

British workers face spiralling levels of debt

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Household debt in Britain stands at a record £801 billion, with poorer households proportionally taking on much of the borrowing.

Much of the rise is accounted for by record levels of mortgage borrowing, which rose by £5.6 billion in October, the largest-ever monthly increase. For a time spiralling property prices—now growing at an annual rate of 30 percent—have been offset by the relatively low cost of borrowing. But economists are now warning that the property boom is becoming unsustainable, raising the prospect of a “negative equity” crisis surpassing that of the 1980s when tens of thousands had their homes repossessed due to mortgage arrears.

Property prices have been fuelled by lenders massively extending the amount people can borrow relative to their income. According to the property website, *Rightmove*, the gap between house prices and average earnings has widened to 6.19 times. This is almost double the house price/income gap in 1989, when house prices peaked and then fell, causing mortgage repayments to increase to some 50 percent of average salaries.

Already millions of householders have been warned that the endowment mortgage policies they were encouraged to take out during the 1990s will leave them owing thousands on their homes. One in ten of the population has endowment policies, which combine a mortgage loan with a separate savings scheme. Endowment schemes were sold as a cheaper and quicker means of buying property—the monthly mortgage repayment paying off interest payments on the loan whilst the remainder was invested on the stock markets. When share prices were soaring, people were told they would be able to build up a tidy sum relatively quickly, enabling them to pay off their home and still have money leftover. Falling stock markets, coupled with the high prices charged to set-up the policies, have

left tens of thousands out of pocket.

The endowment crisis has helped fuel the increase in remortgaging. Record numbers have been taking advantage of the increase in property values to raise finance. According to the Council of Mortgage Lenders so-called “equity withdrawal” hit a record £8.9 billion last month. Since 1997 the value of remortgages has rocketed by more than 400 percent, from £13 billion to £67.5 million, and now accounts for 43 percent of total lending, with most using the additional monies to “pay off debts, pay school fees or buy a car”. The implication is that any collapse in house values would affect even larger layers of the population, not just relatively new homebuyers.

The record level of debt is only partially accounted for by property borrowing, however. Consumer credit debt—which excludes mortgage lending—has doubled since 1995, rising by 126.4 percent to £140.1 billion. In contrast, average earnings have grown by only 28.5 percent over the same period.

Credit card debt is now at an all time high in the UK. Spending on credit cards rose by £2 billion in August alone, with almost five percent of cardholders owing more than £5,000. According to Mintel, with average interest rates on cards of 14.9 percent, that debt would take 10 years of minimum payments to clear, including £4,700 in interest.

Whilst the record level of debt is creating problems for the Bank of England in determining the most effective interest rate policy, its long-term implications are more severe.

Data by the public finance think-tank, the Institute for Fiscal Studies (IFS), reveals that the debt burden resembles an inverse pyramid, with those least able to afford carrying the burden.

IFS analysis of official data from the year 2000 shows that of the bottom fifth of the population—those earning less than £8,730 a year, more than one-third

have debts averaging £3,337, excluding mortgages. Those aged below 35 years of age are most likely to be heavily in debt—70 percent of those aged between 30-34 years owe an average of £5,301.

Not surprisingly, the research also shows that those with the least amount of savings and investments are more likely to be in debt—53 percent of those with less than £1,000 in liquid assets, compared to 36 percent of those with more than £5,000.

In October, the Consumer Credit Counselling Service (CCCS) warned that more and more people were failing to keep up with debt repayments. In the three months to September, some 12 percent of people fell behind on their debt management plans—where interest on debts is frozen in return for guarantee monthly repayments—compared to nine percent the previous year. The total value of debt had also increased by 5.6 percent over the same period, the CCCS warned, to £24,000.

In contrast to many reports citing a “culture of greed” for debt problems, the CCCS report said the rising number of defaults were due to companies cutting back on workers’ overtime. The increase was “particularly worrying at a time of relative economic stability”, the CCCS continued, before warning of the consequences if economic conditions led to rising unemployment or cuts in wages.



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