Credit Conditions Review

2017 Q1

BANK OF ENGLAND

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This 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, 45% of the stock of consumer credit (excluding student loans), and 65% of the stock of lending to businesses at end-December 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-March 2017. Unless stated otherwise, the data reported cover lending in both sterling and foreign currency, expressed in sterling.

The 2017 Q3 *Credit Conditions Review* will be published on 12 October 2017.

The Bank intends to publish future editions of the *Credit Conditions Review* (*CCR*) every six months, such that the next *CCR* will be published on 12 October 2017. The *Bank Liabilities Survey* and *Credit Conditions Survey* will continue to be conducted and published on a quarterly basis, with the Q2 survey results due to be published on 13 July 2017.

(1) The *Bank Liabilities Survey* and the *Credit Conditions Survey* for 2017 Q1 were conducted between 20 February and 10 March 2017. 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) This definition 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

Banks continued to have ready access to affordable funding in Q1. The cost of funding fell a little in 2017 Q1, on account of wholesale funding and retail deposit spreads over relevant reference rates being, on average, somewhat lower in Q1 than in the previous quarter. In recent discussions, most major UK lenders thought that the Bank of England's Term Funding Scheme had contributed to this reduction in spreads. Respondents to the Bank of England's *Bank Liabilities Survey* reported that transfer prices fell significantly in Q1.

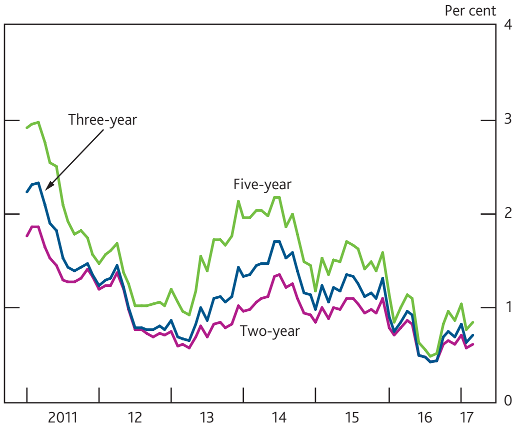
Household credit conditions were little changed in 2017 Q1. There has been a slight fall in quoted rates on mortgage products, while lenders responding to the Bank of England's *Credit Conditions Survey* (*CCS*) reported little change in the availability of secured credit. Annual growth in consumer credit remains high relative to recent years at 10.5% in February, similar to growth of 10.9% in November 2016. There has been little change on the quarter in price and non-price terms of consumer credit and there continues to be strong competition between lenders in these markets. However, lenders responding to the *CCS* reported that the availability of unsecured credit decreased slightly in the first quarter of the year, mainly driven by tighter credit scoring criteria.

Lending to businesses continued to grow in early 2017, albeit at a somewhat more subdued rate, which probably reflects some weakness in corporates' demand: the annual growth rate was 1.7% in February. UK businesses have continued to raise funds from capital markets: taken together with lending from UK MFIs, net finance raised was £0.9 billion a month, on average, across January and February. The availability and cost of bank credit has been broadly unchanged over the past three months.

1 Bank funding

Banks continued to have ready access to affordable funding in Q1. The cost of funding fell a little in 2017 Q1, on account of wholesale funding and retail deposit spreads over relevant reference rates being, on average, somewhat lower in Q1 than in the previous quarter. In recent discussions, most major UK lenders thought that the Bank of England's Term Funding Scheme had contributed to this reduction in spreads. Respondents to the Bank of England's *Bank Liabilities Survey* reported that transfer prices fell significantly in Q1.

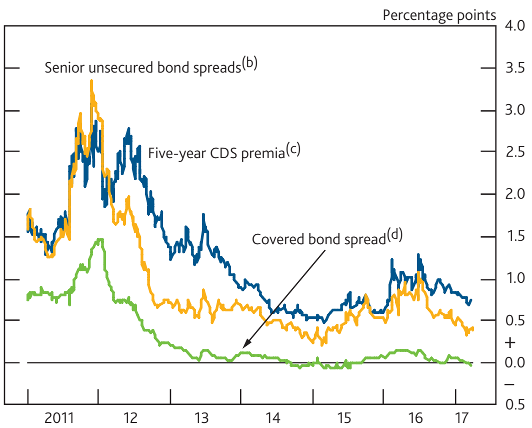
Chart 1.1 Swap rates at different maturities(a)



Source: Bloomberg.

(a) Data are to end-March 2017 and are month-end observations. Sterling swap rates.

Chart 1.2 Indicative long-term funding spreads(a)



Sources: Bloomberg, IHS Markit and Bank calculations.

(a) Data are to end-March 2017.
(b) Constant-maturity unweighted average of secondary market spreads to mid-swaps for the major UK lenders' five-year euro-denominated senior unsecured bonds or a suitable proxy when unavailable.
(c) Unweighted average of five-year euro-denominated senior CDS premia for the major UK lenders.
(d) Constant-maturity unweighted average of secondary market spreads to swaps for the major UK lenders' five-year euro-denominated covered bonds or a suitable proxy when unavailable.

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 a swap rate), and the prevailing level of that reference rate in financial markets.

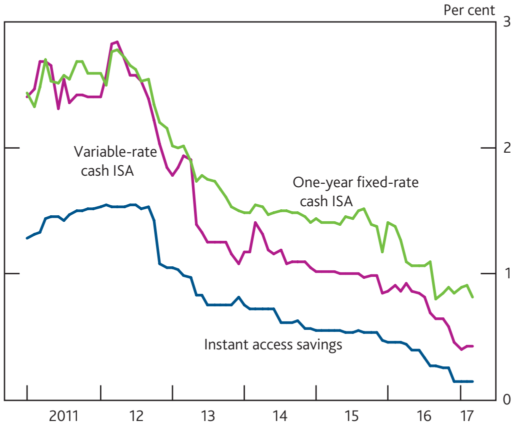
Banks continue to be able to fund themselves at affordable rates, which fell a little in 2017 Q1. Swap rates in 2017 Q1 were broadly unchanged (**Chart 1.1**), whilst indicative measures of banks' wholesale funding spreads over the relevant reference rates — such as senior unsecured bond spreads and credit default swap (CDS) premia — fell a little in the first quarter of 2017, and remain low relative to recent years (**Chart 1.2**). In recent discussions, most major UK lenders cited the Bank of England's Term Funding Scheme (TFS) as exerting downwards pressure on wholesale funding spreads.

The outlook for wholesale funding spreads will depend upon a range of factors, including geopolitical developments and investor demand. In the near term the TFS should help to mitigate the impact of any pickup in wholesale funding spreads on banks' funding costs, and therefore on the cost of credit to UK households and companies.

The cost to banks of new retail deposit funding decreased slightly over the past three months. Quoted interest rates on new time deposits for households (**Chart 1.3**) were a little lower in 2017 Q1 compared to their levels in 2016 Q4. Effective rates on the stock of household and private non-financial corporation (PNFC) deposits fell by around 5–10 basis points between end-November and end-February, reflecting the pass through of past falls in quoted deposit rates to the stock of deposits.

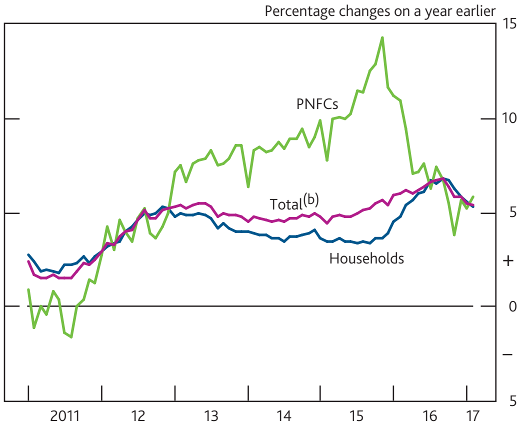
On balance, Bank of England's *Bank Liabilities Survey* (*BLS*) respondents reported that transfer prices — internal prices

Chart 1.3 Quoted rates on household savings products[a]



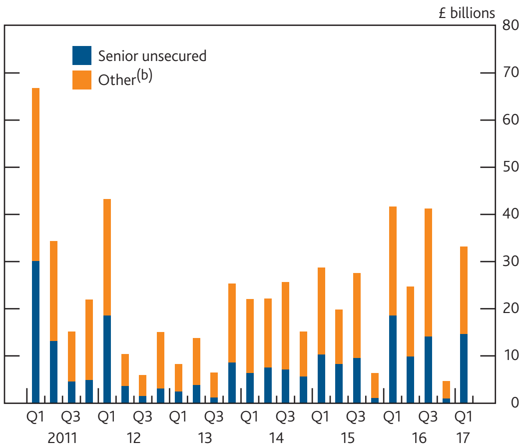
(a) Rates on sterling deposits. The Bank's quoted interest rates series is currently compiled using data from up to 19 UK MFIs. Non seasonally adjusted. The quoted rates are end-month rates.

Chart 1.4 Household and PNFC deposits[a]



(a) Rate of growth in MFIs' M4 liabilities. Seasonally adjusted. Data are up to February 2017.
(b) Total is the rate of growth of PNFCs' and households' deposits together.

Chart 1.5 Gross wholesale term issuance by UK lenders in public markets[a]



Sources: Thomson Reuters Deals Business Intelligence 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.

charged to business units to fund the flow of new loans — fell significantly in 2017 Q1. This was reported to have been driven in particular by a significant fall in long-term unsecured wholesale funding spreads.

Funding volumes

Banks continued to have ready access to funding markets in 2017 Q1. Although lenders reported in the *BLS* that funding volumes had declined in Q1, banks expect this to be temporary and for volumes to increase significantly in Q2. Lenders reported no change in the supply of deposits from households and corporates in Q1, and that investors' demand for banks' wholesale debt had increased.

Annual growth in total retail deposits fell from an average of 6.0% in 2016 Q4 to 5.4% in February 2017 (**Chart 1.4**). This brings growth in total retail deposits closer to its 2012 to 2015 average of 4.8%. As a reason for this fall, lenders responding to the *BLS* reported that the cost of deposit funding relative to the cost of other liabilities was a factor in reducing their demand for deposits. Market share objectives, however, pushed up on their demand for retail funding.

In Q1, respondents to the *BLS* also reported a decrease in their 'other' funding volumes, which includes wholesale funding and funding via central bank operations. Gross wholesale term issuance by UK lenders has been weaker so far in Q1 than in the comparable period of the previous year (**Chart 1.5**). But banks have so far drawn down around £53 billion (as at 29 March 2017) as part of the Bank of England's TFS, which was not in place in 2016 Q1.

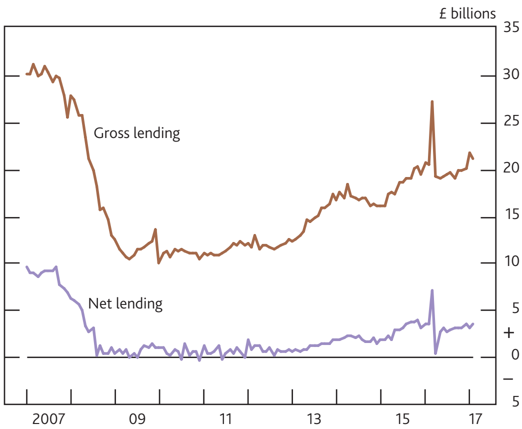
Capital instruments are also a source of bank funding, and banks' capital positions will influence their funding cost. Respondents to the *BLS* reported that their total level of capital increased slightly in 2017 Q1. As reasons for this, lenders reported strategic decisions, regulatory drivers and changes in the size of their balance sheet.

2 Household and corporate credit conditions

Household credit conditions were little changed in 2017 Q1. There has been a slight fall in quoted rates on mortgage products, while lenders responding to the Bank of England's *Credit Conditions Survey* (*CCS*) reported little change in the availability of secured credit. Annual growth in consumer credit remains high relative to recent years at 10.5% in February, similar to growth of 10.9% in November 2016. There has been little change on the quarter in price and non-price terms of consumer credit and there continues to be strong competition between lenders in these markets. However, lenders responding to the *CCS* reported that the availability of unsecured credit decreased slightly in the first quarter of the year, mainly driven by tighter credit scoring criteria.

Lending to businesses continued to grow in early 2017, albeit at a somewhat more subdued rate, which probably reflects some weakness in corporates' demand: the annual growth rate was 1.7% in February. UK businesses have continued to raise funds from capital markets: taken together with lending from UK MFIs, net finance raised was £0.9 billion a month, on average, across January and February. The availability and cost of bank credit has been broadly unchanged over the past three months.

Chart 2.1 Secured lending to individuals[(a)]



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

Secured lending to households

The annual growth rate of secured lending was 3.0%, while net lending stood at £3.5 billion in February 2017 (**Chart 2.1**).

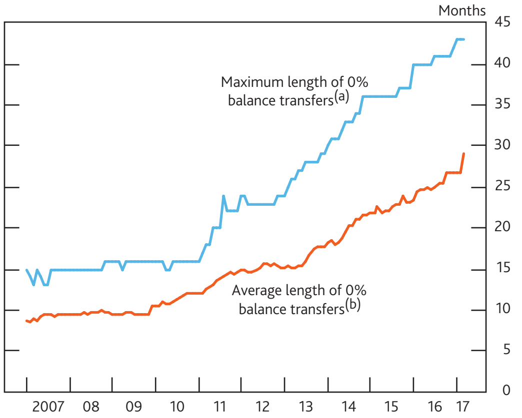
Overall, there has been little change on the quarter in secured credit conditions in 2017 Q1. Secured credit availability was reported to have been unchanged in Q1, according to respondents to the Bank of England's *Credit Conditions Survey* (*CCS*). Quoted rates on most fixed-rate mortgages in March, and effective rates on the stock of outstanding secured loans in February, fell slightly relative to December. Lenders responding to the *CCS* reported that spreads on secured lending to households were reported to have narrowed significantly in Q1.

Looking ahead, lenders responding to the *CCS* expect an increase in secured credit availability in 2017 Q2, while spreads on secured lending are expected to be unchanged.

An exception is the market for mortgages at 95% loan to value (LTV), for which the two-year quoted rate increased by around 40 basis points between December and March. Market intelligence suggested that this is unlikely to have implications for the outlook for the pricing of other mortgage products.

Demand for secured lending decreased in the first quarter of 2017, according to respondents to the *CCS*. Lower demand for

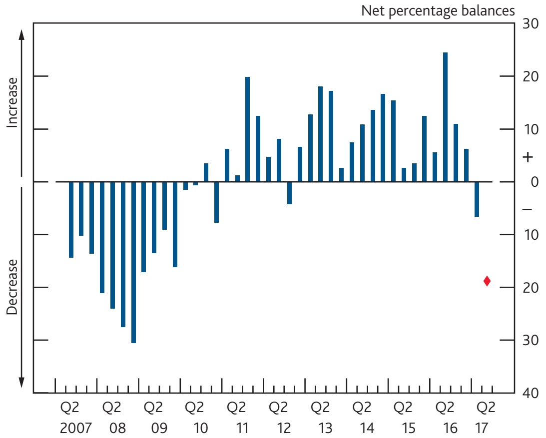
Chart 2.2 Maximum and average duration of 0% balance transfers



Sources: Moneyfacts Group and Bank calculations.

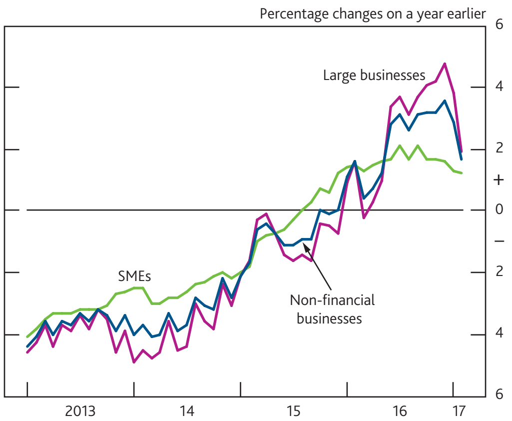
(a) Indicates maximum 0% balance transfer term available in the overall market. End-month data.
(b) Indicates average of each lender's maximum 0% balance transfer term available. Whole market data, excluding values of zero. End-month data.

Chart 2.3 *Credit Conditions Survey*: changes in availability of unsecured credit to households[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.

Chart 2.4 Lending to UK non-financial businesses[a]



(a) Rate of growth in the stock of lending. Lending by UK MFIs. Data are to February 2017. Non seasonally adjusted. Large businesses are those with annual debit account turnover on the main business account over £25 million. SMEs are those businesses with annual debit account turnover on the main business account less than £25 million.

buy-to-let lending was quoted as the most important factor contributing to this, although demand for prime lending also fell slightly.

Consumer credit

The intensity of competition in the consumer credit market remains robust, and in recent conversations the major UK lenders expected this to continue. Quoted rates on new £5,000 personal loans fell over the past three months, while those on £10,000 personal loans were broadly stable at a historical low. Competition in the credit card market continued to centre on non-price terms and conditions, with the length of interest-free balance transfers currently on offer remaining at its highest point since the series began in 2004 (**Chart 2.2**).

Lenders responding to the 2017 Q1 *CCS* reported that the availability of unsecured credit decreased slightly in the first quarter of the year (**Chart 2.3**). This is the first decrease since 2010 Q4, mainly driven by tighter credit scoring criteria for granting both credit card and other unsecured personal loans. Looking ahead, lenders expect availability to decrease further in Q2.

Demand for credit card lending from households was unchanged but demand for other unsecured lending increased slightly in the three months to mid-March, according to lenders responding to the *CCS*.

Consistent with this evidence, annual growth in consumer credit remains high relative to recent years, at 10.5% in February, similar to growth of 10.9% in November 2016.

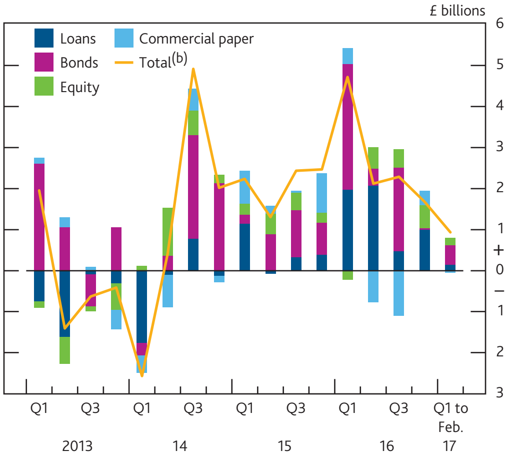
Write-off rates on consumer credit were broadly unchanged in the year to 2016 Q4 at 2.0%. Losses given default were reported to have been slightly lower in 2017 Q1, according to respondents to the *CCS*.

Lending to corporates

Lending to businesses has continued to grow in 2017, although the pace has moderated in the most recent months. The annual growth rate in the stock of bank lending to UK non-financial businesses was 1.7% in February, compared to around 3% in mid-2016 (**Chart 2.4**). This slowing in the growth rate was initially broad based across major industrial sectors and size of business, although, the most recent fall appears to have been among larger businesses.

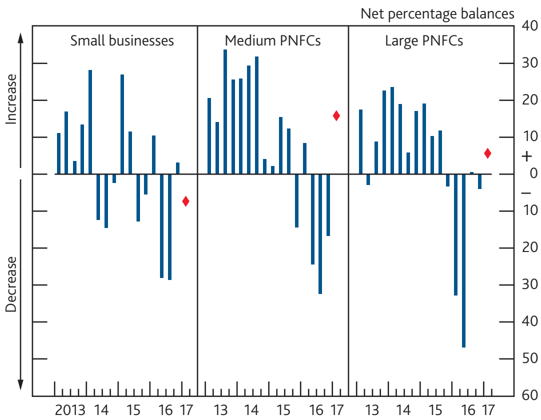
As well as bank lending, businesses can raise funds from capital markets, such as bond and equity markets. Net finance raised by UK PNFCs from UK MFIs and capital markets remained positive on average across January and February — with the largest contribution from net bond issuance — but overall it was slightly weaker than in 2016 H2 (**Chart 2.5**).

Chart 2.5 Net finance raised by UK businesses[(a)]



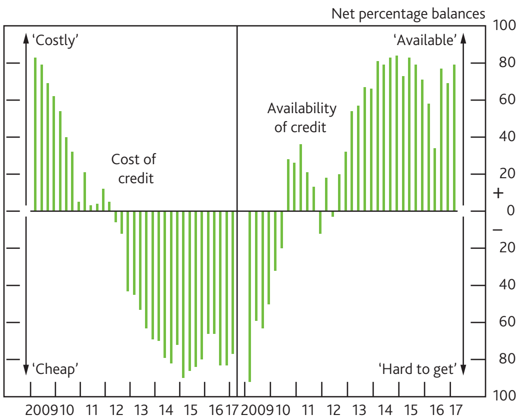
(a) Monthly average presented at a quarterly frequency. Finance raised by PNFCs from UK MFIs and capital markets. Bonds data cover debt issued by UK companies via UK-based Issuing and Paying Agents. Seasonally adjusted. Bonds and commercial paper data are non seasonally adjusted.
(b) Owing to the seasonal adjustment methodology, this series may not equal the sum of its components.

Chart 2.6 *Credit Conditions Survey*: changes in corporate demand for lending by firm size[(a)(b)]



(a) See footnote (a) to **Chart 2.3**.
(b) Small businesses are defined as those with annual turnover of less than £1 million; medium-sized corporates are defined as those with annual turnover of between £1 million and £25 million; and large corporates are defined as those with annual turnover of over £25 million.

Chart 2.7 *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 balance 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'.

The volume of lending to corporates will depend importantly on their demand for credit. There was mixed evidence on businesses' demand overall in 2017 Q1, but it appears likely that this has contributed to the slowing growth rate.

Lenders responding to the *CCS* noted a decrease in demand from medium-sized businesses, but an unchanged demand from small and large businesses (**Chart 2.6**). *CCS* respondents reported that a reduction in capital investment by firms had exerted a significant drag on their demand for credit for the second consecutive quarter.

In recent discussions, the major UK lenders noted that demand for lending had exceeded expectations following the EU referendum; but some also noted that it had remained subdued in Q1. Intelligence from the Bank's network of Agents suggested some rise in demand for loans, reflecting continued activity growth and slightly higher business investment intentions.

Another key influence for the rate of growth in bank lending to businesses is credit supply conditions. A range of indicators and intelligence suggested that the cost of credit has been broadly unchanged in recent months. The effective rates on both outstanding and new floating-rate loans were little changed, having fallen following the package of measures announced by the Monetary Policy Committee in August 2016.

Lenders responding to the 2017 Q1 *CCS* reported no change in the availability of credit to businesses, which had generally remained higher than normal according to the Bank's network of Agents. And in recent discussions, the major UK lenders noted that credit was readily available. For large corporates, the net percentage balance of respondents to the *Deloitte CFO Survey* who reported that credit was 'available' increased to 79% in Q1 (**Chart 2.7**).

Loan performance has remained strong over recent months, according to a number of indicators and intelligence. The write-off rate on banks' corporate lending was little changed in the year to 2016 Q4.

Abbreviations

BLS — *Bank Liabilities Survey*.
CCS — *Credit Conditions Survey*.
CDS — Credit default swap.
CFO — Chief financial officer.
LTV ratio — Loan to value ratio (see below).
MFIs — Monetary financial institutions (see below).
PNFCs — Private non-financial corporations (see below).
SMEs — Small and medium-sized enterprises.
TFS — Term Funding Scheme.

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).

Covered bonds A secured bond issued by a bank or other financial institutions. The bond is secured not only on the institution's assets generally, but also on a particular pool of assets, typically mortgage loans, that are specifically designated as collateral.

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.

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).

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.

Quoted interest rates The weighted average of a sample of advertised deposit and loan rates: weights calculated from Bank of England statistical collections.

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.

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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