BANGOR BUSINESS SCHOOL

Will banks weather this latest recession?

Crises in energy and cost-of-living have plunged the UK into the depths of economic recession, with negative growth in stark contrast to European markets. This calls into question how banks can support their customers during this economic storm, with high inflation and increased interest rates causing financial hardship for millions of households nationwide.

Recession equals misery

Economic indicators suggest that a significant proportion of the world's nations are entering, or have already entered, recession. The post-pandemic recovery in economic output has stalled; rising inflation has been driven by increases in energy and food prices, exacerbated by the war in Ukraine.

The UK has been especially hard hit, with inflation rising to 11.1% in November 2022 and expected to increase still further before subsiding in 2023. A turbulent political environment has created uncertainty, forcing the government to abandon an unfunded dash for growth in favour of policies that seek to restore confidence and stability, culminating in the Autumn Statement on 17 November. The UK's problems are well documented: the rate of economic growth lags behind many of its international trading partners; the economic impact of Brexit is expected to suppress growth by approximately 4% of GDP; private and public investment is about 17% of GDP compared with 22-26% in the rest of the G7 as of November 2022. Expectations of recovery are low, with unemployment expected to increase in 2023 and 2024.

Recession is always accompanied by misery for many individuals, households and firms. The fact that this most recent recession is the first experience of 'stagflation' (simultaneous low growth and high inflation) of the 21st century for many young people creates problems that they have never encountered before.

Before 2022 there had been a long period of low interest rates. Borrowers had become accustomed to cheap borrowing, so the rapid increases in interest rates in autumn 2022 created immediate problems for new borrowers and expected future problems for others, notably the estimated three-quarters of UK borrowers who are on fixed mortgage rate deals. When the fixed interest rate periods expire, some borrowers will be faced with higher repayments, whether they revert to standard variable rate or decide to remortgage elsewhere. These pressures, together with cost-of-living increases – through higher food and energy bills – will inevitably create hardship for many.

Banks have challenges of their own, but will be able to play their part in mitigating the adverse effects of recession as well as providing a platform for eventual recovery. Since the 2008 financial crisis, there has been a cultural shift, with banks becoming more attuned to customers' needs, quicker to align their risk appetite with changing market dynamics and more robust systems of governance.

Here are some of the ways in which banks can avail themselves of opportunities to shine in difficult times.

Customer-centric approach

While banks deal with a broad spectrum of stakeholders, it is now imperative for them to place customers at the heart of everything they do. For more than a decade, regulatory bodies have progressively built on rules, principles and guidance contained in sourcebooks, the most recent initiative being Consumer Duty, launched in 2022. While the Financial Conduct Authority acknowledges that this and other frameworks reinforce what good banks have been doing all along, banks will have to move away from utilitarian solutions that suit the majority but may be inappropriate for others. For example, packaged bank accounts became a major source of complaints in 2016 as many customers felt that they were not given a choice, were unaware of costs, did not want or need some of the features or were even unaware of what they had purchased. While it is a noble aspiration to align products and services with customer needs, this is a challenge in a marketplace that has increasingly diverse requirements.

In a recession, some individuals and groups in society are more likely to have special or changing needs. These include customers experiencing financial difficulties and vulnerable customers. Banks will need to have processes in place to identify such pressures and commit resources to minimise the risk of customer detriment.

Trusted advisory functions

Banks can provide customers with expert guidance when important financial decisions have to be made. In a recession this is profoundly important when a borrowing decision can have far-reaching implications for the future well-being of the customer. The demand for financial products is a derived demand; for example, a customer applying for a mortgage wants to buy a property and the mortgage is merely the means of facilitating this. To many customers the product, choices and application process are all complex with a high level of information asymmetry; often, they know little about the product and need to be guided. The best advisers can use all of their skills to enable customers to make informed choices.

Likewise, when disposable income is under severe pressure, customers have to choose what not to buy as well as the best product for them. Extending the example of the mortgage, it may be beneficial for a borrower to consider not only a mortgage but also buildings and contents insurance, mortgage protection, income protection insurance and critical illness cover, but it may be impossible for the customer to afford all of these products.

Banks are now better placed to provide sound, balanced advice than ever before. They are obliged to carry out suitability and affordability checks and to warn customers of the potential effects of future changes in their personal circumstances, such as the impact of future interest rate movements as well as changes in personal circumstances. These have been statutory requirements since 2014. Inevitably, during an economic downturn some applicants for credit will be disappointed if they cannot raise as much finance as they would like or are declined altogether, but it serves nobody's interest to create credit contracts that will create future financial difficulties.

Forbearance in hard times

It is inevitable that many individuals and households will encounter financial difficulties in a time of recession. As disposable incomes are squeezed, customers can be faced with difficult decisions. These may involve reorganising or refinancing existing debts, postponing or cancelling borrowing decisions, providing assistance to other family members and so on. As many customers use their banks for basic financial needs such as money transmission services, banks are able to take a holistic view of the customer's financial circumstances, enabling them to identify the options available. Good reputations rely not only on doing things well in good times, but also providing wise counsel when things go wrong.

Banks should also know their own limitations. Not all difficult situations can be resolved by the bank alone, but it should be able to refer customers to external agencies, including those able to offer advice on managing debt, state benefits and in other specialised fields.

Banking for businesses

In the wake of the 2008 financial crisis, banks were widely criticised for reducing the availability of credit to businesses. This reflected the capital pressures faced by most banks, as well as the need to reduce risk. Today, they are able to help sustain businesses through tough times and have experience in business lending. Developments in advanced communications technology enable detailed business analysis. Predictive analytics supplement the essential human judgment necessary to arrive at sound lending decisions. The marketplace for business banking is certainly more diverse than in the past; in many cases lenders will have little or no expertise in the field of operations of their clients. However, the principles underpinning good lending decisions remain constant. In any recession, there are opportunities for struggling businesses. CB