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Saving vs debt – are you making the most out of your spare cash?

By Karen Barrett, Chief Executive of unbiased.co.uk

With the recession causing us all to tighten our belts, it is becoming harder and harder for many people to find those extra pounds to stash away for a rainy day. However, putting aside a little each month has never been more important, as should you be unlucky enough to lose your job it will tide you over until you can find yourself a new income.

Some people are making payments to their savings account when they have outstanding debts still to be paid off. Those who are doing this are applying a 'savings brake' to their efforts – the interest they are paying on their debt far outweighs the benefits of making monthly savings.

Interestingly, the recession caused a change in behaviour in the way consumers service their debts and made savings. Throughout the nine year period that Unbiased.co.uk has carried out the research, consumers have always had savings which they have failed to use to pay off their outstanding debt. However, during Q3 and Q4 2008, consumers abandoned their saving and instead began to pay off some of their debts. By Q4 2008, consumers were repaying £1.66 of their debt for every pound they saved, and new saving during this period almost halved to £21 billion.

However, by Q1 2009, consumers had reverted to their old ways of continuing to service high levels of debt as well as paying into their savings. More debt has been taken out than they repaid for the first time in six months. As a result, the first quarter of this year saw new debt rise to £2.7 billion, while savings levels dropped to an all time low.

Unbiased.co.uk's Savings Brake research reveals the ratio of how much we are borrowing (excluding mortgage debt) contrasted with how much we are saving. In Q1 2009, savings levels hit £14 billion – the lowest level since the research was first commissioned nine years ago.

As a nation we are now borrowing 19p for every pound saved. This is in stark comparison to the second half of 2008 which saw consumers fight the recessionary doom and gloom by concentrating on clearing their debts, with £1.66 of debt repaid for every pound saved.

Therefore, those who pay off any debts before starting their savings will often find they end up with more in the long run, as interest on debt quickly increases. Once you are in a position to save, IFAs generally recommend keeping a savings cushion of around three months' earnings in an easy-to-access account, as 'rainy day' money for emergencies or to tide you over if you lose your job.

One way of making sure you maintain your savings discipline – and reducing the pain – is by using monthly direct debits or standing orders for your payments.

It is surprising how quickly people forget money which is automatically taken out of their pay packets or accounts. Going to see an independent financial adviser can help you to work out the best savings plan for you to ensure you are making the most out of your money. Go to www.unbiased.co.uk/find-an-ifa to find an independent financial adviser near you.