

Household Debt

THE ESSENTIALS

Household debt is made up of **consumer credit** and **housing loans**.

Credit involves a financial institution allocating funds for a fixed period of time against payments of a fixed or variable interest rate. A variable interest rate means that the rate is revised periodically, usually every year on the anniversary date of the loan, based on an underlying benchmark rate or index, which is often the SONIA (Sterling Overnight Index Average). On the other hand, when it is fixed, the interest rate does not vary during the term of the loan. The majority of loans in the UK, and the Bailiwick, are fixed-rate.



Why are loans useful for borrowing households?

Consumer loans can be used in the short term for the purchasing of goods and services, for example, household furniture and vehicles, or in the medium term for various objectives like the financing of studies.



Home financing can be used for the purchasing of a property.

To finance a project, a household may decide to partly use savings and take a loan for the remainder.

Savings and credit are two complementary sources of financing. In January 2024, the debt ratio of UK households was 78.5%, compared to 65.7% in France and 99.5% in the US.

Why are loans useful for the national economy?

Consumer loans support household purchasing, which is one of the drivers of economic growth.

Home financing loans make it possible to acquire new real estate, which also promotes the construction sector, including the redevelopment of older properties, and maintenance of housing (such as insulation) which contributes to climate transition.

Which factors influence household debt?

Demand: Meeting consumption or real estate investment needs, the demand for credit is linked to income. It also depends on the level of interest rates and the degree of confidence that households have in the future.



Supply: To grant a loan, the financial institution considers its **affordability** (i.e. whether the household has the ability to meet the loan repayments). The **interest rate** offered by the bank then depends on the **Bank of England's base rate**, to which a margin is added, including the **cost of risk for the lender** (risk of non-repayment) plus its **profit**. The **duration** of the loan also takes into account a borrower's ability to repay, as well as their age.

Financial institutions (in the broad sense, i.e. including institutions linked to major retail brands or institutions specialising in consumer credit) also have their own **commercial policy** which encourages, to varying degrees, households to take out loans.



Banking regulations related to **financial stability** influence the granting of credit, by requiring the lending institution to comply with **prudential rules**.

Commercial money creation i.e. the increase in the stock of money, is mainly the result of **granting new credit**, particularly to households. Indeed, a new loan translates into a new bank deposit, i.e. an increase in available money. Conversely, **the repayment of a loan** by a household takes the form of a **reduction** in a bank deposit on its account, i.e., monetary destruction.

As the outstanding amount of loans to households generally increases in the UK (more new loans than repayments), household debt most often generates money creation.

