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READY TO GROW?

Lending with confidence in a time of uncertainty

November 2021

The economy is recovering
Now's the time to go for growth

To the surprise of many, the UK economy is showing tremendous powers of recovery and resilience as we move into the last quarter of 2021.

The government's furlough scheme has largely been a success, protecting jobs and businesses, as well as preventing millions from falling into unemployment. It's also played a critical role in allowing so many people to save money and pay off their debts more quickly. As a result, we've seen a notable improvement in credit ratings and affordability levels.

But there are, of course, still concerns – about everything from what happens next with the pandemic, to the full impact of Brexit on jobs and living costs.

Understanding the implications of this period of transition and the disparities of consumer requirements is crucial.

At Experian, it's our belief that despite the complexities in the market, lenders shouldn't play the wait-and-see game any longer. The depth and coverage of bureau data – the insight it reveals about people's credit behaviour and their capacity to borrow – can provide the invaluable tool you need to improve your decisioning and help you get back to lending.

In this paper, we explore specific current economic trends and look at strategies that can support return-to-growth initiatives.

About the **authors**

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Craig Lupton - Craig Lupton is the Consumer and Automotive Insight Lead for Experian's UK Data Office with 20 years experience working in the UK credit industry. Craig spent 10 years working in the banking sector specialising in collections strategy, vulnerability and customer experience. He has a wealth of knowledge in analytics, data visualisation and interpretation and has spent the last 10 years delivering consultancy, insight and analysis on the consumer lending markets for Experian.

Dave Kerry - Dave Kerry is Head of Insight for Experian's UK Data Office. He has over 25 years experience across the credit risk life cycle with a specific focus on analytics, decisioning, data and insight. Following more than a decade in banking, Dave is currently in his 11th year at Experian where he has delivered a host of successful and complex data and insight projects in the consumer, commercial, private and regulatory sectors, in addition to analysing and presenting on credit risk trends affecting the industry and it's consumers.

Simon Waller – Simon Waller is part of Experian's UK Go-to-Market Leadership team responsible for Experian's market-facing strategy, engagement and client relationships with all the UK and Ireland major banking institutions. A highly experienced sales and business leader, with a broad technology and consulting background, he has an excellent record of delivering sustainable business growth through continuous innovation and a high-performance team culture.

The great **bounce back**

The easing of lockdown has significantly boosted the UK economy, with July 2021 marking six straight months of economic growth.

Employment rates are up, and despite one of the worst recessions in history, households on average are financially better off today than they were before the pandemic.

Monthly GDP Growth (%)

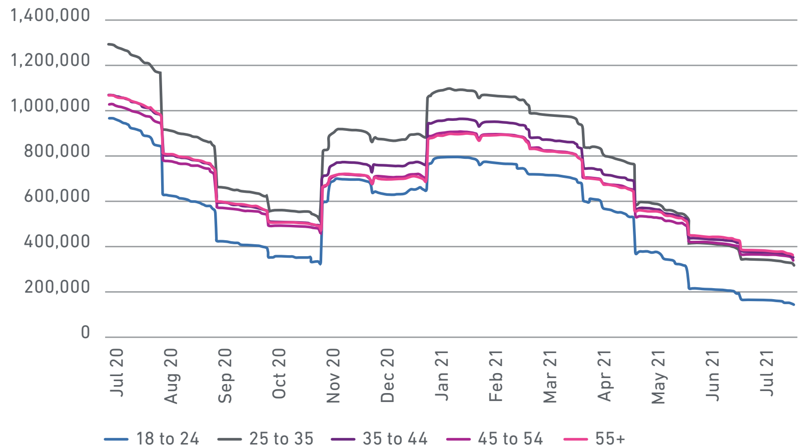
Source: ONS

A recession like no other

Every recession in history has led to a fall in household income, but the pandemic and resulting economic shock is markedly different. The lack of opportunity to spend, along with income and job protection through the furlough scheme, emergency payment holidays and other support mechanisms, have led to many people saving more and paying off their debts. At the same time, delinquency rates remain low and stable as consumers make use of the breathing space and either resolve their debts or repay them.

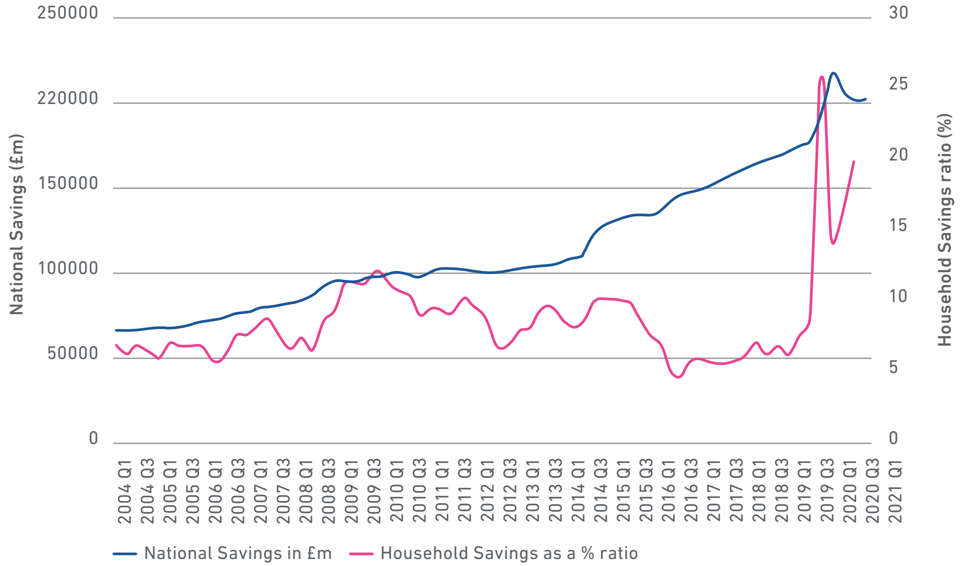
Furloughed employees: a downward trend across the age group

The recent trend for furloughed employees is downward across the age groups, but interesting trends emerge when you look at the composition.



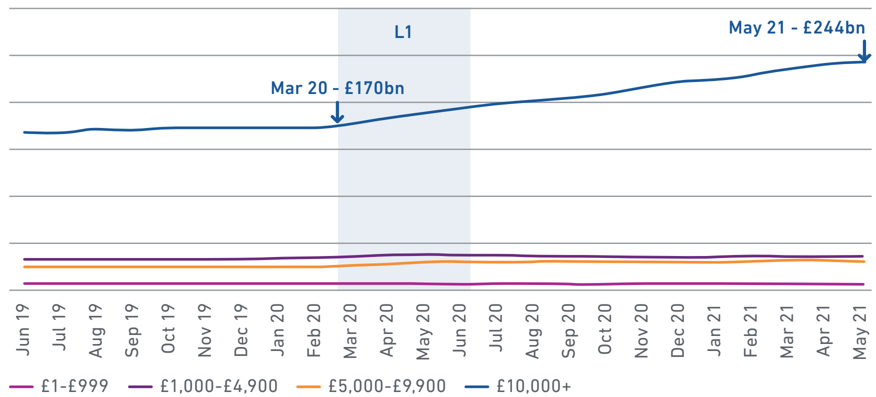
Source: HMRC CJRS and PAYE Real Time Information. **Figures are as of 1st July 2021

Saving more and...



Aggregate bank balances (in credit) by band

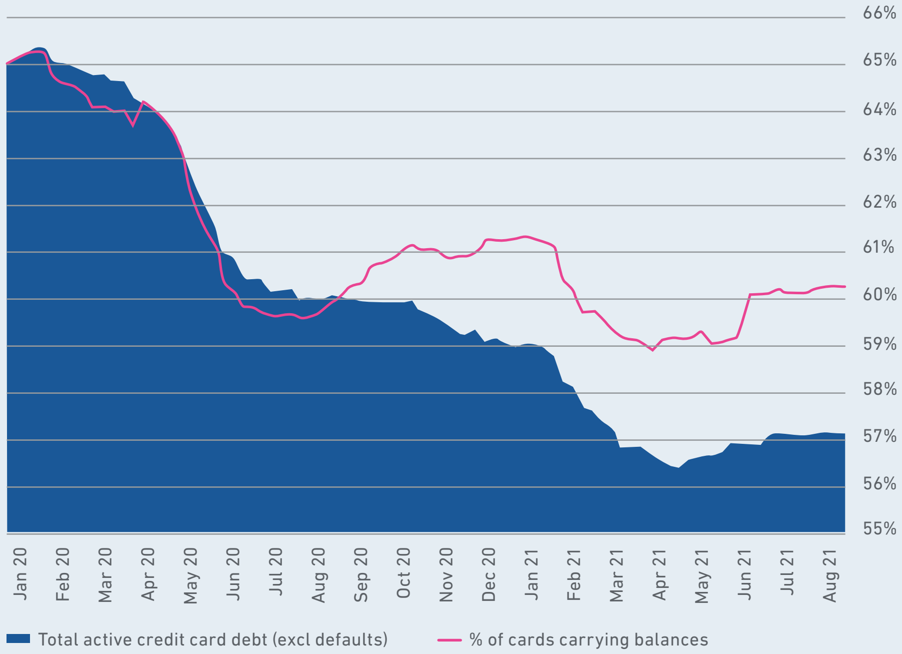
64m accounts across 48m people - including May 21 balances



Source: CATO

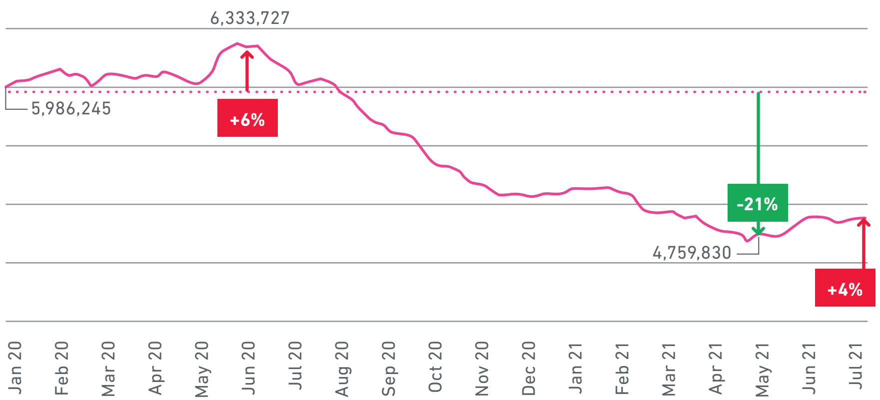
...paying off debts

Credit card balances and % of cards carrying a balance



Delinquency rates **remain low and stable**

Collections status 1-6 (account volumes) - total credit market
Data to 19/07/21



But the picture is polarised

Consumers that have remained in full-time employment and continued to receive a regular salary have had the opportunity to save and reduce their credit commitments, as their cost of living has shrunk. Dive into the detail though, and we see that it's high/middle-income families - the so-called 'Covid Comfortables' - who are more than twice as likely to have reduced their debt during the pandemic than lower income families.

At the same time, it's older consumers who appear to have had the financial resilience to weather the storm, or in some instances even prosper.

Since the start of the pandemic...

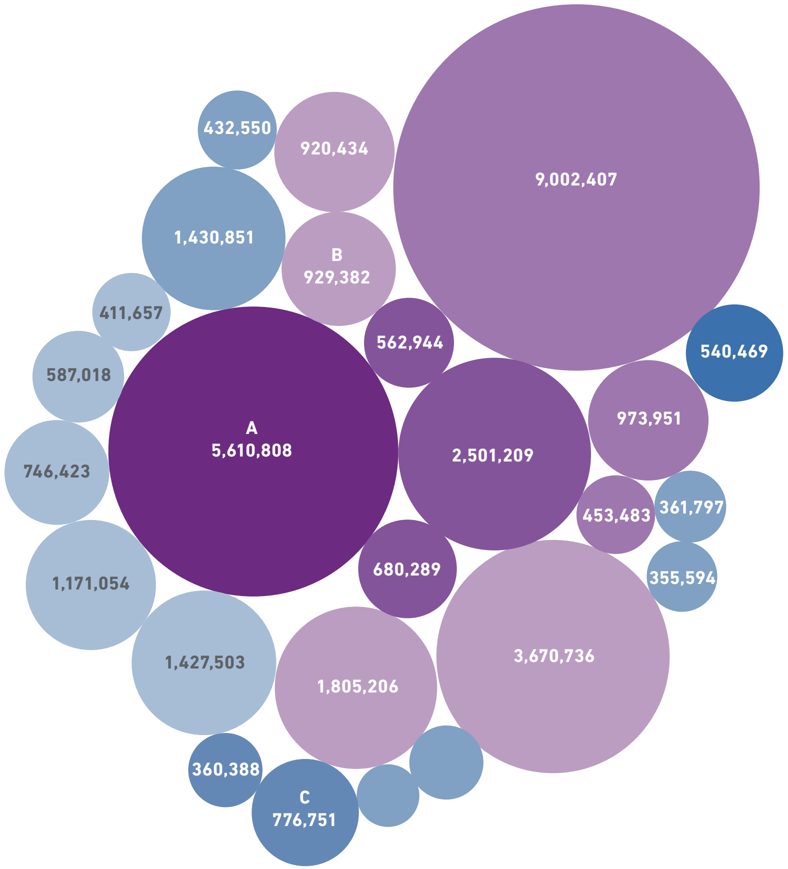
£12bn in credit card balances paid off

£250bn increase in current account balances

£500bn increase in personal savings

Segmenting credit risk

Figure 10: Segmentation of the Experian consumer bureau by credit risk



UK Population % - 66

Segment A – Excellent credit risk

Low levels of indebtedness, low search activity, no payment holiday taken through the pandemic, and income has remained good.

Segment B – Good credit risk

Though they have made use of a payment holiday during the pandemic and have medium forecast unemployment risk.

Segment C – Poor credit risk

Highly indebted with a poor credit score, with a risk of unemployment.

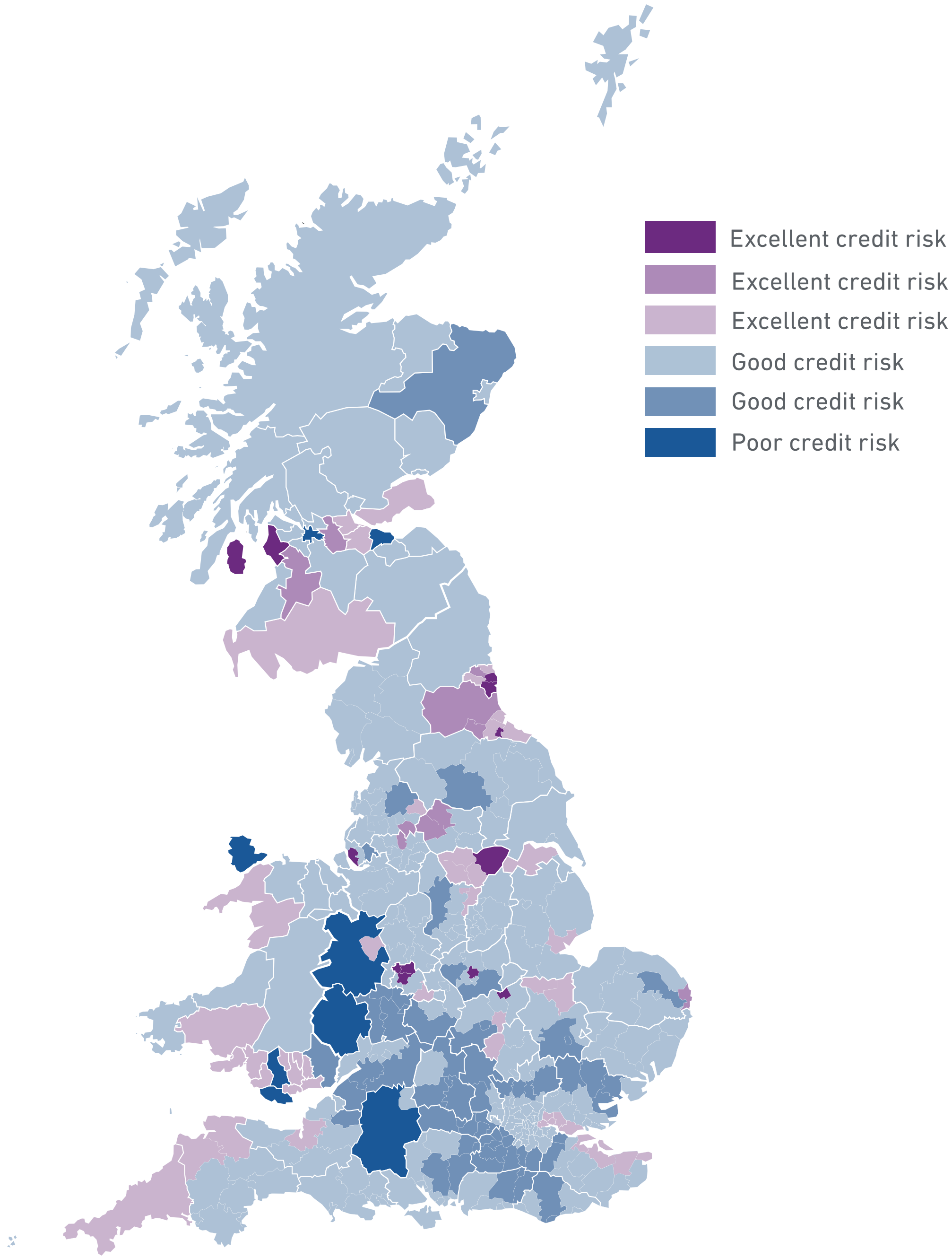
Experian's consumer bureau has identified 5.6m consumers who represent excellent credit risk. An increase of 1.1m consumers who have improved their credit status in the last 12 months.

UK distribution of **credit risk**

Double disparity

For the 6.6m consumers who have suffered a significant drop in income as a result of being furloughed or losing their jobs, and the 3.5m who took out an emergency payment holiday, the pandemic experience has been very different. Many of these consumers are younger, employed in industries such as retail, hospitality and travel, and are credit active but maybe less financially astute.

Their credit behaviour prior to the pandemic pre-disposed them to increased financial vulnerability. The impact of Covid has exacerbated this weakness and left them struggling to make ends meet. Their lack of experience of previous recessions and limited money management skills has disadvantaged them, leaving them less well-equipped to deal with the financial fallout of the pandemic.



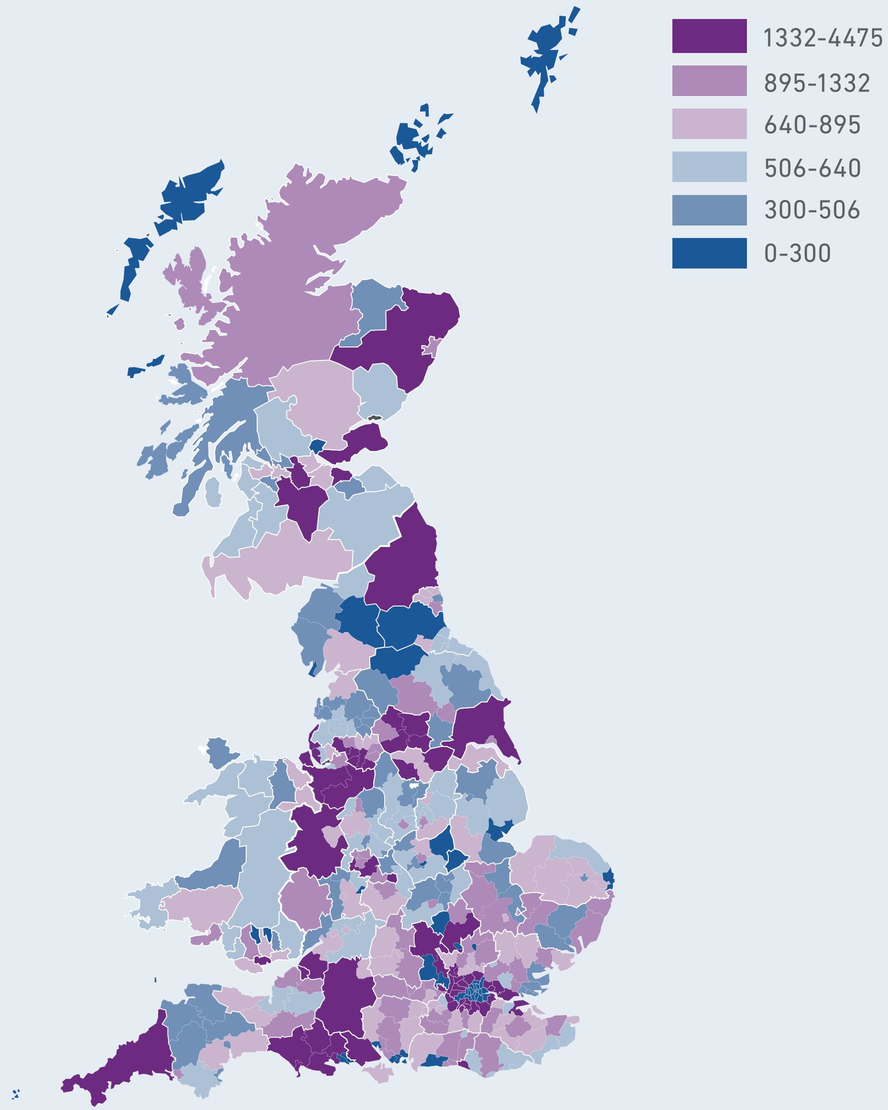
UK distribution of **real household disposable income***

Payment holidays and the breathing space permitted on debt repayment has given the most financially exposed consumers the opportunity to defer credit repayment. However, signs are already emerging that these consumers will fall into further hardship, particularly if they seek to maintain their pre-Covid consumption of credit.

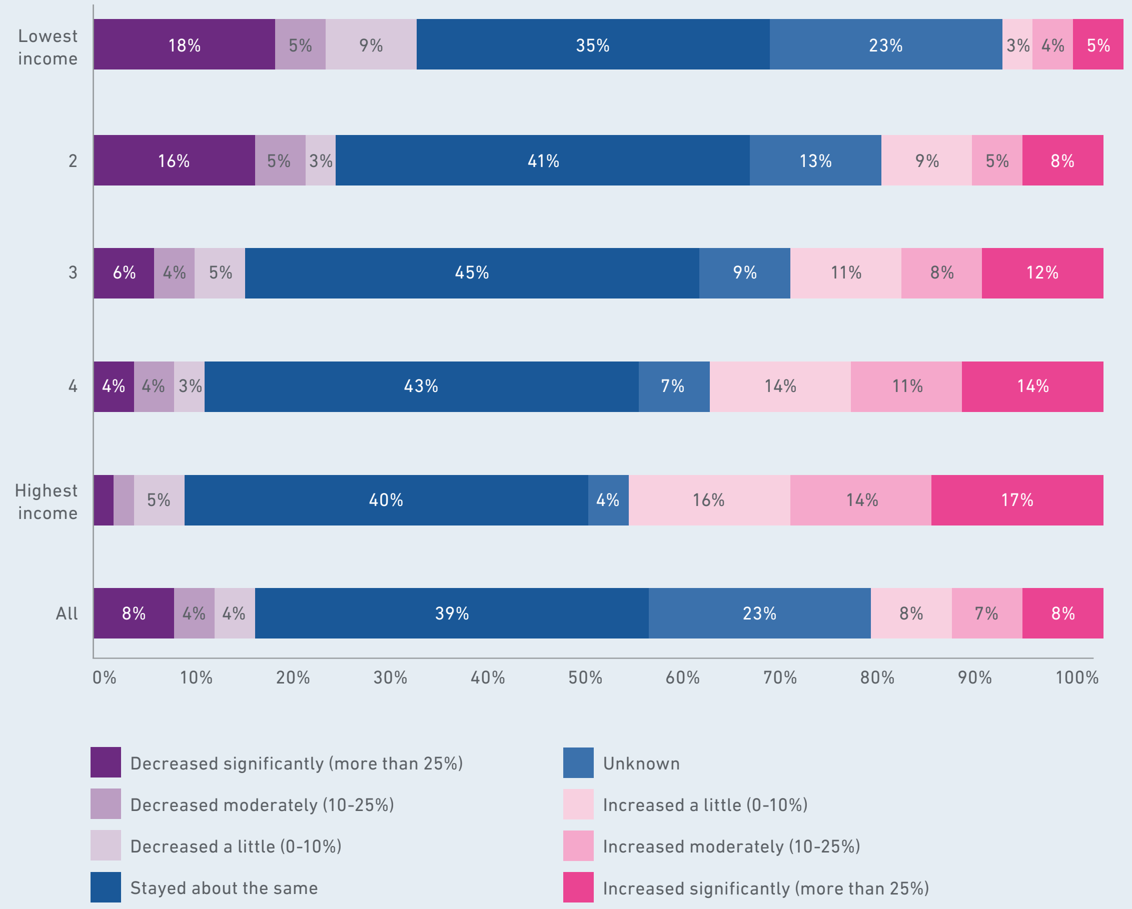
*Real household disposable income is defined as total income (be that from wages, interest accrued, property income and/or dividends) after income tax and national insurance as well as council payments and interest due. This is adjusted in real terms, taking account of inflation.

While on average consumers have better financial health, now is a critical time to ensure the continuation of habits is monitored. Should we return to the same behaviours as pre-2020, the impact is likely to be sharper and more severe.

Real household disposable income (£, 2021)



Proportion of families reporting changes in savings, by income quintile: UK, February 2020 to May 2021



Source: Resolution Foundation

Better customer quality, **improved credit market?**

The broad improvement in household financial health, along with lenders restricting access to many products, has led to a significant increase in customer quality with, on average, lower credit risk and better affordability than before the pandemic.

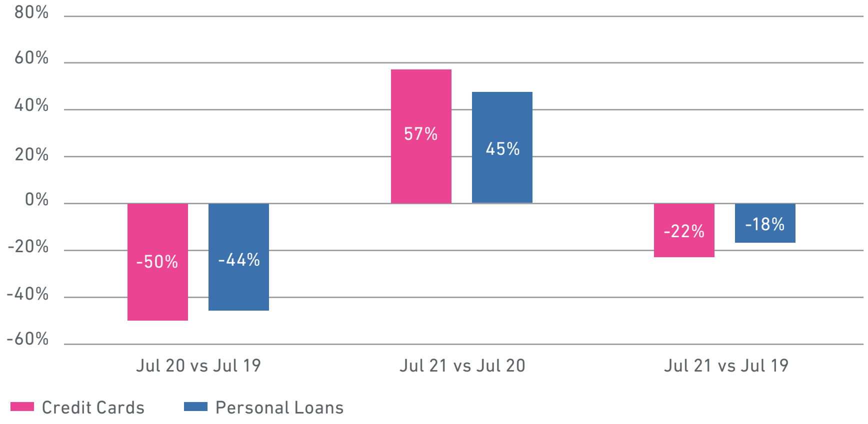
But the improvement in customer quality has not, so far, translated into widespread improvement in the credit market. Unsecured lending remains way down over the same period in 2019, even though we've seen a big increase in online searches for credit cards and loans since the third lockdown lifted, suggesting an appetite to spend.

It's critical to monitor portfolios at a macro and household/account level to ensure averages are not misrepresentative of reality. In addition, it's worth remembering that change can happen fast. As such, monitoring your portfolio and scorecards, alongside revisions to policies and strategy rules, becomes a critical requirement in order to respond and react.

Unsecured lending applications

July 2021 vs July 2019

Average Daily Volumes July MTD Comparison



Secured lending applications

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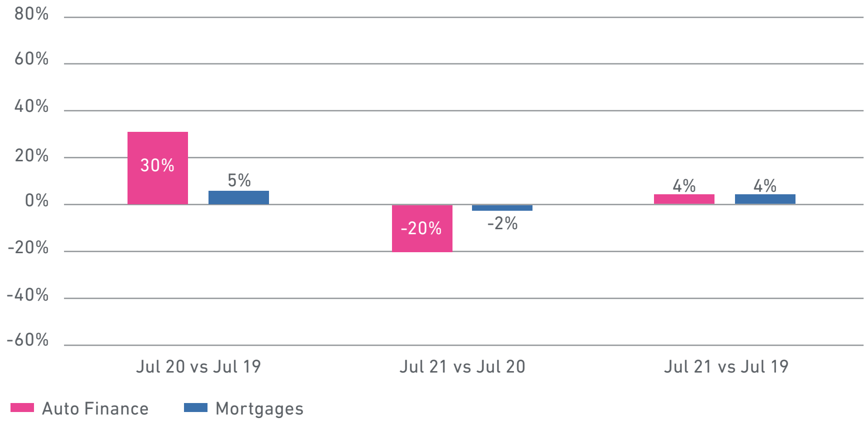


Credit cards

22% lower

Personal loans

18% lower

Mortgages

4% higher

Auto finance

4% higher

Uncertainty leading to hesitancy

As we head into the tail end of 2021, the UK population is ready, willing and able to start spending again on everything from holidays and entertainment, to new clothes and eating out. Credit searches are up by 18% in the first two weeks after Covid restrictions were lifted. The increase in current account balances over £10,000 has slowed, possibly due to consumers spending again. In fact, online retail sales have seen four years of growth in just 12 months. Once these savings are depleted, consumers may start to turn to credit even more, driving increased demand.

With a definite shift in consumer mood, we've started to see lenders bring products back to market. 61% of customers using Experian's Marketplace in August 2021 saw a credit card they were pre-approved for – a 30% increase on January's figures. Similarly, in the same month, 44% of customers saw a loan they were pre-approved for – a 33% increase over the same period.

However, we are still seeing some hesitancy in the credit market. Why?

1. Pandemic unpredictability

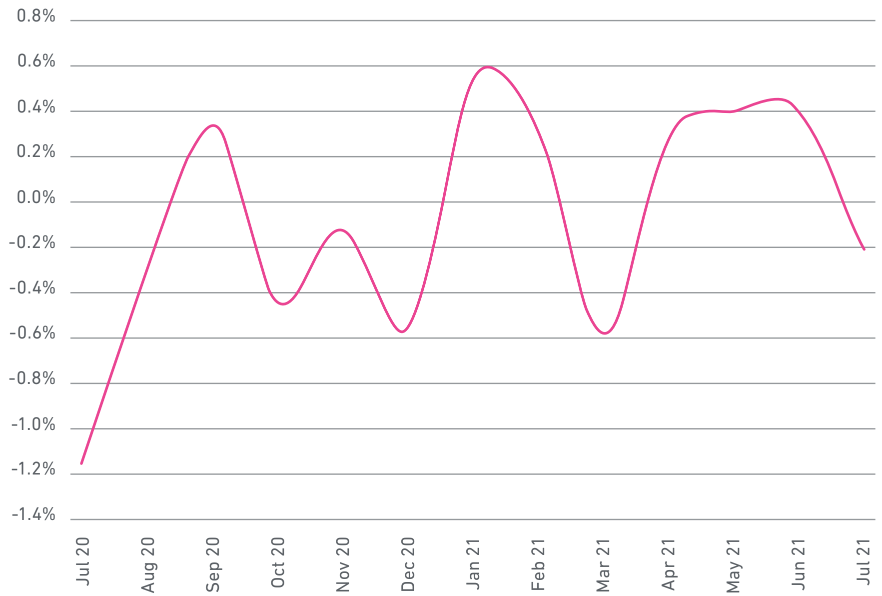
As of September 2021, a return to a full, nationwide lockdown seems unlikely, particularly as the vaccines continue to keep hospitalisations and death rates relatively low. But there's still a lot of uncertainty around Covid. Rates are rising as we head into winter, and we don't yet know the full effect school, university and office returns will have in the months ahead – not to mention the potential for further virus mutations.

It's worth noting that with each subsequent lockdown, the economy has adapted and become more robust, suggesting that it can cope with further restrictions.

2. Jobs uncertainty

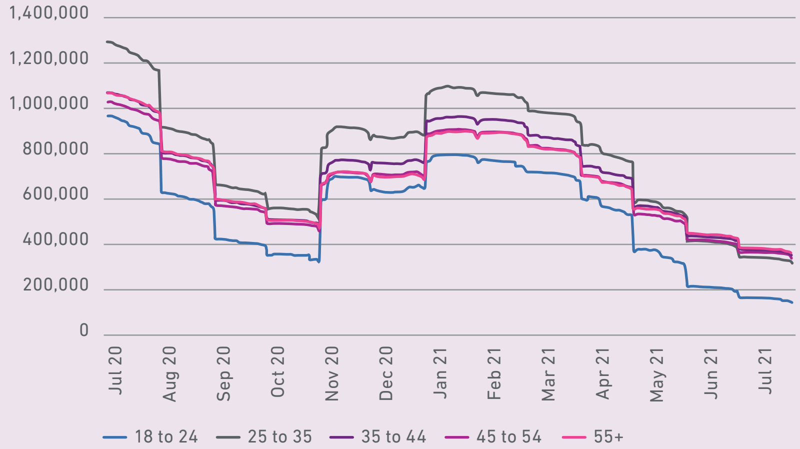
The labour market is recovering, with vacancies at an all-time high. Although the alarming unemployment levels once predicted seem to have abated, the end of furlough could still see around 500,000 (mostly older) people left unemployed. How quickly and easily will these people find work again?

UK employment growth (%, 16-64)



Source: ONS, LFS

Number of employments on furlough by age



Source: HMRC CJRS and PAYE Real Time Information. **Figures as of 1st July 2021

3. Cost of living increases

The yet to be fully realised impact of Brexit, product shortages, rising utility bills, the predicted cut to Universal Credit and increase in National Insurance could leave many households feeling the squeeze in the coming months. As we've seen, there's a cohort of consumers that have been already badly affected by the pandemic. As the cost of living increases, this group could be tipped over the edge into delinquency and debt that will start to impact on the health of your portfolio. Understanding exactly who will be affected – and how – will be key.

4. Consumers reverting to type

Perhaps one of the biggest concerns for lenders is that the improvement in customer quality over the last few months is temporary and that, with the economy opening up again, it won't be long before everyone returns to their pre-pandemic behaviour.

The big questions now are what have consumers learnt from the pandemic and will its impact make them more cautious in their consumption of credit? With more money saved and debt reduced, will consumers feel confident enough to resume their lending habits of the past?

The economic constraints, including tax rises and inflation, may well make consumers more cautious, but it's clear that for some the impact of the pandemic may have already pushed them into irreversible debt.

A tale of **two generations**

Although it varies by market, the last few months have seen a definite shift, with younger people offering growth opportunities for lenders. This is particularly apparent in mortgages, following the changes in stamp duty, and also deferred lending thanks to the boom in fast, frictionless, buy-now-pay-later (BNPL) players targeting customers at the point of sale (see to the right). While this audience might have an appetite for credit, poor financial management and lack of understanding of credit may well make them more exposed.

At the same time, we've seen a reverse of the lending-into-retirement trend of recent years, with older people – perhaps more financially savvy and naturally cautious throughout the pandemic – less in need of credit. However, will the younger generation, particularly those looking to buy for the first time, increasingly need the Bank of Mum & Dad? If so, we could see an increase in credit demand for that older population.

Right now, the challenge for lenders is to satisfy the needs of a credit hungry, digital-savvy, less risk-averse younger generation, while offering products that are attractive to older, more financially stable people, who could be ready to start spending again.

BNPL's instant value

Although the younger generation have always, generally, been indifferent to using credit cards, they do strive for a smooth digital experience and convenience. With BNPL, they get both: a quick decision – handily integrated within the retail site they're using – and zero interest if they pay within 90 days. It's instant value providing instant access to a purchase.

The growth in BNPL represents one of the biggest changes in the UK credit economy for a decade. Whilst its deployment in other global economies is more established, the advent of BNPL In the UK is dramatically changing the dynamics of credit supply, and the financial behaviour of UK consumers. It represents both a redistribution of spending behaviour by consumers, as well as a growth opportunity for lenders.

The challenge for traditional lenders is how to compete with the BNPL players and offer similar levels of frictionless decisioning. Any solution requires an understanding of affordability, whether that's via bureau data supplemented with additional insights , or via Open Banking which brings the added value of behavioural and attitudinal characteristics for credit that can reveal vulnerabilities, as well as head-room for credit.

Reducing risks through **clarity and certainty**

This is an unprecedented time. On the one hand we have a UK population with improved credit risk and affordability (albeit unevenly spread). On the other, we have an economic climate made unpredictable by multiple, increasingly complex risk factors (not least of which the double-whammy uncertainties of Covid and Brexit).

For lenders, a more nuanced understanding of customers and how they could be affected by so many variables is the key to securing future growth.

The insight to get you back to growth

At Experian, we've invested heavily in increasing the depth and coverage of our bureau to include trended behavioural data and Covid-related insight such as income shock, payment holidays and account turnover metrics.

These are complemented by non-traditional data sources, including bank transaction information, which is invaluable for identifying financial resilience and vulnerabilities. This is now being extended to include access to payroll data to verify an individual's income and employment directly from their employers HR payroll. Automating access to payroll data has tangible benefits in providing additional credit risk insight, as well as opening up the opportunity for extending financial inclusion to individuals such as those employed in the Gig Economy whose transient employment lifestyle can limit their access to mainstream credit.

Of course it's not just about the data, value comes from the insight you can derive from it. Through state-of-the-art modelling and machine learning, you can dig deep into scenarios and customers on an individual level to understand what impact those uncertainties around the pandemic, employment, Brexit, the cost of living and even climate change are having.

That insight can power robust, more automated decisions and faster, more customer-friendly digital journeys. You can then quickly test your approach and monitor performance, deploying change in real time.

How **Experian data** can help you

Our Experian Ascend offers you a window on to our credit bureau combined with a powerful set of analytical tools that can be used to benchmark your market performance, improve the accuracy of your credit insights and proactively manage your credit strategy. The Ascend platform includes a set of self-serve analytical tools - Sandbox, Data Services and Insights - as well as Ascend Intelligence Services which give you access to our analytical expertise as a managed service to help you build, optimise, deploy, and monitor models through a single platform.

Identify the economic trends that will shape your business strategy moving forwards. Understand how your credit portfolio compares to your peers and how it's likely to be impacted by changes in lending policy, market competition and the economy in the future. Our experts in economics, credit risk, market analysis and portfolio benchmarking combine to provide an in-depth understanding of economic data and the market and economic context in which you manage your business – now and in the future.

Use our consultancy and expertise to understand how your business is performing in relation to the market and your competitors. Experian's new Consumer CAIS Insight dashboard can provide this insight, giving you a more detailed understanding of the impact of changes in the economy on your portfolio and consumer consumption of credit.

Experian's Consumer Bureau can help you manage borrowers carefully and fairly by having a complete, accurate picture of their financial well-being. The growth in the coverage and depth of our bureau data means that we can provide you with more detailed and timely insight to accurately identify opportunities for growth and protect the vulnerable to keep you and your customers safe. Use our latest Delphi Generation 11 scores and data blocks to enhance your insight and improve your credit performance.

Find out how we can help you

Our financial experts can work closely with your business to help you target and retain better quality customers. Find out how:

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