



Deepen and Diversify UK Financial Infrastructure To Enable Small Business Growth

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The views expressed here and any errors are solely my own, and not those of either



or



The overlooked problem



Yes, attempting to prevent a repeat of the last crisis is worthwhile, but, our hosts are right to wonder:

What also needs to happen to make sure that the British banking system supports the real economy in the UK?

My partial answer:

Diversify and deepen UK sources of funding for SMEs and new businesses

A long-standing long-term problem



- The banks' provision of finance to smaller non-financial corporations in the UK has been poor for a long time
 - The Macmillan Committee 1929-31
- Alternative forms of non-bank finance available to smaller non-financial corporations in the UK have stayed limited
 - Little SME bond issuance since '70s
 - Elsewhere, they have broadened

Structure of G7 financial markets

The UK stands out as *under-banked*



	Canada	France	Germany	Italy	Japan	UK	US	Average
Stock Market Capitalisation ^(a)	1.47	1.02	0.57	0.50	1.06	1.41	1.44	1.07
Private Sector Bond Market Capitalisation ^(b)	0.30	0.51	0.34	0.60	0.38	0.16	0.26	0.36
Short term Private Sector Securities ^(c)	0.11	0.22	0.21	0.01	0.07	0.16	0.26	0.15
Banking Sector Capitalisation ^(d)	1.74	3.16	3.12	1.63	1.94	4.45	0.77	2.40
Banking Sector Concentration ^(e)	0.56	0.58	0.71	0.35	0.46	0.60	0.34	0.51
Banks per Million Persons ^(f)	2.95	7.90	22.60	12.49	6.66	8.50	31.70	13.26

- (a) As ratio of GDP. Data as of end 2007, Source: World Bank Financial Structure Dataset
- (b) As ratio of GDP. Data as of end 2008, Source: Bank Calculations and BIS
- (c) As ratio of GDP. Data as of end 2008, Source: Bank Calculations and BIS
- (d) Consolidated Banking Group Assets as ratio of GDP. End of 2007 except for UK which is end 2008. Sources: The Banker, Bankscope, IMF and Bank Calculations
- (e) Assets of three largest banks as share of assets of all commercial banks. Data as end of 2007, Source: World Bank Financial Structure Dataset
- (f) Source: Bankscope, IMF and Bank Calculations.

From under-banked to credit constrained post-crisis

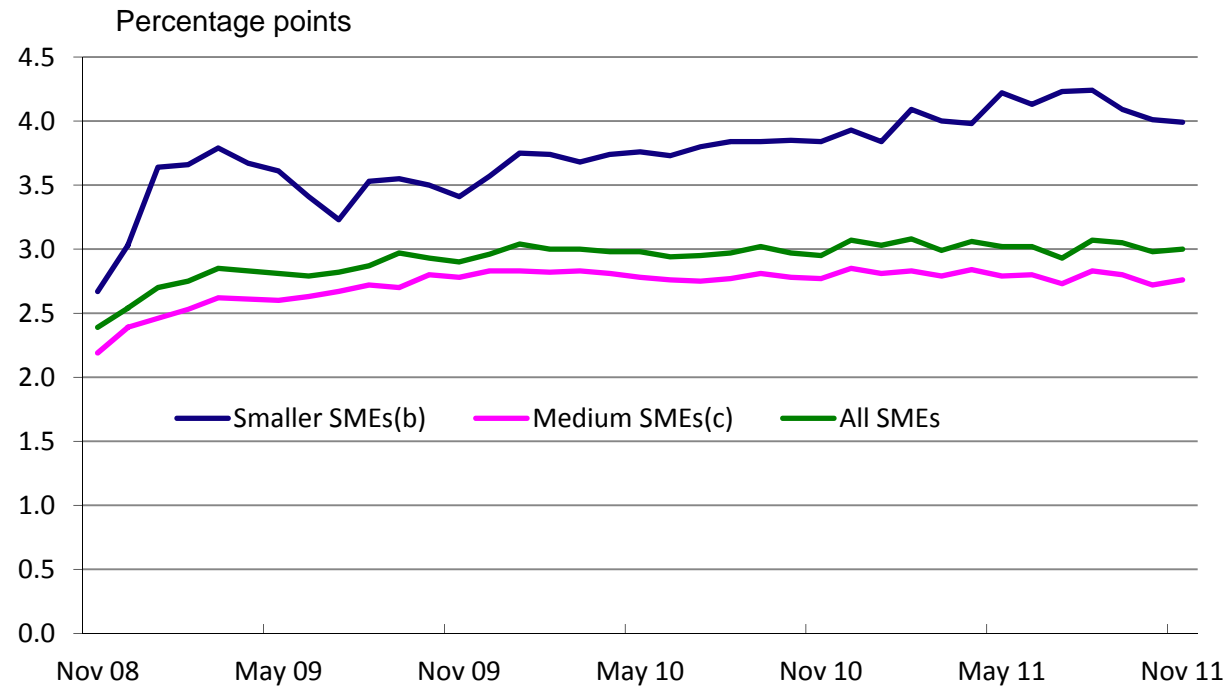


- The crisis has made this credit shortfall even worse, if not dire, for SMEs and new businesses,
- Not enough to assert banks would provide, if there was credit demand
 - As the Bank of England documents, the price of credit is going *up*, not down
 - We don't leave labor market institutions unreformed when historical development led to market failures

UK SME loan rate spreads have gone up



Spread over Bank Rate of indicative median interest rates on new SME variable-rate facilities^(a)



Source: Bank of England, BIS and Bank calculations. Chart 2.5 in Trends in Lending, January 2012.

(a) Median by value of new SME facilities priced at margins over base rates, by four major lenders (Barclays, HSBC, Lloyds Banking Group and Royal Bank of Scotland). Data cover lending in both sterling and foreign currency, expressed in sterling terms. Non seasonally adjusted.

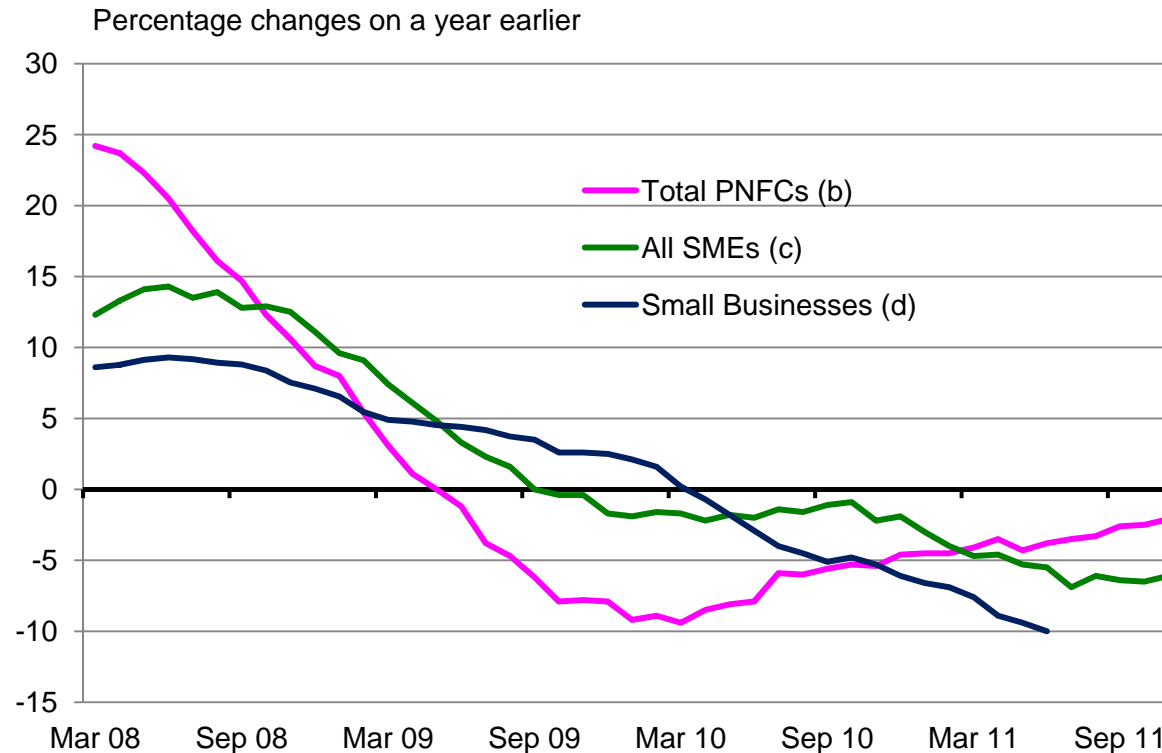
(b) SMEs with annual bank account debit turnover under £1 million.

(c) SMEs with annual bank account debit turnover between £1 million to £25 million.

UK SME lending growth Not high during the boom, net down now



Lending to small and medium-sized enterprises^(a)



Source: Bank of England, BBA, BIS and Bank calculations. Chart 1.1 in Trends in Lending, January 2012.

Total PNFCs and all SMEs cover lending in both sterling and foreign currency terms expressed as sterling. Small Businesses cover lending in sterling terms only.

(a) Rate of growth in the stock of lending. Non seasonally adjusted.

(b) Data cover lending in both sterling and foreign currency, expressed in sterling terms.

(c) Source: monthly BIS survey, Bank calculations. Lending by four UK lenders to enterprises with annual bank account debit turnover less than £25 million. Data cover lending in both sterling and foreign currency, expressed in sterling terms. Data prior to January 2009 have been revised.

(d) Source: BBA. Lending by seven UK lenders to commercial businesses with an annual bank account debit turnover of up to £1 million. Sterling only. This survey terminated at June 2011. Available at www.bba.org.uk/statistics/small-business

How to do more

- In my September 2011 speech, I urged creation of two UK institutions:
 - a bank dedicated to SME lending;
 - a securitizing entity for SME loans;
 - enabled by HMG and Bank efforts
- The issue is the lending infrastructure
 - Call it ‘credit easing’, fine; Re-purpose existing publicly controlled banks, fine.
 - But let’s really move forward and do something to deepen credit markets

SME loan applications in the UK

High rejections pre-crisis, huge post



	Unsuccessful loan applications by SMEs (as a % of total loan applications)	
	2007	2010
Belgium	2.2	5.7
Bulgaria	3.1	35.5
Cyprus	0	4.2
Denmark	3.7	18.5
Finland	0	0.2
France	2	7
Germany	6.7	8.2
Greece	0.7	10.8
Ireland	1	26.6
Italy	1.2	4.9
Latvia	4.3	26.4
Lithuania	1.8	21.2
Luxembourg	6	10.7
Malta	0	2.2
Netherlands	6.8	22.5
Poland	3.7	4.3
Slovakia	3.7	9.2
Spain	3	13.2
Sweden	8.7	6.1
United Kingdom	5.6	20.8

Source: Eurostat. Data based on a survey covering 25 000 businesses across the EU.
See http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/4-03102011-AP/EN/4-03102011-AP-EN.PDF

Practical goals for a new British SME credit infrastructure



- We need to end up with more diversity and competition in corporate finance, but moves so far are insufficient in this direction
- Some additional measures to pursue
 - Standardizing and easing loan applications and due diligence as a public good for SMEs
 - Creating an actuarial database of SME lending or making it available from credit scoring experts
 - Creating of a junk bond market and a securitized lending market for SME loans
 - Either creating more new banks or getting old (bad) loans off of the books of the existing banks faster

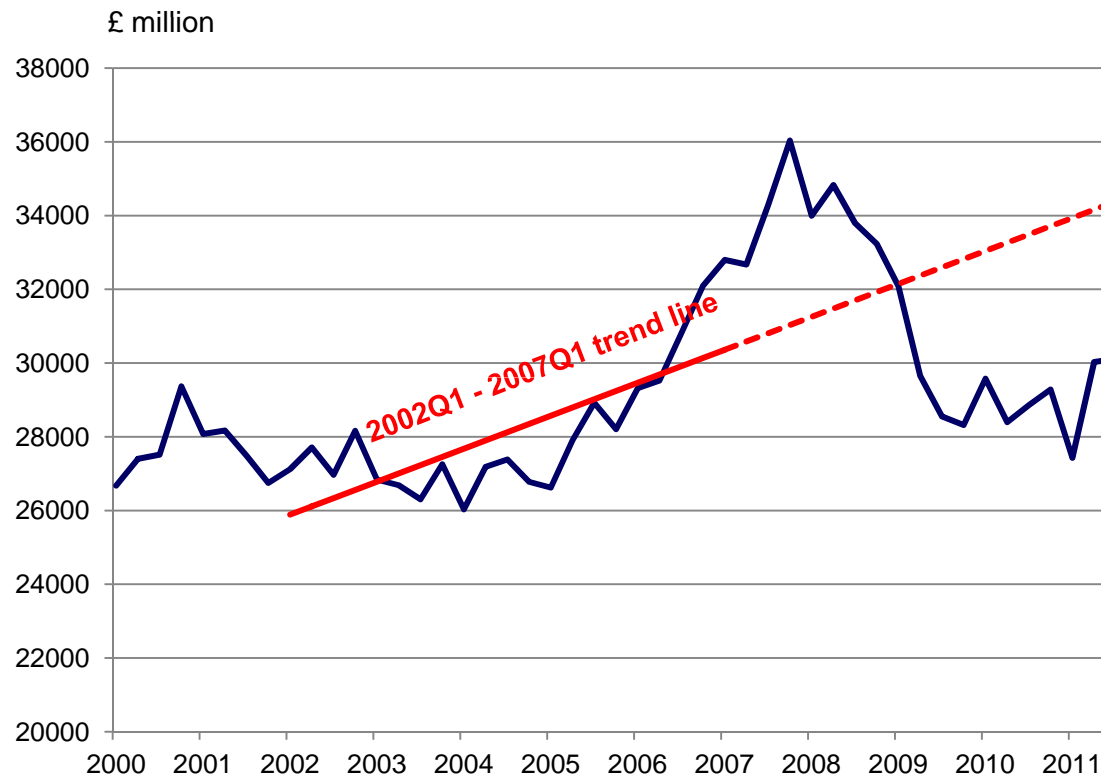
Some progress has been made



- I applaud the emergence of the Business Growth Fund, of the Business Finance Partnership scheme, and of new entrants to the UK banking system
- It is worth considering some subsidized lending to SMEs, and proposals for a national infrastructure bank
- We will only have done enough when we see the gap between SME/big lending narrow, and when competition provokes changes in lending behavior by big banks

UK business fixed investment level

Many good projects are still foregone



Source: OECD and Bank calculations

Red line: linear trend 2002 Q1 to 2007 Q1, shortfall in 2011 Q3 = 1.2% of GDP.

Yes, there is a public role in credit infrastructure



- There's too much fear of a public role in creating financial infrastructure and seeding the capital
 - lots of countries have public lenders
 - central banks can discount loans without choosing who to lend to
- Moreover, the crisis we are in was due to *private* misallocation of funds
- Like at Kew Gardens, we should let a thousand different flowers bloom – but first you have to plant and fertilize them

Serving growth *and* stability simultaneously in the UK



- We need to have a more diverse set of corporate financing institutions, and more competition among them, for the sake of the real economy
 - SME and new business lending is critical to innovation and employment
- We need a more diverse and competitive financial system for stability reasons, too
 - As argued by Haldane, Turner, and the ICB
- And we can increase demand in the short-run by improving supply in the long-run this way without much public risk or expenditure