NAVIGATING A NEW CREDIT LANDSCAPE

How to manage risk and seize opportunities during the cost-of-living squeeze and beyond

Experian are continually tracking and analysing the economy, and its impacts on the credit markets. The data within this paper is correct at the time of writing (April 2022), however is subject to change. For the latest analysis, please get in touch.

April 2022

Executive **summary**

On the face of it, the UK economy made a strong recovery from the Covid lockdown(s):

- By October 2021, UK GDP was back to pre-Covid levels
- Experian predicts 4.7% growth for the UK economy in 2022
- Unemployment did not spike and is back at pre-Covid levels

Lending portfolios have performed reasonably well:

- Delinquency dropped during the pandemic as consumers spent less and forbearance supported consumers and businesses in a time of need
- Volumes of new credit agreements are largely back at pre-Covid levels in all sectors bar personal loans, which are 20% down

But the impacts of the cost-of-living squeeze are now flowing through:

- Inflation is at a 30-year high and may go above 8% in 2022
- Wages are not keeping pace. Regular pay has fallen by 1%. Real incomes are projected to fall by 2% by the end of 2022

There are already signs of consumer stress:

- Current-account balances are falling
- Overdraft use is rising
- Credit-card balances are rising
- Collections cases rose 7% between December 2021 and February 2022

The rising cost of fuel has repercussions throughout the economy:

- Inflation at the end of 2022 is likely to be even higher due to supply shortages in gas, oil, corn and commodities such as titanium
- Disrupted trade is also likely to reduce GDP in 2022 by around 0.8%

The crunch is producing a new credit landscape, characterised by uneven pressures on consumers:

- Experian has identified a group of 7.5 million people with low discretionary income levels who face acute affordability pressures in 2022
- More affluent consumer groups will also experience declines in discretionary income, but are better prepared to weather the impact
- The effect of inflation will be variable across consumers, with some facing 10–15% price rises

Executive **summary**

Sector and regional trends continue to be strong predictors of affordability stress:

- Some sectors are not recovering strongly, leaving borrowers working in them at greater risk
- 2022 will see stark differences in regional economic performance, leaving those in the weakest-performing regions at greater risk

The new landscape brings both challenges and opportunities for lenders:

- Managing portfolio risk will need granular, individual-level stress tests, that consider multiple scenarios
- The full picture of likely risk and opportunity has not yet emerged and will keep evolving
- Assessing affordability, including ability to pay becomes a critical measure for credit risk analysis
- There are still growth opportunities for lenders, as many borrowers remain in robust financial health. Blanket withdrawal of credit lines will prevent lenders realising those opportunities. Consumers will also have a need for credit and will be searching for better deals for items such as mortgages, current accounts and credit cards to help manage their money

Lenders should be:

- Enhancing their organisation's ability to assess and spot changes in customer stress
- Adding many more variables into portfolio assessment and stress tests
- Developing the ability to forecast the effects on their portfolios of both multiple economic scenarios and changes in credit strategy
- Transitioning from using ONS averages to more nuanced and effective data sources
- Using tools to spot stress early, enabling proactive customer management and forbearance – both of which save costs and have proven ability to mitigate risk
- Consider how best to operationalise the use of economic forecasts, new bureau current account balance insights and sources of Open Data such as Open Banking and digital payroll to better inform an individual's affordability

Introduction
A new credit landscape

Successful lenders will not respond to the squeeze and future economic shocks with blanket policies that limit availability of credit; instead, they'll use powerful new data tools to understand the unique and changing risk presented by each customer in their portfolios.

An unprecedented cost-of-living squeeze is already affecting UK consumers and lenders.

It is changing the UK credit landscape. Previous key indicators of likely consumer stress – such as unemployment – are no longer the best predictors. Among the growing number of consumers not in employment, many still represent excellent credit prospects. Others will find it hard to cover repayments despite being in full-time employment.

Experian research shows the squeeze will lead to highly uneven consumer pressures, depending on individual circumstances, including which sector a consumer works in and where they live. The key message for organisations today, is that no two individuals are alike in their experience of the pressures of the squeeze, or in their resilience.

What is needed now are not stress indicators based on broad categories – like employment – but real-time tracking of income, expenditure and affordability for each customer.

A unique number of factors are shaping risk, and consumer affordability in the new credit landscape:

- a real rate of inflation that varies widely for different consumers
- big differences between the richest and the poorest in the percentage of discretionary income they are set to lose
- big differences in the strength of recovery between employment sectors and geographical regions

In short, the risk picture is complex, and fast-changing. The winners in the credit market will be organisations who can:

- see the changing picture in granular detail and real-time to spot opportunities for growth
- test the likely effects of new credit strategies against a range of different future scenarios

With such insight, lenders can manage portfolio risks in an effective, profitable and consumer-first approach. In turn, they can seize valuable new lending opportunities too.

In this insight report we cover:

- the rapid recovery of the UK economy and credit markets post pandemic
- the evolving nature of the cost-of-living squeeze and its impact on credit markets
- the key features of the new credit landscape
- what this landscape looks like for consumers
- what it means for lenders, and how they can respond

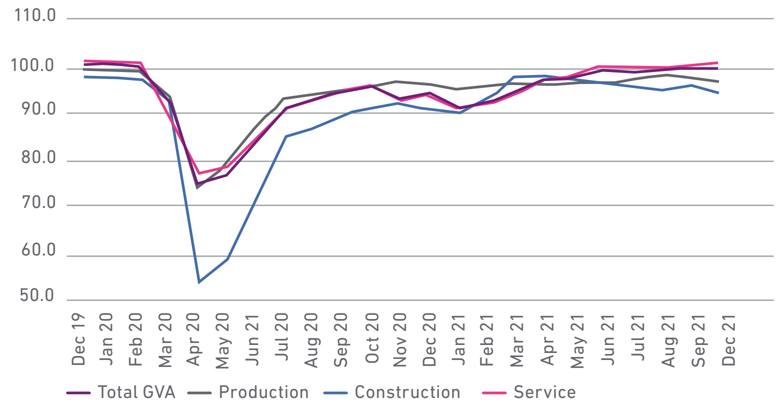
A rapid recovery: **the UK economy and credit markets in March 2022**

Strong bounce in GDP

The economy roared back into life as the lockdown eased in the summer of 2020, and it kept growing in 2021 despite a second national lockdown. It has regained its pre-Covid size. In 2021 GDP grew by 7.5% – the fastest rate in the advanced world. Growth is flattening, but Experian's economists still predict that UK GDP will grow by another 4.7% in 2022.

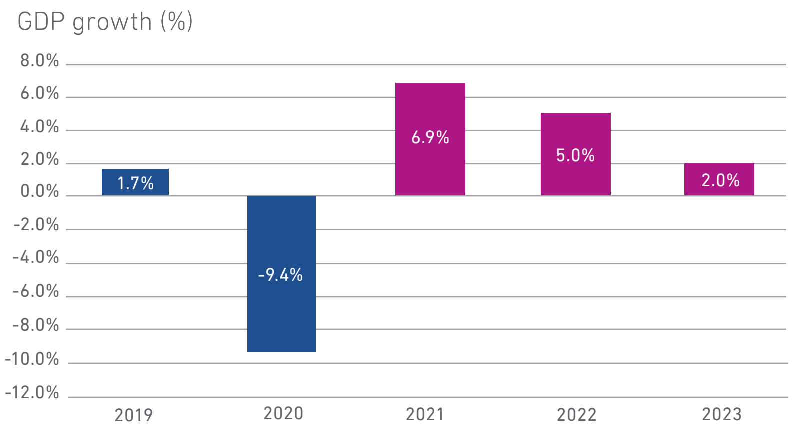
On several key measures, the economic and credit picture in the UK looks much healthier than many feared when the nation closed for business in March 2020.

Economic recovery levelling off



Seasonally adjusted 2019 =100
Source: ONS

GDP forecast strong



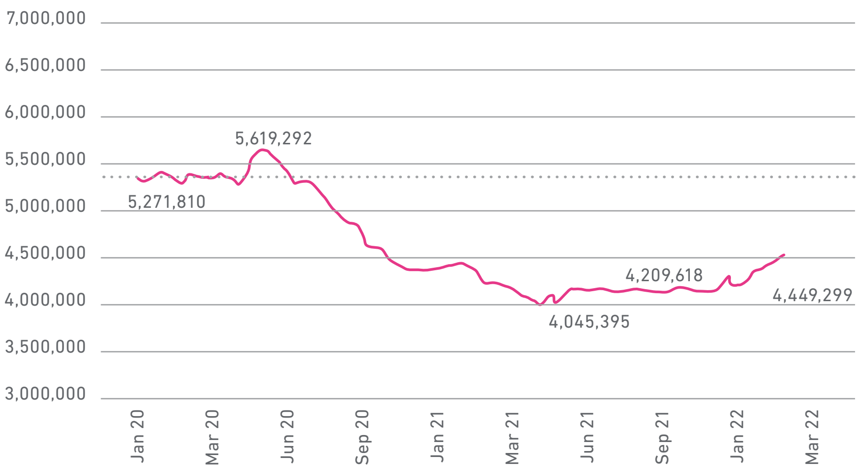
Unemployment low

The UK unemployment rate is **back at pre-pandemic levels.** This is unexpectedly good news: early in the pandemic many predicted it would soar beyond 10%. Unemployment has in the past been a key predictor of a borrower's likelihood of default, though this pattern is becoming significantly more complex as more people have changed jobs, switched to flexible working or opted out of full-time employment.

Credit delinquency low

The credit market has been buoyed by low levels of defaults. Strikingly, **delinquency fell during the pandemic,** with many consumers cutting spending, repaying debt and, in some cases, receiving government and/or lender support that enabled them to meet repayments more comfortably.

Delinquency overview volumes



Collections Status 1-6 (account volumes) - Total Credit Market. Data to Feb 2022.

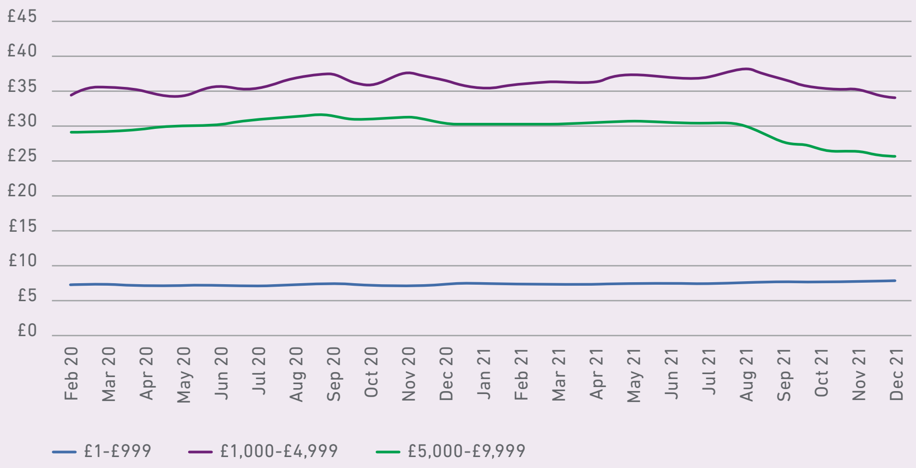
New-agreement volumes recover

New credit agreements bounced back by 8% in 2021, driven mainly by demand for credit cards. **By early 2022, monthly application volumes were back at or above pre-pandemic levels in all credit markets except loans.** The UK credit market has come out of the pandemic in robust shape.

Current-account balances down

The growth in current-account balances over the pandemic seems to have peaked. Aggregate balances are now slowly falling (Experian data).

Aggregate bank balances (in credit) by band



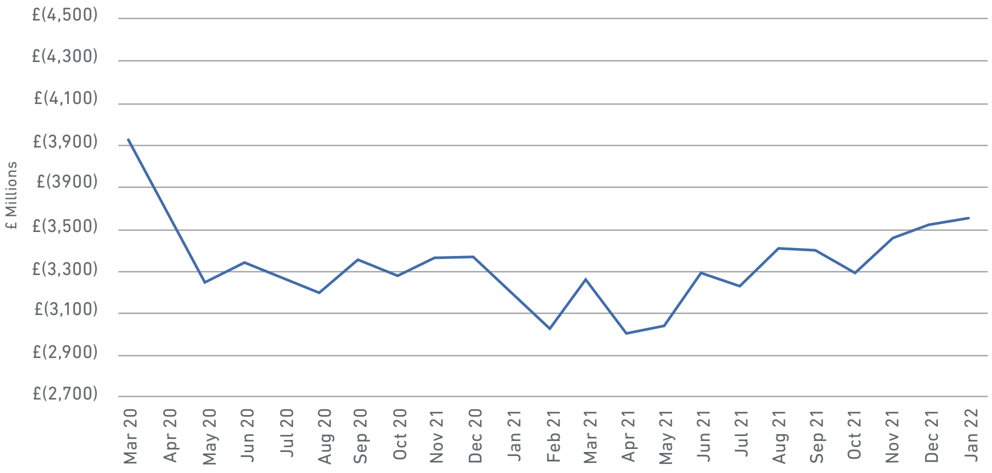
Source: CATO.

The first signs of the cost-of-living squeeze are now visible.

Overdraft usage up

From a low base, overdraft balances are trending upwards – suggesting that more consumers are needing more leeway to meet costs (Experian data). 4.6m current accounts are in overdraft, up 17% from the low point in May 2021.

Aggregate overdraft balances

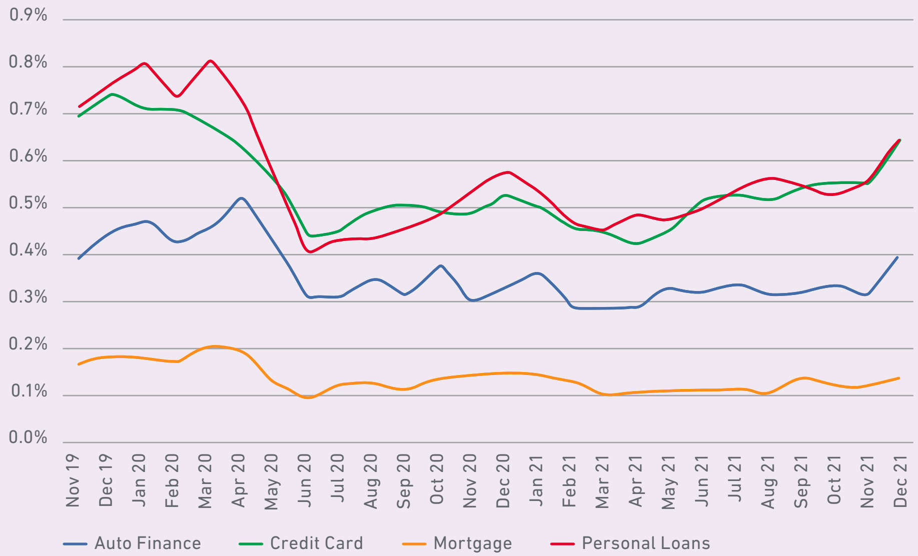


Source: CATO

Delinquency edging upwards

The total volume of collections cases fell during the pandemic but increased by 7% between December 2021 and February 2022 (Experian data).

Collections entry trends - Stock - 0 to 1 flow rate



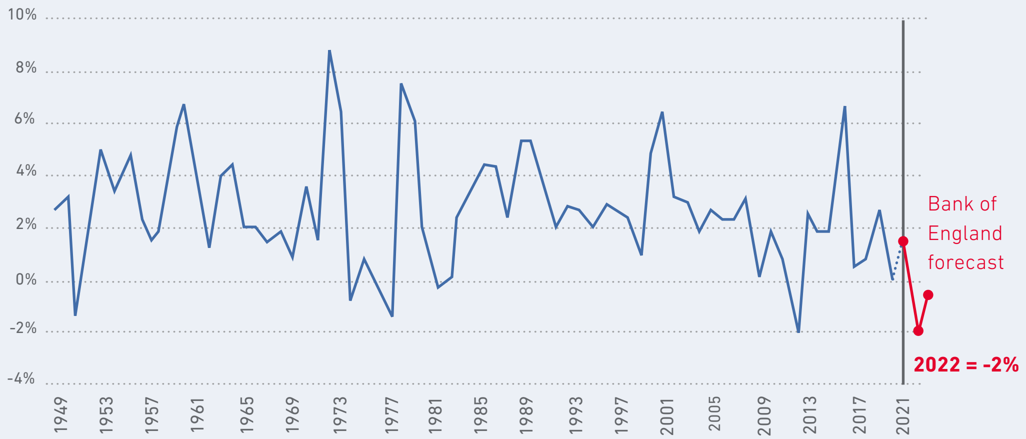
At the point of writing, the first signs of stress among borrowers are becoming apparent. These trends are likely to continue in the coming months as the impact of inflation, price rises and shrinking disposable income grows.

The cost-of-living crisis: **Record falls in real disposable income**

According to the Bank of England (BOE), real income will be squeezed harder in 2022 than at any time since the Second World War. The BOE estimates that real incomes – a measure of the actual purchasing power of what we earn – will fall by 2%.

Real household disposable income

Growth, outturn and February 2022 Bank of England projection: UK

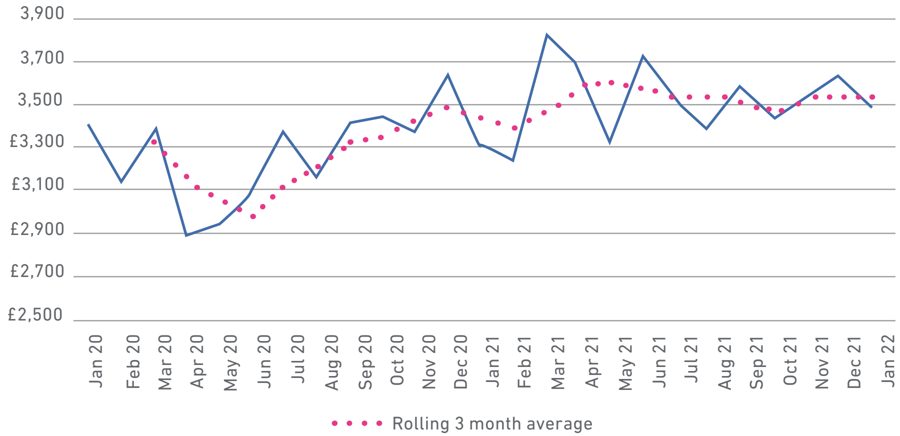


This is a rare event. Only three times since the Second World War have UK households seen real-terms disposable income fall, and the BOE's analysis suggests the 2022 crunch will be the sharpest of all.

Inflation is rising sharply. It hit a 30-year high at 6.2% in February 2022. The most significant contributors have been rises in transport, housing and energy costs. Hikes in these sectors are being driven by demand for UK housing outpacing supply and continued oil and gas supply problems – not issues with immediate solutions. The National Institute for Economic and Social Research expects inflation to hit 8.1% in Q3 2022.

Income has stabilised. Although inflation will create pressure for wage rises, the BOE has already tried to dampen expectations in an attempt to avoid a wage-price inflationary spiral. There is little prospect of wages keeping up with price rises.

CATO derived income



The new credit landscape: **Challenges and opportunities for lenders**

The coming crunch will affect everyone. Every household faces rising grocery bills and an unprecedented spike in energy costs. Most will see real wages trimmed by a 1.25% National Insurance rise.

But when we look at the exact combination of pressures consumers face, and their likely resilience to those pressures, each individual is in a segment of one.

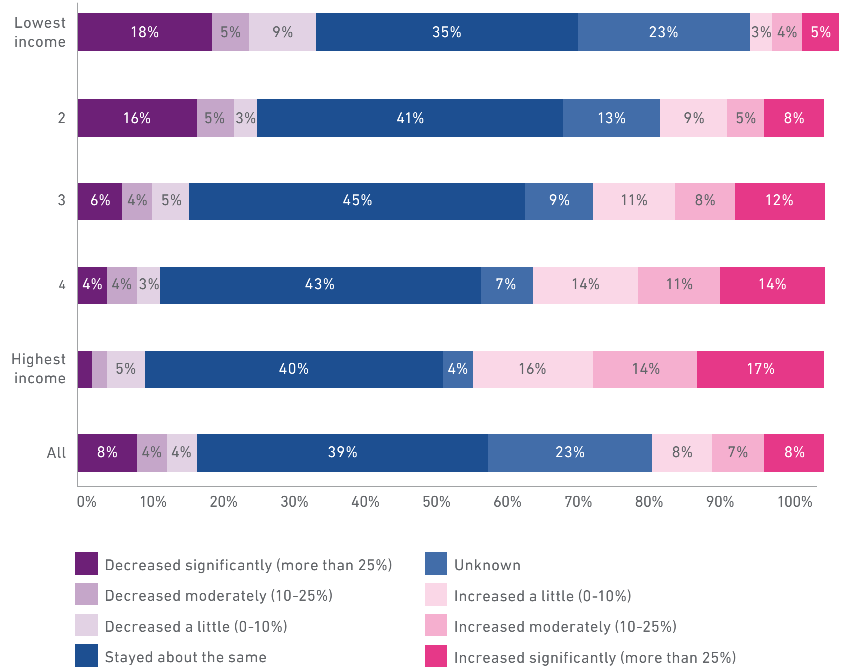
The crunch will affect individuals in very different ways

The level of stress felt will be highly personalised. A patchy recovery means that when it comes to affordability risk, individuals in some employment sectors and regions are at significantly lower risk than others.

Uneven consumer pressures

A variety of interacting economic cross-currents mean the effect of the crunch on individuals is likely to be highly variable.

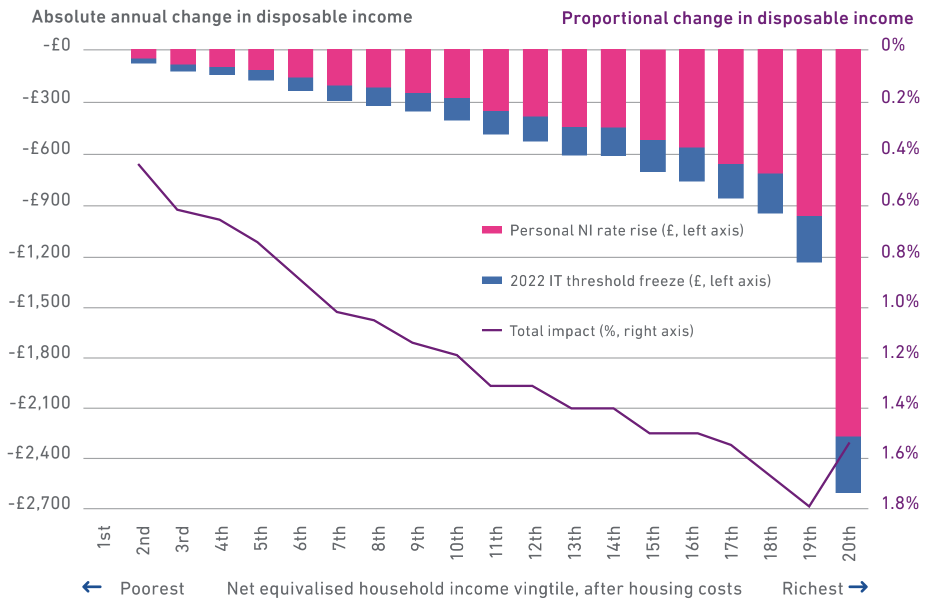
- **The real rate of inflation faced by consumers is varying widely.** Those whose spending is mainly on everyday basics will face real price rises of 10–15%. Consumers' starting points also vary widely. Almost half of the most affluent 20% grew their savings over the pandemic. A third of the poorest quintile had to draw down on reserves.



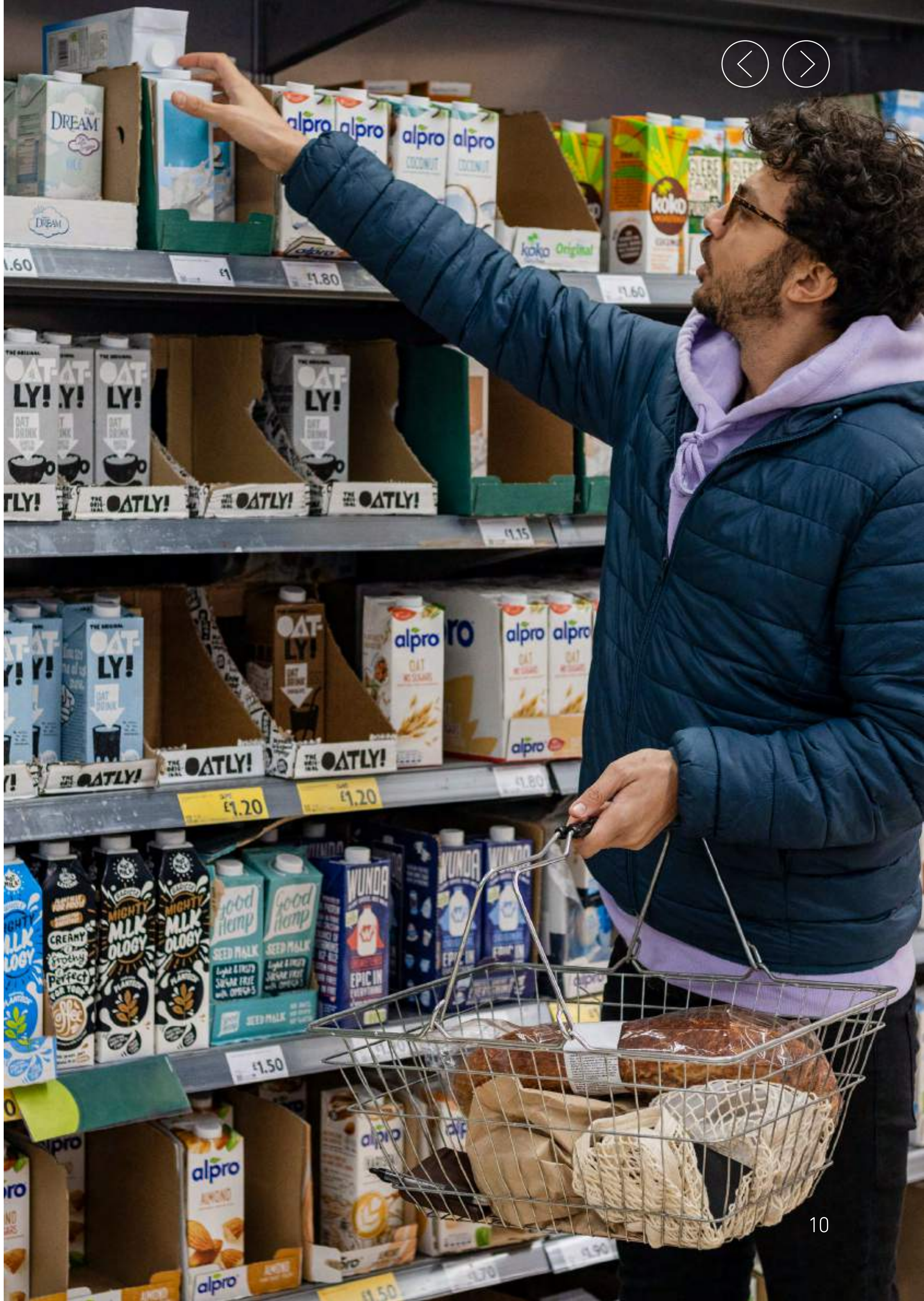
Source: Resolution Foundation

- The National Insurance hike will hit the discretionary income of the most affluent hardest.

Annual impact on average disposable household incomes in 2022/23, by equivalised income vingtile after housing costs: UK



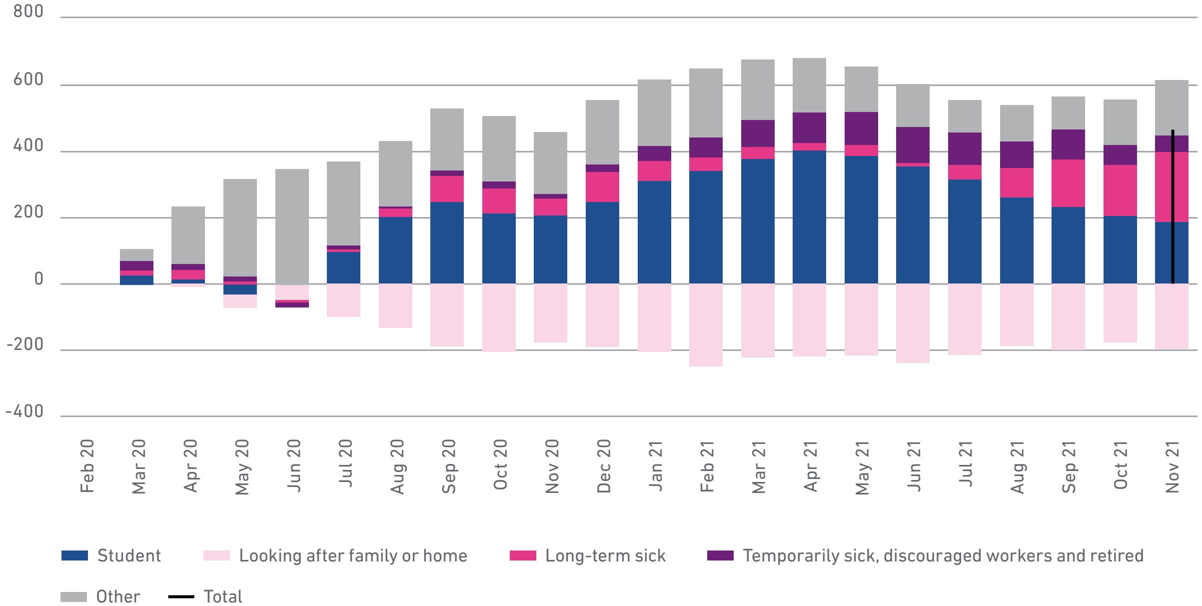
- **Spending habits are changing and varied.** Many of those who faced a 20% income drop through furlough have already pared back spending, and present less affordability risk. Others are coming into the squeeze with less frugal habits, which present potential risks.
- **Fewer people are as economically active than pre-Covid, but the reasons are varied,** and some will still be good credit prospects.



Experian has identified a group of 7.5 million people with low discretionary income levels that face acute affordability pressures in 2022.

Reasons for change in inactivity

Changes in economic activity since the start of the pandemic (Dec 2019 - Feb 2020), by reason and overall.



- **Long Covid and its effect on the ability of sufferers to work full time is further complicating affordability calculations.** Compared with pre-pandemic figures, 200,000 more adults in the UK are now not economically active due to long-term illness.
- **Many of the poorest 20% will be hit hardest.** They stand to lose the highest proportion of their discretionary income. Their income is spent disproportionately on essential foods, fuel and home energy – sectors where price rises are set to be the greatest.

  For instance, a low-paid single mother working full-time to earn £167 a month in discretionary income in 2021 faces a 29% fall in that figure this year, to £118 a month (Experian data). To meet their FCA obligations, lenders will need to be able to identify and support those facing significant stress before they start to fall into arrears and collections.
- **The more affluent will also experience a significant fall in discretionary income:** Experian estimates that couples earning £85,000 a year will experience a reduction of 12%.

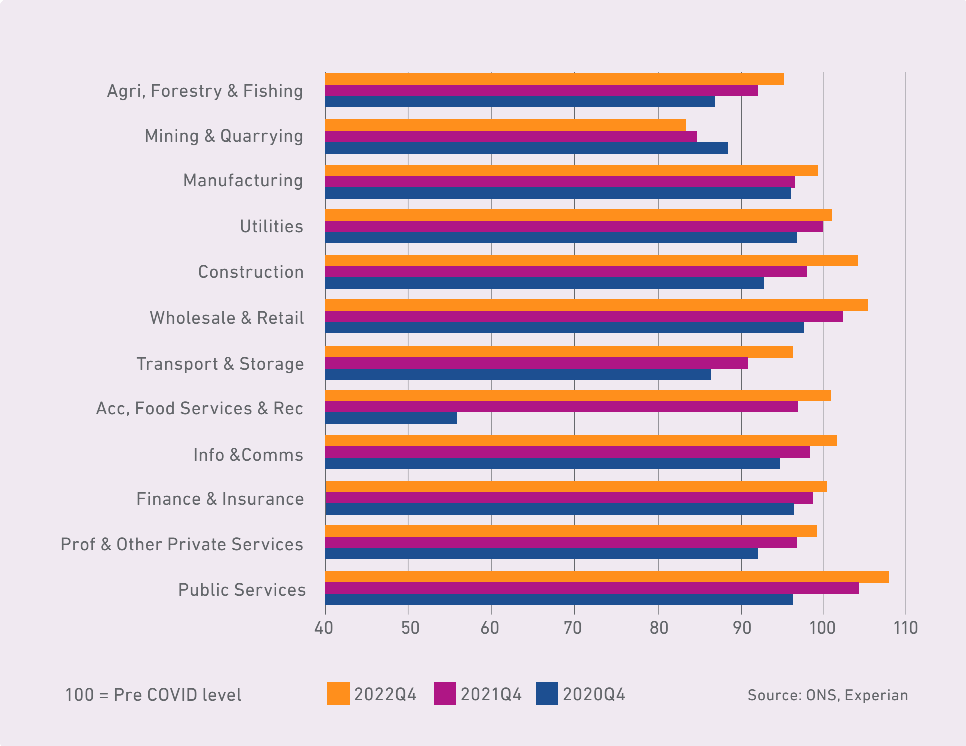
Diverse sector outlook

Overall, the bounce-back in UK GDP has been unexpectedly strong and fast. But this disguises a patchy recovery.

Some sectors have been slow to bounce-back and we anticipate that several will still not have reached their pre-Covid size even by the end of 2022 (Experian data). These include:

- Agriculture, forestry and fishing
- Mining and quarrying
- Manufacturing
- Transport and storage
- Professional and other private services

Organisations will need to be aware of which sectors they are most exposed to so they can manage their portfolios accordingly.



Some sectors are not recovering strongly, leaving borrowers who work in them at greater risk. Others have bounced back, leaving many consumers who work in them in strong affordability positions.

Many sectors face unusual levels of uncertainty

Many key employment sectors face post-pandemic uncertainties that could significantly change the financial position of those working within them, either positively or negatively.

In 2022 and beyond, the level of financial pressure on borrowers will depend significantly on the fortunes of their employer and employment sector.

Knowing which sector a consumer works within will be an increasingly important tool in risk management.

Diverse sector outlook – considerations

Retail
- Spending habits
- High Street vs online behaviours

Auto
- Intention for purchasing a new vehicle (plus EV take-up)
- Legislation

Travel
- Changing behaviour/attitude to where we'll travel
- Restrictions

Leisure
- Changing attitudes to staying in/going out
- Consumer squeeze

Insurance
- Propensity to own a pet
- Changing requirements for home working

Finance
- Changing attitudes to financial position
- Product ownership

Utilities
- Attitudes towards environment e.g solar panels, EV
- Price increases

Telcos
- Product ownership
- Propensity to churn

Polarised regional performance

We anticipate a growth-rate gap of almost 10% between the best-performing and weakest UK regions in 2022 (Experian data).

Have and have nots: predicted GDP growth in 2022 by region

Source: Experian. Created with Datawrapper

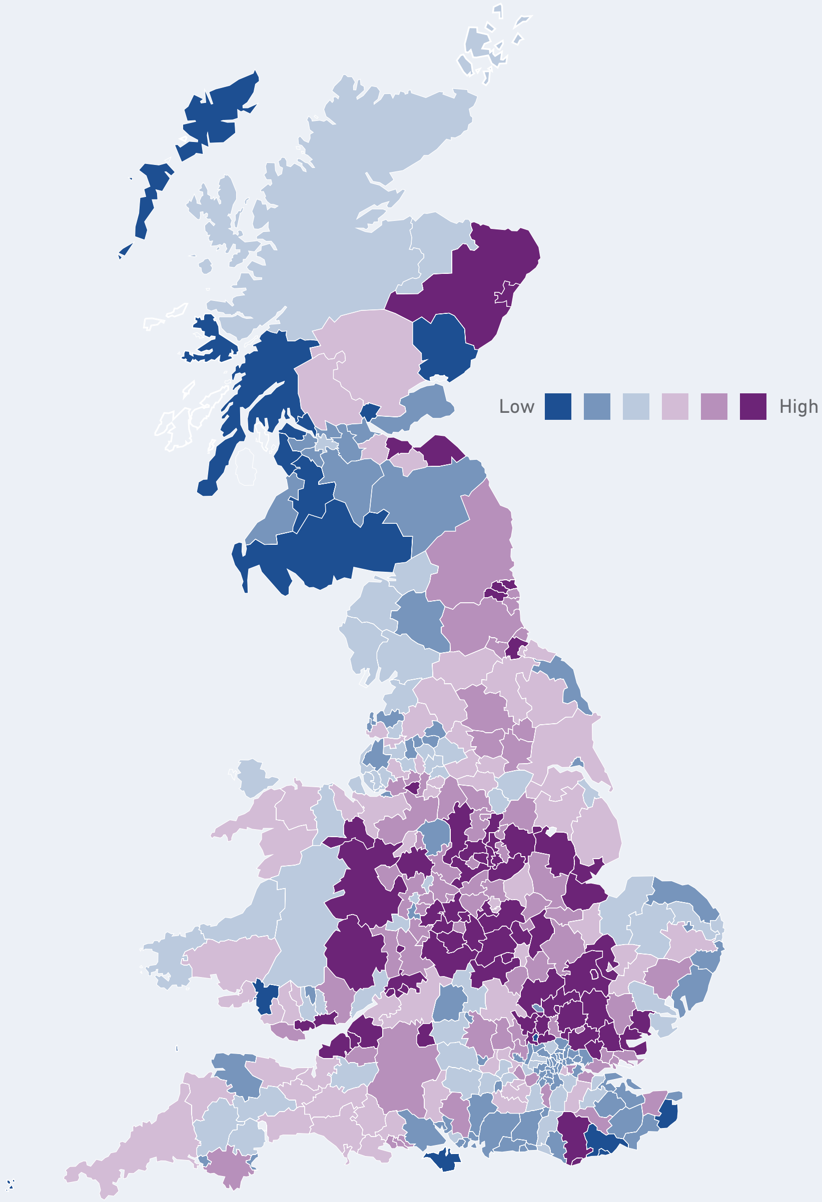
2022 will see stark differences in regional economic performance, leaving those in the weakest-performing regions under greater financial stress.

Uneven consumer pressures: **Household income 2022**

Growing regional disparities in real household income growth

We already see a very sharp regional divide in disposable incomes, with consumers in parts of the South-East and Central England enjoying greater room for manoeuvre than many other parts of the UK (see map).

We expect growth in real-term disposable income in 2022 to vary widely by region, with the East of England and London performing strongest, and with patterns of risk varying accordingly.



Source: Experian. December 2021 RPS

What the effects of the crunch **look like at consumer level**

Across consumers, the impact will be felt differently, as the table below shows. New and varied data alongside sophisticated analytics will become key to understanding this complex picture, and to making appropriate decisions. Each person in the table below has circumstances that need to be fully understood in order for lenders to make optimal decisions.

		Gross income 2021	Discretionary income 2021	Discretionary income 2022	Change in Discretionary income 2021 to 2022
	**Jenny** Working mum of one, limited income	£17,601	£2,000	£1,408 **£953**	£592 **-£1,047**
	**Chris and Joanna** Affluent, middle age	£84,794	£20,000	£18,883 **£17,873**	£1,117 **-£2,127**
	**The George's** Two children, reliant on universal credit	£19,021	£2,300	£1,598 **£1,057**	£702 **-£1,243**
	**Albert** Retired, dependent on state pension	£8,983	£1,500	£852 **£429**	£648 **-£1,071**
	**Jess** Young professional	£28,201	£6,000	£5,183 **£4,680**	£817 **-£1,320**

The above examples are derived as an average across all deciles. It is a simplified example to demonstrate how Experian ONS+ data can provide a more accurate forecast of a consumer's disposable income and affordability so you can make better informed decisions on approvals for credit.

Jenny has lost half of her discretionary income in a single year. Armed with that knowledge, lenders can intervene early to offer appropriate help – doing the right thing, meeting their FCA obligations and leading to what has been shown to be a less costly outcome than allowing Jenny to drift into delinquency.

Chris and Joanna are not in a segment usually associated with risk. But a trimming of their discretionary income means they will have to adapt their spending habits. If the data shows that they are doing so, they remain potentially valuable customers for new credit products.

The George's have also lost half their discretionary income in 2022. Identifying that before they slip into arrears on their commitments would allow a restructuring of their debt before they move towards collections – an approach that allows the family breathing space and saves the lender money.

Albert, retired, getting by on the state pension, now has less than £40 a month in discretionary income and has exceptionally low financial resilience. He is clearly a vulnerable customer under FCA definitions and the lender therefore has an obligation to make him aware of support available and to avoid trying to sell him products that could make his situation worse.

Jess has also seen her discretionary income fall. However, it remains healthy enough that she is unlikely to default on a mortgage should she apply for one – and she would represent a lost opportunity for a lender if she were turned down due to a blanket policy to cut back lines of credit.

What the new landscape **means for lenders**

The critical message is that the crunch will affect consumers differently. Uneven consumer pressures, a diverse sector outlook, and polarised regional economic performance mean that stress is no longer well indicated merely by employment.

In late 2022 and beyond, overlapping economic currents will create a complex set of credit-risk and affordability challenges. Lenders will need granular, real-time data to manage risk effectively and see opportunities for growth.

Unemployment is no longer the only key to understanding risk

In past periods of economic uncertainty, lenders' best indicator of consumer stress and default was unemployment.

That is not the case now. Even people in employment will be stretched by the cost-of-living crisis. The key questions are:

- How much is the consumer earning?
- Is that income stable?
- Is it keeping up with inflation and the cost of living?
- In which industry sector is an individual employed?

Managing portfolio risk will demand more granular consumer analysis

The new landscape is one that cannot be understood well using tools based on averages or broad segments.

Portfolio risk management will require sophisticated analysis, with customer-level insight. The best-positioned lenders will be able to benchmark their portfolio positions against the rest of the UK market or specific peer groups. They will use that benchmarking to measure their effectiveness in portfolio management, to assess their levels of exposure, and to see how their customer risk profiles compare.

The full picture of risk will not be clear for many months and will keep evolving

Forecasting the probable effects of policy changes will be crucial. So will being able to forecast the effects on portfolios of different future economic scenarios.

There are still growth opportunities

There are millions of potential borrowers in the UK who are in robust financial health despite the cost-of-living squeeze. £492m of debt was paid down over the pandemic (Experian figures). Delinquency remains very low by historic standards. The housing market is booming.

Therefore, blanket policies to minimise exposure run the risk of lenders missing out on valuable business. Lenders who understand the changing needs of customers within the market will be able to see clearly where these growth opportunities are arising.

What should lenders be doing to **manage cost-of-living risks and maximise opportunities?**

- **The cost-of-living crunch is forcing organisations to think again about how they assess and spot changes in a customer's affordability** – and ability to pay. Lenders need to proactively monitor the emerging risks across their portfolio as the impact of the cost-of-living crunch plays out. They would also be wise to enhance affordability with additional models and data, in order to gain a more accurate view of today – and likely future change.
- **Portfolio assessments and stress tests** need to consider many more variables and indicators or predictors of risk. These should include factors at the macro, regional, household and account level. They should allow for multiple future economic scenarios. Doing so helps you understand what will impact who, to what extent and when.
- **Accurately understanding risk** will be crucial for informing credit origination and customer-management decisions, as well as for predicting delinquency and likely impact on collections resources. Automated and customer informed analytics will offer key insight in real-time which can be acted on.
- **Organisations need to understand the cost-of-living impact on capital adequacy**, contingent risk and the overall health of lending portfolios; exploring product lines and customer segments to understand where exposure is emerging – or will emerge as the cost of living impacts further.
- **Accessing additional data** which can enhance models is key. Enhancing traditional data like ONS expenditure estimates with extra analysis can provide a far more accurate view of income and expenditure to improve affordability calculations.
- **There are a variety of bureau-based data points** – including credit consumption, utility payments and Council Tax, as well as data on net and disposable income, current-account balances and inflation that need to be monitored.
- **New sources of consumer consented data** such as Open Banking and direct access to payroll information sourced from an employer (with a consumer's consent) provide more accuracy.
- **Lenders should implement customer-centric strategies** which support self-cure and flag predelinquency as part of their programme of proactive customer management.
- **It's clear that the introduction of effective customer management – and forbearance** – can mitigate the risk of collections. As we now move into the period of need – which will span up to five years – reinstating or developing forbearance strategies will become critical if you are to minimise risk and default, and provide the necessary support for consumers.

Conclusion: New landscape, new tools

Understanding an evolving credit landscape takes an evolving set of tools. Real-time, sophisticated and detailed monitoring of portfolio risk, customer stress and affordability has never been more important.

This means using a much wider range of data for risk modelling, based not on backward-looking averages, but on up-to-the-minute individual realities that reveal the truth about risk.

These insights can then be turned into actions that deliver clear value: strategy and policy changes that control risk while allowing growth; meaningful and effective early intervention when vulnerability is spotted; and optimised credit decision making.

A confident understanding of credit risk is what will allow lenders to thrive through the cost-of-living squeeze and beyond.

What data points do you need to monitor?

- **Credit consumption**
- **Current account balances**
- **Affordability**
- **Inflation**
- **Delinquency**
- **Capital adequacy**
- **Score and strategy performance**
- **ONS expenditure estimates**

Tools to help you stay informed

Account level economic forecasts

Cost of living indications

ONS expenditure updates

Credit market insight

Monthly insight of credit utilisation & delinquency

Bureau insights

Monthly Current account balance insights, credit scores and triggers

Categorisation on the Cloud

Automated bank + credit card transaction analysis in batch

Open banking

Bank + credit card transaction analysis in real-time

Digital payslips

Real-time exchange of payslips to verify income & employment

Buy Now, Pay Later Bureau

BNPL transactional data block of utilisation

Enhanced scores

Test, learn and simulate policy changes

Find out how we can help you

Our financial experts can work closely with your business to help you target, acquire and manage customers responsibly.
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