TransUnion Industry Insights Report

Quarterly overview of consumer credit trends released by TransUnion Financial Services

SECOND QUARTER 2018

Executive Summary

Escalating global trade tensions might pull back Hong Kong's GDP growth in the second half of the year, but for now the economy continues to deliver strong results on the back of robust retail sales and positive export momentum. This is good news for consumers, who are experiencing low levels of unemployment alongside high levels of labour force participation and, as a result, rising wages. The Hong Kong consumer lending environment reflects that strength for the most part, with good balance growth. That growth was, however, tempered by some signs of growing risk, in particular among unsecured loans.

Credit cards led the growth, albeit as an artefact of a strong festive season rather than a particularly strong second quarter. Total balances had climbed sharply in Q4 2017 and again in Q1 2018, and so even though they fell 1.6% in Q2 2018 they remained 5.3% higher year-over-year. This is now the third consecutive quarter in which year-over-year balance growth exceeded inflation, and younger customers were once again the engine for that.

While Baby Boomers (1946 to 1964) reduced their balances by 4% year-over-year, Millennials (born 1980 to 1994) grew theirs by 18% and accounted for 2 out of every 3 dollars added by the credit card industry in the year between Q2 2017 and Q2 2018. And even younger borrowers grew their balances even faster: 3 out of 10 credit cards added in the last 12 months were opened by Generation Z (1995 onwards) and Generation Z balances have almost doubled on the back of this, ending this quarter with 85% year-over-year growth.

This age-growth relationship is not surprising. Many new Generation Z consumers are entering the market for the first time and maturing in the labour force so their earning potential and credit needs are evolving in the short and medium terms. However, what is interesting is that when they enter the market they often do so quickly—the average Generation Z consumer with a *super prime* score already has 3 cards in their wallet by 23 years of age. That's 37% fewer than the average *super prime* Millennial (4.8) and 45% fewer than the average *super prime* Generation X'er (5.6), but enough to show how quickly card issuers need to react if they want to tap this growth market.

The first quarter of the year was also positive in terms of new account originations, with a 20% year-over-year increase. As a result, the number of open cards in the market has now passed the 19 million mark.

Unsecured loans introduce a more complex story. Total personal loan balances ended Q2 2018 down quarter-over-quarter, cutting year-over-year growth almost in half—from 3.0% to 1.7%. Despite a similar quarter-over-quarter drop in revolving loan balances, year-over-year growth there remained high at 7.3%, but instead there are emerging risk concerns. While both of these products experienced large enough quarter-over-quarter increases in serious delinquency to lead to year-over-year increases, only revolving loan delinquencis reached levels not seen in the last two years—rising from 0.40% in Q1 2018 to 0.55% in Q2 2018. However, that increase does appears to have been driven by a small pocket of high-balance accounts, rather than a more widespread weakening among customers.

Regarding secured debts, mortgage inquiry volumes reached their highest levels in three years despite both rising house prices and rising interest rates. This suggests that the small quarterly drop in new account originations seen in Q1 2018 was more likely seasonal than demand driven.

In summary, then, the consumer credit economy remains well-positioned, but some lenders will be paying closer attention to delinquency levels in the short-term.

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Bankcard Summary

BANKCARD METRICS	Q2 2018	Q-O-Q Change	Y-O-Y Change
Number of Accounts	19.1 M	1.3%	4.0%
Outstanding Balance	130.2 B	-1.6%	5.3%
Total Credit Lines	1.194 T	1.8%	6.8%
Average Balance (per consumer)	39.0 K	-2.1%	2.9%
Average Credit Line (per consumer)	288.3 K	1.2%	4.3%
Number of Consumers with Access to an Active Trade	4.1 M	0.6%	2.4%
Number of Consumers Carrying a Balance	3.4 M	0.6%	2.4%
Origination Volumes (Q1 2018)	587.1 K	4.6%	19.8%
Average New Account Credit Line (Q1 2018)	59.1 K	8.2%	-2.6%
Account-Level Delinquency Rate (90+ DPD)	0.02%	0 bps	0 bps
Consumer-Level Delinquency Rate (90+ DPD)	0.07%	0 bps	-1 bps
Balance-Level Delinquency Rate (90+ DPD)	0.18%	2 bps	-2 bps

Credit card balances fell from Q1 2018 to Q2 2018, but the 1.6% drop was in-line with seasonal norms and thus the year-over-year growth remains high, at 5.3%. Government-published figures show a similar trend in retail spend in the SAR, which was down from Q1 2018 before but still up 12% year-over-year.

However, as expected, total credit limits suffered no such seasonal downturn and so total credit limits are once again growing faster than total balances, which has pushed limit utilization back onto its longer-term downward track, and back under 11%.

Demand for new credit cards is reviving, too—the 587,063 accounts opened in Q1 2018 was the most the industry has opened since Q2 2016. Young borrows are powering this revival—51.3% of accounts opened in the most recent quarter were opened by Millennials (1980 to 1994) and Generation Z (1995 onwards), up from 44.3% just a year ago. As a result of this growth, Generation Z card balances have now passed $1 billion, held against credit limits of $3.7 billion. Last quarter there were $902 million in Generation Z balances held against $3.0 billion in limits, that's about a 20% quarter-over-quarter increase for both.

And Generation Z has room to grow from here, with Millennial consumers carrying average balances that are 4X higher than theirs and Generation X (1965 to 1979) consumers carry average balances that are 6X higher. Against this, there has been a post-festive season increase in delinquency. However, the quarter-over-quarter increase was relatively small and serious balance-level delinquency remains down year-over-year.

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LOAN ON CARD METRICS	Q2 2018	Q-O-Q Change	Y-O-Y Change
Number of Accounts	371.6 K	1.2%	8.4%
Outstanding Balance	28.6 B	2.8%	16.9%
Average Balance per Consumer	102.04 K	1.8%	9.0%
Number of Consumers Carrying a Balance	280.3 K	1.0%	7.3%
Origination Volumes (Q1 2018)	79.1 K	-5.7%	-11.5%
Average New Account Balance (Q1 2018)	85.4 K	2.2%	10.1%
Account-Level Delinquency Rate (60+ DPD)	0.01%	0 bps	0 bps
Consumer-Level Delinquency Rate (60+ DPD)	0.01%	1 bps	0 bps

Included within the $130.2 billion of credit card balances is $28.6 billion that is reported as loans on card (22.0%). This is once again a larger proportion than in the last quarter, since loans on cards experienced no seasonal dip—growing 2.8% between Q1 2018 and Q2 2018, while card balances dipped.

Only half of all loan on card issuers contribute their full portfolios to TransUnion, but with five quarters of new bookings now captured in the data as presented the gap between reported balances and actual balances is becoming less relevant. That said, the 11% year-over-year drop in originations is likely to be an overstatement of the true drop in demand as the final vestiges of the loading process wash through the portfolio. Plus, while the number of new accounts being opened may be down, the average balance of those new loans is significantly higher—up 2.2% quarter-over-quarter and 10.1% year-over-year—and as a result total new balances added are down just 3.6% year-over-year.

The new loans on card booked in Q1 2018 were less risky than those booked a year before, with 45.5% better-than-*prime* versus 41.6%; this improving profile has played a role in that increasing average new loan balance, since the average new *super prime* loan is three times larger than the average new *subprime* loan.

From a broader risk perspective, loan on card balances fall between credit card balances and personal loan balances. 22% of loan on card balances are better-than-*prime*, compared to 40% of credit card balances and 10% of personal loan balances. This is not reflected in the delinquency numbers, because lenders tned to close delinquent loan on card accounts and transfer arrear balances back to the card portfolio.

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Auto Loan Summary

AUTO LOAN METRICS	Q2 2018	Q-O-Q Change	Y-O-Y Change
Number of Accounts	59.9 K	-1.2%	-4.3%
Outstanding Balance	42.0 B	0.7%	0.4%
Average Balance	842.4 K	1.9%	5.1%
Number of Consumers Carrying a Balance	50.2 K	-1.1%	-4.3%
Origination Volumes (Q1 2018)	3.7 K	-8.7%	-23.7%
Average New Account Balance (Q1 2018)	722.4 K	-12.4%	-17.0%
Account-Level Delinquency Rate (60+ DPD)	0.13%	2 bps	0 bps
Consumer-Level Delinquency Rate (60+ DPD)	0.14%	1 bps	1 bps
Balance-Level Delinquency Rate (60+ DPD)	0.03%	0 bps	-2 bps

Auto loans are a niche product in Hong Kong. And after five consecutive quarters of falling origination volumes, they also appear to be a product without momentum, although the average loan balance remains very high—a little over $1 million in the *super prime* tier, for example. In fact, new account originations fell for the fifth consecutive quarter in Q1 2018, and fell in every risk tier. New account originations are now down 24% year-over-year.

Added to this, average new loan values are down quarter-over-quarter and year-over-year, too. The net impact of these two negative forces is that the $2.7 billion of new loan balances booked in Q1 2018 was the lowest injection of new balances in two years, and 36% less than was added in the same period a year ago.

The industry's average new loan balance has fallen for two reasons. Firstly, average new loan balances *have* fallen on a risk-adjusted basis—average new *super prime* loans are down 16% year-over-year and average new *prime* loan balances are down 21%, for example. But at the same time, the account distribution has shifted towards the higher risk end of the spectrum—37% of new loans added in Q1 2018 were *super prime* loans compared to 40% in Q2 2017, while 33% were worse-than-*prime* compared to 30%. The latter impacts average new loan balances because of significant risk-based loan sizing: the average new *super prime* loan was booked for $1 million, while the average new *prime* loan was booked for just over half of that, and the average new *subprime* loan was booked for $305,337.

Serious delinquency remains very low, helped by that same risk-based loan sizing. This means that although serious account-level delinquency is at 0.13%, serious balance-level delinquency is just 0.03% (down 2 basis points year-over-year).

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Mortgage Summary

MORTGAGE METRICS	Q2 2018	Q-O-Q Change	Y-O-Y Change
Number of Accounts	532 K	1.7%	7.6%
Origination Volumes (Q1 2018)	26.5 K	-8.8%	0.7%
Account-Level Delinquency Rate (60+ DPD)	0.04%	0 bps	-1 bps

Hong Kong property prices continue to rise, with the Centa-City Leading Index adding approximately 17% year-over-year. This is compounded by mortgage lending rates that have started to climb, which may put pressure on demand for new home purchases. Despite these headwinds, the number of mortgage inquiries in Q2 2018 reached the highest levels in over three years.

This suggests that the 8.8% quarter-over-quarter drop in the volume of new accounts opened in Q1 2018 was more likely to be seasonal in nature than market driven. And despite that drop, origination volumes remained marginally higher year-over-year.

According to the HKMA, the average new mortgage is now being booked for a $4 million. With LTV ratios capped by regulations, consumers seem to be turning to longer loan tenors to aid affordability—the average mortgage tenor is now 26 years and 7 months, ten months longer than it was in Q2 2016 and five years longer than it was ten years ago according to the same source.

Longer loan tenors can introduce more risk, but mortgages remain a very low risk product overall. 76% of all mortgages and 80% of all new mortgages were lodged with consumers who scored in the *prime plus* or *super prime* tiers. The small niche of *subprime* mortgage is where money lenders have their largest market share (16.4%) and this share falls to just 2.2% in the *prime plus* and *super prime* space.

The high down payment requirements must play a role in keeping the profile of mortgage borrowers older. Despite that, Millennials (born 1980 to 1994) have made 36.3% of all mortgage inquiries this year and Generation Z (1995 onwards) 1.3%—up from 33.8% and 0.8% in the first half of 2017, respectively. So the gap between younger and older mortgage holders is closing.

Generation X (1965 to 1979) still opens the most mortgages (41.8%), mind you, but the gap between them and Millennials (34.5%) has shrunk from two years ago when Generation X opened 65% more accounts than Millennials to now, when they open only 21% more. At this rate, these two generations will be opening a similar number of mortgages in Q2 2019 and Millennials will be opening more in 2020.

Mortgage delinquencies have continued to fall, more slowly than before but at 0.04% there isn't much downward space to occupy. However, Hong Kong mortgage delinquency rates have displayed an historical inverse relationship to property prices and so, if those were to fall, delinquency would likely rise regardless of the originations strategies employed by lenders. Therefore, the threats to demand presented by rising housing costs extend into the risk sphere, if falling demand were to lead to falling house prices.

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Unsecured Personal Loan Summary

UNSECURED PERSONAL LOAN METRICS	Q2 2018	Q-O-Q Change	Y-O-Y Change
Number of Accounts	618.9 K	-1.2%	-2.1%
Outstanding Balance	101.7 B	-0.5%	1.7%
Average Balance (per consumer)	243.2 K	0.6%	3.8%
Number of Consumers Carrying a Balance	422.1 K	-1.1%	-2.2%
Origination Volumes (Q1 2018)	78.8 K	-2.4%	6.2%
Average New Account Balance (Q1 2018)	180.8 K	-1.4%	-3.0%
Account-Level Delinquency Rate (60+ DPD)	0.62%	-0 bps	-15 bps
Consumer-Level Delinquency Rate (60+ DPD)	0.75%	1 bps	-15 bps
Balance-Level Delinquency Rate (60+ DPD)	0.43%	8 bps	2 bps

Total personal loan balances fell by 0.5% quarter-over-quarter, enough to cut year-over-year balance growth in half. This despite the fact that the average balance per consumer with a loan has risen in every quarter for the last two years. New account originations were down quarter-over-quarter, too, but this was more in-line with seasonal expectations so volumes were 6.2% higher year-over-year. That increase in demand was moderated by average new loan values, which were down 3.0% in the same period.

The growth story is more nuanced when we look at the lender categories separately. The quarter-over-quarter dip in balances was enough to turn banks' balance growth negative, but money lenders' loan balances were up 9% year-over-year. Money lenders now have 25.1% of personal loan balances, up from 23.2% in Q2 2017.

Since banks have a younger customer profile and younger consumers tend to grow credit balances faster, this may seem counterintuitive. And indeed, age did play a role in determining loan growth rates: Baby Boomer (1946 to 1964) money lender balances were down 6% year-over-year and while Generation X (1965 to 1979) balances were up, they were up just 1%, compared to Millennial (1980 to 1994) balances which were up 11% and Generation Z (born 1995 onwards) balances which were up 85% year-over-year.

However, money lenders also grew their higher-risk balances while banks shrunk theirs. In what is likely to be a reflection of differing risk-appetites, banks shrunk their *near prime* and *subprime* loan balances by 6% year-over-year and grew their prime-and-better balances by 6%.

With regards to risk, there are some areas of concern from delinquency, too. At an account-level, serious delinquency retained its improvements from last quarter but at a balance-level delinquencies jumped from 0.35% in Q1 2018 to 0.43% in Q2 2018. An increase after the festive season is common, and the fact that serious balance-level delinquency had been improving up to that point reduces the longer-term impact, but this is still a 2 basis point increase when measured year-over-year.

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Unsecured Tax Loan Summary

UNSECURED TAX LOAN METRICS	Q2 2018	Q-O-Q Change	Y-O-Y Change
Number of Accounts	34.7 K	-2.2%	-3.2%
Outstanding Balance	5.648 B	-19.5%	12.3%
Average Balance (per consumer)	172.2 K	-18.5%	13.5%
Number of Consumers Carrying a Balance	33 K	-1.2%	-1.3%
Origination Volumes (Q1 2018)	13.3 K	-2.3%	16.4%
Average New Account Balance (Q1 2018)	184.9 K	-23.6%	16.5%
Account-Level Delinquency Rate (60+ DPD)	0.10%	0 bps	1 bps
Consumer-Level Delinquency Rate (60+ DPD)	0.09%	-1 bps	-1 bps
Balance-Level Delinquency Rate (60+ DPD)	0.07%	1 bps	-4 bps

Demand for tax loans is highly seasonal, with 99% of new accounts booked between October and March. In our previous *Industry Insights Report* we reported a relatively weak start to this tax loan season, but Q1 2018 was stronger. 13,339 accounts were booked in Q1 2018 (up 16% year-over-year) and those accounts were booked with higher average balances. As a result, although the 26,992 accounts booked across the season were 3% lower than the combined bookings of the season before, the $5.8 billion in new balances added was 9% higher year-over-year.

That late-season boost helped total tax loan balances generate 12.3% year-over-year growth; 13.5% year-over-year growth in terms of the average balance per consumer.

Tax loans attract an older customer profile, but this is changing over time. 32% of the tax loans opened this season were opened by Millennials (1980 to 1994) or younger, up from 28% the year before. Tax loans also attract a loyal customer profile. 30% of older tax loan customers are returning customers, which is to say they had a previous tax loan in at least one of the previous two years. 86% of those returning borrowers are returned to the very same lender. As such, young consumers entering the market unattached present an attractive pool of potential customers—40% of Baby Boomers (1946 to 1964), 32% of Generation X (1946 to 1964), and 19% of Millennials are returning customers, compared to only 2% of Generation Z.

Serious delinquency is seasonal, too, and typically rises in the second quarter and peaks in the third. Serious balance-level delinquency did rise slightly in Q2 2018 and, with early delinquency rising too, this pattern seems set to repeat.

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Unsecured Revolving Loan Summary

UNSECURED REVOLVING LOAN METRICS	Q2 2018	Q-O-Q Change	Y-O-Y Change
Number of Accounts	555.5 K	-1.3%	-0.7%
Outstanding Balance	32.1 B	-0.7%	7.3%
Total Credit Lines	75.1 B	0.4%	7.8%
Average Balance (per consumer)	135.8 K	0.3%	9.2%
Average Credit Line (per consumer)	166.8 K	1.5%	8.2%
Number of Consumers with Access to an Active Trade	0.5 M	-1.2%	-0.5%
Number of Consumers Carrying a Balance	0.2 M	-1.0%	-1.7%
Origination Volumes (Q1 2018)	14 K	-8.8%	-0.5%
Average New Account Credit Line (Q1 2018)	232.2 K	25.2%	50.0%
Account-Level Delinquency Rate (60+ DPD)	0.30%	0 bps	-7 bps
Consumer-Level Delinquency Rate (60+ DPD)	0.34%	0 bps	-8 bps
Balance-Level Delinquency Rate (60+ DPD)	0.55%	22 bps	15 bps

Revolving loan balances were essentially flat in Q2 2018, protecting most of the gains made in the previous quarter. At $32.066 billion, total balances are up 7.3% year-over-year despite still-falling consumer numbers, thanks to average balances per consumer that are up 9.2% in the same period.

Origination volumes were down, though, falling by 8.8% in the quarter and 0.5% year-over-year. Furthermore, those newly booked loans were riskier—90% of loans opened in Q1 2018 were *prime*-or-worse, compared to 86% of those opened in Q1 2017.

This is noteworthy because risk has begun to emerge as a concern for the product. As with personal loans, it is not account-level delinquency that spiked but balance-level delinquency. Having fallen throughout last year and the first quarter of this year, we saw a sudden-but-significant increase in balance-level delinquency in Q2 2018, rising from 0.33% in Q1 2018 to 0.55%.

Because the account-level and consumer-level delinquency rates didn't rise in lockstep, and because the median balance of accounts that are 60+ days in arrears rose by just 12% while the average balance of those accounts rose by 68%, this looks like a situation caused by a few highly-exposed consumers going seriously delinquent rather than one caused by a more widely-felt downturn.

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