The New York Times
nytimes.com



September 3, 2003

# Personal Debt Surges in Britain

By ALAN COWELL

LONDON, Sept. 2 - Throughout this balmy summer, when temperatures hit their highs and people shopped for flimsy clothing and cooling drinks, Britons set records of their own - mainly of red ink in soaring personal debt that could spell an imminent end to a feel-good era.

The signs of the boom years are easy to see - late-model cars bought on credit, restaurants and pubs bulging with diners and drinkers, housing prices higher than ever and crowds of shoppers invading the clothing, music and shoe stores of Oxford Street in London.

Britons, once dismissed as a nation of shopkeepers, now seem to be a nation of shoppers: so intense has been their spree that consumer spending accounts for virtually all of the country's economic growth.

But there is a more ominous side to the spending boom. In the month of June alone, consumer borrowing surged by $15 billion from May, the highest monthly increase on record, taking total household debt to the equivalent of $1.4 trillion - meaning that the mortgages, credit card debt, loans and overdrafts of the average British resident total at least 120 percent and possibly 130 percent of annual disposable income.

That proportion of debt to income is similar to personal debt levels in the United States, said John Butler, an economist at HSBC Bank, but British debt is growing much faster than its American counterpart. During Britain's last big economic boom, in the late 1980's, the proportion of debt to disposable income was around 80 percent, showing just how much Britons have come to rely on easy credit.

"Many people have a habit of describing the U.K. as a mini-version of the U.S." in its readiness to borrow, Mr. Butler said. "In fact, it's a maxi-version." The sudden acceleration of borrowing in the last 18 months has been driven largely by people spending money from extra mortgage loans they have acquired at the lowest interest rates in more than 40 years.

And the borrowing has not stopped at mortgages. "The key is that all forms of debt have been rising, so it's not just about shifting the kinds of borrowing," Mr. Butler said. "It's all rising," setting Britain apart from the Continent, where he described many people as "savers rather than spenders."

Over the summer, figures released by Datamonitor, a private research group, said the average Briton's unsecured debt on credit cards and other borrowings had risen by about 40 percent in the last five years, to the equivalent of $5,400.

The government-run National Association of Citizens Advice Bureau said the number of people seeking advice on debt problems had risen by almost half over the last five years, with the average debtor confronted by repayment demands of about $17,000, equivalent to 13 months' income.

"The U.K. is one of the most unbalanced economies in the world," said Holger Schmieding, a European economist at Bank of America. Its growth is based on consumption, he said, while investment is weak and the level of personal debt is "like a sword hanging over the economy."

The debt free-for-all seems sharply at odds with the financial ethic advanced by Gordon Brown, the chancellor of the exchequer, who insists that his economic watchword is prudence, even as the nation earns tax income from the increased spending.

The story of British borrowing, thus, has little to do with caution and everything to do with lopsided growth that sets this country apart from the slowing European economies of France, Germany or Italy. Britain is still forecasting growth of 2.25 percent this year, though it may not reach that target, while important Continental economies have ground to a halt.

And it is a story that highlights the distinction between the British and Continental economies that may obstruct British membership in the eurozone.

For the last five years, housing prices here have been skyrocketing, and even with a recent slowdown, the annual increase is still 17.9 percent, compared with 25 percent a year ago, according to the Nationwide Building Society, a leading mortgage lender.

At the same time, unemployment, which has risen in some other major European economies to around 10 percent, has fallen to its lowest level in more than four decades, to slightly more than 3 percent, providing more people with earnings to spend. The government itself has overseen the hiring of an additional 340,000 employees in the last six years.

The increase in real estate prices enabled many people to simply expand their mortgage loans to obtain extra cash, secure in the knowledge that the value of their property more than offset the extra loans. And, with interest rates down - they are currently pegged by the Bank of England at 3.5 percent, the lowest since the 1950's - mortgage repayment costs also fell.

Financial institutions that once discouraged debt, moreover, now encourage it with fierce competition among mortgage lenders, banks, loan consolidation companies and credit card issuers to lure customers with offers of low interest rates.

Television commercials offer people in financial trouble a chance to group all their loans into one, sometimes with their homes as collateral. Credit card companies vie with one another in introductory offers of zero interest for six months followed by repayments at an annualized rate of 14 percent.

Over the last year, though, there has been a shift. Increases in compulsory National Insurance withholdings to finance government pensions and increases in local residential taxes have offset wage increases running at 3 to 4 percent. So real income has begun to shrink, just as the dinner table chatter turns to the gradual easing of real estate prices. But despite the alarm signals, people have continued to borrow.

The latest official figures suggest that consumer spending is growing by 1.3 percent a quarter, while lending is increasing by 14 percent a year, the fastest rate since 1990, at the end of another renowned boom that led to a painful retreat. In July, said the Confederation of British Industry, a leading employers' organization, sales at Main Street stores were "unexpectedly good."

At the same time, though, many mortgage lenders are expecting interest rates to rise next year, so all those extra loans will cost more to repay. "We would urge all borrowers to ensure that they are building in enough flexibility to their household finances to be able to cope with higher mortgage repayments," said Michael Coogan of the Council of Mortgage Lenders, an industry group.

The concern among economists is that while British growth continues to be pushed along by consumer spending, the debt-fueled boom cannot last forever, creating a quandary for the Bank of England's policy makers: a further drop in interest rates could spur growth from other sectors of the economy, but it would also increase consumer spending and personal debt.

As ever, though, economists are looking at the housing market as the herald of a downturn. "Prices are now so high that it's starting to become unaffordable for first-time buyers," Mr. Schmieding at Bank of America said. "We will see the peak of the credit boom in the next few months."

 