‘Debt Strikes Back’ or ‘The Return of the Regulator’?

Liverpool University Institute of Risk and Uncertainty
24 July 2017

Alex Brazier
Member of the Financial Policy Committee
Annual growth in UK real economy credit and nominal GDP

- Total credit to UK real economy (a)
- Lending to UK real economy from UK MFIs (b)
- Nominal GDP growth rate

Percentage changes on a year earlier


Values: -5, 0, 5, 10, 15, 20
The economic dangers of debt

- High mortgage debt
  - Big spending cut backs

- High level of debt

- High consumer debt
  - More defaults

- Deeper economic downturn

- Cut backs on lending

- Risk of losses at banks
Risks to future growth were growing throughout 2000’s...
Spiral of Complacency

Good economic performance
Low loan losses
Lender optimism bias
Risks priced lower
Credit cheaper
Underwriting standards looser
Debt levels increase
Mortgage debt expands, house prices rise
T&Cs loosen, easier to service consumer debts
Low loan losses. Bias confirmed!
UK household debt high by historic standards

- Household debt to income ratio (of which mortgages)
- Household debt to income ratio (excluding mortgages)
- Total household debt to income ratio

Per cent of income
House prices have risen relative to incomes
Consumer credit growing faster than incomes

Dealership car finance
- Total consumer credit
- Credit card
- Nominal household income growth
- Other (non-credit card and non-dealership car finance)
Stylised PCP deal

- Deposit
- Monthly payments
- Balance remaining
- Car value
- Car value/amount left to repay (£)
- Optional balloon payment

Month
PCP is risky for the lender, even if the borrower makes all the monthly payments.
Safeguards in place

1. Lenders must attest (and provide evidence of how) they are avoiding any spiral of complacency

2. Stress testing of lenders. They have the strength to absorb severe losses

3. Direct restrictions on high loan-to-income mortgage lending to guard against risk to wider economy
Major UK banks’ capital can absorb severe losses

CET1 capital, % of risk weighted assets

£44bn of losses in stress test
The economic dangers of debt

High level of debt

High mortgage debt
Big spending cut backs

Deeper economic downturn

Cut backs on lending

Risk of losses at banks

High consumer debt
More defaults
Safeguards in place

1. Lenders must attest (and provide evidence of how) they are avoiding any spiral of complacency.

2. Stress testing of lenders. They have the strength to absorb severe losses.

3. Direct restrictions on high loan-to-income mortgage lending to guard against risk to wider economy.
The economic dangers of debt

High mortgage debt
Big spending cut backs

Deeper economic downturn

Cut backs on lending

Risk of losses at banks

High consumer debt
More defaults

High level of debt
‘Debt Strikes Back’ or ‘The Return of the Regulator’?

Liverpool University Institute of Risk and Uncertainty
24 July 2017

Alex Brazier
Member of the Financial Policy Committee