



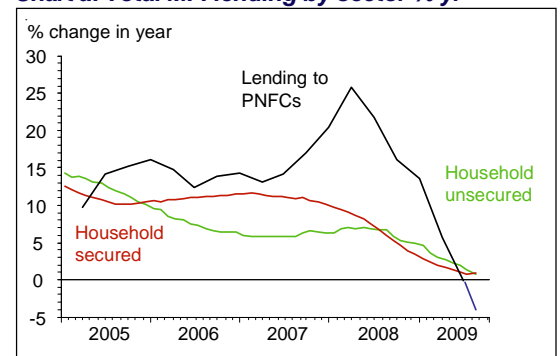
Economics Weekly

26 October 2009

Credit conditions have eased, but challenges remain

The Bank of England's (BoE) latest monthly *Trends in Lending* report was published last week. The report provides a timely assessment of lending conditions in the UK, and provides an update on the BoE's recently released Q3 *Credit Conditions* survey. Below, we examine the recent BoE surveys and assess the extent to which credit constraints have eased. With the UK FTSE-100 recently hitting a new twelve-month high and spreads in the interbank markets having dropped to their pre-crisis levels, sentiment in the financial markets have clearly improved. But a prerequisite for any enduring financial or economic recovery is a sustained rise in the supply of and demand for credit.

Chart a: Total MFI lending by sector % yr



Decline in credit growth has been led by the corporate sector

Chart a shows recent trends in lending to the non-financial corporate (PNFC) and household sectors. Since the onset of the credit crisis in summer 2007, lending growth across both sectors has slowed sharply. The slowdown has been particularly sharp in the PNFC sector where, in the twelve months to August, lending fell 4.2% - its sharpest drop since 1994. Notably, in the household sector, annual lending growth for both secured and unsecured credit has slowed, but remains positive. Within the household sector, however, divergent trends are emerging. In keeping with the recent signs of improvement in the housing market, loans for house purchase appear to have bottomed out. The annual rate of growth of secured lending rose from 0.8% in July to 0.9% in August – the first monthly increase since September 2007. By contrast, the slowdown in unsecured lending growth appears to be accelerating. Indeed in August, net consumer credit posted its second consecutive monthly decline for the first time since the series began in the early 1990s (see chart b).

But the BoE surveys report that credit conditions have improved

As the BoE has acknowledged, it is difficult to disentangle the extent to which the drop in lending growth has been driven by a weakening of supply or a weakening of demand. There can be little doubt that both have played a role. The pressure on banks' balance sheets and the rise in the cost of wholesale and retail funding have clearly impacted on the willingness of banks to extend credit over the past two years. At the same time, the fall in house prices, the onset of recession and, for some companies, the availability of cheaper sources of finance have weakened the private sector's demand for MFI loans.

Nevertheless, the BoE's recent credit surveys suggest that conditions have improved. Chart c shows the net percentage of lenders reporting a loosening in credit *availability*. The biggest improvement has been in the availability of loan finance to PNFCs. Since September 2008, the net balance of lenders reporting a loosening in credit availability to the corporate sector has risen from -36% to +25% (a swing of 61%). The percentage balances for both household loans for house purchase and unsecured credit have also risen, but remain in negative territory. Admittedly, the improvement in the availability of loan

Chart b: Net consumer credit breakdown

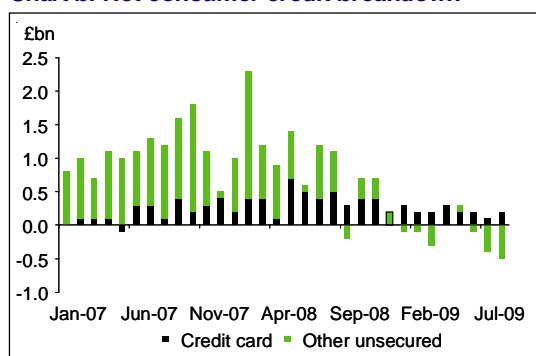
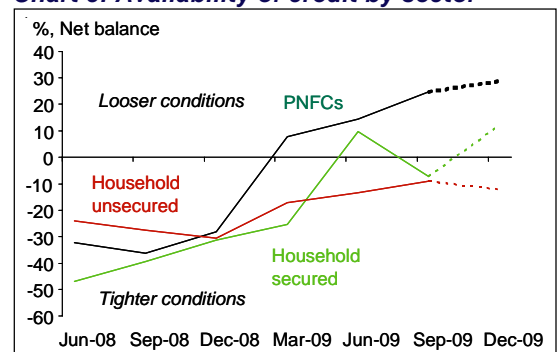


Chart c: Availability of credit by sector



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2009/10 calendar of central bank meetings

European ECB (1.00%)
 5 November, 3 December, 14 February, 4 March
US FOMC (0-0.25%)
 4 November, 16 December, 27 January, 16 March
UK MPC (0.50%)
 5 November, 10 December, 7 January, 4 February, 4 March

Chart d: Demand for credit by sector

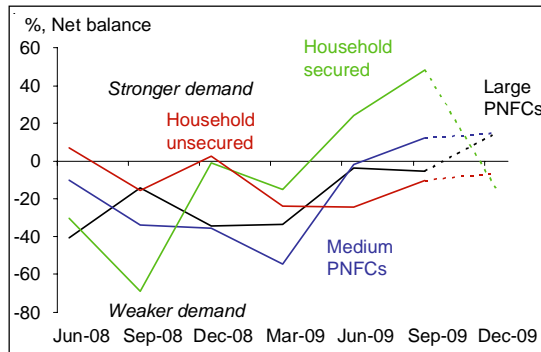
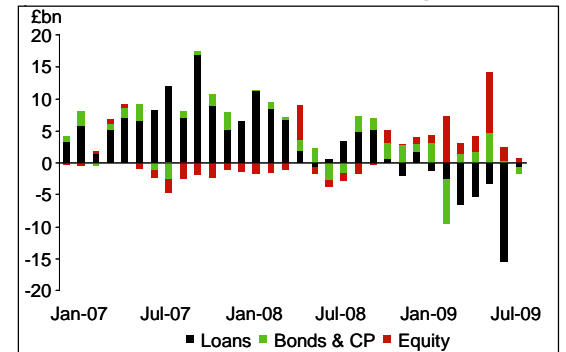


Chart e: Sources of corporate funding



finance in all three areas has been from a low base, and other surveys continue to report that credit conditions remain tight. Nevertheless, policy initiatives such as quantitative easing, coupled with improvements in liquidity in the wholesale funding markets have clearly begun to have a positive impact on the availability of loan finance.

Rolling calendar of UK data releases and events

CBI distributive trades (27/10)
 Mortgage approvals (29/10)
 Manufacturing PMI (2/11)
 Services PMI (4/11)
 Industrial production (5/11)
 NIESR GDP (6/11)
 Producer prices (6/11)

Demand for loans has also risen

Chart d shows that there has also been a rise in the *demand* for MFI credit from both corporates and households. The biggest improvement has been in loans for house purchase, where the net balance of lenders reporting an increase in demand has risen from -69% to +48% over the past year. By contrast, demand for unsecured credit has improved only marginally. The ongoing weakness in the demand for unsecured credit is consistent with the downturn in consumer spending and the ongoing desire of households to rebuild their precautionary savings and strengthen their balance sheets.

Amongst PNFCs, the rise in loan demand appears to have been driven by small and medium-sized companies. This is largely explained by the fact that larger companies have sought to substitute away from bank finance towards alternative sources of funding. This is consistent with the rise in capital market issuance this year and the net repayment of corporate bank loans. In the three months to August, PNFCs repaid a net £20bn. The repayment appears to have been financed, at least in part, by a rise in equity and bond issuance (see chart e). Smaller companies, by contrast, remain highly reliant on bank finance. Indeed, lending to SMEs with a turnover of less than £25mn per year has risen by 1.6% over the past twelve months, while lending to those with a turnover of less than £1mn, has risen by an annual 6.4%.

Rolling calendar of US data releases and events

Consumer conf (27/10)
 Durable goods orders (28/10)
 New home sales (28/10)
 GDP Q3 (29/10)
 Core PCE deflator (30/10)
 Manufacturing ISM (2/11)
 Factory orders (3/11)

Credit conditions set to ease further, but significant challenges remain

Looking ahead, the BoE's latest credit conditions survey suggests that lenders expect demand for loans from both large and medium-sized companies to increase in the fourth quarter. The anticipated rise reflects expectations of stronger M&A activity, increased corporate confidence, and a rise in demand for working capital, particularly from those companies that may have de-stocked too rapidly and now need to rebuild their inventory levels. The survey suggests, however, that credit conditions facing the household sector are likely to be mixed in the months ahead. While the *availability* of secured finance is expected to rise further, *demand* for mortgages for house purchase is anticipated to drop, although this may partly be due to the usual seasonal lull in housing activity in Q4.

By contrast, the anticipated weakness in unsecured lending is likely to be more enduring. As the ongoing rise in unemployment, the recent weakness in retail sales and the surprise 0.4% quarterly drop in GDP in Q3 highlight, the UK economy, and the consumer sector in particular, continue to face substantial headwinds. Faced with these headwinds, the desire of both households and corporates to deleverage their balance sheets is likely to remain a sizeable impediment to a rapid economic recovery not only in Q4 but over the year ahead.

Adam Chester, Senior UK Economist, Corporate Markets

*** All charts are sourced to Lloyds TSB Corporate Markets Economic Research, Bloomberg and Datastream, Bank of England**

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Weekly economic data preview

26 October 2009

US Q3 GDP to be boosted by stronger consumption

Following in the footsteps of the first estimate of UK Q3 GDP last week, the US will release its advance GDP estimate this week. Although UK quarterly growth surprised to the downside and remained negative, US growth is expected to be comfortably positive, helped by stronger consumption. Nevertheless, significant policy stimulus remains in place and the question is how strong recovery will be when they are eventually reversed. In the UK, the CBI distributive trades survey will provide an early snapshot of retail activity in October, while BoE data could show a small rise in mortgage approvals. The euro zone flash CPI estimate and economic sentiment indicators are also due. Elsewhere, the BoJ is expected to keep interest rates on hold at 0.1% and Australia releases Q3 CPI data. Bond markets will also digest record US issuance of \$123bn this week. Norway is expected to raise interest rates on Wednesday.

- The UK has a limited economic data calendar this week, with Bank of England monetary statistics along with a number of house price surveys and the latest CBI Distributive Trades Survey scheduled for release. We look for the number of mortgage approvals to have risen slightly in September from 52.3k previously, leaving them more than 50% higher than a year earlier. In contrast to remortgaging activity, gross lending for house purchases has been trending higher and this explains the pick-up in the number of mortgage approvals since late last year. However, approvals are still less than half the level seen before the economic and financial crisis started back in mid-2007, with early signs of improvement in secured credit availability to households yet to become well established. Meanwhile, net consumer credit data for September are also published, where we envisage a £0.3bn contraction, as the process of household sector deleveraging continues. If realised, this would be the third consecutive monthly decline. Finally, October house price numbers from the Nationwide and Hometrack are due for release this week.
- Following last week's broadly positive preliminary PMI reports and German Ifo survey, this week sees a further wave of forward-looking business surveys in the euro zone. We look for the European Commission's economic confidence index to improve to a reading of 83.5 in October from 82.8 previously, aided by a modest rebuilding of stocks in the euro area, combined with continued optimism in financial markets. Net balances on industrial, services and consumer confidence are also due. As in many regions around the world, rising joblessness poses a real threat to economic recovery. German unemployment data for October are scheduled for Thursday, where we look for an increase of some 30k, while the euro zone unemployment rate is released on Friday (forecast: 9.7%). Preliminary euro zone CPI data are published the same day, where we look for an outturn of -0.1% in the year to October as last year's high energy prices start to fall from the annual comparison. In terms of monetary indicators, September euro zone M3 money supply data seems likely to show an outright contraction in bank lending to the private sector (mortgage lending has been falling on annual basis for much of the past five months).
- The first estimate of US Q3 GDP is due this week and is expected to show positive quarterly growth for the first time since Q2 2008. Although the UK equivalent figure, released last week, surprised to the downside and remained negative, the US economy is expected to show comfortably positive quarterly growth of around 3.5% (annualised). A key driver of the return to growth is expected to be stronger personal consumption, as well as a slower pace of destocking and less of a drag to growth from residential investment. Nevertheless, the return to positive growth was heavily influenced by the macroeconomic stimulus, including the cash-for-clunkers programme. It remains to be seen how strong growth will be when further policy measures are reversed. Indeed, although indicators of consumer confidence have risen from lows seen earlier this year, they have shown limited improvements in the past quarter. The Conference Board and (final) University of Michigan consumer confidence surveys are released this week. Also due are new home sales and the Case-Shiller house price data which have shown tentative signs of improvements lately.

Hann-ju Ho, Senior Economist

Chart 1: UK mortgage approvals and house prices have improved in recent months

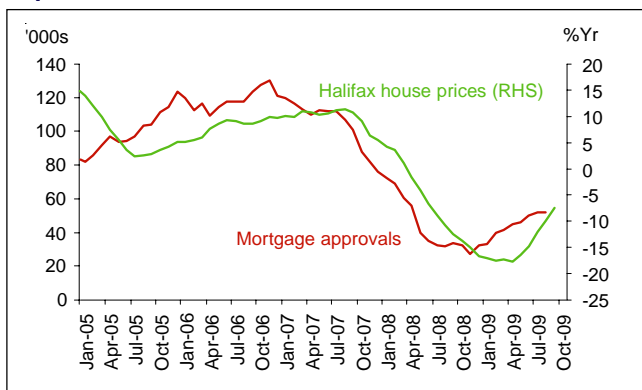
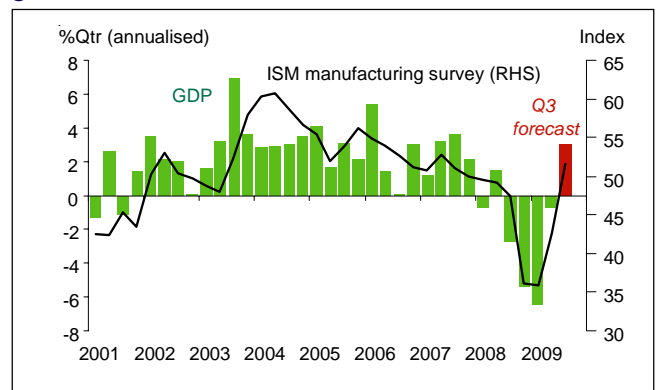


Chart 2: US economy expected to have returned to growth in Q3



| Date | United Kingdom | United States | EU-16 |
|--------|---|--|---|
| Mon 26 | Nationwide house prices (07:00) (Oct) (26-30) Sep +0.9% Y-O-Y zero | | German GfK consumer confidence (07:00) Oct +4.3 Nov (f'cast) +4.5 Median +4.5 Range +4.0:+5.0 |
| Tue 27 | CBI distributive trades' survey (11:00) Sep +3 Oct (f'cast) +5 | House prices (S&P/CaseShiller)(Aug)(13:00) Jul Y-O-Y -13.3% Median -11.8% Range -12.5%:-11.0% Consumer confidence (14:00) Sep 53.1 Oct (f'cast) 52.0 Median 53.5 Range 48.0:57.0 | EU-16 money supply, M3 (sa) (09:00) Aug Y-O-Y +2.5% Sep (f'cast) Y-O-Y 2.0% Median +2.2% Range +1.8%:+2.6% |
| Wed 28 | | Durable goods orders (12:30) Aug -2.4% Y-O-Y -xx% Sep (f'cast) +1.0% Median +1.0% Range -1.0%:+3.0% New home sales (14:00) Aug 429k Sep (f'cast) 443k Median 440k Range 412k:453k | German import prices (07:00) Aug +1.3% Y-O-Y -10.9% Sep (f'cast) -1.0% Y-O-Y -11.0% Median -0.7% Range -1.4%:+0.4% German CPI (07:00) (prel) Sep Y-O-Y -0.5% Oct (f'cast) Y-O-Y -0.1% Median -0.1% Range -0.4%:+0.1% |
| Thu 29 | Money supply, M4 (final, sa) Aug zero Y-O-Y +12.1% Sep (prel) +0.7% Y-O-Y +11.3% Consumer credit Aug -£0.3bn Sep (f'cast) -£0.3bn Median -£0.2bn Range -£0.4bn:+£0.1bn Net mortgage lending (sa)(Sep) Aug +£1.0bn Sep +£0.8bn Range +£0.5bn:+£1.5bn Mortgage approvals Aug 52.3K Sep (f'cast) 52.8k Median 53.6K Range 50.5k:59.0k | GDP (sa, annualised) (12:30) Q2 -0.7% Q3 (f'cast) +3.5% Median +3.2% Range +2.0%:+4.8% GDP deflator (sa, annual) (12:30) Q2 zero Q3 (f'cast) +1.2% Median +1.5% Range zero:+2.3% Initial claims (w/e 24/10) (12:30) Previous 531k Forecast 515k | German unemployment (sa) (08:55) Sep -12K Rate 8.2% Oct (f'cast) +20K Rate 8.3% Median +15K Range -1K:+45K EU-16 consumer confidence (10:00) Sep -19 Oct (f'cast) -18 Median -18 Range -21:-17 EU-16 industrial confidence (10:00) Sep -24 Oct (f'cast) -22 Median -22 Range -24:-20 |
| Fri 30 | Consumer confidence (GfK) (00:01) Sep -16 Oct (f'cast) -16 Median -14 Range -17:-9 | Personal income (12:30) Aug +0.2% Y-O-Y -2.6% Sep (f'cast) zero Median zero Range -0.2%:+0.2% Personal spending (12:30) Aug +1.3% Y-O-Y -0.3% Sep (f'cast) -0.3% Median -0.5% Range -0.9%:+0.1% Core PCE deflator (12:30) Aug +0.1% Y-O-Y +1.3% Sep (f'cast) +0.1% Y-O-Y +1.4% Median +0.2% Range -0.2%:+0.2% Chicago PMI (13:45) Sep 46.1 Oct (f'cast) 47.8 Median 48.5 Range 47.0:52.5 Uni. of Michigan confidence (final) (14:00) Oct (prel) 69.4 Oct (f'cast) 70.0 Median 70.0 Range 69.0:74.7 | German retail sales (07:00) Aug -2.4% Y-O-Y -2.6% Sep (f'cast) +0.5% Y-O-Y -3.0% Median +1.0% Range +0.4%:+1.8% French producer prices (07:45) Aug +0.4% Y-O-Y -8.5% Sep (f'cast) -0.3% Y-O-Y -8.1% Median -0.3% Range -0.8%:+0.4% EU-16 CPI (10:00) (flash) Sep Y-O-Y -0.3% Oct (f'cast) Y-O-Y -0.1% Median -0.1% Range -0.3%:zero EU-16 unemployment rate (10:00) Aug 9.6% Sep (f'cast) 9.7% Median 9.7% Range 9.6%:9.8% |
| Mon 2 | UK Manufacturing PMI (Oct) Sep 49.5 Halifax house prices (sa) (Oct) (02-06) Sep +1.6% 3m/Y-O-Y -7.4% | ISM manufacturing index (15:00) (Oct) Sep 52.6 | French Manufacturing PMI (08:50) (Oct) Oct (prel) 55.3 German Manufacturing PMI (08:55)(Oct) Jul (prel) 51.1 EU-16 Manufacturing PMI (09:00)(Oct) Oct (prel) 50.7 |

NB: UK data released at 9.30 a.m., unless otherwise stated. Market medians are as of preceding Friday. Release times of US data are stated in brackets after the description of the indicator. Events are listed in the events column on the next page.

| Date | Japan | Other Countries | Main events |
|--------|---|---|--|
| Mon 26 | | | <ul style="list-style-type: none"> • Bank of England publish Asset Purchase Facility Report (09:30) • Bank of Canada Governor Carney speaks in Montreal (12:55) • Bank of England MPC member Posen speaks in London (18:35) |
| Tue 27 | | | <ul style="list-style-type: none"> • ECB member Stark speaks in Germany (08:45) • Bank of Canada Governor Carney speaks on Monetary Policy (15:00) • US Treasury to sell \$44bn of 2yr notes (17:00) • US Treasury Secretary Geithner speaks (20:30) |
| Wed 28 | Industrial output (00:50) (prel) (Sep) Aug +1.6% Y-O-Y -19.0% | | <ul style="list-style-type: none"> • Germany to sell 5yr bonds due 2014 • Norges Bank interest rate decision, interest rates expected to rise by 25bps to 1.50% (13:00) • US Treasury to sell \$41bn of 5yr notes (17:00) |
| Thu 29 | Job-applications ratio (23:30) Aug 0.42 Sep (f'cast) 0.42 Median 0.42 Range 0.41:0.43 Unemployment rate (23:30) Aug 5.5% Sep (f'cast) 5.6% Median 5.6% Range 5.4%:5.7% Workers' spending (23:30) Aug Y-O-Y +2.6% Sep (f'cast) Y-O-Y +1.2% Median +1.0% Range -0.2%:+2.6% Tokyo core consumer prices (23:30) Sep Y-O-Y -2.1% Oct (f'cast) Y-O-Y -2.2% Median -2.1% Range -2.3%:-1.9% National core consumer prices (23:30) Aug Y-O-Y -2.4% Sep (f'cast) Y-O-Y -2.4% Median -2.4% Range -2.6%:-2.3% | Canada IPPI (12:30) Aug +0.5% Sep (f'cast) zero Median +0.1% Range -0.3%:+0.3% Canada RMPI (12:30) Aug +3.7% Sep (f'cast) +0.5% Median +1.0% Range -0.9%:+1.5% | <ul style="list-style-type: none"> • Fed to purchase Notes/Bonds (amount tbc) (15:00) • US Treasury to sell \$31bn of 7yr notes (17:00) |
| Fri 30 | Japan interest rate decision (05:00) Current: 0.10% Forecast: 0.10% | Canada GDP, monthly (12:30) Jul zero Aug (f'cast) +0.1% Median +0.1% Range -0.1%:+0.4% | |
| Mon 2 | | | <ul style="list-style-type: none"> • Fed member Tarullo speaks in Washington (20:15) |