1: Demand and Output

Demand and Output

March 2015

DSI and UK Teams

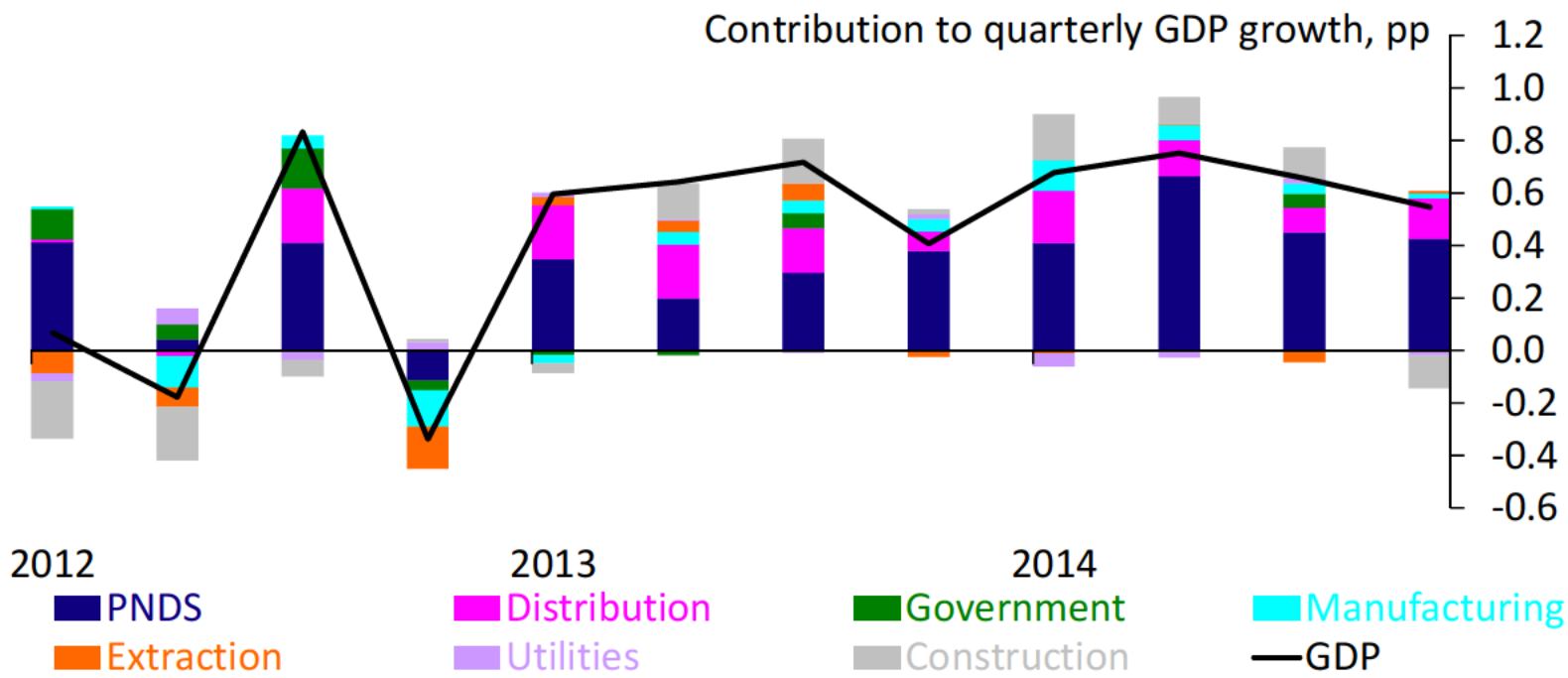
Monetary Analysis

Outline

Is the February *IR* projection on track?

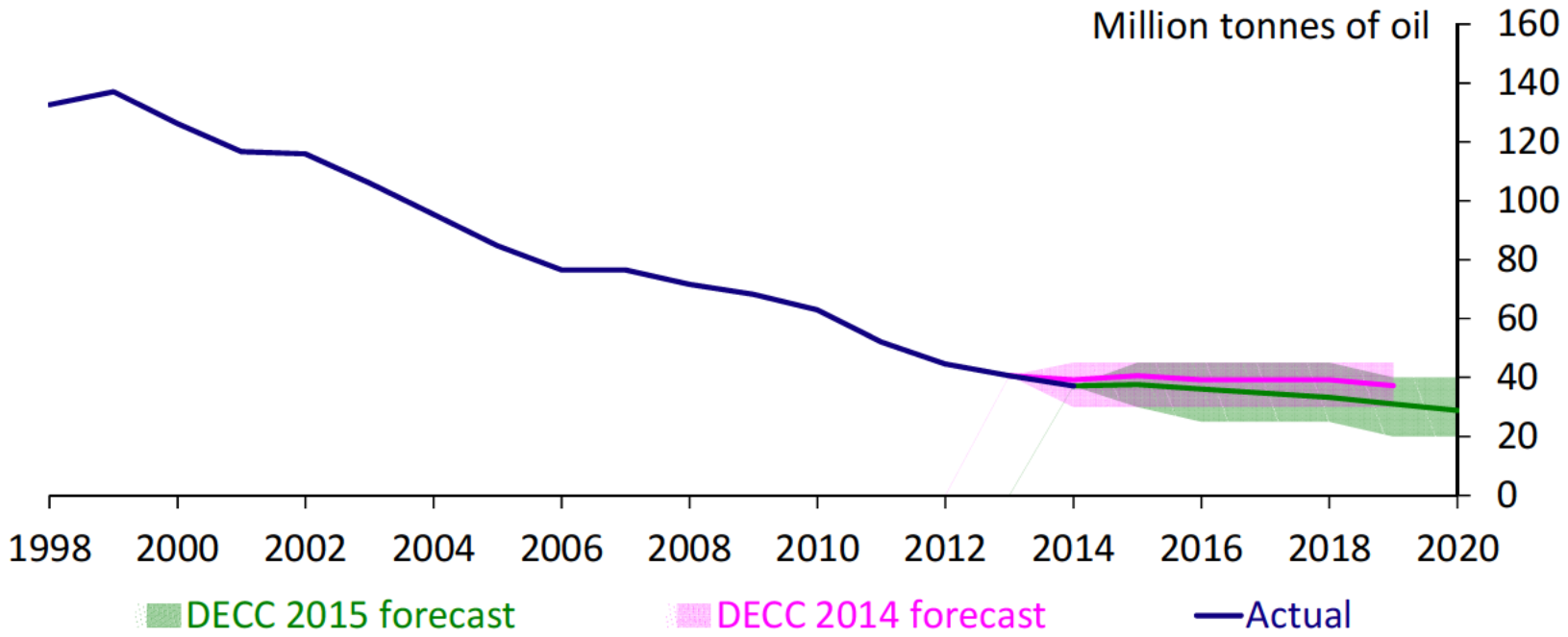
- Short-term GDP outlook unchanged since *IR*
- But expenditure mix in Q4 raises concerns about strength further ahead

Real GDP



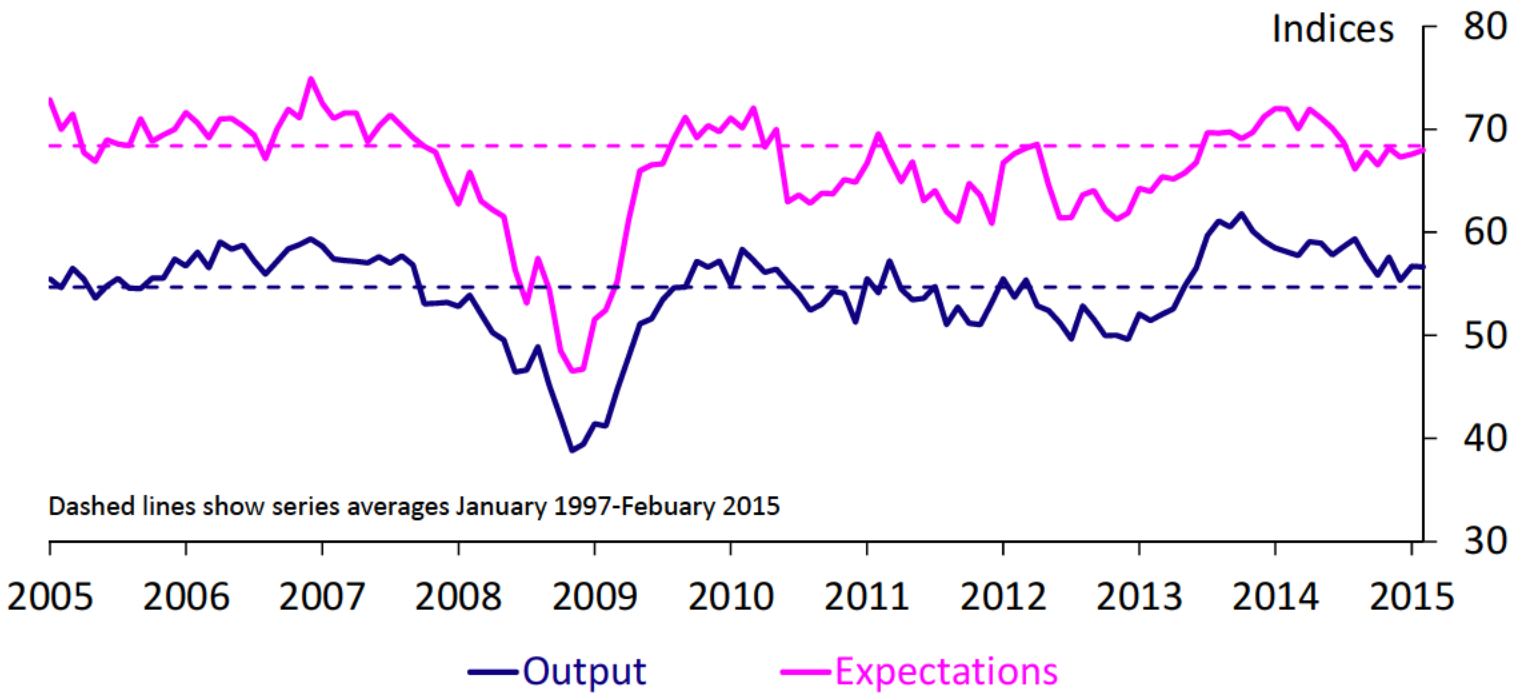
- The second estimate of quarterly GDP growth was unrevised at 0.5%

Forecasts for oil output



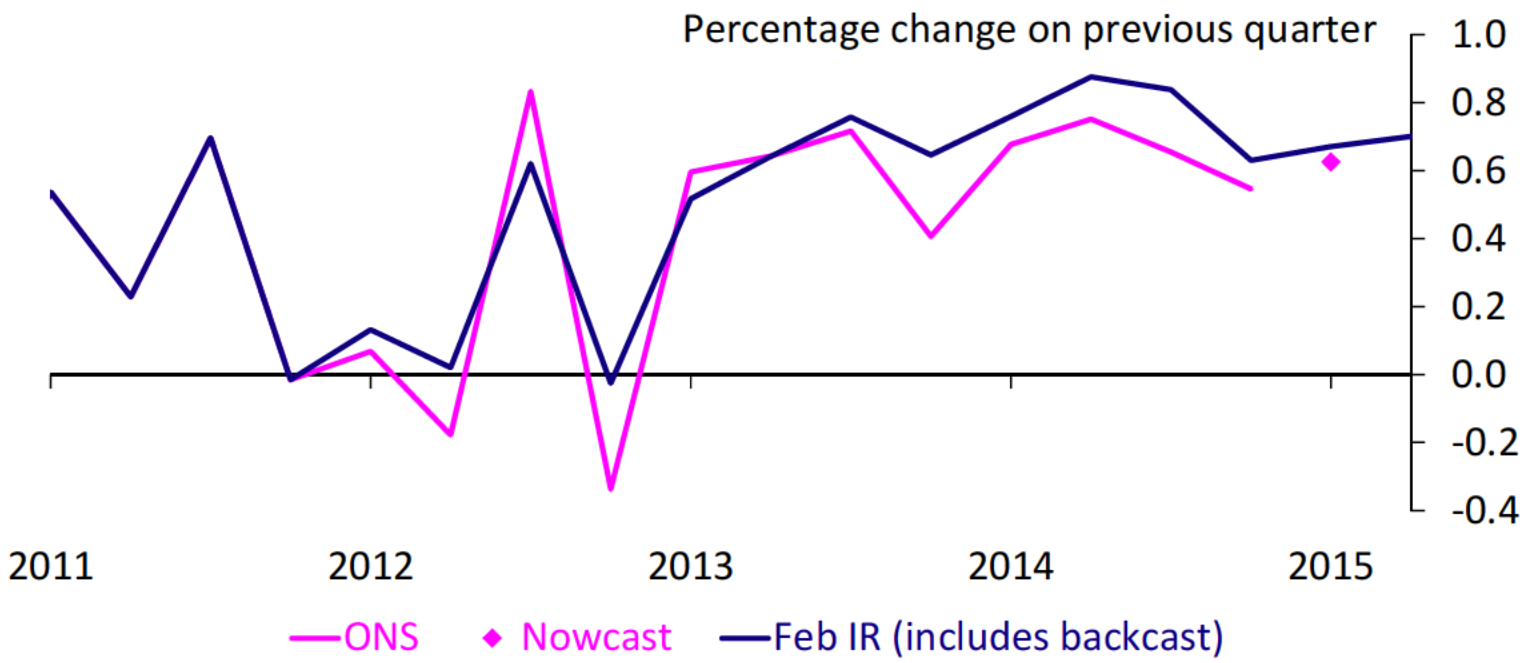
- Oil output to fall by 6.5% over the next three years according to new DECC forecasts, taking less than 0.1pp off annual GDP growth, lower than average since peak in late 1990s.

Composite Markit/CIPS output and expectations



CARE: Confidential and market sensitive. Data are confidential until 9:30am on Wednesday 4th March

Near-term GDP outlook



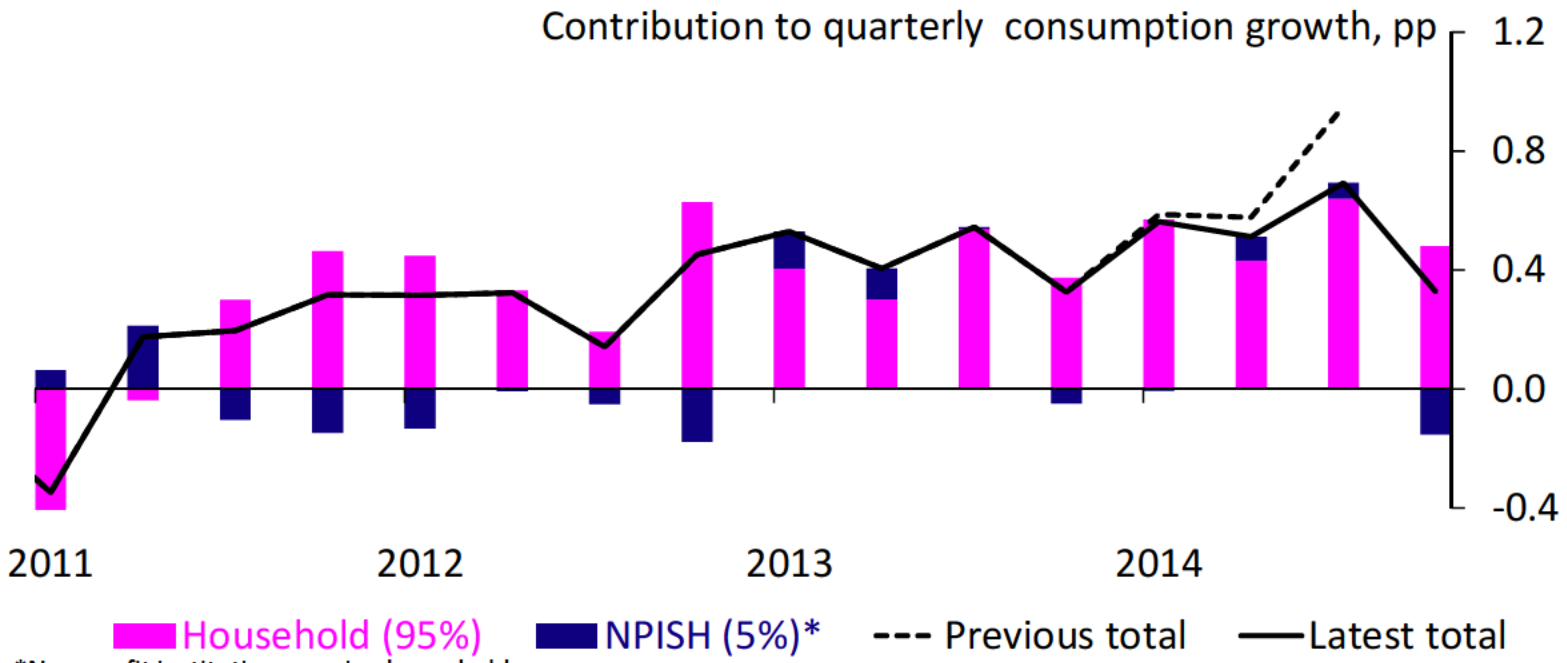
- Our nowcast for Q1 remains at 0.6% preliminary estimate (0.7% final)

Expenditure breakdown

	Q4		
	2nd release %	Feb *IR* %	Contribution to error^, pp
GDP	**0.5**	**0.5**	0.0
Final domestic demand	0.2	0.8	-0.6
Private consumption	0.3	0.8	-0.3
Government consumption	0.0	-0.1	0.0
Total Investment			
o/w housing	0.8	0.6	0.0
o/w business	-1.4	2.5	-0.4
o/w government	0.9	2.0	0.0
Net trade*	0.6	0.6	0.1
Stockbuilding (excl. AA)*	-0.2	-0.9	0.7
AA*	0.0	0.0	0.0

*Contribution to GDP growth
^Summation may not equal total due to rounding and statistical discrepancy

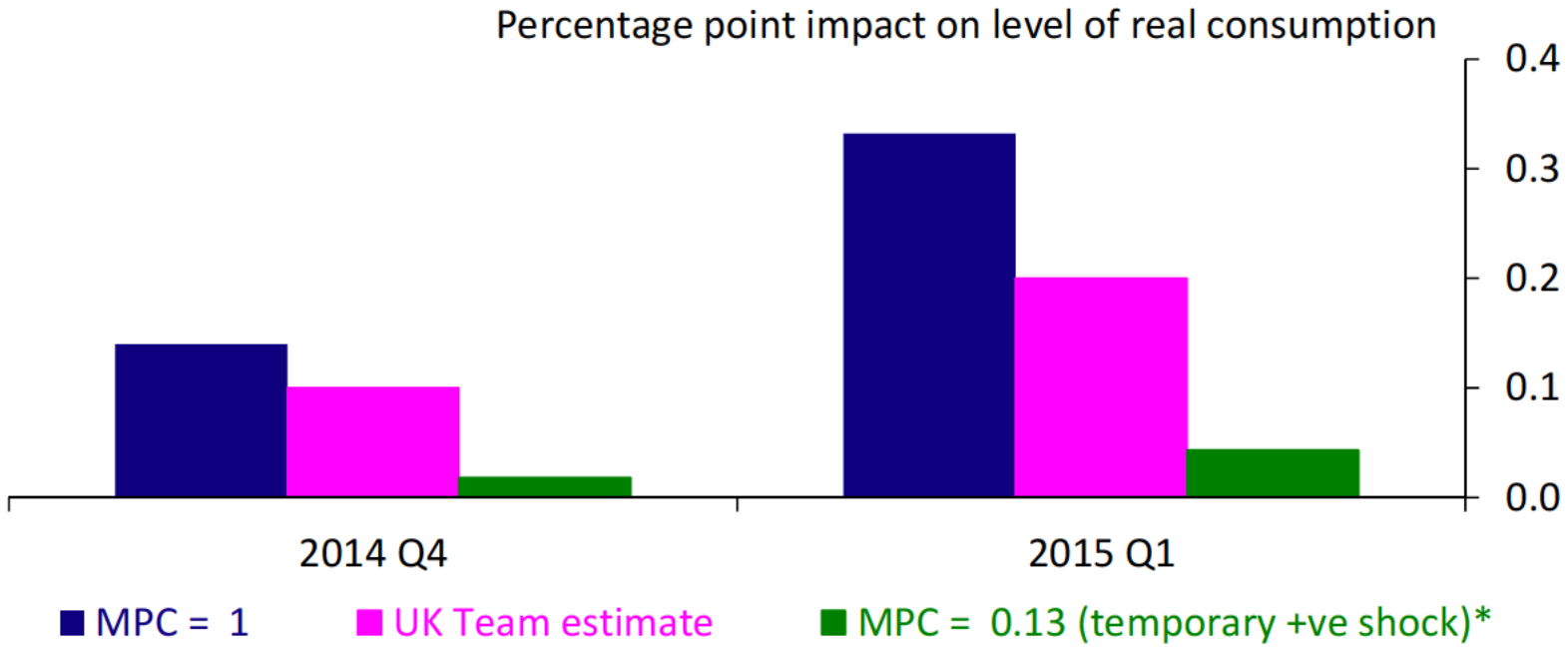
Consumption growth



*Non-profit institutions serving households
Share of 2011 total consumption are in brackets

- NPISH accounted for over half of the fall in consumption growth between Q3 and Q4

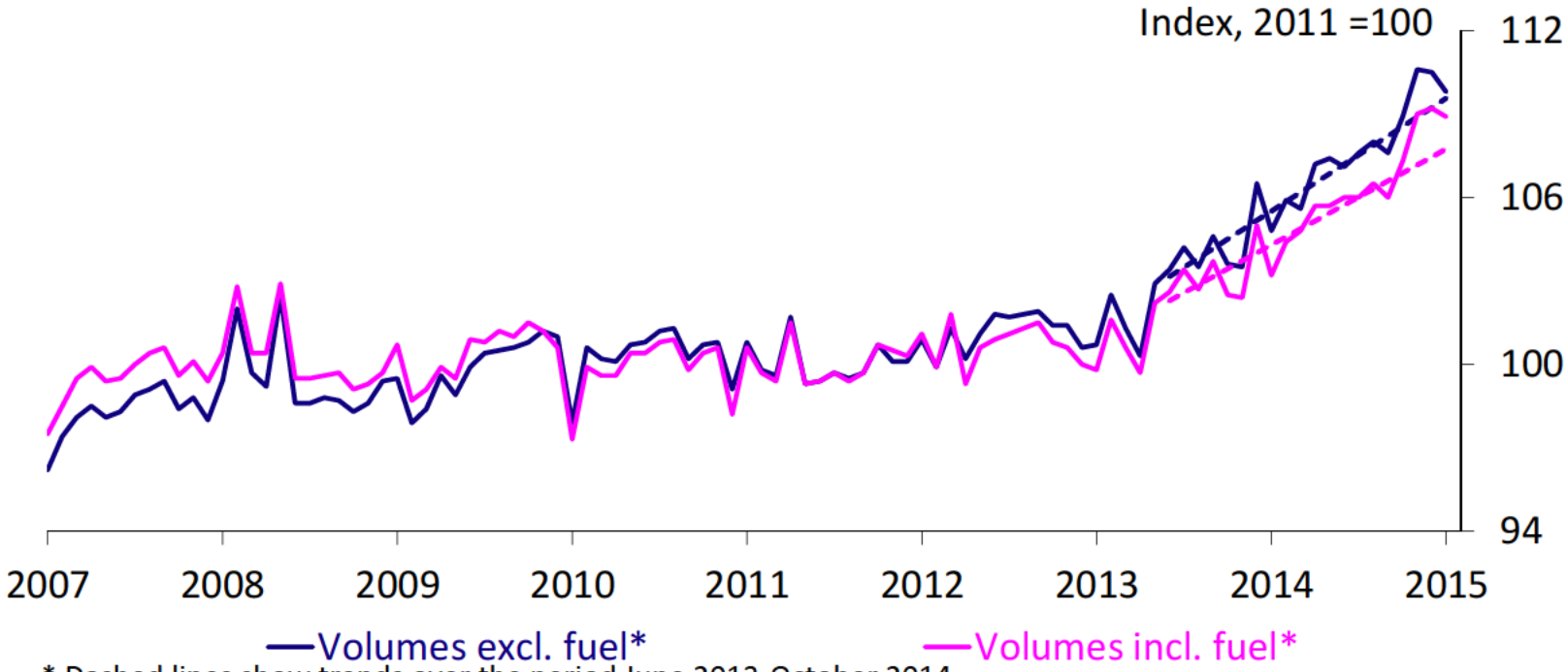
Estimated impact of lower fuel prices



*

- The majority of the direct impact still to come through in Q1

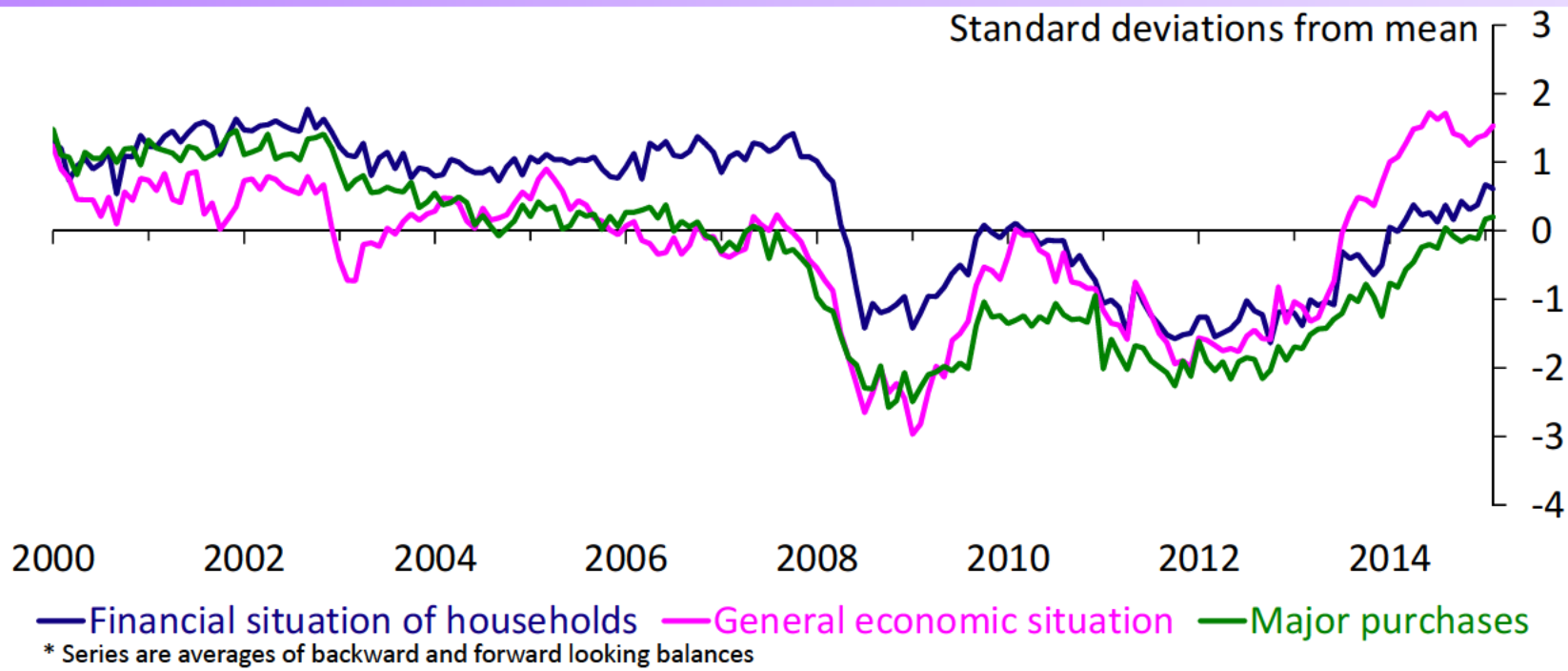
Retail sales



* Dashed lines show trends over the period June 2013-October 2014

- January data suggest Black Friday displaced sales. Fuel sales boosted by fall in prices.

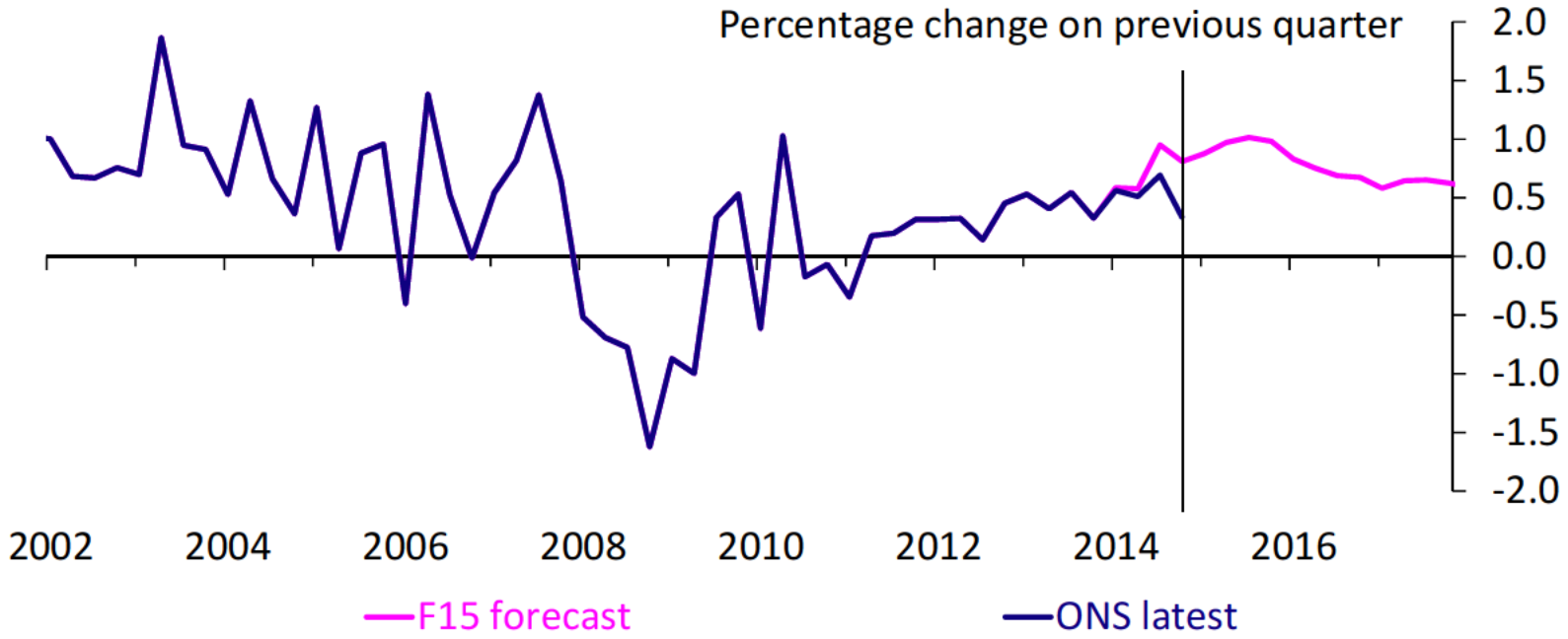
GfK consumer confidence



* Series are averages of backward and forward looking balances

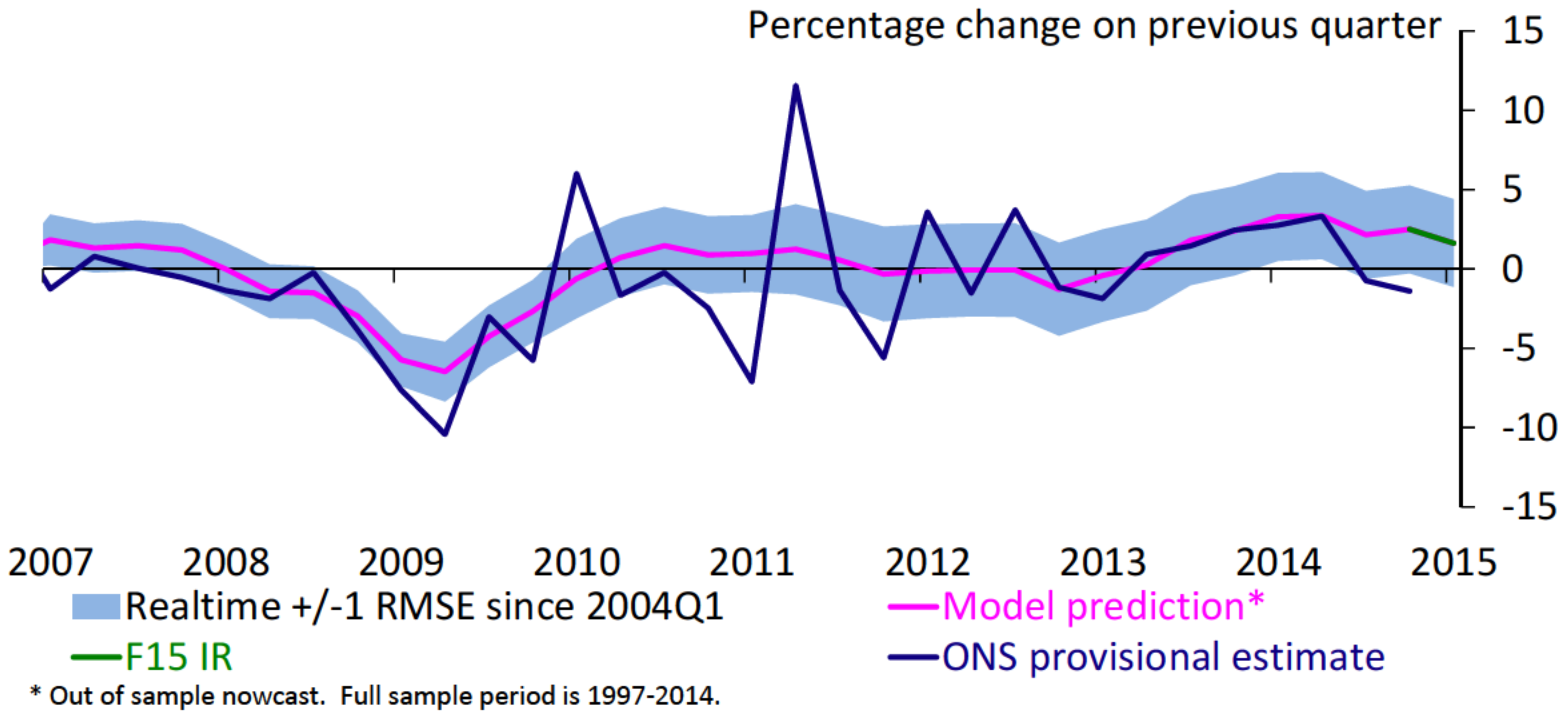
- Indicators of consumer confidence picked up in February

Consumption growth



- Consumption growth would need to pick up strongly to deliver the F15 forecast

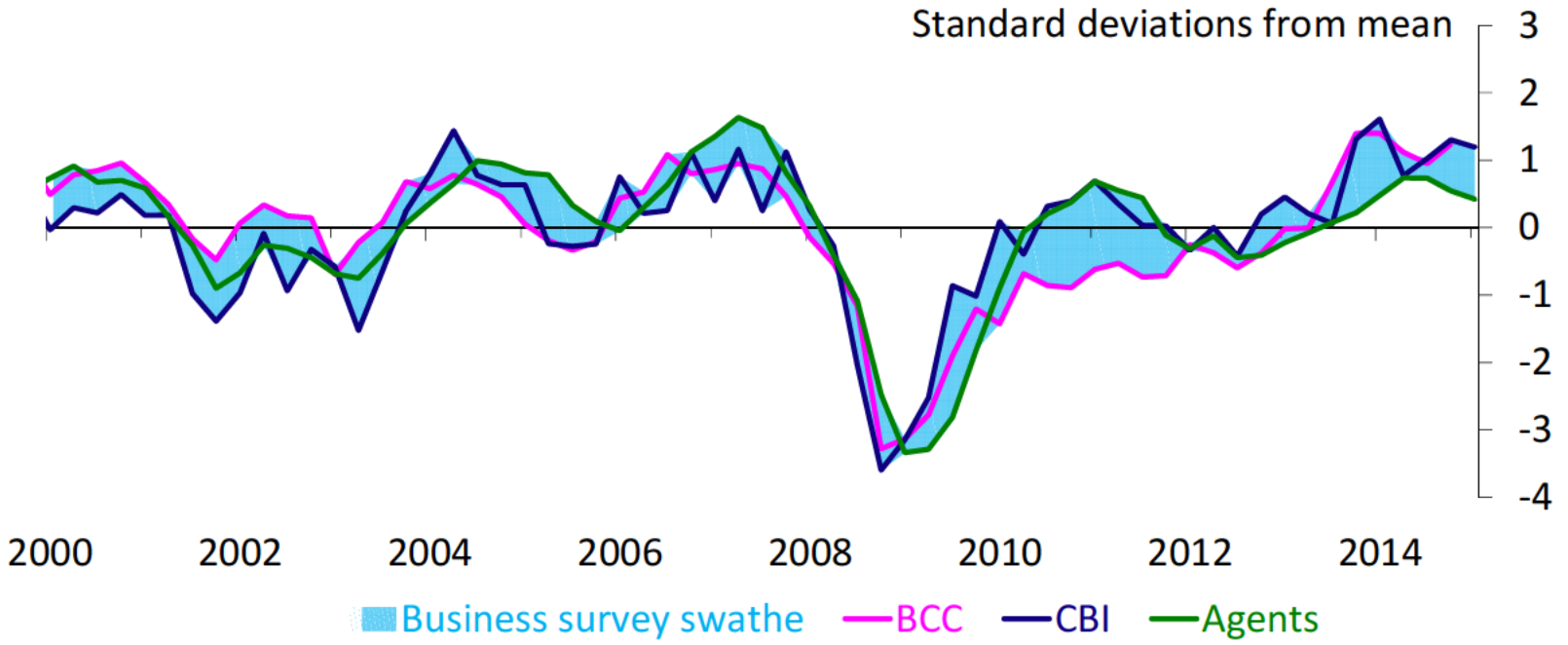
Business investment



* Out of sample nowcast. Full sample period is 1997-2014.

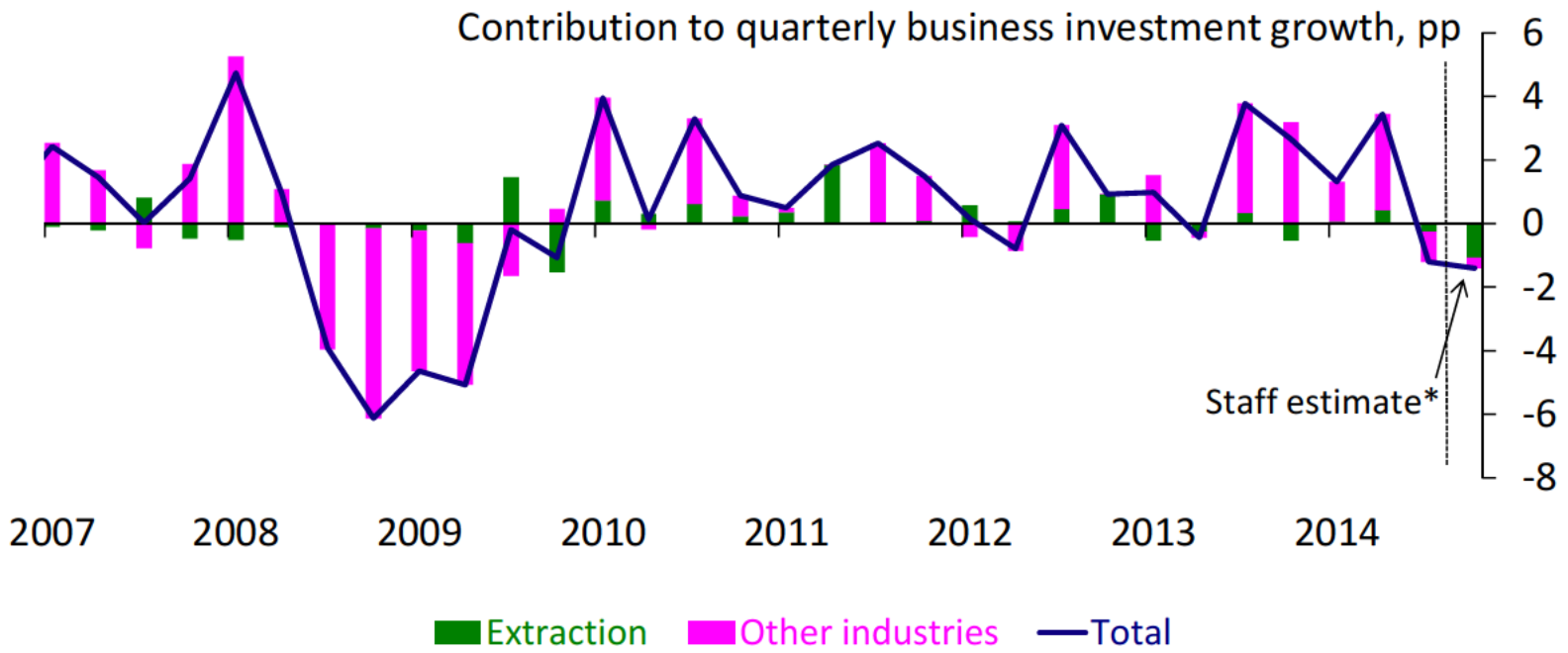
- Q4 business investment fell by 1.4%, much lower than expected

Business investment survey swathe



- Investment intentions remain robust, although the Agents' series has fallen a little

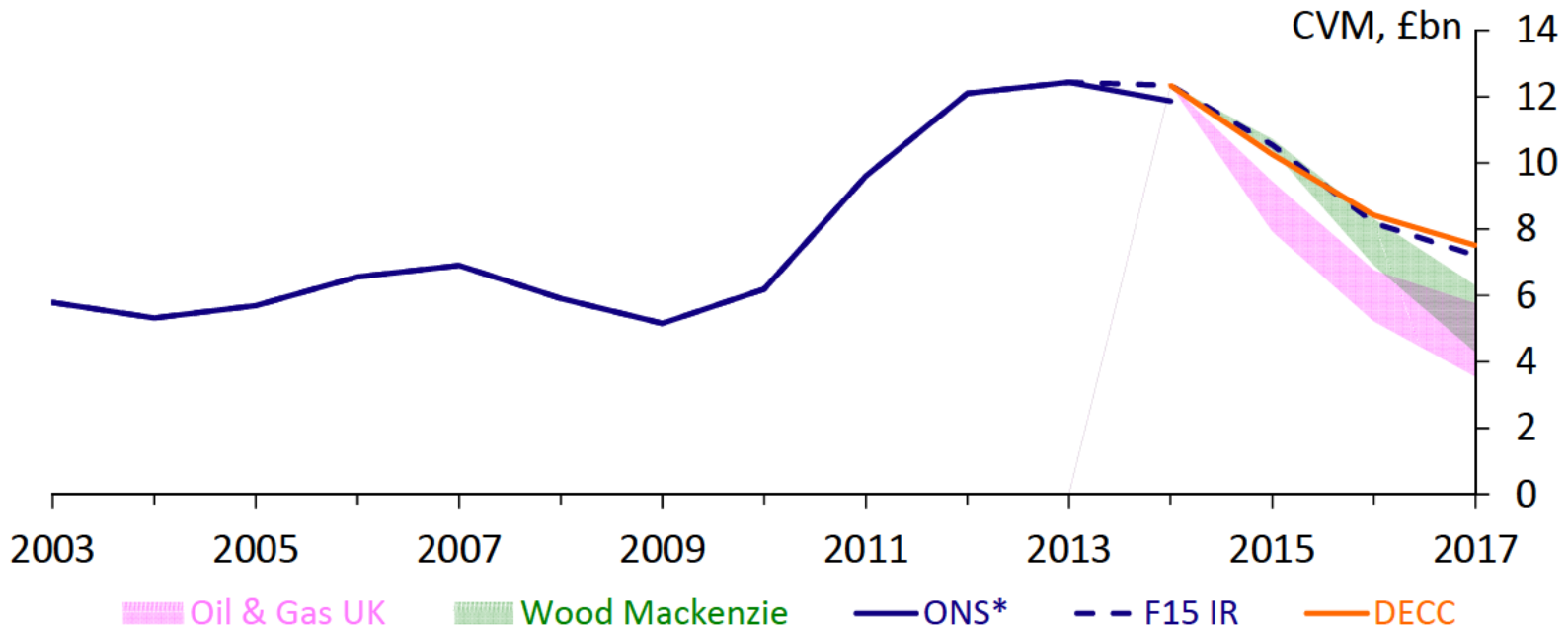
Industry composition of business investment



* The split between extraction and other has been estimated using CAPEX data benchmarked to the ABS

- Extraction likely to have accounted for the bulk of the fall in business investment in Q4

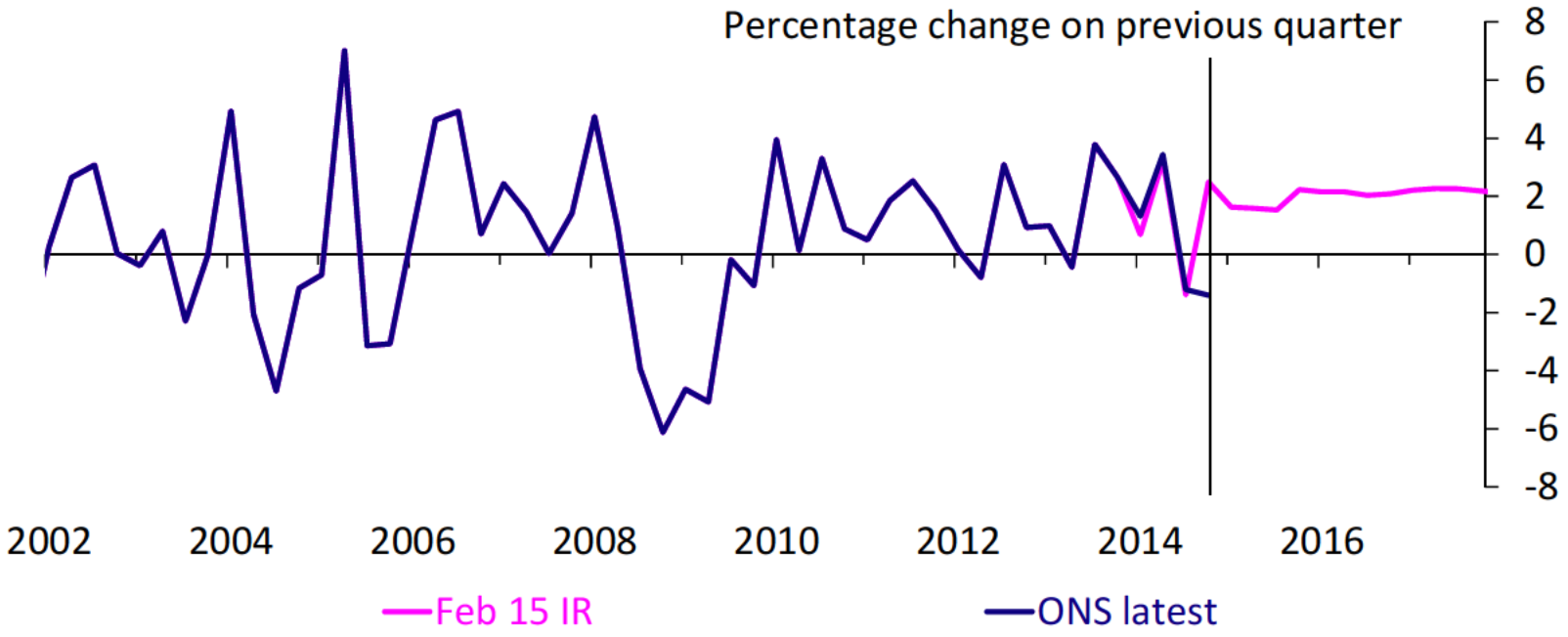
Business investment in the oil sector



* Extraction investment in 2014 Q4 estimated using CAPEX data benchmarked to the ABS

- Feb IR in line with DECC, but higher than other externals

Business investment growth forecast



- Growth would need to pick up strongly to deliver the F15 forecast

Summary

Is the February *IR* projection on track?

- Short-term GDP outlook unchanged since *IR*
- But expenditure mix in Q4 raises concerns about strength further ahead

GDP tables

Excluding revisions:

Current quarterly GDP growth & initial release projections

	Headline GDP#		GDP**^	
	Now	Feb IR	Now	Feb IR
2013 Q1	0.6	0.6	0.7	0.7
Q2	0.6	0.6	0.5	0.5
Q3	0.4	0.7	0.5	0.5
Q4	0.4	0.4	0.5	0.5
2014 Q1	0.7	0.6	0.6	0.5
Q2	0.8	0.8	0.8	0.8
Q3	0.7	0.7	0.7	0.7
Q4	0.5	0.5	0.7	0.7
2015 Q1	0.6	0.6	0.7	0.6
Q2	N/A	N/A	N/A	N/A

Including revisions:

Final quarterly GDP growth estimates & projections

	Headline GDP#		GDP**^	
	Now	Feb IR	Now	Feb IR
2013 Q1	0.5	0.5	0.6	0.6
Q2	0.6	0.6	0.5	0.5
Q3	0.6	0.8	0.7	0.5
Q4	0.6	0.6	0.7	0.7
2014 Q1	0.8	0.8	0.8	0.7
Q2	0.9	0.9	1.0	0.9
Q3	0.8	0.8	0.9	0.9
Q4	0.6	0.6	0.8	0.8
2015 Q1	0.7	0.7	0.8	0.7
Q2	0.7	0.7	N/A	N/A

market prices

^ basic prices

GDP** = GDP at basic prices excluding oil and gas extraction, and construction

END

2: Cost and Prices

Costs and Prices

27 February 2015

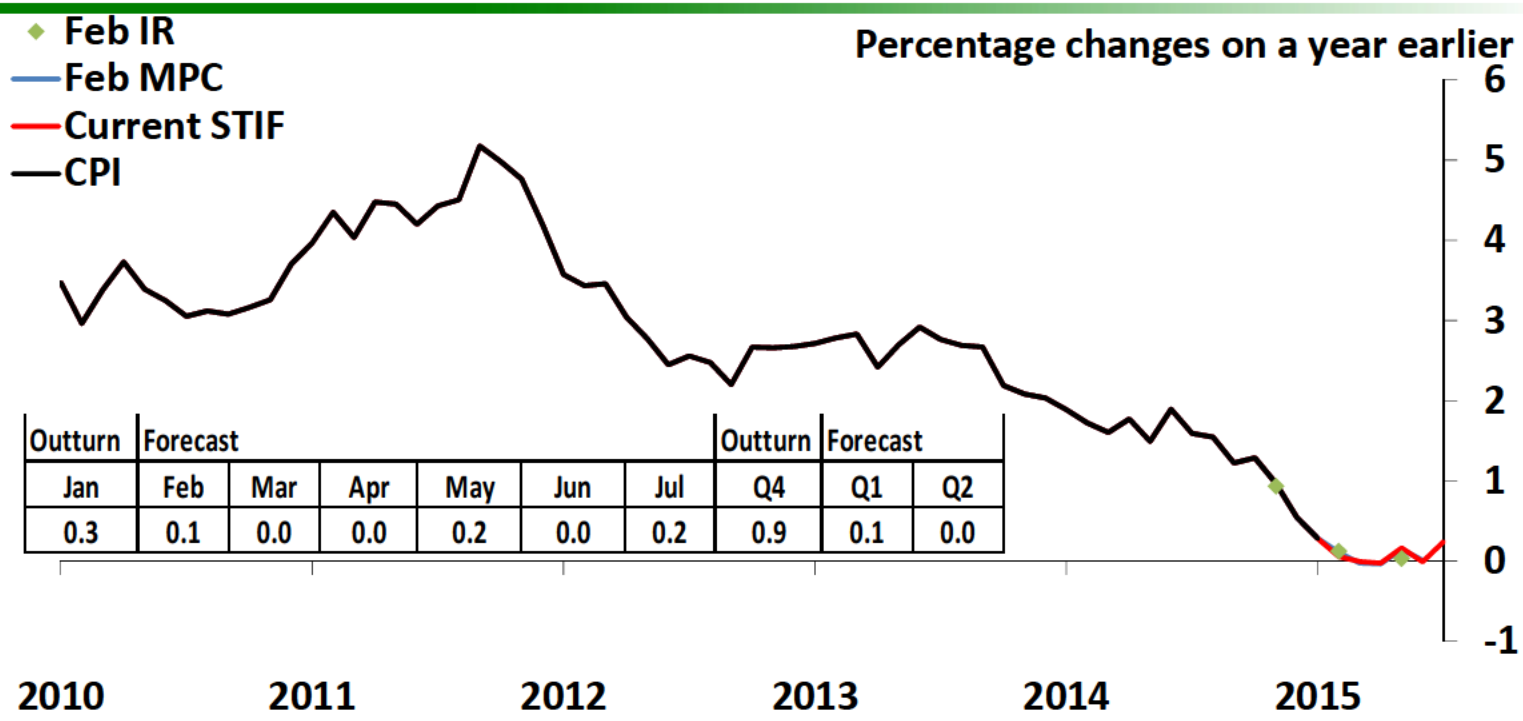
Structural Economic Analysis Division

Outline

- Latest inflation data.
- Factors affecting wage growth.

Inflation

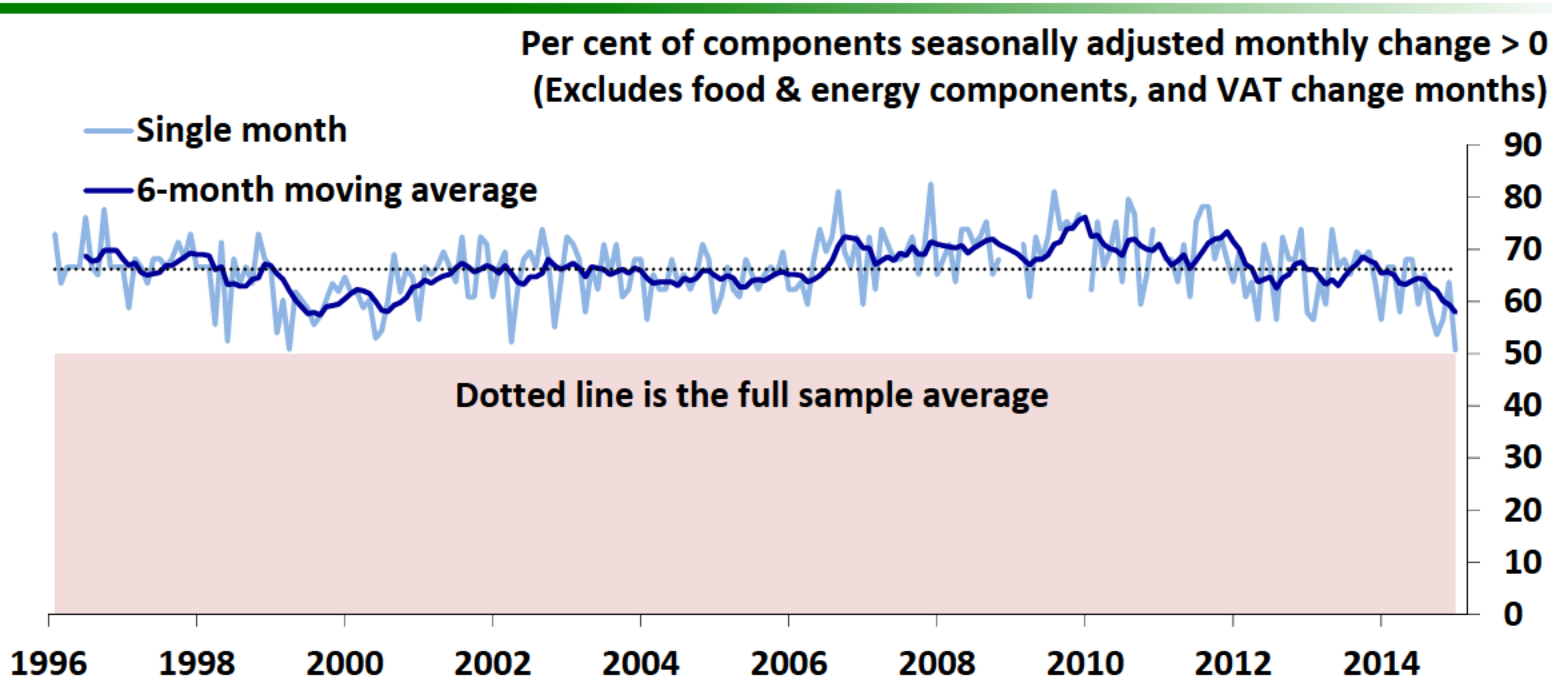
Short-term inflation forecast



Outturn	Forecast						Outturn	Forecast	
Jan	Feb	Mar	Apr	May	Jun	Jul	Q4	Q1	Q2
0.3	0.1	0.0	0.0	0.2	0.0	0.2	0.9	0.1	0.0

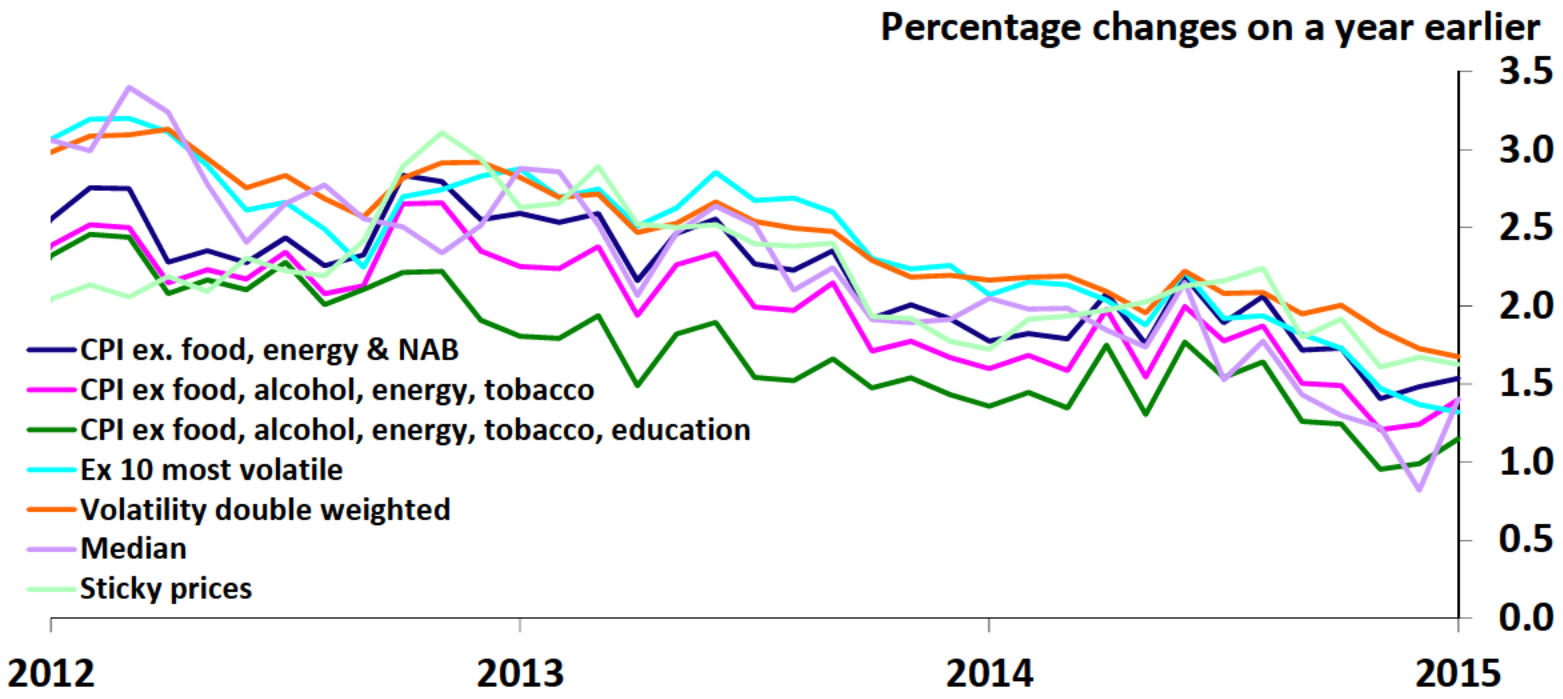
- Inflation still expected to hit zero in March.

Core inflation diffusion index



- **Proportion of core CPI components increasing has fallen recently.**

Measures of core inflation



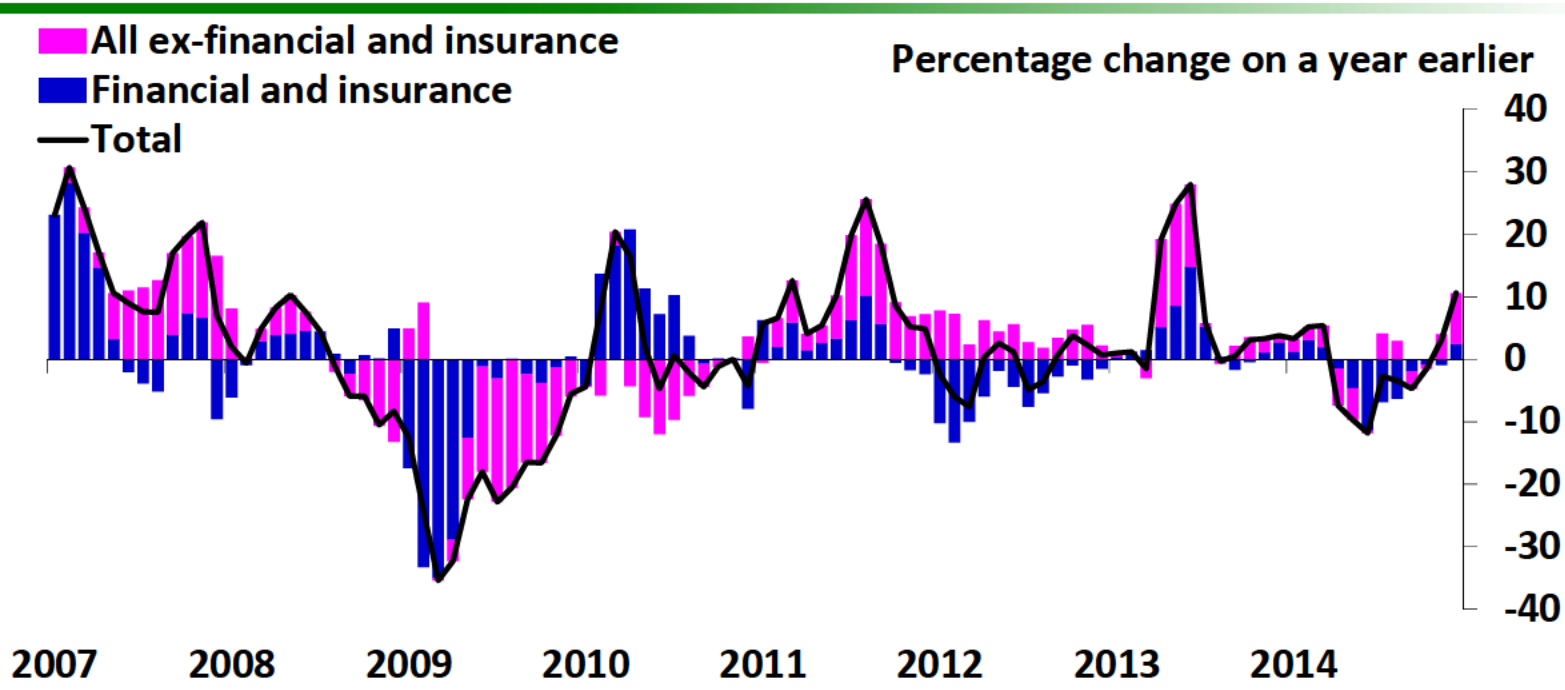
- **But measures of core inflation remain centred around 1½%.**

Key messages

- Inflation expected to reach zero in March.
- Little sign disinflationary pressure is becoming more generalized.

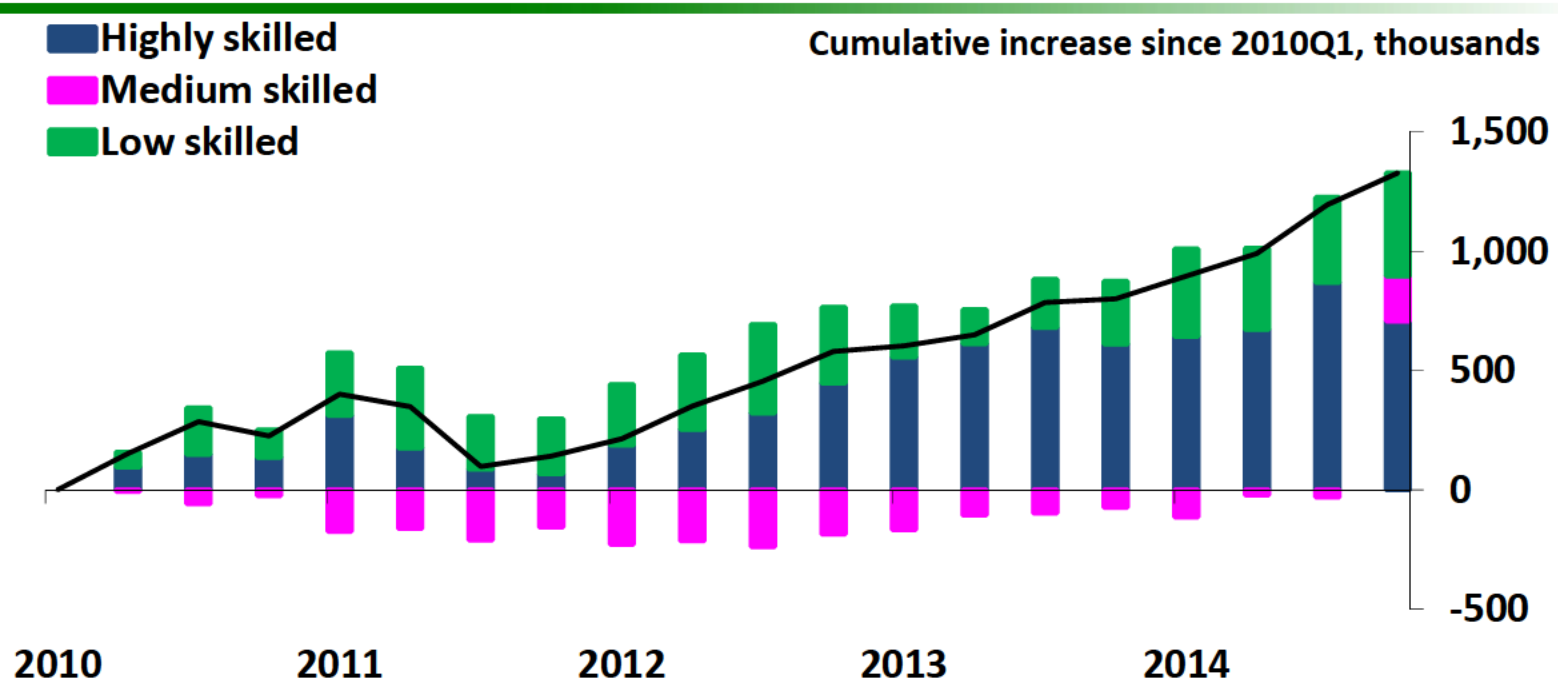
Wages

Contributions to AWE bonus pay growth



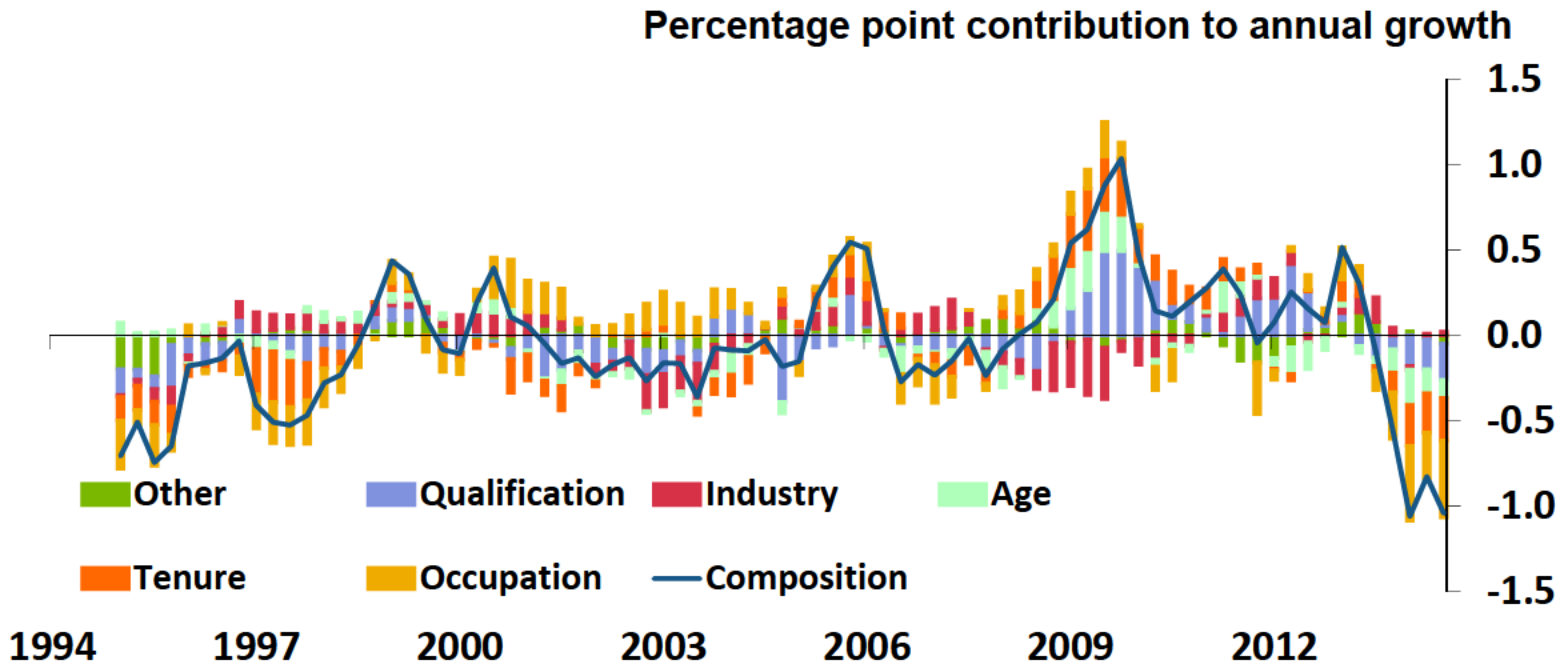
- Bonuses increased strongly in December, across a range of sectors.

Employment by skill level (employees)



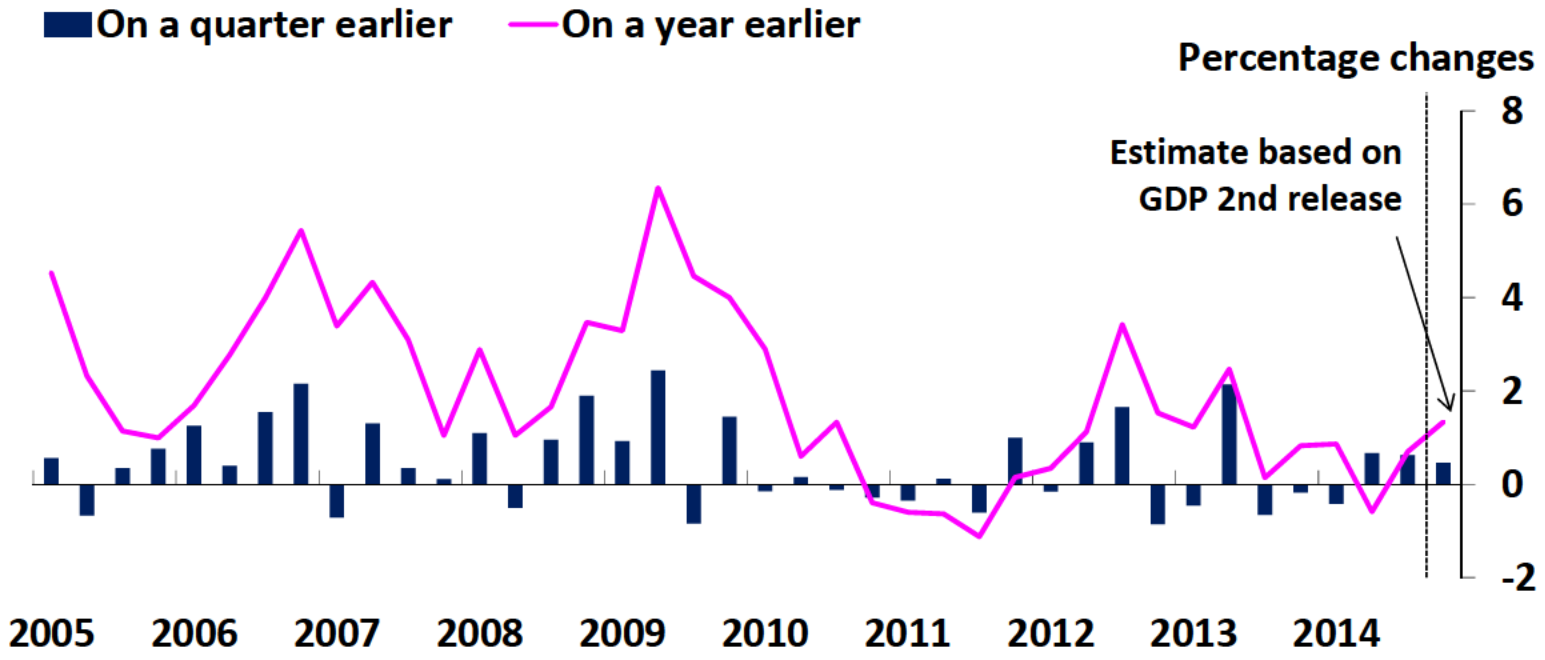
- Fall-back in high-skilled roles may suggest a drag on pay growth.

Compositional effects on pay



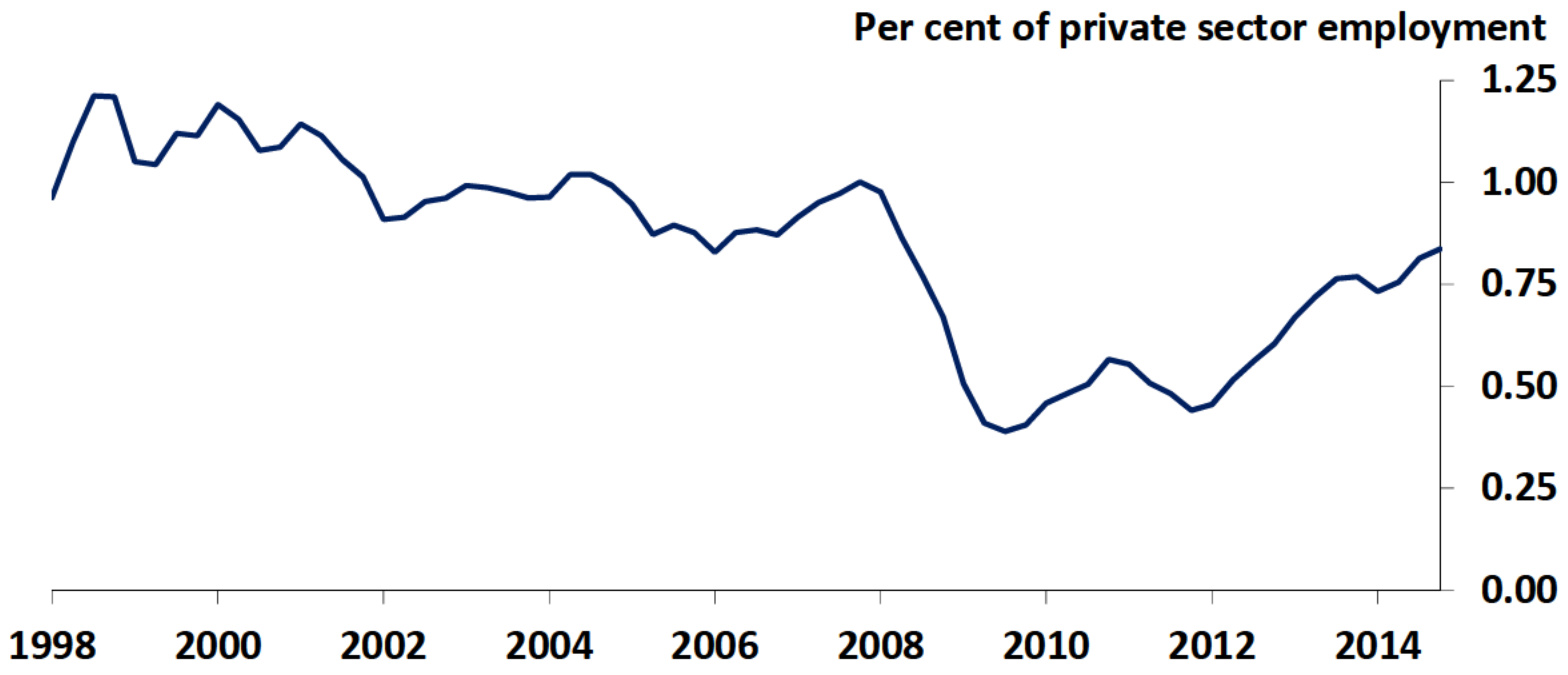
- Compositional effects pulling down on pay growth by about 1p.p..

Unit Labour Costs



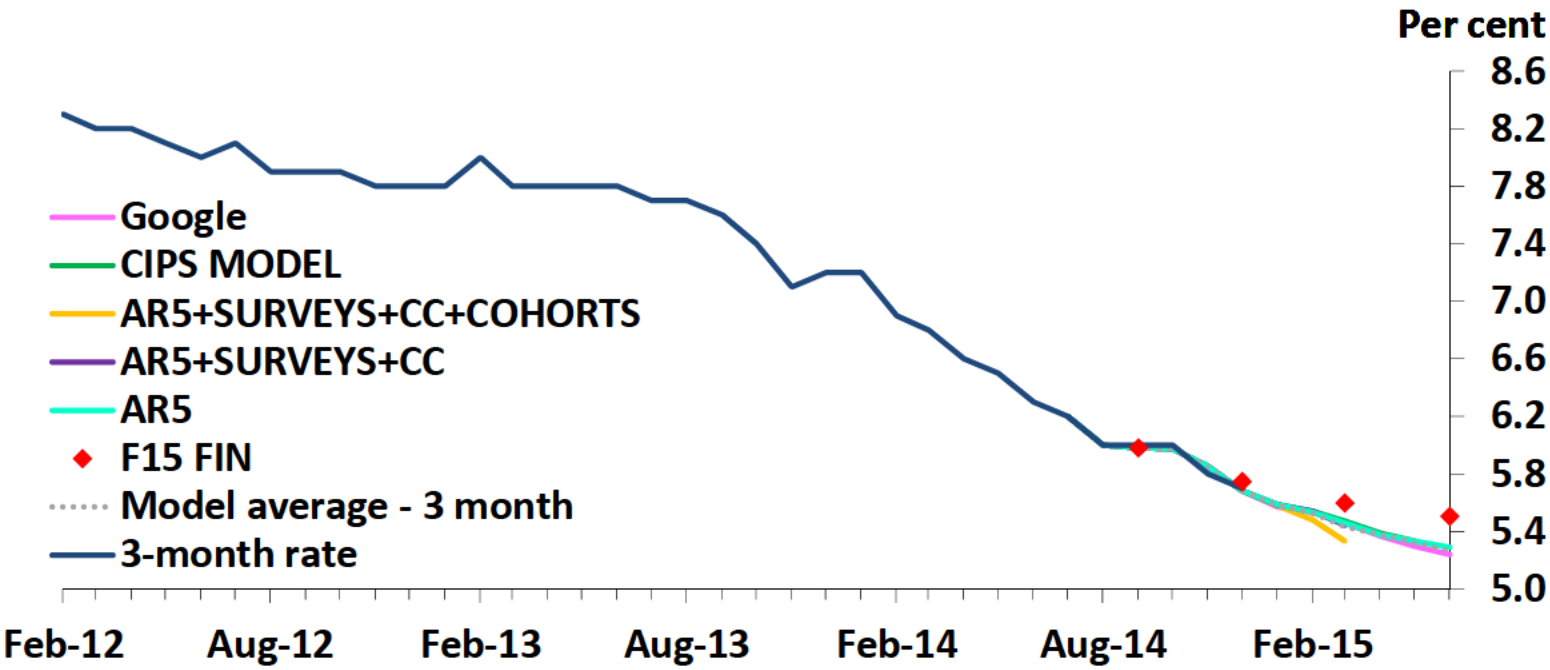
- GDP 2nd release suggests ULCs rose more sharply in the year to Q4 than expected in the February IR.

Private sector job-to-job flows



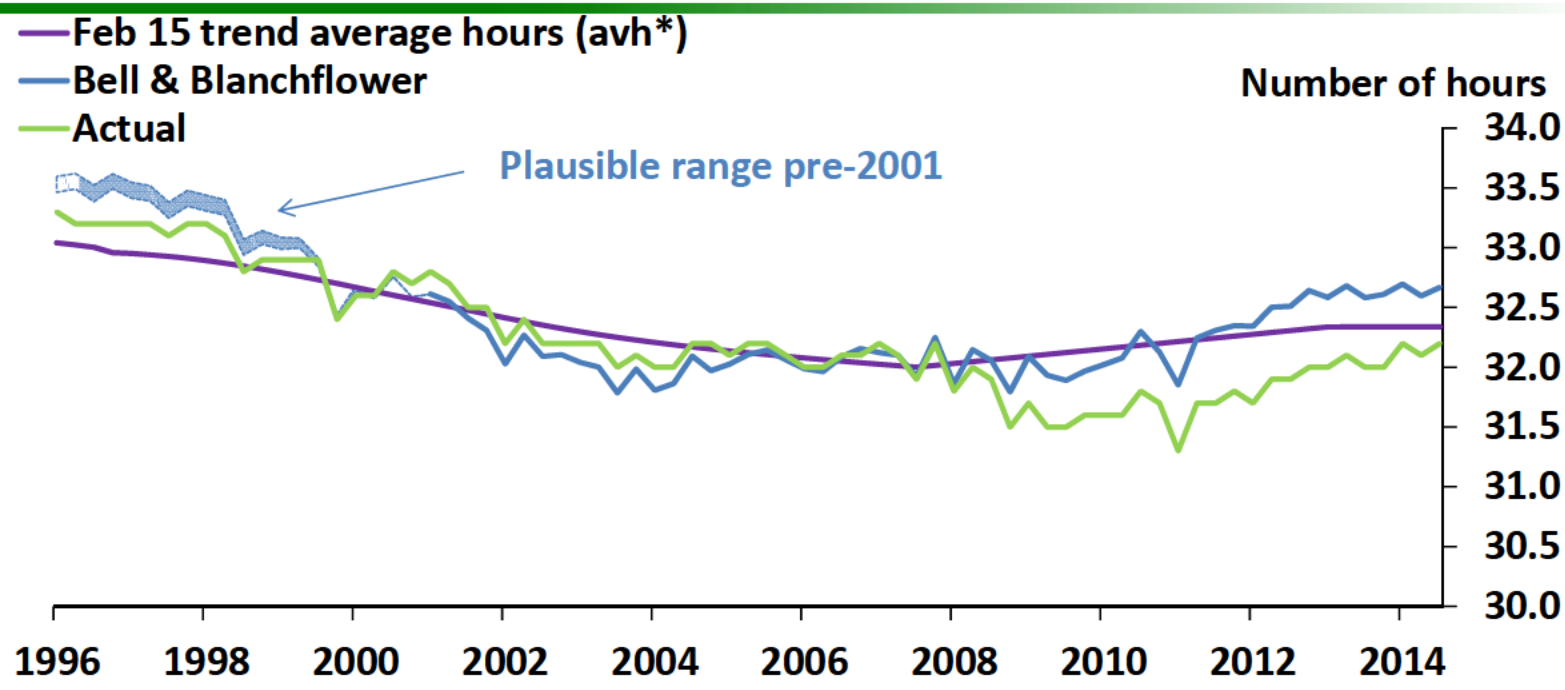
- **Rising churn may point to increased pressure on pay.**

Short-term unemployment forecast



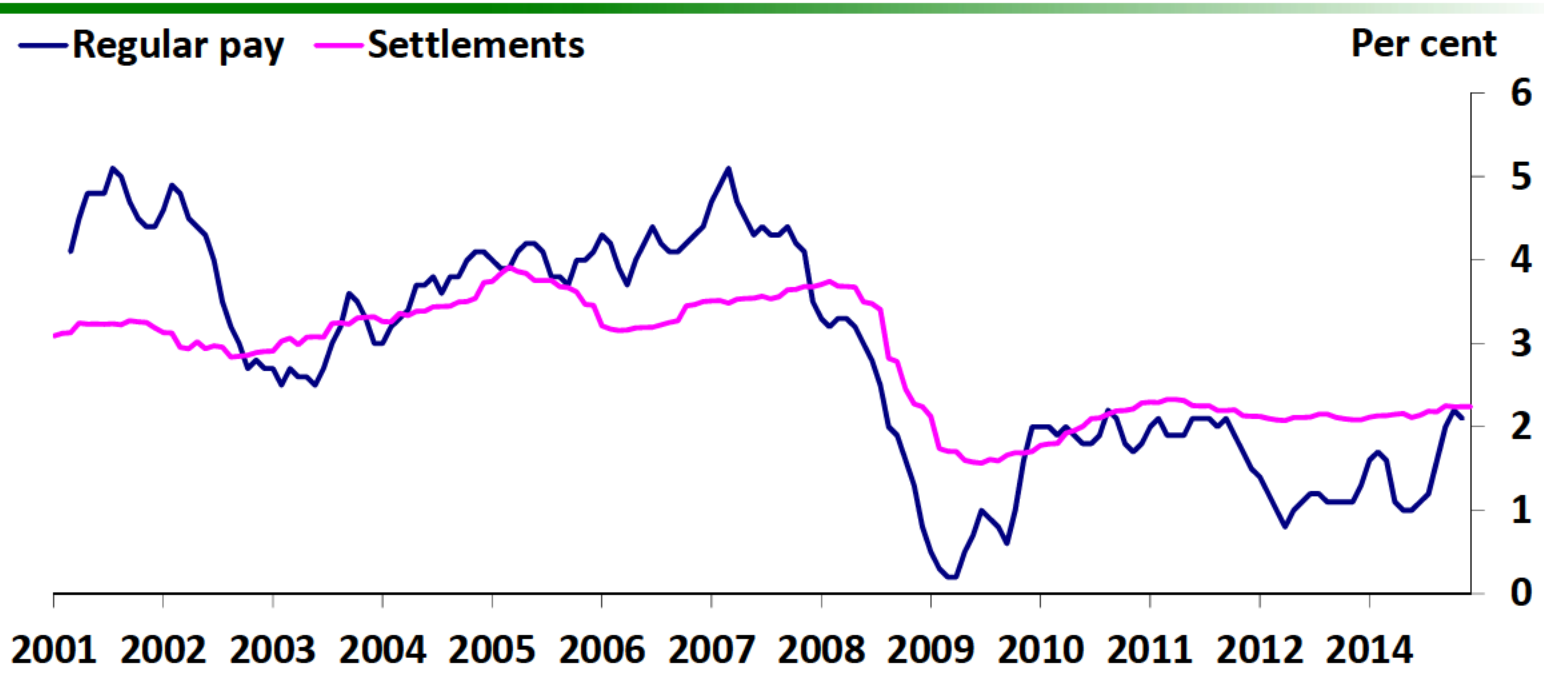
- Unemployment forecast to reach 5.3% in Q2. For more information on labour market quantities, please see the .

Bell & Blanchflower desired hours measure



- This measure of desired hours remained little changed in Q4.

Private sector AWE growth and settlements



- Settlements pretty flat, but AWE growth more variable. For more information on settlements data .

Main messages

- Inflation expected to reach zero in March.
- Little sign disinflationary pressure is becoming more generalized.
- Unemployment expected to fall faster than in the February *IR*.
- Wage growth still expected to pick up, even if settlements remain more stable.

THE END

3: Inflation Expectations

Inflation Expectations

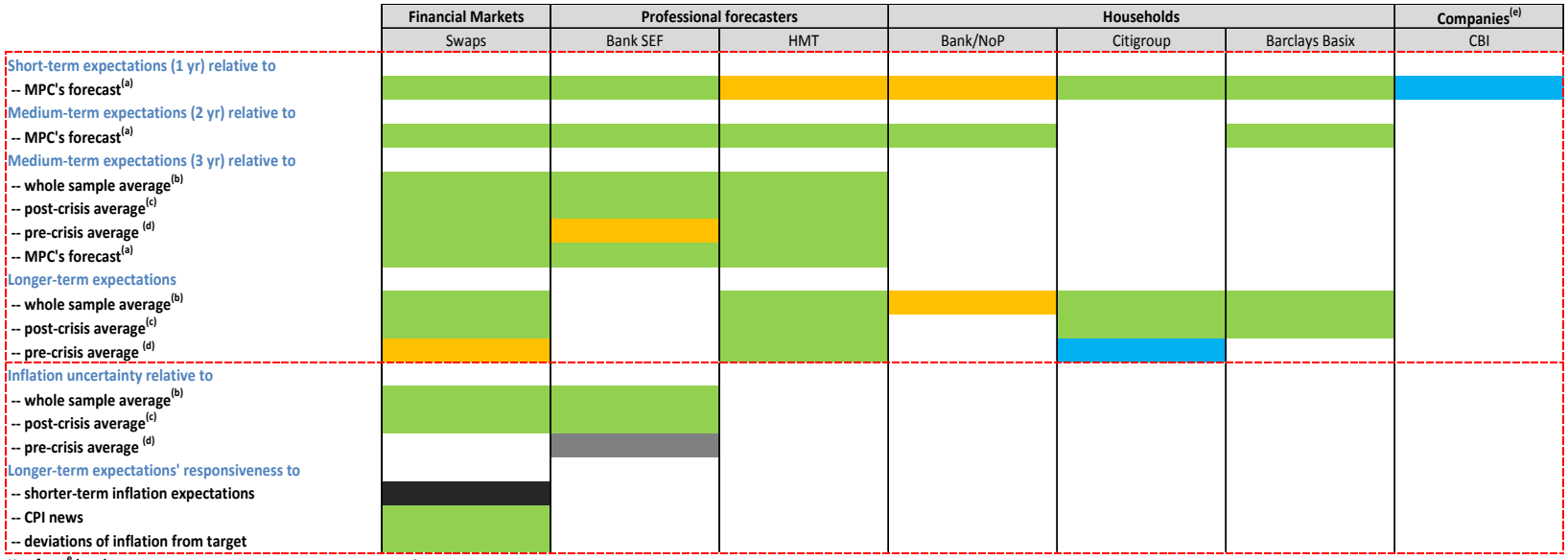
Joint FPC/MPC Briefing Meeting 27 February 2015

Prepared by MASD, MFAD, Markets

Agenda

- How have inflation expectations changed on the month?
- How should we interpret current levels of inflation expectations?

Inflation expectations heatmap – February 2014



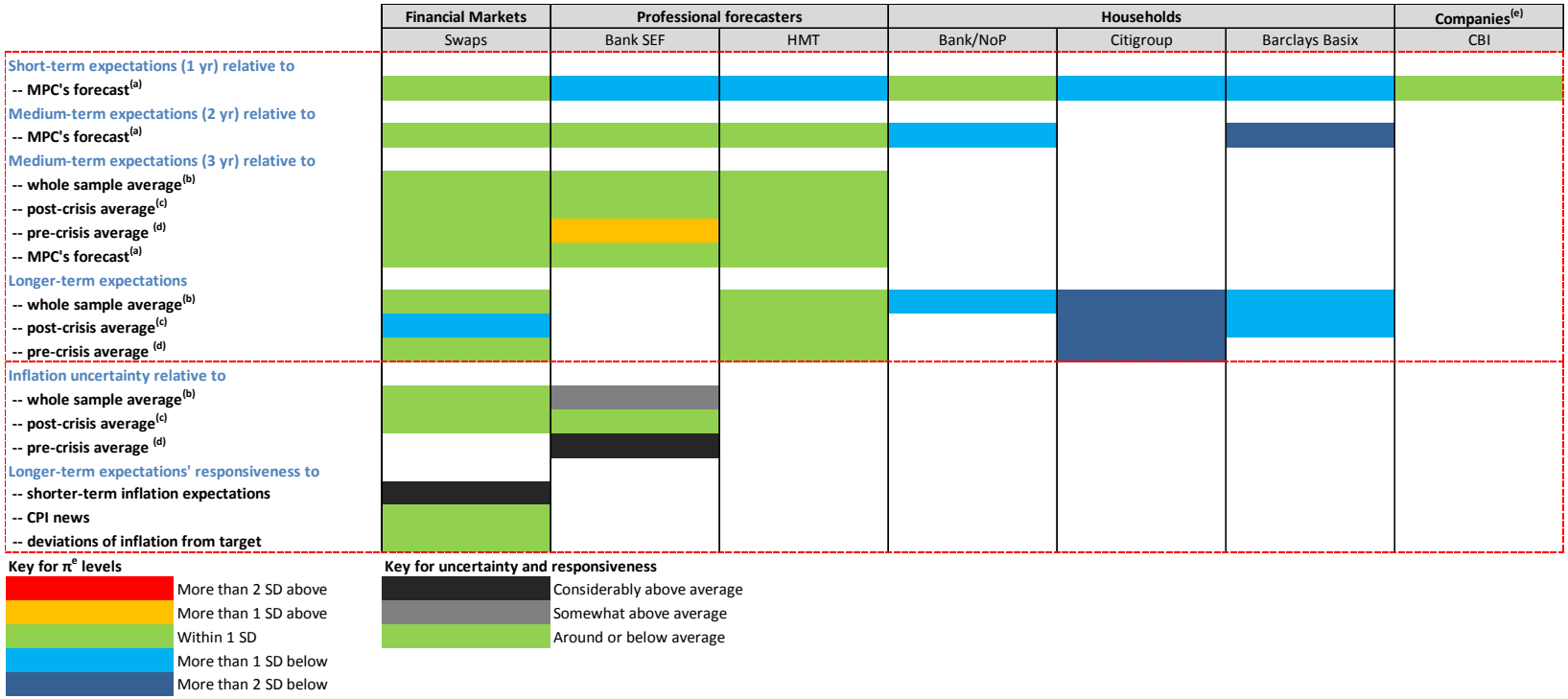
Key for π^e levels

- More than 2 SD above
- More than 1 SD above
- Within 1 SD
- More than 1 SD below
- More than 2 SD below

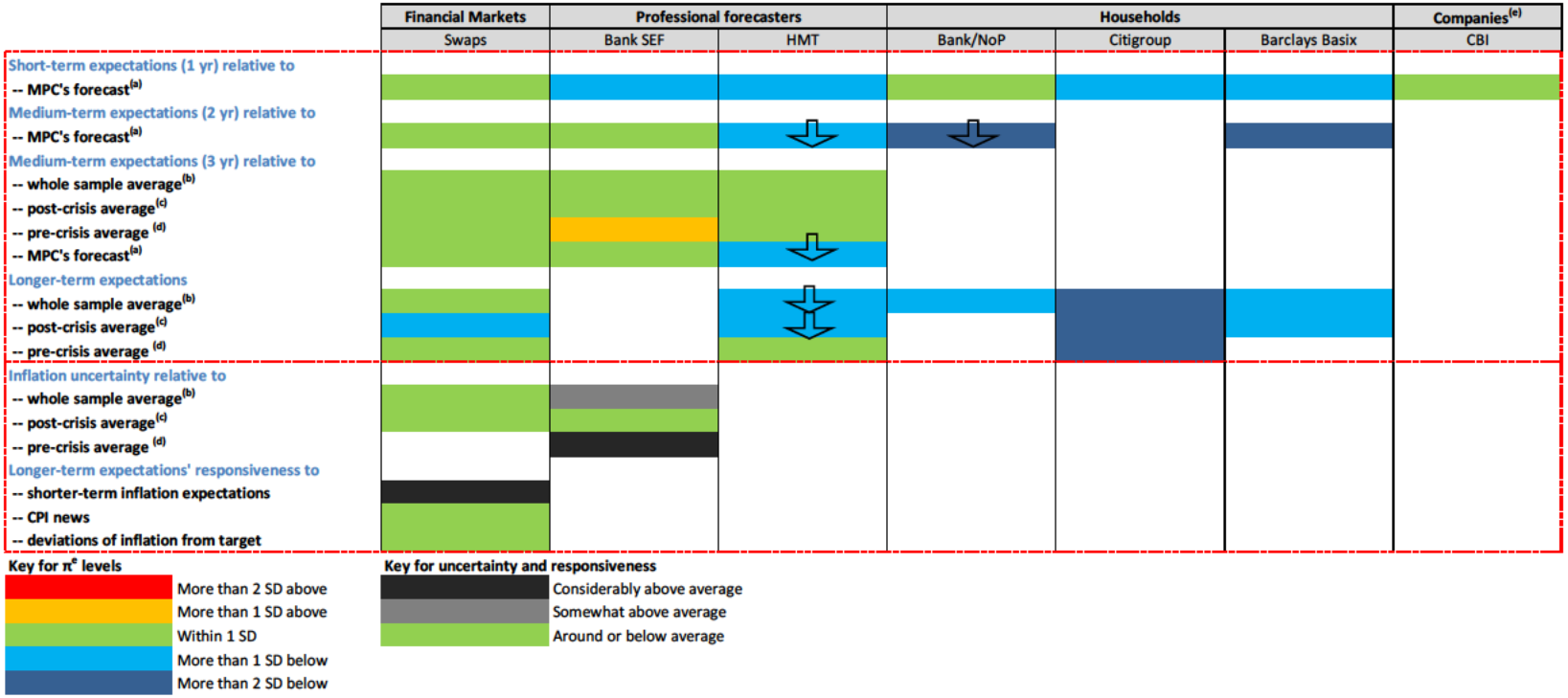
Key for uncertainty and responsiveness

- Considerably above average
- Somewhat above average
- Around or below average

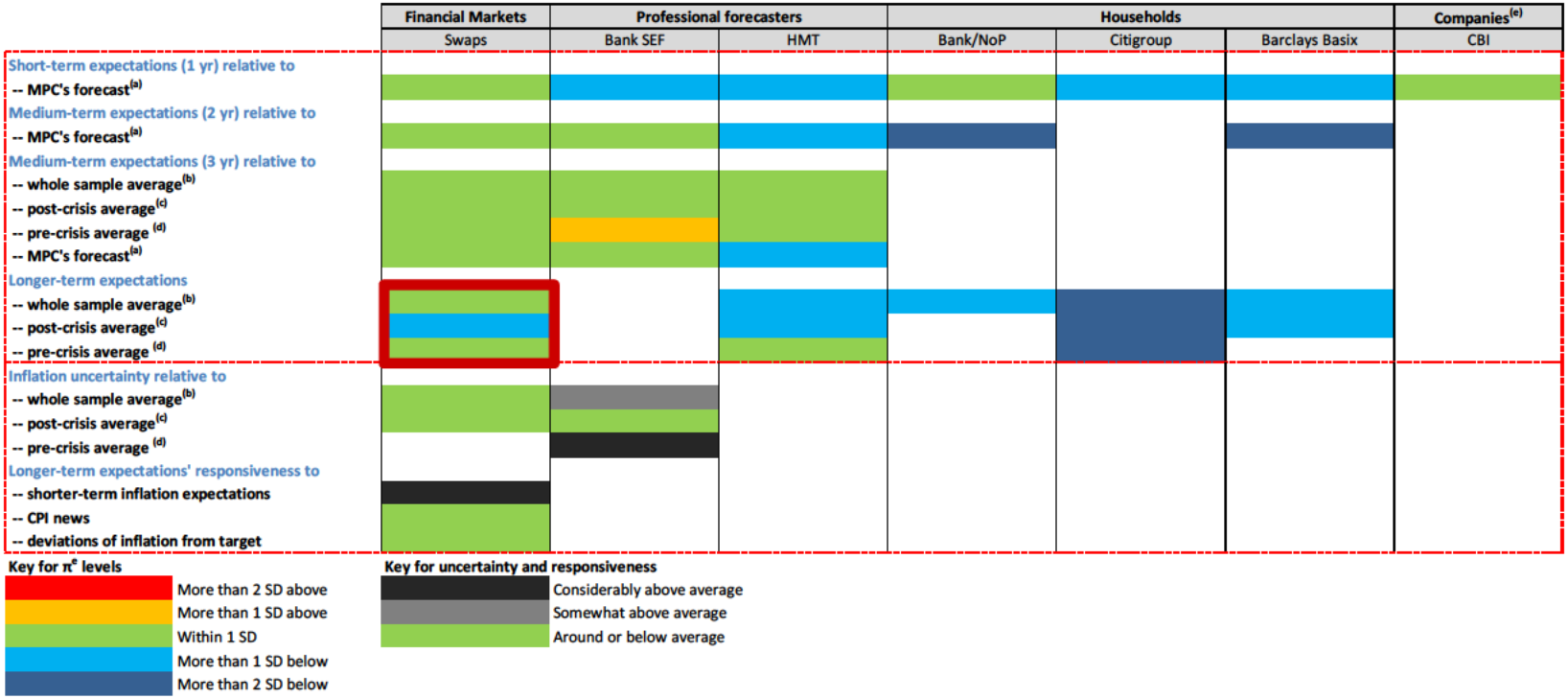
Inflation expectations heatmap – February 2015



Inflation expectations heatmap – March 2015

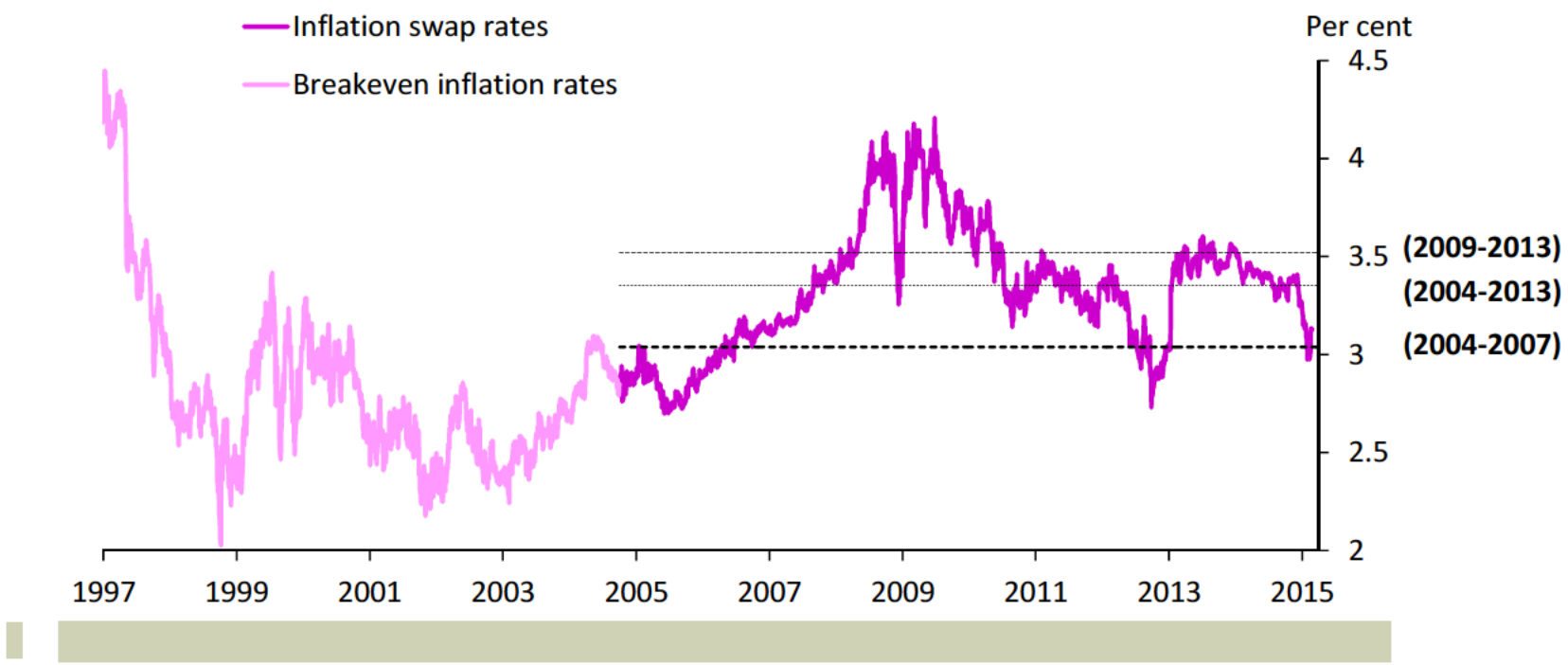


Inflation expectations heatmap – March 2015



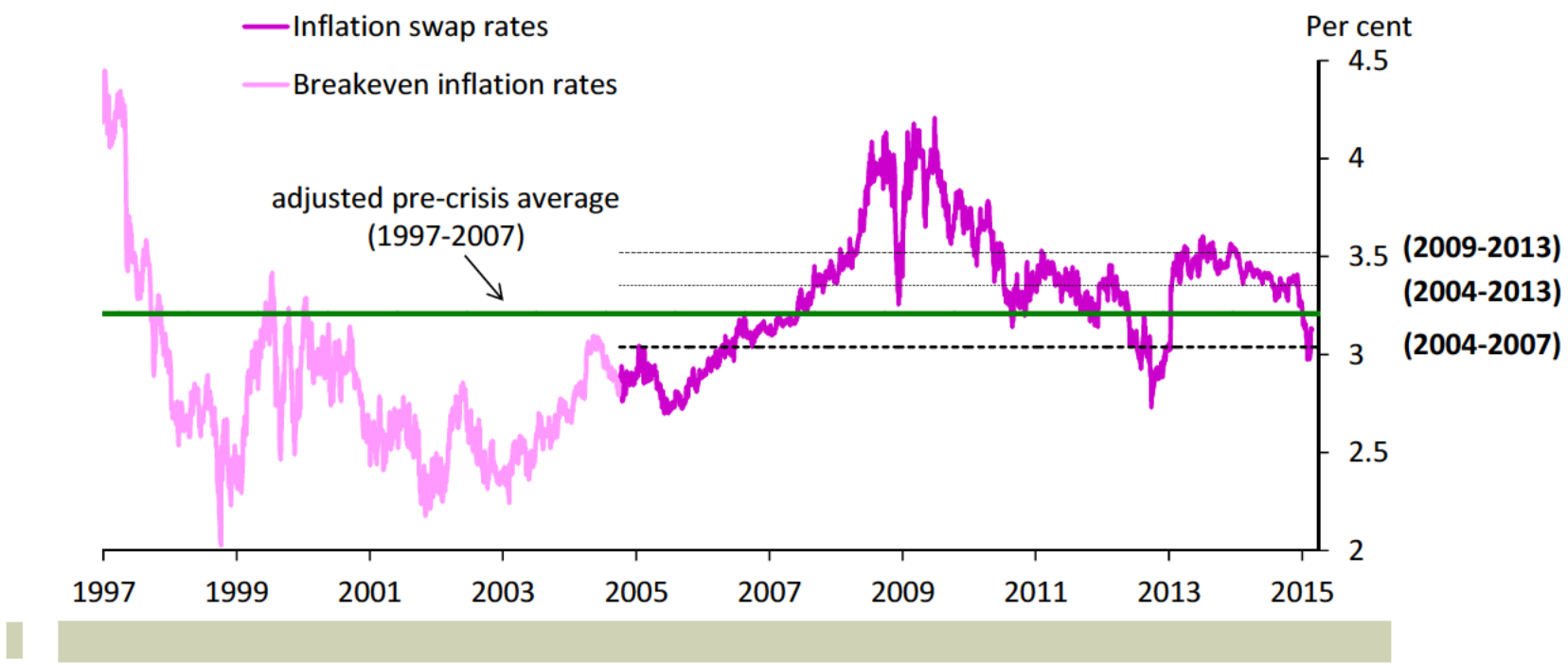
Pinning down 'target consistent' inflation swap rate not easy…

5y5y inflation swaps and heatmap averages



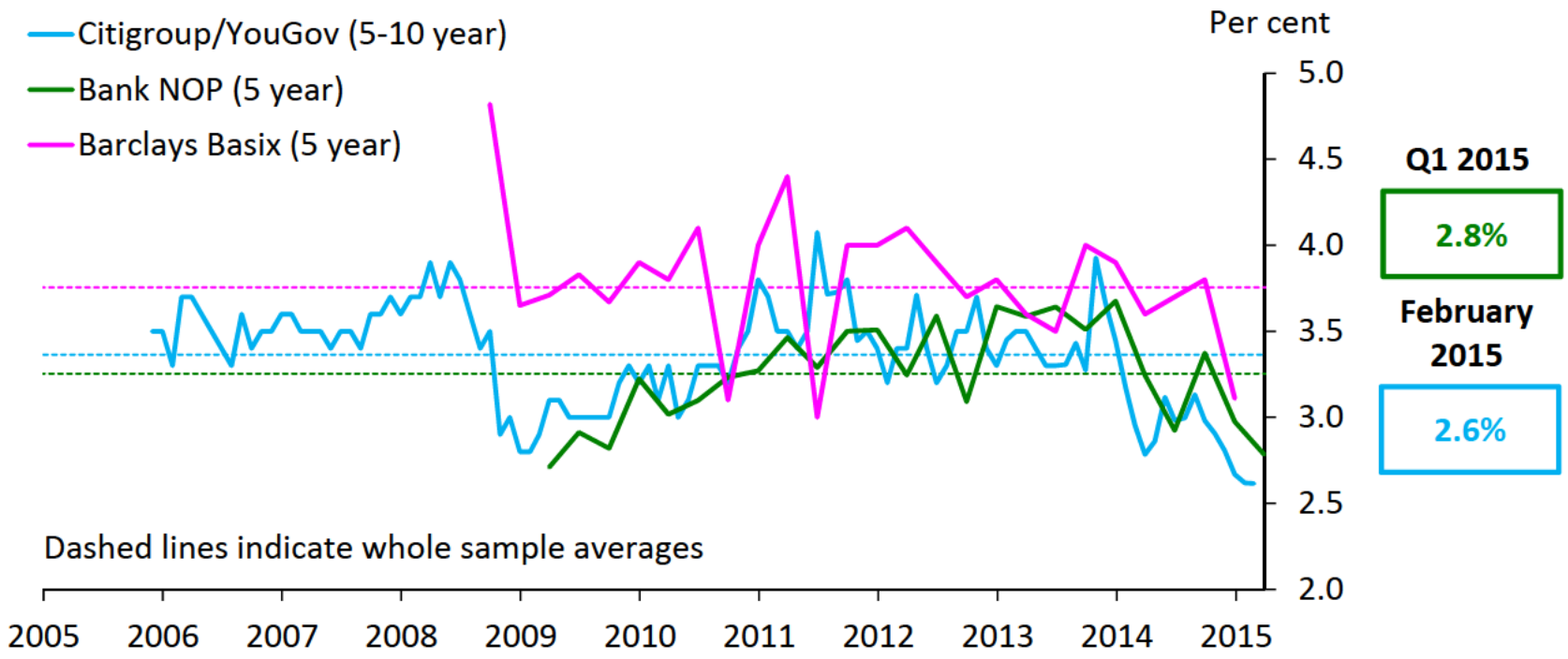
… our best guess is around 3.2%

5y5y inflation swaps and heatmap averages



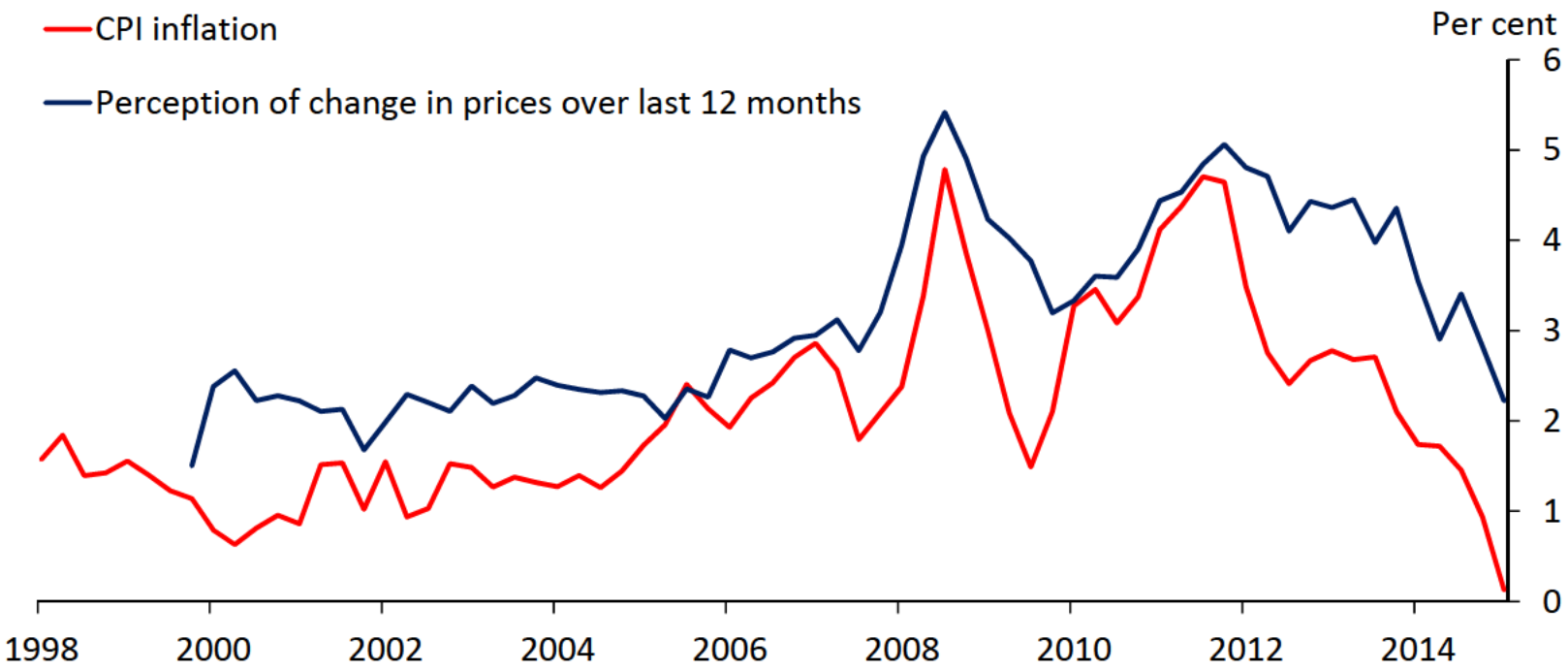
Citigroup 5-10 year expectation is below pre-crisis average

Long-term measures of inflation expectations



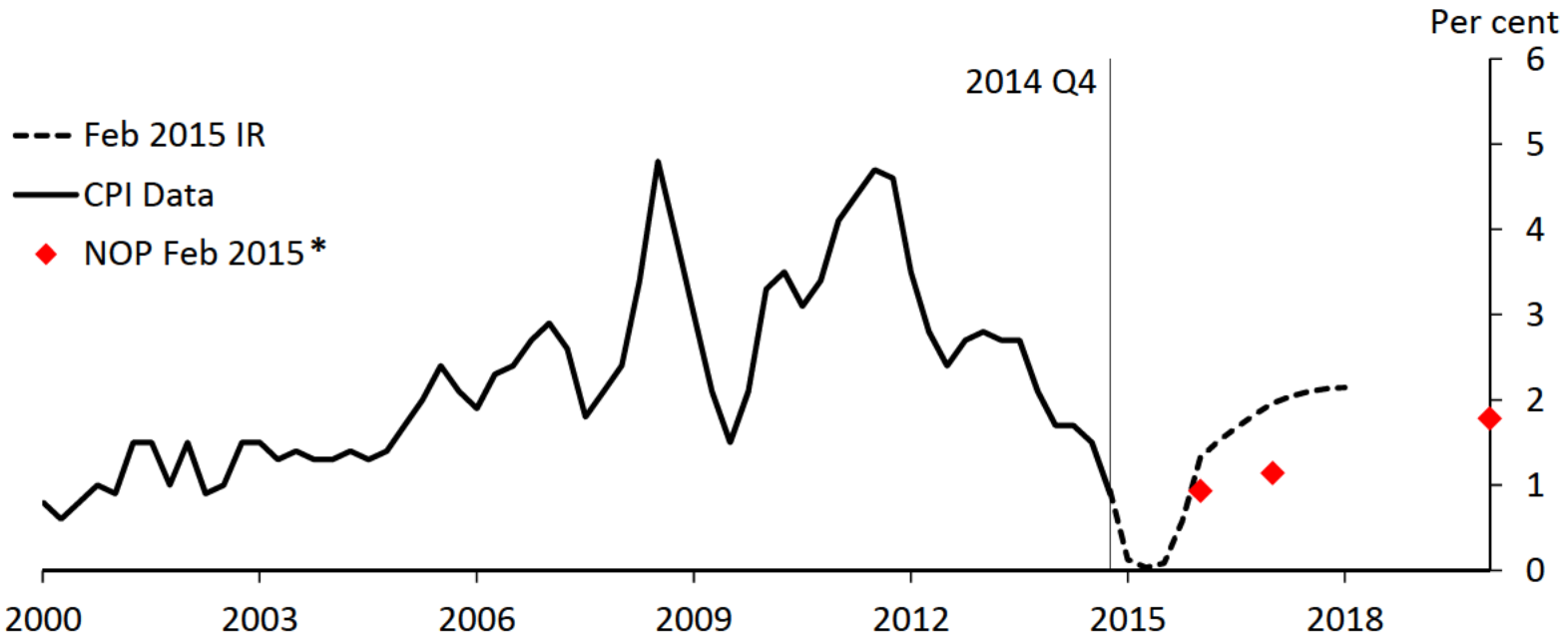
Households' perceptions are 1pp higher on average than CPI inflation

Actual inflation (CPI) and perceived inflation (Bank/NOP survey)



Households expect inflation to take longer to return to target than MPC do…

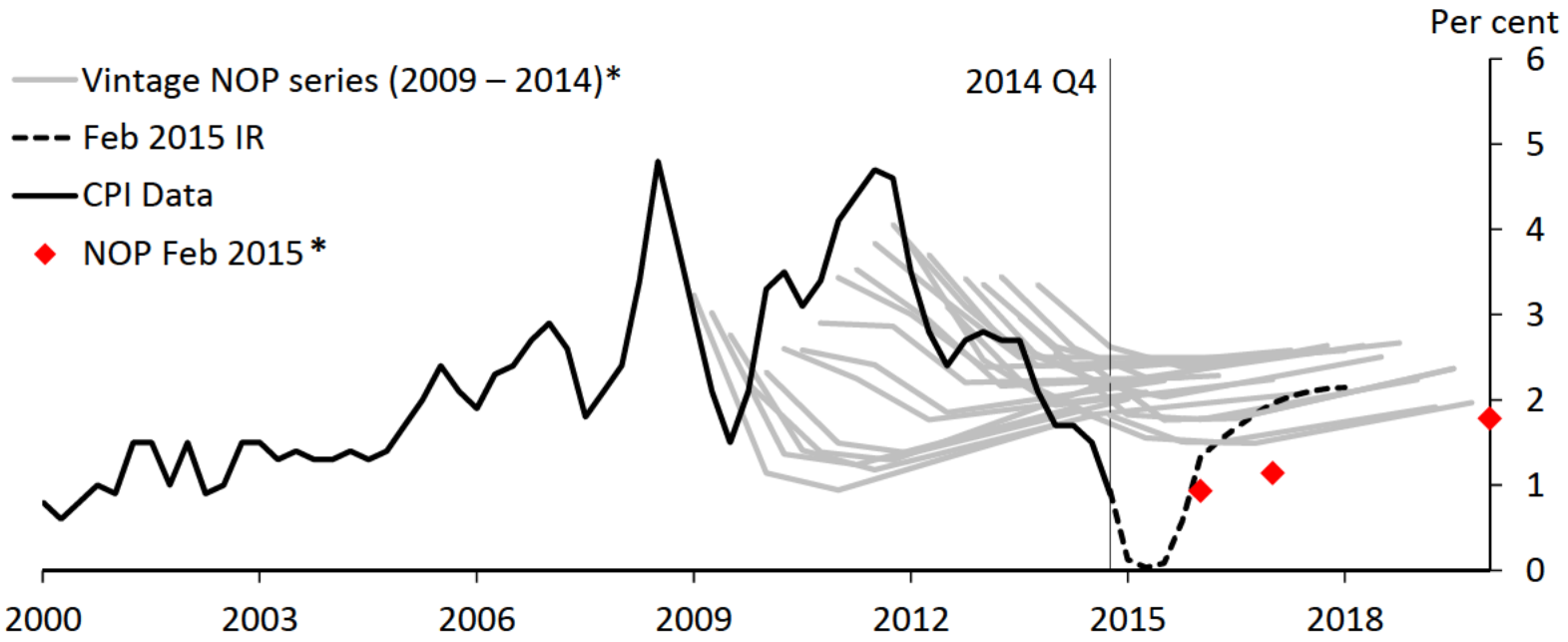
CPI inflation and inflation expectations



* Bank/NOP series adjusted for **average** wedge between perceptions & CPI outturn

… and expectations term structure is lowest on record

CPI inflation and inflation expectations



* Bank/NOP series adjusted for **average** wedge between perceptions & CPI outturn

Inflation expectations key messages

- Aside from financial market measures, inflation expectations continued to drift downwards this month.
- The levels of financial market inflation expectations are broadly in line with our best guess of a target-consistent level.
- But that is not the case for households: increasing evidence that they expect inflation to return to target more slowly than you do.

4: Financial Markets

FPC/MPC Briefing Meeting

Financial Markets

CMD, Markets, MFAD, BIAD, PRA and FCA

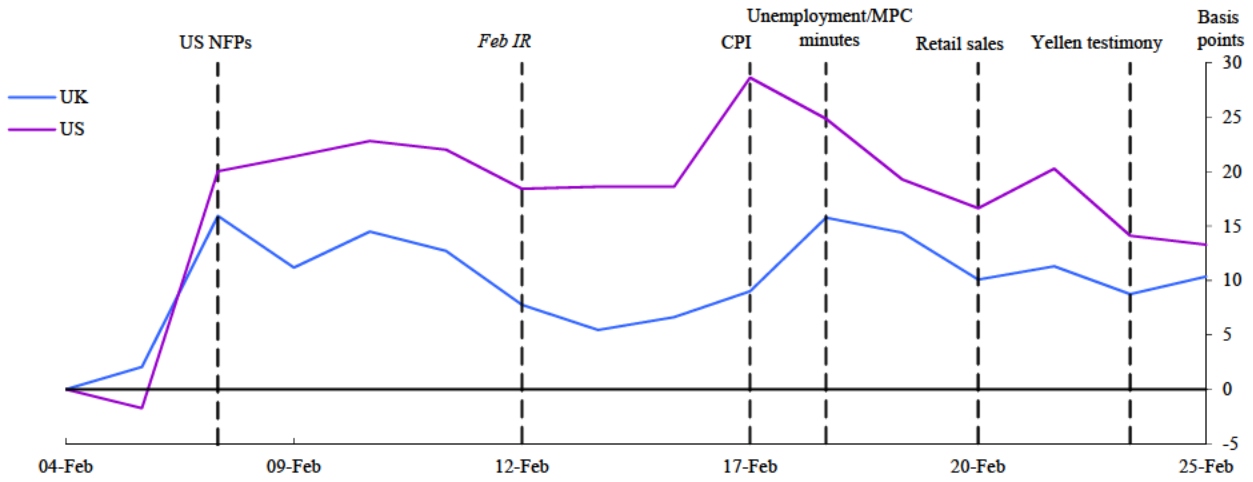
27 February 2015

Plan

- **Interest rates and exchange rates**
- **The impact of low and negative rates**
- **Risk appetite, market liquidity, and volatility**

Interest rates and exchange rates

Changes in 1-year,1-year forward OIS since last MPC

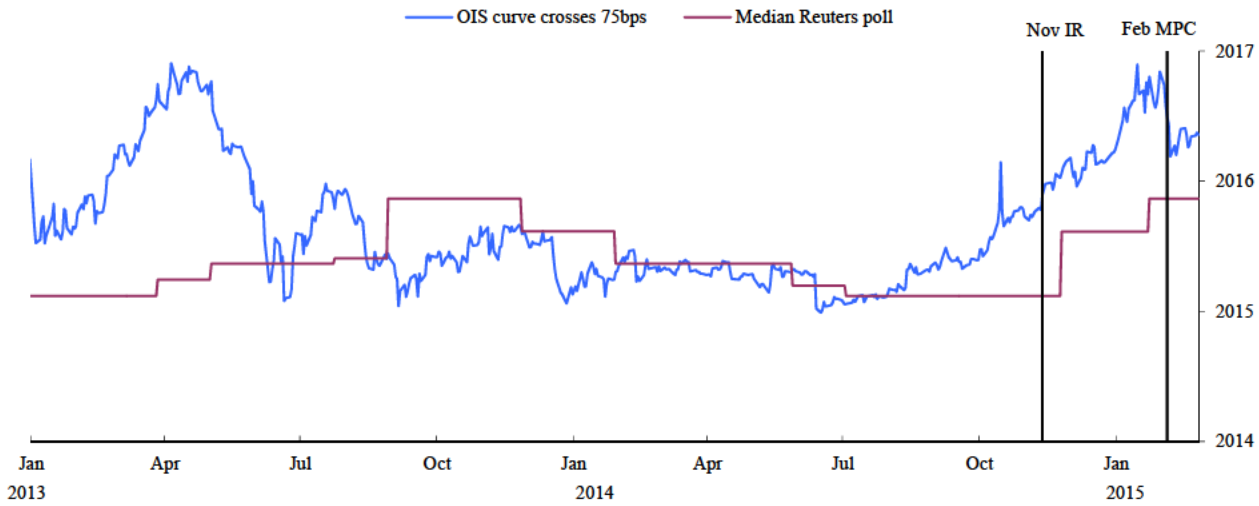


- *IR* seen in line with expectations but the possibility of rate cuts gained some attention.
- Stronger data likely behind most of the rise in interest rate expectations since last MPC.

For more information .

BANK OF ENGLAND

Market and survey-implied date of first Bank Rate rise



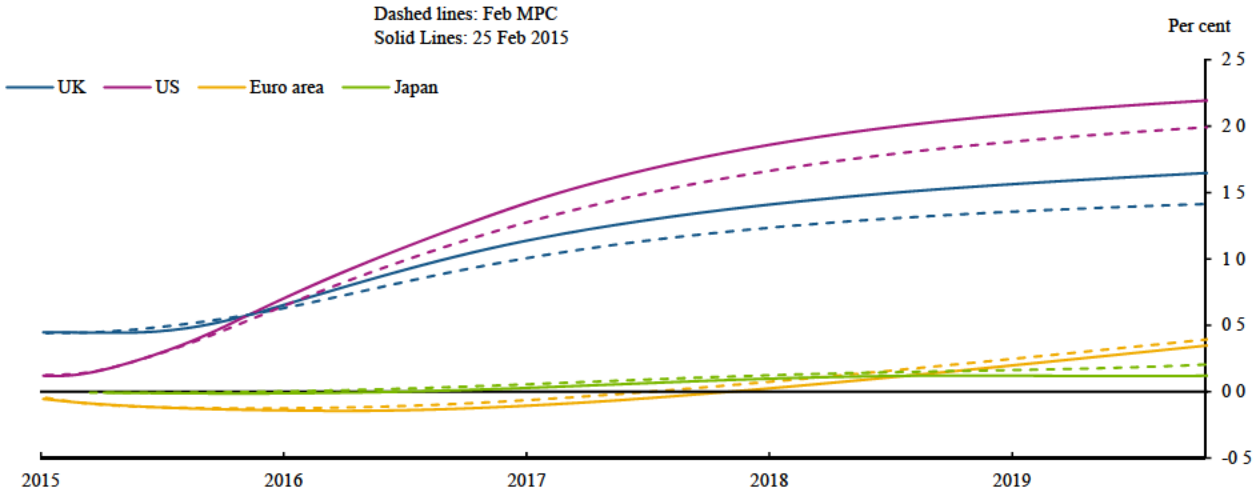
Latest	Last MPC
May 2016	June 2016
Q4 2015	Q4 2015

- Markets have brought forward the timing of the first rate hike to May 2016.
- By comparison, the median of analysts' expectations remains for a rate hike before year end.

For more information

BANK OF ENGLAND

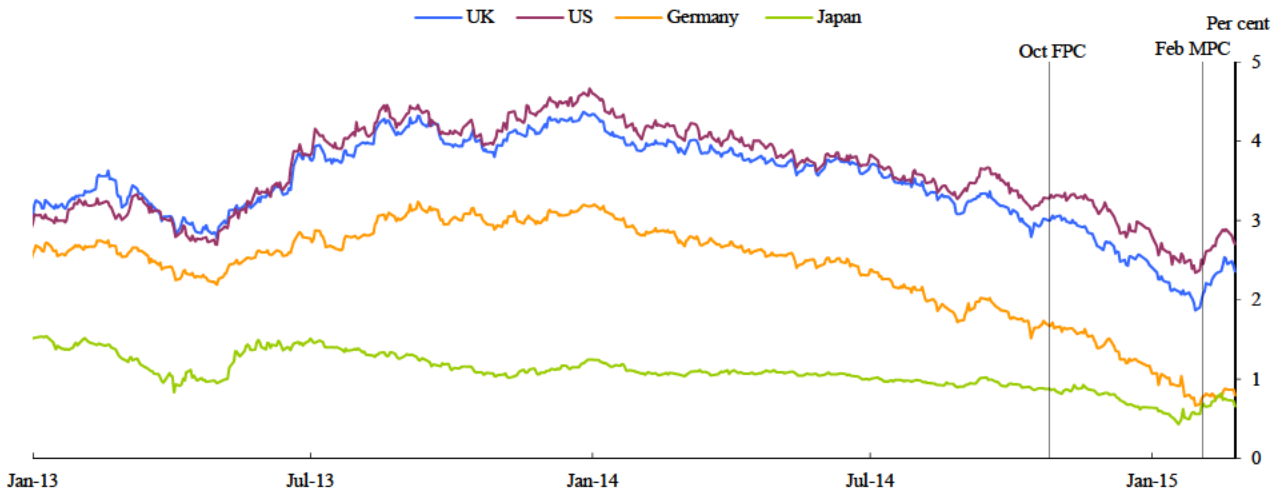
International instantaneous forward OIS curves



- Policy expectations in the US/UK and €A/Japan are increasingly divergent.
- 21 central banks have eased policy or adjusted exchange rate targets in 2015.

BANK OF ENGLAND

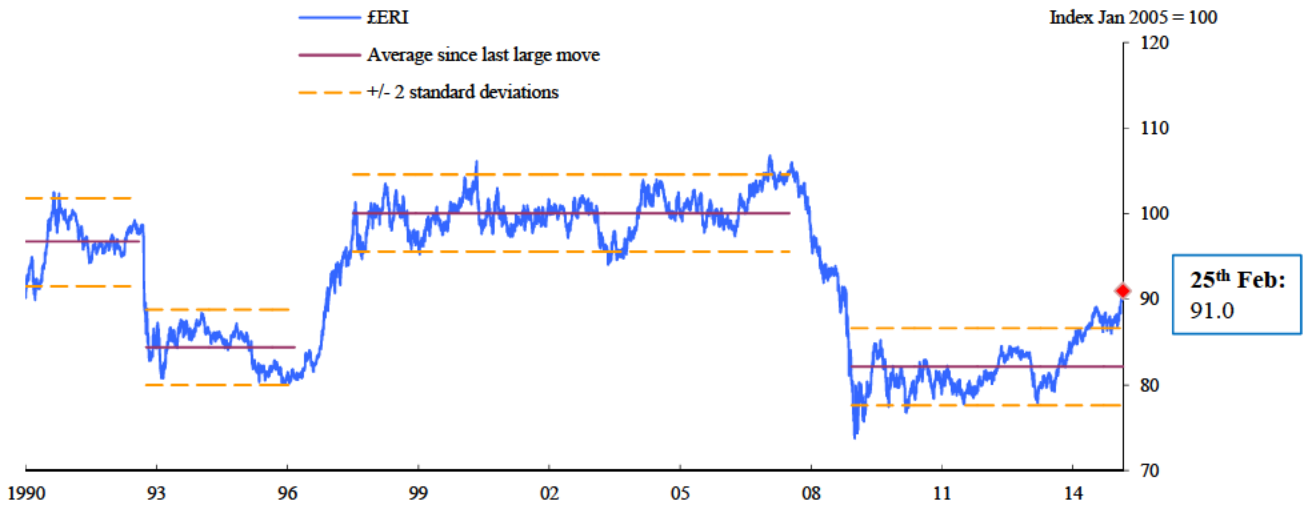
International 5-year, 5-year forward rates



- Increasing divergence is also evident in forward markets for longer-term rates.
- Better data have been driving US and UK rates while German and Japanese forward rates continue to be compressed by policy actions and expectations.

BANK OF ENGLAND

Sterling exchange rate index



- Sterling has reached its highest level since the collapse of Lehman Brothers.
- Contacts have reported that uncertainty around the election may be starting to exert some downward pressure on sterling.

For more information, please see

BANK OF ENGLAND

The impact of low and negative rates

European bond yields

Positive | Negative

(%)	Policy Rates	Maturity (years) 1	2	3	4	5	6	7	8	9	10
Switzerland	-0.75*	-1.06	-1.02	-0.78	-0.57	-0.40	-0.30	-0.19	-0.14	-0.05	0.04
Denmark	-0.75	-0.94	-0.70			-0.33	-0.04		0.12		0.25
Germany	0.05	-0.25	-0.24	-0.23	-0.20	-0.14	-0.06	0.03	0.13	0.23	0.33
Austria	0.05	-0.16	-0.15	-0.13	-0.09	-0.05	-0.01	0.08	0.20	0.29	0.40
Netherlands	0.05		-0.15	-0.12	-0.10	-0.04	-0.02	0.06	0.18	0.29	0.38
Finland	0.05	-0.19	-0.16	-0.12	-0.08	-0.04	-0.01	0.06	0.19	0.25	0.35
France	0.05	-0.15	-0.17	-0.13	-0.06	0.04	0.15	0.26	0.37	0.49	0.59
Sweden	-0.10	-0.20	-0.24		-0.09	0.13		0.35	0.52		0.64
Belgium	0.05	-0.14	-0.13	-0.08	-0.01	0.03	0.11	0.24	0.35	0.46	0.57
Spain	0.05	0.11	0.19	0.29	0.43	0.64	0.78	0.99	1.17	1.28	1.38
Italy	0.05	0.09	0.21	0.37	0.54	0.73	0.92	1.10	1.27	1.43	1.58
Norway	1.25	0.81		0.75		0.80		1.03		1.24	1.34
UK	0.50	0.33	0.53	0.78	1.01	1.19	1.35	1.47	1.59	1.68	1.77

*centre of target range

- A combination of negative policy rates and ECB QE has driven longer-term interest rates in Europe into negative territory.

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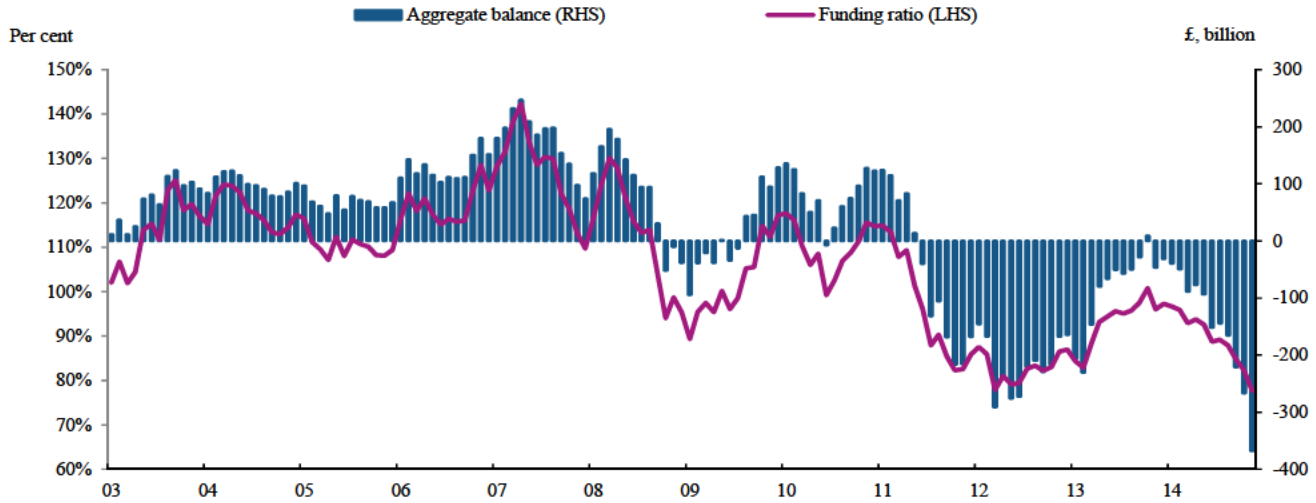
15

Impact on UK defined benefit pension schemes



- Low bond yields are negatively affecting the valuation of defined benefit pension funds.
- Previous staff analysis suggested possible effect on wages and dividends only, although reports from regional agents suggested there could also be effects on investment.

For analysis on the impact of higher pension costs to investment

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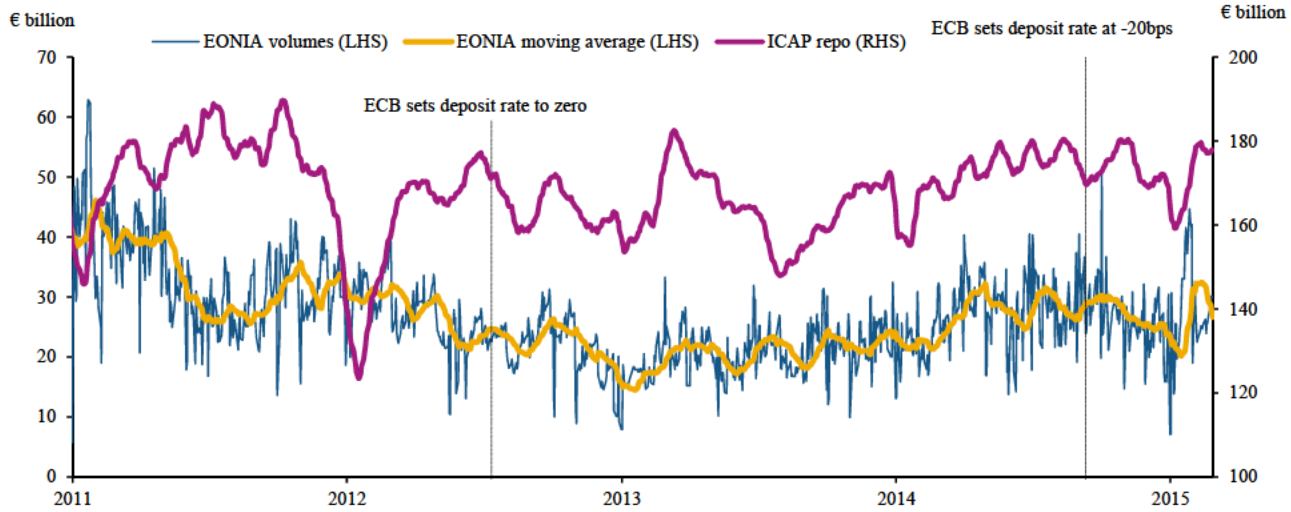
17

Impact on European money markets

Volumes in the Euro Area unsecured and secured money markets



- Concerns that negative interest rates would harm money market functioning is not evident in recent European experience.

For more information

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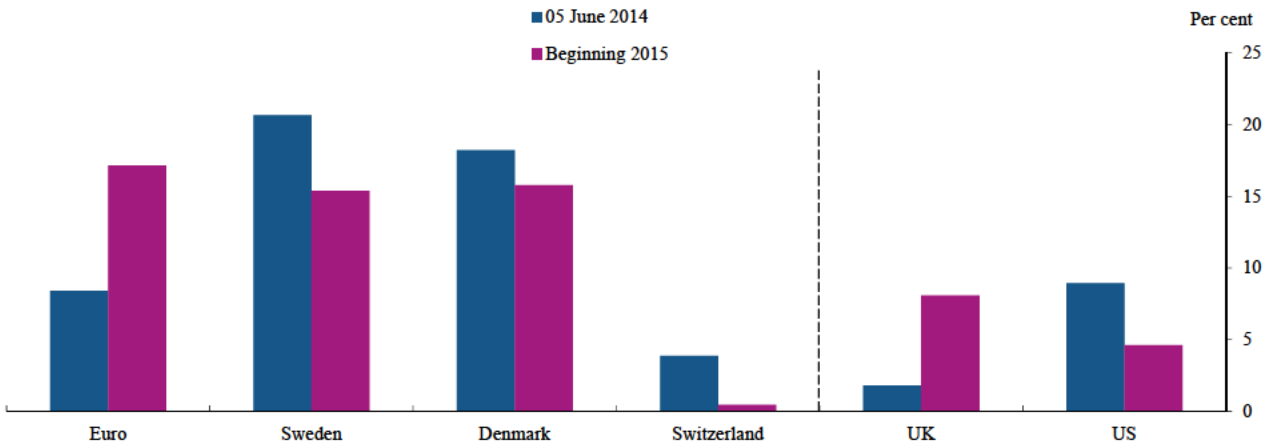
Impact on European equity markets[a]

Changes in equity indices since:



(a) In local currency terms.

- Equity markets in countries with negative bond yields have generally outperformed those in the US and UK.

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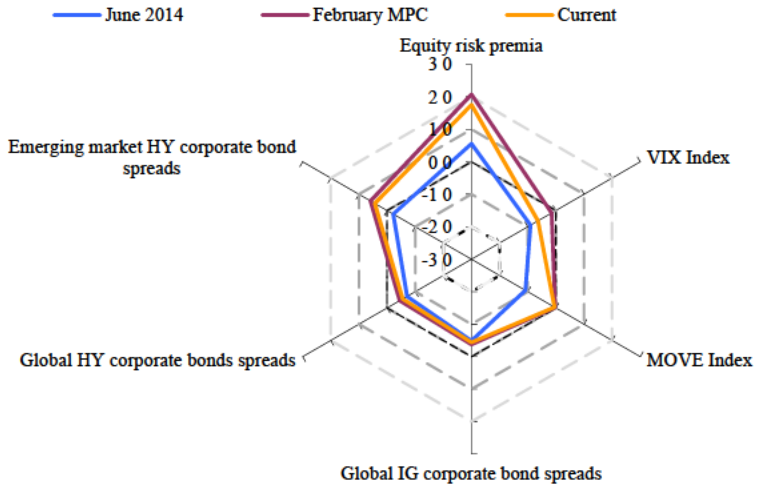
Risk appetite, market liquidity, and volatility

Risk appetite[a]

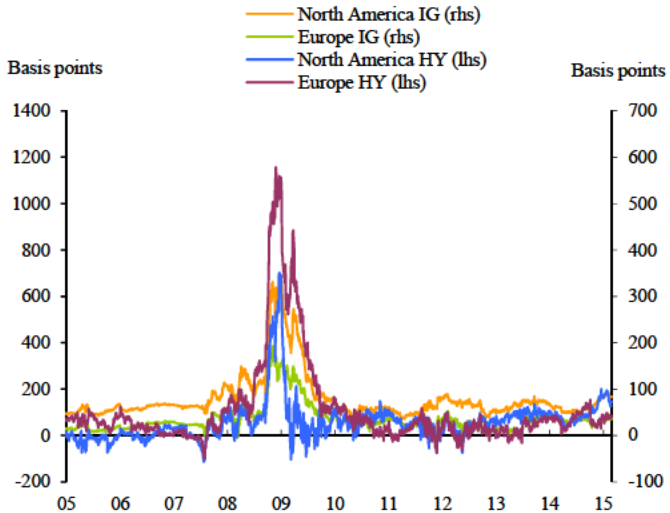


(a) Differences from averages since 2003 in standard deviations.

- Risk appetite appeared to diminish from mid-2014 but has strengthened since last MPC.
- The scope for a disorderly correction remains in markets where underlying liquidity is poor.

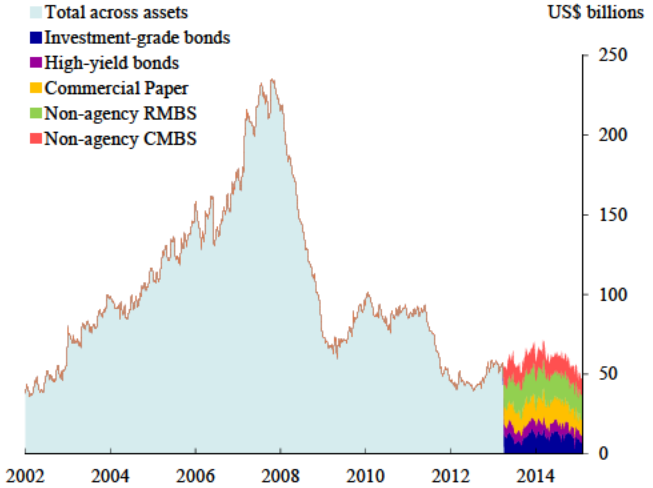
Liquidity: corporate bonds

Cash-CDS basis[a]



(a) The difference between option-adjusted non-financial bond spreads and CDS premia for investment-grade and high-yield corporate bonds, approximately maturity and composition matched.

US primary dealer inventory in fixed income securities



- Some measures of liquidity risk premia in corporate bond markets have picked up a little but dealer inventories have fallen further in recent months.

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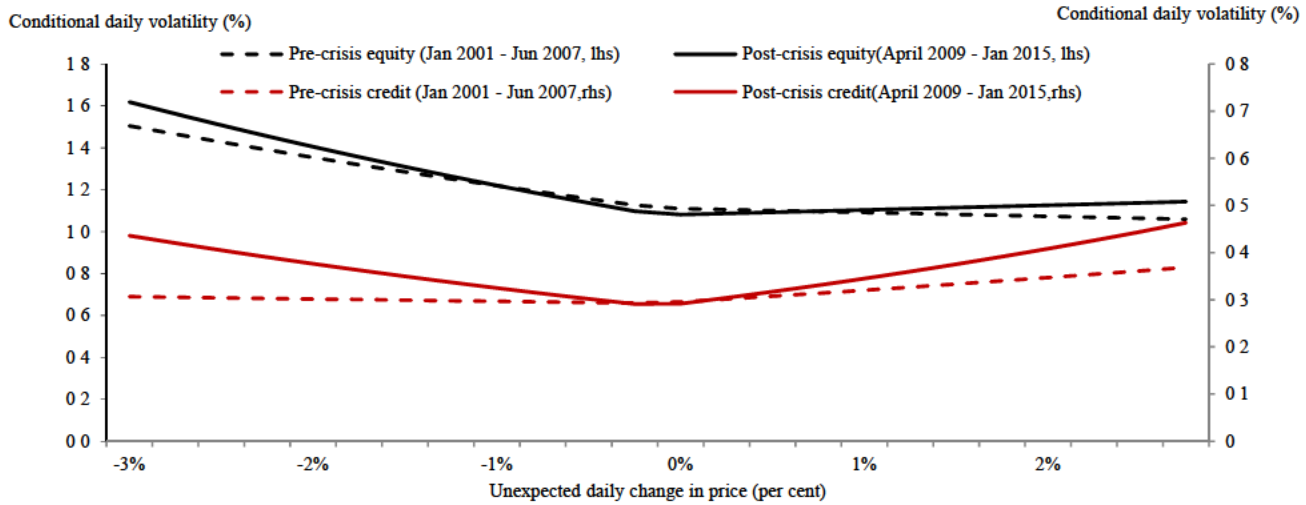
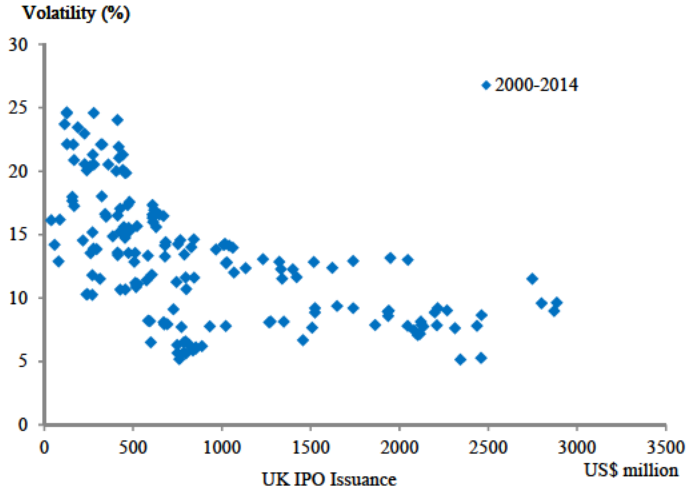
Impact of news on UK asset volatility



- There is some evidence that the sensitivity of volatility to news has risen in UK markets.
- This seems consistent with reduced market liquidity and could act as a potential amplification mechanism at times of stress.

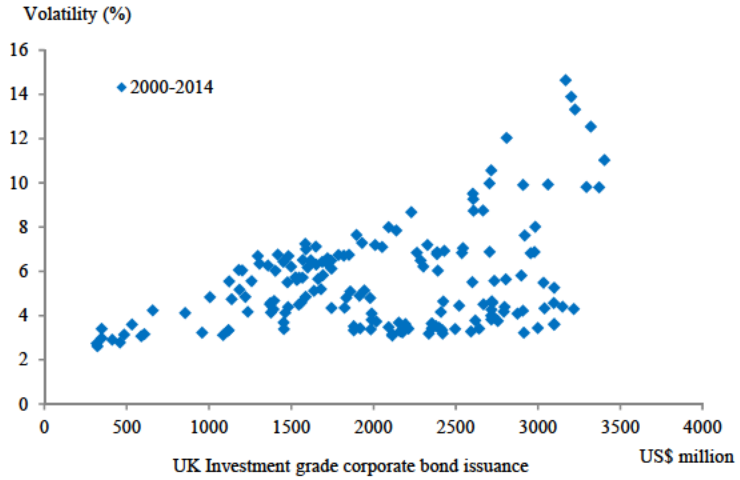
Risks for market-based finance

UK equities: realised volatility vs IPO Issuance[a]



(a) Realised volatilities are taken over a 22-day horizon, calculated using annualised standard deviations of daily price changes in the FTSE100.

UK IG corporate bonds: realised volatility vs bond issuance[b]



(a) Realised volatilities are taken over a 22-day horizon, calculated using annualised standard deviations of daily price changes in UK investment grade corporate bonds.

- Past increases in volatility have been associated with lower equity and higher bond issuance.
- This could suggest that market-based finance could be particularly vulnerable to a combination of equity market volatility and illiquidity in corporate bond markets.

Main messages

- **Interest rates and exchange rates…**

…have been increasingly driven by expectations of monetary policy divergence

- **The impact of low and negative rates…**

…is hard to judge but may be driving search for yield behaviour in some markets

- **Risk appetite, market liquidity, and volatility…**

…remain a major FS risk despite moving closer to historical averages

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5: Global Environment and Risks

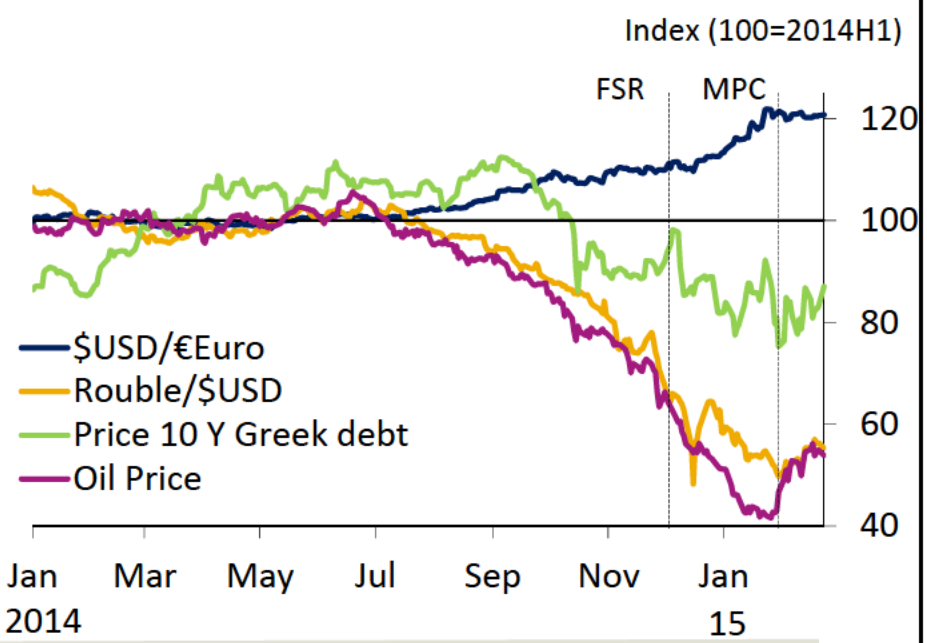
Bank of England
International Directorate

Global Environment and Risks
March 2015

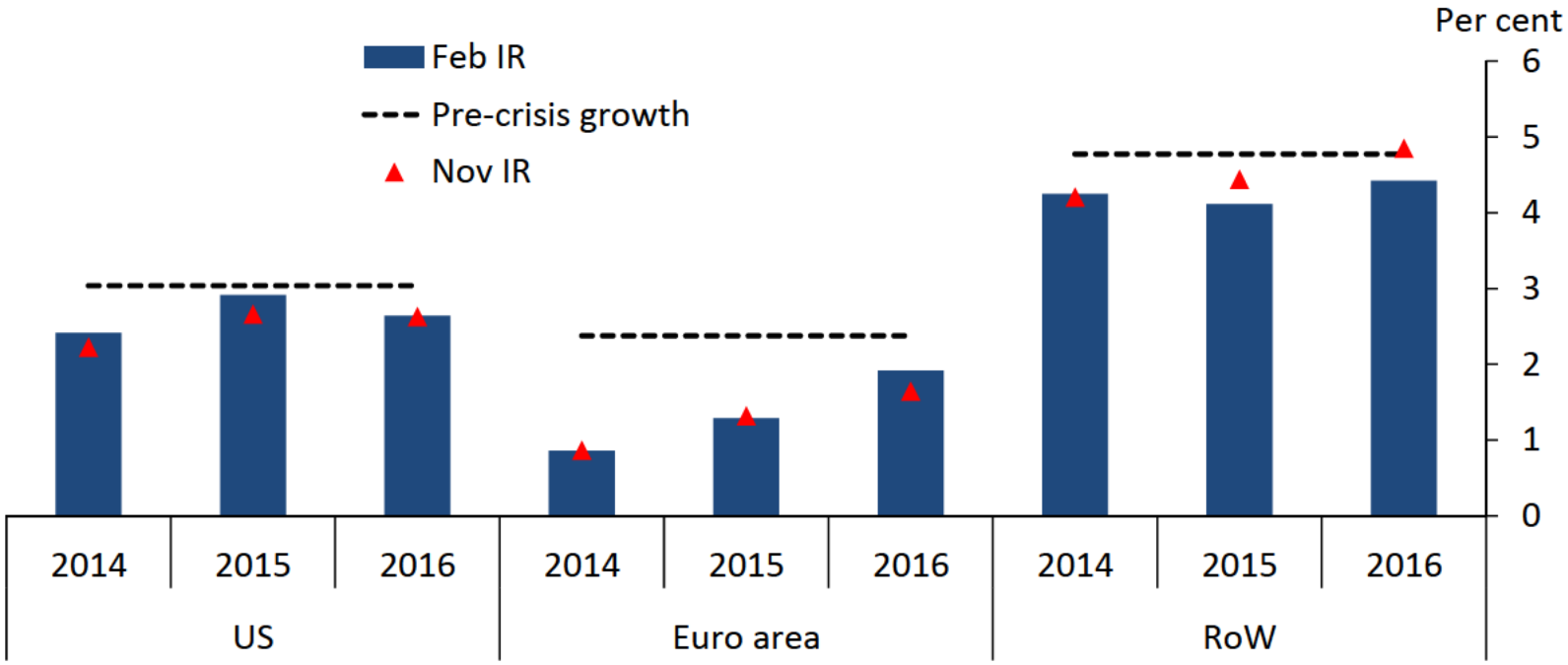
International developments

Plan

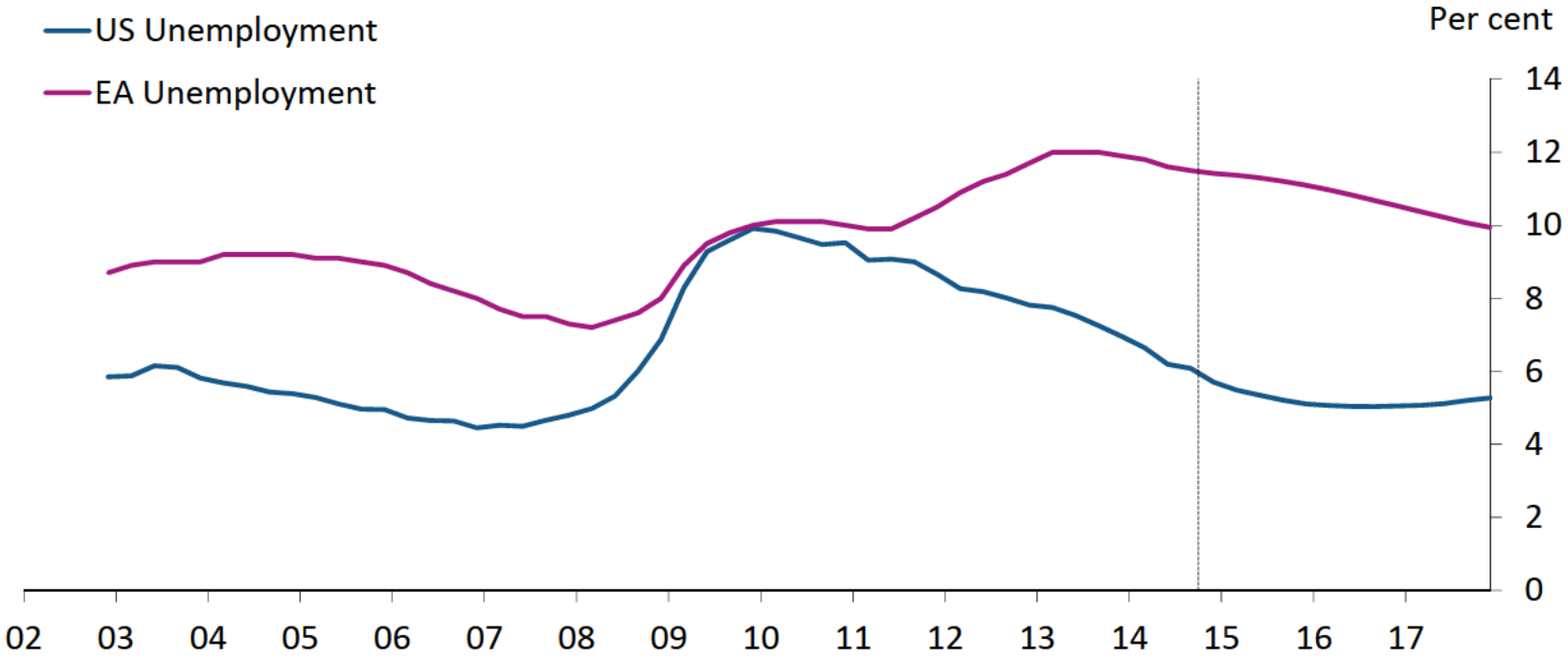
- Divergent prospects: US tightening
  - Update on oil
  - Dollar borrowings by EMEs
    - Update on Russia/Ukraine
    - Risk of hard landing in China
- Divergent prospects: ECB easing
  - Vulnerabilities to low nominal GDP growth
  - Update on Greece
- For ID's view of international risks,



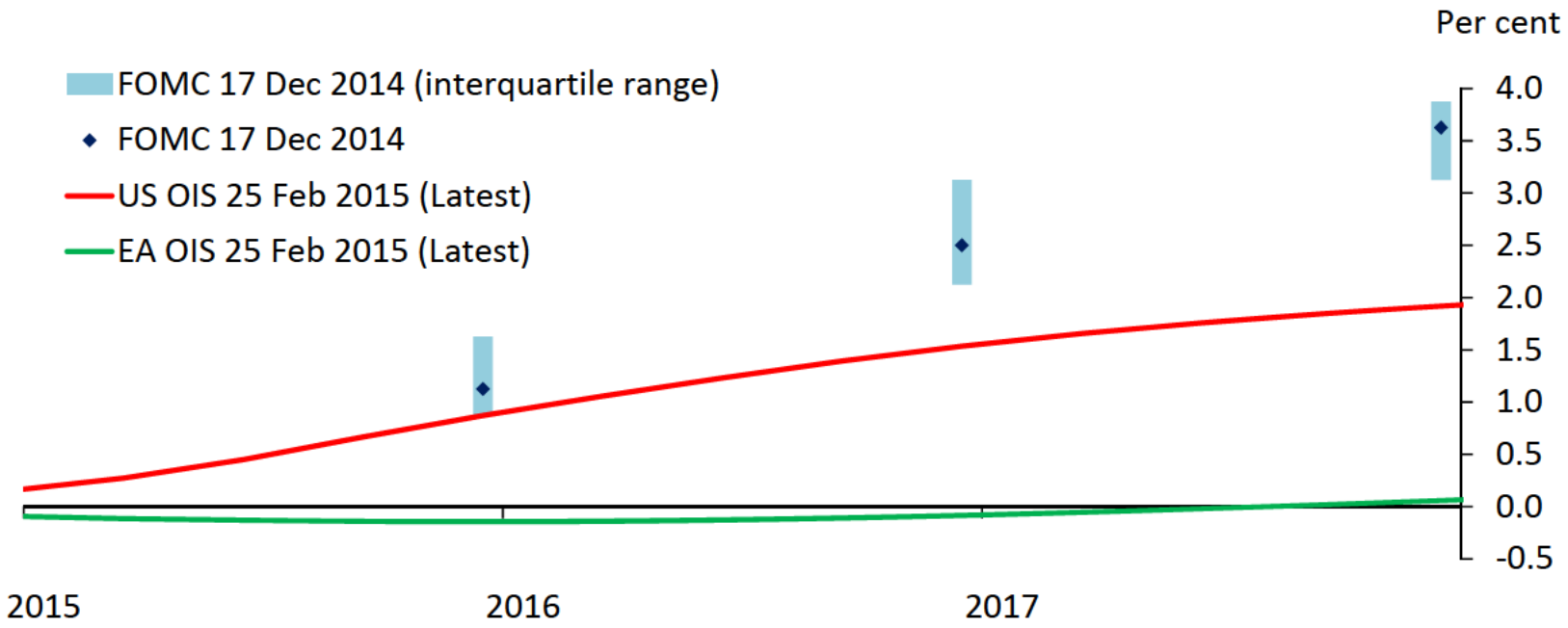
Latest MPC growth forecasts



Diverging economic prospects



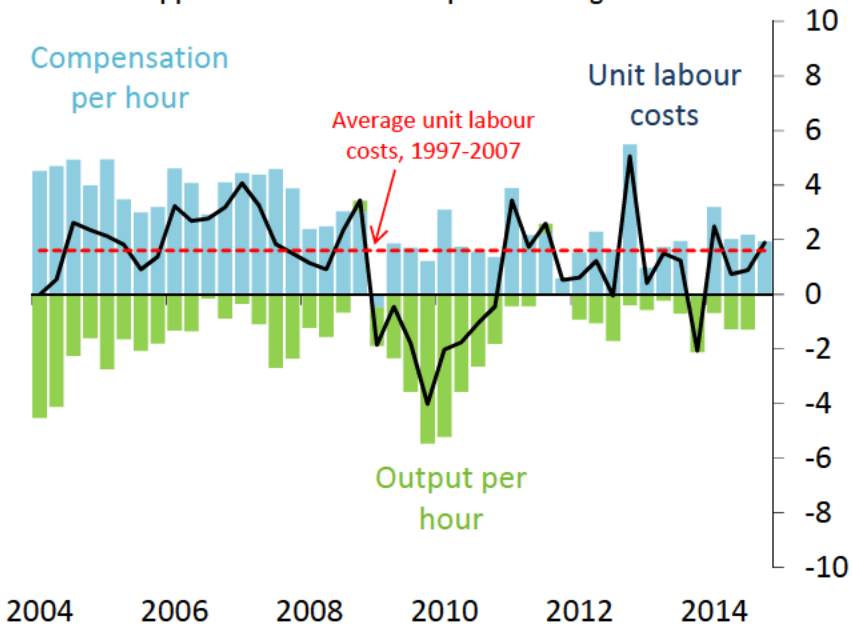
Divergent monetary policies



US inflationary pressure

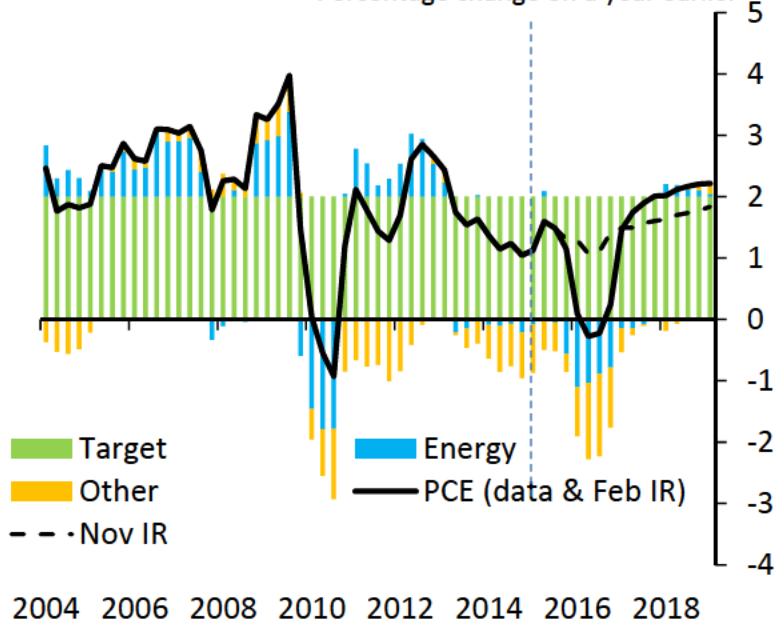
Unit labour costs

pp contribution to four-quarter change in unit labour costs

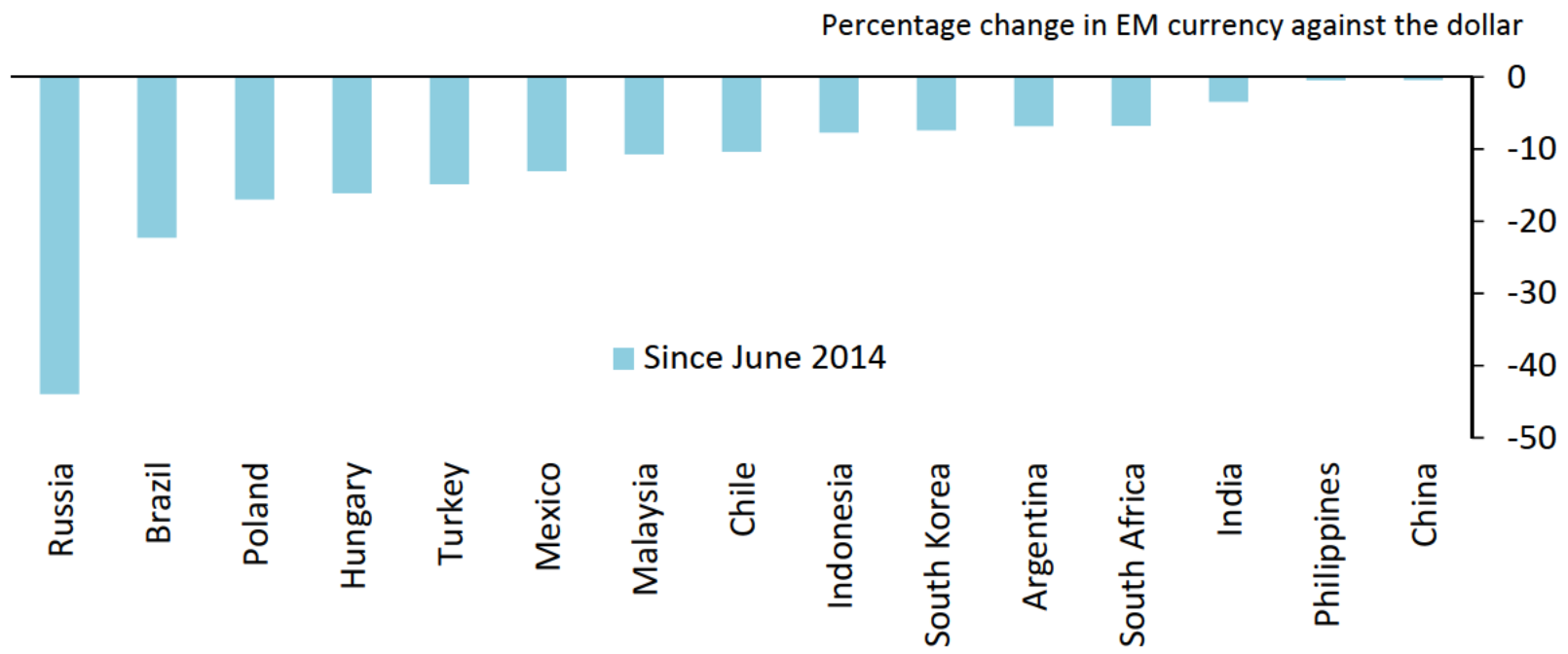


PCE inflation

Percentage change on a year earlier

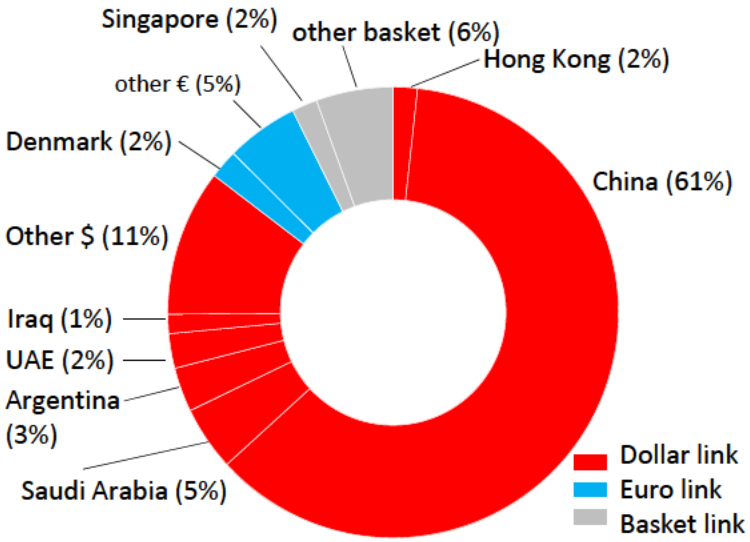


Large appreciation in the dollar relative to many EMEs



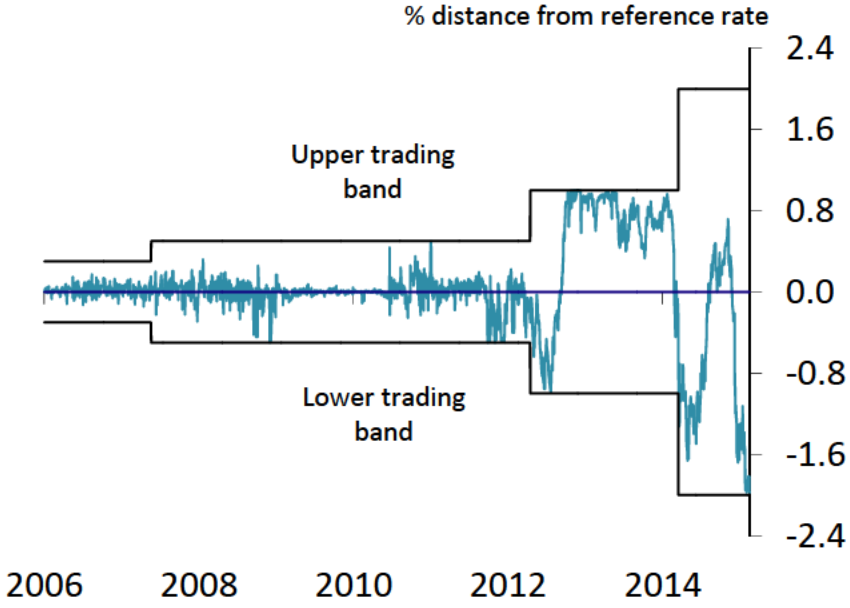
Managed exchange rate regimes under pressure

Managed ER regimes weighted by GDP



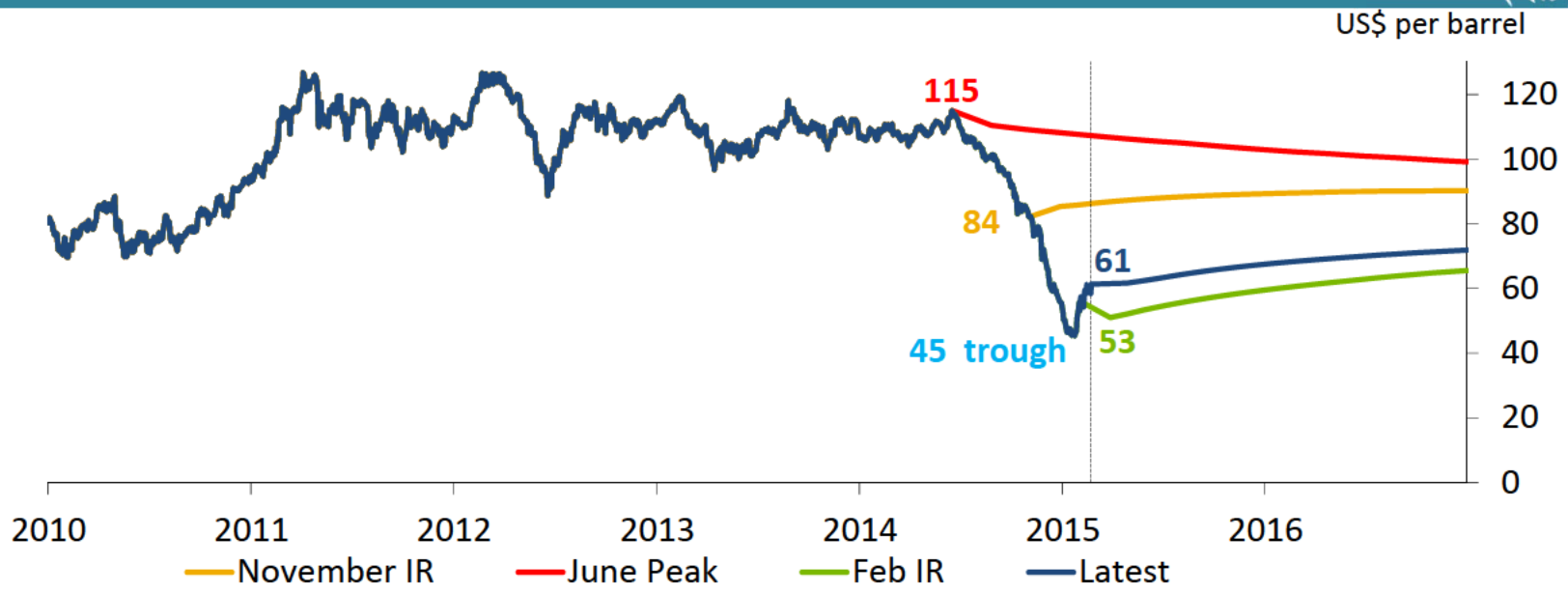
Total GDP linked to currency anchors: $16tn (21 % of World GDP)

RMB exchange rate



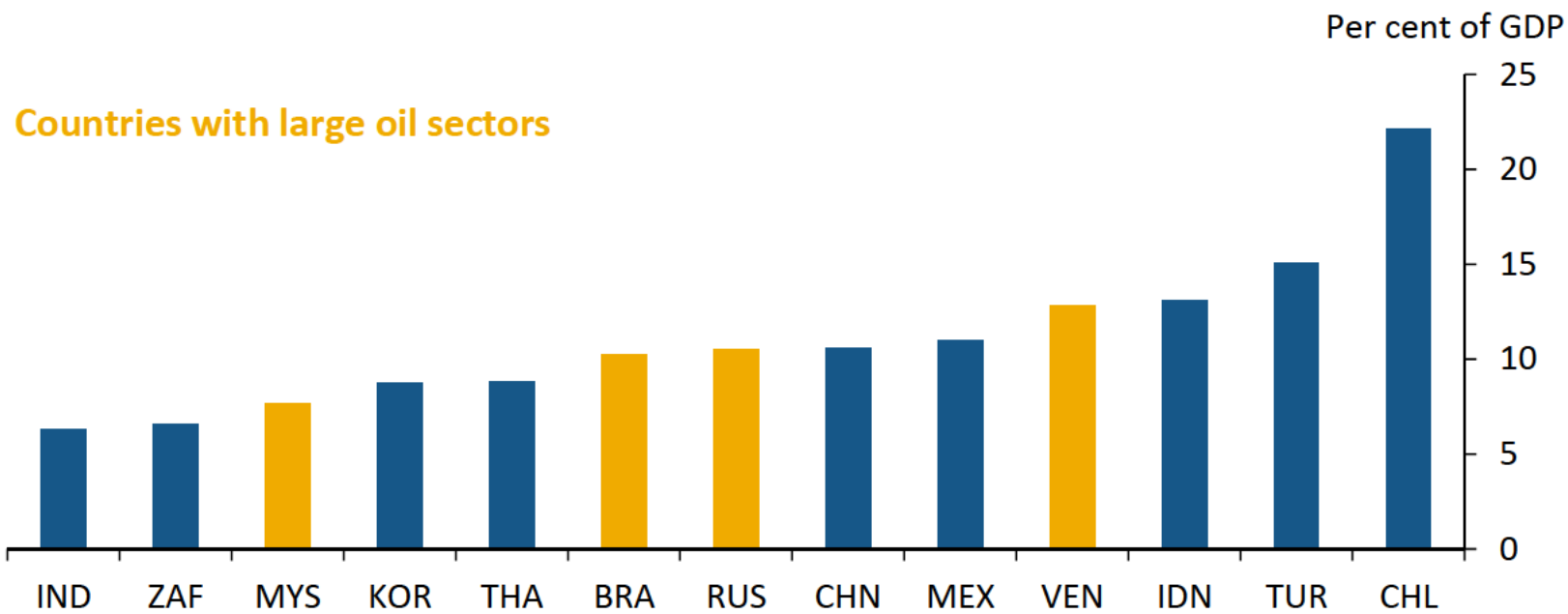
- For more details

Oil



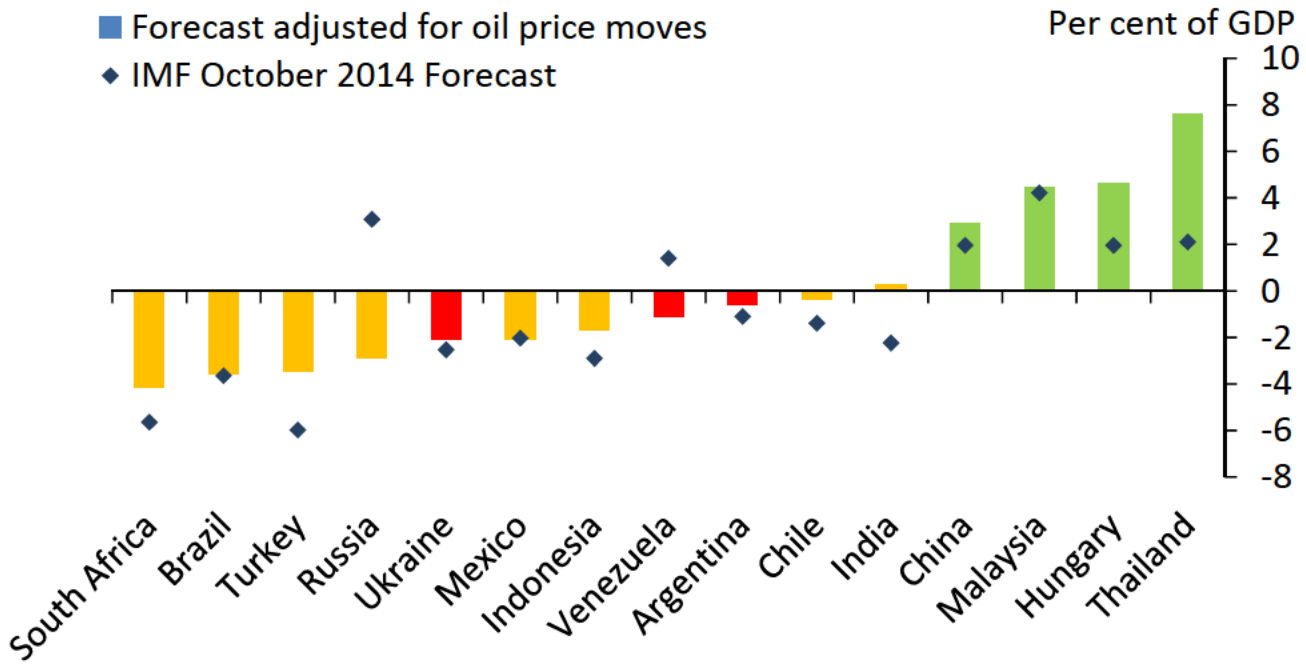
- Oil price up over 10% since MPC following 0.5m barrel fall in forecasts for US production in 2015Q4.
- For more details on the impact of the fall in prices since the summer

EM corporate sector $-denominated debt



- Further dollar appreciation could expose vulnerabilities in countries with large dollar-denominated liabilities, especially if not matched with dollar assets or covered with FX reserves.
- For more details

The fall in the oil price has improved current account positions for some



Reserves/GDP in 2014

Venezuela	1.1
Argentina	4.9
Ukraine	4.9
South Africa	12.2
Indonesia	12.4
Turkey	13.0
India	14.2
Mexico	14.3
Chile	14.5
Brazil	15.8
Russia	15.9
Hungary	32.2
Malaysia	33.2
China	37.5
Thailand	39.2

Russia and Ukraine

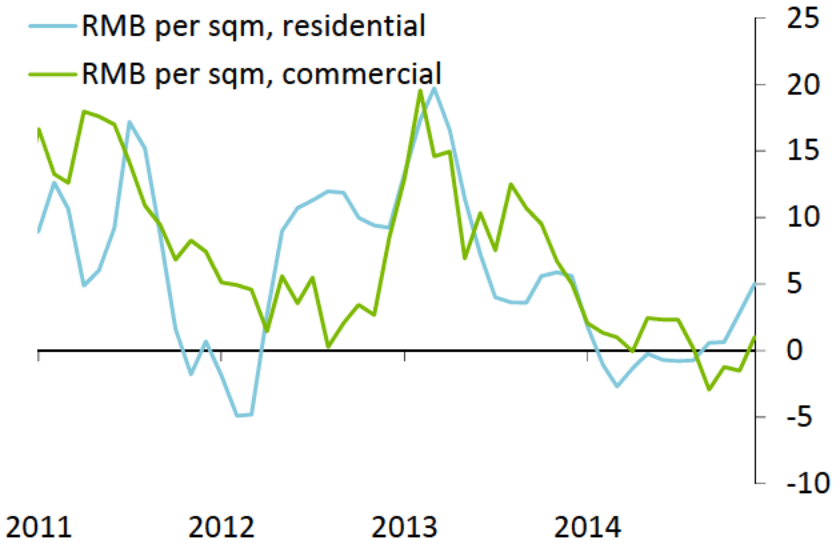
- **Russian** reserves at $376bn in January, down from $454bn in September, but still more than enough to cover external debt repayments due over the next two-years.
- Majority of debt owed by Russian corporations and banks and may prove difficult to roll if sanctions continue; decision to support these firms a political one.

- **Ukraine** has only $6bn of foreign reserves (1 month's imports) and the value of currency has halved since end-January.
- IMF Board expected to consider an Extended Funding Facility on 11th March. Likely to involve around $15bn of re-profiling/restructuring of private sector debt.

Risks from commercial property in China

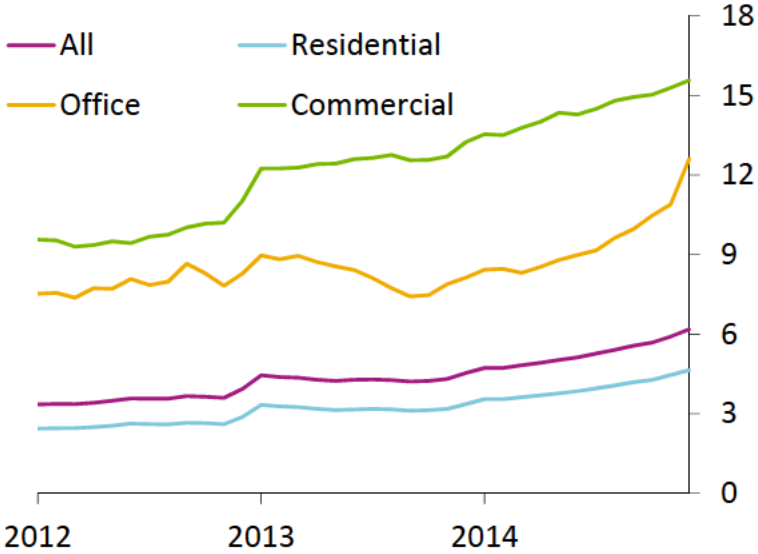
Property Prices

Percentage change on the year, 3m moving average



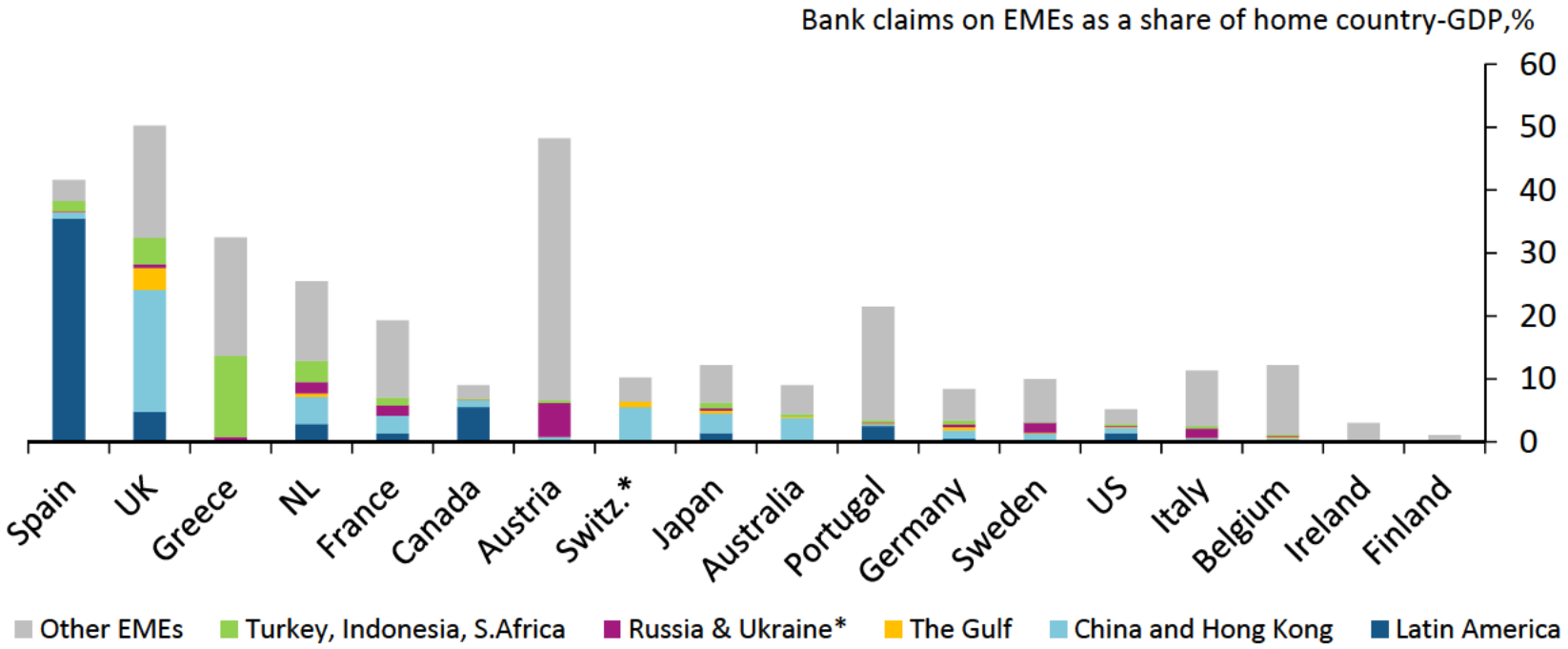
Overhang of unsold property

Months of new sales



- Targeted easing in the property market has led to some signs of stabilisation in the residential market, though situation for commercial property looks more precarious.
- For more details

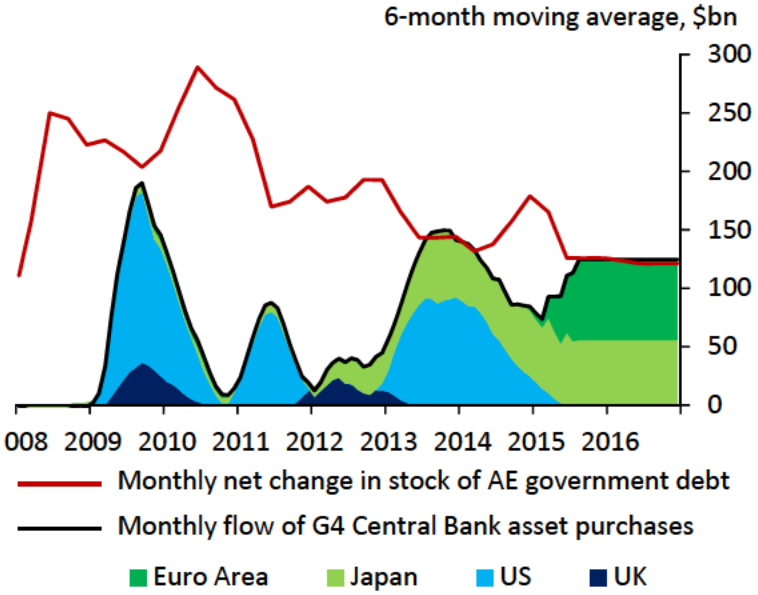
UK and Spanish banks most exposed to vulnerable EMEs



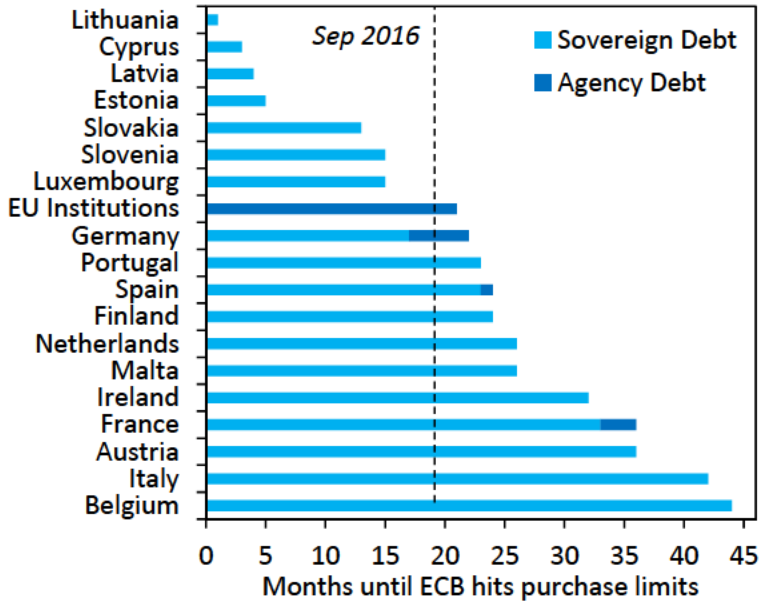
Divergent Prospects: ECB easing

ECB and BoJ QE enough to hoover up all net AE government bond issuance

Flow of QE and AE gov. bond issuance

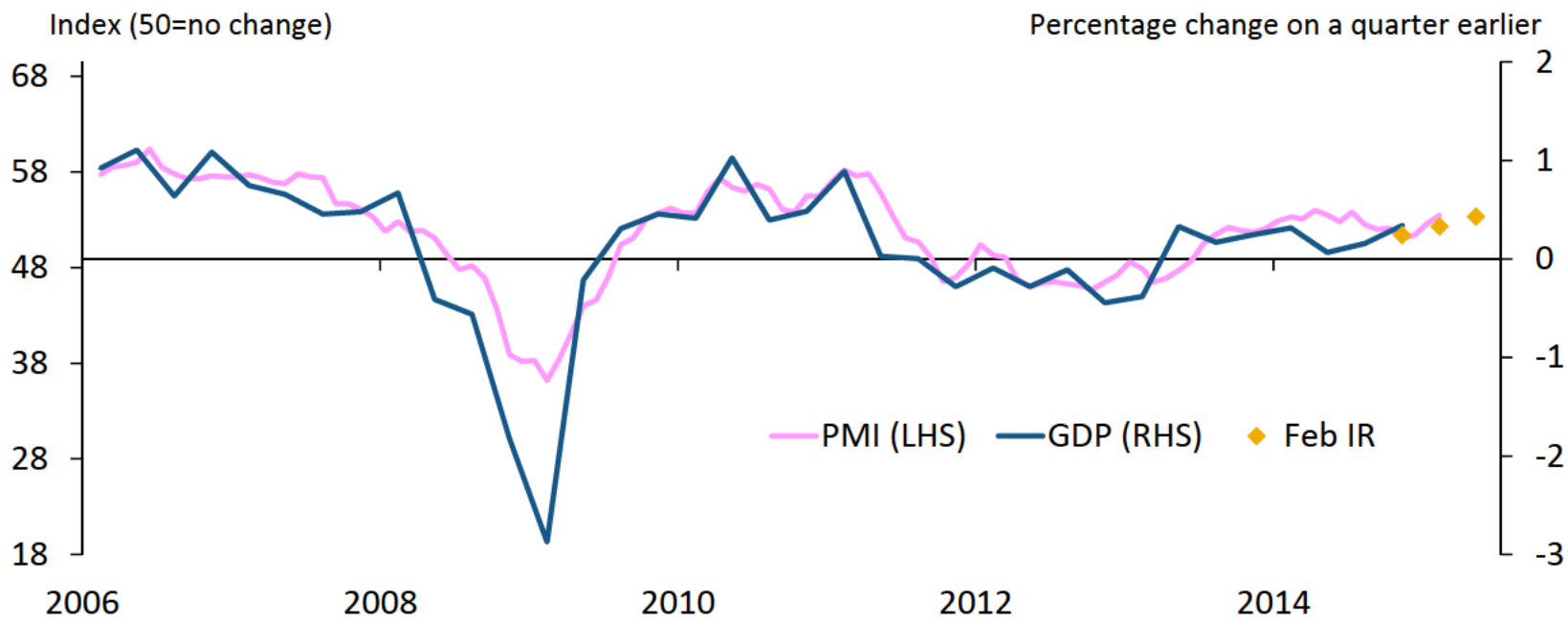


Months until ECB hits its QE purchase limits



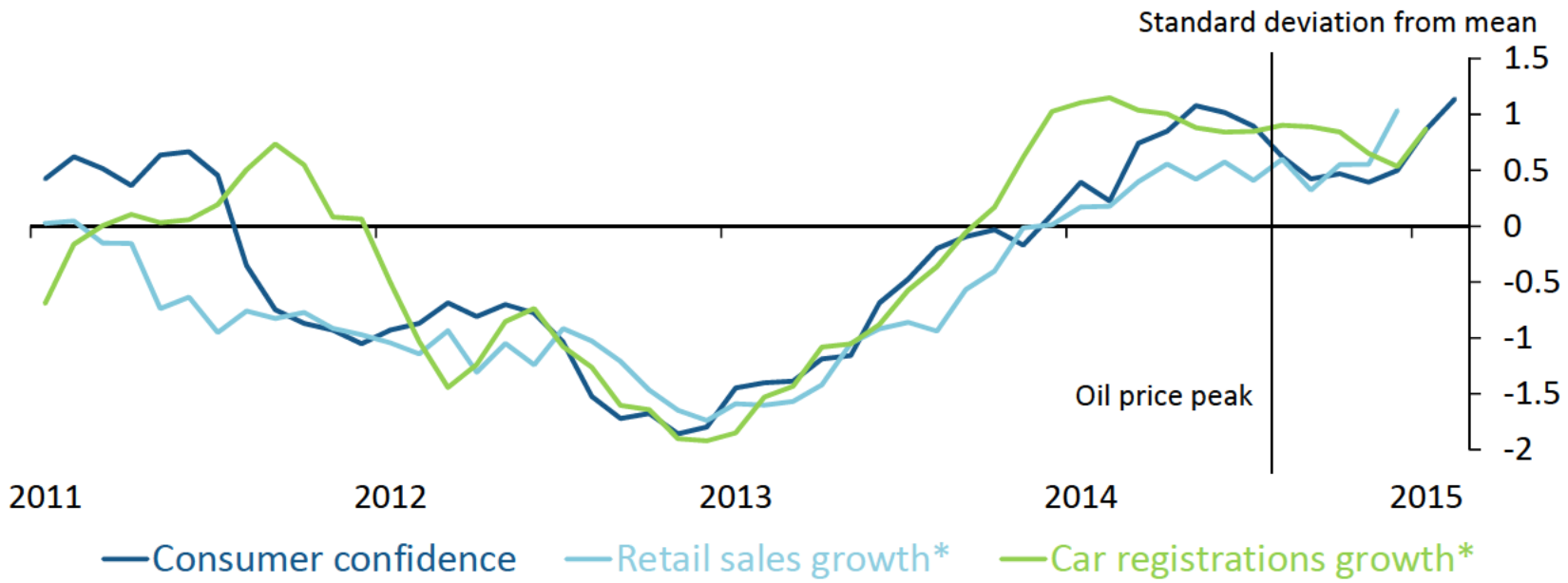
- Though, on current limits, ECB might run out of room for further purchases by September 2016.
- For more details see *International Economics Monthly: The Central Bank Relay - Passing the QE Baton*

EA growth picking up



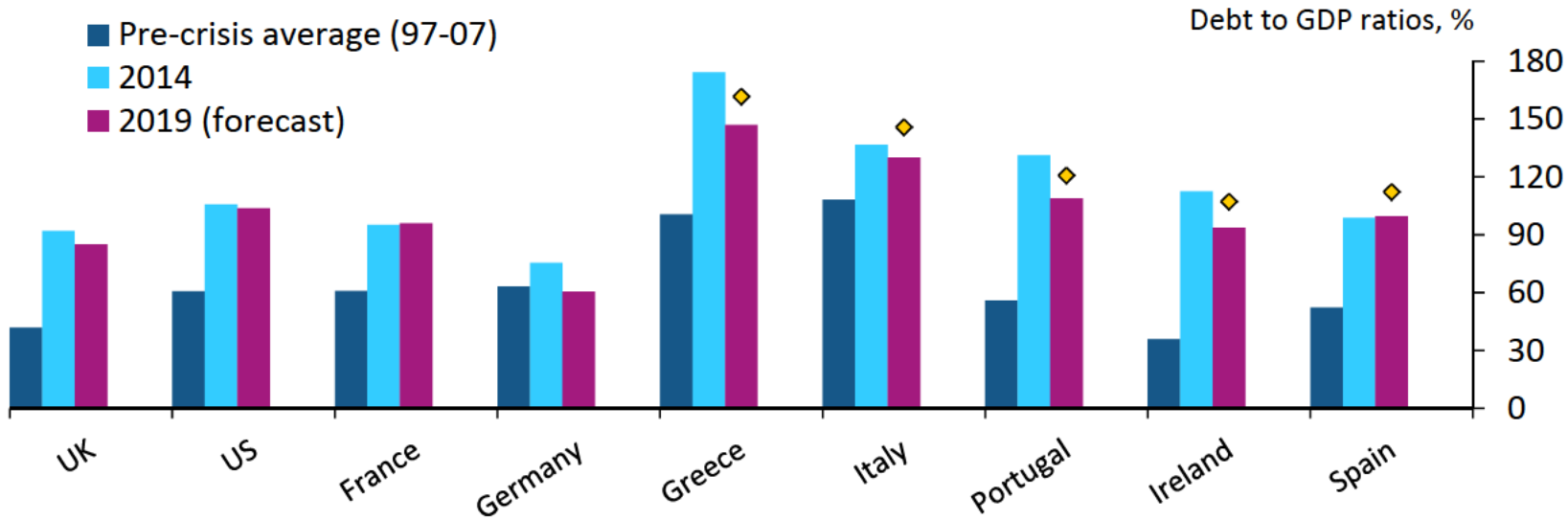
- Q4 GDP growth of 0.3% a tenth stronger than expected. Surprise driven by Germany, with consumption growth strong at 0.8%.

With signs of strength in consumption



All series are shown as standard deviations from mean for comparability.
** 3 month on 3 month a year ago growth rates*

€A periphery still vulnerable to weak growth



*Diamonds represent forecasts for debt-to-GDP ratios in 2019 under our 'severe' scenario, where inflation remains around 2pp lower per year than the current forecast

- For more details
- Japan is also vulnerable to weak nominal growth.

Greece

- Euro-group deal provisionally extends support programme until end-June.
- €7.2.bn disbursement would follow satisfactory review of reform efforts in April.
- The Greek government may need to raise cash ahead of then to cover €3.1bn of debt payments due; though there are some reports of stabilisation, further rapid deposit outflows would pose significant risks to banking system liquidity.
- A comprehensive deal will be needed by July. Deal might be possible if Greece underlines its commitment to structural reforms and creditors willing to accept an interest-rate waiver and lower targets for Greek primary surpluses.
- [redacted] for more details.

Summary

Outlook

- Oil prices up on the month following lower prospects for US supply. But 80% of price fall since the summer intact.
- Signs of boost from oil to €A consumption. Growth picking up slightly faster than expected in Feb IR.
- First decision on whether to increase US rates telegraphed for June. Weak productivity means growth in US unit labour cost has been picking up.
- Ukraine running out of money. IMF programme expected on 11 March.

Risks

- Trigger points in the summer: possible Fed tightening; outcome of Greek negotiations.
- Divergent monetary policy: Latin American corporates look most vulnerable to the dollar's appreciation.
- China hard landing: Measures taken to support residential market, but overhang of unsold commercial property.
- Vulnerabilities to low nominal GDP growth: Lower oil price and ECB QE has reduced probability of debt deflation. Elevated debt-levels leave periphery vulnerable to shocks.

End

6: Credit Conditions

Credit Conditions

Joint FPC/MPC Briefing Meeting 27 February 2015

Prepared by MA, SRDD, FSSR, PRA

Agenda

How do outturns for:

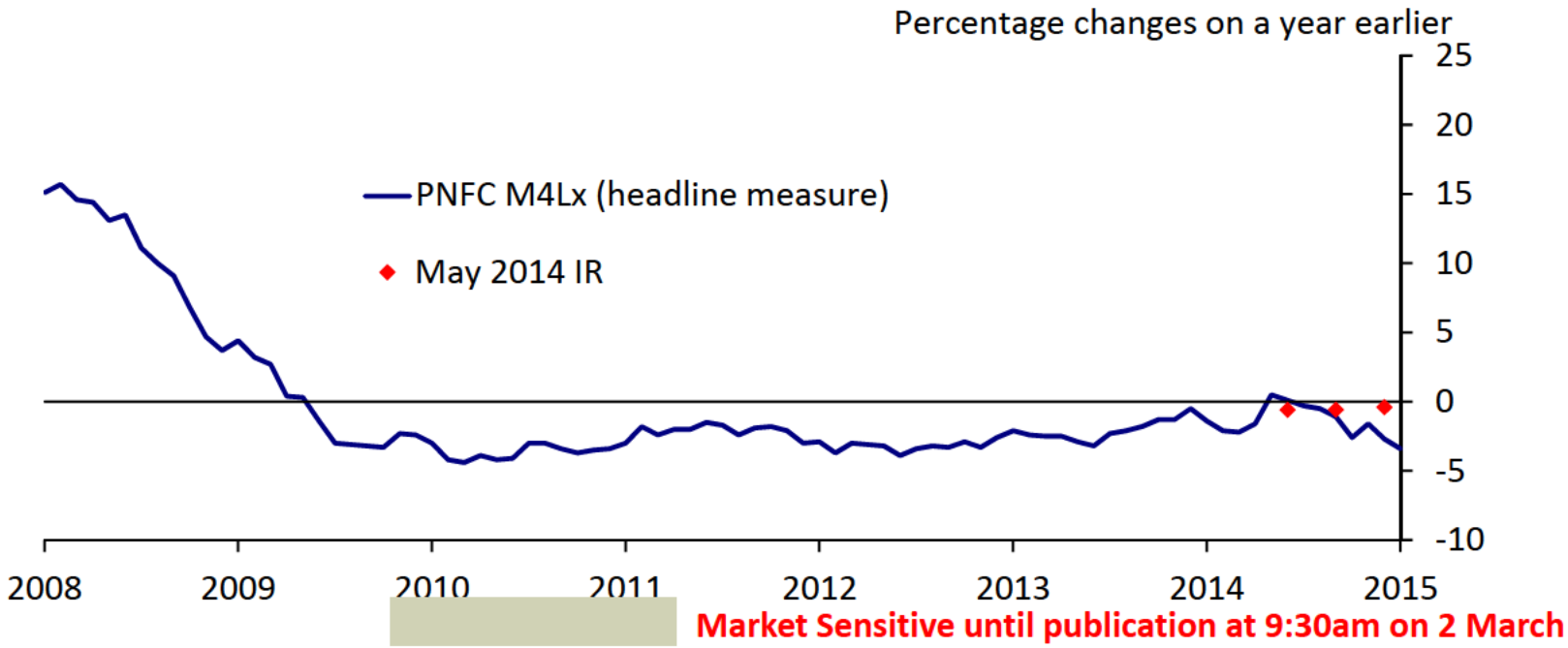
- Corporate lending
- Household lending

Compare with our May 2014 *Inflation Report* forecasts*

* The baseline for the FPC's 2014 housing recommendations

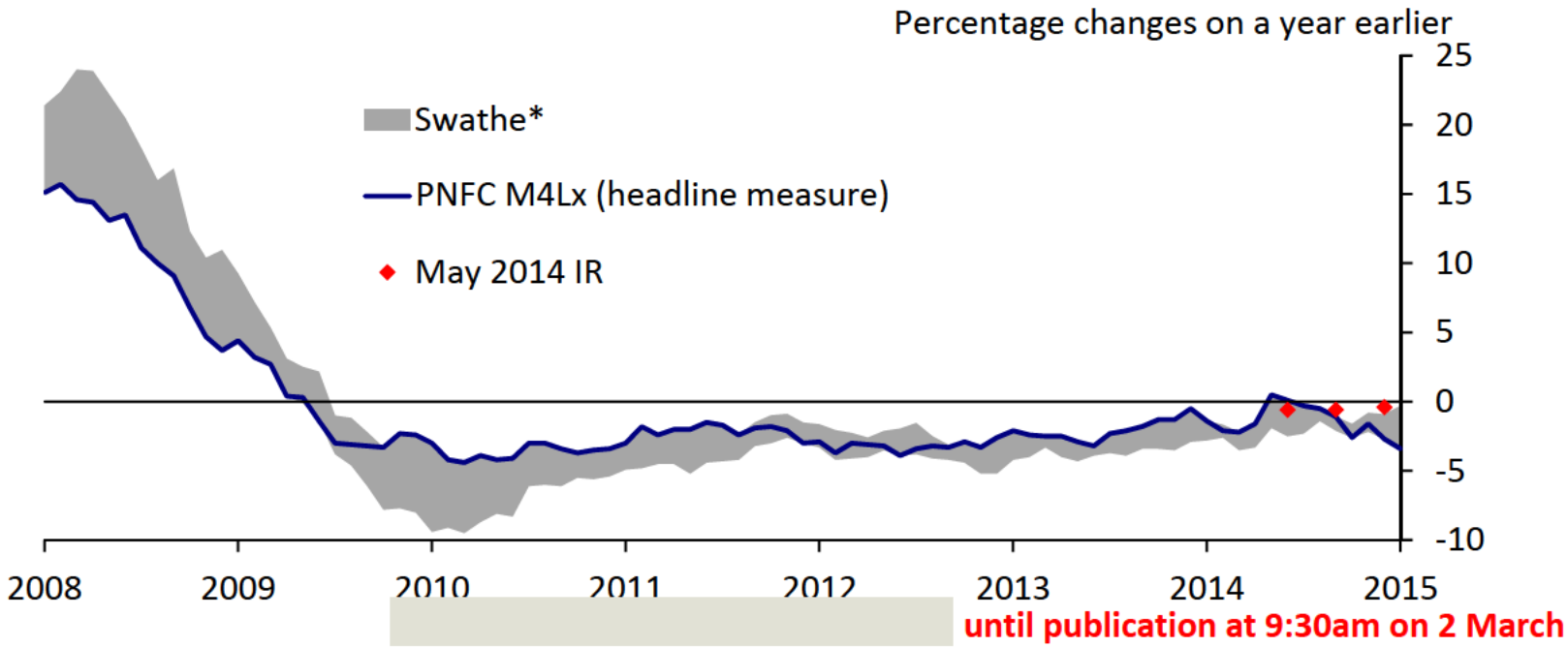
Headline measure of corporate lending contracted in H2…

Measures of lending to UK businesses



...but headline data overstate the fall in corporate lending (a little)

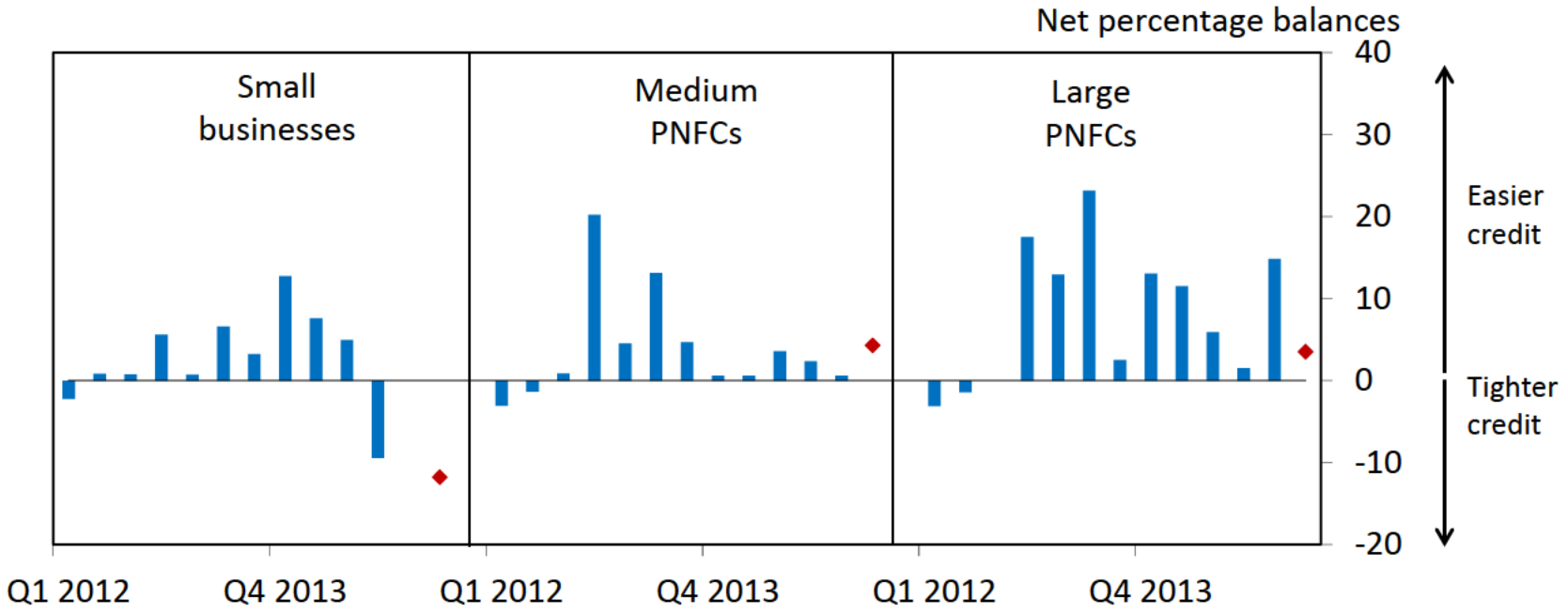
Measures of lending to UK businesses



*PNFC M4Lx (SA), sterling loans to PNFCs (SA), all currency loans to PNFCs (SA) and all currency loans to non-financial businesses (NSA)

Credit availability has improved for large PNFCs…

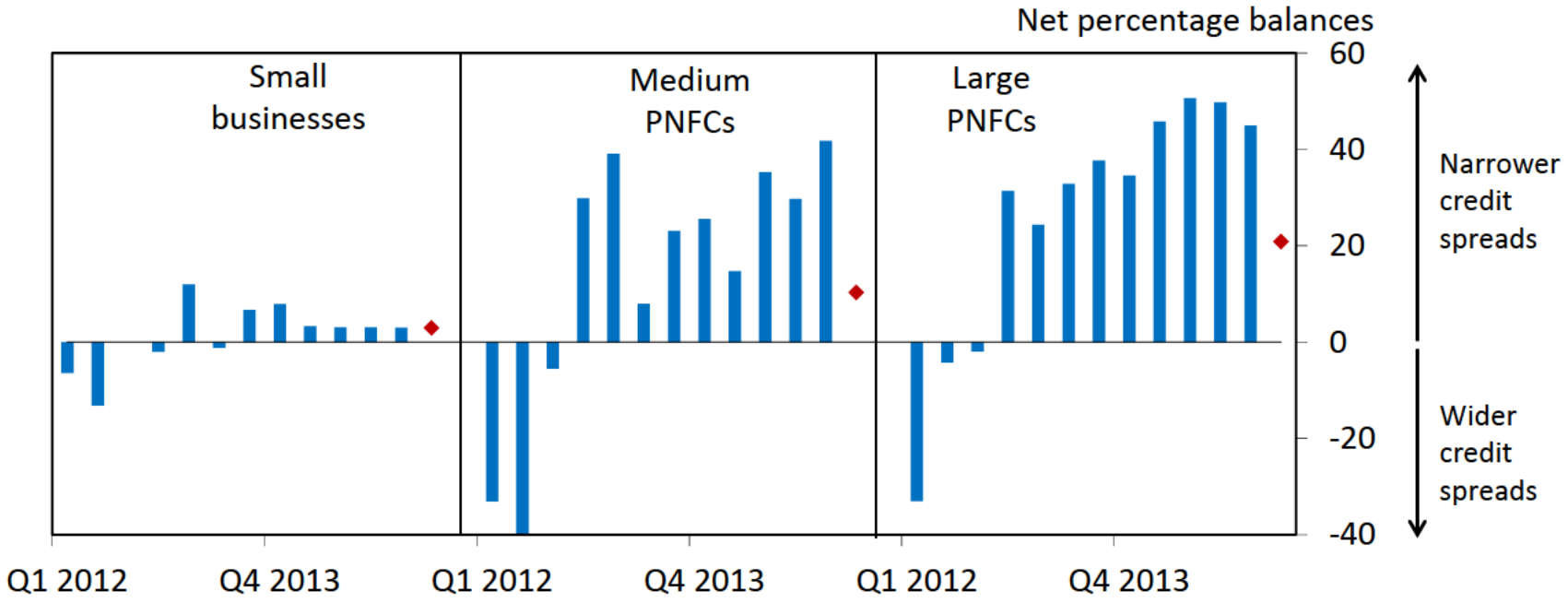
Credit availability to corporates by firm size, Credit Conditions Survey



Bars show responses over previous three months, diamond shows expectation for next 3 months

… and spreads on lending to large/medium PNFCs have narrowed

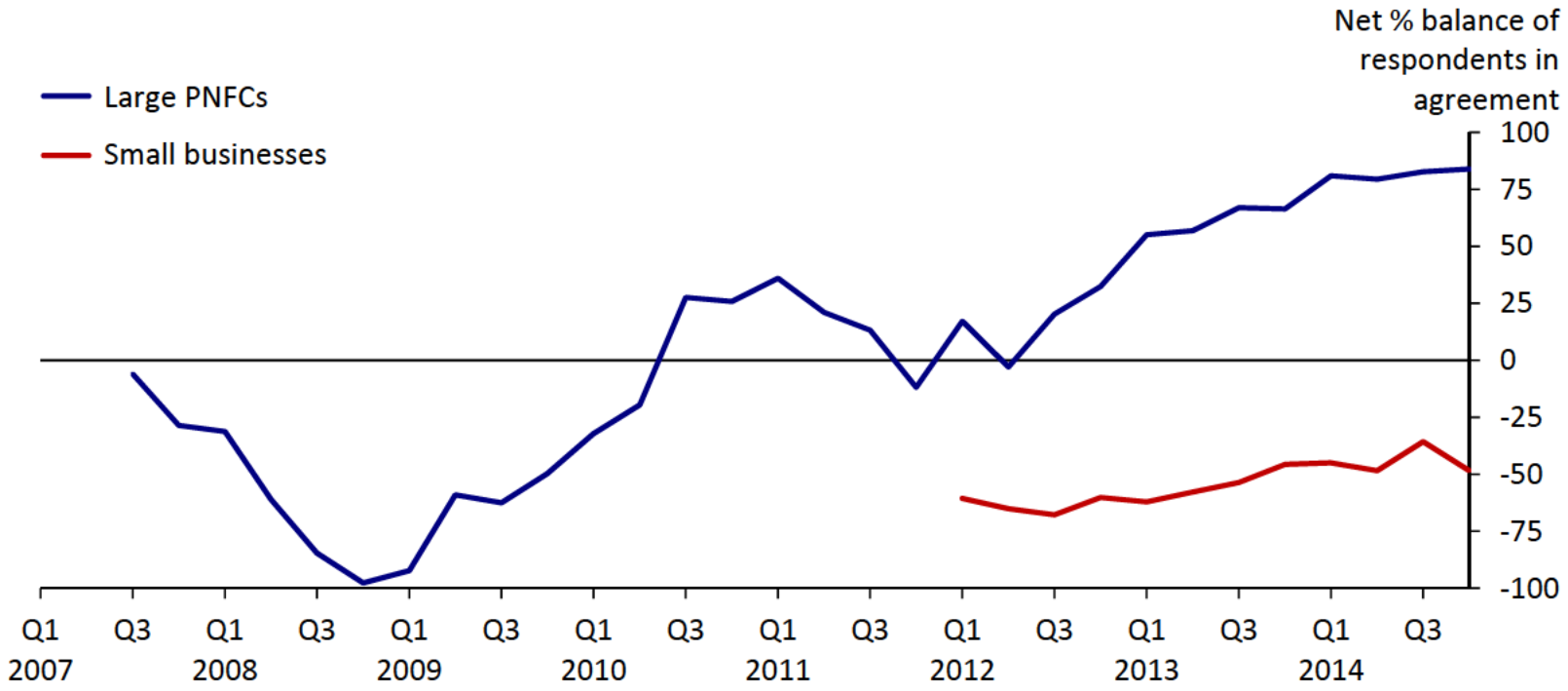
Spreads on lending to corporates by firm size, Credit Conditions Survey



Bars show responses over previous three months, diamond shows expectation for next 3 months

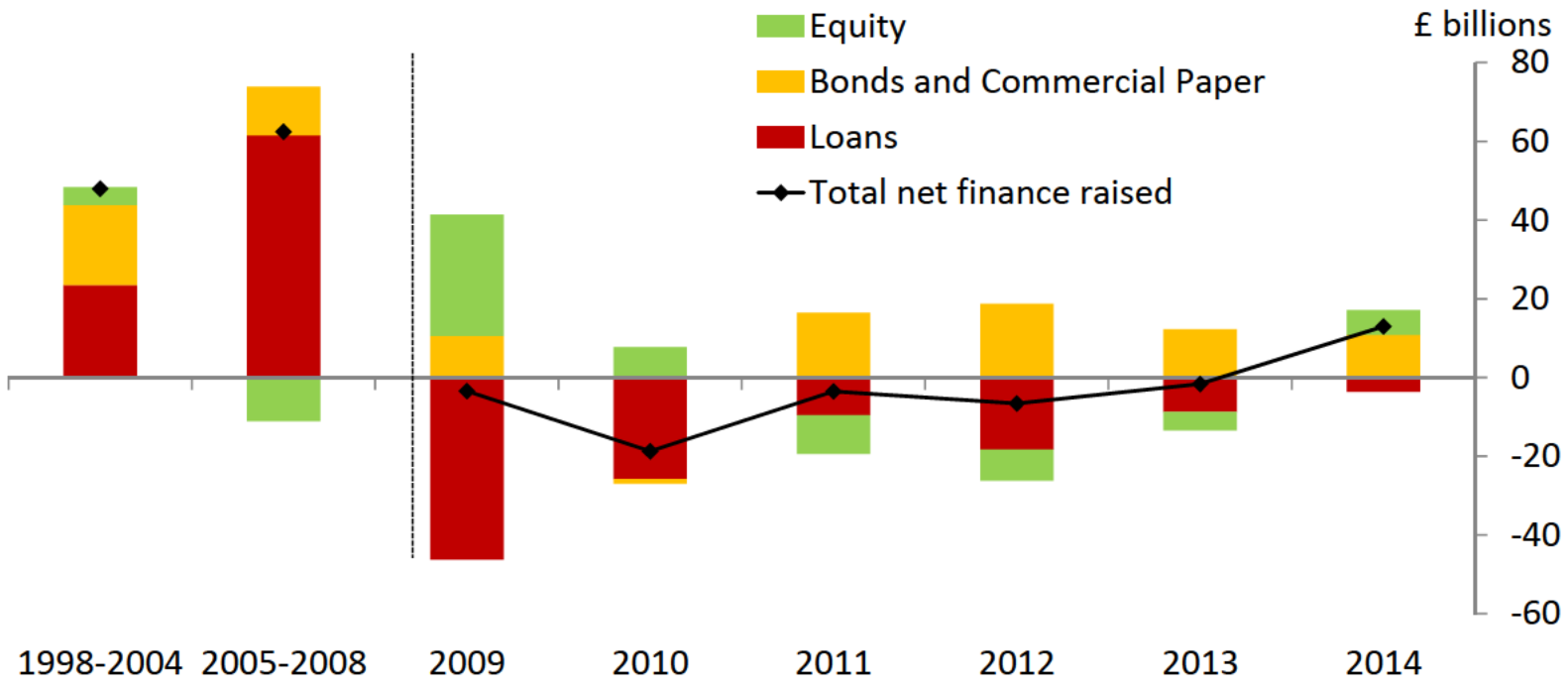
Large companies see credit conditions as easy; small firms do not

Deloitte CFO and FSB surveys: is credit easily available?



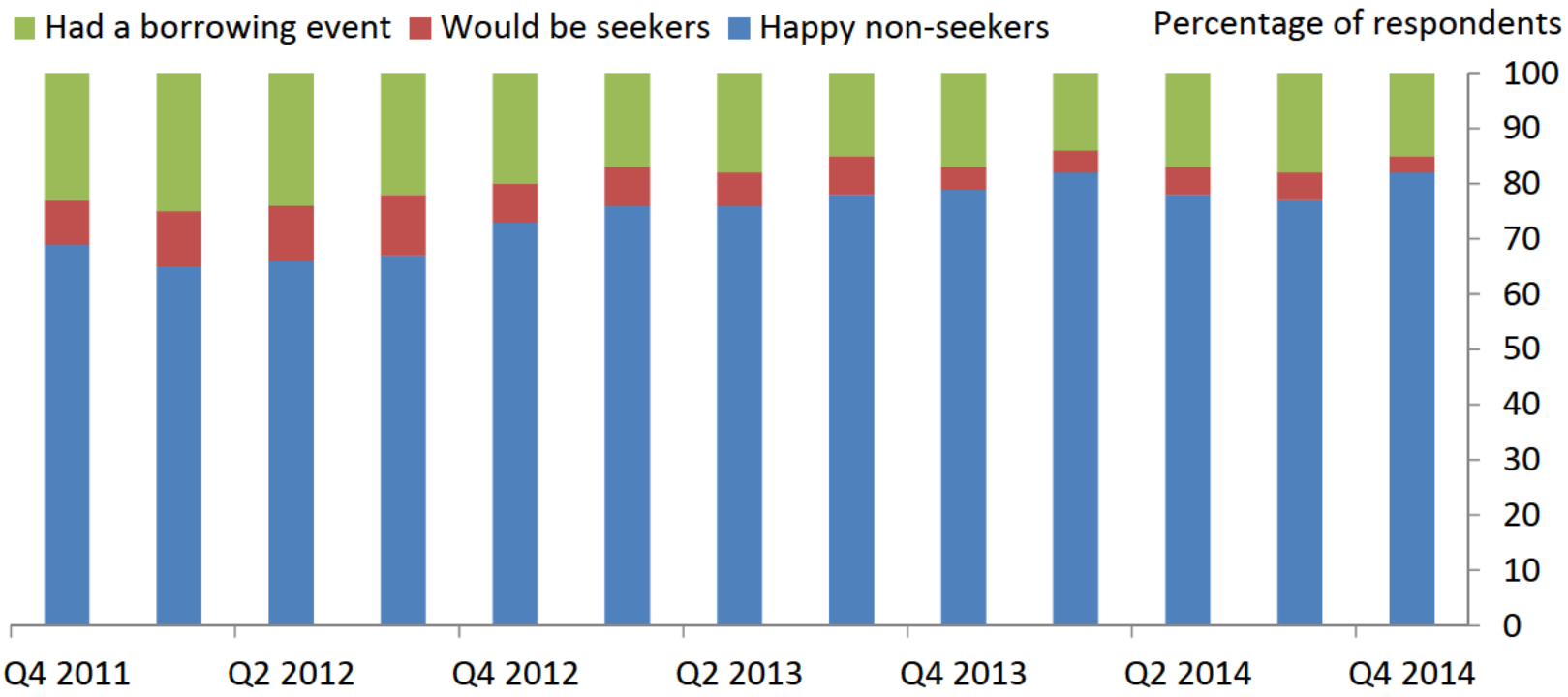
Large companies are increasingly raising finance from capital markets…

Net finance raised by PNFCs from capital markets and UK MFIs



… and small firms remain 'happy non-seekers' of credit

Responses to SME Finance Monitor: approach to bank credit over previous 12 months

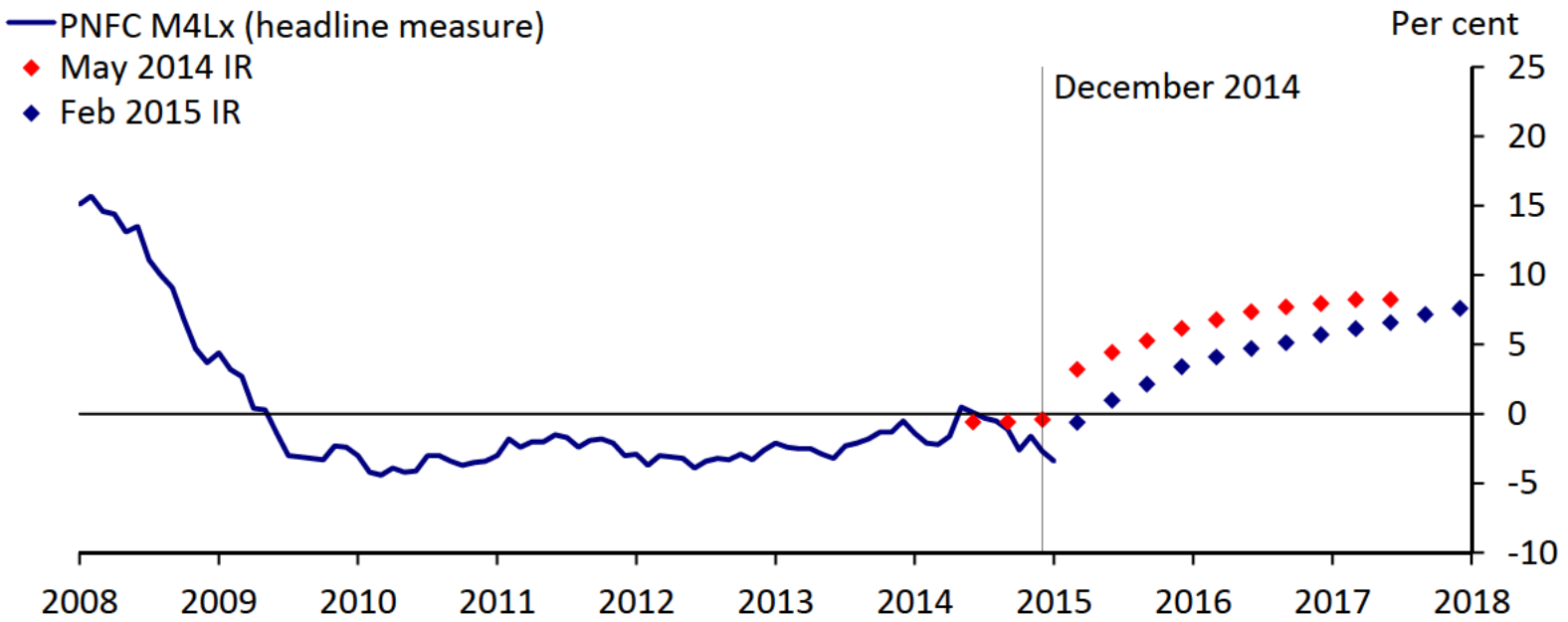


Summary: credit demand drives weaker-than-expected corporate lending…

- Credit getting easier and cheaper for large corporates
- Conditions in mid-market improving, but still tight for smallest corporates
- Demand for external finance from large firms has picked up a little, financed by capital markets
- Credit demand remains very weak for small firms

… but bank lending expected to pick up to finance corporate spending

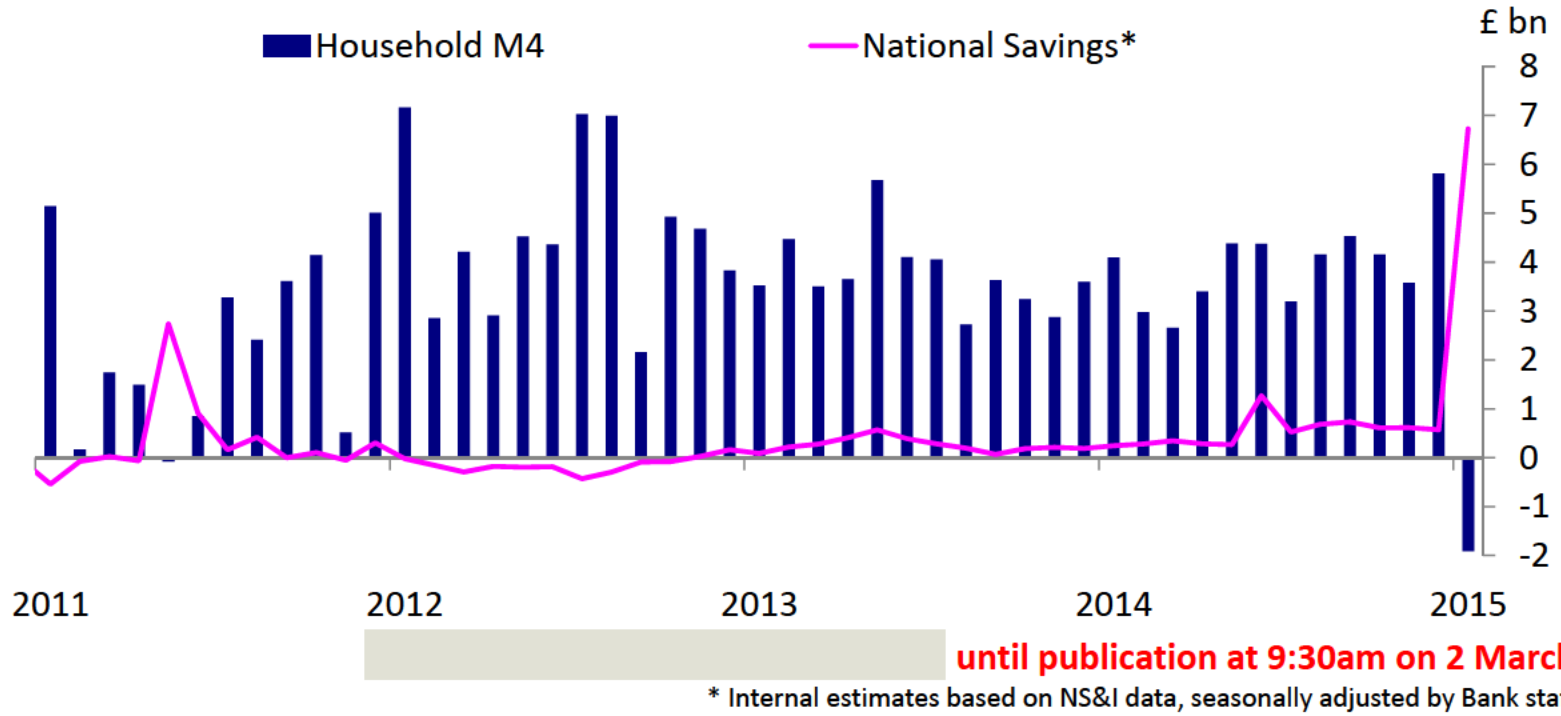
PNFC lending, 12m growth



until publication at 9:30am on 2 March

Uptake of pensioner bonds leads to fall in household M4 in January

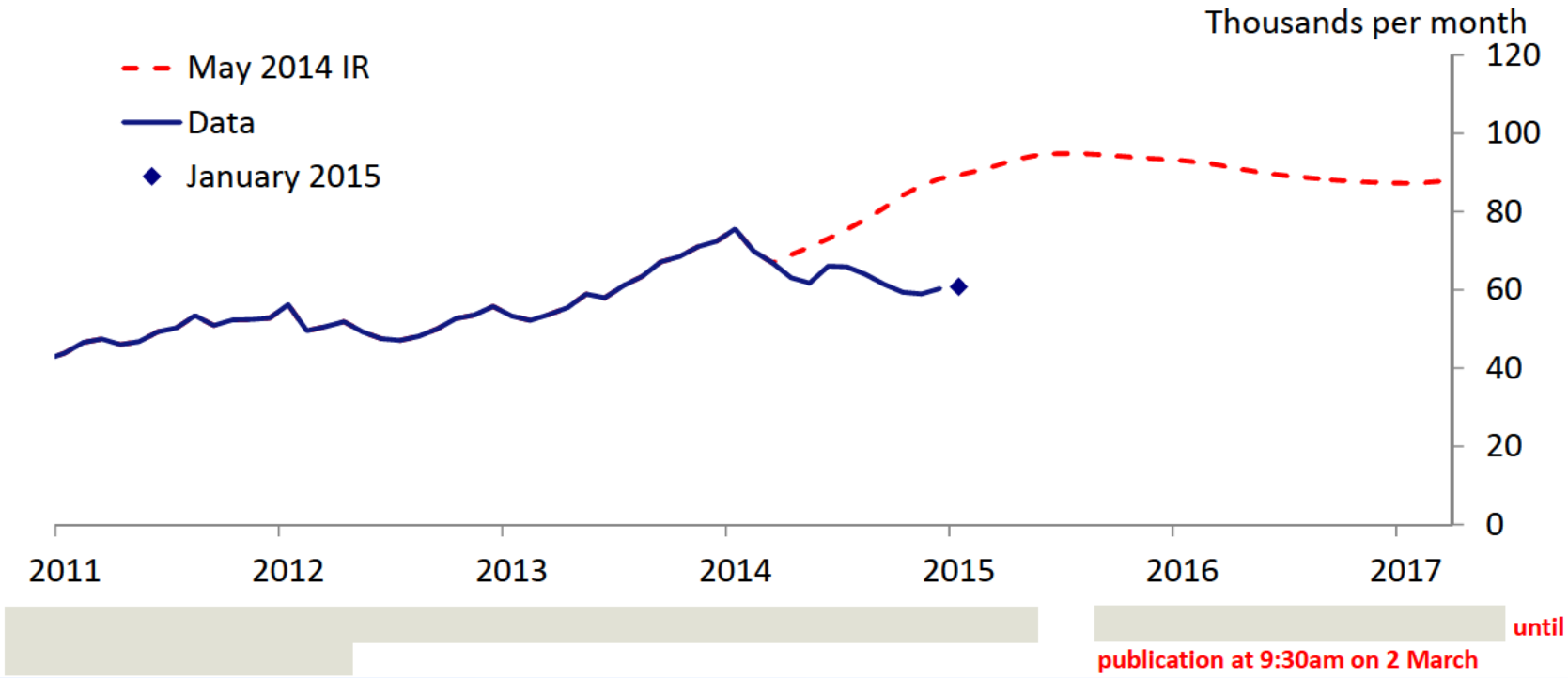
Flows into selected household liquid assets, SA



* Internal estimates based on NS&I data, seasonally adjusted by Bank staff

Approvals have disappointed relative to May 14 forecast…

Mortgage approvals for house purchase, SA



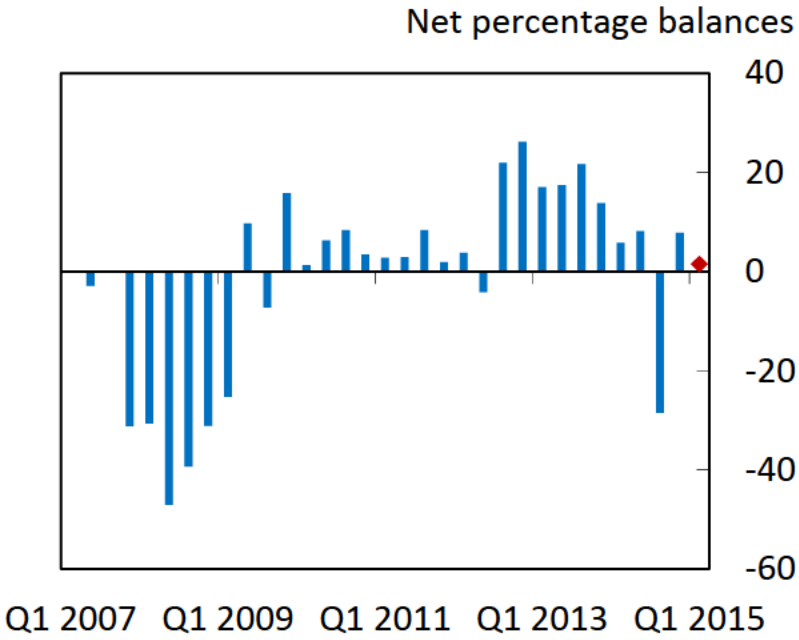
… consistent with over-estimation of churn in market

In our May 2014 forecast, we took insufficient account of the disincentives to move house associated with:

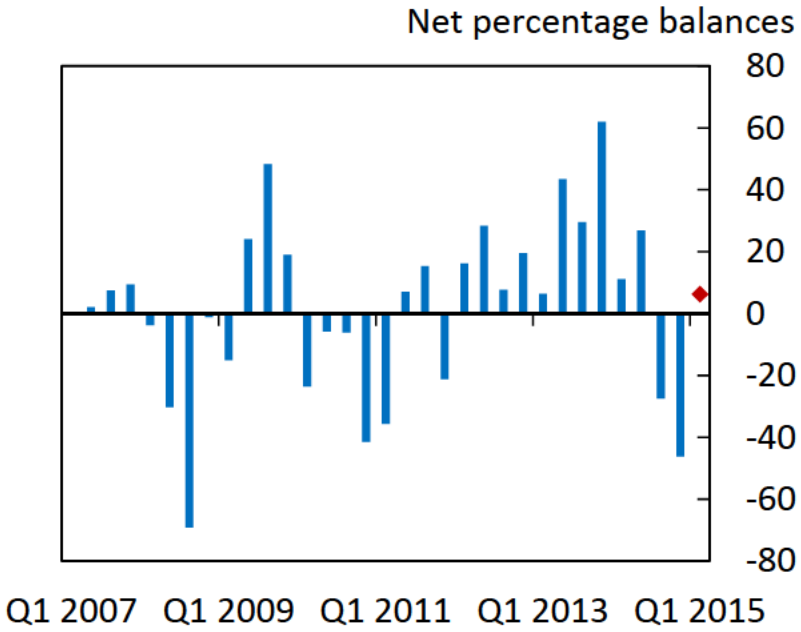
- Banks price discriminating more across LTVs
- Up to a quarter of mortgagors not being able to refinance
- A quarter of mortgagors paying rates below current market rates

CCS points to both credit demand and supply factors in 2014 H2…

Household secured credit availability



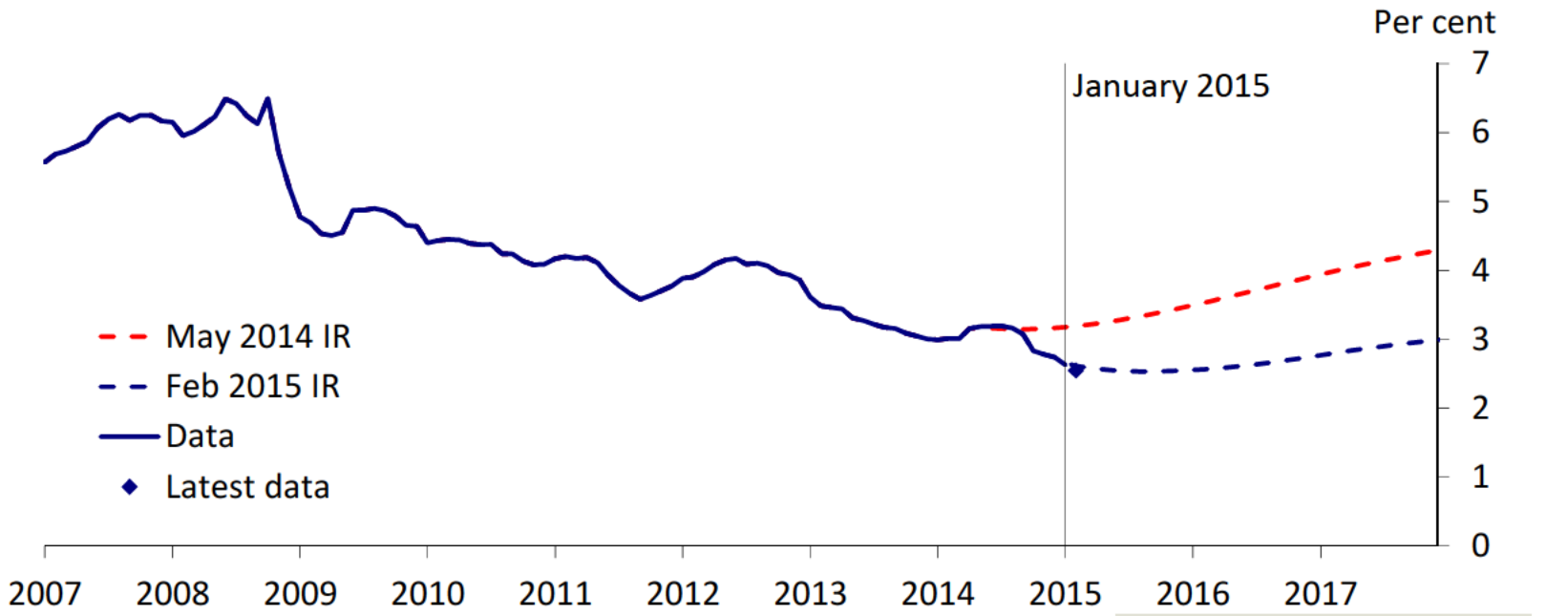
Household demand for secured lending to finance a house purchase



Bars show responses over previous three months, diamond shows expectation for next 3 months

… and mortgage rates have fallen significantly…

Weighted average quoted mortgage rate*, May 2014 *IR* and February 2015 *IR* forecasts

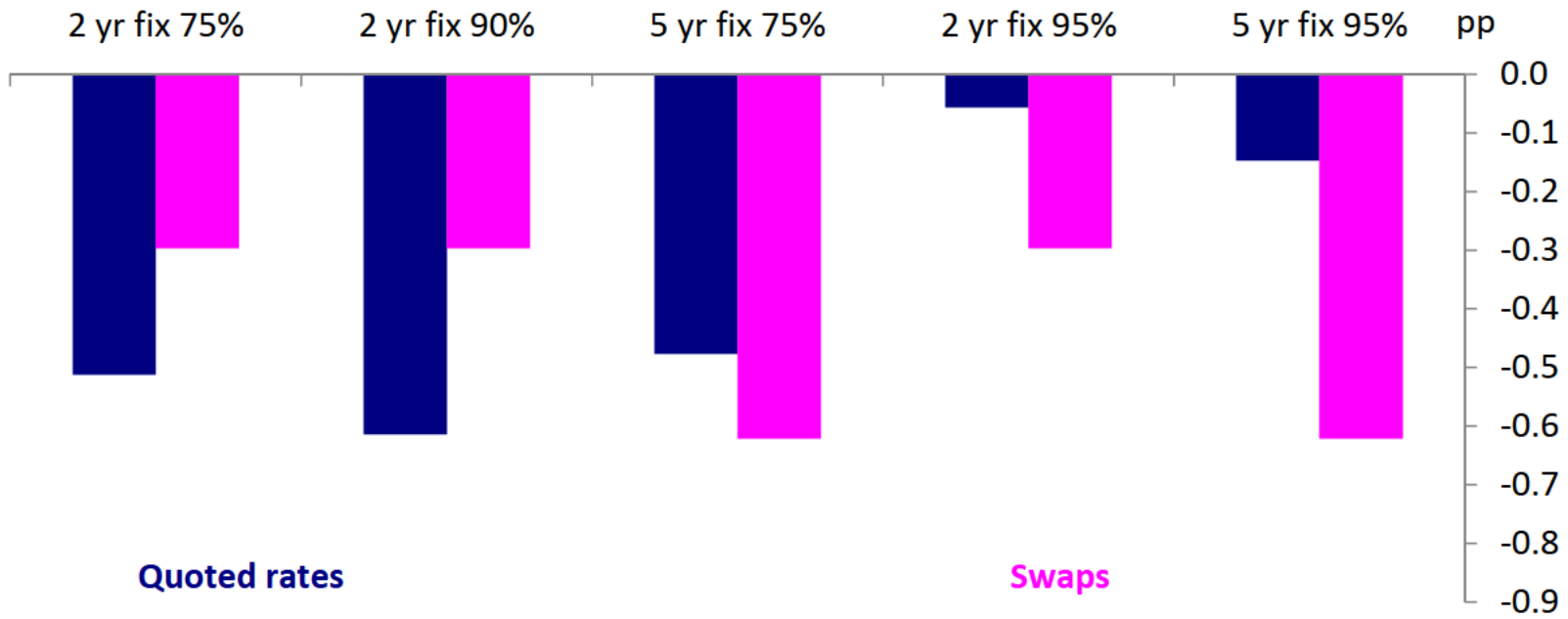


* Rates included: Lifetime tracker 75% LTV, 2 year fix 75% LTV, 5 year fix 75% LTV, 2 year fix 90% LTV

until publication at 9:30am on 2 March

… particularly in competitive segments in 2014H2…

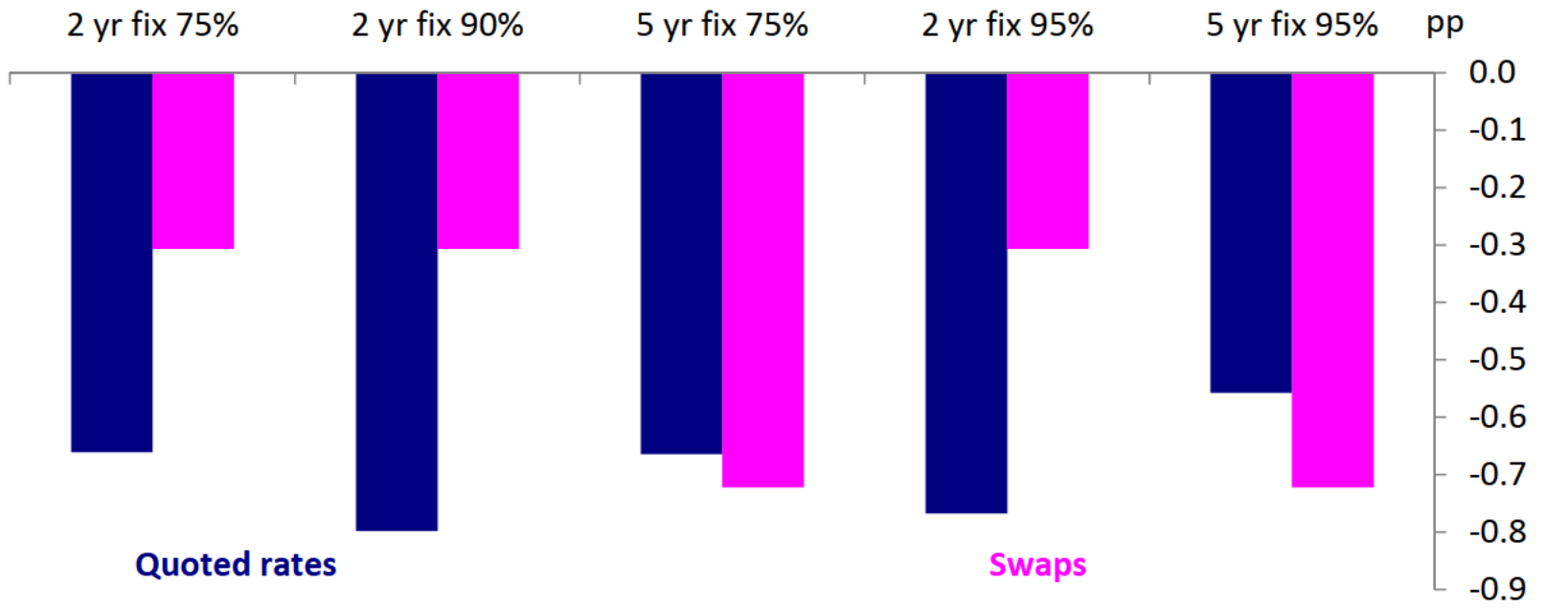
December 2014 vs June 2014, changes in quoted mortgage rates and swaps



until publication at 9:30am on 10 March

… and in other segments so far in 2015

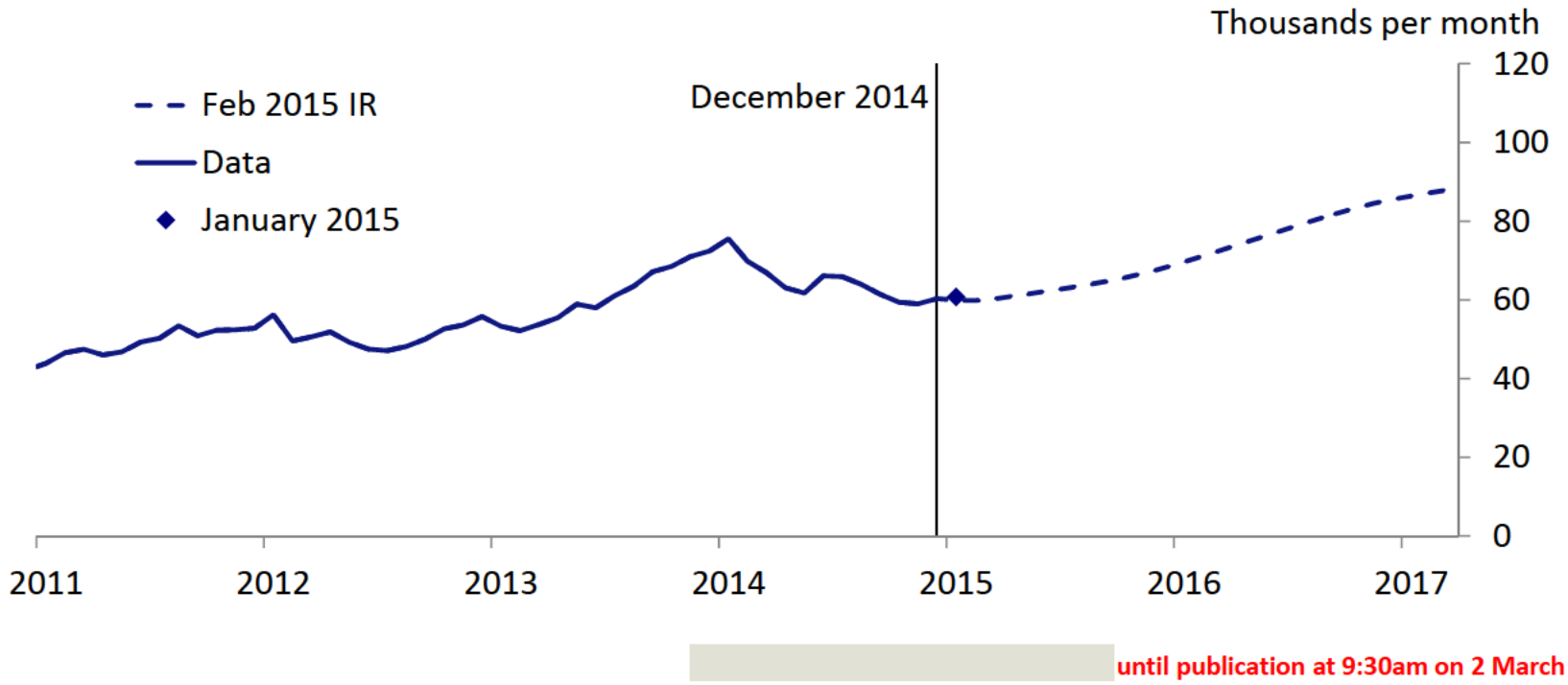
February 2015 vs June 2014, changes in quoted mortgage rates and swaps



until publication at 9:30am on 10 March

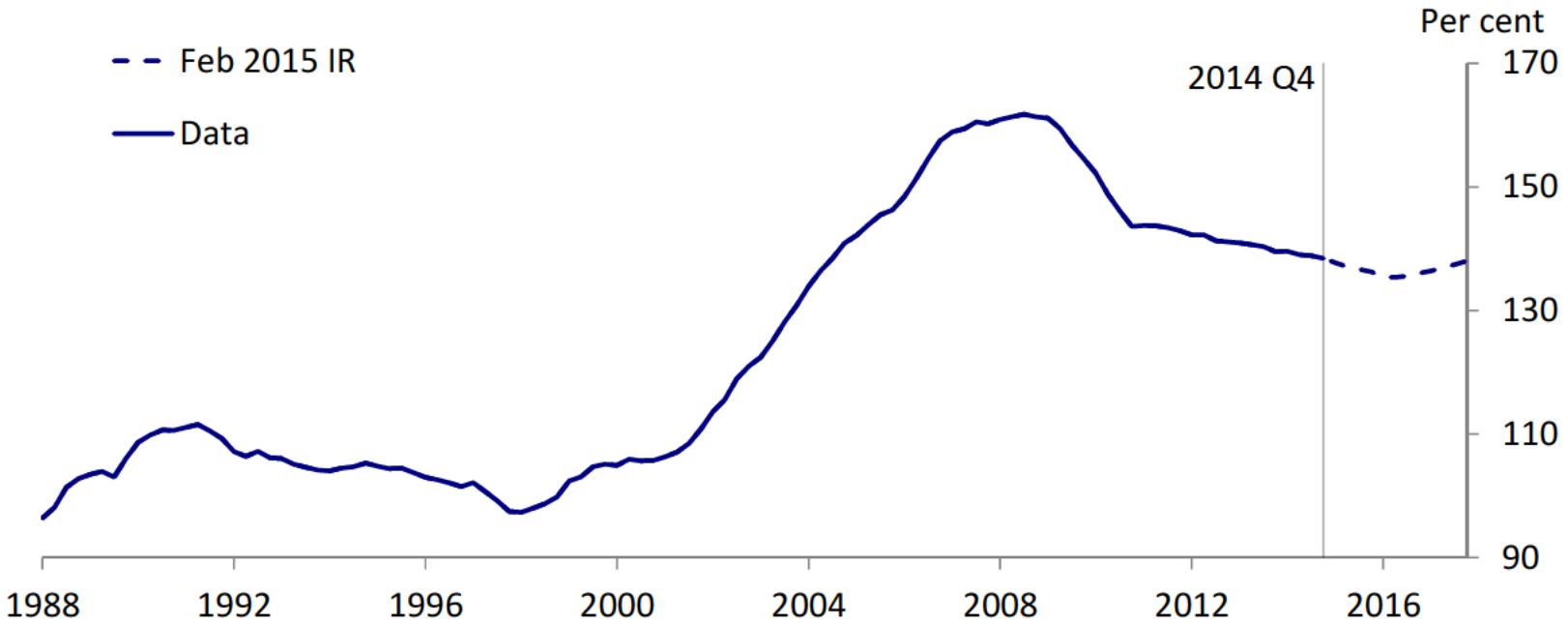
We expect approvals to pick up as lower rates boost demand

Mortgage approvals for house purchase, SA



Household debt to income ratio is expected to be broadly flat

Household debt to income ratio



Summary: why was housing activity weaker than expected?

- Weaker-than-expected home-mover activity;
- Lower credit demand; and
- Slightly larger-than-expected impact of MMR.

But…

- Large recent falls in mortgage rates should act to boost housing activity going forwards.

7: Domestic Real Economy

Domestic real economy

- Housing and impact of FPC LTI policy

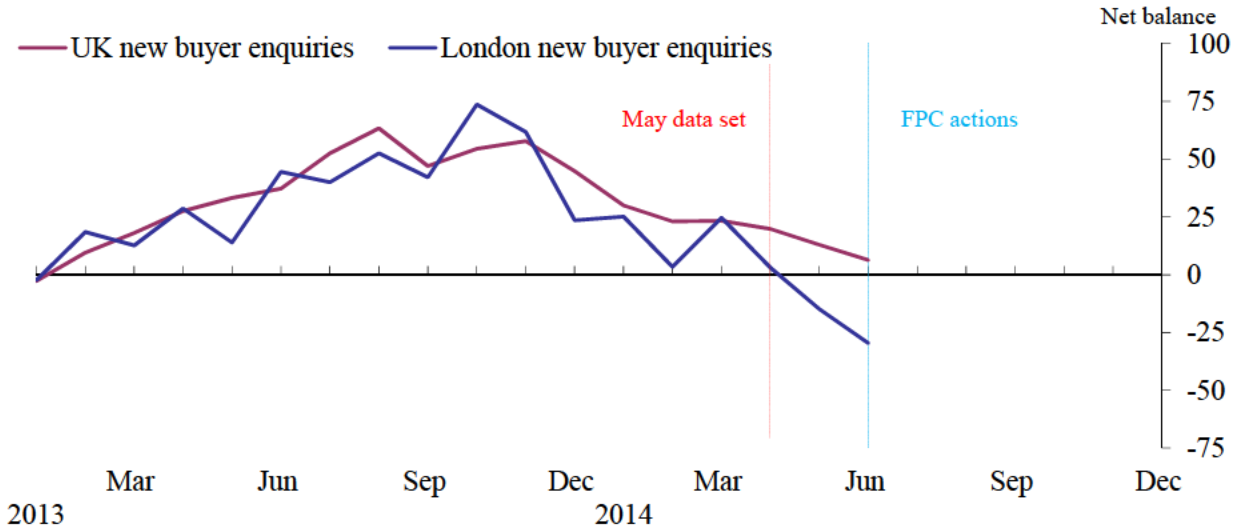
See Recent developments in, and prospects for, the housing market

- Current account update

See

Prepared by FSSR-MRD, MA-SEAD, MA-MASD and ID-GSID
27th February 2015

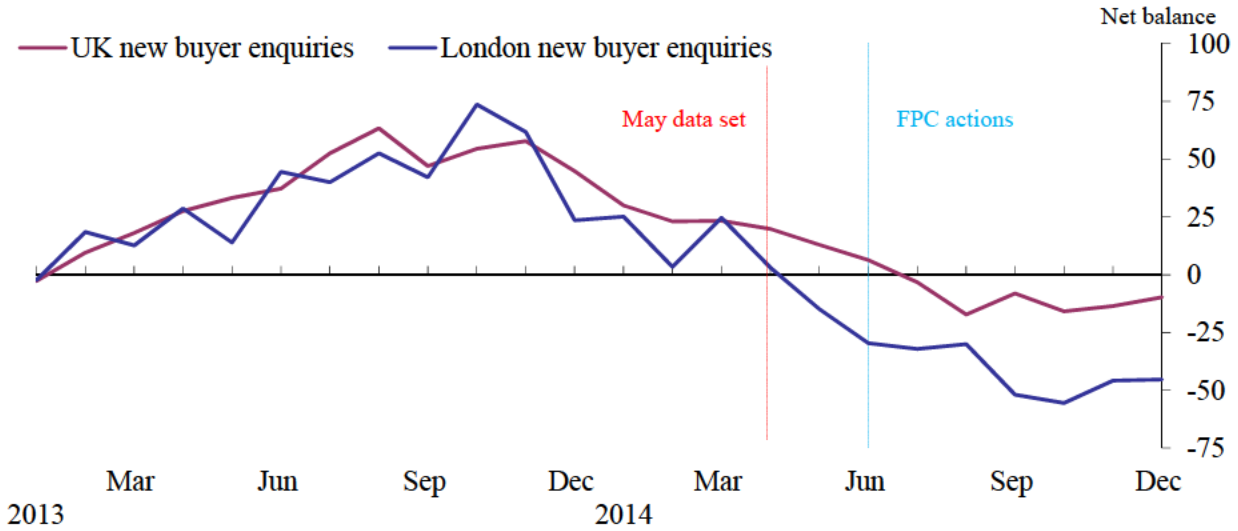
When did the slowdown start ?



Source: RICS

See 'Recent developments in, and prospects for, the housing market'

When did the slowdown start ?



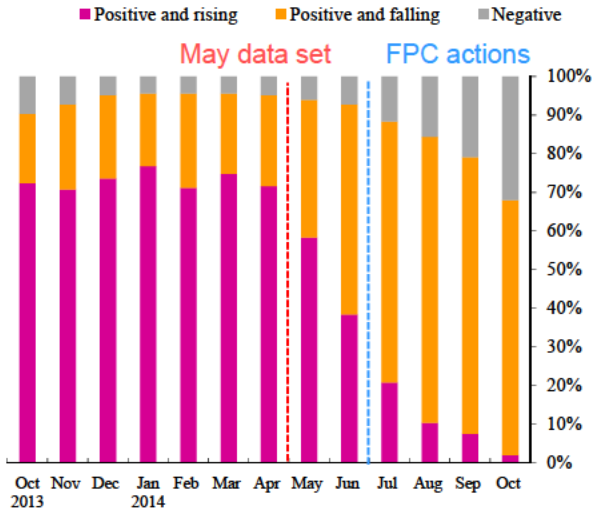
Source: RICS

See 'Recent developments in, and prospects for, the housing market'

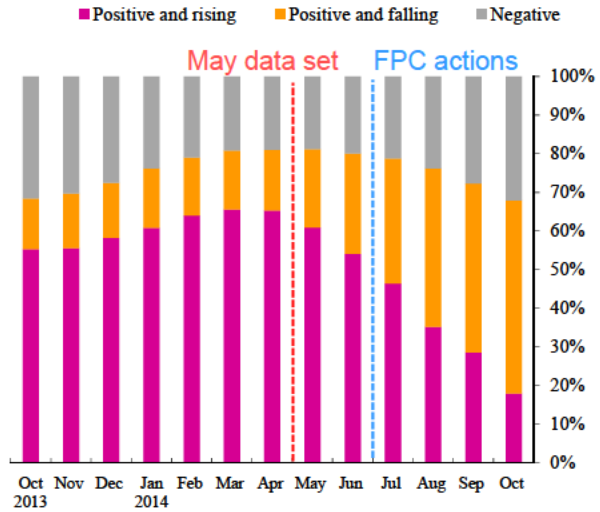
When did the slowdown start ?

Proportion of postcodes with positive/negative house price inflation

London



UK



FPC impact on credit supply and lack of substitution

	Lender	LTI restriction	Maximum estimated impact on lending for house purchase (% of loans)
Pre-FSR		4 if loan value>£500k	0.1%
		4 if loan value>£500k	0.1%
		5 (down from 6)	0.8%
Post-FSR		4.75	0.4%
		4.5	0.2%
	Total		**0.6-1.6%**

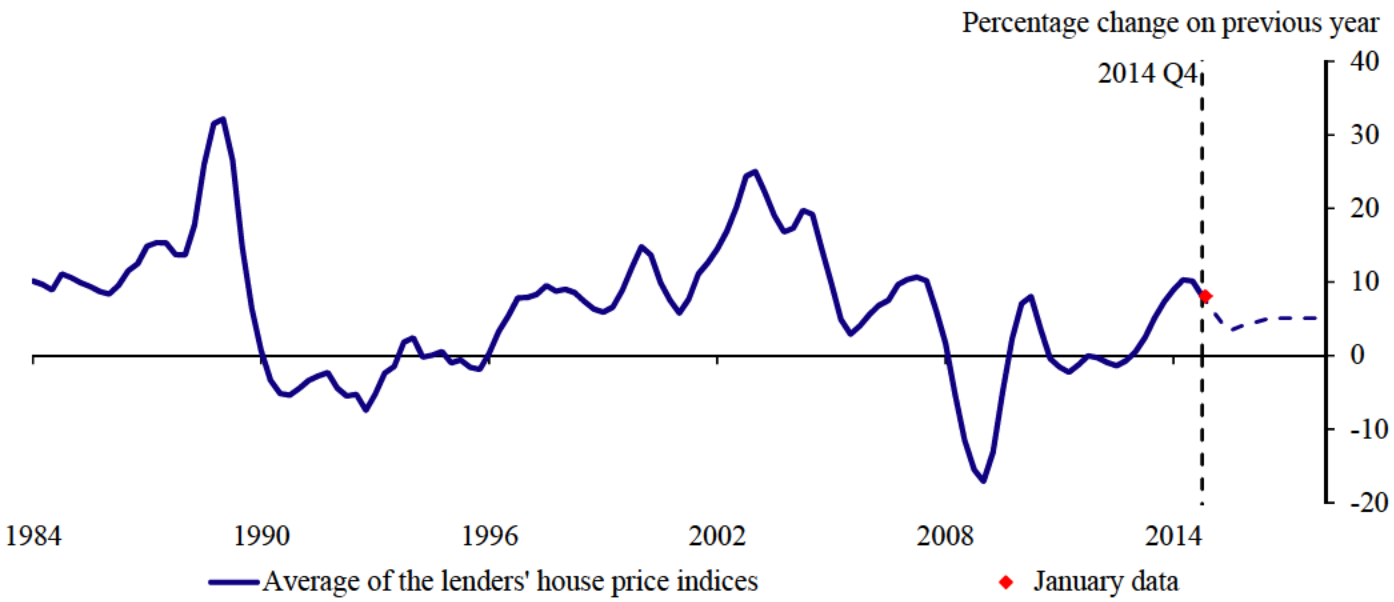
* Not publically announced

FPC impact on credit supply and lack of substitution

	Lender	LTI restriction	Maximum estimated impact on lending for house purchase (% of loans)
Pre-FSR	LBG	4 if loan value>£500k	0.1%
	RBS	4 if loan value>£500k	0.1%
	Santander*	5 (down from 6)	0.8%
Post-FSR	Nationwide	4.75	0.4%
	HMT H2B	4.5	0.2%
	Total		**0.6-1.6%**
2015	Barclays	4.5	~1.2%
	Santander	4.5 for FTBs	~0.8%
	Total		**~2%**

* Not publically announced

Housing market outlook and risks



Housing market outlook and risks

Risk	Direction	Timing
FPC policy affects lender behaviour	↓	Short term
Political uncertainty, particularly surrounding the election	↓	Short to medium term
Search for yield fuels buy-to-let market	↑	Short to medium term
Irrational exuberance by owner occupiers due to extrapolative expectations, strong house price inflation and low interest rates	↑	Medium term
Housing supply rises faster than expected	↓	Medium to long term

Domestic real economy

- Housing and impact of FPC LTI policy

See Recent developments in, and prospects for, the housing market

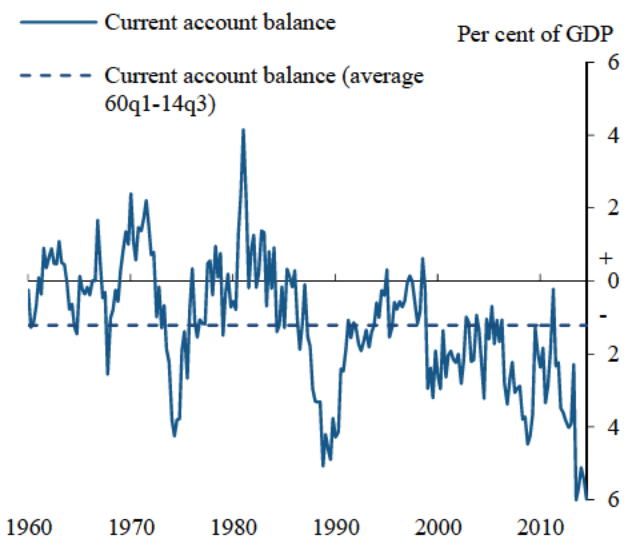
- **Current account update**

See

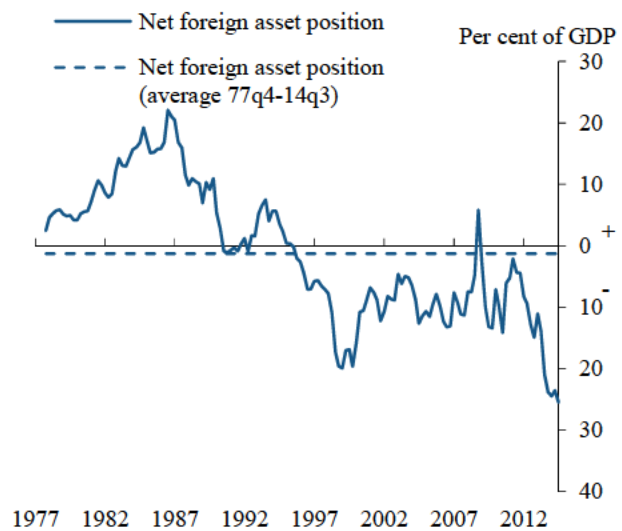
Prepared by FSSR-MRD, MA-SEAD, MA-MASD and ID-GSID
27th February 2015

FPC core indicators

i) Current account balance



ii) Net foreign asset position



Note: this series is based on ONS data, without the in-house market value adjustment to FDI stocks

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A helpful(!?) accounting framework

Sector: **UK**

trade balance
+
income balance
=
current account

A helpful(!?) accounting framework

Sector: **UK**

current account

=

+ new assets

- new liabilities

A helpful(!?) accounting framework

Sector: **UK**

	current account
	=
Financial accounts	+ new assets - new liabilities
Balance sheets	Assets Liabilities

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A helpful(!?) accounting framework

Sector: **UK**

	current account
	=
Financial accounts	+ new assets
	- new liabilities
Balance sheets	Assets
	-
	Liabilities
	Net foreign asset position

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A helpful(!?) accounting framework

Sector:	**UK**
Income accounts	trade balance + income balance
	current account
	=
Financial accounts	+ new assets - new liabilities
Balance sheets	Assets - Liabilities
	Net foreign asset position

A helpful(!?) accounting framework

Sector:	**UK**
Income accounts	trade balance + income balance = current account
	=
Financial accounts	+ new assets - new liabilities
Balance sheets	Assets - Liabilities Net foreign asset position

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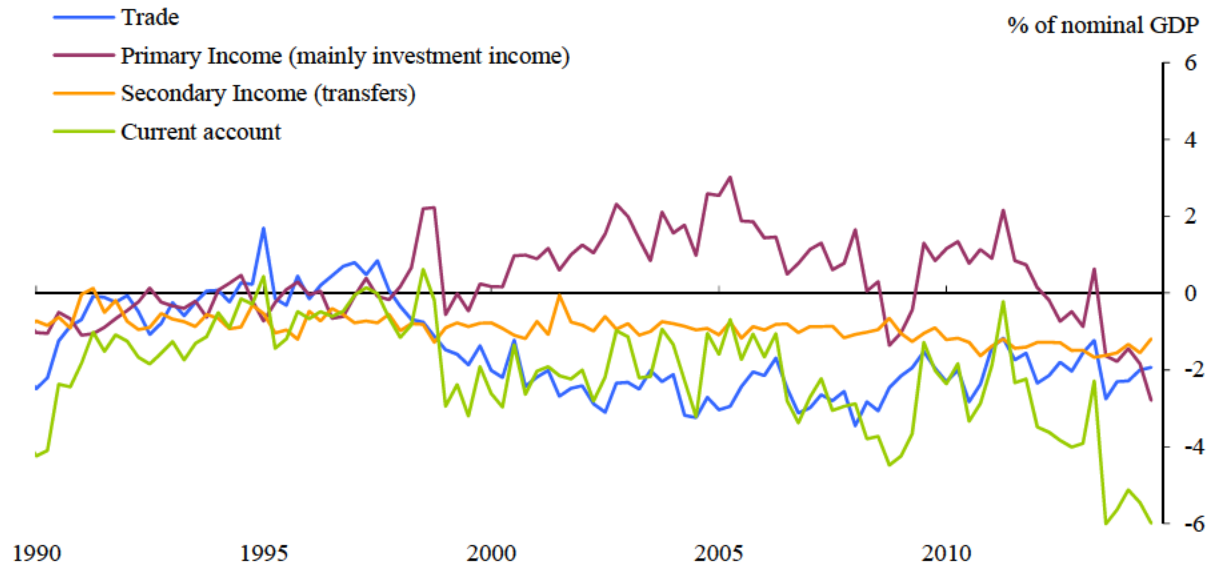
Data: what has driven the weakening?



"Primary income" includes investment income, compensation of employees and small miscellaneous components
"Secondary income" is mainly transfers (government contributions to EU, overseas development assistance etc.)

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A helpful(!?) accounting framework

Sector:	**UK**
Income accounts	trade balance + income balance
	current account
Financial accounts	= + new assets - new liabilities
Balance sheets	Assets - Liabilities
	Net foreign asset position

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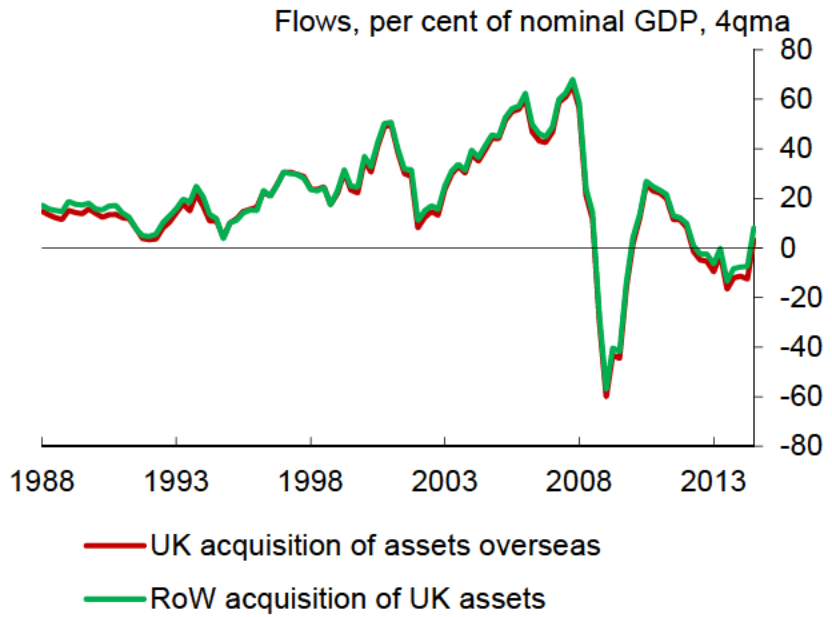
Data: how has the deficit been financed?



Each of these lines is based on figures for net transactions on one side of the balance sheet: the green line is the financial accounts series "net acquisition of financial liabilities" and the red series "net acquisition of financial assets".

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Reasons to worry about a current account deficit

- Risk of a “sudden stop”
- Risk that the national balance sheet will deteriorate to the point where foreigners are reluctant to finance it
- A sign of domestic imbalances, which are themselves risks

A helpful(!?) accounting framework

Sector:	**UK**
Income accounts	trade balance + income balance = current account
Financial accounts	= + new assets - new liabilities
Balance sheets	Assets - Liabilities Net foreign asset position

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A helpful(!?) accounting framework

Sector:	UK		Households		PNFCs		Govt		Financial sector
Income accounts	trade balance + income balance =								
	current account	=	financial balance	+	financial balance	+	financial balance	+	financial balance
Financial accounts	= + new assets - new liabilities								
Balance sheets	Assets - Liabilities Net foreign asset position								

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A helpful(!?) accounting framework

Sector:	UK		Households		PNFCs		Govt		Financial sector
Income accounts	trade balance + income balance =		+ income - expenditure		+ income - expenditure		+ income - expenditure		+ income - expenditure
	current account	=	financial balance	+	financial balance	+	financial balance	+	financial balance
Financial accounts	= + new assets - new liabilities								
Balance sheets	Assets - Liabilities Net foreign asset position								

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A helpful(!?) accounting framework

Sector:	UK		Households		PNFCs		Govt		Financial sector
Income accounts	trade balance + income balance =		+ income - expenditure		+ income - expenditure		+ income - expenditure		+ income - expenditure
	current account	=	financial balance	+	financial balance	+	financial balance	+	financial balance
Financial accounts	= + new assets - new liabilities		+ new assets - new liabilities		+ new assets - new liabilities		+ new assets - new liabilities		+ new assets - new liabilities
Balance sheets	Assets - Liabilities Net foreign asset position								

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A helpful(!?) accounting framework

Sector:	UK		Households		PNFCs		Govt		Financial sector
Income accounts	trade balance + income balance =		+ income - expenditure		+ income - expenditure		+ income - expenditure		+ income - expenditure
	current account	=	financial balance	+	financial balance	+	financial balance	+	financial balance
Financial accounts	= + new assets - new liabilities		+ new assets - new liabilities		+ new assets - new liabilities		+ new assets - new liabilities		+ new assets - new liabilities
Balance sheets	Assets - Liabilities Net foreign asset position		Assets Liabilities		Assets Liabilities		Assets Liabilities		Assets Liabilities

29

A helpful(!?) accounting framework

Sector:	UK		Households		PNFCs		Govt		Financial sector
Income accounts	trade balance + income balance =								
	current account	=	financial balance	+	financial balance	+	financial balance	+	financial balance
	-6.0%		0.1%		-0.8%		**-6.3%**		0.1%
Financial accounts									
Balance sheets	Assets - Liabilities		Assets		Assets		Assets		Assets
			Liabilities		Liabilities		Liabilities		Liabilities
	Net foreign asset position								

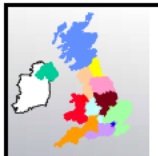
Financial balances figures are for 2014Q3 and exclude the statistical discrepancy between expenditure and income.
Arrows in the final row depict the movements in a sector's gross balance sheet liabilities since calendar year 2012.

30

Reasons to worry about a current account deficit

- Risk of a “sudden stop”
- Risk that the national balance sheet will deteriorate to the point where foreigners are reluctant to finance it
- A sign of domestic imbalances, which are themselves risks

8: Agents’ Update



Agents' Update

27 February 2015

Agency for the East Midlands
Inflation Report & Agency Intelligence Division

Outline

- Macroeconomic “radar” view
- Housing market update

- **Corporate credit conditions**
  - Credit availability
  - Underwriting standards from the perspective of the borrower
- **Commercial real estate**

Macroeconomic "radar" view

- **Little evidence to push back on UK team nowcast**
- **Minimal evidence of low inflation spill-overs to pay**
  - Not a primary driver of thinking on pay at present
- **Electoral/ geopolitical uncertainty not affecting investment plans**

Housing market update: flat

Transactions have stabilised at lower levels than early 2014

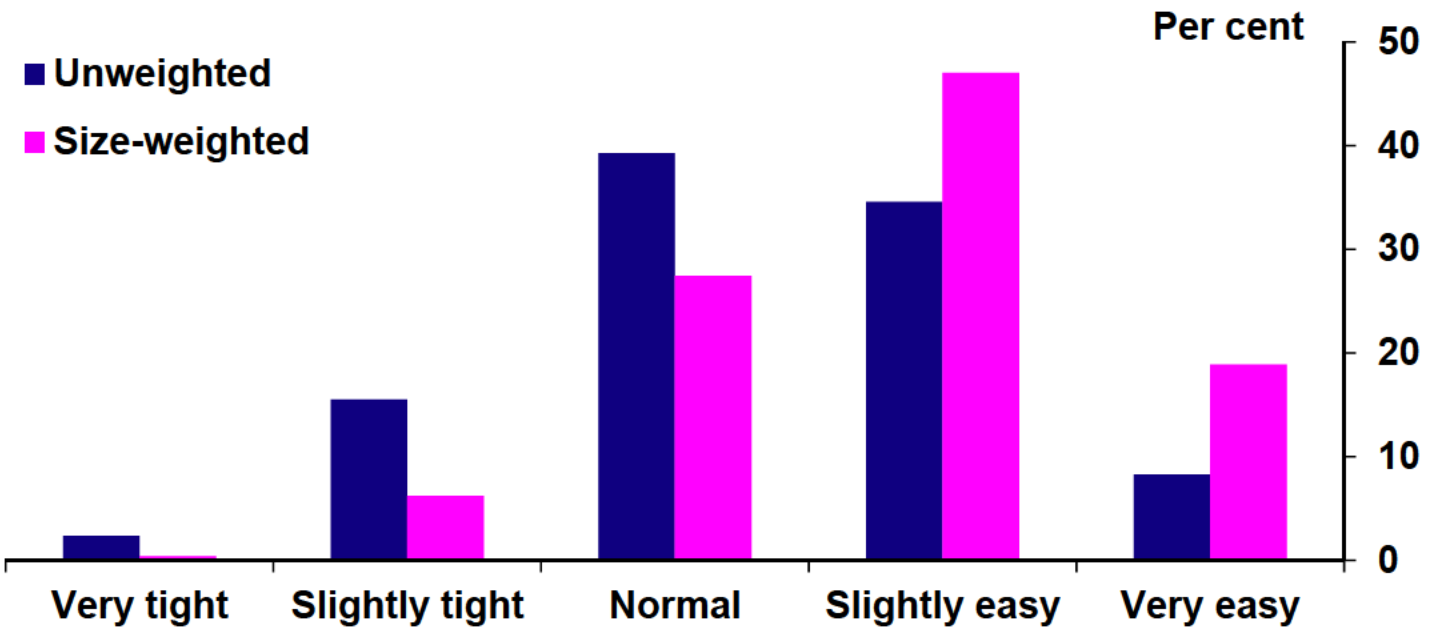
- Stock shortage
- Affordability concerns limit demand

2015

- Early 2015 uptick in viewings/ instructions
- Stamp duty changes offer potential
- But possible election hiatus

Credit availability: rarely a significant concern

Agency Company Visit Scores for Credit Availability: Oct 2014 to present



Stories behind the scores

Very easy credit (8%)

- Broadening capital market access
- Competition from banks to lend
- Significantly reduced cost of finance
- Refinancing common

Slightly easy credit (35%)

- Competitive quotes for re-banking
- Indications of appetite to lend issued by banks
- Faster decisions

Tight credit (18%)

- Ongoing disputes with bankers
- Lack of P&L track record
- Very small firms
- But often described as “easing but still tight”

Not seeing strong growth in demand for finance

Contacts' description of their current use of external finance

	All firms
Increased use of external finance	38%
No change/ passively de-gearing	45%
Actively de-gearing	10%
Refinancing *(usually not increasing current drawings)*	14%

- **Regional banking contacts talk of increased competition**

Are bank underwriting standards loosening?

Unsolicited offers of additional funding	Hearing often
Lending at high EBIT multiples	Hearing occasionally
Lending against less security (e.g. higher LTV)	Handful of reports
Lax non-financial covenants	Handful of reports
Cursory assessment of risk - rapid decision making	Handful of reports
Lax interest cover covenants	Never hearing
Waivers of normal non-price terms	Never hearing
Cursory assessment of risk - ease of financing "change" projects	Never hearing
Ease of funding MBO/ MBI/ Start up	Never hearing

Never hearing ■ Handful of reports ■ Hearing occasionally ■ Hearing often ■

Agency intelligence on Commercial Real Estate

- **Regional CRE activity growing**
  - Crowding out of London opportunities by foreign capital
- **Risks to regional rental flows and capital values identified by contacts**
- **But little evidence that funding structures have become more risky**
  - Valuers not being pressurised to make deals work

Summary

- **Credit availability**
  - Rarely a major concern for SME or large business contacts
  - But still a challenge for those without a P&L track record
- **Demand for finance**
  - No rapid growth in demand so competition to lend increasing
- **Bank underwriting standards for corporate lending**
  - Little evidence of material loosening of underwriting standards
- **Commercial real estate outside London**
  - Investor demand increasing despite risks to yield/ capital values
  - No evidence that funding structures have become more risky