Credit Conditions Review

2015 Q2

BANK OF ENGLAND

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This quarterly publication presents the Bank of England's assessment of the latest developments in bank funding conditions and household and corporate credit. It draws mainly on long-established official data sources, such as the existing monetary and other financial statistics collected by the Bank, and other data sources such as surveys of businesses and data from other organisations. The analysis also draws on the results of the Bank of England's *Bank Liabilities Survey* and *Credit Conditions Survey*.(1)

These data are supplemented by discussions between Bank staff and the major UK lenders and this intelligence is reflected in the report. The major UK lenders(2) are Banco Santander, Barclays, HSBC, Lloyds Banking Group, Nationwide and Royal Bank of Scotland and together they accounted for around 75% of the stock of mortgage lending, 50% of the stock of consumer credit (excluding student loans), and 70% of the stock of lending to businesses at end-March 2015. The report also draws on intelligence gathered by the Bank's network of Agents and from market contacts.

The report covers data and intelligence gathered up to end-June 2015. Unless stated otherwise, the data reported cover lending in both sterling and foreign currency, expressed in sterling.

The quarterly *Credit Conditions Review* replaces the Bank of England's *Trends in Lending* publication.(3) For more details, see the box on page 1 in *Trends in Lending* April 2015, available at www.bankofengland.co.uk/publications/Documents/other/monetary/trendsapril15.pdf.

The publication date for the *Credit Conditions Review* 2015 Q3 is 13 October 2015.

(1) The *Bank Liabilities Survey* and the *Credit Conditions Survey* for 2015 Q2 were conducted between 22 May and 12 June 2015. These surveys can be found at www.bankofengland.co.uk/publications/Pages/other/monetary/bls/default.aspx and www.bankofengland.co.uk/publications/Pages/other/monetary/creditconditions.aspx.
(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.
(3) Previous editions of *Trends in Lending* are available on the Bank's website at www.bankofengland.co.uk/publications/Pages/other/monetary/trendsinlending.aspx.

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Longer-term wholesale funding costs for UK banks increased in 2015 Q2, but remained low. Reflecting this, transfer prices rose slightly in Q2, having fallen in each quarter since 2013 Q3, according to respondents to the *Bank Liabilities Survey*. Retail funding spreads fell slightly. Issuance of wholesale term funding in 2015 Q2 was a little lower than in the previous quarter. Retail deposit growth was steady. Respondents to the *Bank Liabilities Survey* expected their total funding volumes to increase slightly in Q3.

Mortgage approvals for house purchase were higher in April and May than the average in Q1 and the net flow of mortgage lending increased slightly in the three months to May. This is consistent with the increase in demand for secured lending reported in the 2015 Q2 *Credit Conditions Survey*. Mortgage rates fell slightly further and remained at historically low levels. Unsecured credit continued to grow robustly.

Growth in the stock of lending to UK businesses picked up in 2015 to date. And net finance raised by UK businesses, which also includes funds raised in capital markets, was positive. The pickup in corporate borrowing is likely to reflect the improvement in the availability of credit since late 2012. Demand for credit from small and large companies also increased in 2015 Q2, according to respondents to the *Credit Conditions Survey*. Some surveys suggested that the overall level of demand for bank lending from small and medium-sized enterprises, however, remained subdued.

1 Bank funding

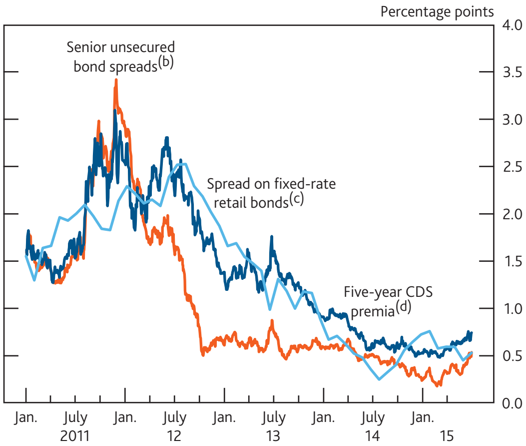
Longer-term wholesale funding costs for UK banks increased in 2015 Q2, but remained low. Reflecting this, transfer prices rose slightly in Q2, having fallen in each quarter since 2013 Q3, according to respondents to the *Bank Liabilities Survey*. Retail funding spreads fell slightly. Issuance of wholesale term funding in 2015 Q2 was a little lower than in the previous quarter. Retail deposit growth was steady. Respondents to the *Bank Liabilities Survey* expected their total funding volumes to increase slightly in Q3.

Chart 1.1 Swap rates at different maturities[(a)]

Sources: Bloomberg and Bank calculations.

(a) Data are to end-June 2015. Sterling Libor swap rates. Swap rates are monthly averages of daily data.

Chart 1.2 Indicative long-term funding spreads[(a)]



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

(a) Data are to end-June 2015.
(b) Constant-maturity unweighted average of secondary market spreads to mid-swaps for the major UK lenders' five-year euro senior unsecured bonds or a suitable proxy when unavailable.
(c) Unweighted average of spreads for two-year and three-year sterling fixed-rate retail bonds over equivalent-maturity swaps. Bond rates are end-month rates and swap rates are monthly averages of daily rates.
(d) Unweighted average of the five-year euro senior CDS premia for the major UK lenders.

Funding costs and transfer prices

The cost of bank funding influences the interest rates charged to households and corporates.[(1)] It can generally be decomposed into the spread over a given reference rate (such as swap rates), and the prevailing level of that reference rate in financial markets.

Swap rates increased slightly in 2015 Q2 (**Chart 1.1**). Two and three-year swap rates were around 10 basis points higher, on average, in Q2 than in Q1. Five-year swap rates rose by a little more.

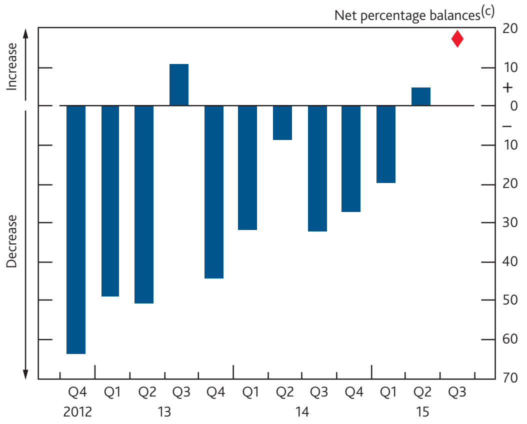
There was a slight increase in indicative measures of banks' wholesale funding spreads in Q2, such as those on senior unsecured bonds trading in the secondary market, although they continued to be at low levels (**Chart 1.2**). In recent discussions, some major UK lenders attributed the slight widening in spreads partly to risks in relation to Greece and its financing needs. They also noted a rise in new issue premia — the cost an issuer typically pays in addition to those implied by secondary market prices in order to attract investors when issuing new debt. The combination of these changes and moves in swap rates meant longer-term wholesale funding costs for UK banks increased in Q2, but remained low.

By contrast, spreads on fixed-rate retail bonds fell slightly in Q2 (**Chart 1.2**). Respondents to the Bank of England's *Bank Liabilities Survey* (*BLS*) expected spreads on retail funding to fall further in Q3.

A bank's transfer price is the marginal absolute cost charged internally to business units for obtaining funding from the

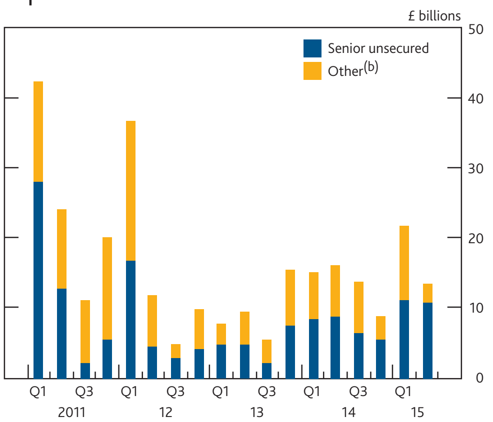
(1) See Beau, E, Hill, J, Hussain, T, and Nixon, D (2014), 'Bank funding costs: what are they, what determines them and why do they matter?', *Bank of England Quarterly Bulletin*, Vol. 54, No. 4, pages 370–84; www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q401.pdf.

Chart 1.3 *Bank Liabilities Survey*: changes in banks' marginal cost of providing funds to business units[(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 diamond shows the expectation over the next three months. The expectation balance has been moved forward one quarter. Where the *Bank Liabilities Survey* is discussed, descriptions of a 'significant' change refers to a net percentage balance greater than 20 in absolute terms, and a 'slight' change refers to a net percentage balance of between 5 and 10 in absolute terms.
(b) Question: 'How has the marginal absolute cost of providing funds to business units changed (sometimes referred to as the 'transfer price')?'.
(c) A positive balance indicates an increase in funding cost.

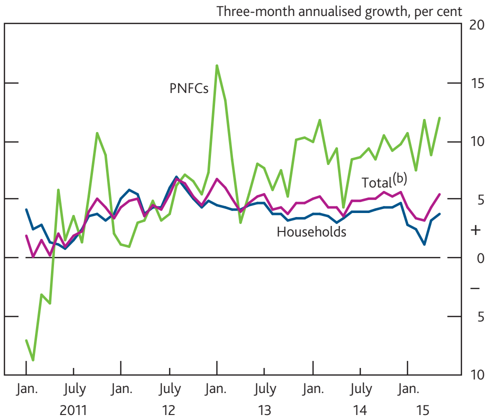
Chart 1.4 Gross wholesale term issuance by UK lenders in public markets[(a)]



Sources: Dealogic and Bank calculations.

(a) Term issuance is defined here as issuance exceeding 18 months maturity. UK lenders is defined by the nationality of the operations of the issuer's parent company. Data include issuance in all currencies, converted to sterling. Non seasonally adjusted.
(b) Other is composed of: asset-backed securities; commercial and residential mortgage-backed securities; covered bonds; subordinated unsecured debt and secured or subordinated medium-term notes.

Chart 1.5 Household and PNFC deposits[(a)]



(a) Rate of growth in monetary financial institutions' (MFIs') M4 liabilities. Seasonally adjusted.
(b) Total is the rate of growth of PNFCs and households.

treasury unit, ie the cost of funding the flow of new loans.[(1)] Transfer prices rose slightly in 2015 Q2, having fallen in each quarter since 2013 Q3, according to respondents to the *BLS* (**Chart 1.3**). They attributed this to a slight increase in reference rates and a rise in longer-term wholesale funding spreads. Transfer prices were expected to rise further in 2015 Q3 (**Chart 1.3**).

Funding volumes

Lenders in the *BLS* reported that their total funding volumes had increased slightly in the three months to mid-June. Total funding volumes were expected to increase slightly further over the next three months.

UK lenders' issuance of wholesale term funding in public markets in 2015 Q2 was a little lower than in the previous quarter, according to data from Dealogic (**Chart 1.4**). Most funding was raised in the form of senior unsecured debt in Q2. Respondents to the *BLS* reported that regulatory drivers were the main factor boosting their demand for long-term wholesale debt issuance.

Total retail deposit growth was steady in the three months to May, in line with average growth since 2012 (**Chart 1.5**). The three-month annualised growth rate of household deposits was 3.7% in the three months to May, having slowed slightly in Q1 reflecting the issuance of pensioner bonds by National Savings & Investments. Between March and May this year, flows into ISAs were higher than in the comparable period in 2014, but similar to 2013.

PNFC deposit growth was strong in the three months to May (**Chart 1.5**). Respondents to the *BLS* reported that their demand for corporate deposits had been significantly boosted in Q2 by regulatory drivers and the rates paid on PNFC deposits relative to the cost of other liabilities. The supply of deposits by PNFCs was reported to be broadly unchanged in Q2.

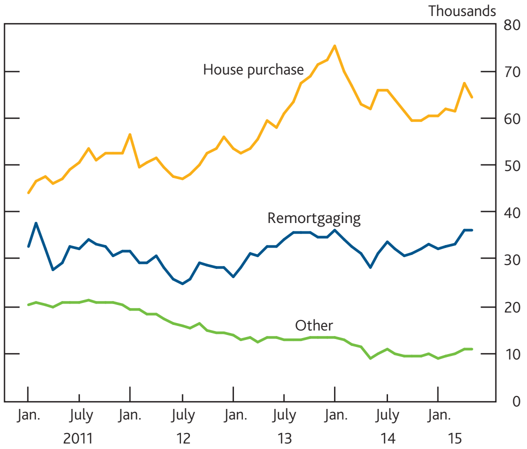
In addition to issuing wholesale debt and raising retail deposits, banks can issue capital instruments of various types as a source of funding.[(2)] Respondents to the *BLS* reported a significant increase in their total level of capital in Q2 for the fifth consecutive quarter, with a further significant increase expected in Q3. Regulatory drivers were again reported to be the most significant factor boosting respondents' total demand for capital.

(1) See Cadamagnani, F, Harimohan, R, and Tangri, K (2015), 'A bank within a bank: how a commercial bank's treasury function affects the interest rates set for loans and deposits', *Bank of England Quarterly Bulletin*, Vol. 55, No. 2, pages 153–64; www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q204.pdf.
(2) See Farag, M, Harland, D, and Nixon, D (2013), 'Bank capital and liquidity', *Bank of England Quarterly Bulletin*, Vol. 53, No. 3, pages 201–15; www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2013/qb130302.pdf.

2 Household credit conditions

Mortgage approvals for house purchase were higher in April and May than the average in Q1 and the net flow of mortgage lending increased slightly in the three months to May. This is consistent with the increase in demand for secured lending reported in the 2015 Q2 *Credit Conditions Survey*. Mortgage rates fell slightly further and remained at historically low levels. Unsecured credit continued to grow robustly.

Chart 2.1 Approvals of loans secured on dwellings(a)



(a) Data are for monthly number of approvals covering sterling lending by UK MFIs and other lenders to UK individuals. Approvals secured on dwellings are measured net of cancellations. Seasonally adjusted.

Table 2.A Secured lending to individuals(a)

	Averages					2015		
	2003–08	2012	2013	2014	2015 Q1	Mar.	Apr.	May
Net monthly flow (£ billions)	7.4	0.9	1.1	1.9	1.8	2.0	1.7	2.1
Three-month annualised growth rate (per cent)	10.7	0.8	1.0	1.9	1.7	1.7	1.7	1.9
Twelve-month growth rate (per cent)	11.4	0.8	0.9	1.7	1.8	1.8	1.8	1.8

(a) Sterling lending by UK MFIs and other lenders to UK individuals. Seasonally adjusted.

Table 2.B Consumer credit(a)

	Averages					2015		
	2003–08	2012	2013	2014	2015 Q1	Mar.	Apr.	May
Net monthly flow (£ billions)	1.2	0.2	0.6	0.9	1.0	1.3	1.2	1.0
Three-month annualised growth rate (per cent)	8.8	0.5	5.0	6.6	6.4	7.4	8.2	8.5
Twelve-month growth rate (per cent)	9.5	-0.3	3.7	5.9	6.8	6.9	7.2	7.2

(a) Sterling lending by UK MFIs and other lenders to UK individuals. Consumer credit consists of credit card lending and other unsecured lending (other loans and advances) and excludes student loans. Seasonally adjusted.

Lending to UK households

The number of mortgage approvals by all UK-resident mortgage lenders for house purchase were higher in April and May than the average in 2015 Q1 (**Chart 2.1**). Approvals for remortgaging also increased. Nonetheless, mortgage approvals for house purchase and remortgaging remain much lower than in the years prior to the financial crisis.

The monthly net flow of mortgage lending increased slightly in the three months to May (**Table 2.A**). That said, in recent discussions, some major UK lenders expected total gross mortgage lending in 2015 to be broadly similar to that in 2014, compared with expectations at the start of the year of an increase.

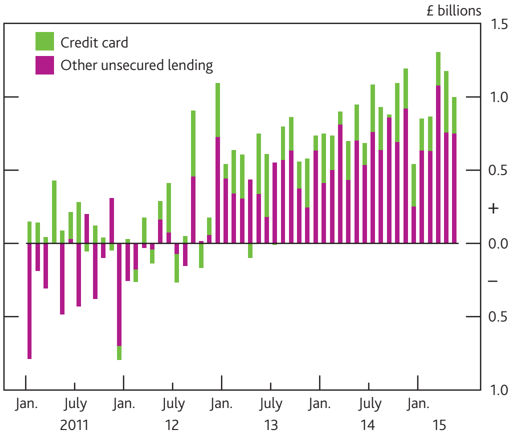
Total net unsecured consumer credit flows (excluding student loans) increased in the three months to May (**Table 2.B**). Within this, monthly flows remained higher for other unsecured lending than for credit cards (**Chart 2.2**). In recent discussions most major UK lenders attributed these flows to increased consumer confidence and low personal loan rates, with the low rates in turn reflecting strong competition amongst lenders. The three-month annualised growth rate for other unsecured lending increased in May to reach rates last observed in 2005.

Loan pricing

Mortgage rates continued to drift downwards in recent months, and remained at historically low levels. The overall effective rate on new mortgages fell in the three months to May.

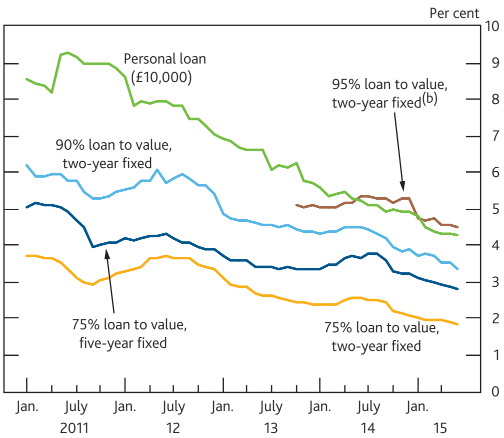
Most quoted fixed mortgage rates, indicating the rates offered to borrowers, also drifted down in 2015 Q2 (**Chart 2.3**). With swap rates increasing over this period (**Chart 1.1**), spreads over relevant reference rates fell over the quarter. In recent discussions, most major UK lenders did not expect rates to fall much further at lower loan to value (LTV) ratios, but some noted there was some scope for reductions for higher LTV mortgage products.

Chart 2.2 Net consumer credit flows(a)



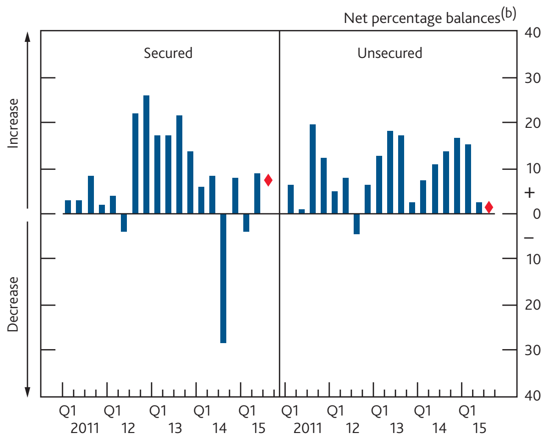
(a) Sterling lending by UK MFIs and other lenders to UK individuals. Consumer credit consists of credit card lending and other unsecured lending (other loans and advances) and excludes student loans. Seasonally adjusted.

Chart 2.3 Quoted interest rates on fixed-rate mortgages and personal loans(a)



(a) End-month rates on sterling lending. The Bank's quoted interest rates series are currently compiled using data from up to 22 UK MFIs. Non seasonally adjusted.
(b) This series was not available between May 2008 and September 2013 as fewer than three products were offered from the sample of lenders in that period.

Chart 2.4 *Credit Conditions Survey*: changes in availability of secured and unsecured credit to households(a)



(a) Net percentage balances are calculated by weighting together the responses of those lenders who answered the question. The bars show the responses over the previous three months. The diamonds show the expectations over the next three months. Expectations balances have been moved forward one quarter. Where the *Credit Conditions Survey* is discussed, descriptions of a 'significant' change refer to a net percentage balance greater than 20 in absolute terms, and a 'slight' change refers to a net percentage balance of between 5 and 10 in absolute terms.
(b) A positive balance indicates that more credit is available.

Quoted rates on some personal loans also continued to fall in 2015 Q2 (**Chart 2.3**), with the quoted rate on a £10,000 loan at its lowest since the start of the series in 1995. The quoted rate on credit cards was broadly similar in Q2 compared to that in the previous quarter. Respondents to the 2015 Q2 Bank of England's *Credit Conditions Survey* (*CCS*) reported that although spreads on credit card lending were unchanged, the length of interest free periods available on balance transfers and new purchases increased.

Supply and demand

Consistent with the fall in mortgage pricing, the supply of secured credit was reported to have increased a little in recent months. Respondents to the *CCS* reported that the availability of secured credit to households increased slightly in the three months to mid-June 2015 (**Chart 2.4**). Lenders also reported that the availability of secured credit to borrowers with loan to value ratios above 75% increased in Q2, though their willingness to lend at LTV ratios above 90% was unchanged. Market share objectives and a changing appetite for risk were both reported to have boosted credit availability slightly. Lenders in the survey also reported a slight loosening in credit scoring criteria. Looking ahead, the availability of secured credit was expected to increase slightly in 2015 Q3.

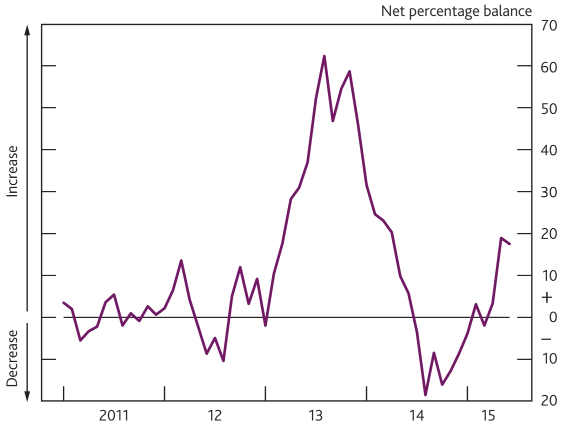
Demand for secured lending for house purchase increased significantly in 2015 Q2, according to respondents to the *CCS*, having fallen in the previous three surveys. Respondents reported a significant increase in demand for both prime and buy-to-let lending. Some other surveys have also pointed to an increase in demand. The Royal Institution of Chartered Surveyors' (RICS) new buyer enquiries balance, for example, was positive in Q2 (**Chart 2.5**). Looking ahead, respondents to the *CCS* expected demand for secured credit for both house purchase and for remortgaging to increase in 2015 Q3.

The supply of unsecured credit has increased in recent years, according to survey data. While respondents to the *CCS* indicated that the amount of unsecured credit made available to households was unchanged in 2015 Q2, it had increased in most quarters since the start of 2011 (**Chart 2.4**). Demand for credit card lending was also unchanged in 2015 Q2 though increased slightly for other unsecured lending products, such as personal loans, according to respondents to the survey.

Loan performance

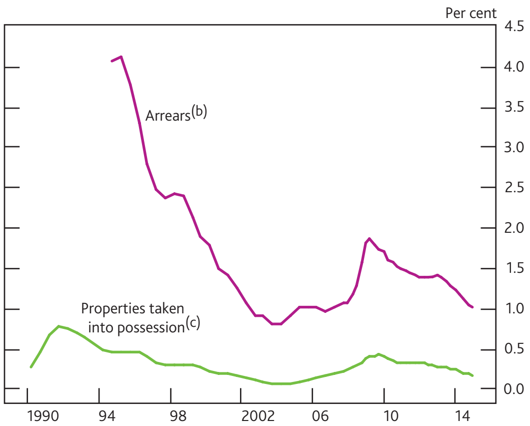
Loan performance on secured lending either improved or remained at similar rates in recent months, according to both quantitative and survey data, having improved in recent years. Data from the Council of Mortgage Lenders indicated that the mortgage arrears rate was little changed in 2015 Q1 (**Chart 2.6**), having drifted down since mid-2009. The write-off rate on mortgages — the ratio of write-offs on secured loans to the stock of lending — was little changed in the year to 2015 Q1. The possessions rate continued to tick

Chart 2.5 *RICS Residential Market Survey*: new buyer enquiries(a)



(a) Net percentage balance for new buyer enquiries is calculated as the proportion of respondents reporting an increase in enquiries over the previous month, less the proportion reporting a decrease. A positive balance indicates an increase in enquiries. Seasonally adjusted.

Chart 2.6 Mortgage arrears and possessions rates(a)



Sources: CML, Bank of England and Bank calculations.

(a) Series are expressed as the proportion of the number of outstanding mortgages. Data are semi-annual up to end-2007 and quarterly since then. Non seasonally adjusted.
(b) Mortgages in arrears of 2.5% or more of the outstanding mortgage balance.
(c) Properties taken into possession over the preceding twelve-month period.

down in 2015 Q1 (**Chart 2.6**). Lenders in the *CCS* reported a fall in default rates in Q2 and a significant fall in losses given default. Further falls were expected by the lenders in the next three months.

The write-off rate on consumer credit — the ratio of write-offs on unsecured loans to the stock of unsecured lending — was little changed and the rate of personal insolvencies in England and Wales fell slightly in 2015 Q1. These rates remain significantly lower than the period following the financial crisis. Default rates fell on credit card lending, but rose for other unsecured lending in 2015 Q2, according to respondents to the *CCS*.

3 Corporate credit conditions

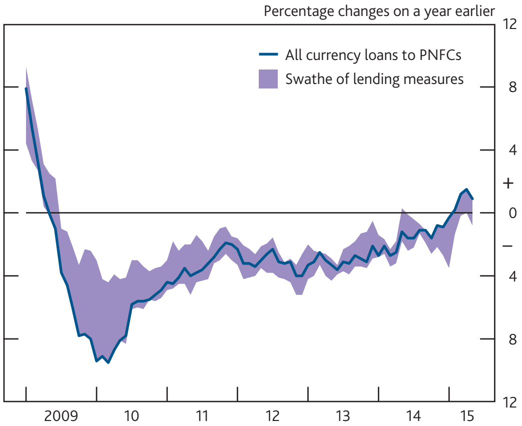
Growth in the stock of lending to UK businesses picked up in 2015 to date. And net finance raised by UK businesses, which also includes funds raised in capital markets, was positive. The pickup in corporate borrowing is likely to reflect the improvement in the availability of credit since late 2012. Demand for credit from small and large companies also increased in 2015 Q2, according to respondents to the *Credit Conditions Survey*. Some surveys suggested that the overall level of demand for bank lending from small and medium-sized enterprises, however, remained subdued.

Table 3.A Lending to UK businesses(a)

	Averages					2015		
	2003–08	2012	2013	2014	2015 Q1	Mar.	Apr.	May
All currency loans to PNFCs(b)								
Net monthly flow (£ billions)	3.8	-1.5	-0.7	-0.3	1.2	2.5	0.5	0.0
of which sterling loans(c)	*3.3*	*-1.2*	*-0.5*	*-0.7*	*0.7*	*1.4*	*0.6*	*-0.5*
Three-month annualised growth rate (per cent)	12.4	-3.7	-2.7	-1.1	2.6	3.7	4.8	3.2
Twelve-month growth rate (per cent)	12.5	-3.1	-3.0	-1.7	0.4	1.2	1.5	0.9

(a) Seasonally adjusted.
(b) Data cover loans in both sterling and foreign currency, expressed in sterling.
(c) This measure includes loans and UK MFIs holdings of bills and acceptances and excludes commercial paper.

Chart 3.1 Lending to UK businesses(a)



(a) Lending by UK MFIs to PNFCs or non-financial businesses. Rate of growth in the stock of lending. Series included in the swathe are PNFC M4L (seasonally adjusted), all currency loans to PNFCs (seasonally adjusted), sterling loans to PNFCs (seasonally adjusted), and all currency loans to non-financial businesses (non seasonally adjusted). Further details on the series used in the chart are provided in *Bankstats* (*Monetary and Financial Statistics*), August 2014, 'Measures of lending to UK businesses'; www.bankofengland.co.uk/statistics/Documents/ms/articles/art1sep14.pdf. Details on recent changes to the PNFC M4L series are provided in *Bankstats* (*Monetary and Financial Statistics*), April 2015, 'Changes to the treatment of loan transfers and lending to housing associations'; www.bankofengland.co.uk/statistics/Documents/ms/articles/art1apr15.pdf.

Lending to UK businesses

Net lending to UK businesses by banks and building societies picked up in the first half of 2015. Net lending on the all currency loans measure was £3.1 billion in the three months to May, while the annual growth rate in the stock of loans in May was 0.9% (**Table 3.A**), having been negative for much of the period since the financial crisis. Growth rates across a range of other measures also improved in 2015 to date (**Chart 3.1**). And the increase in lending was broadly based across industries, as further discussed in the box on pages 12–14.

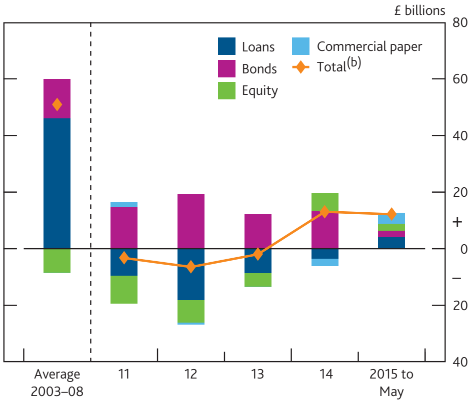
There were signs of a pickup in net lending for both large and smaller businesses.(1) Net lending to large companies was close to zero in the three months to May, following a period of negative net lending. The same was true for net lending to small and medium-sized enterprises (SMEs). Net lending to SMEs by participants in the Funding for Lending Scheme Extension in 2015 Q1 was £0.6 billion.(2)

Larger companies have access to more bank lending sources than smaller businesses, such as the syndicated lending market. The total value of new gross syndicated lending facilities granted in the UK market in 2015 Q2 was £17.3 billion, lower than the value granted in the same period last year. In recent discussions, some major UK lenders reported that the decline in activity in this market partly reflected companies having brought forward refinancing activity from 2015 to 2014. By contrast, activity related to mergers and acquisitions had reportedly begun to increase.

Capital markets, such as bond and equity markets, also provide an alternative source of external finance for larger

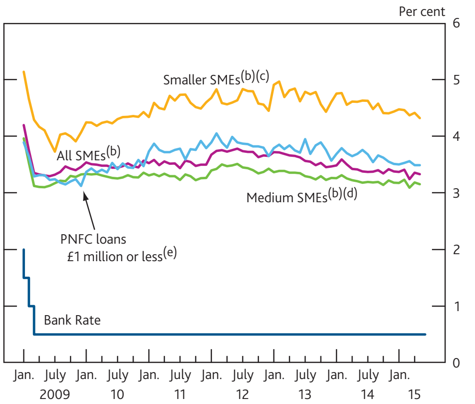
(1) For more details, see the 'Flows' tab in *Bankstats* Table A8.1 'Monetary financial institutions' loans to non-financial businesses, by size of business'; www.bankofengland.co.uk/statistics/Documents/bankstats/2015/jun/taba8.1.xls. Non seasonally adjusted.
(2) Net lending in the FLS Extension includes lending related to non-bank credit providers. For more details, see 'Funding for Lending Scheme Extension — usage and lending data'; www.bankofengland.co.uk/markets/Pages/FLS/extensiondata.aspx. Non seasonally adjusted.

Chart 3.2 Net finance raised by UK businesses[a]



(a) Finance raised by PNFCs from UK MFIs and from capital markets. Bonds data cover debt issued by UK companies via UK-based Issuing and Paying Agents. Data cover funds raised in both sterling and foreign currency, expressed in sterling. Seasonally adjusted. Bonds, equity and commercial paper are not seasonally adjusted.
(b) Owing to the seasonal adjustment methodology, this series may not equal the sum of its components.

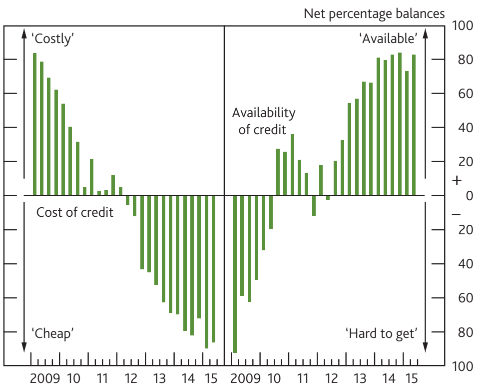
Chart 3.3 Indicative interest rates on lending to SMEs[a]



Sources: BIS, Bank of England and Bank calculations.

(a) These indicative rates do not reflect the impact of cashback deals or fees. Data for Bank Rate are to end-June and for all other series to end-May. Non seasonally adjusted.
(b) Median by value of SME facilities (new loans, new and renewed overdrafts) priced at margins over base rates, by four major UK lenders (Barclays, HSBC, Lloyds Banking Group and Royal Bank of Scotland). Data cover lending in both sterling and foreign currency, expressed in sterling.
(c) Smaller SMEs are businesses with annual debit account turnover on the main business account less than £1 million.
(d) Weighted average of new lending to PNFCs of all sizes by UK MFIs for advances less than or equal to £1 million, an indicator of pricing for small business loans. Data cover lending in sterling. The Bank's effective interest rates series are currently compiled using data from 22 UK MFIs.
(e) Medium SMEs are businesses with annual debit account turnover on the main business account between £1 million and £25 million.

Chart 3.4 *Deloitte CFO Survey*: cost and availability of credit[a]



(a) Net percentage balances 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 percentage balances 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 credit is 'available'.

companies. Net finance raised by UK businesses from capital markets was positive in 2015 to May (**Chart 3.2**). In recent discussions some major UK lenders reported that corporate bond issuance had been somewhat subdued in recent weeks, which partly reflected the increased volatility in these markets.

Loan pricing

Pricing on lending to SMEs overall appeared to be little changed over recent months. Indicators of interest rates on lending to SMEs were broadly unchanged in the three months to May, although had drifted down a little since mid-2012 (**Chart 3.3**). The Federation of Small Businesses' *Voice of Small Business Index* suggested that small businesses continued to regard bank credit as somewhat costly. The net percentage balance of small businesses in this survey who perceived credit to be 'affordable' remained negative in 2015 Q2, albeit less so than in Q1.

Pricing on lending to large companies remained favourable. Lenders reported in the Bank of England's *Credit Conditions Survey* (*CCS*) that spreads on lending to these firms fell significantly in 2015 Q2. Non-price terms, such as fees and commissions and loan covenants, were also reported to have improved. Some major UK lenders noted that the fall in spreads reflected continued competitive pressures in these markets. According to the *Deloitte CFO Survey* for 2015 Q2, which surveys large corporates, a net percentage balance of 86% of corporates reported that new credit was 'cheap', broadly the same as the previous quarter (**Chart 3.4**).

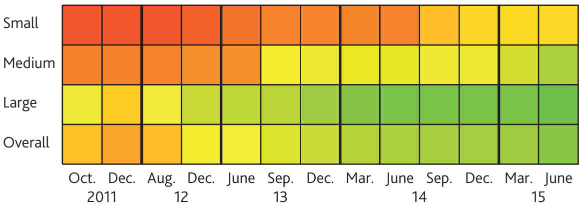
Looking ahead, respondents to the *CCS* expected spreads on new lending in 2015 Q3 to fall slightly for medium and large companies, but to be unchanged for small businesses.

Supply and demand

The overall availability of credit to businesses remained unchanged in 2015 Q2, according to respondents to the *CCS*. Looking further back, the survey suggests that credit availability has improved since late 2012. This is consistent with reports from the Bank's network of Agents (**Chart 3.5**).

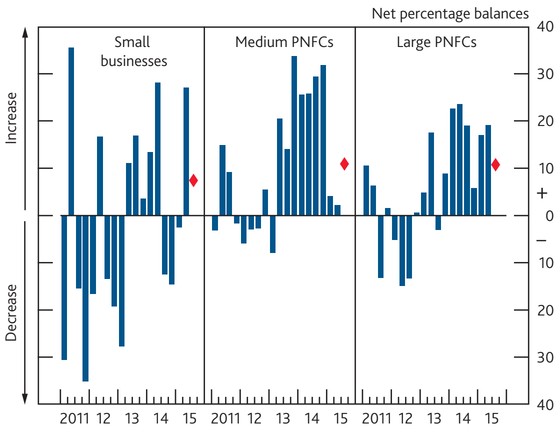
Credit appeared more widely available for large companies than for small firms. Contacts of the Bank's Agents noted that large corporates were readily able to access funding from both bank and non-bank sources. And according to the *Deloitte CFO Survey* for 2015 Q2, the net percentage balance of respondents who reported that credit was 'available' was 83% (**Chart 3.4**). By comparison, the Bank's Agents reported that credit availability remained relatively tight for small companies, although it had been improving gradually (**Chart 3.5**). Consistent with that improvement, lenders reported in the *CCS* that credit availability had increased for small businesses over the past three months.

Chart 3.5 The Bank's Agents' assessment of corporate credit availability[(a)]



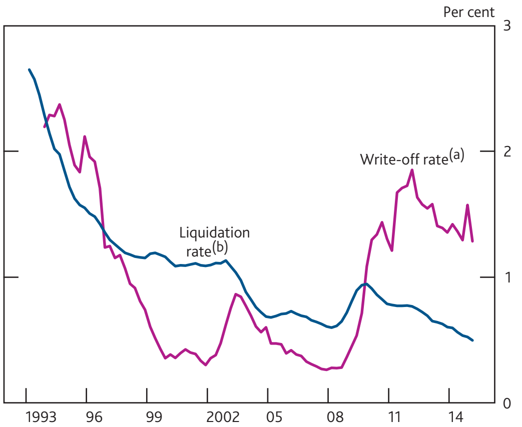
(a) This mapping is based on individual Agencies' national assessments of corporate credit availability, weighted by the gross value added of their regions or countries. The greater the intensity of red, the tighter credit availability; the greater the intensity of green, the looser credit availability. Yellow indicates normal conditions. Includes bank and non-bank credit. Overall availability is an average of small, medium and large corporate credit availability weighted by estimates of the share of bank lending by company size. For more details, see England, D, Hebden, A, Henderson, T and Pattie, T (2015), 'The Agencies and 'One Bank'', *Bank of England Quarterly Bulletin*, Vol. 55, No. 1, pages 47–55; www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q104.pdf.

Chart 3.6 *Credit Conditions Survey*: changes in corporate demand for lending by firm size[(a)(b)]



(a) See footnote (a) to **Chart 2.4**. A positive balance indicates an increase in demand.
(b) Small businesses are defined as those with annual turnover of less than £1 million; medium-sized corporates are defined as those with annual turnover of between £1 million and £25 million; and large corporates are defined as those with annual turnover of over £25 million.

Chart 3.7 Corporate liquidations and write-off rates



Sources: The Insolvency Service and Bank of England.

(a) Write-off rate on lending by UK MFIs to PNFCs. The series has been calculated as annualised quarterly write-offs divided by the corresponding loans outstanding at the end of the previous quarter, and is expressed as a four-quarter moving average. Series starts in 1993 Q4. Lending in both sterling and foreign currency, expressed in sterling terms. Non seasonally adjusted.
(b) Calculated as the total number of liquidations in the previous four quarters divided by the average number of active registered companies over the previous four quarters. Since the Enterprise Act 2002, a number of administrations have subsequently converted to creditors' voluntary liquidations. These are not included in the data. Data relate to England and Wales. Seasonally adjusted.

Overall, demand for lending appeared to have increased over the past three months. Lenders in the *CCS* reported that demand had increased for small businesses and large corporates in 2015 Q2, but was unchanged for medium-sized businesses (**Chart 3.6**). Lenders cited commercial real estate and mergers and acquisitions as factors pushing up on credit demand.

But some surveys suggested that the overall level of demand for bank credit from SMEs remained subdued. The proportion of SMEs described as 'happy non-seekers' was 79% in 2015 Q1, according to the latest *SME Finance Monitor,* broadly the same as in recent quarters. Contacts of the Bank's Agents reported that the availability of non-bank sources of finance to SMEs had been increasing, although use of this type of external finance remained small compared to bank lending. Recent data from ABFA indicated that the stock of SMEs' funding from asset-based finance was £9 billion in 2015 Q1, equivalent to around 6% of the stock of bank lending to SMEs.[(1)]

Looking ahead, respondents to the *CCS* expected demand for credit to increase from medium and large companies in 2015 Q3, and to increase slightly for small businesses.

Loan performance

Indicators of corporate distress improved slightly over recent months. The corporate write-off rate — the ratio of banks' write-offs on corporate lending to the stock of that lending — fell slightly over the year to 2015 Q1, though it remained elevated compared to the pre-crisis period (**Chart 3.7**). The rate of company liquidations over the past year also fell slightly (**Chart 3.7**). Lenders in the *CCS* reported that corporate loan performance improved in 2015 Q2. Default rates decreased on lending to all business sizes and most significantly on lending to small businesses, while losses given default on lending to businesses also fell.

(1) The Asset Based Finance Association (ABFA) published a more detailed breakdown of the stock of asset-based finance by clients' annual turnover in its 2015 Q1 data. Estimates for SMEs are Bank calculations based on data for companies with client annual turnover less than £25 million. Data are available at www.abfa.org.uk/statistics/2015/Q1%202015/ABFA%20Statistics%20Q1%202015.pdf.

Trends in lending and capital market issuance, by major industrial sector

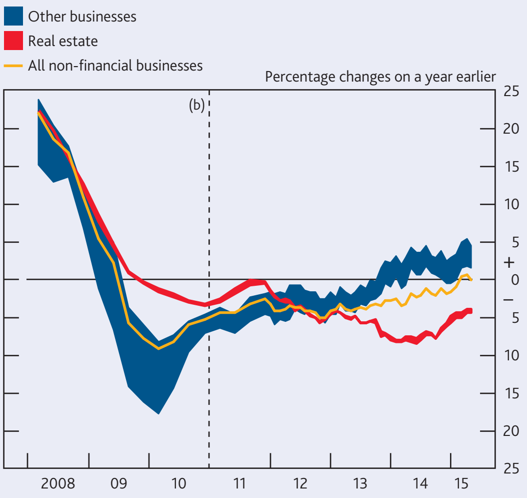
This box provides an update of lending, by major industrial sector, using Bank of England statistics and data from other sources. Net bond and equity issuance by each of these sectors since 2014 is also discussed.(1)

The increase in bank lending to industrial sectors over this period, other than the real estate sector, was broad-based and the growth rate in the stock of lending to businesses in the real estate sector became less negative in recent months. Sectors with significant positive net bond issuance since 2014 were real estate, manufacturing and mining and quarrying and those with notable positive net equity issuance were transport and communication, professional and other services, real estate and distribution.

Bank lending by major industrial sector

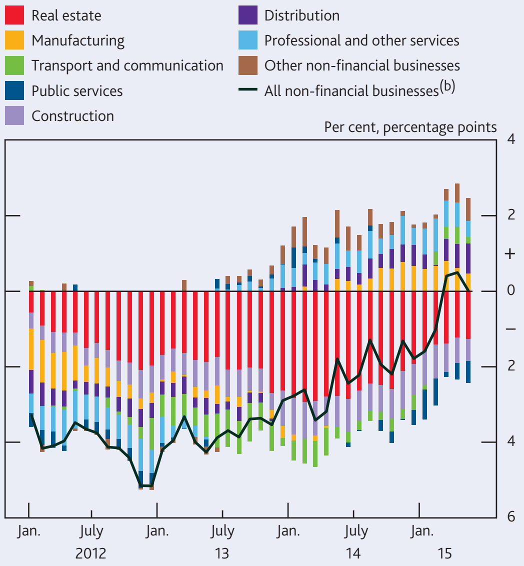
The pickup in the overall growth rate in the stock of lending to UK businesses since the start of 2014 mainly reflected a turnaround in lending to businesses in aggregate in sectors other than the real estate sector (**Chart A**). This was broadly based across sectors, with the professional and other services, manufacturing and the distribution sectors having positively contributed to the overall growth rate (**Chart B**). More recently, the transport and communication sector had a small positive contribution to the overall growth rate. The contribution of the construction sector remained negative.

Chart A Lending to the UK real estate sector and other businesses(a)



(a) Lending by UK MFIs. Rates of growth in the stock of lending. Non seasonally adjusted. For details on the series included in the swathes see tab 'Chart 1.1 appendix'; www.bankofengland.co.uk/publications/Documents/other/monetary/lendingtoukbusinessesandindividualsoctober2014.xls.
(b) From January 2011, data are on the SIC 2007 basis. Changes in the SIC codes have led to some components moving between industries. As a result, growth rates in 2011 may be affected.

Chart B Lending to UK businesses by major industrial sectors(a)



(a) Lending by UK MFIs. Data cover lending in both sterling and foreign currency, expressed in sterling. Contributions to the annual rate of growth in the stock of lending. Non seasonally adjusted. Further details on the series used in the chart are provided in the spreadsheet; www.bankofengland.co.uk/publications/Documents/other/monetary/additionalboxesjuly2014.xls.
(b) Rate of growth in the stock of lending.

The annual growth rate in the stock of lending to the real estate sector has become less negative over the recent past (**Chart A**). This in turn has reduced the negative contribution of the real estate sector (red bars, **Chart B**) to the annual rate of growth in the stock of lending to businesses.

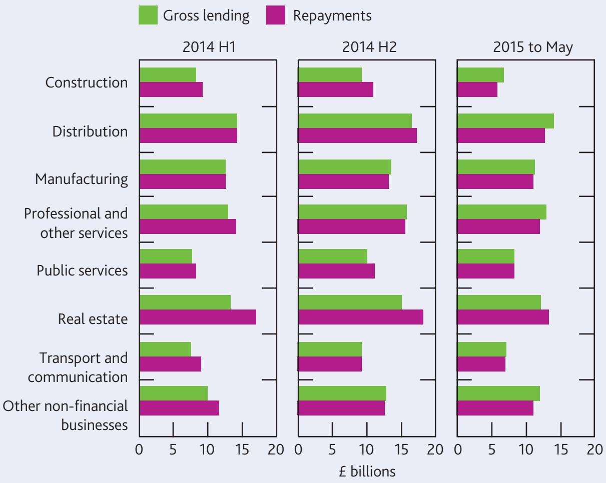
The share of the real estate sector in the total stock of loans to UK non-financial businesses was 31% as at May 2015, the largest of the major industrial sectors. This share has decreased somewhat since the financial crisis as some banks have actively reduced their exposures to commercial real estate companies, including through loan sales. Contacts of the Bank's network of Agents reported that there was continued improvement in funding conditions in the commercial real estate sector from bank and non-bank lenders in recent months.

Gross lending flows (excluding overdrafts) were similar in the real estate, distribution, professional and other services, and manufacturing sectors since the start of 2014 (**Chart C**). Together, these four sectors accounted for 60% of the total gross lending flows. Repayments of loans (excluding overdrafts) were the largest by businesses in the real estate sector.

Overdrafts are estimated to have accounted for 9% of the amounts outstanding of loans to all non-financial businesses

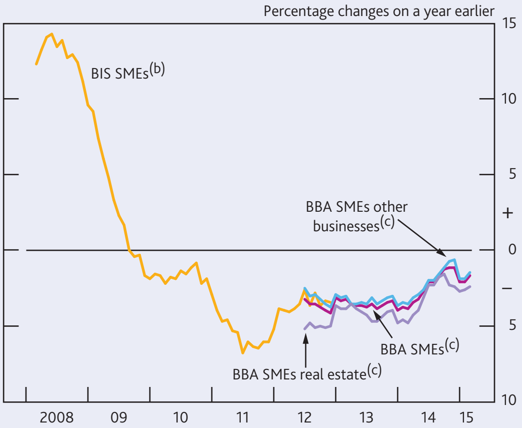
(1) For information on capital market issuance by major industrial sectors in earlier periods, see the boxes in July 2014 and January 2015 *Trends in Lending*; www.bankofengland.co.uk/publications/Pages/other/monetary/trendsinlending.aspx.

Chart C Gross lending to and repayments by major industrial sectors, 2014 H1–May 2015[(a)]



(a) Loans by UK MFIs to UK non-financial businesses and repayments by them. Data exclude overdrafts. Data cover lending in both sterling and foreign currency, expressed in sterling. Non seasonally adjusted. Further details on the series used in the chart are provided in the spreadsheet; www.bankofengland.co.uk/publications/Documents/other/monetary/additionalboxesjuly2014.xls.

Chart D Lending to UK SMEs[(a)]



Sources: BBA, BIS and Bank calculations.

(a) Rate of growth in the stock of lending. Lending by UK MFIs, unless otherwise stated. Data cover lending in both sterling and foreign currency, expressed in sterling. Non seasonally adjusted. Further details on some of the series are provided in the spreadsheet; www.bankofengland.co.uk/publications/Documents/other/monetary/lendingtoukbusinessesandindividualsjuly2014.xls.
(b) Lending by four UK lenders to enterprises with annual bank account turnover less than £25 million. The survey terminated in December 2012.
(c) Lending by a BBA panel of lenders to SMEs in Great Britain. SMEs are defined as businesses with turnover up to £25 million. Data are to March 2015.

in 2014.[(1)] Within this, the professional and other services sector had the largest share of 24%, followed by the distribution sector.

Lending to small and medium-sized enterprises (SMEs) by major industrial sector

The annual growth rate in the stock of lending to SMEs has been negative for over five years (**Chart D**). It has been less negative since the start of 2014, similar to the movement in the growth rate in the stock of lending to all non-financial businesses (**Chart A**).

Data on lending to SMEs within each major industrial sector are obtained from a British Bankers' Association (BBA) panel of lenders. The real estate sector had the largest share in the stock of loans to SMEs as at end-March 2015. The growth rate in the stock of lending to SMEs in the real estate sector and to other businesses remained negative, though less so since the start of 2014 (**Chart D**).

The share of overdrafts used by SMEs in the amounts outstanding of loans was 11% in 2014, according to data from the BBA. Within this, the agriculture, forestry and fishing, and distribution sectors accounted for 28% and 19% of overdrafts on average in 2014. The value of new borrowing facilities by SMEs approved in 2015 Q1 was broadly spread across industries and for most was greater compared to a year ago.[(2)]

For those SMEs that use external funding, trade credit is an option alongside bank loans, bank overdrafts or credit cards. Trade credit was received by 33% of SMEs in 2014 Q3–Q4, according to the *SME Finance Monitor*. By sector, the use of trade credit varied between 20% in the health sector to 47% in the manufacturing sector.

Capital market issuance by major industrial sector

Larger companies are able to raise funds from capital markets — such as the equity and bond markets — as well as borrowing from banks. Total net capital market issuance by UK businesses in 2014 was the highest in five years.

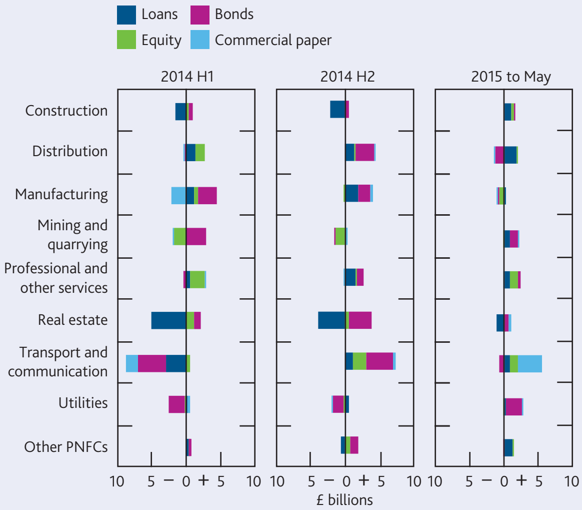
Positive net bond issuance was recorded in most major industrial sectors since the start of 2014, with significant issuance in the real estate, manufacturing and mining and quarrying sectors (**Chart E**). Businesses in the utilities sector had negative net bond issuance in 2014, for the first time since the series began in 2003, though this has reversed in 2015 to date.

Industrial sectors with notable positive net equity issuance since 2014 were transport and communication, professional and other services, real estate and distribution (**Chart E**).

Net issuance of commercial paper was negative in 2014 and turned positive in 2015 to date (**Chart 3.2**). This was mostly accounted for by the transport and communication sector (**Chart E**).

(1) For more details on the amounts outstanding on overdrafts and loans, see *Bankstats* Table A8.1; www.bankofengland.co.uk/statistics/Documents/bankstats/2015/jun/taba8.1.xls. Non seasonally adjusted.
(2) See Figure 6, *Bank support for SMEs — 1st Quarter 2015*, British Bankers' Association, available at www.bba.org.uk/news/statistics/sme-statistics/bank-support-for-smes-1st-quarter-2015/.

Chart E Net finance raised by UK businesses by major industrial sectors, 2014 H1–May 2015(a)(b)



(a) Finance raised by PNFCs from UK MFIs and capital markets. Data cover funds raised in both sterling and foreign currency, expressed in sterling. Data for 2015 are up to and including May. Non seasonally adjusted. Further details on the series used in the chart are provided in the spreadsheet available at www.bankofengland.co.uk/publications/Documents/other/monetary/additionalboxesjuly2014.xls.

(b) Data for PNFCs have been estimated by subtracting elements of the industrial breakdown for non-financial corporations thought to contain mainly public sector industries (public administration and defence, education, health and social work and recreational, personal and community services). For these reasons, the total yearly flows for 2014 will not exactly equal the data for PNFCs in **Chart 3.2**.

Overall, positive net capital market issuance was slightly offset by negative bank lending, such that net finance raised by UK businesses from UK MFIs and capital markets was positive in 2014 (**Chart 3.2**). With net finance from these sources positive in 2015 to date, overall net finance raised remained positive.

Abbreviations

ABFA — Asset Based Finance Association.
BBA — British Bankers' Association.
BIS — Department for Business, Innovation and Skills.
BLS — *Bank Liabilities Survey*.
CCS — *Credit Conditions Survey*.
CDS — credit default swap.
CFO — chief financial officer.
CML — Council of Mortgage Lenders.
FLS — Funding for Lending Scheme.
ISA — individual savings account.
Libor — London interbank offered rate (see below).
LTV ratio — loan to value ratio (see below).
M4L — Sterling M4 lending excluding the effects of securitisations etc.
MFIs — monetary financial institutions (see below).
PNFCs — private non-financial corporations (see below).
RICS — Royal Institution of Chartered Surveyors.
SIC — standard industrial classification.
SMEs — small and medium-sized enterprises.

Glossary

Arrears rate The number of loans in arrears divided by the number of loans outstanding.

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.

Liquidations rate The number of corporate liquidations divided by the number of companies.

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 repayments of debt in a given period.

Other funding Funding in wholesale public debt capital markets, private placement markets and directly from central bank operations.

Personal insolvency rate The number of individual insolvencies divided by the adult population.

Possessions rate The number of properties taken into possession divided by the number of mortgages outstanding.

Private non-financial corporations (PNFCs) All corporations (and partnerships) 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.

Retail funding Funding raised by banks in the form of deposits from households and PNFCs.

Senior unsecured debt Debt securities issued by lenders that pay a coupon, along with a final redemption payment, which are repaid before junior liabilities if a bank becomes insolvent.

Specialist/other mortgage lenders Providers of mortgage loans for niche markets that generally fall outside the scope of mainstream mortgage lending.

Syndicated loan A loan granted by a group of banks to a single borrower.

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.

Total funding Retail and other funding, which includes wholesale funding.

Transfer price The marginal absolute cost charged internally to business units for obtaining funding from the treasury unit, ie the cost of funding the flow of new loans.

Write-off rate The value of write-offs divided by the stock of loans outstanding.

Symbols and conventions

Except where otherwise stated the source of data in charts is the Bank of England.

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

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