The personal lending climate

What's the best course for financial institution marketers?

Quad

A marketing experience company

The personal lending climate

While the economy seems undecided about where it's headed, personal lenders face a confusing set of signals as they chart their marketing approach. Positive developments like strong job growth and steady consumer spending are intermixed liberally with worrying signs like increasing household debt, delinquency rates that are starting to creep up, and a steep drop in demand for mortgages.

For lenders, the challenge is to capitalize on the positives while adjusting their marketing to reassure and educate consumers. While some financial institutions (FIs) have chosen to pull back or limit marketing campaigns, past experience suggests that this could shortchange future growth.

Recent research from Analytics Partners shows that "60% of brands that increased their media investment during the last recession saw ROI improvements" while "those who slashed spend risked losing 15% of their business to competitors who boosted theirs."

This e-book presents an overview of the often conflicting trends in the lending marketplace, and key takeaways FI marketers can use to shape strategies that will help them succeed in the current complex environment.

> **"Companies that make bold moves during uncertain times generate greater returns in future business cycles."**
>
> *McKinsey & Co. "The great uncertainty: U.S. consumer confidence and behavior during inflationary times"*

CHAPTER 1

Household debt is growing

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Americans added $312 billion — 2% — to their total household debt in the second quarter of 2022, the New York Fed Center for Microeconomic Data reported in August. While 2% may not seem like much, it put total aggregate debt at $16.5 trillion. That's $2 trillion higher than at the end of 2019, before the COVID-19 pandemic.

Debt increased across all categories of lending except student loans. The Federal Reserve Bank of New York (FRBNY) noted that non-housing balances grew by $103 billion, a 2.4% increase, the largest since 2016.

$312 billion

The amount Americans added to their total household debt in the second quarter of 2022

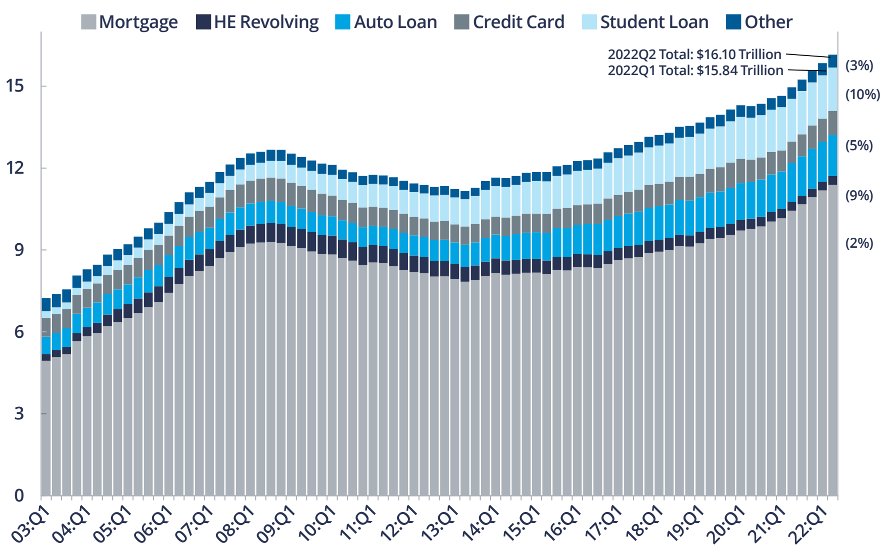
Some notable facts:

- Balances on mortgages, the largest segment of household debt, increased by $207 billion during the second quarter, to $11.39 trillion.
- After dropping over many years, balances on home equity lines of credit (HELOC) rose a modest $2 billion to $319 billion in the quarter.
- Credit card balances jumped $46 billion in Q2 2022, up 5.5% from Q1 and 13% year-over-year, the largest Y-O-Y increase in more than 20 years.
- Still, credit card balances remain slightly below pre-pandemic levels.
- Auto loan balances rose $33 billion in the second quarter, continuing a rise that started in 2011.
- Other balances, which include retail cards and other consumer loans, grew by a robust $25 billion.

CHAPTER 1

Household debt is growing

Q2 2022 Total Debt Balance and Its Composition



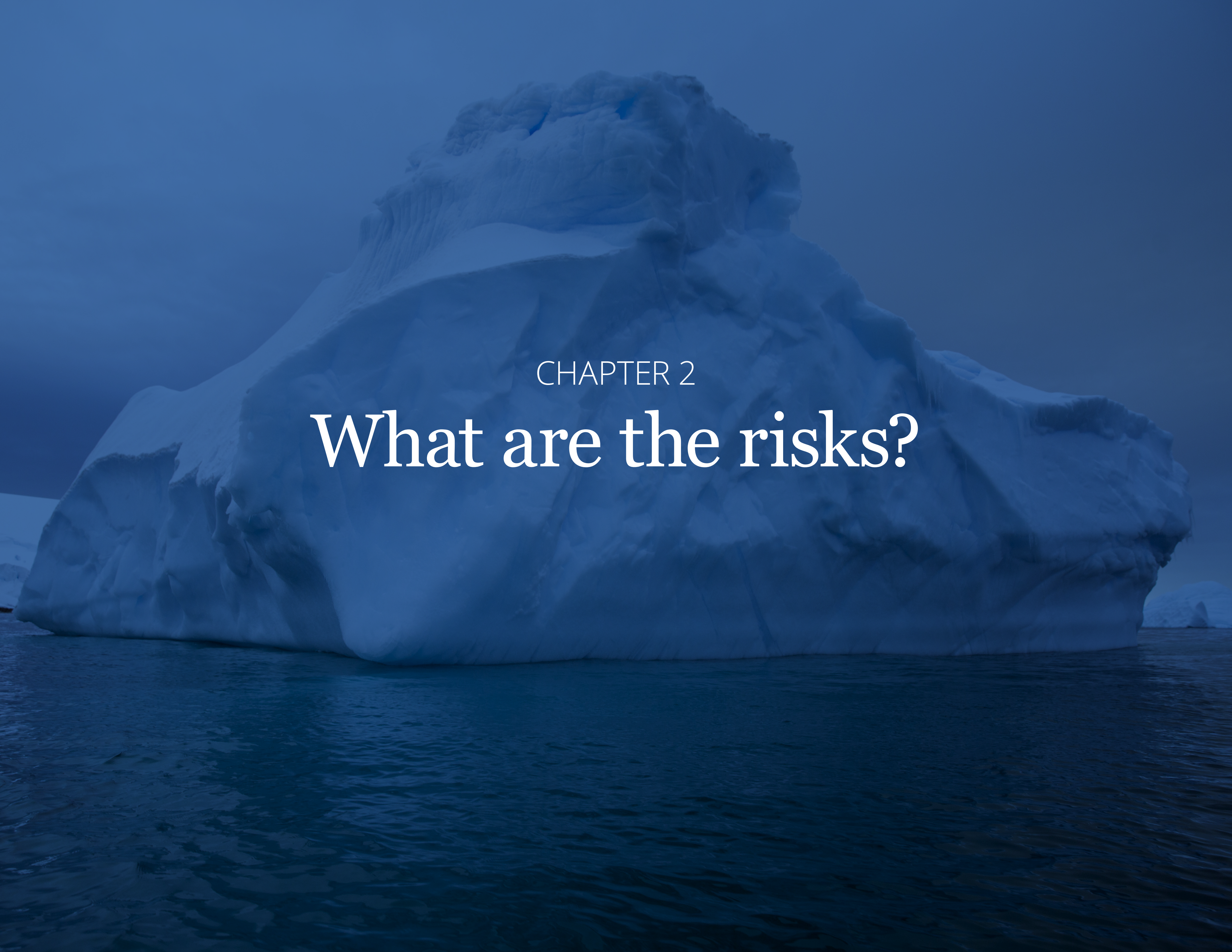
Source: New York Fed Consumer Credit Panel/Equifax

According to the New York Fed:

- The number of credit inquiries over the past six months — an indicator of consumer credit demand — was roughly unchanged at 110 million.
- 233 million new accounts were opened in Q2, up from Q1 and the highest since 2008.

Takeaways:

- The numbers indicate steady consumer demand and spending, though a portion of the balance increases are due to people spending more on what they've always bought because of higher prices, rather than buying more goods and services. Still, continued demand means continuing opportunities for personal lenders.
- The rise in HELOC balances after years of decline indicates a growing need for credit as prices shoot up.
- Demand for unsecured personal loans — which carry a higher interest rate — can also be expected to increase as continuing inflation fuels consumers' need for extra help meeting expenses. Craig Martin, managing director and global head of wealth and lending Intelligence at J.D. Power, said such loans are attractive even for people who own homes because they can get their hands on the money faster. Fintechs offering unsecured personal loans make decisions on approvals quickly, often within hours, compared to as long as 45 days for a HELOC.



CHAPTER 2

What are the risks?

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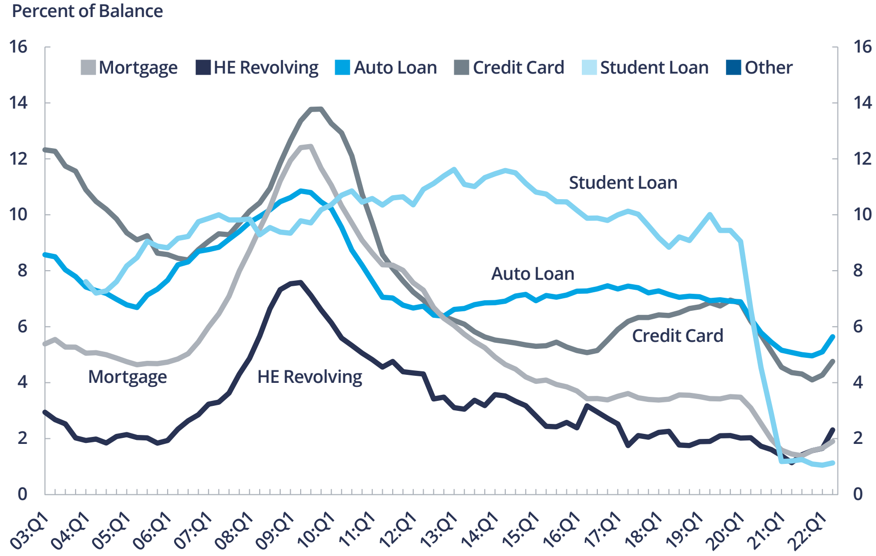
Delinquencies are ticking up.

- The delinquency transition rate for credit cards, auto loans and other debts increased by 0.5 percentage points in Q2.
- HELOC delinquencies increased by 0.7 percentage points.

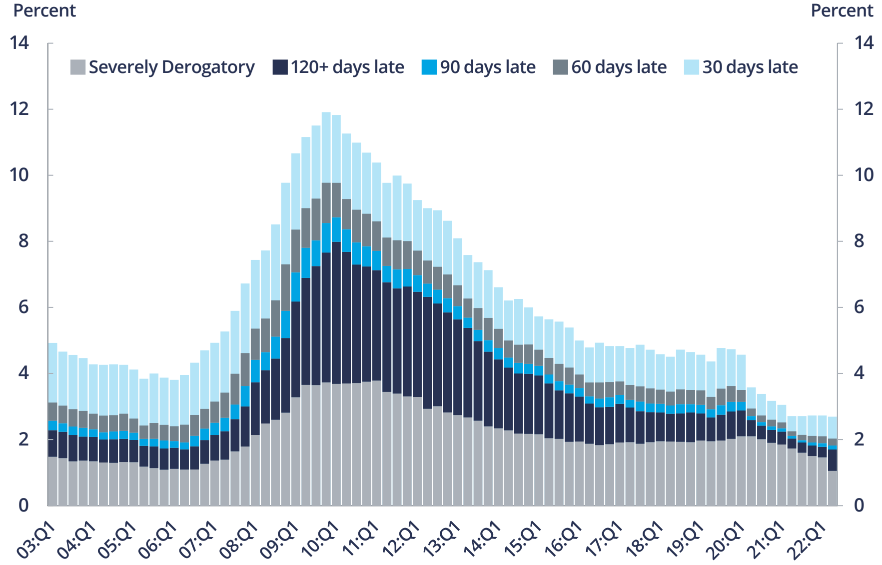
But serious delinquencies (90 days or more) are still low by historical standards, the New York Fed noted.

Q2 2022 Transition Into Delinquency (30+) by Loan Type



Source: New York Fed Consumer Credit Panel/Equifax
Note: 4 Quarter Moving Sum
Student loan data are not reported prior to 2004 due to uneven reporting

Q2 2022 Total Balance by Delinquency Status



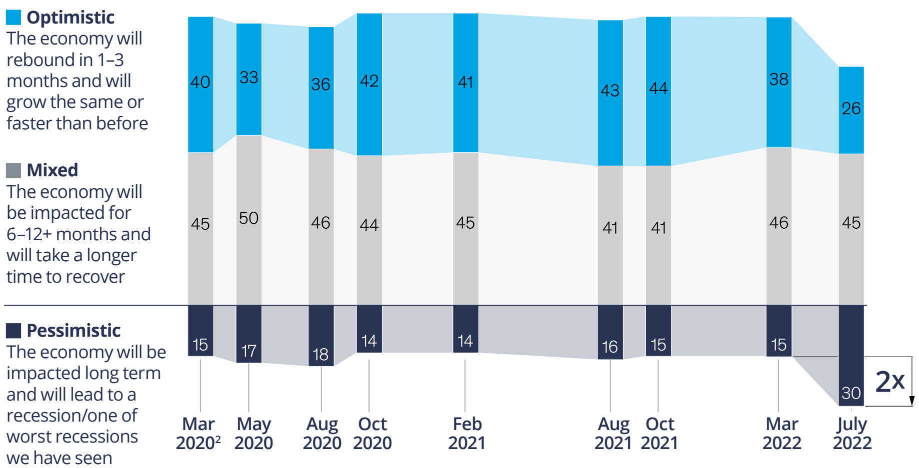
Source: New York Fed Consumer Credit Panel/Equifax

The number of consumers who expect not only a recession but "one of the worst recessions we have seen" is twice what it was in 2020 and 2021 at the height of the pandemic — 30% vs. between 14% and 18%.

McKinsey Consumer Pulse Survey conducted in the first half of July 2022

Consumer Confidence in U.S. Economy[1]

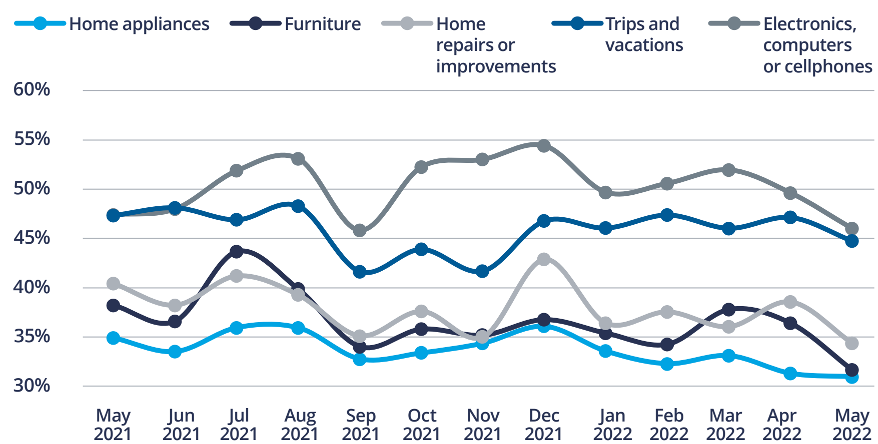
percentage of respondents



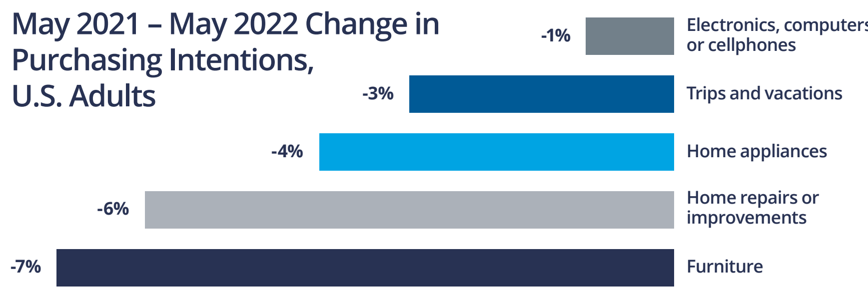
Source: McKinsey US Consumer Pulse Surveys; sampled & weighted to match the US general population 18+ years
[1]Question: What is your overall confidence level surrounding economic conditions in the US? Rated from 1, "very optimisitc" to 6, "very pessimistic." Optimistic = respondents selecting "very optimistic" and "optimistic" options; pessimistic = respondents selecting "very pessimistic" and "pessimistic" options; mixed = respondents selecting "somewhat optimistic," "somewhat pessimistic" options. Figures may not sum to 100%, because of rounding.
[2]Average of weekly pulse surveys for Mar 2020.

Declining consumer confidence appears to be taking a toll on purchase intent. Since consumer spending is the primary engine of U.S. economic growth, that's concerning.

U.S. Adults Planning to Buy the Following in the Next 12 Months



May 2021 – May 2022 Change in Purchasing Intentions, U.S. Adults



Source: Morning Consult Economic Intelligence

What are the risks?

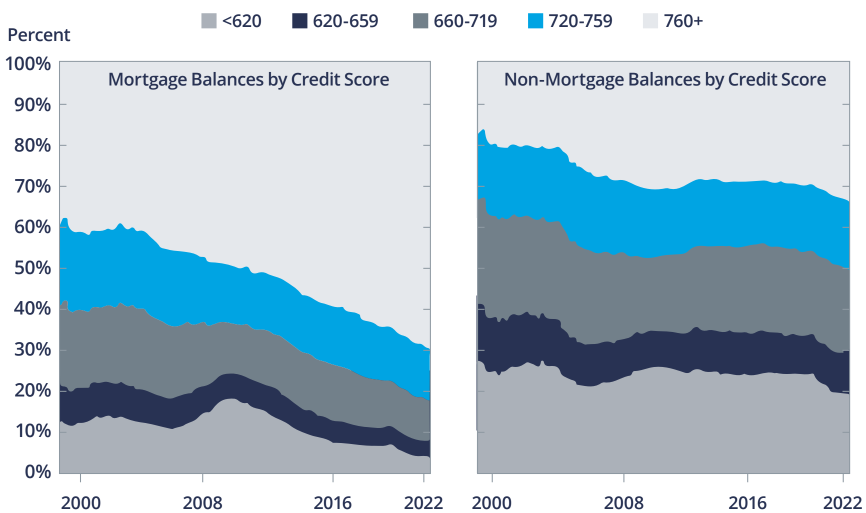
Even though debt balances have increased, the creditworthiness of most borrowers remains strong.

- Financial Institutions tightened lending standards during the pandemic, and that's reflected in the large share of mortgage balances that have shifted to higher-score consumers.
- Other debt balances have also shifted in that direction, but not as dramatically.

But there are signs that less well-off consumers are beginning to struggle.

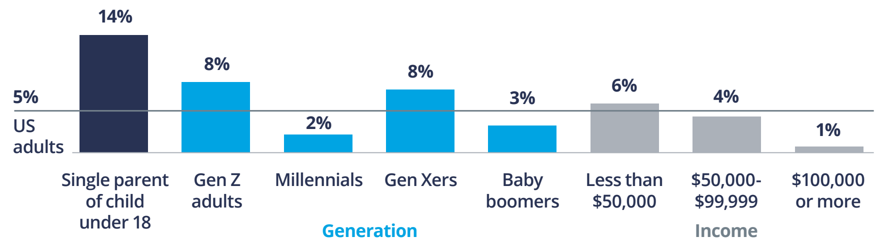
- The credit card debt of lower-income renters has risen sharply, according to the Consumer Financial Protection Bureau, rising more than 39% in the second half of 2021 and early 2022.
- By June 2022, that group's debt was 20% higher than it had been in June 2019, pre-pandemic.

Balances Outstanding by Credit Score Are Increasingly Prime



Source: New York Fed Consumer Credit Panel/Equifax
Notes: Charts show the percentage of total balances outstanding. Credit score is Equifax Risk Score 3.0.

May 2021 – May 2022 Change in Share of Adults Who Said They Typically Have an Unpaid Credit Card Balance Remaining



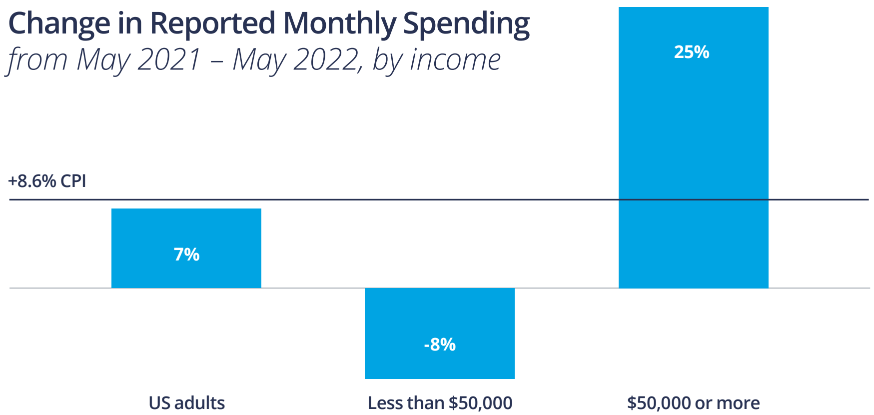
Source: Morning Consult Economic Intelligence

What are the risks?

Unsurprisingly, more solvent households are showing less price sensitivity and continue to spend.

- Households with annual income of $50,000 or more reported a 25% increase in monthly spending from May 2021 to May 2022, considerably higher than the 8.6% consumer price index increase over the same period.

Change in Reported Monthly Spending
from May 2021 – May 2022, by income



Source: Morning Consult Economic Intelligence

Takeaways:

- While consumer spending held up through late August 2022, the data show that many are doing that by dipping into savings, increasing credit card debt and using buy-now-pay-later (BNPL) options.
- According to Morning Consult, as of mid-2022 the average number of U.S. adults who reported using BNPL at least once in the past month didn't drop below 16%.
- Higher-income adults used it even more: 21% of those with household income between $50,000 and $99,999 said they used it in June 2022, as had 20% of adults with household income of $100,000 or more. Look for more financial institutions to start offering BNPL options.
- As financial stressors intensify for lower-income Americans, expect more lenders to begin entering the subprime market, which carries heightened risk for both the institutions and those consumers.

CHAPTER 3

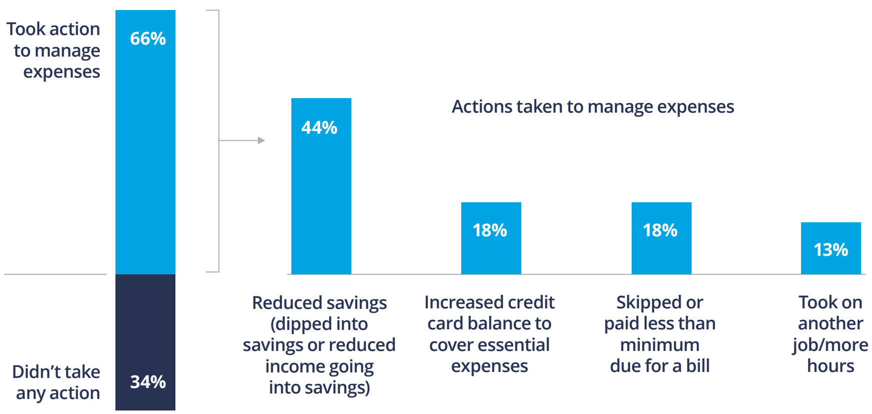
How consumer behaviors are changing

How consumer behaviors are changing

High inflation prompted two-thirds of people questioned in McKinsey's July 2022 Consumer Pulse Survey to take steps to manage their household budgets.

- 44% said they had reduced savings.
- 18% increased their credit card balances.
- Another 18% said they had either skipped paying or paid less than the minimum due on bills.
- 13% took on another job or more hours.

Share of Respondents Reporting Having Taken Defensive Financial Actions[1]

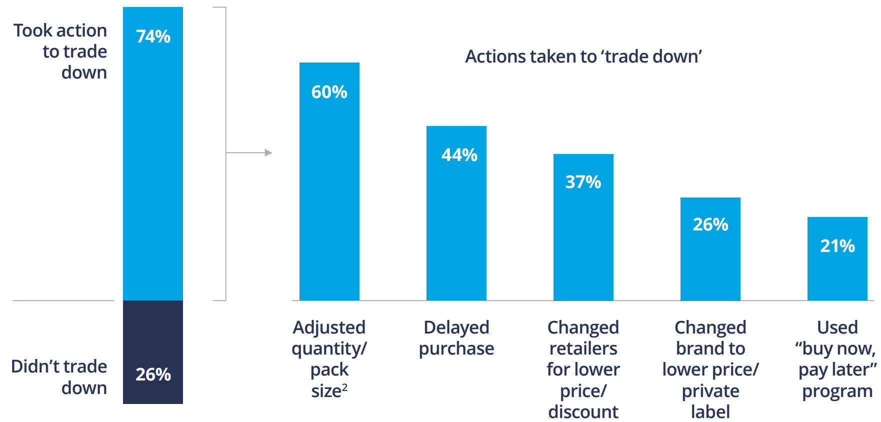


Source: McKinsey US Consumer Pulse Survey, July 6-10, 2022;
n = 4,009 sampled and weighted to match the US general population 18+ years
[1]Question: Which, if any, of the following have you done in the past 4–6 weeks?
% respondents selecting any of the given financial options shown

While younger generations expressed less concern about high inflation than older ones, a higher percentage of Gen Z and Millennials had taken such actions — more than three-quarters, vs. two-thirds of Gen X and 55% of Boomers — according to the McKinsey survey.

Three-quarters of all consumers said they had also changed shopping behaviors to "trade down," doing things such as buying smaller sizes/quantities or cheaper brands, and using BNPL options.

Share of Respondents Reporting Changing Shopping Behavior to 'Trade Down'[1]



Source: McKinsey US Consumer Pulse Survey, July 6-10, 2022;
n = 4,009 sampled and weighted to match the US general population 18+ years
[1]Question: Within the past 3 months have you done any of the following when purchasing a product (asked across multiple categories)? Trade-down behavior includes one or more of the following answer choices: shopped from a lower-priced retailer, shopped from lower-priced brand, bought private label, bought a brand for which you had a coupon, used buy now, pay later, delayed a purchase, bought a larger-size pack for lower price, bought smaller size or quantity, made more shopping trips in search of discount.
[2]Consolidates respondents who answered "Bought a larger-size pack/bulk quantity with lower price per serving/unit (than you normally would)" or "Bought a smaller size or quantity than you normally would because of current prices." These categories had minimal overlap for a given respondent.

But spending plans varied across groups, depending on income, McKinsey found. As of the summer of 2022:

- Credit and debit spending was up 5 percent year-over-year (real growth, adjusted for inflation).
- High-income consumers' real credit and debit spending was 9% higher.
- Middle-income household spending grew 2% year-over-year.
- Lower-income households spent 2% less.

And spending on some discretionary categories, like travel and cosmetics, has continued to grow.

Takeaways:

- The fact that McKinsey found that a higher percentage of Gen Z and Millennials are taking actions to actively manage their budgets indicates that younger generations may be more receptive to personal lending offers.
- Providing consumers educational resources on how to better manage finances in these uncertain times will help build productive relationships with customers and prospects, especially for younger generations.
- It's important to understand your customers/prospects' triggers. For example, loan and credit card offers that feature lifestyle images of travel and other fun activities will appeal to consumers with higher incomes and/or savings who long for a release after two-plus years of COVID, continuing supply chain issues, dire world events and, now, inflation.

CHAPTER 4

Trust is the elephant on the horizon

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Consumer spending drives the U.S. economy — and through the first eight months of 2022, despite rising inflation, that spending remained relatively strong.

Consumers who believe higher prices are due to external factors companies can't control are inclined to continue to spend. But there are signs that belief is starting to fray, according to the Deloitte Global State of the Consumer Tracker.

- Globally, more than half (54%) of consumers believe companies are raising prices beyond their own rising operating costs in an attempt to increase profits, Deloitte reported.
- A belief that pricing is unfair correlates to consumers planning to spend less, especially in discretionary categories such as entertainment, travel and restaurants, Deloitte said.

That obviously has negative implications for personal lenders (people who plan to spend less have less need for financial products).

Takeaways:

- While FIs can't control what consumer product/service companies do, they must take steps to reassure customers/prospects that they are conducting business ethically and want to help consumers, not take advantage of them. Customer communications need to be consistent, frequent and highly personalized/targeted.
- Transparency is key. Educational "explainers" on what factors figure into the interest rates they charge should be available on financial institutions' websites, in literature offered to customers, and in information shared by customer service personnel.
- If targeting lower-income consumers, frame loan products as something more than "Couldn't you use an extra $2,000 right now?" Set them up so they can be a means to help consumers build a better credit profile. Messages and offers can and should be tested to see what resonates best with high-value segments.

Who is Quad?

Quad (NYSE: QUAD) is a global marketing experience company that helps brands reimagine their marketing to be more streamlined, impactful, flexible and frictionless. Quad's strategic priorities are powered by key competitive advantages that include integrated marketing platform excellence, innovation, and culture and social purpose. The company's integrated marketing platform is powered by a set of core disciplines including business strategy, insights and analytics, technology solutions, managed services, agency and studio solutions, media, print, in-store and packaging.

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