

## Economics

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### UK

#### “Project Merlin” – Do The Numbers Reflect Reality?

- Data released this morning by the BoE suggest that the major banks are roughly on target to meet their stated “Project Merlin” targets (*“a capacity and willingness to lend £190 billion of new credit to business in 2011, with £76 billion of this lending capacity allocated to small and medium-sized enterprises”*). In Q3, lending “made available” on the “Project Merlin” basis totaled £57.4bn, bringing the cumulative total for Q1-Q3 up to £157.7bn (83% of the way to the £190bn full-year target). Of this, lending “made available” to small and medium sized enterprises (SMEs) has totaled £56.1bn in Q1-Q3, 75% of the way to the full-year target of £76bn.
- However, this apparent achievement of the “Project Merlin” targets probably is not translating into any genuine overall improvement in the availability and cost of credit for small firms. Project Merlin appears to be a classic case of “managing to the target”, a familiar pattern whereby a numerical target is set, numbers are produced showing the target is achieved, but the underlying reality is not greatly changed. Other measures suggest that credit availability remains poor, especially for small firms. (1) BoE data show that the total of outstanding sterling credit facilities for UK non-financial firms by UK banks fell by £23.3bn YoY (3.8%) in September, while the total of sterling plus FX credit facilities for UK non-financial firms fell by £47.3bn YoY (6.1%). (2) The level of unused sterling credit facilities granted by UK banks (including unused facilities for households, non-financial companies and non-bank financial firms) fell by 17.0% YoY in September. (3) The BoE also report that net bank lending to UK non-financial companies fell by 3.4% YoY in August, while lending to SMEs fell by 5.1% YoY. (4) Finally, the BoE report that the median interest rate on new variable rate loan facilities for small SMEs was 4.68% in August, while that for medium SMEs was 3.33%. By contrast, the average interest rate on all new variable rate loans to private non-financial companies in August was 2.29%. The spread between the interest rates charged to smaller SMEs and the average has risen since the start of this year.
- We suspect that, in aggregate, banks are meeting their Project Merlin targets by making credit available at a high price and on tough terms that few firms can afford to meet. This cautious attitude may make sense for individual banks, but overall it adds to the headwinds for the economy. Unsurprisingly, the British Chambers of Commerce survey suggests that micro firms (less than 20 employees) are notably gloomier than the average across all firms in terms of confidence, employment intentions, investment intentions, orders and cashflow. Our view is that numerical targets alone will not succeed. We suspect that the cost and availability of credit for small firms will remain poor unless the government takes a far more prescriptive and forceful approach to the banks (eg running the nationalized banks on non-commercial grounds, ordering them to lend more to small UK firms at low rates, and if necessary changing the management to achieve this).

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