

## VII UK corporate and personal sectors

Sections I to VI have described developments in the international environment. The implications for the UK's financial system arise directly through the global links discussed earlier, 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

On the latest ONS data, GDP was estimated to be flat in both 2001 Q4 and 2002 Q1, and year-on-year growth halved from 2% to 1% over these six months. But survey evidence and Consensus forecasts point to a renewed pick-up in growth this year, and the modal projection published in the Bank's May 2002 *Inflation Report* envisaged that growth would recover to above-trend rates over the next twelve months.

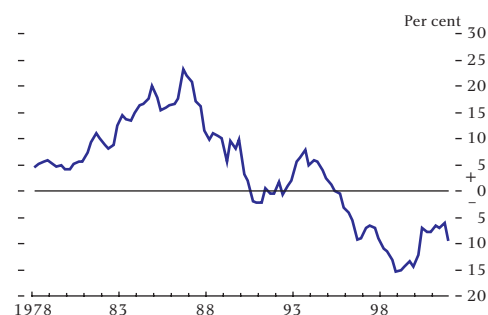
Consumer demand and (to a lesser extent) services output have remained resilient, while net external demand and manufacturing output have continued to be weak. Particularly important for the assessment of financial stability is the stock – or external balance sheet – position. Net external liabilities have risen again recently, to more than 9% of GDP in 2001 Q4 (Chart 125), although there is a large margin of error around short-term changes in these estimates. Around one-third of this rise was accounted for by net flows and the remainder by valuation changes.

The current account deficit is the counterpart to the net balance of the domestic sectors. The financial deficit of the non-bank private sector fell in 2001 Q4, largely accounted for by a reduced deficit of private non-financial companies (PNFCs), so the increase in the external deficit largely reflected the move of the public sector from surplus to deficit (Chart 126).

### The corporate sector

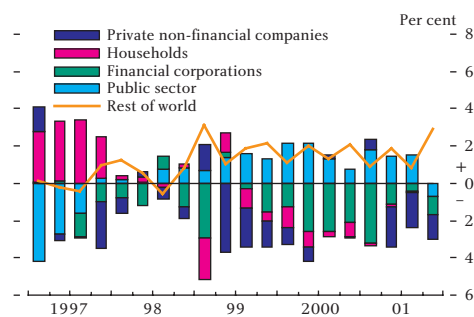
Although it fell back somewhat in 2001 H2, the continuing financial deficit of the corporate sector has been accompanied by a rising debt-to-income ratio (Chart 127), reflecting, in the recent past, mainly reduced profitability. Borrowing from UK-resident banks has slowed since the beginning of 2001, with the annual growth rate falling below 5% in April. Bond finance has, however, been more resilient recently: gross issuance has risen significantly since autumn 2001 and in the three months to May 2002 was almost twice the level of the corresponding period a year earlier. This is consistent with reports that – as elsewhere (see Sections II and VI) – some companies are switching from bank to bond finance in order to lengthen debt maturities and lock in to low long-term nominal interest rates.

**Chart 125:**  
UK net external assets as a percentage of GDP



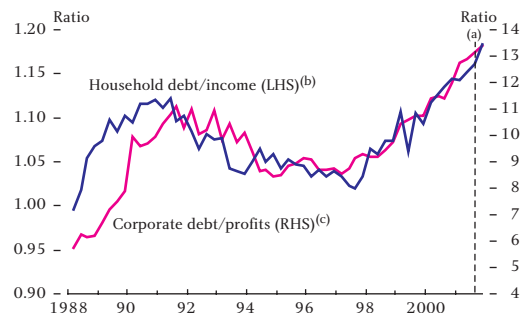
Source: ONS.

**Chart 126:**  
Sectoral financial balances as a percentage of GDP



Source: ONS.

**Chart 127:**  
Corporate debt-to-profits and household debt-to-income ratios



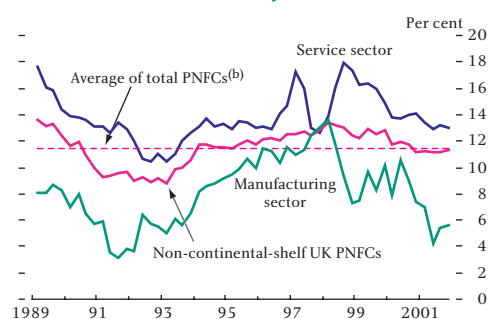
Source: ONS.

(a) Dec. 2001 *Review*.

(b) Gross disposable income, quarterly data.

(c) Gross operating surplus, quarterly data.

**Chart 128:**  
**Net rate of return on capital<sup>(a)</sup>**

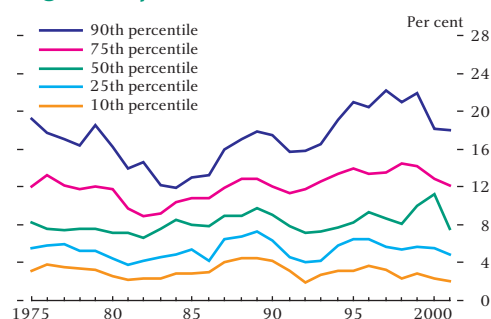


Source: ONS.

(a) Net operating surplus/net capital employed.

(b) Average 1989 Q1 – 2001 Q4.

**Chart 129:**  
**Distribution of weighted operating profit margins of quoted PNFCs<sup>(a)(b)</sup>**

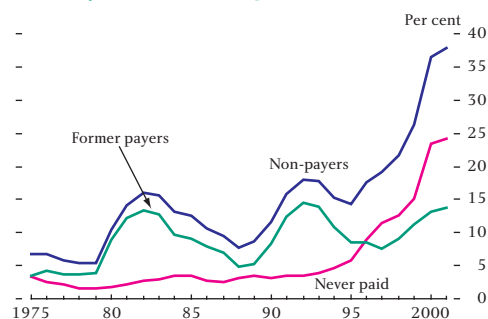


Sources: Thomson Financial Datastream and Bank calculations.

(a) Earnings before interest and taxes divided by turnover, sales weighted.

(b) 2001 data are based on 1,202 accounts.

**Chart 130:**  
**UK companies omitting a dividend<sup>(a)(b)</sup>**



Sources: Thomson Financial Datastream and Bank calculations.

(a) 2001 data are based on 1,202 accounts.

(b) As a percentage of companies' accounts reported.

### Profitability

The slowing economy was associated with a further reduction in corporate sector profitability in 2001 H2, as measured by gross operating surplus in relation to GDP. The net rate of return on capital was unchanged overall, but it fell somewhat in the service sector, while recovering a little from an historically depressed level in manufacturing (Chart 128). Company accounts data<sup>39</sup> suggest a further substantial fall in the profitability of the least profitable companies in 2001, concentrated among smaller companies. These (unweighted) data also show that some 30% of UK quoted companies (again, mainly the smaller ones) made losses in 2001, compared with 28% in 2000 and only around 15% in the early 1990s. Even when weighted by sales, operating profit margins still fell at all points of the distribution (Chart 129).

### Corporate sector adjustment and balance sheet ratios

There are signs that the falls in profitability and increased gearing of recent years have induced adjustments on the part of some companies, designed to strengthen balance sheets<sup>40</sup>. Dividend payments, capital expenditure, inventories and M&A activity (including foreign direct investment) all declined significantly in 2001 Q4, helping to reduce the PNFC financial deficit to 1.3% of GDP from 1.9% of GDP in Q3 (Chart 126). Company accounts reveal that the proportion of companies not paying a dividend in 2001 rose to an historical high of 38% (Chart 130). Although most of these companies have never paid a dividend, the proportion (14%) that have previously paid a dividend – possibly a more significant indicator of balance sheet adjustment – was close to the peaks in the early 1980s and 1990s.

Notwithstanding these adjustments, PNFCs' capital gearing increased further in 2001 H2. Indebtedness relative to the capital stock measured at replacement cost is at a 30-year high, while gearing relative to capital measured at current market valuations has reached the levels of the early 1990s, although it fell back slightly in Q4 (Chart 131).

Other indicators, however, paint a stronger picture. Liquidity has risen a little on most measures (Chart 132). Income gearing remains modest and, reflecting official interest rate reductions, fell during 2001 Q4 (Chart 131). Evidence from company accounts data suggests that the income gearing of the quartile of profitable companies with the highest income gearing remains well below the levels during the recessions of the early 1980s and early 1990s, although it rose somewhat in 2001 (Chart 133).

39: Data for 2001 are based on a sample of some 1,202 quoted companies that have thus far reported results for the year to end-2001.

40: See the Box on page 90 of the December *Review* for an account of the ways in which companies may adjust their balance sheets in the face of adverse developments.

### Defaults and insolvency risk

Any build-up of pressure on individual companies is not evident in corporate sector defaults. If anything, given the slowdown in GDP growth and debt increases over recent years, the aggregate rate of corporate liquidations has remained surprisingly low over the past two years – perhaps reflecting low income gearing<sup>41</sup>. But administrations rose significantly towards the end of last year, which may herald some increase in corporate liquidations later this year. This is also suggested by the April 2002 Euler Trade Indemnity survey, which indicated that bad debts rose in 2002 Q1, with policyholder claims climbing to an eight-year high. According to industry contacts, there has been some continued tightening in trade credit insurance terms and conditions, reflecting concerns over rising credit risk and increased premium rates charged by reinsurers after 11 September (see Section VI). Data from Dun and Bradstreet showed a rise of 9.5% in total business failures (including unincorporated businesses) in Q1, although the rate of company insolvency recorded in the DTI statistics (covering only incorporated companies) remained unchanged.

Company accounts data show that just under 6% of the most heavily geared UK companies also recorded low profitability and low liquidity in 2001, slightly higher than in 2000 but around half the percentage in 1999<sup>42</sup>. These disaggregated statistics suggest that there is a small subset of companies that face rather higher risks of failure than may be apparent from the aggregate indicators.

### Sectoral developments

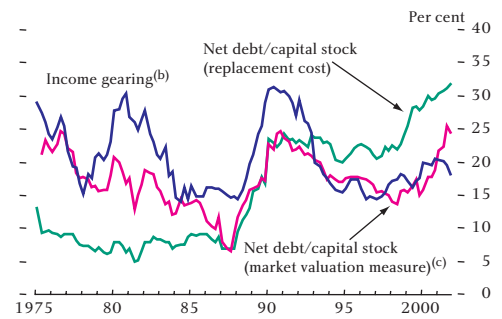
The more vulnerable companies tend to be concentrated in particular sectors of the economy. The manufacturing sector has been under substantial pressure given the slowdown in the world economy and sterling's earlier strength against the euro. Signs of adjustment have been especially marked in this sector; indeed, manufacturing companies have made net repayments to UK-resident banks in each of the past six quarters.

TMT companies have also exhibited continuing weakness, reflected in a particularly sharp fall in output in the electrical/optical and information, communication and technology (ICT) sectors (19% in the year to April 2002). The more established UK telecoms operators have sought to restructure their balance sheets, but the resulting cutbacks in capital expenditure have put further pressure on smaller telecoms firms, such as Marconi, Colt Telecom and Telewest.

41: See the article by Gertjan Vlieghe, 'Corporate Liquidations in the UK', in the June 2001 *Financial Stability Review*; and the Box on page 71 of the December 2000 *Review*.

42: For the purposes of this comparison, the most heavily geared companies are defined as those in the top quintile of companies ranked by capital gearing at replacement cost; and the least profitable and least liquid firms are defined as those in the bottom quintiles of firms ranked by operating profit margin and cash ratio respectively.

**Chart 131:**  
**PNFCs' capital and income gearing<sup>(a)</sup>**



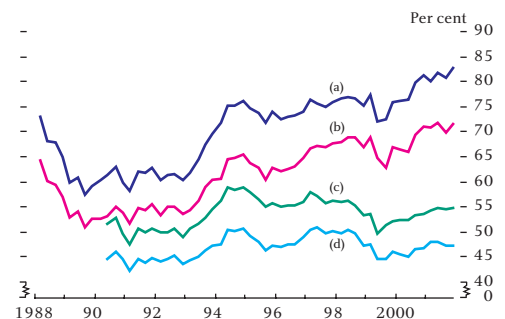
Sources: ONS and Bank of England.

(a) Data are seasonally adjusted.

(b) Interest payments divided by pre-tax profits.

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

**Chart 132:**  
**PNFC liquidity**



Sources: ONS and Bank calculations.

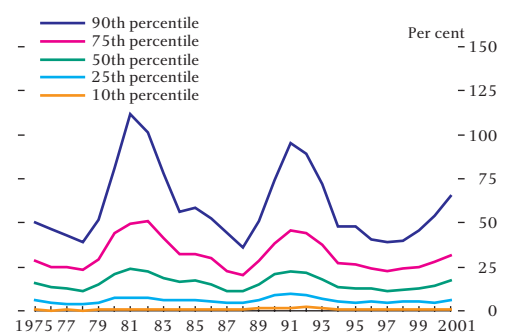
(a) Defined as all currency deposits, money market instruments (MMIs) and bond assets held, divided by all currency short-term bank and building society borrowing and MMIs issued.

(b) As (a) excluding holdings of MMIs and bonds.

(c) As (a) including bond liabilities.

(d) As (b) including bond liabilities.

**Chart 133:**  
**Distribution of income gearing of quoted PNFCs<sup>(a)(b)</sup>**

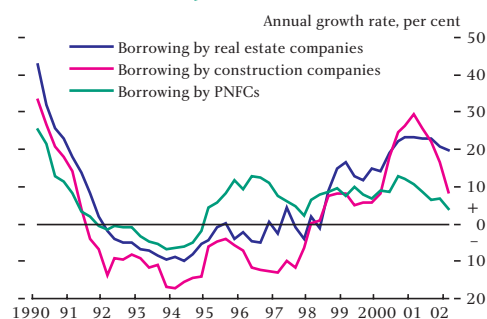


Sources: Thomson Financial Datastream and Bank calculations.

(a) 2001 data are based on 1,202 accounts.

(b) Income gearing calculated for profit-making firms only.

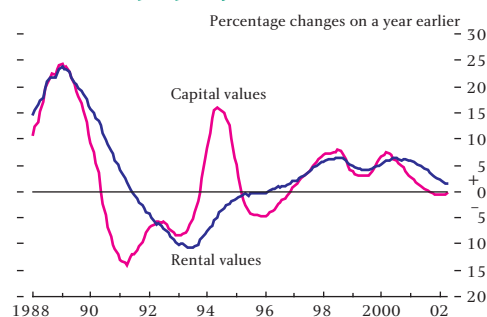
**Chart 134:**  
**Bank borrowing by real estate companies, construction companies and PNFCs<sup>(a)</sup>**



Source: Bank of England.

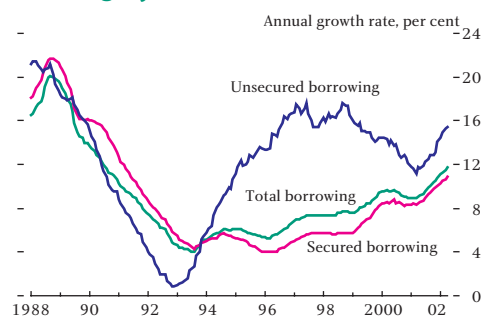
(a) Borrowing by PNFCs includes banks' holdings of securities, but borrowing by real estate and construction companies does not.

**Chart 135:**  
**Capital values and rental values in the commercial property market**



Source: Investment Property Databank.

**Chart 136:**  
**Borrowing by individuals<sup>(a)</sup>**



Source: Bank of England.

(a) Data are seasonally adjusted.

Bond spreads of telecoms firms have accordingly risen further since the December Review, and over half of rating downgrades in 2002 to date (some 18 in total) involved these companies.

### Commercial property

The other main source of risk in the corporate sector remains the commercial property market. Bank lending to real estate companies, most of which is for commercial property, grew at around 20% per annum or more in each of the seven quarters to 2002 Q1 (Chart 134), a period when growth of capital and rental values has been falling (Chart 135).

Discussions at the Bank's Property Forum<sup>43</sup> tentatively suggest that part of the increased bank borrowing may have been for refurbishment or conversion, rather than new development. Recent survey evidence suggests that lending is predominantly for investment property, rather than development, purposes<sup>44</sup>. Refinancing arrangements in support of sale and leaseback transactions, which transfer debt to property investment companies from other parts of the corporate sector, have also been common. A preference for debt rather than equity finance has been manifested in the number of leveraged public-to-private deals. This continues a longer-term trend – the number of quoted property companies has fallen from around 130 to just over 70 over the past decade. Those that remain generally trade at a significant discount to net asset value, so debt is often their only realistic source of capital. Taking into account lending by non-bank financial institutions and securitised debt, DTZ Research<sup>45</sup> estimates that total debt outstanding to the commercial property sector was £105 billion at the beginning of 2002, well above the peak of the early 1990s in both nominal and real terms. But there is little sign as yet of any material increase in property-related defaults by borrowers or losses for banks (see Section VIII).

### Pension obligations

In addition to coping with a period of weaker demand and output growth, many companies have also been affected by low asset returns – particularly on equity – given their defined benefit pension obligations to past and current employees. For companies whose market capitalisation has shrunk over the years, this can be a material issue, particularly if in the past they had a large workforce and thus guarantee the obligations to be met from a large pension fund. While much of the public debate has centred on FRS 17, Box 8 explores the nature of – and downside risks from – financial contracts represented by defined

43: For background on the Property Forum, see the Box on page 72 of the November 1999 Review.

44: Discussed in 'The UK Commercial Property Lending Market 2001: Research Findings', De Montfort University, May 2002.

45: DTZ Research, 'Bank lending to UK Property Companies, 2002 Q1'.

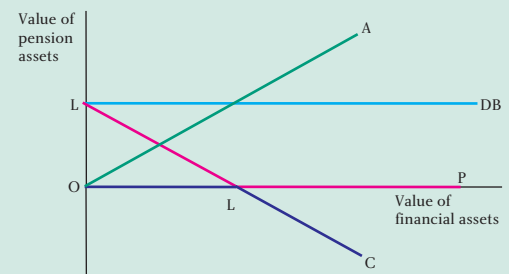
## Box 8: The risk in company-sponsored defined benefit pension schemes

Defined benefit (DB) pension schemes promise to pay members guaranteed pensions based typically on final salary and years of service. Such obligations are met out of pension funds invested in a range of assets, with the sponsoring company making up any shortfall in the fund. The risks to the sponsoring company include the possibility that pensioners will live longer than expected and that asset returns will prove inadequate. The main risk to the members is that, in those circumstances, the sponsoring company will also be unable to meet its obligations in full. The downside and upside risks to the corporate sponsor can be analysed in terms of long maturity options<sup>1</sup>.

Suppose that the present value of the scheme's liabilities is known for certain ( $L$ ) but that the financial assets are uncertain. The value of the liabilities is, then, independent of the scheme's assets and is illustrated in Chart A by the horizontal blue line. The value of the assets is shown by the upward sloping green line ( $OA$ ). If the value of the fund turns out to be greater than  $L$ , the employer keeps the excess value in the same way as if it had purchased a call option from the employees at strike price  $L$ . If the value of the fund turns out to be less than  $L$ , the employer is obliged to make up the difference as if it had written a put option purchased by the employee with strike price  $L$ . Thus the DB pension can be seen as being made up of the underlying assets of the fund plus a put option written by the employer and a call option written by the employee.

One way of broadly assessing the risks in DB pension schemes is to value these implicit options. By way of illustration, the standard Black-Scholes option pricing formula is used here to value the implicit put option in a set of stylised DB schemes of varying maturity and risk where the present values of the assets and liabilities of the fund are equal to £100 (Table A). The table demonstrates that the downside risk to a sponsor – and, hence, the cost of purchasing an option that would cover that risk – increases with the duration of the guaranteed return and with the volatility of the assets in the fund. By the same token, a sponsor's upside risk – the value of the implicit call option – increases with the same factors. The main point of the analysis is that DB schemes involve very long maturity optionality. The debate around FRS 17 is about how to reflect the expected value of pension schemes in company accounts, but not about the upside and downside risks on which this Box focuses.

**Chart A:**  
The option composition of a defined benefit scheme<sup>(a)</sup>



Source: Blake, D. (1998).

(a) The figure shows how the guaranteed return on a DB pension scheme (LDB) could be replicated by holding the underlying assets of the scheme ( $OA$ ), plus a put option at strike price  $L$  (LLP), less a call option written at the same strike price (OLC).

**Table A:**  
Value of the put option for different portfolios and maturities<sup>(a)(b)</sup>

Proportion in equity (Per cent)	Time to maturity (years)							
	1	2	5	10	15	20	25	30
100	8.0	11.3	17.7	24.8	30.2	34.5	38.3	41.6
75	6.0	8.4	13.3	18.6	22.6	25.9	28.7	31.2
50	4.0	5.6	8.9	12.4	15.1	17.3	19.2	20.8
25	2.0	2.8	4.4	6.2	7.5	8.6	9.6	10.4
5	0.4	0.6	0.9	1.2	1.5	1.7	1.9	2.1

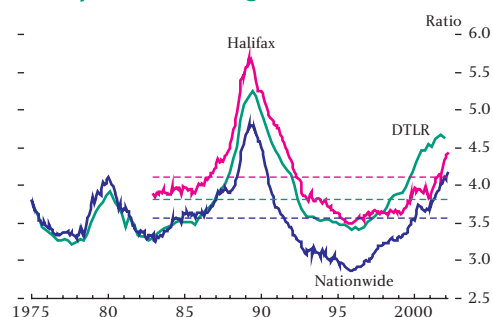
Source: Bank calculations.

(a) For these calculations; Black-Scholes pricing equations have been used (see Hull, JC (2000) "Options, Futures & Other Derivatives", Prentice-Hall Inc.).

(b) The gilt yield curve is used to obtain the risk-free rates for each maturity and a volatility of 20% is assumed for equity (this is the historical volatility of UK one-year equity returns over the past 100 years).

1: See Blake, D. (1998) 'Pension Schemes as Options on Pension Fund Assets: Implications for Pension Fund Management' *Insurance: Mathematics and Economics* 23, pp 263-86.

**Chart 137:**  
House price-to-earnings ratio<sup>(a)(b)</sup>

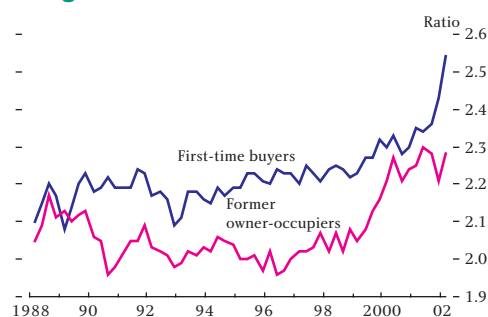


Sources: Nationwide, DTLR, Halifax, ONS and Bank calculations.

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

(b) Dashed lines indicate the respective averages from the start of each series.

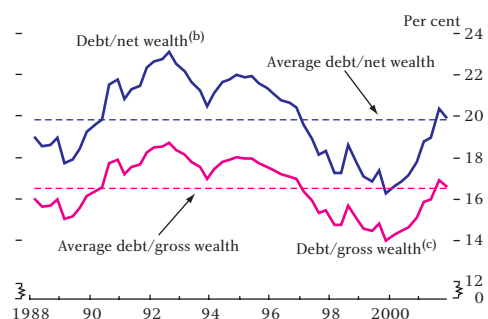
**Chart 138:**  
Average advance-to-income ratio<sup>(a)</sup>



Source: Council of Mortgage Lenders.

(a) Data prior to 1992 are for building societies; thereafter they include all lenders.

**Chart 139:**  
Household sector capital gearing<sup>(a)</sup>



Sources: ONS and Bank of England.

(a) Averages 1988 Q1 – 2001 Q4.

(b) Total liabilities as a percentage of the sum of net financial assets and housing wealth.

(c) Total liabilities as a percentage of the sum of total financial assets and housing wealth.

benefit pension commitments. The risk in banks' corporate sector loan portfolios may be affected if those companies already under financial pressure were, following unexpectedly adverse asset price returns and extended pensioner longevity, to face large deficits on their pension schemes. In a sample of 57 FTSE-100 companies that have so far produced data on net liabilities under FRS 17 assumptions, a majority of firms had pension fund deficits at their most recent reporting date. But for two-thirds of them the deficit was less than 10% of pension fund assets and less than 2% of market capitalisation. As discussed in Section II, there have been similar developments in the USA.

## The household sector

Notwithstanding unusually rapid income growth last year (just over 5%), the household debt-to-income ratio was at a record level (1.183) at end-December (Chart 127). Since then, borrowing has continued to accelerate, reaching an annual growth rate of 12% in April, the fastest for over 11 years (Chart 136). Robust mortgage borrowing has been associated with the strength of real disposable incomes, intense competition between lenders, low official interest rates, and a rapid increase of house prices. Both the Halifax and Nationwide measures of house prices rose by around 18% in the year to May. House price-earnings ratios have risen rapidly over the past five years on all three of the main measures, and are now well above their historical averages, if still in varying degrees below their 1989 peaks (Chart 137). Loan-to-income ratios for first-time buyers (but not former owner-occupiers) have increased substantially over the past two years, and are now at an historically high level (Chart 138). The distribution shows a significant rise in the proportion of both first-time buyers and former owner-occupiers with high income multiples (above three): from 23.0% and 24.4% respectively in 2001 Q1 to 33.3% and 29.2% in 2002 Q1. Average loan-to-value ratios, by contrast, have risen only slightly recently, following falls between 1995 and 2001 (see Section VIII).

Remortgaging activity has increased as borrowers have taken advantage of discounts and lower fixed rates available from lenders. This has facilitated mortgage equity withdrawal, which reached 4% of personal income in 2001 Q4, compared with a peak of 8.5% in 1988 Q3. Buy-to-let market borrowing has also grown robustly, although it still represents only a very small proportion of the total mortgage market – around 2.5% in 2001 H2 according to the Council of Mortgage Lenders.

Unsecured borrowing rose by around 15% in the year to April (Chart 136), and now accounts for just under 20% of total household debt, compared with around 16% in 1990. The recent renewed acceleration of unsecured borrowing may have been driven partly by competitive conditions – credit card rates have fallen relative to the repo rate since December, and more UK

lenders have expanded into the so-called 'near-prime' sector (see Section VIII).

#### Balance sheet robustness

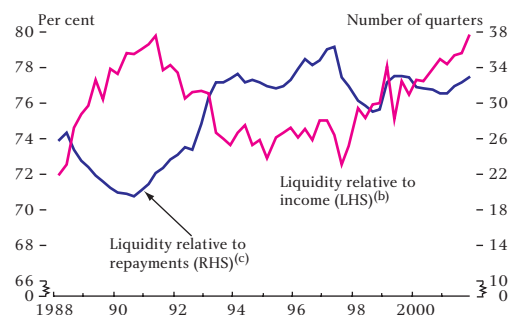
At an aggregate level, household debt is not, however, historically high relative to wealth (Chart 139), in part due to the rise in house prices. Income gearing ratios have fallen further since the *December Review*, and remain well below the peaks of the early 1990s (Chart A in Box 9). This reflects the combination of low nominal interest rates and buoyant household incomes. As discussed in Box 9, however, interpreting these data is not straightforward.

Modest income gearing ratios suggest that the household sector is not under immediate pressure. Given the macroeconomic conditions envisaged in the *May Inflation Report*, this is most likely to continue to be the case. But risks have increased since the *December Review*. With higher debt outstanding, households are now potentially more vulnerable to two types of risk: sharp falls in real incomes associated with any material deterioration in labour market conditions; or an unexpectedly large rise in interest rates. Adjustment to these risks, should they crystallise, could be made more difficult if they were accompanied by sharp falls in wealth, reflecting any marked correction in either or both house or equity prices (see above and Section VI respectively).

Any necessary adjustment would be eased if households have built up a cushion of savings, particularly of liquid assets. Holdings of liquid assets have, in fact, risen in recent years relative to disposable income and are well above the levels of the early 1990s relative to regular debt-servicing commitments<sup>46</sup> (Chart 140). Household bank deposits have for a while been rising rapidly: nearly 8<sup>1</sup>/<sub>2</sub>% in the year to April 2002, partly reflecting equity market uncertainty and weak unit trust sales.

Overall, the household sector was in rough financial balance in 2001 H2. There is an interesting contrast with 1989/90, when the household sector as a whole returned to financial balance after a period of net deficit. Whereas in the early 1990s households cut spending and the elimination of the deficit was associated with a reduction in borrowing growth, the current position is characterised by households still borrowing heavily but, in aggregate, accumulating financial assets (Chart 141). Aggregate data cannot reveal whether the heavily borrowing households are the same as those acquiring liquid assets – for example for precautionary motives, or because of equity market uncertainty, as discussed above. This underlines the importance of disaggregated analysis, given that the risks associated with the

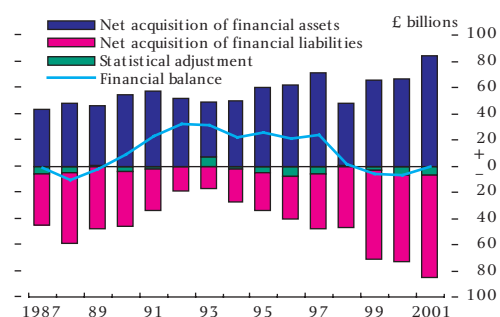
**Chart 140:**  
**Household M4 liquidity measures<sup>(a)</sup>**



Source: ONS and Bank of England.

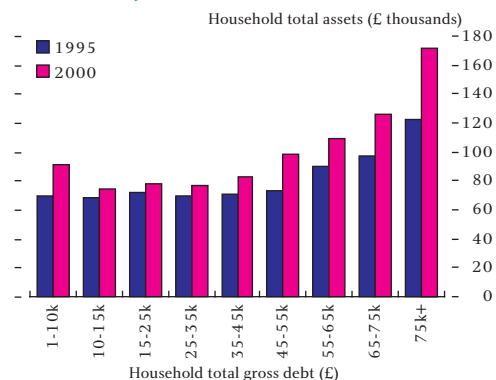
- (a) Liquid assets are defined as household M4 holdings.
- (b) Liquid assets divided by household disposable income.
- (c) Liquid assets divided by quarterly interest payments and regular mortgage principal repayments.

**Chart 141:**  
**Household balance sheet flows**



Sources: ONS and Bank.

**Chart 142:**  
**Average total assets at different levels of household indebtedness (mortgage holders only)**

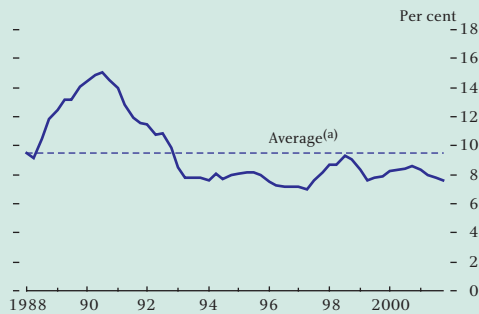


Sources: BHPS and Bank calculations.

<sup>46</sup> Regular commitments are defined here as debt interest payments plus regular mortgage principal repayments (excluding regular payments into endowment mortgage policies, which are allocated to savings in the national accounts).

## Box 9: Measures of household sector income gearing

**Chart A:**  
**Household sector income gearing<sup>(a)</sup>**

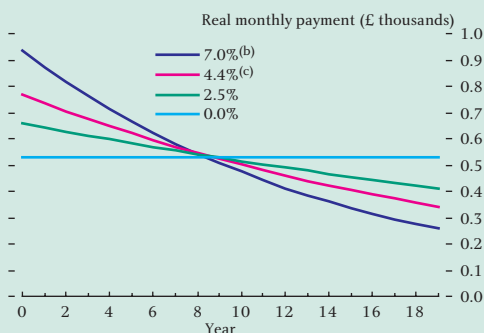


Source: ONS.

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

(b) Average 1988 Q1 – 2001 Q4.

**Chart B:**  
**Real value of monthly mortgage payments under different assumptions about inflation<sup>(a)</sup>**



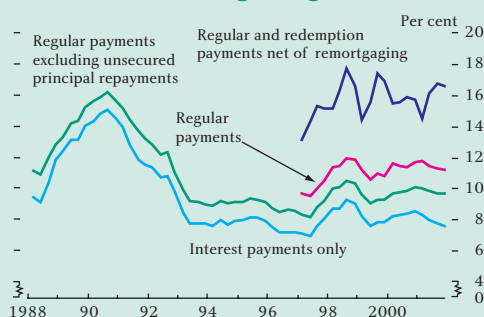
Sources: ONS and Bank calculations.

(a) Repayments of a £100,000 loan at a 2.5% real mortgage rate over 20 years.

(b) Average inflation rate 1980 – 89.

(c) Average inflation rate 1990 – 97 Q1.

**Chart C:**  
**Measures of income gearing**



Sources: ONS, NOP Financial Research Survey and Bank calculations.

The standard measure of household sector income gearing (Chart A) has two main limitations. First, it does not capture the sensitivity of the time profile of the *real* debt-servicing burden to different inflation regimes. Chart B illustrates the difference in the annual profile of *real* mortgage repayments for a hypothetical mortgage, at a given real interest rate, under different assumptions about inflation. Under the current low inflation environment, the initial burden of servicing a mortgage is lower than during past periods of high inflation. But, other things being equal, it will not fall away to the same extent. That might encourage more loan demand, while creating uncertainty about any longer-term risks.

Second, the standard measure of income gearing excludes repayments of principal. Adjustments might be made for three kinds of mortgage principal repayment: regular repayments on capital repayment mortgages<sup>1</sup>; redemption repayments; and lump-sum repayments. Data are available on regular principal repayments on building society mortgages back to 1987. The corresponding series for bank mortgages is available from only 1997 Q4, but can be extended back by making crude assumptions about the proportion of principal repayments in total secured loans extended by banks. The Financial Research Survey can be used to calculate regular principal repayments on unsecured debt<sup>2</sup>, albeit only from 1997. These adjustments raise income gearing by up to four percentage points, although the profile over time appears little changed (the red line in Chart C).

There is less justification for including lump-sum and redemption principal repayments. The former are typically made voluntarily by households with sufficient resources to pay down mortgages early. The latter are typically made on expiry of a mortgage, but will also include voluntary terminations of mortgages that form part of remortgaging activity. But other redemption repayments – for example shortfalls on endowment mortgages – represent an obligation on households and arguably could be included in a measure of income gearing. It is possible to derive an adjusted series for mortgage redemption repayments by deducting the proportion attributable to remortgaging the same property, using data (from 1993 only) available from the Council of Mortgage Lenders. When added to the adjusted measure of income gearing, the resulting series (the dark blue line in Chart C) shows no particular trend since 1997, but was more than twice the level of the standard measure in 2001 Q4.

1: Regular contributions to endowment policies should also be included, but these are treated as saving in the national accounts.

2: This excludes credit card principal repayments, which are difficult to identify.

rapid growth of debt may be lower if it is concentrated among higher-wealth or higher-income households.

#### Disaggregated data

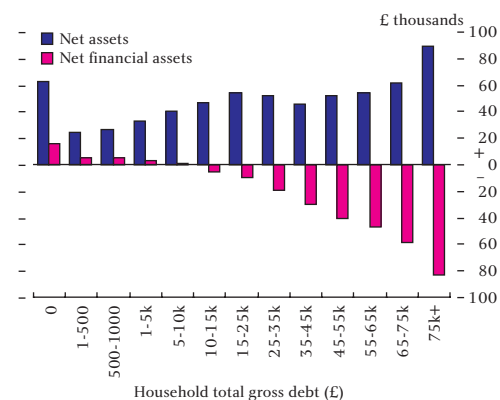
Evidence from the latest (2000) British Household Panel Survey (BHPS)<sup>47</sup> suggests that debt may, in fact, be concentrated among such households. For mortgage holders, the most indebted surveyed households (by gross liabilities) had the highest levels of gross assets in 2000 (Chart 142). The role of housing is very significant in interpreting these data. Although the most indebted households also had the highest levels of net assets in 2000, they had the highest levels of net financial liabilities as well (Chart 143). At the level of house prices prevailing in 2000, positive net housing equity more than offset total debt for most households.

A second, suggestive, BHPS finding is that debt-income ratios were highest and, from 1995 to 2000, grew most rapidly among the lowest-income (and youngest) of mortgage-holding households (Table 6). These households also accumulated unsecured debt most rapidly. Furthermore, unsecured debt rose substantially in relation to incomes for nearly all household income groups (Table 7). On the face of it, the proportionately greater build-up of debt by the lowest-income and youngest age groups might increase risks to the household sector, given that BHPS data also indicate that these households are more vulnerable to financial shocks and spells of unemployment.

#### Arrears and defaults

With capital and income gearing close to or below post-1988 average levels, there is little sign of any imminent risk of a significant increase in defaults by the household sector. Mortgage arrears have continued to fall and personal bankruptcies remain stable, reflecting low unemployment, low official interest rates and buoyant incomes. Judging from past patterns, any financing pressures would be likely to show up initially in the unsecured debt and especially credit card markets. Credit card arrears and write-offs have been rising since 1995 (Chart 158, Section VIII), possibly owing something to increased credit card penetration among lower-income households. But there is little sign in the recent past of any substantial pick up in the rate of increase of credit card defaults.

**Chart 143:**  
Average net assets at different levels of household indebtedness in 2000



Sources: BHPS and Bank calculations.

**Table 6:**  
Household debt as a percentage of household income, for mortgage holders only

	1995	2000	Percentage change
<b>Household income (£)</b>			
Up to 11,499	334.5	426.5	27.5
11,500 – 17,499	208.8	200.0	-4.2
17,500 – 24,999	156.2	182.3	16.7
25,000 – 34,999	132.6	145.5	9.7
35,000 – 49,999	119.8	128.4	7.2
50,000 +	105.3	106.5	1.1
<b>Age of household head</b>			
16 – 20	170.0	239.1	40.6
21 – 24	190.2	181.8	-4.4
25 – 34	171.5	171.5	0.0
35 – 44	143.1	151.6	5.9
45 – 54	110.7	102.5	-7.4
55 – 64	85.7	92.6	8.1
65 +	83.3	102.3	22.8

Sources: BHPS and Bank calculations.

**Table 7:**  
Household unsecured debt as a percentage of household income

	1995	2000	Percentage change
<b>Household income (£)</b>			
Up to 11,499	4.8	9.6	100.0
11,500 – 17,499	6.9	7.7	11.6
17,500 – 24,999	7.7	10.7	39.0
25,000 – 34,999	7.5	10.6	41.3
35,000 – 49,999	6.5	10.5	61.5
50,000 +	5.0	7.5	50.0
<b>Age of household head</b>			
16 – 20	9.8	33.7	243.9
21 – 24	12.9	20.8	61.2
25 – 34	8.7	13.8	58.6
35 – 44	7.3	11.1	52.1
45 – 54	6.4	8.1	26.6
55 – 64	4.3	5.7	32.6
65 +	1.3	2.0	53.8

Sources: BHPS and Bank calculations.

47: The BHPS is an annual survey of households in Britain, conducted since 1991. The sample design is based on a nationally representative sample of adult members in around 5,500 households in 1991. The original sample members are re-surveyed each year.