Credit Conditions Review

2016 Q2

BANK OF ENGLAND

BANK OF ENGLAND

Credit Conditions Review

2016 Q2

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-March 2016. 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-June 2016. Unless stated otherwise, the data reported cover lending in both sterling and foreign currency, expressed in sterling.

The 2016 Q3 *Credit Conditions Review* will be published on 14 October 2016.

(1) The *Bank Liabilities Survey* and the *Credit Conditions Survey* for 2016 Q2 were conducted between 23 May and 10 June 2016. 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.

Contents

Executive summary

Having been little changed through most of Q2, measures of banks' long-term wholesale funding spreads increased following the outcome of the EU referendum. But spreads remained significantly below levels seen a few years ago, and the increase in spreads was offset by a fall in swap rates over the same period. In discussions conducted at the end of June, most major UK lenders expected wholesale funding spreads to remain somewhat higher in Q3, but low swap rates and retail funding costs were expected to limit the impact of this on transfer prices. UK lenders had continued to issue wholesale term debt in public markets in Q2. Retail deposit rates remained low, and retail deposit growth remained strong relative to recent years.

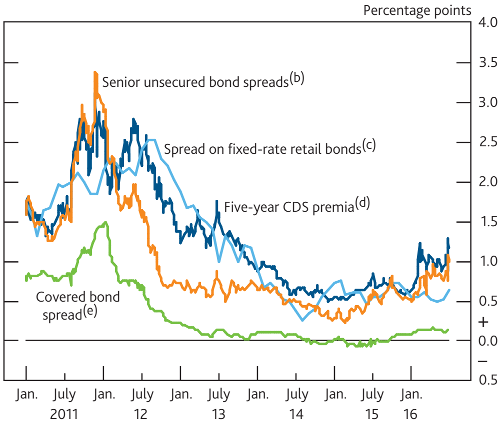
Secured credit availability to households tightened slightly in the three months to mid-June, according to lenders responding to the Bank of England's *Credit Conditions Survey*. Despite this, quoted rates on a range of two-year fixed-rate mortgages remained broadly flat in recent months and close to historical lows. In discussions that took place after the EU referendum, the major UK lenders expected the availability of secured credit to be little changed in the near term but the demand for secured credit to fall. Respondents to the *Credit Conditions Survey* suggested that both the supply of and demand for unsecured credit continued to rise in the three months to mid-June.

The cost and availability of credit to companies of all sizes was unchanged in the three months ahead of the EU referendum, according to lenders responding to the *Credit Conditions Survey*. But lenders reported a fall in availability to the commercial real estate sector for the first time since 2012 Q2. Demand for credit from large corporates slowed prior to the referendum according to lenders responding to the *Credit Conditions Survey*. In discussions conducted after the referendum, the major UK lenders expected the availability of credit to the corporate sector to remain steady, although a further tightening was expected for the commercial real estate sector. Lenders expected the demand for credit to fall back in the near term.

1 Bank funding

Having been little changed through most of Q2, measures of banks' long-term wholesale funding spreads increased following the outcome of the EU referendum. But spreads remained significantly below levels seen a few years ago, and the increase in spreads was offset by a fall in swap rates over the same period. In discussions conducted at the end of June, most major UK lenders expected wholesale funding spreads to remain somewhat higher in Q3, but low swap rates and retail funding costs were expected to limit the impact of this on transfer prices. UK lenders had continued to issue wholesale term debt in public markets in Q2. Retail deposit rates remained low, and retail deposit growth remained strong relative to recent years.

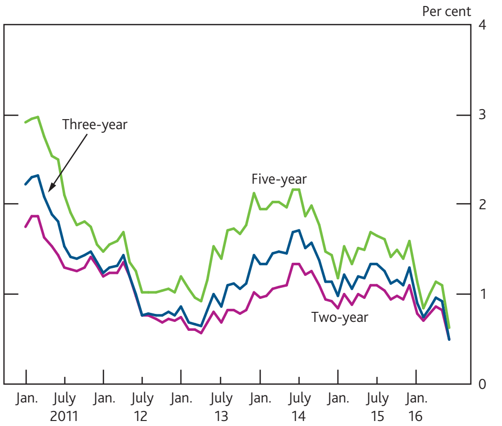
Chart 1.1 Indicative long-term funding spreads[(a)]



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

(a) Data are to end-June 2016.
(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.
(e) Unweighted average of covered bonds for the major UK lenders.

Chart 1.2 Swap rates at different maturities[(a)]



Sources: Bloomberg and Bank calculations.

(a) Data are to end-June 2016 and are month-end observations. Sterling swap rates.

Funding conditions following the EU referendum

Indicative measures of banks' wholesale funding spreads — such as senior unsecured bond spreads and CDS premia — rose by around 25 basis points between the outcome of the referendum and the end of the month (**Chart 1.1**). But measures of wholesale funding spreads remained much lower than the levels seen in 2011 and 2012. Swap rates declined following the referendum (**Chart 1.2**), offsetting the impact of higher spreads on overall funding costs. The fall in swap rates likely reflected changes in financial market participants' expectations for the path of Bank Rate.

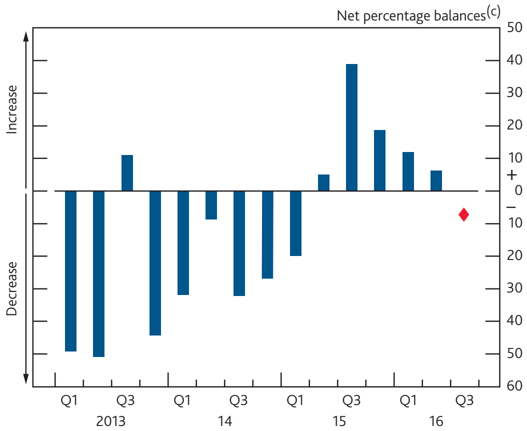
In discussions conducted at the end of June, most major UK lenders reported that following the result of the referendum, they expected long-term wholesale funding spreads to remain somewhat higher in Q3. But most did not expect higher wholesale funding spreads to feed through to an increase in their transfer prices — the internal price charged to business units to fund the flow of new loans — as these were expected to be offset by the recent fall in swap rates and the low cost of retail funding. In the Bank of England's *Bank Liabilities Survey* (*BLS*), which was conducted between 23 May and 10 June and so before the referendum, lenders had expected transfer prices to decline slightly in Q3 (**Chart 1.3**).

UK banks have accessed wholesale funding markets following the referendum. In discussions at the end of June, some major UK lenders noted that there remained good investor demand for bank debt. Some also noted that they were ahead of their 2016 plans for wholesale issuance.

Funding conditions prior to the EU referendum

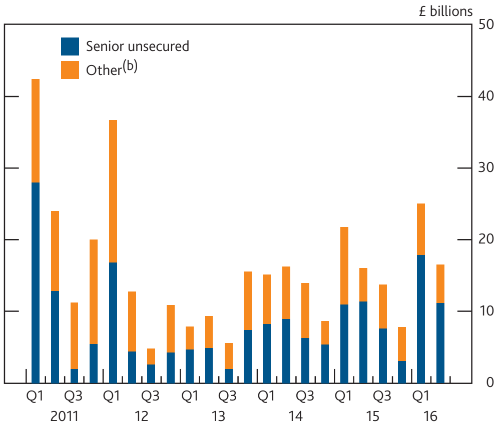
Prior to the referendum, senior unsecured bond spreads had been little changed on average during Q2, having picked up in the previous quarter (**Chart 1.1**). In part reflecting that increase in wholesale funding spreads, lenders had reported

Chart 1.3 *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 expectation over the next three months. The expectation balance has been moved forward one quarter. 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.

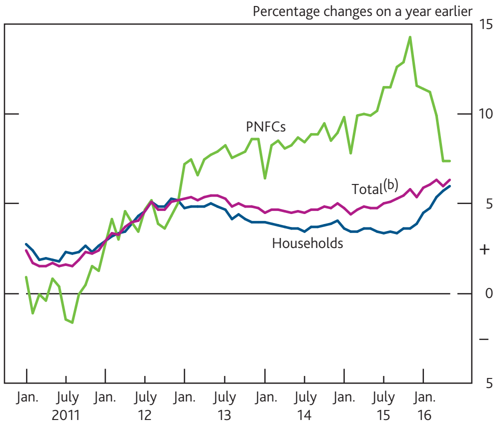
Chart 1.4 Gross wholesale term issuance by UK lenders in public markets[(a)]



Sources: Dealogic and Bank calculations.

(a) Term issuance is defined here as issuance with maturity exceeding 18 months. 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 MFIs' M4 liabilities. Seasonally adjusted.
(b) Total is the rate of growth of PNFCs' and households' deposits together.

higher transfer prices in recent *BLS's* (**Chart 1.3**). But there has been little evidence so far of higher transfer prices feeding through to the rates facing households (Section 2) or companies (Section 3).

Respondents to the *BLS* reported that their 'other' funding volumes, which includes wholesale debt funding and wholesale deposits, had fallen in the three months to mid-June. Nevertheless, UK lenders had continued to issue wholesale debt in public markets (**Chart 1.4**). Gross wholesale term issuance was £16.6 billion in 2016 Q2, following issuance of £24.9 billion in Q1.

In terms of retail funding, effective interest rates on household and private non-financial corporations (PNFCs) deposits were little changed in the three months to May at low levels. Spreads on retail deposits, such as on fixed-rate retail bonds (**Chart 1.1**) were also little changed. Annual growth in retail deposits increased a little in the three months to May, and remained strong relative to recent years at 6.3% (**Chart 1.5**). Deposits from PNFCs rose modestly and while the annual growth rate has eased, it was positive at 7.4% in May. Annual growth in household deposits continued to pick up, reaching 6.0% in May.

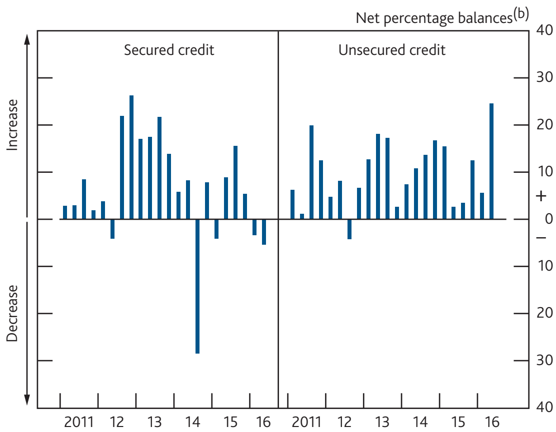
Capital instruments are a source of bank funding and banks' capital positions will influence their funding costs. Respondents to the *BLS* reported that their total level of capital had increased in 2016 Q2, as they have done in most quarters since the *BLS* began in 2012 Q4. Higher levels of bank capital may be one reason why wholesale funding spreads have picked up by less, so far, than they did in the period of financial market volatility in 2011 and 2012.[(1)] Lenders reported in the *BLS* that investor demand for capital instruments fell slightly in Q2.

(1) For more on the resilience of the UK financial system, see the July 2016 *Financial Stability Report*, available at www.bankofengland.co.uk/publications/Documents/fsr/2016/fsrjul16.pdf.

2 Household credit conditions

Secured credit availability to households tightened slightly in the three months to mid-June, according to lenders responding to the Bank of England's *Credit Conditions Survey*. Despite this, quoted rates on a range of two-year fixed-rate mortgages remained broadly flat in recent months and close to historical lows. In discussions that took place after the EU referendum, the major UK lenders expected the availability of secured credit to be little changed in the near term but the demand for secured credit to fall. Respondents to the *Credit Conditions Survey* suggested that both the supply of and demand for unsecured credit continued to rise in the three months to mid-June.

Chart 2.1 *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. 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.

Most of the data on household credit conditions relate to the period before the EU referendum. These are discussed below, alongside intelligence from the major UK lenders about the near-term outlook for credit conditions gathered after the referendum.

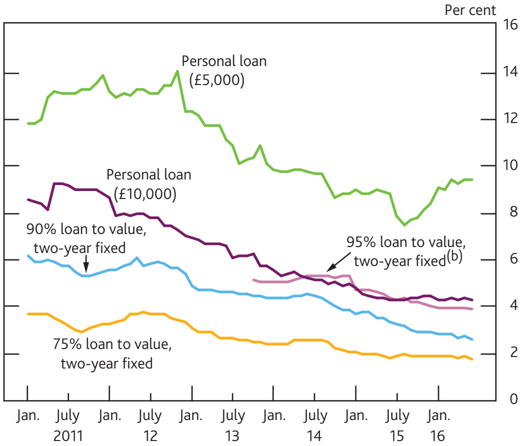
Availability and cost of credit

Lenders responding to the Bank of England's *Credit Conditions Survey* (*CCS*), which was conducted between 23 May and 10 June and so before the referendum, reported a slight fall in secured credit availability over the previous three months (**Chart 2.1**). Credit scoring criteria for secured lending were also reported to be slightly tighter. While availability was reported as slightly tighter, the cost of secured credit was little changed in Q2: quoted rates on a range of two-year fixed-rate mortgages have remained broadly flat in recent months and close to historical lows (**Chart 2.2**).

In discussions at the end of June, the major UK lenders expected the availability of credit for mortgages to remain broadly the same in the near term. Consistent with this, the lenders did not expect mortgage rates to change markedly. Some lenders noted that credit conditions could tighten if the macroeconomic outlook deteriorated.

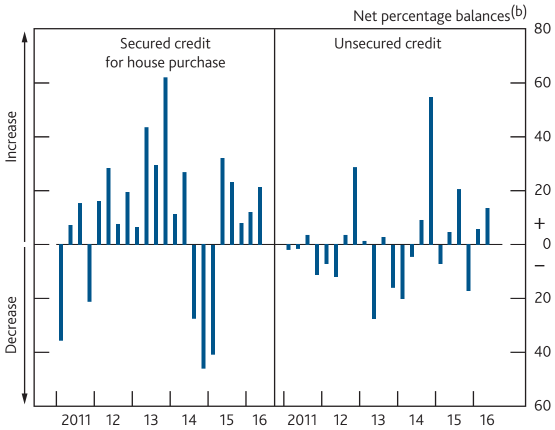
In contrast to secured lending, lenders responding to the *CCS* reported that the availability of unsecured credit had increased significantly in the three months to mid-June (**Chart 2.1**), with the net percentage balance at its highest level since the survey started in 2007 Q2. Within this, there appeared to be an increase in the availability of 'other' unsecured credit, such as personal loans, with credit scoring criteria reported to have loosened again. Consistent with an increase in credit supply, personal loan rates have fallen markedly over recent years although the average quoted £5,000 personal loan rate has

Chart 2.2 Quoted rates on secured lending and personal loans to households[a]



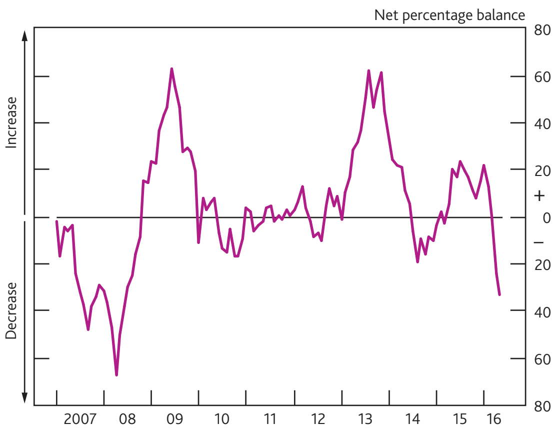
(a) Rates on sterling lending. The Bank's quoted interest rates series are currently compiled using data from up to 19 UK MFIs. Quoted rates are end-month rates. Non seasonally adjusted.
(b) This series was not available between May 2008 and September 2013 as fewer than three products were offered from the sample of lenders in that period.

Chart 2.3 *Credit Conditions Survey*: changes in demand for secured and unsecured credit to households[a]



(a) See footnote (a) of **Chart 2.1**.
(b) A positive balance indicates an increase in demand.

Chart 2.4 *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. Data are to May 2016. Seasonally adjusted.

increased slightly, and the £10,000 rate has been broadly flat in recent months (**Chart 2.2**). In discussions that took place at the end of June, most major UK lenders expected personal loan rates to remain at low levels in the near term.

Demand for credit

Demand for secured credit for house purchase increased significantly in the three months to mid-June according to lenders responding to the *CCS* (**Chart 2.3**). Within this, lenders responding to the survey reported that demand for prime lending had increased significantly, while demand for buy-to-let lending had fallen slightly. The reported fall in demand for buy-to-let lending in Q2 likely reflected buy-to-let housing transactions that had been brought forward to Q1, ahead of increases in stamp duty land tax for additional properties, which took effect from 1 April 2016.

Looking ahead, evidence indicates that the demand for secured credit may slow. The Royal Institution of Chartered Surveyors' (RICS) survey suggested a fall in demand for house purchase: the new buyer enquiries balance was negative again in May and recorded the lowest balance since June 2008 (**Chart 2.4**). Furthermore, in discussions at the end of June, most major UK lenders expected that demand for secured credit would fall.

Demand for unsecured credit was reported to have increased in the three months to mid-June, according to respondents to the *CCS* (**Chart 2.3**). Within this, demand for other unsecured lending increased significantly for four consecutive quarters. But as with secured lending, most major UK lenders expected that the demand for unsecured credit would decline in the near term.

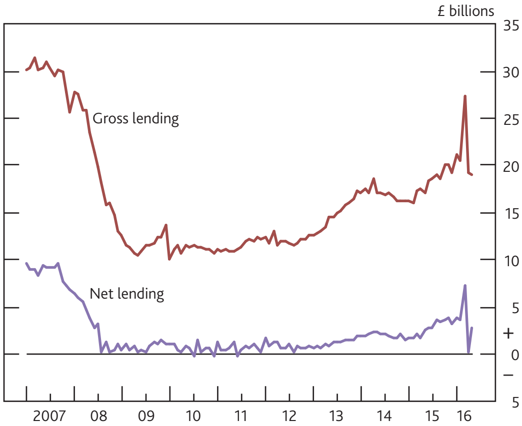
Lending data

Secured lending had been volatile in recent months, having been affected by the rise in stamp duty on additional properties implemented on 1 April. Gross and net secured lending increased significantly in March and subsequently fell back (**Chart 2.5**). Annual growth in the stock of secured lending was 3.2% in May, broadly in line with the previous three months.

Consumer credit growth remained strong relative to the rates in the immediate post crisis period: annual growth in the stock of lending was 9.9% in May. Within this, the annual growth rate in the stock of credit card lending rose to 7.4%, while the stock of other loans and advances grew by 11.2%.

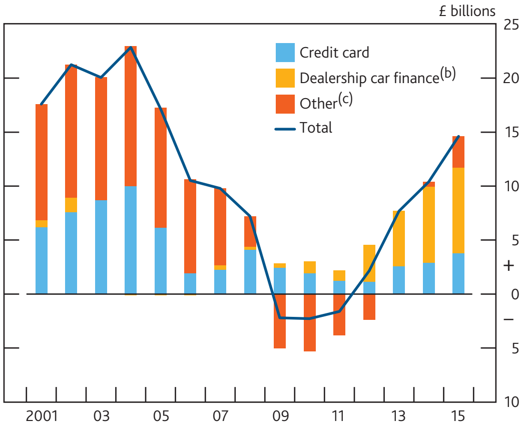
Dealership car finance has played an important role in the strength of other loans and advances (which also includes personal loans and overdrafts) in recent years. The net flow of car finance through dealerships had increased significantly since 2011, according to data from the Finance & Leasing

Chart 2.5 Secured lending to individuals[a]



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

Chart 2.6 Consumer credit[a]



Sources: Finance & Leasing Association, Bank of England and Bank calculations.

(a) Annual sterling net lending by UK MFIs and other lenders to UK individuals excluding student loans. Non seasonally adjusted.
(b) Dealership car finance net lending is estimated using change in outstanding stock rather than net lending. Net lending may therefore reflect breaks in the series as well as underlying flows.
(c) Other is estimated as total consumer credit lending minus dealership car finance as provided by the Finance & Leasing Association and credit card lending.

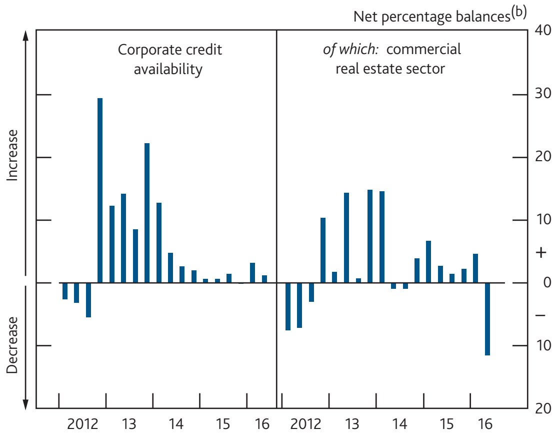
Association (FLA) (**Chart 2.6**).[1] In 2016 Q1, the net flow of dealership car finance was £1.3 billion, more than twice the flow in the corresponding quarter in 2013.

(1) These data represent car finance provided to consumers by FLA members and include credit provided by the finance arms of car manufacturers, bank-owned and other finance providers. For data on gross lending and the stock of car finance (through dealerships) see Table 2 in the box on 'Consumer credit to UK individuals', *Credit Conditions Review*, 2015 Q3, available at www.bankofengland.co.uk/publications/Pages/creditconditionsreview/2015/q3.aspx.

3 Corporate credit conditions

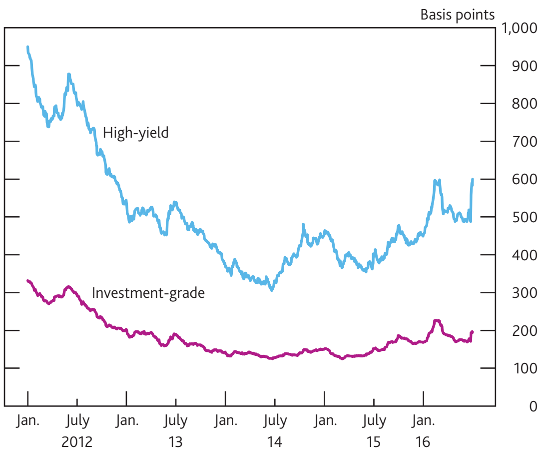
The cost and availability of credit to companies of all sizes was unchanged in the three months ahead of the EU referendum, according to lenders responding to the *Credit Conditions Survey*. But lenders reported a fall in availability to the commercial real estate sector for the first time since 2012 Q2. Demand for credit from large corporates slowed prior to the referendum according to lenders responding to the *Credit Conditions Survey*. In discussions conducted after the referendum, the major UK lenders expected the availability of credit to the corporate sector to remain steady, although a further tightening was expected for the commercial real estate sector. Lenders expected the demand for credit to fall back in the near term.

Chart 3.1 *Credit Conditions Survey*: changes in availability of credit provided to the corporate sector[(a)]



(a) See footnote (a) to **Chart 2.1**.
(b) A positive balance indicates that more credit is available.

Chart 3.2 Sterling-denominated corporate bond spreads[(a)]



Source: Bank of America Merrill Lynch Global Research.

(a) Spreads over UK government bond yields. Sterling-denominated corporate bonds issued in domestic or Eurobond markets. Data are to end-June 2016.

Most of the data on corporate credit conditions relate to the period before the EU referendum. These are discussed below, alongside intelligence from the major UK lenders about the near-term outlook for credit conditions gathered after the referendum.

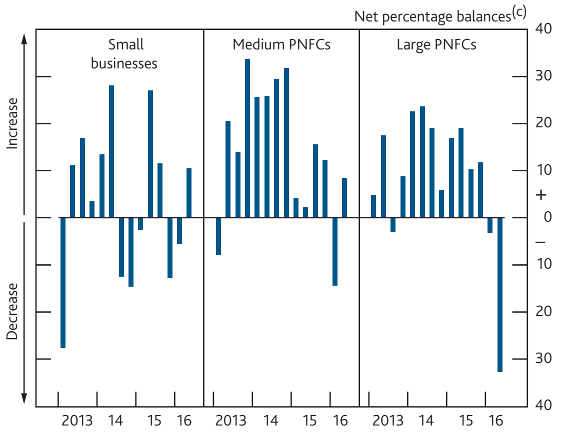
Availability and cost of credit

Having improved over the past few years, the availability of credit to companies of all sizes was unchanged in the three months ahead of the referendum, according to lenders responding to the *Credit Conditions Survey* (*CCS*) (**Chart 3.1**). But lenders reported a tightening in the availability of credit to the commercial real estate (CRE) sector for the first time since 2012 Q2 (**Chart 3.1**), with lenders citing a weak outlook for commercial property prices as a factor pushing down availability.

The cost of credit was also little changed in the three months leading up to the referendum, with respondents to the *CCS* reporting that spreads on lending to companies of all sizes were little changed. Other indicators, such as indicative interest rates on lending to small and medium-sized enterprises (SMEs) provided by BIS, and corporate bond spreads, were also little changed in the three months to May.

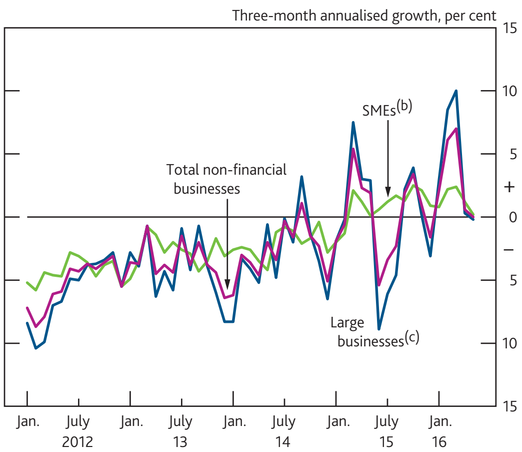
In the period following the announcement of the referendum result on 24 June and the end of the month, both investment-grade and high-yield corporate bond spreads picked up, albeit to levels that are well below those seen in 2012 (**Chart 3.2**). These rises in spreads were more than offset by falls in risk-free rates such that yields on corporate bonds fell. In discussions with the major UK lenders following the referendum, most expected the availability of corporate credit to remain steady in the near term, although availability to the CRE sector was expected to tighten further. Some major UK lenders noted that spreads on bank lending to large

Chart 3.3 *Credit Conditions Survey*: changes in corporate demand for lending by firm size(a)(b)



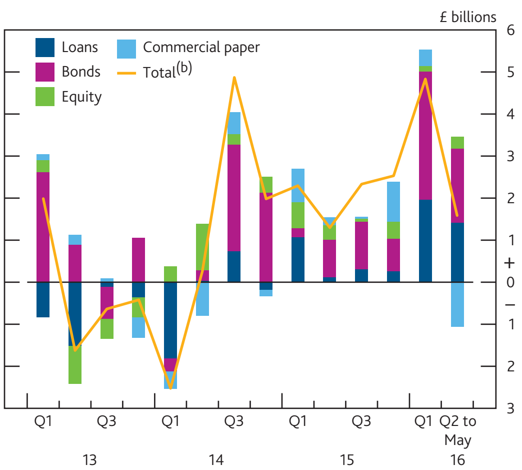
(a) See footnote (a) to **Chart 2.1**.
(b) Small businesses are defined as those with annual turnover of less than £1 million; medium-sized corporates are defined as those with annual turnover of between £1 million and £25 million; and large corporates are defined as those with annual turnover of over £25 million.
(c) A positive balance indicates an increase in demand.

Chart 3.4 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.

Chart 3.5 Net finance raised by UK businesses(a)



(a) Monthly averages presented at a quarterly frequency. 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 sterling and foreign currency, expressed in sterling. Seasonally adjusted. Bonds and commercial paper are not seasonally adjusted.
(b) Owing to the seasonal adjustment methodology, this series may not equal the sum of its components.

corporates, which have fallen to low levels in recent years, could see modest increases in the second half of the year.

Demand for credit

Demand for credit from large corporates slowed significantly ahead of the referendum, according to respondents to the *CCS* (**Chart 3.3**). Lenders cited significantly lower demand for CRE lending, less mergers and acquisitions activity and caution ahead of the referendum as factors driving this. Consistent with lower demand for credit, gross syndicated lending facilities granted in the UK market in 2016 Q2 were much lower than in Q1, according to Dealogic data. In contrast to large corporates, demand for lending from SMEs increased in the three months to mid-June according to lenders responding to the *CCS* (**Chart 3.3**).

In discussions carried out after the referendum, the major UK lenders thought there was likely to be a slowdown in demand for credit in the near term from both large corporates and SMEs, partly reflecting some investment decisions being delayed and mergers and acquisitions activity slowing. Consistent with that expectation, a survey by the Institute of Directors carried out between 24 and 26 June found that over a third of their members thought that the referendum outcome would cause them to cut investment in their business.

Lending data

The three-month annualised growth in the stock of lending to UK non-financial businesses was 0.0% in May 2016 (**Chart 3.4**). Total net finance raised by UK PNFCs — which includes borrowing from capital markets — was £1.6 billion on average in April and May (**Chart 3.5**), and £17.7 billion in 2016 to date, stronger than in the comparable period in 2015.

Abbreviations

BIS — Department for Business, Innovation and Skills.
BLS — *Bank Liabilities Survey*.
BTL — Buy-to-let.
CCS — *Credit Conditions Survey*.
CDS — Credit default swap.
CRE — Commercial real estate.
FLA — Finance & Leasing Association.
MFIs — Monetary financial institutions (see below).
PNFCs — Private non-financial corporations (see below).
RICS — Royal Institution of Chartered Surveyors.
SMEs — Small and medium-sized enterprises.

Glossary

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

Businesses Private non-financial corporations.

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

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

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

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

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 This refers to wholesale debt funding, wholesale deposits and funding via central bank operations.

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.

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.

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.

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

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.

ISSN: 2040-4042 (online)