Are Britons borrowing beyond their means?

Precious Plastic 2017

Exploring the latest trends in UK consumer credit

pwc

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Introduction

Welcome to Precious Plastic 2017, PwC's tenth annual survey of the UK's unsecured lending landscape.

Our report highlights the continued rise of unsecured debt in the UK, with the average household now owing a record £11,000. In the past year alone, this has risen by 11% – a faster rate than any of the past 15 years. The growth of consumer credit has attracted widespread media coverage, as as well as, more recently, scrutiny from the Bank of England. Against this backdrop of rapidly rising levels of borrowing, this year's version of *Precious Plastic* seeks to understand: *are Britons borrowing beyond their means?*

Part One of our report examines how much people are borrowing and how, while Part Two addresses the affordability of debt levels and includes the results of our annual PwC Credit Confidence survey.

We hope that you find the report interesting and useful. If you would like to discuss any of the issues raised, please feel free to contact one of the authors listed on page *14*.

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Overall size and growth of the UK unsecured credit market

Size

Total unsecured debt now exceeds the pre crisis peak in 2008 by 30%

£300bn

£11,000
average unsecured household debt

Growth

11%

Close to **£80m** a day
(the fastest rate of growth for 15 years)

Nearly **4x** faster than growth of secured debt in 2017

Favourable macro-economic backdrop… for now

4.4% Lowest unemployment rate since 1975

0.25% Bank of England base rate at record lows

£2700 (2010) vs **£970** (2017) Interest cost of a £10k loan over 5 years today vs in 2010

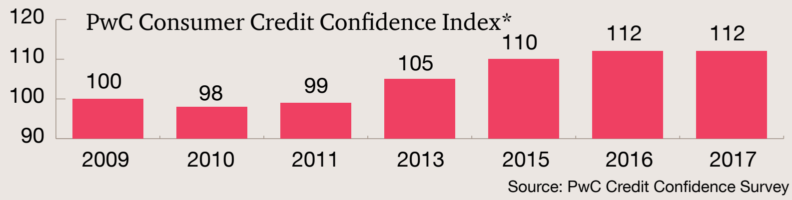
Some headwinds emerging

1.1% GDP growth forecast to slowing 2018

2.8% vs **2.2%** Inflation higher than wage growth

PwC Credit Confidence Survey

Overall credit confidence remains high…



Slight deterioration in confidence in some areas…

	2009 (Peak of Financial Crisis)	2016	2017
Worried about ability to make future debt repayments	25%	15%	18%
Expect pay to be frozen or decline in next year	28%	22%	24%
Worried about availability of credit for future purchases	25%	13%	15%

Brexit fuelling some of this concern…

	2016	2017
I am worried about the impact of Brexit on my finances	36%	42%
Brexit will make me more cautious about borrowing in the future	26%	34%

*The indicator is based on seven attributes across three measures of consumer credit confidence:(i) people's level of ability to make debt repayments today and their worry about this in the future; (ii) their worry about their future access to and use of credit; and (iii) their worry about job security and expectations for wage growth.

Affordability – at the aggregate level

Total household debt to disposable income ratio

2007	2017	2022
158%	147%	153%

8.8x Net household assets as a proportion of household debt a stronger position than at any point in almost **100** years

Affordability – by consumer groups

The use of credit to pay for essential items in the past six months

By Age

20% 25-34 vs **6%** 55+

By Income

16% £10-20k vs **8%** £50k

By Home Ownership

19% Renters vs **11%** Home owners (with a mortgage)

Average individual unsecured debt to income ratio

By Age

52% 25-34 vs **10%** 55+

By Income

38% £10-20k vs **9%** £50k

By Home Ownership

46% Renters vs **17%** Home owners (with a mortgage)

Preparedness for a change in circumstances

British household savings ratio at a record low

Year	Savings ratio
2010	4.7%
2016	1.5%
2017	-0.4%
2020	-1.3%

Headline savings ratio has declined significantly from the post-financial crisis peak of 4.7% in 2010, and is forecast to fall to -0.4% in 2017 and -1.3% by 2020

Impact of Base Rate rises

67%

Percentage of people who think they understand how an increase in the base rate will impact their loan repayments

vs

12%

vs percentage who correctly answered a basic question requiring them to estimate the impact

0.25% → 1.25% **£1,000**

Approximate increase in annual interest payments on a 25-year tracker mortgage if the interest rate increases from 0.25% to 1.25%

Financial literacy

	% of people who feel they have a good understanding of the following financial products	% of people who correctly estimated the interest costs and repayments of these products
Credit cards	72%	32%
Personal loans	58%	33%
Mortgages	57%	21%
Payday loans	35%	4%

6%

Respondents that recall receiving any formal education at school about how to manage their personal finances

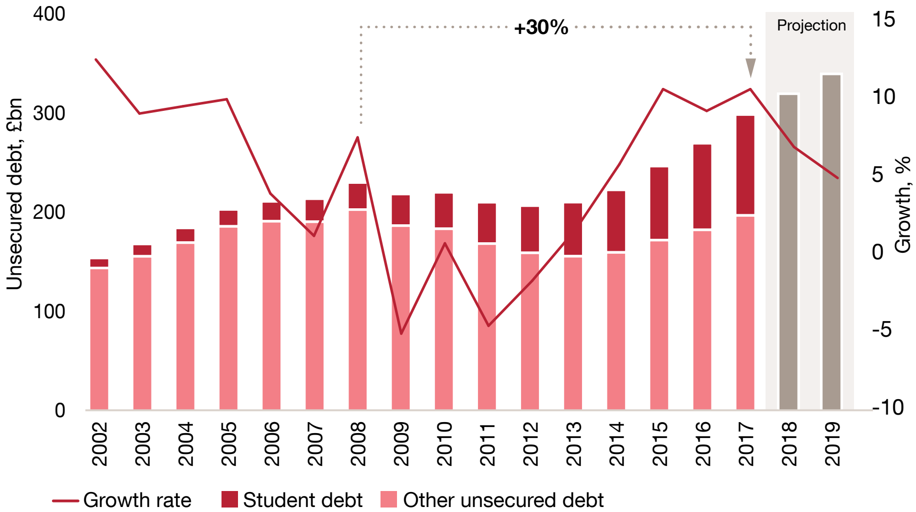
Part One – How much are we borrowing and how?

1. Unsecured debt has reached an all-time high of £11,000 per household, growing at a faster rate than any of the past 15 years

The average level of unsecured household debt now stands at a record level of £11,000. At £300bn, total unsecured debt is close to 30% higher than the pre-crisis peak *(see figure 1).*

In the past year unsecured debt has risen by 11%, or around £80m per day, growing at the fastest rate since 2002 and three times faster than secured debt.

Figure 1: **UK total unsecured lending and growth, 2002-2017**



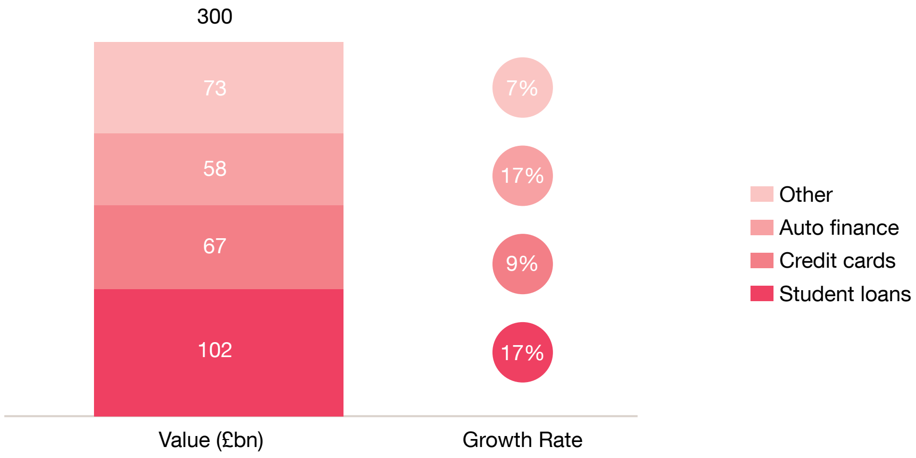
Source: Bank of England, PwC analysis

[1.] The Financial Times, 2017

Student debt, credit cards and car finance represent over three-quarters of the total stock and recent growth in unsecured lending *(see figure 2)*. Car finance has grown by at least 15% for each of the past five years, and 17% in 2017[2], which represents the largest increase among the main unsecured lending products. Newer forms of lending, such as Peer-to-Peer, are also growing, but still only represent a relatively small proportion of total borrowing. As of the first quarter of 2017, the outstanding loan book of Peer-to-Peer lending to individuals was only £1.5bn[3], representing around 0.5% of total unsecured borrowing.

Consistent with our central macro-economic scenario, we project continued growth in unsecured borrowing over the next two years, albeit at a slower rate of 7% in 2018 and 5% in 2019. However, risks to the downside have increased e.g. Brexit related uncertainty. Furthermore, rising inflation is out-pacing wage growth, and this could stunt further growth in unsecured lending.

Figure 2: **Value of unsecured lending, 2017 (£bn)**



Source: Bank of England, PwC Analysis

[2] The Financial Times, 2017
[3] Peer-to-Peer Finance Association (P2PFA)

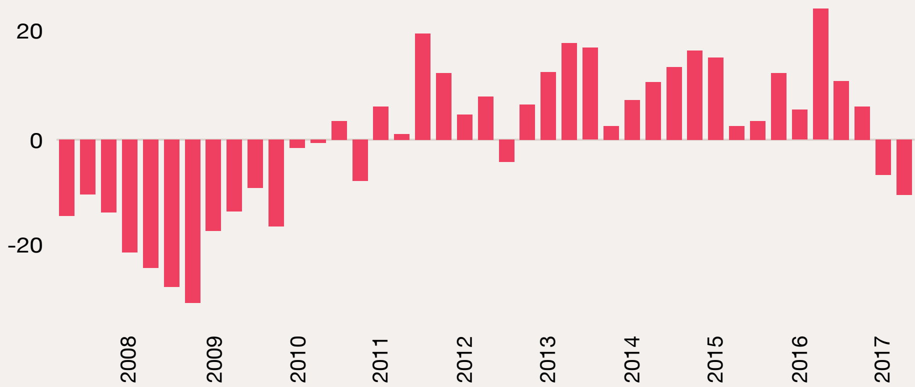
2. The supply of unsecured debt has decreased for two consecutive quarters for the first time since the crisis

Following the financial crisis there was a material reduction in the availability of unsecured credit for households *(see figure 3)*, as financial institutions retrenched and tightened their lending criteria.

The supply of unsecured credit began to rebound from late 2010, with the value of non-bank lending doubling by 2017 and fuelling much of this growth *(see figure 4)*. In contrast, it took banks almost ten years to recover to the level of lending they provided to consumers in 2006.

Figure 3: **Household unsecured credit availability**

Net percentage balances

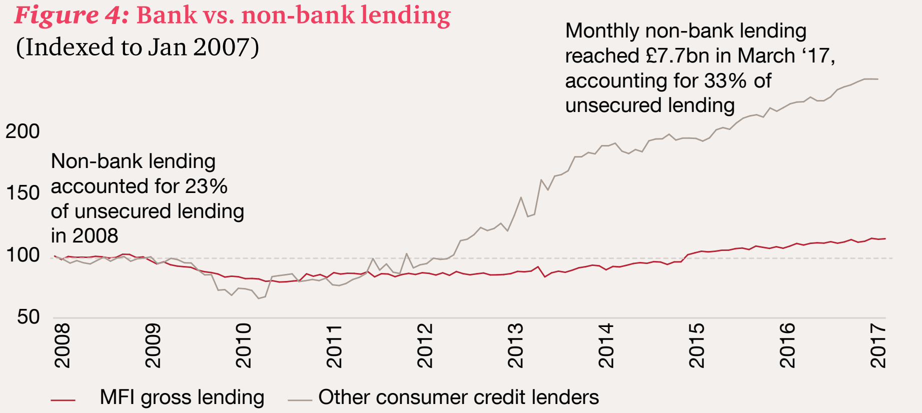


Source: Bank of England

Net percentage balances are calculated by weighting together the responses of those lenders who answered the question about expected access to credit.

Figure 4: **Bank vs. non-bank lending**

(Indexed to Jan 2007)



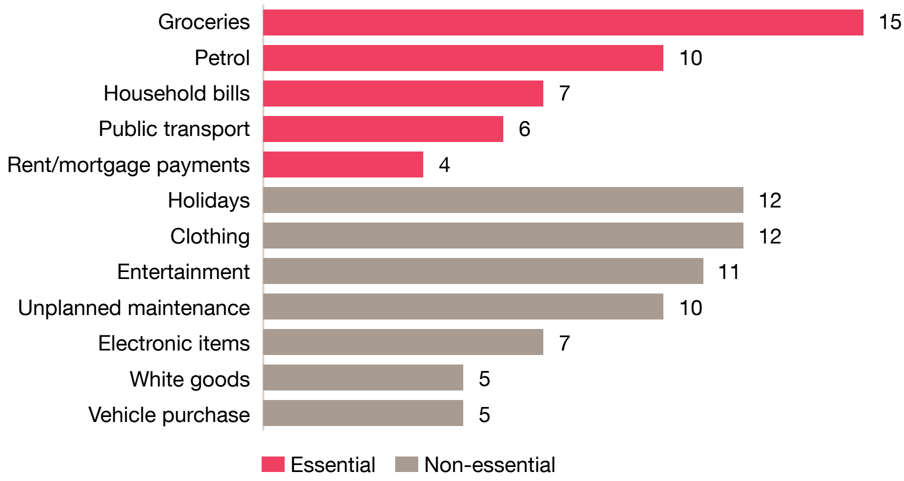
Source: Bank of England

More recently, there are signs supply may have begun to tighten, with the Bank of England also having concern over rising levels of consumer debt. It warned that banks could stand to lose around £30bn in the event of a severe recession and ordered them to hold an additional £10bn[4] in capital to cover potential losses. However, the Bank of England did not specify that similar requirements would apply to non-bank lenders. The proportion of the main high-street lenders expecting to restrict access to credit between April and June was the highest since the financial crisis in 2008 (*see figure 3*).

While the level of unsecured household debt has risen sharply over the last five years, our PwC Credit Confidence survey results show that the proportion of adults using it to spend on essential items has held broadly flat at around 12%.

Where credit is spent on essential items, groceries, petrol and household bills comprise of the most common spend items *(see figure 5)*. For non-essential items, holidays, clothing and evening entertainment are the most frequent uses of credit.

Figure 5: **Items purchased using credit, proportion of adults (%)**



Source: PwC Credit Confidence Survey 2017, YouGov

[4] The Bank of England, 2017

Part Two – Should we be concerned?

How we examine the affordability of unsecured debt

In this section of the report, we seek to understand whether we should be concerned about current levels of consumer debt. We do this by examining affordability across a range of factors.

We begin by setting the size and growth of lending in the context of the **wider economy**. We then draw upon the results of our **PwC Consumer Credit Confidence** survey, assessing consumers' attitude and concerns their current and future borrowing.

We then examine levels of bad debt and other affordability measures at the **aggregate level**, before assessing how this varies by certain **consumer groups**.

We conclude by assessing how prepared consumers are for a **change in circumstances**, such as a rise in interest rates, and how **financial literacy** varies among the population.

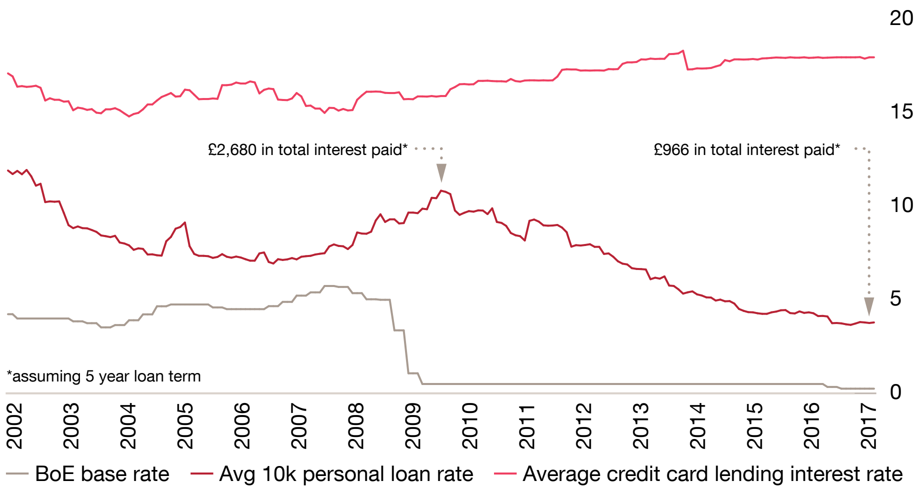
3. Macro-economic conditions have been relatively benign, but with increasing risks to the downside

The record levels of unsecured debt have been amassed against a relatively benign macroeconomic backdrop. However, more recently we have seen slowing growth, rising inflation and increasing risks to the downside. Up to now, low unemployment, low interest rates, economic growth and real wage growth have underpinned consumer confidence and growth in borrowing, but the outlook is now less strong:

Figure 6: **UK employment rates (1995-2017)**

Source: Office of National Statistics

Figure 7: **Monthly Bank of England base rate vs. average £10k personal loan rate and credit card rate**



Source: Bank of England, PwC analysis

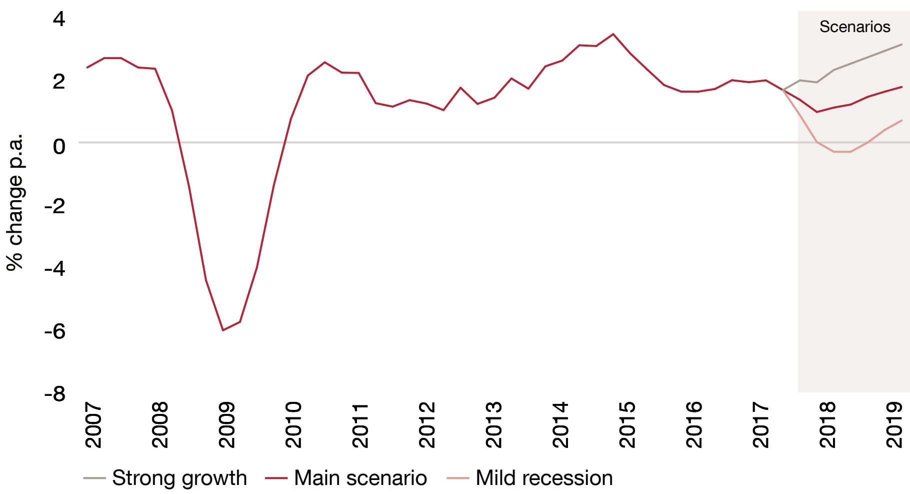
i. **Low unemployment**
Unemployment has fallen to its lowest level in the UK since 1975 *(see figure 6)*, which has helped support rising spending and borrowing levels.

ii. **Low interest rates**
Interest rates remain at record lows, with households continuing to benefit from low debt servicing costs. The headline rates for many unsecured lending products have fallen over the past decade *(see figure 7)*, increasing their attractiveness to consumers and the ease of repayment. Over half of consumers we surveyed[5] in September 2017 expect the Bank of England to raise interest rates within the year, with around a third saying they were worried about the impact.

iii. **Economic growth**
Our central scenario for the UK economy is for relatively slower growth over the next two years. *(see figure 8)*. We expect GDP growth of 1.4% in 2018, followed by 1.8% in 2019, as the UK faces the impact of uncertainty surrounding Brexit.

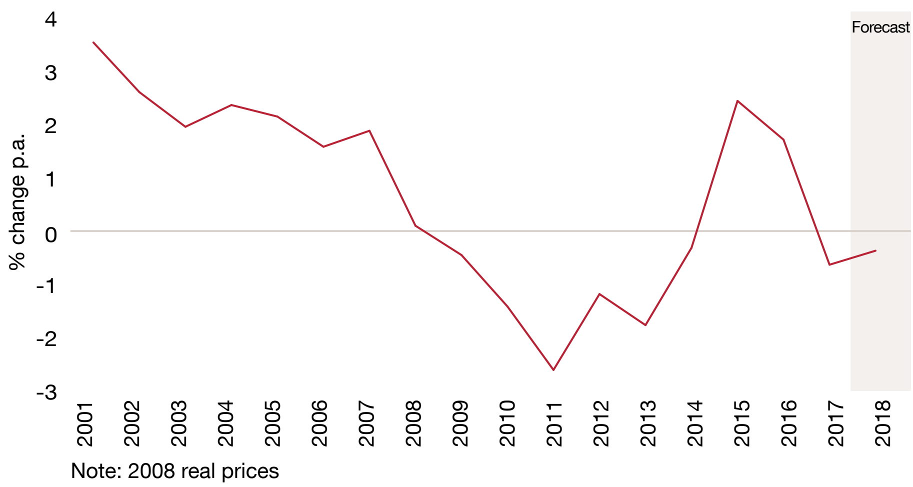
iv. **Negative real wage growth**
Real wage growth is falling into negative territory, meaning that consumers' disposable income will begin to fall in real terms *(see figure 9)*. For example, average annual earnings of £25,200[6] in 2008 would have in fact fallen in real terms to £24,600 by 2017. This has been driven partly due to a weakening of the Pound post Brexit, leading to imported inflation. Consumer appetite and ability to borrow may be impacted if this continues.

Figure 8: **UK GDP growth and alternative future scenarios**



Source: Bank of England, PwC analysis

Figure 9: **Growth in inflation-adjusted average annual earnings (excl bonus)**



Source: Bank of England, PwC analysis

5. PwC Credit Confidence Survey
6. ONS, 2017

The PwC Consumer Credit Confidence Survey

In conjunction with YouGov, we polled over 2,000 British consumers about their attitudes towards debt, their ability to repay and their future borrowing intentions. First run in 2008, the PwC Consumer Credit Confidence survey provides one of the longest running and most comprehensive pictures of Britons' finances.

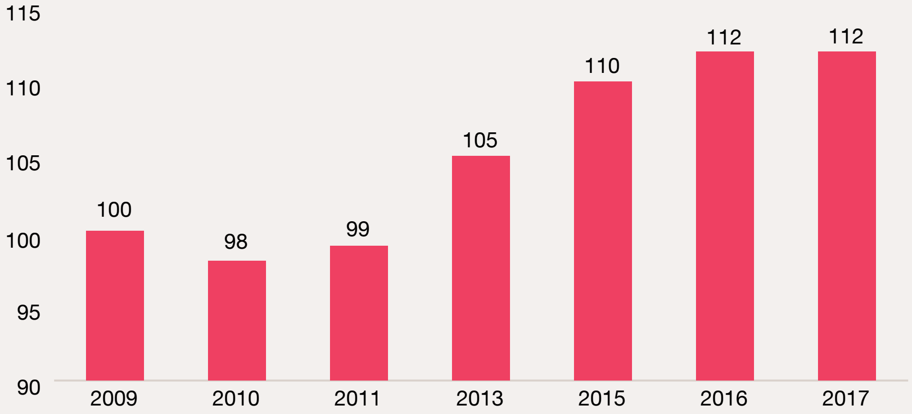
4. Consumer Credit Confidence has remained strong, despite the continued rise in unsecured debt

Our Consumer Credit Confidence Index[2], which brings together all the key aspects of the survey into a single consolidated measure, *(figure 10)* shows overall confidence as being level with last year. Although this year's result brings to end four years of consecutive increases, overall confidence remains higher than at anytime since the financial crisis, despite overall unsecured debt levels being 30% higher.

While the overall level of confidence among consumers is stable on last year, and relatively high in the context of the past decade, there has been a slight increase in concern across some measures. For example, the proportion of consumers who are worried about their ability to make future debt repayments has risen from 15% to 18%, while those worried about the availability of credit for future purchases has risen from 13% to 15% *(see figure 11)*.

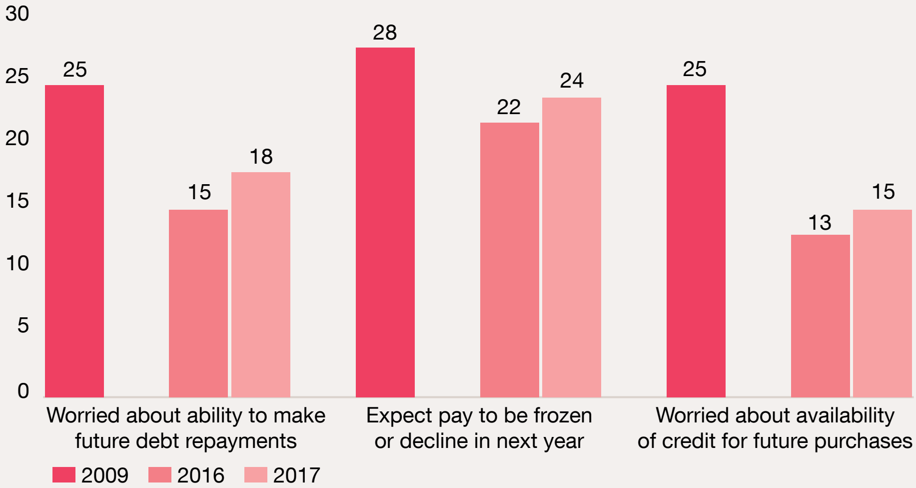
Consumers are also more concerned about Brexit than they were a year ago. They are more worried about the impact of Brexit on their finances and are more cautious about borrowing in the future as a result *(see figure 12)*.

Figure 10: **PwC Consumer Credit Confidence Index**



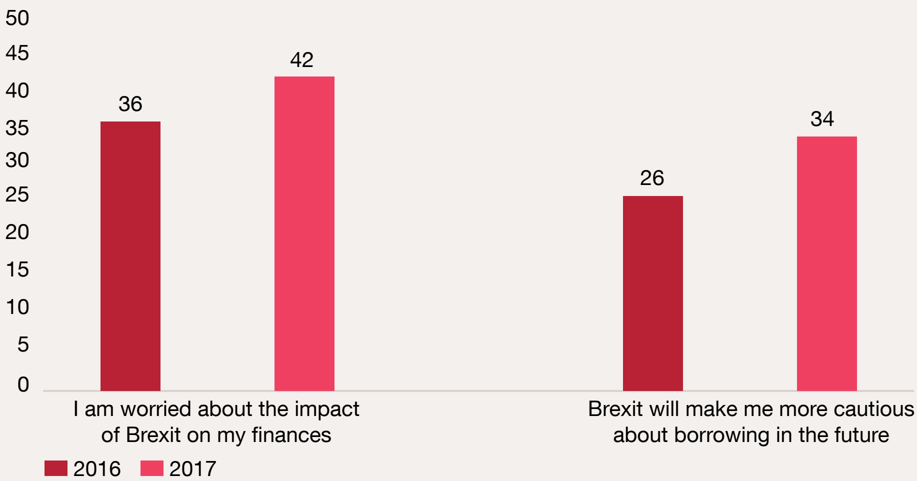
Source: PwC Credit Confidence Survey

Figure 11: **Percentage of adults that agree with the following statements**



Source: PwC Credit Confidence Survey

Figure 12: **Percentage of adults that agree with the following statements**



Source: PwC Credit Confidence Survey

5. Levels of bad debt remain low in historic terms, with affordability measures still well below pre-crisis peaks

Credit card write-offs as a proportion of outstanding balances have continued on a downward trend and are at historically low levels *(see figure 13)*. This fall in the proportion of bad debt has been driven by a number of factors: high growth in outstanding balances, (i.e. the numerator) a period of economic growth, as well as lenders' own efforts, such as the tightening of underwriting criteria. Individual insolvencies have also fallen, from a peak of around 36,000 to 22,000 per quarter, between 2009 and 2017 *(see figure 14)*.

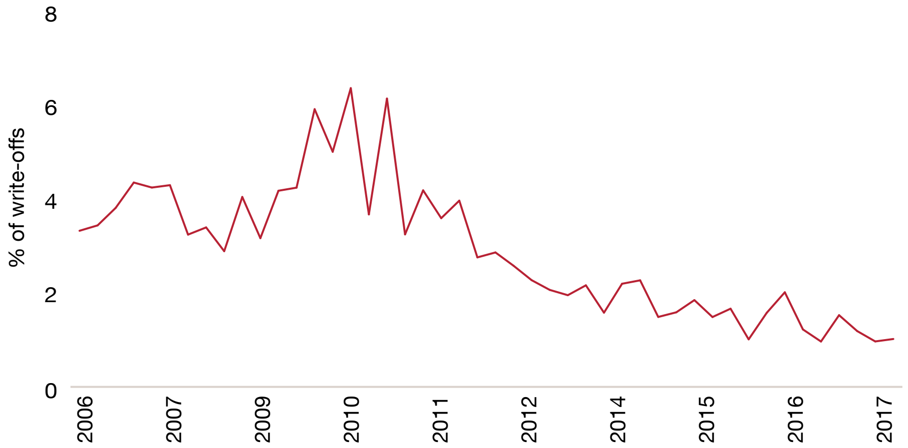
At the aggregate level, debt affordability levels do not give rise to particular concerns. UK household debt to disposable income ratio has risen to 147% but is still below its pre-crisis peak of 160% *(see figure 15)*. What's more, revised forecasts suggest that this level will not be exceeded within the next five years, reaching an estimated 153% by 2022.

Although unsecured debt has been growing rapidly since 2012 (8% annual growth rate), secured debt[7] – which makes up over 80% of total borrowing – has grown only by around 2% per year. This weighting has resulted in a more gradual rise in the overall debt to income ratio.

Looking at the household balance sheet also suggests a relatively healthy position. Net household assets (after deducting debt) now stand at 8.8 times household income in 2017[8] – a stronger position than at any point in almost 100 years.

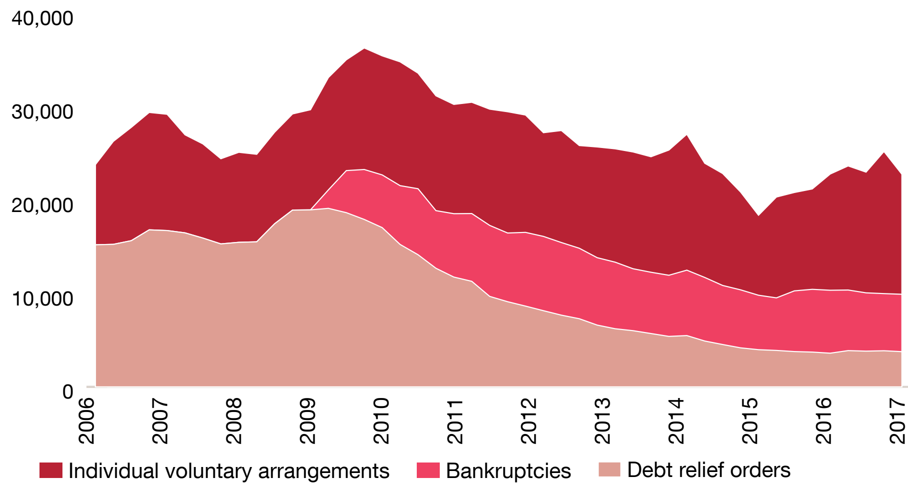
While affordability measures at the aggregate level may not suggest immediate risks, certain consumer groups are already exhibiting concerns.

Figure 13: **Credit write-offs as a proportion of outstanding balances**



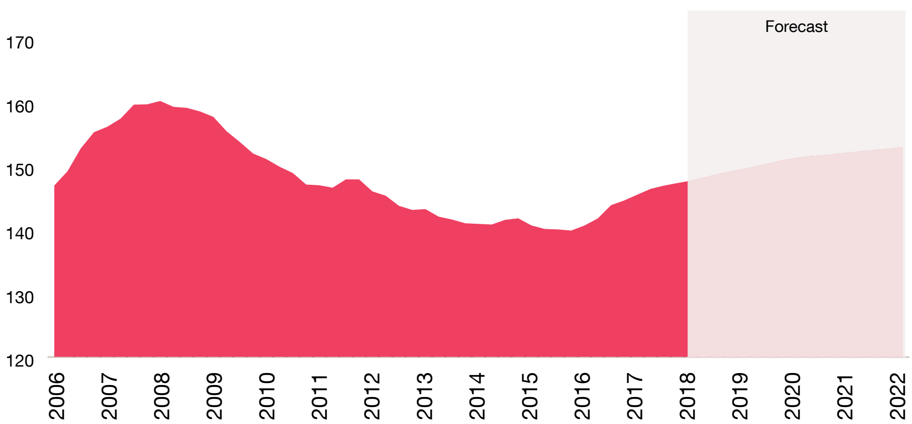
Source: Bank of England

Figure 14: **Total individual insolvencies per quarter by type**



Source: Insolvency Service

Figure 15: **Total UK household debt to disposable income ratio**



Source: OBR

7. Bank of England
8. OBR, March 2017

6. Younger borrowers and renters are significantly more concerned about their debt

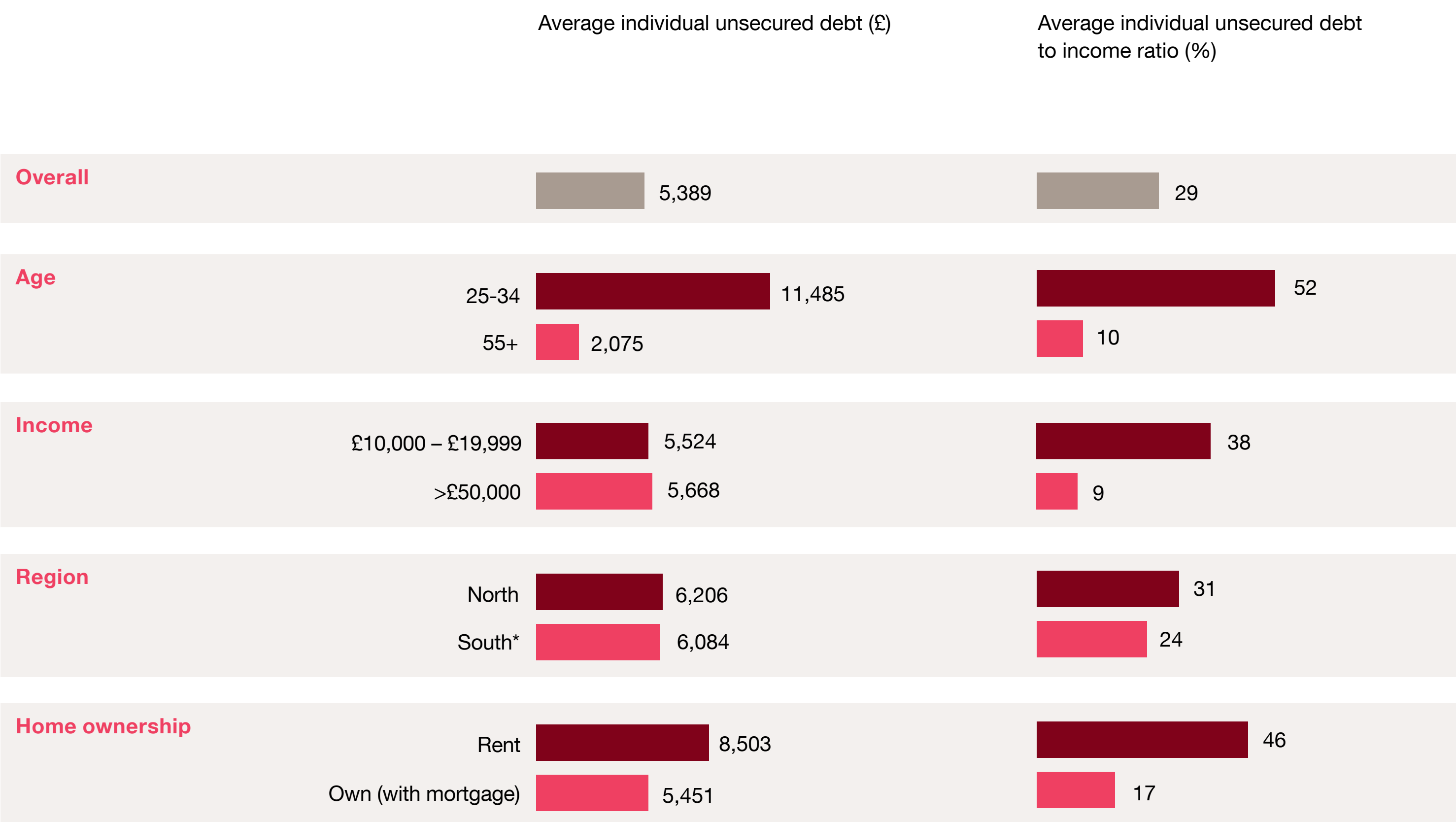
While overall affordability measures may not give rise to particular concern, these aggregate measures mask a more complex underlying picture. The FCA defines credit card customers to be in persistent debt if they have paid more in interest and charges than they have repaid of their borrowing over an 18 month period.

An estimated 3.3m people are in persistent debt, which costs them an average of £2.50 in interest and charges for every £1 borrowed.[9]

Certain consumer groups are more likely to express concern about the debt they hold *(see figure 16)*. For example, compared to older borrowers (55+), 25-34 year olds typically hold five times more unsecured debt, are three times more likely to need to use credit to pay for essential items and are three times more worried about their ability to repay their debts in the future.

Low earners are also more likely to be concerned. Our survey indicates that lower earners typically hold a similar amount of unsecured debt to higher earners and therefore have the burden of a debt to income ratio which is four times more onerous. Lower earners (£10-20k per annum) are also twice as likely to use credit to spend on essential items and are twice as concerned about making repayments than those on higher incomes (£50k+).

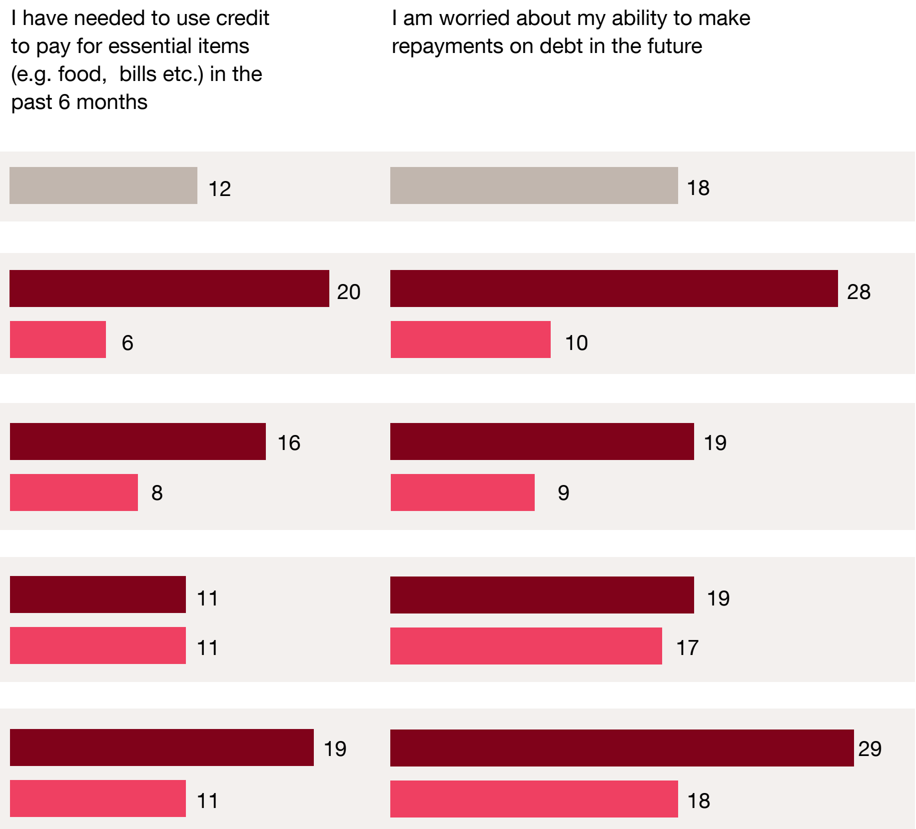
Figure 16: Comparison of individual debt circumstances and areas of concern across consumer groups



[9] Source: FCA consultation paper "CP17/10: Consultation on persistent debt and earlier intervention remedies" published on 03/04/2017

Our survey also identifies that those who rent are much more concerned. Compared to owners with mortgages, renters are close to twice as likely to have needed to pay for essential items on credit and to be worried about their ability to repay future debt.

Percentage of adults that agree with the following statements (%)



*includes London

Source: PwC Survey 2017

7. Consumers lack understanding of the implications of interest rate rises and may be under-prepared

While there is currently a relatively low level of bad debt, record levels of employment and the overall debt to income still well below its pre-crisis peak, how well prepared are consumers for a change of circumstances?

Households are increasingly turning to borrowing ahead of saving, and are of course incentivised to do so by the low interest rate environment. The household savings ratio has fallen significantly since 2010 and is projected to remain negative for the next five years *(see figure 17)*. With lower savings, households may be less prepared to respond to a change in circumstances e.g. losing their job or interest rate rises.

The Bank of England has recently signalled intent to raise interest rates, yet our Consumer Credit Confidence Survey reveals consumers do not fully understand the implications. 67% of adults we surveyed felt they had a good understanding of how an increase in the base rate would impact their loan repayments – yet only 12% correctly answered a question testing their actual understanding. This disconnect between their perceived and actual understanding of the impact of rate rises (see figure 18), may give lenders cause for concern.

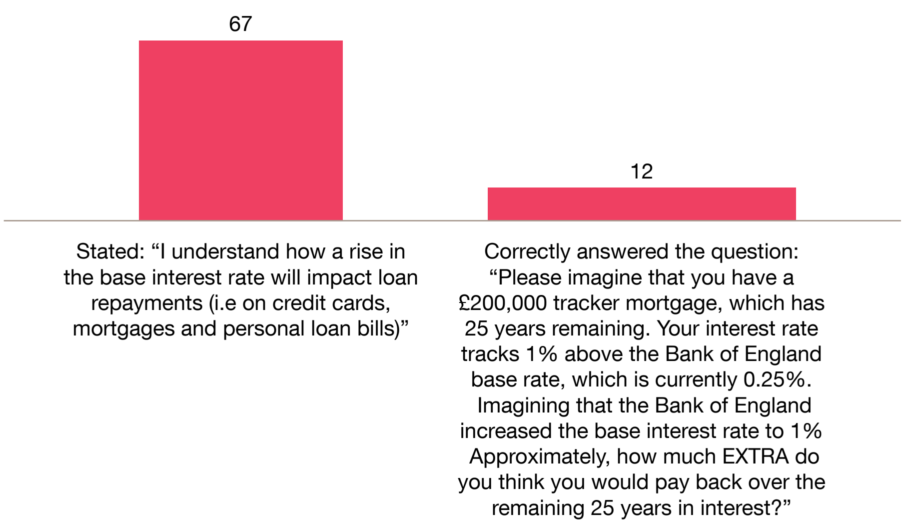
For some, a rise in interest rates could lead to a significant increase in the cost of repayments. For those on tracker mortgages or paying their lender's standard variable rate, a 1% increase in the base rate may lead to an annual increase in repayments of around £1,000 (assuming £150,000 mortgage over a 25-year term)[10], a stretch that some, especially with the backdrop of falling real wages, may find difficult to absorb.

Figure 17: **Headline savings ratio (%)**

*savings ratio excluding pensions

Source: ONS, OBR

Figure 18: **Comparison of perceived and actual understanding of the impact of a change of interest rates (%)**



Source: YouGov, PwC analysis

[10] Council of Mortgage Lenders, 2017

8. Levels of financial literacy in the UK are low and consumers can struggle to estimate the actual cost of borrowing

Our Consumer Credit Confidence Survey reveals a wide range in the level of understanding of basic financial products. While 72% felt they had a good understanding of credit cards, just 57% felt the same about mortgages and 35% about payday loans *(see figure 19)*.

While generally respondents felt they had a good understanding, far fewer correctly answered simple questions that tested their understanding of the actual cost of borrowing on these products. This lack of understanding was particularly acute for younger respondents *(see figure 20)*.

Just 4% of people correctly estimated the repayment value for a payday loan (from a choice of four options), indicating that the use of the APR measure may not be as suitable for this product.

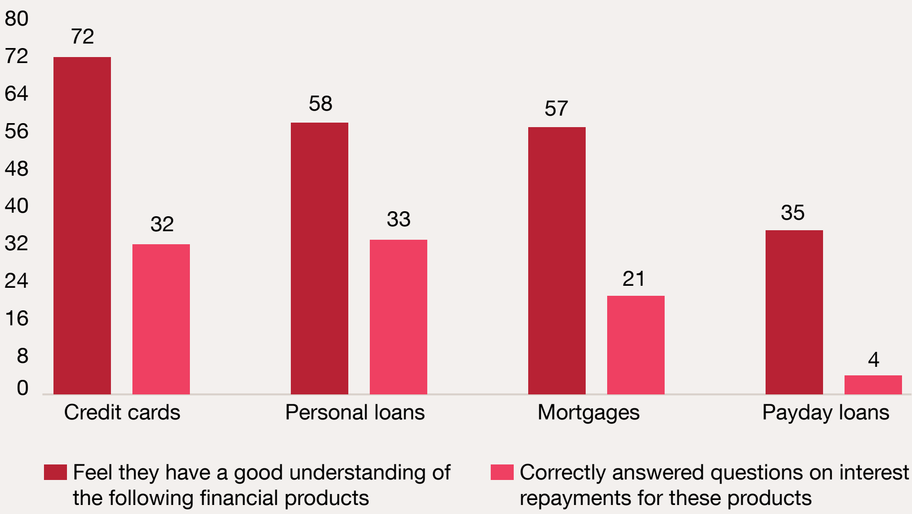
Furthermore, during our recent Citizens' Jury on issues within the financial services sector, members of the public highlighted that the complex language used by the financial industry makes it seem too distant and out of touch for them to properly engage with and understand it.

The UK scores below the OECD average for teaching financial literacy. Just 6% of the adults we surveyed said they had received any formal education at school about how to manage their personal finances.

The introduction of financial education to the national curriculum in the UK in 2014 can be seen as a positive progress. However, over-three quarters of teachers surveyed by The Money Charity reported little or no improvement since its introduction.

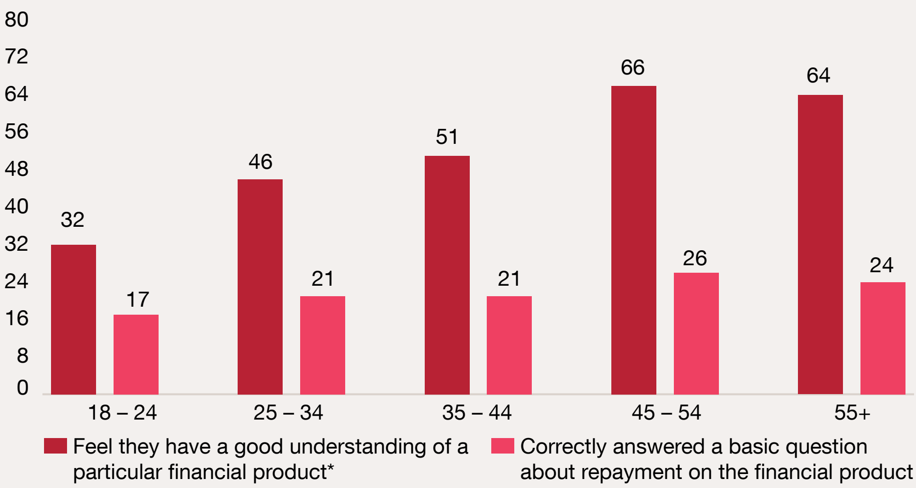
As Britain's debt burden expands further, the importance of financial literacy as a crucial life skill is only increased.

Figure 19: **Percentage of adults who**



Source: YouGov, PwC analysis

Figure 20: **Percentage of adults, by age, who**



*average of results for credit cards, personal loans, mortgages and payday loans

Source: YouGov, PwC analysis

Conclusion

While total unsecured debt has reached a new all-time high, the analysis in our report paints a mixed picture in terms of just how worried we should be.

The overall debt to income ratio, while relatively high at 147%, remains well below the pre-crisis peak, and this fact, combined with the still benign macroeconomic backdrop, perhaps doesn't give rise to immediate concern. However, our Credit Confidence Survey clearly reveals that certain segments are already under more pressure than others e.g. younger borrowers and renters who have a relatively higher debt to income ratio and are substantially more concerned about their ability to repay.

With interest rate rises on the horizon, and macro-economic risks to the downside, it will be important for all borrowers to be prepared for a potential change in circumstances. Our Credit Confidence Survey indicates a poor level of understanding in terms of the implications of base rate rises and a concerning level of financial literacy, with around three quarters of borrowers routinely underestimating the true cost of borrowing.

It is important to note that a significant portion of the growth in unsecured debt has been driven by student loans. While student debt will of course weigh heavy on those who hold it, repayment is dependent on reaching certain income thresholds and loans come with a maximum term (after which as residual outstanding amount is written off). Arguably, therefore, student debt should not be considered as equivalent to other forms of unsecured lending. Looking at the underlying picture without student debt reduces the overall position from around £300bn to £200bn, which is broadly the same level reached before the financial crisis in 2008.

With this in mind, the current trajectory and affordability of unsecured debt will remain a hot topic.

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The YouGov Survey total sample size was 2046 adults. Fieldwork was undertaken between 13th – 14th September 2017. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

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