequent lives: research shows that people currently in their early 30s who have spent time without jobs and not in education or training when younger, earn less than their peers.

It seems likely that many of those at the start of their career can no longer count on exceeding or even equalling their parents' standard of living.

CCCS Interest Burden Index (IBI)

For the population as a whole, debt servicing costs remain stable with the CCCS IBI showing that the average household paid £197 a month servicing debts in Q1. This accounts for more than a quarter (27.6 percent) of the average household's income left after taking out essential living costs.

As mortgage debt made up two thirds of the IBI, last month's news that several major mortgage lenders increased their standard variable rates bodes ill for many households. A two percent rise in interest rates would raise the monthly cost of such mortgages by half.

About this report:

This report has been compiled by the Centre for Economic and Business Research (Cebr) for the Consumer Credit Counselling Service (CCCS). It 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.

Economic Overview by Tim Ohlenburg, Cebr Senior Economist – Income squeeze to last into 2014, bringing more financial distress

Unfortunately the first quarter of 2012 did not signal the start of an economic recovery that many hoped for. Instead, the UK economy stalled and another quarter of falling national income means that the second recessionary period of a 'double dip' has arrived. The eurozone – Great Britain's most important trading partner – only narrowly avoided a recession, although action by the European Central Bank staved off a banking crisis that may well have spawned another financial crisis.

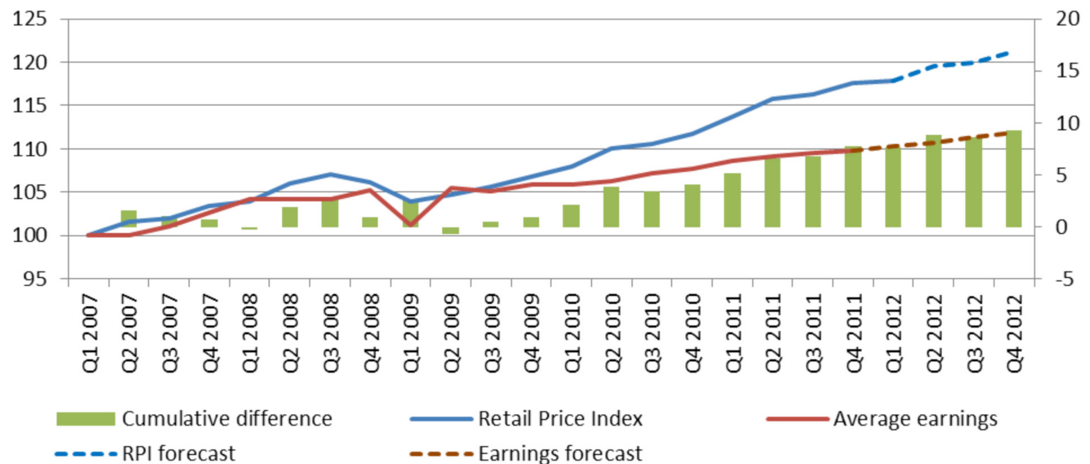
Even if GDP figures are revised upwards, as some commentators expect, any improvement in economic conditions would be limited and need to be put in perspective. The up-and-down pattern of GDP growth we have seen since the second half of 2010 may well continue for some time. Even if Q2 produces growth in national output, we will see setbacks again because fundamental drivers of the economy are languishing. The Treasury continues to steer the austerity course with only about a sixth of government spending cuts implemented to date, while the continued high price of crude oil, with British benchmark Brent trading significantly above $100 per barrel, is another drag on growth. The Eurozone was briefly calmed by a massive injection of credit to banks, but the causes of the crisis remain unaddressed - uncertainty will return to haunt markets and deter investment.

The effect on consumers that the moribund economy has cannot be overestimated. Energy prices are on track to set a record high this year, resulting in steep transport costs and pushing up consumer prices, both directly and through second round effects. Contrary to our earlier expectation, inflation has remained high and looks set to stay significantly above the Bank of England's two percent inflation target for the rest of the year.

Rising prices mean that consumers have less real purchasing power, and a familiar narrative of squeezed household budgets caught between inflation on one side and low earnings growth on the other has emerged. Figure 1 shows the gap between wage increases and price rises. From the beginning of 2007 to the end of 2012, prices are set to have risen by 21 percent, while earnings will only have gone up by about 12 percent. The bottom line is that actual purchasing power has dropped nearly one tenth.

Only in 2014 is wage growth likely to catch up with inflation, meaning half a decade of falling ability to spend for UK households. The budget offered little relief to those in debt, with an increase in the income-tax-free allowance the only substantial point. As we argue below, the young have been especially hard-hit by the recession and instead of addressing the youth unemployment crisis, education spending is being cut back. Generally speaking, further spending cuts will reduce welfare services and impact the most vulnerable, resulting in consistently high demand for debt advice from CCCS and other credit advice organisations.

Figure 1: Retail price index and average weekly earnings index (Q1 2007 = 100), and difference between the indices



Source: Office for National Statistics, Cebr

Interest burden remains high while inflation chips away at purchasing power

Interest payments make up a big part of monthly expenses for UK citizens. According to the latest CCCS IBI, the average household has to come up with £197 each month to service their current debt. This compares with a marginally higher amount of £198 in the last quarter of 2011, meaning that debt servicing costs have remained high, while elevated inflation has made other items of essential spending more costly.

The main component of the IBI is mortgages, which account for about £128, or two thirds of total interest payments. This means movements in mortgage rates can have an outsized impact on personal finances due to the large volume of lending secured on homes. It is worrying therefore that April saw an increase in the standard variable rate of several lenders. In this context it is worthwhile bearing in mind that a two percent rise in the effective interest rate consumers pay on their mortgage would currently raise the monthly cost of a standard variable mortgage by half.

Unsecured credit is the second component of the IBI, which shows that nine percent of interest payments by households are from credit card debt, two percent from student loans and another 23 percent from a variety of unsecured credit products. Although the Bank of England's base interest rate has been at the effective minimum of 0.5 percent for about three years some consumer credit rates have gone up since the financial crisis. If this happens sooner than previously expected due to high inflation then households will be hit by a double whammy of falling purchasing power and rising monthly payments obligations. We anticipate a rise in the need for debt advice as the Bank of England starts raising interest rates.

The £197 per month amount to 27.6 percent of the average household's discretionary income. Discretionary income is defined as after-tax income minus spending on essential items such as food, clothing and transport, but excluding mortgage interest payments to avoid double counting. We have revised the way pensions and social security benefits are modelled to better capture increased payments as a result of the deteriorating labour market as well as fine-tuning the basket of essential items. The changes have raised the discretionary share of income payments from 24 percent to 28 percent.

One group that has been especially affected by the deteriorating economy is young people. With reduced hiring, many have found it hard to gain a foothold in the labour market. In the following section we take a closer look at youth unemployment, followed by an examination of the financial situation of young people turning to CCCS for advice.

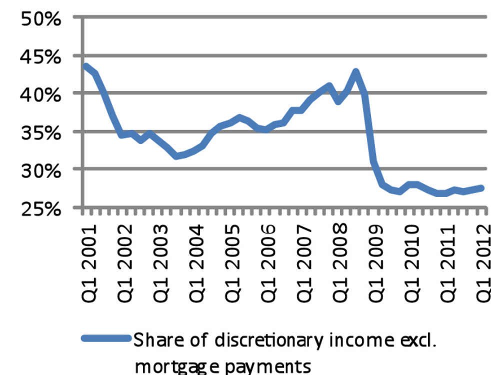
The Interest Burden Index

- Mortgage interest: £128.4
- Credit card interest: £18.5
- Student loan payments: £4.6
- Other unsecured interest: £45.9
- Total monthly interest payments: £197.3

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

Source: Bank of England, Student Loan Company, Cebr

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



Source: Bank of England, Student Loan Company, Office for National Statistics, Cebr

Two in five unemployed are below the age of 25

Unemployment and reduced income from employment or self-employment are currently the most common causes of debt for CCCS clients. The loss of the primary income source often turns a manageable financial situation into an unsustainable one according to research from the Institute for Social & Economic Research at Essex University.[1] One part of the labour market has been hit especially hard by the financial crisis and its low-growth aftermath: job prospects of young people, i.e. those below the age of 25. The unemployment rate for this group has reached a worryingly high level in the United Kingdom, with almost one in four now out of work. At 22.5 percent, the unemployment rate for under 25s is nearly double the level of May 2001, which was the minimum recorded in the data that stretches back two decades. For those between 18 and 24, one in four – 26.3 percent – have been out of work for over a year, and one in ten for over two. Overall we can conclude that there is a lack of work opportunities for the young, a worrying trend for an ageing society.

Looking at the situation in more detail, it becomes clear that young males are more likely to be unemployed than young females. Having fallen as low as 1.6 percentage points, young men's unemployment rate now stands 7.3 percentage points over that of young females (see Figure 5). About one in four young males is out of work, compared with fewer than one in five women.

Unemployment is particularly prevalent among the very youngest labour market participants (16 & 17 year olds). For this specific group the unemployment rate started rising markedly from around 2004 onwards. Since then it has nearly doubled to 39.4 percent and shows no signs of coming down. With an unemployment rate of 44.3 percent in January male youths aged 16 to 17 are the demographic group with the worst employment outcome. Female youths fare better, but nevertheless slightly more than one in three is out of work.

Figure 4 demonstrates how the recession has affected the young more than other age group. Under 25s now make up the largest proportion of all unemployed people. Currently nearly two in five of all unemployed people are aged 16 to 24 although they make up only one in five of the working age population. Young people benefited less from the pre-crisis economic boom, making up a progressively larger share of unemployment. When many lost their jobs during the recession the share dropped, but now it is clearly rising again.

Several factors have conspired to make this an unusually challenging time for the young. Where previous generations could bank on rising incomes and an improving standard of

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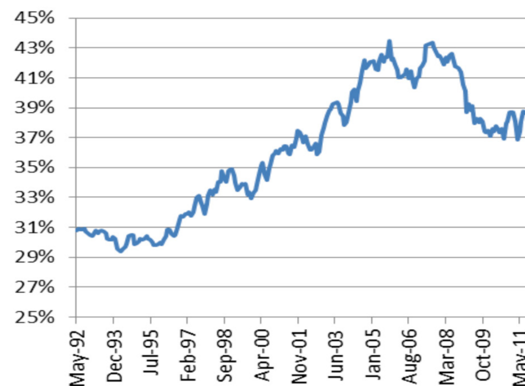
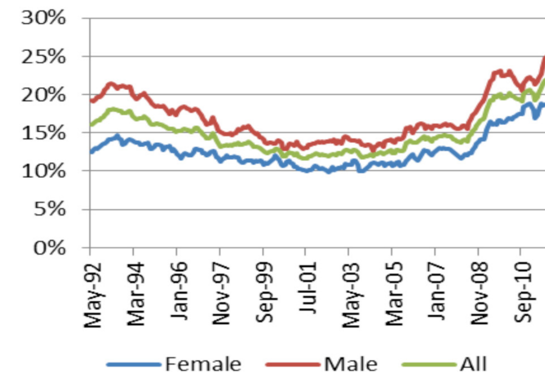
Figure 4: Unemployment share of 16-24 year olds



Source: Office for National Statistics

Figure 5: Male, female and total unemployment of 16-24 year olds



Source: Office for National Statistics

1 http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/o/11-747-over-indebtedness-in-great-britain-analysis

living, those embarking on their careers now cannot be sure that they will be better off than their parents were. Stagnating median incomes are one aspect, changes in pensions amid an ageing population another. Importantly, the detrimental effects of unemployment at a young age can persist for many years. For instance, a recent report from Association of Chief Executives of Voluntary Organisations (ACEVO) highlights research showing how time spent not in employment, education or training (NEET) during youth correlates with lower earnings at age 30/34. This loss is estimated as £3,337 for men who experience the average time NEET and £1,779 for women. This represents 140 percent and 75 percent respectively of the current yearly household interest burden identified above. This raises a clear concern that high youth unemployment will contribute to a higher vulnerability to debt problems to households in future.[2]

The figures presented here refer to the economically active population only, i.e. those available and actively looking for work, possibly in full-time education. Generally speaking, women are less likely to be economically active.

2 http://www.bristol.ac.uk/cmpo/publications/other/youthunemployment.pdf

Young CCCS clients in distress despite moderate debt burdens

At an average age of 22 years, many young people in the 18-24 age bracket are turning to CCCS for advice on their financial situation. In the first quarter of 2012, to which all figures in this section refer, they accounted for 3,600 counselling sessions. In other words, about forty young people reach out of for help every day via CCCS. The information in this section draws exclusively on data collected for counselling sessions.

A closer look at the debt profile of young people shows that despite their age, many have already run up a sizeable debt burden. The average CCCS client aged under 25 owes about £5,800 in unsecured debt from a variety of sources such as personal loans, overdrafts and store cards and has an average mortgage of about £2,950. Although this overall average seems low (because only three percent of young clients have a mortgage) it shows that 97 percent of CCCS clients aged under 25 are in trouble despite total debts of 'only' about £6,600. The wider population has a much higher debt load of £70,000 to which mortgages contribute two thirds.

However, debt problems must be seen through the prism of income levels. In terms of incomes, young CCCS clients have an average amount of £940 disposable per month. That compares with £1,380 for the average client. The difference in incomes can be explained by lower wages and by higher joblessness. Among young people calling CCCS, 31 percent have a full-time job and 16 percent have part-time jobs, slightly below average, while only about 30 percent of all clients are unemployed, the ratio rises to 45 percent for the young. Retirement and self-employment for average clients make up the difference between the figures, with the young obviously not yet retired and, with a few exceptions, not running their own businesses.

At a regional level, clear differences emerge that show how the experience of indebted young people varies around the country. Parts of the UK that are struggling economically show a higher ratio of young people contacting CCCS per 100,000 population, with Yorkshire & the Humber, the North West and the West Midlands generating significantly more calls from young persons (see Figure 6). Low volumes from Northern Ireland and Scotland probably reflect a lower take-up of CCCS services overall rather than an absence of financial distress. London shows a major difference to the overall trend. Despite the fact that overall more people from London contact CCCS than from any other region, the capital only comes in the middle of the pack when it comes to contacts from the young. A likely explanation is high mortgage debt in the London metropolitan area due to high house prices. With fewer young people having mortgages, they are more sensitive to the general labour market rather than the housing market.

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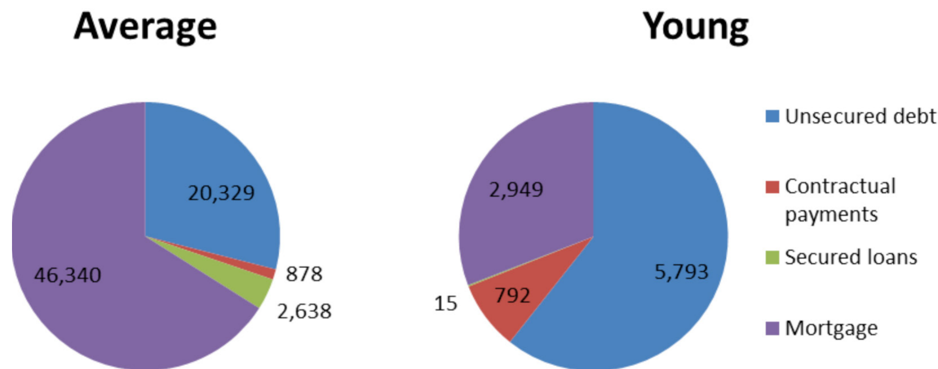
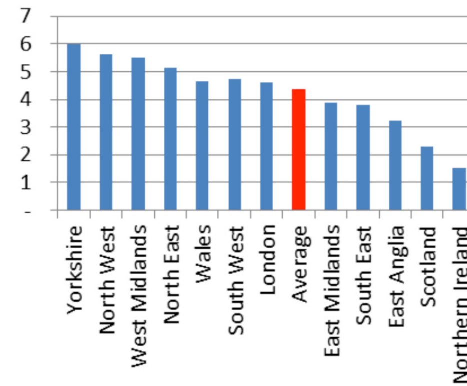
Figure 6: Debt profiles of CCCS clients in Q1 2012, £



Source: CCCS

High tuition fees will add to the debt burden of future generations. With an average course duration of about 3.5 years and a drop-out rate of 10 percent, undergraduates in England and Wales will accumulate £27,100 of debt over the course of an average degree. The figure is based on tuition fees of £8,754 pounds, as compiled by the Guardian for the 2010/2011 academic year. Assuming a cost of £9,000 for an undergraduate course in Scotland and £10,850 in Northern Ireland, the national average stands at £23,800. With two in five young people of the 18-22 age group enrolled in undergraduate courses, tuition fees add roughly £9,500 to the debt burden of the average British citizen of future generations under current policy. Although repayment should largely happen by what essentially are higher income taxes, the financial burden means lower savings and thus more risk of debt distress.

Figure 7: Demand for telephone debt advice from young persons, per 100,000 inhabitants



Source: CCCS, Department for Communities and Local Government

London hardest hit by financial distress – no improvement in sight

Given the challenging economic situation due to high inflation and low wage growth as well as the rise in unemployment since Q2 2011, it comes as little surprise that demand for debt advice remained at an elevated level in the first quarter of 2012. Having fallen to 43,162 in Q4 2011, the number of telephone and online counselling sessions shot up by 31 percent to 56,591 in the first three months of 2012. Although seasonal variations in demand for debt advice are well documented, from a purely economic perspective there is little reason for this early winter lull in counselling sessions. In fact, retail spending in the run-up to Christmas strains household budgets and should accentuate financial woes. Rather than reflecting an improving financial position at year end, seasonal changes in demand demonstrate some deferment of dealing with unsustainable debt loads over the festive season. In the New Year, this displaced activity results in higher call volumes.

At a regional level, a clear trend has been the gradual rise of financial distress in London. The capital already has the highest ratio of CCCS client contacts per inhabitant of any UK region, but a further upwards trajectory is evident nonetheless. Q1 also saw record demand in the South East, Yorkshire & the Humber, the West Midlands and Northern Ireland. In other parts of the country, the situation is quite different, with demand in the East of England and the East Midlands lower now than a year ago. London demonstrates that general prosperity doesn't protect households from financial distress. High debt levels there suggest the need for targeted measures to ease the burden on households struggling to make ends meet in areas with elevated living costs and high property prices.

A factor related to the high prevalence of debt distress appears to be rental costs. London, the region with most CCCS clients when adjusted for population size, is also the region with the highest rent levels. Rent arrears support this

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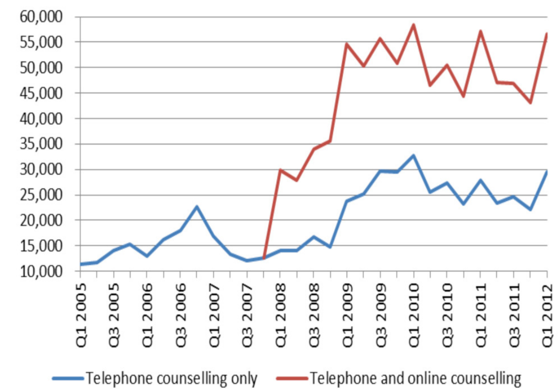
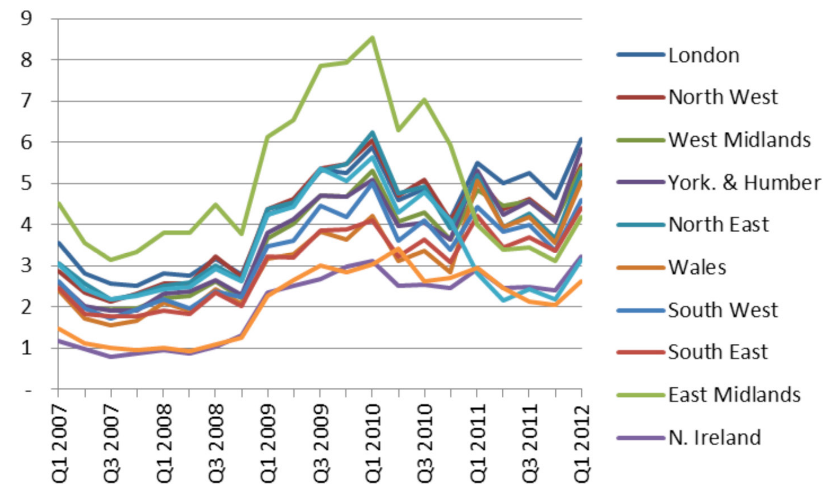
Figure 8: Counselling sessions per quarter, including and excluding online counselling



Source: CCCS, Cebr

Figure 9: Contacts per 10,000 households by UK region



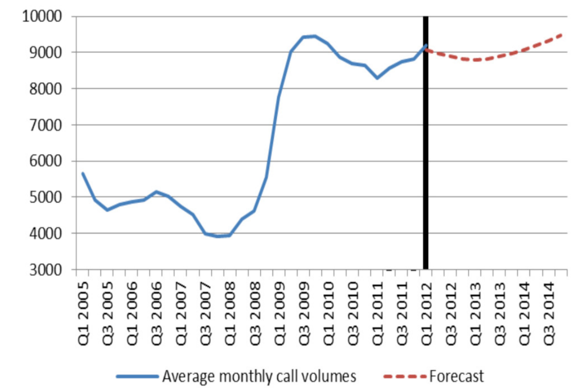
Source: CCCS

interpretation, with £144 the average level of rent arrears for CCCS clients in London. Apart from the expensive South East with a value of £77, the other English regions range from £57 to £45 and we find lower values in Wales (£33), Scotland (£32) and Northern Ireland (£16).

Looking ahead, the demand for debt advice is expected to remain high for the next few years. In line with elevated unemployment, public spending cuts and weak general economic growth, we anticipate a consistent number of clients requesting advice on managing their finances. While economic growth should resume more markedly from 2014 onwards, interest rates are expected to rise at the same time. Higher interest burdens are likely to outweigh the benefits of an improved job market for the economy as a whole in terms of the number of people getting into financial difficulties. Correspondingly, we expect roughly 9,000 telephone counselling sessions to take place each month until 2014, with little variation between the years (see Figure 10). That implies about 18,000 total counselling sessions, including the online Debt Remedy service, per month. While perhaps surprising that the effects of the last recession should be this long-lasting, it should be borne in mind that output dropped sharply and has been recovering so sluggishly that UK GDP will probably not scale its pre-crisis peak before 2015.

CCCS has two primary channels of engaging clients, telephone counselling and the internet-based Debt Remedy service. Since the introduction of Debt Remedy in 2008, around half of counselling session are handled by each channel and Q1 2012 was no exception. About 52 percent client contacts were made via the telephone and the remaining 48 percent via the internet. Debt Remedy attracts a slightly younger group of clients with an average age of 36, compared with 42 years for telephone counselling in Q1 2012.

Figure 10: Quarterly CCCS counselling sessions, historical data and forecast



Source: CCCS, Department for Communities and Local Government, Cebr

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 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 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 forecasting section is based on a multivariate time series regression that draws on 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 10 representing a smoothed series that represents the central tendency of the forecast values.

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