ECB survey signals large drop in credit demand and tighter lending standards

- Today, the ECB published its bank lending survey (BLS) for the eurozone for 1Q23. The survey was conducted between 22 March (i.e. three days after the UBS-Credit Suisse deal) and 6 April. It shows a further clear tightening of lending standards and a substantial drop in demand, for both non-financial corporations (NFCs) and households. While the tightening of lending standards was broadly in line with our expectation, the scale and breadth of deterioration in demand stands out. Given that the April inflation data also showed that eurozone core inflation is finally starting to turn, we think there is enough for the ECB to downshift the pace of hiking to 25bp on Thursday.

- Eurozone banks continued to tighten their lending standards for loans to NFCs significantly, with the pace of net tightening remaining at the highest level since the sovereign debt crisis in 2011. The tightening was stronger than banks had expected in the previous survey and mainly reflects banks' heightened risk perception and risk aversion, while the impact of funding costs and balance-sheet constraints was still moderate. As a matter of fact, banks reported deteriorating access to retail and wholesale funding, but the extent of such worsening does not appear to be a major source of concern. Banks expect the tightening of lending standards for loans to NFCs to slow in 2Q23.

- Banks also reported a further meaningful tightening of lending standards for mortgages, although the net tightening became less pronounced for consumer credit. Similarly to what was reported for lending to NFCs, the tightening was mainly driven by banks' risk assessment. In 2Q23, banks expect ongoing tightening of lending standards for mortgages, albeit at a slower pace.

- Loan demand was the real weak spot of the survey. NFCs' net demand for loans fell strongly, at the fastest pace since 2008, dragged down mainly by the level of interest rates and weakness in fixed investment. Support from inventories and working capital faded, after several quarters of positive contribution. In 2Q23, banks expect demand for loans to NFCs to decline further, although at a more moderate pace.

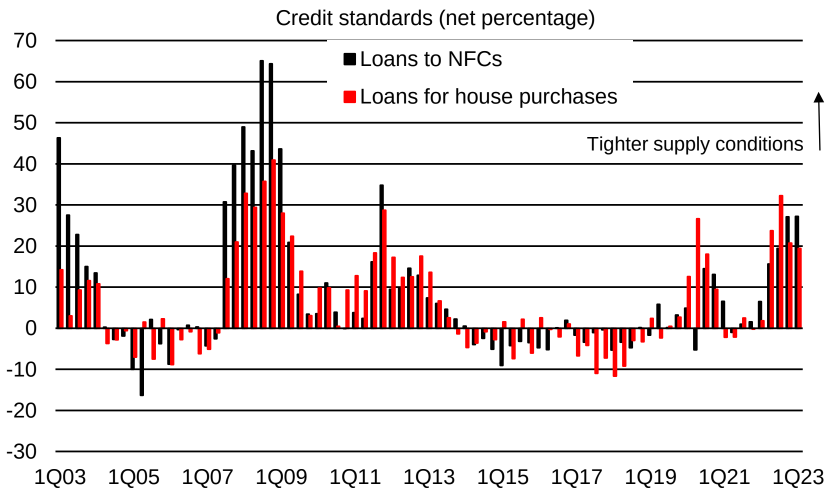
- Net demand for mortgages continued to decline strongly, at a pace similar to that recorded in 4Q22, which was the weakest point since the inception of the survey in 2003. Weakness continued to mainly reflect higher interest rates, the deteriorating outlook for the housing market and low consumer confidence. In 2Q23, banks expect the pace of demand contraction to slow substantially.

- Overall, the BLS shows increasingly clear signs of strengthening transmission of monetary policy. Along with a turning point in core inflation, a subdued GDP reading for 1Q23 and weakness in surveys of industrial activity, it strengthens the case for a 25bp hike by the ECB on Thursday. Hawks in the Governing Council will probably point out the limited impact of funding costs on credit supply, and that actual lending data point to a gradual and orderly deceleration in lending aggregates. This is unlikely to be enough to tilt the balance towards a 50bp move, although we suspect that they will successfully push for a clear signal that more rate hikes will follow.

In greater detail:

The BLS shows that lending standards continued to tighten across the board. The pace of tightening for loans to NFCs remained the strongest since the sovereign debt crisis.

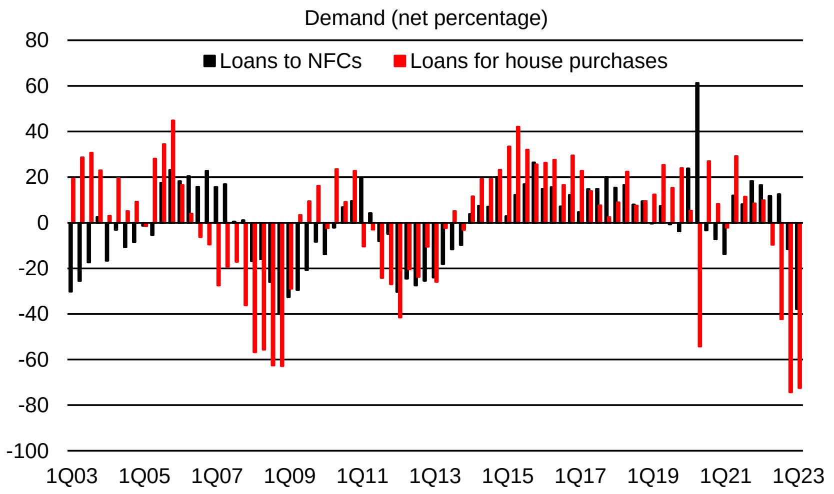
CHART 1: LENDING STANDARDS TIGHTEN SUBSTANTIALLY FURTHER



Source: ECB, UniCredit Research

The main highlight of the survey is the strong deterioration in loan demand. Net demand for loans to NFCs dropped to the weakest level since the GFC, while net demand for mortgages held close to a record low.

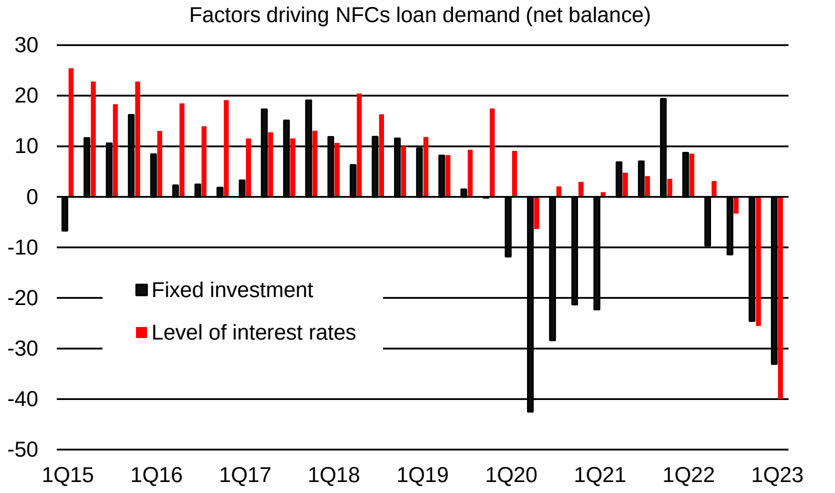
CHART 2: DEMAND WEAKNESS INTENSIFIES



Source: ECB, UniCredit Research

Deteriorating loan demand from NFCs mainly reflects the drag from interest rates and the outlook for fixed investment.

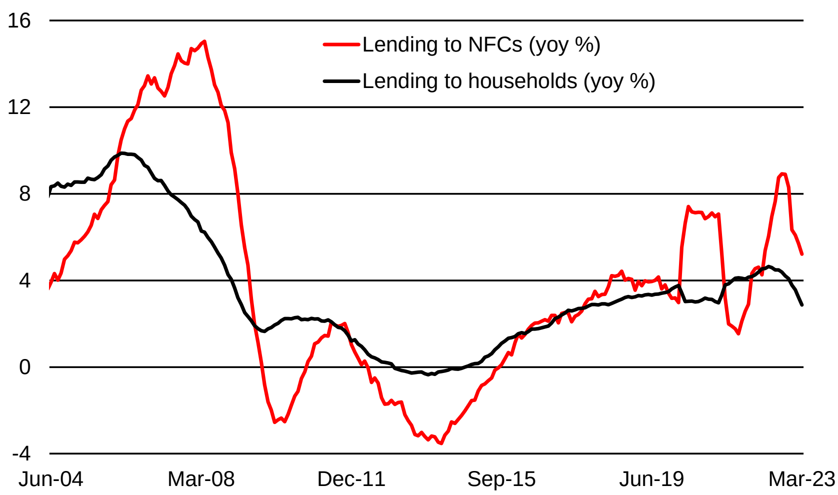
CHART 3: RISING INTEREST RATES AND WEAKER INVESTMENT OUTLOOK WEIGH ON FIRMS' LOAN DEMAND



Source: ECB, UniCredit Research

Is the BLS too pessimistic? Actual data point to an orderly slowdown in credit aggregates until March.

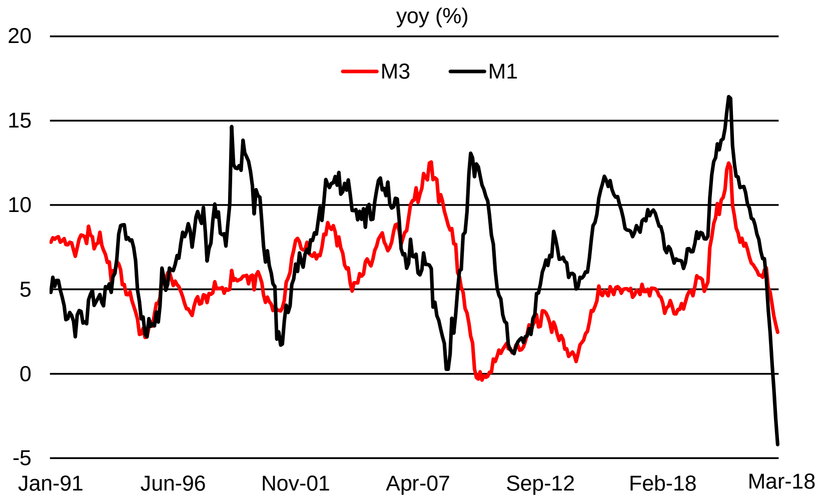
CHART 4: ORDERLY SLOWDOWN, FOR NOW



Source: ECB, UniCredit Research

Money aggregates feel the pressure from the fastest tightening of policy rates in decades.

CHART 5: MONEY AGGREGATES ON THEIR WAY DOWN



Source: ECB, UniCredit Research

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