



## MACRO STRATEGY

# Buy Now, Pay Later: Early Warning Signs of a Weaker Consumer?

December 7, 2022

### Key Points

- The “Buy Now, Pay Later” (BNPL) industry grew rapidly with pandemic online shopping—five, large lenders made over 180 million loans in 2021.
- Gen Z shoppers are the heaviest users of BNPL services, and over 55% of digital buyers in that demographic are predicted to use a BNPL loan in 2022.
- BNPL loans have been showing increased defaults and late payments, a possible sign of stress for the lower- and lower-middle income consumers.

The “Buy Now, Pay Later” (BNPL) landscape is a window into consumer spending (and stress) for the lower-two income quintiles—a segment of the population highly affected by the inflationary macroeconomic environment. Younger, lower-income consumers, who are less financially established, are more likely to use BNPL loans. As inflation persists, credit usage has generally increased, and lower-income consumers have depleted much of their savings.

## BNPL – Gen Z’s Credit Card Alternative

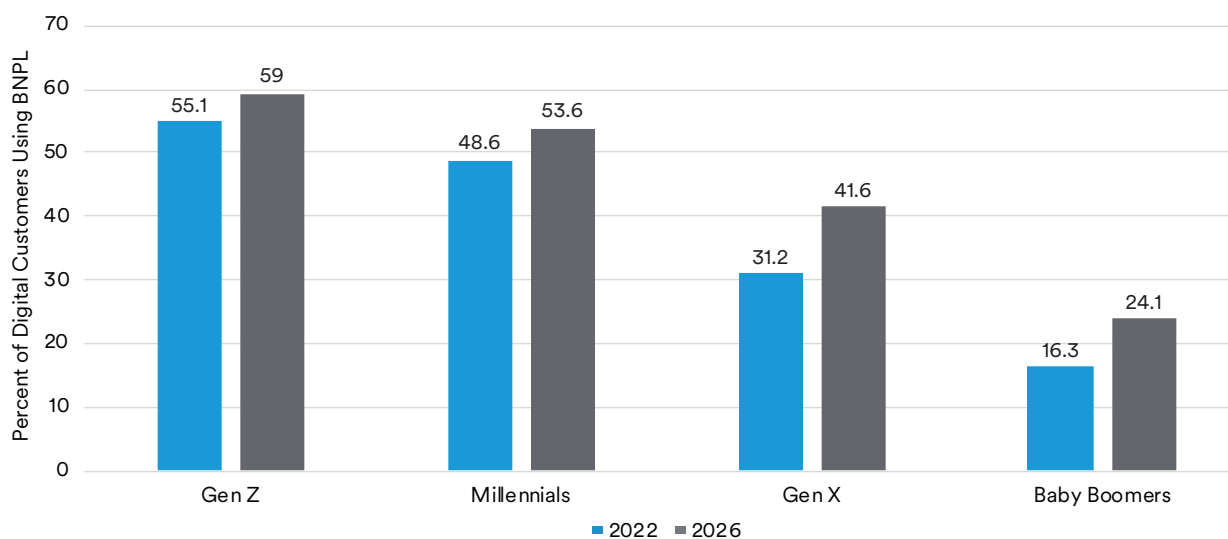
BNPL loans allow consumers to split transactions (typically less than \$1,000) into smaller installments, usually four, spread over a few weeks. BNPL is appealing compared to traditional credit cards or installment loans for a few reasons.

First, BNPL loans have faster and easier approval processes and high approval rates (~70%+). The services can be easily accessed from merchants’ websites directly at checkout or through a lender’s app, and only basic personal information is required. Some firms do no credit checks at all, while others perform soft pulls; a borrower’s repayment history with a lender can also be used for underwriting and credit increases. Historically, loans were not reported on credit reports.

Additionally, BNPL loans do not generally charge interest, giving consumers fixed and predictable payments. Firms make money from merchant fees and commonly charge fees for late payments. Avoiding the variable APR of credit cards is especially appealing in the current rate environment.

These characteristics make BNPL services particularly attractive to borrowers who have lower incomes or lower credit scores, are credit averse, or simply younger and financially less established. In 2021, 49.4% of BNPL borrowers from five, large lenders were under 33 years of age, and 55.1% of Gen Z is predicted to use a BNPL service at least once in 2022.<sup>1</sup> Borrowers that had a very poor-to-fair, self-reported credit score, were not college educated and had a family income less than \$50,000 (roughly the bottom-40% of earners), were more likely to use BNPL services.<sup>2</sup> Half of BNPL borrowers struggle with monthly bills.<sup>3</sup>

**Figure 1 | BNPL Penetration is Highest in Gen Z**



Source: Insider Intelligence, June 2022

The BNPL industry grew rapidly as an alternative to credit cards during the pandemic online shopping boom, but more competition (from both traditional finance and fintech firms) has caused consolidation as the industry matures. A CFPB report on five, large BNPL lenders showed originations grew from \$2 billion in 2019 to over \$24 billion in 2021, consisting of over 180 million loans. Dollar originations for the five lenders grew almost 200% in 2021 alone.<sup>4</sup> BNPL volume is currently dwarfed by traditional credit cards, which had a U.S. purchase volume of \$4,564 billion in 2021.<sup>5</sup> However, total U.S. BNPL transactions are forecast to surpass \$100 billion by 2024,<sup>6</sup> and the global BNPL market is expected to be worth \$3,680 billion by 2030.<sup>7</sup>

## BNPL Consumers Showing Signs of Stress

Macroeconomic headwinds pose challenges to BNPL-using consumers.

Directly, higher inflation disproportionately affects lower- and middle-income consumers. In a 2021 BNPL consumer survey, 46% of respondents indicated they are likely to make a late payment in the next 12 months.<sup>8</sup> Another study found 84% of people surveyed used BNPL to make purchases they otherwise would not be able to afford, and 39% say they “regularly” pay late fees due to missed payments.<sup>9</sup> According to the Federal Reserve SHED survey, 51% of consumers cited using BNPL services because it was the only way they could afford the transaction.

The effect can be seen from firms’ perspectives as well. BNPL charge-offs (when the lender has very low expectations of collecting) have increased. The charge-off rate for the five lenders in the CFPB report increased to 3.79% in 2021. The trend has extended into 2022: one lender reported its dollar charge-off rate (net charge-offs as a percentage of gross merchandise volume) increased to 3.03% in the first half of 2022, from 2.31% in the second half of last year. Late fees, which will occur before a charge-off, are also increasing; borrowers paying late fees increased by between 3% and 10% between 2020 and 2021. Virtually all BNPL loans are set up with autopay, so a late payment likely indicates a lack of funds rather than the borrower forgetting to make a payment.

## Looking Forward: Will the Current Problems Spread?

Even though the BNPL market is still relatively small compared to other traditional credit sources, it is a rapidly growing and dynamic industry especially appealing to younger and/or less financially established consumers. This concentration may make it a useful guide for judging increasing consumer struggles in lower-income quintiles.

While higher-income consumers still have savings and continue to spend, lower- and lower-middle-income consumers are having more difficulty. Consumer struggles may be moving up the income brackets and signaling the start of a broadening consumer weakness.

### End Notes

<sup>1</sup> “Buy Now Pay Later Transactions Will Surpass \$100 billion by 2024,” Insider Intelligence, June 2022

<sup>2</sup> “Economic Well-Being of U.S. Households (SHED),” Federal Reserve, May 2022

<sup>3</sup> Lux, Marshall and Bryan Epps, “Grow Now, Regulate Later? Regulation Urgently Needed to Support Transparency and Sustainable Growth for Buy-Now, Pay-Later,” Harvard Kennedy School, Mossavar-Rahmani Center for Business and Government, April 2022

<sup>4</sup> “Buy Now, Pay Later: Market Trends and Consumer Impacts,” CFPB, September 2022

<sup>5</sup> “Credit Cards in the U.S.,” Nilson Report, January 2022

<sup>6</sup> “Buy Now Pay Later Transactions Will Surpass \$100 billion by 2024,” Insider Intelligence, June 2022

<sup>7</sup> “Buy Now Pay Later Market Size is projected to reach USD 3.68 Trillion by 2030, growing at a CAGR of 45%: Straits Research,” Global Newswire, July 2022.

<sup>8</sup> “Buy Now, Pay Later Statistics and User Habits,” C+R Research, 2021

<sup>9</sup> Manya Saini, “U.S. BNPL consumer debt set to hit \$15 bln by 2025 – study,” Reuters, September 2022

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