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BRIEFING

An outstanding balance?

Inequalities in the use – and burden – of consumer credit in the UK

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Summary

From buying a home, to replacing an appliance or meeting an unexpected emergency, UK households very often rely on some form of credit. But as the 2010s drew to a close, both policymakers and the press raised concerns about rising levels of UK household debt, with some warning it could soon bring about the next recession. Borrowing levels have indeed grown substantially over recent decades: the total stock of secured debt (mostly mortgages) rose from £363bn in 1997 to £1.4tn in 2018, while the stock of consumer (mostly unsecured) debt rose from £58bn to £203bn over the same period.

And yet, there is evidence to suggest that concerns about household debt causing an imminent recession are overblown. The total value of household secured debt relative to disposable income today (97 per cent) is indeed higher than in 1994 (62 per cent) but substantially below levels reached during the financial crisis (110 per cent). Similarly, putting student to loans to one side (since they operate more like a tax than debt), the value of unsecured (mostly consumer) debt is, at 15 per cent of income, higher than it was during 1994 (9 per cent) but 4 percentage points lower than levels reached immediately before the financial crisis. In other words, *household debt remains below crisis levels.*

More importantly, the overall *cost of debt is lower*, too. Sharp reductions in the Bank of England's Bank Rate during the financial crisis, along with a decade of continued loose monetary policy, have helped to drive a substantial reduction in average quoted mortgage rates. In practice this means debt has become less costly. The interest rate on a ten-year loan, for instance, is at 5 per cent down by half from its 2010 peak.

Stepping back, however, it looks as though we should focus our attention more on the distribution than the total amount of secured and consumer debt. For instance, the reductions in the Bank Rate discussed above may have eased mortgage costs but they did little to drive down average quoted rates on consumer products, like credit cards and overdrafts. *The differentiation in interest rate reductions has distributional implications*: while those in the top household income quintile are more than three times as likely as those in the bottom to access mortgages (which on average have offered reduced interest rates compared to the past), they are equally as likely to access consumer credit products (which, on average, have not).

So although changes in the level and cost of household debt may be less concerning than the headline figures suggest, policymakers would be right to turn their attention to the spread of consumer debt across the population, and specifically the extent to which low-to-middle income households are increasingly exposed. At first glance, it becomes

clear that the relative proportion of lower-income households using consumer debt rose just as, following on from the financial crisis, the rate of UK pay growth slowed.

During 2006-08 households in the top income quintile were substantially more likely (10 percentage points) to use consumer credit than those at the bottom. Today that difference has shrunk to just under two points. In fact, between 2006-08 and 2016-19, the rise in the proportion of households using consumer credit overall, and some of the more expensive forms of consumer credit in particular, *has been greater for those in the bottom income quintile than it has for middle and higher-income households.*

For instance, there was a 13 percentage point rise in the share of households in the bottom income quintile using a credit card, as compared to a 4 point rise among those in the middle and 2 points among those in the top. There was a 4 percentage point rise in the share of households in the bottom income quintile using overdrafts as compared to a 2 point rise among those in the middle and a 1 point fall among those at the top. The share of households in both the bottom and top income quintiles using mail order purchase facilities rose by 3 points while falling for everyone else.

Therefore it's unsurprising that, relative to their incomes, *lower-income families remain significantly more exposed to consumer debt than their higher-income counterparts*. Of those who had any, the median level of consumer debt was equivalent to 16 per cent of pre-tax income for households in the bottom income quintile during 2006-08 and 17 per cent 2016-18. Consumer debt to (pre-tax) income ratios held roughly flat for households in the middle of the income distribution (at between 8 and 11 per cent) and reduced slightly for those at the top, from 6 to 4 per cent over the same period.

Although these figures should come with something of a health warning (the Bank of England have flagged concerns that some households have difficulty estimating their total consumer debt left outstanding), it appears that despite a decade of low interest rates in the main, *typical consumer debt-to-income ratios remain more than three times higher for lower-income households as compared to their higher-income counterparts.*

Moreover, typical consumer debt repayments, relative to monthly pre-tax income, also remain nearly 3 times as high for households in the lower-income quintile (8 per cent) compared against their higher-income counterparts (2.7 per cent). And although the typical value of lower-income households' consumer debt repayments relative to income has fallen slightly over the past two years (from 8.8 to 8.0 per cent between 2015-16 and 2018-19), there is some indicative evidence to suggest a longer-time rise in distress at the tail: the proportion of households in the bottom income quintile with payments in excess of £500 (nominal) more than doubled, from 4 to 9 per cent, between 2006-08 and 2016-19.

These higher levels of exposure are particularly worrying given lower income households' weaker balance sheets: recent Resolution Foundation research has shown that fewer than half of low-to-middle income families reported having any savings in 2016-17, representing a rise of 15 percentage points since the financial crisis.

This growing level of financial fragility will have real effects on the lived experience of lower income households. Evidence shows that lower-income households with outstanding consumer debt tend to experience more financial stress than both their counterparts in the bottom income quintile who do not have any outstanding consumer debt and those in higher income quintiles who do.

For instance, more than half (53 per cent) of working-age households with children in the bottom pre-tax income quintile with outstanding consumer debt report struggling to meet accommodation costs, up from 33 per cent in 2006-08. For comparison, 39 per cent of lower-income households without consumer debt (regardless of children) struggle with accommodation costs, as do 31 per cent of households in the top income quintile that have both consumer debt and children. Fewer than one-in-three (32 per cent of) lower-income households with consumer debt feel they have enough money set aside for emergencies, as compared to 42 per cent of those in the third income quintile that have consumer debt and 65 per cent of those at the top.

While consumer borrowing in and of itself may not be the cause of these financial worries, it can help to compound them. Accumulating interest, rising repayment rates and the potential for add-on fees will reduce a household's ability to spend where may be needed, and to accumulate sufficient savings to allow the household to avoid consumer borrowing in future.

These constraints are all the more concerning given the rise in households struggling with other forms of debt. For instance, the number of households in debt to energy suppliers has risen from 2.4 to 2.9 million between 2016 and 2018 alone. The charity Citizens Advice found that in 2018 nearly one-in-ten households in England and Wales were behind on their council tax in 2017-18, with the total amount of council tax debt rising by 30 per cent since 2010. Income shocks and rising living costs, such as in relation to utilities and council tax, can drive lower-income households into higher levels of consumer debt which can, in turn, constrain their ability to meet ongoing commitments. In other words, the cycle runs both ways.

Debt can, of course, be a good thing: it can help households respond to short-term shocks and, under the right conditions, manage a host of necessary transactions. However, high-cost credit can put households into difficult circumstances. Thankfully, policymakers have in recent years taken action on some lending practices that prove particularly costly for borrowers. For instance, the UK's Financial Conduct Authority (FCA) in 2015 put caps on payday loan default fees and interest rates.

More recently, the FCA called on banks to equalise fees between arranged and unarranged overdraft fees, and also proposed regulations to cut the overall consumer cost of mail-order and hire-purchase agreements. These are welcome first steps that reflect the need for regulators to disaggregate lending that tends to be costlier because of its inherent risk (unsecured loans that are not attached to any form of collateral), and lending where the costs to consumers exceed any reasonable risk to the lenders.

Beyond regulating the market as it exists today, policymakers would do well to further investigate the factors that often drive households, *particularly those towards the bottom of the income distribution, to unsecured and often costly, borrowing in the first place.* For instance, this briefing note finds that consumer borrowing has risen most among families with children, those who are in work, and particularly among households on lower-incomes – and has an apparent association with their ability to pay for their accommodation an or successfully handle a financial emergency.

Bearing this in mind, policymakers may want to consider the link between expensive borrowing and core living standards challenges, including insecure working arrangements, pay volatility and, increasingly, delays and difficulties with benefit payments. They should also broaden their focus on debt in order to include the growing role of council tax and utilities in pushing households into arrears. Borrowing can be a good thing – but it shouldn't make a bad situation worse.

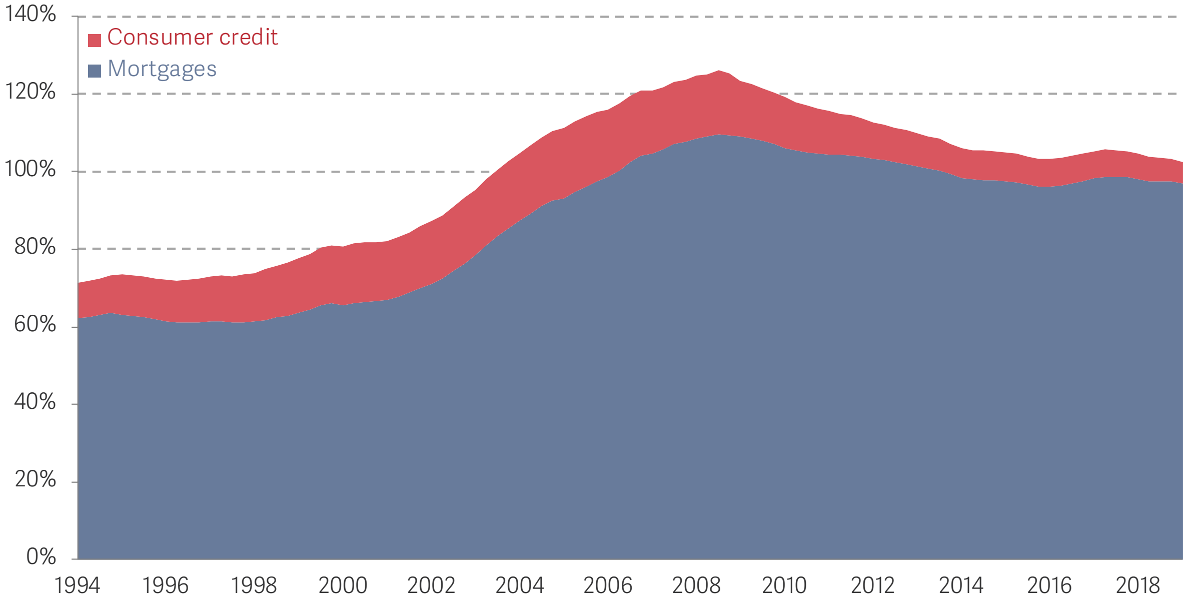
Despite concerns about the growing stock of UK household debt, mortgage and consumer debt remain below levels reached in the financial crisis

Over recent decades, UK households have increasingly relied on credit to finance a range of transactions – from buying a home to funding the purchase of a television. Between 1994 and 2019 the total stock of UK households' secured debt (comprised mostly of mortgages) rose from £363 billion to £1.4 trillion. The stock of consumer debt (mostly unsecured),[1] more than trebled – from £58bn to £203bn – over the same period.[2] The measurement of debt is discussed in more detail in Box 1, but viewed in aggregate these increases have been eye catching. They have prompted worries – including from policy makers – about whether a sharp rise in concerns about debt levels could exacerbate – or even cause – a recession.

1 The Bank of England's NMG Consulting Survey, which is used throughout this briefing note, refers to car dealership finance as an "unsecured debt instrument" although it is effectively secured with the car serving as collateral. For that reason, the term 'consumer credit' is used in preference to 'unsecured credit' wherever dealership car finance is included in the analysis.
2 Bank of England, Net lending to individuals data series

FIGURE 1: **Relative to household disposable income, debt levels have fallen since the financial crisis**

Household debt to disposable income ratio: UK



NOTES: Student loans, typically classified as unsecured lending, are excluded. Mortgages are classified as secured credit whereas most forms of consumer credit (excluding car finance) are classified as unsecured.
SOURCE: Bank of England, Financial Stability Report and Record, December 2019

In this context, it is important to consider the long-term increase in debt alongside the steady rise in total household income, as in Figure 1. Indeed, in early 2019, the UK's total stock of secured household debt was equivalent to 98 per cent of disposable household income. This is substantially higher than the consumer debt-to-household income ratios that prevailed during the mid-1990s (which sat at 62 per cent in 1994, the beginning of our time series), but well below levels reached in the lead-up to the financial crisis: 110 per cent in 2008. The picture on consumer debt is similar: as of early 2019, total consumer debt was equal to 15 per cent of total household income – roughly 6 percentage points higher than the total consumer debt-to-disposable household income ratio in 1994, but 4 percentage points lower than levels reached during 2008.[3]

3 Bank of England, Financial Stability Report and Record, July 2019

BOX 1: Secured, unsecured and consumer debt

At a basic level, we can divide lending into two forms: secured and unsecured. Secured lending, predominantly comprised of home mortgages, is anchored to a specific asset. If a borrower defaults on their payments, the lender has a claim on that asset. As such, lenders' ability to recoup an asset during default reduces risk, and that is part of what allows interest rates on most secured products to be relatively low.

Unsecured lending – which is made up of a range of forms of lending including credit cards, credit for small-goods purchases (such as appliances, electronic goods and furniture) and personal loans – has no collateral involved. This means nothing purchased with the agreement's funds can be forfeit.[4] The lack of collateral makes these types of loans inherently riskier for the lenders. And so to counteract this perceived risk, lenders in most cases charge a higher interest rate.

Most of the instruments covered in this report (including credit cards, overdrafts, student loans, personal loans, payday loans, social fund loans, store cards, mail order purchase and hire purchases) can be categorised as 'unsecured' and are labelled as such in the Bank of England's NMG Consulting Survey on the Financial Position of British Households. One wrinkle to this is dealership car finance which, according to the NMG Consulting Survey was used by nearly one-in-five 18-64 year-olds over 2016-19, is effectively a secured instrument even though the survey categorises it as 'unsecured'. So in order to use a consistent terminology throughout the report, we collectively refer to the aforementioned unsecured instruments and to dealership car finance as 'consumer' debt rather than unsecured. Where car finance is excluded from the analysis, the term 'unsecured' is used.[5]

Moreover, low levels of overall borrowing costs should also be considered alongside borrowing levels. The Bank of England's policy rate (known as 'Bank Rate') is currently at 0.75 per cent. This represents a slight increase over the past few years (it was at 0.25 per cent between August 2016 and November 2017). But Bank Rate remains well below rates both preceding the financial crisis (5.75 per cent in July 2007) and during the mid-1990s (6.6 per cent by the end of 1995).[6] This low level of policy interest rates has translated

4 Instead, creditors will usually assign debt collectors to attempt to retrieve funds and in extreme cases, sue borrowers for reneging on the agreement.
5 This terminology is consistent with that of the Bank of England's Financial Stability Reports. See for instance: Bank of England, Financial Stability Report, June 2018
6 Bank of England, Interest Rates and Bank Rate, October 2019

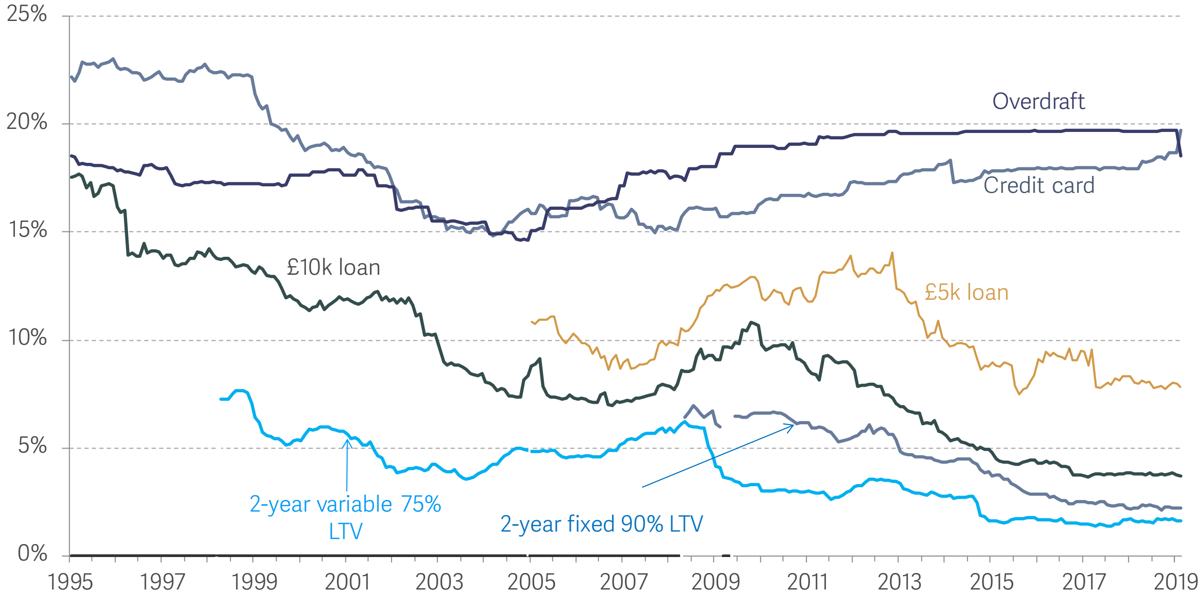
into low levels a broader range of interest rates and has meant that borrowing costs have generally been low by historical standards. This, in combination with below-crisis level debt-to-income ratios, suggests that the risks to financial stability from high household debt are currently relatively contained.

But the benefits of low borrowing costs have accrued disproportionately to higher-income households

The sharp cuts to Bank Rate in the aftermath of the financial crisis fed through to reductions in average quoted mortgage rates.[7] For instance, as shown in Figure 2, the average quoted rate for standard two-year variable-rate mortgage with a 75 per cent loan-to-value ratio was 6.1 per cent in April 2008; it halved to 3 per cent by the start of 2011; and fell even further, to a low of 1.4 per cent by April 2017. Cuts in Bank Rate also appear to have led to falling rates for personal loans, but only once the economy had started to recover.

FIGURE 2: **Historically low Bank Rate fed through to mortgages but not to riskier products like credit cards or overdrafts**

Average quoted household interest rates on selected loan products: UK



SOURCE: Bank of England

The interest rates on consumer debt products are typically higher than their secured counterparts reflecting the higher level of risk. Notably, the average quoted rates on riskier consumer products, such as over overdrafts and credit cards, have actually increased since the financial crisis, despite cuts to Bank Rate. For example, the rates on

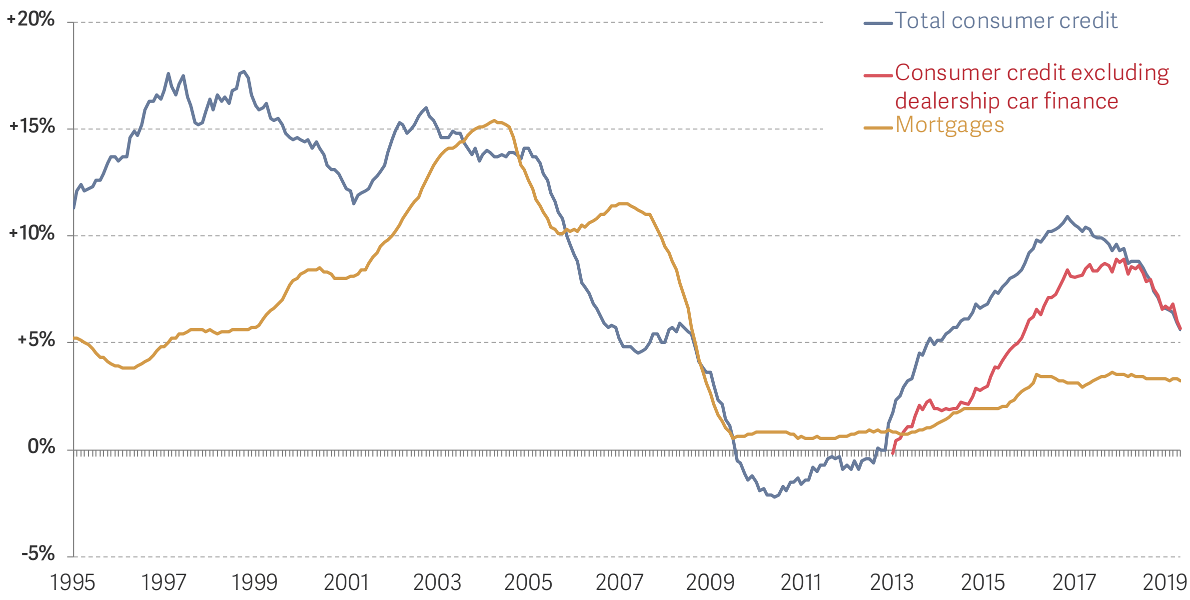
7 56 per cent of the stock of UK mortgages at the end of 2008 were floating rate meaning that average household mortgage costs fell as Bank Rate was cut. See: Bank of England, Data Viewer.

overdrafts remained between 19.5 and 19.7 per cent between 2011 and 2019, only falling (to 18.5 per cent) at the start of 2019. Average quoted rates on credit cards rose in the wake of the financial crisis and, after a slight drop in 2013, held steady at 19 per cent between 2014 and March 2018. They have risen continuously since then, reaching 19.7 per cent in February 2019 – the highest average rate for credit cards this century.[8]

And although absolute levels of household debt are lower for the, largely more expensive, consumer debt products like credit cards and overdrafts, growth in such lending has outstripped that of secured credit. Figure 3 shows the year-on-year growth rate of lending in both secured and consumer sectors (new issuance minus repayments. Growth in lending for both secured and consumer products fell to its lowest rate during the financial crisis, with outright contractions in net consumer lending.

FIGURE 3: **In the aftermath of the financial crisis, lending for consumer products has grown faster than mortgage lending**

Annual growth rate of mortgage and consumer credit lending: UK



NOTES: Consumer credit figures exclude car finance from 2013
SOURCE: Bank of England Financial Stability Report and Record, 2019

Since the financial crisis, growth in consumer lending has consistently been higher than growth in secured lending, despite the slowdown since 2017. At the end of 2018, year-on-year growth in consumer lending stood at 7 per cent, while growth in secured lending stood at just 3 per cent. Car finance, particularly that using personal contract purchases,

8 Average annual percentage rates on credit cards in the UK have risen sharply over recent months as lenders have pulled lower-cost products off the market. See: L Warwick-Ching, 'Credit card interest rates rise to highest levels in 13 years', Financial Times, 17 September 2019.

has been a major contributor to the rise in consumer lending rising particularly quickly from 2013. In contrast, growth in secured lending seems to have been held back by the Mortgage Market Review (MMR), which tightened rules around mortgage lending starting in 2014.

The proportion of UK households using consumer credit has grown over the past decade, with lower-income households, younger households and those with children experiencing a particularly large rise

Taking a somewhat longer view allows us to see how consumer borrowing has become an increasingly common part of life for some types of households. During 2006-08, 54 per cent of UK households headed by someone aged 18-64 had an outstanding balance on at least one form of consumer debt (excluding student loans, e.g. credit card, overdraft and payday loan), rising to 61 per cent by 2016-19.[9] And while use across the overall population grew by 5 percentage points over the past eleven years, Figure 4 illustrates the extent to which it grew more strongly for different types of households.

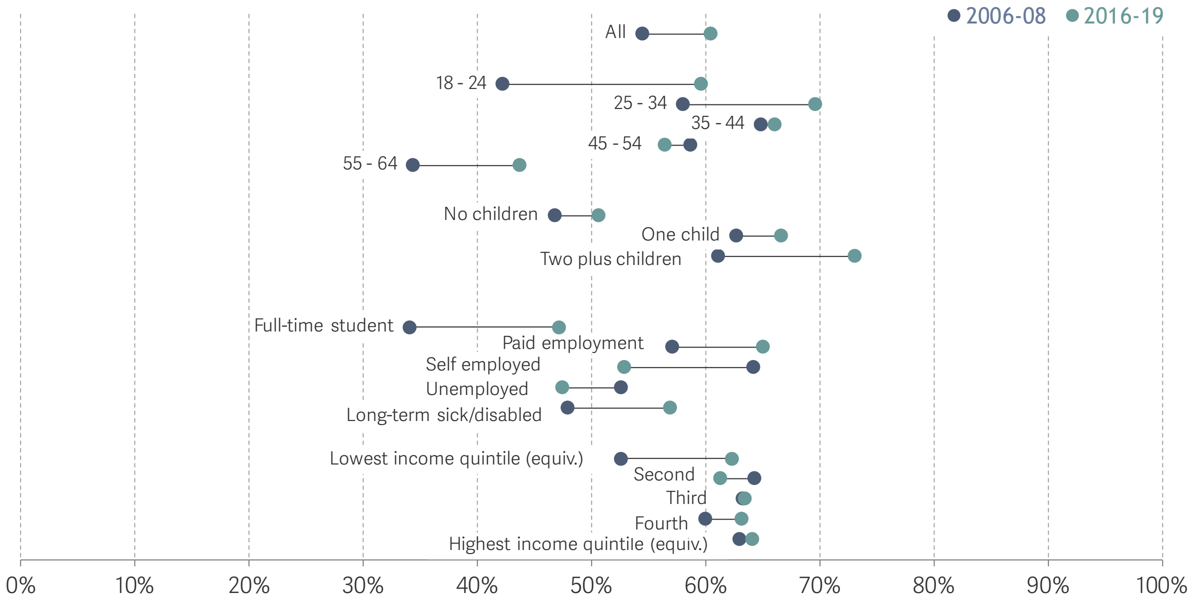
For instance, larger growth in consumer debt was recorded for younger households (aged 18-24 and 25-34) compared with their older counterparts. And while families with children have traditionally used consumer credit at a higher rate than those without, use of consumer credit grew most among households with two more children: as of 2016-19, more than seven-in-ten households with two or more children used some form of consumer credit.

While the proportion of households headed by someone is either self-employed or unemployed using consumer credit fell, the proportion of full-time students, people with a disability or long-term illness and those in paid employment that use consumer credit all rose. More than two-thirds of in-work, working-age households were engaged it at least one form of consumer credit during this period.

9 This excludes instances where respondents are planning to pay their balance in full over the next month.

FIGURE 4: **The proportion of UK households using consumer credit has grown over the past decade, with lower-income households catching up to those at the top of the income distribution**

Proportion of working-age (18-64 year-old) headed households using at least one form of consumer credit: GB



NOTES: Student loans excluded in all years. Instruments included in 2006-08 are: credit cards (except where respondents intend to pay their balance in full on the next payment date), overdrafts, personal loans, store cards, mail order purchases, social fund loans, hire purchase agreements and "something else". 2016-19 figures include the aforementioned with additional categories for dealership car finance (disaggregated from hire purchase agreements) and payday loans. Unlike NMG data for 2016-19, the 2006-08 survey did not ask respondents how many adults reside in the household separate from the person responding, which is required in order to equivalise income by household size. As a result, the equivalised 2006-08 pre-tax household income figures here use a proxy for the number other adults: they are calculated by subtracting the number of children under age 16 in the household from the number of individuals reported in the household. Unequivalised figures were computed and found similar patterns between the two methods. Figures here are inclusive of all households, including those with no reported income. All income is pre-tax.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey

Growth in the use of consumer credit is particularly noteworthy when split by household income. During 2006-08, 53 per cent of households in the lowest (pre-tax, equivalised[10]) income quintile had used at least one form of consumer credit, rising by 9 percentage points to 62 per cent in 2016-19. This is striking, both because households in the bottom income group experienced a larger rise in in consumer borrowing than households in other income quintiles and also because they largely 'caught up' to borrowing rates of these other groups. During 2006-08, the proportion of households in the top equivalised household income quintile using consumer credit was 10 percentage points larger than the proportion doing so at the bottom; in 2016-19 it was just 1 percentage point larger.

10 Equivalisation factors differ slightly between 2006-08 and 2016-19 figures because between 2004 and 2011 the NMG Consulting Survey did not ask respondents how many adults reside in the household separate from the person responding, which is required in order to equivalise income by household size. As a result, the equivalised 2006-08 household income figures here use a proxy for the number of other adults: they are calculated by subtracting the number of children under age 16 in the household from the number of individuals reported in the household. Because of this difference, this note also analyses patterns and trends in consumer credit use according to unequivalised household income. While figures across quintiles varied slightly from Figure 3 the overarching trend - borrowing rates rose to a large degree at the bottom but moved much less in either the middle or the top – remained.

The amount of consumer debt held by the typical UK household has risen too. Figures from the Office for National Statistics (ONS) Wealth and Assets Survey show that the median level of household consumer debt rose (excluding those households without consumer debt) from £3,900 over 2010-12 to £4,000 in 2014-16 and again to £4,500 in 2016-18.[11] Policymakers may take some comfort from the fact that, according to the Bank of England's NMG Consulting Survey, the typical size of consumer debt relative to pre-tax income hasn't changed all that much in aggregate for working-age households: during 2006-08 the median consumer debt to pre-tax income ratio was 8.2 per cent; in 2016-18 it 8.5 per cent.

Still, they should be concerned that median consumer debt-to-income ratios have consistently been higher for lower-income households, and that these do not appear to have reduced over recent years. The median consumer debt to pre-tax income ratio was 16 per cent in both 2006-08 and just over 17 per cent in 2016-18. It held roughly flat (between 8 and 11 per cent) for those in the middle of the income distribution) and fell slightly (from 6 to 4 per cent) among those households at the top.[12] (These figures should be interpreted with some caution, given Bank of England warnings that some survey respondents struggle to provide an accurate estimate of their total outstanding consumer debt levels.[13]) Of course, these patterns should be considered alongside variation in the conditions attached to different forms of consumer credit, including interest rates, add-on fees and penalties.

Interest rates for different forms of consumer credit can vary by a large amount

Although these figures illustrate the extent to which consumer borrowing as a whole has shifted across different groups of households, it masks both differences between the types of products on offer and the extent to which different types of households use them. Table 1 sets out the most common forms of consumer lending, noting the proportion of working-age households engaged in these agreements over 2016-19 as well as the average interest rate (annual percentage rate) attached to each.

11 Figures are deflated to April 2016-March 2018 prices using CPIH. Mean figures rose from £9,000 to £9,400 over the same period. See: ONS, 'Household debt in Great Britain: April 2016 to March 2018,' 5 December 2018.

12 Outstanding household consumer debt figures are skewed upward in both time periods: while the median ratio of household consumer debt to pre-tax income was 8.2 and 8.5 per cent in 2006-08 and 2016-18, respectively, the average figure was 25 and 37 per cent, respectively, illustrating substantial growth in the tails. However, whether using median or mean figures, lower-income households have consistently had higher consumer debt to pre-tax income ratios and have experienced a reduction in those ratios since 2006-08.

13 According to the Bank of England's summary of their 2019 NMG Consulting Survey, the NMG Survey has "has tended to significantly understate households' unsecured credit holdings, compared to the aggregate data". Their 2017 summary noted that total consumer debt figures found in the NMG do "not appear to pick up the continuing strength in consumer credit, as recorded in the official data." They suggest this underreporting could, in part, be driven by households omitting particular forms of consumer debt when asked to provide a top-down, overall household financial debt figure. They also note the possibility that an individual respondent will not have an accurate estimate for other household members' consumer debt levels. As a result, the variable that captures total consumer debt (asked in a top-down manner) was not included in the final 2019 results. See: Bank of England, The financial position of British households: evidence from the 2019 NMG Consulting survey, 20 December 2019; Bank of England, The financial position of British households: evidence from the 2017 NMG Consulting survey, December 2017

TABLE 1: **Costs of different types of consumer lending vary widely**

Examples of consumer credit arrangements and proportion of households using them: GB, 2016-19

	Proportion of 18-64 year-old households w/ an agreement	Average outstanding balance reported by 18-64 year-old households (2019)	Typical Annual Percentage Rate (APR)
Credit card	38%	£1,335	19%
Overdraft	19%	£250	15-20%
Dealership car finance (personal contract purchase)	18%	£910	4-7%
Personal loan	17%	£760	4%
Payday loan	3%		70-1,500%
Store card	11%		20-40%
Mail order purchase/ catalogue credit	9%	Avg. of payday, mail order, hire purchase (ex. car finance): £765	30%
Hire purchase/ rent to own	3%		70-100%

NOTES: Average interest rate can vary depending on several factors including, credit rating and perceived ability to repay. For the purposes of the table, it has been presented for a standard consumer with a typical credit rating. Overdrafts can be split into arranged (agreed) and unarranged. They can also charge with a fee structure as opposed to a flat interest rate. For the purposes of the table, banks with interest rate structures were selected.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey; Money Advice Service and Citizens' Advice

One clear takeaway from this table is that discussing consumer and unsecured credit as a single entity can be misleading: there is a wide variation in the conditions and commonality of different instruments. For instance, credit cards, the most common form of consumer credit, are used by roughly 40 per cent of working-age households and feature Annual Percentage Rates (APRs)[14] in the range of 20 per cent – although rates can go up to 40 per cent. Credit purchase facilities, which include store cards, mail/catalogue

14 While an interest rate refers to interest charged on a loan's principal, APRs reflect interest rates in addition to other fees.

order purchases and hire purchase agreements (including rent-to-own furniture and appliance contracts) tend to feature higher interest rates, and can also include a number of add-on costs and penalties.

Some facilities, like personal loans from a bank and dealership car finance agreements, offer substantially lower interest rates than other forms of consumer credit but have more stringent eligibility requirements – potentially putting them out of reach for a large share of mid-to-lower-income households. Payday loans are used by a relatively small proportion of households (3 per cent), but, in stark contrast to both personal loans and car finance agreements, have substantially looser eligibility requirements and can feature APRs of up to 1,500 per cent.

While the consumer credit market includes a host of demonstrably different products, the proportion of the population that uses these individual products have shifted over time – in some cases causing regulatory authorities to intervene in the market and attempt to reign in lending practices, that included excessive interests and rollover loans, while also boosting creditworthiness requirements.

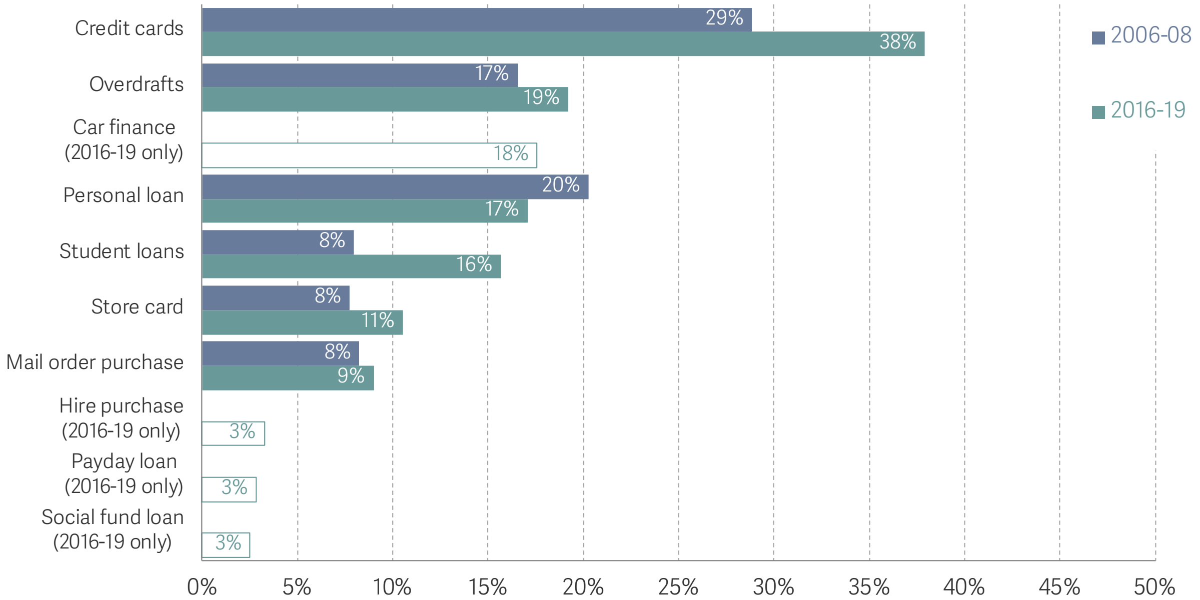
Earlier versions of the Bank of England's NMG Consulting Survey provide some insight into how use of these different consumer instruments has changed over time, although early vintages of the survey did not capture the full range of consumer instruments that the more recent NMG Consulting Surveys do – particularly payday loans.[15] Figure 5 sets out how use of these different facilities has grown, across all UK working-age households, between 2006-08 and 2016-19.

The proportion of households using credit cards and student loans increased most in percentage point terms: with credit cards rising from 29 to 38 per cent and student loans doubling from 8 to 16 per cent. Store card use also rose, from 8 to 11 per cent of working-age households, while there was a slight reduction (from 20 to 17 per cent) in the proportion accessing personal loans. Other forms of consumer credit, such as social fund loans and mail order purchases have shifted to a much lesser degree – and are currently used by around 3 and 9 per cent of working-age households respectively.

15 For instance, surveys in 2006-08 did not include specific questions about payday loans, car finance agreements (and hire purchase agreements excluding car finance). The NMG Consulting Survey has, in each edition asked about unsecured credit instruments that fall into the 'something else' category but given that the instruments that fall into this category will have changed over time, it is excluded from longitudinal analysis in this report.

FIGURE 5: **Most forms of consumer borrowing have risen over the past decade**

Proportion of working-age headed (18-64 year-old) households using different types of consumer credit instruments: GB



NOTES: Surveys in 2006-08 did not include specific questions about payday loans, car finance agreements (and hire purchase agreements excluding car finance). The NMG Consulting Survey has, in each edition asked about unsecured credit instruments that fall into the 'something else' category but given that the composition of instruments that fall into this category will have changed over time, it is excluded from longitudinal analysis in this briefing note.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey

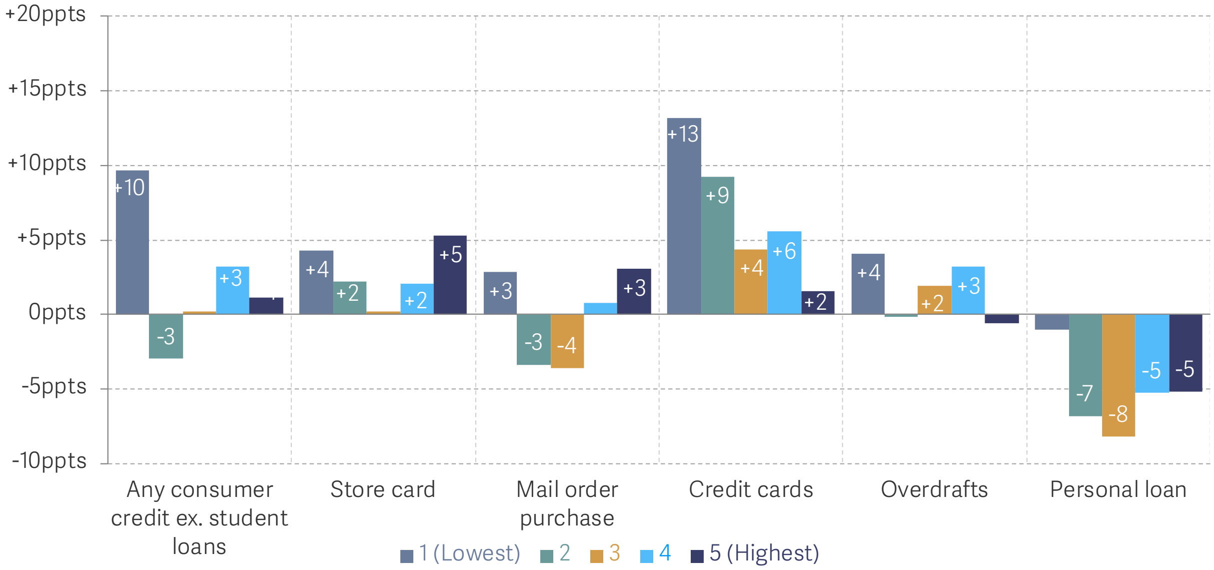
Unlike their higher-income counterparts, lower-income households are substantially more likely to use credit cards and overdrafts today than they were in the mid-2000s

Figure 4 showed that since the mid-2000s consumer borrowing has risen to a much larger extent among lower-income households than those on higher incomes. Of course, the use of different instruments has also grown at different rates, with credit card use, for instance, rising much more than the use of other instruments since 2006-08.

But have changes in the use of different instruments been similar across the household income distribution? Figure 6 indicates that the answer is: no. Between 2006-08 and 2016-19 the proportion of households in the bottom income quintile that used a credit card grew by 13 percentage points. This compares with just 4 percentage points for those in the middle quintile and 2 percentage points for those at the top.

FIGURE 6: **The proportion of lower-income households using credit cards and overdrafts has risen substantially in recent years**

Percentage point change in use of credit instrument, by working-age pre-tax household income quintile: GB, 2006-08 to 2016-19



NOTES: Workless households with no reported pre-tax income are included in the income quintiles. Unlike NMG data for 2016-19, the 2006-08 survey did not ask respondents how many adults reside in the household separate from the person responding, which is required in order to equivalise income by household size. As a result, the equivalised 2006-08 household income figures here use a proxy for the number other adults: they are calculated by subtracting the number of children under age 16 in the household from the number of individuals reported in the household. Running the same comparison across unequivalised household income quintiles yielded a similar pattern. All income is pre-tax. Use of other consumer credit instruments, including hire-purchase excluding car finance, dealership car finance and payday loans are excluded due to inconsistencies in the unsecured credit categories featured in earlier versions of the NMG Consulting Survey.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey

In other areas, like store cards and mail order purchases, growth was similar in percentage point terms, although in no major consumer category (student loans excluded) was percentage point growth larger among households in the top quintile. Unfortunately, we are unable to determine whether growth in the use of other instruments, such as payday loans, car dealership finance and hire purchases excluding car finance was skewed by income: these specific instruments were not included in earlier versions of the survey.

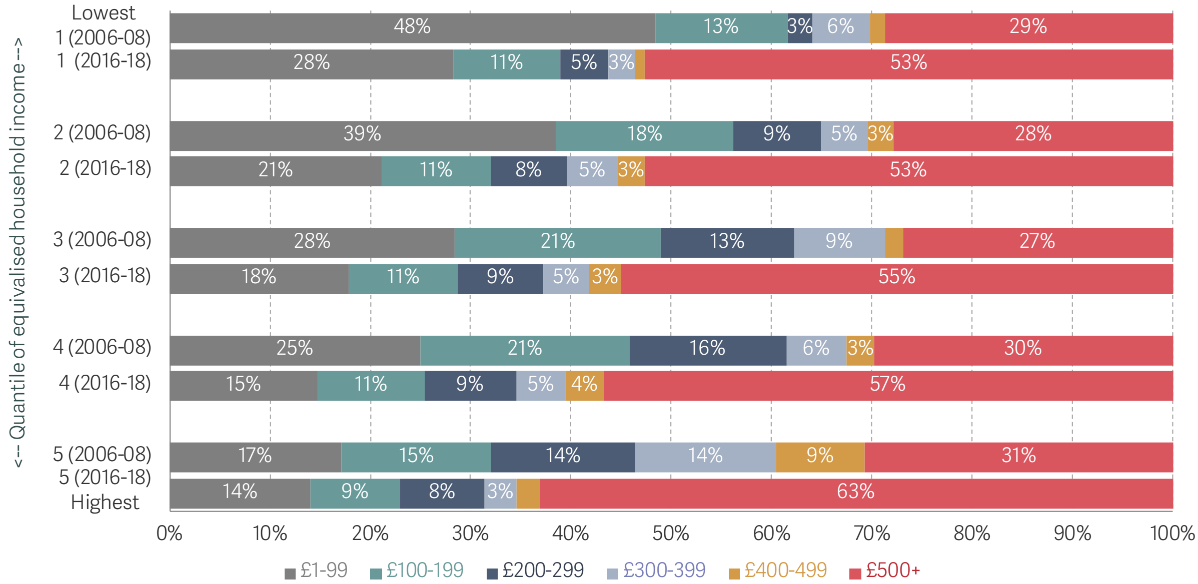
However, figures do suggest that the combination of growing rates of consumer credit use among lower-income households have, in combination with rising rates of more expensive product use, served to drive up monthly repayments in absolute terms – including those in the bottom household income quintile.

The level of consumer debt relative to pre-tax income is twice as large for the typical household at the bottom of the income distribution compared to those at the top

In 2006-08, 65 per cent of households in the bottom income quintile with consumer debt reported paying between £1 and £99 pounds in repayments over the past month, while 4 per cent reported paying £500 or more (these are nominal figures – that is, not adjusted for inflation). But, as Figure 7 indicates, by 2016-19 those figures had shifted: 59 per cent of households in the bottom income quintile with consumer debt reported repayments of between £1 and £99, while the proportion paying greater than £500 (nominal) more than doubled, from 4 to 9 per cent.

FIGURE 7: **The proportion of households whose monthly consumer debt payments are over £500 has risen substantially for those on lower-incomes**

Latest monthly consumer credit repayment (nominal) for households with outstanding consumer debt, proportion of 18-64 year-old households: GB



SOURCE: RF analysis of Bank of England, NMG Consulting Survey

Although the proportion of households in the top income quintile reporting monthly repayments of over £500 also grew (from 21 to 30 per cent) over the same time frame, it's worth bearing in mind that £500 forms a much larger share of pre-tax monthly income for those at the bottom than it does for those at the top).

Later editions of the NMG Consulting Survey, which include additional information on debt repayments, allow us a clearer sense of how the size of monthly repayments has changed relative to pre-tax household income. During 2015-16, the typical household with outstanding consumer debt reported paying 5.4 per cent of their monthly income on consumer debt repayments, falling very slightly to 5 per cent by 2018-19.[16] Encouragingly, this (very slight) fall in the relative value of repayments appears to have occurred across the income distribution: consumer debt repayment to monthly income ratios fell by nearly one percentage point for households at both the top and bottom of the income distribution, and less than one half of a point for those in the middle.

Still, the relative value of repayments remains substantially higher for lower-income households: in 2018-19, the median consumer debt repayment-to-monthly-income ratio for those in the bottom income quintile was 8 per cent, as compared to 5.4 per cent for those in the third income quintile and just 2.7 per cent for those at the top.

Getting a clear sense of the composition of debt that has driven these changes is difficult, in large part because the consumer credit market has changed and new products have been added to the survey over time. However, putting aside these changes, we do find that there remain large differences in some of the products that lower and higher-income households appear to rely on.

Lower-income households are less likely to use low-interest products than their wealthier counterparts

A natural concern in this context is that higher-income households would disproportionally access instruments with lower costs while lower-income households would rely most heavily on the most expensive ones. Such a disparity may well reflect the additional risk that lending to lower-income households entails, but could also be driven partially by unscrupulous practises at certain types of financial firm and/or the financial understanding of individuals applying for credit.

Table 2 sets out the extent to which that skewed income pattern prevails today. The big-picture is a simple one: mortgages are very much the preserve of higher-income households. While 34 per cent of working-age households currently have a mortgage, those in the top income quintile are more than three times as likely to have one as those in the bottom.

By contrast, the proportion of working-age households using any form of consumer credit (excluding student loans) varies much less across the household income

16 Monthly pre-tax income is calculated by dividing each respondent's reported annual income by 12. While this is the only available method for calculating monthly income in the NMG Consulting Survey, it runs the risk of masking volatility in weekly and monthly income – which particularly affects lower income households and is likely to put lower-income households at even greater risk of falling into arrears. See: D Tomlinson, Irregular payments: assessing the breadth and depth of month to month earnings volatility, Resolution Foundation, October 2018.

distribution: while 62 per cent of working-age households in the bottom income quintile reported having at least one form of outstanding consumer debt as compared to 64 per cent of those at the top.

TABLE 2: **Lower-income households are less likely to access lower-cost credit**

Proportion of working-age households with an outstanding balance on different debt instruments, by equivalised pre-tax household income quintile: GB, 2016-19

	1 (Lowest)	2	3	4	5 (Highest)
Mortgage	16%	29%	42%	49%	52%
Any consumer debt	68%	67%	68%	68%	68%
Consumer debt excluding student loans	62%	61%	63%	63%	64%
Credit cards	33%	39%	41%	42%	43%
Overdraft	19%	21%	23%	20%	19%
Student loan	14%	15%	16%	16%	15%
Personal loan	16%	18%	19%	20%	20%
Payday loan	4%	3%	2%	3%	3%
Car finance	12%	14%	19%	21%	25%
Social fund loan	6%	3%	1%	1%	2%
Something else	1%	1%	1%	1%	1%
Credit purchases	22%	21%	20%	18%	18%
Mail order	13%	13%	9%	7%	6%
Store card	11%	11%	11%	10%	12%
Hire purchase	3%	3%	4%	4%	4%

NOTES: Workless households with no reported pre-tax income are included in the income quintiles.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey

Digging deeper into the use of specific consumer credit instruments shows that some, like overdrafts, student loans, personal loans and store cards, display reasonably little variation across income quintiles. Payday loans feature less of an income gradient than might be expected: 4 per cent of households in the bottom income quintile report currently owing money on one, compared to 3 per cent of those in the top quintile.

Other instruments, like credit cards, rise more clearly with income: from 33 per cent of households in the bottom quintile to 41 per cent in the middle and 43 per cent of those in the top – though we have found that over the previous ten years growth in credit card use has been substantially larger among lower-income households than among their middle and higher-income counterparts (see Figure 6).

And yet there are other types of products with even clearer income gradients. For instance, car finance agreements, which typically feature interest rates that are lower than other consumer (and unsecured) products, are more substantially skewed towards higher-income households. The proportion of those in the top income quintile with a car finance agreement (25 per cent) is more than twice as large as the proportion in the bottom quintile (12 per cent).

At the other end of the spectrum, mail order purchase agreements, which typically charge interest rates of about 30 per cent (10 percentage points higher than typical quoted credit cards, are skewed in the opposite direction: 13 per cent of households in the bottom income quintile report having had one, as compared to 6 per cent of those at the top.

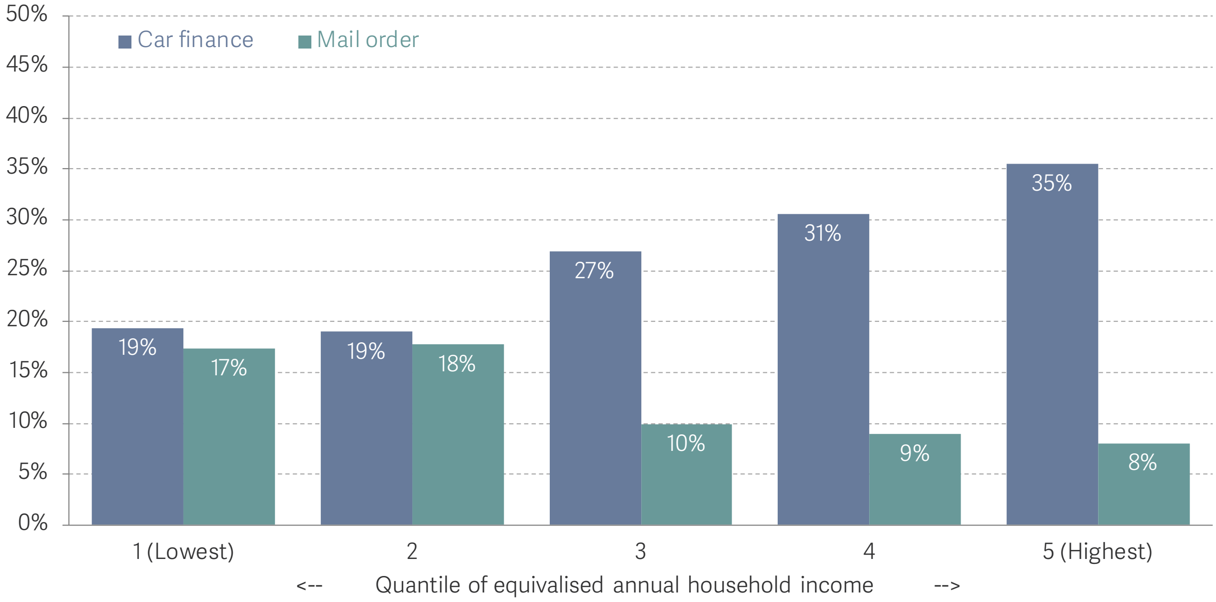
Across the income distribution, households with children are more likely to use consumer credit than other groups

As could be expected, reliance on consumer credit in general tends to be higher among the younger and middle-aged (25-34 and 35-44 year-old) households regardless of whether or not they include children: 70 per cent of 25-34 and 66 per cent of 35-44 year-old households without children have at least one form of consumer or unsecured product (excluding student loans), although this rises to 78 and 69 per cent, respectively, where households have at least one child.

The income-based skews in consumer credit use outlined in Table 2 persist among younger households with children. For instance, Figure 8 shows that younger families at the top of the income distribution are nearly twice as likely as those at the bottom to use a car finance agreement, and those at the bottom are still more than twice as likely to use a mail order/catalogue purchase. This is similar to the difference between income groups that exists for their all-age counterparts. That said, younger households with young children are more likely to use these instruments than older households and/or those without children, particularly towards the bottom of the income distribution.

FIGURE 8: **Higher and lower-income families tend to use different forms of credit**

Proportion of households headed by a 25-44 year-old with at least one child that owe money for a mail order purchases and car finance agreements by equivalised pre-tax household income quintile: GB, 2016-19



NOTES: Workless households with a reported pre-tax income are included in the income quintiles.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey

The proportion of 25-44 year-old households with children at the bottom of the income distribution using a mail order purchase facility is 17 per cent, slightly higher than the proportion of all-age households in the bottom of the income distribution that use them more generally (15 per cent). For those at the top of the income distribution these figures are 8 and 6 per cent respectively.

Differences in use across income groups, age and household type ultimately reflect a combination of different consumer needs and the likelihood of meeting eligibility requirements. And while there are worrying patterns of use within specific types of instruments, instruments with the most punishing interest rates and charges are not entirely concentrated at the bottom of the income distribution. However, we should not ignore the relative burden of these instruments, including the extent to which debt can weigh differently upon households at opposite ends of the income scale.

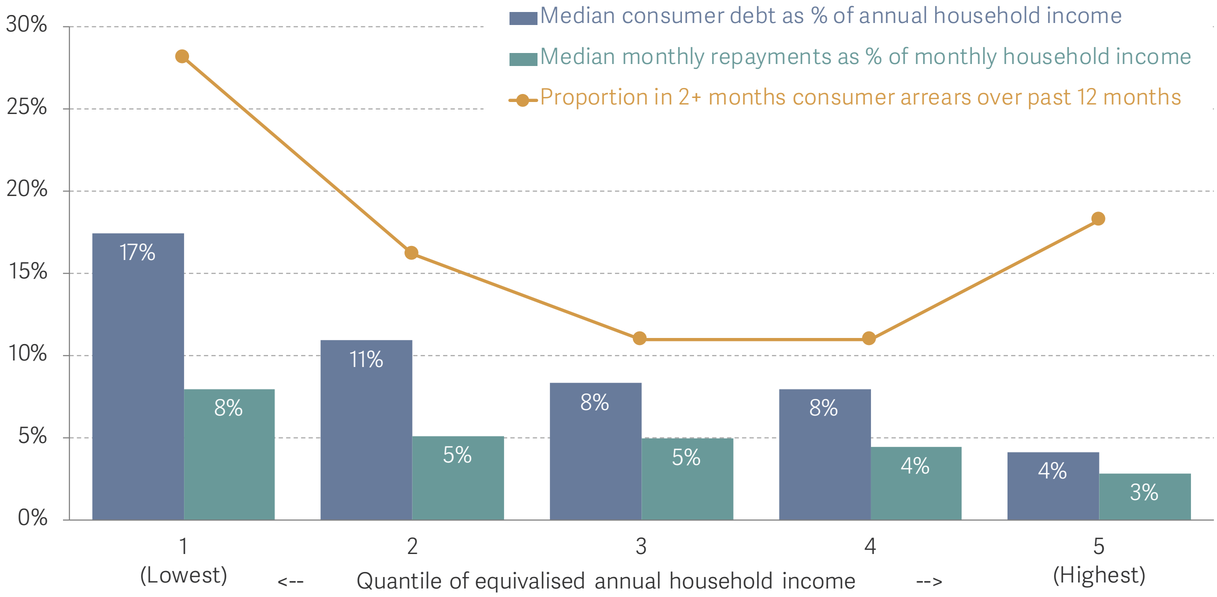
Lower-income households remain substantially more likely than their higher-income counterparts to experience high levels of debt distress

The burden that consumer debt places on a household can be measured in a number of different ways. On the one hand, the absolute level of debt, relative to income, can help shed light on the overall pressure of debt, and the length of time it may take to reduce it. On the other hand, more specific measures on repayments and arrears bring us a bit closer to the lived experience of over-indebtedness, illustrating the extent to which borrowers may struggle to service debt and the extent to which debt repayments cut into financial resources.

Figure 9 shows a clear, negative, association between consumer debt-to-income ratios and total household income. For the median household in the top income quintile, outstanding consumer debt is worth 3 per cent of pre-tax annual household income. For those in the middle (third) quintile, it is worth about 8 per cent of annual household income, and for those at the bottom it is equal to 17 per cent.

FIGURE 9: **Consumer debt burdens weigh most heavily on lower-income households**

Median levels of consumer debt and monthly repayments as a proportion of pre-tax household income, proportion of households in arrears, by equivalised pre-tax household income quintile, 18-64 year-old households with consumer debt: GB, 2016-19



NOTES: Workless households with a reported pre-tax income are included in the income quintiles.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey

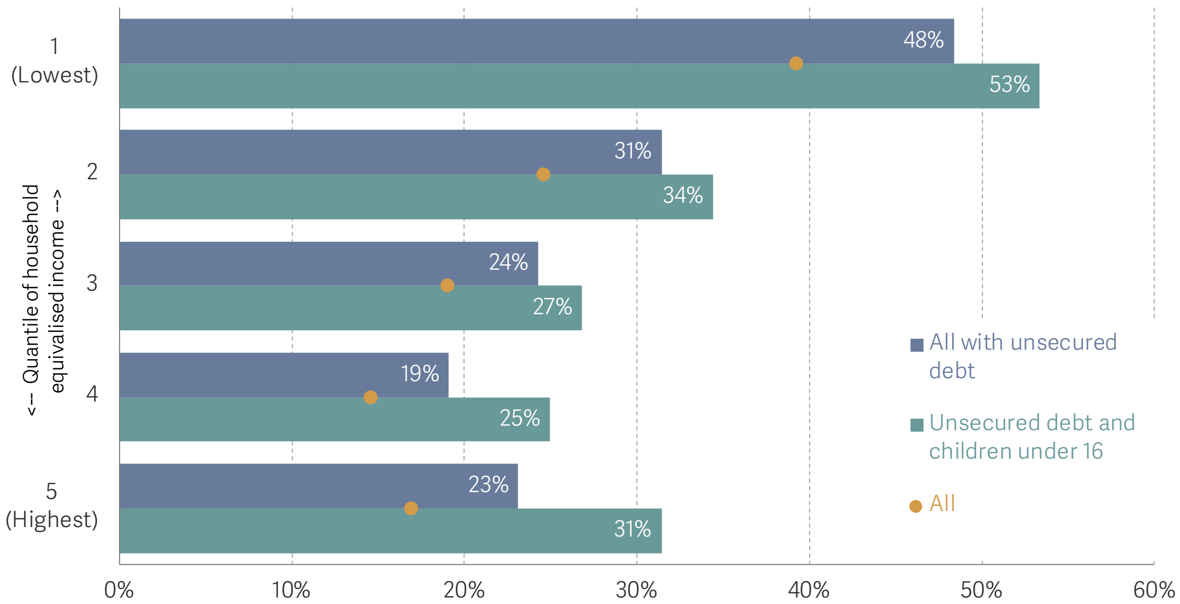
The median value of monthly repayments, relative to pre-tax monthly income, is also higher among lower-income households: for those in the lowest income quintile, monthly repayments are on average worth 8 per cent of monthly income, as compared to 5 per cent of income for those in the middle quintile and 3 per cent for those at the top.

It is, therefore, unsurprising that lower-income households will, on average, struggle most when it comes to keeping up with repayments. Indeed, 28 per cent of those in the bottom income quintile reported having been in arrears of two months or more over the past year; that is more than twice as high as the proportion of households in the middle quintile reporting the same (11 per cent) and substantially higher than those at the top saying so (18 per cent).

We can get a sense of the link between debt burdens and living standards more specifically by looking at the proportion of households that report having struggled to meet their accommodation costs at any point over the previous 12 months. Figure 10 shows that the overall proportion of lower-income households in the bottom income quintile that report struggling with accommodation costs (39 per cent) is twice as a high as those in the top two income quintiles (15 per cent of those in the fourth and 17 per cent of those in the fifth quintile).

FIGURE 10: **More than half lower-income families with consumer debt report struggling to meet accommodation costs**

Proportion of working-age households that report having struggled to meet accommodation costs over the previous 12 months by family type, equivalised pre-tax household income quintile and use of consumer debt: GB, 2016-19



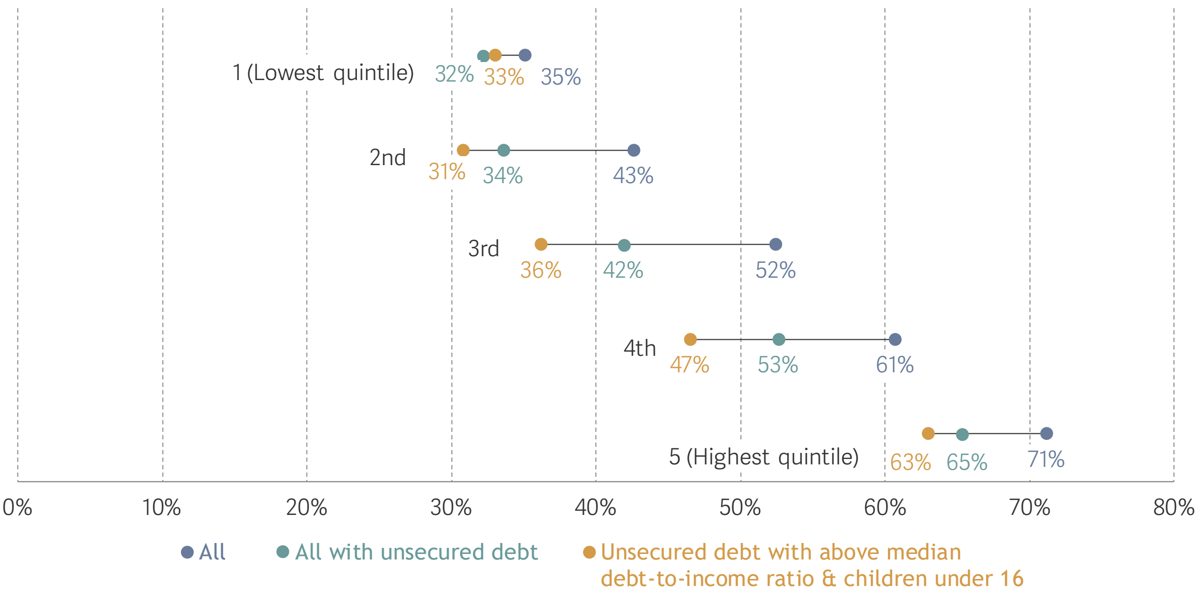
NOTES: Workless households with a reported pre-tax income are included in the income quintiles.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey

Across all income quintiles, these figures rise once we focus specifically on households with consumer debt, and rise again for households with consumer debt and children. For instance, 23 per cent of households with consumer debt in the top income quintile report struggling with accommodation costs. This rises to 31 per cent for those who also have children. The picture is particularly worrying for those in the lowest income quintile: 48 per cent of those with consumer debt report struggling with accommodation, as do more than half (53 per cent) of those households with children. This is up from 2006-08, when one-third of low-income households with children and with consumer debt reported difficulties paying for their accommodation.

Given the difficulties that lower-income, and especially indebted lower-income, families have in meeting accommodation costs, we might expect them to feel unprepared in the event of a financial emergency. Figure 11 shows that, overall, 65 per cent of households in the highest income quintile report feeling they have enough savings in the event of an emergency, compared with slightly more than half (52per cent) in the middle-income quintile, and just over one-in-three (35 per cent) in the bottom income quintile.

FIGURE 11: **Fewer than one-in-three lower-income households with consumer debt feel they have enough money set aside for emergencies**

Proportion of working-age households reporting they "have enough money set aside for emergencies" by equivalised pre-tax household income quintile and use of consumer debt: GB, 2016-19



NOTES: Workless households with no reported pre-tax income are included in the income quintiles. Median consumer debt-to-income ratio was 8.5 per cent per cent over 2016-19. Workless households with a reported pre-tax income are included in the income quintiles.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey

Across all income groups, the proportion feeling prepared is lower where households have any outstanding consumer debt (6 per cent of those in the top, 42 per cent in the middle and 33 per cent at the bottom) and substantially lower – particularly for those in the middle of the income distribution – where a household has both children and a consumer debt-to-income ratio that is higher than the typical ratio of 8.5 per cent. Here, 63 per cent of those in the top quintile report being prepared, falling to 42 per cent of those in the middle quintile, and at 33 per cent of those at the bottom.

This is a worrying picture for all households outside the top income quintile: less than half of families with children and a higher-than-typical consumer debt level have enough set aside to meet an emergency. This includes one-in-three of those in the bottom two quintiles. In fact, recent Resolution Foundation research shows that the proportion of low-to-middle income families that report having no savings or investments rose by 15 percentage points in the aftermath of the financial crisis, and remained well over 50 per cent as of 2016-17.[17] Moreover, the ability to meet such an emergency through further borrowing is likely to be much weaker for those lower-income households already weighed down by a consumer debt burden.

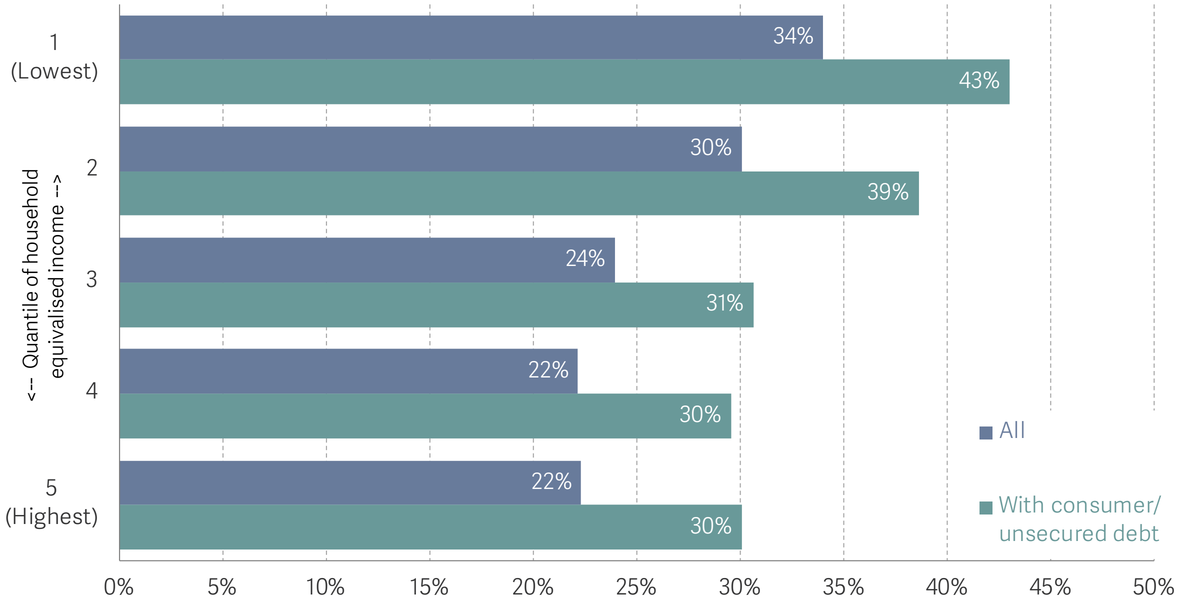
Overall, one-in-four UK households report being put off from spending due to concerns that they will not be able to access credit when they need it. Figure 12 shows that this ranges from 22 per cent households in the top income quintile, to 24 per cent among those in the third and just over one-in-three (34 per cent) of those at the bottom.

Among those with outstanding debt, the proportion who are put off spending due to perceived constraints is higher – regardless of income quintile. This includes nearly one-third (30 per cent) of those in the top income quintile, 31 per cent of those in the middle and 43 per cent of those at the bottom. To the extent that these figures reflect a genuine credit constraint (over and above individuals' own *fears* about credit constraints), they are concerning. Although further debt accumulation would, for most, probably be undesirable, the inability for households to access financing when in a difficult position could push them into even deeper financial straits.

17 C Pacitti & J Smith, A problem shared: What can we learn from past recessions about the impact of the next across the income distribution?, Resolution Foundation, August 2019

FIGURE 12: **More than one-third of lower-income households with consumer credit are "put off spending" because they are concerned they won't be able to access credit when they need it**

Proportion of working-age households reporting on they are "put off spending" because of concerns they "will not be able to get credit when [they] need it", by equivalised pre-tax household income quintile and use of consumer debt: GB, 2016-19



NOTES: Workless households with a reported pre-tax income are included in the income quintiles.
SOURCE: RF analysis of Bank of England, NMG Consulting Survey

Without asserting that the use of unsecured and other forms of consumer credit is, on its own, responsible for financial stress, it is worth taking a step back and understanding its broader effects. Because debt repayments, by their nature, reduce the amount of money that households have to spend on other areas, unsecured/consumer debts inflict on households some level of stress. Moreover, those using consumer credit are increasingly likely to be from lower-income households, and are likely to have experienced some level of financial stress before borrowing. As their debt burdens rise, it will become even harder for these households to reduce costs and build up savings that would allow them to cope with future financial stress. In other words, causality between financial difficulties and debt runs in both directions.

This cycle is particularly concerning given the rise of other, non-consumer forms of debt. Over recent years utility and council tax debt have grown rapidly: the number of households with energy debt rose from risen from 2.4 to 2.9 million between 2016 and 2018 alone.[18] There has also been a large rise in the number of households falling behind on their council tax: Citizens Advice found that in 2018 nearly one-in-ten households in England and Wales were in council tax arrears during 2017/18, with the total amount of council tax debt rising by 30 per cent since 2010. These pressures have the potential to

18 A Vaughn, Number of UK households in energy debt rises by 300,0000, The Guardian, 2 November 2018

exacerbate – and in some cases drive up – the use of consumer credit, though they often aren't included in policymakers' typical conception of debt.[19]

Going forward, policymakers will want to balance access to credit against practices which drive up costs unfairly, without ignoring how wider living standards challenges can drive families towards consumer borrowing

Over recent years, UK financial regulators have stepped up their scrutiny of some consumer lending products. Payday loans were among the first instruments to be reviewed: in 2015, the Financial Conduct Authority (FCA) capped payday loan costs. They also firmed up creditworthiness requirements, limiting the amount of interest rates and add-on charges,[20] and banning rollover loans – such that borrowers would never repay more than twice the amount that they originally borrowed.[21]

By 2018, Wonga, the UK's largest payday lender, had gone into administration.[22] But although recent rules may have had some effect in reducing the burden of payday loans on individual households, the number of payday loans does appears to be on the rise, with the FCA reporting there were 1.5m payday loans issued in the second quarter of 2018 as compared to 1.2m in the third quarter of 2016. And while more stringent regulations on payday loans' interest rates and charges are welcome, some have argued that regulations remain too lax: in some Canadian provinces for instance, interest rates on payday loans cannot exceed 15 per cent.[23]

Regulators have also begun to turn to other consumer products. For instance, last year the FCA reported that just 1.5 per cent of customers, most of whom were from deprived areas, formed as much as half of lenders' unarranged overdraft fees.[24] In late 2018, they announced plans to restrict charges on unarranged overdrafts as well as force banks to put into place clearer information on overdraft interest rates.[25] They have also proposed stricter rules on hire-purchase agreements, arguing that companies should be banned from charging more than 100 per cent interest on items.[26]

To a certain extent, these regulatory initiatives reflect an effort to draw a distinction between borrowing costs which are higher due to consumer lending being higher-risk,

19 R Derricourt et. al, The costs of collection: the high price of council tax, Citizens Advice, April 2019
20 Including capping default fees at £15 and an initial cap of 0.8 per cent per day. See: Critical Research, Price cap research: summary report (prepared for the Financial Conduct Authority), June 2017
21 C Barrett, 'Charities slam FCA for failing to end the 'debt trap', Financial Times, 9 July 2009
22 In large part, this firm's collapse was down to management and misselling penalties. See: N Megaw and C Binham, 'Wonga collapses after surge of customer complaints', Financial Times, 30 August 2018
23 See: L Noonan, 'Rules juggle protection of payday loan borrowers and lending market' Financial Times, 17 October 2019
24 An unarranged overdraft is where a customer spends more money than exists in their bank account, without first agreeing an overspend facility (i.e. an overdraft) with their bank.
25 N Megaw & C Binham 'UK watchdog to ban higher fees for unarranged overdrafts', Financial Times, 18 December 2018
26 N Megaw, 'FCA proposes cap on 'rent-to-own' retailer prices', Financial Times, 22 November 2018

and borrowing costs which are higher due to predatory behaviour. They also reflect efforts to ensure a balance between the cost of consumer credit and its availability; in other words, stamping out bad practice without removing lower-income households' ability to access consumer and often short-term finance or indeed leaving those in need to borrow from illegal money lenders.

Important though these efforts are, policymakers also need to consider the factors that continually drive lower-income households towards more expensive borrowing. This briefing note illustrates the extent to which borrowing (and high rates of borrowing relative to income) are increasingly common among lower-income and working households, with a suggestion that consumer debt can bear down on a family's ability to pay for their accommodation and/or manage a financial emergency.

With those conditions in mind, policymakers would be right to focus attention on the interaction of the different factors that can lead to demand for high-cost borrowing - such as insecure working arrangements, pay volatility and, increasingly, delays and difficulties with benefit payments, particularly under Universal Credit. But they also should broaden the traditional conception of debt to account for rising pressures lower-income households face with regard to council tax and utilities.

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