



Economics Weekly

29 September 2008

Despite the credit crisis, debt accumulation still on going in the UK

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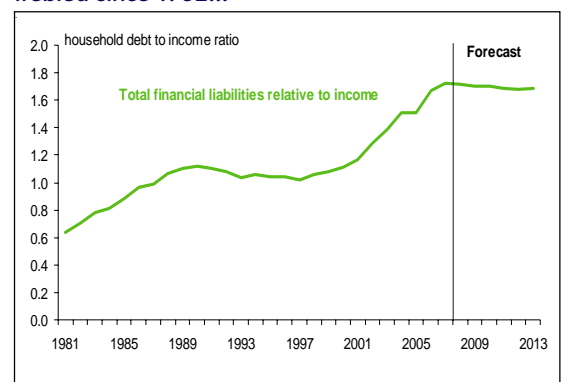
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The credit crisis has resulted in less credit being made available for households and companies...

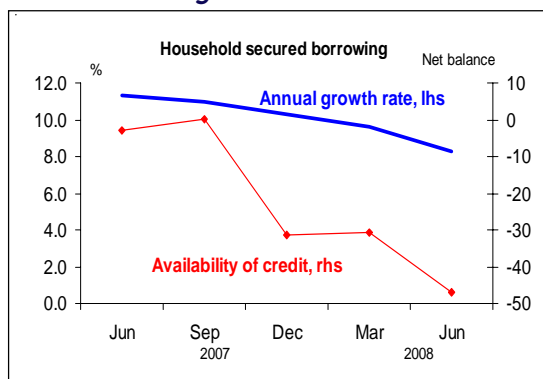
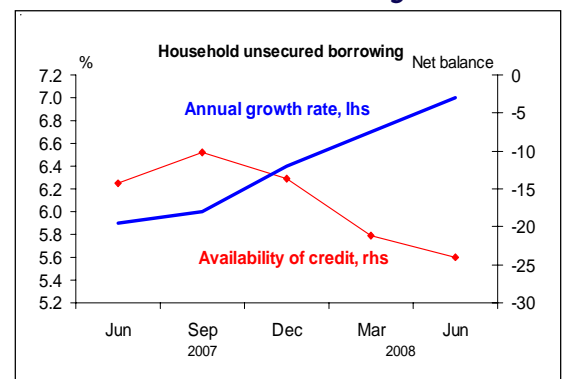
The credit crisis is still in full swing; in fact, it is worse now than when it first started in Q3 of last year. Credit spreads have widened out and interbank spreads are the widest that they have been at any time in the last 12 months. But our focus in this weekly is on the fact that with credit conditions tightening - a higher cost of borrowing and less credit being made available - we should be seeing a significant reduction in leverage by households and companies by now. But the data do not yet show that this is occurring; although debt accumulation is slowing it is still taking place. Given current events in financial markets, is it just a matter of time before it slows more sharply? We look at some evidence of where we are currently in the analysis that follows.

Chart a: UK household debt ratio has nearly trebled since 1982...**...but UK households are still accumulating debt faster than they are growing income...**

UK households have accumulated a vast amount of debt since 1981, but this accelerated particularly sharply from about 1997 onwards, see chart a. During this period there was a dramatic fall in price inflation and so sharp cuts in interest rates, which made it easier to obtain credit. But there was also deregulation and a surge in the supply of credit, which increased the ability of households to get access to loans. Also, employment reached a record high and unemployment fell to a 35 year low as UK economic growth averaged 2.9%, adding to the fast pace of growth of loans.

We think that a combination of the credit crisis and slower economic growth will result in weaker growth in employment and a stalling of the 10 year falling unemployment trend over the next few years. This will result in a flattening in debt accumulation in the UK over the period to 2013, see chart a. But for that to happen, growth in loans relative to growth in incomes must slow so that loan growth is at least in line with income growth.

At present, as charts b and c show, although the credit crisis has meant that loans are less available for mortgages and for unsecured credit, there has only been a mild slowdown in the rate of borrowing of UK households. Indeed, looking at unsecured loan growth, it has accelerated. This may be a bad sign if it suggests increasing use of this form of credit to pay off debt on secured loans. Only time will tell, as we should see higher default rates and ultimately a sharp fall in this form of borrowing if that is the case. In the meantime, however, it is clear that the sort of loan slowdown that one would expect from the credit crisis is not yet significantly underway.

Chart b: ...but the credit crisis means that less credit is now being made available...**Chart c: ...however, this has not stopped growth in unsecured debt from accelerating**

2008/09 calendar of central bank meetings

European	ECB	(4.25%)
6 November, 4 December,		
15 January, 5 February		
US	FOMC	(2.00%) - 29
October, 16 December, 28		
January, 17 March		
UK	MPC	(5.00%) - 9 October,
6 November, 4 December, 8		
January		

Chart d: UK corporate borrowing is still growing rapidly, despite a reduction in credit availability...

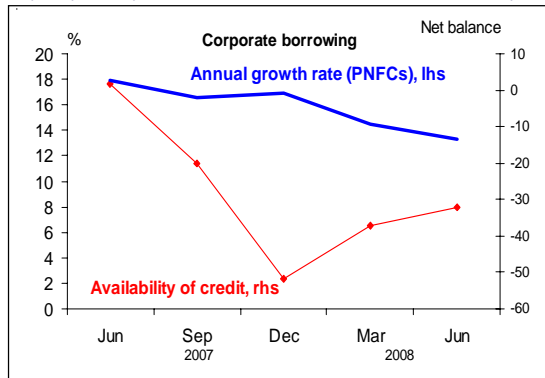
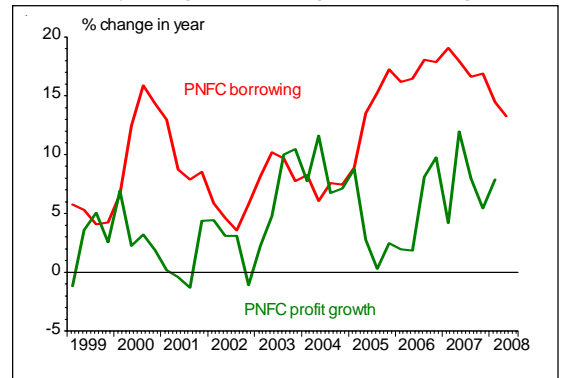


Chart e: ...and UK company loan growth is well in excess of profit growth though it is slowing



The same applies to corporate loan growth, see chart e, where profit growth is less than loan growth, implying a rise in the level of indebtedness of non-financial companies to lenders. This trend may, of course, be good news for the economy as it implies that the negative feedback loop from a cutting of loans to a cutting of spending by borrowers is not kicking in as much as many fear, at least not yet. But it could be bad news if the economy enters a deep recession, as debt defaults will likely rise to unprecedented levels.

Rolling calendar of UK data releases and events

Industrial production (6/10)
Trade balance (9/10)
Producer prices (13/10)
Consumer prices (14/10)
Official house prices (14/10)
Labour market stats (15/10)
Average earnings (15/10)

...and this is leading to a further rise in the UK's debt burden though we think this trend will flatten in the years ahead as the economy slows and less credit availability bites

Looking at growth in borrowing by households, which amounted to about £1.4 trillion at end July 2008, currently accounting for some 170% of annual income, it is still rising well in excess of growth in income, see chart f. Indeed, breaking this total down into mortgage borrowing growth and unsecured borrowing growth shows that both categories are rising faster than income, meaning that the household debt burden as a share of income is still rising. However, for both categories of household debt the pace of growth is slowing, see chart g, and has slowed fastest for unsecured loans than for mortgages (unsecured loan growth has picked up in the past year). This trend needs to continue in order for the debt to income ratio to stabilise: in other words, debt cannot rise faster than income. There is a possibility that borrowing growth could fall below income growth if the credit crisis really bites and if households take fright at rising unemployment as the economy slows, and so increase their saving rate. Our central view, at present, is that a combination of this occurs in the years ahead and household borrowing and income growth balance for the first time in well over 20 years. This will show up as a flattening in debt to income ratios, albeit at a high level, see chart a.

Rolling calendar of US data releases and events

Consumer credit (7/10)
Wholesale inventories (9/10)
Trade balance (10/10)
Import prices (10/10)
Producer prices (15/10)
Retail sales (15/10)
Business inventories (15/10)

As said at the start, the evidence would suggest that loan growth in the UK (company and household) is still faster than income growth so the adjustment to a more restrictive supply of credit - at a higher cost, and by fewer lenders - does not yet appear to be impacting borrowers as much as one would have thought one year into the credit crisis. However, it may just be a matter of time and, as the economy weakens, a slowdown in borrowing growth to a more sustainable pace becomes ever more likely.

Trevor Williams, Chief Economist, Corporate Markets

Chart f: Household mortgage borrowing rising faster than income, though slowing

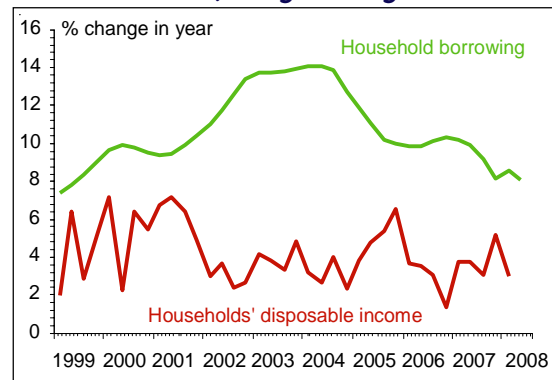
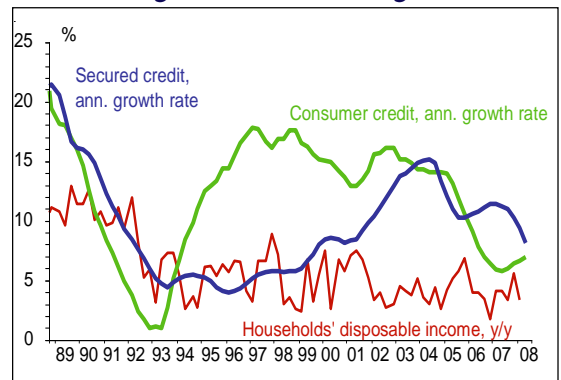


Chart g: UK Household unsecured loan growth slowing but is still stronger overall than income growth



*** All charts are sourced to Lloyds TSB Corporate Markets Economic Research and Datastream**

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Weekly economic data preview

W/c 29 September 2008
www.lloydstsb.com/corporatemarkets

Market events to overshadow data

The European Central Bank (ECB) meets to discuss interest rates on Thursday, amid intensifying financial market stress and growing signs of weakening euro zone economic activity. However, these concerns will have to be balanced with the still unfavourable inflationary backdrop, despite signs that the annual rate may have peaked. Although we expect interest rates to remain on hold at 4.25%, the press conference from ECB president Trichet could contain surprises. The US September employment report, on Friday, is forecast to show that the US economy lost jobs for a 9th successive month. We look for a 90,000 decline, with the risk of a sharper fall. The unemployment rate will also attract attention, after rising to a five-year high of 6.1% in August. A disappointing report will raise speculation of a cut in US interest rates. However, we believe interest rates are already low at just 2% and a further reduction will have only a limited impact on the credit crisis and current slowdown.

- UK data this week will provide further clues to whether the economy has entered recession. We forecast the UK will skirt recession this year, with any quarterly contraction likely to be relatively modest should it occur. The final estimate of Q2 UK gdp, on Tuesday, may provide a surprise, if growth is revised from unchanged over the quarter. While we believe there is a risk on either side, given recent economic data, the most likely outcome is for no change. But a large scale revision of the method of calculating gdp has been underway and the results of this could lead to a surprise. Any contraction would be the first since 1992 and will raise market speculation of interest rate cuts, possibly as soon as next week. However, we remain of the view that the majority of the MPC will want to wait for clearer signs that inflation has peaked though the worsening credit market conditions will raise the risk of a cut in rates. A sharp slowdown in economic growth is ultimately required to increase spare capacity and bring inflation to target over the Bank's two-year horizon. However, the destabilisation of money markets and generalised tightening in credit conditions - UK 3-month Libor is up more than 50bps since the September MPC meeting. A further deterioration in credit conditions ahead of the next MPC meeting could shift the balance of risks to growth from inflation.

We expect the PMI data this week to show both services and manufacturing activity contracted in September. However, the headline indices should remain close to levels broadly consistent with slow to stagnant economic growth. The retail sector, which has been surprisingly buoyant of late, is also not covered by these indices. We remain of the view that UK Q3 gdp growth could be slightly positive. Lending figures published by the BoE this morning are likely to show a further fall in mortgage approvals and net mortgage lending in August. This should come as no surprise given the significant tightening of household credit conditions and weakening sentiment about the housing market, and suggests that further falls in house prices are likely in the months ahead. However, net consumer credit may have picked up, possibly to a six month high of £1.3bn, from 1.1bn in July.

- The economic landscape in the US continues to be dominated at present by bank failures and the much publicised \$700bn rescue package to remove illiquid mortgage backed assets off banks' balance sheets. However, with Congress close to agreeing a compromise over the weekend, attention should soon return to the real economy. Economic data last week highlighted the risk of a relapse in Q3 gdp growth, with business investment and housing markets registering weak demand. The rise in weekly unemployment claims last week to 492,000 suggests that the labour market picture is also darkening. The September employment report is due this week and may add to market perceptions that the Fed will cut interest rates, possibly as soon as October 29th. We are not convinced. The US consumer confidence index, ISM surveys and personal income and spending data are also published this week.
- The ECB finds itself in a very similar position like the BoE, with monetary policy currently being dictated by high inflation and rising fears about economic growth. However, challenging credit markets, worsening forward-looking indicators and signs that inflation has peaked, suggest that the ECB could soon switch its stance on interest rates towards an easing bias. The main data highlights this week are the 'flash' estimate of September CPI and EU-15 retail sales in August.

Kenneth Broux, Economist

Jeavon Loyal, Senior Economist

Chart 1: Recent data highlight the slowdown in eurozone economic growth in Q3

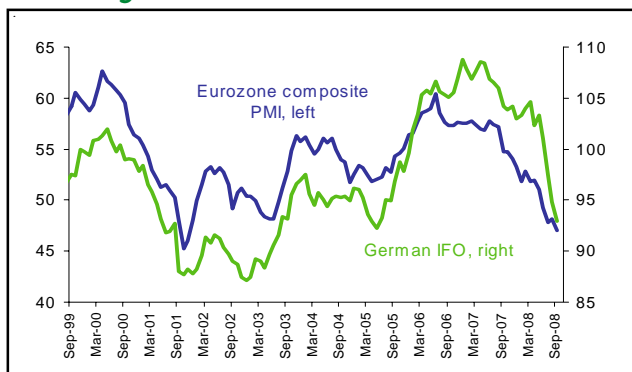
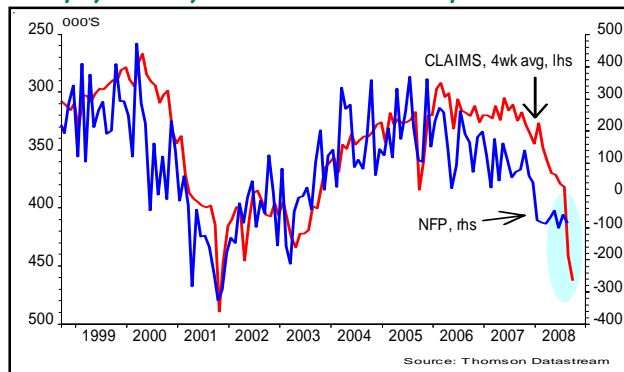


Chart 2: US weekly claims suggest pace of decline in non-farm payrolls may have accelerated in September



Date	United Kingdom	United States	EU-15
Mon 29	Money supply, M4 (final, sa) (Aug) Jul +0.9% Y-O-Y +11.2% Aug (act) +1.4% Y-O-Y +11.5% Consumer credit Jul +£1.1bn Aug (act) +£1.2bn Median +£1.0bn Range +£0.8bn:£1.3bn Net mortgage lending (sa) Jul +£3.0bn Aug (act) +£0.1bn Median +£2.8bn Range +£1.0bn:£3.1bn Mortgage approvals Jul 33K Aug (act) 32K Median 30K RangeK 25K:33K	Personal income (13:30) Jul -0.7% Y-O-Y +4.2% Aug (f'cast) +0.3% Y-O-Y +4.0% Median +0.2% Range -0.3%:+0.4% Personal spending (13:30) Jul +0.2% Y-O-Y +5.3% Aug (f'cast) +0.2% Y-O-Y +5.2% Median +0.2% Range -0.2%:+0.5% PCE deflator (13:30) (Aug) Jul Y-O-Y +4.5% Median +4.5% Range +4.3%:+4.7% Core PCE deflator (13:30) Jul +0.3% Y-O-Y +2.4% Aug (f'cast) +0.3% Y-O-Y +2.4% Median +0.3% Range -0.1%:+0.3%	EU-15 consumer confidence (10:00) Jul -19 Aug (act) -19 Median -19 Range -22:-17 EU-15 industrial confidence (10:00) Jul -9 Aug (act) -12 Median -12 Range -13:-11
Tue 30	Consumer confidence (GfK) (00:01) Aug -36 Sep (f'cast) -40 Median -40 Range -42:-36 GDP (final) Q2 (prel) zero Y-O-Y +1.4% Q2 (f'cast) +0.1% Y-O-Y +1.4% Median zero Range -0.1%:+0.1% Current account Q1 -£8.4bn Q2 (f'cast) -£9.0bn Median -£9.7bn Range -£13.2bn:£7.0bn	House prices (S&P/CaseShiller)(Jul)(15:00) Jun Y-O-Y -15.9% Chicago PMI (14:45) Aug 57.9 Sep (f'cast) 56.0 Median 54.0 Range 49.0:58.0 Consumer confidence (15:00) Aug 56.9 Sep (f'cast) 56.0 Median 55.0 Range 50.0:66.0	German retail sales (07:00) (30/9-5/10) Jul -1.5% Y-O-Y zero Aug (f'cast) +0.3% Y-O-Y -2.6% Median +0.5% Range -1.0%:+1.3% French producer prices (07:45) Jul +0.7% Y-O-Y +7.3% Aug (f'cast) -0.4% Y-O-Y +6.2% Median +0.2% Range -0.5%:+0.3% German unemployment (sa, rate) (08:55) Jul -40K Rate 7.6% Aug (f'cast) -15K Rate 7.5% Median -15K Rate -65K:+10K EU-15 CPI (prel) (10:00) (flash) Aug Y-O-Y +3.8% Sep (f'cast) Y-O-Y +3.4% Median +3.6% Range +3.4%:+3.9%
Wed 1 Oct	Manufacturing PMI Aug 45.9 Sep (f'cast) 45.0 Median 45.0 Range 43.4:46.3	ADP employment change (13:15) Aug -33K Sep (f'cast) -50K Median -50K Range -135K:-20K ISM manufacturing index (15:00) Aug 49.9 Sep (f'cast) 48.5 Median 49.8 Range 48.0:50.5 Construction spending (sa) (15:00) Jul -0.6% Aug (f'cast) -0.5% Median -0.5% Range -1.1%:zero	French manufacturing PMI (08:50) (final) Sep (prel) 43.6 Sep (f'cast) 43.6 Median 43.6 Range 43.6:43.6 German manufacturing PMI (09:00) (final) Sep (prel) 48.1 Sep (f'cast) 48.1 Median 48.1 Range 48.1:48.1 EU-15 manufacturing PMI (09:00) (final) Sep (prel) 45.3 Sep (f'cast) 45.3 Median 45.3 Range 45.3:45.3 EU-15 unemployment rate (10:00) Jul +7.3% Aug (f'cast) +7.3% Median +7.3% Range +7.3%:+7.4%
Thu 2	Nationwide house prices (07:00) (Sep) Aug -1.9% Y-O-Y -10.5%	Initial claims (w/e 27/9) (13:30) Previous 493K Forecast 432K Median 468K Range 432K:490K Factory Orders (15:00) Jul +1.3% Aug (f'cast) -1.6% Median -2.0% Range -6.0%:+0.5%	EU-15 producer prices (10:00) Jul +1.1% Y-O-Y +9.0% Aug (f'cast) -0.4% Y-O-Y +8.6% Median -0.5% Range -0.8%:+1.1% ECB interest rate decision (12:45) Current: 4.25% Forecast: 4.25%
Fri 3	Services PMI Aug 49.2 Sep (f'cast) 48.0 Median 48.0 Range 47.5:48.8	Non-farm payrolls (13:30) Aug -84K Sep (f'cast) -90K Median -100K Range -150K:-60K Unemployment rate (13:30) Aug 6.1% Sep (f'cast) 6.0% Median 6.1% Range 5.9%:6.3% Average earnings (sa) (13:30) Aug +0.4% Y-O-Y +3.6% Sep (f'cast) +0.4% Y-O-Y +3.6% Median +0.3% Range +0.2%:+0.4% Average weekly hours (sa) (13:30) (Sep) Aug 33.7 Median 33.7 Range 33.6:33.7 ISM Services index (15:00) Aug 50.6 Sep (f'cast) 50.0 Median 50.0 Range 48.3:52.5	French services PMI (08:50) (final) Sep (prel) 50.4 Sep (f'cast) 50.4 Median 50.4 Range 50.4:50.4 German services PMI (09:00) (final) Sep (prel) 49.3 Sep (f'cast) 49.3 Median 49.3 Range 49.3:49.3 EU-15 services PMI (09:00) (final) Sep (prel) 48.2 Sep (f'cast) 48.2 Median 48.2 Range 48.2:48.2 EU-15 retail sales (10:00) Jul -0.4% Y-O-Y -2.8% Aug (f'cast) +0.2% Y-O-Y -2.4% Median +0.1% Range -0.6%:+0.4%
Mon 6	Industrial production (sa) (Aug) Jul -0.4% Y-O-Y -1.9% Manufacturing output (sa) (Aug) Jul -0.2% Y-O-Y -1.4%		

NB: UK data released at 9.30 a.m., unless otherwise stated. Market medians are as of preceding Friday. Release times of US data are stated in brackets after the description of the indicator. Events are listed in the events column on the next page.

29 September - 6 October 2008

Date	Japan	Other Countries	Main events
Mon 29	Retail sales (prel) (00:50) Jul Y-O-Y +2.0% Aug (act) Y-O-Y +0.7% Median +0.2% Range -1.1%:+1.3%		<ul style="list-style-type: none"> • BoJ Deputy Governor Nishimura speaks (04:30)
Tue 30	Job-applications ratio (00:30) Jul 0.89% Aug (f'cast) 0.88% Median 0.88% Range 0.87%:0.90% Unemployment rate (00:30) Jul 4.0% Aug (f'cast) 4.1% Median 4.1% Range 4.0%:4.2% Workers' spending (00:30) Jul Y-O-Y -0.5% Aug (f'cast) Y-O-Y -1.5% Median -1.3% Range -2.6%:-0.1% Industrial output (00:50) (prel) Jul Y-O-Y +2.4% Aug (f'cast) Y-O-Y -6.2% Median -6.3% Range -7.3%:+0.9%	Canada IPPI (13:30) Jul +0.4% Aug (f'cast) -0.3% Median -0.5% Range -0.6%:+0.2% Canada RMPI (13:30) Jul +1.4% Aug (f'cast) -3.0% Median -3.0% Range -3.0%:+0.5% Canada GDP, monthly (13:30) Jun +0.1% Jul (f'cast) +0.1% Median +0.1% Range +0.1%:+0.2%	<ul style="list-style-type: none"> • US Fed member Hoenig speaks (01:45) • ECB member Gonzalez-Paramo speaks at the Spanish Capital Market forum (08:25) • ECB President Trichet speaks (17:00) • US Fed member Lockhart speaks (18:00)
Wed 1 Oct	Tankan manufacturing index (00:50) Q2 +5 Q3 (f'cast) -2 Median -2 Range -7:+2 Tankan services index (00:50) Q2 +10 Q3 (f'cast) +5 Median +5 Range -16:+8		<ul style="list-style-type: none"> • ECB President Trichet speaks (10:00) • UK DMO auction of 4.25% £2.25bn, 2049 Treasury Gilt
Thu 2			<ul style="list-style-type: none"> • US Fed member Hoenig speaks (02:45) • ECB interest rate decision (no change at 4.25% expected) (12:45) • US Fed member Evans speaks (18:00) • US Fed member Bullard speaks (23:00)
Fri 3			
Mon 6		Canada building permits (13:30) (Aug) Jul +1.8% Canada Ivey PMI (15:00) (Sep) Aug 51.5	<ul style="list-style-type: none"> • US Fed member Evans speaks (17:00)