experian

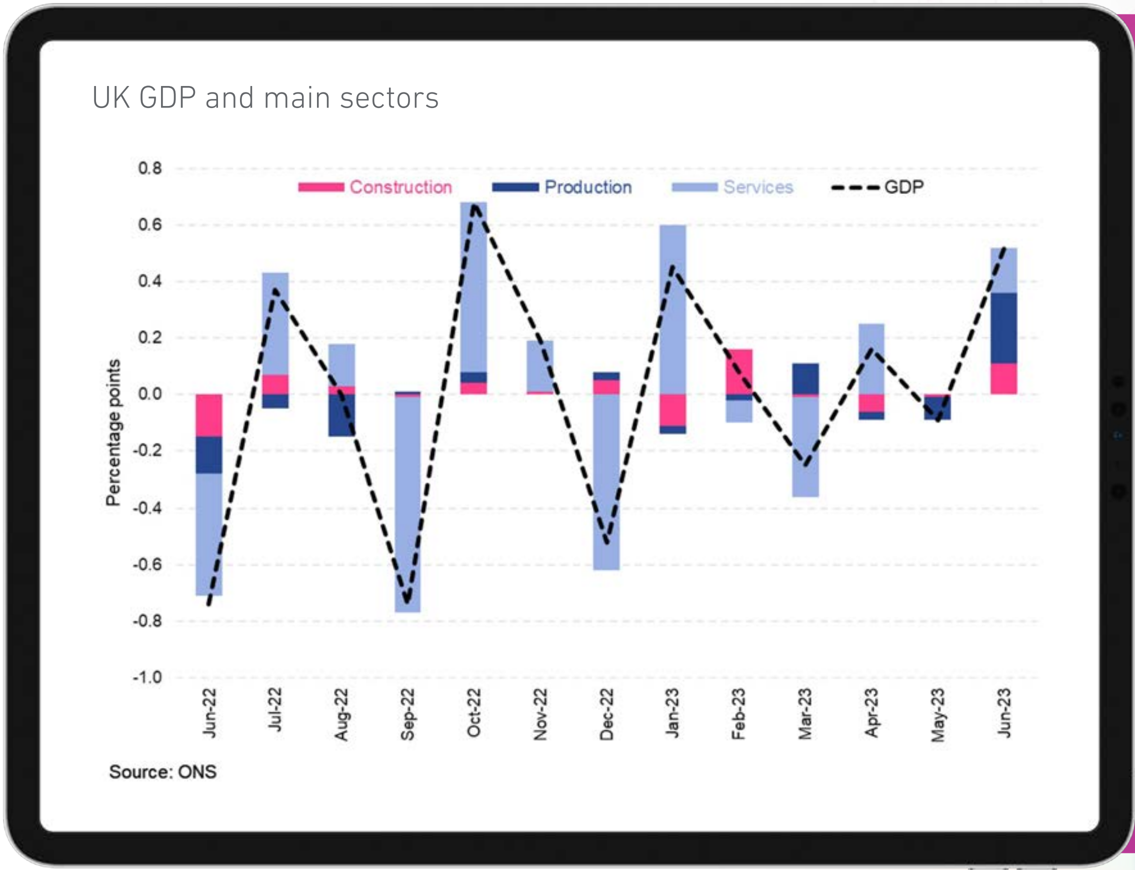
REPORT

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

H2 2023

Contents

GDP is expanding, **but weak outlook remains**



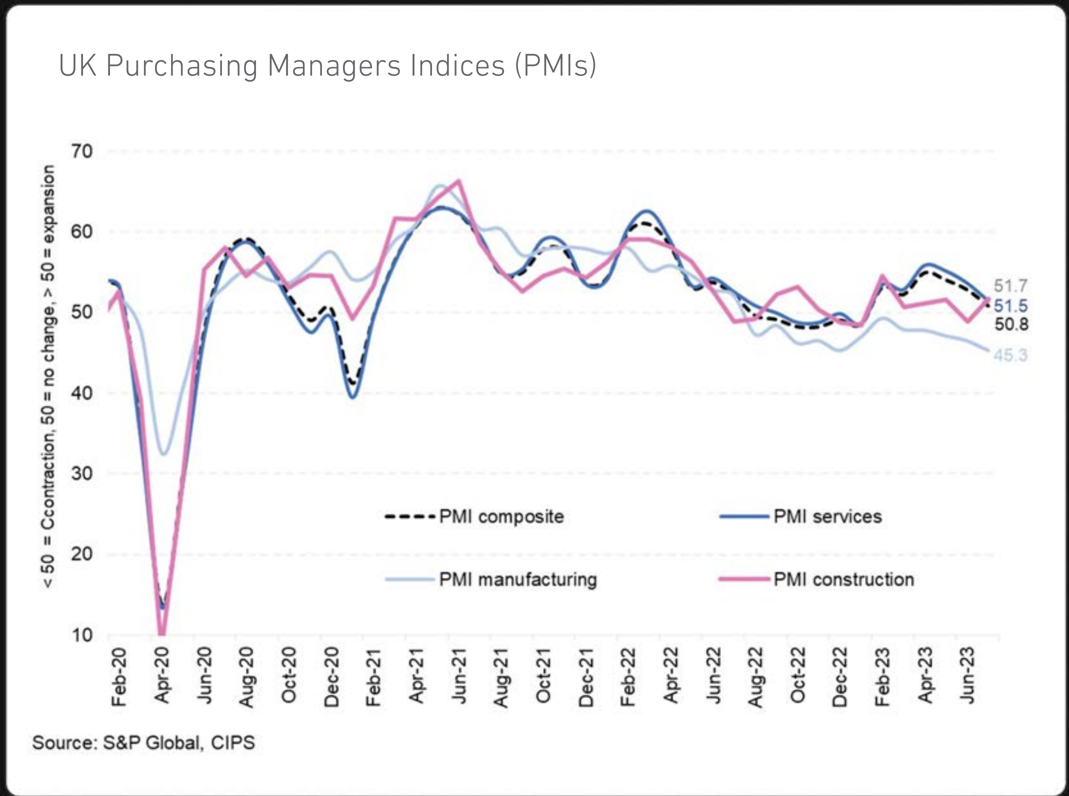
Monthly GDP is estimated to have grown by 0.5% in June 2023 following a fall of 0.1% in May 2023 and stands 0.8% above its pre-pandemic level.

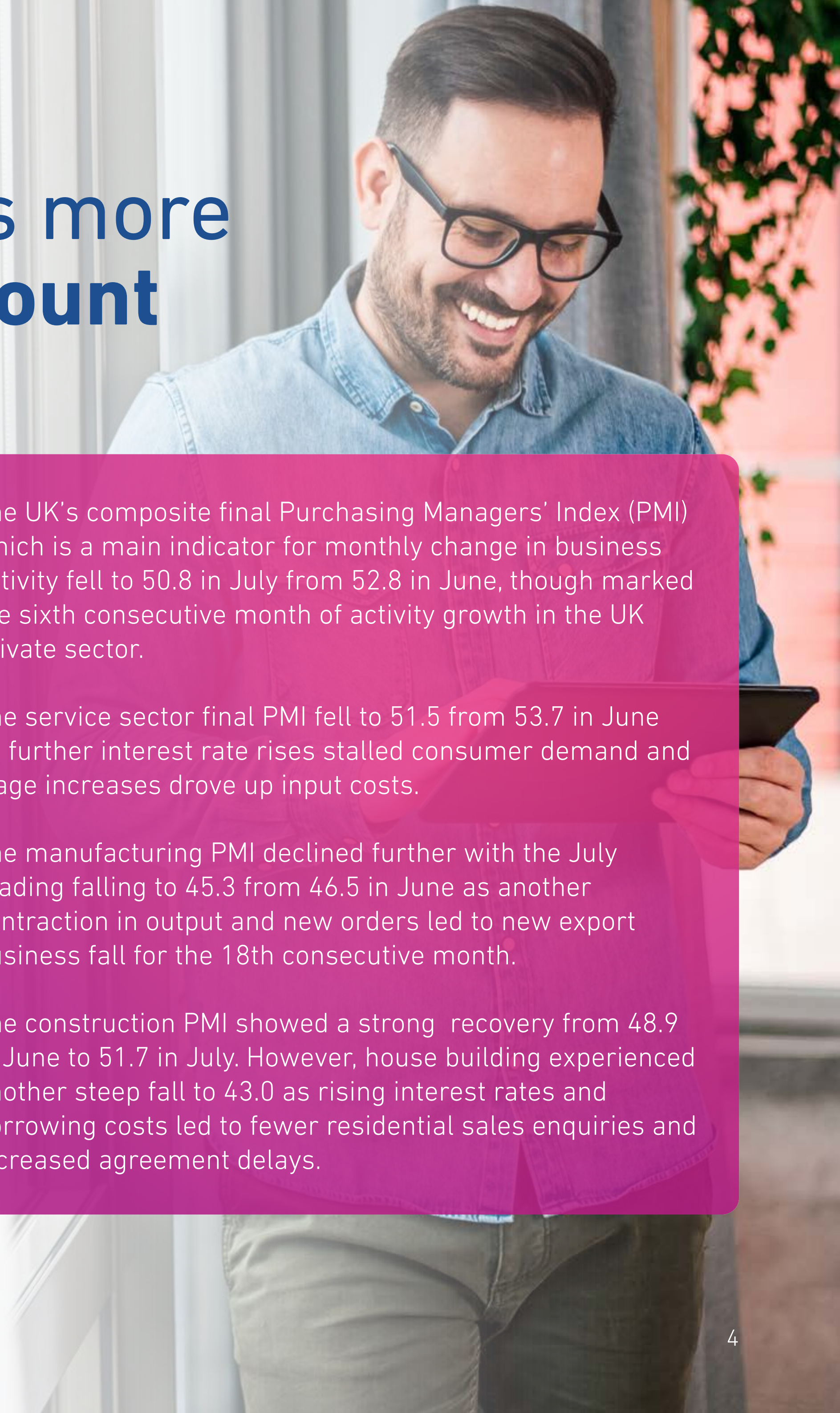
All major sectors showed growth in June 2023, with production output as the main driver with a 1.8% increase following a fall of -0.6% in May 2023. At the same time, the construction and services sectors expanded by 1.6% and 0.2% respectively.

The June increase partly reflects a rebound from May, where a business day was lost to the King's Coronation. Nonetheless the increase exceeded expectations and in the three months to June 2023 the economy grew by 0.2%.

The UK is likely to avoid a recession this year, though growth is set to be tepid at best in the short-term, with a mild recovery forming in 2024 as inflation continues to ease.

Business sentiment becomes more modest as **rate pressures mount**





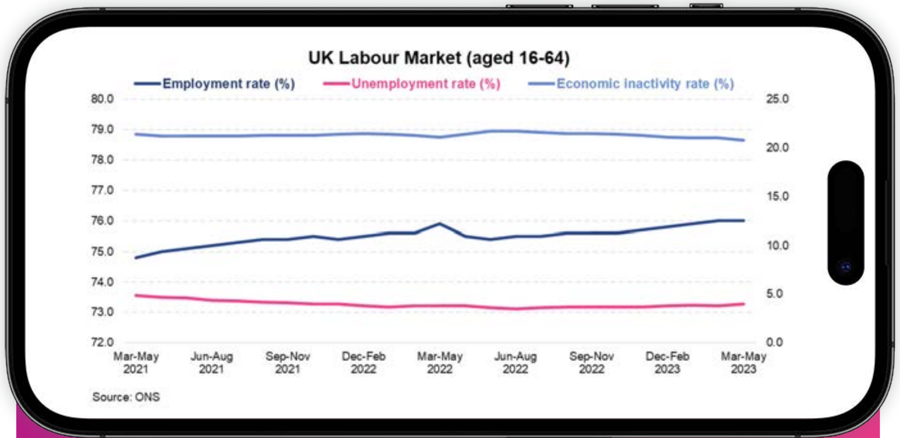
The UK's composite final Purchasing Managers' Index (PMI) which is a main indicator for monthly change in business activity fell to 50.8 in July from 52.8 in June, though marked the sixth consecutive month of activity growth in the UK private sector.

The service sector final PMI fell to 51.5 from 53.7 in June as further interest rate rises stalled consumer demand and wage increases drove up input costs.

The manufacturing PMI declined further with the July reading falling to 45.3 from 46.5 in June as another contraction in output and new orders led to new export business fall for the 18th consecutive month.

The construction PMI showed a strong recovery from 48.9 in June to 51.7 in July. However, house building experienced another steep fall to 43.0 as rising interest rates and borrowing costs led to fewer residential sales enquiries and increased agreement delays.

Labour market: **Job vacancies fall back from historic highs**



Unemployment rate

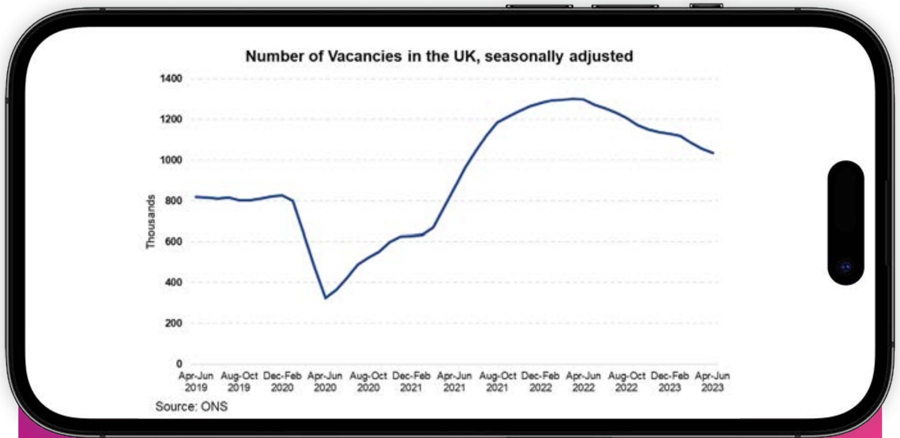
Unemployment rate (Aged 16-64)

Quarterly change: 0.2pps

Since Dec-Feb 2020: -0.0pps

The unemployment rate is up on the quarter and on the year, and at pre-pandemic levels

Source: ONS LFS



Job vacancies

Number of job vacancies

Quarterly change: -85,000

Since Jan-Mar 2020: 232,000

Vacancies decreased on the quarter but are above pre-pandemic levels.

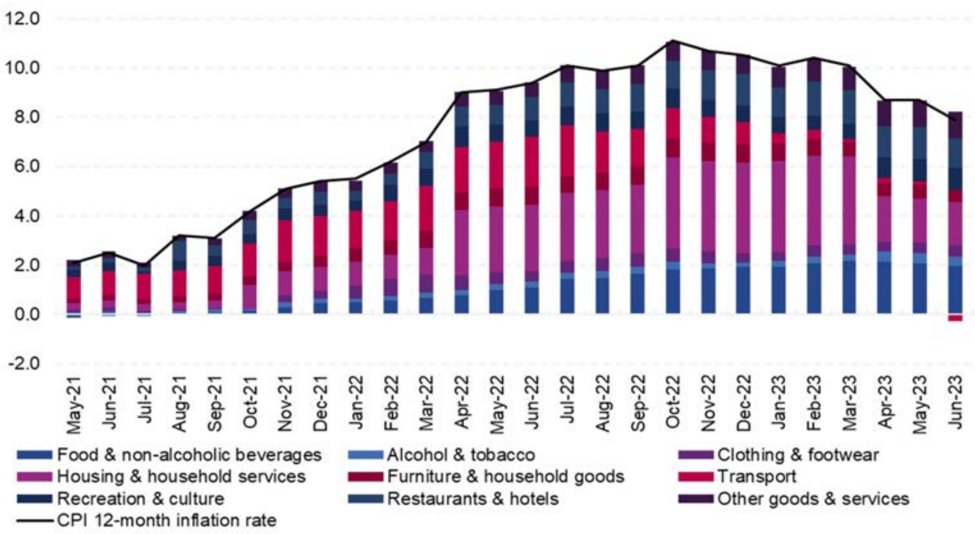
Source: ONS Vacancy Survey

The UK employment rate was estimated at 76.0% in March to May 2023, 0.2 percentage points higher than the December 2022 to February 2023 period. The increase in employment over the latest three-month period was driven by part-time workers.

Vacancy numbers have fallen for the 12th consecutive period in April to June 2023, and are down 7.6% since the January to March 2023 peak. Nevertheless, vacancy rates remain historically high as it stands 232,000 above the pre-pandemic levels.

CPI continues easing, **but remains high**

Inflation and contributions



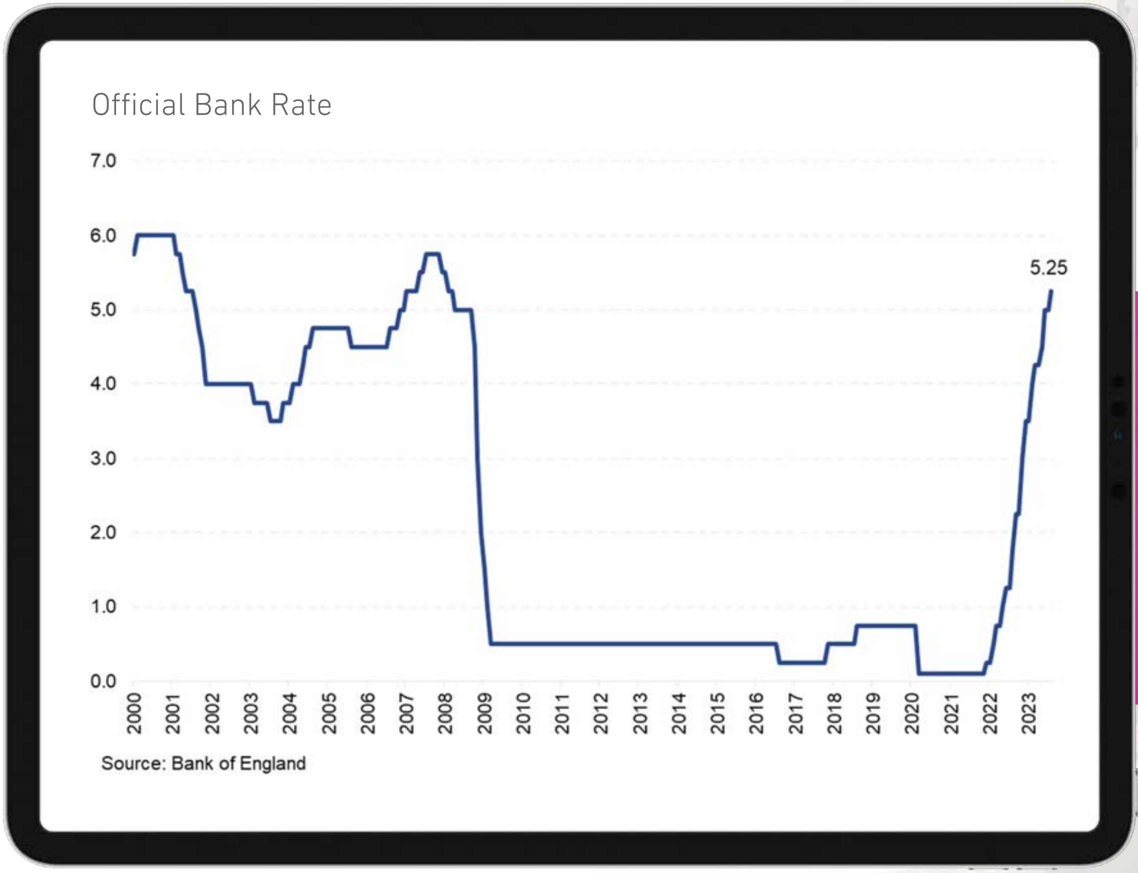
Source: ONS

Consumer Price Index (CPI) inflation rose by 7.9% in the 12-months to June 2023, down from 8.7% in the previous month.

Falling prices for motor fuel led to the largest downward contribution to the monthly change in CPI annual rate.

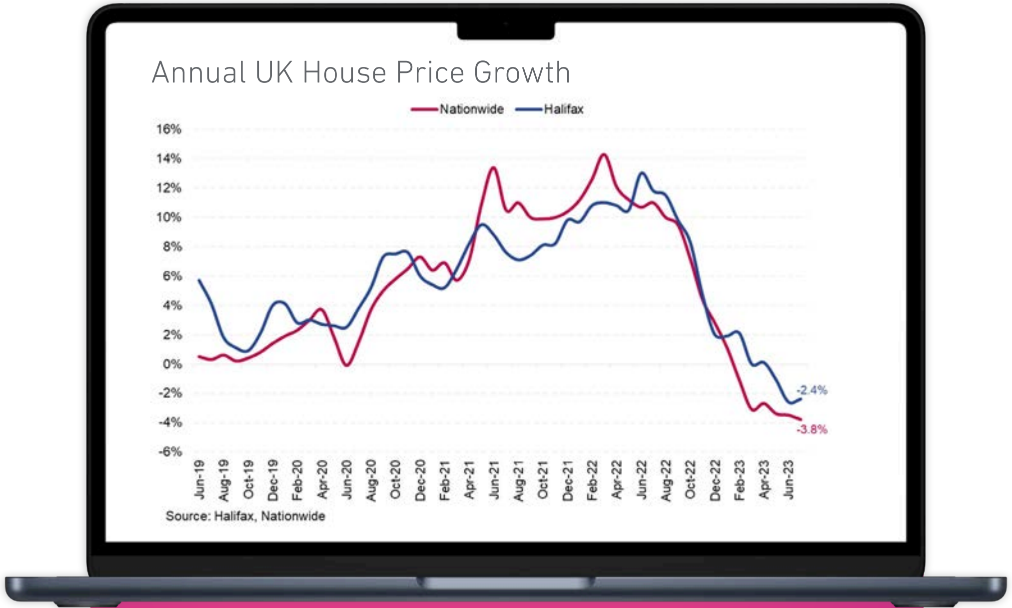
Meanwhile, core CPI (excluding energy, food alcohol, and tobacco), rose by 6.9% in the 12 months to June 2023, down from 7.1% in May.

Interest rates: **Nearing a peak of 15 years**



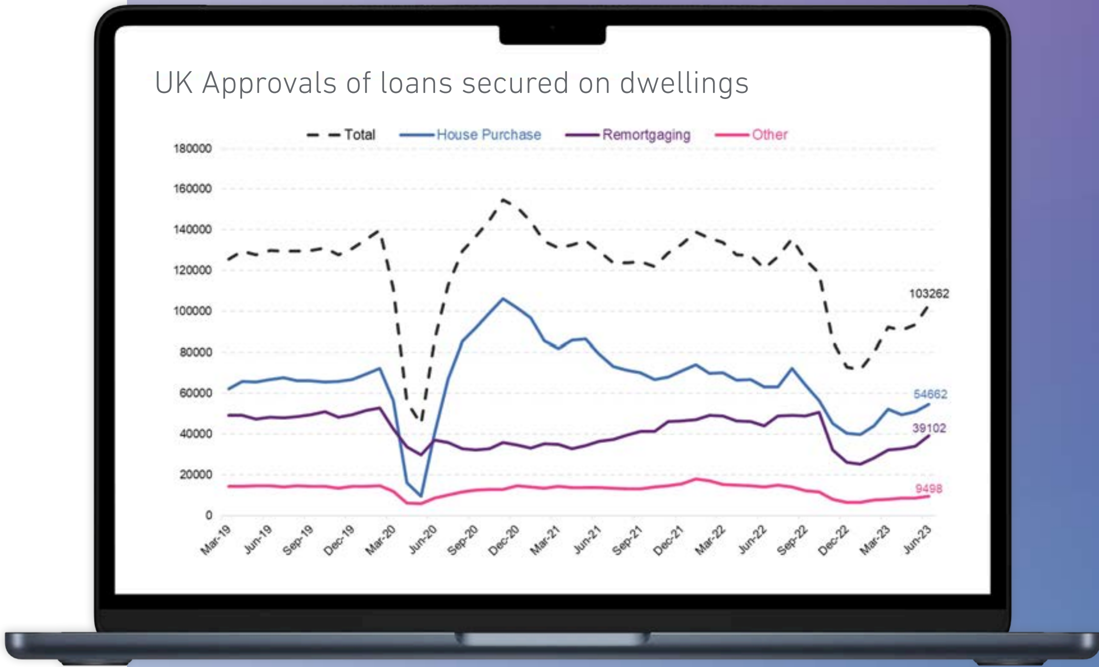
At their August meeting the Monetary Policy Committee (MPC) voted 6:3 to raise the base rate by 0.25pp, taking it to 5.25%, the highest rate in 15 years and the fourteenth consecutive interest rate hike since December 2021.

Housing trends: **downturn becomes entrenched**



House prices fall across all major surveys.

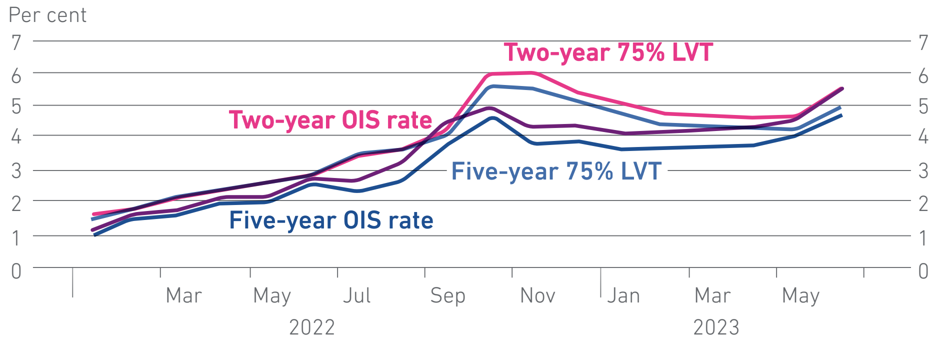
Mortgage approvals remain below monthly averages but in June 2023 were at their highest since October 2022.



Recent RICS surveys shows that buyer enquiries, agreed sales and new sales are declining, while both price and sales expectation remain downbeat in the near term.

Monthly mortgage **interest repayments soar**

Average quoted rates on two-year and five-year fixed-rate mortgages with 75% LTV, and the two-year and give-year OIS rates

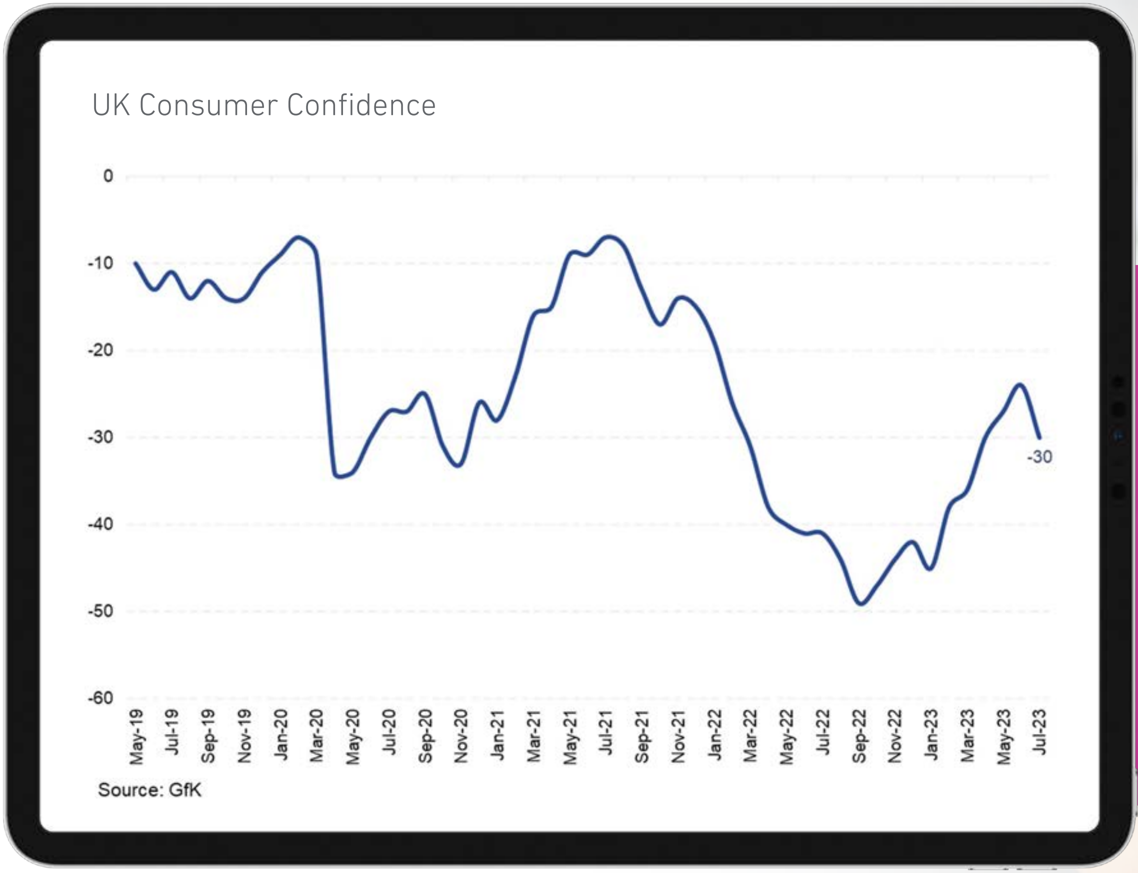


It is estimated that half of all mortgage accounts (4.5mn) will have experienced increases to repayments since late 2021.

Meanwhile, most of the remaining mortgage owners on fixed-term (commonly two or five years, and around 4 million accounts) will be impacted by the end of 2026 as interest rates remain higher for longer.

According to current quoted mortgage rates the average mortgagor who is rolling off a fixed-rate deal in the second half of 2023 will see monthly interest repayments increase by £220.

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



Source: GfK

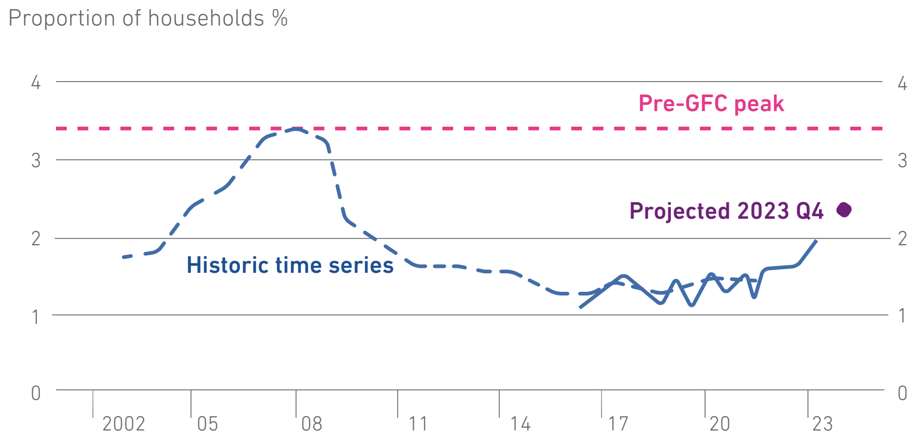
UK consumer confidence experienced a decline to -30 in July, after the metric reached its highest level since January 2022 in June, at -24 .

The sharp monthly fall signals the continued and mounting pressure that elevated interest rates are placing upon household budgets.

Though this also displays an improvement since last winter's overwhelming cost-of-living crisis and is 11 points higher than in the same month in 2022.

Monthly mortgage **interest repayments soar**

Share of households with high costs of living-adjusted DSRs, and share of households in each COLA-DSR group

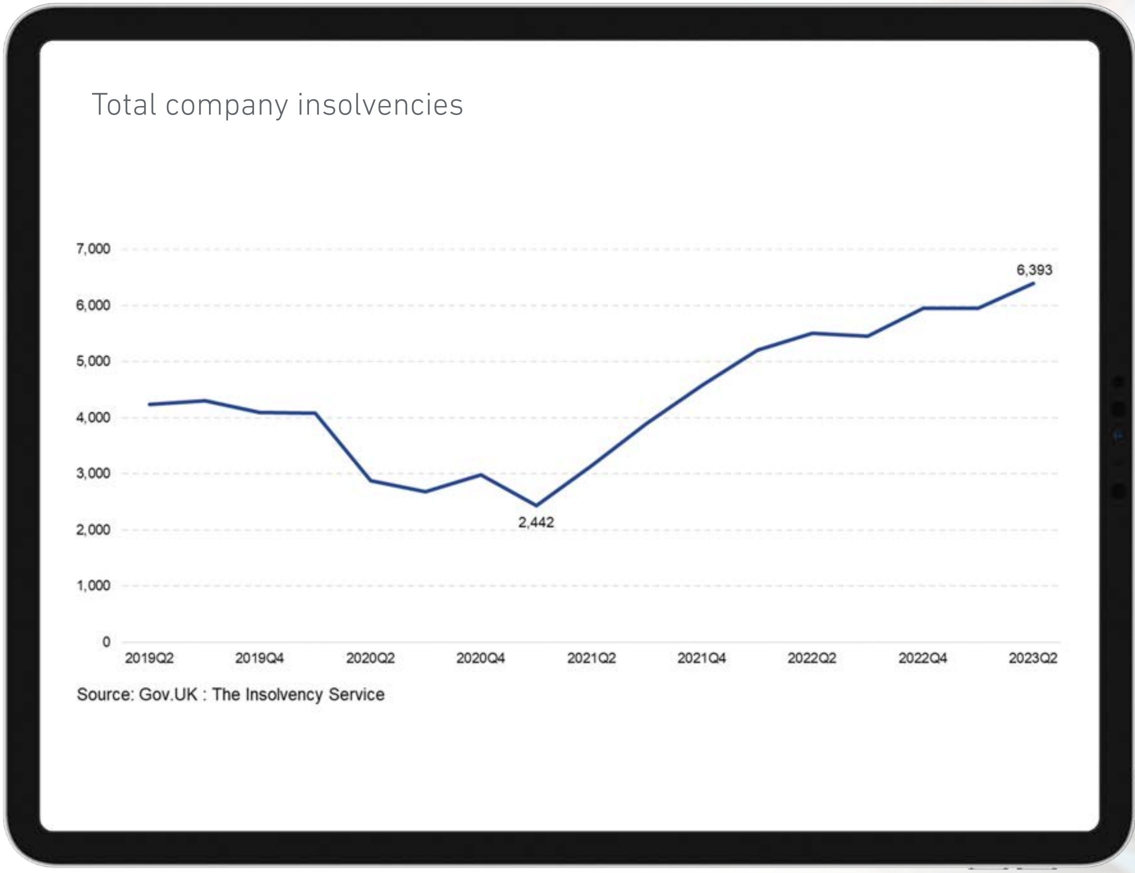


Source: Bank of England

The cost of essential goods is expected to continue increasing, while the proportion of households with cost-of-living adjusted mortgage debt-servicing ratios (COLA-DSRs) which measure how much income after taxes, essentials and housing costs is spent on servicing consumer credit debts are projected to rise to 650,000 households (2.3%) by the end of the year.

There has been an increase in households choosing to borrow over longer terms as they attempt to offset the impact of higher mortgage rates by reducing monthly capital repayment. The proportion of households which hold new lending on terms longer than 35 years has risen to 11% in Q1 2023 from 5% in Q1 2022.

Quarterly **business insolvencies** reaches historic high



The number of registered company insolvencies in Q2 2023 was 6,393, the highest quarterly figure since the study began in 2013.

The number of registered company insolvencies in Q2 2023 was 16% higher than Q2 2022, 7% higher than Q1 2023 and 56% higher than the pre-pandemic level (Q4 2019).

The latest monthly figures highlighted 2,163 company insolvencies during June 2023, 27% higher than the same month in 2022 (1698) and now stands 25% above the January 2019 level (1726).

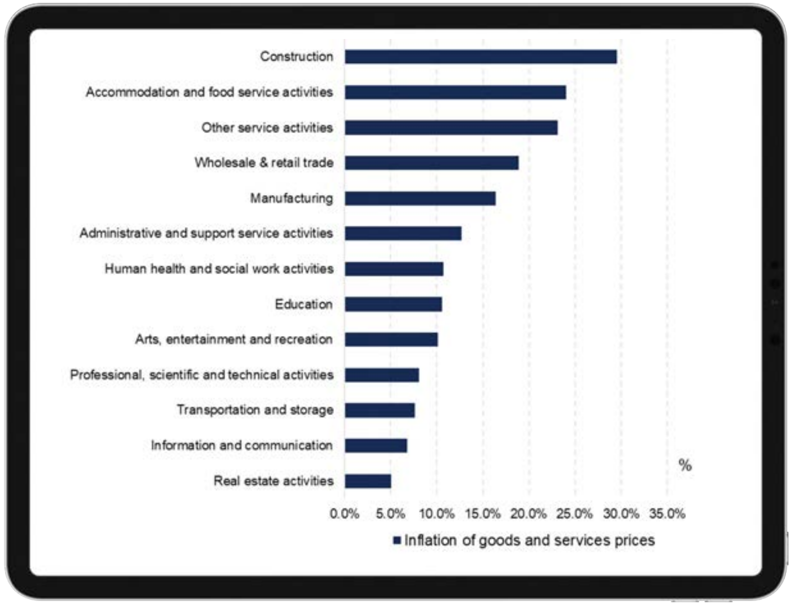
Business creations reach near historic lows in Q2

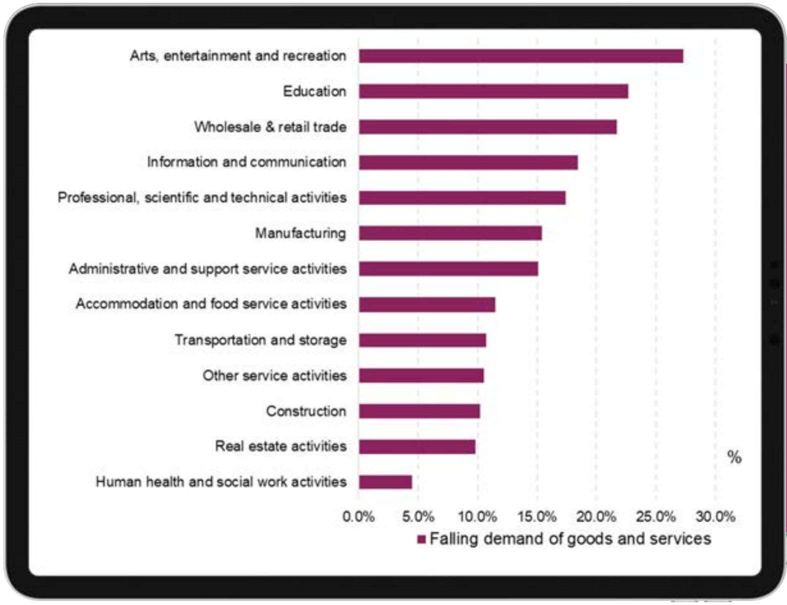
Business closures in Q2 2023 were the second highest Q2 figure since the series began in 2017, 12% lower than the Q2 2022 record. The largest driver came from closures in the professional, scientific and technical industry (-25%).

Concurrently, business creations have significantly slowed since Q1 2022 with Q2 2023 reporting the second lowest number of creations since the series began in 2017, 14% lower than Q2 2022 outturn, with 14 of the 16 industry groups experiencing a decline.

Key concerns: **uneven distribution across sectors**

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

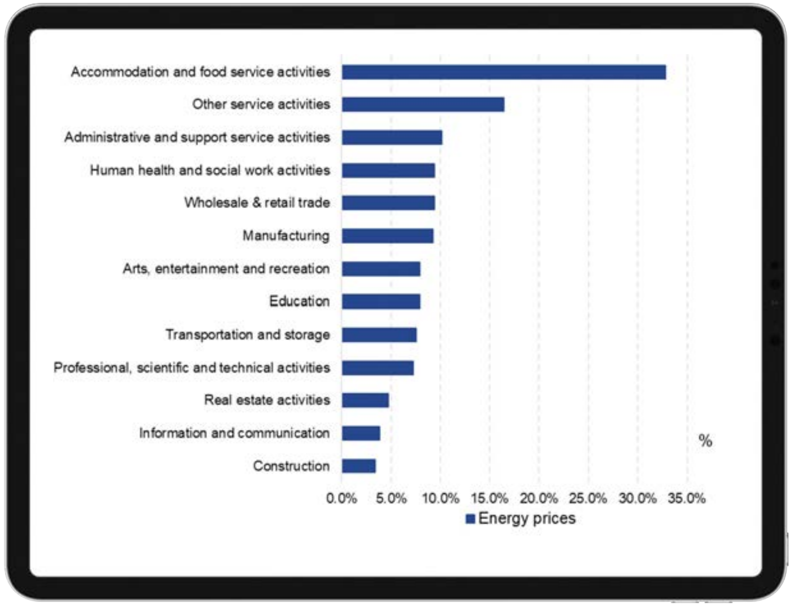


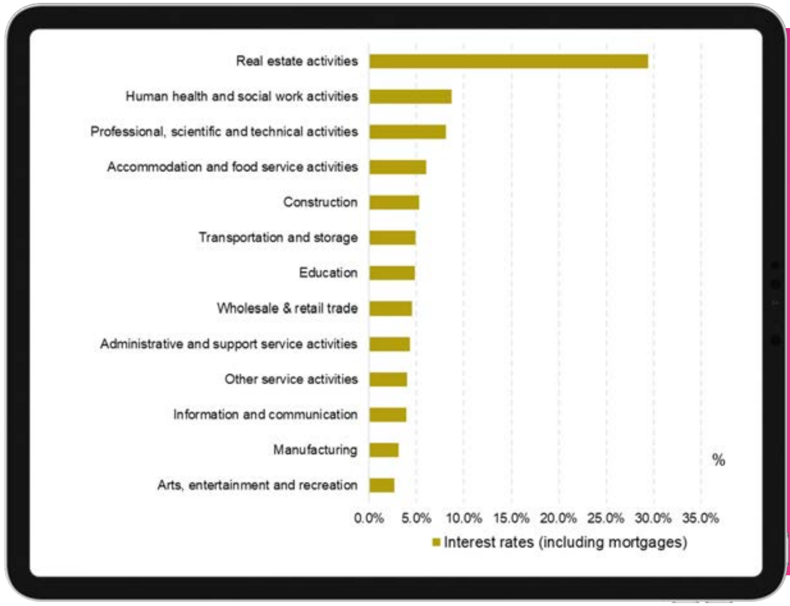


Key concerns remain centred around costs, but the industry specific concerns are unevenly spread and there has been a surge in concern for falling demand of goods and services.

Key concerns: **uneven distribution across sectors**

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





Construction and arts, entertainment and recreation services are key sectors with the largest concerns for cost pressures alongside real estate activities which will continue to suffer as interest rates remain heightened.

Summary: **key economic risks**

Labour market fundamentals and strikes threaten growth

Soaring monthly mortgage repayments as households come off fixed rate mortgage contracts

Domestic wage pressures

Acute affordability pressures at the lower affluence levels

GDP outlook has improved, but a recessionary backdrop remains a threat

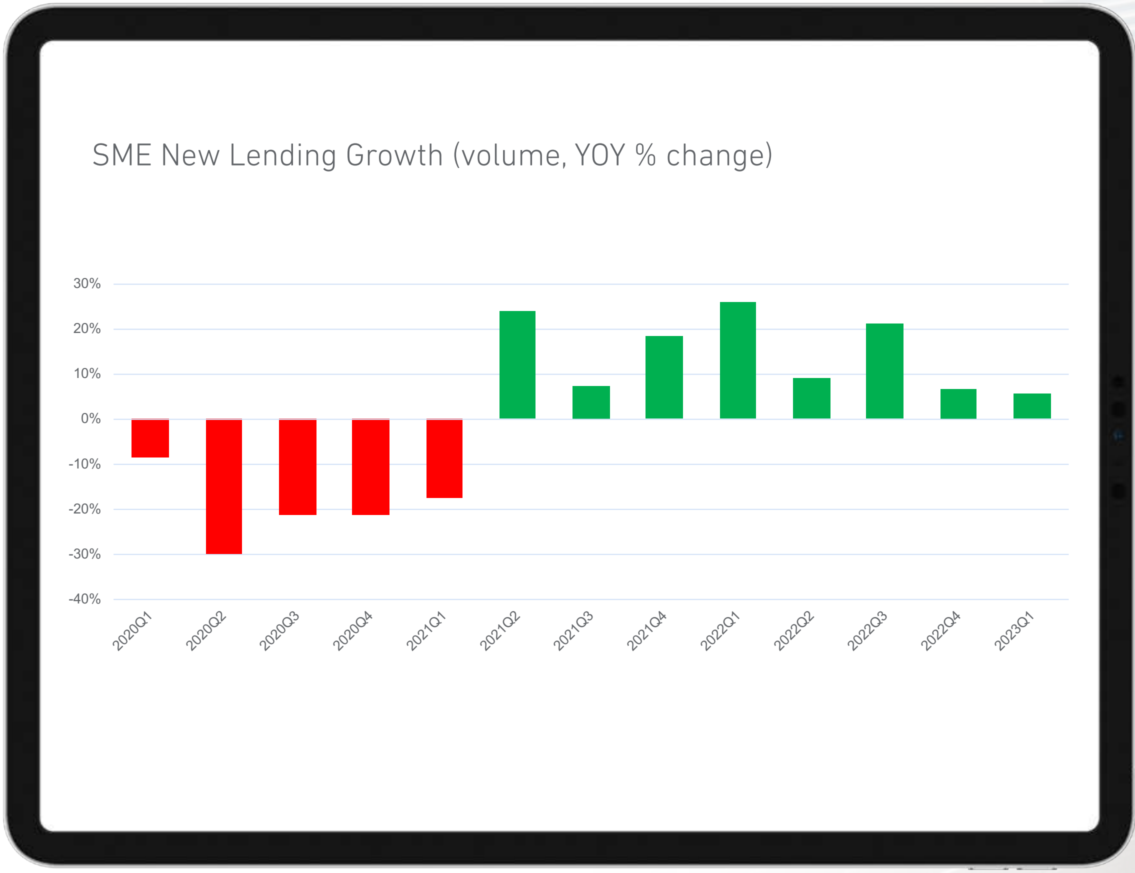
Russian Ukrainian conflict

Wage price spiral emerges

How has the economic environment affected SME lending?

SME New Lending

The pace of growth has eased – but new lending to SMEs continues to grow



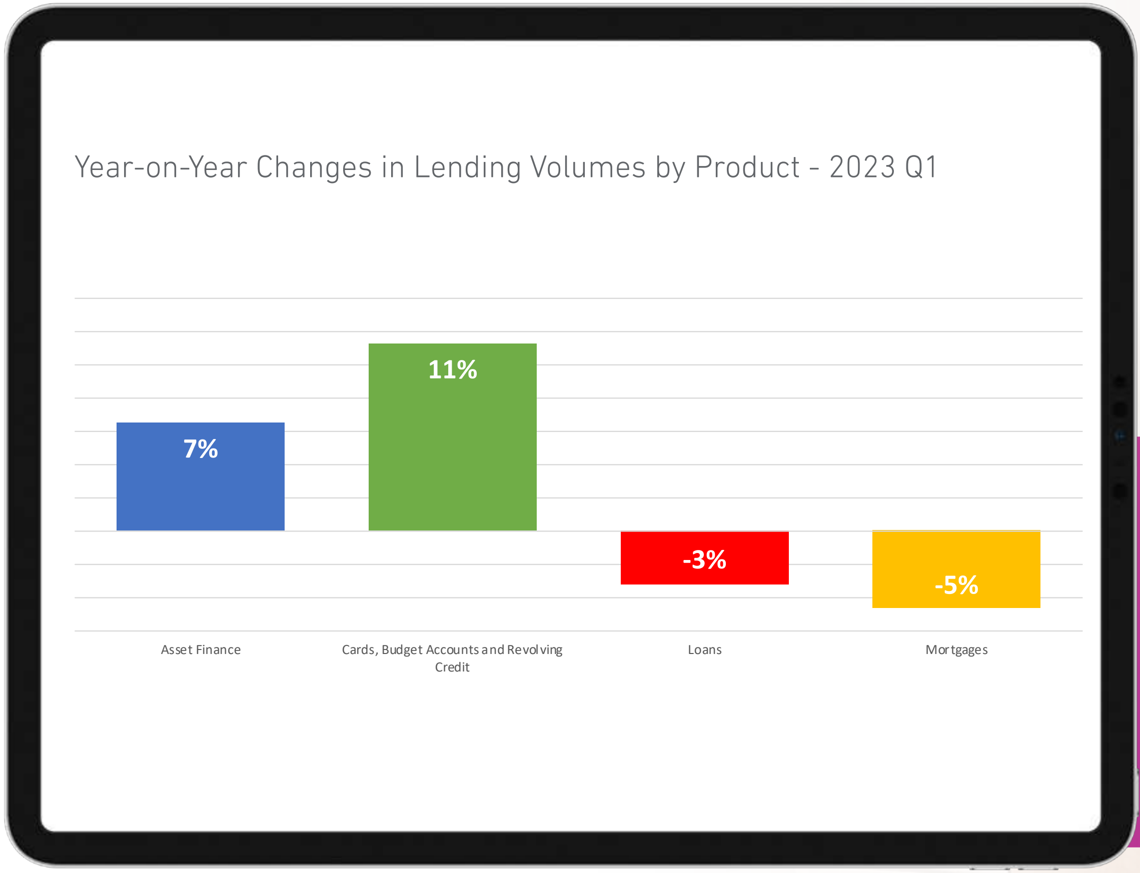
Although the pace of growth in lending eased in 2022Q4 and 2022Q1, lending is still growing.

In 2022Q4, lending volumes to SMEs were up +7% year-on-year

New lending data is lagged by one quarter as a result of credit reporting cycles

SME New Lending

There has been a shift in the mix of product types used by SMEs

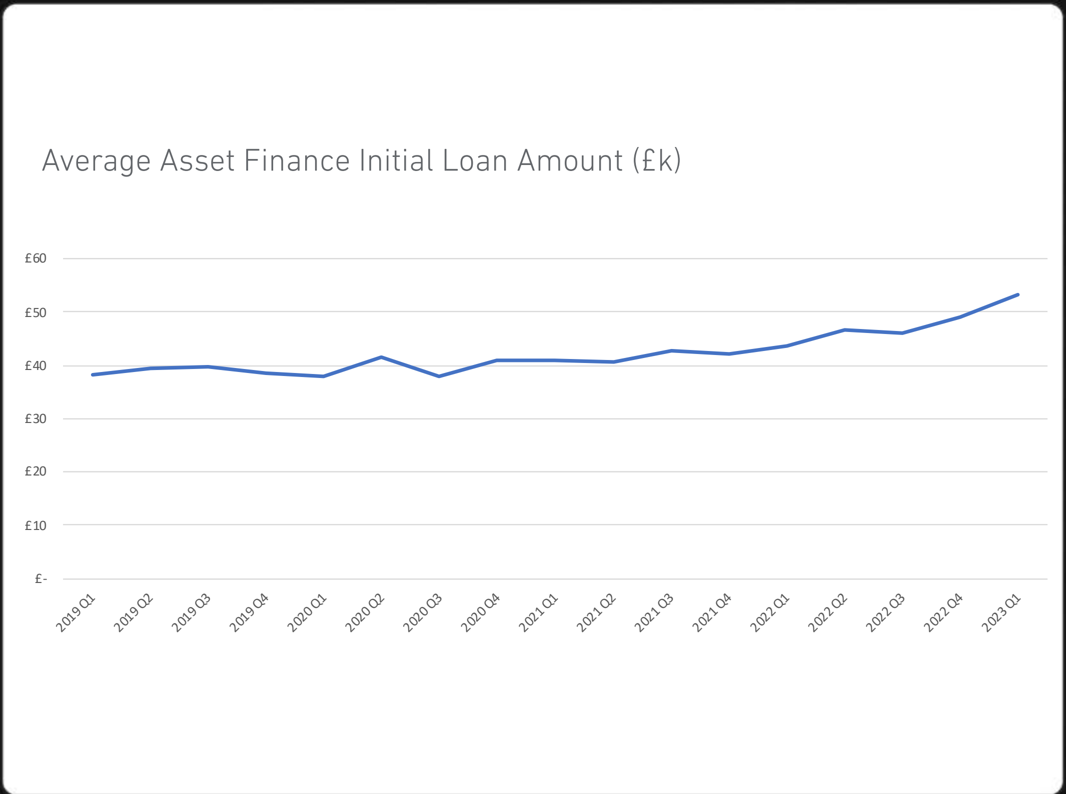


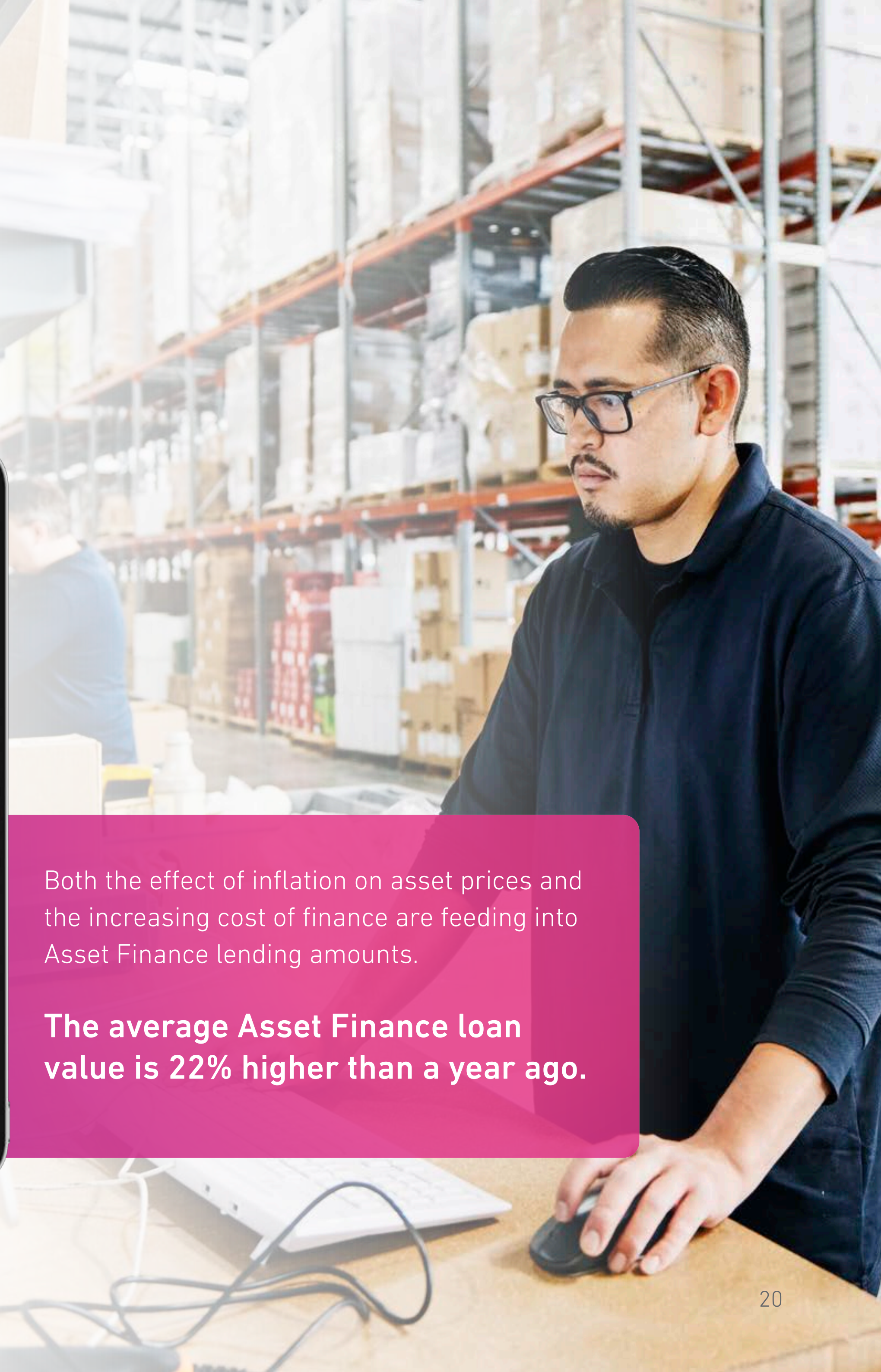
Growth in asset finance, cards and budget accounts more than offset sharp falls in traditional business loans and mortgages.

New lending data is lagged by one quarter as a result of credit reporting cycles

SME New Lending

Inflation and the increasing cost of finance is feeding into lending





Both the effect of inflation on asset prices and the increasing cost of finance are feeding into Asset Finance lending amounts.

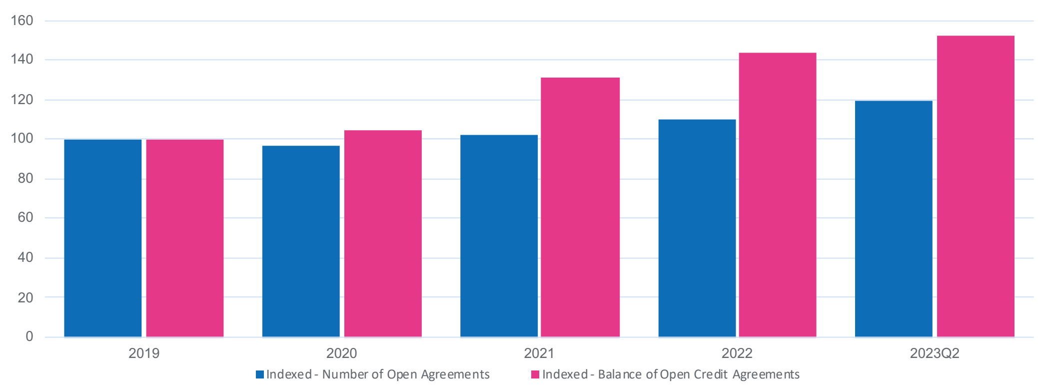
The average Asset Finance loan value is 22% higher than a year ago.

New lending data is lagged by one quarter as a result of credit reporting cycles

Overall SME Borrowing

The total level of SME borrowing on bureau has expanded rapidly

Growth in SME Borrowing
(Indexed – Dec 2019 = 100)

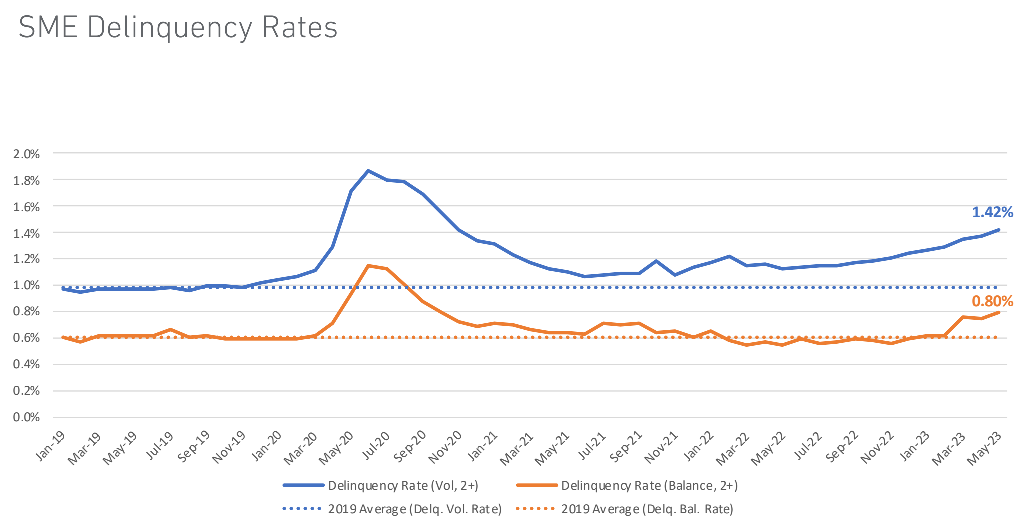


Even excluding pandemic relief lending, there has been significant growth in SME borrowing.

The total number of open loans is now 20% higher than it was at the end of 2019 - while outstanding loan balances are over 50% higher.

SME Credit Performance

The performance of SME credit agreements is deteriorating

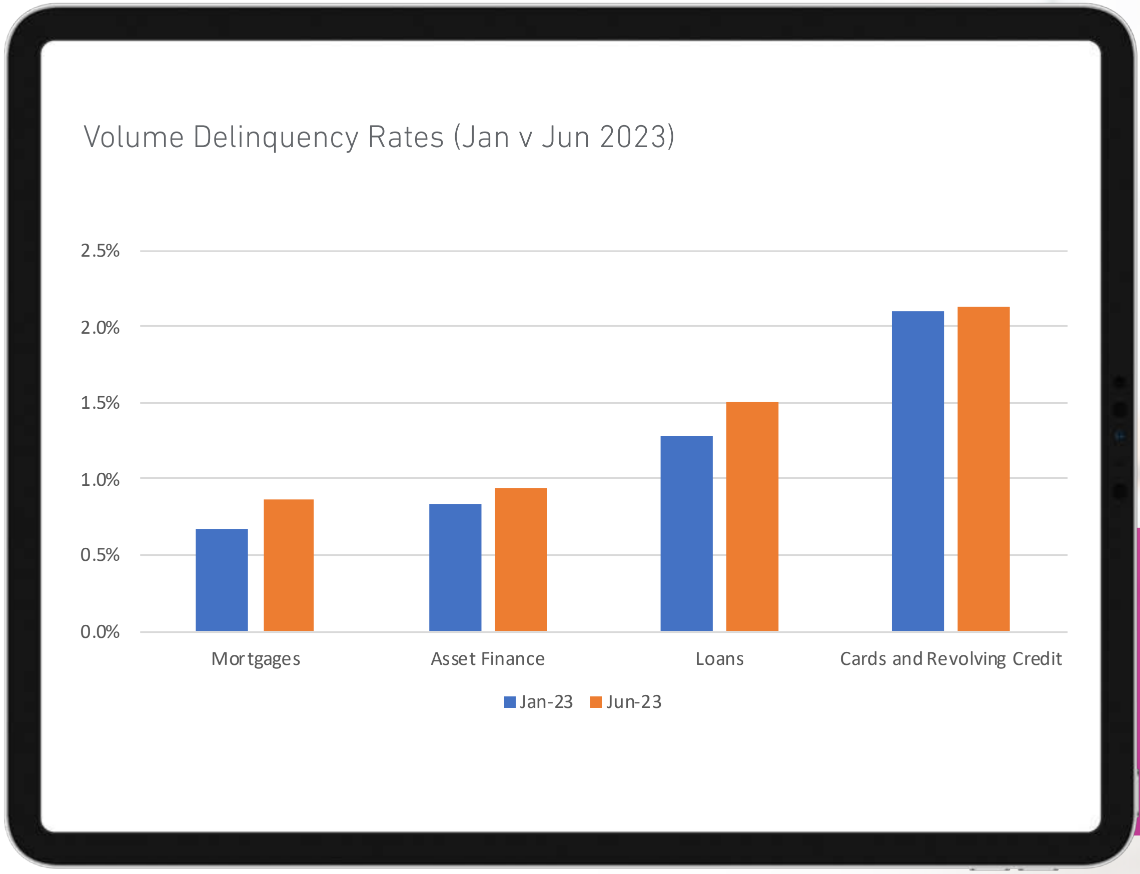


Delinquency on SME credit agreements (2 or more missed payments) has been increasing markedly

At the end of Q2, volume delinquency rates on SME credit agreements were 35% higher than they were at the start of the year.

SME Credit Performance

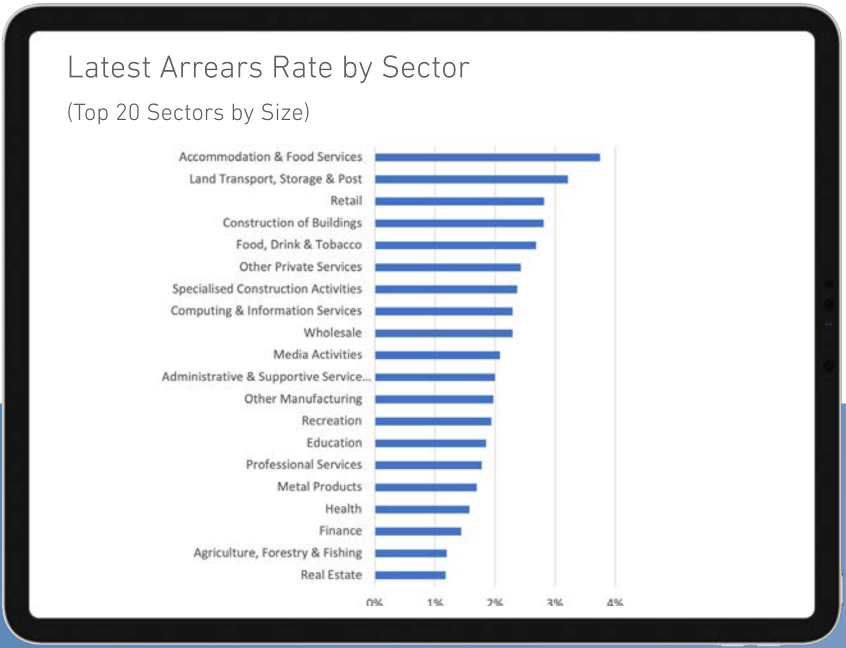
The deterioration in performance is being seen across all products

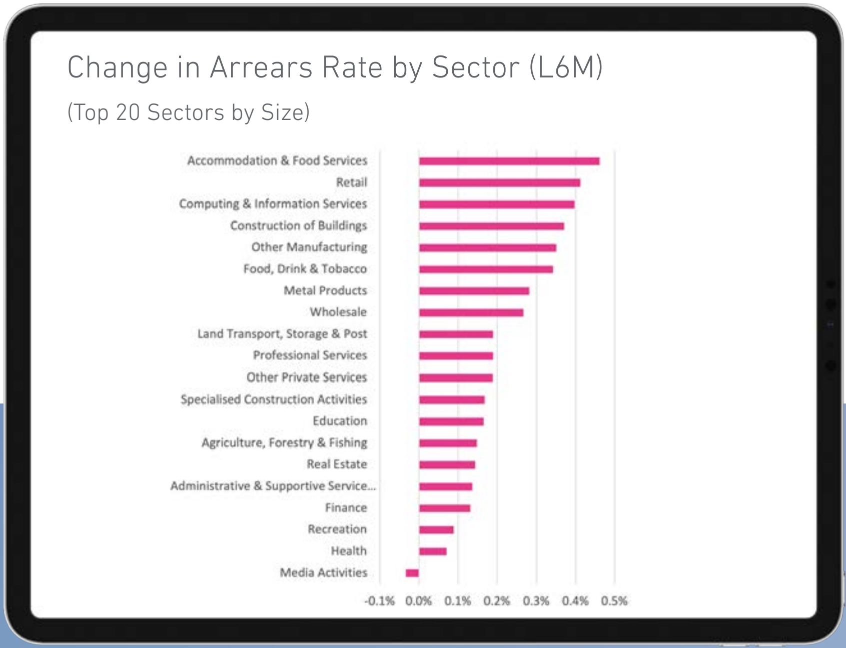


The deterioration in delinquency rates over the last 6 months is something that is evident in all products, whether they are secured or unsecured.

Delinquency rates

Credit performance is deteriorating in (almost) every sector





The sharpest deterioration in arrears has been in sectors most exposed to changes in consumer spending.

However, the deterioration can be seen across the board - in sectors linked to business-to-business services, construction and manufacturing.

Key takeaways and risks

Business concerns are changing. Energy prices are still high on the list of concerns, but the focus is now turning to falling demand and interest rates.

Levels of business lending remain high. Cost of finance and inflation in asset prices is increasing total lending value considerably.

SMEs Lending levels remain below pre-pandemic levels. With businesses delaying investment in 2023, growth may slow.

Arrears and delinquency rates are increasing across all core SME credit products, in almost every sector.

The **biggest increase** in arrears is in Sectors exposed to consumer spending **(Accommodationand Food Services and Retail).**

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

Ongoing economic uncertainty puts more pressure on lenders

Uncertainty makes the process of decision-making much more complex, leading to challenges such as:

Inaccurate risk management of your existing portfolio, who can pay, how much and when

Lack of understanding of changes in customer behaviours and income trends

Missing growth opportunities and not being able to upsell/ cross-sell across portfolio

Lack of strong relationships with the customers: how can they improve their financial health?

How can you reduce and effectively manage risk in a turbulent economy?

Gain a full picture of the risk associated in your customer base with deeper insights

Decipher those that can pay from those that either cannot or deliberately will not

Manage changes in risk across your customer base in near real-time

Know when customers change circumstances that could affect their payment ability

Know where to focus your limited resource within your portfolio to make it go further

A focused view, with access to high quality business information, can help reduce bad debt and operational overheads, while delivering improved business performance…

… leading to better decisions

Introducing 4D Credit...

Credit risk

Affordability

Survivability

Growth opportunity

The first step to reducing and effectively managing risk in a turbulent and unpredictable economy is understanding your existing portfolio and spotting growth opportunities

Gain a deeper understanding of your portfolio and exploit hidden growth opportunities

Minimise risk exposure, whilst avoiding missing out through being over-cautious

Refine lending strategies and criteria to support your customers

Summary

In a volatile environment, the latest and most reactive data sets enable you to:

1 **Determine which businesses are going to fail and which ones are best equipped to survive or grow**

2 **Optimise your risk appetite to support the underserved businesses and make decisions based on their long-term impact**

3 **Protect your portfolio by proactively managing problem debt**

Find out more about 4D Credit

4D Credit provides access to the widest possible data universe at your fingertips

Commercial Delphi Gen 6

Affordability

Commercial CATO

- Current Account, Credit/ Debit Turnover
- The most recent data being just 15 days old
- Balances (High/ Low/ Average)

Commercial CAIS data

- Monthly Repayment Information
- Historical Balances & Arrears
- Range of Credit Products

Payment Performance data

- Trade Credit invoices
- Over 6 million ledger transactions
- Days Beyond Terms scores

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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