Credit cards create another bubble

By Jack Harmsworth, Business Editor (2017)
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The Bank of England's Financial Policy Committee warned last week that the UK economy was at a significant risk from credit bubbles. Sound familiar? Barely a decade after the Financial Crash in 2008 and already a major economic commentator is warning of another unsustainable level of credit in the UK economy.

This time the credit bubble can be found in credit card and car loan markets. According to the Bank of England's own statistics, consumer credit growth has been outpacing household income for the past five years. Dealership car finance has been the fastest growing credit industry with annual growth above 15 per cent for the past three years.

In many respects this new bubble can be put down to the tightening of the mortgage market post-financial crisis as well as stagnating incomes. With new rules resulting in harder access to capital from the value of your house and tighter rules on acquiring a mortgage, many consumers are turning to alternate sources of finance to keep afloat. On top of this, research from the TUC finds that from 2008-2015 incomes fell on average 1 per cent per year. With incomes stagnating and access to more stable forms of debt declining, it is little wonder that consumers are turning to more precarious forms of credit to maintain spending.

Add to this higher levels of inflation post-Brexit and we can see a toxic cocktail of factors creating the grounds for another credit crash. Higher inflation will mean an increase in the cost of living making wages stretch even less. Mike O'Connor, chief executive of the StepChange debt charity warns that the level of borrowing in the UK economy is "approaching levels not seen since the economic crisis". This is being accelerated by predatory credit card and car loan lenders charging high levels of interest and credit limits.

In response to this growing problem the Labour party used its recent party conference to put forward a new policy which would cap the total debt repaid on any credit or loan at 100 per cent. With evidence from the Financial Conduct Authority (FCA) finding more than three million people are in persistent debt, such a policy may come as a big relief. The Labour Shadow Chancellor John McDonnell stated that the best way to address the problem in the long term would be to invest in industries producing well paid jobs. The Conservatives responded by saying significant credit plans were already in place.

A modest way forward can be found in the FCA's reaction to the excessive payday loan market where it intervened in order to protect consumers in 2014. Through stringent legislation restricting interest rates the number of payday loan companies had fallen from 400 to 144 by the end of last year.

Overall the level of debt held in the form of credit whether on plastic or through car loans is a worrying signal of an ailing British economy. With worker's earnings squeezed like never before, credit has become a requirement for many just to stay afloat. Much of the debt is simply servicing ever increasing costs in bills and travel.

In the long term, more well paid jobs will not be enough. The government must do more to ensure sunk costs such as water, energy and transport are made cheaper, leaving consumers less exploited and as such less reliant upon debt financing. Until then, the FCA must step in to take immediate regulatory action.

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