The impact of the credit crunch on British workers

Chris Talbot
18 February 2008

Indications of the severity with which the credit crunch is likely to hit working people in Britain are contained in a number of recent reports and press articles. These focus, firstly, on the impact of credit becoming more difficult to obtain and, secondly, on the cost of mortgages.

Significant levels of short-term debt—unsecured or secured against property, as well as credit cards—is widespread. Over the last ten years the economy under the Labour government has grown in large part because of consumer spending financed by debt.

According to the National Institute of Economic and Social Research, the ratio of household debt to national income is 1.62 in the UK, the highest for a major economy. It compares to 1.42 in the United States, 1.36 in Japan and 1.09 in Germany. Last year, for the first time, the total stock of consumer debt—at £1,325 billion—was greater than Britain's GDP. It has trebled over the last ten years.

Figures put out by the Office of National Statistics last June show that British people are saving the smallest amount of their wages since 1960. Real household disposable income—wages after tax, interest payments and pension contributions, adjusted for inflation—fell for two successive quarters.

A recent report by the independent price comparison and switching service uSwitch.com shows that over the last ten years the average net income has gone up by 48 percent, only slightly more than essential living costs (43 percent). But average debt repayments have more than doubled, with an increase of 105 percent.

Out of an adult population of 47.5 million, uSwitch found that 4.8 million spent more than they earned last year, nine million just broke even, and the average consumer only had £157 ($309) left in the bank at the end of the month.

This reliance on credit means that millions are now feeling the squeeze. The financial information firm Moneyfacts said at the end of last year that "the credit crunch has caused the personal loan market to tighten, lenders have withdrawn from the market and rates have seen a continuous increase throughout 2007." Last November alone the number of unsecured loan providers fell by 10 percent.

In the first such action to be taken, the credit card company Egg, which is owned by the US bank Citigroup, withdrew credit cards from 160,000 of its customers. Citigroup's press statement says that "customers affected had a higher than acceptable risk profile."

Signs that the collapse of cheap credit is beginning to affect mortgage repayments is contained in a January report from the government's Financial Services Authority (FSA). House prices in Britain have been part of the global "bubble", with the average price now standing at over £182,000—some seven times the average income of about £26,000 a year. In 2004 the ratio was five times the average income, whilst back in 1969 it was only two and a half times.

The proportion of houses which are owner occupied is now 70 percent (out of a total of 25 million homes), with some 12 million of these paying mortgages. Public or so-called council housing was largely sold off in the 1980s under the Thatcher government and now accounts for only 10 percent of the total. There is a severe shortage of affordable houses, especially for families and first time buyers. According to charities there are already 526,000 families, including 900,000 children, living in overcrowded accommodation—with 80,000 homeless families in temporary accommodation and 1.6 million on waiting lists for council houses.

Although they do use the term "sub-prime," the FSA more often refer in their report to "product innovation" and state that new loans have been "concentrated in groups which historically have not been homeowners."

The FSA examines the risks now facing homeowners, looking at three categories: 1) the loan was taken out for more than 25 years; 2) it was worth more than 90 percent of the house value when sold; or 3) it was for more than 3.5 times the income of the purchaser. The FSA considers the two million people who have taken out mortgages in the two and a half years before September 2007 that fall into just one of these categories "may not represent significant consumer

© World Socialist Web Site

risks”. But with more than one million people who fall into two or more of these categories, it considers “there is a greater cause for concern.” Some 150,000 homeowners fall into all three categories and the FSA consider these “most likely to default on loans.”

These figures are probably an underestimate. There were 27,000 house repossessions in 2007, an increase of 21 percent on the previous year and the highest since 1999. But the figure for repossession represents only a fraction of the total number of people who have run into difficulties with their mortgage repayments. In these circumstances most people manage to negotiate an arrangement with their mortgage provider. They do not, therefore, appear in the figures for defaulters. Shelter, the homeless charity, says it took more than 80,000 calls in 2007 from homeowners concerned about falling behind with payments, eight times the number in 2006. As credit conditions become tighter, mortgage providers may be less willing to agree to such arrangements.

Even if the million or so at risk do not end up defaulting on mortgages, the FSA point out that they may be unable to meet payments on other debts: “We are concerned that many consumers are ill-prepared for a deterioration in economic conditions and may have placed too great a reliance on their ability to depend on cheap credit and housing wealth to sustain their consumption levels and investment plans.”

The FSA’s head of financial strategy and risk, Lyndon Nelson, emphasised this point when he told the *Guardian*, “It is not necessarily the affordability of the mortgage. It is their other debt. Customers with other borrowing in addition to the mortgage are struggling.”

“The other borrowings tip them over the edge,” he said.

The FSA point out that many of the current mortgages were taken out before the interest rate rises of 2006 and 2007. When mortgages were taken out in 2005 the median repayment was about 24 percent of net income. Current standard rate mortgages take up 27-29 percent of income and will rise to 30 percent should interest rates rise by one percent. This year some 1.4 million mortgages that were taken out on short term fixed rate, i.e., before the rises over the last two years, will have to be re-negotiated. The FSA calculate that moving back to a standard rate would add an average of £210 a month to repayments. This is likely to hit many of the million or so homeowners who fall into two or more risk categories.

Neither the Bank of England nor the government have any room to manoeuvre in this situation. The Bank of England has lowered its base rate a little, but it has been unwilling to follow the sharp cut in the US. Well aware that the British economy is moving into recession, the Bank does not dare boost the economy with more cheap credit because of the threat of inflation.

At a press conference this week presenting the quarterly report of the Bank of England’s Monetary Policy Committee (MPC), the Bank’s governor, Mervyn King, said that predictions were “not inconsistent” with two quarters of zero or negative growth, the technical measure for a recession.

The MPC’s main concerns were that the credit crunch would weigh down on demand, as in the rest of the world, but rising food and energy prices would push up inflation. “Both developments are now more acute than in November,” said King. “As a result the near-term outlook is one of inflation rising sharply alongside a marked slowing in growth.”

Nor is the UK government in a position to stimulate the economy as it has done in the past. In the global downturn following the dot.com crash at the beginning of the century, Chancellor Gordon Brown pumped money into the economy through public spending. Now Prime Minister Brown faces a budget deficit that is likely to reach £43 billion ($84 billion) in 2007-8.

The *Economist* has warned that “Britain will be hit hard by the credit crunch.” It points out, “Lenders slashed the amount of credit they were prepared to make available late last year, and they intend restricting it again in the first quarter of 2008.”

It comments on the significance of the housing price bubble as follows: “The housing market is already wilting, as banks tighten the terms on which they make mortgage loans and would-be buyers take fright at the possibility of instant losses on their purchases. That augurs ill for consumer spending, which has been buoyed over the past couple of years by another bout of rapid house-price inflation. Rising housing wealth has offset a dismal period for living standards as, despite a strong economy, rising inflation, taxes and interest payments have eroded growth in real disposable incomes. Now this prop is about to be removed. Indeed, the first signs of a consumer slowdown are already apparent.”

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site