UK Finance

Business Finance Review 2025 Q1

Quarterly commentary on business finance for small and medium-sized enterprises.

June | 2025

2025 Q1 Highlights

UK Finance provides a regular analysis of how the finance needs of small and medium-sized enterprises (SMEs) are being supported through lending from mainstream lenders and specialised finance providers and looks at their deposit holdings. This latest *Business Finance Review* provides a round-up of lending activity to SMEs in the first quarter of 2025.

Executive Summary

- Gross lending to SMEs by the main retail banks rose to nearly £4.6 billion in the first quarter of 2025. This was nearly 14 per cent up on the same period a year ago and the highest level since 2022 Q2. This follows the gradual recovery in finance applications over the past 18 months.
- The rise in lending to the smallest businesses was particularly strong in Q1, increasing by 30 per cent compared with a year ago. Gross lending to medium-sized businesses also showed growth of nine per cent over the same period, nudging net lending for this cohort into positive territory.
- However, differences in lending across industry sectors continue to be apparent, with Q1 growth in gross lending driven by agriculture, manufacturing, wholesale and retail, and health.
- Data point to some further momentum for lending in the coming quarter with a further rise in the number and value of approvals for loans, though the pace of growth has eased. Approvals to small companies, in particular, are holding up with both value and volume of new loans the highest since the start of 2022.
- Approvals of new or increased overdrafts have also slowed, notably for medium-sized businesses. Despite the gradual increase in demand for overdraft facilities in recent years utilisation remains fairly static, with usage rates across all sectors below those reported prior to the pandemic. This could indicate that demand is precautionary in the face of an uncertain cost environment, rather than meeting an immediate need.
- The stock of SME deposits continues to decline, but at a more moderate pace than was seen during 2023 and 2024, however the rate of decumulation varies significantly by sector, with consumer-facing industries more likely to be recording the biggest falls.

Economic context

Headline GDP growth in the UK in the first quarter of this year came in stronger than expected at 0.7 per cent. This was an improvement on the meagre 0.1 per cent growth in the final three months of last year. Looking at the sector contributions to growth, rising output at the start of the year was fairly broad-based.

Services made the biggest impact on growth, also expanding by 0.7 per cent. Within this, both consumer-facing and non-consumer-facing sectors grew (0.9 per cent and 0.7 per cent respectively). The strongest performing sub-sectors were admin support services, and wholesale and retail, offset by contractions in education, and accommodation and food services.

Manufacturing activity also bounced back strongly in Q1 after a fairly stagnant 2024. Output increased by 0.8 per cent over the quarter with most sub-sectors contributing positively to the rise. There were particularly strong gains in investment goods and transport equipment. However, weak production data for the motor vehicles industry at the start of Q2 indicate that transport sector growth looks set to drop off in the coming quarter.

Finally, construction activity was flat at the start of the year, dragged down by a particularly weak January. There was continued weakness in repair and maintenance activity and private commercial work, with some modest growth in new housing and infrastructure.

The positive headline GDP numbers are, however, at odds with significantly weaker survey indicators, such as the purchasing managers' indices (PMIs). The manufacturing PMI has been in contractionary territory since last autumn, with worries about tariffs and weak global demand weighing on sentiment. It is likely that some of the rebound in the official manufacturing data at the beginning of the year comes from activity pulled forward ahead of President Trump's tariff announcement in April.

Services indicators have also been more volatile at the start of the year. Global economic headwinds also played a role, but weak UK consumer confidence and renewed concerns about inflation are also dampening activity.

Additionally, data also points to company insolvencies remaining high relative to historic levels in Q1. While the number was down both on a year ago and the highs seen in 2023, insolvencies remain elevated in construction, retail and hospitality.

The Bank of England attaches some weight to these indicators and reports from its agents' network. In the May Monetary Policy Report (MPR) it noted that while headline GDP growth was better than expected, the underlying picture is considerably weaker, and it expected official estimates for Q2 to drop back to around 0.1 per cent.

As noted in the Bank's MPR and a host of recent international forecasts, US trade policy (both in terms of actual tariffs announced and the unpredictably of their introduction) present one of the biggest downside risks to demand. A recent Decision Maker Panel survey showed that nearly a third (31 per cent) of UK businesses expect their sales to be lower as a result of US tariffs.

There are domestic challenges too. UK inflation picked up sharply in April, and while this was expected due to planned increases in energy and other regulated prices, this represents a renewed squeeze on households which are already concerned about the economic outlook and labour market prospects.

Balancing the rise in inflation and the risks to growth, the Monetary Policy Committee voted again to cut Bank Rate by 25-basis points, to 4.25 per cent, in May. The Committee was divided with two members calling for a bigger half-point cut and two preferring to leave rates unchanged. The future path of interest rates, while most likely down, will be dependent on how the balance of risks unfolds.

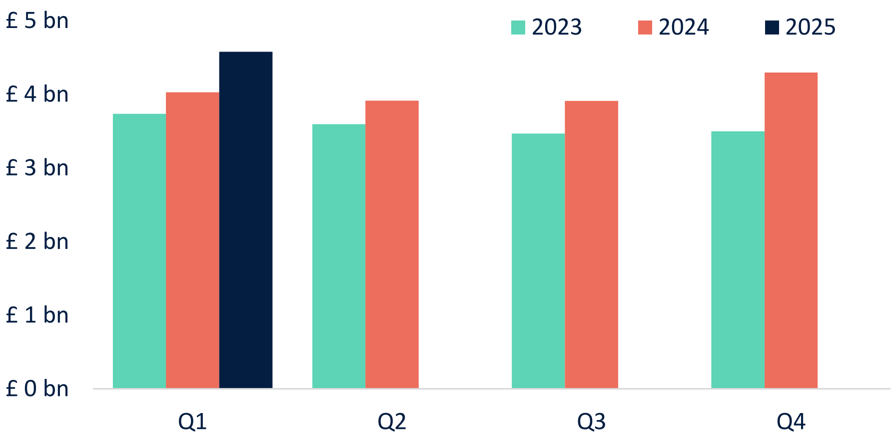
Just as important as the cost of borrowing for businesses are some significant set-piece announcements from the government in the run up to the summer. The outcome of the spending review, including a strategy for defence, industrial strategy and more details on business support will all be key in creating a supportive domestic business environment for businesses to plan, invest and grow.

Lending to SMEs

Against the backdrop of weak underlying growth, elevated uncertainty and a subdued appetite for new investment, 2025 Q1 nevertheless saw the sixth consecutive quarterly rise in gross lending by the main retail banks to small- and medium-sized business (**chart 1**).

In the first three months of the year gross lending picked up to nearly £4.6 billion, a 14 per cent rise on the same quarter a year ago, and the highest since 2022 Q2.

Chart 1. Gross lending to SMEs, £billion



Source: UK Finance

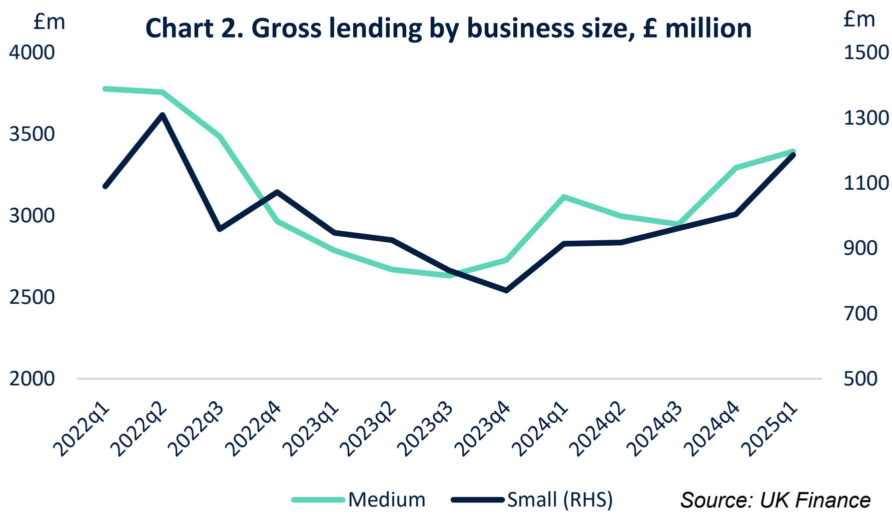
As we have cautioned since our data first showed signs of recovery, however, lending by the main retail banks remains significantly below pre-Covid norms. Recent reductions in borrowing costs may go some way to explaining the rise in lending. Respondents to the SME Finance Monitor survey in the second half last year noted that higher interest rates were an impediment to borrowing. Of those SMEs that might be future seekers of finance, around a third said lower interest rates would make them more likely to consider borrowing, followed by a more certain economic outlook and stronger customer demand.

However, at the start of this year we did also see a greater degree of sector variation in gross lending. In the latter part of 2024, almost all sectors we report on saw year-on-year rises in gross lending, the exceptions being transport and storage, and hospitality. In Q1 the rise in lending was driven by agriculture, manufacturing, wholesale and retail, and health.

As noted in the introduction, manufacturing, and wholesale and retail had a solid start to the year, albeit with some of this activity pulled forward ahead of the introduction of US tariffs at the start of Q2. Some lending could potentially have been to support increased production activity and mitigation against possible supply chain disruptions.

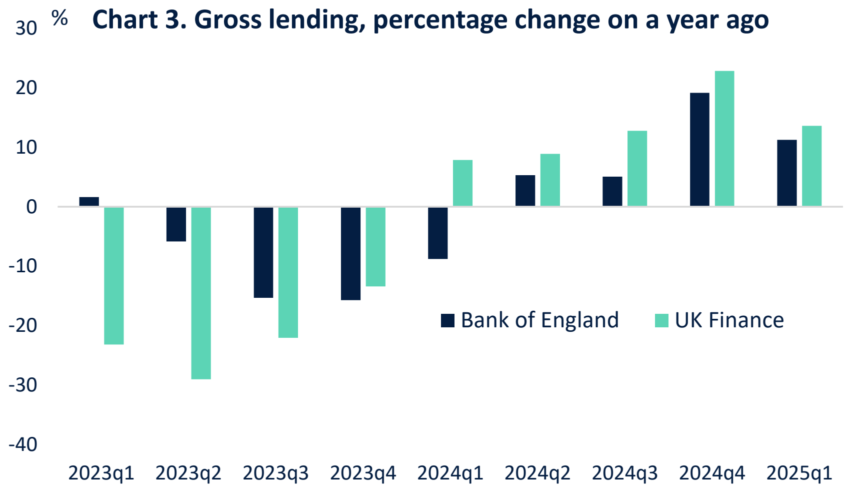
The data does, however, point to some ongoing caution across some consumer facing sectors, including accommodation and food services, and recreation. A potential response on fragile consumer confidence and worries about the rise in National Insurance Contributions, which businesses were hit with at the start of Q2, are likely to have contributed to this caution.

Encouragingly, our data shows gross lending to both small and medium-sized business segments on an upward trajectory (**chart 2**). There was particularly strong year-on-year growth in new lending to the smallest businesses (up to £2m turnover), with gross lending nearly 30 per cent higher that in 2024 Q1. Medium-sized firms still saw a healthy nine per cent annual increase in lending.



The trends noted above align with that reported by the Bank of England agents' network in the latest MPR: *"High Street banks seem more willing to lend, including to* *small and medium-size enterprises, as interest rates fall and property valuations stabilise.*

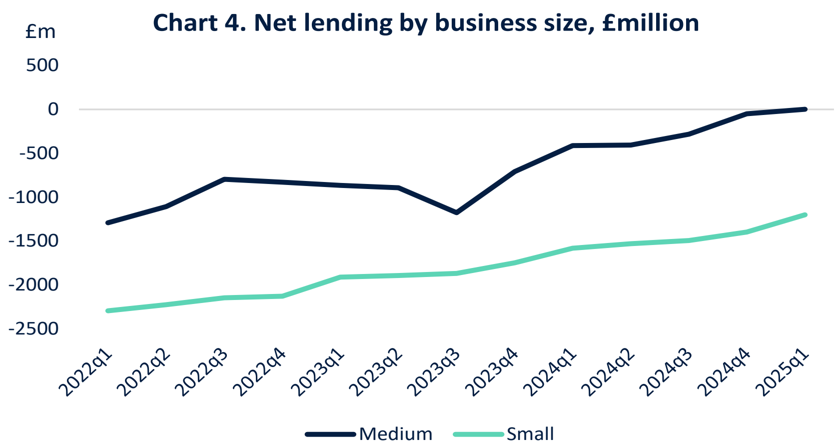
Indeed, gross lending by the main retail banks to SMEs has been rising at a slightly faster pace than total lending, as reported by the Bank of England (**chart 3**). However, this follows several years in which the high street lenders were reporting much more pronounced declines in new lending compared with the wider market. In part this was a consequence of the relative dominance of the main lenders in supporting the government's Covid loan schemes. Additionally, rising Bank Rate and the financial market turmoil around the autumn 2022 budget may also have had a more material impact on the appetite to lend across this cohort of banks.



Source: UK Finance

As the British Business Bank reported in its recent Small Business Finance Markets report, in 2024 the share of SME lending by challenger and specialist banks rose to over 60 per cent. Stronger growth in new lending from the main retail banks, if sustained, could see some increase in their overall sharing of lending this year. However, the rise in total lending to SME over the past year does indicate a competitive supply of finance to SMEs

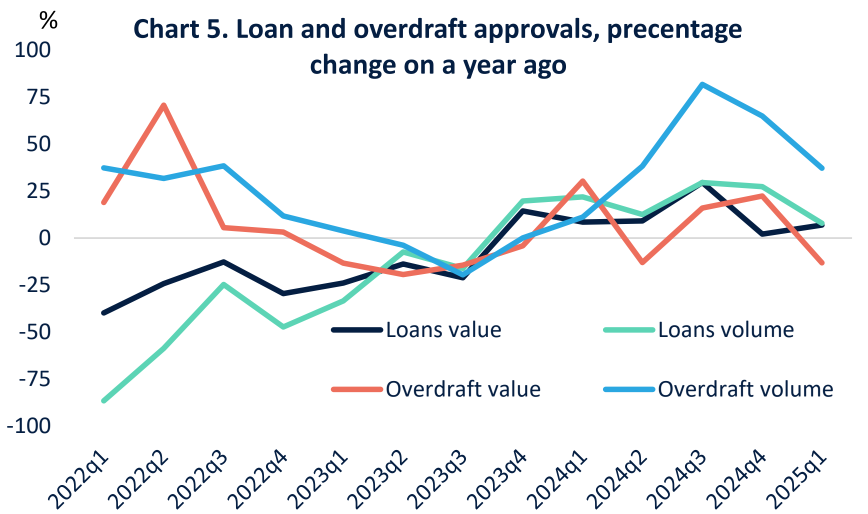
Finally, a further noteworthy development in our data is the positive trajectory of net lending. Subdued demand for finance and SMEs continuing to meet their Covid-loan repayment obligations has led to negative net lending for nearly four years. For the first time since the pandemic, net lending to medium-sized business just tipped into positive territory (**chart 4**).



Source: UK Finance

New finance approvals

The somewhat more positive picture on SME lending over the past year has been signalled in previous Business Finance Reviews, with approvals for new finance showing signs of recovery since the end of 2023.

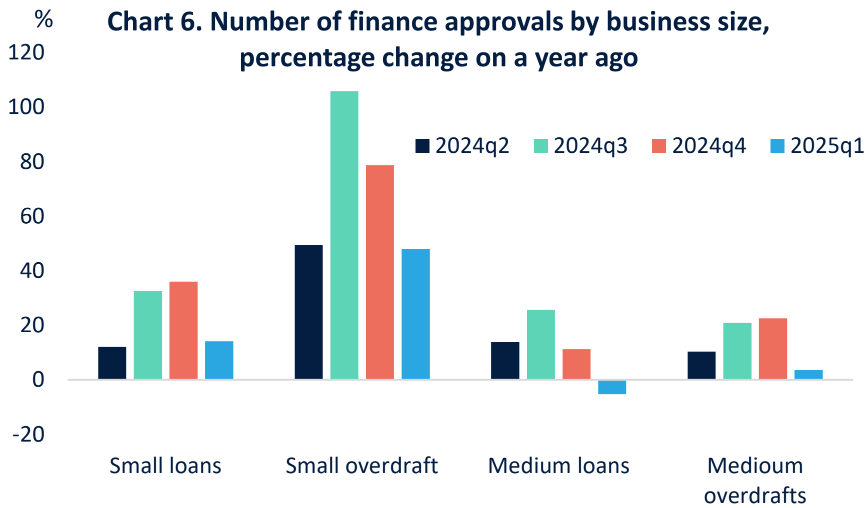


Source: UK Finance

Our latest data points to some continued momentum in new finance approvals, but growth in the first quarter of this year has fallen back from the peak last autumn.

Compared with the same quarter a year ago, the number of new loans and overdrafts approved in Q1 was 37 per cent and eight per cent higher respectively. This softening in the rate of growth in approvals is unsurprising in light of the additional sources of economic and policy uncertainty that have materialised since the start of the year.

Surveys continue to indicate a cautious approach to investment across many industry sectors – the ONS BICS survey, for example, reports that fewer than ten per cent of businesses had planned to increase investment over the past year, with demand uncertainty both the main barrier to investment and one that has been increasing over time. The relative resilience of overdraft demand, however, is perhaps an ongoing sign of the cost pressures facing some SMEs. Increased labour costs following April's NICs increase as well as the risk of rising input costs from global trade tensions are among the factors supporting continued growth in overdraft demand – especially among smaller SMEs (**chart 6**).

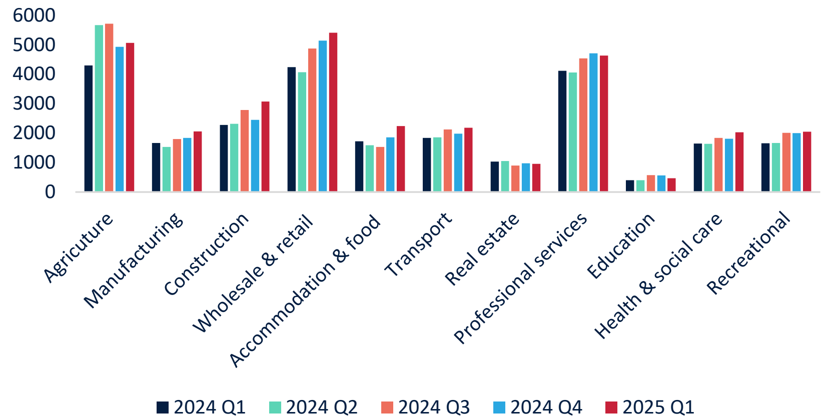


Source: UK Finance

While the number of applications approved is still on the increase, the value of approvals in the quarter was down on a year ago. This represents a clear divergence in trends between small and medium SMEs with the value of overdrafts approved to the former hitting the highest level since 2020 Q2, while it fell to medium-sized firms.

Looking at the sector composition of new finance approvals, both loans and overdrafts,

Chart 7. Finance approvals by sector, number



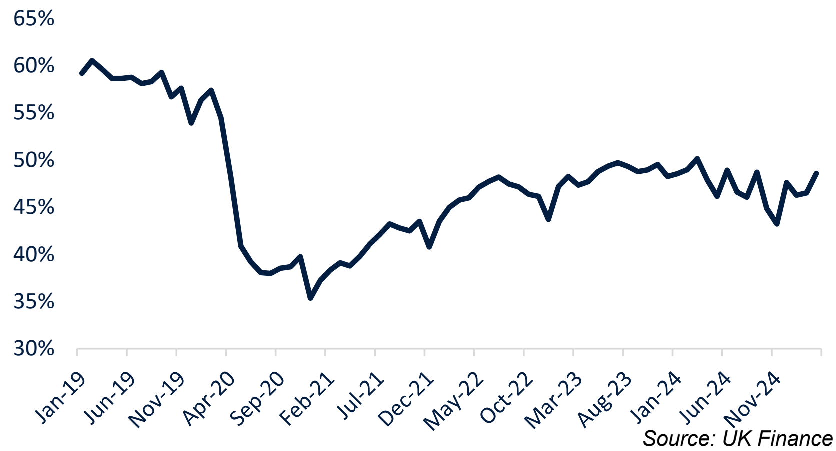
Source: UK Finance

chart 7), in almost all sectors the volume of approvals in Q1 was up on the same period a year ago. Growth, both in terms of the number and value of approvals, was particularly notable in manufacturing, construction and hospitality.

Utilisation of existing facilities and deposits

Despite the number of overdraft approvals continuing its slow but steady recovery from

Chart 8. Overdraft utilisation, percentage



Source: UK Finance

the lows reported in 2020, utilisation rates have barely budged over the past two years, hovering below 50 per cent, excluding some seasonal bumps (**chart 8**). In the most recent quarter, there were modest year-on-year falls in recreation, hospitality and real estate, offset by rises in wholesale and retail, and construction. Nevertheless, at the aggregate level we have not observed any significant movements in overdraft utilisation, by either business size or sector, and in all cases usage rates are below those reported at the start of 2020.

This points to SMEs continuing to retain a reasonable degree of headroom within their existing finance facilities and suggests the ongoing demand for new or increased facilities is a precautionary move in the face of risks of rising costs and renewed pressure on margins.

Similarly, we see only modest movements in the aggregate deposit holdings for SMEs. While the total amount of cash held in business current accounts and notice accounts continued to edge down, the pace of decumulation continued to slow. In Q1, total deposits were a little under three per cent lower compared with a year ago (**chart 9**).

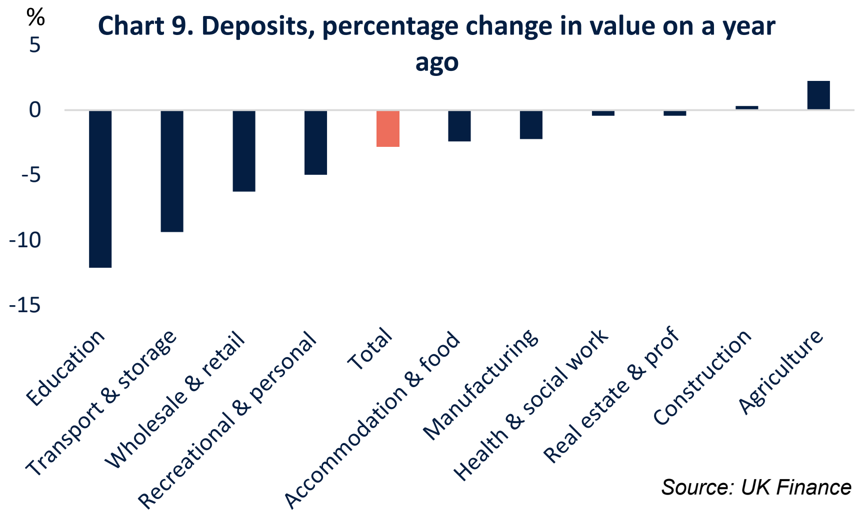


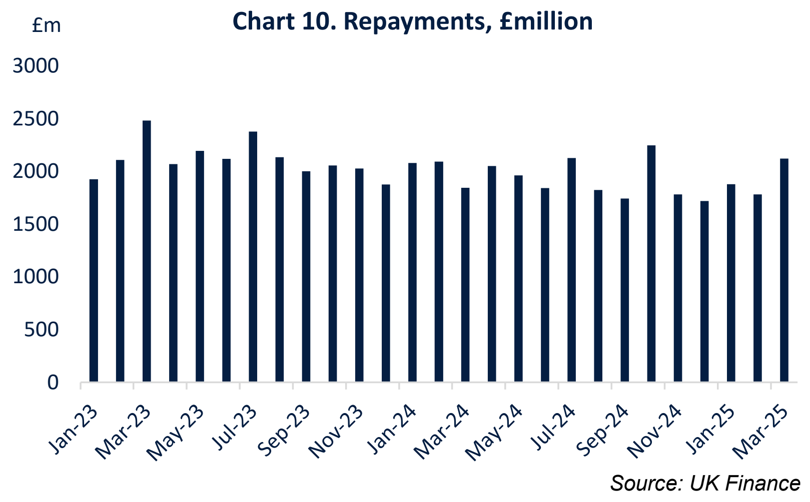
Chart 9. Deposits, percentage change in value on a year ago

This is entirely concentrated in falls in sight deposits, with cash held in notice accounts up on a year ago.

The overall decline compares with the year-on-year declines of over ten per cent in the second half of 2023 when energy and other cost rises were really biting.

Of all our SME finance data series, movements in deposit holdings show the largest differences across sectors. The biggest declines have consistently been seen in more consumer-facing sectors. As noted previously, transport and storage, which continues to run down deposits at a faster pace than the average, has aggregate cash holdings below the levels recorded pre-pandemic.

In the most recent quarter, businesses in the education sector have also hit that milestone, with recreation and personal services likely to be in a similar position within the next quarter or two. The rapid contraction in deposits in education may be linked to the introduction of VAT on school fees at the start of the year and the need for some establishments to absorb some of the increase. The extent to which there may be some timing effects in this sector will become more apparent in future data.



In contrast to the greater degree of variation in the data on SME deposits, there continues to be a very stable picture on the profile of loan repayments. Quarterly repayments have been trending at a consistent £5.8 billion over the past two years (**chart 10**). As we have reported in the Reviews over this period, this reflects the ongoing requirement for the repayment of Covid-related lending. Since March 2022 the stock of outstanding lending on fixed rates has reduced by 40 per cent, with minimal variation by size or sector.

SME finance outlook

In almost every quarter since the pandemic it has felt like the outlook for SMEs and their demand for finance been uncertain. From supply chain disruptions and rising costs to political change and global trade tensions, SMEs have been navigating an unpredictable demand environment for several years.

Despite this, there have been signs of some increase in demand for finance with a gradual rise in the flow of new lending to SMEs and further increases in approvals of new facilities. While growth in approvals has eased back, some continued momentum should drive further near-term modest increases in new lending.

It does, however, appear to be finance in support of short-term business needs and some precautionary cashflow management facilities rather than lending in support of more strategic business development and investment. Nevertheless, this will be important, alongside the remaining cash cushion, in helping businesses show some resilience in the current economic climate.

It is not until a stronger demand outlook becomes clearer on the horizon and policy uncertainty wanes that we can expect SME's appetite for finance to invest to increase materially.

That said, upcoming announcements from government on its industrial strategy, the growth guarantee scheme and new business support service have the potential to help create a more supportive business environment in which SMEs can plan.

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