Credit Conditions Review

2015 Q4

BANK OF ENGLAND

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This quarterly publication presents the Bank of England's assessment of the latest developments in bank funding and household and corporate credit conditions. 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; 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; together they accounted for around 75% of the stock of mortgage lending, 50% of the stock of consumer credit (excluding student loans), and 65% of the stock of lending to businesses at end-September 2015. The *Review* also draws on intelligence gathered by the Bank's network of Agents and from market contacts.

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

The *Credit Conditions Review* replaced the Bank of England's *Trends in Lending* publication in 2015 Q2.(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 dates in 2016 for future *Credit Conditions Reviews* are:
2016 Q1 *Review* on 13 April 2016.
2016 Q2 *Review* on 13 July 2016.

(1) The *Bank Liabilities Survey* and the *Credit Conditions Survey* for 2015 Q4 were conducted between 23 November and 11 December 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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Long-term wholesale funding spreads for UK banks increased slightly, on average, in 2015 Q4 and remained higher than the post-crisis lows reached in the early part of 2015. Those higher wholesale funding spreads continued to push up transfer prices in 2015 Q4 according to lenders responding to the *Bank Liabilities Survey*, although the survey suggested that the increase in transfer prices was smaller than in the previous quarter. Retail funding spreads remained low. Wholesale term funding issuance by UK lenders was subdued in Q4, while deposit growth picked up a little and, within this, corporate deposit growth remained particularly strong.

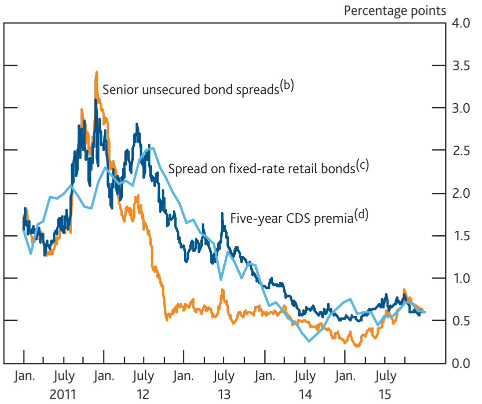
Secured lending growth continued to pick up in recent months; growth in the stock was 3.5% on a three-month annualised basis in November. This is likely to partly reflect favourable credit conditions: lenders reported a further slight increase in credit availability in the 2015 Q4 *Credit Conditions Survey*, and most mortgage spreads have fallen in 2015 particularly at higher loan to value ratios. Consumer credit continued to grow strongly, particularly for other loans and advances such as personal loans and overdrafts. Though quoted and effective rates on personal loans have increased a little in recent months, they remain close to historically low levels.

Lending to UK businesses picked up in recent months, with annual growth in the stock of lending on the all currency loans measure reaching 2.1% in November. Net lending increased across most industrial sectors. The pick-up in corporate borrowing is likely to partly reflect the improvement in credit availability since late 2012, as well as a more recent increase in demand. While the improvement in credit conditions has been apparent across all business sizes, smaller SMEs appear to have experienced a more gradual improvement than larger companies.

1 Bank funding

Long-term wholesale funding spreads for UK banks increased slightly, on average, in 2015 Q4 and remained higher than the post-crisis lows reached in the early part of 2015. Those higher wholesale funding spreads continued to push up transfer prices in 2015 Q4 according to lenders responding to the *Bank Liabilities Survey*, although the survey suggested that the increase in transfer prices was smaller than in the previous quarter. Retail funding spreads remained low. Wholesale term funding issuance by UK lenders was subdued in Q4, while deposit growth picked up a little and, within this, corporate deposit growth remained particularly strong.

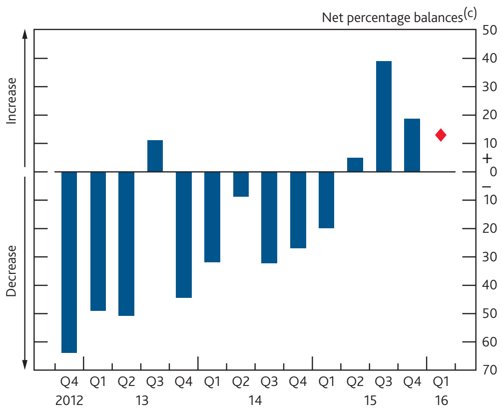
Chart 1.1 Indicative long-term funding spreads[(a)]



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

(a) Data are to end-December 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 five-year euro senior CDS premia for the major UK lenders.

Chart 1.2 *Bank Liabilities Survey*: changes in banks' transfer prices[(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 expectations over the next three months. Where the *BLS* 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 transfer prices.

Funding costs and transfer prices

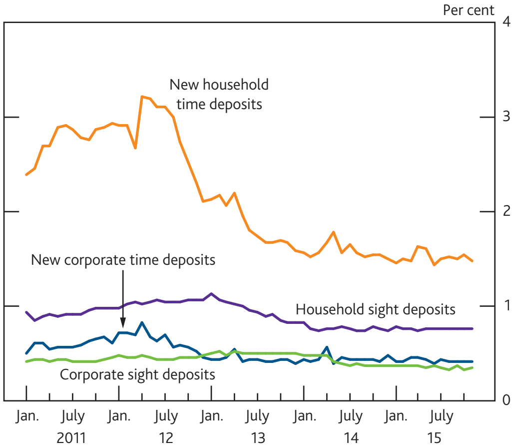
The cost of bank funding influences the interest rates charged to households and corporates. It can generally be decomposed into the spread over a given reference rate (such as swap rates), and the prevailing level of that reference rate in financial markets.

In terms of banks' long-term wholesale funding, senior unsecured bond spreads declined a little over 2015 Q4, but, on average, they were slightly higher than in Q3, and remain around 40 basis points higher than the post-crisis lows reached in the early part of 2015 (**Chart 1.1**). Senior unsecured bond spreads remain much lower than the levels seen in 2011 and 2012. In recent discussions, some major UK lenders noted that new issue premia — the cost an issuer typically pays in addition to the spread implied by secondary market prices — stayed slightly higher than in the first half of the year. Swap rates were marginally lower in 2015 Q4 than in 2015 Q3 across all maturities.

Respondents to the Bank of England's *Bank Liabilities Survey* (*BLS*) reported that higher wholesale funding spreads had continued to push up transfer prices — the internal price charged to banks' business units to fund the flow of new loans — in Q4. But the net percentage balance was lower than in the previous quarter, suggesting a smaller increase (**Chart 1.2**).

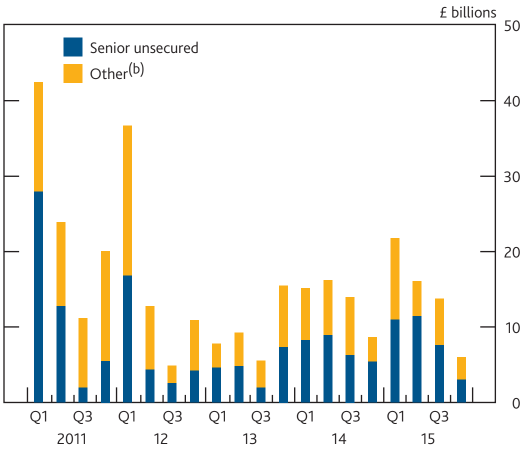
As noted in the December 2015 *Financial Stability Report*, banks have reduced their reliance on wholesale funding in recent years in favour of retail deposits. Despite some volatility in spreads on some retail funding products during 2015 — **Chart 1.1** shows the spread on fixed-rate bonds — interest rates paid on retail deposits remained low by historical standards. The effective rates on new household and corporate time deposits were broadly flat in 2015 Q4 at 1.5% and 0.4% respectively, while rates on sight deposits also remained low (**Chart 1.3**). In recent discussions, some major

Chart 1.3 Rates on household and PNFC deposits(a)



(a) Effective rates on sterling household and PNFCs deposits. The Bank's effective rate series are currently compiled using data from up to 22 UK MFIs. The effective rate is an average monthly rate. Non seasonally adjusted. The rates on sight deposits show rates on interest-bearing deposits only.

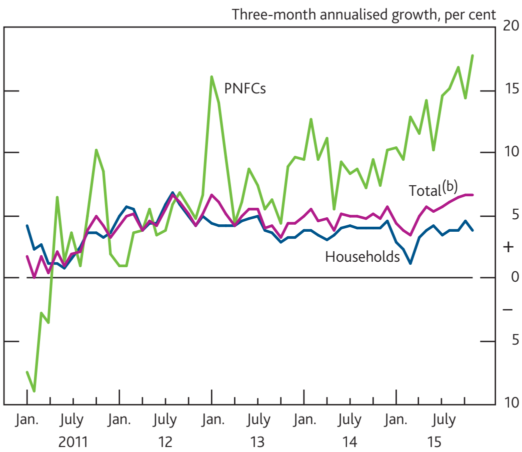
Chart 1.4 Gross wholesale term issuance by UK lenders in public markets(a)



Sources: Dealogic and Bank calculations.

(a) Term issuance is defined here as issuance exceeding 18 months' maturity. UK lenders are defined by the nationality of the operations of the issuer's parent company. Data include issuance in all currencies, expressed in 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 deposits together.

UK lenders expected retail deposit rates to remain broadly flat in 2016.

Funding volumes

Respondents to the *BLS* reported that their total funding volumes stayed broadly unchanged in the three months to mid-December 2015. Within the total, lenders reported that retail funding had increased significantly, while 'other' funding, which includes wholesale debt funding and wholesale deposits, had fallen. Lenders expected total funding volumes to fall slightly in 2016 Q1.

UK banks' gross issuance of wholesale term funding was weak in 2015 Q4 relative to the strong level of issuance in the first nine months of 2015, according to data from Dealogic (**Chart 1.4**). In recent discussions, the major UK lenders noted that weaker issuance in Q4 reflected banks having completed the majority of their funding plans in the earlier part of the year.

The total volume of household and corporate deposits picked up over 2015, with growth rates increasing in the second half of the year and reaching 6.7% on a three-month annualised basis in November (**Chart 1.5**). Lenders' responses to the *BLS* suggested that deposit growth was supported by an increase in the supply of deposits from households and corporates in Q4. And lenders cited regulatory drivers, market share objectives and the favourable cost of corporate deposits as factors that were pushing up their demand for deposits.

Growth in household deposits was little changed over the past three months, staying at around 4% on a three-month annualised basis in November. Deposit growth for private non-financial corporations (PNFCs) was particularly strong throughout 2015, reaching 17.8% on a three-month annualised basis in November (**Chart 1.5**). Contacts of the Bank's Agents gave a wide range of reasons for high levels of corporate deposits, including gently rising profitability for many firms coupled with still modest levels of investment and — particularly among smaller companies — a persistent desire to rely on internal funds rather than borrowing from banks as their main source of finance.(1)

In addition to issuing wholesale debt and raising retail deposits, banks can raise capital as a source of funding. Respondents to the *BLS* reported an increase in their total level of capital in Q4 for the seventh consecutive quarter. But they expected capital levels to remain broadly unchanged in 2016 Q1. Regulatory drivers were reported to have pushed up lenders' demand for capital, although the net percentage balance was much lower than in previous quarters, while demand for capital instruments from a range of investors was reported to have increased.

(1) For more detail see *Agents' summary of business conditions*, 2015 Q4, available at www.bankofengland.co.uk/publications/Pages/agentssummary/2015/dec.aspx.

2 Household credit conditions

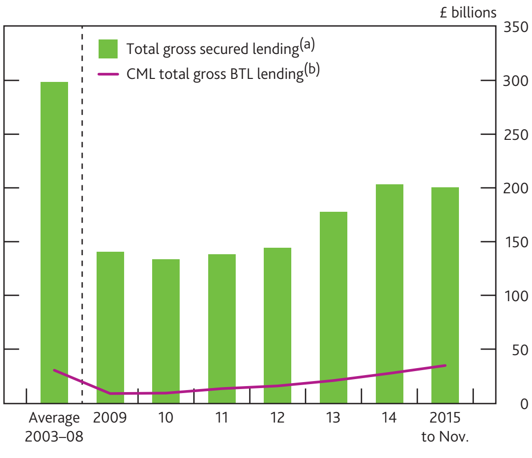
Secured lending growth continued to pick up in recent months; growth in the stock was 3.5% on a three-month annualised basis in November. This is likely to partly reflect favourable credit conditions: lenders reported a further slight increase in credit availability in the 2015 Q4 *Credit Conditions Survey*, and most mortgage spreads have fallen in 2015 particularly at higher loan to value ratios. Consumer credit continued to grow strongly, particularly for other loans and advances such as personal loans and overdrafts. Though quoted and effective rates on personal loans have increased a little in recent months, they remain close to historically low levels.

Table 2.A Secured lending to individuals[a]

		Averages					2015		
	2003–08	2013	2014	2015 Q1	2015 Q2	2015 Q3	Sep.	Oct.	Nov.
Net monthly flow (£ billions)	7.4	1.1	1.9	1.9	2.4	3.3	3.6	3.6	3.9
Three-month annualised growth rate (per cent)	10.7	1.1	1.9	1.7	2.1	2.9	3.2	3.4	3.5
Twelve-month growth rate (per cent)	11.4	0.9	1.7	1.9	1.8	2.1	2.2	2.4	2.5

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

Chart 2.1 Gross lending secured on dwellings



Sources: CML and Bank of England.

(a) Total gross lending secured on dwellings. Data for 2015 are to November. Data cover sterling lending by UK MFIs and other lenders to UK individuals. Non seasonally adjusted.
(b) Sterling. Data are to November 2015. Non seasonally adjusted.

Secured lending to UK households

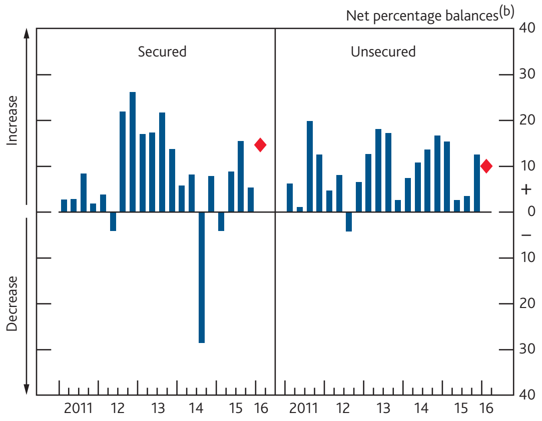
Mortgage approvals for house purchase remained around 70,000 per month in the three months to November, but secured lending continued to pick up. Growth in the stock reached 3.5% on a three-month annualised basis in November, with annual growth at 2.5% (**Table 2.A**). These growth rates are the highest since 2008 and 2009 respectively, but remain considerably below their averages seen in the period leading up to the financial crisis. Similarly, gross secured lending, which has increased since 2010, is lower in 2015 to date than the annual average in the pre-crisis period (**Chart 2.1**).

The buy-to-let (BTL) sector has driven growth in the UK mortgage market in recent years.[1] Looking ahead, the Council of Mortgage Lenders (CML) noted considerable uncertainty surrounding the outlook for this sector stemming from factors such as the recently announced stamp duty changes. The CML expect overall BTL activity in 2016 to be similar to its 2015 level.[2] In recent discussions, most major UK lenders noted that growth in BTL house purchase activity could slow in 2016. Lenders also commented that some BTL activity could be brought forward into 2016 Q1, before the changes announced in the 2015 Autumn Statement take effect.

The pickup in secured lending is likely to partly reflect an increase in the availability of secured credit. Lenders responding to the Bank of England's *Credit Conditions Survey* (*CCS*) reported a further slight increase in credit availability in Q4, having reported increases in most quarters since mid-2012 (**Chart 2.2**). Contacts of the Bank's network of Agents noted that competition had remained intense in the owner-occupier

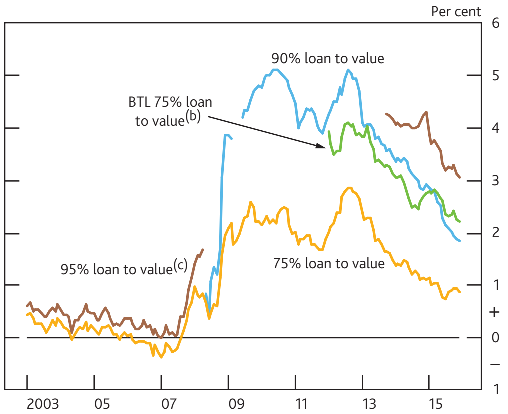
(1) For more details, see the *Financial Stability Report*, December 2015, No. 38, page 29; www.bankofengland.co.uk/publications/Documents/fsr/2015/dec.pdf.
(2) For more details of the forecasts made by the CML, see www.cml.org.uk/news/news-and-views/market-commentary-december-2015/.

Chart 2.2 *Credit Conditions Survey*: changes in availability of secured and unsecured credit to households[a]



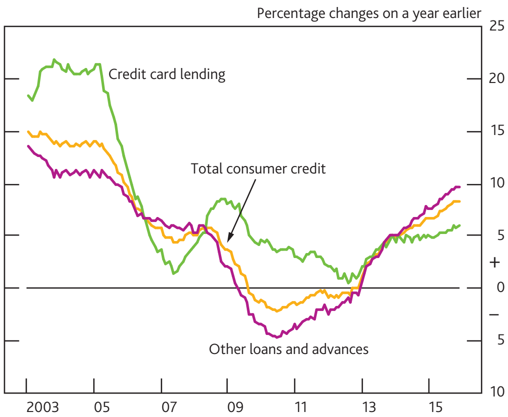
(a) Net percentage balances are calculated by weighting together the responses of those lenders who answered the question. The bars show the responses over the previous three months. The diamonds show the expectations over the next three months. Expectations balances have been moved forward one quarter. Where the *CCS* 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.

Chart 2.3 Spreads on quoted two-year fixed-rate mortgages[a]



(a) The Bank's quoted interest rate series are on sterling lending and are currently compiled using data from up to 22 UK MFIs. Non seasonally adjusted.
(b) End-month rates on sterling lending. This series is currently compiled using data from up to 30 MFIs, based on largest BTL lenders according to and weighted by MLAR data. Non seasonally adjusted.
(c) 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 Consumer credit[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.

mortgage market, with some increase in the availability of higher loan to value (LTV) lending.

Consistent with an increase in credit supply, spreads on most mortgages — such as those on the fixed-rate products shown in **Chart 2.3** — declined in 2015. That decline has been particularly marked at higher LTV ratios: spreads on two-year products at 90% and 95% LTV ratios fell by around 100 basis points in 2015 as a whole. Spreads on BTL mortgages have also fallen. In contrast, spreads (and rates) on 75% LTV two-year fixed rate mortgage products have risen a little since their trough in mid-2015. That may reflect the impact of the slight pickup in wholesale funding spreads and transfer prices in the past two quarters (Section 1).

The rise in secured lending in 2015 may also reflect an increase in demand for secured credit. Respondents reported a slight increase in demand for secured lending for house purchase in the *CCS* in Q4, having reported significant increases in the previous two quarters. In addition, lenders reported a significant increase in demand for BTL lending and an increase in demand for remortgaging in Q4. Other indicators such as the Royal Institution of Chartered Surveyors' new buyer enquiries balance for October and November continued to point to increasing demand. Contacts of the Bank's Agents noted however that the availability of properties for sale had continued to constrain growth in activity in most parts of the United Kingdom.

Consumer credit

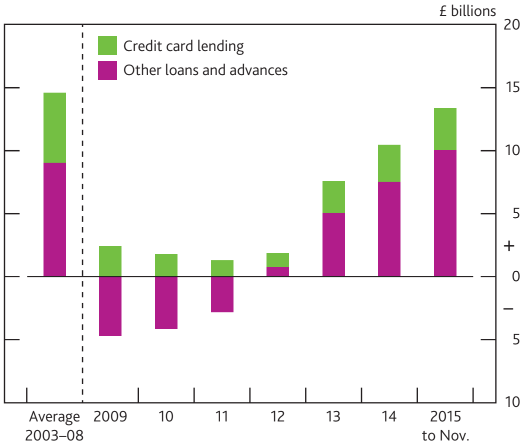
The annual rate of growth in the stock of consumer credit (excluding student loans) picked up to 8.3% in November (**Chart 2.4**). Within this, other loans and advances such as for personal loans and overdrafts, continued to account for the majority of the overall net flow (**Chart 2.5**). Indicative estimates, which are only available for 2014 and 2015, suggest that the majority of these flows were for car finance.[1]

Though quoted and effective rates on personal loans have increased a little in recent months, they remain close to historically low levels (**Chart 2.6**). Rates on credit card lending were largely unchanged in Q4, but competition in this market remains centred on other terms. The length of the interest free period on balance transfers increased significantly in recent years.

The increase in consumer credit and low personal loan rates are likely to partly reflect an increase in the availability of such credit. Lenders reported an increase in the availability of unsecured credit in the Q4 *CCS*, and have been reporting increased availability for most of the past three years

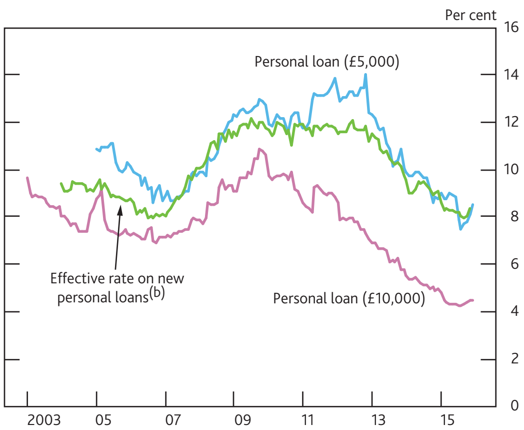
(1) For more details on car finance and other loans and advances, see the box on 'Consumer credit to UK individuals', in the 2015 Q3 *Credit Conditions Review*; www.bankofengland.co.uk/publications/Pages/creditconditionsreview/2015/q3.aspx.

Chart 2.5 Net consumer credit flows[(a)]



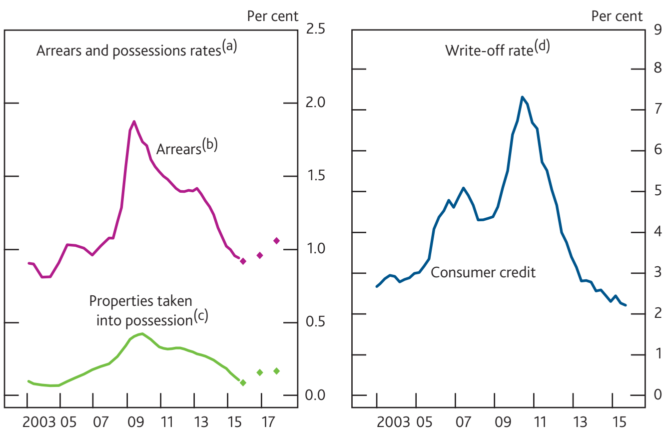
(a) See footnote (a) to **Chart 2.4**.

Chart 2.6 Quoted and effective interest rates on personal loans[(a)]



(a) Rates on sterling lending. The Bank's quoted and effective interest rates series are currently compiled using data from up to 22 UK MFIs. Quoted rates are end-month rates. The effective rate is an average monthly rate. Non seasonally adjusted.
(b) Effective interest rate on new fixed-rate unsecured loans to households with maturities of one to five years.

Chart 2.7 Arrears, possession and write-off rates



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. The green/magenta diamonds show the CML forecast for end-2015, end-2016 and end-2017 made in December 2015. 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.
(d) Lending by UK MFIs. 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. Lending in both sterling and foreign currency, expressed in sterling. Non seasonally adjusted.

(**Chart 2.2**). In the Q4 *CCS*, the increase in unsecured credit availability appears to have been concentrated in non-credit card lending such as personal loans and overdrafts: credit scoring criteria for such lending was reported to have loosened.

Loan performance

Indicators of loan performance on secured lending continued to improve, according to the latest data. Data from the CML indicated that the mortgage arrears and possessions rates drifted lower in 2015 Q3, relative to Q2 (**Chart 2.7**). And the write-off rate on mortgages — the ratio of write-offs on secured loans to the stock of lending — remained very low. The CML forecast is for the arrears and repossessions rates to drift up a little over the next two years from current low levels.

Some measures of loan performance on consumer credit also improved in recent months. The write-off rate on consumer credit ticked down in the year to 2015 Q3 and remained at historically low levels (**Chart 2.7**). The rate of personal insolvencies in England and Wales was little changed, though remains significantly lower than the period following the financial crisis.

3 Corporate credit conditions

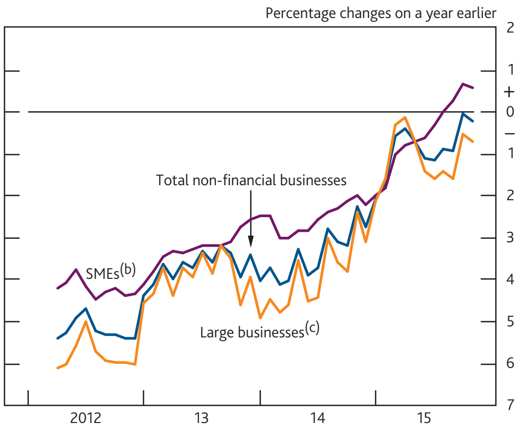
Lending to UK businesses picked up in recent months, with annual growth in the stock of lending on the all currency loans measure reaching 2.1% in November. Net lending increased across most industrial sectors. The pick-up in corporate borrowing is likely to partly reflect the improvement in credit availability since late 2012, as well as a more recent increase in demand. While the improvement in credit conditions has been apparent across all business sizes, smaller SMEs appear to have experienced a more gradual improvement than larger companies.

Table 3.A Lending to UK businesses[a]

	Averages						2015		
	2003–08	2013	2014	2015 Q1	2015 Q2	2015 Q3	Sep.	Oct.	Nov.
All currency loans to PNFCs[b]									
Net monthly flow (£ billions)	3.9	-0.7	-0.3	1.2	0.0	0.3	0.1	1.9	0.3
of which, sterling loans	*3.4*	*-0.5*	*-0.7*	*0.8*	*-0.7*	*0.8*	*0.6*	*1.0*	*0.4*
Three-month annualised growth rate (per cent)	12.5	-2.6	-1.1	2.7	2.8	-0.1	0.8	3.5	2.4
Twelve-month growth rate (per cent)	12.6	-3.0	-1.7	0.4	1.3	1.0	1.0	2.2	2.1

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

Chart 3.1 Lending to UK non-financial businesses[a]



(a) Rate of growth in the stock of lending. Lending by UK MFIs. Data cover lending in both sterling and foreign currency, expressed in sterling. Non seasonally adjusted.
(b) SMEs are those businesses with annual debit account turnover on the main business account less than £25 million.
(c) Large businesses are those with annual debit account turnover on the main business account over £25 million.

Borrowing by UK businesses

Net lending to UK businesses picked up over the three months to November, with annual growth in the stock of all currency loans reaching 2.1% (**Table 3.A**). Growth in the stock of lending increased across most industrial sectors, while the drag on growth from the real estate sector, which pushed down lending growth through much of the post-crisis period, eased.[1]

Annual growth in the stock of lending to both large businesses and small and medium-sized enterprises (SMEs) rose over the past three months (**Chart 3.1**). It remained negative for large companies in November, but for SMEs annual growth had reached 0.6%. Net lending to SMEs by participants in the Funding for Lending Scheme in 2015 Q3 was £0.7 billion, having also been positive in 2015 H1.[2] Companies continued to raise funds from non-bank sources such as capital markets in 2015, as discussed in the box on pages 12–14.

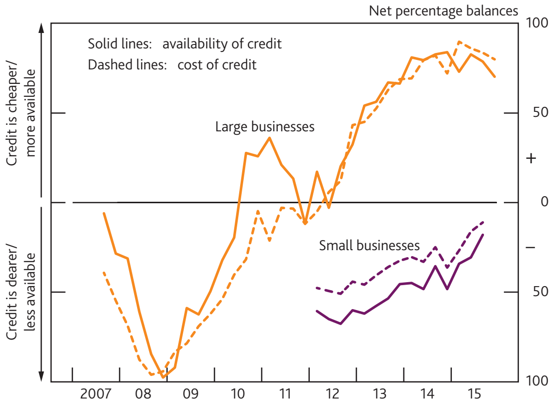
This pick up in lending growth to both large companies and SMEs has been underpinned by the improvement in corporate credit conditions over recent years, which is discussed in the remainder of this section.

Large corporates

The overall availability of credit for large businesses remained high. According to the *Deloitte CFO Survey* for 2015 Q4, the net percentage balance of respondents who reported that credit was 'available' was 71%, having fallen slightly from its series high (**Chart 3.2**). And the Bank's Agents' assessment is that credit availability for large companies is 'above normal' (**Chart 3.3**). Perhaps reflecting limited scope for

(1) For more details see *Bankstats* Table C1.2 'Industrial analysis of monetary financial institutions' lending to UK residents'; www.bankofengland.co.uk/statistics/Documents/bankstats/2015/dec/tabc1.2.xls.
(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.

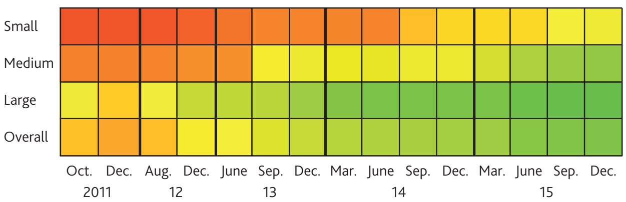
Chart 3.2 Availability and cost of credit, according to the *Deloitte CFO Survey* and FSB *Voice of Small Business Index*[(a)(b)(c)]



Sources: Deloitte, Federation of Small Businesses and Bank calculations.

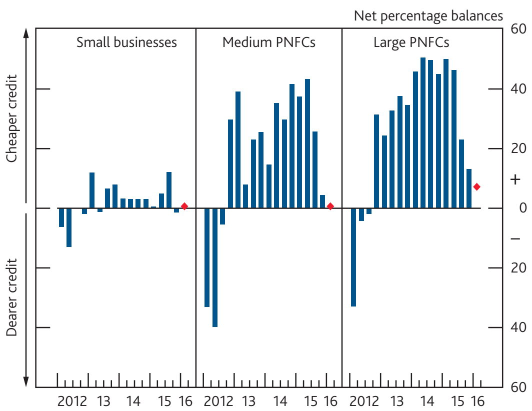
(a) Net percentage balances for the cost of credit are calculated as the percentage of respondents reporting that bank credit is 'cheap' in the *Deloitte CFO Survey* for large corporates or is 'good' in the Federation of Small Businesses' (FSB) *Voice of Small Business Index* for small businesses less the percentage reporting that it is 'costly' in the *Deloitte CFO Survey* for large corporates or 'poor' in the FSB *Voice of Small Business Index* for small businesses.
(b) Net percentage balances for the availability of credit are calculated as the percentage of respondents reporting that credit is 'available' in the *Deloitte CFO Survey* for large corporates or is 'good' in the FSB *Voice of Small Business Index* for small businesses less the percentage of respondents reporting that it is 'hard to get' in the *Deloitte CFO Survey* for large corporates or 'poor' in the FSB *Voice of Small Business Index* for small businesses.
(c) A positive balance indicates that a net balance of respondents report that credit is cheaper or credit is more available.

Chart 3.3 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 3.4 *Credit Conditions Survey*: spreads on lending over reference rates to corporates by firm size[(a)(b)(c)]



(a) See footnote (a) to **Chart 2.2**.
(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.
(c) Spreads are over Bank Rate or London interbank offered rate (Libor) for small businesses, and over Libor for medium-sized companies and large corporates. A positive balance indicates that spreads have fallen such that, all else being equal, it is cheaper for companies to borrow.

improvement, lenders responding to the *CCS* reported that credit availability for large corporates was unchanged in Q4.

The *CCS* also suggested that terms and conditions on bank lending to large companies were still improving, albeit at a slower pace. For example, lenders reported that spreads on lending fell in 2015 Q4, but the net percentage balance was the lowest for three years (**Chart 3.4**). And contacts of the Bank's Agents noted that although strong competition to lend from banks persisted, a small number of larger contacts had recently reported an increase in loan spreads.

There was evidence of an increase in demand for credit from large corporates. Lenders in the *CCS* reported a rise in demand from large companies in Q4, which was expected to persist into 2016 Q1 (**Chart 3.5**). Lenders reported that a significant driver of this increase was a growing appetite for mergers and acquisitions. Consistent with this, the value of UK mergers and acquisitions deals was at its highest level since 2000, according to data from Dealogic. However, most major UK lenders noted that this was driven by a number of very large deals.

In recent discussions, most lenders noted that mergers and acquisitions activity had also supported syndicated lending in 2015. Some lenders noted that there had been an increased use of bridge-to-bond financing in this market. That said, gross new syndicated lending facilities in the UK market in 2015 were £113 billion, down from the very strong levels recorded in 2014, according to Dealogic data. Most lenders noted that there was less refinancing activity in 2015.

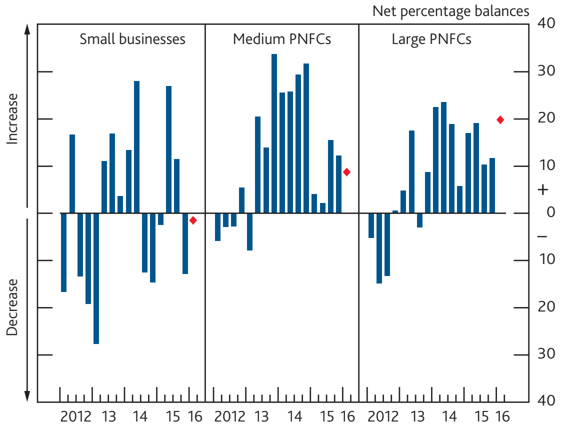
Small and medium-sized enterprises

Credit availability for SMEs improved over 2015, consistent with the recent rise in net lending, according to the FSB *Voice of Small Business Index* (**Chart 3.2**) and the Bank's Agents (**Chart 3.3**). There was little change in availability in Q4 according to lenders responding to the *CCS*.

Improvements in availability in recent quarters appear to have been less pronounced among smaller SMEs. The Bank's Agents continue to report tighter conditions for small companies (**Chart 3.3**), with some SMEs reporting that their finance options were limited to invoice discounting. The BDRC's *SME Finance Monitor* suggested that very small firms continued to experience higher rejection rates than larger SMEs over 2015, and those planning to apply remained less confident in their ability to access bank finance than their larger counterparts, though this gap had narrowed in 2015 Q3.

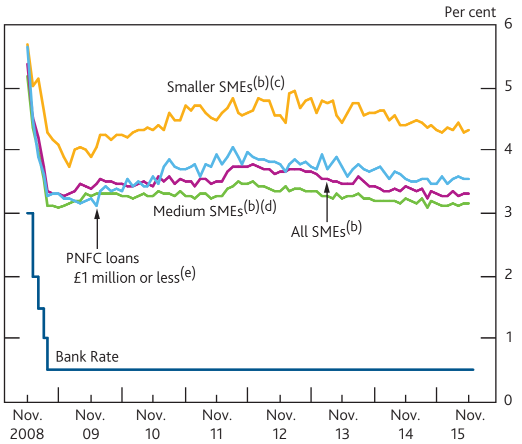
Although credit availability appeared to have increased, pricing on lending to SMEs was little changed according to the available data. Lenders in the *CCS* reported that spreads on loans to SMEs were unchanged in Q4 (**Chart 3.4**). And indicators of interest rates on lending to SMEs were broadly

Chart 3.5 *Credit Conditions Survey*: changes in corporate demand for lending by firm size[(a)(b)]



(a) See footnotes (a) and (b) to **Chart 3.4**.
(b) A positive balance indicates an increase in demand.

Chart 3.6 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-December and for all other series to end-November. 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) Medium SMEs are businesses with annual debit account turnover on the main business account between £1 million and £25 million.
(e) Weighted average rate on 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.

unchanged in the three months to November, although they had drifted down slightly over the past few years (**Chart 3.6**).

There was limited evidence of an improvement in demand for credit from SMEs. Respondents to the *CCS* reported that demand from medium-sized companies increased in Q4 (**Chart 3.5**). But lenders also noted that demand from small firms had fallen. Moreover, the proportion of SMEs described as 'happy non-seekers' was 80% in 2015 Q3, according to the latest *SME Finance Monitor*, broadly the same as in recent quarters.[(1)]

Loan performance

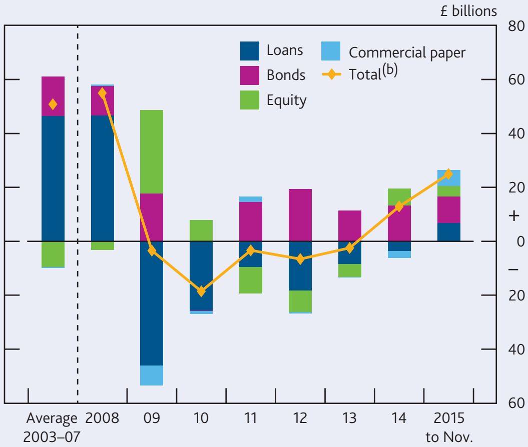
Indicators of corporate distress have improved in recent quarters. The corporate write-off rate — the ratio of banks' write-offs on corporate lending to the stock of that lending — fell slightly in the year to 2015 Q3 to 1.2%, the lowest level since 2009, while the rate of company liquidations over the past year had also drifted lower.

(1) 'Happy non-seekers' are those SMEs that had not had a loan/overdraft borrowing event/automatic renewal, and also said that nothing had stopped them applying for either loan or overdraft funding in the previous twelve months.

External sources of finance for UK businesses in 2015

Net finance raised by UK businesses from banks and capital markets in 2015 to November was £24.9 billion, the highest since 2008 (**Chart A**). All major components were positive together on an annual basis for the first time since the series began in 2003. Within this, net capital market issuance of bonds, equity and commercial paper accounted for 80% of total net finance raised in 2015 to date. Net bank lending turned positive for the first time since 2008.

Chart A Net external finance raised by UK businesses from banks and capital markets(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 non seasonally adjusted.
(b) Owing to the seasonal adjustment methodology, this series may not equal the sum of its components.

This box discusses developments in UK capital markets in 2015. It also provides updated estimates of other sources of external finance. More details on credit conditions for SMEs and large businesses are discussed in Section 3 on pages 9–11.

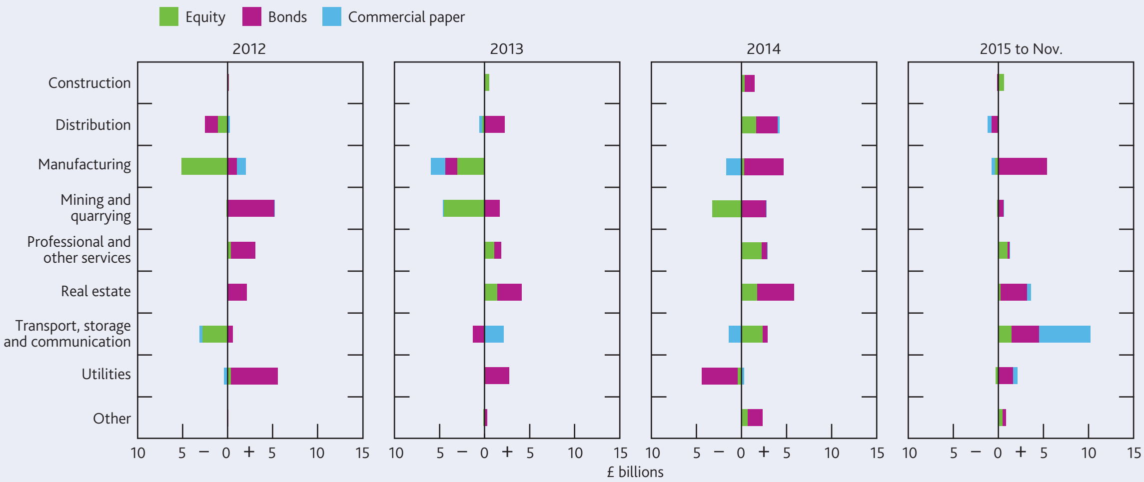
Bond and Commercial paper markets

Net bond issuance was £10.0 billion in 2015 to date, lower than the previous year. Positive net bond issuance was recorded in most major industrial sectors in 2014. By contrast, positive net issuance in 2015 was largely concentrated in the manufacturing and real estate sectors, with a larger contribution from the transport, storage and communication sector compared to the previous year (**Chart B**).

Gross bond issuance by UK-resident corporates was lower in 2015 compared to the previous year, according to Dealogic data (**Table 1**). Average monthly flows in 2015 H2 were around 40% lower than in H1, partly reflecting market volatility. While sterling-denominated high-yield and investment-grade bond spreads ticked up in the second half of the year relative to the first, they remained low compared to the years immediately following the financial crisis (**Chart C**).

The vast majority of bond issuance is carried out by large corporates, with SMEs rarely using corporate bond markets to raise finance. Over two thirds of respondents to the *Deloitte CFO Survey* — which covers large companies — continued to report that bond finance was an 'attractive' source of finance in 2015 Q4. Over the year however, the balance of respondents declined and remains below that for bank borrowing (**Chart D**).

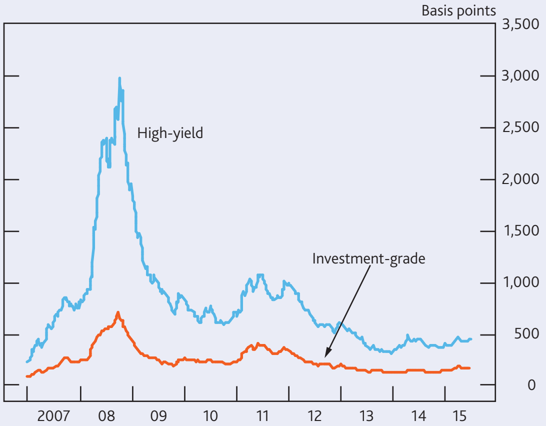
Chart B Net capital market issuance by UK businesses by major industrial sectors(a)(b)



(a) Finance raised by PNFCs from capital markets. Data cover funds raised in both sterling and foreign currency, expressed in sterling. Data for 2015 are up to and including November. 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) 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 2015 will not exactly equal the data for PNFCs in **Chart A**.

Net issuance of commercial paper was £5.9 billion in 2015 to date, the highest since the series began in 2003. This was mostly accounted for by one business in the transport, storage and communication sector (**Chart B**), with net issuance across other sectors close to zero.

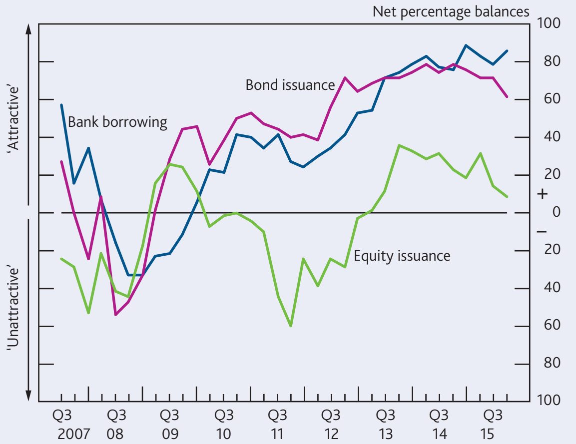
Chart C Sterling-denominated corporate bond spreads[(a)]



Source: BofA Merrill Lynch Global Research.

(a) Option-adjusted spreads. Sterling-denominated corporate bonds issued in domestic or eurobond markets. Data are to end-December 2015.

Chart D *Deloitte CFO Survey*: attractiveness of different sources of corporate funding[(a)]



(a) Net percentage balances are calculated as the percentage of respondents who reported that each source of funding was 'attractive' less the percentage who reported that it was 'unattractive'. A positive balance indicates that a balance of respondents found that particular source of funding 'attractive'.

Equity markets

Net equity issuance in 2015 to date was £3.8 billion, slightly lower than in 2014 which was a particularly strong year for equity issuance and the IPO market in particular. Relative to 2014, where net equity issuance was broad based across sectors, the net flow in 2015 was largely driven by the professional and other services and transport, storage and communication sectors (**Chart B**).

As with bond issuance, the balance of respondents to the 2015 Q4 *Deloitte CFO Survey* continued to report that equity issuance represented an attractive source of funding (**Chart D**). But the balance declined to its lowest level since 2013 Q3.

Alternative sources of external finance

In addition to banks and capital markets, alternative types of funding for businesses include asset-based finance and peer-to-peer business lending. Gross lending flows of such finance are smaller in comparison to bank lending and flows from capital markets (**Table 1**). Nevertheless, gross flows of peer-to-peer business lending increased in 2015. Research from the British Business Bank indicates that equity investment — which excludes public markets and investment by family or friends — in small businesses grew in the four years to 2014 Q3.[(1)]

Non-bank finance has also become increasingly important for the commercial real estate sector. The share of outstanding debt secured by commercial property and held by insurance companies and other non-bank lenders doubled between 2012 and the first half of 2015, to approximately 20% according to estimates by De Montfort University.

Trade credit, which usually takes the form of provision of goods and services from one business to another on delayed payment terms, is another form of finance. The 2015 Q3 *SME Finance Monitor* reported that a third of SMEs use trade credit from suppliers and of those SMEs, two thirds reported that this reduced their need for external finance.

(1) For more details see 'Review of equity investment in small businesses' British Business Bank, March 2015; http://british-business-bank.co.uk/wp-content/uploads/2015/03/050315-Equity-report-FINAL.pdf.

Table 1 Estimates of the flows of some external sources of finance for UK businesses[a]

	Source	Type	2012	2013	2014	2015
Net flows (£ billions)						
Bank lending[b]	Bank of England	PNFCs[c]	-18	-9	-3	9
		Total non-financial businesses[d]	-27	-16	-12	3
		SMEs[e]	-8	-4	-4	2
		Large[e]	-19	-12	-9	1 (to November)
Bond markets (public)	Bank of England[f]	Net issuance	19	11	13	10 (to November)
Equity markets (public)	Bank of England[f]	Net issuance	-8	-5	6	4 (to November)
Insurance companies, pension funds	ONS[g]	Net loans	3	1	3	2 (to Q3)
Peer-to-peer SME lending	Peer-to-Peer Finance Association[h]	SMEs				0.3 (to Q3)
Gross flows (£ billions)						
Bank lending	Bank of England	Gross lending[i]				
		Total non-financial businesses	146	163	190	187
		SMEs	38	43	53	53
		Large	108	120	136	134 (to November)
Bond markets (public)	Dealogic[j]	Gross issuance	66	54	55	45
Equity markets (public)	Dealogic[j]	Gross issuance	8	14	25	22
Asset finance (leasing and hire purchase)	Finance & Leasing Association[k]	New finance	22	23	26	26 (to November)
Peer-to-peer lending/crowdfunding	Nesta[l], AltFi[m]					
Peer-to-peer business lending		New business lending	0.06	0.19	0.70[m]	1[m]
Invoice trading[l]		New business lending	0.04	0.10	0.30	
Equity-based crowdfunding[l]		Amount invested	0.00	0.03	0.08	
Reward-based crowdfunding[l]		Amount invested	0.00	0.02	0.03	

(a) The information contained in this table should be viewed as indicative as data and definitions are not directly comparable across different sources. There can be some double counting across estimates. Flows data are cumulative totals for the year or to the date stated. Non seasonally adjusted. Most numbers have been rounded to the nearest billion. For a description of the terms used, see Table 1 of the box 'Estimates of sources of external finance for UK businesses' in October 2013 *Trends in Lending*, available at www.bankofengland.co.uk/publications/Documents/other/monetary/trendsoctober13.pdf. For more details on the data in this table and a longer backrun, including data on stocks see the accompanying spreadsheet: www.bankofengland.co.uk/publications/Documents/creditconditionsreview/2015/externalfinanceforbusinessesq415.xlsx.
(b) Data include overdrafts and loans in both sterling and foreign currency, expressed in sterling.
(c) Loans by UK-resident MFIs to PNFCs, excluding MFIs' holdings of commercial paper.
(d) Loans by UK-resident MFIs to UK non-financial businesses. For more details see *Bankstats* Table A8.1, available at www.bankofengland.co.uk/statistics/Pages/bankstats/current/default.aspx. The total may not equal the sum of its components due to rounding.
(e) SMEs are defined as those businesses with annual debit account turnover less than £25 million. Large businesses are defined as those with annual debit account turnover greater than £25 million.
(f) Data are not comparable to gross issuance data due to different sources.
(g) Release MQ5 Q3 2015, Table A, Office for National Statistics. Flows data are net investment and are calculated as the change in stock. Available at www.ons.gov.uk/ons/rel/fi/mq5--investment-by-insurance-companies--pension-funds-and-trusts/q3-2015/stb-mq5-q3-2015.html.
(h) Available at http://p2pfa.info/data.
(i) Data exclude overdrafts and cover loans in both sterling and foreign currency, expressed in sterling. See footnote (e) for definitions of SMEs and large businesses. The total may not equal the sum of its components due to rounding. For net lending data excluding overdrafts see *Bankstats* Table A8.1, available from the link in footnote (d).
(j) Bond issuance data may include issuance via the Order book for Retail Bonds (ORB). Data are not comparable to net issuance data in 'Net flows' due to the different sources.
(k) Available at www.fla.org.uk/index.php/category/press-release.
(l) Data for 2012–13 are from Nesta, available at www.nesta.org.uk/publications/understanding-alternative-finance-uk-alternative-financeindustry-report-2014. Peer-to-peer business lending is debt-based transactions between individuals and existing businesses who are mostly SMEs. Invoice trading is firms selling invoices or receivables to a pool of individuals or institutional investors. Equity-based crowdfunding is the sale of registered securities by mostly early stage firms to investors. Reward-based crowdfunding is transactions where donors have an expectation that recipients will provide a tangible (but non-financial) reward or product in exchange for their contribution.
(m) Data from 2014 onwards sourced from AltFi, available at www.altfi.com/data/indices/UKvolume.

Abbreviations

BIS — Department for Business, Innovation and Skills.
BLS — *Bank Liabilities Survey*.
BTL — buy-to-let.
CCS — *Credit Conditions Survey*.
CDS — Credit default swap.
CFO — Chief financial officer.
CML — Council of Mortgage Lenders.
FLA — Finance & Leasing Association.
FLS — Funding for Lending Scheme.
FSB — Federation of Small Businesses.
Libor — London interbank offered rate (see below).
LTV ratio — Loan to value ratio (see below).
MFIs — Monetary financial institutions (see below).
MLAR — Mortgage Lenders and Administrators Return.
PNFCs — Private non-financial corporations (see below).
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.
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 repayments of debt in a given period.
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.
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.
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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