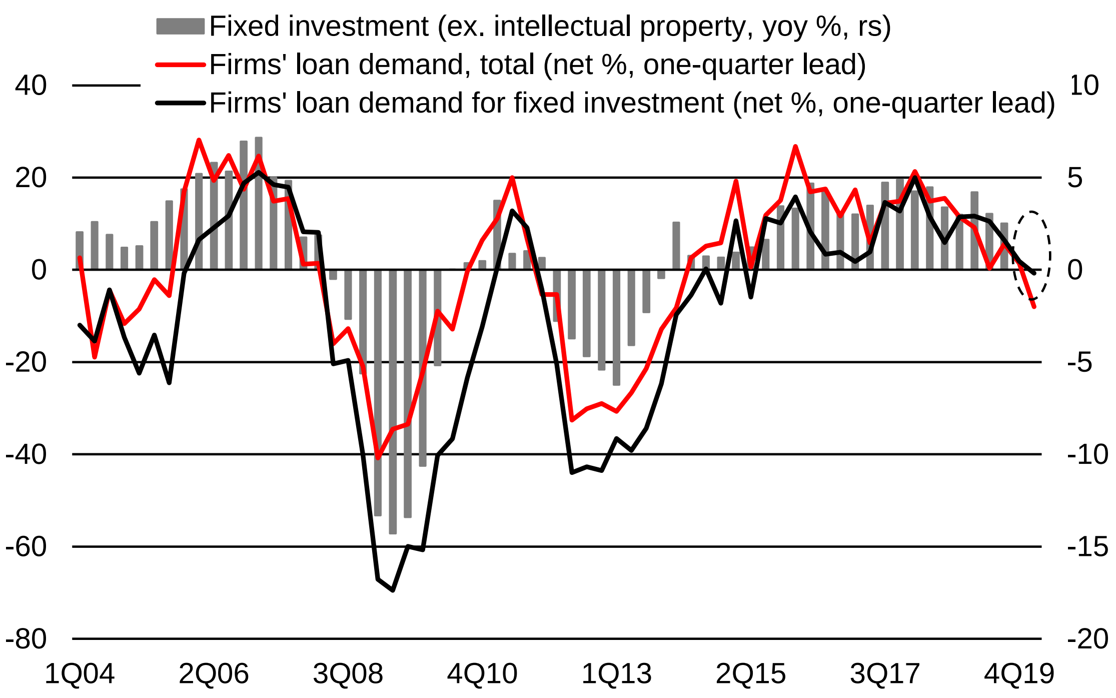
Eurozone: Weakening loan demand suggests investment is slowing



Fixed investment excludes intellectual property (IP) due to the high volatility of IP values, largely explained by Ireland.
The "net percentage" indicator for loan demand is defined as the difference between the sum of the percentage of banks reporting higher demand for loans and the sum of the percentage of banks reporting decreasing loan demand.

Source: ECB, Eurostat, UniCredit Research

- On Tuesday, the ECB published its Bank Lending Survey (BLS) for 4Q19. The BLS provides valuable and timely information in regard to developments in supply and demand of bank credit in the euro area. Amid broadly stable lending standards, headlines have mainly focused on the first decline in net demand for loans to firms since the end of 2013. At that time, declining loan demand came with a contraction in fixed investment.

- Our Chart of the Week shows that firms' loan demand as reported in the BLS (red line) tracks investment spending reasonably well, with a lead of one quarter. However, firms' total loan demand is explained not only by financing needs for fixed investment, but also by factors such as availability of alternative sources of financing, or financing needs for inventories and working capital. Loan demand for fixed investment (black line), which is a sub-component of firms' total loan demand, tends to display a tighter correlation with investment spending and is, therefore, more useful for tracking the eurozone investment cycle in a timely fashion.

- Loan demand for fixed investment is on a downward trajectory, although somewhat less steep than that of total loan demand. This is consistent with slowing investment activity at the turn of the year but does not indicate a collapse. We do not predict any improvement soon. The squeeze in firms' profitability is likely to drag on investment plans, the construction cycle has probably peaked, and the US-China trade deal does not represent a breakthrough that can finally lift uncertainty and improve business visibility. In this context, loose monetary policy will remain the most important support factor.

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