Trends in Lending

April 2009

BANK OF ENGLAND

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This new monthly Bank of England publication presents the Bank's assessment of the latest trends in lending to the UK economy. The publication is launched at a time when the world economy has entered a deep and synchronised downturn, with the global banking and financial system in a fragile state. Against a backdrop of heightened interest in developments in the banking sector, this publication provides a summary of the most recent lending data. But it is important to understand the context for recent developments. This first report provides a longer-term perspective and is therefore more comprehensive than will be the case for future editions, which will focus more on the data reported month by month.

This report draws mainly on long-established official data sources, such as the existing monetary and financial statistics collected by the Bank of England. But these data are supplemented by the results of a new collection, established by the Bank of England in late 2008, to provide more timely data covering aspects of lending to the UK corporate and household sectors. The Bank collects these data to feed into the Lending Panel,(1) which was established by the Chancellor in November 2008 to monitor lending to the UK economy, and to promote best practice across the industry in dealing with borrowers facing financial difficulties.

The new collection — referred to as 'Lending Panel data' — covers the major UK lenders:(2) Banco Santander, Barclays, HSBC, Lloyds Banking Group, Nationwide and Royal Bank of Scotland. Together they accounted for around 65% of the stock of lending to businesses, 50% of the stock of consumer credit, and 70% of the stock of mortgage lending at the end of 2008. Lending Panel data have provided a useful input to discussions between the major lenders and Bank staff, giving staff a better understanding of the business developments driving the figures, and this intelligence is reflected in the report. The report also draws on intelligence gathered by the Bank's regional Agents and from market contacts, as well as the results of other surveys. The focus of the report is on lending, but broader credit market developments, for example trade credit or capital market issuance, may be discussed where relevant.

Lending Panel data are provided to the Bank on a 'best endeavours' basis. That, together with their relative timeliness, means that they may not be as accurate as established data collections. Where the new data have been included in charts, less weight should therefore be placed on them relative to the official data in this report. As the new data collection process becomes more established, we hope to increase the amount of Lending Panel data that is included in the report.

This report covers official data up to February 2009, supplemented by Lending Panel data and intelligence gathered up to end-March 2009. Unless stated otherwise, the data reported cover lending in both sterling and foreign currency, are expressed in sterling terms, and are not seasonally adjusted.

(1) The Lending Panel comprises Government, lenders, consumer, debt advice and trade bodies, regulators and the Bank of England. See www.hm-treasury.gov.uk/press_126_08.htm.
(2) Membership of the group of major UK lenders is based on the provision of credit to UK-resident companies and individuals, regardless of the country of ownership.

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Executive summary

Since the summer of 2007, banks have been seeking to restructure their balance sheets, through injections of new capital, selling assets and reining back their lending. Although this adjustment is necessary to improve the longer-term health of the banking system, it risks exacerbating the wider economic downturn if it also restricts the amount of lending available for creditworthy businesses and households in the short run. Movements in lending also have to be seen in the context of companies' and households' demand for lending. Historically, growth in lending to both businesses and households — which reflects the combination of demand and supply effects — tends to fall sharply in recessions.

Growth in the stock of lending to UK businesses slowed markedly during 2008, reflecting reduced flows of net lending by foreign as well as domestic lenders. Total net lending flows remained weak in the first two months of 2009, though companies have increasingly returned to the capital markets to raise funds. Having tightened price and non-price conditions during 2008, some major lenders reported further tightening since the turn of the year, in part to reflect the increasing perceived riskiness of corporate borrowers. Companies setting up new borrowing facilities face higher spreads and fees and so their overall cost of borrowing has fallen by less than Bank Rate or Libor. Tighter terms and conditions, and the deteriorating economic outlook, have contributed to weak demand for new borrowing facilities, in particular for capital investment. But looking ahead, some lenders expect the overall availability of credit to the corporate sector to increase over the next three months.

Growth in the stock of mortgage lending to individuals has slowed sharply since the start of the financial crisis, and stands at its lowest annual rate since the series began in 1988. Gross mortgage lending has fallen to its lowest level since March 2001, in part reflecting a marked fall in remortgaging activity. Spreads on new mortgage lending have risen over the same period, though interest rates on new mortgages have fallen given the reductions in Bank Rate and swap rates. Credit availability has declined since the start of the crisis, in large part reflecting a withdrawal from new lending by specialist lenders and a reduction in the number of higher loan to value mortgages on offer, though some increase in mortgage availability is expected by lenders in the 2009 Q1 *Credit Conditions Survey*. Demand for mortgages for house purchase has also fallen, perhaps as potential buyers have anticipated further house price falls. Lenders expect demand for secured credit to remain weak in coming months.

Growth in the stock of unsecured lending has slowed sharply over the past year or so, and the monthly net flow of lending was negative in February for the first time since the series began in April 1993. Effective interest rates have been little changed despite falls in Bank Rate and Libor, in part reflecting perceptions of increased credit risk on unsecured lending. Having tightened credit availability over the past year, lenders expect that credit availability will remain unchanged in 2009 Q2. Weak demand for unsecured lending is expected to continue over the coming months.

The context for *Trends in Lending*

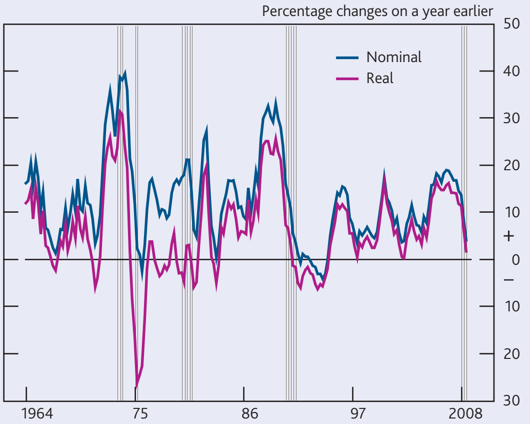
Trends in Lending is launched at a time when the world economy has entered a deep and synchronised downturn, with the global banking and financial system in a fragile state. Since the summer of 2007, banks have been seeking to restructure their balance sheets, through injections of new capital, selling assets and reining back their lending. Although this adjustment is necessary to improve the longer-term health of the banking system, it risks exacerbating the wider economic downturn if it also restricts the amount of lending available for creditworthy businesses and households in the short term. Businesses need funds from banks to help meet working capital requirements and to fund longer-term investments; households need funds to purchase houses and other assets, and to finance their consumer spending over time.

A key issue for policymakers when assessing how best to support the flow of credit to the wider economy is the extent to which the observed weakening in lending reflects a reduction in *supply*, such as a tightening in banks' credit provision, or weaker *demand* for funds from businesses and households as the UK economy entered recession. Assessing the balance of these factors requires an assessment both of lending quantities and of loan pricing adjusted for risk. If the lending slowdown is predominantly driven by weaker demand then, other things equal, we would expect spreads charged on lending to fall. By contrast, if a tightening of supply is more important, spreads would be expected to rise.

Such an assessment is difficult over the longer term because the Bank's effective interest rate series do not extend back to earlier recessions. Nonetheless, a longer-term perspective of lending growth can help aid interpretation. **Chart A** shows long runs of lending to businesses,[1] with periods of recession (defined as two or more consecutive quarters of falling UK real output) shaded. The chart shows that both nominal and real lending slowed sharply in past recessions, and in some cases contracted — particularly in real terms. **Chart B** provides a similar back-run for growth in lending to individuals, and shows sharp falls around the time of the recessions of both the 1970s and the early 1990s. Although some earlier recessions were also associated with bank failures, they were not so characterised by widespread financial crisis. So this pattern of lending slowdowns across recessions cautions against assuming that current weak lending growth necessarily reflects reductions in lending supply alone. The charts also show that growth in lending — particularly to individuals — has often slowed well ahead of a recession and, in the case of the 1990s recession, remained subdued for a number of years afterwards.

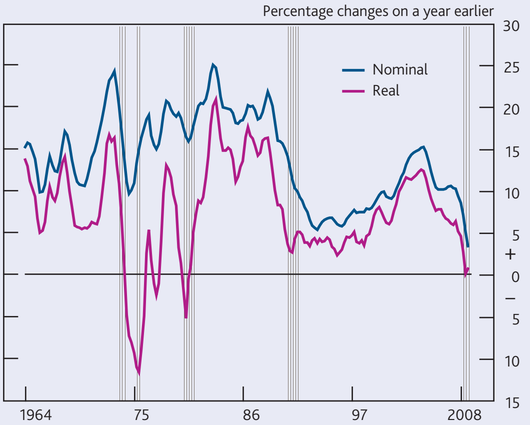
In assessing lending at the present time, this report looks more widely at evidence that can help identify the driving forces behind developments, including recent evidence on loan pricing. However, the Bank's effective interest rate data do not control for changes in risk or adjust for fees, which will also affect the overall cost of credit. Further, such data only capture rates paid by those who are able to access credit — some customers who are perceived as riskier borrowers may be prevented from borrowing due to credit constraints. As a result, loan pricing data alone can provide a misleading indication of the balance of loan demand and supply. So this publication also looks at surveys, including the Bank's *Credit Conditions Survey*, and other intelligence, such as that collected by the Bank's regional Agents from a range of businesses, to provide additional evidence on the extent to which demand and supply factors are influencing the flow of credit. Insights from discussions with the major UK lenders about the Lending Panel data provide another important source of information. By bringing these various strands together on a monthly basis, *Trends in Lending* will provide a timely assessment of lending developments.

Chart A Lending to businesses[(a)(b)(c)]



(a) UK private non-financial corporations. Sterling lending only. Seasonally adjusted data.
(b) Deflated by the GDP deflator. Source: ONS.
(c) Shaded areas mark periods of recession.

Chart B Lending to individuals[(a)(b)(c)]



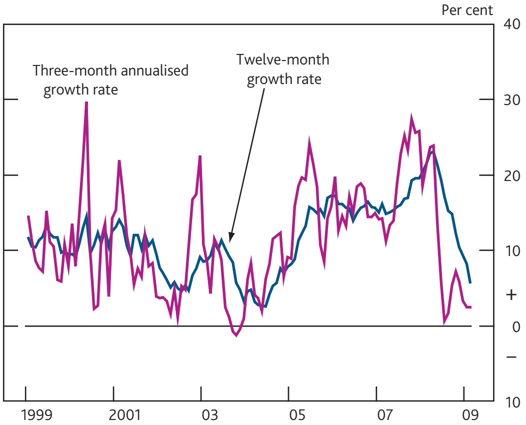
(a) Also includes lending to housing associations. Sterling lending only. Seasonally adjusted data.
(b) Deflated by RPI. Source: ONS.
(c) Shaded areas mark periods of recession.

(1) 'Businesses' is used throughout this report to denote private non-financial corporations.

1 Lending to UK businesses

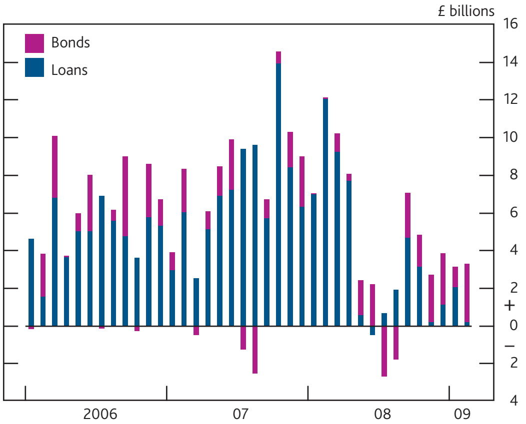
Growth in the stock of lending to UK businesses slowed markedly during 2008, reflecting reduced flows of net lending by foreign as well as domestic lenders. Total net lending flows remained weak in the first two months of 2009, though companies have increasingly returned to the capital markets to raise funds. Having tightened price and non-price conditions during 2008, some major lenders reported further tightening since the turn of the year, in part to reflect the increasing perceived riskiness of corporate borrowers. Companies setting up new borrowing facilities face higher spreads and fees and so their overall cost of borrowing has fallen by less than Bank Rate or Libor. Tighter terms and conditions, and the deteriorating economic outlook, have contributed to weak demand for new borrowing facilities, in particular for capital investment. But looking ahead, some lenders expect the overall availability of credit to the corporate sector to increase over the next three months.

Chart 1.1 Lending to UK businesses[(a)(b)]



(a) Lending by monetary financial institutions to private non-financial corporations. Investments and holdings of securities are not included.
(b) Seasonally adjusted.

Chart 1.2 Net funds raised by UK businesses[(a)]



(a) Private non-financial corporations. Loans are seasonally adjusted, but bond issuance is not, as it has been found not to be significantly seasonal. Commercial paper is included within bonds.

Between 2005 and 2007, benign macroeconomic conditions, along with rising asset prices and low global interest rates, boosted lending to companies in the United Kingdom and internationally. Lending to commercial property and leveraged buyout companies increased particularly rapidly, as banks were able to finance new loans by repackaging existing debt and selling it on to investors through securitisation and other credit markets. These trends have been documented extensively in the Bank's *Inflation Report* and *Financial Stability Report*.[(1)]

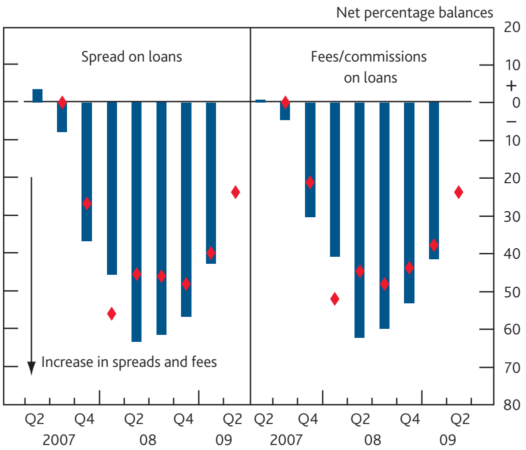
As credit markets seized up during the summer of 2007, banks were unable to sell on loans. That increased the amount of corporate loans remaining on banks' balance sheets, helping to boost measured net lending by banks to businesses over the following months. Annual growth in lending to businesses peaked in early 2008 (**Chart 1.1**).

Wholesale funding market conditions have since remained difficult, and banks have been seeking to restructure their balance sheets, through injections of new capital, selling assets and reining back their lending. The annual rate of growth in lending to businesses approximately halved over 2008, with that slowdown broadly based across the manufacturing and service sectors.

The flow of net lending was close to zero in February 2009. But in recent months companies have increasingly returned to the capital markets to raise funds, and bond issuance in particular has picked up (**Chart 1.2**). Banks have reported that some of the funds raised are being used to repay bank debt, as

(1) See www.bankofengland.co.uk/publications/inflationreport/index.htm and www.bankofengland.co.uk/publications/fsr/index.htm.

Chart 1.3 *Credit Conditions Survey*: spreads and fees on loans(a)(b)



(a) Net percentages are calculated by weighting together the responses of those lenders who answered the questions. The blue bars show the responses over the previous three months. The red diamonds show the expectations over the next three months. Expectations balances have been moved forward a quarter so that they can be compared with the actual outturns in the following quarter.
(b) A negative balance indicates an increase in spreads and fees. Covers lending to medium-sized companies only.

companies restore a more diverse funding base following high reliance on bank debt in the recent past. However, bond issuance remains largely restricted to investment-grade companies.

Data collected by the British Bankers' Association indicate that the flow of net lending to small businesses was positive in the first two months of 2009, though below the average flow in 2008.[1]

Corporate loan pricing

The total cost of bank finance to a company can be decomposed into the fees charged by the bank to provide facilities, the spread over a given funding rate at which loans are offered, and the prevailing level of that funding rate in the financial markets.

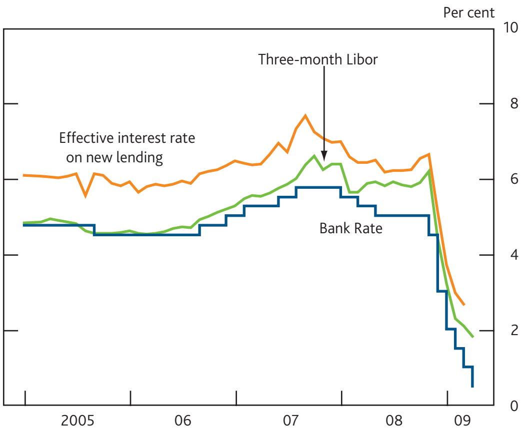
Over the years leading up to the start of the financial crisis in Summer 2007, fees and spreads fell to historically low levels, driven by strong competition among lenders. Survey evidence indicates that since the onset of the crisis, these components of loan costs have risen substantially. The Bank's *Credit Conditions Survey* indicates that spreads and fees on corporate lending facilities have been increasing since 2007 Q3 (**Chart 1.3**). This has been echoed by other surveys, such as those undertaken by the Association of Corporate Treasurers (ACT) and the Confederation of British Industry (CBI),[2] and by reports to the Bank's regional Agents. The latest *Credit Conditions Survey* indicates that lenders expect these components of the overall cost of finance to rise further in 2009 Q2.

In discussions since the turn of the year, the major UK lenders have said that spreads over Bank Rate or the London interbank offered rate (Libor) have been increased to reflect better the higher costs of longer-term funding and of capital, as well as increased credit risk. Longer-term funding for banks remains scarce and expensive relative to earlier in the decade. Increases in fees have often reflected the withdrawal of discounts that had been offered when competition was intense, rather than increases in 'headline' fees — lenders emphasised that, with hindsight, spreads and fees had fallen to unsustainably low levels by early 2007. Charges for unused facilities in particular are also reported to have risen, in part to reflect higher capital requirements under the new Basel II capital adequacy framework.

The cost of finance for some borrowers will also have been affected by changes to the relevant funding rate to which their loans are tied. Typically loans to small businesses have been linked to Bank Rate. By contrast, loans to the largest

(1) See www.bba.org.uk/content/1/c6/01/56/27/Small_Business_Monthly_Feb%2009.pdf.
(2) See 'Credit crisis and corporates — funding and beyond', February 2009, ACT, and the CBI's monthly *Access to Finance* survey.

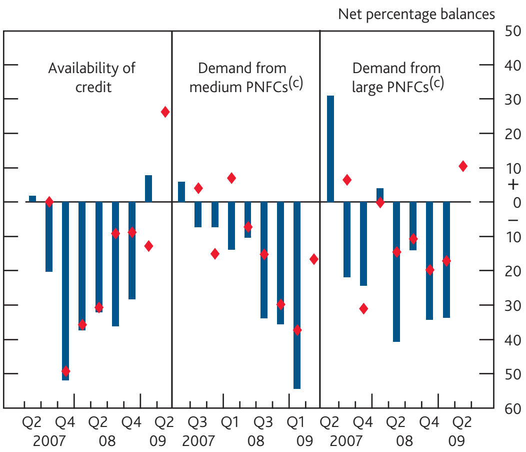
Chart 1.4 Effective interest rate on new lending to UK businesses[a]



Sources: Bank of England and Bloomberg.

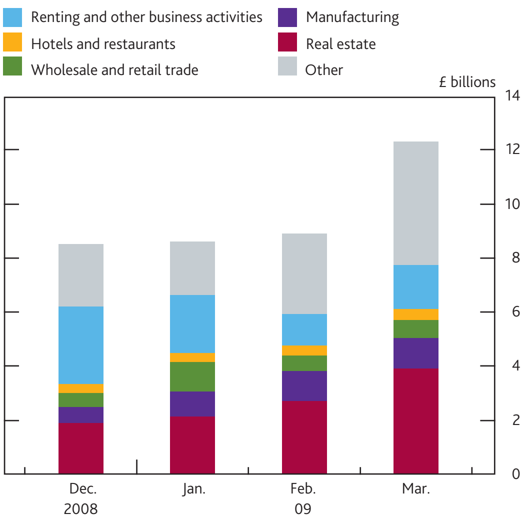
(a) The Bank's effective interest rates series comprise data from 29 monetary financial institutions.

Chart 1.5 *Credit Conditions Survey*: corporate credit availability and demand for credit[a][b]



(a) See footnote to **Chart 1.3**.
(b) A positive balance indicates that more credit is available or there is greater demand.
(c) Private non-financial corporations.

Chart 1.6 Gross new loan facilities granted by the major UK lenders[a]



(a) Lending Panel data, available from December 2008 only. Lending Panel data are generally of lower quality than existing data sources and have a short history. As a result, less weight should be attached to this chart than to those using existing data sources.

businesses are often linked to Libor. Historically it had mattered little whether loans had been linked to Bank Rate or to Libor, as the relationship between the two was relatively stable. But Libor rose at the onset of the crisis, and its average spread over Bank Rate has since remained elevated. In response, lenders have increasingly sought to reference the cost of new credit lines to Libor, which they report better reflects the cost of funding such lending through wholesale markets.

Increases in spreads have not as yet become apparent in data published by the Bank on the effective (weighted average) interest rates paid by companies on the flow of new lending. These effective interest rates have fallen sharply since October 2008 (**Chart 1.4**), broadly in line with the falls in three-month Libor and Bank Rate over the same period. But these interest rate data do not include fees so they will not capture the full cost of bank finance to companies. And this weighted-average measure may have fallen because lending is now more focused on the least risky borrowers who typically pay the lowest rates. It is also consistent with reports from the major lenders that a large proportion of the current flow of lending reflects companies drawing down existing facilities that were arranged at pre-crisis margins.

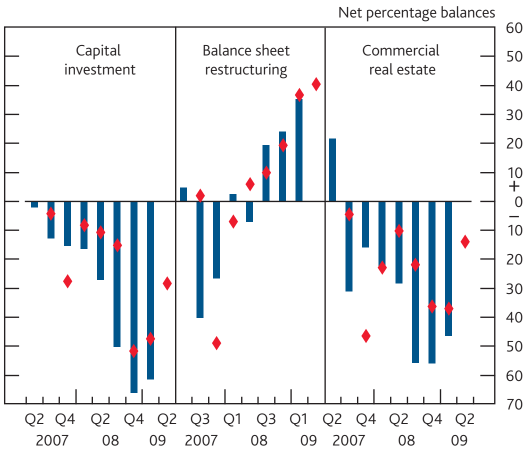
Supply and demand

The amount of lending and its price depend on the interaction of demand and supply factors. Disentangling the separate influences of changes in the supply of and demand for credit is extremely difficult, though surveys can help. The 2009 Q1 *Credit Conditions Survey* indicates that lenders reduced the availability of credit to businesses between 2007 Q3 and the end of 2008 (**Chart 1.5**). And, as the box on page 9 explains, credit has also become less available following the withdrawal from the market of several foreign lenders, after a period when their contribution to lending growth had been unusually strong. Credit extended by one company to another, known as trade credit, is also an important source of short-term financing for many businesses, and potentially provides a substitute for scarce bank credit. However, the Bank's regional Agents have reported that companies are finding it difficult to protect themselves against the risks associated with extending credit to their trading partners, reducing the availability of trade credit in some sectors.[1]

More recently, the *Credit Conditions Survey* indicated that corporate credit availability had increased slightly in 2009 Q1. Moreover, the major lenders reported that the value of gross new facilities granted in March was higher than in each of the previous three months (**Chart 1.6**).[2] However, in discussions with the Bank, the major UK lenders said that a high proportion of these new facilities are associated with the

(1) See the box on page 15 of the February 2009 *Inflation Report*.
(2) These data are not seasonally adjusted so there may be a seasonal element to the pickup in March.

Chart 1.7 *Credit Conditions Survey*: drivers of change in demand for corporate lending(a)(b)



(a) See footnote to **Chart 1.3**.
(b) A positive balance indicates that the change in the factors described has served to increase demand for corporate borrowing.

refinancing or restructuring of their existing customers' facilities — contributing to gross lending rather than net 'new' lending. This is consistent with the 2009 Q1 *Credit Conditions Survey*, in which the only area of stronger corporate credit demand is for balance sheet restructuring (**Chart 1.7**).

Lenders have been reporting a decline in demand for new credit from companies for capital investment, investment in commercial real estate, and for mergers and acquisitions. Companies' reports to the Bank's regional Agents since the turn of the year have confirmed a weakening in demand for loans — across practically all sectors — as tighter credit conditions and the worsening global economic outlook have led businesses to cut back on spending. Some contacts have reported becoming increasingly wary of approaching banks for finance for fear of triggering an unfavourable review of existing terms. And a net balance of 30% of companies responding to the CBI's March 2009 *Access to Finance* survey reported that financing conditions had adversely affected their output over the past three months.

Looking forward, the Government has implemented a number of measures to reinforce the supply of credit. Under the Government's Asset Protection Scheme, Lloyds Banking Group and Royal Bank of Scotland have made commitments to increase their lending over the next year.(1) And the supply of credit may also be aided by the Government's Enterprise Finance Guarantee and Working Capital schemes, which are aimed at small and medium-sized enterprises. Consistent with that, in the 2009 Q1 *Credit Conditions Survey* a net balance of lenders expected to increase corporate credit availability over the next three months.

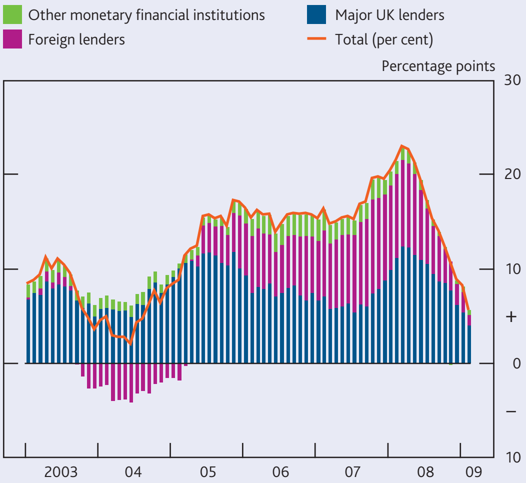
(1) See www.hm-treasury.gov.uk/press_23_09.htm and www.hm-treasury.gov.uk/press_19_09.htm for details of the agreements.

Changes in lending capacity

This box uses official Bank of England statistics on lending to businesses and on mortgage lending to gauge the extent of changes in lending capacity in the United Kingdom over the past year or so.

The growth rate of the stock of lending to businesses was persistently strong in 2006 and 2007 and peaked at over 20% on a twelve-month basis by early 2008. Since then, however, the annual growth rate of lending to businesses has eased markedly, falling to around 5% in February 2009 (**Chart A**).

Chart A Contributions to growth in lending to UK businesses[(a)]

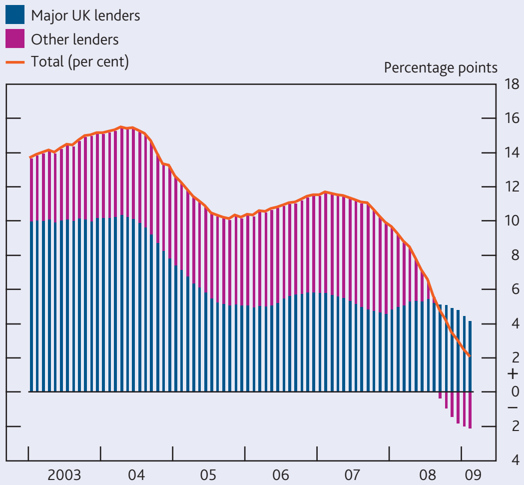


(a) Private non-financial corporations. Twelve-month growth rates in the stock of lending.

About half of the growth in lending to businesses in 2007 can be attributed to the activities of foreign lenders. However, as the balance sheets of banks globally came under severe strain during the latter part of 2007, the contribution of those foreign lenders began to fall. And that decline gathered pace in the second half of 2008, as banks internationally cut back on new lending abroad. The withdrawal of new credit by foreign lenders has been particularly evident in the real estate, retail and wholesale sectors. Growth in lending by the major UK lenders has also fallen back, but their relative contribution to overall growth is now greater than in 2007.

Mortgage lending growth has also slowed significantly over the past 18 months, from over 10% in 2007 to around 2% in February 2009, on a twelve-month basis (**Chart B**). Foreign lenders are less active in the UK mortgage market — they accounted for some 15% of the decline in net mortgage lending flows between 2007 and 2008. Rather, the majority of the slowdown in mortgage lending can be accounted for by the withdrawal of specialist mortgage banks and other specialist lenders. These lenders had often focused on higher-risk mortgage lending — including to borrowers with adverse credit histories, higher loan to value ratios or self-certified income — and the buy-to-let market. Many of these lenders relied heavily on wholesale funding through securitisation markets to finance their activities. With those funding markets effectively closed, and with losses crystallising on some of their portfolios, these lenders have withdrawn from the market, in some cases ceasing lending completely. However, for one of those lenders, Northern Rock, the Government announced in February the agreement of a new business strategy that would see them increase mortgage lending,[(1)] subject to market demand. This will dissipate the previously contractionary effect of the restructuring of Northern Rock on mortgage lending capacity.

Chart B Contributions to mortgage lending growth[(a)(b)]



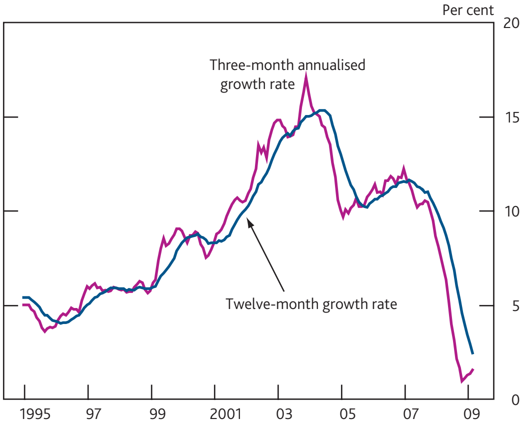
(a) Twelve-month growth rates in the stock of lending.
(b) Excludes lending to housing associations.

(1) See www.hm-treasury.gov.uk/press_15_09.htm for more details.

2 Mortgage lending

Growth in the stock of mortgage lending to individuals has slowed sharply since the start of the financial crisis, and stands at its lowest annual rate since the series began in 1988. Gross mortgage lending has fallen to its lowest level since March 2001, in part reflecting a marked fall in remortgaging activity. Spreads on new mortgage lending have increased over the same period, though interest rates on new mortgages have fallen given the reductions in Bank Rate and swap rates. Credit availability has declined since the start of the crisis, in large part reflecting a withdrawal from new lending by specialist lenders and a reduction in the number of higher loan to value mortgages on offer, though some increase in mortgage availability is expected by lenders in the 2009 Q1 *Credit Conditions Survey*. Demand for mortgages for house purchase has also fallen, perhaps as potential buyers have anticipated further house price falls. Lenders expect demand for secured credit to remain weak in coming months.

Chart 2.1 Secured lending to individuals(a)(b)



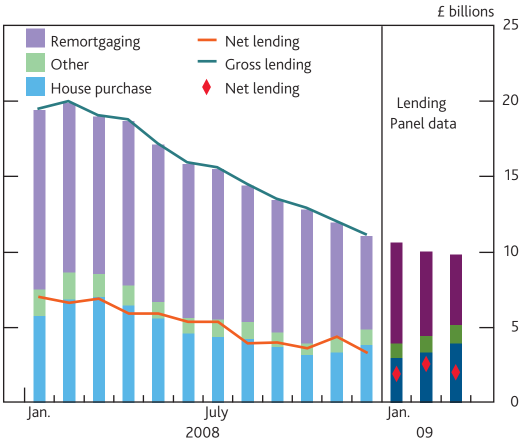
(a) Secured lending by monetary financial institutions and other lenders to UK individuals.
(b) Seasonally adjusted data.

For much of the past decade, the availability of apparently cheap and plentiful funding through securitisation and other wholesale money markets increased the availability of mortgage finance. Strong competition in new mortgage lending drove mortgage interest rate spreads progressively lower, and mortgages became available to a wider range of borrowers, including those with limited or no deposits. Alongside strong demand for housing, these factors contributed to a prolonged period of strong growth in the outstanding stock of mortgage lending (**Chart 2.1**).

As the box on page 9 discusses, since lenders' main wholesale funding markets seized up in the summer of 2007, the availability of mortgages has been sharply reduced, particularly for higher-risk borrowers such as those with high loan to value (LTV) ratios or with impaired credit histories. And as the housing market and wider macroeconomic outlook have deteriorated, demand for mortgages has also fallen. Net lending flows have weakened so that the annual growth of mortgage lending to individuals has fallen to its lowest rate since the series began in 1988.

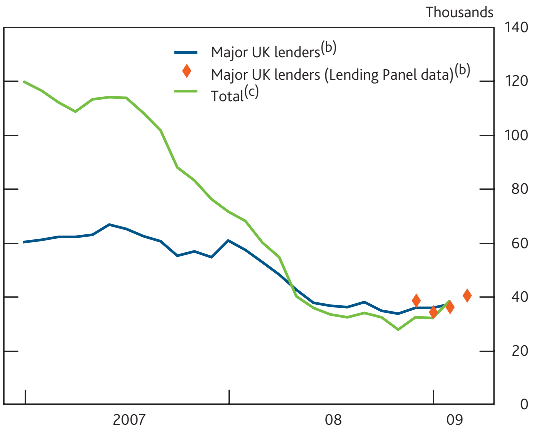
In February, the monthly flow of gross lending was at its weakest since March 2001. **Chart 2.2** uses Lending Panel data and estimates based on official data to provide a split of gross lending by purpose over time, and shows how the fall in gross lending flows over the past year has been concentrated in remortgaging activity. The major UK lenders have attributed that decline to the pass-through of recent reductions in Bank Rate to standard variable rate (SVR) mortgage rates, to which many shorter-term mortgage deals revert on maturity. With the SVR having fallen relative to most other mortgage rates,

Chart 2.2 Gross mortgage lending by the major UK lenders[(a)(b)(c)]



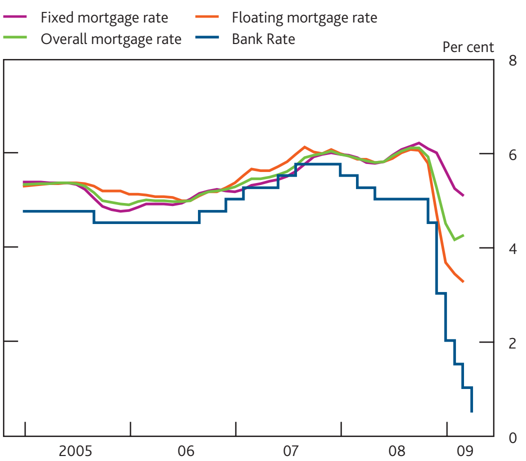
(a) Gross lending split by purpose during 2008 is estimated using gross lending data and the split of loan approvals between house purchase, remortgaging and other purposes.
(b) Gross lending split by purpose in the Lending Panel data from January 2009 onwards is reported, rather than estimated, data. Lending Panel data are generally of lower quality than existing data sources and have a short history. As a result, less weight should be attached to the flow of gross lending as measured by the Lending Panel data in this chart than to the flow of gross lending measured by official data.
(c) Seasonally adjusted data.

Chart 2.3 Approvals for mortgages for house purchase[(a)]



(a) Seasonally adjusted.
(b) Gross approvals data.
(c) Monetary financial institutions and other lenders. These data are net of cancellations and hence the total can fall below the gross approvals data shown for the major UK lenders.

Chart 2.4 Effective interest rates on new mortgage lending to individuals[(a)]



(a) The Bank's effective interest rates series comprise data from 29 monetary financial institutions.

borrowers have tended to remain on the SVR rather than refinance. This has reduced the levels of 'churn' in the market, whereby borrowers refinance their mortgages through a series of fixed-term deals, often with different lenders. Indeed, it is likely that some borrowers will not have been able to refinance expiring fixed-term deals with new deals, given increases in LTV ratios resulting from house price falls, which would further add to the number of borrowers on standard variable rate mortgages.

Looking ahead, approvals for house purchase rose in February, though they remained at a low level by historical standards, and the major UK lenders have reported a slight further increase in March (**Chart 2.3**). Mortgage approvals for remortgaging fell further in February.

Mortgage pricing

During much of the past decade, strong competition in mortgage lending contributed to a marked decline in mortgage interest rate spreads. But over the past 18 months or so, mortgage spreads over Bank Rate and swap rates have widened as banks have sought to restructure balance sheets, funding costs have risen and the compensation required for credit risk has increased. The latter has reflected greater risk aversion on the part of lenders, higher default risk and the effect of falling house prices on collateral values.

Nonetheless, for mortgage products that are still available, those increases in spreads have been more than offset by falls in Bank Rate and swap rates, so that effective new mortgage rates have fallen sharply since October 2008 (**Chart 2.4**). Overall effective new mortgage interest rates in February 2009 were 1.7 percentage points lower than in October 2008, compared with a fall of 3.5 percentage points in Bank Rate over that period.

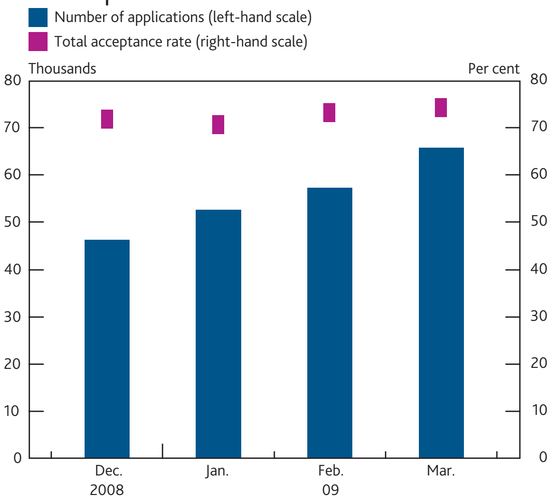
Effective interest rates do not factor in fees, however, which will also affect the overall cost of borrowing. Responses to the *Credit Conditions Survey* indicate that lenders have been increasing fees on secured lending since 2007 Q4, although in the 2009 Q1 *Survey*, lenders expected fees to be little changed in 2009 Q2.

Supply and demand

As on the corporate side, it is difficult to identify precisely the separate influences on overall mortgage lending of changes in the supply of and demand for mortgages.

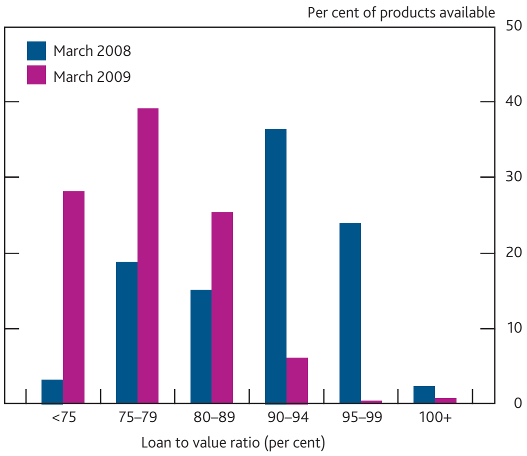
On the supply side, lenders' responses to *Credit Conditions Surveys* indicate that they have reduced the availability of secured credit to households over the past twelve to 18 months. Maximum LTV ratios have been reduced since the end of 2007, and the 2009 Q1 *Survey* indicated that a small further reduction was expected in 2009 Q2; credit scoring criteria have been similarly tightened, with a further

Chart 2.5 Applications and acceptances for mortgages for house purchase[(a)(b)(c)]



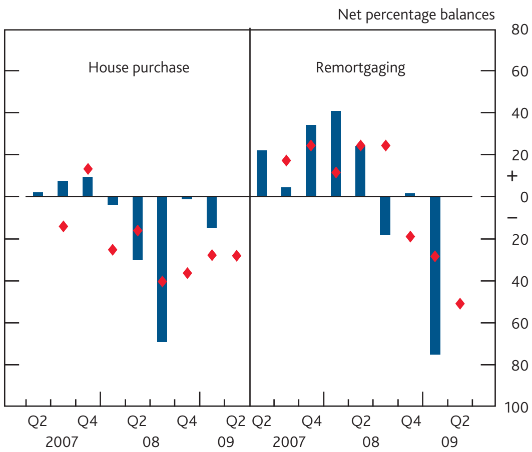
(a) Reported by the major UK lenders in the Lending Panel sample. Data are only available from December 2008.
(b) Lending Panel data are generally of lower quality than official data sources and have a short history. As a result, less weight should be attached to this chart than to those using official data sources.
(c) Absolute levels should be given less weight than any movement over time. The acceptance rate in a given month is unlikely to apply to the applications that month, given lags in the application process. More than one application may be made for a mortgage.

Chart 2.6 Products by loan to value ratio



Sources: Moneyfacts Group and Bank calculations.

Chart 2.7 *Credit Conditions Survey*: demand for household secured lending[(a)(b)]



(a) See footnote to **Chart 1.3**.
(b) A positive balance indicates an increase in demand.

modest tightening expected in 2009 Q2. However, a net balance of lenders expected an increase in overall credit availability in 2009 Q2, the first positive balance of expectations since 2007 Q3. Some lenders have commented that they have not yet had enough time to assess the full impact on future lending of recently announced lending commitments.

In recent discussions, the major UK lenders have generally noted only limited changes in their overall mortgage supply conditions since the turn of the year. Consistent with that, Lending Panel data suggest acceptance rates are little changed in recent months (**Chart 2.5**). However, in line with the 2009 Q1 *Credit Conditions Survey*, a number of the major UK lenders have reported that they intend to make some increase in the availability of mortgage lending in coming months. And as also described in the box on page 9, outside of the major UK lenders, the Government announced in February the agreement of a new strategy that would see Northern Rock increase mortgage lending, subject to market demand.[(1)] This will have the effect of dissipating the previously contractionary effect of the restructuring of Northern Rock on mortgage lending capacity.

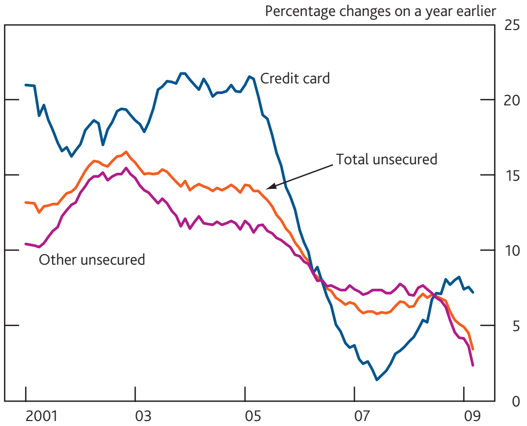
The major UK lenders attribute a significant proportion of the recent weakness in mortgage lending to a fall in demand for house purchase. The rise in mortgage applications in Lending Panel data in 2009 so far (**Chart 2.5**) is reported to largely reflect seasonal factors and changes in mortgage product ranges, rather than a significant pickup in underlying demand. However, the Royal Institution of Chartered Surveyors' new buyer enquiry balance rose in March to its highest level since September 2003, which could indicate that demand for mortgages for house purchase is rising. It may be that part of the apparent weakness of mortgage demand perceived by lenders reflects constraints in loan supply. In particular, the withdrawal of a number of products with high LTV ratios over the past year had markedly reduced the number of mortgage products with LTVs greater than 90% (**Chart 2.6**), which may have deterred some potential first-time buyers from applying for mortgages. In recent weeks, some new products with higher (90%) LTV ratios have been announced which, if indicating a wider return to such lending, might help first-time buyers return to the market. However, the 2009 Q1 *Credit Conditions Survey* indicated that lenders expect weak demand for secured lending to continue in 2009 Q2 for both house purchase and remortgaging activity (**Chart 2.7**).

(1) See www.hm-treasury.gov.uk/press_15_09.htm for more details.

3 Consumer credit

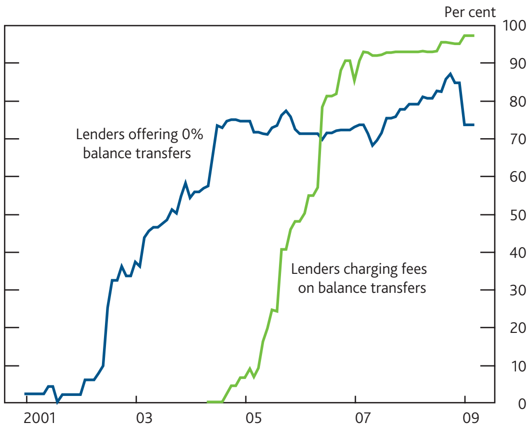
Growth in the stock of unsecured lending has slowed sharply over the past year or so, and the monthly net flow of lending was negative in February for the first time since the series began in April 1993. Effective interest rates have been little changed despite falls in Bank Rate and Libor, in part reflecting perceptions of increased credit risk on unsecured lending. Having tightened credit availability over the past year, lenders expect that credit availability will remain unchanged in 2009 Q2. Weak demand for unsecured lending is expected to continue over the coming months.

Chart 3.1 Unsecured lending to individuals[(a)(b)]



(a) Unsecured lending by monetary financial institutions and other lenders to UK individuals.
(b) Seasonally adjusted data. Sterling lending only.

Chart 3.2 Shares of credit card lenders offering 0% balance transfer deals and charging fees on balance transfers



Source: Moneyfacts Group.

Consumer credit comprises credit card debt, overdrafts and other loans and advances, such as personal loans. Growth in consumer credit was very rapid during the first half of the decade (**Chart 3.1**), particularly for credit cards which account for around a quarter of total outstanding consumer credit. However, an increase in write-offs in 2005 prompted a retrenchment by lenders, contributing to a moderation of unsecured lending growth in recent years. As part of that tightening, credit card lenders have increasingly charged fees on balance transfers, where previously these had been offered on a 0% interest rate and no-fee basis (**Chart 3.2**).

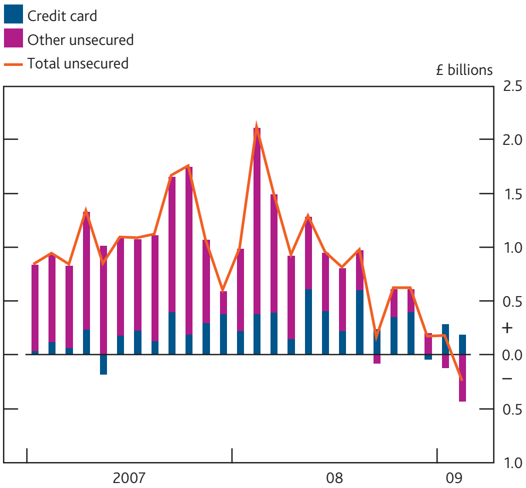
The slowdown in overall unsecured lending has intensified in recent months, with the annual growth rate of the stock of lending falling below 5%, from rates of around 15% earlier in the decade. And in February 2009, repayments of unsecured lending were greater than gross lending flows, so that the stock of unsecured lending contracted for the first time since the monthly series started in April 1993 (**Chart 3.3**).

Consumer credit pricing

Interest rates charged on different forms of consumer credit vary between products. For example, effective interest rates on credit cards and, to a lesser extent, overdrafts, are generally higher than for personal loans (**Chart 3.4**). That may partly reflect greater uncertainty about the length of time it takes for credit card debt and overdrafts to be repaid, as well as the increased flexibility for borrowers to vary the actual amount borrowed/drawn.

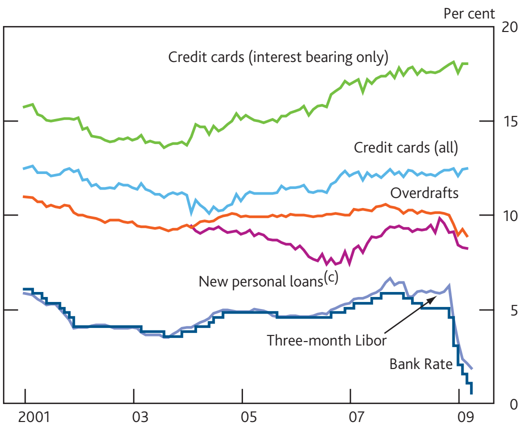
In contrast to mortgage rates, effective interest rates charged for different forms of unsecured lending have generally remained little changed despite sharp falls in Bank Rate and Libor, consistent with a widening of spreads. That widening is reported to reflect in part lenders' perceptions of increased credit risk on unsecured lending as default rates have risen, as well as an earlier underpricing of risk.

Chart 3.3 Net unsecured lending flows to individuals(a)(b)



(a) Monetary financial institutions and other lenders.
(b) Seasonally adjusted data. Sterling lending only.

Chart 3.4 Effective interest rates on unsecured lending(a)(b)



(a) The Bank's effective interest rates series comprise data from 29 monetary financial institutions.
(b) The rate for personal loans is for new business. For the other series the rates shown are for the stock of lending, as comparable data for new lending are not available.
(c) Only available from January 2004.

Supply and demand

Having cumulatively reduced the availability of unsecured credit significantly over the past year, reflecting concerns about the economic outlook and reduced appetite for risk, lenders reported in the 2009 Q1 *Credit Conditions Survey* that they expected availability to be broadly unchanged in 2009 Q2. However, they expected the recent trend of declining demand for unsecured credit, consistent with weak consumption, to continue. Overall, most of the major UK lenders expected net consumer credit flows to remain weak in the coming months.

Abbreviations

ACT – Association of Corporate Treasurers.
CBI – Confederation of British Industry.
GDP – gross domestic product.
Libor – London interbank offered rate (see below).
LTV – loan to value ratio (see below).
PNFCs – private non-financial corporations.
RPI – retail prices index.
SVR – standard variable rate.

Glossary

Bank Rate The official rate paid on commercial bank reserves by the Bank of England.

Basel II An international framework for banks' capital requirements (revised from the previous Basel I framework).

Businesses Private non-financial corporations.

Consumer credit Borrowing by UK individuals to finance expenditure on goods and/or services. Consumer credit is split into two components: credit card lending and 'other' lending (mainly overdrafts and other loans/advances).

Facility An agreement in which a lender sets out the conditions on which it is prepared to commit to advance a specified amount to a borrower within a defined period.

Gross lending The total value of loans advanced by an institution in a given period.

Loan approvals Lenders' firm offers to advance credit.

Loan to value ratio (LTV) Ratio of outstanding loan amount to the market value of the asset against which the loan is secured (normally residential or commercial property).

London interbank offered rate (Libor) The rate of interest at which banks borrow funds from each other, in marketable size, in the London interbank market.

Major UK lenders Banco Santander, Barclays, HSBC, Lloyds Banking Group, Nationwide and Royal Bank of Scotland.

Monetary financial institutions A statistical grouping comprising banks and building societies.

Mortgage lending Lending to households, secured against the value of their dwellings.

Net lending The difference between gross lending and gross repayments of debt in a given period.

Other specialist lenders Non-bank, non-building society lenders (such as insurance companies or retailers) granting mortgage or consumer credit.

Remortgaging A process whereby borrowers repay their current mortgage in favour of a new one secured on the same property.

Securitisation The process of converting bank loans (most commonly mortgages) or other non-tradable financial instruments into tradable securities (eg bonds).

Swap rate The fixed rate of interest in a swap contract in which floating-rate interest payments are exchanged for fixed-rate interest payments. Swap rates are a key factor in the setting of fixed mortgage rates.

Symbols and conventions

Except where otherwise stated, data are non seasonally adjusted and the source of data in charts is the Bank of England.

On the horizontal axes of graphs, larger ticks denote the first observation within the relevant period, eg data for the first quarter of the year.

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