

Economics in Brief



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Euro area: the credit channel is working!

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New lending business with non-financial corporations has been growing again since the end of 2014, recently by over 15%. These rates were rarely achieved even before the financial crisis. Thus, despite widespread reservations over increasing banking regulation, it can indeed be said that the credit channel as the 'classic' monetary transmission mechanism is currently working.

ECB has improved lending conditions

Under President Mario Draghi, the European Central Bank (ECB) has adopted a number of unconventional measures to provide commercial banks with more liquidity by expanding its balance sheet (Figure 1) and to improve overall lending conditions – including through lower interest rates on the demand side.

Ultimately, all ECB measures are targeted at fulfilling its mandate of safeguarding price stability in the medium term (an inflation rate of close to but just below 2%). Three channels exist for transmitting the ECB's policies to the real econ-

omy: the (direct) credit channel, the portfolio balance channel (influencing yields and exchange rates) and the 'signalling' channel (expectations management). This paper will examine only the credit channel and, within it, the effect on loans extended to non-financial corporations (NFC), that is, the 'classic' transmission into the real economy. The effectiveness of this channel can be assessed using the ECB's 'Bank Lending Survey' (quarterly survey of banks in the euro area) and the various ECB statistics on existing and new lending business.

Banks are easing lending criteria

First, the 'Bank Lending Survey' shows that banks again eased their lending criteria slightly in the past quarters – for the first time since 2007. The beginning of this easing coincided with the adoption of the most recent unconventional ECB measures in 2014. The easing is also reflected in banks' lending business with NFCs: after a three-year contraction phase, credit portfolios are currently expanding again.

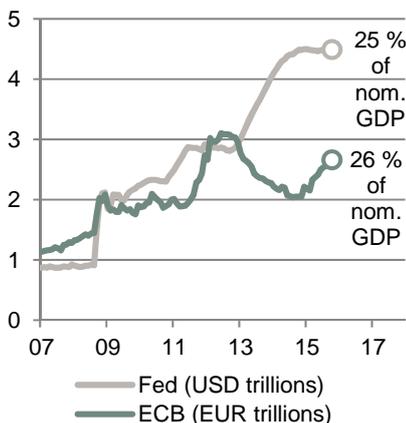
New lending business is firing up

But because loan portfolios are slow to respond, it is worth taking a look at new lending business, which better reflects the current momentum. Total new lending business for the euro area has been on the increase since the end of 2014. Growth currently fluctuates around 10% (Figure 2). In other words, the credit channel is working!

What is interesting in this regard is that new lending did not kick off until the ECB had adopted its unconventional measures (negative deposit rates, TLTROs, QE) in 2014. Another factor that probably contributed to the observable momentum is that key projects of the new euro area banking architecture were not completed until late 2014 (including the Asset Quality Review and stress tests). That has reduced uncertainties while improving the overall lending environment.

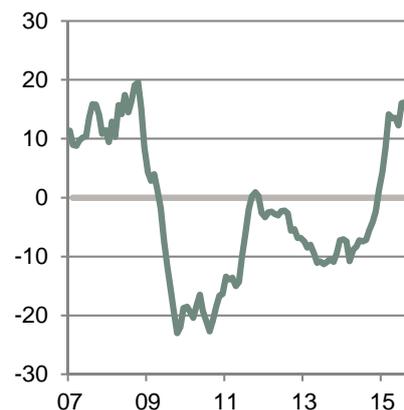
The ECB's decision to now launch additional monetary stimuli is mainly in response to inflation expectations which have dropped below 2% and which it wants to correct (Figure 3). The new ECB measures should further encourage new lending business. ■

Figure 1: ECB expands balance sheet strongly again (EUR and USD in trillions)



Sources: Fed, ECB, BEA, Eurostat own calculations

Figure 2: New lending business is growing (smoothed rate of variation on previous year in per cent)



Source: ECB

Figure 3: Inflation expectations are still too low (5y5y inflation swap rate in per cent)



Source: Bloomberg