

»» Credit markets in the euro area: heterogeneous but healthy

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New lending to businesses in the euro area trended downwards after the financial crisis. Even as the economy recovered from 2014 onwards, it showed no sustained growth at first. But for the past year or so, new lending business has picked up again and is giving the recovery in the euro area a new quality.

Stark differences remain from one country to another. While the credit boom put the regulator on its guard in France, new corporate lending continues to drop in Italy. As in Spain, the main problem here, however, is the decline in large exposures because large enterprises are increasingly using their own resources or directly tapping the capital market to fund their business.

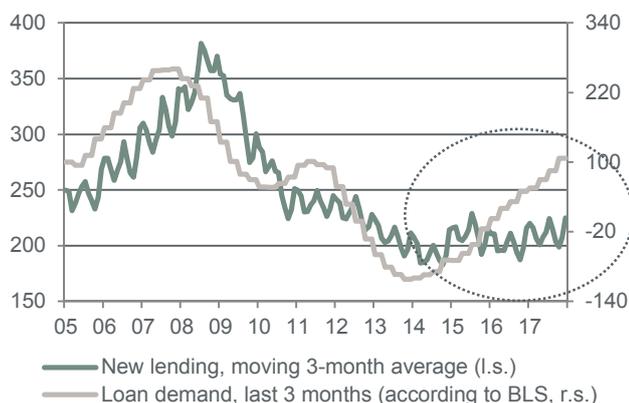
All in all, the situation in the market for corporate loans in the euro area has brightened significantly in the past quarters. And it appears that this positive momentum will continue even further – a good signal for the economy and credit markets in the euro area. A small question mark hangs over developments in Italy, however.

New lending in the euro area is growing again

After the financial crisis, new lending to non-financial corporations (NFCs) was on the decline for a long time in the euro area. A revival that set in from mid-2014 was followed by a renewed phase of weakness only about a year later (Figure 1).

Figure 1: New lending and loan demand in the euro area according to the Bank Lending Survey

New lending to non-financial corporations (NFCs) in EUR billions, NFC loan demand as cumulative net percentage balances according to the BLS (1st quarter 2005=100), each on a quarterly basis



Source: ECB, own rendition

That fuelled doubts as to the sustainability of the economic recovery of the monetary union and the functioning of the credit channel and prompted our analysis of December 2016.¹ We gave a cautiously optimistic outlook at the time. It can now be stated that new lending in the euro area is indeed on a modest upward trend again (see also Figure 1).

However, the differences between individual countries are very significant and that has been the case for quite some time. What is new is that the heterogeneity can in fact be considered healthy if we take into account the idiosyncrasies of the national markets. Before we look at them more closely, we will provide a broad overview of the development of the supply and demand side of the market for corporate loans in the euro area.

Supply conditions are improving further ...

Conditions have improved further on the supply side. Despite the cautious interest rate reversal that began in late 2016 for longer maturities in the capital market, average interest rates for loans to non-financial corporations have remained nearly unchanged overall in the past months. For smaller loan volumes of up to EUR 1 million, which are usually requested by small and medium-sized enterprises (SMEs), they have actually fallen once again (Figure 2).

Figure 2: Average loan interest rates

For loans to NFCs on a monthly basis and in per cent



Source: ECB, own rendition

Since the euro area is recovering well and the phase-out of the ECB's unconventional monetary policy has begun, the trend will presumably reverse in 2018. This is also being signalled by the most recent yield increases on government bonds and the upward trend of swap rates in the interbank market. In the short term, this should actually have a positive

impact on the momentum of new lending. Because credit costs are rising, enterprises that are planning to borrow in the future anyway should now take up debt capital soon in order to reap the benefits of the low interest rate level.

It is not just the credit costs for enterprises that continue to be very favourable. Barriers to credit access have also dropped again recently according to the ECB's 'Survey on Access to Finance of Enterprises'. Now only around 6% of surveyed enterprises in the euro area are still reporting problems accessing credit (Figure 3). Besides, credit conditions are being loosened further according to the ECB's Bank Lending Survey (BLS).

Figure 3: Survey on Access to Finance of Enterprises: Enterprises with problems accessing bank loans

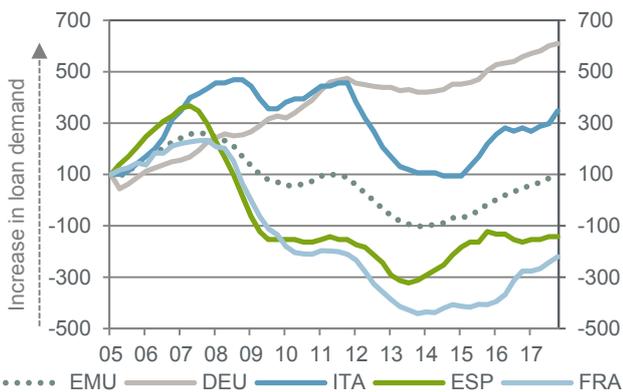
Applies to NFCs, on a half-yearly basis and in per cent



Source: ECB, own rendition

Figure 4: Credit demand of the past 3 months according to the BLS

Cumulative net percentage balances, on quarterly basis (1st quarter 2005=100)



Source: ECB, own rendition

... and demand is rising

On the other side of the market, the BLS demonstrates that the trend of rising credit demand perceived by the credit institutions since 2014 is unbroken in the monetary union (Figure 4). Based on the euro area as a whole, the demand indicator of the BLS – gathered from qualitative assessments – even points to significant upward potential for new lending (Figure 1).

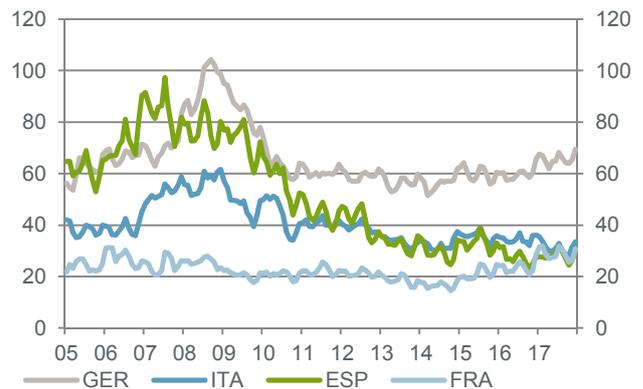
The gap between the indicator and actual new lending business is widening and might not close but this may be due to the fact that lending has become more modular. It is true that credit demand is picking up broadly and banks are receiving more loan applications. At the same time, however, the average loan amount approved is falling. This is likely to be the case particularly in Spain and Italy, where large exposure volumes are generally shrinking while the volume of aggregate small loans is growing (see further below). Overall, it must be stated that credit demand in the euro area obviously remains on a clear upward trend.

Development in the euro area: heterogeneous but healthy

As indicated above, the credit markets of the four major euro countries present very distinct trends. New lending shows the strongest momentum in France. In Germany it is also clearly pointing upwards again (Figure 5). We describe local developments in our quarterly 'Credit Market Outlook'², so we will dispense with a more in-depth analysis of the German market in this publication. Finally, credit markets in Spain and Italy generally appear to be moving sideways.

Figure 5: New lending in the large euro countries

To NFCs, on a monthly basis and in EUR billions



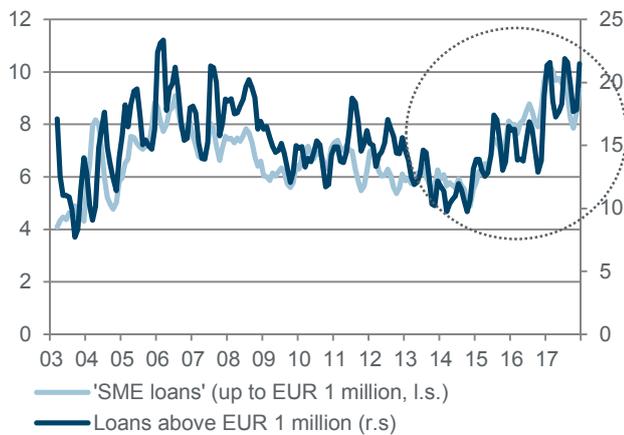
Source: ECB, own rendition

France: credit boom has put the regulator on its guard

The strongest growth in new lending to non-financial corporations can be seen in France. Since the end of 2014 the trend has clearly pointed upwards for both smaller loans and large exposures (Figure 6). However, the French market for new loans was by far the smallest of the four large euro countries before its recent surge (Figure 5). One reason for its relatively small size is that the French economy has significantly more large enterprises – which fund themselves primarily in the capital market – than the remaining states of the euro area. The volume of outstanding securities (excluding shares) of non-financial corporations in France is almost as high as in all the other states of the euro area combined and almost 18 times higher than in Spain, for example. Nevertheless, new lending in France has now caught up with the levels of Spain and Italy (Figure 5).

Figure 6: New lending in France by loan amount

To NFCs, moving 3-month average (on a monthly basis), in EUR billions



Source: ECB, own rendition

This is partly responsible for the recent significant increase in the debt levels of French companies – bucking the trend in the euro area.³ It has also caught the attention of the French financial supervisory authority. In December the ‘Haut Conseil de Stabilité Financière’ (HCSF) adopted a macro-prudential measure aimed at protecting the financial sector from the negative consequences of over-indebtedness of individual enterprises. It called upon the country’s three systemically relevant banks (Société Générale, BNP Paribas and Groupe Crédit Agricole) to limit their exposures to the most highly indebted enterprises to a maximum of 5% of their equity. According to media reports, this affects around ten out of a total of 250 French large-scale enterprises. This measure now awaits the approval of the European authorities. It is scheduled to take effect in the middle of the year.⁴

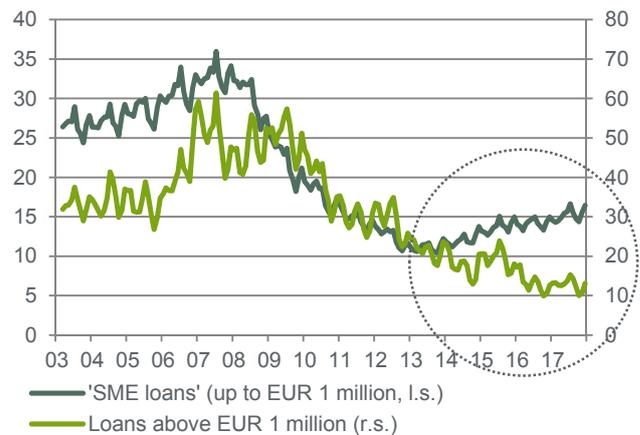
Despite – or precisely because of – the intervention of the regulator, the positives dominate the development of the French credit market. The number of large enterprises regarded by the HCSF as being at risk of unsustainable debt so far is low. This shows that the agency’s intervention was timely, raising the probability of a positive outcome. Besides, loans are reaching SMEs, which are so important for the overall economic recovery. This is illustrated by the general growth in loans up to EUR 1 million (Figure 6). In addition, growth in new lending is taking place against the background of strong increases in corporate investment which, in turn, is a precondition for a prolonged real economic recovery. And finally, the growth rates of large exposure volumes that were very high just last summer are dropping again already. In the final quarter of 2017 they were back to the relatively unproblematic level of 14% on the previous year.

Spain: Gap between small and large loans

In our last Focus on credit markets in the euro area a good year ago, we put a question mark next to Spain. The reason was the gap that was widening between loans up to EUR 1 million and loans in higher amounts. Recently, that gap has actually widened. While new lending in smaller amounts continues to increase, large-scale loans are bottoming out at best.

Figure 7: New lending in Spain by loan amount

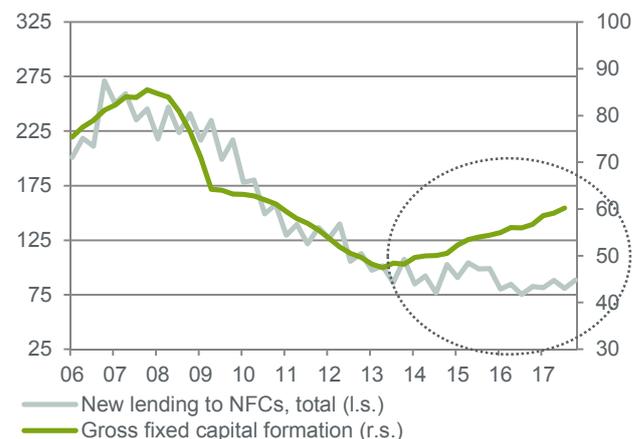
To NFCs, moving 3-month average (on a monthly basis), in EUR billions



Source: ECB, own rendition

Figure 8: New lending and investment in Spain

New lending to NFCs and nominal gross fixed capital formation, on a quarterly basis and in EUR billions



Sources: Eurostat, ECB, own rendition

Today we can replace the question mark next to Spain with an exclamation mark. The observable trend is very clearly a healthy one. First, growth in lending to SMEs is intact (Figure 7). This in itself already indicates a sound and broad recovery of the Spanish economy, which is also reflected in the remaining economic indicators. The upswing is now in its fifth year. Second, large Spanish enterprises have increased the issuance of securities to fund themselves for some years now (Figure 10). Third, they are evidently using more of their own funds (which grow as the economic upturn advances) – also with the aim of further reducing their debt levels, which were greatly increased before the financial crisis.⁵ That is the only way to explain the second gap that is widening in Spain: the gap between gross fixed capital formation, which has been rising steadily since 2013, and new lending to non-financial corporations, which has been moving only sideways since then (Figure 8).

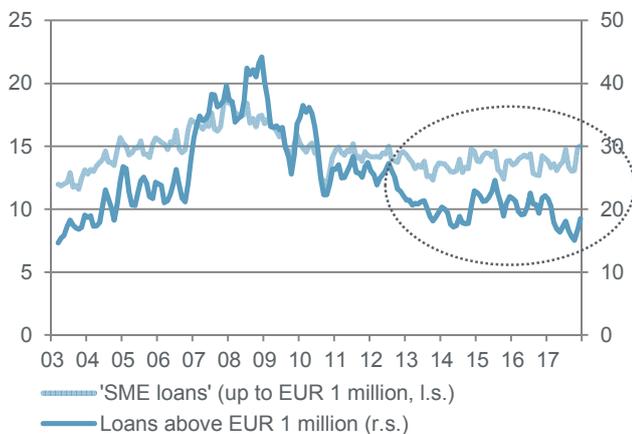
Italy: following in Spain's footsteps?

Italy exhibits a similar trend in new lending as Spain. Here, too, the gap between small loans and large exposures is widening. But the discrepancy in the Italian market is less

pronounced than on the Iberian Peninsula. This is mostly due to the rather more subdued momentum in SME lending. However, the gap has been widening here as well since the middle of last year. And as the economy recovers and corporate investment increases there is hope that Italy will follow in Spain's footsteps. In fact, Banca d'Italia puts forward the same arguments as the ones set out for Spain above. It explains the weakness of large exposures by the fact that Italy's big corporations are increasingly refinancing their operations in the capital market (Figure 10) and with funds of their own.⁶ It therefore regards the decline in new large-volume loans as unproblematic, or even desirable, from the perspective of the enterprises and the economy.

Figure 9: New lending in Italy by loan amount

To NFCs, moving 3-month average (on a monthly basis), in EUR billions



Source: ECB, own rendition

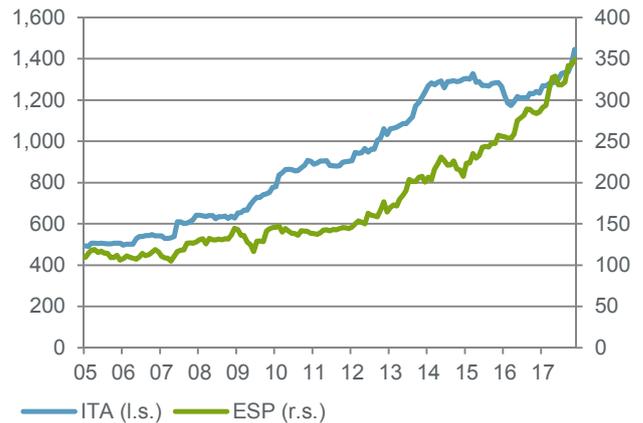
Good prospects for new lending in the euro area

New lending in the euro area has been growing again since 2016. But significant differences exist between the individual markets within the monetary union. While France is experiencing a credit boom and new lending in Germany is growing at a robust rate, developments in Spain and Italy are clearly weaker. But in the latter two countries, the strong

growth of smaller loans is being concealed by the weak trend in large-volume lending. The latter, however, is only due to the fact that companies demanding large amounts are increasingly turning to the capital market and using funds of their own. Excessively high credit constraints or a weak business cycle that would make borrowing or debt-financed investment unattractive cannot explain this phenomenon.

Figure 10: Securities outstanding (without shares)

From NFCs, on a monthly basis and in EUR billions



Source: ECB, own rendition

Given the strong and broad economic upswing in the euro area, for which KfW Research forecasts real GDP growth of 2.4% for 2018, new lending business in the monetary union can be expected to grow at a healthy rate this year as well. If growth turns out more subdued than in previous times, it will be because large enterprises in particular are using alternative sources of funding. This can be regarded as healthy if relatively highly indebted enterprises succeed in lowering their debt by using more funds of their own – as has occurred in the past years in Spain and in Italy, where it is still observable. ■

¹ Cf. Wanke, S. (2016), Euro area credit markets: step by step, little by little, Focus on Economics No. 152, KfW Research.

² The series of Credit Market Outlooks can be found here: www.kfw.de/kreditmarktausblick

³ Cf. Haut Conseil de Stabilité Financière (2017), report 'État des lieux de l'endettement des agents privés non financiers', published on 15 December 2017, page 4.

⁴ Banque de France (2017), Interview with François Villeroy de Galhau, governor of Banque de France, BFM Business, 18 December 2017, page 2.

⁵ See also e.g.: Haut Conseil de Stabilité Financière (2017), report 'État des lieux de l'endettement des agents privés non financiers', published on 15 December 2017, page 4.

⁶ Cf. Banca d'Italia (2018), Economic Bulletin, January 2018, p. 29.