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››› Euro area credit markets: step by step, little by little

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The key mechanism for monetary policy transmission is the credit channel, especially the one leading to non-financial enterprises. Only if this mechanism works are central bank measures certain to have the desired impact on the real economy. Across much of 2014 and 2015, the euro area recorded strong growth in new lending for the first time since the financial crisis, but the momentum dissipated again in the past quarters. This shows that new lending is on a slow growth path – at a time when it is hoped to provide a boost to the economy.

Individual euro area countries show very mixed trends. The development in Germany and France is relatively good, but it is rather sobering in Italy, Spain, Portugal and Greece – for different reasons. It is precisely in Italy, the euro area's second biggest market for loans to non-financial enterprises, that economic growth is weak. Here, helpful measures would include scaling back the large portfolios of non-performing loans on banks' balance sheets to create more scope for new lending and economic momentum.

In general, strengthening the overall banking sector should enable the credit channel to work even better. Credit institutions are currently benefiting from a yield curve that has steepened since last summer. Looking further ahead, reducing the number of non-performing loans on the balance sheets of – primarily Italian – banks would probably be the best way to increase momentum on the credit market.

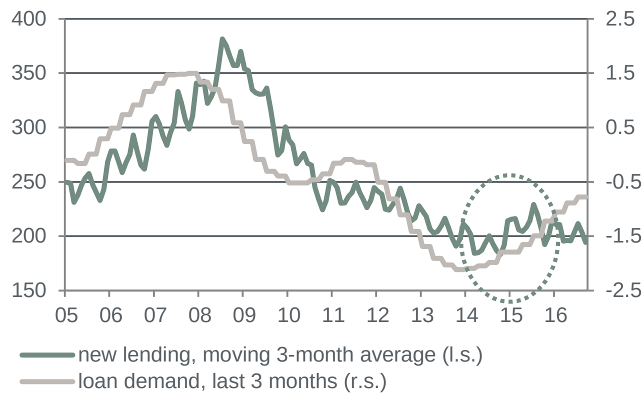
New lending in the euro area has been lacklustre of late

New lending to non-financial corporations was on the decline in the euro area since the collapse of the investment bank Lehman Brothers in 2008 up to mid-2014. After that, new lending picked up noticeably on the back of an economic recovery, record-low interest rates and a variety of unconventional measures by the ECB. In the second half of 2015, however, that trend reversed again. Lately it has been moving roughly sideways (Figure 1). In this context it is interesting to explore where the most recent weakness is coming from. This is crucial for assessing further trends and deciding on necessary monetary or general economic policy measures. One thing is clear, however: the answer to this question is neither trivial nor simple.

Looking at the supply side, the first thing to note is that nominal interest rates have dropped to unprecedented lows, both for large enterprises and for small and medium-sized enterprises. At the same time, according to the half-yearly ECB Survey on Access to Finance of Enterprises for the entire euro area, the proportion of businesses reporting difficulties in accessing credit has dropped to a level not seen since 2010 (Figure 2). Access has improved for all company size classes, particularly since 2013. To a lesser extent, according to the Bank Lending Survey (BLS), the same trend can be observed in credit standards, the lending criteria that set the overall framework for the granting of loans. In the past years they were loosened again slightly in the euro area (Figure 3). Lending conditions, the criteria applied to specific agreements, were relaxed even more, according to the BLS. All in all, this shows a generally positive situation since 2014.

Figure 1: New lending to non-financial corporations in the euro area and loan demand according to the BLS

New lending in EUR billions, Loan demand as cumulative net percentages



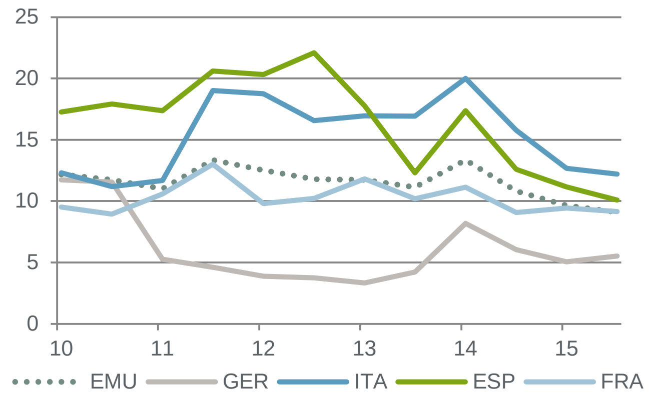
Sources: ECB, own rendition

Fewer indicators are available on the demand side. For this aspect we can again refer to the BLS, in which the banks of the euro area submit their estimates of the trend in loan demand every quarter. They have perceived an increase since 2014. Moreover, the momentum expressed by this indicator HHH – although a purely qualitative one – appears stronger than the relaxation of lending standards described above (Figures 1 and 4).

Thus the conditions on the credit markets have tended to develop favourably since 2014. They would even suggest a higher momentum in new lending. The fact that this is not the case may be partly due to lagged effects, as there elapses always a certain amount of time between initiating and actually disbursing a loan. Another reason is probably the fact that the euro area banks' lending capabilities are currently hampered by a relatively weak profit situation caused by various factors (such as bad debts and increasing regulation). In order to explore this proposition more closely, it is useful to look at the individual countries of the euro area.

Figure 2: Survey on Access to Finance of Enterprises: firms facing financing obstacles

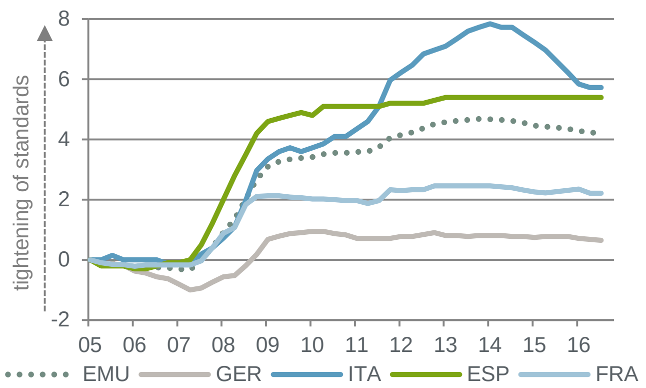
in per cent



Sources: ECB, own rendition

Figure 3: Credit standards for loans to enterprises, last 3 months according to the BLS

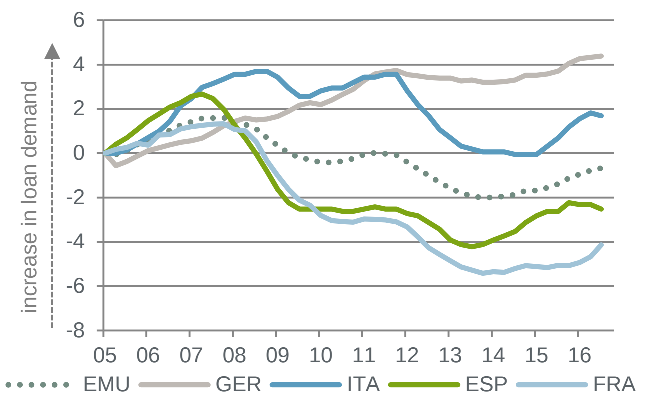
Cumulative net percentages



Sources: ECB, own rendition

Figure 4: Loan demand of enterprises, last 3 months according to the BLS

Cumulative net percentages



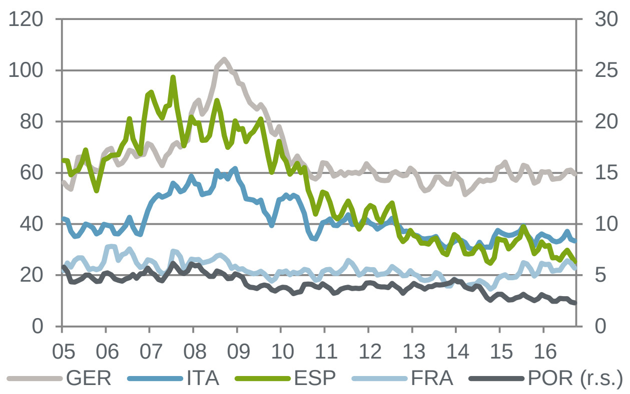
Sources: ECB, own rendition

Once again, the euro area is a mixed bag

New lending in the large euro countries presents a mixed picture. First there is France, with strong growth since mid-2014, although its market for loans to non-financial corporations is the smallest of the "big four" (Figure 5). Then there is Germany, where businesses can draw on plenty of own resources to finance their operations, and Italy, which have both seen a mild upward trend in new lending since 2014. That trend is rather shallow, however. At the current juncture, in the third quarter of 2016, new lending to non-financial enterprises was slightly below the volume of the previous year in Germany (-0.2 %) and significantly lower in Italy (-2.1 %). But that is nothing compared with the decline in Spain, where new lending literally collapsed on the previous year, plummeting by 23 %. Portugal saw a similar trend (-15 %). In Greece the trend is actually starting to stabilise on an extremely low level – and amid a scant supply of reliable data.

Figure 5: New lending to non-financial corporations

Moving 3-month averages in EUR billions



Sources: ECB, own rendition

Spain is going its own way

Spain comes with a particular question mark as its credit market is even internally split. New loans of up to EUR 1 million, which are sought mainly by small and medium-sized enterprises (SMEs), have exhibited a solid upward trend since 2013. In the third quarter of 2016 they were up slightly on the previous year. New loans in excess of EUR 1 million, on the other hand, have been on the decline since mid-2015 and were nearly 40 % below the previous year's level in the same quarter of 2016 (Figure 6).

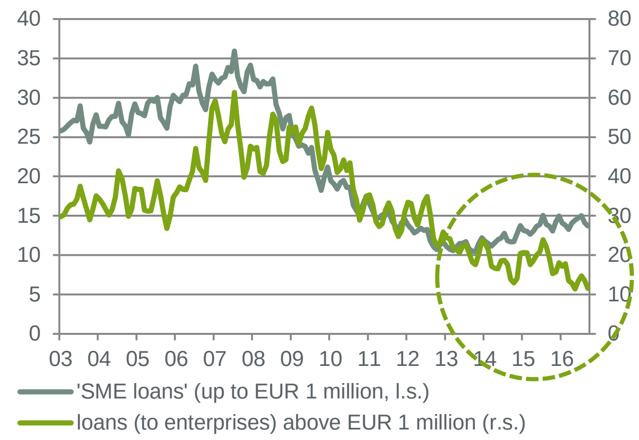
This is all the more irritating considering that Spain's economy has returned to high and steady growth. It has shown annualised real rates of 2 to 4 % each quarter on the previous quarter for the last two and a half years. There are very few such cases of economic growth without credit growth. The phenomenon of declining large exposures can be partly explained by the fact that the low-interest environment with its narrowing spreads has created outstanding conditions for the issuance of corporate bonds. In fact, the volume of corporate bonds in circulation in Spain in the past quarter was 13 % above the previous year's level – the strongest growth rate of all "big four" euro countries.

In this context Banco de España, Spain's central bank, has pointed out in its analyses that large Spanish enterprises currently can actually obtain funding at more favourable terms via the capital market than through bank loans – among other reasons because of the ECB's corporate sector purchase programme. That has also led it to conclude that the current weakness in lending above EUR 1 million can be explained – at least in part – by the fact that enterprises are increasingly issuing papers and are thus substituting bank loans with bond issuances.[1]

However, new monthly large-scale lending volumes averaged around 17 times higher in the past twelve months up to September 2016 than the Spanish corporate sector's monthly issuance of bonds. This shows that funding via the capital market is making up for only a small fraction of the decline in the demand for large-scale loans.

Figure 6: New lending to non-financial corporations in Spain

Moving 3-month averages in EUR billions



Sources: ECB, own rendition

Spain's economic cycle might provide a further explanation. After the recession the Spanish economy began to recover at the end of 2013. During that phase, businesses' demand for loans may have been high at first. But the ensuing upswing has probably improved their liquidity significantly, which created additional scope for avoiding fresh loans – especially since Spain has been facing more of a general deleveraging process than other euro countries since its real estate crisis. This proposition is congruent with the Spanish Bank Lending Survey, in which banks have reported since the end of 2015 that internal financing is increasingly reducing enterprises' demand for loans.

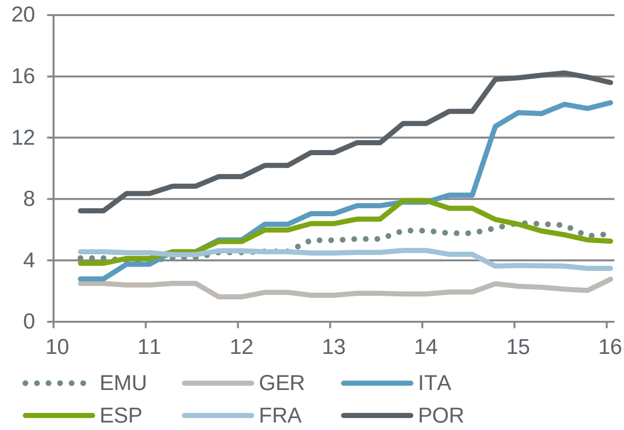
Even if the causes of this phenomenon cannot be finally identified here, it does not appear to pose a problem for the Iberian economy. This is expressed not just by the relevant indicators (such as the EU Commission's Economic Sentiment Indicator and the Markit Purchasing Managers' Indexes). Another sign is the robust development of new lending of up to EUR 1 million. It should, after all, be a reflection of loan demand by Spain's SMEs and, hence, of the breadth of the economic recovery (Figure 6).

Italian risk

New lending is facing different challenges in Italy. On the one hand, despite recent negative variation rates on the previous year, the mild upward trend since 2014 generally appears to remain intact. On the other hand – and quite unlike Spain – Italy's economic growth continues to be very subdued. Behind this might also be the sluggish performance of the country's market for loans to enterprises as there is a strong interdependence between the two. One indication in that respect gives the "SAFE" survey, which revealed that Italian businesses have been deploring disproportionately high credit constraints for years – compared with the overall euro area average (Figure 2). More than twice as many Italian than German businesses reported, for instance, obstacles when trying to access new credit. This is probably also an effect of the pressure non-performing loans are exerting on the balance sheets of Italy's banking sector. Unlike Spain, Italy has not yet successfully tackled this challenge (Figure 7).

Figure 7: Non-performing loans as a percentage of total loans

In per cent



Sources: ECB, own rendition

Step by step, little by little – increase momentum by getting rid of bad loans!

It can be noted that the revival of new lending business in the euro area is turning out to be rather sluggish. But overall, the credit channel is generally working across the currency area. However, the individual countries are showing very mixed performances. While new lending in France and Germany is trending upward (at different levels of intensity) and the weakness in Spain can be explained by special factors, the development in Italy, in particular, could definitely be better.

Of the four big euro countries, Italy is the one where enterprises face the highest barriers to accessing credit. This is likely due primarily to the high proportion of non-performing loans on the Italian banks' balance sheets. The situation is similar in Portugal and Greece – where markets are significantly smaller.

Consequently, reducing the number of non-performing loans held by the banks would help the credit channel work better in these countries. That should free up funds that would then be available for new loans when demand picks up.

Cautious optimism

As described, new lending business in the euro area is currently between a rock and a hard place. But the recently steepening yield curve is generally good for banks' profits and, thus, for their lending business – provided the rise in interest rates that has been observable since early autumn stays within a moderate range in the near term.

At the same time, the growing loan demand identified by the Bank Lending Survey combined with rising business confidence (compared with last summer) is generating a cautiously optimistic outlook for the credit market. Meanwhile, there are no signs of a new surge such as the one of 2015.

The biggest potential for greater momentum in new lending lies in Italy, assuming the banks tackle the challenge of non-performing loans on their balance sheets. But given the country's political uncertainties that solution currently appears to be difficult to achieve. ■

[1] Cf. Banco de España: Boletín Económico, Septiembre 2016, p. 17, 43 f.