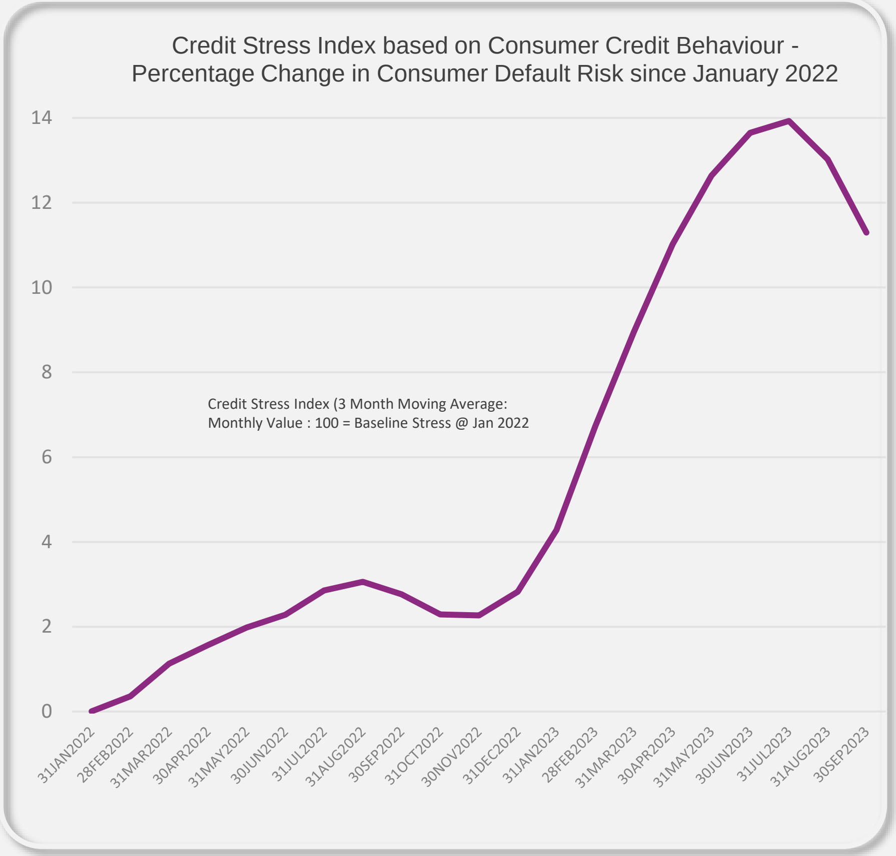
Australian Consumer Credit Stress Barometer

December 2023

Credit Stress Barometer @ Sept 2023 – Rising Credit Stress over 2022/23 (11%) Possible Sign of a Recent Improvement – (2% lower in Q3 2023)

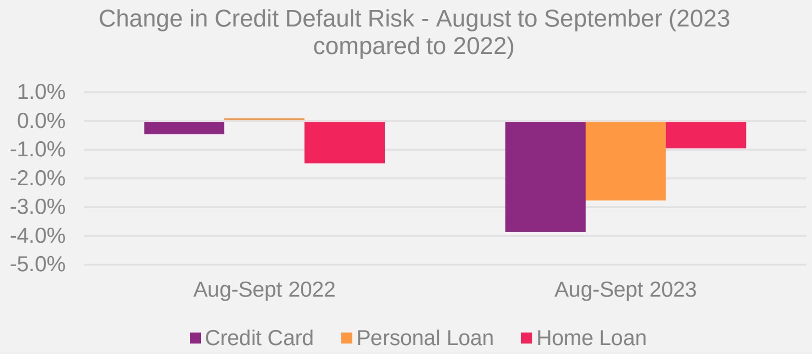


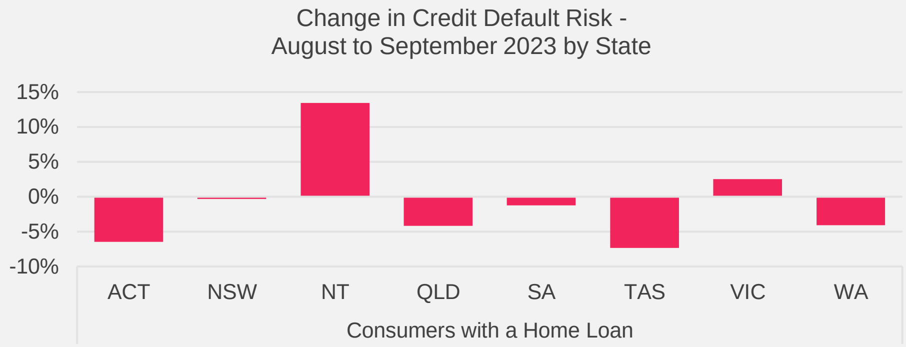
The illion Credit Stress Barometer for September 2023 continues to show a long-term trend to deteriorating Credit Default Risk but also indicates a possible turnaround in Q3 2023.

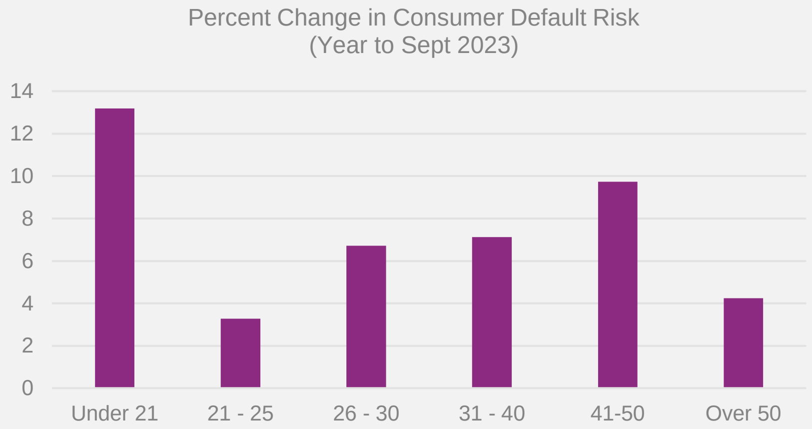
This may suggest that Australian Consumers have started to adapt to their economic circumstances in Q3 2023 and are now better positioned to manage these risks.

- The Credit Default Risk of Australian Consumers has risen 11% since January 2022 and 8% in the year to September 2023.
- It has fallen by 2% in Q3 2023, but this is consistent with a fall (albeit lower) around the same time in 2022. This improvement may therefore be partly seasonal but is also potentially, the first positive sign of improvement for around 12 months.
- Positive influences on this tentative turnaround include:
  - An improvement in the risk of consumers holding credit cards and personal loans
  - A generally lower deterioration in credit stress amongst younger Australians (21–39-year-olds)
- Factors working against this improvement are :
  - Higher household expenses (including rents, medical costs and fuel costs)
  - No clear turnaround yet in mortgage stress, especially in the major capital cities
- Home loan borrowers (at least, those from the major capital cities) and renters still look vulnerable, being burdened by higher servicing and housing costs.
- As this improvement pre-dates the recent interest rate rise in November 2023, it may raise questions about the longevity of this tentative turnaround through Q4 2023 and into 2024.
- Mature age borrowers have recently shown the greatest shift to higher credit stress; most likely from higher priced mortgage debts. RBA decisions around future cash rates may now prove to be the strongest indicator of credit stress going forward.

Credit Stress of Consumers holding Credit Cards and Personal Loans is improving: But Mature Home Loan Consumers are struggling to improve



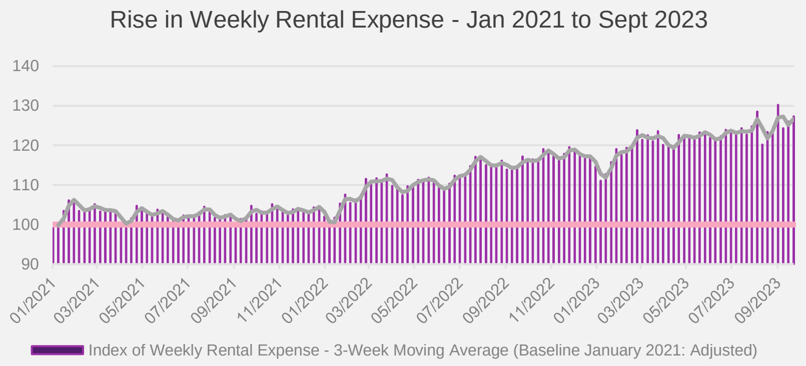


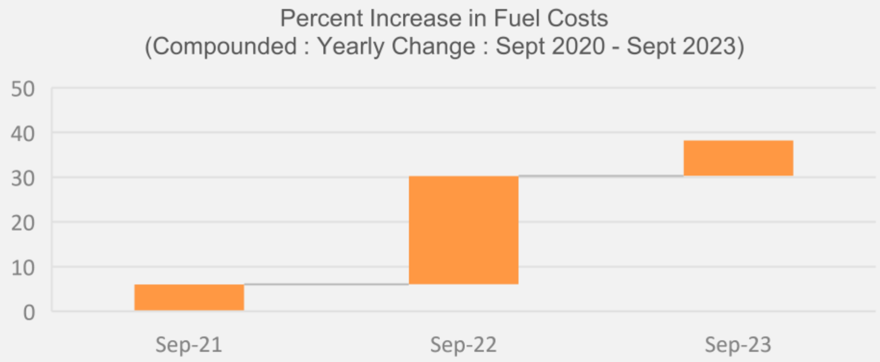


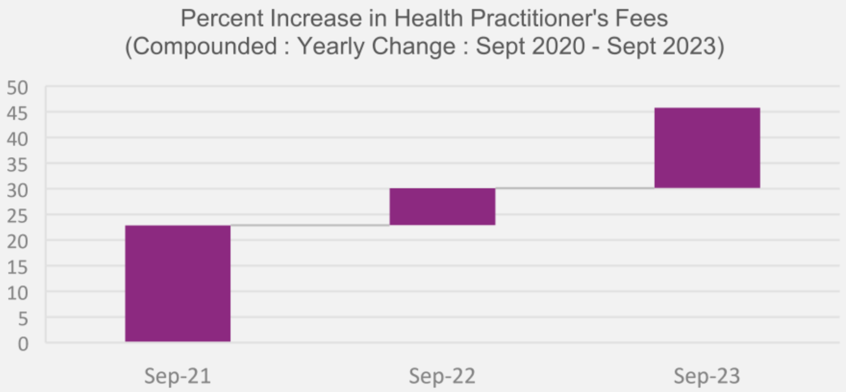
Signs of improving Credit Risk but this is not uniform and 'comes with a catch'

- The credit default risk of Credit Card holders has improved by 4% in September 2023; similarly, the risk of Personal Loan holders has fallen by 3%. This is the largest improvement in risk amongst consumptive credit holders for over 12 months and far outweighs the improvement seen over the same time last year, suggesting that some re-normalisation of credit default risk has occurred.
- The situation for Home Loan consumers is less clear, as their risk has fallen only slightly in Q3 2023 (1%) and even less so than for the same period in 2022 (1.5%). Therefore, while there is a slight improvement in risk, this trails the improvement seen at this time of year generally and the improvement achieved by consumptive credit consumers in Q3 2023.
- On a state-by-state basis, the default risk of HL borrowers in NSW (0%) has not improved in September 2023, while the risk of HL borrowers has deteriorated in VIC (2.5%) and in NT (14%). While the situation in NT may be due to unique circumstances, the situation in NSW and VIC appears to be aligned to a rise in housing expense. Sydney and Melbourne consumers have dealt with higher housing cost inflation over Q3, (compared to the Australian average) and this may have weighed more heavily on households whose income growth has not kept pace with inflation or where savings/assets have been insufficient to absorb this additional expense.
- While very young Australians have shown an increase in default risk (14% increase in the year to September 2023), the longer-term deterioration in credit stress has affected more mature Australians (especially those in their 40's). This is consistent with the stubborn state of Home Loan risk and especially, in the more expensive state capital cities. The risk of middle aged, family households holding a Home Loan (while not high relative to other borrowers) may be ingrained for the time being; at least, until there is a fall in interest rates.

Stretched Household Budgets –
Rising Rents, Medical Bills and Fuel Costs are affecting Middle Australia







Consumer Stress is illustrated by rising Housing, Medical and Fuel Costs; all essential costs that are increasing above CPI and most likely affect lower to middle income households

- Rises in spending on essential items is affecting the general welfare of Australians; having the largest impact on lower-income households and 'middle Australia' mortgage holders and renters.

- Households with a weaker asset-base and lower household income (i.e.. the younger, singles and couples not able to enter the housing market) continue to be affected by substantial rises in rental costs (25-30% higher now than in Jan 2022), with no clear stabilisation apparent. Therefore, while the financial stress on mortgage holders continues to be stubborn, the burden suffered by renters appears to be similar.

- The welfare of middle Australia is being tested (especially those living in outer suburbs), with fuel costs rising by 23% in the year to Sept 2022 and a further 8% in the year to Sept 2023 (baselined to 2020). In most cases, this is a fixed commuter cost, which has an inequitable effect on Australian households, with those in the outer suburbs more heavily affected. That said, fuel costs are at least, showing some sign of stabilising.

- At the same time, medical costs (mainly doctor's fees) have risen substantially (7% in 2022; 15% in 2023). This cost increase affects lower income Australians disproportionately, either through more stressed budgets, longer waiting lists at bulk billing clinics or fewer doctor visits. Whichever is the case, this compounding rise adversely affects the basic wellbeing of Australians.

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Appendix: Definition of the Credit Stress Barometer

Background Notes: Basis of Credit Stress Barometer

Illion's Credit Stress Barometer shows the risk of Australian Consumers defaulting on Consumer Credit contracts in the next 12 months. The barometer is a,

- metric, showing the percentage of consumers at risk of defaulting on their credit agreements
- forward looking prediction of this default risk
- trend-line, showing the changing nature of credit stress, both directionally and in magnitude.

The barometer is created by modelling the risk of credit default from a consumer's

- Current and historical credit performance – i.e.. trends in credit repayment performance across various types of credit contracts
- Current and historical credit demand – i.e.. the appetite for credit by considering application volumes and loan take-up; this is across different types of credit, including housing, investment and consumptive credit agreements.
- Financial exposure to different types of credit products – fixed loans, revolving loans, housing finance, car finance, investment loans
- Demand for credit in various industry risk sectors – e.g. the level of credit demand and repayment performance on borrowings from the Prime, Near Prime and Sub Prime lenders segments.

The Credit Stress Barometer is shown as the change in the percentage of consumers at risk of Credit Default, with the percentage calculated relative to a Baseline @ January 2022. This baseline has been chosen to a) remove the early biases/effects from COVID and to b) focus on current economic impacts from broad-based inflation and higher interest rates on borrowings.

In order to smooth monthly fluctuations, these trends are calculated as moving averages over a rolling 3-month period to the month shown in the trend diagram (Slide 2).

Additional insights into savings and expenditure patterns are incorporated in this Credit Stress Barometer pack to show financial trends that are likely to have an impact on the Credit Risk of Australian consumers.

The source data used in the creation of this report was derived from illion's proprietary credit and expenditure databases.

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