Credit Conditions Review

2016 Q3

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 70% 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-June 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-September 2016. Unless stated otherwise, the data reported cover lending in both sterling and foreign currency, expressed in sterling and are seasonally adjusted.

The publication dates in 2017 for future *Credit Conditions Reviews* are:
2016 Q4 *Review* on 13 January 2017.
2017 Q1 *Review* on 13 April 2017.
2017 Q2 *Review* on 13 July 2017.
2017 Q3 *Review* on 12 October 2017.

(1) The *Bank Liabilities Survey* and the *Credit Conditions Survey* for 2016 Q3 were conducted between 23 August and 14 September 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.

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Executive summary

Bank funding conditions have seen a substantial improvement throughout 2016 Q3, having deteriorated somewhat in the immediate aftermath of the UK referendum on membership of the EU. Bank funding costs were lowered by falls in swap rates across all maturities. Measures of banks' long-term wholesale funding spreads have also declined over the past three months and are now close to their lowest levels in 2016. Key retail deposit rates have also fallen. In the Bank of England's *Bank Liabilities Survey*, UK banks reported that lower funding costs led them to decrease their transfer prices significantly. Issuance of long-term debt by UK banks was strong in Q3 relative to the past few years, and retail deposit growth remained robust.

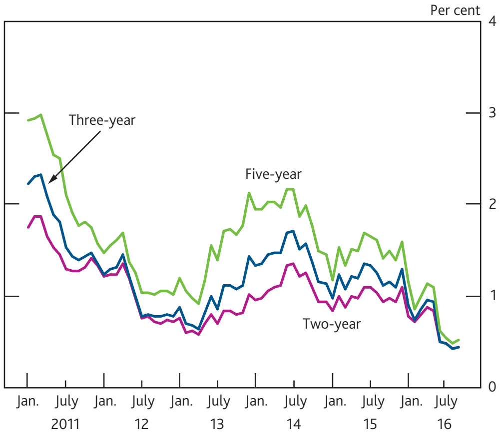
UK lenders have announced reductions in secured and unsecured lending rates, for both new and existing loans to households, on average, over the past few months. Secured credit demand for house purchase fell significantly in the three months to mid-September, while availability was unchanged, according to lenders responding to the Bank of England's *Credit Conditions Survey*. In discussions that took place in late September, major UK lenders reported that the fall in demand was likely to have been driven by temporary factors that led borrowers to defer mortgage applications, particularly the outcome of the UK referendum on membership of the EU. Consumer credit continued to grow solidly, and in contrast to secured lending, lenders responding to the *Credit Conditions Survey* reported that demand for non-credit card unsecured lending increased slightly in Q3, and was expected to increase further in Q4.

The cost of credit to most businesses appears to have fallen alongside recent decreases in reference rates. Lenders responding to the Bank of England's 2016 Q3 *Credit Conditions Survey* reported no change in spreads over reference rates for small and large businesses and a significant fall for medium-sized private non-financial corporations. The availability of credit to businesses was little changed according to lenders responding to the *Credit Conditions Survey*, though in recent discussions some major UK lenders noted that availability had tightened slightly for businesses in the real estate sector. Demand for credit from businesses weakened across all business sizes in Q3.

1 Bank funding

Bank funding conditions have seen a substantial improvement throughout 2016 Q3, having deteriorated somewhat in the immediate aftermath of the UK referendum on membership of the EU. Bank funding costs were lowered by falls in swap rates across all maturities. Measures of banks' long-term wholesale funding spreads have also declined over the past three months and are now close to their lowest levels in 2016. Key retail deposit rates have also fallen. In the Bank of England's *Bank Liabilities Survey*, UK banks reported that lower funding costs led them to decrease their transfer prices significantly. Issuance of long-term debt by UK banks was strong in Q3 relative to the past few years, and retail deposit growth remained robust.

Chart 1.1 Swap rates at different maturities(a)



Source: Bloomberg.

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

Chart 1.2 Indicative long-term funding spreads(a)

Sources: Bloomberg, Markit Group Limited and Bank calculations.

(a) Data are to end-September 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 five-year euro senior CDS premia for the major UK lenders.
(d) Unweighted average of euro-denominated covered bonds for the major UK lenders.

Funding costs and transfer prices

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

On 4 August, the Bank's Monetary Policy Committee (MPC) announced a package of measures to support the economy, including: a 25 basis point cut in Bank Rate to 0.25%; a new Term Funding Scheme to reinforce the pass-through of the cut in Bank Rate; the purchase of up to £10 billion of UK corporate bonds; and a £60 billion increase in purchases of UK government bonds, taking the total stock of these asset purchases to £435 billion. The package had implications for key reference rates, as well as for the spreads on bank funding instruments.

Swap rates across all maturities decreased in the immediate aftermath of the UK referendum on membership of the EU, as market participants' expectations for the future path of Bank Rate fell. Swap rates declined further after the policy announcement on 4 August, while they rose a little in subsequent weeks. Some of the key swap rates were about 35–50 basis points lower at the end of September than their averages in the three months prior to the referendum (**Chart 1.1**).

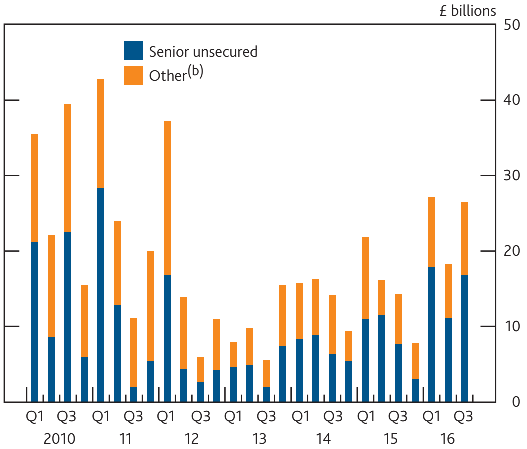
Indicative measures of banks' wholesale funding spreads — such as senior unsecured bond spreads and covered bonds — are lower than three months ago, having risen immediately after the referendum. The secondary market spreads on senior unsecured debt are now close to their lowest levels seen in 2016 (**Chart 1.2**). In recent discussions, some major lenders thought part of the fall in funding spreads could be attributed to the improved market sentiment following the introduction

Table 1.A Deposit rates[a]

		Share (2016 Q2, per cent)	Latest level (per cent)	Changes since (basis points): May 2016	Changes since (basis points): Average: June 2014 — May 2016
Effective rates (to Aug.)	**PNFCs**				
	Outstanding business				
	Interest-bearing sight	55[b]	0.27	-8	-9
	Time	9[b]	0.62	-5	-6
	New business				
	Time		0.35	-24	-11
	Households				
	Outstanding business				
	Interest-bearing sight	54[c]	0.64	-3	-12
	Time	34[c]	1.28	-8	-35
	New business				
	Time		1.12	-15	-36
Quoted rates (to Sep.)	**Households**				
	Instant access including unconditional bonuses		0.28	-12	-27
	Variable ISA including unconditional bonuses		0.57	-25	-42
	One-year fixed-rate bond[d]		0.82	-16	-40
	Bank Rate (to Sep.)		0.25	-25	-25

(a) Rates on sterling deposits. The Bank's quoted and effective interest rates series are currently compiled using data from up to 19 UK MFIs. Quoted rates are end-month rates and effective rates are average monthly rates. For further details of the series used in this table please see *Bankstats* Tables G1.3–G1.5. Non seasonally adjusted.
(b) Share of the total stock of outstanding PNFCs deposits.
(c) Share of the total stock of outstanding households deposits.
(d) The share of one-year fixed-rate bonds in total retail fixed-rate bond purchases was 65% in 2016 Q2.

Chart 1.3 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.

of the MPC's policy package. CDS premia have, however, risen recently.

The cost to banks of retail deposit funding has also fallen. Effective rates on the stock of private non-financial corporations' (PNFCs) and households' deposits have fallen by 3 to 8 basis points between May and August, and are now between 6 and 35 basis points lower than their average over the two previous years (**Table 1.A**). Interest rates on new deposits have fallen by more. For example, the quoted rates on household deposit products fell by 12–25 basis points between May and September. Respondents to the *Bank Liabilities Survey* (*BLS*) reported that they expected the spreads of deposit rates over reference rates to fall over the next three months.

BLS respondents reported that transfer prices — internal prices charged to business units to fund the flow of new loans — decreased significantly in Q3. The falls in swap rates and lower spreads on long-term unsecured wholesale funding were reported to be the key drivers of the reduction in transfer prices.

Funding volumes

Respondents to the *BLS* reported that their total funding volumes had increased in 2016 Q3, and expected them to be broadly flat in Q4.

Wholesale debt issuance in public markets by UK lenders was strong in 2016 Q3 relative to the past few years. Banks issued £17 billion of senior unsecured debt in Q3, making it the strongest Q3 since 2010, according to data from Dealogic (**Chart 1.3**). In recent discussions, some major UK lenders noted that market conditions for issuance have been favourable, helped by the recent MPC stimulus package and the stance of monetary policy in the euro area. Some lenders noted that investor demand for bank debt was greater than the supply of debt into the market. This was amid evidence of stronger investor appetite for riskier forms of debt, such as holding company unsecured debt and additional Tier 1 (AT1) instruments, an improvement from 2016 H1.

Annual growth in total retail deposits increased a little in the past three months and in August was 6.6%, stronger than in recent years. Within this, annual growth in household deposits continued to pick up, reaching 6.5%. And PNFC deposit growth, which has been volatile in 2016 thus far, was 7.2%.

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 significantly in 2016 Q3, but they expected a significant decrease in Q4. Changes in balance sheet size were reported to be the key driver pushing up lenders' demand for capital in Q3 alongside strategic decisions to increase risk and changes in the riskiness of assets.

2 Household credit conditions

UK lenders have announced reductions in secured and unsecured lending rates, for both new and existing loans to households, on average, over the past few months. Secured credit demand for house purchase fell significantly in the three months to mid-September, while availability was unchanged, according to lenders responding to the Bank of England's *Credit Conditions Survey*. In discussions that took place in late September, major UK lenders reported that the fall in demand was likely to have been driven by temporary factors that led borrowers to defer mortgage applications, particularly the outcome of the UK referendum on membership of the EU. Consumer credit continued to grow solidly, and in contrast to secured lending, lenders responding to the *Credit Conditions Survey* reported that demand for non-credit card unsecured lending increased slightly in Q3, and was expected to increase further in Q4.

Table 2.A Mortgage rates(a)

		Share (2016 Q2, per cent)	Latest level (per cent)	Changes since (basis points): May 2016	Changes since (basis points): Average: June 2014 — May 2016
Effective rates (to Aug.)	*Outstanding business*				
	Floating rate	48(b)	2.82	-4	-10
	Fixed up to five years(c)	51(b)	2.81	-8	-43
	New business				
	Fixed up to five years(c)	84(d)	2.37	-9	-45
Quoted rates (to Sep.)	*New business*				
	Fixed rate				
	Two-year 75% LTV		1.59	-29	-45
	Two-year 90% LTV		2.40	-30	-105
	Lifetime tracker		2.38	-20	-30
Reference rates (to Sep.)	Bank Rate		0.25	-25	-25
	Two-year swap rate(e)		0.44	-37	-57

Sources: Bloomberg, Bank of England and Bank calculations.

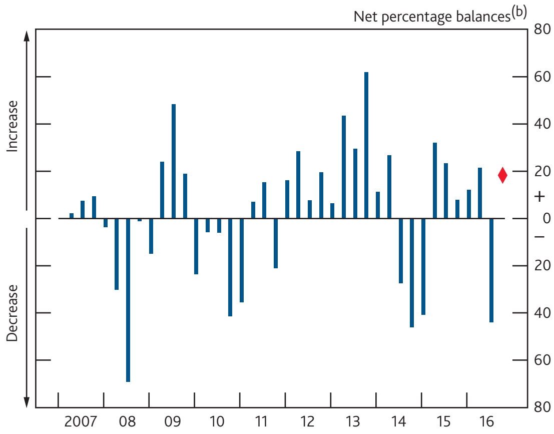
(a) Rates on sterling lending. The Bank's quoted and effective interest rates series are currently compiled using data from up to 19 UK MFIs. Quoted rates are end-month rates and effective rates are average monthly rates. For further details of the series used in this table, please see *Bankstats* Tables G1.3–G1.5. Non seasonally adjusted.
(b) Share of the total outstanding stock of mortgages.
(c) Prior to January 2016, this series consisted of rates on lending to unincorporated businesses and individuals and was for the 1–5 year fixation period. From January 2016 onwards, this series only includes rates on lending to individuals.
(d) Share of new mortgage lending.
(e) Data are monthly averages of daily data.

Secured lending to UK households

The reduction in Bank Rate by 25 basis points on 4 August 2016 will lower rates for existing borrowers with floating rate mortgages, such as tracker or standard variable rate (SVR) mortgages. The effective rate on the stock of outstanding floating rate mortgages, which accounts for around 50% of the stock of outstanding mortgages, fell by 4 basis points between May and August (**Table 2.A**). This should fall further over subsequent months as announced changes on floating rate mortgages take effect for existing mortgagors. For example, lenders accounting for the vast majority of the stock of mortgage lending, including the six major UK lenders, have announced changes in their SVRs, many of which will have been implemented from September onwards. Pass-through of rate reductions to existing borrowers on fixed-rate mortgages is slower, as it happens when borrowers refinance.

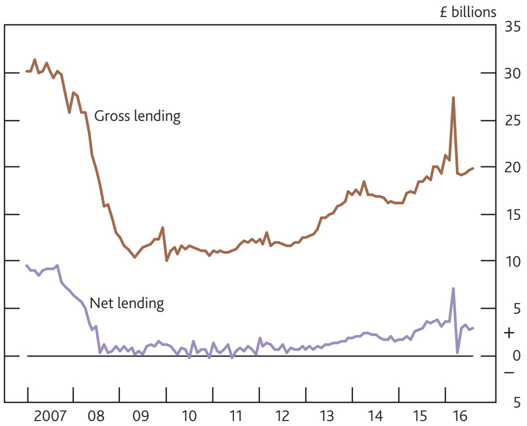
Quoted rates on new mortgages have fallen by 20–30 basis points since May 2016, following reductions in Bank Rate and swap rates (**Table 2.A**). As discussed in Section 1, swap rates have fallen by around 35–50 basis points since the EU referendum. More generally, swap rates have fallen over the past couple of years, and the effective rate on new fixed-rate loans was around 45 basis points lower at end-August than its recent average. In discussions that took place at the end of September, most major UK lenders observed that competition on price remained strong, for both mortgages with low and high loan to value (LTV) ratios. Some lenders also observed that price competition was likely to remain strong in the coming months, particularly as swap rates are expected to remain low and some lenders have been looking to grow their loan books.

Chart 2.1 *Credit Conditions Survey*: changes in demand for secured credit for house purchase[(a)]



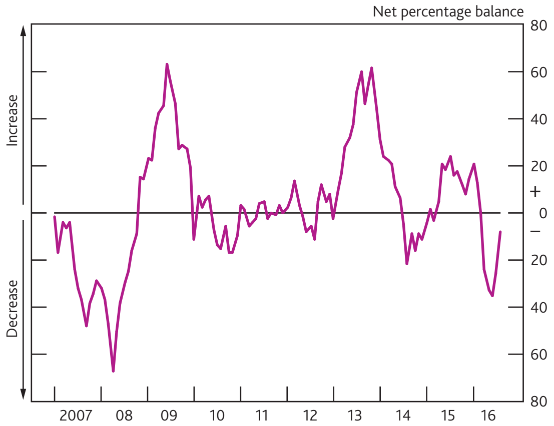
(a) Net percentage balances are calculated by weighting together the responses of those lenders who answered the question. The blue bars show the responses over the previous three months. The red diamond shows the expectation for the next three months. Where the *CCS* is discussed, descriptions of a '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 an increase in demand.

Chart 2.2 Secured lending to individuals[(a)]



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

Chart 2.3 *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 August 2016.

Although mortgage rates fell across a range of different products, lenders reported in the Bank of England's *Credit Conditions Survey* (*CCS*) that the availability of secured credit was unchanged in the three months to mid-September. Lenders also expected availability to remain unchanged in Q4.

Lenders in the *CCS*, however, reported a significant fall in households' demand for secured credit for house purchase in Q3 (**Chart 2.1**). Both demand for prime and buy-to-let lending contributed to the fall, and the fall in buy-to-let was the largest since the *CCS* began in 2007 Q2. Lenders attributed some of the fall in demand to the EU referendum, with customers deferring purchases in the weeks before and immediately after the referendum. Speculation on future reductions in Bank Rate was also cited as another factor that may have contributed to temporarily weaker demand, as borrowers waited to see if mortgage rates fell further. Consistent with the fall being temporary, lenders expect demand to rebound somewhat in Q4 (**Chart 2.1**).

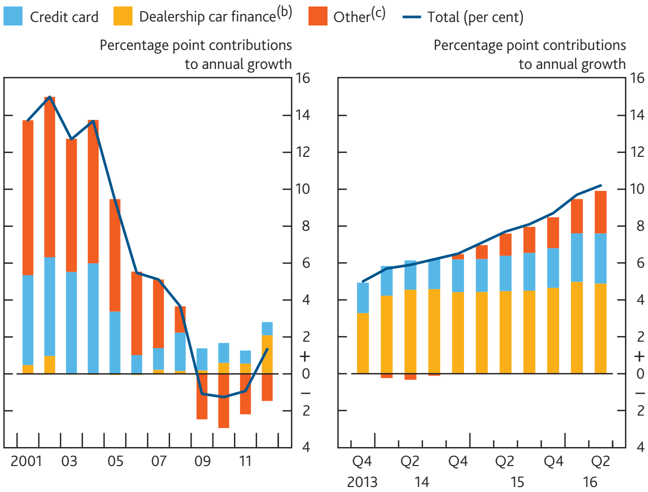
Lending data suggest that activity had been relatively stable between May and August 2016 (**Chart 2.2**), in contrast to the reported weakening in demand associated with the EU referendum. Gross lending rose slightly, while net lending was broadly unchanged. This followed sharp movements in lending earlier in the year related to stamp duty changes. In the discussions that took place at the end of September, some major lenders observed that the fall in demand reported in the *CCS* was primarily in June and early July, and had started to stabilise thereafter. The Royal Institution of Chartered Surveyors' (RICS) survey also suggested that demand conditions improved over Q3. The balance for new buyer enquiries was negative and falling over 2016 Q2, but then picked up substantially from its low in June 2016 (**Chart 2.3**).

Consumer credit

Consumer credit growth has been strong since late 2013. Dealership car finance continued to account for a substantial share of that growth, according to data from the Finance & Leasing Association: the box on pages 12–13 discusses recent innovations and developments in car finance. But the pickup in credit growth in recent quarters has been driven by neither credit card nor car dealership finance (**Chart 2.4**). This is consistent with intelligence from the Bank's Agents which suggests that growth in demand for new cars had continued to slow in the three months to August 2016, but they reported that consumer credit demand growth was steady overall.

Consistent with strong growth in consumer credit, lenders responding to the *CCS* have reported increases in availability in this sector since late 2012. Quoted rates on new personal loans of £10,000 have fallen by around 25 basis points since May 2016, and credit scoring criteria were reported to have loosened in Q3, according to respondents to the *CCS*.

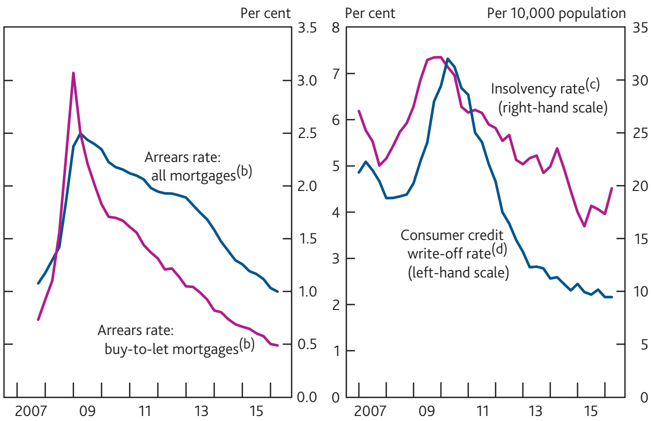
Chart 2.4 Consumer credit growth[a]



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

(a) Sterling net lending by UK MFIs and other lenders to UK individuals excluding student loans. Data are annual to 2012 and quarterly thereafter. Non seasonally adjusted.
(b) Dealership car finance net lending is estimated using change in outstanding stock. It 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.

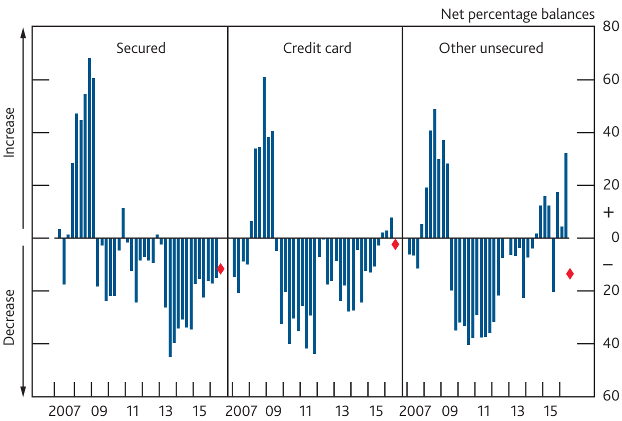
Chart 2.5 Indicators of household loan performance[a]



Sources: CML, ONS, The Insolvency Service, Bank of England and Bank calculations.

(a) Non seasonally adjusted.
(b) Mortgages in arrears of three months or more of the outstanding mortgage balance. Series are expressed as the proportion of the number of outstanding mortgages.
(c) For more details about the personal insolvency rate series, see Chart 3.2, footnote (b), in *Trends in Lending* September 2010.
(d) For more details about the consumer credit write-off rate series, see Chart 2.7, footnote (d), in *Credit Conditions Review* 2015 Q4.

Chart 2.6 *Credit Conditions Survey*: changes in default rates[a]



(a) See footnote (a) in **Chart 2.1**.

Demand for other unsecured lending,[1] such as personal loans, increased slightly in Q3 according to lenders responding to the *CCS*, in contrast to the reported fall in demand for secured lending. Over the next three months, lenders anticipated that demand for consumer credit will increase, but availability will be unchanged.

Loan performance

Indicators of loan performance for secured lending continued to improve according to the latest data. Mortgage arrears rates continued to drift lower in 2016 Q2, according to data from the Council of Mortgage Lenders (**Chart 2.5**), and lenders reported in the *CCS* that the default rate on secured loans fell in Q3, for the thirteenth consecutive quarter (**Chart 2.6**).

Recent indicators of loan performance for consumer credit have been somewhat mixed. The write-off rate on consumer credit was unchanged in 2016 Q2, and remained at historically low levels (**Chart 2.5**). The rate of personal insolvencies in England and Wales meanwhile picked up in Q2, though remains significantly lower than the period following the financial crisis. According to *CCS* responses, default rates on other unsecured loans increased significantly in Q3, bringing the balance to its highest level since 2009 Q2 (**Chart 2.6**). Lenders, however, expected the increase in default rates to be temporary, and anticipated a decline in Q4.

(1) In the *CCS*, other unsecured lending is defined as unsecured lending excluding credit cards.

3 Corporate credit conditions

The cost of credit to most businesses appears to have fallen alongside recent decreases in reference rates. Lenders responding to the Bank of England's 2016 Q3 *Credit Conditions Survey* reported no change in spreads over reference rates for small and large businesses and a significant fall for medium-sized private non-financial corporations. The availability of credit to businesses was little changed according to lenders responding to the *Credit Conditions Survey*, though in recent discussions some major UK lenders noted that availability had tightened slightly for businesses in the real estate sector. Demand for credit from businesses weakened across all business sizes in Q3.

Table 3.A Corporate loan rates[a]

		Share (2016 Q2, per cent)	Latest level (per cent)	Changes since (basis points): May 2016	Changes since (basis points): Average: June 2014 — May 2016
Effective rates (to Aug.)	***Outstanding business***				
	PNFC floating	82[b]	2.62	-13	-20
	SME[c][d]				
	floating	84	2.96	-12	
	of which: Libor		*2.93*	*-8*	
	of which: Bank Rate		*2.98*	*-13*	
	fixed	16	4.75	-7	
	New business				
	PNFC floating	90[e]	2.52	1	-15
	SME[c][f]				
	floating	91	3.00	-27	
	of which: Libor		*2.77*	*-34*	
	of which: Bank Rate		*3.20*	*-14*	
	fixed	9	4.07	-27	
Reference rates (to Sep.)	Bank Rate		0.25	-25	-25
	Three-month Libor[g]		0.38	-21	-19

Sources: Bloomberg, Bank of England and Bank calculations.

(a) Rates on sterling lending on loans and exclude overdrafts. The Bank's effective interest rates series are currently compiled using data from up to 19 UK MFIs. Effective rates are average monthly rates. For further details of the series used in this table please see *Bankstats* Tables G1.4–G1.5. Non seasonally adjusted.
(b) Share of outstanding business lending to corporates.
(c) SMEs are defined as those businesses with annual debit account turnover on the main business account of less than £25 million and exclude unincorporated businesses. For more details on these series, see 'Forthcoming improvements to interest rate statistics', *Bankstats*, August 2016; available at www.bankofengland.co.uk/statistics/Documents/articles/2016/18sep.pdf. Series start in January 2016.
(d) Amounts outstanding for SMEs was 44% of total new business lending to corporates, of this 84% was done at floating rates and 16% at fixed.
(e) Share of total new business lending to corporates.
(f) New business lending for SMEs was 31% of total new business lending to corporates in 2016 Q2, of this 91% was done at floating rates and 9% at fixed.
(g) Data are monthly averages of daily data.

Cost and availability of credit

The recent reduction in reference rates, such as Bank Rate and swap rates, will reduce businesses' cost of credit as lower bank funding costs are passed through to borrowers. The effective floating rate on the stock of loans to businesses fell by 13 basis points between May and August 2016 (**Table 3.A**). Floating rate loans account for around four fifths of outstanding business loans; but some companies, particularly large ones, may hedge their interest rate exposure.

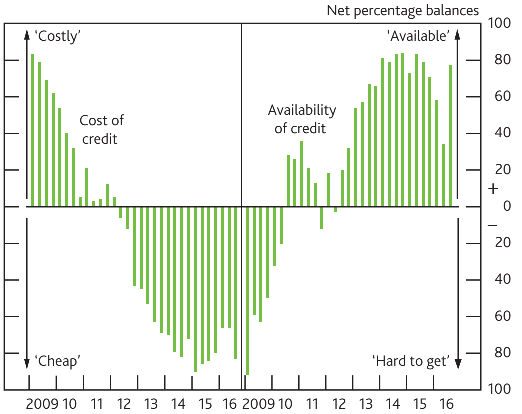
The fall in effective rates on the stock of loans to businesses appears to have been broad-based; for example, the effective floating rate for small and medium-sized enterprises (SMEs) also fell by a similar amount. Around one third of these floating rate loans to SMEs have a reset period of three months or more, according to estimates by the Bank of England. Looking forward, this suggests that these rates might fall further.

Interest rates on new lending have also fallen for SMEs. The overall effective floating rate charged to SMEs fell by 27 basis points since May, with those priced over Libor falling by slightly more. This is consistent with the FSB's *Voice of Small Business Index*, which reported that the net percentage balance of respondents who perceived credit to be 'affordable' in Q3 was at its highest level since the series began in 2012.

For large corporates, the net percentage balance of respondents in the *Deloitte CFO Survey* who reported the cost of bank credit to be 'cheap' increased in Q3 to 83% (**Chart 3.1**). Non-price terms such as fees and commissions and loan covenants were reported to be unchanged, according to respondents to the Bank of England's 2016 Q3 *Credit Conditions Survey* (*CCS*).

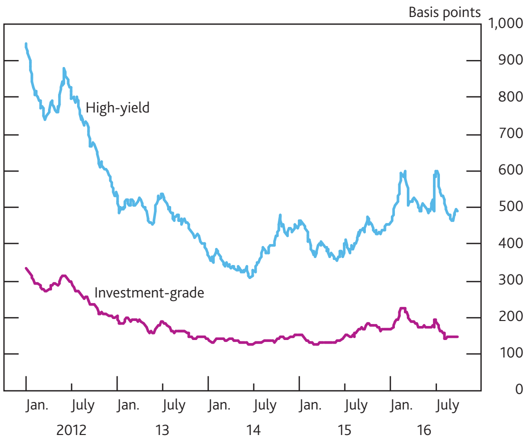
Lenders responding to the *CCS* reported no change in loan spreads for small and large businesses, although there had

Chart 3.1 *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'.

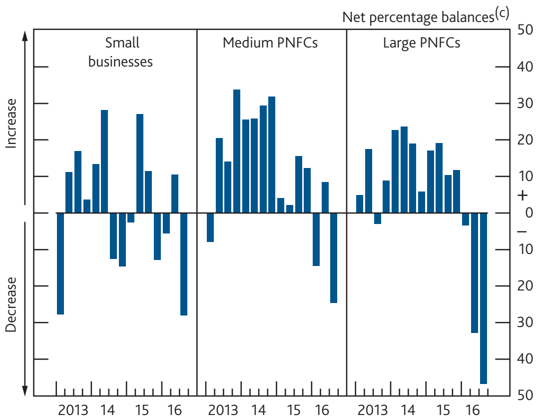
Chart 3.2 Sterling-denominated corporate bond spreads(a)



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-September 2016.

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.

been a significant fall for medium-sized PNFCs. In recent discussions, some major UK lenders noted that spreads on lending to businesses had plateaued.

In the corporate bond market — an important source of finance for some large companies — sterling-dominated investment-grade bond spreads fell slightly in 2016 Q3 (**Chart 3.2**). Following the MPC's announcement of corporate bond purchases in August, investment-grade spreads fell by around 10 basis points. However, spreads have remained broadly unchanged for high-yield issuers (those with lower credit ratings).

The availability of credit to businesses was little changed in the three months to mid-September, having improved over the past few years, according to *CCS* respondents. For large corporates, the net percentage balance of respondents to the *Deloitte CFO Survey* who reported that credit was 'available' picked up in 2016 Q3 to 77%, having fallen in Q2 (**Chart 3.1**). Notwithstanding this, in recent discussions some major UK lenders noted some tightening in the availability of bank lending to the commercial real estate (CRE) sector. This is consistent with intelligence gathered by the Bank's network of Agents.

Demand for credit

Demand for credit from businesses weakened in 2016 Q3. Lenders responding to the *CCS*, which was conducted between 23 August and 14 September, noted a significant fall in demand for credit across business sizes (**Chart 3.3**). Respondents partly attributed this fall to uncertainty following the outcome of the EU referendum.

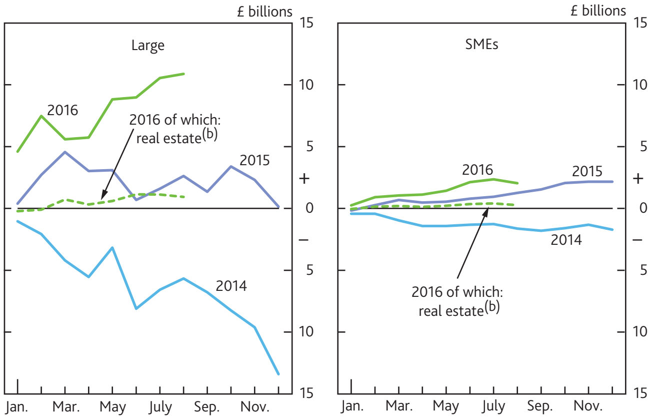
In recent discussions, some major UK lenders noted an uptick in demand from some large companies looking to refinance or for event-driven activity such as mergers and acquisitions. Contacts of the Bank's Agents noted that while demand for credit had generally held up following the outcome of the EU referendum, it had eased somewhat for CRE transactions. Contacts also noted an increase in the number of syndicated deals from larger corporates looking to refinance.

The proportion of SMEs described as 'happy non-seekers' of credit was 81% in 2016 Q2, according to the BDRC's *SME Finance Monitor*, broadly the same as in recent quarters. Looking ahead, some major UK lenders expected demand for credit from SMEs to be slightly weaker than earlier in the year due to increased macroeconomic uncertainty.

Lending data

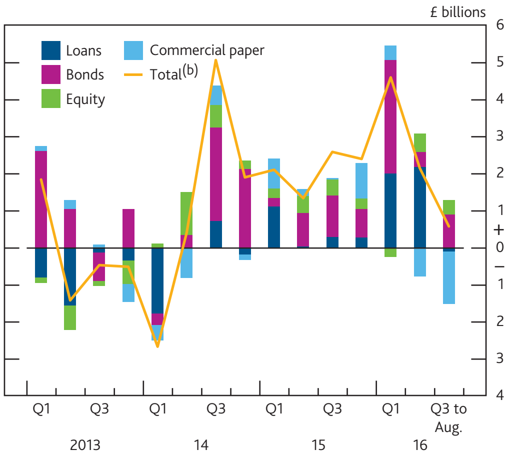
Cumulative net bank lending (excluding overdrafts) to both large businesses and SMEs was higher in 2016 to date than in previous years (**Chart 3.4**). Within this, cumulative net lending to the real estate sector was relatively low but positive across business sizes, according to Bank of England estimates.

Chart 3.4 Cumulative net lending to UK non-financial businesses[a]



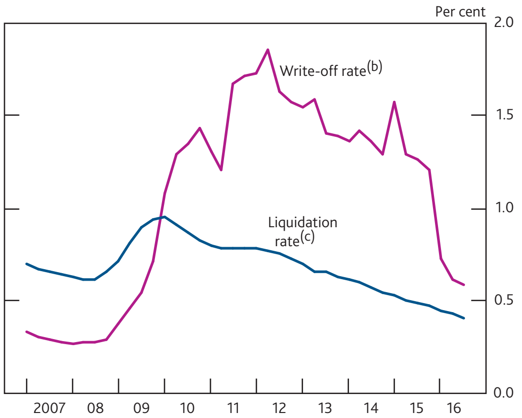
(a) Loans by UK MFIs to non-financial businesses. Net lending is defined as gross lending minus repayments. Data exclude overdrafts and cover lending in both sterling and foreign currency, expressed in sterling. Non seasonally adjusted. For more details on bank lending to SMEs and large businesses, see *Bankstats* Table A8.1 'Monetary Financial Institutions' loans to non-financial businesses, by size of business'; available at www.bankofengland.co.uk/statistics/Pages/bankstats/current/default.aspx.
(b) Buying, selling and renting of own or leased real estate and real estate and related activities on a fee or contract basis. Data for these series start in January 2016.

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 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.

Chart 3.6 Corporate liquidations and write-off rates[a]



Sources: The Insolvency Service and Bank of England.

(a) For more details on these series, see Chart 3.7 in *Credit Conditions Review* 2015 Q2; available at www.bankofengland.co.uk/publications/Pages/creditconditionsreview/2015/q2.aspx.
(b) Write-off rate on lending by UK MFIs to PNFCs. Non seasonally adjusted.
(c) Data relate to England and Wales. Seasonally adjusted.

This is in contrast to negative net lending in previous years to the real estate sector overall.[1] The majority of the positive cumulative net lending in 2016 to date is accounted for by other sectors such as the professional and other services, and distribution sectors.

Net bank lending to UK PNFCs was weaker on average in July and August than earlier in the year (**Chart 3.5**). There was a weakening in net commercial paper issuance. With strong net bond issuance, total net finance raised by UK businesses from banks and capital markets in Q3 to date remained positive, but was slightly weaker than in 2016 H1.

In addition to bank lending and capital markets, businesses continued to raise funds from alternative sources of external finance in 2016, including via peer-to-peer (P2P) platforms. Recent developments in P2P lending are discussed further in the box on pages 12–13.

Gross bond issuance by UK PNFCs in 2016 to date was broadly similar to the comparable period last year. Issuance was £3.8 billion in August,[2] with the majority of this issued in sterling. This was the highest August since the series began in 2003. It also followed the announcement of the Corporate Bond Purchase Scheme, which had been relatively unexpected by financial market participants.

Loan performance

Indicators of corporate distress were broadly unchanged in the year to 2016 Q2. The rate of corporate liquidations and the corporate write-off rate — the ratio of banks' write-offs on corporate lending to the stock of that lending — were little changed (**Chart 3.6**). Respondents to the *CCS* expected a decrease in the default rate on loans to small businesses over the next three months, and no change for medium and large PNFCs.

(1) See Chart A in the box in *Credit Conditions Review* 2016 Q1; available at www.bankofengland.co.uk/publications/Pages/creditconditionsreview/2016/q1.aspx.
(2) For more details on capital issuance by UK PNFCs, see *Bankstats* Table E3.1 'Capital issuance by UK residents'; available at www.bankofengland.co.uk/statistics/Pages/bankstats/current/default.aspx. Non seasonally adjusted.

Some recent innovations in lending

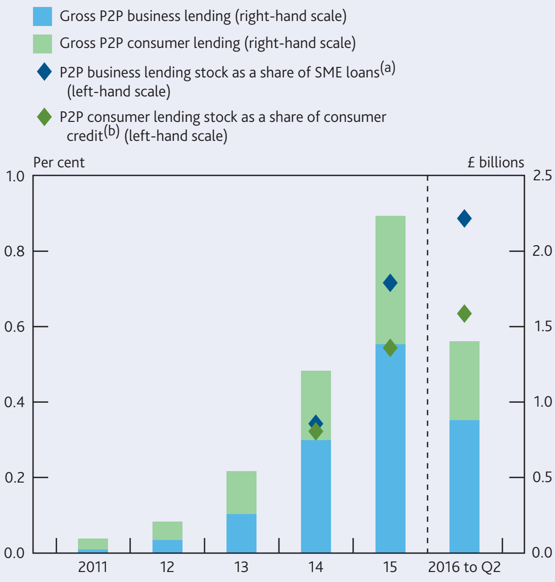
There have been many innovations in lending over the years.(1) This box looks at two examples of recent innovations and developments in lending to UK businesses and households: peer-to-peer lending and dealership car finance.

Peer-to-peer lending

Peer-to-peer (P2P) lending platforms connect investors and borrowers directly through online interfaces. This has allowed surplus capital from individuals and companies to be made available to borrowers. P2P lending began in the United Kingdom in 2005 with the public launch of Zopa.(2) Since then P2P lending has grown, providing an alternative source of external finance to households and businesses.(3)

Gross P2P lending flows to businesses have increased in recent years (**Chart A**). The real estate sector accounted for around 40% of these flows in 2015, according to estimates by Nesta.(4) P2P business flows were equivalent to around 3% of bank lending to SMEs in 2015, but the P2P business stock remained less than 1% of the stock of outstanding loans. The main driver of demand for P2P business lending was a continued perception of a lack of access to bank funding on terms that some borrowers were comfortable with, according to the Bank's network of Agents.(5)

Chart A P2P lending in the United Kingdom



Sources: Peer-to-Peer Finance Association, Bank of England and Bank calculations.

(a) SMEs are those with annual debit account turnover on the main business account less than £25 million. SME loans outstanding are sterling and foreign currency lending by UK MFIs to UK non-financial businesses. For more details on bank lending to SMEs, see **Chart 3.4**. Non seasonally adjusted.
(b) Consumer credit consists of credit card lending and other loans and advances and excludes student loans. Consumer credit outstanding are sterling lending by UK MFIs and other lenders to UK individuals. For more details on consumer credit, see *Bankstats* Table A5.6 'Consumer credit excluding student loans'; available at www.bankofengland.co.uk/statistics/Pages/bankstats/current/default.aspx. Non seasonally adjusted.

Gross lending to consumers through P2P lending platforms has also increased in recent years, and was £0.8 billion in 2015 (**Chart A**). As with P2P business lending, these flows remained relatively small compared to consumer credit, and the P2P consumer credit stock was equivalent to less than 1% of the stock of lending.

The P2P lending market has continued to grow through developments such as the increased activity of institutional investors. They accounted for 32% and 26% respectively in 2015 of total P2P funding to consumers and businesses.(6) The Bank's Agents noted that this has allowed P2P lenders to finance larger deals.

Car finance

Over the past decade, the car finance market has developed through the increased use of finance products, including those provided by car manufacturers. The net flow of car finance through dealerships has grown in recent years, according to data from the Finance & Leasing Association (FLA).(7) 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.

There are multiple ways of financing a car purchase through a dealership such as a personal loan, leasing, personal contract purchase (PCP) or hire purchase (HP). These are explained in further detail in **Table 1**.

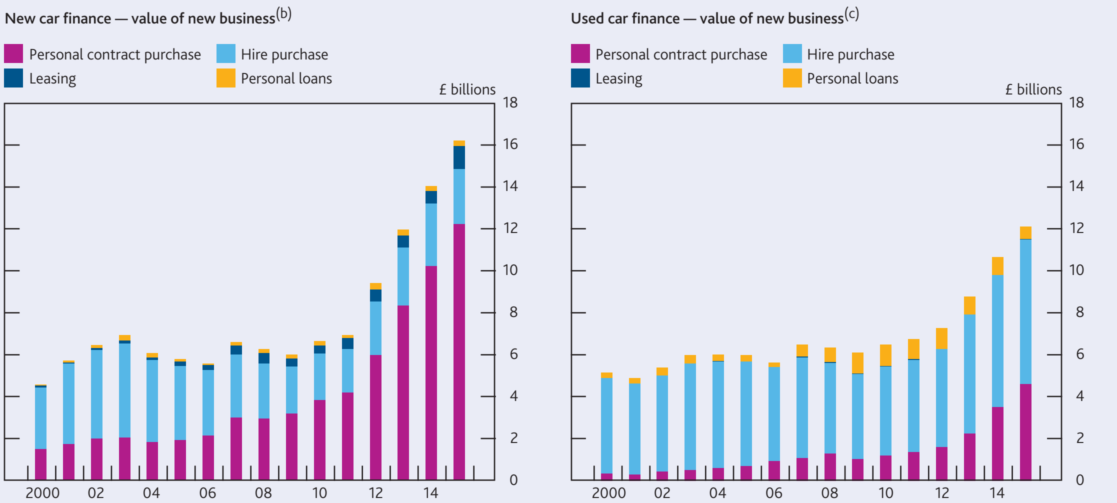
Gross lending through dealerships for new cars has increased rapidly in recent years and has been greater than that for used cars since 2010 (**Chart B**). This pickup in dealership car finance for new cars partly reflects the increased use of PCP which has been the most utilised form of new car finance, by value, since 2007. The growth in PCP has been partly attributed to manufacturers offering attractive three and four-year finance packages to new car buyers.(8) The Bank's network of Agents noted that PCP tends to increase the likelihood of repeat

(1) For a history of credit cards since 1880, see 'History of credit cards', Sainsbury's Bank; available at www.sainsburysbank.co.uk/money-matters/credit-card-history.
(2) For more details on the history of P2P lending see Atz, U and Bholat, D (2016), 'Peer-to-peer lending and financial innovation in the United Kingdom', *Bank of England Staff Working Paper No. 598*, available at www.bankofengland.co.uk/research/Pages/workingpapers/2016/swp598.aspx.
(3) For more details on recent estimates of some external sources of finance for UK businesses, see Annex; available at www.bankofengland.co.uk/publications/Documents/creditconditionsreview/2016/externalfinanceforbusinessesq316.xlsx.
(4) 'Pushing boundaries: the 2015 alternative finance industry report', Nesta, February 2016; available at www.nesta.org.uk/sites/default/files/pushing_boundaries_0.pdf.
(5) For more details, see *Agents' summary of business conditions*, 2016 Q2; available at www.bankofengland.co.uk/publications/Documents/agentssummary/2016/q2.pdf.
(6) See footnote (4).
(7) For more details, see Chart 2.6 in *Credit Conditions Review*, 2016 Q2; available at www.bankofengland.co.uk/publications/Pages/creditconditionsreview/2016/q2.aspx.
(8) See *The Used Car Market Report 2014*, The University of Buckingham Business School; available at www.bcamarketplaceplc.com/~/media/Files/B/BCA/documents/bca-used-car-market-report-2014.pdf.

purchases by the customer, with the manufacturer, and had changed the way consumers view the purchase of a car.

Gross lending for used car finance has also increased in recent years and accounted for 43% of total car finance provided by FLA members. In the early 2000s, HP was the predominant form of used car finance by value, and its share has remained high at 57% in 2015.

Chart B Gross lending on new and used dealership car finance by product type(a)



Source: Finance & Leasing Association.

(a) Dealership car finance provided by Finance & Leasing Association members. Annual sterling gross lending to UK individuals. Non seasonally adjusted. For a description of the terms used see **Table 1**.
(b) Due to improved reporting by some members and changes in membership there is a break in the series in 2007.
(c) Due to improved reporting by some members and changes in membership there are breaks in the series in 2007 and 2009.

Table 1 Types of dealership car finance

Personal contract purchase	A variation of a hire purchase (see below). The key difference is that the value of the car at the end of the contract is calculated at the start of the agreement by the finance provider — the Guaranteed Minimum Future Value (GMFV). This is subject to factors such as mileage and conditions of use. Generally monthly payments are lower than a comparable hire purchase agreement. At the end of the agreement, the customer can either pay the GMFV (balloon payment) with any associated fees, return the vehicle, or part-exchange if the value is greater than the GMFV.
Hire purchase	A hire agreement, where the loan repayments are normally fixed and the loan is secured against the vehicle being bought. Ownership typically transfers at the end of the agreement.
Leasing	The vehicle is hired with a rental price over a fixed period. At the end of the agreement, the lease can be extended or the vehicle returned. This will include personal contract hire.
Personal loan	An unsecured loan with the purpose of financing the purchase of a vehicle.

Abbreviations

AT1 — Additional Tier 1.
BLS — *Bank Liabilities Survey*.
CCS — *Credit Conditions Survey*.
CDS — Credit default swap.
CFO — Chief financial officer.
CML — Council of Mortgage Lenders.
CRE — Commercial real estate.
FLA — Finance & Leasing Association.
FSB — Federation of Small Businesses.
HP — Hire purchase.
Libor — London interbank offered rate (see below).
LTV ratio — Loan to value ratio (see below).
MFIs — Monetary financial institutions (see below).
MPC — Monetary Policy Committee.
ONS — Office for National Statistics.
PCP — Personal contract purchase.
PNFCs — Private non-financial corporations (see below).
P2P — Peer-to-peer.
RICS — Royal Institution of Chartered Surveyors.
SMEs — Small and medium-sized enterprises.
SVR — Standard Variable Rates.

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.

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

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

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

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

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).

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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