EUROZONE: PEAK OF MONETARY POLICY'S RESTRICTIVE EFFECTS ON BANK LENDING IS BEHIND US

In line with previous months, the recovery in the private sector credit impulse continued in the first quarter of 2024, after the dip seen in the third quarter of 2023. This said, the recovery was slightly slower than at the end of 2023 and the overall trend is still negative.

Developments in lending to business are traditionally more volatile over the cycle than those in lending to households. Recent ones have not deviated from this rule: in the autumn of 2023, at a time when the effects of the tightening of monetary policy were at their strongest, the impulse of lending to households did not fall as far, in absolute terms, as that for lending to businesses. Conversely, its recovery since then has been less vigorous. Taking a longer-term view introduces an additional observation: the impulse of lending to households are still close to those seen at the historic low at the beginning of 2009, whilst that of lending to business have not returned to such levels since.

Meanwhile, movements in real GDP and in outstanding loans have been relatively tightly synchronised. The former saw a modest upturn in the first quarter (0.4% year-on-year) after two quarters of barely positive growth in the third and fourth quarters of 2023 (0.1% in both cases). At the same time, and for the first time since the summer of 2022 and the beginning of the ECB cycle of rate increases, outstanding credit in the private sector has stopped slowing down (+0.6% year-on-year in December 2023, +0.8% in March 2024). However, these overall trends need to be put in perspective since they are due solely to lending to the financial sector, with outstanding loans to households (+0.4% and +0.2% respectively) and to a lesser extent loans to non-financial companies (+0.5% and +0.4%) continuing to slow, albeit less markedly than in previous quarters.

The 157 banks surveyed in the first fortnight of March for the ECB's Bank Lending Survey indicated that they had only very slightly tightened their credit standards applied to the approval of loans for businesses in the first quarter of 2024 and, more importantly, by less than they had expected at the time of the previous survey. At the same time, and for the first time in three years, they had eased their credit standards for mortgages. They also continued to tighten lending standards for consumer loans, where the share of new production considered as higher risk has increased. Overall, the increase in perceived risk has encouraged a tightening of terms and conditions, whilst stiffer competition, particularly for mortgages, and greater risk tolerance have pushed towards an easing of lending conditions.

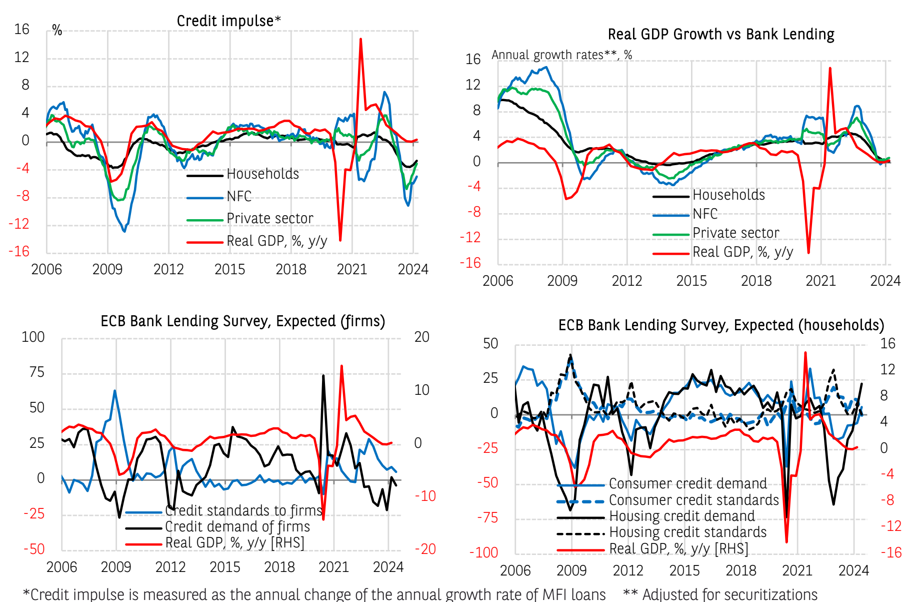
The fall in demand for loans and the drawing down of credit lines by businesses has surprised in terms of its scale, with banks expecting a stabilisation, on average, in the survey conducted during the fourth quarter of 2023. Demand for mortgages has seen a more modest contraction. Demand for consumer loans has stayed more or less stable. As in previous quarters, demand for bank financing was negatively affected by higher interest rates, a reduction in productive investment by companies and the weakness of consumer confidence.

Banks have reported reduced ability to collect resources from their retail banking clients, but also better access to bond market and, to a lesser extent, to the money market. The continued reduction of Eurosystem's securities portfolio had negative effects on financing conditions and liquidity positions over the last six months, which contributed to the tightening of lending conditions and the contraction of new production. Banks believe that this process has not yet had an effect on lending conditions but that they could be affected over the next six months.

Repayments under TLTRO III continued to weigh on the liquidity positions of lending establishments. However, because of the significant repayments since November 2022 and the now modest residual outstandings from these operations, the impact on their own financing conditions is considered negligible and the effect on conditions applied to clients is considered neutral.

Banks reported a positive impact from the increase in key policy rates on interest margins over the past six months, but they now expect this to diminish over the next six months. Conversely, they highlight the depressive effect on financing volumes, that they expect to persist over the next six months. Lastly, they believe that the overall effect of higher rates on levels of banking profitability will be negative over that period, due to the increase in the cost of risk. This assessment holds true for banking systems where the share of variable-rate loans is relatively high (Portugal, Finland and, to a lesser extent, Italy and Spain), which is not the case for France, Belgium and Germany.

CREDIT IMPULSE IN THE EUROZONE



*Credit impulse is measured as the annual change of the annual growth rate of MFI loans ** Adjusted for securitizations

SOURCE ECB, ECB SURVEY ON THE DISTRIBUTION OF CREDIT, BLS, BNP PARIBAS CALCULATIONS

For the second quarter of 2024 the banks expect a modest fall in demand for financing from business and an increase in demand from households. They expect lending conditions (rates, guarantees, etc.) to be tightened slightly on loans to companies and to stay more or less the same for households. We believe that demand for borrowing will continue to be constrained by financing costs, which will remain lastingly higher than those seen up until 2022 and be penalised by expectations of adjustments in real estate markets. Amongst other factors, this will support the disinflationary trend in the euro zone (annual inflation stable at 2.4% in March and April, from 2.9% in December 2023), opening the way to the first cut in ECB policy rates next month.

Laurent Quignon