Personal saving and borrowing

*The **Governor** comments[1] on some of the factors that have contributed to the rapid growth in personal borrowing in recent years and considers the impact of the credit boom on the prudential position of the banks and its macroeconomic and social effects. He suggests that it is the social issue that is the main present concern and stresses the importance of preventative measures, particularly public education of borrowers and responsible advertising and proper circumspection on the part of lenders.*

It is a very great pleasure to be here this evening to celebrate your Association's 10th Anniversary. When the Association was formed there were just 15 organisations in London eligible to join it, whereas I am told that you now have over 40 members. This must surely reflect well on your Association, and I hope it also says something about the benefits of London as a place to do business.

Since this is a gathering of the savings industry, I thought I would say something about borrowing! In fact this is not too perverse since savings banks, while special in many respects, do after all share with all banks the common function of finding employment for idle money.

There are essentially only three things they can do with that money—lend it to Government, to corporations, or to individuals. That leaves you all plenty of scope, and precisely what business you undertake depends on the regulatory environment you work in and on customer behaviour. Neither is ever fixed, and in fact both have been changing rapidly in recent years, certainly here in the United Kingdom.

Historically, many savings institutions, whether by convention or by law, tended to employ their assets in liquid or high quality securities—Government bonds, for example. But over the past ten years we in the United Kingdom have been lifting restrictions of this kind; so that, for example, the TSB movement is now a fully fledged bank, although it has maintained its emphasis on retail business. Also, and perhaps more importantly, the trend in all of our monetary control arrangements has been to move away from directions and controls—quantitative or qualitative.

I have few regrets about this policy in so far as it has spurred innovation and competition, increased consumer choice, and ended what amounted to *de facto* rationing of personal credit. But it has had some quite startling effects.

It has clearly been a factor in the rapid and massive growth in personal borrowing. Over the past ten years—which it just so happens is the life-span of your Association!—the net savings of the personal sector in this country—that is gross savings less borrowing—have fallen from 13% to 5% as a proportion of disposable income.

Again, ten years ago, the amount of consumer credit outstanding was equivalent to 3½ weeks' total post-tax income; now it is equal to more than 7 weeks' income. And as we all know, mortgage debt has grown even faster.

This is, I would suggest, both a symptom and a cause of a wider cultural change in our society. Thrift has gone out of fashion. Indeed, the all too prevalent outlook on life has become 'I want it, and I want it *now*'.

We in the Bank of England have therefore asked ourselves three broad questions about the credit boom, concerning its impact on the prudential position of our banks, and its macroeconomic and social effects.

So far as the banks are concerned, I do not think the credit boom has created a prudential problem—though banks do tend to rush into new areas rather vigorously and all at the same time. And they do need to watch their exposure to the personal sector just as they watch any other exposure. But we think they are aware of that, and have taken steps in recent years to improve their capacity to lend in this area without acting imprudently, and to identify and address early signs of difficulty. Nevertheless, they must temper their natural enthusiasm when conditions become more buoyant again.

Nor do I think that there is a macroeconomic problem that current policies and instruments are not equipped to deal with. Plainly the credit boom had considerable and undesirable effects, but we have responded decisively, and in the most appropriate way. I do not want to go into this in depth tonight—I can almost hear the sighs of relief!—but I will just say that high interest rates address directly the 'I want it *now*' problem, since they raise the cost of current consumption relative to consumption in the future.

(1) In a speech at the 10th Anniversary Dinner of the Association of International Savings Banks, in London, on 14 June.

So the main concern, I would suggest, is a social one. Some people are undoubtedly in difficult situations. Very often arrears mount just when borrowers are least able to cope with the situation—they feel vulnerable and confused. Not only will repayments on loans be missed, but so will bills for rent, gas, electricity, telephones, and so on. The distress suffered by individuals and their families is obviously a matter of concern for all of us, whether or not we are directly affected.

Where a problem has already developed, the key is nearly always early and realistic dialogue between all concerned.

But we must also examine possible preventative measures. One reason these problems develop is that some people have not, I am afraid, been fully prepared for the responsibilities and choices that go with greater credit availability. Inevitably, some have made mistakes and, sadly, are suffering because of them. These individuals do not make a proper assessment of whether they can afford the repayments or understand how compound interest works.

There will of course always be those who are unable to pay their debts and we cannot reasonably expect miracle cures. But a good deal can, I hope and believe, be achieved by public education. The OFT has made a tremendous contribution with its publications on consumer credit, as have the Money Advice Centres and Citizens Advice Bureaux in dealing with individual cases of hardship and difficulty.

As for lenders, who *do* understand the risks to themselves and to individuals, they must market their products responsibly. Lenders, understandably, tend to reject these strictures but I have to say that, in the Bank's view, credit advertising over the past few years has risked damaging the reputation of lenders in the United Kingdom, whatever their size or standing.

Lenders have to recognise that their reputations for probity and fair dealing, for decency and restraint are important, and do count in the market of public opinion.

So it must be wise—I put it no stronger than that—for lenders to exercise some circumspection in a market where even a few cases of unpleasantness can rebound against them. This means, I suggest, a responsible approach to advertising credit, focusing on providing clear information rather than dramatic incentives, on calculation rather than consumption. Second, it means rigorous credit assessment that covers not just the statistical risk of loss but the likelihood of the customer damaging his own interests. Finally, when difficulties do occur, a sensitive and intelligent approach to individual problems is extremely important.

These two elements: education and responsible advertising come together of course. It is in neither party's interest for a lender to make a loan which the borrower cannot repay. The best form of credit scoring is, therefore, the one which leads the potential borrower to recognise the dangers in advance and to 'reject himself' as it were, by not applying for a loan. It is accordingly in the interests of all *responsible* lenders to make as much information as possible available to their customers in a form which enables customers fully to recognise its implications for their family's position, and in particular recognise that in a world of variable interest rates repayment obligations can increase. And for this to work, the customer must understand what he or she is being told.

I think that the tone and content of some credit advertising has greatly improved.

But it is clear that payment difficulties for individuals are a greater problem now than they were a year ago, and lenders still need to exercise restraint and caution.

The other side of the coin is, of course, saving, and let me therefore turn to the other side of your business; increasing saving is just as important as ensuring prudent lending and borrowing.

This is not just true in a narrow domestic context. Given the prospective increase in the demand for capital brought about by the changes in Central and Eastern Europe, a return to a climate of thrift would bring considerable benefits throughout the world, and specifically might allow investment in the reforming economies to be funded at lower real interest rates.

Your savings movement has a strong historical association with thrift.

The fiscal background also makes a difference of course. And I therefore greatly welcomed the recently improved national savings terms and the earlier Budget measures designed to open up more possibilities for the encouragement of saving. Again, savings institutions can play a vital role as intermediaries in the various new schemes on offer. There will be no overnight miracle, but a more favourable climate has been created.

Specifically, I hope that financial institutions will put the same effort into advertising and marketing savings products as they have into advertising the availability of credit.

Over the past ten years people have adjusted to greater freedom in the lending market. The banks have participated fully—perhaps too fully—in that process. Now let me urge them to help people adjust equally to the new opportunities in the savings market.