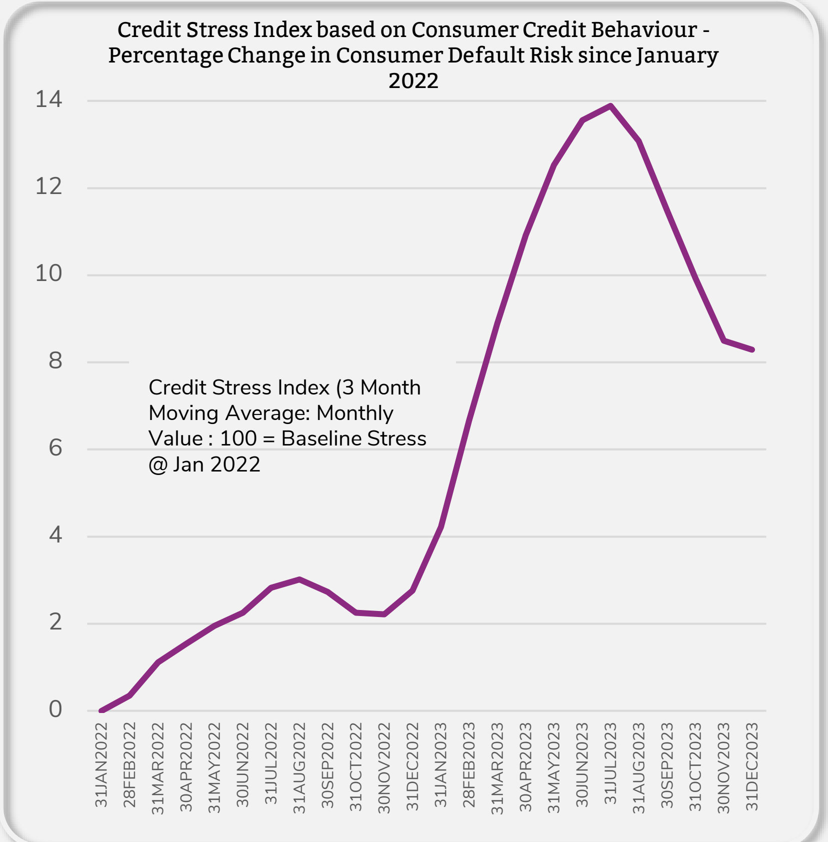
Australian Consumer Credit Stress Barometer

March 2024

Credit Stress Barometer @ Dec 2023 – Credit Stress falling H2 '23 but may be at a threshold. 'We're not out of the woods yet' – higher risk than '22 and indications it could rise again



The illion Credit Stress Barometer for December 2023 shows a recent turnaround, suggesting that there may be some normalising of credit risk in Australia. However, it is still 8% higher than 2 years ago and December has seen a possible halt to this improvement.

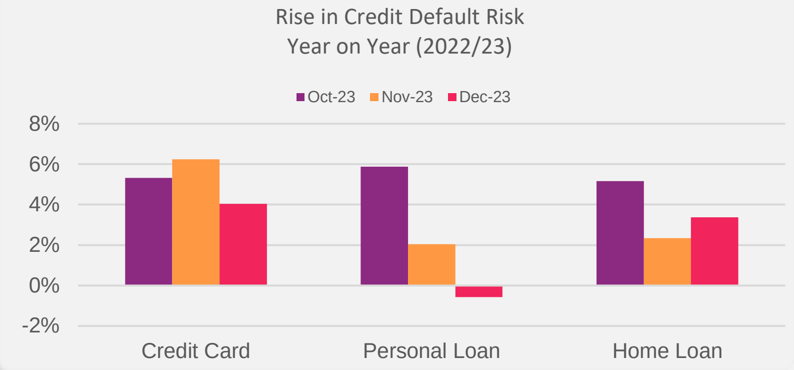
On one hand, this may suggest that Australian consumers have started to adapt to their economic circumstances in H2 2023 and may now be better positioned to manage these risks. But the credit risk observed in December 2023 may instead suggest that we have seen it improve as far as it can for the time being, unless there is substantial cost relief for households in 2024.

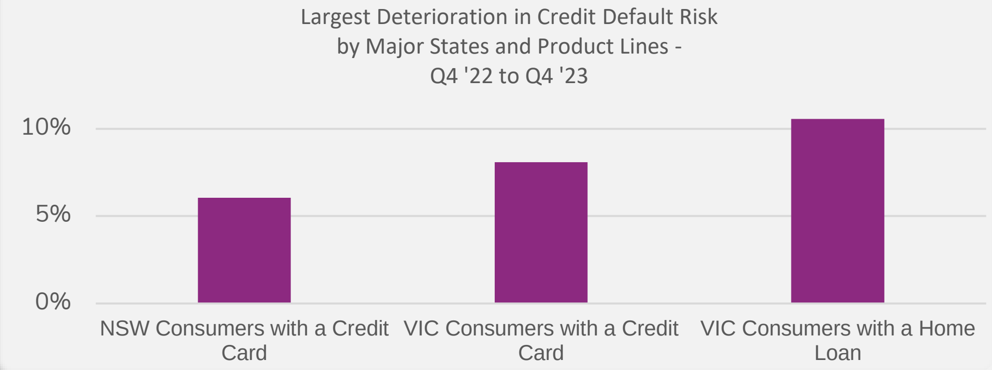
Coinciding with this improvement over H2 2023, we have seen higher discretionary spending by Australians but also a recent rise in early delinquencies, which is now beginning to show in the credit stress barometer. Australians may have therefore become too euphoric as interest rate rises and CPI have started to moderate.

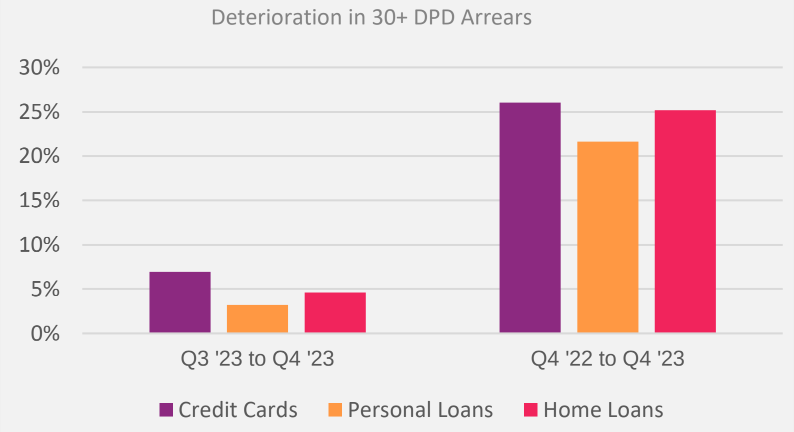
Specific observations for Q4 2023 are as follows:

- The Credit Default Risk of Australian Consumers has fallen by 60 points in H2 2023 (from the 14% rise between January 2022 to July 2023) to now show just an 8% rise in the 2 years to December 2023.
- However, the fall in credit risk has been minimal in December 2023 and this has coincided with some significant deterioration in default risk in particular geographic areas. Specifically,
    - missed credit repayments are now 25% higher in Q4 2023 when compared to Q4 2022
    - missed credit repayments have risen 5% in Q4 2023 alone
    - default risk of Victorian Home Loan borrowers and Credit Card holders has risen by near 10% YOY
    - default risk of Credit Card holders in NSW has risen by 5% YOY
- With this higher default risk and deterioration in credit repayments, we are also seeing higher levels of consumer confidence and household spending on discretionary food and entertainment:
    - Food Orders (up 12% in Q4 2023 compared to 2022 and up 19% in Q4 compared to 2021)
    - Digital Products and Services (up 19% compared to Q4 2022 and 33% compared to Q4 2021)

Credit Stress of Personal Loans Consumers is improving nationally. Home Loan and Credit Card Consumers are still struggling, especially in Victoria







Signs of improving Credit Risk but this is driven by 'where they live' and 'which credit is held'

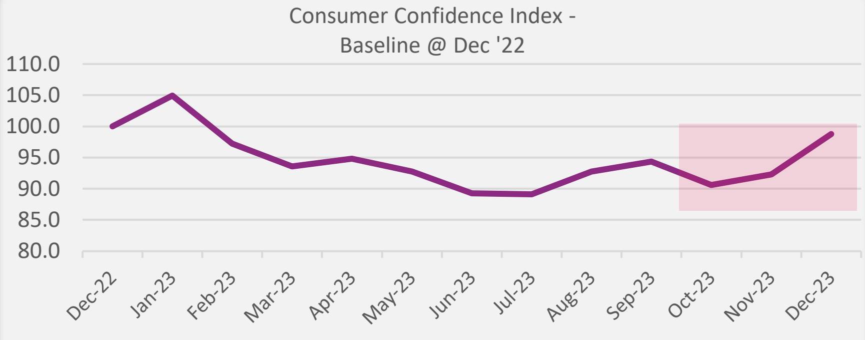
- The credit default risk of Personal Loan consumers has improved substantially in Q4 2023, to the point where it is now lower than in December 2022 (and counter to the overall credit risk of Australians). This significant turnaround may suggest that less affluent consumers have actively managed their credit stress, either through the refinancing or consolidation of debts, or by clearing their most costly debts as general living costs have risen. Equally, tighter lending policy by banks may have ensured that consumers have not taken on credit contracts that they would struggle to service in the current economic environment. As such, this improvement may be due to a combination of changing consumer behaviour and prudent lending practices in these more difficult economic times.

- The credit risk of more mainstream consumers (those holding credit cards and home loans) has deteriorated over the last 12 months (4% higher). This may have been caused by a higher debt servicing burden placed on consumers (from rising interest rates and large existing debts), but also from the take-up of new debts to soften the immediate financial impact from rising living expenses. Therefore, it's feasible that we see broader economic stress in Australia, where more affluent people have taken on debt to manage their financial circumstances.

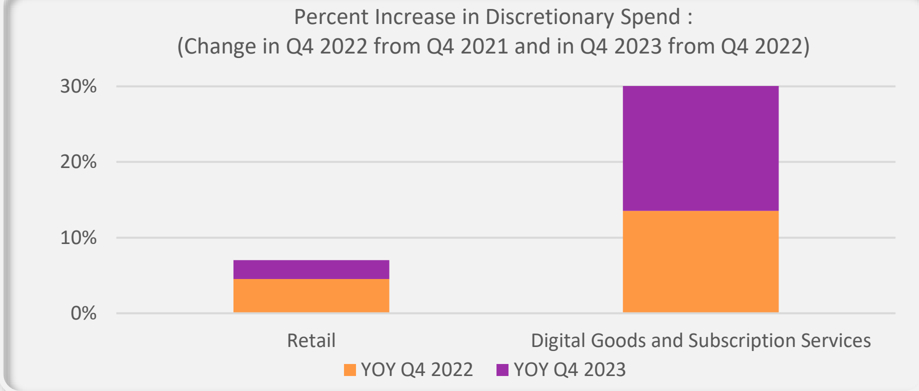
- This rise in credit stress seems to be most apparent in Victoria, with Home Loan borrower risk 11% higher in Q4 2023 (YOY) and Credit Card holder risk 8% higher - and while affecting Victorians uniformly, those most at risk of default include people in outer mortgage belt suburbs and inner-city apartment dwellers. The deterioration in the risk of NSW Credit Card holders is also notable (around 6% higher) meaning that the greatest warning sign of further credit stress into 2024 appears to be concentrated in Australia's most populated states.

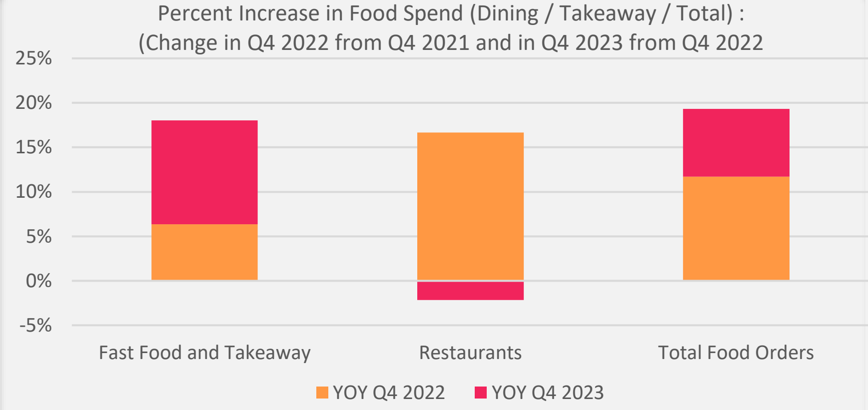
- Exacerbating this credit default risk, we are now also seeing a substantial rise in early credit delinquency in Q4 2023, which may filter through to the overall default risk of Australians as we head into 2024. The 25% YOY rise in 30+DPD delinquency and 5% quarterly rise in Q4 may suggest that credit stress will deteriorate further.

Households showing confidence again – but is it premature? Discretionary Spend on Food Orders, Retail and Digital rising - but also Credit Arrears rising



Source: ANZ-Roy Morgan Consumer Confidence Rating includes the five component questions on personal finance, the Australian economy and whether now is a 'good' or 'bad' time to buy.





Q4 2023 : Significant Rise in both Consumer Confidence and Discretionary Spending by Australians, but also in Credit Arrears. Is the Improvement in Default Risk therefore sustainable or fleeting?

- The December quarter (and the month of December in particular) saw Australia's most substantial rise in confidence in recent times- up around 10% on Q3.
- This rise in confidence has coincided with substantially higher discretionary spending by Australians. After a substantial rise in retail and household digital spending in Q4 2022 over Q4 2021 (5% and 14% respectively) we have seen another rise in Q4 2023 (3% and 19% respectively). Therefore, while Australians may be changing their spending habits from 'going out' to 'staying at home', demand for consumables and home entertainment has been strong, even as budgets have tightened.
- Similarly, although Australians have changed their dining habits (less 'dining out') they're spending more (in total) on food orders - ie. replacing dining out (2% down YOY in Q4 2023 on a substantial rise of 17% YOY in Q4 2022) with take-away options (up 6% in Q4 2022 and 12% in Q4 2023). In total, this spending has risen 20% in 2 years with no sign of falling.
- This rise in discretionary spending coincides with an increase in credit delinquency (especially on consumer credit cards and home loans), thereby raising a question as to whether Australians are becoming over-confident. With the Credit Stress barometer possibly showing that the fall in default risk has reached its end we may be seeing a return to higher levels again. The horizon for Credit Stress is therefore unclear into 2024.

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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