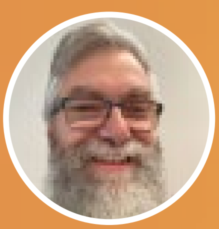
Consumer Stress Barometer



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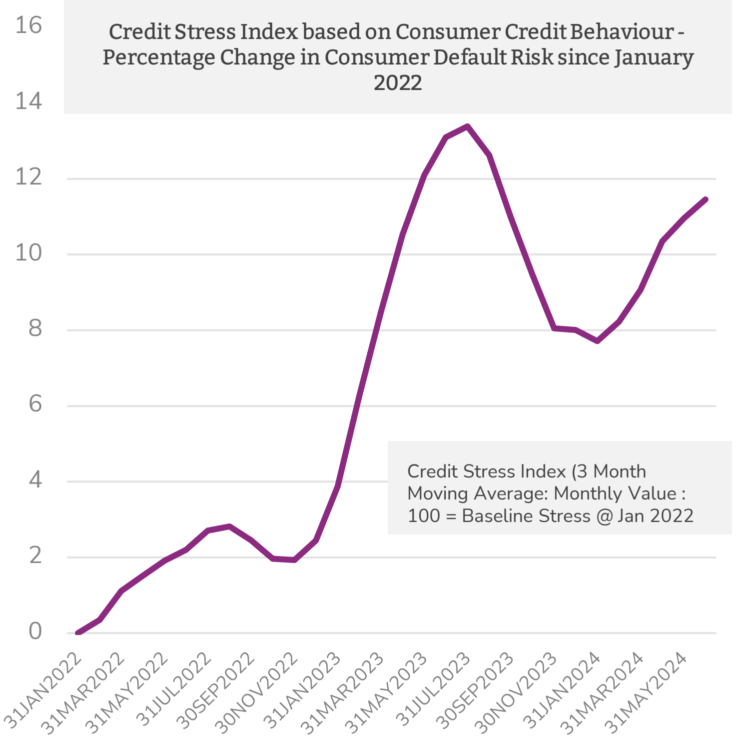
Australia

September 2024

illion

Credit Stress Barometer @ June 2024 – After improving in late 2023, Credit Stress has again deteriorated throughout 2024, continuing the long-term trend to higher default risk.



The illion Credit Stress Barometer for June 2024 indicates that the consumer credit default risk of Australians is continuing to deteriorate. After improving over the latter half of 2023, this risk has deteriorated to a level last seen in September 2023, with every month since February 2024 showing signs of deterioration. As a long-term trend, it is 11% higher than at the start of 2022, and over the short-term, it has risen 4% since the start of 2024.

Both recent and longer-term trends are showing no clear signs of moderation, which, together with the underlying insights presented later in this report, lead us to believe that Australians will continue to struggle through 2024 and into 2025 (and possibly longer, depending on their economic stability).

Home loan consumers and borrowers of consumptive credit products continue to struggle, this stress being most prominent in Victoria.

In addition, while we are seeing home buyers struggling, this credit stress is not confined to them. Renters are also being adversely affected by rising costs, even as there are some recent signs of rental price and interest rate stability. The fact is, a sizeable amount of damage has already been done to their household budgets so that, the green-shoots observed in late 2023 appear to have been a 'false dawn'.

Without a re-balancing of household income to out-goings, we don't see any clear improvement in sight for Australians; especially, as there is some evidence that unemployment and underemployment are beginning to rise. If this does worsen, it may create a dual economy into 2025, where the employed obtain cost of living relief, through lower interest rates, while the under-employed may face an uncertain future.

Specific observations for the June quarter are:

- The credit default risk of mortgage-holders has increased by 3% since March, with the over 50's faring worst; their risk deteriorating by over 4%. Victorians continue to struggle the most, as their risk has deteriorated by 5%. However, we are now also seeing the default risk of mortgage-holders in NSW and WA also beginning to rise (both 3% higher than March). The rising cost of housing over 2023/24 in these two markets (which is spilling over into rising loan servicing costs) appears to be catching up with householders in these markets.
- The default risk of non-mortgage holders (e.g. renters) is also concerning. Most notably, we're seeing a rise in the default risk of older, personal loan holders rising around 4% in the June quarter, while the risk of younger ones has risen by around 2.5%.
- This deterioration in credit default risk has come at the same time as household savings have continued to dwindle (by around 16% in the year to June 2024), and while rents have increased by around 12%.
- At a time when mortgage servicing, rents and general expenses are all rising, we are also seeing Australians resorting to instalment credit facilities for purchases, with a 38% rise in BNPL payment obligations observed in FY23/24 (all while personal loan and home loan default risk is growing).

The June 2024 quarter shows that the Credit Default Risk of Mortgage-holders is on the rise again, with the improvement seen in late 2023 wiped out.

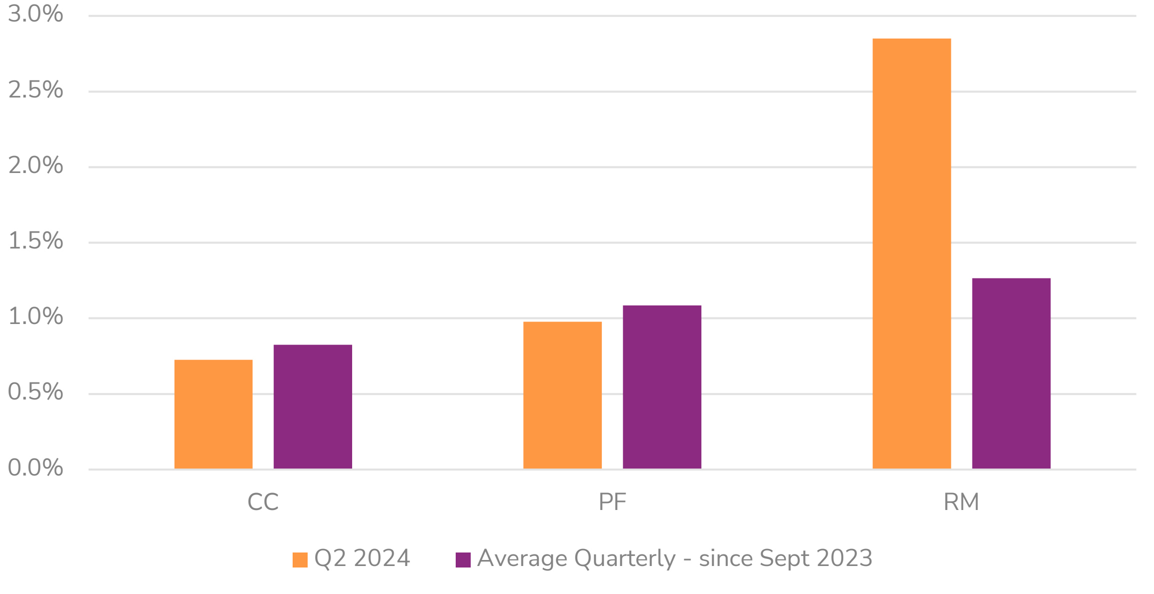
The stress on home loan borrowers is being felt by older Australians, especially in Victoria. Home loan borrowers in Western Australia and New South Wales are now also showing signs of stress.

After seeing the risk of consumptive credit holders deteriorate in the March quarter, we are now seeing mortgage-holder stress rising again. The June quarter saw the default risk of home loan borrowers deteriorate at 3-times the rate of personal loan and credit card borrowers, suggesting that mortgage stress has re-appeared in the Australian economy.

The 3% deterioration observed in the June quarter means that the improvement in home loan risk, evident in the six months to March 2024, has now been completely wiped out. In fact, mortgage-holder risk is now worse than in September 2023, and this is at a time when interest rates have barely risen.

That said, we have also seen a deterioration in the risk of credit card and personal loan holders since September 2023, meaning that there are broader economic problems being faced by Australians. With the risk of a recession on the rise, we don't see any clear sign of this risk moderating in the foreseeable future.

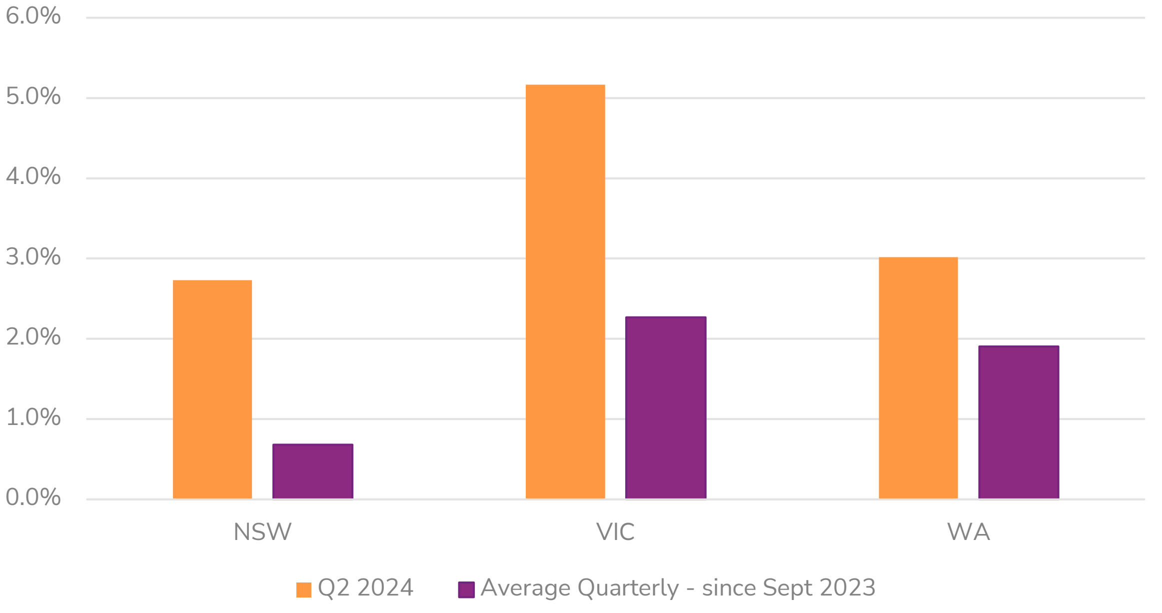
Change in the Credit Default Risk of Australians



As shown in the following graph, the June quarter saw the default risk of Victorian mortgage-holders rise by 5%; a near doubling of the deterioration seen in the next worst states. The economic well-being of Victorian home loan borrowers is therefore of the highest concern, as we are seeing both recent and longer-term deterioration in that state. To illustrate, the average quarterly deterioration in Victoria since September 2023 has been 3-times higher than in NSW, even though housing affordability has hit NSW borrowers harder.

Notwithstanding, there has also been a sizeable deterioration in the default risk of mortgage-holders in both NSW and WA over the June quarter (both rising by close to 3%). While not yet clear, it is possible that the economic impact from Sydney's huge property prices (i.e. the average dwelling price of $1.1million) and from Perth's significant rise in property prices (i.e. around 7% in the year to June) has contributed to the credit stress of borrowers in these states.

Change in Credit Default Risk of Mortgage-holders (by State)

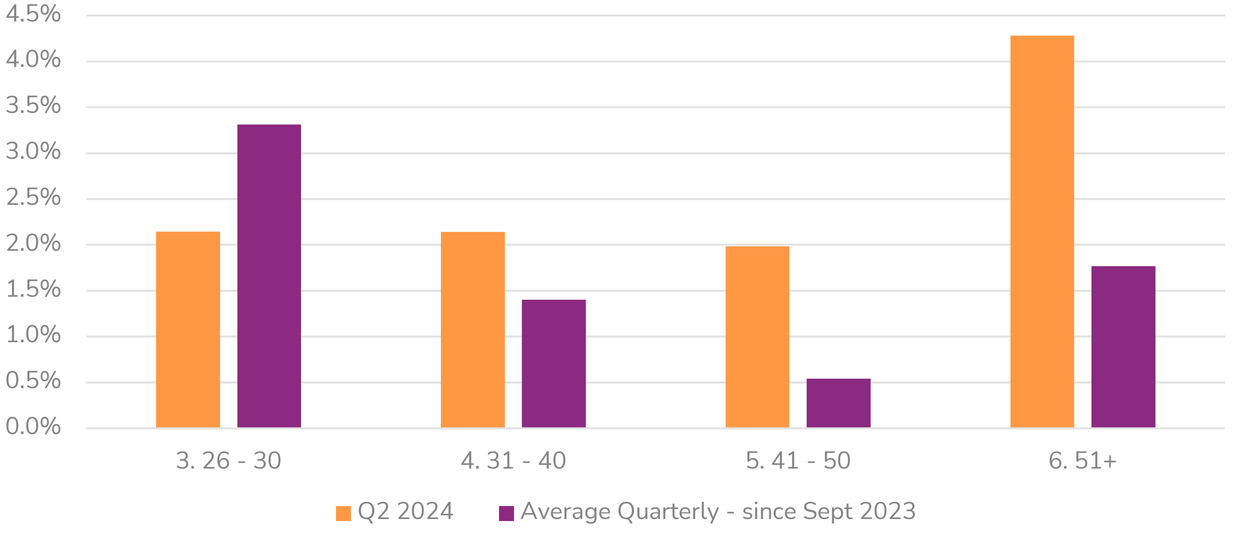


The deterioration in mortgage-holder risk has affected all age-groups, but especially older Australians. While the default risk of Australians under 50, has risen by 2%, the risk of Australians over 50, has risen by over 4%. This may suggest that 1) people taking out mortgages later in life, 2) parents, supporting their children while still paying off their own houses and 3) people, who have serviced debt for many years, but are still struggling under its weight, are now showing signs of stress.

With older Australians finding it harder to move between jobs, this rise in stress could become endemic if an economic downturn leads to longer-term unemployment. Should this happen, we risk having our older population being tipped into the unpredictable rental market, while also seeking government welfare for subsistence. Such an outlook would be socially and economically damaging for Australia.

We are also seeing a longer-term rise in the risk of young mortgage-holders (rising over 3%, amongst the under-30's since September 2023). This is quite possibly an outcome of younger Australians wanting to enter the property market at any cost, thereby affecting their own economic health, as well as possibly that of their parents in some cases.

Change in Credit Default Risk of Mortgage-holders (by Age Group)

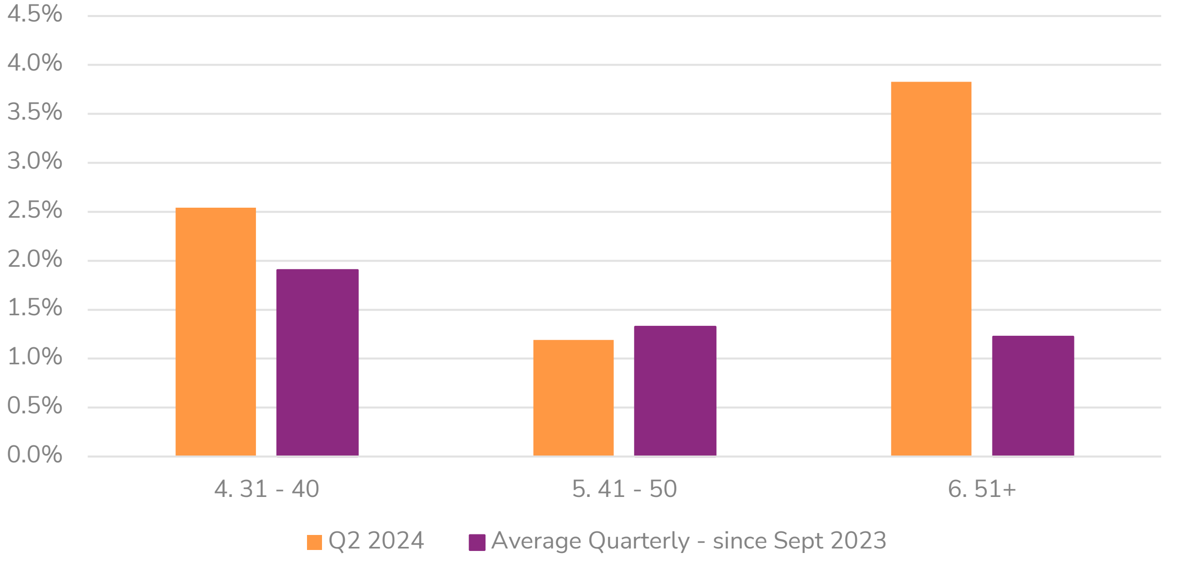


Credit Stress is also affecting Personal Loan borrowers. Their outlook may be especially bleak, as their savings are eroded by household costs, and they have few assets on which to draw.

Australians are facing a new reality, as they turn to non-traditional credit products to spread their debts, while their budgets becomes tighter, and their savings dwindle.

- Credit stress has not only affected mortgage-holders, as the risk of default amongst consumptive credit-holders has also risen in the June quarter. This has been especially apparent amongst personal loan consumers, aged over 50. From the graph below we can see that, while the default risk of 30-somethings has risen by 2.5% in the June quarter (the second highest increase by age), the risk of 50-somethings has risen by nearly 4%. This means that the recent deterioration in credit stress felt by borrowers, has been especially hard on older Australians, irrespective of whether they have been weighed down by home loan debt or rental stress.
- Of most concern for governments, lenders and welfare agencies, is that we are seeing this stress rising in an age-group that would typically, be more economically independent. If older Australians continue to struggle under the weight of debt, this may have ramifications for personal bankruptcy, for long-term government financial support and for private economic support from charitable organisations. It also may mean that Australia loses a significant portion of its future consumer base.

Change in Credit Default Risk of Personal Loan holders (by Age Group)

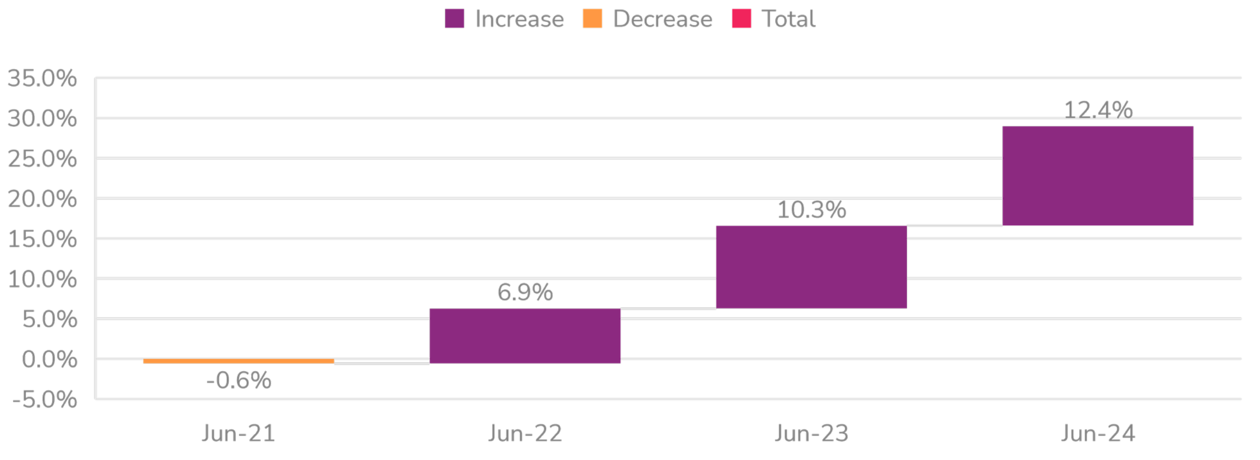


The overall economic stress on renters is particularly noteworthy, given the substantial rise in rents over the last few years. When we couple the effects of rental stress with higher personal loan debt, the future for lower-wealth Australians may be bleak.

To illustrate, the graph below shows that, while Australians have fallen behind on their personal credit obligations, they have also suffered through rising rents; up 12% in FY23/24, after already rising 10% in FY22/23 and 7% in FY21/22. Overall, renters have endured an average 30% rise over 3 years, meaning that if rents had absorbed 40% of a person's income in 2021, it would now absorb around 50% (even if we allowed for some modest rise in wages over the same time).

While there is some sign of a moderation in rental rises currently, in many cases, the damage has already been done and, while we have seen this stress in household budgets previously, we are now also seeing this in people's ability to service personal loan debt.

Annual Increase in Rental Expenses of Australian Consumers – Comparing Q2 2021/22/23/24 with Q2 2020 Baseline

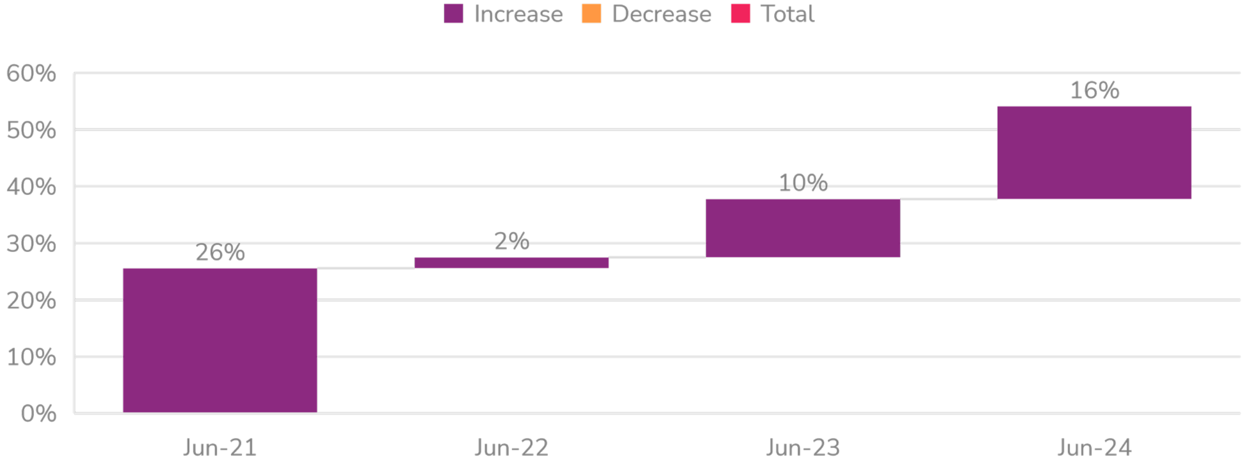


The stress on both renters and mortgage-holders has had a detrimental effect on household savings and, while this looked to be stabilising in late 2023, the following graph shows the damage that has occurred to the savings pool of middle to lower income Australians over the last 4 years.

Since COVID, the savings of these consumers have been eroded, to the point where they are now 54% lower than pre-COVID, having fallen by 26% in FY20/21, 10% in FY22/23 and 16% in FY23/24. Half of this lost balance (26% overall) has occurred in the last 2 years (i.e. since living costs started to rise significantly). Inflation and interest rate rises have together, erased the savings amassed by lower-income consumers since the early days of COVID, leaving them with a savings pool that is substantially lower than 4 years ago and whose value (i.e. spending power) is also greatly diminished.

It is unsurprising that, in wanting to manage their household finances, consumers have resorted to taking-on debt. But, that said, this decision may have an adverse impact on their financial well-being, and to Australia's economic growth in the longer-term, as debt servicing may need to be prioritised over both higher savings and spending as we move through 2025 and into 2026.

Annual Fall in Savings Balances of Australian Consumers since June 2020



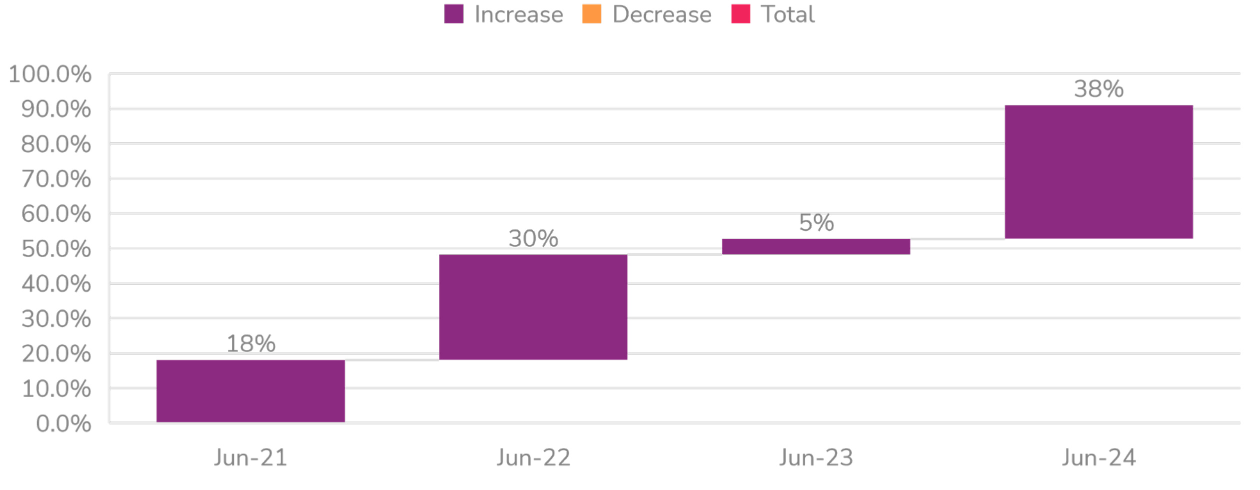
An example of consumers taking on additional debt is the rise in BNPL servicing costs by lower-income and middle-income Australians, as savings have been eroded.

To illustrate this rise in BNPL expenditure, we can see from the graph below that lower to middle income Australians have increased this expense in each of the last 4 years with all, but the FY22/23 year, showing a substantial increase over the previous year.

Overall, the annual amount spent on BNPL services has risen by over 90% in the last 4 years, and while consumers were initially very cautious to spend in FY22/23 (5% annual increase as living costs bit into their budget), we can see that FY23/24 has seen the most substantial annual rise in BNPL spending over the last 4 years (38% annual increase over FY22/23).

With their household budget tightening, their savings dwindling and credit risk rising, consumers, who are also taking on BNPL debts are at greater risk of exacerbating their already, fragile economic health. This is especially worrying if their disposable income becomes so trapped in a debt repayment spiral, that they risk indebtedness and eventual, financial collapse. Close monitoring of the credit and budgetary position of lower to moderately affluent Australians will therefore be required to manage this risk of collapse.

Annual Rise in the BNPL Expenses of Australian Consumers since June 2020



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 (Page 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.

About illion

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