Credit Portfolio Outlook 2025

Credit Risk Management and Data Science Services

March 2025

Open Analytics

About Open Analytics

Open Analytics is an Australian financial services consulting company founded on a vision to modernise and strengthen underwriting, risk management and customer engagement for banks and credit providers. We offer a unique design methodology and holistic approach to implementing pro-active, efficient and ethical decisioning processes with a strong emphasis on long-term sustainability and optimised risk-reward outcomes.

Credit Data Architecture

Expertise in structured data-model implementation, designed to enrich the value of lender's data assets by increasing interpretability, traceability and consistency of data.

Credit Risk Modelling

Specialised expertise in advanced predictive modelling and machine learning methods which maximize the use of a broad range of data types to predict and mitigate credit risk.

Credit Risk Management

Credit policy and automated decisioning process design including acquisitions strategy, underwriting policy, marketing, credit line management, risk-based pricing and collections.

Our Clients

Open Analytics provides support to financial institutions and creditors of all shapes and sizes, ranging from online FinTechs to big-4 banks.

Banks, Credit Unions and Bureaus

Non-Bank Creditors and Fintechs

Private Credit Funds

Core Products and Services

Hosted Products (Externally Managed)

- Credit Portfolio Manager
- Hosted Behavioural Scoring
- Hosted Model Monitoring

Hosted solutions include a range of credit scoring, monitoring and provisioning solutions. Our hosted Credit Portfolio Manager (CPM) is our most popular product covering core risk estimates, portfolio monitoring and AASB-9 compliant provisioning.

Credit Rating Services

- Credit Ratings
- Funder Rapid Deal Assessment

We offer a range of credit rating services for private credit funds and asset managers.

In House Solutions (Self Managed)

Application Scoring	Behavioural Scoring
Collections Models	Basel Capital Models
Auto-Serviceability Models	IFRS-9 Provisioning
Financial Rating Models	Geographic Risk Models

We develop a wide range of credit models and automated decisioning solutions to facilitate automated credit processes, capital management, provisioning and credit risk management.

PART 1

Current State

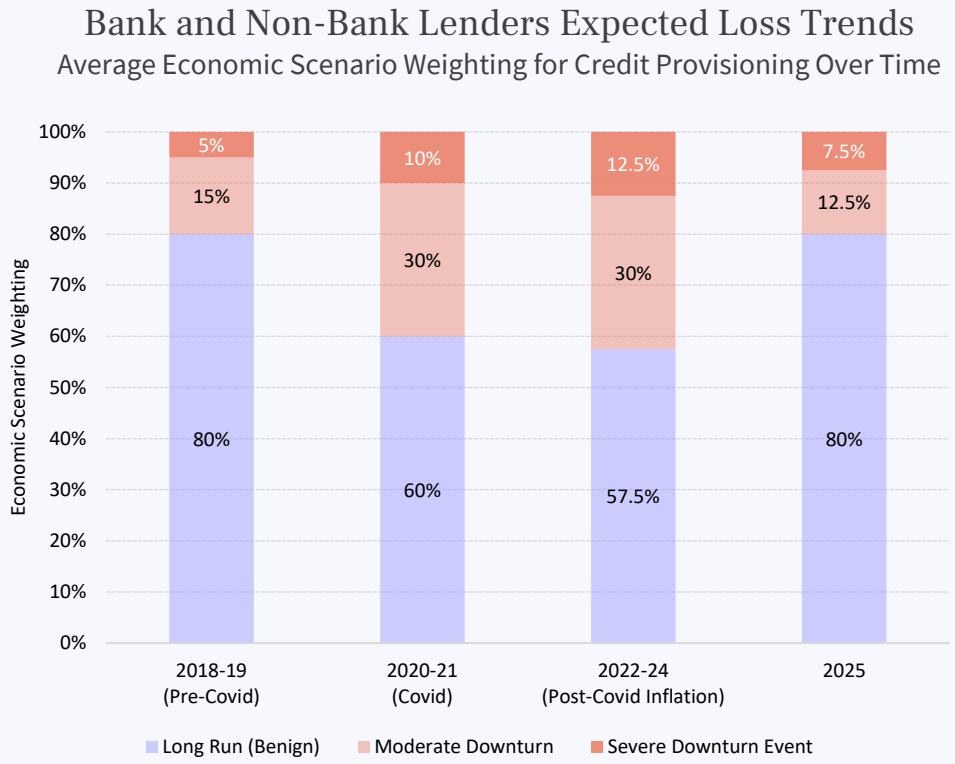
Open Analytics

Big Picture

- Business insolvencies are still increasing. Annualized insolvency rates have more than doubled over the last 18 months.
- Consumer mortgage 90+ arrears are trending up moderately across most lenders though for some lenders are starting to flatten or even decline again
- Hospitality and construction industries are struggling the most. Insolvencies and arrears rates are highest for hospitality and construction industries respectively.
- Inflation and interest rates have both peaked, however their effects on credit losses have a lag so the impacts of past inflation and rate rises are yet to be fully realized.
- Trump tariffs and a potential trade war introduce significant uncertainty and could spoil an otherwise soft landing. Tariffs introduce risks of a reversal in the recent inflation trends and a general slowdown in the world economy.

Credit Provisions - Weighting to Downturn Scenarios

Banks and Non-Bank lenders steadily increased provisions for future credit losses since Covid by weighting more heavily towards loss estimates under downturn scenarios. We have seen a significant shift to less pessimistic downturn scenario weightings in 2025.



*Source: Open Analytics **Credit Portfolio Manager**. Figures based on a "typical" setting among our clients.*

From 2021 to 2024 the forward-looking view for most lenders was cautious and factoring in the possibility of significant stress and credit losses in the next 12 months.

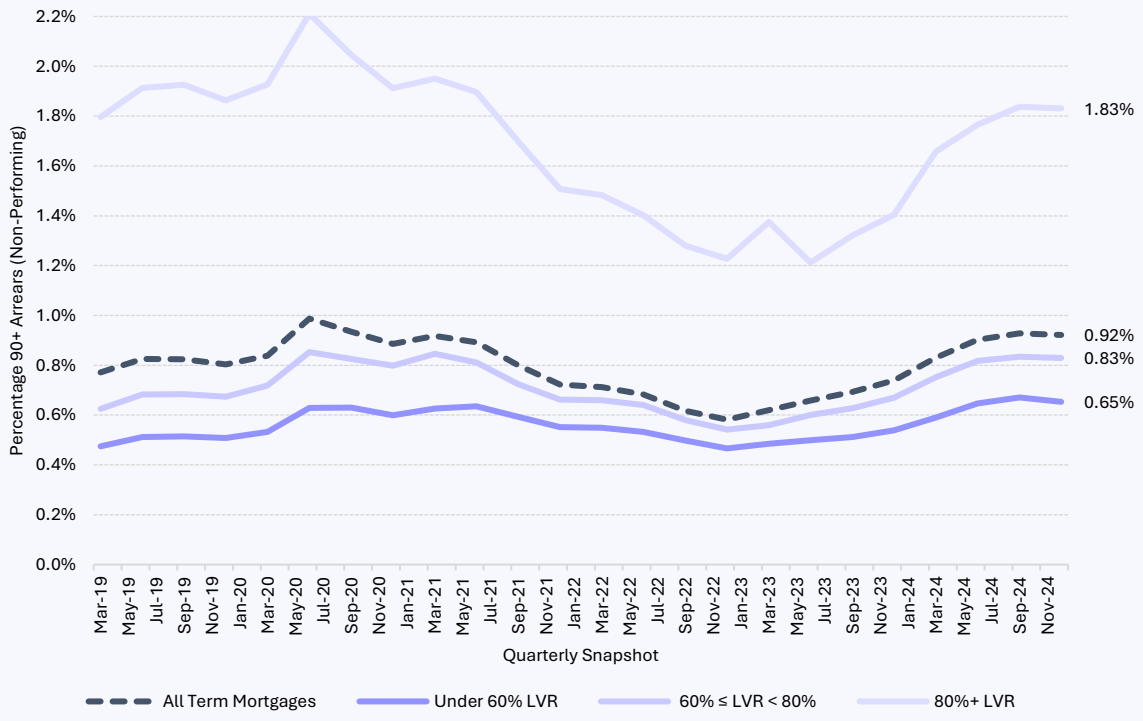
Clear shift to lower weightings for stress scenarios in 2025.

Is the optimism justified?

Home Loan Arrears

ADI Term Mortgage Arrears Rate Timeseries by Loan to Value Ratio

Source: APRA Quarterly ADI Property Exposure Statistics Table 1b



At a portfolio level mortgage arrears have actually not been that bad with 90+ rates still below pre-covid levels.

Perhaps surprisingly non-bank mortgage lenders 90+ default rates are consistently 10-20bp lower than major banks*.

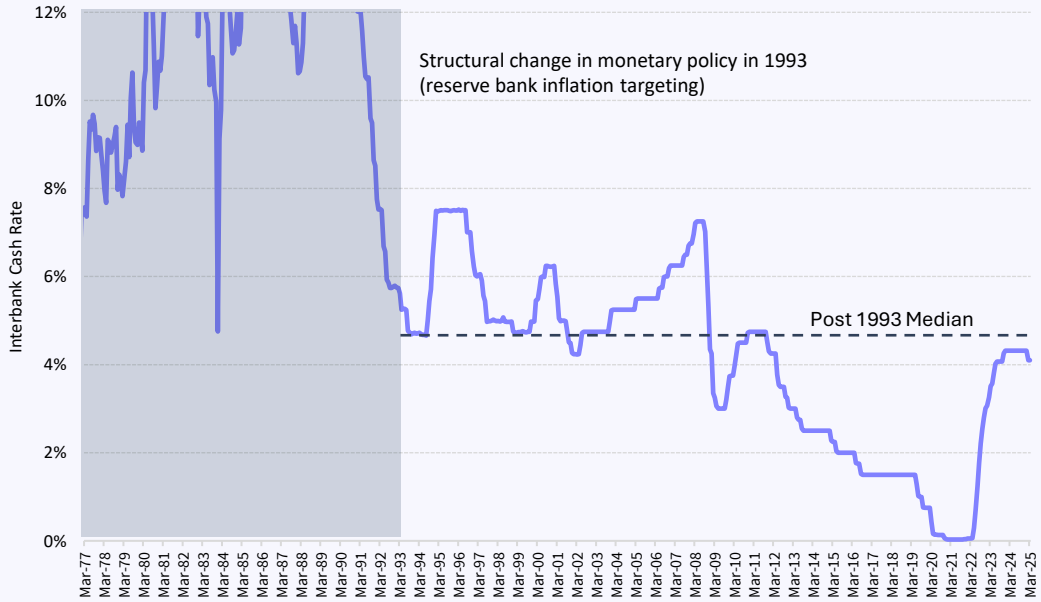
Largest driver of difference among lenders is LVR policy as higher LVR (80+) are driving most of the increase over the last 2 years.

Source: Open Analytics **Credit Portfolio Manager.*
Peer benchmarking non-bank mortgage portfolios 1-year default rates comparison to big-4 mortgage portfolios

Home Loan Interest Rate Risk

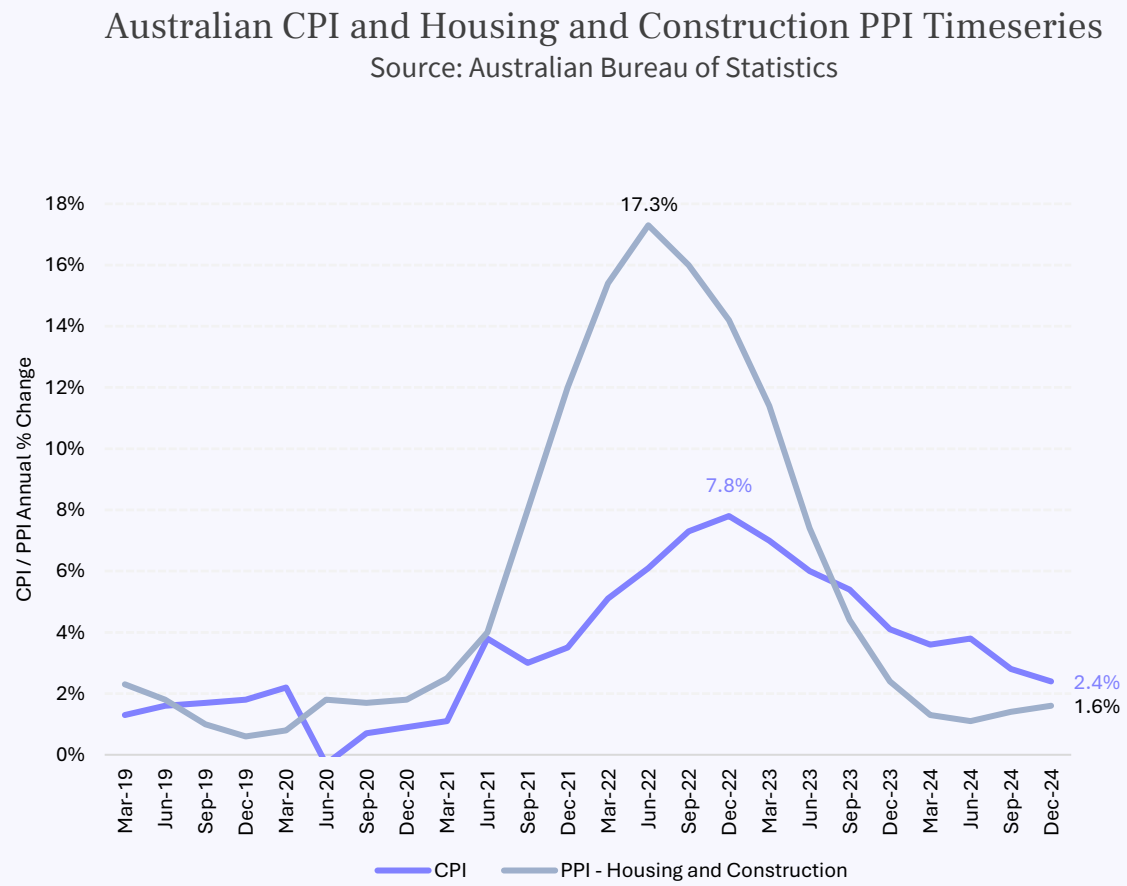
Believe it or not, interest rates are below a long-term median. Risk to loan books is not due to interest rates being too high, it is the amount of increase in such a short period of time. Mortgage serviceability interest rate buffers combined with conservative living expense estimation means that the rate rises and inflation can be absorbed by most (not all) borrower.

Australian Interbank Cash Rate
Source: Australian Bureau of Statistics



ADI Residential Mortgage New Loan Interest Rate vs Serviceability Rate
Source: APRA Quarterly ADI Property Exposure Statistics Table 1b

Inflation Impacts on Consumer Discretionary Spending and Construction



Housing and construction PPI peaked at 17.3% in June 2022, the good news is cost inflation for builders has moderated.

Cost of living pressures remain due to the cumulative effects of 3-4 years of high inflation however CPI has fallen to normal levels.

Inflation in consumer goods has the largest effect on (A) highly leveraged middle-income borrowers and (B) low-income borrowers, particularly those with high-interest unsecured lending.

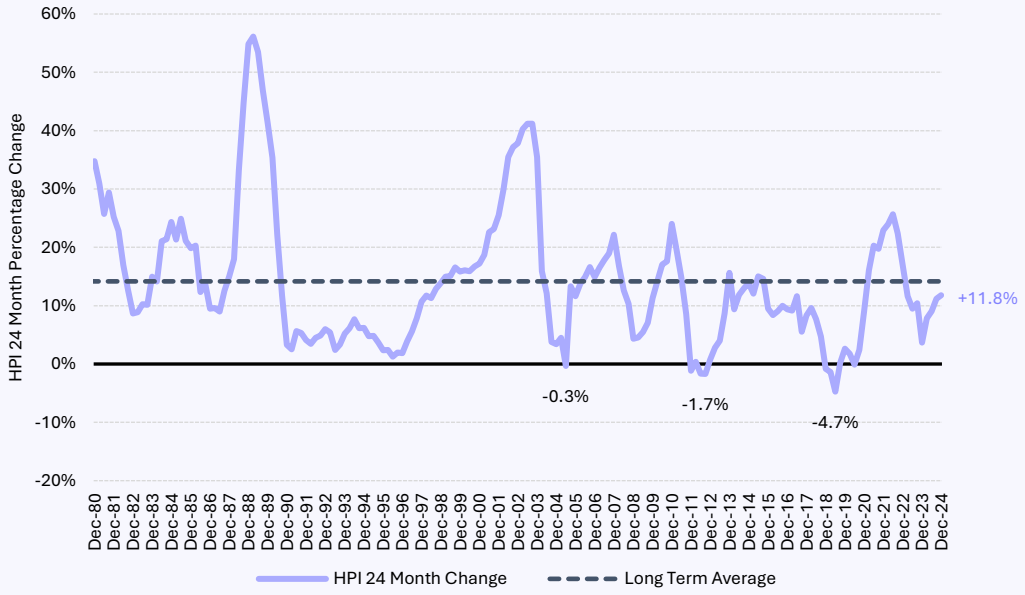
Industries dependent on discretionary spending which consumers can substitute (e.g. hospitality) are hardest hit.

Asset Values

Property and vehicles are the most common forms of collateral for secured consumer and business lending. Property price growth is approaching the long-term average, whilst prices for used vehicles have reverted to the mean following supply-chain driven price increases post covid.

Australian National House Price Index 24-Month Change

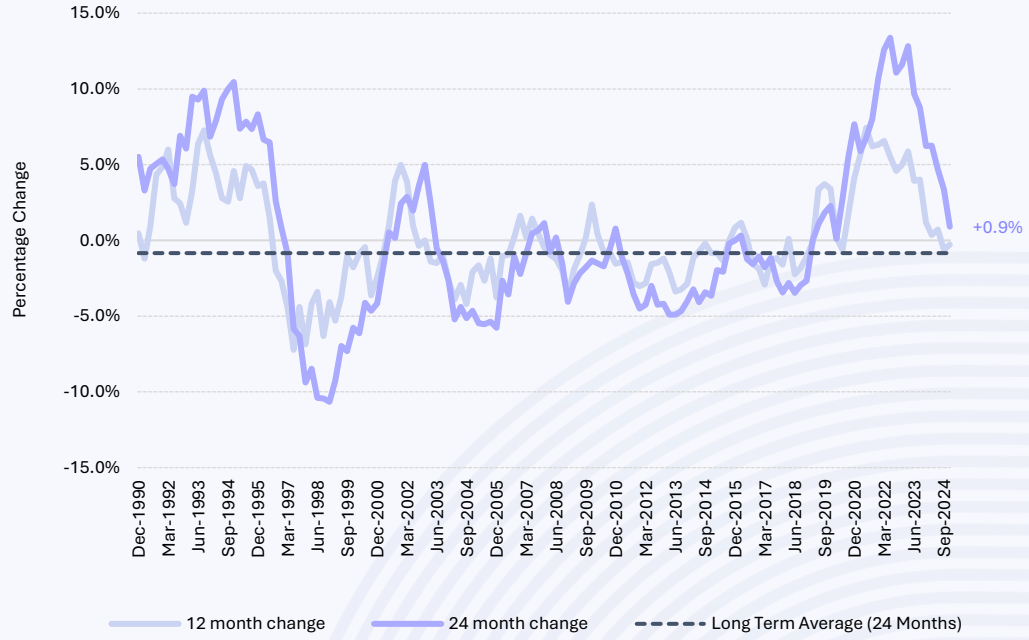
Source: Australian Bureau of Statistics



Longer term changes (e.g. 2-3 years) are most relevant for lenders considering collateral coverage and LVR policy since time taken for loans to default and asset to be liquidated as a path to recovery s typically more than 2 years for property secured lending.

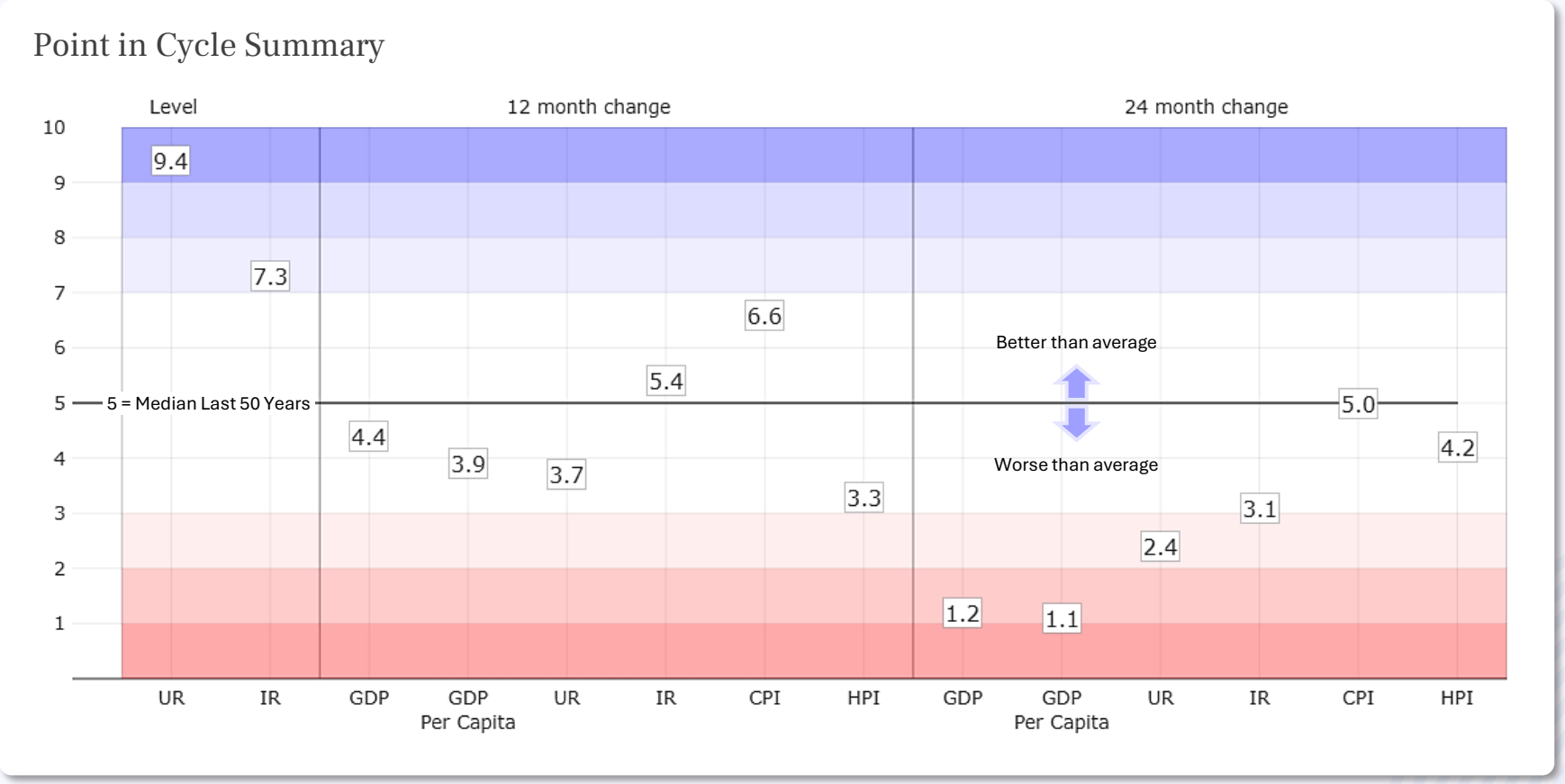
Australian Motor Vehicles Price Index 12 and 24 Month Change Timeseries

Source ABS 6401.0 Consumer Price Index - Table 7



Other Economic Indicators – Point In Cycle

Where do key economic indicators sit compared to a long-term average?



UR: Unemployment Rate

IR: Interbank Cash Rate

GDP: Gross Domestic Product

CPI: Consumer Price Index

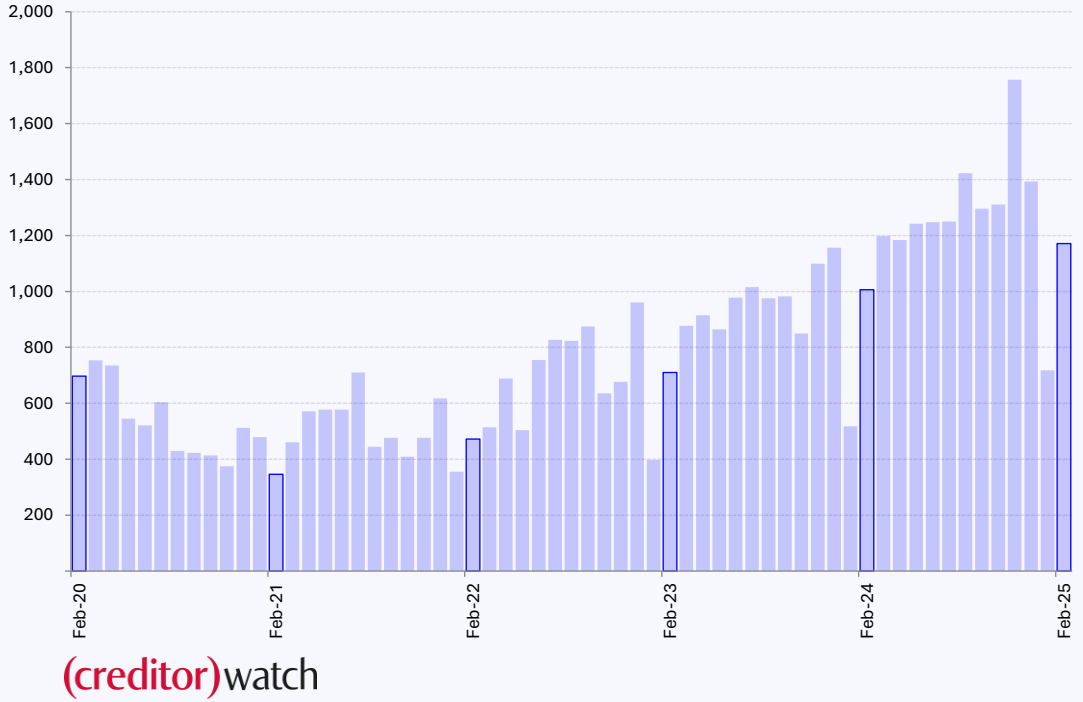
HPI: House Price Index

*Source: Open Analytics **Credit Portfolio Manager** – Point in Cycle Reporting*
Link: pic.oa-cpr.com.au

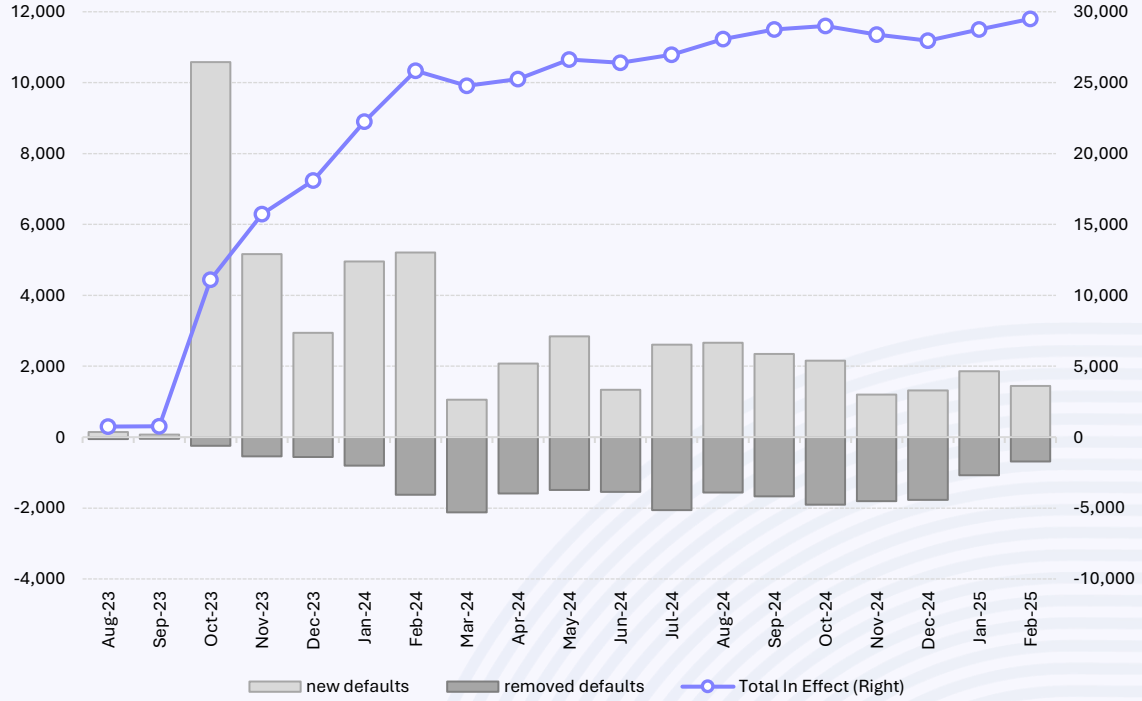
Business Stress Indicators

Business insolvencies have been consistently increasing since early 2022. ATO collections has been a source of added stress and driver of insolvencies, however ATO tax defaults have moderated.

Monthly Number of Insolvencies
Source ASIC, CreditorWatch



Rolling Annual Insolvency Rate Timeseries
Source ASIC, CreditorWatch

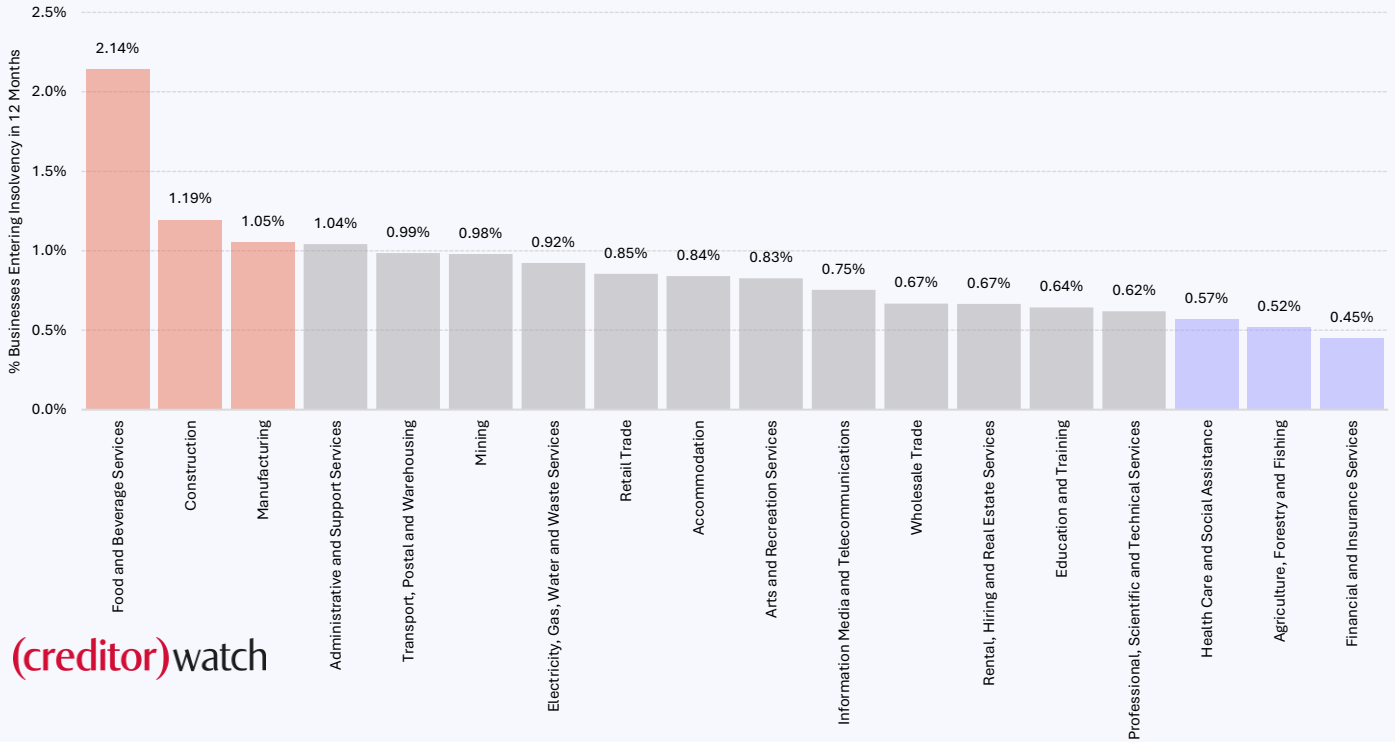


Industry Risk

Insolvency rates vary significantly by industry

Rolling Annual Insolvency Rate by Industry - 12 Months March-24 to February-25

Source: ASIC, CreditorWatch Industry Data



Hospitality and construction are the highest risk industries. Construction has some positive sign however insolvencies for hospitality are accelerating.

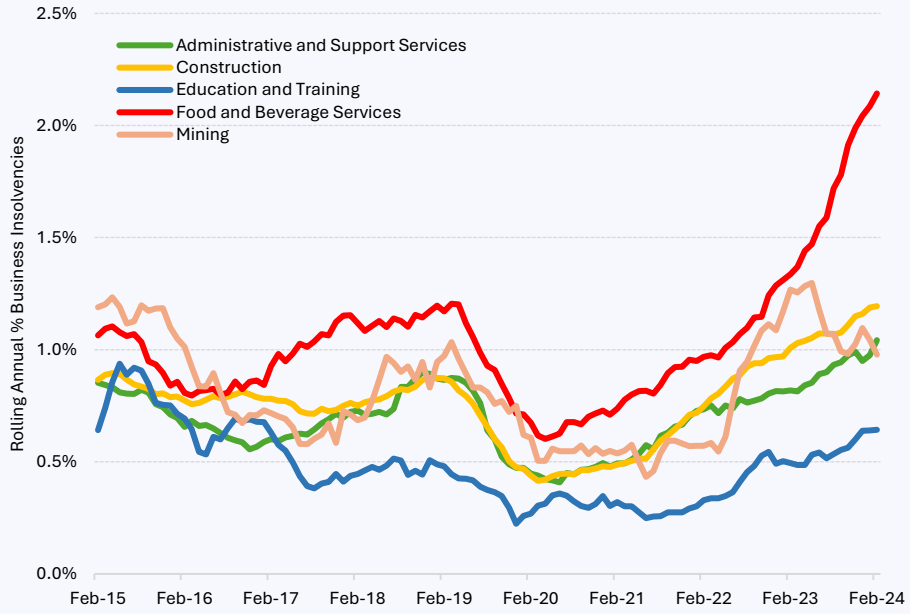
Financial services, agribusiness and health are all performing well.

Hospitality is a Major Concern

Insolvencies are accelerating for the hospitality industry due to inflation hitting discretionary spending hardest. Eastern seaboard capital city centers are hardest hit.

Insolvency Rate by Industry

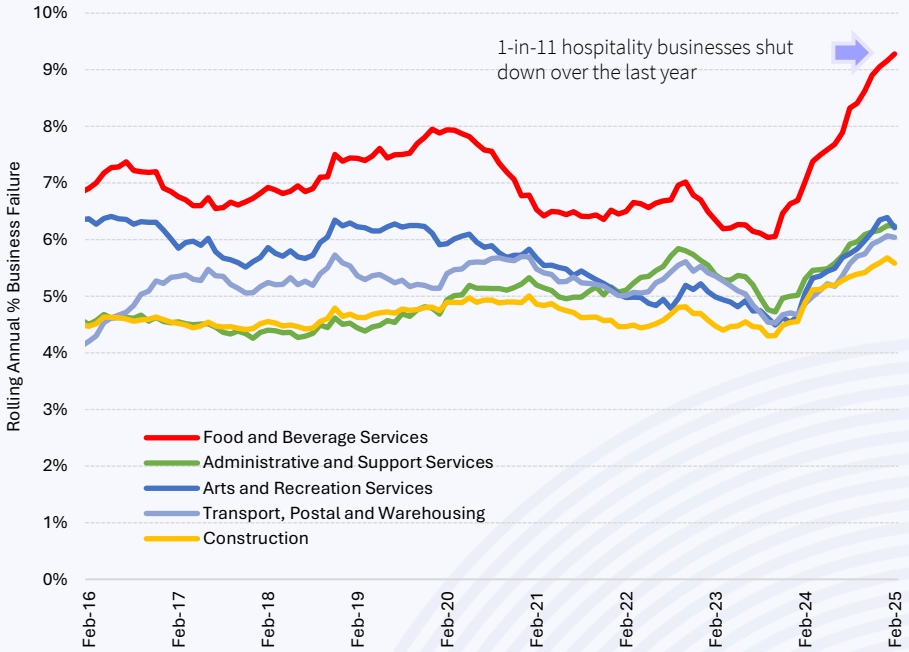
Source: ASIC, CreditorWatch Industry Data



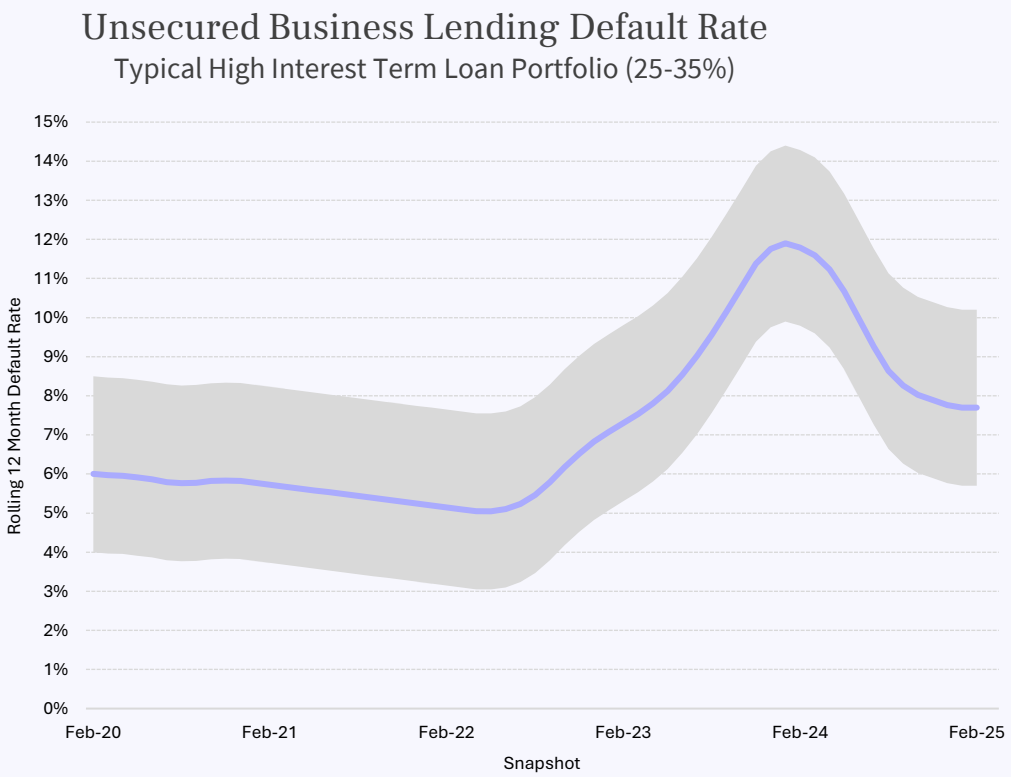
(creditor)watch

Business Failure (Exit) Rate by Industry

Source: ASIC, CreditorWatch Industry Data



Non-Bank Unsecured Business Lending



*Source: Open Analytics **Credit Portfolio Manager**.*
Unsecured business lending data pool

Non-bank lenders offering unsecured credit have experienced significantly greater deterioration in credit portfolio performance compared to banks. Some unsecured portfolios experiencing as high as 3X increase in defaults (90+ arrears) and loss rates approaching high teens for the worst hit.

Higher interest and less focus on financial risk assessment and loan serviceability is the key driver of greater susceptibility to stress for these portfolios. Borrowers in this market are less able to absorb rising costs and higher interest rates.

We have seen a lot of policy tightening for unsecured business credit after large spikes in defaults and losses, this means for a lot of lenders default rates have reduced due to fundamental change in new lending and short loan terms allowing composition to be changed rapidly.

Significant shifts in policy and target market in response to unsustainable bad debts, e.g. targeting “premium” customers, unsecured lenders exploring secured lending (primarily asset finance) and improving credit scoring.

Pressure from private credit funds to tighten, driven by both the funds risk appetite and fund’s auditors who are starting to apply greater scrutiny.

PART 2

Outlook

Open Analytics

Property Secured Lending Outlook

Not anticipating significant stress, in very good shape due to low average LVRs and conservative loan serviceability assessment.

Property development loans are the exception, there is still some material losses to come here though there are signs of improvement.

Losses on liquidated consumer mortgages are likely to remain low given the property market has moderate growth and LVR policy for the majority of lenders provides a sufficient buffer to absorb collateral haircut and any plausible stress in the property market in the short to medium term.

Commercial office space in major city centers still poses some risks given higher vacancy rates due to the seemingly structural shift to hybrid and remote working arrangements for professional services industries. Risks of commercial property value reductions can be mitigated to some extent with LVR policy.

Unsecured Consumer Lending Outlook

For high interest lending in SACC, MACC and BNPL products expect continued stress. For regular personal loans (LACC) some moderate stress.

Inflation and cost of living impacts lower income borrowers the most.

Inflation needs to stay low for several years for cost-of-living pressures to abate and therefore we expect lending to fund discretionary spending to experience higher than average loan arrears for some time to come.

These portfolios are relatively high loss at any time in the cycle and there are a number of levers that lenders have to pull back loan arrears at any time including minimum bureau scores (or internal scores), serviceability criteria and minimum income and employment requirements.

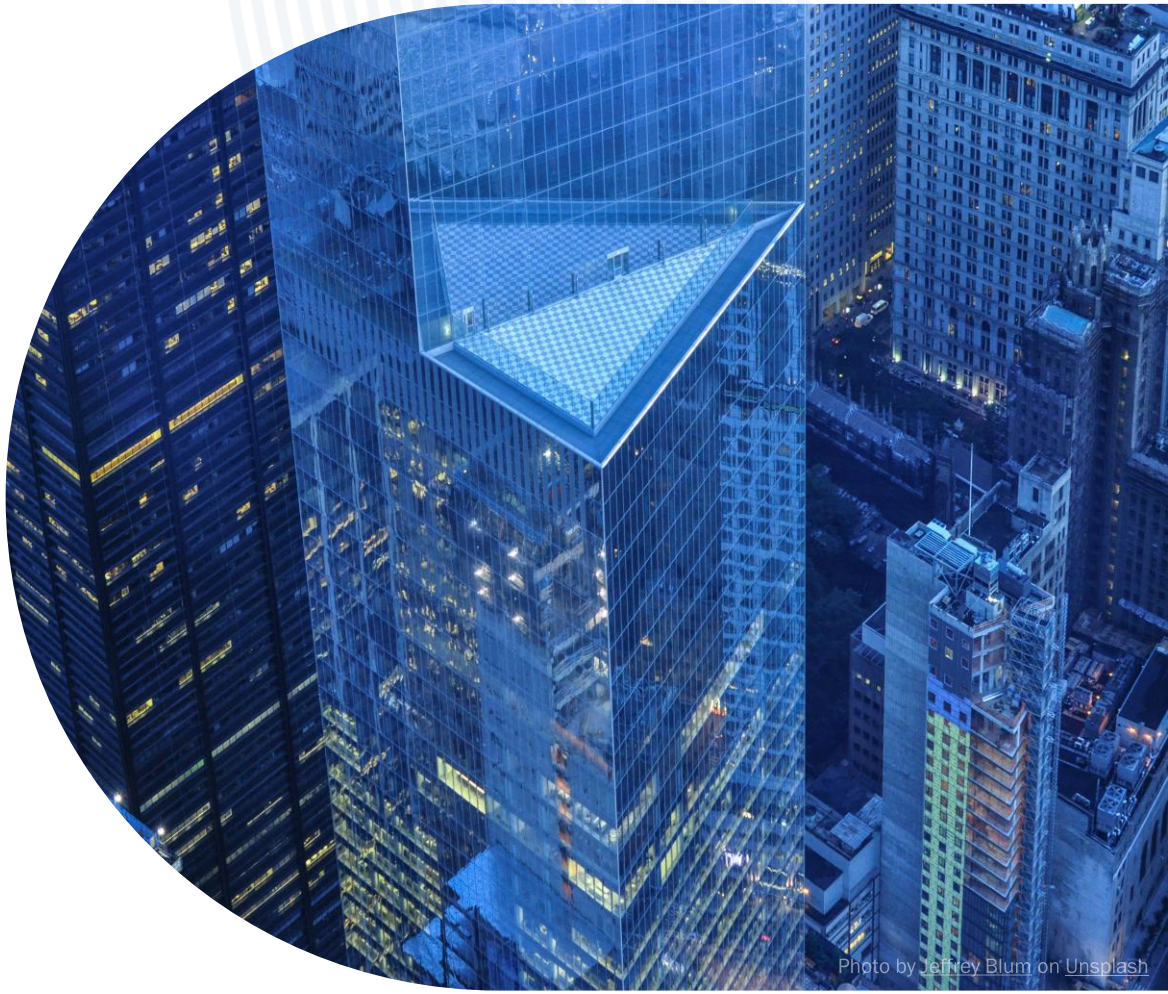

Photo by Andrea Natali on Unsplash

Asset Finance Outlook

In good shape, expect a pretty good year ahead, depending on industry.

We would suggest strict concentration limits and stringent credit criteria for lending to hospitality businesses as this sector will experience high insolvencies and loan defaults in 2025.

Some additional credit criteria for construction borrowers is warranted though we would not suggest going overboard or cutting off lending to this sector as there are still plenty of healthy businesses and sole traders in the building industry.



Invoice Finance Outlook

Fraud and operational risk is what matters for invoice finance, credit risk and even the general state of the economy is less significant in comparison.

Fraud risk may increase for industries under stress and exacerbated by high concentration risk in a number of non-bank providers. We have seen some large individual fraud losses severely impact some lenders, there are possibly risks of this becoming a wider issue.

Lender's policy and operational controls regarding invoice verification and ability to control receivables is what matters most and will continue to be the case regardless of the state of the economy.

Unsecured Business Lending Outlook

Has experienced the most stress recently, however control is very much in the hands of lenders.

Short term lending in this space allows portfolio composition to be changed relatively quickly if losses are exceeding risk appetite (long term lending losses are more difficult to turn around).

The most direct path to reduce credit losses is a greater level of financial risk assessment and serviceability and minimizing exposure to higher risk industries and borrowers with poor credit histories (score cut-offs).

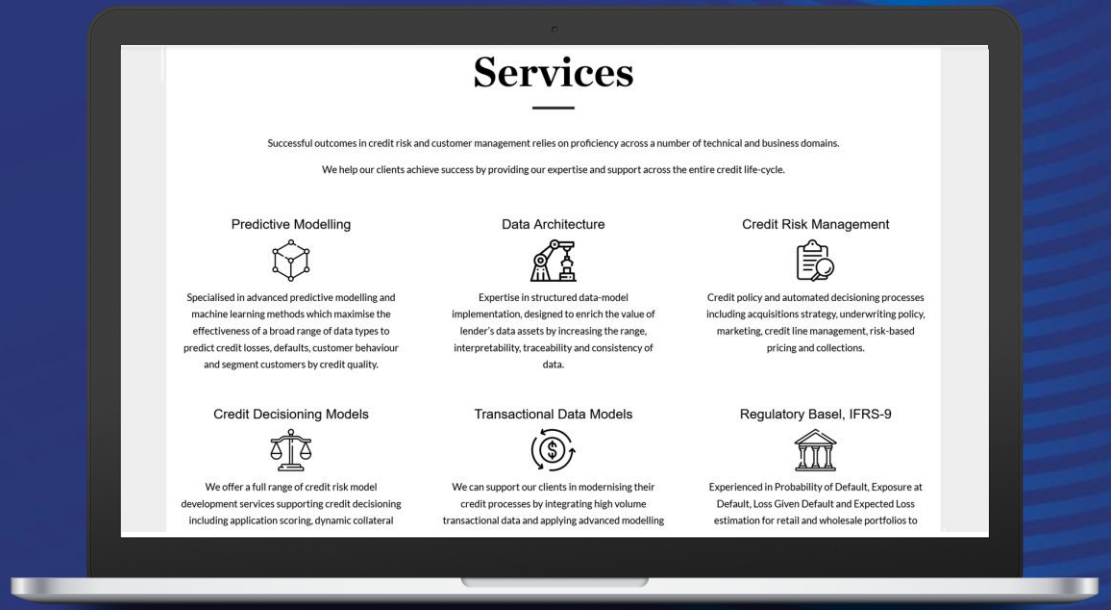
Similarly to all business lending, we would suggest strict concentration limits and stringent credit criteria for lending to hospitality businesses and some more moderate constraints on building and construction.

We expect to continue to see high variability across different lenders in this segment given variety in lending practices and risk appetite.

Photo by Scott Graham on Unsplash

Contact us

For more information, contact our team at:
contact@open-analytics.com.au



www.open-analytics.com.au

OA
Open Analytics