# Trends in Lending

January 2011

BANK OF ENGLAND

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This quarterly publication presents the Bank of England's assessment of the latest trends in lending to the UK economy.(1) It draws mainly on long-established official data sources, such as the existing monetary and financial statistics collected by the Bank that cover all monetary financial institutions.

These data are supplemented by the results of a new data set, established by the Bank in late 2008, to provide more timely data covering aspects of lending to the UK corporate and household sectors.(2) These data cover the major UK lenders:(3) 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, 45% of the stock of consumer credit, and 75% of the stock of mortgage lending at end-November 2010. In future, key elements of this data set are to be included in the Bank's regular data collections, with data drawn from a wider range of reporters.(4)

These data have provided a useful input to discussions between the major UK 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 network of 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, such as those relating to capital market issuance, or trade credit, are discussed where relevant.

The report covers official data up to November 2010, supplemented by data from the major UK lenders and intelligence gathered up to end-December 2010. Unless stated otherwise, the data reported cover lending in both sterling and foreign currency, expressed in sterling terms. The major UK lenders' data are provided to the Bank on a 'best endeavours' basis. This, together with their relative timeliness, means that they may not be as accurate as the established data sets for monetary financial institutions as a whole. As a result, care is needed in interpreting the major UK lenders' data presented in this report.

(1) This is the first quarterly edition of *Trends in Lending*, which was a monthly publication from April 2009 to October 2010. See www.bankofengland.co.uk/statistics/2011.pdf for details of future publication dates.
(2) For a fuller background please refer to the first edition of *Trends in Lending* available at: www.bankofengland.co.uk/publications/other/monetary/TrendsApril09.pdf.
(3) 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.
(4) For more information see www.bankofengland.co.uk/statistics/ms/articles/art2oct10.pdf.

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# Executive summary

The stock of lending to UK businesses fell in the three months to November. The stock of lending to small and medium-sized businesses continued to contract, but syndicated lending facilities to UK businesses increased. The flow of net mortgage lending by all UK-resident mortgage lenders has remained subdued. Gross mortgage approvals for house purchase fell in December, according to data from the major UK lenders. The flow of net consumer credit was positive in September and October but slightly negative in November. The annual rate of growth edged up over the past three months, but remained low.

Spreads over reference rates on new lending continued to narrow for large businesses in 2010 Q4 according to the Bank of England's *Credit Conditions Survey*, though were reported to have increased for small businesses. Spreads on mortgage lending remained elevated though some major UK lenders reported that competition among lenders at lower loan to value ratios had put some downward pressure on mortgage pricing. Effective interest rates on interest-bearing credit cards, personal loans and overdrafts remained broadly unchanged in the three months to November.

Notwithstanding a reported tightening of wholesale funding conditions over 2010 Q4, credit availability to households and to businesses overall was little changed, according to lenders in the Bank of England's 2010 Q4 *Credit Conditions Survey*. Contacts of the Bank's network of Agents noted that credit conditions for smaller businesses remained tighter than for larger corporates, though there were a few reports of a recent improvement in their access to credit. Demand for credit from businesses and households remained subdued in 2010 Q4, according to the major UK lenders.

# 1 Lending to UK businesses and individuals

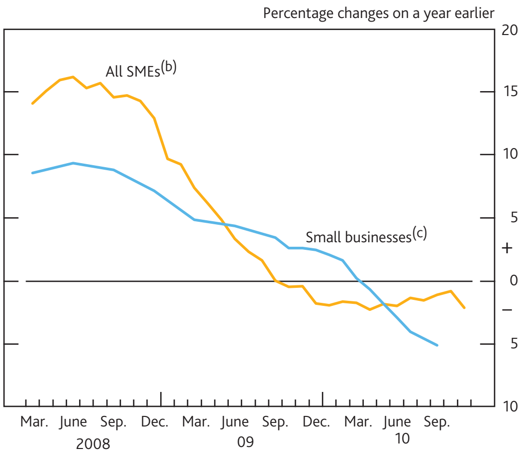
**The stock of lending to UK businesses fell in the three months to November. The stock of lending to small and medium-sized businesses continued to contract, but syndicated lending facilities to UK businesses increased. The flow of net mortgage lending by all UK-resident mortgage lenders has remained subdued. Gross mortgage approvals for house purchase fell in December, according to data from the major UK lenders. The flow of net consumer credit was positive in September and October but slightly negative in November. The annual rate of growth edged up over the past three months, but remained low.**

**Table 1.A** Lending to UK businesses[(a)]

| | Averages | | | | 2010 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 Q1 | 2010 Q2 | July | Aug. | Sep. | Oct. | Nov. |
| Net monthly flow (£ billions) | 7.4 | 3.9 | -3.9 | -3.2 | -2.1 | -2.8 | -0.1 | -3.8 | -2.8 | 1.3 |
| Three-month annualised growth rate (per cent) | 20.9 | 10.7 | -7.6 | -7.0 | -4.5 | -6.0 | -4.7 | -5.1 | -5.2 | -4.1 |
| Twelve-month growth rate (per cent) | 16.8 | 17.9 | -1.8 | -9.3 | -8.2 | -5.8 | -5.6 | -5.7 | -5.5 | -5.1 |

(a) Lending by UK monetary financial institutions to PNFCs. Data cover lending in both sterling and foreign currency, expressed in sterling terms. Seasonally adjusted.

**Chart 1.1** Lending to small and medium-sized enterprises[(a)]




Sources: BBA, BIS and Bank calculations.

(a) Non seasonally adjusted.
(b) Source: monthly BIS survey. Lending by four UK lenders to enterprises with annual bank account debit turnover less than £25 million. Data cover lending in both sterling and foreign currency, expressed in sterling terms.
(c) Source: BBA. Lending by seven UK lenders to commercial businesses with an annual bank account debit turnover of up to £1 million. Sterling only. Available at www.bba.org.uk/statistics/small-business.

This section presents a summary of the recent data on lending to UK businesses and individuals. The annual rate of growth of corporate lending remained negative over the past three months. Growth in the stock of lending to individuals — both secured and unsecured — was positive over the past quarter, though remained weak.

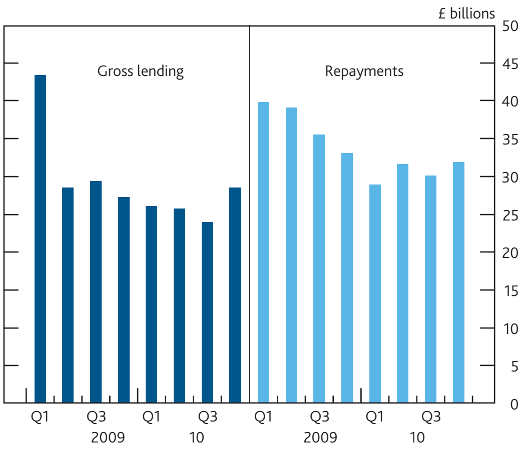
## Lending to UK businesses

Official data covering lending by all UK-resident banks and building societies indicated that the stock of lending to businesses contracted by around £5 billion in the three months to November. A contraction in September and October was partially offset by an increase in November (**Table 1.A**), the first positive monthly figure for net lending since February 2010. Data from the major UK lenders indicated that net lending to businesses was weak in December. In recent discussions, the major UK lenders indicated that the severe weather in December had not materially affected business lending activity, though some applications may have been delayed.

The contraction in lending to businesses overall has also been reflected in key sectors within the total, including lending to small and medium-sized enterprises (SMEs) (**Chart 1.1**).[(1)] The Bank's network of Agents reported that many small firms continued to be focused on repaying bank debt. Looking forward, some major UK lenders anticipated that lending to the SME sector would grow slightly in 2011 as macroeconomic prospects gradually improved. The stock of lending to businesses in the commercial real estate sector has also contracted. In recent discussions, some major UK lenders expected lending activity in the commercial real estate sector to remain low in the coming year and similar to 2010.

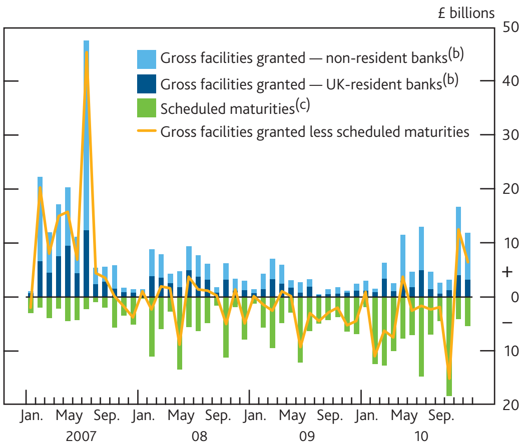
(1) See also the box on 'Lending to small and medium-sized enterprises' in *Trends in Lending*, October 2010, available at www.bankofengland.co.uk/publications/other/monetary/TrendsOctober10.pdf.

**Chart 1.2** Gross lending by and repayments to the major UK lenders[(a)]




(a) Data from the major UK lenders for the flow of gross lending to and repayments by UK PNFCs. Data cover lending and repayments in both sterling and foreign currency, expressed in sterling terms. Non seasonally adjusted.

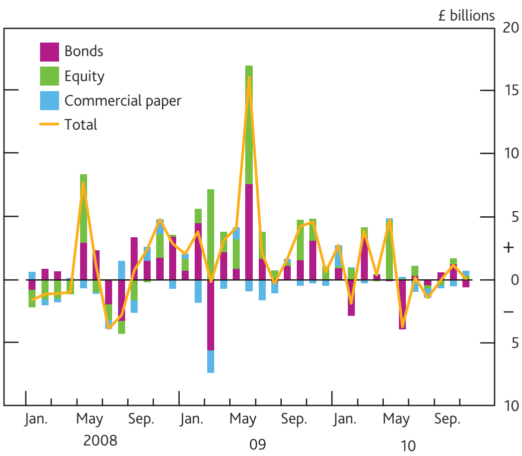
**Chart 1.3** Estimates of syndicated lending facilities granted to UK businesses[(a)]




Sources: Dealogic and Bank calculations.

(a) Defined broadly as PNFCs. Data cover lending facilities in both sterling and foreign currency, expressed in sterling terms. Non seasonally adjusted.
(b) New syndicated lending facilities excluding cancelled or withdrawn facilities. The series have been updated for the cancellation of the BHP Billiton deal referenced in the September 2010 *Trends in Lending*.
(c) Scheduled maturities of syndicated lending facilities excluding cancelled or withdrawn facilities, translated into sterling. Actual maturities will also reflect the effects of refinancing and prepayments, exchange rate changes and other effects.

**Chart 1.4** Net capital market issuance by UK businesses[(a)]




(a) Funds raised by PNFCs from UK capital markets. Data cover funds raised in both sterling and foreign currency, expressed in sterling terms. Non seasonally adjusted.

The decline in the stock of business lending over the past two years is consistent with data from the major UK lenders which indicated that their gross lending has been lower than repayments made to them since 2009 Q2 (**Chart 1.2**). Gross lending by the major UK lenders in 2010 was lower than in 2009. Repayments of debt were also lower than in 2009, though remained higher than gross lending.

In some contrast to this pattern for gross lending by the major UK lenders, the total value of new syndicated lending facilities granted in the UK market doubled in 2010 compared to 2009 (**Chart 1.3**). However, the value of new syndicated lending facilities has remained below the values seen in the period 2003–07. In recent discussions, most major UK lenders attributed much of the syndicated lending activity during 2010 to the refinancing of existing loans, reflecting the scale and maturity of earlier syndicated lending.

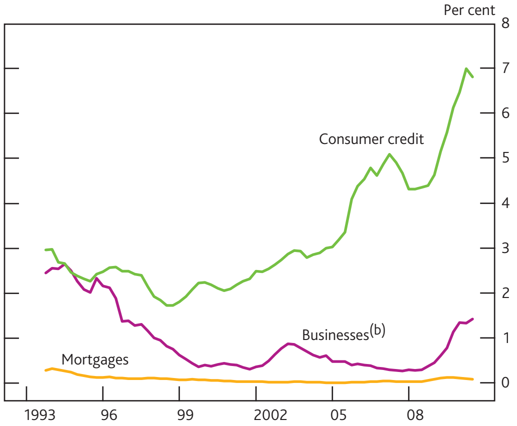
Previous editions of *Trends in Lending* have discussed how proceeds from capital market issuance had been used subsequently by some businesses to repay bank debt. Coincident with the decline in repayments of bank debt in 2010 relative to 2009, net capital market issuance by UK businesses in 2010 was lower than in 2009 (**Chart 1.4**), though similar to its average over 2003–08. Notwithstanding subdued net capital market issuance, a majority of respondents to the *Deloitte CFO Survey* for 2010 Q4 — which covers very large companies — indicated that they still viewed bond issuance as an 'attractive' source of finance, though equity issuance was neither 'attractive' nor 'unattractive'. More generally, debt financing was viewed as an 'attractive' source of funding, with a balance of chief financial officers (CFOs) viewing bank borrowing almost as favourably as bond issuance. A balance of CFOs also viewed the UK corporate sector as currently running appropriate levels of leverage.

That view could partly reflect the recent stability or easing in some indicators of corporate distress. During 2010, the write-off rate — the ratio of banks' write-offs on corporate lending to the stock of that lending — was broadly stable (**Chart 1.5**), with the corporate liquidations rate continuing to fall from its peak in 2009 Q4. Most lenders reported that write-offs in 2010 were below or in line with expectations. Looking forward, there was a range of views on the likely path of write-offs and insolvencies in 2011. However, lenders generally saw upside risks to their projections, particularly for sectors that were likely to be more affected by the fiscal consolidation currently under way in the United Kingdom.

## Secured lending to individuals

The average monthly flow of net sterling mortgage lending by all UK-resident mortgage lenders was £0.7 billion in the three months to November, with the annual rate of growth in the stock of lending stable at around 0.8% (**Table 1.B**). According to data from the major UK lenders, net mortgage lending flows

**Chart 1.5** Write-off rates on lending to UK businesses and individuals(a)



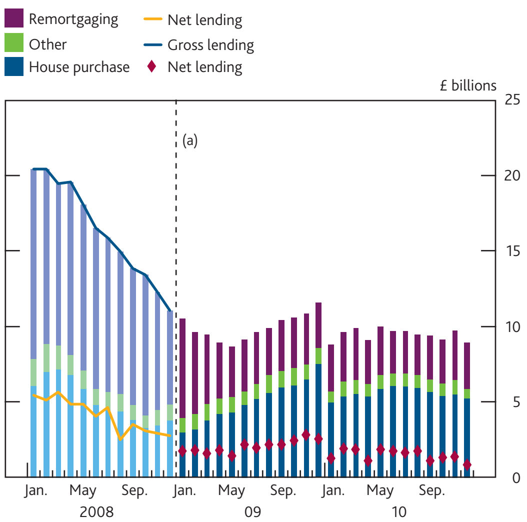

(a) Lending by UK monetary financial institutions. The series are calculated as annualised quarterly write-offs divided by the corresponding loans outstanding at the end of the previous quarter. The data are presented as four-quarter moving averages. Series start in 1993 Q4. Lending in both sterling and foreign currency, expressed in sterling terms. Non seasonally adjusted.
(b) PNFCs.

**Table 1.B** Secured lending to individuals(a)

| | Averages | | | | | 2010 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 Q1 | 2010 Q2 | July | Aug. | Sep. | Oct. | Nov. |
| Net monthly flow (£ billions) | 9.0 | 3.4 | 0.9 | 1.1 | 0.7 | -0.3 | 1.7 | 0.2 | 1.2 | 0.8 |
| Three-month annualised growth rate (per cent) | 10.4 | 4.1 | 0.9 | 1.2 | 0.6 | 0.4 | 0.6 | 0.5 | 1.0 | 0.7 |
| Twelve-month growth rate (per cent) | 11.0 | 6.9 | 1.4 | 0.9 | 0.9 | 0.9 | 0.9 | 0.8 | 0.9 | 0.8 |

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

**Chart 1.6** Mortgage lending by the major UK lenders(a)




(a) The split in 2008 is estimated using gross lending data and the split of loan approval values between house purchase, remortgaging and other advances. The split from 2009 onwards is reported data from the major UK lenders, rather than estimated data. Data cover lending in both sterling and foreign currency, expressed in sterling terms. Seasonally adjusted.

fell in December alongside a decline in total gross lending (**Chart 1.6**).

Data provided by the major UK lenders include a split of gross lending between house purchase and the refinancing of existing mortgages (remortgaging). Gross mortgage lending for house purchase decreased slightly in the three months to December (**Chart 1.6**). Remortgaging activity remained weak, though edged up a little compared to the flows seen in the summer. Some major UK lenders reported that the recent pickup in remortgaging partly reflected competitive deals offered by some lenders. A significant increase in remortgaging was only expected by some major UK lenders when Bank Rate started to rise.

The recent stability in gross lending by the major UK lenders for house purchase was reflected in the data on approvals for house purchase up to November. However, mortgage approvals for house purchase fell in December, according to data from the major UK lenders (**Chart 1.7**). In recent discussions, the major UK lenders indicated that approvals for house purchase were little affected by the severe weather in December, though most lenders reported that applications for house purchase had been affected somewhat.

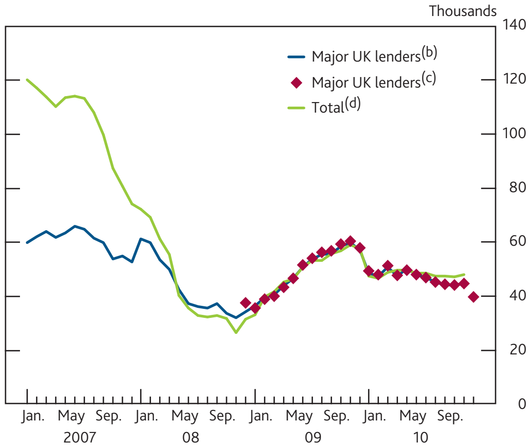
Recent indicators of mortgage distress have either been little changed or have eased slightly. Data from the Council of Mortgage Lenders (CML) indicated that the mortgage arrears rate was broadly unchanged in 2010 Q3 (**Chart 1.8**). The write-off rate on mortgages — the ratio of write-offs on secured loans to the stock of secured lending — was also little changed (**Chart 1.5**). Claims for possessions issued in the courts continued to fall in the year to 2010 Q3 as did the number of properties taken into possession. Arrears on riskier forms of lending extended by some specialist lenders — such as credit-impaired mortgages — continued to fall and arrears on buy-to-let mortgages, which had fallen over the past year, were stable in 2010 Q3.

In recent discussions, some major UK lenders indicated that some indicators of mortgage distress in 2010 had been lower than initially anticipated. Looking forward to 2011, some lenders expected arrears and possessions to be at similar levels to those in 2010, though this view was conditional on a number of assumptions about unemployment, the housing market and the effects of the fiscal consolidation about which there was a high level of uncertainty. The CML predicted a modest increase in arrears and possessions in 2011 whereas the Royal Institution of Chartered Surveyors predicted a slight fall in possessions over the same period.

## Consumer credit

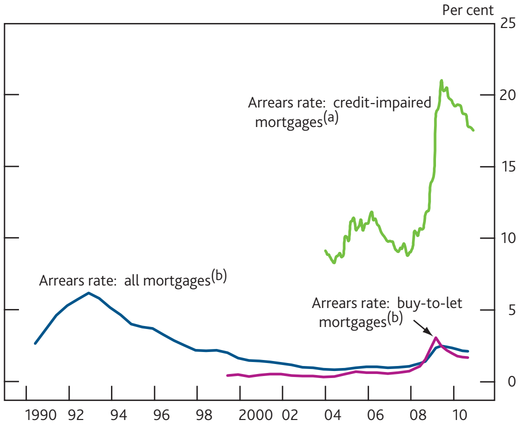
Total net consumer credit flows were positive in September and October (**Table 1.C**). They were slightly negative in November, with repayments increasing by more than gross

## Chart 1.7 Approvals for mortgages for house purchase[(a)]




(a) Seasonally adjusted.
(b) Gross approvals data covering lending in both sterling and euros.
(c) Gross approvals from additional, more timely, data reported by the major UK lenders since late 2008. Data cover lending in all currencies.
(d) UK 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. Data cover lending in sterling only.

## Chart 1.8 Arrears rates: buy-to-let, credit-impaired and the wider mortgage market




Sources: Moody's Investors Service, as provided by Moody's Analytics, CML and Bank calculations.

(a) Series are extracted from the Moody's report *UK Non-Conforming RMBS Indices*, 12 January 2011. Moody's delinquency rate data are monthly, available from January 2004. Data cover securitised non-conforming mortgages only. The delinquency rate shows the proportion of mortgages in arrears of 90 days or more. Data are to end-December 2010. Non seasonally adjusted.
(b) CML arrears data are semi-annual up to end-2007 and quarterly since then. Data for all mortgages are estimated prior to 1994 H2. The arrears rate shows the proportion of mortgages over three months in arrears. Buy-to-let arrears exclude cases where a receiver of rent has been appointed. Data are to 2010 Q3. Non seasonally adjusted.

## Table 1.C Consumer credit[(a)]

| | Averages | | | | | 2010 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 Q1 | 2010 Q2 | July | Aug. | Sep. | Oct. | Nov. |
| Net monthly flow (£ billions) | 1.1 | 0.9 | -0.1 | 0.3 | 0.1 | 0.1 | -0.2 | 0.1 | 0.3 | -0.1 |
| Three-month annualised growth rate (per cent) | 6.5 | 5.2 | -0.2 | 1.1 | 0.7 | 0.6 | -0.4 | -0.1 | 0.3 | 0.4 |
| Twelve-month growth rate (per cent) | 6.1 | 6.3 | 1.7 | -0.1 | 0.0 | 0.1 | 0.1 | 0.2 | 0.6 | 0.6 |

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

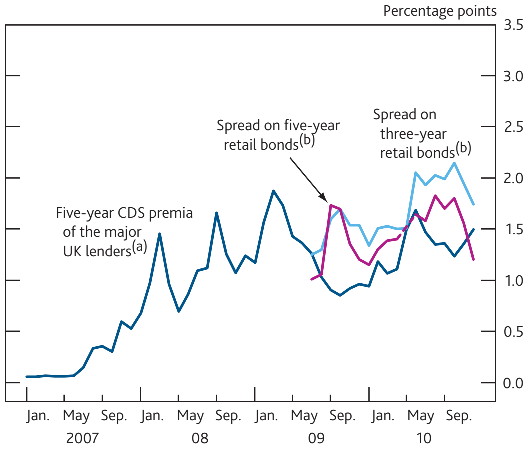
lending. The annual rate of growth picked up in October and November to 0.6%, the highest rate seen since September 2009, though remaining low. Within the total, net credit card lending flows remained positive over the past three months. By contrast, non credit card lending continued to contract. Net lending flows for consumer credit were weak in December, according to the major UK lenders.

The write-off rate on consumer credit fell slightly in 2010 Q3 (**Chart 1.5**), and the rate of personal insolvencies in England and Wales fell for the second successive quarter. Some major UK lenders expected these indicators to be at broadly similar levels in 2011, with the risk of some upward pressure from possible effects on incomes of fiscal consolidation.

# 2 Loan pricing

**Spreads over reference rates on new lending continued to narrow for large businesses in 2010 Q4 according to the Bank of England's *Credit Conditions Survey*, though were reported to have increased for small businesses. Spreads on mortgage lending remained elevated though some major UK lenders reported that competition among lenders at lower loan to value ratios had put some downward pressure on mortgage pricing. Effective interest rates on interest-bearing credit cards, personal loans and overdrafts remained broadly unchanged in the three months to November.**

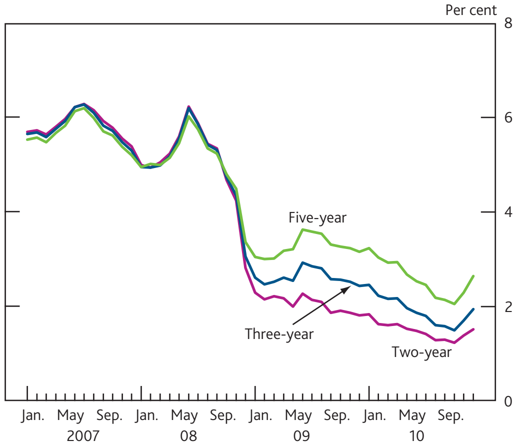
**Chart 2.1** Indicative long-term funding spreads




Sources: Markit Group Limited, Bank of England and Bank calculations.

(a) The spread on long-term wholesale bonds is proxied by an unweighted average of the five-year CDS premia of the major UK lenders.
(b) Sterling only. Spread over the relevant swap rate. The three-year and five-year retail bond rates are weighted averages of rates from banks and building societies within the Bank of England's normal quoted rate sample with products meeting the specific criteria (see www.bankofengland.co.uk/mfsd/iadb/notesiadb/household_int.htm). The series for the five-year bond is not published for May 2010 as only two or fewer institutions in the sample offered products in that period.

**Chart 2.2** Swap rates at different maturities[a]




Sources: Bloomberg and Bank calculations.

(a) Swap rates are monthly averages of daily data.

This section discusses recent developments in loan pricing for businesses and individuals, based on statistical data, survey evidence and discussions with the major UK lenders.

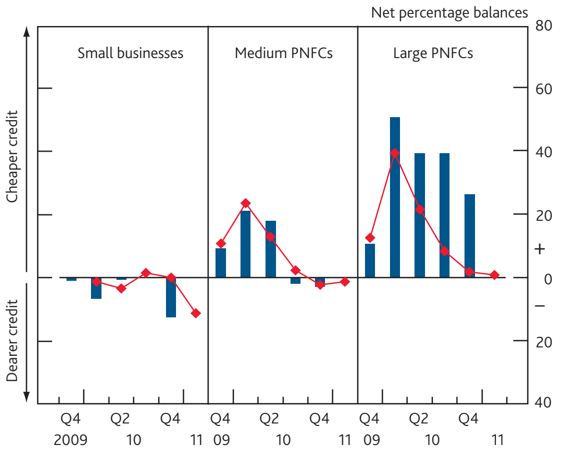
The total cost of bank finance to a company or individuals can generally be decomposed into the fees charged by the lender to provide loan facilities, the spread over a given reference rate (such as three-month Libor or Bank Rate) at which loans are offered, and the prevailing level of that reference rate in the financial markets.

Previous editions of *Trends in Lending* have discussed the increase in spreads over reference rates on new lending since the start of the financial crisis. To some extent, elevated spreads reflect heightened credit risk and a repricing of risk. But they are also likely to reflect the relatively high cost to lenders of raising longer-term funding.

Conditions in longer-term wholesale funding markets had improved in the first half of 2010 Q4, according to the major UK lenders, but tightened in the latter part of the quarter. An indicative measure of the spread on wholesale bonds — the five-year CDS premia of the major UK lenders — fell in October and November though remained elevated and picked up in December (**Chart 2.1**). Some major UK lenders reported that issuance had rebounded strongly in early January, though concerns remained about peripheral European sovereign risk. A box on pages 11–12 looks more closely at recent developments in funding volumes using statistical data collected by the Bank of England.

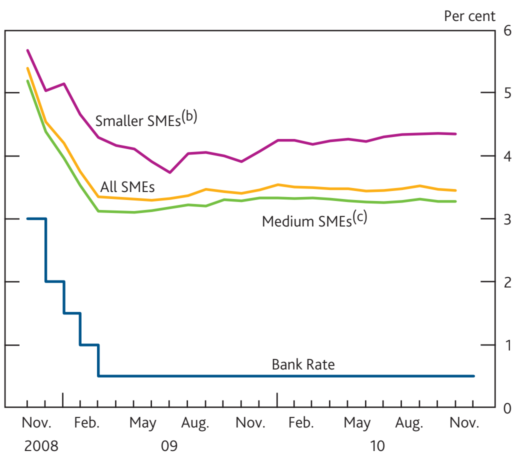
Spreads over reference rates on longer-term retail deposits — such as those over equivalent-maturity swap rates for three and five-year fixed-rate bonds — have fallen back sharply over the past couple of months (**Chart 2.1**). That has reflected increases in swap rates seen during this period (**Chart 2.2**), with rates offered on longer-term retail bonds little changed. In recent discussions, lenders reported that competition in the retail funding market remained intense.

**Chart 2.3** *Credit Conditions Survey*: spreads over reference rates on lending to corporates by firm size(a)(b)




(a) Net percentage balances are calculated by weighting together the responses of those lenders who answered the question. 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 one quarter so that they can be compared with the actual outturns in the following quarter.
(b) A positive balance indicates that spreads over reference rates have become narrower, such that all else being equal, it is cheaper for corporates to borrow.

**Chart 2.4** Indicative median interest rates on new SME variable-rate facilities provided by the major UK lenders(a)




Sources: BIS and Bank calculations.

(a) Median by value of new SME facilities priced at margins over base rates, by four major lenders. Data cover lending in both sterling and foreign currency, expressed in sterling terms. Non seasonally adjusted.
(b) SMEs with annual bank account debit turnover under £1 million.
(c) SMEs with annual bank account debit turnover £1 million to £25 million.

## Corporate loan pricing

Spreads over reference rates on new lending continued to narrow for large businesses in 2010 Q4 according to the Bank of England's *Credit Conditions Survey* (**Chart 2.3**), with fees and commissions also reported to have fallen. A balance of respondents in the *Deloitte CFO Survey* for 2010 Q4 reported that the cost of new credit was lower than at any time since 2007 Q3. But contacts of the Bank's network of Agents reported that recent improvements in terms of credit were mostly restricted to larger companies and that the cost of finance, compared to Bank Rate, for these businesses remained significantly higher than its pre-crisis level.

Consistent with that, respondents in the *Credit Conditions Survey* indicated that spreads on lending to medium-sized businesses were broadly unchanged in 2010 Q4, though fees and commissions were reported to have fallen. For small businesses, lenders in the *Credit Conditions Survey* reported that spreads, fees and commissions had risen in 2010 Q4. Indicative median interest rates and spreads on new facilities to small and medium-sized enterprises remained broadly unchanged in recent months, according to survey data from the Department for Business, Innovation and Skills (**Chart 2.4**).

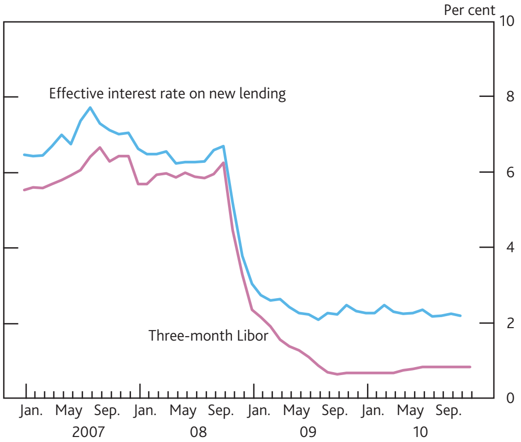
Looking forward, respondents to the *Credit Conditions Survey* did not expect spreads for larger companies to fall further in the coming quarter. Spreads were expected to widen for small businesses and remain unchanged for medium-sized businesses.

The effective interest rate on new borrowing for businesses overall, which may include new lending on facilities arranged earlier at low pre-crisis rates, was broadly unchanged in the three months to November (**Chart 2.5**). In recent discussions, most major UK lenders expected loan pricing across business sizes to remain broadly similar in 2011 to that in 2010, but noted risks on the upside from funding costs.

## Mortgage pricing

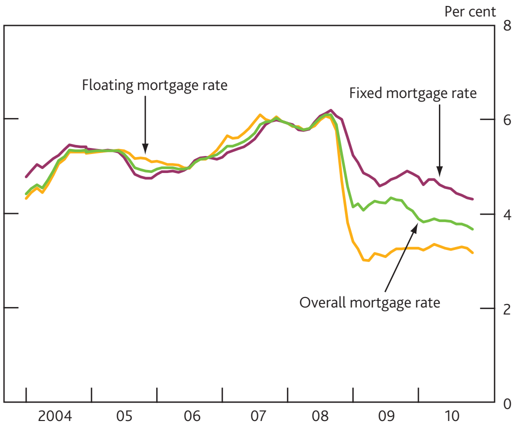
The Bank's measure of the effective floating mortgage rate on new lending has remained broadly unchanged since the start of 2010 (**Chart 2.6**). In contrast, the Bank's measure of the effective new fixed mortgage rate has fallen over this period, which the major UK lenders reported primarily reflected a fall in swap rates earlier in the year (**Chart 2.2**). Similar to the effective new fixed mortgage rate, the Bank's measures of quoted rates on fixed-rate mortgages have also fallen since the start of 2010, with the five-year fixed mortgage rate at 75% LTV ratio falling by around 80 basis points in 2010. In recent discussions, some major UK lenders indicated that the recent rise in swap rates was starting to put upwards pressure on fixed mortgage rates. More generally, spreads over reference rates have remained elevated, partly reflecting longer-term funding costs.

**Chart 2.5** Effective interest rate on new lending to UK businesses[(a)]



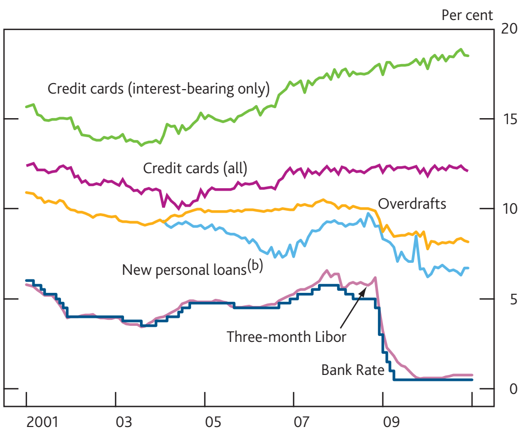

(a) PNFCs. Sterling only. The Bank's effective interest rates series are currently compiled using data from 23 UK monetary financial institutions. Data for three-month Libor are to end-December and for the effective rate to end-November. Non seasonally adjusted.

**Chart 2.6** Effective rates on new mortgage lending[(a)]




(a) Sterling only. The Bank's effective interest rates series are currently compiled using data from 23 UK monetary financial institutions. Non seasonally adjusted.

**Chart 2.7** Effective interest rates on consumer credit[(a)]




(a) Sterling only. The Bank's effective interest rates series are currently compiled using data from 23 UK monetary financial institutions. 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. Data for Bank Rate and three-month Libor are to end-December and for effective rates to end-November. Non seasonally adjusted.
(b) Only available from January 2004.

In recent discussions, some major UK lenders reported that, overall, competition among lenders at lower LTV ratios had continued to put some downward pressure on mortgage pricing. Respondents to the 2010 Q4 *Credit Conditions Survey* reported that spreads on total new secured lending had fallen over the quarter, particularly for prime lending, and expected spreads to remain broadly unchanged in 2011 Q1.

## Consumer credit pricing

Effective interest rates on interest-bearing credit cards, personal loans and overdrafts remained broadly unchanged in the three months to November (**Chart 2.7**). Respondents to the 2010 Q4 *Credit Conditions Survey* reported that spreads on credit card lending were broadly unchanged over the previous three months, while spreads on non credit card lending had fallen. More generally, spreads between effective interest rates and Bank Rate and Libor for consumer credit as a whole remain significantly wider than in late 2008, which lenders report partly reflects heightened credit risk on this form of lending. Lenders in the *Credit Conditions Survey* expected that spreads on overall unsecured lending would rise a little in 2011 Q1.

## Recent trends in funding

Banks and building societies fund their lending activities from a range of sources. In recent discussions, lenders have noted a trend towards increased diversification in funding across instruments, counterparts and currencies. This box looks at recent developments in funding informed by both the Bank of England's statistical data and intelligence from the major UK lenders.

All UK-resident monetary financial institutions[(1)] (MFIs) report balance sheet information to the Bank. These data on their assets and liabilities can be viewed in a number of different ways: for example by instrument, counterpart and currency;[(2)] and for liabilities, divided into retail and wholesale constituents.[(3)] For example, **Table 1** shows their liabilities broken down by component instrument.

**Table 1** MFIs' liabilities — amounts outstanding[(a)]

£ trillions

| | Monthly averages | | | November | | |
|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010[(b)] | 2008 | 2009 | 2010 |
| Sight and time deposits | 5.0 | 5.2 | 5.3 | 5.4 | 5.2 | 5.2 |
| Repurchase agreements | 1.3 | 1.0 | 1.1 | 1.2 | 1.1 | 1.1 |
| CDs and CP[(c)] | 0.4 | 0.4 | 0.3 | 0.3 | 0.4 | 0.3 |
| Bonds with original maturity ≤ five years | 0.3 | 0.4 | 0.4 | 0.3 | 0.4 | 0.4 |
| Bonds with original maturity > five years | 0.2 | 0.2 | 0.3 | 0.2 | 0.2 | 0.3 |
| Other[(d)] | 0.8 | 0.8 | 0.9 | 0.8 | 0.9 | 0.9 |
| **Total** | **7.9** | **8.0** | **8.3** | **8.2** | **8.2** | **8.2** |

(a) Data cover liabilities in both sterling and foreign currency, expressed in sterling terms. UK monetary financial institutions' liabilities, end-month amounts outstanding. Non seasonally adjusted.
(b) 2010 averages are for January to November only.
(c) Certificates of deposit (CDs) and commercial paper (CP).
(d) Includes acceptances granted, accrued amounts payable, capital and other internal funds, cash-loaded cards (sterling only), items in suspense and transmission, net derivative positions and notes outstanding (sterling only).

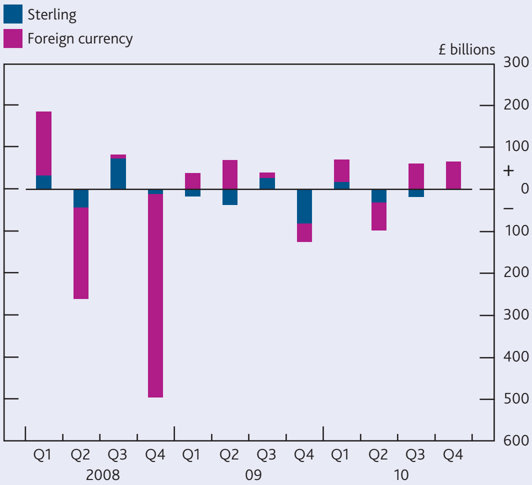
Prior to the financial crisis, MFIs were able to rely for part of their wholesale funding requirements on short-dated unsecured borrowing and the securitisation market. The crisis, and associated regulatory developments,[(4)] have resulted in a general reduction in appetite for unsecured exposures and securitisation markets have only partially reopened. In recent discussions, some major UK lenders reported that in response to the reduced availability of funding from these sources an ongoing diversification is under way across instruments, counterparts and currencies. This trend was expected to continue into 2011 as lenders search globally for pools of liquidity that can be tapped to provide funding.

In recent articles in the *Quarterly Bulletin*[(5)] and the *Financial Stability Report*[(6)] the Bank discussed innovations in funding instruments used by MFIs. Prominent among these have been long-dated and extendible (or evergreen) repurchase agreements and putable certificates of deposit (putable CDs).

Some major UK lenders reported that they were active in long-dated and extendible repurchase agreements in 2010 and expected to remain so in 2011. For some of the major UK lenders, possible concentrations of refinancing risks from putable CDs — for example if an adverse market event were to trigger widespread exercising of the put option among investors — were seen as a constraint on issuance of this instrument. Generally, lenders said that liabilities incurred in these instruments remained limited as a share of their overall liabilities.

As well as diversifying funding through new or revived instruments, the major lenders have also reported diversification across counterparts and currencies. In addition to core issuance in sterling, US dollar and euro, they reported that there had been increased issuance — some of it longer-term — in other currencies including Australian, Canadian and Singapore dollar, Swiss franc, Mexican peso and Japanese yen. For some lenders, issuance outside their established range of foreign currencies provided a route for complementing core funding, while for others it was to enable them to move towards a closer match of the currency composition of assets and liabilities. In line with lenders' comments, MFIs' net foreign currency issuance in 2010 H2 was positive, with net sterling issuance close to zero (**Chart A**).

**Chart A** MFIs' liabilities (repurchase agreements, CDs and CP) — net flows by currency[(a)]

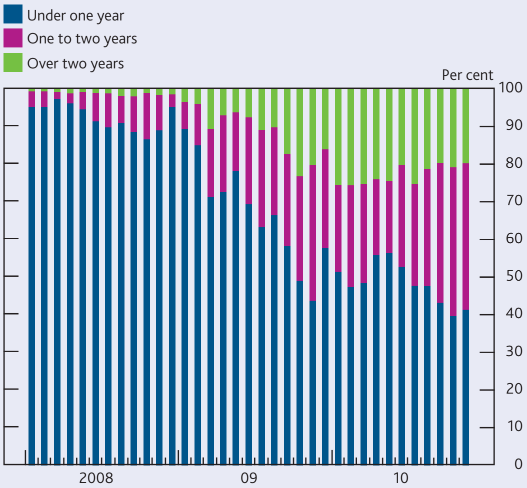



(a) Data cover liabilities in both sterling and foreign currency, expressed in sterling terms. UK monetary financial institutions. For 2010 Q4, data are available for October and November only. Non seasonally adjusted.

Lenders secure funding across a range of counterparts. Typically these include: depositors (households, businesses and other lenders); conventional asset managers such as life, pension and insurance funds; and money market mutual funds. The major lenders reported that over the past year or so there had been an effort to broaden the range of counterparts, for example to include investors such as smaller non-resident banks and high net worth individuals. More generally, private placements were reported to have been a large part of some lenders' funding in 2010.

As shown in **Table 1**, a substantial proportion of MFIs' liabilities are deposits. Retail deposits[7] can be broken down into sight and time deposits.[8] Focusing on fixed-rate retail time deposits, **Chart B** shows that in recent months depositors have increasingly favoured products with a maturity of one year or more. Some major UK lenders indicated that this was a result of the ongoing search for yield by retail depositors and that demand for longer-term fixed-rate retail deposits could be expected to remain relatively strong while short rates remain at low levels.

Chart B New fixed-rate retail time deposits — by maturity[a]




(a) Sterling only. Gross new business balances on fixed-rate retail time deposits expressed as a percentage of the total. Currently compiled using data from 23 UK monetary financial institutions. From January 2010 onwards, building society balances are included. Non seasonally adjusted.

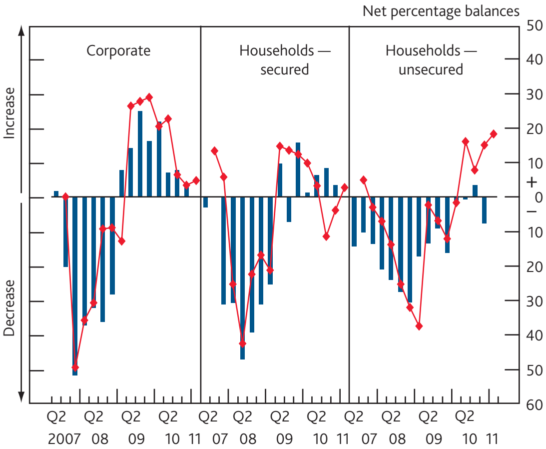
Most recently, some lenders noted that following a marked slowdown in wholesale issuance in late 2010, issuance had picked up strongly in the first weeks of January. Issuance was said by some lenders to have been concentrated in covered bonds, in part reflecting investor concerns about proposals for 'bail-in' of senior unsecured debt. More generally a number of lenders reported that they continued to seek to extend the maturity of their funding, notwithstanding earlier increases during 2010.[9]

(1) In the United Kingdom this comprises banks and building societies.
(2) See *Bankstats* table B1.4 available at www.bankofengland.co.uk/statistics/bankstats/current/tabb1.4.xls.
(3) Retail liabilities — typically deposits — are defined as those which arise from customers' acceptance of an advertised rate for a particular product; usually retail deposits will be taken in MFIs' branch networks or in equivalent telephone or on-line transactions. Wholesale deposits are more closely related to money market operations and typically entail customers being offered a specific rate for a particular size deposit for a given period.
(4) For example see: Financial Services Authority (2008), 'Strengthening liquidity standards', *Consultation Paper 08/22*. Available at www.fsa.gov.uk/pubs/cp/cp08_22.pdf.
(5) See pages 168–69 at www.bankofengland.co.uk/publications/quarterlybulletin/qb1003.pdf and pages 254–56 at www.bankofengland.co.uk/publications/quarterlybulletin/qb1004.pdf.
(6) See pages 38–39 at www.bankofengland.co.uk/publications/fsr/2010/fsrfull1012.pdf.
(7) See footnote (3).
(8) Sight deposits are those, whether interest bearing or not, for which the entire balance is accessible without penalty on demand or by the close of business on the day following that on which the deposit was made. All deposits not classified as sight deposits are time deposits.
(9) See also December 2010 *Financial Stability Report*, page 37 at www.bankofengland.co.uk/publications/fsr/2010/fsrfull1012.pdf.

# 3 Credit supply and demand

Notwithstanding a reported tightening of wholesale funding conditions over 2010 Q4, credit availability to households and to businesses overall was little changed, according to lenders in the Bank of England's 2010 Q4 *Credit Conditions Survey*. Contacts of the Bank's network of Agents noted that credit conditions for smaller businesses remained tighter than for larger corporates, though there were a few reports of a recent improvement in their access to credit. Demand for credit from businesses and households remained subdued in 2010 Q4, according to the major UK lenders.

**Chart 3.1** *Credit Conditions Survey*: availability of credit[(a)(b)]




(a) See footnote (a) to **Chart 2.3**.
(b) A positive balance indicates that more credit is available.

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 difficult though survey data can help. This section looks at recent trends in credit supply and demand, drawing on surveys, reports from the Bank's network of Agents and discussions with the major UK lenders.(1)

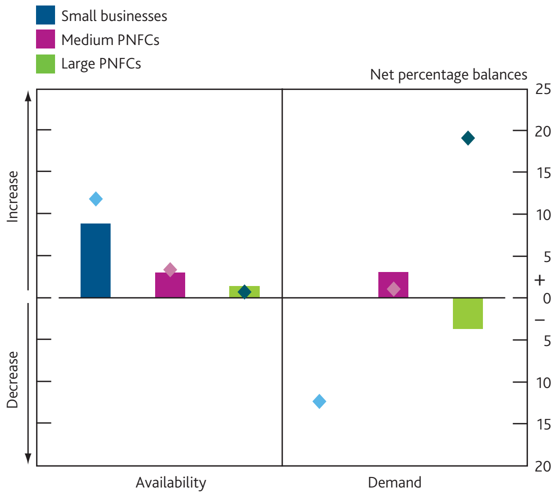
The availability of credit is likely to be affected by conditions in markets used by lenders to fund their activities. Notwithstanding a reported tightening of wholesale funding conditions over 2010 Q4, credit availability to households and to businesses overall was little changed, according to lenders in the Bank of England's 2010 Q4 *Credit Conditions Survey* (**Chart 3.1**). Demand for credit from businesses and households remained subdued in 2010 Q4, according to the major UK lenders.

## Credit conditions for businesses

Credit availability for businesses overall remained broadly unchanged during 2010 Q4, having eased over the year as a whole, according to respondents to the *Credit Conditions Survey*. Within that, respondents reported that credit availability had increased slightly for small businesses (**Chart 3.2**). Contacts of the Bank's Agents noted that credit conditions for smaller businesses remained tighter than for larger corporates, though there were a few reports of a recent improvement in their access to credit. The Bank's Agents continued to hear that credit conditions were improving for large firms, with many contacts reporting that the availability of credit had returned to a level that might broadly be considered 'normal', albeit tighter than had prevailed in the

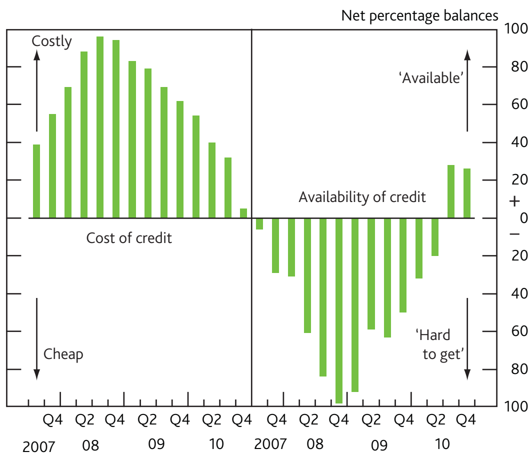
(1) See also Bell, V and Young, G (2010), 'Understanding the weakness of bank lending', *Bank of England Quarterly Bulletin*, Vol. 50, No. 4, pages 311–20, which reviews the available evidence on the relative importance of the supply and demand for credit in explaining the weakness of bank lending since mid-2007. Available at www.bankofengland.co.uk/publications/quarterlybulletin/qb100406.pdf.

**Chart 3.2** *Credit Conditions Survey*: availability and demand for credit across firm sizes reported in the 2010 Q4 survey(a)(b)




(a) Net percentages are calculated by weighting together the responses of those lenders who answered the question. The bars in the chart show the net percentage balance reported over the three months to early December. The diamonds show the associated expectations for the next three months.
(b) In the first panel, a positive balance indicates that more credit is available. In the second panel, a positive balance indicates an increase in demand.

**Chart 3.3** *Deloitte CFO Survey*: cost and availability of credit(a)




Source: *Deloitte CFO Survey* 2010 Q4.

(a) Net percentages for the cost of credit are calculated as the percentage of respondents reporting that bank credit is costly less the percentage reporting that it is cheap. Net percentages for the availability of credit are calculated as the percentage of respondents reporting that credit is available less the percentage of respondents reporting that it is 'hard to get'. A positive balance indicates that a net balance of respondents report that credit is costly or there is availability of credit.

run-up to the recession. For very large companies, a balance of respondents in the *Deloitte CFO Survey* 2010 Q4 reported that credit continued to be 'available' for the second consecutive quarter (**Chart 3.3**). Looking forward, credit availability to small businesses was expected to increase in 2011 Q1, but to be broadly unchanged for medium and large businesses, according to the *Credit Conditions Survey*.

In recent discussions, the major UK lenders reported that demand for new lending remained subdued. Lenders in the *Credit Conditions Survey* in 2010 Q4 reported that demand for credit was broadly unchanged across size of business (**Chart 3.2**). Demand from small businesses was expected to fall in 2011 Q1, with demand from medium-sized businesses expected to be little changed and demand from large businesses to increase (**Chart 3.2**). More generally, most major UK lenders expected corporate credit conditions to be broadly unchanged in 2011, though some lenders highlighted risks including the impact from fiscal consolidation, regulatory changes and higher cost of funding.

## Credit conditions for households

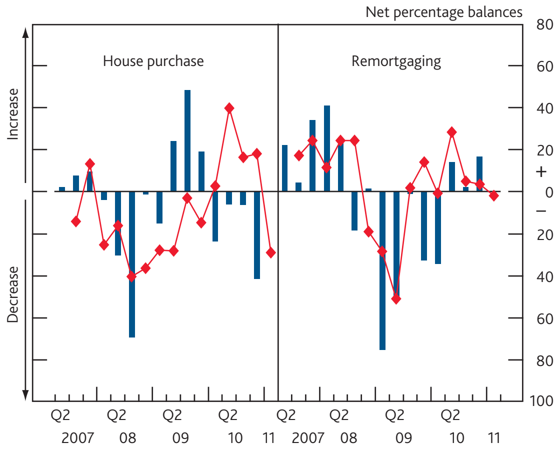
As with business lending, the amount of new secured credit made available to households was little changed over 2010 Q4, according to the *Credit Conditions Survey* (**Chart 3.1**). Respondents also expected the availability of secured lending to be broadly unchanged in 2011 Q1. The availability of new secured lending at LTV ratios greater than 75% had decreased slightly in 2010 Q4, while the availability of new lending at low LTV ratios had increased.

Household demand for secured lending for house purchase was reported to have fallen unexpectedly and markedly in 2010 Q4, according to the *Credit Conditions Survey* (**Chart 3.4**) and was expected to fall further over the next three months. The Royal Institution of Chartered Surveyors' new buyer enquiries balance remained negative over the past three months, indicating a weakening in demand for house purchase.

Contacts of the Bank's Agents reported that access to credit, particularly for first-time buyers, continued to weigh on demand for house purchase. In recent discussions, the major UK lenders reported that housing market activity remained subdued, partly reflecting a weakening of house prices and potential impacts on incomes from fiscal consolidation. The major UK lenders expected both housing market activity and gross lending for house purchase to be broadly flat in 2011, with house prices expected to be little changed or to decline slightly over that period.

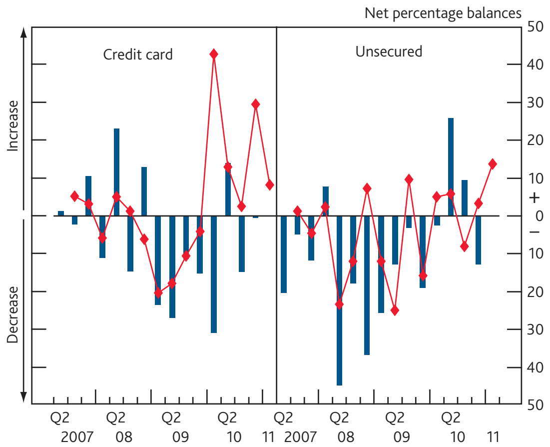
In some contrast to secured lending, total demand for consumer credit was broadly unchanged in 2010 Q4 according to a balance of respondents to the *Credit Conditions Survey*. Within the total however, both demand for credit card borrowing and for other unsecured loans was weaker than

Chart 3.4 *Credit Conditions Survey*: demand for household secured lending(a)(b)




(a) See footnote (a) to **Chart 2.3**.
(b) A positive balance indicates an increase in demand.

Chart 3.5 *Credit Conditions Survey*: demand for household unsecured lending(a)(b)




(a) See footnote (a) to **Chart 2.3**.
(b) A positive balance indicates an increase in demand.

expected (**Chart 3.5**). Lenders expected total demand for consumer credit to increase in 2011 Q1.

On credit availability, respondents to the *Credit Conditions Survey* reported that the amount of unsecured credit made available to households fell in 2010 Q4 (**Chart 3.1**), but was expected to increase in 2011 Q1. Lenders reported that lower risk appetite had limited availability in 2010 Q4. Credit-scoring criteria were reported to have tightened again over the past quarter, though for the first time since 2007 Q2 credit-scoring criteria on other unsecured loan applications were expected to loosen in 2011 Q1. For 2011 overall, most major UK lenders expected total consumer credit flows to be broadly similar to those seen in 2010.

## Abbreviations

**BBA** — British Bankers' Association.
**BIS** — Department for Business, Innovation and Skills.
**CD** — certificate of deposit.
**CDS** — credit default swap.
**CFO** — chief financial officer.
**CP** — commercial paper.
**CML** — Council of Mortgage Lenders.
**Libor** — London interbank offered rate (see below).
**LTV ratio** — loan to value ratio (see below).
**MFIs** — monetary financial institutions (see below).
**PNFCs** — private non-financial corporations (see below).
**SMEs** — small and medium-sized enterprises.

## Glossary

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

**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).

**Effective interest rates** The weighted average of calculated interest rates on various types of sterling deposit and loan accounts. The calculated annual rate is derived from the deposit or loan interest flow during the period, divided by the average stock of deposit or loan during the period.

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

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

**Loan approvals** Lenders' firm offers to advance credit.

**Loan to value (LTV) ratio** 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 (MFIs)** 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.

**Private non-financial corporations (PNFCs)** All corporations whose primary activity is non-financial, and that are not controlled by central or local government.

**Reference rate** The rate on which loans are set, with an agreed margin over the reference rate (typically this will be Bank Rate, Libor or a swap rate).

**Remortgaging** A process whereby borrowers repay their current mortgage in favour of a new one secured on the same property. A remortgage would represent the financing of an existing property by a different mortgage lender.

**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 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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