Credit Conditions Review

2018 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, 50% of the stock of consumer credit (excluding student loans), and 65% of the stock of lending to businesses at end-December 2017. 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 2018. Unless stated otherwise, the data reported cover lending in both sterling and foreign currency, expressed in sterling.

The 2018 Q3 *Credit Conditions Review* will be published on 11 October 2018.

The Bank publishes the *Credit Conditions Review (CCR)* every six months, such that the next *CCR* will be published on 11 October 2018. The *Bank Liabilities Survey* and *Credit Conditions Survey* are conducted and published on a quarterly basis, with the 2018 Q2 survey results due to be published on 12 July 2018.

(1) The *Bank Liabilities Survey* and the *Credit Conditions Survey* for 2018 Q1 were conducted between 19 February and 9 March 2018. 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

The total cost of bank funding increased a little in 2018 Q1 but remains low by historic standards. Sterling swap rates rose due to market expectations of increases in Bank Rate. Indicative measures of bank funding spreads also increased in Q1. Respondents to the Bank of England's *Bank Liabilities Survey* report that transfer prices increased for the first time since 2016 Q2. UK lenders total funding volumes have increased over recent quarters.

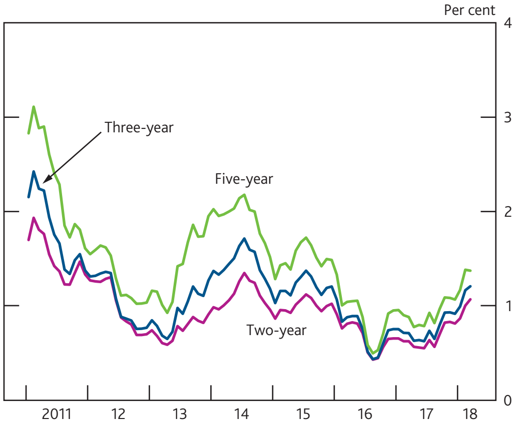
Competition between lenders in the mortgage market has continued to intensify. Consequently, spreads over appropriate reference rates on new mortgage lending have fallen, despite increases in quoted rates on most mortgage products. Mortgage lending continues to grow steadily, with higher remortgaging in recent months. Consumer credit growth remains strong, although contributions from dealership car finance have declined slightly in recent months. Competition in the consumer credit market remains robust despite some continued signs of tightening in availability.

The availability and cost of corporate credit has remained favourable in recent quarters, though there have been some further signs of tightening in conditions at the margin. The cost of finance increased slightly following increases in swap rates. The rate of growth in net finance raised by UK businesses decreased over 2017 H2, mainly due to decreases in net equity issuance and bank lending growth. Demand has remained fairly subdued across all business sizes.

1 Bank funding

The total cost of bank funding increased a little in 2018 Q1 but remains low by historic standards. Sterling swap rates rose due to market expectations of increases in Bank Rate. Indicative measures of bank funding spreads also increased in Q1. Respondents to the Bank of England's *Bank Liabilities Survey* report that transfer prices increased for the first time since 2016 Q2. UK lenders total funding volumes have increased over recent quarters.

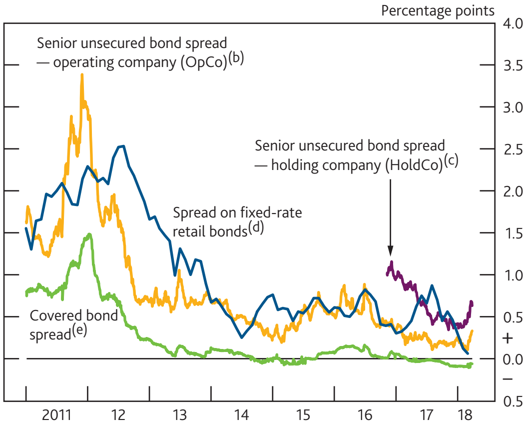
Chart 1.1 Swap rates at different maturities[(a)]



Source: Bloomberg.

(a) Data are to end-March 2018 and are monthly average observations of daily data. Sterling swap rates.

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



Sources: Bloomberg and Bank calculations.

(a) Data are to end-March 2018.
(b) Constant maturity unweighted average of secondary market spreads to mid-swaps for the major UK lenders' five-year euro-denominated senior unsecured bonds issued by the operating company or a suitable proxy when unavailable.
(c) Constant maturity unweighted average of secondary market spreads to mid-swaps for the major UK lenders' five-year euro-denominated senior unsecured bonds issued by the holding company or a suitable proxy when unavailable.
(d) Unweighted average of spreads for two-year and three-year sterling quoted fixed-rate retail bonds over equivalent-maturity swaps. Bond rates are end-month rates and swap rates are monthly averages of daily rates.
(e) 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 prevailing level of a given reference rate (such as a swap rate) and the spread over that reference rate in financial markets (such as unsecured bond spreads).

The total cost of bank funding has increased over the past six months but remains near post-crisis lows. In part, the increase reflects a rise in swap rates. Ahead of November's Bank Rate rise, and again at the start of 2018, sterling swap rates increased across all maturities. Rates rose by around 50 basis points between August and March (**Chart 1.1**).

Indicative measures of banks' wholesale funding spreads over the relevant reference rates have risen since the beginning of the year (**Chart 1.2**). This followed broad stability in late 2017, consistent with the favourable funding conditions seen throughout 2017. Market contacts attributed the recent rise to the prospective end of the ECB's corporate bond purchase scheme, increased US debt issuance and US tax reforms. Spreads, though elevated compared to recent quarters, remain at similar levels to those seen in early 2017 and low by historic standards.

The cost to banks of new deposit funding has also increased in recent months (**Table 1.A**). Quoted rates on households' sight deposits, which account for approximately two-thirds of the stock of deposits, have increased by 9 basis points on a range of products since October. Time deposits have increased by less than this however, and rates have fallen on some products. Interest rates on private non-financial corporations' (PNFCs') deposits have also increased. The effective rate rose by 13 basis points on sight deposits between October and February.

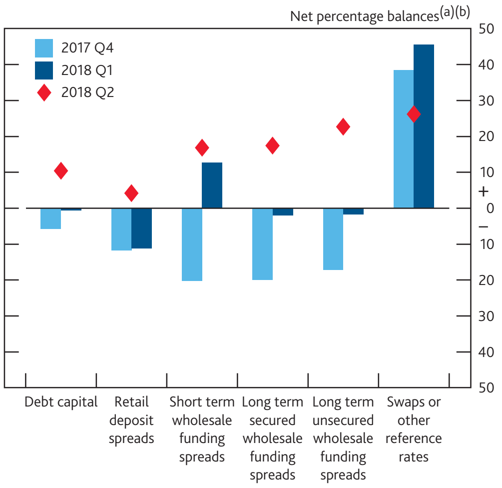
Banks' transfer prices — the internal prices charged to business units to fund the flow of new loans — have increased in recent months according to respondents to the 2018 Q1 *Bank Liabilities Survey (BLS)* (**Chart 1.3**). The increase reported

Table 1.A Effective and quoted rates on deposits[a]

	Latest level (per cent)	Changes since (basis points) October 2017
Effective rates (to Feb 2018)		
PNFCs		
Outstanding business		
Interest-bearing sight	0.28	14
Time	0.56	13
New business		
Time	0.46	15
Quoted rates (to March 2018)		
Households		
Instant access including unconditional bonuses	0.21	9
One-year fixed-rate bond	0.81	7
Two-year fixed-rate bond	1.05	-11

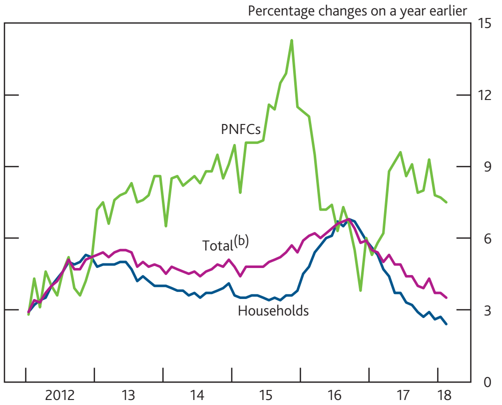
(a) Rates on sterling deposits. The Bank's quoted and effective interest rates are currently compiled using data from up to 19 UK MFIs. Quoted rates are end-month rates and effective rates are average monthly rates. For further details on the series used in this table please see *Bankstats* Tables G1.3–G1.5.

Chart 1.3 *Bank Liabilities Survey*: factors affecting transfer prices



(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 diamonds show the expectations over the next three months.
(b) A positive balance indicates a positive contribution to the transfer price.

Chart 1.4 Household and PNFC deposits[a]



(a) Rate of growth in MFIs' M4 liabilities. Seasonally adjusted. Data are up to February 2018.
(b) Total is the rate of growth of PNFCs' and households' deposits together.

in 2017 Q4, was the first since 2016 Q2. The rise was primarily driven by increases in swap rates. Lenders expect further increases in their transfer prices in 2018 Q2, with the main drivers of these rises expected to be more widespread.

On 28 February 2018, the Bank's Term Funding Scheme (TFS) closed. In recent discussions, major lenders were relatively sanguine about the impact of the scheme's closure on bank funding costs. The total drawdowns as part of the scheme were £127 billion, of which £24 billion was drawn down in the scheme's final quarter.[1] TFS participants are expected to repay loans within four years.

Funding volumes

Respondents to the *BLS* reported that their total funding volumes increased between 2017 Q2 and 2018 Q1. This was driven by an increase in the amount of 'other funding' in 2018 Q1, which includes wholesale funding and funding via central bank operations. Gross wholesale term issuance by UK lenders in public markets was strong in the three months to December 2017, at around £23 billion[2] — the highest Q4 since 2013.

The four-quarter growth rate of total household deposits continued to fall a little, and was 2.4% in February 2018 (**Chart 1.4**). Most recently, intelligence from lenders suggests that this slowdown reflects reduced demand from households to deposit their money with UK banks and building societies. Annual growth in total PNFCs' deposits, which account for approximately 15% of total sterling retail deposits, was broadly unchanged in the months to February 2018 at 7.5%, close to the 2013 average.

Capital instruments are also a source of bank funding, and banks' capital positions will influence their funding costs. The average cost of capital was unchanged over recent quarters, according to *BLS* participants. In line with their previous announcement in June, the Financial Policy Committee (FPC) increased the countercyclical buffer (CCyB) by a further 0.5% to 1.0% in November 2017. Firms are expected to increase capital to meet this additional requirement by 28 November 2018.[3] Those changes are expected to result in a small increase in banks' overall funding costs.[4]

(1) Data on TFS drawings can be found in table D2.3.4 under Monetary & Financial Statistics; www.bankofengland.co.uk/statistics/Pages/bankstats/default.aspx.
(2) Source: Thomson Reuters Deals Business Intelligence.
(3) This statement was maintained at its November meeting. For more detail on the FPC's decision, see the November 2017 *Financial Stability Report*; www.bankofengland.co.uk/financial-stability-report/2017/november-2017.
(4) For more detail on the link between macroprudential capital policy and UK credit conditions, see Harimohan, R and Nelson, B (2014), 'How might macroprudential capital policy affect credit conditions?', *Bank of England Quarterly Bulletin*, Vol. 54, No. 3, pages 287–303; www.bankofengland.co.uk/quarterly-bulletin/2014/q3/how-might-macroprudential-capital-policy-affect-credit-conditions.

2 Household and corporate credit conditions

Competition between lenders in the mortgage market has continued to intensify. Consequently, spreads over appropriate reference rates on new mortgage lending have fallen, despite increases in quoted rates on most mortgage products. Mortgage lending continues to grow steadily, with higher remortgaging in recent months. Consumer credit growth remains strong, although contributions from dealership car finance have declined slightly in recent months. Competition in the consumer credit market remains robust despite some continued signs of tightening in availability.

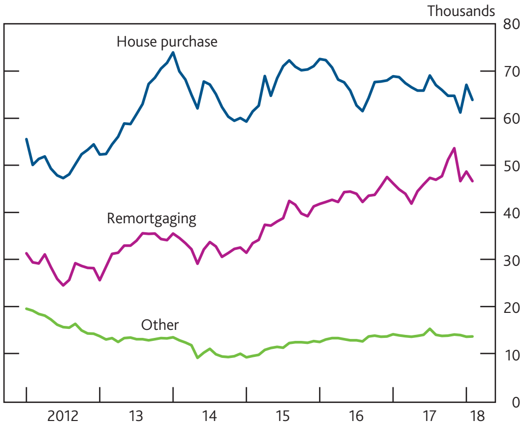
The availability and cost of corporate credit has remained favourable in recent quarters, though there have been some further signs of tightening in conditions at the margin. The cost of finance increased slightly following increases in swap rates. The rate of growth in net finance raised by UK businesses decreased over 2017 H2, mainly due to decreases in net equity issuance and bank lending growth. Demand has remained fairly subdued across all business sizes.

Table 2.A Average quoted household interest rates on secured and unsecured products[(a)]

		Changes since (basis points)
Household mortgages	**Latest level (per cent)**	**August 2017**
Two-year fixed, 60% LTV	1.53	29
Two-year fixed, 75% LTV	1.52	9
Two-year fixed, 90% LTV	2.21	-12
Consumer Credit		
£10,000 unsecured loan	3.79	0

(a) End-month rates on sterling lending. The Bank's quoted interest rates series are weighted averages of rates from a sample of UK MFIs with products meeting the specified criteria. For further details of the series used in this table, please see *Bankstats* Tables G1.3. The latest data points are for March 2018.

Chart 2.1 Approvals of loans secured on dwellings[(a)]



(a) Monthly number of approvals, covering sterling lending by UK MFIs to UK individuals, are measured net of cancellations. Seasonally adjusted.

Secured lending to households

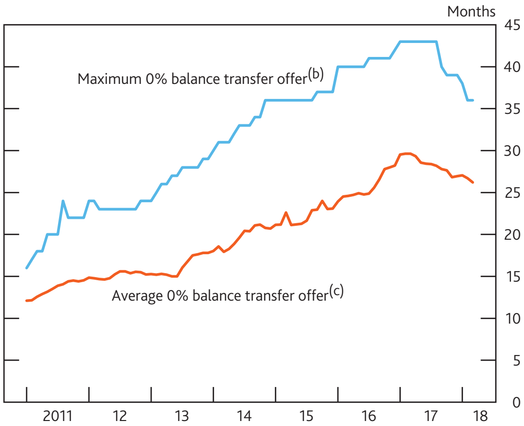
Reference rates are an important factor for banks in determining the price of mortgages. For fixed rate mortgages, which account for over 90% of new mortgage lending, swap rates are the key reference rates.

Quoted rates for most fixed-rate mortgage products increased in October and November 2017 following a rise in swap rates as markets priced in expectations of a rise in Bank Rate. Those increases were smaller for products with higher loan to value (LTV) ratios (**Table 2.A**). Since November, interest rates on lower LTV products have been broadly unchanged, whilst rates on higher LTV products have ticked down despite the continued rise in swap rates.[(5)] These developments mean that the spread of mortgage rates over swap rates has narrowed.

A narrowing of spreads reflects an increase in the level of competition in the mortgage market. In recent discussions, the major UK lenders noted that competition remains very strong and since November has increased in the higher LTV market, perhaps in part because profit-margins for lower LTV products are already squeezed. Consistent with this, the difference between quoted rates on two-year fixed rate 90% and 75% LTV mortgages has narrowed from 90 basis points in August to 69 basis points in March.

(5) For more information about the pass-through of the November Bank rate rise, please see Box 2 in the February 2018 *Inflation Report*; www.bankofengland.co.uk/inflation-report/2018/february-2018.

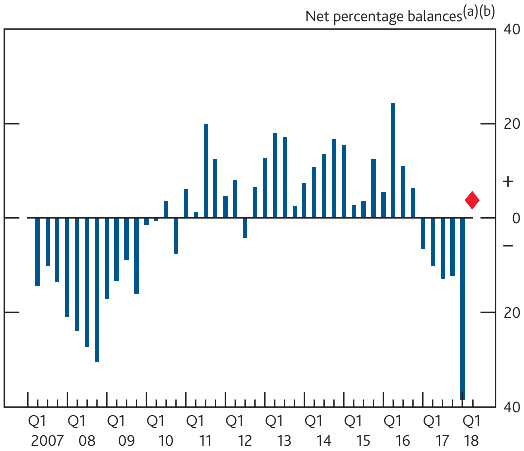
Chart 2.2 Maximum and average duration of 0% balance transfers on credit cards[a]



Sources: Moneyfacts Group and Bank calculations.

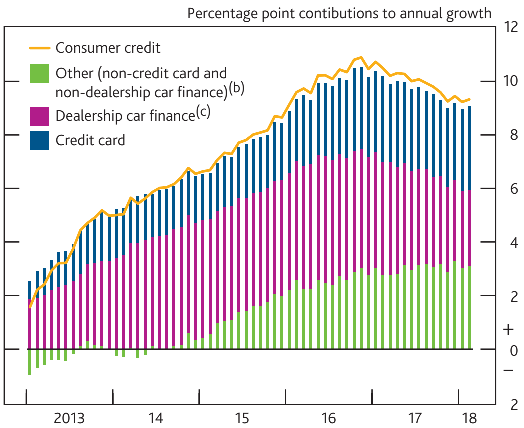
(a) Whole market end-month data, excluding values of zero and nil returns.
(b) The maximum 0% balance transfer term available across all lenders.
(c) The average of the maximum 0% balance transfer term available for each lender.

Chart 2.3 *Credit Conditions Survey*: household unsecured credit availability



(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.
(b) A positive balance indicates that more unsecured credit is available.

Chart 2.4 Annual growth in consumer credit[a]



Sources: Bank of England and Bank calculations.

(a) Sterling lending by UK MFIs and other lenders to UK individuals (excluding student loans). Non seasonally adjusted.
(b) Other is estimated as total consumer credit lending minus dealership car finance and credit card lending.
(c) Identified dealership car finance lending by UK MFIs and other lenders.

Mortgage lending continues to grow steadily, and at an annual rate of 3.3% in February was in line with the average over the last two years.

Approvals for remortgaging have risen since early 2015 and there were a couple of particularly strong months in late 2017 (**Chart 2.1**). More frequent remortgaging has partly been encouraged by the increase in popularity of two-year fixed rate deals. Intelligence from lenders suggests a particularly large number were coming up for renewal in late 2017.

Consumer credit

Competition in the consumer credit market remains robust, despite some continued signs of tightening in availability. Lending spreads have tightened in recent months as interest rates remained broadly unchanged following the rise in Bank Rate. This is consistent with interest rates on consumer credit products having been less responsive to changes in Bank Rate in the past. Consequently, quoted rates for personal loans remain near historic lows.

There has been a modest tightening in the availability of consumer credit over the past year. The average interest-free period on credit card balance transfers has fallen to 27 months (**Chart 2.2**). In recent discussions, some lenders attributed this decline to lower returns on longer balance transfer offers looking forward. The Financial Policy Committee (FPC) and the Prudential Regulation Authority (PRA) have also been monitoring developments in the consumer credit market and both published statements in 2017. In addition, lenders responding to the Bank of England's *Credit Conditions Survey (CCS)* reported that the availability of unsecured credit fell significantly in 2018 Q1, driven by changing risk appetite and stricter credit scoring criteria. Looking ahead, lenders expect this to remain unchanged (**Chart 2.3**).

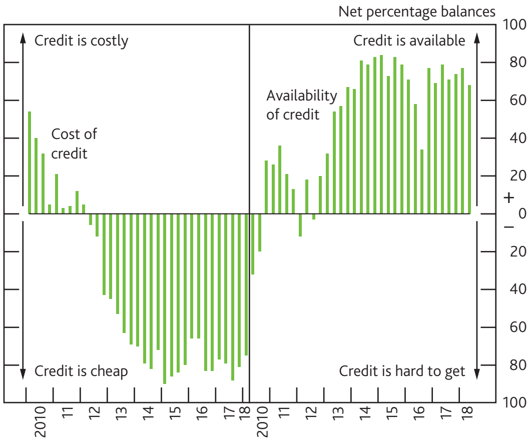
Consumer credit growth remained strong at 9.4% in February, though was below its peak in late 2016 (**Chart 2.4**). The contribution to growth from dealership car finance has slowed since July 2016, as new lending for car finance has stabilised and repayments have risen. This has been partly offset by a pickup in growth of credit card lending, driven by the major UK lenders.

There have been tentative signs of weakening demand for consumer credit although it remains robust. Lenders responding to the *CCS* reported a slight decrease in demand for unsecured credit over the past two quarters, the first decline reported since 2015. Demand is expected to increase slightly in the next few months.

Lending to corporates

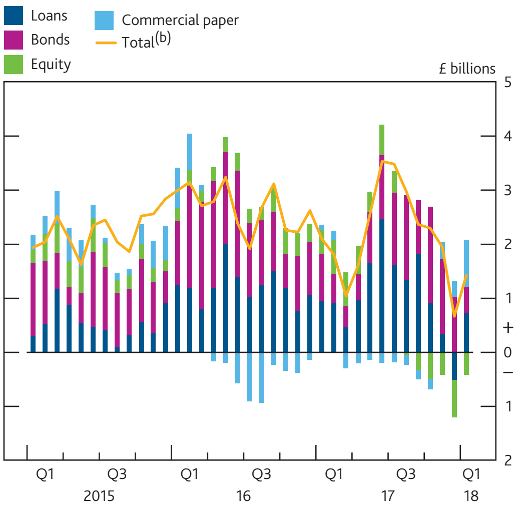
Credit supply conditions remain broadly favourable for corporate borrowers, though there have been some further tentative signs of tightening for specific sectors. According to

Chart 2.5 *Deloitte CFO Survey*: cost and availability of credit[(a)]



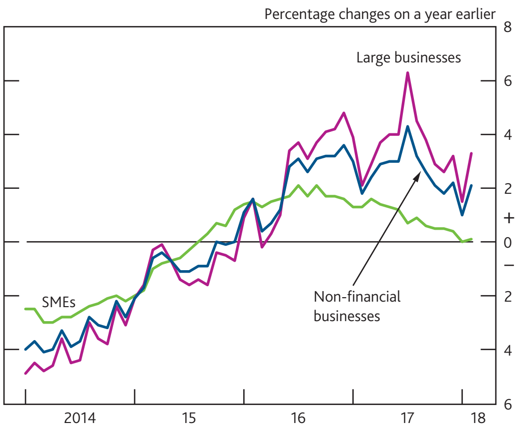
(a) Net percentage balances for the cost of credit are calculated as the percentage of respondents reporting that bank credit is 'costly' less the percentage balance reporting that it is 'cheap'. Net percentage balances for the availability of credit are calculated as the percentage of respondents reporting that credit is 'available' less the percentage of respondents reporting that it is 'hard to get'.

Chart 2.6 Net finance raised by UK PNFCs[(a)]



(a) Six-month rolling average presented at a monthly 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 2.7 Lending to UK non-financial businesses[(a)]



(a) Rate of growth in the stock of lending by UK MFIs. Data are to February 2018. 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.

the Bank's network of Agents, some UK MFIs have reduced the availability of finance to sectors that are particularly reliant on consumer spending and construction.[(6)] The perceived availability of credit to small businesses decreased slightly in 2018 Q1, according to respondents to the Federation of Small Businesses' (FSB) *Voice of Small Business Index*. Credit availability for larger businesses has been broadly stable over the past eighteen months according to the 2018 Q1 *Deloitte CFO Survey* (**Chart 2.5**).

The cost of corporate credit has increased following the increase in Bank Rate and swap rates. Around 85% of bank lending to companies is at floating rate, typically linked to a short-term market rate. The effective rate on new loans to PNFCs rose by 38 basis points, to 2.77% in the six months to February.[(7)] Despite the recent increases, prices remain low in historical context. Spreads on corporate lending are little changed. Although supply has been broadly favourable, the rate of growth in net finance raised by UK businesses from UK MFIs and capital markets decreased in 2017 H2 (**Chart 2.6**). This was mainly attributable to a decrease in net equity issuance and lower bank lending growth. The slowdown in net bank lending growth is apparent across lending to all business sizes (**Chart 2.7**).

Bond issuance, in contrast to other forms of borrowing, remained strong in 2017. Total gross bond issuance by UK PNFCs in 2017 was £57.3 billion, the highest year on record. It is not yet clear if this relative strength has continued into 2018: in February 2018, there was a net redemption of £2.0 billion worth of bonds.[(8)]

On balance, evidence from surveys and market intelligence from lenders are consistent with continued subdued demand for bank credit across all business sizes in 2018 Q1. In recent discussions with lenders, general uncertainty about future conditions, and a preference for using excess cash flows instead of further borrowing, were cited as reasons for the subdued demand. Looking forward, some lenders expect demand to remain muted. There is also some evidence that demand for credit may have continued to weaken among small businesses, with the FSB *Voice of Small Business Index* reporting a decline in confidence throughout 2017, although this has ticked up in 2018 Q1.

(6) For more information, see the February 2018 *Agents' summary of business conditions*; www.bankofengland.co.uk/about/people/agents.
(7) For more information about the pass-through of the November Bank rate rise, please see Box 2 in the February 2018 *Inflation Report*; www.bankofengland.co.uk/inflation-report/2018/february-2018.
(8) For more details on capital issuance by UK PNFCs, see *Bankstats* Table E3.1 'Capital issuance by UK residents'; www.bankofengland.co.uk/statistics/tables. Non seasonally adjusted.

Abbreviations

BLS — *Bank Liabilities Survey*.
BTL — Buy-to-let.
CCS — *Credit Conditions Survey*.
CDS — Credit default swap.
HoldCo — Holding company.
LTV ratio — Loan to value ratio (see below).
MFIs — Monetary financial institutions (see below).
OpCo — Operating company.
PNFCs — Private non-financial corporations (see below).
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).

Covered bonds A secured bond issued by a bank or other financial institution. 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.

Holding companies (HoldCo) Parent companies of banking groups.

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.

Operating companies (OpCos) Legal entities that lenders typically use to undertake their lending and other business activities.

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 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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