

The background of the entire page is a close-up photograph of several coins of different denominations and colors, including copper, silver, and gold. The coins are scattered and overlapping, with some in sharp focus and others blurred in the background. The lighting is dramatic, highlighting the metallic textures and intricate designs on the coins.

ABFA

Economic Report

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ABFA Economic Report March 2009

THE ABFA ECONOMIC REPORT

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Disclaimer: The views are those of the author and not necessarily those of the Centre for Finance and Credit Markets or the University of Nottingham.

EXECUTIVE SUMMARY

Economic conditions have deteriorated considerably... Latest figures from the United States show annual GDP growth for the fourth quarter of 2008 fell 6.2% compared to a year ago, while industrial output in Japan fell by 10%. Few economies have escaped the downturn, demand is expected to weaken further and the UK is officially in recession. Sentiment indicators show that firms are very pessimistic about sales, orders, profits and employment.

...but the extent to which growth falls depends on resolution of the financial crisis,... The worsening of the financial position of financial intermediaries undermines confidence and the willingness to lend, but central banks schemes have pledged to purchase assets for which there is an impaired market through the Troubled Asset Relief Programme (TARP) in the United States, and the Special Liquidity Scheme-Asset Purchase Facility in the United Kingdom.

...government fiscal stimulus packages, and monetary policy responses. Governments have committed to large fiscal stimulus packages amounting to \$1.75tn, in the United States, €200bn in the EU, €26bn in France, €50bn in Germany, and £20bn in the United Kingdom to support jobs, infrastructure, education and R&D. Interest rates have been cut further from 1.50% to 0-0.25% in the US, from 5% to 1% in the UK, and 4.75% to 2.25% in the eurozone.

Turnover in the asset based finance industry has increased, and advances have grown... The annualized percentage change in turnover has grown by 9%. In the UK, the industry advanced £17.1 billion at the end of December 2008, against invoices, stock, property and other trading assets worth £30.6 billion. This represents a growth rate in advances of 8% from figures recorded in December 2007. In Ireland, the advances were €1.6 billion against €3.6 billion of assets.

...meanwhile credit conditions in general are tightening. Other measures of lending have declined, M4 lending grew at an annual rate of just 4% and conditions in credit markets remain tight in stark contrast to the asset based finance sector. Surveys show expectations about the future and increased costs were influential over credit availability. Respondents to a Bank of England survey indicating that on balance 28% more had cut credit to corporate clients than had increased credit.

Evidence of financial distress is more apparent. Further evidence of financial distress can be seen from the average number of days debts remain outstanding as businesses are waiting longer to receive payment on debts. The numbers of credit protection payments being made to clients by ABFA members in the UK has increased by 18.5% to £6.4 million in the year to December 2008 compared to £5.4 million at the end of 2007.

GLOBAL ECONOMIC OVERVIEW

ECONOMIC CONDITIONS HAVE DETERIORATED CONSIDERABLY...

Since the publication of the previous economic report conditions in the world economy have deteriorated markedly. In November the International Monetary Fund projected a growth rate for the world economy of 3% for 2009, but this has subsequently been revised downwards to just 0.5%. **Charts 1a and 1b** report actual and projected GDP growth figures to the 4th quarter of 2010 from the International Monetary Fund. According to the IMF World Economic Outlook, Update issued in January, the United Kingdom will experience a growth reduction of 2.8% in 2009 and a further 0.6% in 2010. These projections suggest that Britain will contract more sharply than any other advanced nation.

On average the advanced nations are expected to face a reduction to growth of 2%, with Japan shrinking by 2.6%, Germany by 2.5%, and the United States by 1.6%. However, latest figures from the United States show that the downturn is much more severe than anticipated in 2008 as annual GDP growth for the fourth quarter of 2008 fell 6.2% compared to a year ago. Recession was declared in the United Kingdom as official figures showed the economy had contracted for two successive quarters. The United Kingdom and the United States have fared particularly badly due to their reliance on financial services, but other countries without high exposure to the financial sector have also been hit hard. Germany has experienced its slowest growth since reunification, and Italy the

sharpest drop since 1980, Japan has seen a 10% fall in industrial output, the largest fall in fifty years of recorded data. France and the Netherlands have also experienced a fall in output.

The impact of the downturn has increasingly been felt by emerging economies that have largely avoided the direct effects of financial crisis, but are hard hit by the decline in demand from their export destinations. These economies are projected to continue to grow - in the case of China and India the growth rates for 2009 are expected to be 6.7% and 5.1%, and for Brazil, 1.8% - but this is a much slower rate than in previous years and below their long-term trend growth rates. Russia is particularly exposed to a downturn due to the reduction in the price of oil and gas, which are major contributors to export earnings, and there is expected to be a contraction of 0.7% in 2009 and slow growth in 2010. The effects of the downturn will affect employment: the Organisation for Economic Co-operation and Development (OECD) suggests the industrialized countries will see a further 8 million people unemployed over the next two years as a result of the recession.

...BUT THE EXTENT TO WHICH GROWTH FALLS DEPENDS ON RESOLUTION OF THE FINANCIAL CRISIS...

The growth projections discussed earlier depend very much on the assumption that economies affected by the financial crisis will succeed in stabilizing their financial systems and reduce uncertainty in the markets. There is a vicious circle that means a worsening of the financial position of financial intermediaries

undermines confidence and the willingness to lend, which further reduces output growth, prospects for the world economy, and the valuation of assets. As asset values in general have fallen so house prices have continued to decline, which undermines the valuation of mortgage-backed securities held by banks and reduces the net wealth of consumers and further. Comparing the current downturn in housing markets to previous experience, it appears that there is still some way to go before house prices stabilise. To break the circle the monetary authorities in many countries have agreed to purchase assets from financial institutions in order to encourage them to lend to businesses and households. Examples of these schemes include the Troubled Asset Relief Programme (TARP) in the United States, and the Special Liquidity Scheme-Asset Purchase Facility in the United Kingdom. Central banks purchase assets for which there is an impaired market at less than face value in exchange for more liquid assets such as government bonds (US Treasuries or UK Gilts).

...AND GOVERNMENT FISCAL STIMULUS PACKAGES.

During economic downturns governments can rely on the automatic stabilizing nature of fiscal policy to help reduce the negative impact of macroeconomic shocks. Government spending rises automatically as more households claim income support or benefits and the tax take from the economy falls. But governments have undertaken discretionary spending to boost their economies, recapitalize banks, offer direct lending to businesses and insure loans made by others. In the United States the budget deficit for the current year is predicted to be \$1.75tn, which represents 12.3% of GDP, the largest deficit in the post war period. The spending plans to revive the economy will be directed to healthcare reform (\$634bn), bank bailouts (\$250bn) and spending on wars in Iraq and Afghanistan (\$200bn). Other governments are spending additional sums to boost demand. An EU-wide fiscal stimulus package worth €200bn is just 1.5% of EU GDP but it will be supplementing country level spending. France plans a €26bn stimulus package for jobs, infrastructure, and R&D. Germany will provide €50bn for investment on education, infrastructure and child benefits as well as tax cuts. Britain has earmarked £20bn for training and apprenticeships and investment comprising about 1% of GDP. The government has also cut value-added tax from 17.5% to 15% during 2009.

COMMODITY PRICES HAVE FALLEN FROM THEIR PEAKS REDUCING INFLATIONARY PRESSURES...

While governments are spending more to stimulate the economy, the monetary authorities have cut interest rates, which will also have a stimulating effect on the global economy. Inflationary pressures have fallen substantially since the early autumn as commodity prices - most notably oil prices - have fallen from a high of \$147 per barrel to as low as \$33 per barrel. This has had a direct effect on the cost of energy and transport costs, which contributes to falling costs of food and other goods.

Chart 2 shows that although inflation rose sharply in the US, euroarea and the UK in mid 2008, since then it has fallen considerably due to the effect of lower commodity prices. Inflation rates in the United States and the euroarea peaked

CHART 1a
Annualised nominal GDP growth rates

Source IMF

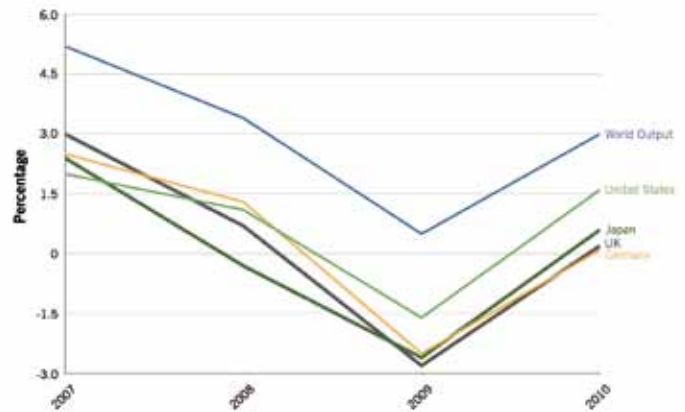


CHART 1b
Growth in BRIC economies

Source IMF

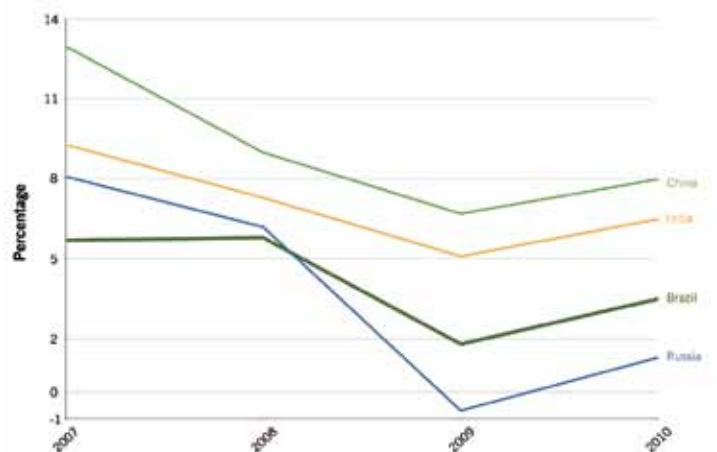


CHART 2
CPI Inflation rates

Source ONS, Irish CSO and Eurostat



respectively at 5.6% per annum and 4.0% in July 2008, but have since fallen to 0.1% per annum and 1.6% and are expected to fall further in 2009. The UK also saw a peak to inflation in September at 5.2% with a reduction in the autumn and winter months. The movement in the sterling exchange rate index has offset this effect to some degree for households and firms in the United Kingdom. Imported goods - including commodities priced in US dollars - are more expensive than they would have been if the sterling exchange rate had not depreciated against the dollar and other currencies. Similarly in 2008 China and India were concerned about relatively high inflation rates at 8.3% and 7.8% but have since faced a reduction in demand that has brought inflation down to more moderate levels.

...AND INTEREST RATES HAVE BEEN CUT IN RESPONSE...BUT THE OUTLOOK FOR MONETARY POLICY IS STILL UNCERTAIN.

As late as September 2008 many central banks in advanced industrialized economies were signaling an intention to raise interest rates, but as the threat of inflation receded with the fall in commodity prices a new danger emerged - the threat of deflation. Deeply entrenched expectations of falling prices of goods and services can be very detrimental to the economy, and can increase the real value of debts and liabilities. Japan experienced a 'lost decade' in the 1990s due to deflationary conditions.

In Industrialised countries, interest rates have been cut further from 1.50% to 0-0.25% in the US, from 5% to 1% in the UK, and 4.75% to 2.25% in the eurozone. The People's Bank of China has increased liquidity provision to the banking system to offset signs of financial weakness and the Reserve Bank of India has cut its repo rate from 9% to 5.5% in a single quarter. Attempts to stimulate the economy have been accompanied by fiscal measures because inflationary pressures have receded and there is greater concern about the impact of the appreciating exchange rates, making goods uncompetitive in key export markets, and weakening demand abroad. Figures released on China's exports show they fell more than expected in January, down 17.5% from January 2008 which is the largest drop in more than 10 years. Brazil, has seen a moderation of demand and falling inflation, and its central bank has cut interest rates in recent meetings with a view to achieving its inflation target.

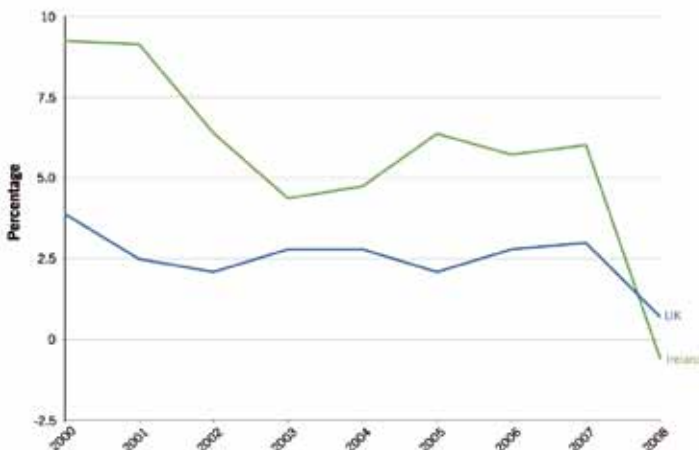
TRENDS IN THE UNITED KINGDOM AND IRELAND

THE UK AND IRELAND ARE IN RECESSION AND OUTPUT GROWTH IS EXPECTED TO CONTINUE TO FALL IN 2009, RISING AGAIN FURTHER OUT...

Annual real GDP growth rates are given in **Chart 3**, where a decline in late 2008 can be clearly seen for both the United Kingdom and Ireland. According to the Office for National Statistics, quarterly output growth for the United Kingdom fell by an annualized rate of 1.5% in 2008Q4. This follows a decline of -0.5% in 2008Q3, putting the UK officially into recession. A large part of the reduction was due to the decline in manufacturing output, which fell by 4.6% compared to the previous quarter, while construction and services fell by 1.1% and 1.0% respectively. The Governor of the Bank of England opened his remarks on the February *Inflation Report* with the statement that 'The UK economy is in a deep recession' marking a change in his assessment from 'flat growth' projections just six months ago. According to its current projections the Bank of England's Monetary Policy Committee believes GDP growth will decline sharply in the near term and continuing to deteriorate into the first half of 2009. This view is markedly lower than the November projection reflecting weakness in the labour market, lower consumer expenditure and investment spending, and weakness in world demand. Their own expectation is that output growth will pick up sharply thereafter, but evidence from the quarterly survey by the Bank's Agents - which indicates persistent weakness in expected demand - does not bear this out.

CHART 3
UK and Ireland annual GDP growth figures

Source ONS and Irish CSO



It is possible that the monetary and fiscal stimulus through lower interest rates and higher government spending will improve conditions, and it is hoped that an improvement in the lending climate and the export market will raise output growth, but the outlook is uncertain. The consensus view for economic performance is very pessimistic.

Irish real GDP growth is expected to drop by 4 percentage points in 2008 based on official statistics, and the positive growth recorded in 2007 has been revised downwards to -1%. The Irish economy faces a sharp contraction, compared to many other European countries that are less export oriented, with slower domestic demand compounded by a weak world economy. Forecasts by the OECD, IMF and the European Commission project a further decline into the first half of 2009, a period of flattening off, before conditions improve in 2010. In Ireland the outlook is heavily conditional on the external situation because the economy is small and open. The relative strength of the euro against other currencies in recent months has contributed to the decline.

...DOMESTIC DEMAND IS DECLINING, GLOBAL TRADE IS SHRINKING...

Table 1 based on official data from the Office for National Statistics and the Irish Central Statistical Office shows the contributions to real GDP growth. The demand for goods and services by UK households has slowed considerably in the final half of 2008, reflecting the impact of labour market weakness that has lowered the real after-tax incomes of those made redundant and other on reduced working hours. This is likely to have more than offset the

effects of lower fuel and food costs, and while prices are expected to fall further, so too are employment prospects. In this uncertain environment spending on discretionary items is often curtailed to allow savings to grow, resulting in diminished spending on vehicles and durable goods for example. The constraint on the availability of credit for purchase of these items has further impacted demand. This is likely to continue over the next year, but the extent of this effect depends on the scale and impact of the stimulus package. Retail sales are expected to be down in value terms for January, following a slowdown in official figures in December, this is in spite of the evidence that discounted sales in the new year boosted sales volumes. The CBI Distributive Trades survey showed evidence of 'weak demand', and the British Chambers of Commerce (BCC) reports 'disastrous falls' as the net balance for home orders of manufacturers dropped 31 points to -38% in 2008Q4.

Other components of demand with the notable exception of government spending growth, which has increased to provide the fiscal stimulus, are unambiguously negative. The fall in residential and commercial property prices continues to reduce real estate investment (which amounts to about 40% of total investment), and the weak level of demand and uncertainty about the length and depth of the recession have contributed to reduced spending on plant and machinery. One indicator that firms expect the recession to affect demand for a considerable period is the recorded decline in inventories. This shows firms have responded by reducing production last quarter rather than increasing inventories, which would be the expected response for a short downturn. For exporters in the United Kingdom the movement in the sterling

TABLE 1 Expenditure Components of Demand	United Kingdom						Ireland	
	2007(a)	2007 Q3(b)	2007 Q4(b)	2008 Q1(b)	2008 Q2(b)	2008 Q3(b)	2007(a)	2008(a)
Household Consumption	3.1	1.6	0.2	1.3	-0.1	-0.2	-0.2	-2.5
Government Consumption	1.9	0.3	0.9	1.0	0.4	1.0	2.9	0.5
Investment	6.0	1.6	-0.5	-1.6	-5.3	-2.4	-18.4	-25.2
Total Domestic Expenditure at market prices	3.8	1.2	0.3	0.1	-0.3	-0.4	-4.5	-7.6
Exports	-5.1	2.7	-0.5	0	-0.5	-0.3	1.2	-0.7
Final Expenditure	1.8	1.5	0.2	0.1	-0.3	-0.4	-1.8	-4.3
Imports	-2.4	3.9	-1.2	-0.6	-1.4	0.1	-3.0	-4.6
Gross Domestic Product at market prices	3.1	0.7	0.6	0.4	0.0	-0.5	-1.0	-4.0

Chained volume measures,
(a) percentage changes on a year earlier
(b) percentage changes on a quarter earlier

Source ONS and Irish CSO

exchange rate against the euro and the US dollar has boosted exports, however, net trade is has deteriorated slightly by -0.2% in the last quarter as a result of the general slowdown in world trade. In the Republic of Ireland consumer expenditure grew at a much slower rate in 2008 compared to 2007, and consumers reported that unemployment, uncertainty about the future at home and abroad were major factors in the decision to increase savings. Sharp reductions in the house price index have undermined the perceived wealth of property owners, and this has also contributed to the decline in consumption. Investment expenditure in 2008Q4 fell substantially, with a 25% reduction in investment compared to the same period in 2007, which follows a decline of 18% in the year to 2007Q4. In construction and manufacturing, there has been a reluctance to invest in the housing stock, where prices are falling, or in machinery or plant, where demand for goods is weak, and the prospects for 2009 are expected to deteriorate further. For businesses in Ireland the appreciation of the euro other currencies has put pressure on export growth, particularly so in the export of services.

...AND BUSINESSES CONDITIONS ARE THE WORST ON RECORD.

The British Chambers of Commerce (BCC) notes that many indicators are the worst on record - sales, orders, investment and confidence have all been badly affected in the last half year. Their surveys of many thousands of businesses across the UK indicate a deep recession that is intensifying at the present time. The balance of firms reported to be more pessimistic about conditions in the in late 2008 is greater now than it was at the

same time in 2007, as indicated by **Table 2**. The BCC reports in 2008Q4 the balance of firms in manufacturing reporting higher v. lower home sales fell by 31 points to -38% compared the previous quarter and home orders fell 17 points to -48%, suggesting the outlook is bleak, these are the worst results on record. Conditions are much the same for large employers and SMEs, and export markets are as badly affected as domestic demand despite the falling pound. Manufacturers export orders dropped by 15 points to -19 and service sector export orders fell 22 points to -13. The conclusion to be drawn from these figures is that an export led recovery will only occur when world demand improves. Given the survey outcomes, it is not surprising to find that investment in plant and machinery has been postponed, with the balance of firms indicating a desire to invest falling to -22 (manufacturing) and -27 (services). Gloomy prospects are revealed for turnover and profitability as net percentage balance figures are negative.

INFLATION IS ABATING AND POLICY MAKERS HAVE ACTED DECISIVELY TO REDUCE INTEREST RATES...

Inflation prospects in the UK and Ireland have moderated considerably in the last six months - the decline in inflation in the United Kingdom from September to December was the sharpest three month fall since 1992. The sharp fall in oil prices has helped to reduce the costs of fuel and transport, which contributes to price declines in other goods. However, since commodities are priced in US dollars the decline in the exchange rate against the dollar has dampened this effect to some degree.

TABLE 2 British Chambers of Commerce Survey	Manufacturing		Services	
	2008Q3	2008Q4	2008Q3	2008Q4
Home Sales	-13	-38	-7	-31
Home Orders	-17	-48	-13	-36
Export Sales	3	-12	13	-9
Export Orders	-4	-19	9	-13
Employment last 3 months	0	-17	2	-22
Investment - Plant & Machinery	-4	-22	-2	-27
Investment - Training	8	-6	4	-11
Confidence - Turnover	4	-32	10	-23
Confidence - Profitability	-11	-39	-12	-34

Source British Chambers of Commerce

All figures are recorded as a percentage balance i.e. the percentage of firms surveyed reporting improvements minus the percentage of firms surveyed reporting worsening conditions. As numbers become smaller from one quarter to the next, it indicates a balance of opinion that conditions are worsening.

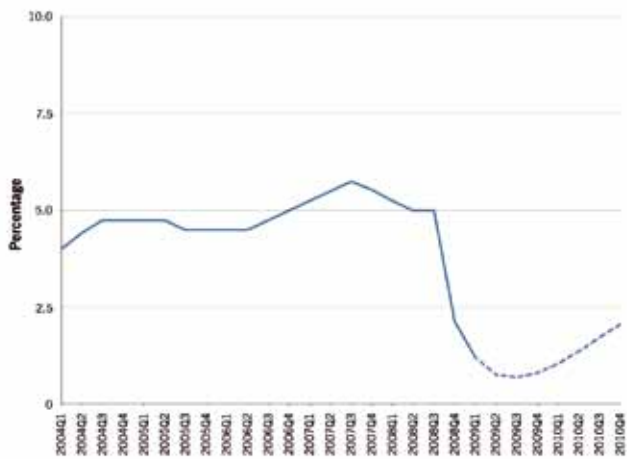
Another contributor has been the reduction in VAT announced in the Pre-Budget Report 2008 by the Chancellor of the Exchequer. VAT reductions from 17.5% to 15% reduce the cost of items in the basket used to construct inflation measures, and indirectly influence demand and hence price pressures, although in the present climate the cost reductions are likely to be more influential. Consumer price inflation (CPI) in the UK has remained above the target, and therefore the Governor of the Bank of England has written a second open letter to the Chancellor to explain the Bank of England's strategy to bring it back to target. Meanwhile, other measures of inflation such as the retail price inflation (RPI) index have fallen more sharply than CPI because they include the effects of lower interest payments which are excluded from CPI. Policymakers' assessments of future movements in oil and gas prices indicate an expectation that prices will rise in the medium term, and this will raise inflation gradually, although fuel suppliers typically hedge to smooth movements in prices. The depreciation of sterling against other currencies will also contribute to higher inflation, but large emerging economies such as China and India have seen a fall in costs and the prices of goods at the factory gate, which may result in lower retail prices for exported goods in the future. The Chinese authorities reported a reduction in prices for the ninth successive month in January, and inflation is now just 1%. Businesses have reported lower pressure to increase prices and wages, and this will also moderate inflation.

In setting interest rates for the United Kingdom, the Bank of England's monetary policy committee must make an assessment of the impact of falling global demand, the net effects of fiscal and monetary changes in the pipeline on demand, and the balance between the effects of exchange rate movements, lower inflation from importing countries, and falling commodity prices. Interest rates have fallen from 5% to just 0.5% in March 2009, the lowest rate in the Bank's history. The Governor, Mervyn King has indicated that there may be little benefit from reducing rates much further, which would incidentally also weaken sterling. The Bank has now decided to make use of the Asset Purchase Facility, that enables the purchase of corporate bonds, commercial paper, and paper issued under the credit guarantee scheme. This facility can be used for both financial stability and monetary stability purposes and is capped initially at £150bn.

Chart 4 shows markets expect official UK interest rates to remain close to 1%, falling slightly to 0.75% in the next quarter and rising thereafter to 2%, but there is considerable uncertainty in the outlook. The wide range for the Bank of England's inflation forecasts into 2011 allows for inflation between 3% and -1%. In the euroarea, inflation has fallen from around 4% in mid 2008 to around 2% near the upper level of the range 0 - 2% used by the European Central Bank to maintain price stability

CHART 4
Bank Rate and projected forward curves

Source Bank of England



over the medium term. Inflation is expected to continue to moderate, and interest rates, which were cut from 4.75% in October 2008 to 2.5% by late 2008, have remained static for the last three months.

...FINANCIAL CONDITIONS REMAIN TIGHT, AMID CONSIDERABLE UNCERTAINTY ABOUT FUTURE POLICY.

Globally the credit crunch intensified after October 2008 with the collapse of Lehman Brothers, the US investment bank. The big five investment banks all sought stronger financial institutions with which to merge or become bank holding companies under the supervision of the US Federal Reserve. Immediately after the events of October 2008, the spread between 3 month LIBOR and official rates jumped to 350 basis points in the United States, and between 150 and 250 basis points in the United Kingdom and the Eurozone. These moderated a little in the United States in subsequent months, but the spreads are still over 150 basis points, compared to only 10 basis points in July 2007 before the crisis. In the United Kingdom the Bank of England has used its Special Liquidity Scheme to inject more than £160 billion of liquidity into the financial system. Uptake was larger than expected, and exceeded by three times the initial estimate of £50 billion thought to be required for this purpose. The European Central Bank has also extended term credit through similar means, against a range of collateral. Banks continue to attempt to rebuild their balance sheets, and they have reduced lending to non-banks; households and firms report tighter lending conditions and higher rates on new loans as well as tighter credit availability. The rates on several forms of credit offered to firms remain far above official rates as margins have been set with reference to LIBOR rates in wholesale markets rather than Bank Rate. Three-month LIBOR rates lie above Bank rate as **Chart 5** illustrates.

SUMMARY

The UK and Irish economies are officially in recession, and growth is expected to further deteriorate before flattening and eventually recovering in late 2009 and 2010. However, there is considerable uncertainty about the projected path for growth and also for inflation. Business confidence, investment, sales and orders are all much reduced and are the worst values on record. On a positive note, inflation is abating and interest rates have fallen from 5% to just 1% in the United Kingdom and from 4.75% to 2.5% in the eurozone. Also, fiscal stimulus measures have also been adopted to attempt to prevent the economic condition from worsening. Meanwhile the financial system is fragile, and banks continue to be adversely affected by the financial crisis and the increased cost of funds in interbank market. This has a knock-on effect on households and firms, but new measures are being deployed to attempt to restore confidence and lending.

CREDIT CONDITIONS AND ASSET BASED FINANCE

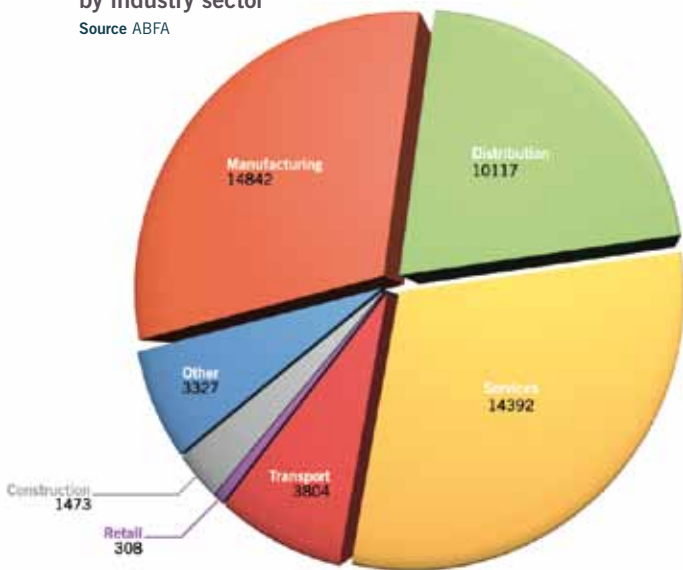
ABFA statistics report asset based finance figures for the half year to December 2008 for the United Kingdom and Ireland. In the UK, the industry advanced £17.1 billion at the end of December 2008, against invoices, stock, property and other trading assets worth £30.6 billion. This represents a growth rate of 8% from figures recorded in December 2007. In Ireland, the advances were €1.6 billion against €3.6 billion of assets. These figures have held up well compared to reported figures six months ago. By comparison growth of total M4 lending (excluding the effects of securitisations etc) to Private Non-Financial Corporations (PNFCs) rose by just 4% over the same period. M4 lending is the total value of loans provided by banks and building societies, the growth of which provides a comparison to the growth of asset based finance. Therefore, asset based finance grew twice as fast as bank lending in 2008.

SALES FIGURES FROM ASSET BASED FINANCE CLIENTS SHOW AN INCREASE IN ASSET BASED FINANCE TURNOVER...

Asset based finance is closely tied to sales figures since borrowers provide liquidity against sales invoices, offering up to 90% of the value. Asset based finance adjusts according to the variation in sales therefore the industry carefully records sales figures of its clients. Asset based finance companies gather information on their clients' sales figures because factoring and invoice discounting provides finance against sales invoice and client sales represent turnover for the ABFA members. Turnover for asset based finance companies in the UK now exceeds £200 billion, and in Ireland over €20 billion.

The recorded ABFA figures on client sales are drawn from non-retail sectors, and the contributions of each sector to the figures are stable over time. Clients are drawn from manufacturing (29%), distribution (20%) and services (30%) sectors, and a further 21% from transport, construction and other industries (see **Chart 6**). Firms in the retail sector amount to just 0.6% of the client base of 48,150 firms. The annualized percentage changes in total sales have grown by 9%. The breakdown of these figures into categories by the ABFA reveals the type of asset based finance used by clients of ABFA members. Growth in sales shows all categories grew over the year to December 2008 except domestic factoring which declined by 4%. The growth of sales over recent quarters can rise because there is a growth in volumes of sales, either because the clients sell more goods and services, or because there are more clients seeking finance from asset based finance providers; the values can also rise because there is modest inflation. The figures fall when sales decline, or

CHART 6
ABFA client numbers
by industry sector
 Source ABFA



firms fail. Annualised growth in real terms (sales figures adjusted for inflation) are recorded in **Chart 7**, which shows total sales have grown in each quarter since the start of the financial crisis.

Quarterly sales growth figures adjusted for inflation are given in **Chart 8**. The figures provide sales figures for non-retail sectors in constant prices (2005=100) that help shed light on recent developments in the real economy. The figures show that most forms of asset based finance have grown healthily in 2008, contributing to an increase in sales of 4.4%. Adjusting for inflation, the growth of domestic invoice discounting was 3.7%, export invoice discounting grew by 50.7%, and import factoring by 9.2%. Since official statistics reveal that sales have declined in the last month of 2008, these figures suggest that asset based finance is increasing because more firms are using asset based finance. This is especially so for medium and larger companies that make use of invoice discounting and asset based lending facilities offered by ABFA members. Invoice discounting is usually used by medium-sized and larger firms that have good back-office arrangements. There has been a persistent decline in the

CHART 7
Annualised growth in total sales
 Source ABFA

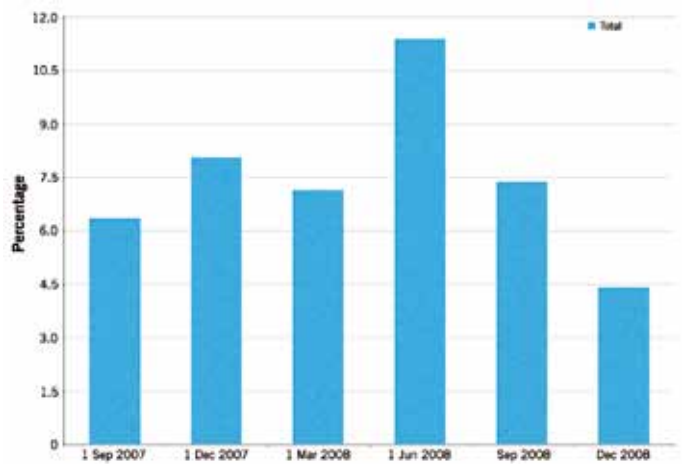
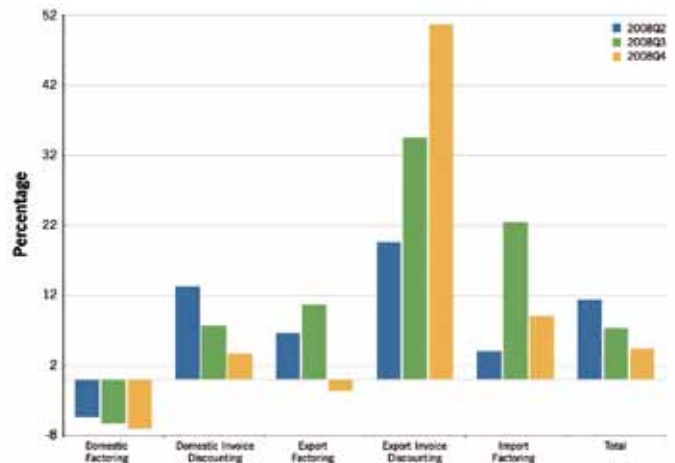


CHART 8
Growth in the components of sales
 Source ABFA



annualized growth of factoring since June 2008; the latest figures reveal a decline of 7%. The decline in factoring is surprising given that it is safer than other forms of lending for the supplier but this probably reflects the fact that although firms may wish to substitute asset based finance for other forms of finance like bank loans, the firms that take it up are smaller, and larger numbers of these firms are failing. Export factoring has also declined marginally in 2008Q4.

TABLE 3 Advances by ABFA Members (£m)	Advances against debt	Advances against other assets	Other commitments	Total Advances
30/9/2007	14,300	441	233	14,974
30/12/2007	15,074	503	197	15,774
31/3/2008	15,479	558	213	16,250
30/6/2008	16,421	614	226	17,261
30/9/2008	16,658	732	290	17,680
31/12/2008	16,032	776	294	17,102
Year-on-year growth rate percentages				
30/9/08	16.49	65.99	24.46	18.07
31/12/08	6.36	54.27	49.24	8.42

Source ABFA

ASSET BASED FINANCE FIGURES ALSO SHOW HEALTHY GROWTH...

In the UK, the industry advanced £17.1 billion at the end of December 2008, against invoices, stock, property and other trading assets worth £31.5 billion. The total advances grew by an annualized rate of 8.4% over the year to December 2008. Total advances are given in **Table 3**. As economic conditions worsen, firms typically turn to asset based finance for funding to replace or supplement bank lending. The vast majority of advances at the end of 2008 (£16 billion) were made against debt (sales invoices) but advances were made against other assets, and these grew at a faster rate. **Table 3** shows advances against debts grew by 6.4% compared with a year ago, while advances against other assets grew at an annualized rate of 54.3%. Although still relatively small, the value of stock used to secure advances was £1603 million at the end of December 2008, and the value of property was £440 million. Total advances against assets other than debt receivables amounted to over £1 billion at the end of the 2008.

A large number of these advances were made as factoring arrangements for small firms with turnover less than £500,000 per annum. The figures for December 2008 indicate 18,567 clients were advanced just under £1 billion of the total advances, with an average advance to firms in this group of just under £50,000. But the majority of advances were made to medium to large-sized firms in the £1 million - £50 million turnover category. At the end of December 2008 21,201 firms or 44% of client numbers received nearly £10 billion or 58% of the advances, with an average advance of £467,000. The small number of very large asset based lending arrangements to firms with £50 million turnover or more comprises just 1.1% of the client population but they receive some £5.5 billion or 32% of total advances and have an average advance size of £10.6 million. These large advances have fallen for three reasons as weak demand for goods and services has reduced demand for borrowing, merger and acquisition activity has fallen, and ABFA members have reported some uncertainty over capital availability within the banks in the second half of 2008 which has filtered down into asset based finance.

This uncertainty has now been resolved relieving lending constraints on asset based lenders for 2009.

In Ireland, the advances were €1.6 billion against €3.6 billion of assets. Once again a large proportion of the client numbers are small businesses receiving small advances - these firms received €16 million, which is about 1% of the total advances in 2008Q4 while firms with turnover in excess of €75 million received €525 million, or 32% of the total advances.

...WHILE ACCESS TO CREDIT IN GENERAL HAS WORSENE FOR MOST FIRMS.

Both Bank of England and European Central Bank surveys of credit conditions indicate that conditions in credit markets remain tight in stark contrast to the asset based finance sector. In the euro area, expectations about the future and sector specific costs were most influential on the demand for credit, while credit standards and supply were tightening further according to lenders. In the United Kingdom, the Bank of England reports that corporate credit availability also tightened, demand declined and spreads increased. Credit conditions surveys are reported in **Table 4**, where figures report net percentage balances of respondents giving positive or negative answers to the survey questions. The supply of credit tightened with the further intensification of the crisis when Lehman Brothers collapsed in October 2008. A larger percentage of respondents said that they had cut credit to corporate clients compared with those that had increased credit, the net figure was -28%. Overall unsecured credit availability to firms continued to fall - at a faster rate for commercial real estate borrowers and at a slower rate for other corporate borrowers compared to 2008Q3 and 2007Q4. The main reason given for the reduction are i) the macroeconomic outlook, ii) changing sector-specific risks, iii) a change in the risk appetite of the lender and iv) a change in the cost of funds, with the latter having the largest impact. All firms have been affected in similar ways, since small, medium and large firms surveyed separately all report similar conditions. Figures in **Table 4** show that the responses for lenders to medium and large firms are very similar. Lenders have increased interest rates and have increased fees and collateral requirements on corporate borrowers, and anticipate doing so for the next quarter for all firms.

On the supply side banks prefer to offer asset based finance rather than unsecured loans as the economic outlook worsens. For larger firms the use of asset based finance has increased slightly, as asset based lending continues to grow. In the present financial environment, banks are more reluctant to offer syndicated deals and figures have dropped slightly to £5.3 billion from nearly £5.5 billion. This reflects the unsettled nature of the market and the uncertainty about risk appetite of other lenders. On balance asset based finance has risen during downturns and we continue to anticipate this outcome in 2009.

MORE FIRMS ARE SHOWING SIGNS OF FINANCIAL DISTRESS.

Evidence of financial distress can be seen from the average number days debts remain outstanding in **Chart 9**, also known as debt turn. The figure for factoring clients has gone out again to 70 days compared to 64.8 days at the time of the previous economic report. The figure for invoice discounting has improved slightly at 61.0 compared with 62.6 in the previous report. Businesses are waiting longer to receive payment on debts and sales invoices compared to earlier years.

There are other signs of distress. The numbers of credit protection payments being made to clients in the UK has increased by 18.5% to £6.4 million in the year to December 2008 compared to £5.4 million at the end of 2007 as shown in **Chart 10**. These payments are made by the asset based finance industry to their clients when their customers default on debt receivables where a non-recourse facility is in place. When these numbers rise more it shows businesses are failing to pay their debts as they declare insolvency. The Insolvency Service reported 2,428 businesses went into administration or receivership in the final three months of 2008 over a doubling on a year previously. Corporate liquidations rose by a half over the same period, resulting in 4,607 firms being wound up in England and Wales. 15,535 firms or one in 150 trading companies were liquidated for the entire year.

SUMMARY

Evidence from the client sales figures collected by ABFA members shows domestic sales of clients in non-retail sectors had increased and this is probably due to the expansion in the number of firms seeking to make greater use of asset based finance. Credit conditions are continuing to tighten in the euro area and the United Kingdom, with surveys showing that banks are restricting credit availability and raising spreads, fees, covenant restrictions and maximum credit lines are being pulled in. While demand and supply of bank lending are both expected to continue to fall in 2009, this is mostly a response to the weakening of demand. Evidence of financial distress is emerging in many sectors, as many firms are declared insolvent or wound up. Firms have taken longer to pay outstanding debts on factoring, but invoice discounting payments are being brought in line. Asset based finance continues to grow at 8% per annum, twice the rate of lending to private sector firms by banks, and further growth is expected in 2009.

CHART 9
Debt Turn
Source ABFA

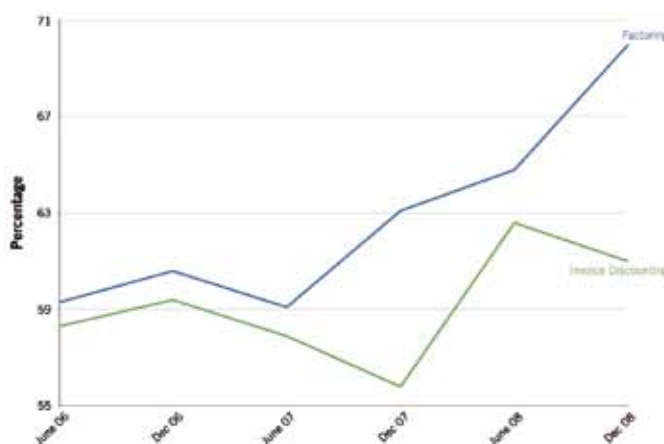
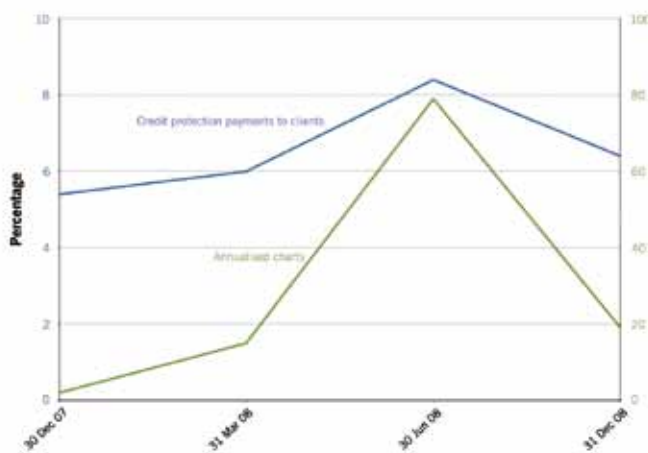


CHART 10
Credit Payment Protection to ABFA Clients
Source ABFA



Note: Credit protection payments on left hand scale, Annualised change on the right hand scale



The Asset Based Finance Association (ABFA) is the body that represents the interests of the asset based finance industry in the UK and Ireland. Members range from subsidiaries of major international banks to independent finance providers. The ABFA provides a variety of services to UK and Irish members, including on-line services, educational courses, lobbying, PR, and educational and networking events. The ABFA is a source of information and reference for those businesses looking to find out more about the products and services that this industry can offer.

For more information on the ABFA, or for more information on asset based finance in general, visit www.abfa.org.uk

This economic report was commissioned by the ABFA, and was written by Professor Paul Mizen, Director of the Centre for Finance and Credit Markets, University of Nottingham.

Disclaimer: The views are those of the author and not necessarily those of the Centre for Finance and Credit Markets or the University of Nottingham.



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Economic Report

