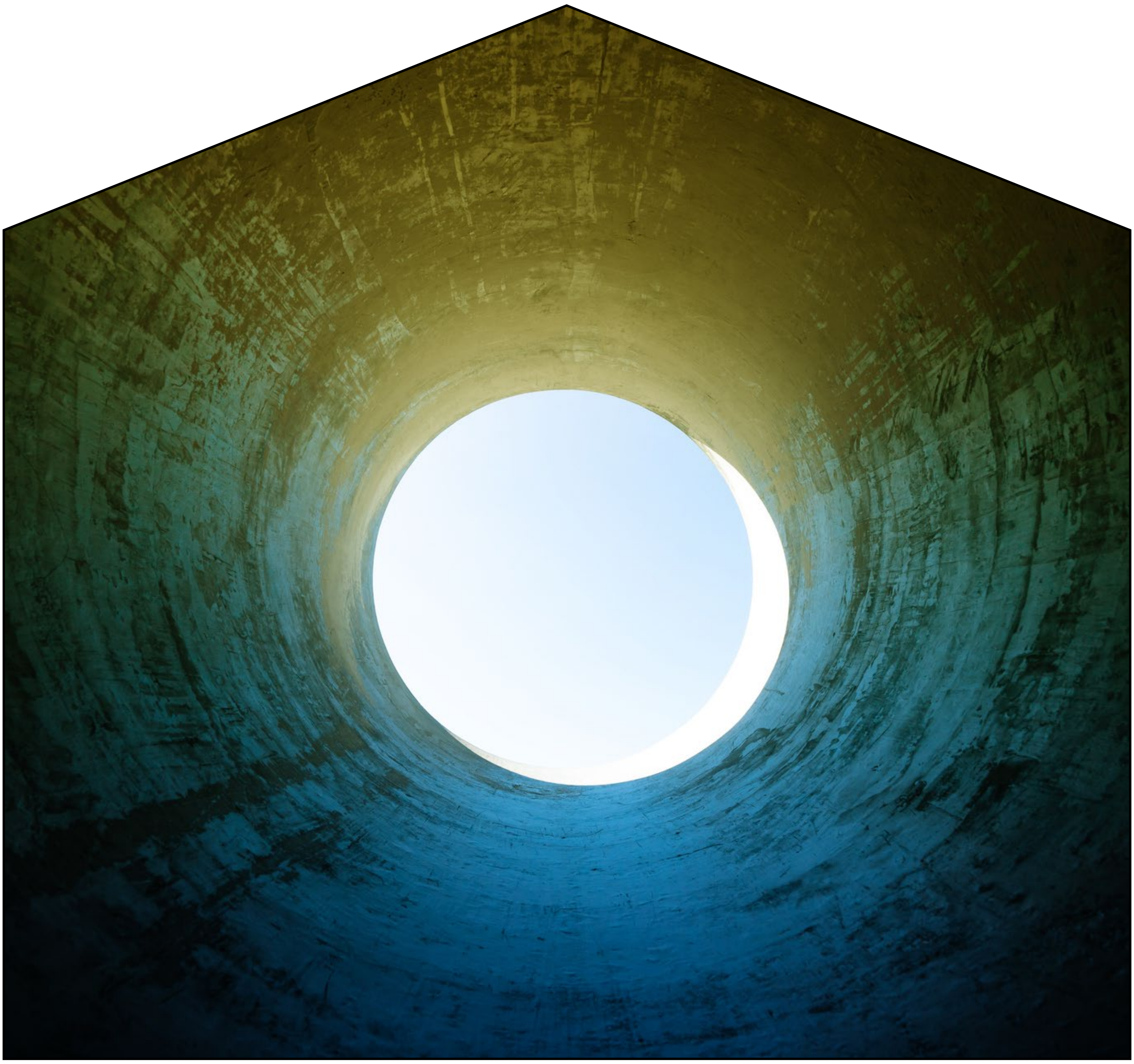
In too deep?

The impact of the cost of living crisis on household debt

Felicia Odamtten & Simon Pittaway

February 2024



Acknowledgements

The authors are grateful to The Health Foundation for supporting this work. Contributions from colleagues at the Resolution Foundation are also gratefully acknowledged, particularly from Torsten Bell, Mike Brewer and James Smith. However, all errors and omissions are the authors' own.

This research uses data from three online surveys conducted by YouGov. Fieldwork for the more recent survey was undertaken online during 13-17 October 2023, and the total sample size was 8,378 UK adults aged 18 and over. It also reuses data from similar surveys of 10,122 UK adults aged 18 and over conducted by YouGov from 6-13 March 2023, and one of 10,470 adults aged 18 and over conducted by YouGov from 23-30 November 2022. All figures have been weighted and are representative of all UK adults. The figures presented from the online surveys have been analysed independently by the Resolution Foundation. The views expressed here are not the views of YouGov.

ONS crown copyright info

Download

This document is available to download as a free PDF at:

resolutionfoundation.org/publications/in-too-deep/

Citation

If you are using this document in your own writing, our preferred citation is:

F. Odamtten & S. Pittaway, *In too deep?: The impact of the cost of living crisis on household debt,* Resolution Foundation, February 2024

Permission to share

Summary

Rising interest rates have brought a renewed focus on household debt in recent years. While much attention has been paid to higher mortgage rates, rates on consumer debt (like credit cards, overdrafts and personal loans) have risen too. With the cost of living crisis piling pressure on family balance sheets, many have expressed concerns that people are turning to costly credit to make ends meet. But we also hear that many families were able make significant savings during the pandemic, and potentially used them to pay down existing debts. So what is going on?

Despite the pressures brought on by the cost of living crisis, British families today have less consumer debt relative to their incomes than at any point since records began in 1999. The pandemic is the main reason for this: in cash terms, aggregate outstanding consumer debt fell by £26 billion between December 2019 and March 2021. This included a record fall of £15 billion in just three months between March and June 2020, when Britons were mostly locked down and not spending. But, coming out of the pandemic and into the cost of living crisis, consumer debt has still fallen relative to income. Debt has started to grow in cash terms, but more slowly than household incomes. This continues the pattern of falling consumer debt since the mid-2000s, leaving the ratio of consumer debt to household income to its lowest level on record (13.2 per cent). Had the UK's debt-to-income ratio remained at its pre-pandemic level, our stock of consumer debt today would be £48 billion higher, worth around £1,700 per household.

Survey data suggests that the share of households using consumer credit hasn't changed in recent years. Instead, it appears that those using this type of borrowing have less debt on average, with the drop in outstanding balances largest for poorer households. In the early part of the pandemic, lockdowns disproportionately curtailed the spending of richer households, and their average credit-card balances fell sharply as a result. But poorer households have seen credit-card balances fall by more since then. The disparity between poorer and richer households is even starker for non-credit card consumer debt (the average combined balance across car finance, personal loans and overdrafts). By September 2023, the average amount of debt for a household with non-credit card debt in the bottom third of the income distribution was 21 per cent lower than in September 2019. For those in the top third of incomes, average balances rose by 6 per cent over the same period.

There is good news here. The recent improvements in household finances are welcome. They've meant that, even after the recent rise in interest rates, British families overall are spending a smaller share of their income servicing their consumer debt than they were before the pandemic. The lower share of income spent today represents a saving of £1.8 billion on UK's annual consumer debt interest bill versus pre-pandemic levels.

But this does not mean all is well. Part of the reason consumer debt has not risen during the cost of living crisis is that lenders have made it harder to access credit. According to the Bank of England's Credit Conditions Survey, lenders have tightened their risk appetite for unsecured lending every quarter since mid-2022. Today's tighter lending conditions are more likely to bite for lower-income households. When surveyed in March 2023, around one-in-eight (13 per cent) of the poorest fifth of families had been rejected for credit in the previous 12 months, compared to just one-in-twenty (5 per cent) of the richest fifth.

Faced with restricted access to consumer debt, debt problems seem to be shifting rather than disappearing. Many poorer families have fallen behind on energy, and other, bills as a way of coping with the rising cost of living. In October 2023, roughly one-in-eight families (12 per cent) in the bottom fifth by income owed money on priority bills like utilities and Council Tax, nearly three times the proportion of families in the top two-fifths (4 per cent).

This is not normal. The scale of arrears on gas and energy bills has increased massively in the past few years. Ofgem data indicates that the number of accounts behind on their gas and electricity bills has reached the highest level since records began in 2012. It's also concerning that, on top of a growing number of households falling into energy-bill debt, the size of the problem for those who find themselves in debt is getting worse. The most recent quarter of data revealed that the average amount owed by those in arrears on their gas or electricity bill has increased by half in a little over a year (up or 51 per cent between Q2 2022 and Q3 2023). This is changing the nature of financial hardship for many of the most vulnerable families. Data from Citizens Advice reveals that, compared to before the pandemic, the average person seeking debt advice today has, on average, almost £1,000 (£984) less credit-card debt but over £500 (£539) more debt on priority bills like energy, rent arears and Council Tax.

Given the nature of the cost of living crisis, we shouldn't necessarily be surprised by the shift from consumer debt to priority debt. Steep rises in energy prices have been a defining feature of the cost of living crisis, so it is unsurprising that more households are finding them unaffordable. And, with consumer debt becoming an increasingly expensive and inaccessible option, typically interest-free priority debt will often be the best available option for families seeking a financial lifeline.

Although going into priority debt might be cheaper than consumer debt, it comes with high stakes. Energy bill debt comes with the threat of being cut off, rent arrears can end up in eviction, and unpaid Council Tax can lead to a prison sentence in England. It's no surprise, then, that priority debt is associated with particularly severe impacts on people's health. For instance, someone is around twice as likely to report feeling under strain if they owe money on priority bills, compared to someone who doesn't.

Overall, we shouldn't ignore the fact that, despite a historic rise in interest rates, we haven't seen an increase in the burden consumer debt. This has been a surprising positive development to come out of the pandemic and cost of living crisis. But taking a broader look at household finances reveals cause for concern. Falling consumer debt isn't just telling us about demand, it also telling us about its increasingly restrictive supply. Meanwhile, priority debt is an increasingly common release valve for under-pressure families, with serious implications for their health and wellbeing. If we want to avoid a repeat in future, it's time to get serious about policies to help families to build up the financial resources they can fall back on in tough economic times.

The combination of the rising cost of living and higher interest rates has raised concerns about Britons' use of debt

The rising cost of mortgage debt has been in the news in recent months.[1] But less attention has been paid to other types of financial debt, such as credit cards, overdrafts and personal loans – which we collectively refer to as consumer debt in this note.[2] One reason for this might be falls in this type of borrowing. Indeed, the total stock of outstanding consumer debt fell in the immediate aftermath of the financial crisis, due to a combination of weak demand and tighter credit conditions. And, despite an uptick in borrowing in the second half of the 2010s, partly driven by a larger share of cars being bought on finance, outstanding consumer debt was significantly lower on the eve of the pandemic than before the financial crisis: in today's prices, outstanding consumer debt fell from £313 billion in July 2008 to £270 billion in December 2019.[3]

However, despite levels of consumer debt falling in aggregate, the 2010s saw a spreading-out of the use of consumer credit – particularly among low-income families. Between 2006-09 and 2016-19, the share of households using some consumer debt rose by 13 percentage points in the bottom fifth of the income distribution, compared to just 2 percentage points in the top fifth.[4] And a particularly concerning trend in this period was the emergence of high-cost credit aimed at lower-income families.[5]

Against a backdrop of a historically widespread use of consumer debt, many have expressed concern that the financial pressures of the pandemic and cost of living crisis – plus higher interest rates – could lead to a rise in consumer-debt problems.

These worries are not unfounded. There is no doubt that the cost of living crisis has forced many families into serious hardship. For example, food banks in the Trussell Trust network distributed 3.0 million emergency food parcels in the UK in 2022/23, a 50 per cent increase on the 1.9 million parcels distributed in 2019/20.[6] When faced with such dire financial conditions, it is natural to think that many people will turn to consumer debt as a way of getting by.

In contrast, the Bank of England has struck a more sanguine tone. It has highlighted some evidence of consumer debt struggles in its recent assessments of risks in the UK financial system, but in the main has not sounded the alarm on consumer debt. Instead,

---

1 See, for example: K Peachey, Mortgage rates soar to highest level for 15 years, BBC News, July 2023.
2 Student loans are sometimes grouped together with consumer debt. We do not include them in our analysis because of two key differences with other forms of consumer debt, namely that they cannot be taken out to fund day-to-day spending and that the loan repayments are income-contingent.
3 Bank of England, Bankstats.
4 J Ahmed & K Henehan, An outstanding balance? Inequalities in the use – and burden – of consumer credit in the UK, Resolution Foundation, January 2020.
5 Financial Conduct Authority, High-cost Credit Review: Consultation on rent-to-own, home-collected credit, catalogue credit and store cards, and alternatives to high-cost credit Discussion on rent-to-own pricing, May 2018.
6 R Bull et al., Hunger in the UK, The Trussell Trust, June 2023.

it has noted that rates on consumer debt are less sensitive to moves in the Bank of England's base rate and that the share of people falling behind on repayments remains low.[7]

So, how concerned should we be about debt in the cost of living crisis? That is exactly the question we tackle in this note. Using insights from aggregate data and recent household surveys, we take an in-depth look at debt since the start of the pandemic and look at new evidence on the impact it is having on health and wellbeing across the UK.

Relative to income, Britons today have less consumer debt than before the pandemic

The Covid-19 pandemic brought with it the biggest UK recession in more than 300 years – sparking worries that many families would find themselves in dire financial trouble. But, perhaps surprisingly, households as a whole were able to save and pay down debt at historic rates.[8] Between December 2019 and March 2021 (when Britain emerged from the third and final national lockdown) the UK's stock of outstanding consumer debt fell by £26 billion in cash terms. Within that period, the first national lockdown saw the largest three-month fall in consumer debt on record, falling by £15 billion between March and June 2020.

As Britain moved out of the pandemic and into the cost of living crisis, families started to borrow once again. Between March 2021 and December 2023, outstanding consumer debt increased by £21 billion. In cash terms, this offset most of fall during the pandemic, leaving the stock of outstanding consumer debt in December 2023 around £5 billion lower than it was four years earlier.

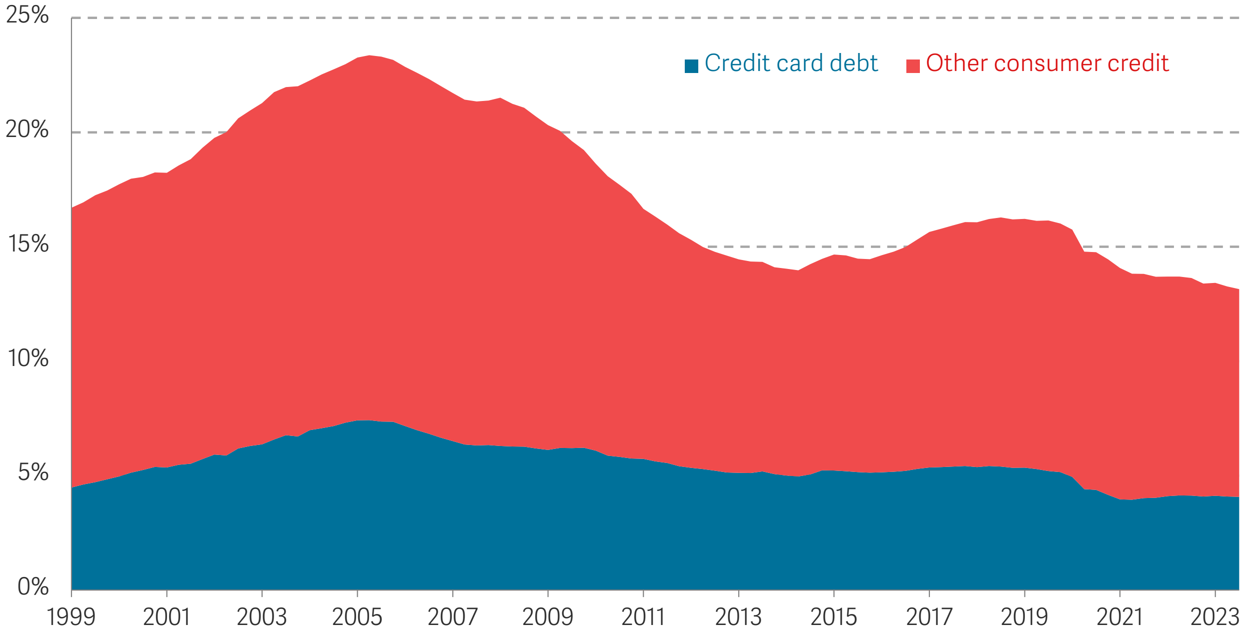
But while consumer debt has grown in the past couple of years, it hasn't kept pace with growth in household incomes. Real wages have been flat in recent years, but nominal wages are growing quickly as workers seek to maintain their purchasing power in the face of high inflation.[9] High inflation has also directly boosted nominal incomes through the inflation-uprating of benefits. As a result, aggregate household disposable income was up 18 per cent between the three months to March 2021 and the three months to September 2023 (the most recent quarter for which we have aggregate income data). Over the same period, outstanding consumer debt grew by just 10 per cent. As shown in Figure 1, this has caused consumer debt as a share of household income to fall to a historic low of 13.2 per cent in September 2023. This is a big change in the space of only a

7 Bank of England, Financial Stability Report, December 2022; Bank of England, Financial Stability Report, July 2023; Bank of England, Financial Stability Report, December 2023.
8 M Broome, I Mulheirn & S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.
9 H Slaughter, Labour Market Outlook Q4 2023, Resolution Foundation, December 2023.

few years: if the ratio of debt to income had remained at its pre-pandemic level, the UK's stock of consumer debt would be £48 billion higher than it is today, worth around £1,700 per household.

FIGURE 1: **Outstanding consumer debt fell rapidly during the pandemic**

Outstanding consumer credit balances of households as a proportion of gross disposable household income: UK



NOTES: Income is measured as a four-quarter rolling sum. Historic data on outstanding balances has been manually break-adjusted to reflect significant changes to the basis of preparation.
SOURCE: RF analysis of Bank of England, Bankstats; ONS, Economic Accounts.

As many families as before the pandemic are using consumer debt - they're just using less of it on average

The aggregate data tells us that, even in cash terms, levels of consumer debt are still below pre-pandemic levels. But the aggregate data cannot tell us what has driven that change. Is it that fewer people today are using consumer debt than before the pandemic? Or have average balances fallen among those with consumer debt? The Bank of England's NMG Survey, which collects data on household finances around the beginning of September each year, can shed some light on this issue.[10]

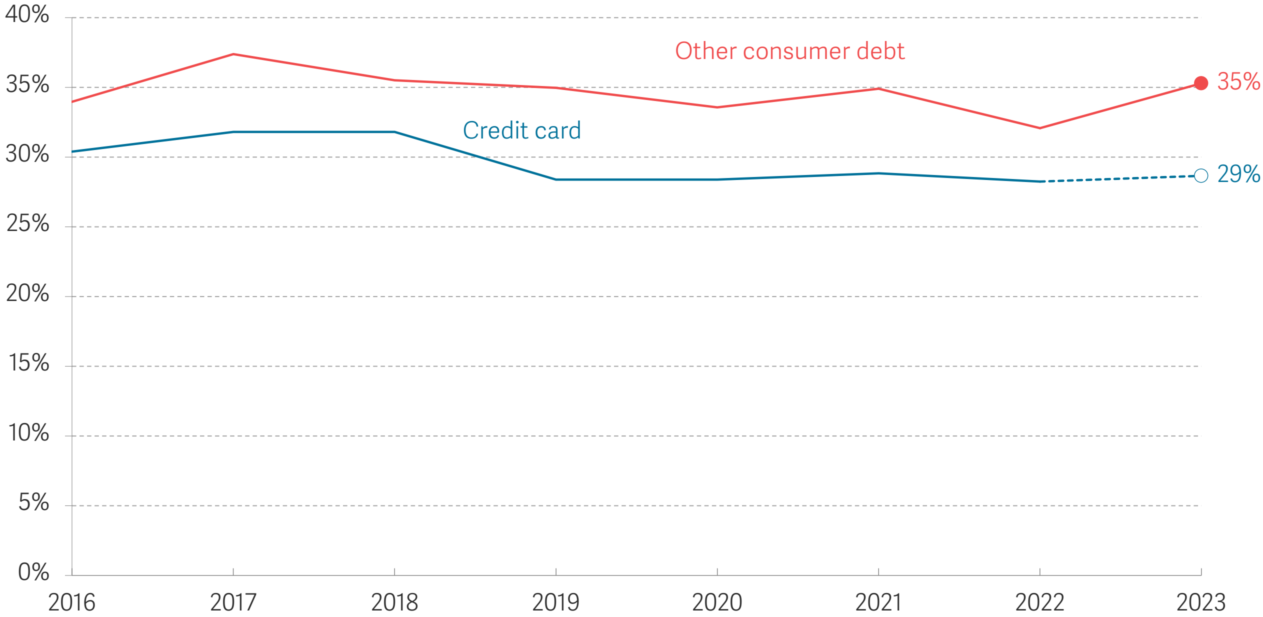
Falling headline levels of consumer debt haven't been matched by a fall in the share of households using consumer debt. As Figure 2 shows, the proportion of households using consumer debt has been broadly flat since the start of the pandemic: both the share of households using credit cards and the share using other types of consumer debt (car

10 For a detailed look at the NMG Survey and a comparison to other surveys of household finances, see: G Anderson et al., The Bank of England / NMG Survey of Household Finances, Fiscal Studies 37(1), March 2016.

finance, personal loans, overdrafts, non-vehicle hire purchase agreements, store cards and payday loans) have stayed at around one-in-three.

FIGURE 2: **The share of households using consumer debt hasn't changed much since the start of the pandemic**

Share of households with outstanding consumer debt, by type: UK



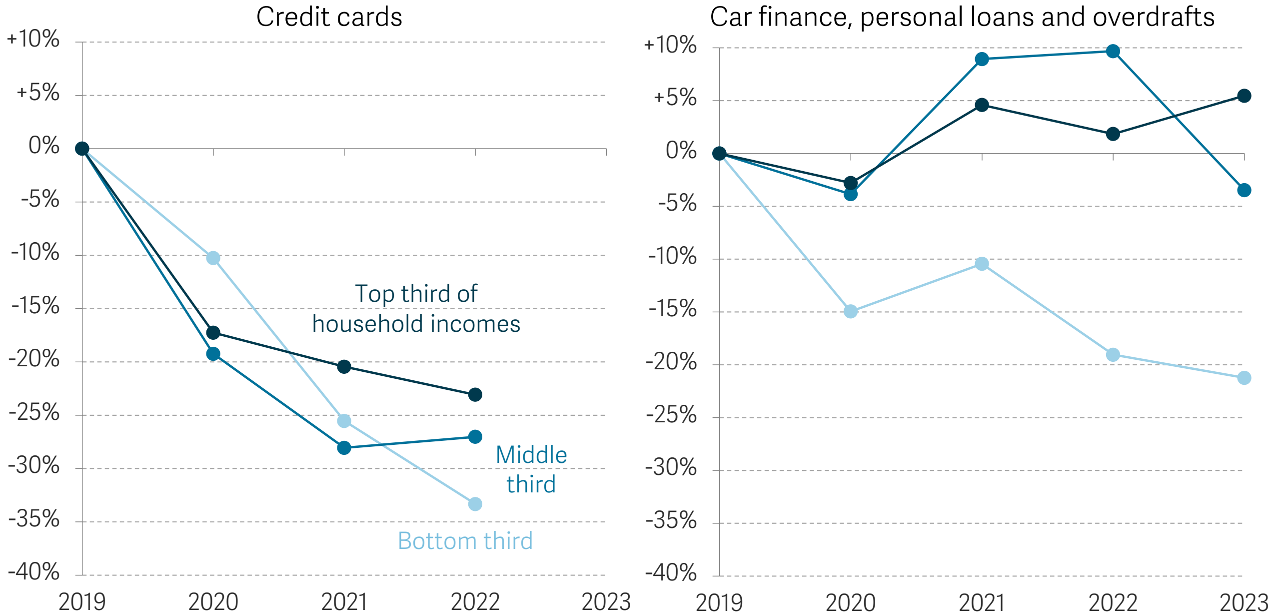
NOTES: Other consumer debt measures the share of households with any of the following: car finance, personal loans, overdrafts, non-vehicle hire purchase agreements, store cards and payday loans. Between 2022 and 2023, the NMG Survey moved to a different methodology for collecting data on credit card debt. Up to 2022, respondents were simply asked if they owed money on a credit card. In 2023, they were asked separately if they owed money on: (i) credit-card balances that they expect to pay in full by the next repayment date, and (ii) credit-card balances that they do not expect to repay in full by the next repayment date. The share of households with some amount of credit card debt in 2023 – i.e. the sum of (i) and (ii) – was 49 per cent, significantly higher than the 28 per cent in 2022. The sharp jump from 2022 to 2023 is likely to reflect a change in the interpretation of the question, rather than a genuine increase in credit card usage. We therefore construct an estimate for the 2023 share of households with credit card debt that is comparable to earlier years of the NMG Survey calculating the change in the share of households with a credit card in the November 2022 and October 2023 waves of the YouGov Cost of Living Crisis Survey, and applying this change to the 2022 share in the NMG Survey.
SOURCE: RF analysis of Bank of England, NMG Survey; YouGov, YouGov, adults age 18+ Cost of Living Crisis November 2022 and October 2023 waves.

The constant proportions of households using various types of consumer credit suggests that falling aggregate levels of consumer debt must be due to lower balances among its users. And this is indeed consistent with the survey evidence.

Households from across the income distribution have paid down credit card debt since the start of the pandemic. Figure 3 shows the change since 2019 in the average positive balance on credit cards, and the average combined balance across other major consumer debt products, for households in each third of the income distribution.[11] Between 2019 and 2020, the fall in average credit-card balances was largest for those in the top two-thirds of the income distribution. This is consistent with richer households spending relatively more on leisure and hospitality than poorer households, and therefore seeing their spending more abruptly curtailed by lockdowns. However, since then, the trend has flipped. As of September 2022, the average outstanding credit card balance for households in the bottom third of the income distribution was a third (33 per cent) lower than in September 2019. The fall was slightly smaller for households in the top two thirds of the income distribution, with average balances down by a quarter (25 per cent) on their September 2019 levels.

FIGURE 3: **Average balances have fallen, particularly on low-income households' non-credit card debt**

Percentage change in outstanding balance of credit card debt (left panel) and total balance across car finance, personal loans and overdrafts (right panel) since September 2019, by income tertile: UK, September 2019-September 2023



NOTES: Average credit-card balances are not shown for 2023, due to a change in the way that balances are recorded in the NMG survey that makes them non-comparable to previous years.
SOURCE: RF analysis of Bank of England, NMG Survey.

Other types of consumer debt – namely the average combined balance across car finance, personal loans and overdrafts (shown together in Figure 3) – indicate a much

11 It is worth noting that the pattern of these changes does not precisely match up with the aggregate data on credit-card balances, perhaps related to the definition of credit card debt in the aggregate data not align with what individuals consider to be credit card debt. The survey data suggests a steeper fall in credit-card balances than other consumer debt, which is also true in the aggregate data. But the magnitude of the fall in credit-card debt is much larger in the NMG Survey than the aggregate data. In nominal terms, aggregate credit-card balances fell by 14 per cent between September 2019 and September 2022. Whereas, over the same time period, the NMG data suggests a fall of 27 per cent. Also, the NMG data does not reflect the rise in nominal aggregate credit-card balances since 2021 (although the NMG does show a slower fall in average credit-card balances after 2020). Nonetheless, the comparison of changes between different income groups is likely to be informative.

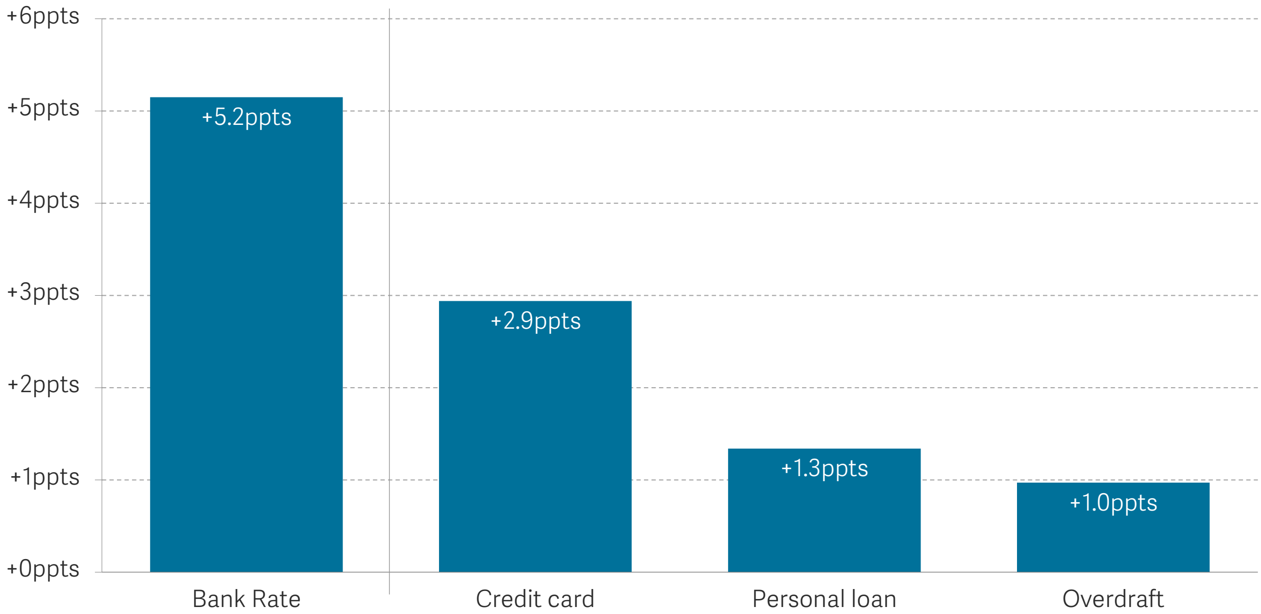
starker difference between poorer and richer households. The average balance for households in the bottom third of the income distribution fell 21 per cent between September 2019 and September 2023. For households in the top third of the income distribution, the average balance grew over this period by 6 per cent, as a result of higher balances on car finance and personal loans.

Less debt means that, despite rising rates, the interest burden of consumer debt is still below pre-pandemic levels

Consumer debt has become more expensive recently. Since the end of 2021, the Bank of England has raised interest rates significantly in its fight against inflation, meaning the interest due on each pound of consumer debt has gone up too, as shown in Figure 4.

FIGURE 4: **Pass-through from Bank Rate rises has been strongest for credit card rates**

Change in Bank Rate and average effective interest rates on outstanding debt balances between November 2021 and December 2023: UK

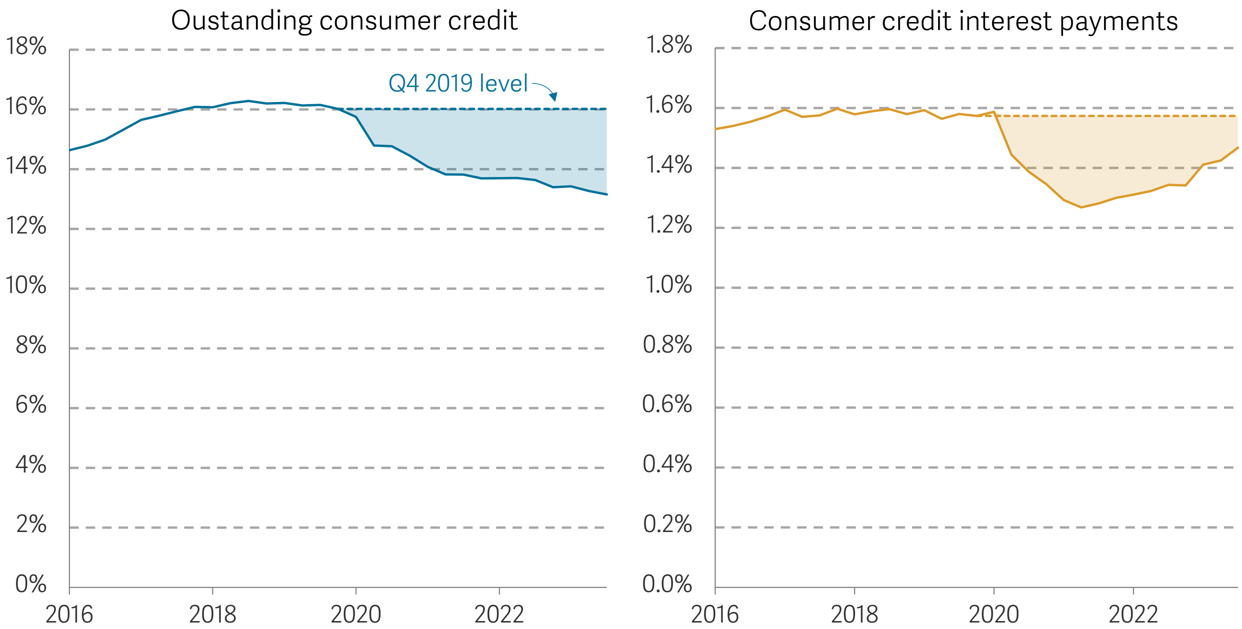


SOURCE: RF analysis of Bank of England, Bankstats.

But, with levels of debt falling relative to incomes and rates rising, what has been the overall effect on Britain's consumer debt interest burden? Figure 5 shows our estimate for the share of aggregate household income spent on consumer debt interest payments in recent years.

FIGURE 5: **Despite rising interest rates, UK households are still spending a smaller share of income on consumer debt interest than before the pandemic**

Outstanding consumer credit balances (left panel) and consumer credit interest payments (right panel) as a share of gross disposable household income: UK



NOTES: In the left panel, income is measured as a four-quarter rolling sum. In the right panel, we show the ratio of interest paid in a given quarter to income earned in that quarter. Interest paid is estimated each month based on: average effective rates on the stocks of credit cards, overdrafts and other consumer debt in that month; the outstanding balance of credit cards at month-end; and estimates for outstanding balances of overdrafts and other consumer debt at month end. These latter estimates are constructed by taking data on total outstanding consumer debt excluding credit cards (i.e. overdrafts plus other consumer debt) and splitting it based on the relative amounts of UK monetary financial institutions' outstanding overdrafts and other consumer credit.
SOURCE: RF analysis of Bank of England, Bankstats; ONS, Economic Accounts.

After the Bank of England cut rates at the outset of the pandemic, rates on consumer debt fell and the share of income spent on consumer debt dropped rapidly, reaching a historic low of 1.3 per cent in the three months to June 2021. But since June 2021 consumer debt interest has been on the rise relative to household incomes. Rising rates have since pushed up the share of household income spent on consumer debt, which stood at 1.5 per cent in the three months to September 2023.

However, thanks to lower levels of debt overall, families are still spending a smaller share of their income on consumer debt interest than before the pandemic (1.6 per cent in the three months to December 2019). Compared to its pre-pandemic level, the lower share of income spent on interest today represents a saving of £1.8 billion on UK households' annual interest bill. And, with rates on consumer debt now levelling off after the Bank has called time on rate rises, it could be some time before we see households' consumer debt interest burden back at pre-pandemic levels.

Lenders appear to be withdrawing credit for lower-income families

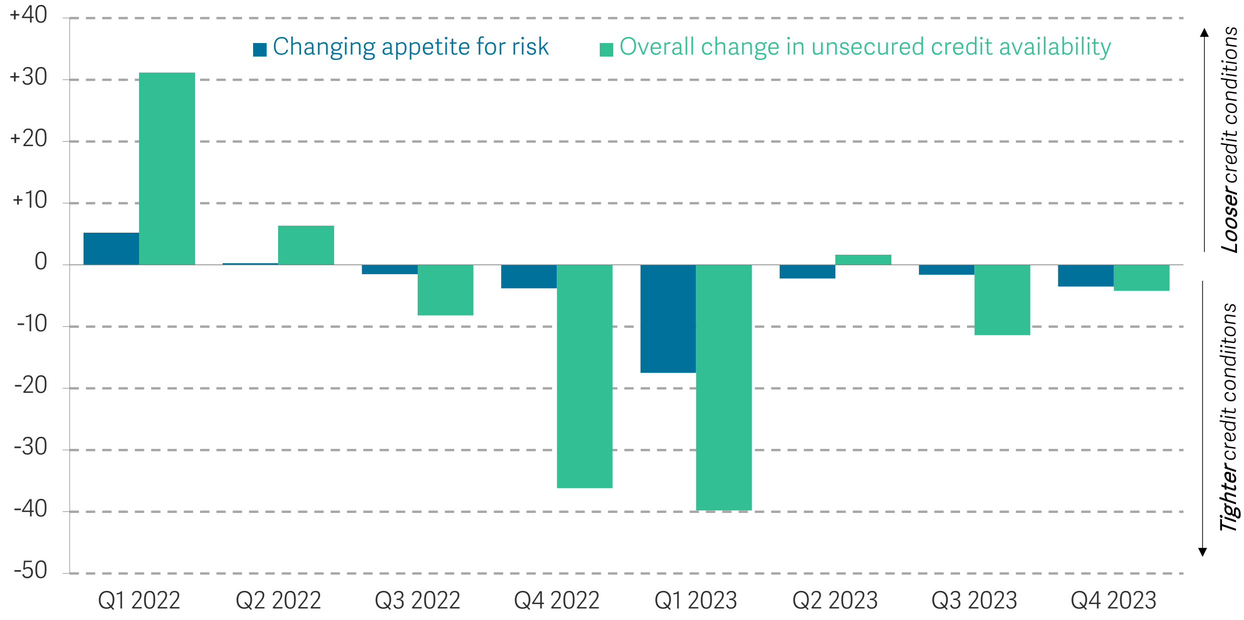
On the face of it at least, this is a good-news story. In recent years, families have lived through enormous economic shocks and a historic rise in interest rates. But, despite this, we have emerged with a lower consumer-debt burden, richer households seemingly getting back to some of their pre-pandemic borrowing habits and poorer households – who have been most exposed to rising food and energy costs – reducing their consumer-debt balances.[12]

But this apparent resilience is puzzling. As discussed above, there is clear evidence that many families have faced major financial hardship during the cost of living crisis. So, after paying down debt during the pandemic, why haven't households made greater use of consumer debt to cope with the cost of living crisis? And why have falling balances been so pronounced among lower-income households?

One big reason is lenders' willingness to extend consumer debt. Since June 2022, there is clear evidence of banks tightening their belts when it comes to lending.

FIGURE 6: **Banks have consistently tightened access to consumer debt since the middle of 2022**

Net percentage balance of the quarterly change in credit availability: UK



SOURCE: RF analysis of Bank of England, Credit Conditions Survey.

As shown in Figure 6, lenders responding to the Bank of England's Credit Conditions said that they reduced the availability of consumer debt in five out of six quarters between

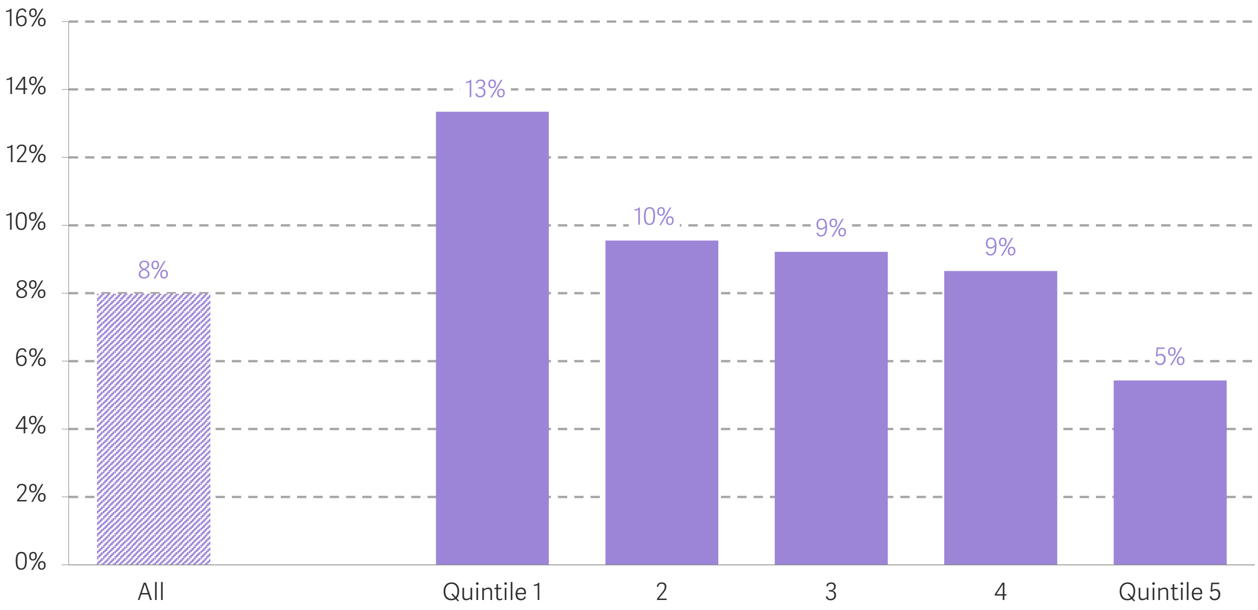
12 For more on the impact of rising food and energy prices across different groups, see: T Bell, J Smith & L Try, Food for thought: The role of food prices in the cost of living crisis, Resolution Foundation, May 2023; M Brewer et al., A chilling crisis: Policy options to deal with soaring energy prices, Resolution Foundation, August 2022.

Q3 2022 and Q4 2023.[13] Lenders becoming more risk-averse is a major driver: their risk appetite for unsecured lending has reduced for six quarters in a row between Q3 2022 and Q4 2023.

Banks' reluctance to lend is likely to have slowed down growth in total consumer debt over this period, but its impact won't have been felt evenly across the income distribution. Tighter credit scoring criteria are more likely to prevent poorer borrowers from accessing credit than richer borrowers, which can be seen in the responses to the March 2023 wave of our YouGov Cost of Living Survey. Respondents in the bottom fifth of the household income distribution were more than twice as likely to have been rejected for credit in the past 12 months than those in the top fifth (13 per cent versus 5 per cent). And, worryingly, research from the Joseph Rowntree Foundation suggests that the share of the poorest households being rejected for consumer debt rose further over the course of last year.[14]

FIGURE 7: **Poorer households are more likely to have been rejected for credit during the cost of living crisis**

Share of respondents rejected for credit, by equivalised net household income quintile: UK, 2023



NOTES: Base = All adults (n=4,156).Quintile 1 (n=808), Quintile 2 (n=799), Quintile 3 (n=859), Quintile 4 (n=786), Quintile 5 (n=904).
SOURCE: RF analysis of YouGov, Cost of Living Crisis March 2023 wave

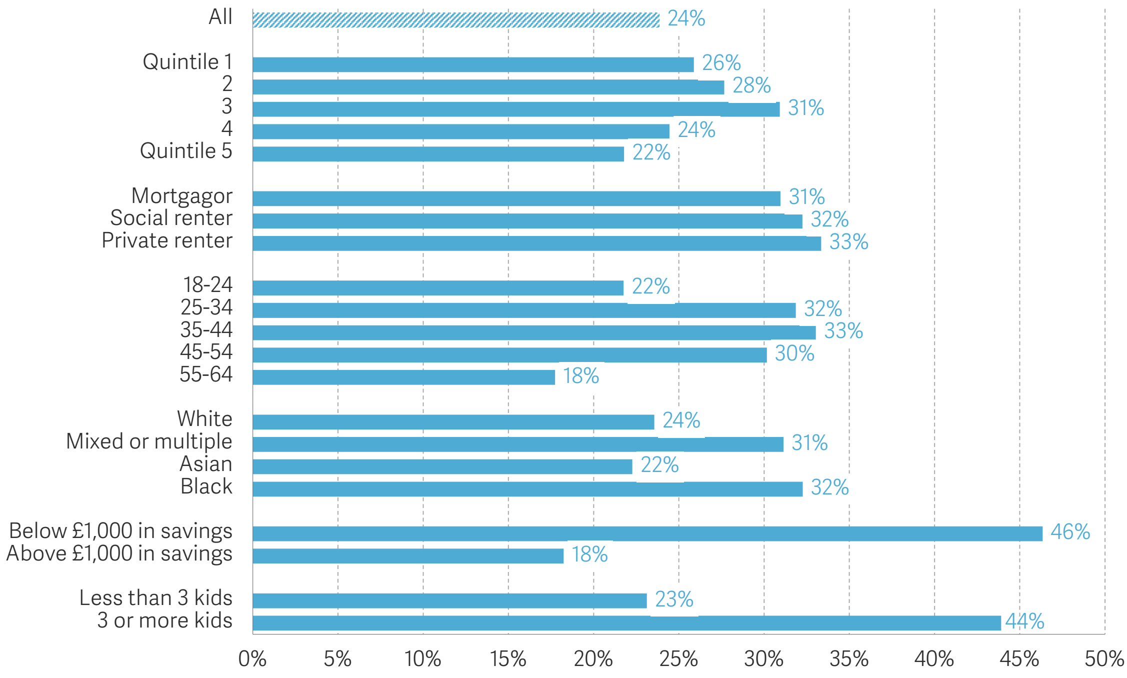
13 The Credit Conditions Survey is filled out by banks, building societies and specialist non-bank lenders that had at least a 1 per cent share of the relevant market over the preceding 12 months. For details, see: V Bell & A Pugh, The Bank of England Credit Conditions Survey, Bank of England Working Paper No. 515, November 2014.
14 Joseph Rowntree Foundation, UK Poverty 2024: The essential guide to understanding poverty in the UK, January 2024.

It is the intersection of demand and supply that determines which families have used consumer debt to cope with the cost of living crisis. As shown in Figure 8, this varies significantly between different groups. Consumer debt use is particularly high among families with less than £1,000 in savings or with three or more children – which chimes with previous research on the financial impacts of low savings and the two-child limit in Universal Credit.[15]

The use of consumer debt across the income distribution is indicative of the impact of supply. Households in the bottom fifth of the income distribution are less likely than those in the middle fifth to have used consumer debt, despite those at the bottom struggling the most financially – seen, for example, by being most likely to cope with the cost of living crisis by cutting back on essentials such and food and energy.[16]

FIGURE 8: **The use of consumer debt as a coping mechanism peaks in the middle of the income distribution**

Proportion of respondents using credit as a coping mechanism, by various characteristics: UK, October 2023



NOTES: Base = all adults aged 18+ (n=8,378). Income quintiles: Quintile 1 (n=1,046), Quintile 2 (n=1,157), Quintile 3 (n=1,144), Quintile 4 (n=1,474), Quintile 5 (n=1,601). Ethnicity: White (n=7,413), Mixed or multiple ethnic backgrounds (n=158), Asian (n=292), Black (n=149). Children: less than 3 (n=8,091), 3 or more (n=287). Housing: mortgagor (n=2,464), social renter (n=909), private renter (n=1,133). Age groups: 18-24 (n=796), 25-34 (n=1,282), 35-44 (n=1,554), 45-54 (n=1,316), 55-64 (n=1,302). Savings: below £1,000 (n=2,052), above £1,000 (n=3,911). Credit debt includes outstanding balances on credit cards not paid in full, overdrafts, personal loans, payday loans, store cards, catalogue credit, other hire purchases (e.g., mail order, car finance), loans from pawnbrokers, borrowing from friends or family, and Department for Work and Pensions social fund loans or similar government schemes.
SOURCE: RF analysis of YouGov, Cost of Living Crisis October 2023 wave.

15 M Broome, I Mulheirn & S Pittaway, Precautionary tales: Tackling the problem of low saving among UK households, Resolution Foundation, February 2024; L Try, Catastrophic caps: An analysis of the impact of the two-child limit and the benefit cap, Resolution Foundation, January 2024.
16 M Broome, K Handscombe & L Try, Hoping and coping: How families were faring in March 2023, Resolution Foundation, April 2023.

Debt among lower-income households is becoming increasingly concentrated in priority areas

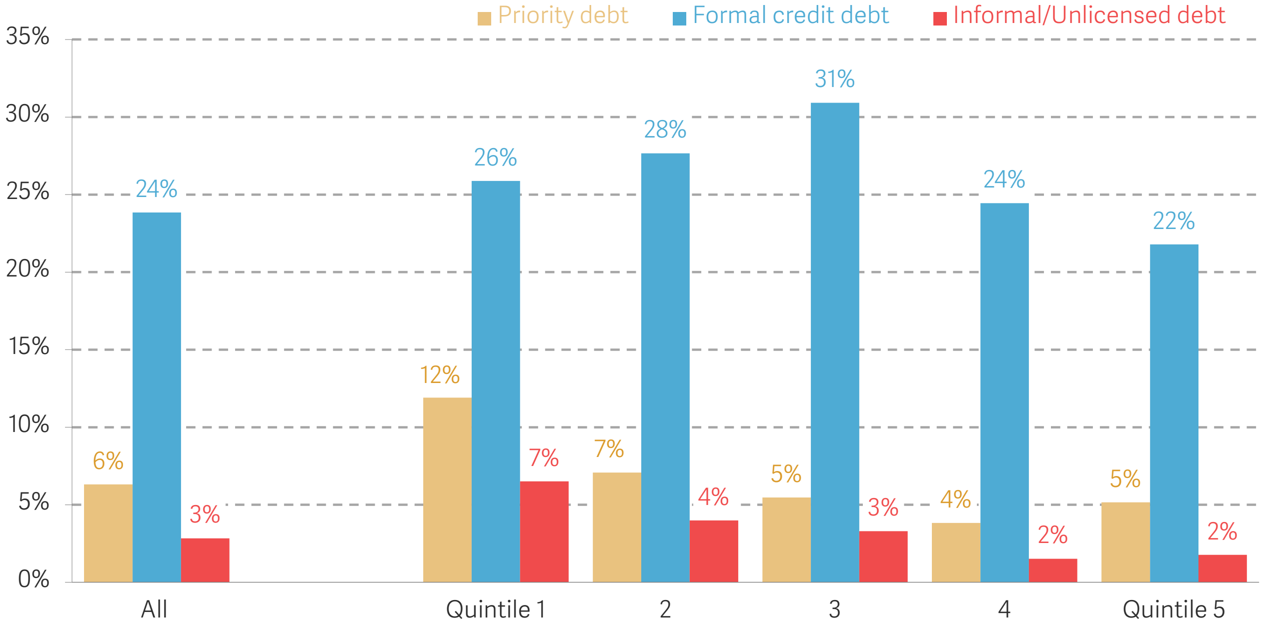
If more than one-in-ten of the poorest households have been turned down for consumer debt – and still more are likely to have been put off applying in the first place – where are low-income families turning to for a lifeline in the cost of living crisis? Increasingly, and worryingly, it appears that they are falling into debt on their priority bills like rent, Council Tax, and energy bills (we refer to this as ‘priority debt’).

Figure 9 highlights an alarming contrast in debt-accumulation patterns across the income distribution. As we showed in Figure 8, use of formal consumer debt is highest in the middle of the income distribution, reflecting the interaction of credit demand and supply. But other forms of debt – namely, priority debt and informal or unlicensed debt – have a clear income gradient, with the highest levels of use among the poorest families. Among the poorest fifth, one-in-eight families (12 per cent) are using priority debt as a financial-coping strategy, around three times the share using priority debt in the richest two-fifths (4 per cent).

There is a similar disparity in the use of informal lending, albeit at slightly lower levels of use. Alarmingly, our findings show that nearly one-in-ten low-income households (7 per cent) have resorted to informal or unlicensed lenders to cope with their financial needs. Such borrowing carries a high level of risk, given the lack of regulation and protection from the Financial Conduct Authority (FCA). Overall, the challenge for poorer households has evolved beyond just managing consumer debt, with priority debt in particular at worrying levels.

FIGURE 9: **Households on lower-incomes are more likely than higher-income families to use informal sources of credit and to fall behind on priority bills**

Proportion of respondents with debt on priority bills and using formal or informal credit as a coping strategy, by equivalised net household income quintile: UK, October 2023



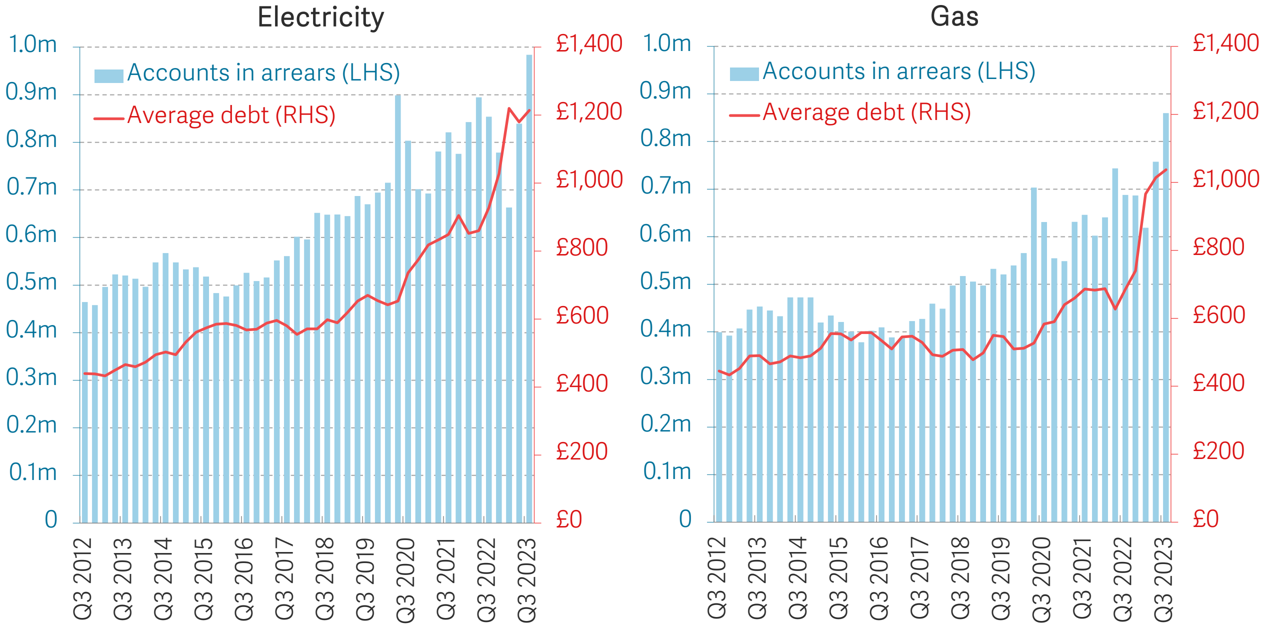
NOTES: Base = all adults aged 18+ (n=8,378). Income quintiles: Quintile 1 (n=1,046), Quintile 2 (n=1,157), Quintile 3 (n=1,144), Quintile 4 (n=1,474), Quintile 5 (n=1,601). This question surveys the use of formal or informal credit as a coping strategy over a three month period beginning July 2023. Credit debt includes outstanding balances on credit cards not paid in full, overdrafts, personal loans, payday loans, store cards, catalogue credit, other hire purchases (e.g., mail order, car finance), loans from pawnbrokers, borrowing from friends or family, and Department for Work and Pensions social fund loans or similar government schemes. Priority debts encompass missed payments over the past three months for essential bills like utilities, Council Tax, and housing costs, as well as obligations including child maintenance, taxes, non-mortgage loans, and court fines.
SOURCE: RF analysis of YouGov, Cost of Living Crisis October 2023 wave.

Historically speaking, today's levels of priority debt are not normal. For example, data from Ofgem, shown in Figure 10, shows that the number of households behind on their utility bill, with no arrangement in place to repay, has reached its highest level since records began in 2012. In Q3 2023, 1 million accounts were behind on electricity bills, a 15 per cent increase compared to just a year earlier, and 860,000 were behind on their gas bill, a 25 per cent increase in a year. Moreover, there has been an even sharper increase in the average debt owed by those in arrears since 2022: the average arrears balance for those behind on their electricity or gas bill was £1,100 in Q3 2023, up £380 (or 51 per cent) on the average balance in Q2 2022. The recent surge in energy prices, which saw a typical household's energy bill more than double between September 2021 and October 2022, is likely to have been a major driver of this increase.[17]

17 Ofgem, Retail market indicators.

FIGURE 10: **The average amount of debt carried by gas and electricity customers who are in arrears has risen to new highs**

Number of gas and electricity customers in arrears, and average level of debt: GB



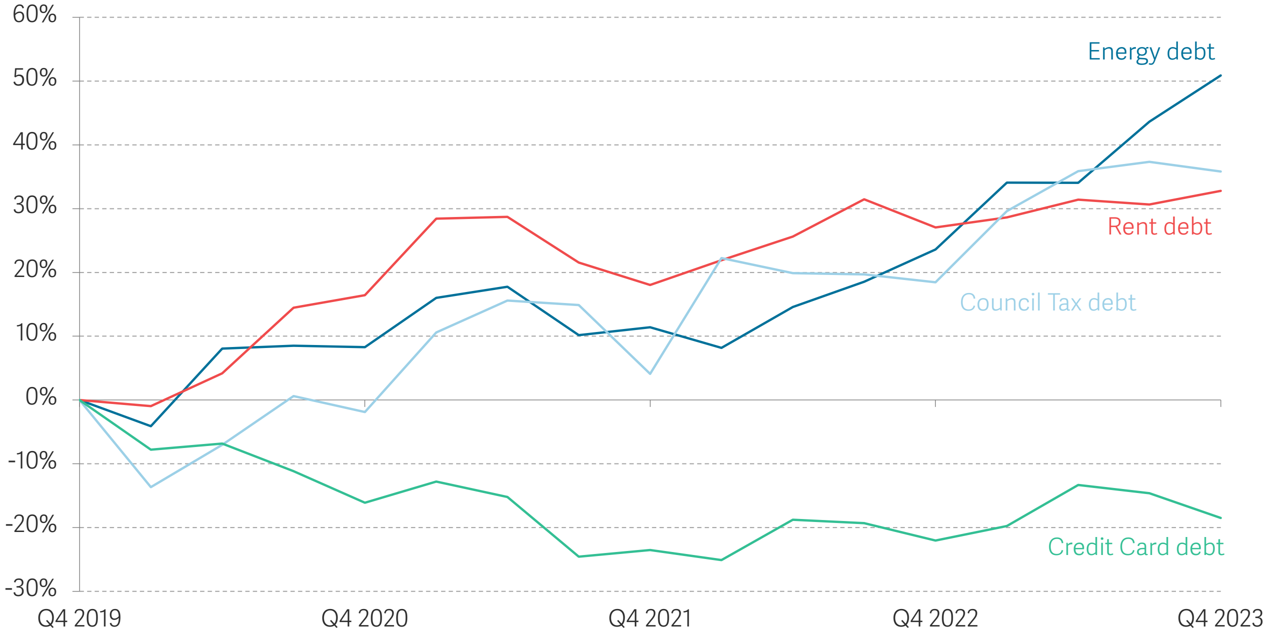
NOTES: This chart shows arrears where there is no arrangement to repay the debt.
SOURCE: Ofgem, Debt and Arrears Indicators.

Higher levels of priority debt have shifted the nature of problem debt for the most financially vulnerable households. We see this in Figure 11, with data on the change in debt balances among clients of Citizens Advice, a network of debt-advice charities[18]. This clearly highlights a change over recent years in the finances of people seeking debt advice. The average level of credit card debt for those seeking debt advice fell by 20 per cent between Q4 2019 and Q4 2023 – a fall of almost £1,000 (£984) in cash terms. By contrast, debt on energy bills, rents and Council Tax have all seen large increases since before the pandemic. In Q4 2023, average outstanding debt on energy bills among those seeking debt advice had increased by 50 per cent since Q4 2019, mirroring the upward trend in Ofgem's aggregate arrears data. In addition, the average amount of Council Tax debt (up 36 per cent) and rent arrears (up 33 per cent) have both increased by around a third on their pre-pandemic levels. Overall, average debt across these three priority bills has increased by just over £500 (£539) since the start of 2019. This data corroborates the change in the nature of the financial pressures during the cost of living crisis, moving from consumer credit to priority debts.

18 Citizens Advice, Our Debt Data, accessed 14 February 2024

FIGURE 11: **Average credit card debt levels have declined, but the average priority debt levels among Citizens Advice clients have significantly increased**

Change since Q4 2019 in the average level of debt of Citizens Advice clients, by debt category: UK



SOURCE: RF analysis of Citizens Advice, Our Debt Data.

What should we make of this shift in the nature of Britain's debt problems? On the face of it, the rebalancing from consumer debt to priority debt is a natural response to period of surging energy bills and high interest rates. The higher price of energy today has stretched family finances, and has meant a faster accumulation in debt for each missed payment. At the same time, consumer debt has become more expensive and less accessible, making it an unaffordable or unattainable option for many.

Priority debt is typically interest-free, making it less financially costly than consumer debt, but the stakes of using it are high. The consequences of being unable to repay priority debt are alarming: energy-bill debt comes with the threat of having your gas or electricity cut off, rent arrears can lead to eviction, and unpaid Council Tax can lead to a variety of legal ramifications, including the possibility of a prison sentence in England.[19] With such high stakes, one potential source of concern about the shift from consumer debt to priority debt is an escalation of debt worries, particularly among lower-income households. In the next section, we return to our YouGov Cost of Living survey to explore the relationship between debt and poor health during the cost of living crisis.

19 StepChange, Priority debts and bills. Find out which debts to pay first, accessed 26 February 2024.

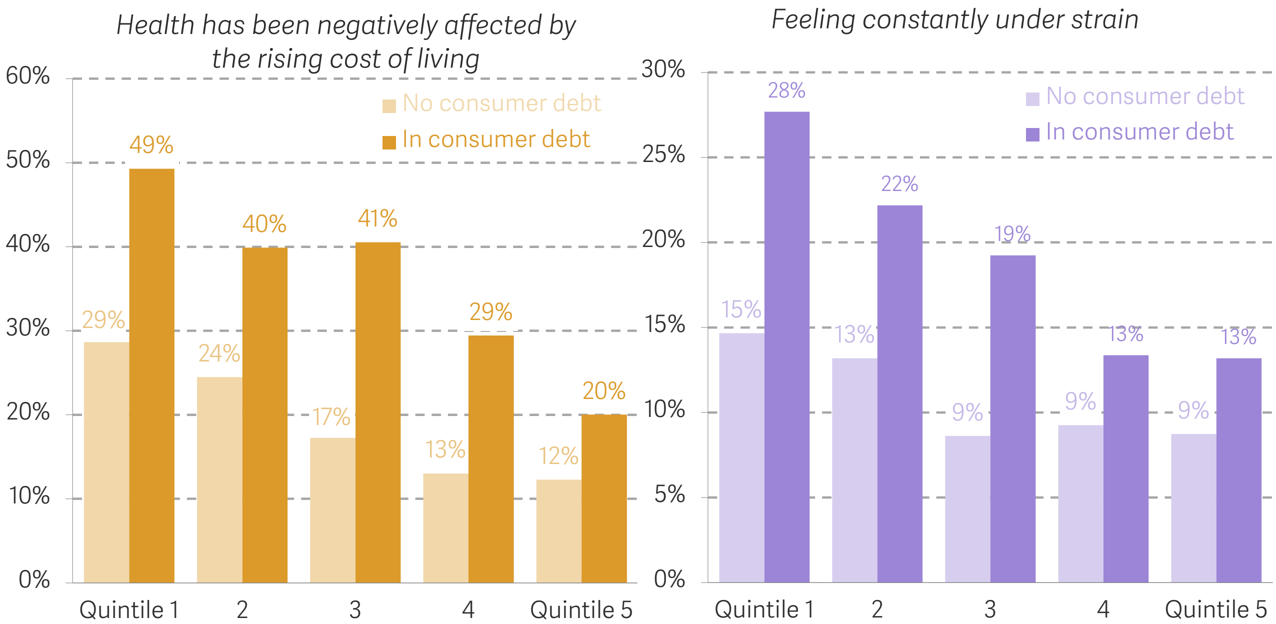
There is a strong association between priority debt and poor mental health

Research has shown that the stress and anxiety triggered by debt can lead to a cascade of negative health and mental-health outcomes.[20] High debt repayments can also limit the amount of money available for essentials that promote health, such as nutritious food and physical activities. In the most severe cases, 'problem debt' (i.e. debt where an individual cannot afford to make repayments) is connected to behaviours that can harm health, including increased risk of suicidal thoughts, smoking and drug use.

Delving deeper into this relationship using the October 2023 wave of our YouGov Cost of Living survey, Figure 12 offers a detailed look at two measures of wellbeing for respondents with, and without, formal consumer debt in different income groups.

FIGURE 12: **Having consumer debt is associated with worse health outcomes across the income distribution, with those on low-incomes reporting the highest levels of strain**

Proportion of respondents reporting various wellbeing measures, by equivalised net household income quintile and whether they had formal credit debt: UK, October 2023



NOTES: Base for those not in credit debt: (n=3,120). Base for those in credit debt (n=4,596). Income quintiles for those not in credit debt: Quintile 1 (n=465), Quintile 2 (n=462), Quintile 3 (n=406), Quintile 4 (n=512), Quintile 5 (n=494). Income quintiles for those not in credit debt: Income quintiles: Quintile 1 (n=512), Quintile 2 (n=646), Quintile 3 (n=694), Quintile 4 (n=934), Quintile 5 (n=1,075).
SOURCE: RF analysis of YouGov, Cost of Living Crisis October 2023 wave.

The data reveals that, regardless of their income level, people with consumer debt report markedly worse health outcomes than their debt-free counterparts. The gap

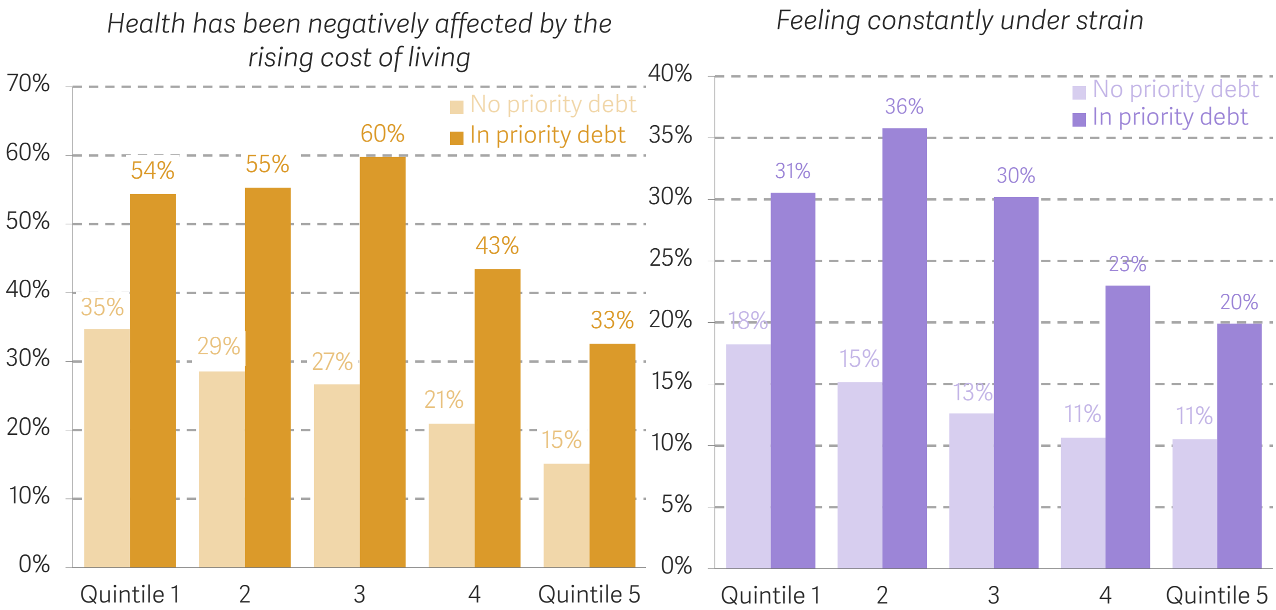
20 A Tinson & S Bunbury, Preventing 'problem debt' during the pandemic recovery, Health Foundation, January 2022.

in health outcomes between those with and without credit debt appears to be most pronounced for those on middle incomes. For example, in the third income quintile, two-in-five respondents with consumer debt (41 per cent) reported their health being negatively impacted by the rising cost of living, compared with just over one-in-five without credit debt (17 per cent). However, in absolute terms, the prevalence of negative health outcomes is highest for those on low incomes, reflecting the wider pressures from the cost of living crisis on low-income families. In the bottom income quintile, half of respondents with credit debt (49 per cent) said that their health had been negatively affected by the rising cost of living, while nearly a third (28 per cent) reported feeling constantly under strain.

But the link between debt and wellbeing is even more alarming if we focus on priority debts. Figure 13 shows that, even at higher income levels, individuals with priority debt are around twice as likely to report experiencing negative health outcomes. For example, in the top income quintile, one-in-five people with priority debt (20 per cent) report feeling constantly under strain, compared to just one-in-ten of those without priority debt (11 per cent).

FIGURE 13: **Priority debt is strongly associated with poorer well-being outcomes especially for those on the lowest incomes**

Proportion of respondents reporting various wellbeing measures, by equivalised net household income quintile and whether they had priority debt: UK, October 2023



NOTES: In priority debt: Base = all adults aged 18+ (n=504), Income quintile 1 (n=118), Income quintile 2 (n=81), Income quintile 3 (n=59), Income quintile 4 (n=55), Income quintile 5 (n=78). Not in priority debt: Base = all adults aged 18+ (n=7,874), Income quintiles for those not in priority debt: Quintile 1 (n=928), Quintile 2 (n=1,076), Quintile 3 (n=1,085), Quintile 4 (n=1,419), Quintile 5 (n=1,523).Priority debts encompass missed payments over the past three months for essential bills like utilities, Council Tax, and housing costs, as well as obligations including child maintenance, taxes, non-mortgage loans, and court fines.
SOURCE: RF analysis of YouGov, Cost of Living Crisis October 2023 wave.

Comparing Figure 13 and Figure 12, we can see that negative health outcomes are much more common among people with priority debt than those with consumer debt. For instance, three-in-five people with priority debt in the middle income quintile (60 per cent) report that their health has been negatively impacted by the rising cost of living, compared to two-in-five (41 per cent) of those with consumer debt in the same income quintile. These findings highlight the significant impact of debt on individuals' mental health and wellbeing. And, given the shift from consumer debt to priority debt over the past few years, the particularly high levels of negative health outcomes for those in priority debt should give us cause for concern.

The rise of priority debt underscores the need for policies to boost financial resilience, particularly for the poorest households

The cost of living crisis has revealed a dramatic shift in the nature of debt problems among Britain's poorest families. Consumer debts were paid down in the pandemic and have stayed down since. And, perhaps surprisingly, consumer debts have fallen the most for those at the bottom of the income distribution. It is undoubtedly good that there doesn't seem to be a significant rise in consumer-debt problems. But there is evidence that the debt problem is merely shifting elsewhere – mainly, to priority debt.

Although the nature of the UK's debt problems has changed, the solution remains the same: we must get serious about policy that helps families access the financial resources they need to support themselves during tough times.

The cheapest and most accessible source of finance will always be savings. But, unfortunately, British families don't save enough. In 2018-20, as many as one-in-three working-age people (30 per cent) were living in families with savings below £1,000.[21]

Stronger economic growth is part of the solution. Low growth over the past 15 years has meant that essential spending (for example, on food and heating) now takes up a larger share of our overall consumption, making it harder to put money aside each month. This is particularly true for poorer families: those in the bottom fifth of the income distribution spent nearly 60 per cent of their budget on essentials in 2019, up from 51 per cent in 2006.[22] Higher real incomes would allow families to spend less on simply making ends meet, creating more room for saving.

But we mustn't wait for economic growth to arrive before taking action. Existing policies can be reformed to better support precautionary saving. To help working families, we

21 M Broome, I Mulheirn & S Pittaway, Precautionary tales: Tackling the problem of low saving among UK households, Resolution Foundation, February 2024.
22 Resolution Foundation & Centre for Economic Performance, LSE, Stagnation nation: Navigating a route to a fairer and more prosperous Britain, Resolution Foundation, July 2022.

should reform the pension system by incorporating a 'sidecar saving' scheme, where the top 2 per cent of an employee's pension contributions would first flow into an instant-access savings account until it reaches a limit of £1,000.[23] And the existing Help to Save scheme, which provides financial bonuses to boost saving for those on the lowest incomes, should be reformed to boost participation – for example, by auto-enrolling new Universal Credit claimants into Help to Save if they are eligible.[24]

More savings would have a transformative impact on British families' financial resilience, but people cannot be expected to have enough precautionary savings to cover every possible eventuality. There will always be some shocks where families will have to borrow from somewhere. It is, therefore, vital that families – particularly poorer families with less access to cheaper forms of consumer debt – have low-cost options available to them. For people who have built up significant pension savings, they should have the option to borrow from their pension under the proviso that they replenish their pension pot in future by making additional pension contributions.[25] Alongside that, the Government and regulators should also strive to improve the accessibility of affordable formal credit for a wide range of potential users.[26]

In sum, we should be positive that, despite tumultuous economic times and a huge rise in interest rates, we haven't seen an increase in the burden of consumer debt. This is definitely not a universally sanguine story, however: falling consumer debt is at least partly about a lack of availability of credit for those on lower incomes, and priority debt is an increasingly common release valve for under-pressure families, with serious implications for their health and wellbeing.

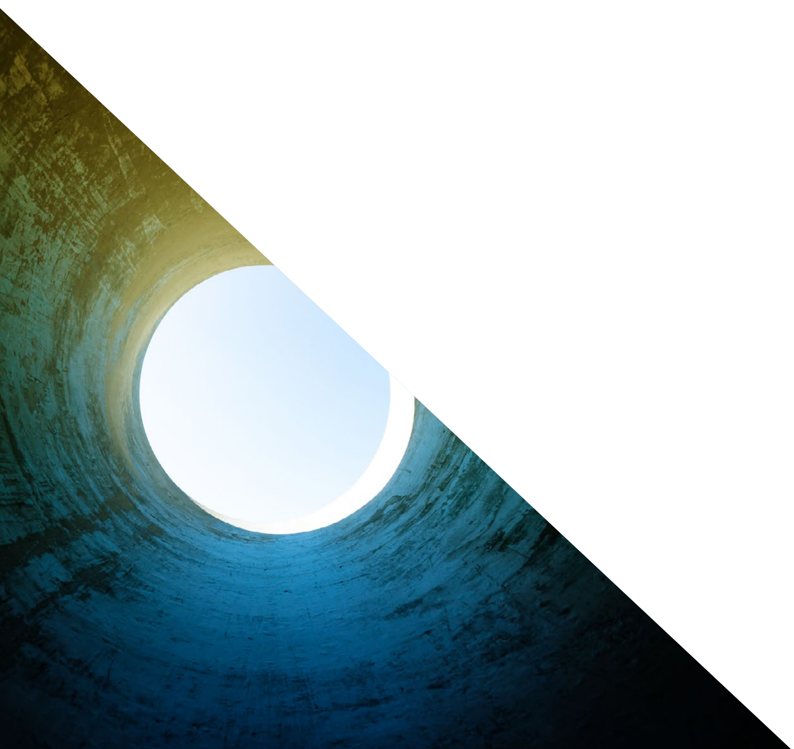
23 M Broome, I Mulheirn & S Pittaway, Precautionary tales: Tackling the problem of low saving among UK households, Resolution Foundation, February 2024.
24 M Broome, A Corlett & J Leslie, ISA ISA Baby: Assessing the Government's policies to encourage household saving, Resolution Foundation, January 2023.
25 M Broome, I Mulheirn & S Pittaway, Precautionary tales: Tackling the problem of low saving among UK households, Resolution Foundation, February 2024.
26 Fiair4All Finance, Financial Inclusion Plan: Part one - Issues and framework, June 2023.

The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged.

We do this by undertaking research and analysis to understand the challenges facing people on a low to middle income, developing practical and effective policy proposals; and engaging with policy makers and stakeholders to influence decision-making and bring about change.

For more information on this report, contact:

Simon Pittaway
Senior Economist
simon.pittaway@resolutionfoundation.org



Resolution Foundation

2 Queen Anne's Gate
London SW1H 9AA

Charity Number: 1114839

@resfoundation
resolutionfoundation.org/publications/in-too-deep/