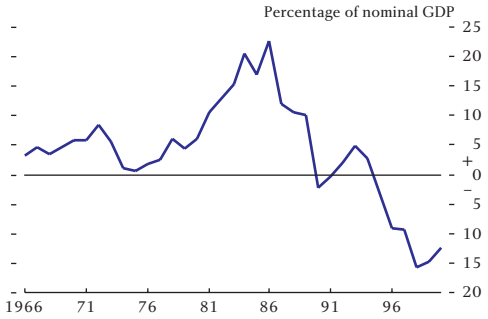
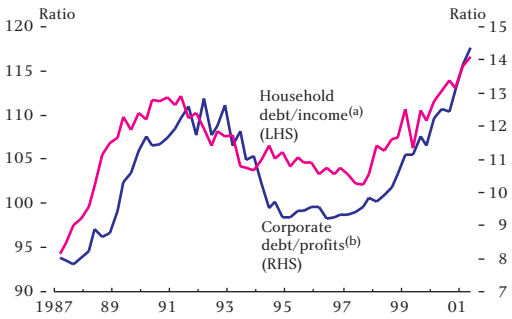
VII UK corporate and personal sectors

Chart 149:
UK net external assets



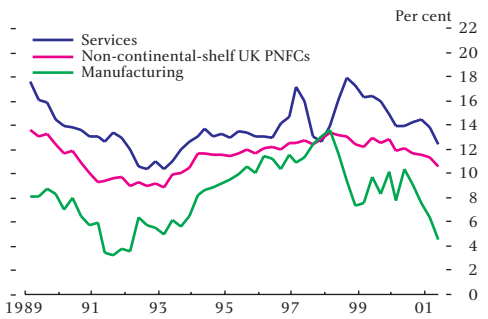
Source: ONS.

Chart 150:
Corporate debt-to-profits and household debt-to-income ratios (per cent)



Source: ONS.
(a) Gross disposable income.
(b) Gross operating surplus.

Chart 151:
Net rate of return on capital[a]



Source: ONS.
(a) Net operating surplus/net capital employed.

The deterioration in the international environment has implications for the UK's financial system not just because of the global links discussed in previous sections, but also through effects on the UK's external balance sheet, and via the UK corporate and household sectors. This section turns to these more domestic issues.

The macroeconomic environment and the UK's external balance sheet

Recent GDP outturns, together with a preliminary estimate of GDP growth in 2001 Q3 of 0.5 per cent, suggest that UK activity has remained resilient. The decline in global demand is, though, plainly a drag on prospective growth, and the Bank's official interest rate has been cut by 1.25 percentage points since June to keep inflation in line with the 2.5 per cent target. The November modal projection of the Bank's Monetary Policy Committee envisages that growth will slow moderately next year before recovering to around trend (see the November *Inflation Report*, page 50).

Final domestic demand has, meanwhile, continued to grow at rates above the long-run average. The imbalances in the economy – on the demand side, between consumption and net external demand and on the output side, between the tradables (especially manufacturing) sector and the non-tradables sector – have, if anything, widened since the June *Review*.

The past and expected current account deficits are, of course, associated with an accumulation of external debt. The MPC has drawn attention to the resulting downside risks to sterling (see the November *Inflation Report*, pages 54-55). A country's external balance sheet can sometimes give an indication of such vulnerabilities. Overall, however, although the numbers are very large, the UK's balance sheet position does not seem to pose a threat to financial stability.

Compared with other major economies, the UK appears to have relatively large *gross* and *net* external liabilities (Chart 149) as a proportion of GDP[64]. Between end-2000 and end-June 2001, the UK's gross external on-balance-sheet assets increased by 8.4 per cent, while gross external liabilities rose by 7.9 per cent. This left estimated net external liabilities at around the level prevailing since end-1998, revaluation effects broadly offsetting the capital account inflows corresponding to the continuing current account deficits.

64: This is, however, uncertain because of shortcomings in the data. In particular, external assets (especially via direct investment) may be greater than estimated by the conventional methods, and there may be off-balance-sheet contracts which to some extent hedge on-balance-sheet risks. Moreover, a large part of the UK's external balance sheet reflects the liabilities and claims of foreign-based financial firms. It is not straightforward to assess the impact on the UK economy of changes in the external position of such firms operating in the City. For a detailed review, see 'The external balance sheet of the United Kingdom: Implications for financial stability?' Senior, S and Westwood, R, *Bank of England Quarterly Bulletin*, Winter 2001, pp 388-405.

Nor has the composition of external assets and liabilities by instrument changed much recently. There is a continuing positive net asset position on direct investment and debt securities, and a negative position on equities and the banking sector's aggregate balance sheet. In its on-balance-sheet business, the UK is still 'long' in foreign currency and 'short' in sterling assets, so any fall in sterling would, other things being equal, tend to strengthen balance sheets measured in sterling. But unmeasured off-balance-sheet activity may alter that picture.

The corporate sector

The rise in the UK's external debt has, in part, reflected financial deficits in the corporate (and household) sectors. In both sectors, capital gearing and debt-income ratios have risen over the past six months (Chart 150), although income gearing has remained moderate given current low interest rates.

Aggregate corporate sector profitability and demand

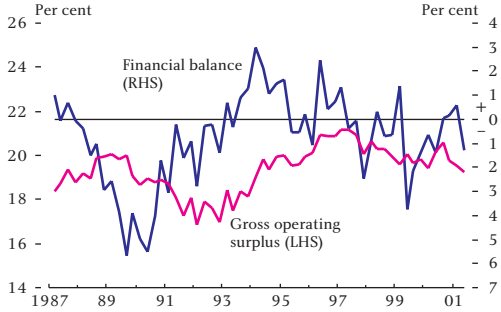
Profitability in the corporate sector as a whole (excluding oil companies) has continued to fall from the robust levels of 1997-8 (Chart 151). The gap between manufacturing and services widened further this year, and the net rate of return for manufacturing is now at its lowest since the recession of the early 1990s. Many parts of the manufacturing sector have continued to be adversely affected by the weaker external environment and sterling's strength against the euro. But the aggregate gross operating surplus of all private non-financial companies (PNFCs) as a percentage of GDP has also fallen and is at its lowest since 1994 (Chart 152). Further downward pressure on profitability might be expected from the slowdown in world demand. Profit warnings have increased significantly over the past year (Chart 153), and a number since 11 September have specifically cited the terrorist attacks as an important factor. Bank analysis shows that profit warnings contain information about short-term movements in actual profitability, and do not merely represent revisions to previously optimistic expectations.

A further fall in internally generated funds seems likely, therefore, in the short run. Whether that would have any implications for stability depends on firms' capability to adjust their cash flows (discussed in Box 8) and on their access to further external finance, through equity, bond or banking markets.

External financing and balance sheet ratios

External financing fell in 2001 H1 compared with 2000 H2, despite large equity issues by British Telecom and Vodafone in Q2. There was a further decline in Q3. In part, that might reflect more difficult market conditions. Several companies opted to postpone equity issues after 11 September. But it also reflects some slowdown recently in lending to companies by UK resident banks and in corporate bond issuance (see Section VIII for a discussion of banks' corporate lending). Corporate debt is,

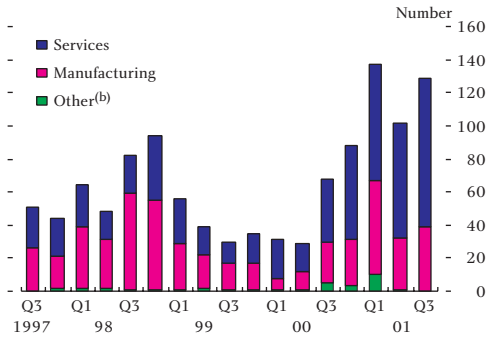
Chart 152:
PNFCs profits and financial balance[a]



Source: ONS.

(a) As a percentage of GDP. Data are quarterly and seasonally adjusted.

Chart 153:
Profit warnings by industry[a]

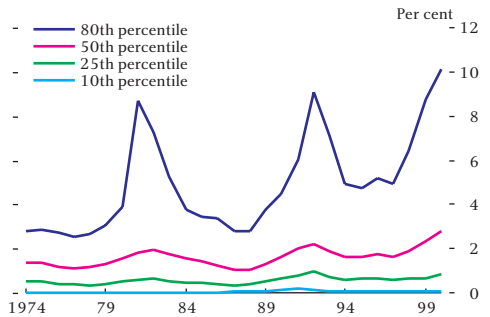


Sources: Bank of England and Financial Times.

(a) Fledgling and AIM companies are not included.

(b) Includes utilities and resources.

Chart 154:
Distribution of debt-to-profits ratio of quoted non-financial UK companies[a][b]



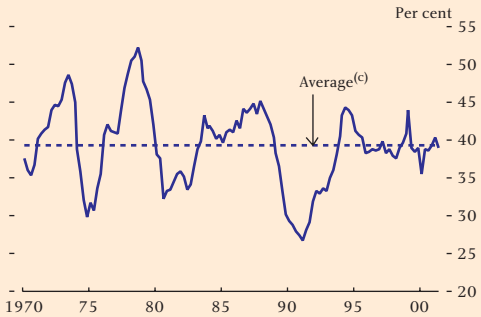
Sources: Thomson Financial Datastream and Bank of England.

(a) Ratio of gross debt to earnings before interest and tax.

(b) Companies with negative profits have their debt to profit ratio recorded to the 95th percentile of the distribution excluding such observations.

Box 8: Corporate sector adjustment mechanisms

Chart A:
Share of PNFC saving out of gross income[a][b]



Source: ONS.

(a) Gross income is sum of gross operating surplus and other sources of income (ie interest, dividends and receipts from foreign direct investment).

(b) Four-quarter moving average.

(c) Average is taken from 1970 Q1 to 2001 Q2.

How can companies adjust their balance sheets in the face of adverse developments? Broadly, they can reduce cash outflows, by cutting costs or spending; increase inflows, by working assets harder, collecting debts earlier etc; or alter the structure and quantum of their financing. The chosen methods depend on the source of the pressure, the longer-run outlook and a firm's underlying financial strength or weakness; and they affect cash flow, balance sheets, and other sectors in different ways.

In terms of adjusting the operation of the business, one of the lowest cost methods to strengthen the balance sheet is to run down inventories, which provides immediate liquidity. Moderating wage costs (or changing prices) can improve cash flows, but may, depending on the circumstances, be constrained by market conditions. Cuts in employment are generally more costly, and also reduce household incomes. Empirical work nevertheless suggests that in the past this has been a key method of adjustment for firms facing financial stress[1].

Other options are available on the corporate finance side. Before having to increase debt, companies can cut dividends, make disposals, or save more/invest less[2]. Deferring or cancelling investment projects can generate short-term savings but at the possible cost of impeding longer-term efficiency improvements. The level of corporate net saving is one possible indicator of the potential reaction to falls in income. In the past, firms have adjusted to major slowdowns in demand by initially allowing the proportion of saving from gross income to fall, before seeking to rebuild savings through reduced expenditure (Chart A). This share is currently close to its 30-year average, suggesting some leeway to adjust in the sector taken as a whole.

1: For example, Nickell, S, and Nicolitsas, D, (1999), 'How does financial pressure affect firms?', *European Economic Review*, 43, pages 1435-1456.

2: Dividend behaviour is discussed in Benito, A, and Young, G, (2001), 'Hard times or great expectations? Dividend Omissions and Dividend Cuts by UK Firms', *Bank of England Working Paper 147*.

however, still rising more rapidly than corporate incomes, and the aggregate debt-to-profits ratio has risen above the levels of the early 1990s (Chart 150). Company accounts data suggest that the corresponding ratios for the most heavily-indebted quintile of companies reached levels in 2000 that were higher than in the recession of the early 1990s (Chart 154).

Other indicators of potential vulnerability present a mixed picture at the aggregate level. Corporate sector capital gearing at replacement cost has since the mid-1990s risen to a 30-year

high; and gearing at market value has also increased following the fall in equity prices over the past two years (Chart 155).

As well as affecting gearing, falls in equity prices have required some companies to increase their contributions to their pension funds in order to meet the solvency requirements on those funds. This would be a potential concern if the balance sheets of these companies were in any case weak. Changes in the accounting treatment of pensions (Financial Reporting Standard 17), to be implemented fully by 2003, make the cost of defined-benefit schemes more explicit. These developments may reinforce other factors, including the Minimum Funding Requirement and increased life expectancy, which are also encouraging companies to shift from defined-benefit to defined-contribution schemes. That transfers some of the risk from the corporate to the household sector. The changes may also promote a further shift in pension fund portfolios away from equity holdings towards bonds (as perhaps illustrated by Boots' recent decision to move its pension fund entirely into bonds).

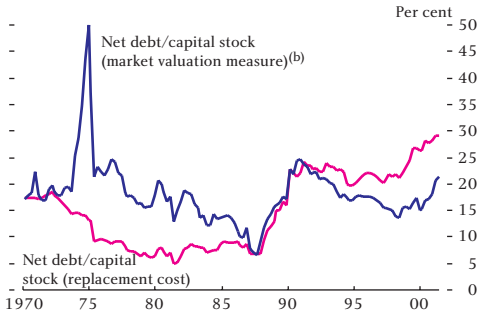
Notwithstanding apparently high corporate indebtedness, income gearing remains low by historical standards (Chart 156). Other things being equal, it would probably take a large fall in corporate income to raise income gearing to the levels reached in the early 1980s and early 1990s.[65] In any case, a rise in income gearing would not immediately imply a greater risk of default if companies have adequate liquid assets. Different aggregate measures of liquidity all tend to show a rise during 2000 and 2001 H1 (Chart 157). Company accounts data also suggest that liquidity rose in 2000 at all levels of gearing, but much more markedly for the least geared firms (Chart 158). Although there are exceptions (computer and related activities, construction and utilities), the overall liquidity position points to firms being better placed to deal with weaker cash flow than two or three years ago, perhaps balancing some of the vulnerability from increases in aggregate debt and weaker aggregate demand.

Company sector debt servicing performance

So far there is little evidence of strain in company failure rates. According to the Euler Trade Indemnity survey, the incidence of bad debts and business failures fell in 2001 Q3, while DTI and Dun and Bradstreet data also imply further reductions in corporate failures in Q3. Contacts with corporate recovery bankers, however, suggest some increase in problem cases during 2001, albeit from low levels. There have also been some suggestions that trade credit insurers have been tightening conditions, and perhaps occasionally withdrawing insurance

65: On a purely mechanical calculation, assuming unchanged debt-servicing obligations, corporate profits would have to fall by over 5 per cent of GDP to raise income gearing to those levels. This mechanical calculation takes no account of the underlying shock, corporate sector adjustment, or policy changes. Pre-tax operating profits fell by around 3 per cent of GDP between 1990 and 1992.

Chart 155:
PNFCs' capital gearing[a]

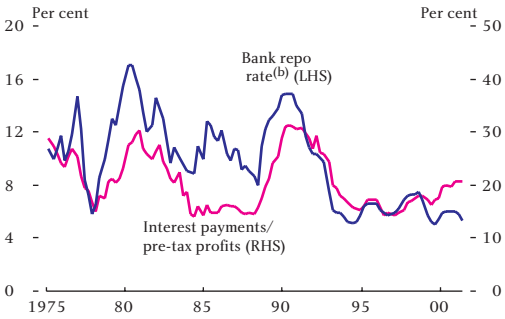


Source: ONS.

(a) Seasonally adjusted.

(b) PNFCs' net debt divided by the sum of the net debt and market value of equity.

Chart 156:
PNFCs' income gearing[a]

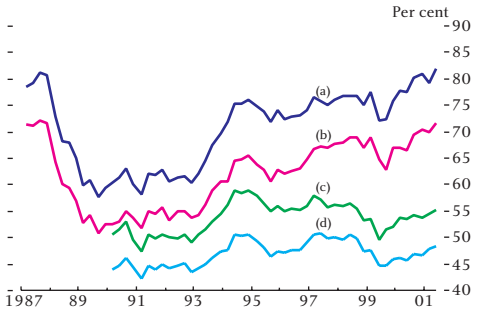


Sources: ONS and Bank of England.

(a) Seasonally adjusted.

(b) Data are quarterly averages.

Chart 157:
Aggregate PNFC liquidity



Sources: ONS and Bank of England.

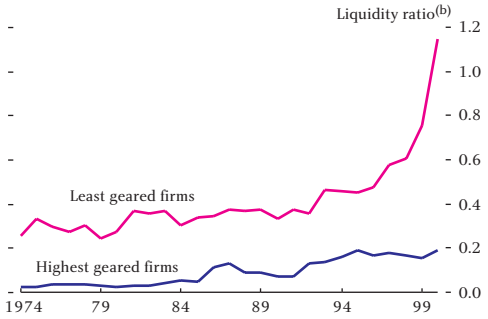
(a) Defined as all currency deposits, money market instruments (MMIs) and bonds divided by all currency short-term bank and building society lending and MMIs.

(b) As (a) excluding MMIs and bond assets.

(c) As (a) including bond liabilities.

(d) As (b) including bond liabilities.

Chart 158:
Corporate liquidity and indebtedness[a]

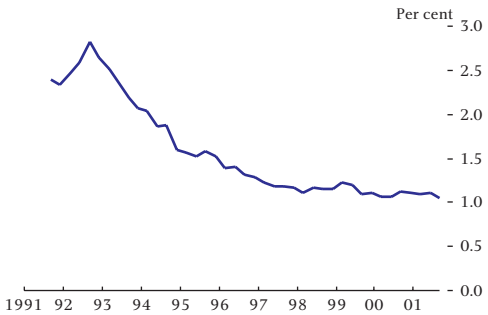


Sources: Thomson Financial Datastream and Bank of England.

(a) The least (highest) geared firms are at or below the 20th (at or above the 80th) percentile of capital gearing at replacement cost (gross debt to replacement cost of capital) in each year.

(b) Liquidity is cash/short-term debt.

Chart 159:
Rate of corporate insolvencies[a][b]

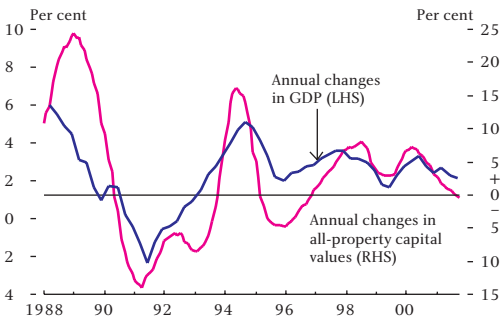


Source: DTI.

(a) Calculated as the annualised number of insolvencies in the quarter divided by the number of active registered companies in the last month of that quarter.

(b) The final observation in 2001 is for Q3.

Chart 160:
Changes in GDP and property capital values



Sources: Investment Property Databank and ONS.

quickly – affecting the availability of banking and other finance – when a firm runs into difficulties.

Nevertheless, the rate of corporate liquidations has fallen from a peak of nearly 3 per cent of the total population of firms in 1992 to just over 1 per cent in 2001 Q3 (Chart 159). A rise is likely next year, given the macroeconomic prospect outlined above, but this should be modest unless the economy weakens more than currently expected. Restructurings may limit the rise in insolvencies, but could still imply some default on debt.

Sectoral developments

Three parts of the UK corporate sector are particularly interesting in the light of recent developments. First, the commercial property sector's borrowing has increased rapidly since early 2000. Property investment is typically relatively highly leveraged[66] and has been a material source of losses to banks in the past. Property is also important as collateral. Second, airlines and associated industries have experienced an abrupt decline in business since 11 September. Third, the TMT sector remains under pressure given the fall in global demand for ICT goods and the heavy debt burden of some companies.

Commercial property

Demand for commercial property slowed in 2001 H1 and, since June, there have been indications - from rising vacancy rates and a fall in take-up of space – of some further deceleration. Discussions at the Bank's Property Forum[67] in October and with other contacts have given a more robust view of demand prospects (with 11 September judged to have had little long-term impact). On the supply side, there is evidence of an increase in available space, although there are some mixed signals from different data sources about the pace of activity in the construction sector. Reflecting these changes in current and prospective demand and supply, annual growth of capital values has fallen further since the June *Review*, and was marginally negative in September 2001 for the first time since end-1996 (Chart 160).

Capital values do not, though, look especially high in real terms. The ratio of property values to the GDP deflator is only about two-thirds of the level recorded in the early 1990s. Lenders point to an absence of a significant overhang of supply and suggest that a large downward adjustment of capital values is unlikely without an unexpected deterioration in macroeconomic conditions. Perhaps partly reflecting this view, bank lending to the commercial property sector grew rapidly throughout the first three quarters of 2001 (Chart 161). Contacts identify a key influence as being the wider gap between property yields and

66: The mean level of capital gearing has been higher in recent years for quoted FTSE-All Share property companies than for all other non-financial companies in the All-Share index.

67: For background on the Property Forum, see Box 6 on page 72 of the November 1999 *Financial Stability Review*.

banks' borrowing costs, together with a move by some institutions to finance their property portfolios via more heavily geared joint limited partnerships. The supply of lending for speculative development, however, is said to be limited. There is some evidence that so-called residual value risk (the proportion of debt not covered by the residual value of the property at the end of the loan period) has increased – see Section VIII.

Overall, the risks in the sector have probably increased somewhat since the June *Review*, while remaining well short of the fragility of the late 1980s.

Airlines and associated industries

Most industries routinely experience shifts in costs, demand and financial conditions, and because of this operate with 'buffers' – including bank lines of credit – to facilitate adjustment. The 11 September attacks, however, caused an unusually abrupt decline in demand for travel, which places a high burden of adjustment on the airlines sector (Section II). The fall in demand has particularly affected those UK airlines with transatlantic routes and, for the industry as a whole, exacerbated underlying problems of excess capacity. In response many airlines, including some UK airlines, have announced job cuts, flight reductions and rescheduling of new aircraft deliveries, shifting some of the adjustment costs to aircraft manufacturers and the household sector.

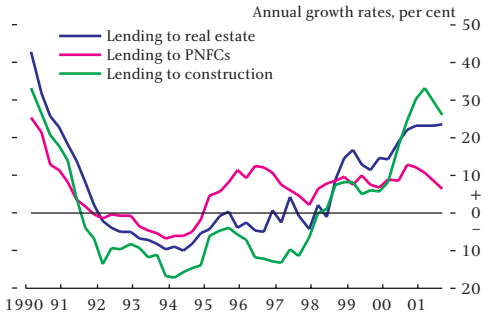
Falls in demand have also spread to firms engaged in travel-related industries and services, putting downward pressure on their cash flow and profitability. Share prices for tourism-sensitive firms have been weaker than the FTSE-100 or FTSE-250 since 11 September, and by more than for a cross-sectoral sample of firms with a high share of sales in the US (Chart 162). Relative bond spreads have also increased, most markedly for UK airlines and other tourism-sensitive firms; in some cases, sterling spreads are now higher than for telecoms firms (Chart 163).

The financing of UK airlines in structurally different in some respects from arrangements in the US market, described in Box 1 in Section II. In particular, for UK airlines, a large proportion of aircraft finance is through bank lending that is either secured or officially guaranteed through export credit assistance. A fall in the value of aircraft resulting from lower demand will increase residual value risk. (See Section VIII for a discussion of the UK bank system's exposures to airlines and other tourism-related sectors.)

TMT

As reported in the June *Review*, 'new economy' firms were strongly represented among the least profitable decile of quoted companies in 1999 and 2000. Market-based indicators suggest that the UK TMT sector continues to be perceived as relatively

Chart 161:
Lending to real estate, PNFCs and construction[a][b]

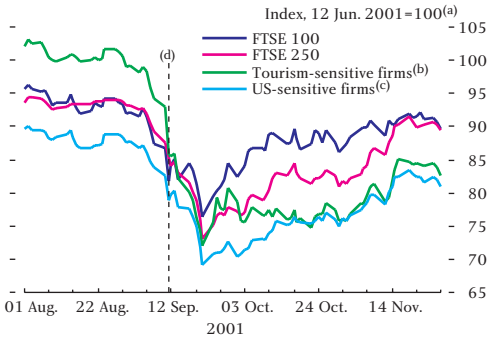


Source: Bank of England.

(a) Not seasonally adjusted.

(b) Lending to PNFCs includes banks' holdings of securities, but lending to real estate and construction does not.

Chart 162:
Equity indices for selected groups



Source: Thomson Financial Datastream.

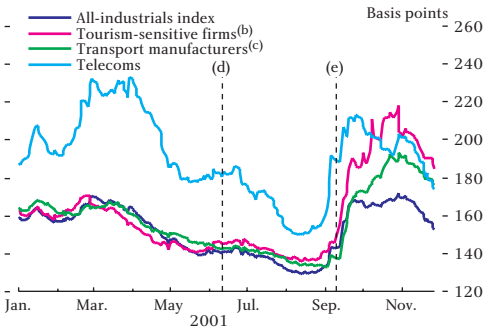
(a) June 2001 *Review*.

(b) Tourism-sensitive firms are defined as tour operators, hotels and transport operators.

(c) Firms that derived at least 25 per cent of sales from the US in 2000.

(d) 11 September 2001.

Chart 163:
Corporate sterling bond spreads by sector[a]



Sources: Merrill Lynch and Bloomberg.

(a) Data are option-adjusted spreads: difference between par yields on index and par yields on government gilts.

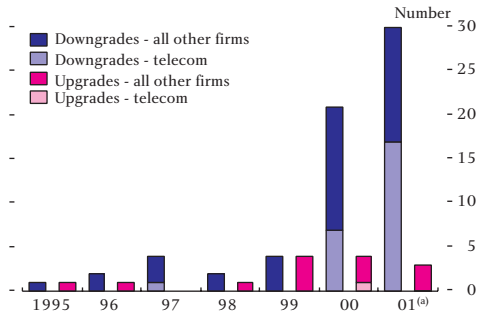
(b) Tourism-sensitive firms are in the cyclical services sector.

(c) Transport manufacturers operate in capital goods sector.

(d) June *Review*.

(e) 11 September 2001.

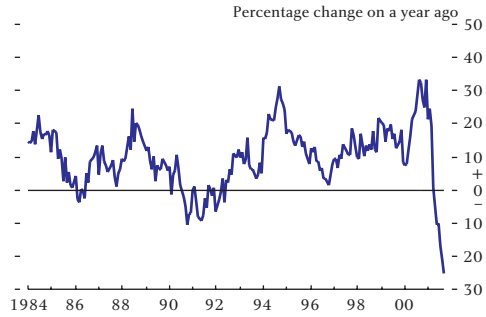
Chart 164:
Issuer ratings changes for telecom and other firms



Sources: Moody's Investors Service and Bloomberg.

(a) 2001 figure is year to 28 November 2001.

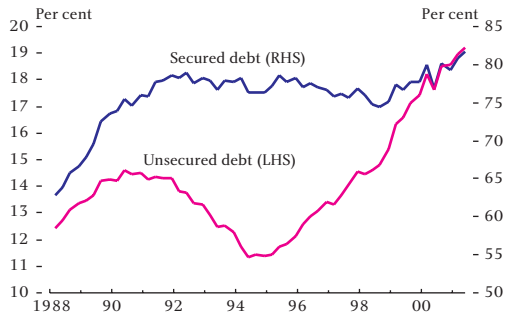
Chart 165:
Production in the ICT sector(a)



Sources: ONS and Bank of England.

(a) Electrical and optical engineering output as a proxy for ICT production.

Chart 166:
Secured and unsecured debt as a proportion of annual disposable income(a)



Sources: ONS and Bank of England.

(a) Disposable income data are seasonally adjusted.

risky, but possibly as stabilising. Share prices have fallen by more than the FTSE All-Share index since June, but have risen by more since 11 September. Corporate bond spreads for telecoms firms remain higher than an average for all industrial corporate bonds, although the gap has narrowed since June and especially since September (Chart 163). The TMT sector accounted for around one quarter of profit warnings in 2001 Q3. Seventeen out of 30 ratings downgrades in 2001 have been for telecoms firms, compared with 7 out of 21 in 2000 (Chart 164); but only four have occurred since June.

The higher-than-average credit risk in the sector is not surprising given the fall in global demand for high-tech goods. Activity information indicates that the output of suppliers to the TMT sector (ie production of ICT goods) fell sharply during 2001 H1 (Chart 165), explaining a large part of the total fall in manufacturing output over that period (see pages 22-23 of the November *Inflation Report*). There is no industry breakdown of the net rate of return in manufacturing, but National Statistics suggest that most of the fall in 2001 Q2 was accounted for by declines in the profitability of these suppliers and of pharmaceutical companies.

The household sector

Since the June *Review*, the household sector has continued to run a financial deficit, although not on the scale of 1988-89. The ratio of debt to income continued to rise rapidly in 2001 H1 (Chart 150), and there is likely to have been a further rise in Q3. Household borrowing grew by over 10 per cent in the twelve months to October, the fastest rate since the early 1990s.

Unsecured debt

Unsecured borrowing grew at an annual rate of nearly 13 per cent in October, although there were signs of deceleration in the three-month annualised rate. The ratio of unsecured debt to disposable income has almost doubled since 1994 (Chart 166). Part of the recent rise may reflect increased competition among lenders, which has increased demand by driving down effective unsecured lending rates. The proportion of total credit card balances bearing interest has also risen (Chart 167), as has the average duration of credit card debt (see the June *Review*, pages 79-80).

The monthly National Opinion Polls' Financial Research Survey (FRS) provides a window on the underlying borrowing behaviour of different income groups[68]. The number of individuals taking on new unsecured loans has risen across most income bands

68: National Opinion Poll's Financial Research Survey is a monthly monitor of the personal finance markets in Great Britain. The database began in 1991. The survey questions approximately 5,000 individuals (over the age of 16) per month. It is based on a random location sample designed to provide a representative sample across the country. Data are then weighted to match the demographic and regional profiles of adults in Great Britain.

since 1991, but most markedly amongst those earning between £25,000 and £35,000[69]. The average value of new loan commitments has increased across all income bands since 1997, although the increase has been smaller for those on below average incomes. In the six months to September, both the value of, and the proportion of individuals taking on, new debt stabilised across most income and age groups.

Capital gearing, mortgage borrowing, and income gearing

As in the corporate sector, aggregate vulnerability indicators are mixed. Household capital gearing has risen over the past two years from historically low levels, reflecting the build-up of debt and the effect on wealth of falling equity values (Chart 168). New and more flexible mortgage products, together with gradual reductions in interest rates charged on secured lending, may have contributed to the further growth in mortgage borrowing. Rising house prices have contained the increase in capital gearing, except insofar as they have encouraged households to increase mortgage equity withdrawal to finance non-housing consumption. House prices are above their long-run historical average relative to earnings (Chart 169), but the recent activity and survey data suggest some easing in the housing market. House prices relative to consumer prices are fairly close to their long-term trend except in London and the south-east. This suggests that the housing market is not a major source of risk for the country as a whole; as does the recent stability of loan-to-value ratios for both first-time buyers and existing owner-occupiers, and across regions.

Household income gearing fell slightly in 2001 H1 and is likely to have fallen further since then, given recent reductions in official interest rates (Chart 168). It has been low since 1993. Comparisons of income gearing over periods with different inflation rates do not, however, adequately capture differences in real debt-servicing costs. Low inflation and low nominal interest rates spread the real debt-servicing burden more evenly over the lifetime of a loan compared with the front-loading typical in a higher inflation environment. Falls in income would, of course, raise income gearing for any given level of interest rates. That would put more direct pressure on debt servicing capability than a change in asset prices[70].

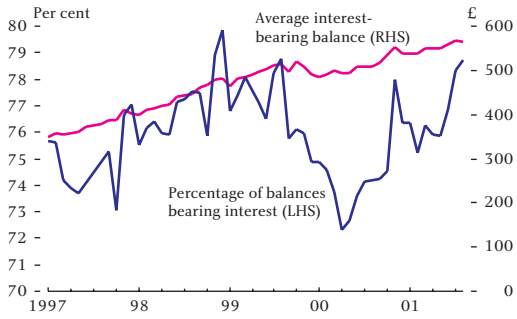
Household debt servicing performance

The emergence of debt-service problems would be more acute if any rise in unemployment were concentrated among financially weaker households. The British Household Panel Survey (BHPS)

69: National average gross annual earnings per full-time employee were £21,842 in 2000 (New Earnings Survey).

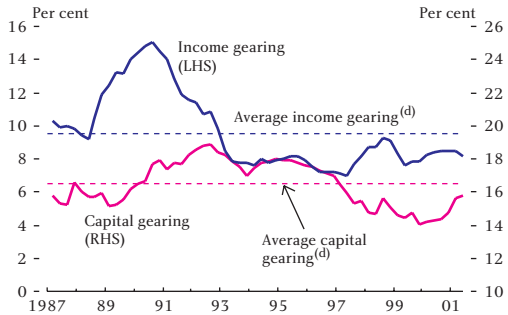
70: On a purely mechanical calculation, assuming unchanged interest-servicing obligations, personal incomes would have to fall by around 15 per cent to raise income gearing to the level prevailing *before* the large rise of 1988-90. This mechanical calculation takes no account of the underlying shock, household sector adjustment, or policy changes.

Chart 167:
Proportion of credit card balances bearing interest and average interest bearing balances



Sources: BBA and Bank of England.

Chart 168:
Household sector income and capital gearing[(a)(b)(c)]



Sources: ONS and Bank of England.

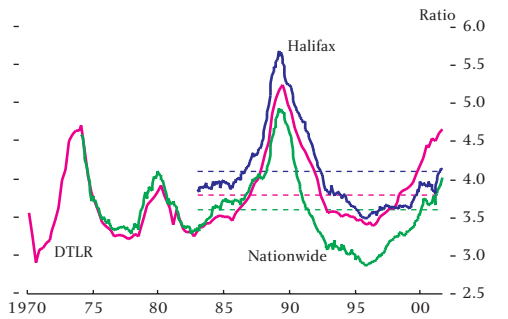
(a) Capital gearing is total liabilities as a percentage of the sum of total financial assets and housing wealth.

(b) Income gearing is total household interest payments as a percentage of total household disposable income.

(c) Disposable income is seasonally adjusted.

(d) Dashed lines indicate respective averages from 1987 Q1 to 2001 Q2.

Chart 169:
House price-to-earnings ratio[(a)(b)]

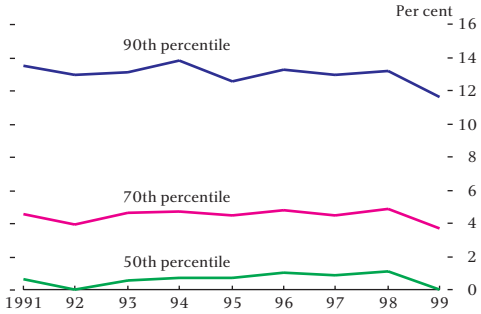


Sources: Nationwide, DTLR, Halifax, ONS and Bank of England.

(a) House prices divided by ONS whole economy annual earnings, seasonally adjusted.

(b) Dashed lines indicate the respective averages.

Chart 170:
Distribution of household saving ratios



Sources: British Household Panel Survey and Bank of England.

Table 12:
Per cent becoming unemployed from year t to year t+1

	No regular saving (per cent)	Regular saving (per cent)
1992	5.1	2.6
1993	4.0	3.1
1994	4.5	2.5
1995	3.2	2.2
1996	3.4	2.1
1997	3.4	2.2
1998	2.6	1.4
1999	4.9	3.2
Average	3.9	2.4

Sources: British Household Panel Survey and Bank of England.

Table 13:
Financial pressures on non-saving households

	Problem set[a]		Problem set[b]	
	A + B	A + B + C	A + D	A + D + C
1991	21.0	9.7	-	-
1993	17.7	9.6	-	-
1995	12.9	6.4	22.5	7.2
1997	11.0	5.4	18.5	5.3
1999	9.0	4.0	21.7	5.5

Sources: British Household Panel Survey and Bank of England.
A: No regular savings.
B: Mortgage payment problems.
C: Mortgage income gearing at or above the 80th percentile of mortgage income gearing.
D: Unsecured debt problems.
(a) As a percentage of household heads with a mortgage and any combination of A, B or C.
(b) As a percentage of household heads with a mortgage and any combination of A, D or C.

provides some information relevant to assessing this, although the latest survey – released in February 2001 – is for 1999. It suggested that around half of households do not save regularly (Chart 170); that around 90 per cent of those households also make no contributions to a personal pension; and that those with no regular saving are more likely to become unemployed (Table 12). Perhaps reassuringly, the proportion of households not saving on a regular basis who also had mortgage payment problems fell throughout the 1990s (Table 13); this was true even among the most heavily geared households. That may be because mortgage income gearing fell across households generally, but especially amongst the most highly geared.

The risk of default on unsecured debt is generally regarded as greater than on secured debt. According to the BHPS, the proportion of non-saving households with unsecured debt problems rose between 1997 and 1999 (Table 13). For the household sector as a whole, the proportion of accounts in arrears of three to six months in 2001 H1 was around eight times the equivalent proportion of mortgage arrears. Credit card arrears of between four to six months rose between August 2000 and March 2001, but have increased less significantly since then. Mortgage arrears and house possessions are low and falling, while personal bankruptcies (including voluntary arrangements) remain well below their peak of 11,000 in 1993.

Were financial pressures to rise, insurers would take on some of the burden because of mortgage protection and unemployment insurance. Around one-third of households have a mortgage protection policy, according to the BHPS. This share has risen since 1995, but does not differ much between those who have mortgage payments problems and those who do not. Section VIII discusses the implications of lenders' insurance arrangements.

Overall, taking the corporate and household sectors together, the increases in debt-income and capital gearing suggest that companies and households are now somewhat more vulnerable to unexpected falls in asset prices and incomes than six months ago. Modest income gearing provides some reassurance that both sectors should be able to service debts without undue difficulty in the current interest-rate environment.