

TRENDS IN GLOBAL BANK LENDING IN THE POST-FINANCIAL CRISIS ERA

...HOW VOLUMES OF PRIVATE SECTOR CREDIT HAVE CHANGED AROUND THE WORLD, AND WHICH COUNTRIES HAVE FARED BEST

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1 – INTRODUCTION

Private sector credit is the lifeblood of global business, enabling companies to invest for the future, grow organically or through acquisitions, or manage on-going peaks and troughs in revenue flow. When supply dries up, as many countries around the world have seen in the aftermath of the financial crisis, the impact can be severe, particularly for smaller businesses.

In the four years since the height of the global recession, the global picture with regards to bank lending has altered significantly. Our research reveals that while lending to the private sector has surged ahead in many developed and emerging economies, in many others, including some of the world's leading economies, the amount of credit extended to businesses remains stagnant.

We appear to be in a two-speed world, each with its own risks;

- Too little credit in the West, condemning some parts of the economy, such as small companies, to below trend growth.
- An excessively fast expansion of credit in parts of the emerging markets – which could result in increase in non-performing loans and a subsequent downturn in credit availability.

In this report, we examine where businesses have been best supported by the banks in the post-financial crisis era, and where they may be finding it tougher to get credit, comparing data across a four-year and a one-year period. We also investigate some of the reasons behind these widely varying fortunes, consider the impact of the credit squeeze on smaller businesses versus major corporates, and assess the outlook going forward.

Lenders' appetite is, of course, a key factor and that is partly determined by the regulatory capital requirements for banks. In the US and UK, that has made lending more tightly controlled and expensive.

As many countries worst hit by the credit crunch see their economies stabilising, lending volumes are slowly starting to improve, although it is doubtful whether this is yet enough to make up for the lag in capital investment that so many countries encountered as a result of the global recession.

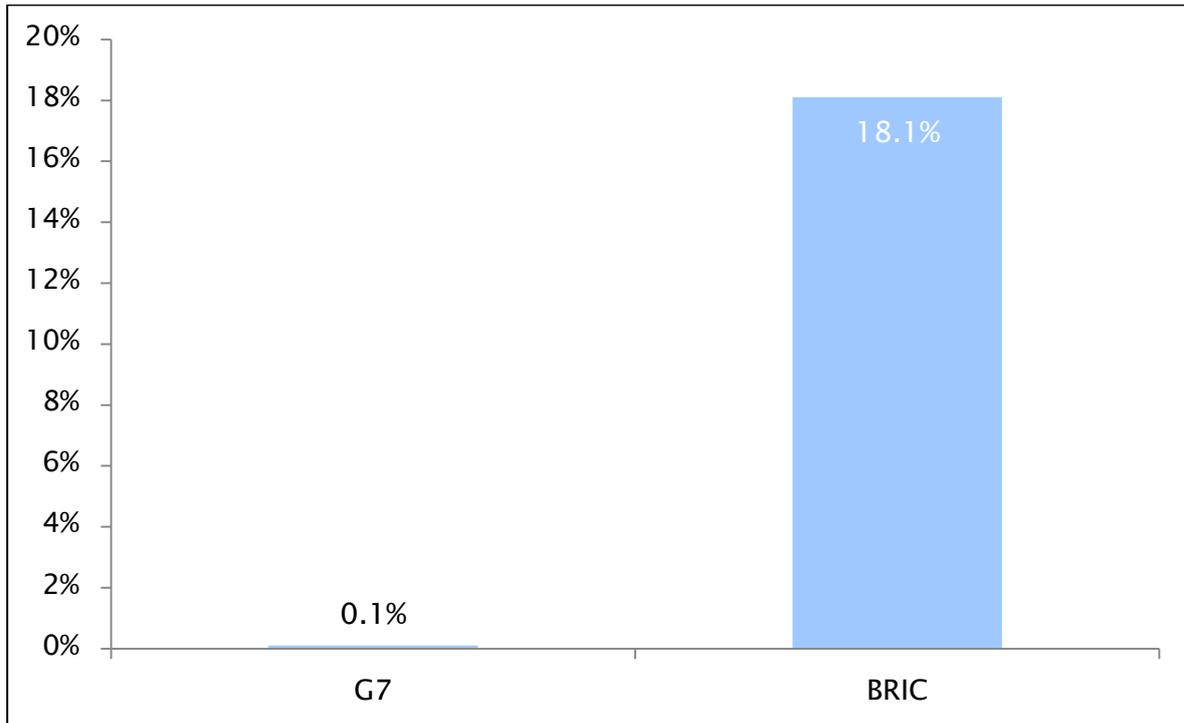
Our experience around the world suggests that, despite an increased appetite for lending from businesses, most still feel that there is not enough competitive long-term finance available. Although businesses' reasons for wanting to borrow are many and varied, there are signs of optimism returning after the global recession. While the vast majority of businesses are looking to use bank lending to deal with cash flow problems, a growing proportion also want to use it for acquisitions or to make capital investments.

At the same time, concerns over the sustainability of debt levels building up in some emerging markets – notably China – are growing, particularly since the fall-out from any downturn in the credit cycle there could have far reaching consequences.

2 – OVERVIEW

Our study reveals that bank lending to the private sector in the G7 group of economies has stagnated in the last year, increasing by just 0.1% in real terms. By contrast, in many major emerging economies, bank credit continues to soar, with the BRIC nations (Brazil, Russia, India, China) leading the way.

AVERAGE REAL TERMS GROWTH IN BANK LENDING IN 2013 – G7 VS BRIC ECONOMIES

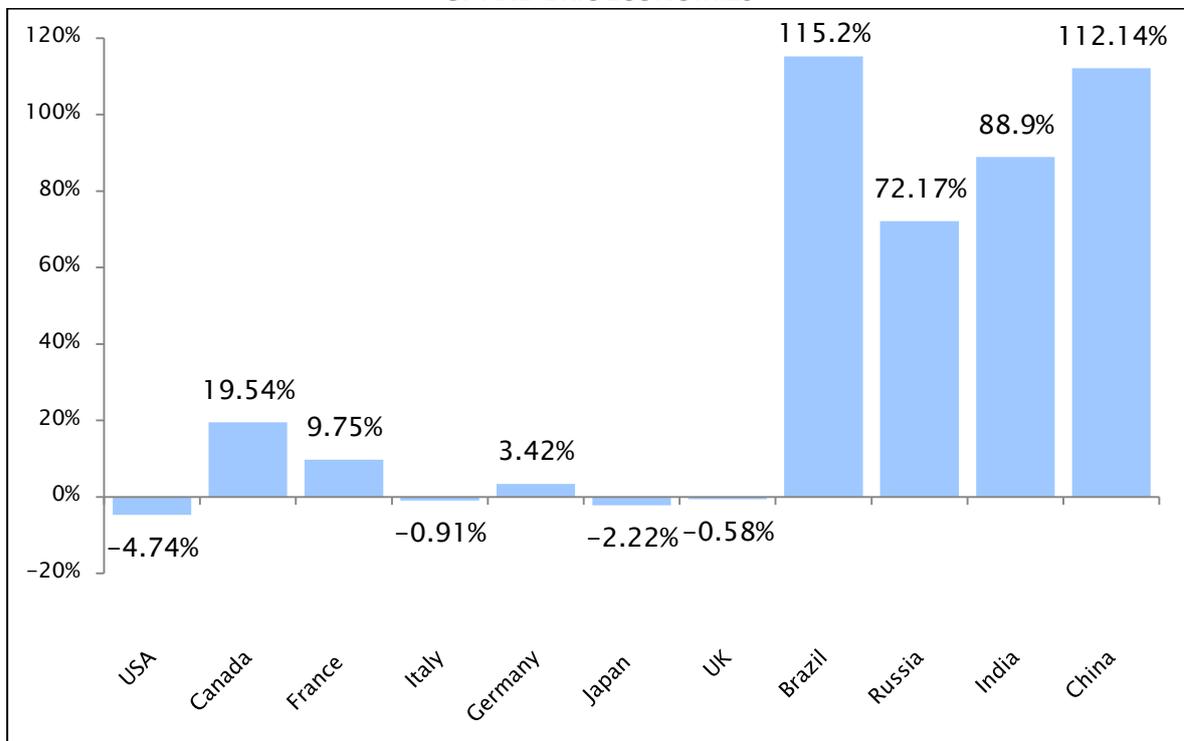


KEY FINDINGS AND ANALYSIS FROM OUR RESEARCH INCLUDE:

- In the US and UK, modest overall expansions in lending in the last year have been wiped out by inflation. In the US there was a real terms decline in bank lending of approximately 0.1% in 2013, and of 2.2% in the UK. Over the four years since the depths of the global recession (January 2009), the volume of bank lending to the private sector in the US has declined by 4.74% in absolute terms, and in the UK by 0.58%
- Other countries most affected by the continued fall in bank lending since the depths of the recession were those hit hardest by the banking crisis, including Spain, Ireland and Italy.
- Those developed economies whose banks and economies were relatively unscathed during the banking crisis and global recession – such as Australia and Canada, neither of which had any banking bail-outs during the financial crisis – continue to fare much better
- The so-called BRIC nations (Brazil, Russia, India, China) have all seen significant increases in lending, as have several other emerging economies. For example, Brazil has seen bank lending to the private sector jump 115% since 2009, and lending in China has risen 112%. While this means that businesses have seen a bigger improvement to access to credit compared to most Western economies – the worry now is that bank lending has expanded too much.

- In the BRIC economies, lending growth remained very substantial even in real terms in the past year. The average lending growth across all four countries in 2013 was 18.7%. In China, lending expanded by 21% in the last year, and inflation was relatively moderate at 2.6%. The country's shadow banking system has also expanded significantly, providing huge volumes of credit, frequently outside the supervision of the central bank.
- The continued slump in lending in developed economies has hit smaller businesses the hardest, as bigger companies have been able to access the bond markets to fill the gap in funding. In the UK, lending through corporate bonds has increased by 35% over the last four years, while in the US it has increased by 44%, and in France by 35%. This leaves small businesses in many countries still in the grips of a "hidden credit crunch".

PERCENTAGE CHANGE IN BANK LENDING OVER LAST FOUR YEARS (2009-2013) – BREAKDOWN OF G7 AND BRIC ECONOMIES



BANK LENDING TO PRIVATE SECTOR BY COUNTRY

Country	% change (4 years)	% change (1 year)	Annual inflation rate (2013)	Real Terms % Change (1 year)
BRAZIL	115.20%	17.90%	6.2	10.59%
CHINA	112.14%	21.40%	2.6	18.27%
INDIA*	88.90%	14.20%	10.9	1.76%
RUSSIA	72.17%	18.90%	6.8	10.85%
SINGAPORE	54.30%	16.90%	2.4	14.05%
MALAYSIA	36.66%	13.60%	2.1	11.21%
BELGIUM	20.52%	1.70%	1.1	0.56%
CANADA	19.54%	4.70%	0.9	3.76%
AUSTRALIA	17.16%	5.40%	2.4	2.86%
CZECH REPUBLIC	12.76%	2.50%	1.4	1.04%
AUSTRIA	12.67%	-0.90%	2	-2.91%
FRANCE	9.75%	-0.10%	0.9	-0.99%
DENMARK	4.84%	-0.60%	0.8	-1.41%
MEXICO	4.72%	-0.60%	3.8	-4.36%
NETHERLANDS	3.64%	-0.70%	2.5	-3.23%
GERMANY	3.42%	1.30%	1.5	-0.22%
CROATIA	3.10%	-4.00%	2.2	-6.12%
GREAT BRITAIN	-0.58%	0.40%	2.6	-2.24%
ITALY	-0.91%	-2.40%	1.2	-3.53%
IRELAND	-1.40%	-5.90%	0.5	-6.36%
JAPAN	-2.22%	3.40%	0.4	3.04%
USA	-4.74%	1.40%	1.5	-0.13%
SPAIN	-10.54%	-6.50%	1.4	-7.80%
BRIC AVERAGE	97.10%	18.10%		16.29%
G7 AVERAGE	3.50%	0.10%		0.13%

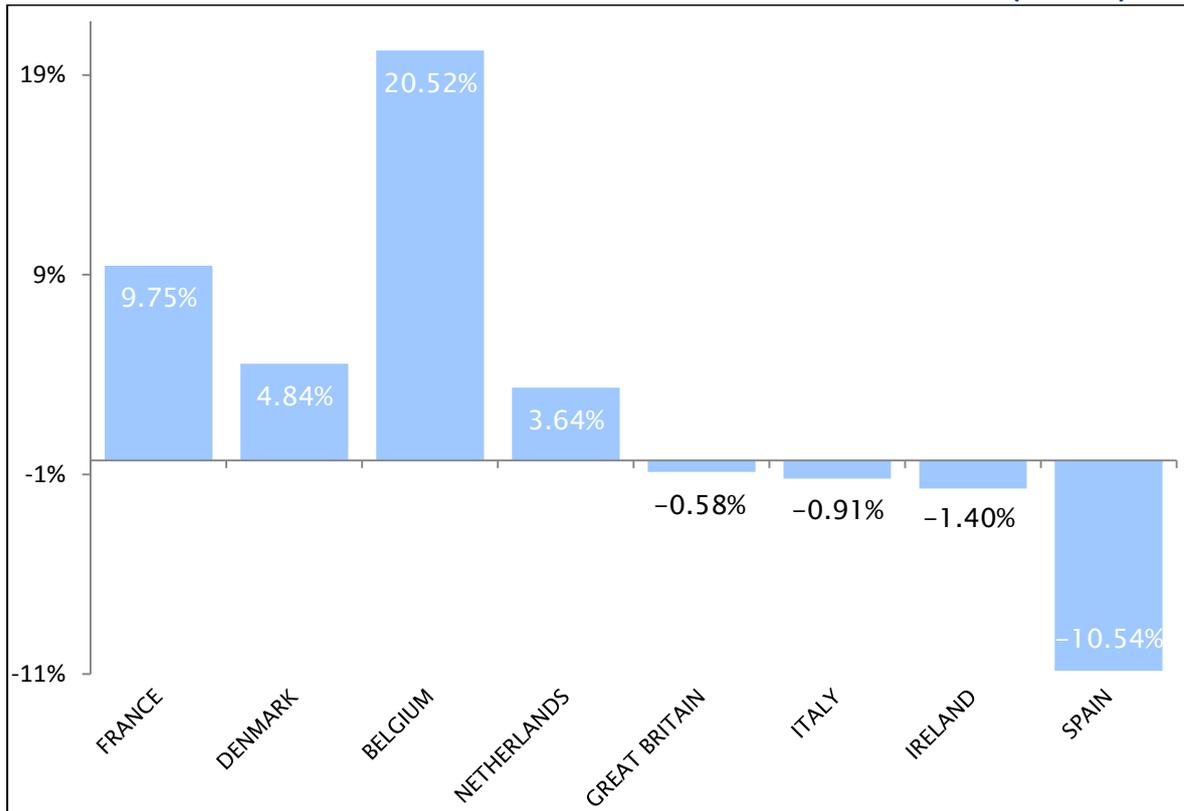
*Analysis of data from Bank of International Settlements, IFC and selected central banks data. Data period: 1st January 2009 – 31st December 2013. Private sector lending includes lending to businesses and households, excluding credit through debt securities such as bonds.

** Source: World Bank

3 – WESTERN EUROPE

There is a mixed picture in bank lending across Western Europe. Here a clear split emerges over the last four years, with those most affected by the banking crisis (Spain, Italy, Ireland and the UK) seeing bank lending contract most severely. By contrast, many other Western European countries (notably Belgium and France) have seen a good recovery in lending growth in the same period, despite the Eurozone crisis.

BANK LENDING IN WESTERN EUROPEAN ECONOMIES – PERCENTAGE CHANGE (4 YEARS)



In the last year the picture has generally improved. European Central Bank research shows that across the Eurozone as a whole, banks now report a slight easing in credit conditions, especially for larger businesses, and in Q1 2014 there was the first increase in demand for corporate loans since Q2 2011.

In the UK in the last year, trends in lending volumes have become mildly positive, while in several European nations, including France, Denmark and the Netherlands, lending has contracted somewhat. The Dutch banks in particular are struggling to retain adequate levels of regulatory capital given the large volumes of interest-only mortgage lending that have been a traditional feature of the country's banking sector thanks to generous tax relief.

Lending to businesses in Ireland continues to suffer the after-effects of the property related boom. One in four Irish SMEs is estimated to be in default on previous loans, with the rate in the property and construction sector closer to 60%. However, again, there are signs of a modest recovery, with banks starting to expand lending to traditionally reliable sectors, notably agriculture.

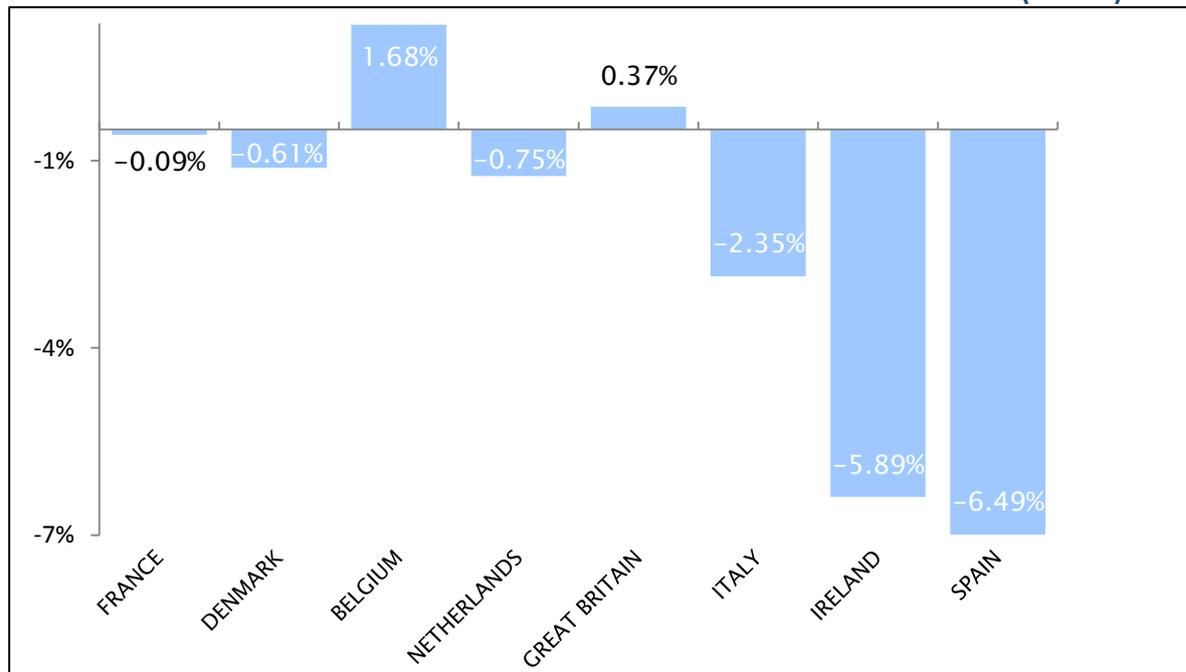
Across Western Europe generally, there is a sense that arrangement fees and lending margins are too high, and some view covenants as too restrictive. Our discussions with businesses suggests that many are looking for bank loans to cover cash flow problems, but also more positive reasons are coming to the fore, such as to fund acquisitions, make capital investments and for export finance.

The UK is seeing demand for business borrowing increasing, but businesses report that banks are less responsive to new requests unless they are from existing customers with a good track record and security. Initiatives such as Funding For Lending, which was designed to encourage banks to lend, has had a limited impact on small business lending, and if restricted access to funding continues, it risks creating a drag on the UK's nascent economic recovery.

In Italy, high lending margins and arrangement fees appear to be exacerbating a lack of long term finance, with the ECB reporting a tightening, rather than a loosening, of credit standards. Demand from businesses seems to be low, indicating that confidence in Italy's economic prospects is yet to return.

In Spain, although lending remains tight, some signs of optimism are starting to appear as the economy starts to gather strength and growth forecasts are revised upwards. Growing numbers of Spanish firms are looking for loans, especially for export finance, as well as to smooth cash flow. The European Central Bank also notes that in Q2 2014, loan margins narrowed, suggesting that banks' lending appetite is returning.

BANK LENDING TO WESTERN EUROPEAN ECONOMIES - PERCENTAGE CHANGE (1 YEAR)



4 – CENTRAL AND EASTERN EUROPE

Several Central and Eastern European nations have fared better than many of their Western European neighbours in terms of bank lending since the recession.

The Czech Republic saw significant growth in lending of 12.76% over the last 4 years, beating the rest of Europe, including Germany (but with the exception of Belgium). This perhaps reflects the Czech Republic's strong industrial sector, low levels of consumer credit and strong ties with the German economy. Its recovery now seems to be well underway, with its Q2 2014 GDP figures registering the fastest growth since 2008.

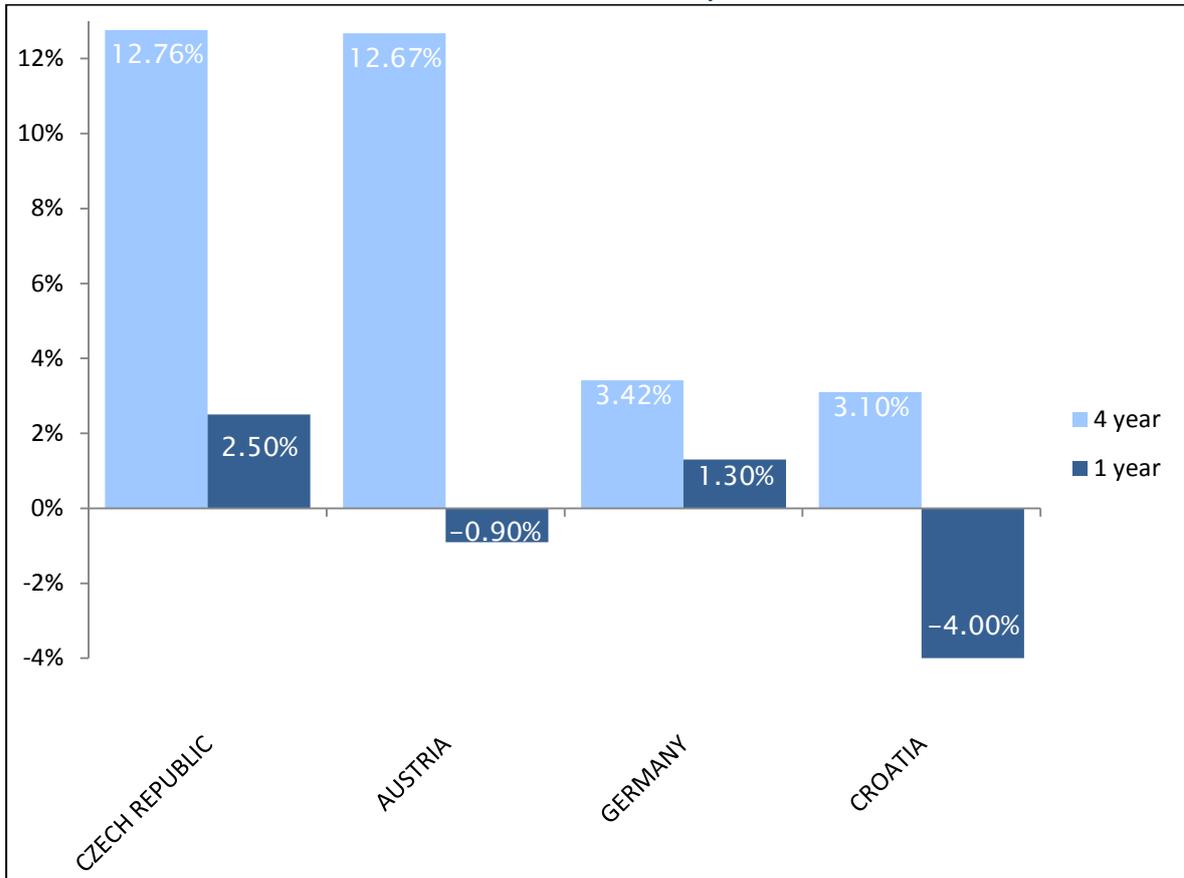
Austria was not far behind, although lending has contracted slightly in the past year, suggesting that the balance is being restored after several years of strong growth. Austrian banks came under pressure to cut lending in Eastern Europe in order to maintain credit flows in Austria.

Seen as a consistent economic performer and an industrial powerhouse, Germany has seen steady lending growth throughout the recession, though by no means as high as some of its neighbours. German SMEs have generally been well supported thanks to close links with one of about 1,500 regional banks.

These long-standing relationships have helped to make sure that lending to the small and medium-sized businesses of Germany's *mittelstand* has not declined during the financial crisis. In turn, German commercial banks have been helped by the government owned development bank called Kreditanstalt für Wiederaufbau (KfW), which amongst its various duties has helped to absorb some of the risks associated with lending to the SME sector and some of the blow-ups from aggressive commercial property lending.

Compared to four years ago, lending in Croatia has expanded by 3.1%, though with a 4% dip in the last twelve month period, as the economy contracted and foreign parent banks deleveraged in anticipation of an increased delinquency rate on their corporate loans. There is currently limited demand for additional lending, and margins on corporate loans are seen as un-competitively high at 8.5% or more.



BANK LENDING TO CENTRAL AND EASTERN EUROPEAN ECONOMIES – PERCENTAGE CHANGE (4 YEARS AND 1 YEAR)

5 – THE BRIC ECONOMIES

Brazil, Russia, India and China (the BRIC nations) have seen the greatest increases in bank lending since the recession, leaving the G7 economies in the shade. Brazil has seen bank lending to the private sector jump 115% since 2009, and lending in China has risen 112%.

One reason for this is their continued economic growth while developed economies fell into recession. However, central government pressure has surely kept the credit flowing here when the taps were turned off in many Western economies.

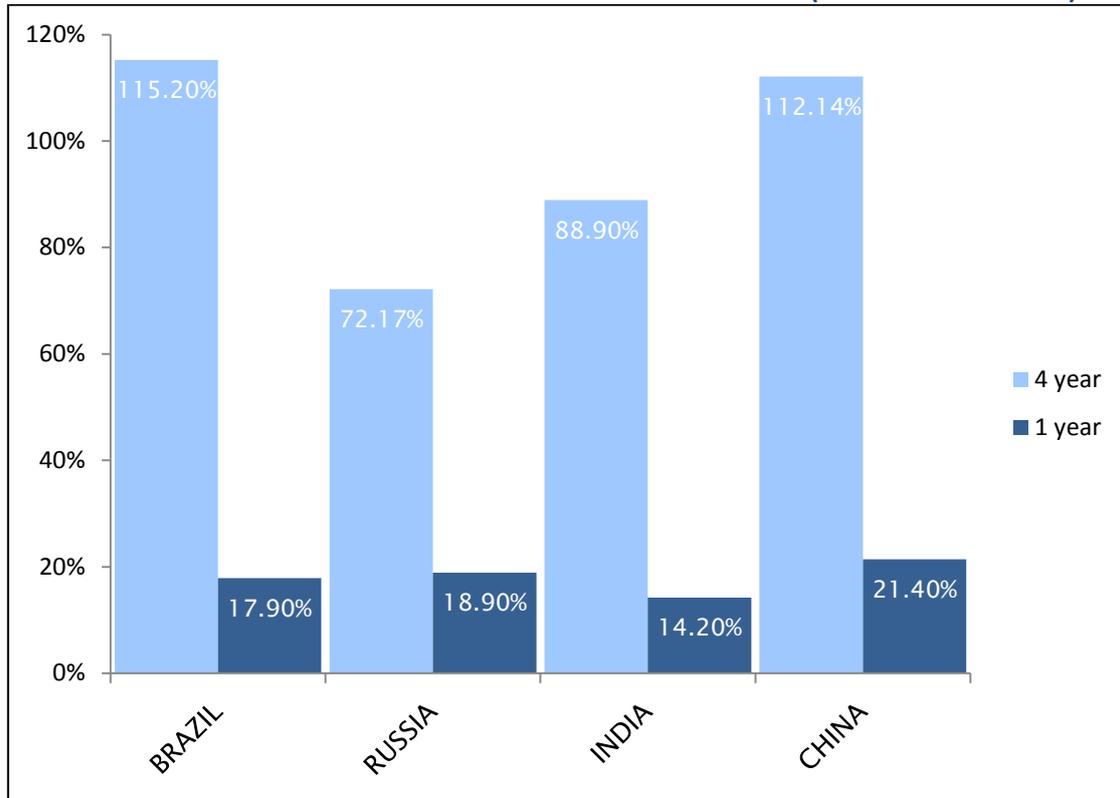
In the last year, lenders' appetite has not responded substantially to concerns being raised increasingly over the sustainability of debt levels, particularly in China. The average lending growth across all four countries in 2013 was 18.7%. Even though inflation in the BRIC economies was high (China excepted), lending growth remained very substantial even in real terms.

In China, lending expanded by 21% in the last year, and inflation was relatively moderate at 2.6%. With its economy powering ahead and poised to overtake the US in the not-too-distant future, lenders still see China as a good bet. However, many businesses are detecting a slight shift in the type of lending available – with the availability of short-term loans improving, while it may be more challenging to obtain long-term finance.

Lending in Brazil has been the strongest in terms of growth of any country in the world since 2009, and its economy has held up well during the global recession. This was supported by a significant boost to funding from the Brazilian National Development Bank (BNDES) via its accredited networks, private and public banks. There is some concern now that as Brazil's economy slows, levels of debt in the system are too high, and that Brazilian businesses will struggle with the levels of debt they have taken on.

One of the world's leading economies, Russia, saw strong growth in its economy and in lending volumes while the Eurozone was contracting, underpinned by its strength in oil and gas. However, around \$160 billion, around a tenth of private sector lending to Russia, was provided by foreign banks at the end of 2013, so that the continuation of the Ukraine crisis could have consequences for the availability of credit in Russia.



BANK LENDING TO BRIC ECONOMIES – PERCENTAGE CHANGE (4 YEARS AND 1 YEAR)

6 – ASIA AND ASIA PACIFIC

Many of the Asian/Asia Pacific countries in our study have seen surging growth in bank lending over the last 4 years – with the exception of Japan.

Australia has performed far better than many other leading developed nations including the US and UK. This could be due in large part to the fact that Australia escaped the financial crisis and global recession. There were no bank bail-outs in Australia, and its resource based economy continued to perform well. Australian business remains focussed on growth, with many requesting loans to fund capital investments and acquisitions.

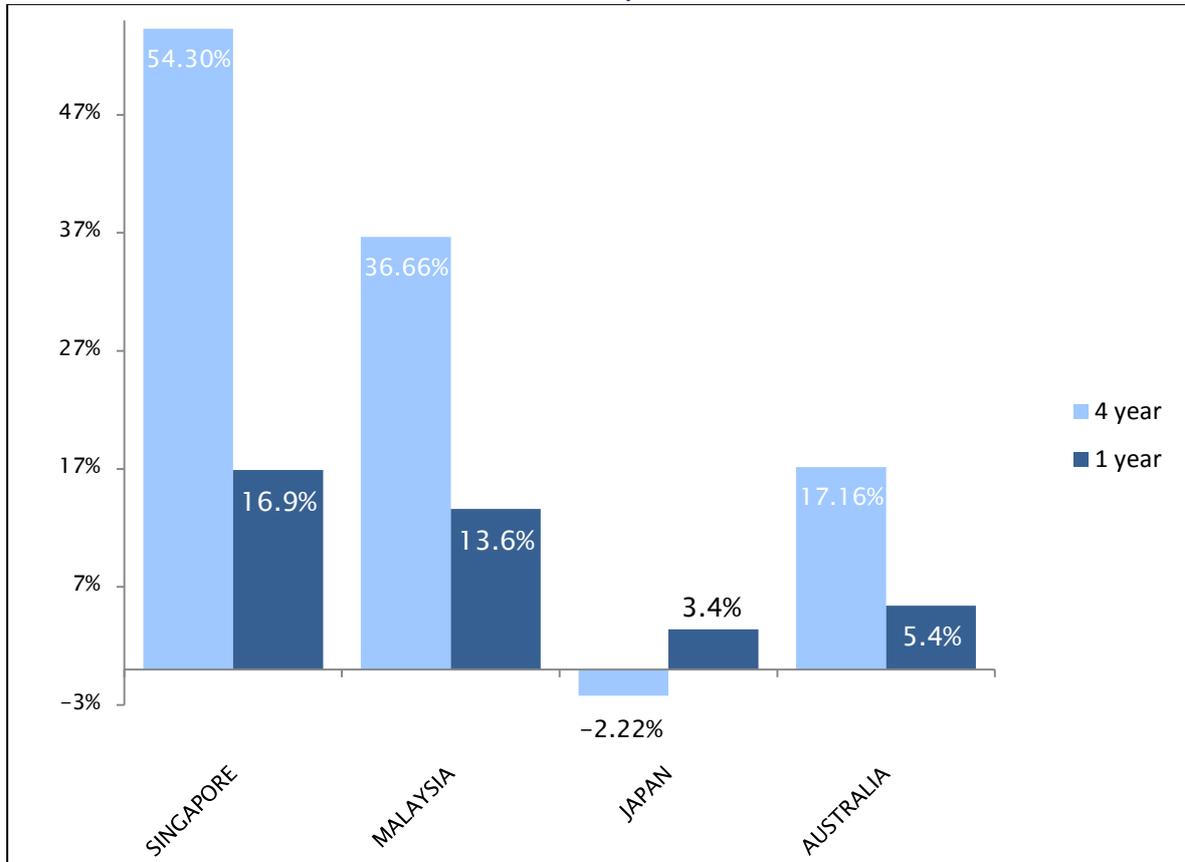
However, Australian banks are not unaffected by a global tightening of regulatory capital standards. The Australian Prudential Regulation Authority recently ruled that the big four systemically important banks must hold an additional 1 percentage point of tier-one capital from 2016, which may have an impact on their ability to lend at affordable margins. This is significant given that many Australian businesses already perceive margins and arrangement fees to be too high.

Singapore and Malaysia have also been powering ahead. Economic growth has been strong in both, although there are fears that a boom in credit has raised debt to unsustainable levels.

Japan was hit hard by the effects of the global recession, as demand for consumer goods such as technology and cars, which make up a large proportion of output, fell, making banks yet more circumspect regarding lending over the last 4 years.

However, the effects of “Abenomics” (the programme of monetary and fiscal policies and growth measures) may be starting to filter through, with lending growing by 3.4% in the last year. Most recently demand for loans has faltered slightly, as businesses wait to assess the impact of the April 2014 sales tax hike.



BANK LENDING TO ASIA AND ASIA PACIFIC ECONOMIES – PERCENTAGE CHANGE (4 YEARS AND 1 YEAR)

7 – THE AMERICAS

In the US, over the four years since the depths of the global recession, the volume of bank lending to the private sector has declined by 4.74% in absolute terms. Even the modest expansion in lending in the last year has been wiped out by inflation - there was a real terms decline in bank lending of approximately 0.1% in 2013. However, there are now signs that the economic recovery is strengthening and, with it, the demand for lending.

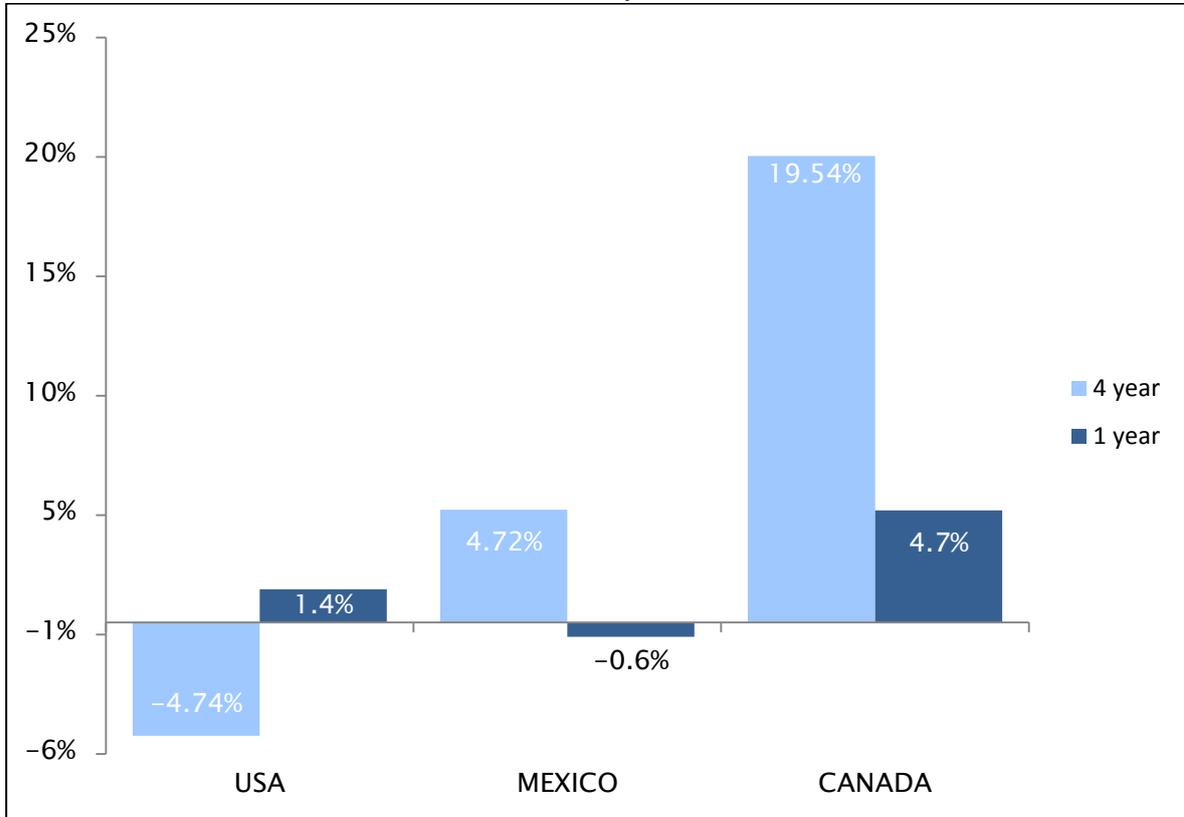
The US was at the epicentre of the financial crash of 2008, and the recovery in lending is only starting to take full effect. Federal Reserve data shows that the volume of bank loans and leases in Q2 2014 saw their biggest annual increase since 2008, largely driven by business loans.

While commercial lending to large corporations has been increasing gradually for several years, there is now increased demand amongst SMEs too. In May 2014 the Thomson Reuters/PayNetSmall Business Lending Index, which tracks small business lending, reached its highest level in more than seven years.

In stark contrast, Canada has seen lending volumes increase by 19.54% since the height of the recession, and by 4.7% in the last year. The country's banking system is widely seen as having been protected from the financial crisis by its relatively conservative regulatory standards.

Mexico saw a strong expansion in lending over the 4 years, with lending volumes increasing by 4.72% over that period, far outstripping the US. The signs are that this may be tailing off, with a 0.6% contraction last year. Moreover, the level of commercial bank credit to the nonfinancial private sector in Mexico is just 15% of GDP, far behind not only developed economies like the USA, but also behind credit ratios in many emerging economies (for example, Brazil's credit ratio is approximately 50%). The Mexican government is attempting to change this, with reforms to bank lending designed to expand the availability of credit for small businesses in particular.



BANK LENDING TO NORTH AMERICAN ECONOMIES – PERCENTAGE CHANGE (4 YEARS AND 1 YEAR)

8 – THE MIDDLE EAST

In the Middle East the picture is mixed.

As Egypt struggles to rebuild its economy, the National Bank of Egypt has launched efforts to expand the availability of loans for SMEs in particular. The impact has been patchy. While some businesses report that short term credit is becoming more available, the amount of available credit has fallen in real terms, with securing long-term finance a particular problem.

By contrast, the UAE's Central Bank reports that credit growth in the UAE is picking up well, as a rebounding economy increases demand for loans - the total loans and advances to the private sector rose by 2.8 per cent during the year up to April 2014.

9 – IMPACT ON SMALLER BUSINESSES

The continued slump in lending in developed economies has hit smaller businesses the hardest, as bigger companies have been able to access the bond markets to fill the gap in funding. In the UK, lending through corporate bonds has increased by 35% over the last four years, while in the US it has increased by 44%, and in France by 35%.

Corporate bonds have long been a good way for larger companies to get the funding they need, but as bank lending has dried up, they have now become a vital tool. Smaller businesses don't have the same luxury, as issuing bonds can be quite costly in terms of advisory and other fees.

Although the recovery is now taking hold in many developed economies, problems over bank funding are far from over. Many banks are still unable to lend, especially to smaller businesses, leaving them facing a hidden credit crunch.

Governments around the world are acutely aware of this problem, and around the globe there are numerous efforts to support SME lending. However, the larger projects, such as the UK's plans to create a bond market specifically for SMEs, will come far too late for this economic cycle.

Although new, alternative forms of finance such as crowd-funding have been gaining traction, these are unlikely to provide an adequate solution for most established businesses. Invoice financing, which is growing in popularity, may be more appropriate. However, it is unlikely to be able to fill the gap completely.



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