

## DEBT BURDEN

# Crippled by the weight of debt

The UK – currently staggering under the weight of household debt – is teetering on the edge of financial disaster

**N**OT one but two major clearing banks – HSBC and Barclays – have now sounded a warning over domestic credit in recent days.

The Chancellor might like to reflect that, misquoting Wilde, to receive one credit warning may be considered a misfortune, to receive two looks distinctly like carelessness.

We are long used to the quantity of debt that has been racked up by the British consumer in keeping our retail growth-led economy fizzing, some £20,000 for every man, woman and child in the UK. But a new doubt is overshadowing the boom, concerns over its quality.

The trouble with trillions of anything is that one loses one's sense of absolute and comparative magnitude – a bit like Charlie in the Chocolate Factory.

The disorientation is aggravated where reference is made at random to closely related currencies – yen, dollars, euros and pounds – when papers, professions, professors and peers comment freely and frequently about all or any, causing a mental merger-effect that blurs the absolute and relative values more than ever.

Stop and consider the implications of our indebtedness as it affects our own wallet, our own bank, our own economy and our own destiny.

The banks' comments embrace lending and exposure to debt overall but UK household debt is ostensibly the most precariously positioned, and the field which is least well analysed, chronicled and understood.

## DEBT IN PERSPECTIVE

Our cumulative household debt is very close to the GDP of Brazil – and one-third as much again as that of France, or of Russia.

Believe it or not, it is rather more than total US state and local government sector debt, currently standing at \$1.7 trillion. Worrying, then?

To put it in (frightening) perspective, our private individual debt tally stands 10 per cent over the GDP of Bermuda – and even that, the highest in the world, is wildly distorted, like the equivalent figures for Monaco, Luxembourg, Liechtenstein and Panama, by the impact of offshore finance on so-called earnings.

It is 30 per cent over the GDP of a head of Belgium, Germany and Finland. What about the US equivalent? Well, US household debt currently stands at a 5 per cent discount to our own: \$35,000, compared with our \$37,000. And US financial sector domestic debt weighs in just over our total domestic debt equivalent at \$40,000 a head.

So much for the quantities. The smouldering word of warning, quality, suggests precisely that which inevitably follows a period of aggressive debt expansion, be it on the level of sovereign states, corporations or individuals.



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All practitioners understand the theory of cyclicalities and boom-and-bust, but the insidious truth is that the passing of time between like-for-like cyclical stages and the ambush-effect of downturns and backlashes are such that a lesson learned unfortunately simply does

not lead on to adequate precautions, let alone abstinence, next time round.

We need to recognise and address a perilous tendency as well as an impending predicament which may well hit us in the face tomorrow and bowl us over next week.

Excess plus optimism has hit cyclical economic and political change, with an effect not dissimilar to an irresistible force meeting immovable object.

## DRIVERS FOR DISASTER

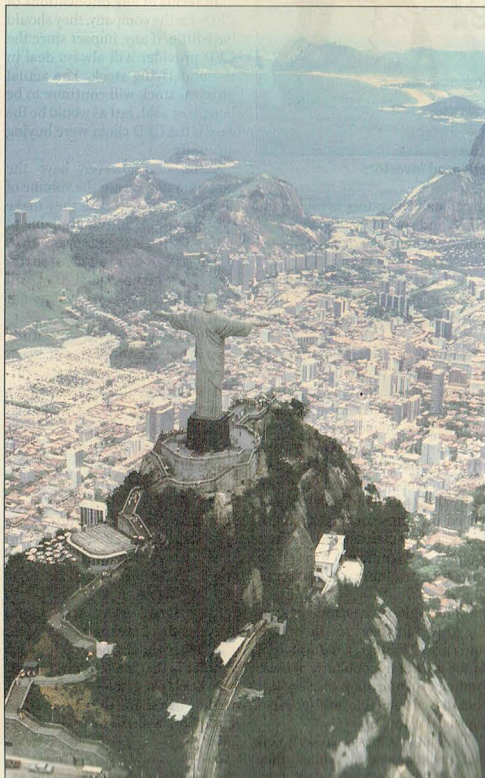
The uneasy combined effects of overdrafts, bank loans and mortgages, often two or more (and no,

these three forms of debt are not one and the same thing); HP contracts and instalment-based purchasing, store, credit and debit cards have collided with the following: minimal, often insufficient, repayments; stagnating house prices conjuring up diminishing prospects of paying off debt from equity release; higher direct and stealth taxes; little or no pension protection and endowment prospects; wobbly Isas; uncertain employment and earnings prospects; and easier access to and exit from the shelter of personal bankruptcy. All conspired to make HSBC tell the uneasy truth.

If the household savings ratio and asset base were to look different, the outlook would be less bleak – but our true savings rate and even net levels of savings may actually be negative at present.

Housing, our only truly negotiable, growth asset form, is approaching the brinks, respectively, of zero net value after repeated remortgaging, and even, perhaps, of negative equity.

Buy-to-let mortgage borrowers are unintentionally fibbing when they say what a lot of money they make: offset their real costs, the interest, depreciation, advertising costs, legal fees, absconder and



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default wastage, maintenance, agency fees, void impacts and tax, and Bob is not your uncle, after all.

Consumers are already hesitating rather than going shopping for unnecessaries every Saturday afternoon, and the retail sector – even the supermarkets, except perhaps Tesco – are slowing to imperceptible or negative growth rates.

Now that the punters are feeling the pinch of even steady levels of debt, and let us not forget that APRs are typically around three times the prevailing base rate, they are quietly starting to frown and even panic.

#### DANGERS AND PITFALLS

Debt consolidation, sub-prime and roll-over borrowing, shark loans, bankruptcy – even disappearance – are beginning to show through the fabric of individual lives as well as the banks' wallpaper.

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Having referred earlier to steady levels of debt, let us not forget that much personal debt is far from steady.

Even when the punter stops going shopping, much of the principal he owes is expanding as unpaid interest accrues, late payment penalties are incurred and compound interest kicks in.

It is less useful, of course, for a pathologist just to complete the biopsy than to diagnose the ills, identify the degree of contagion,

estimate the impact of infection and try to prescribe the right remedy. Having laid it bare, what can this cadaver of debt be telling us?

Consider the following bluffer's guide to symptoms, ills, verdicts and cures:

● **Upside:** The best chances of recovery from household debt rely on steady or declining interest rates together with a sensible withdrawal of the consumer from obsessive spending, notably on compulsive home-trading and

make-overs, and designer goods. The impacts of both eventualities on the economy are self-evident.

● **The Bank of England:** Consequently, the approach to rates will be crucial. The government has heavyweight vested interests; there are cases for rates going both ways; behind the scenes, the Bank's independence will be tested. Watch this space.

● **Residential property:** The only dwindling bulls are a few lonely estate agents. Most domestic debtors' fates depend more on a soft landing than on any other single factor. Stagnation more likely than collapse, but it will not all surge back in a hurry. Buy-to-let is another story, but don't hold your breath.

● **Commercial property:** Less relevant to private debtors, but a linchpin to business health and structure overall – so crucial for

#### KEY POINTS

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● Debt consolidation, sub-prime and roll-over borrowing, shark loans, bankruptcy – even disappearance – are beginning to show through the fabric of individual lives

employment, wages, growth and economic prospects. *Hard to deny* the makings of a bubble: lots of bank lending to latecomer developments without prelessees or sufficient equity.

● **Banks:** Big question. Too much lax lending in the household as well as corporate arenas – especially on property. Criteria and hearts likely to harden, but not in time to mitigate the loan portfolio and provisioning backlashes. HSBC, Barclays, Standard Chartered – perhaps even the Royal Bank, if it takes up its China aim again – will be safer bets and havens than the UK-heavy, high street bank names.

● **Retail sector/supermarkets:** Beware. Twitches of life at the malls and out-of-town centres which have banned hoodies and NY baseball caps are no more than that. The April uplift was a quirk, inflated by desperate discounting. Look at Next, Boots, Sainsbury's – Tesco excels; food prices, at least, will stay low.

● **Logo, designer and luxury goods:** Have fashion and appetite profoundly and permanently changed? They say that eBay, online shopping, vintage and second-hand clothing and cyclical taste-effects are battering them. Caution.

● **Equities:** Who has the best crystal ball? Logic, maths and historic analysis suggest modest domestic

returns, at best, ahead – certainly not enough to help bail out household debtors in any way.

● **Independent research:** Independent analysts outline the traditional proprietary analysts and soothsayers when the cards are on the table and the blood trickling across the floor. The investment banks will say what it takes to preserve their businesses; the financial journalists will zig-zag between alarmism and circulation-boosting views; not many commentators will risk gainsaying the government, let alone the chancellor... while the independents will shine: think Capital Economics, KMatrics, Lombard Street Research, EcoWin and Smithers & Co. – they have no reason to gild the lily, suck up to the Treasury, protect the corporates or promote the banks. A good bet if you want to know the truth – but let us not forget Oscar Wilde telling us that the truth is rarely pure and never simple, close though the independents may get to pinning it down.

HSBC is certainly not laughing all the way to – or from – their bank. Far from it, they are relieved that their global business means that the UK proportion is small enough to minimise deterioration in their consolidated accounts.

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Interest rates: the Bank of England's independence is due to be tested