REPORT

EXPERIAN UK SMALL AND MEDIUM-SIZED ENTERPRISE (SME) **CREDIT TRENDS INDEX**

January 2024

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Foreword

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Optimistic signs, but no certainty yet

After a bruising few years for UK SMEs, there are small yet cumulative signs of optimism. 2023Q4 saw a gradual easing in inflation and the prospect of interest rate cuts.

Our data reveals a strong demand for business credit, facilitated by a growing alternative lending market and slowing business failure in certain sectors. Yet caution is the byword for 2024: with simmering tensions in the Red Sea, an unexpected jump in December's inflation and the prospect of a general election, certainty for lenders remains in short supply.

Indications of a possible thaw ahead

With the UK economy frozen in a state of no growth and high inflation, 2023Q4 heralded a possible thaw. **GDP grew by 0.3% in November**, with a rise in both services and production, and business sentiment strengthened.

Slower pay growth and falling unemployment were matched by an overall falling trend in inflation, increasing the likelihood of interest rate cuts. Meanwhile with house prices once again looking more stable, and with a slight uptick in January '24,coupled with easing mortgage rates and an upsurge in mortgage approvals, could indicate a rise in future borrowing.

Businesses themselves are worrying less about energy prices and inflationary pressures despite their anticipated increases, but more about falling demand for goods and services. **Though insolvencies remain high, there are hopeful signs: for the first time since 2021Q2 there were more business creations than closures.**

Three SME credit trends to watch

#1

Demand exceeds supply

Our data shows no shortage of demand for credit. Online credit searches, increasing year on year, hit a 4-year peak, as businesses looked to ease cashflow or invest in growth. Yet SME lending actually fell in 2023, indicating a strong disconnect between demand and supply. Traditional bank loans that previously dominated the lending market are in decline.

#2

Alternative lenders fill the gap

On a positive note, the slack in traditional loans and mortgages is being taken up by alternative lenders with alternative products. FinTechs have grown their market share steadily over recent years, and this trend accelerated in 2023H2 with a swing towards revolving credit providing SMEs with more flexible borrowing options.

#3

Credit performance shows signs of improvement

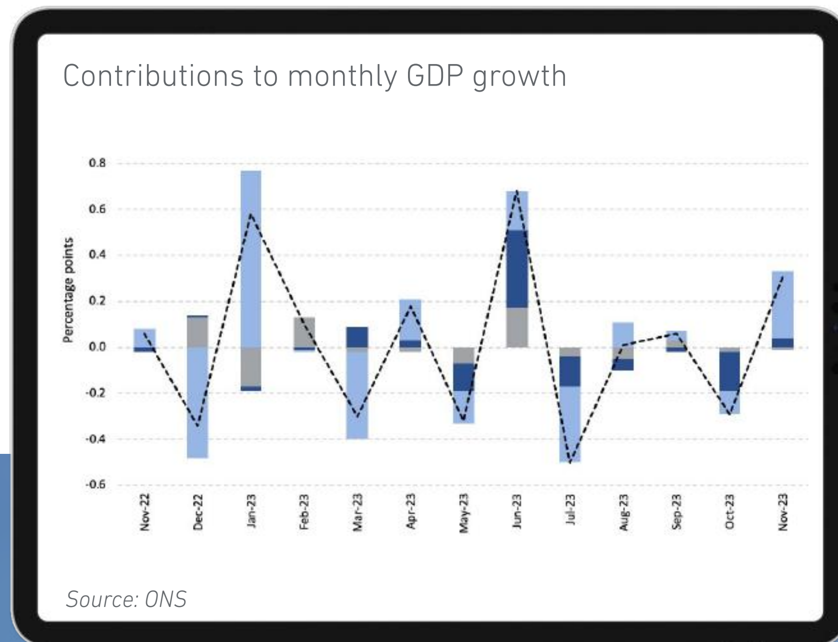
SME delinquency rates rose overall in 2023, but rates stabilised and even fell by volume in December – potentially good news after years of persistent rises. Closer inspection reveals that poor credit performance is largely being driven by loans and mortgages, with fewer issues across asset finance and revolving credit. Many sectors are actually bettering their credit performance: accommodation and food services, while still suffering the highest delinquency rates, have also demonstrated the most improvement.

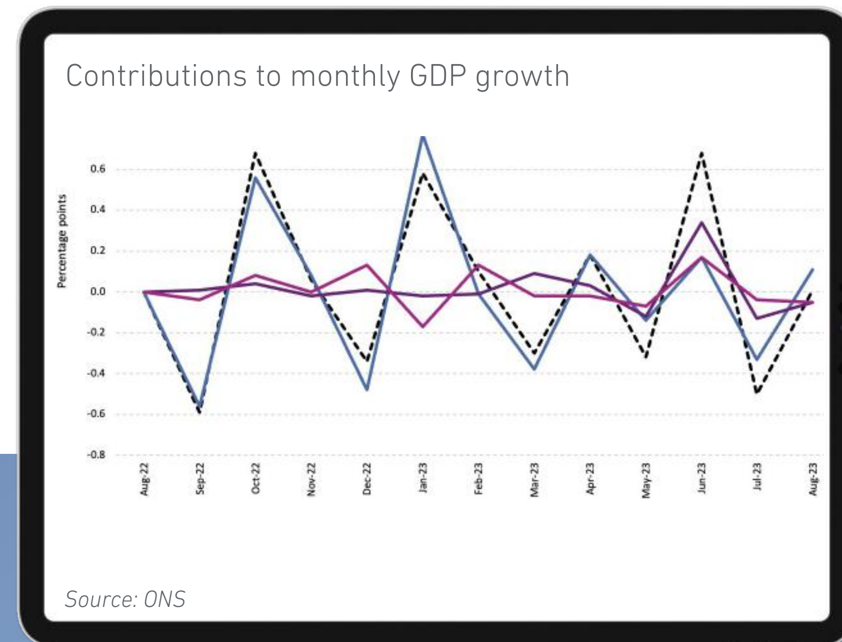
A warmer outlook for 2024?

Optimistically then, businesses will be looking to 2024 for growth. But the forecast is still unclear. Cautious businesses may delay investment until after the General Election. December's unexpected uptick in inflation could stall the lowering of the Bank of England base rate. The fluctuating Red Sea crisis could yet push inflation northwards and undermine business confidence. But with demand for lending growing, it is clear that there is still more for lenders to do. The best lending decisions will come through assessing risk by examining data, not just in the round, but at a specific sector and individual company level.

Macroeconomic outlook

Improving fundamentals to underpin a mild recovery this year





GDP grew by 0.3% in November, following an unrevised fall of 0.3% in October. This leaves the economy 2% larger than it was before the Covid-19 pandemic (February 2020).

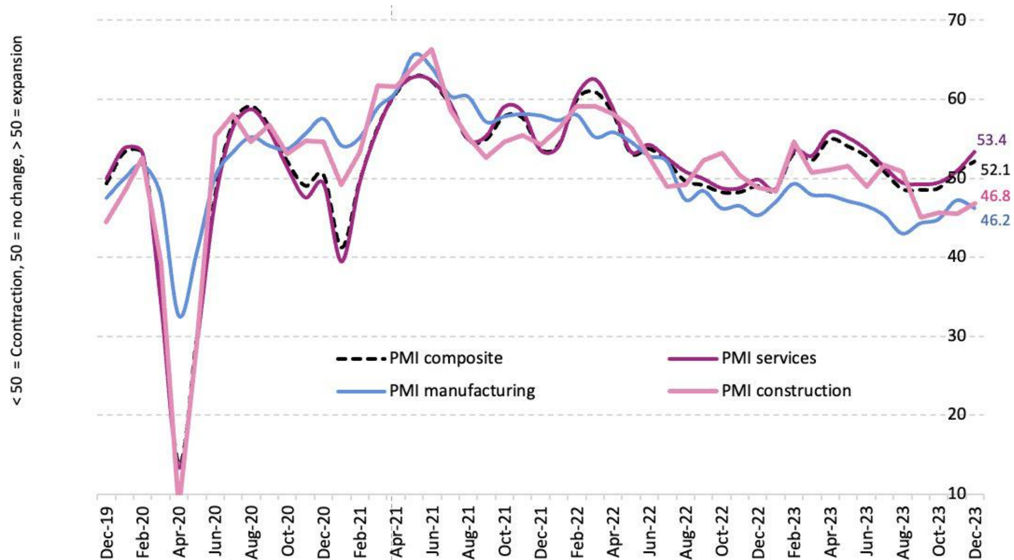
Services grew by 0.4% and is roughly 5% larger than it was pre-pandemic, despite a near 6% shortfall in consumer-facing services. Production, grew by 0.3%, but is around 13% smaller. Conversely, construction, which had been an outperformer has faltered in recent months, as elevated mortgage rates dampen private house building.

The UK economy has barely grown over the past year, and with GDP contracting by 0.1% in 2023Q3 a recession could yet show up in the data for 2023H2.

However, as we head into 2024 economic fundamentals have begun to improve. Inflation has eased markedly, the unemployment rate remains low, and strong, albeit easing pay growth is supporting rising real incomes. Easing inflation also brings into focus the possibility of interest rate cuts.

While we expect output to grow mildly, upside inflationary risks linked to geopolitical tensions in the Middle East and the ongoing conflict in Ukraine could derail the recovery.

Business sentiment improved towards the back end of last year



Source: S&P Global, CIPS

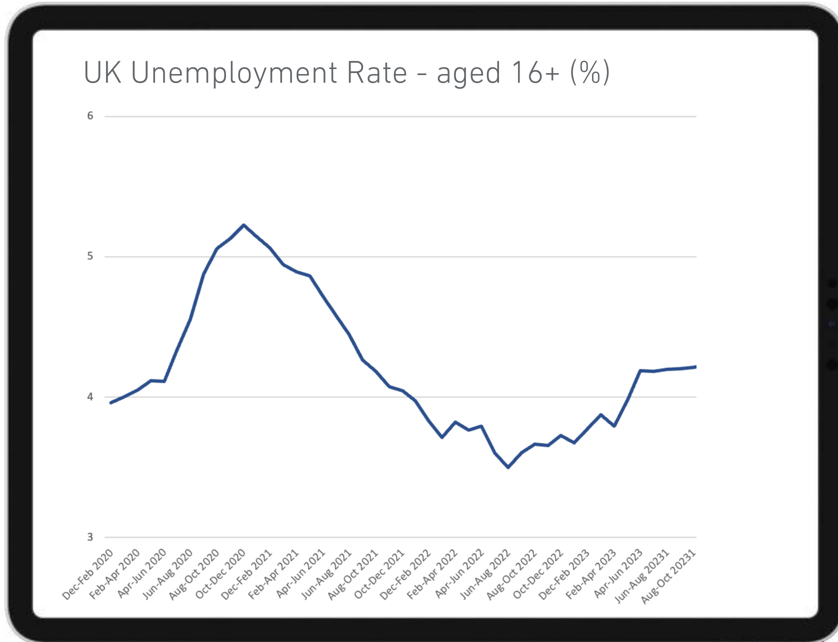
Business sentiment has responded positively to easing inflation, with the Composite Purchasing Managers' Index (PMI) rising to 52.1 in December, the second consecutive reading above the neutral 50.0 value, and the highest since June.

The recovery during the holiday season was particularly strong within the service industry leading to the sharpest uplift in the performance outlook for the year ahead in twenty-four months.

Conversely, while the manufacturing PMI also improved in December, it remained below 50 (indicative of declining output) for a seventeenth consecutive month. All five of the manufacturing sub-indices (output, new orders, employment, stocks of purchases and suppliers' delivery times) came in below 50.

The construction PMI has also remained in negative territory for a fourth month in a row, at 46.8. Activity fell in all three subcomponents (house building, civil engineering and commercial), with the former posting the lowest reading at 41.1.

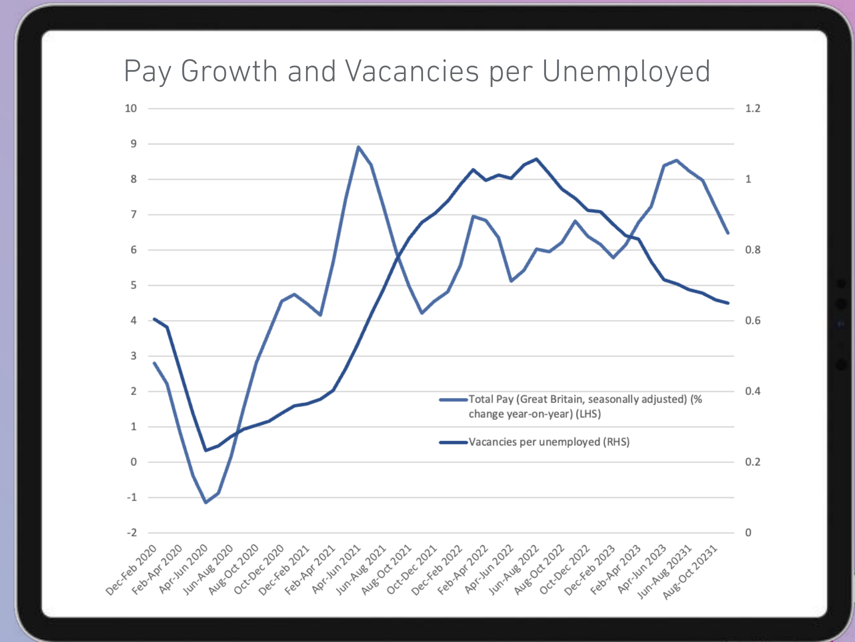
Improving fundamentals to underpin a mild **recovery this year**



Unemployment rate
Unemployment rate (Aged 65+)

Quarterly Change: nil
Since Dec-Feb 2020: +0.3pps

The Unemployment rate has drifted up from a low of 3.6% in 2022Q3 but remains low by historic standards.



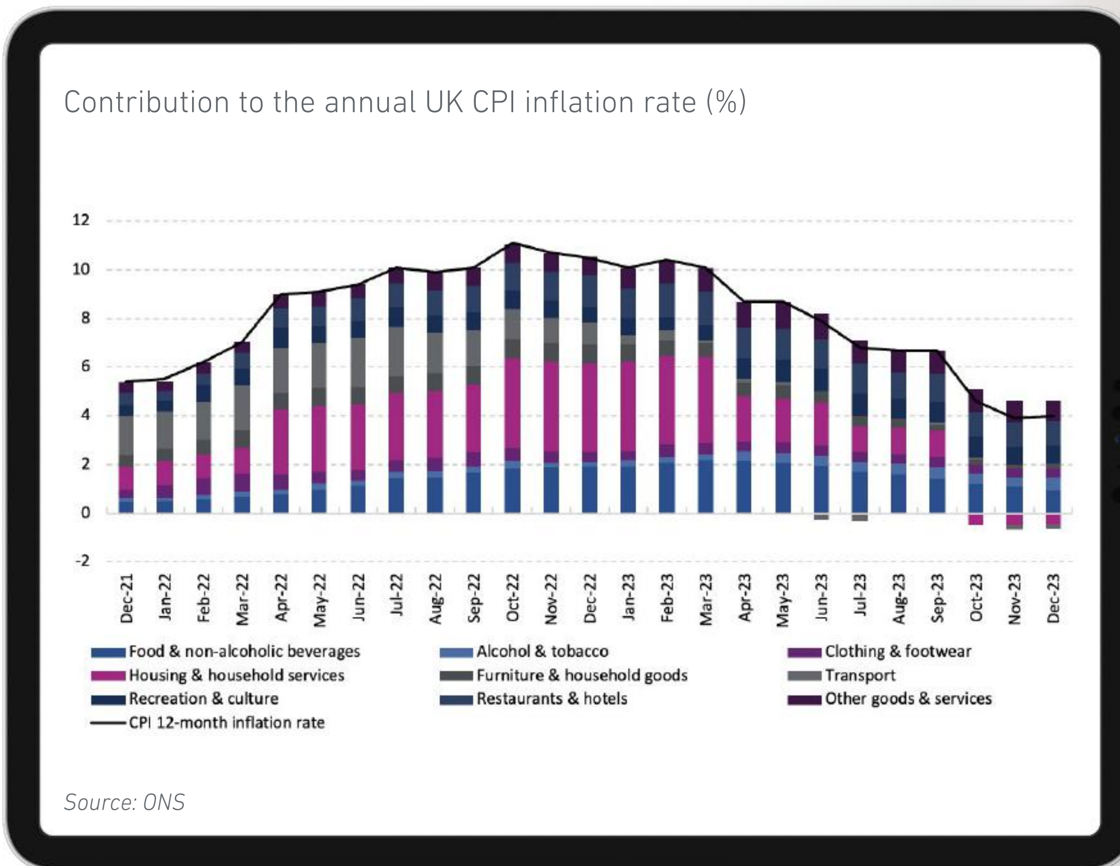
Job vacancies
Unemployment rate (Aged 65+)

Quarterly Change: -49,000
Since Dec-Feb 2020: 108,000

Job vacancies receded further from a record high of 1.3 million in the first half of 2022, to 934 thousand in 2023Q4.

The number of vacancies per unemployed, a measure of tightness in the labour market has moderated to near pre-pandemic levels. This underpinned a slowdown in total (including bonuses) and regular (excluding bonuses) pay growth in the year to September – November, to 6.5% and 6.6% respectively, down from peaks of 8.5% and 7.5% in June.

CPI continues easing, **but remains high**

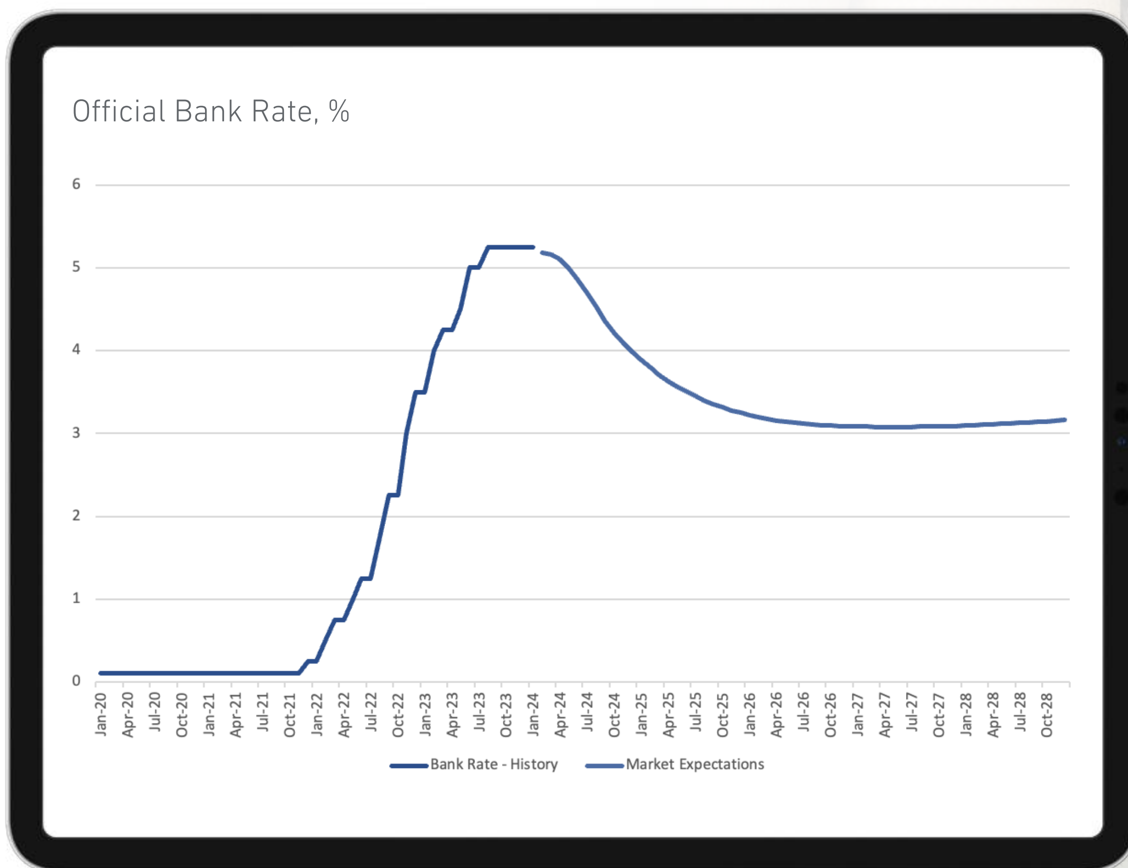


Consumer Price Index (CPI) inflation rose by 4% in the 12-months to December 2023, up slightly from the 3.9% registered in November.

Goods inflation eased by 0.1 percentage points, to 1.9%, with a corresponding upward move in services inflation, to 6.4%.

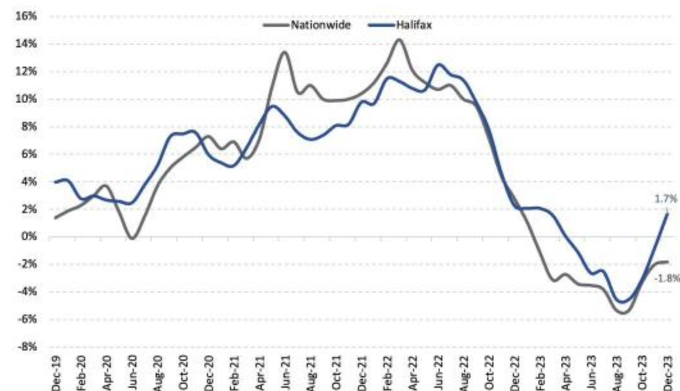
Inflation has trended down since peaking at 11.1% in October 2022, and an expected drop in the Ofgem Energgy Price cap in April is expected to bring the rate down nearer to the 2% target.

Markets expect rate cuts **from as early as May**

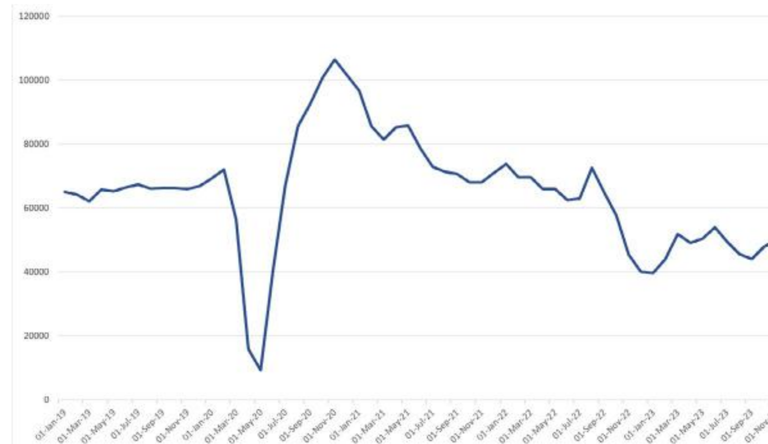


With pay growth and inflation easing more swiftly than the Bank of England (BofE) had been forecasting in November and the economy flatlining, market expectations for interest rate cuts have been brought forward. The latest yield curve from the BofE shows Bank Rate dropping to around 4% by the end of the year, from 5.25% currently.

Housing trends: **downturn becomes entrenched**

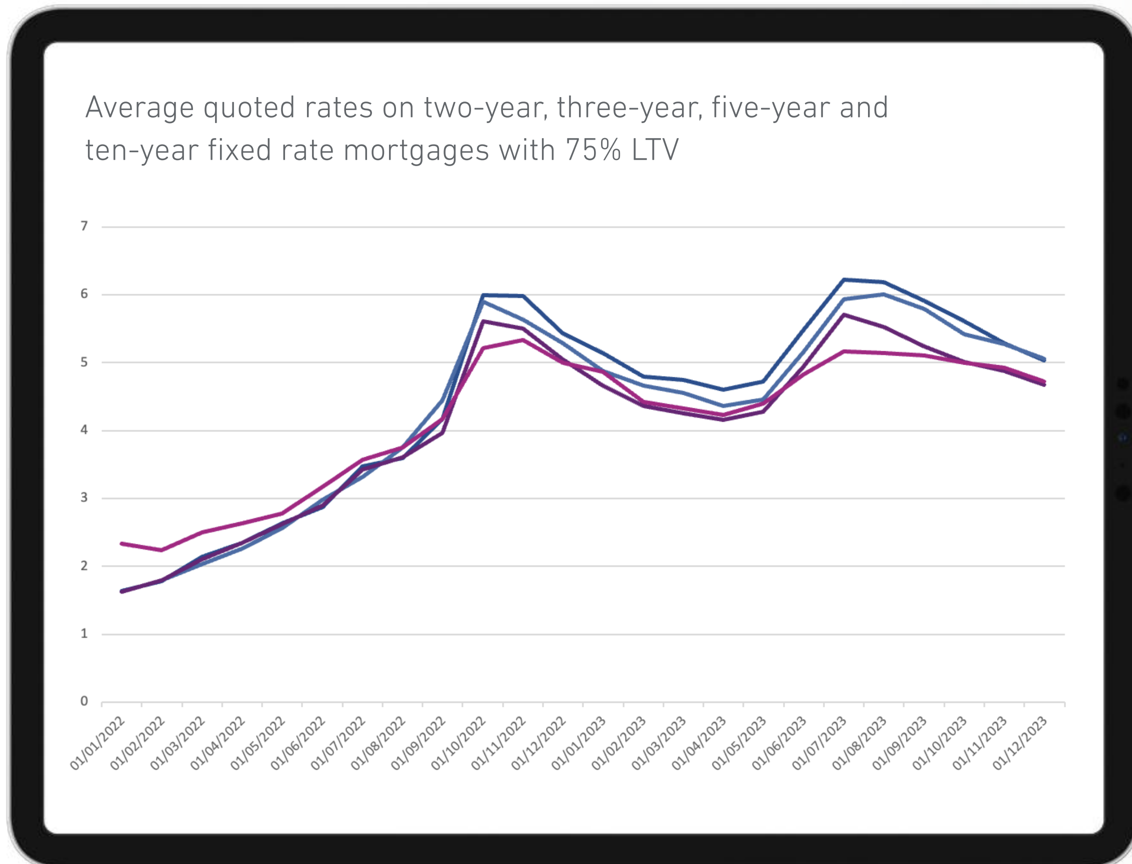


House prices dropped by between four and five percent on an annual basis over the summer, but by December the declines had moderated to 1.8% according to Nationwide, and the latest Halifax data shows a return to growth (1.7%). Further declines are expected to be mild given easing mortgage rates and low supply.



In November, mortgage approvals for house purchase, an indicator of future borrowing, rose to 50,100, from 47,900 in October, having bottomed out at around 40,000 in late 2022. However, this remains roughly 30% below the pre-pandemic run rate.

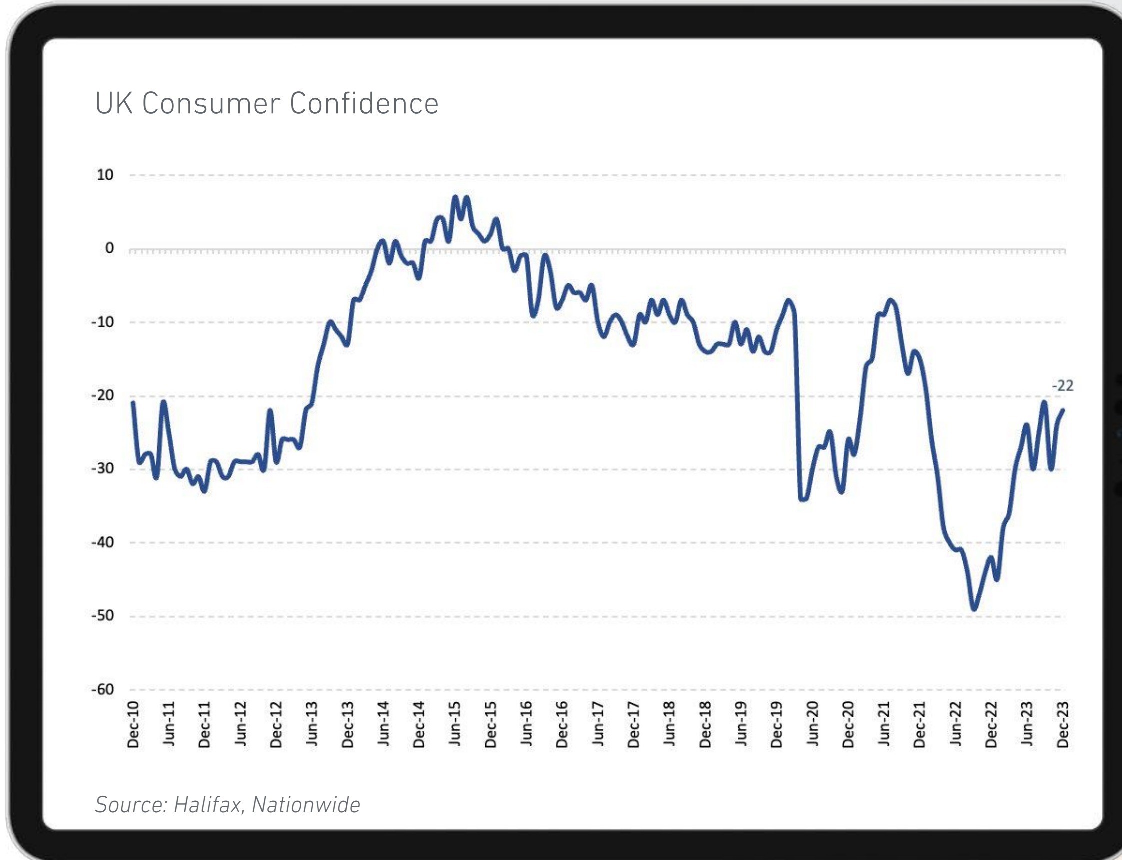
Quoted mortgage rates **ease**



It is estimated that roughly 5.5mn mortgage accounts have seen an increase in repayments since late 2021, with a further 3.5mn yet to roll off lower rates from 2021 or before. Mortgage rates have dropped back since peaking in the summer, with the best 2-year fixes quoted at less than 4.5%, and 5-year fixes at sub 4%. Nonetheless, the average household remortgaging this year will see their interest payments rise by £150 a month.

https://www.bankofengland.co.uk/statistics/visual-summaries/quoted-household-interest-rates

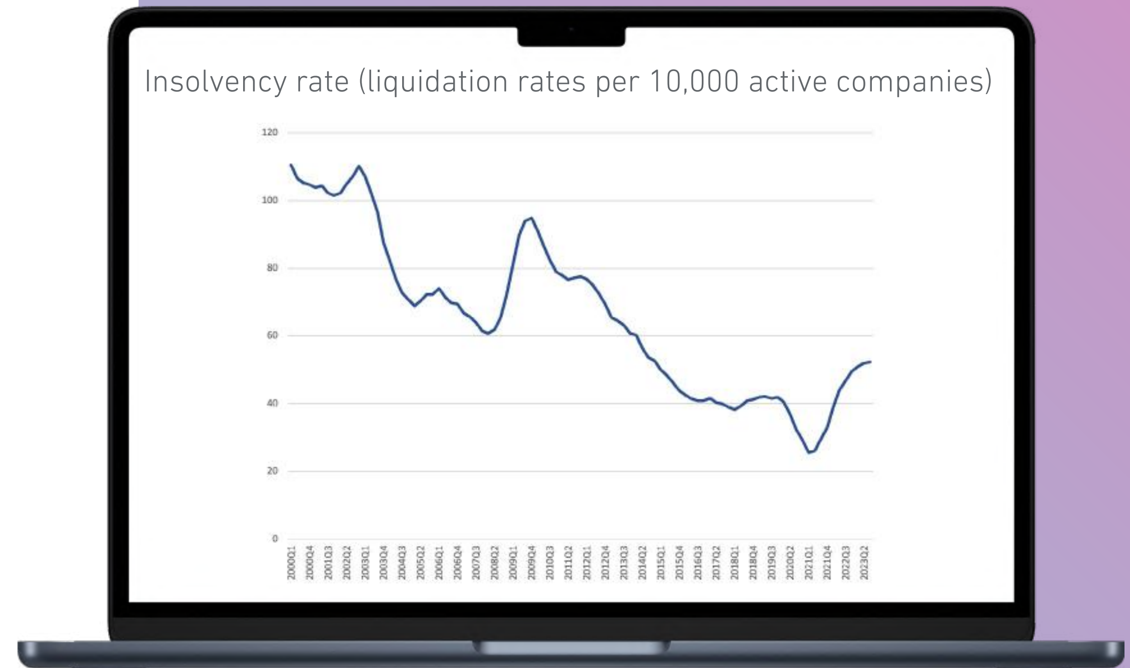
Consumer confidence falls back as affordability concerns **squeeze household budgets**



The GFK consumer confidence index rose by two points in November to -22. The index has been oscillating around a flat trend since June, though is well up on the all-time low of -49 registered in September 2022. All five metrics of the confidence score improved slightly with personal financial situation and general economic situation over the past 12 months increasing by 2 and 5 points, respectively.

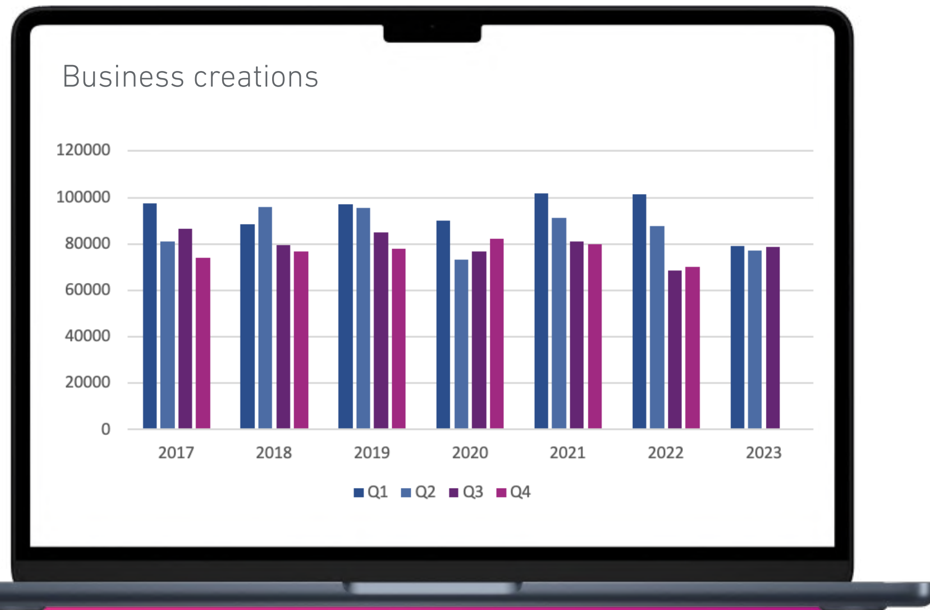
Business insolvencies **moderate slightly**

Registered company insolvencies in 2023Q3 came in at 6,208 (seasonally adjusted), down slightly (2%) from the 6,319 in 2023Q2, but up 10% compared to a year prior. These are the highest readings recorded since 2009Q2.



The insolvency rate data paints a far less bleak picture. There were 52.4 company liquidations per 10,000 active companies in the 12 months ending 2023Q3. While the outturn was greater than in 2023Q2 and 2022Q3, and the highest since 2014, it is well down on the peaks recorded in 1993 and 2009.

Business creations exceed business closures



According to the ONS the number of business closures in the UK in 2023Q3 was 69,445, down 14% on the same period a year prior. Closures decreased in 10 out of 16 main industrial groups year-on-year, with the most significant coming in transport and storage (down 41%). This was underpinned by a 51% fall from unlicensed carriers.

Conversely, the number of business creations grew by 15% in the year to 2023Q3, to 78,655, although the 2022Q3 figure represents an all-time low. Nonetheless, this is the first time since 2021Q2 that there were more creations than closures. Creations rose in 13 out of 16 main industrial groups. The most significant increase came in the professional, scientific, and technical activities industries (up 24% on the year).

Energy prices and inflation are less of a **concern to business as they were**

Question: Which of the following will be the main concern for your business?

Energy prices are the main concern of a lower proportion of businesses than was the case a year ago across all sectors as gas prices in particular have fallen.

Inflation of goods and services has also diminished as a main concern for most sectors as inflation has eased, with a particularly large shift for construction and manufacturing. Accommodation & food services businesses are the most concerned regarding energy and inflation as of January 2024.

Falling demand for goods and services has become a more **prominent concern**

Question: Which of the following will be the main concern for your business?

Falling demand for goods and services has risen as a main concern in most sectors over the past year. Wholesale & retail is a notable exception, though remains near the top of the leaderboard, behind manufacturing.

The proportion of firms that reported taxation as a main concern is broadly similar at a sectoral level as it was a year ago, though has increased markedly in the construction sector.

Summary **and risks**

Easing inflation and slowing pay growth could support interest rate cuts in the Spring

Mortgage rates are easing

Business sentiment is improving

Income tax band freezes and removal of energy bill support will hold back real income growth

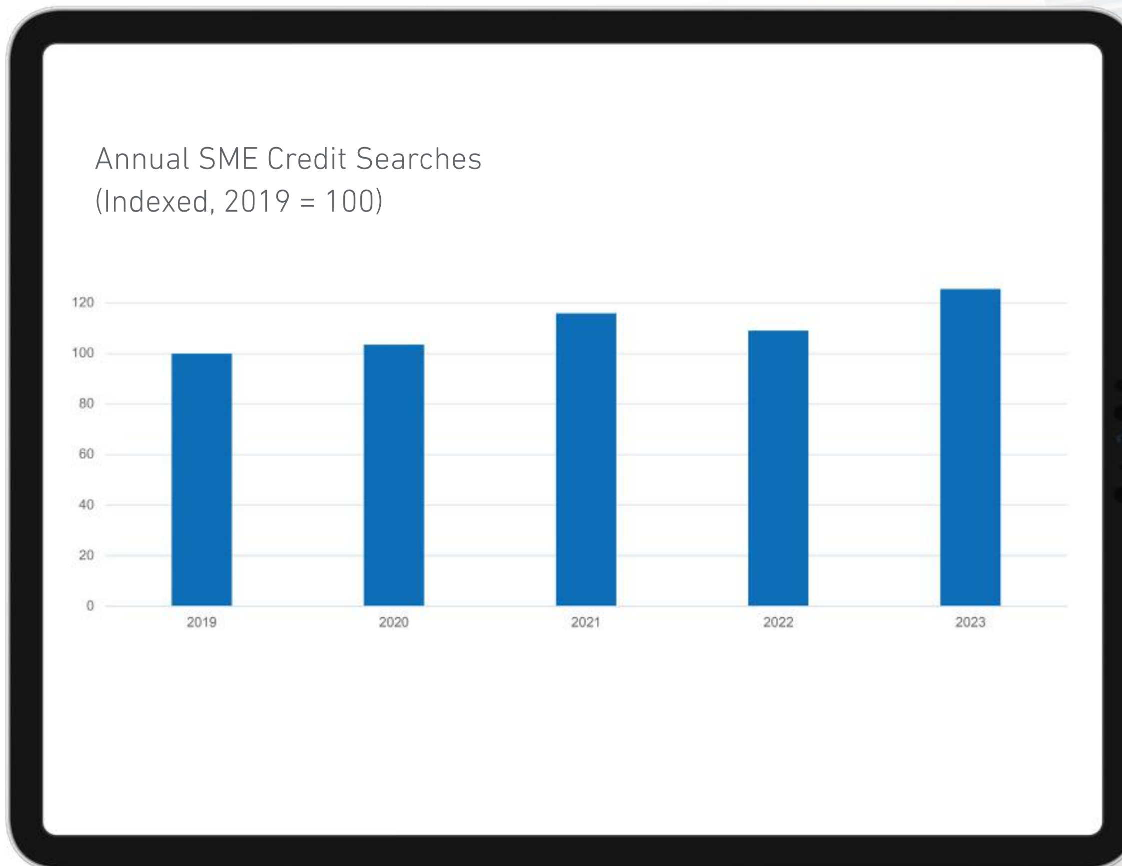
We expect a mild return to growth this year

Upside inflationary risks linked to geopolitical tension in the Middle East and the ongoing conflict in Ukraine threaten to derail the recovery.

How has the economic environment affected SME lending?

SME demand for credit is robust

Credit search volumes are at the highest level in the last 5 years



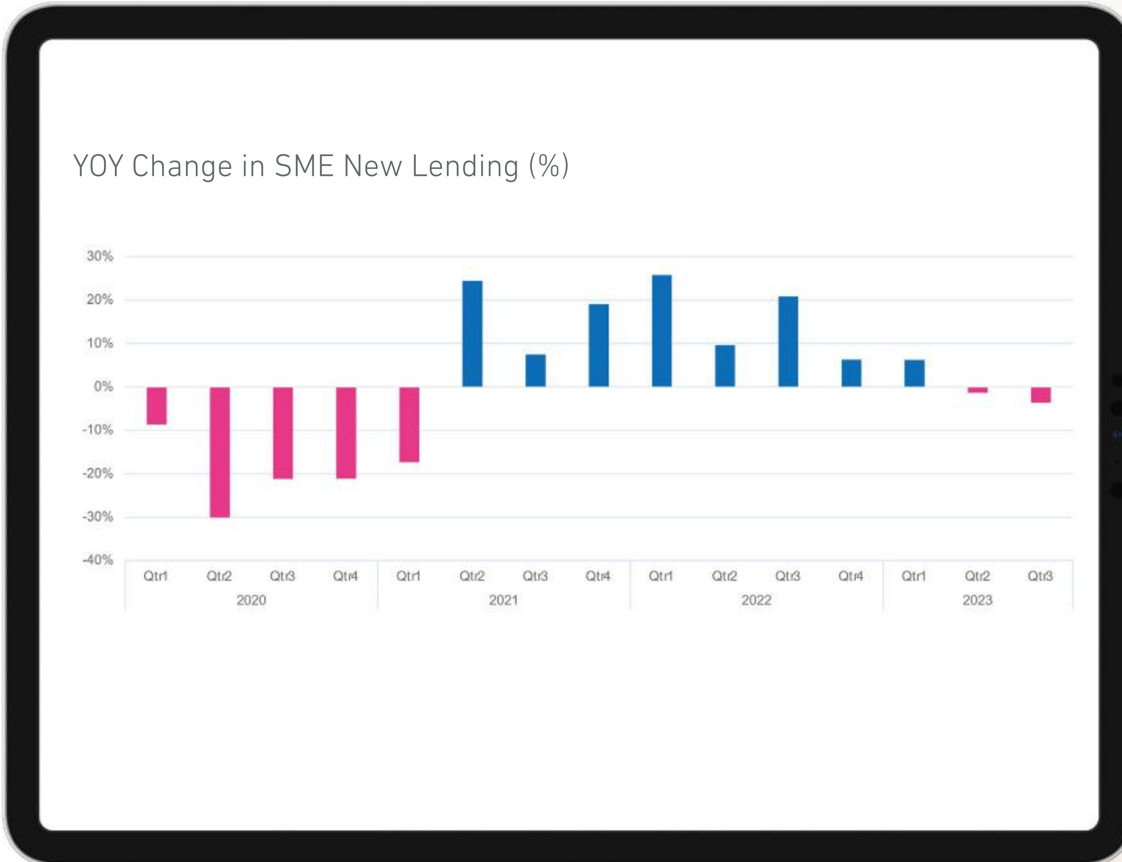
Credit searches of SMEs increased 15% in 2023, reaching a new high over the last 5 years

Overall, SME search traffic now **over 25% higher than it was in 2019**

Source: Experian bureau data – company credit searches

This demand is not translating to lending

Despite the growth in searches, SME new lending volumes eased in 2023

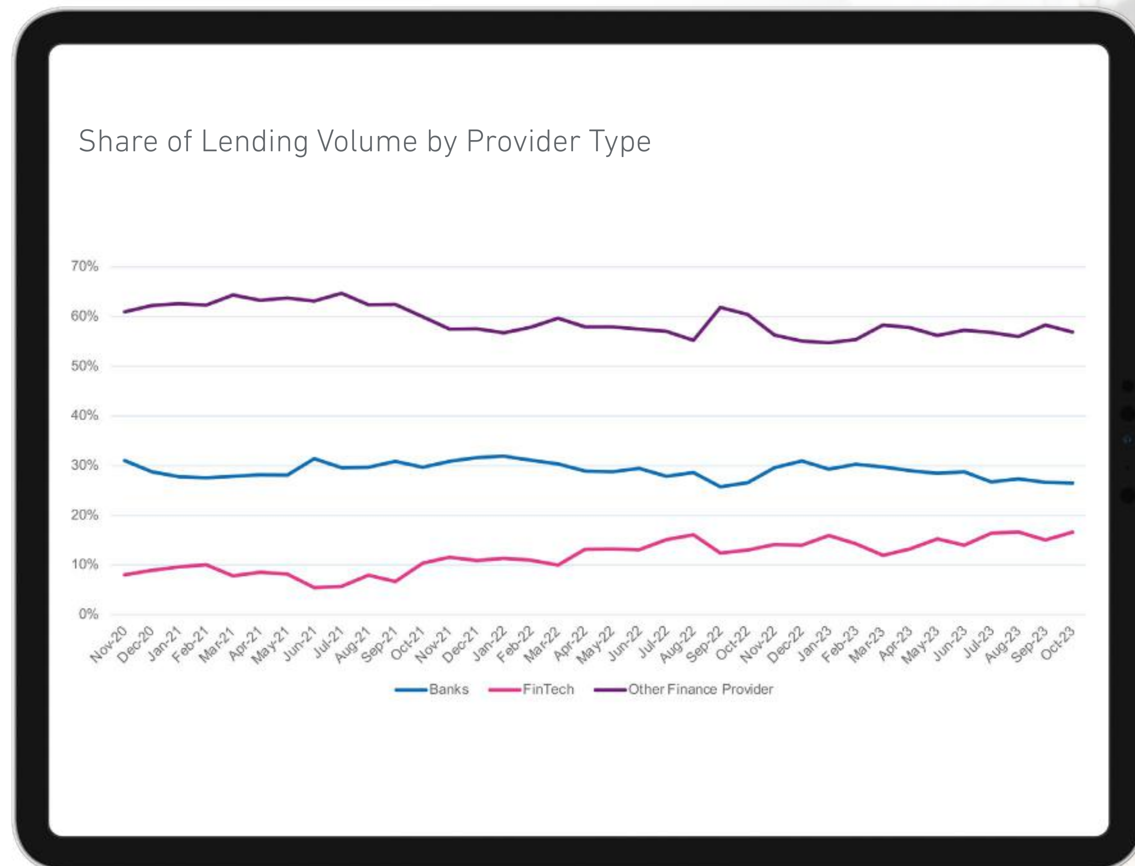


After robust performance in 2021 and 2022, year on year growth in SME lending volume turned negative in 2023

New lending volumes lag by one quarter from reporting period to allow for complete reporting of new accounts from contributing lenders.

Alternative lenders are stepping into the gap

Market share of banks declined during 2023



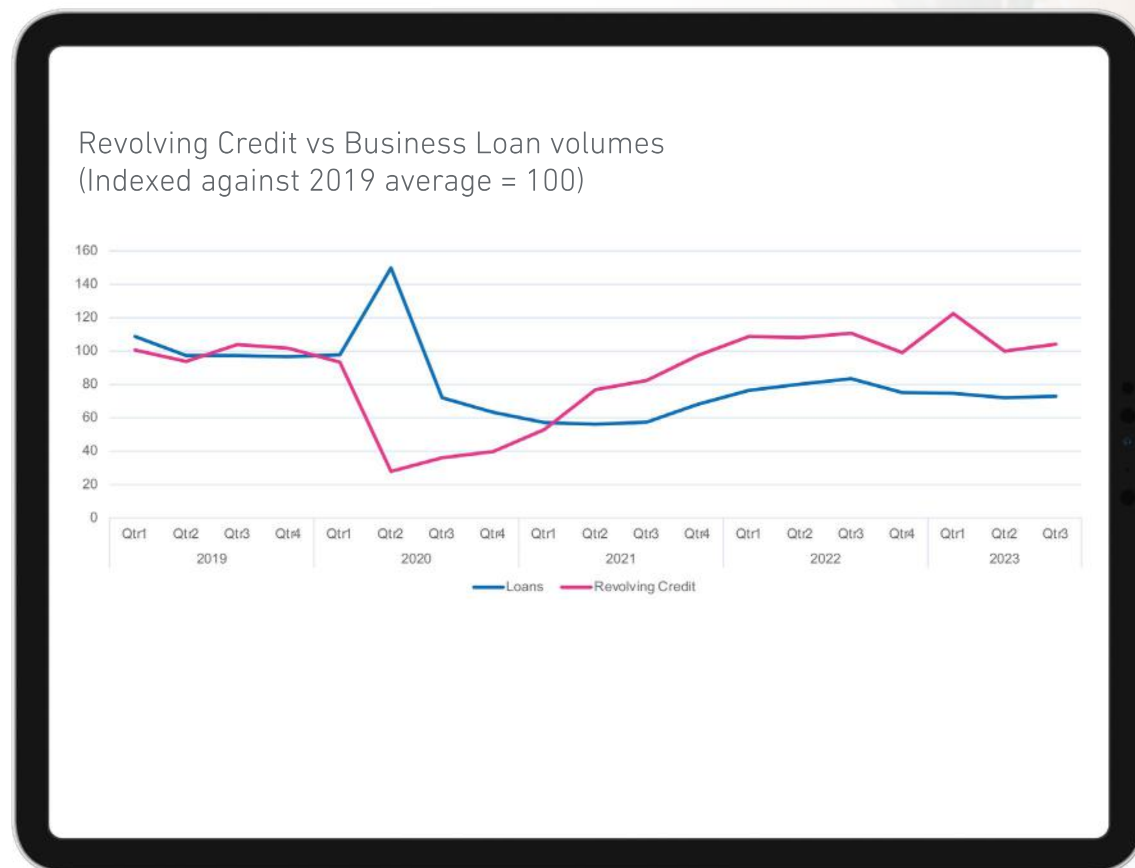
The level of lending on more traditional business loans did not recover after the pandemic – with lending levels on these products still only 75%

In contrast, lending on unsecured revolving forms of finance (credit cards and budget accounts) has bounced back to levels well above 2019 – driven largely by FinTech and challenger organisations

Note: analysis covers core financial products – revolving credit, commercial loans, asset finance and commercial mortgages. Pandemic loans are excluded unless otherwise indicated.

This growth is focused on certain products

Revolving credit growth strong, while traditional loan levels are suppressed



Although running at historically high levels, SME delinquency rates stabilised in H2

However, there has been a deterioration in delinquent balance rates - these ended the year 14% higher than they were in 2022

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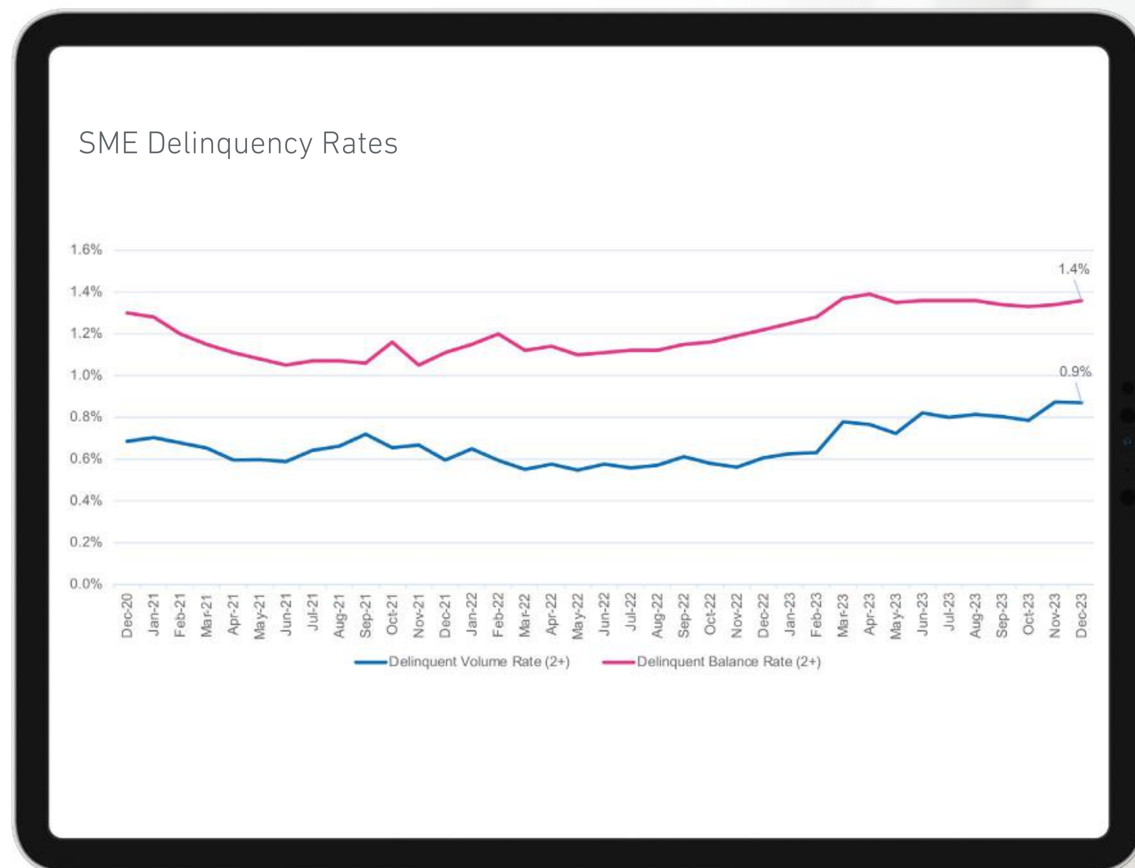
SME credit performance has stabilised

SME delinquency rates held stable in the second half of 2023



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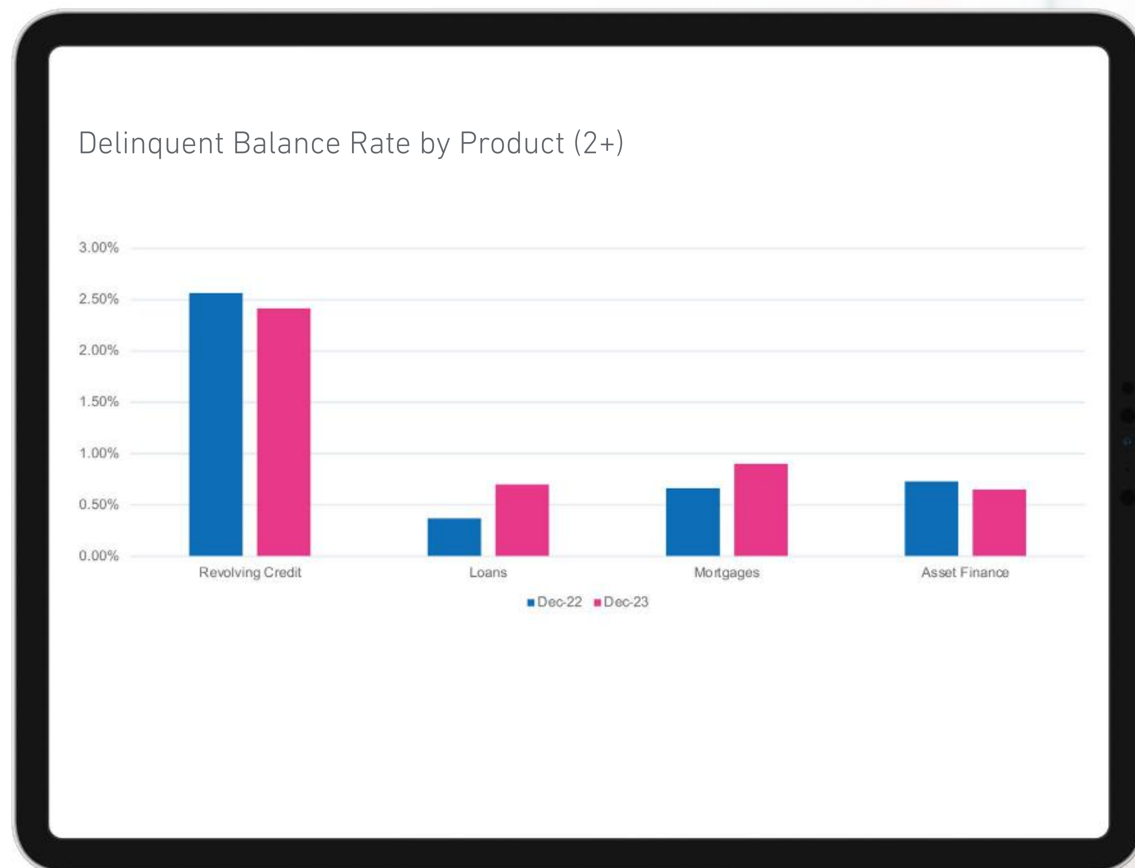
There is a difference in product performance

Deterioration in delinquent balances largely driven by loans and mortgages



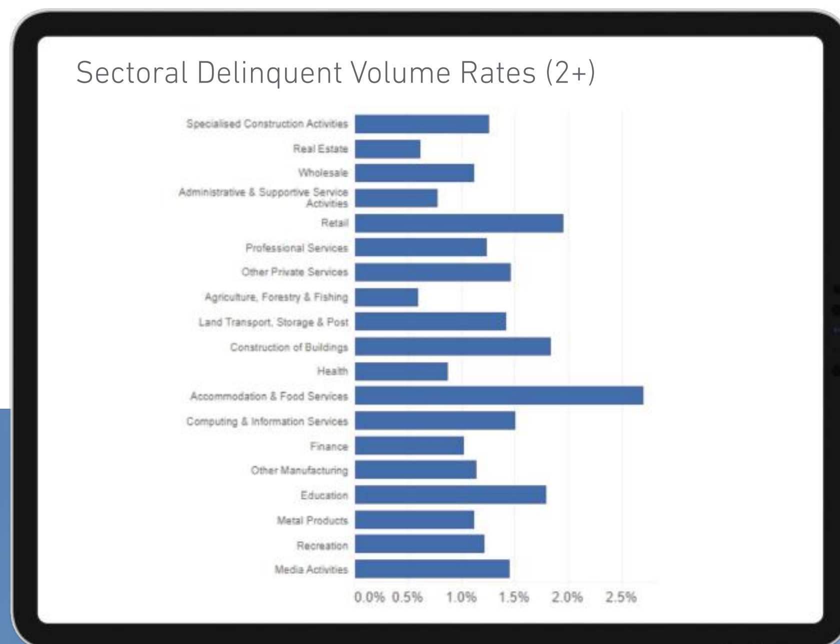
The deterioration in delinquent balance rates is driven by commercial mortgages and loans

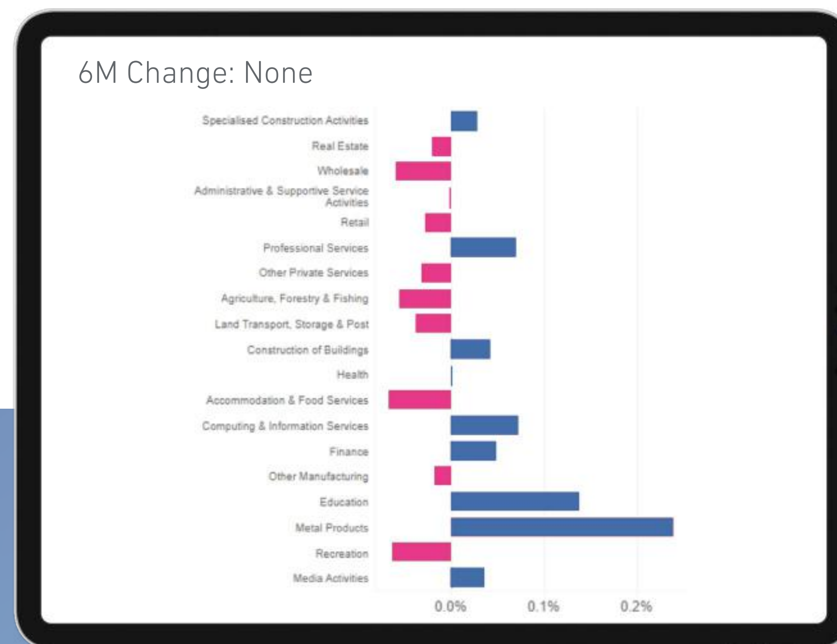
Deterioration in these sectors more than offsets small improvements in delinquent balance rates in other product groups

Note: analysis covers core financial products – revolving credit, commercial loans, asset finance and commercial mortgages. Pandemic loans are excluded unless otherwise indicated.

Sectoral performance

Stress persists – but credit performance in some sectors starting to improve





Alongside the headline stability, the sectoral view us also presenting a more mixed picture than we have seen previously.

While **Accommodation & Food Services** and **Retail** are sectors that remain under a lot of stress, we have seen a marginal improvement over the last 6 months.

Key takeaways and risks

Business sentiment is on an upward trend underpinned by optimism in the services sector.

Falling demand for goods and services has replaced inflation and energy prices as the main concern for UK businesses.

Demand for credit from SMEs is at high levels, but this is not reflected in new lending. Traditional lenders are being more cautious in credit acceptance, and higher interest rates may be deterring take-up of loans.

This leaves a gap in demand that non-traditional lenders are stepping into. The share of lending by Banks has fallen, with FinTechs and Other Finance Providers gaining in market share.

Delinquency rates in highly stressed sectors like Accommodation and Food Services and Retail are starting to improve. Stress persists elsewhere, though – and a difficult Christmas trading window will impact some sectors in January.

Glossary

Term	Description
Average / median Commercial Delphi score	Experian commercial risk score, the lower the score the greater the risk (1-100)
Average credit card debt	The average debt held on all open credit cards carrying a balance. At business level
Average credit card utilisation rate	The percentage of the credit limit utilised on all open credit cards. At business level
Total credit card debt	Total debt held on all open credit cards carrying a balance. At business level
Proportion of current accounts overdrawn	The percentage of open current accounts over their agreed overdraft limit or overdrawn with no overdraft. At business level
Average overdraft utilisation rate	The average percentage of the overdraft limit being used. At business level
Average non-mortgage debt	The average debt for open asset finance, credit card and loan accounts. At business level
Average mortgage debt	The average debt for open mortgage accounts. At business level
Average asset finance debt	The average debt for open asset finance accounts. At business level
Status 1+ delinquency rate	By volume, the percentage of open accounts that have been reported between 1 and 6 months behind on payments
Status 2+ delinquency rate	By volume, the percentage of open accounts that have been reported between 2 and 6 months behind on payments
Status 3+ delinquency rate	By volume, the percentage of open accounts that have been reported between 3 and 6 months behind on payments
Default rate	By volume, the percentage of accounts that entered formal default during the month

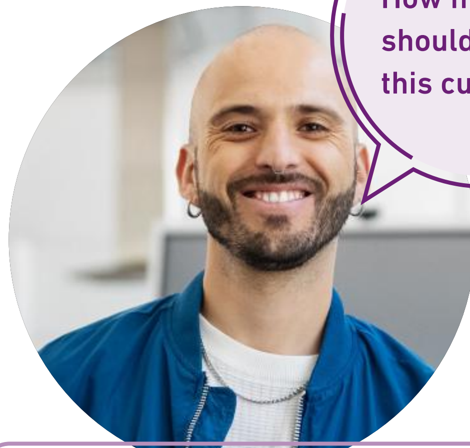
Now more than ever, lenders should focus on customer affordability

Should I lend to this customer?

48 Above average risk

FCA Handbook

“The risk that the customer will not make repayments under the agreement by their due dates. This is sometimes referred to as credit risk.”



How much should I lend to this customer?

£14k Credit Limit

FCA Handbook

“The risk to the customer of not being able to make repayments under the agreement. Referred to as ‘affordability risk’.”

The Lending Standards Board states that:

“Before providing any form of credit, granting a limit or increasing the customer’s borrowing, firms should assess, from the information available at the time, whether the customer will be able to repay it in a sustainable manner without incurring financial difficulty.”

Experian can help you with this

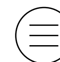
Traditional lending has focused on business eligibility for credit more than affordability.
In our current capacity, Experian helps lenders to assess the risk to their own business. We calculate the likelihood that your commercial customers will not make repayments, to help you decide if you should or shouldn't engage with them, depending on your risk appetite. But this is only part of the story.

Affordability is about assessing the risk to the customer, not the lender.
To understand that risk, we need to understand how much they could reasonably afford to pay.

In the current economic environment, there are businesses who will struggle.
Fair and responsible lending to these customers is of upmost importance.

Experian can help you with this. We are working directly with banks and financial services to build an affordability assessment that works for both you and your customers.

Using a balanced assessment of income vs expenditure, we can define the amount your commercial customers could suitably afford to borrow.



Get the full view on the current trends to help you make better commercial lending decisions, **download our M.Index report**

Speak to your Account Manager or visit **Experian.co.uk/business** today to find out more about how we can help your business identify, monitor and mitigate risk.

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