PICTET 1805

Flash Note

Euro area: monetary & credit aggregates

Credit flows rebound in October, but the credit impulse remains weak

Pictet Wealth Management - Asset Allocation & Macro Research | 28 November 2016

Euro area bank credit flows to non-financial corporations rebounded strongly in October, by EUR11 bn in adjusted terms. Bank loans to households continued to expand at a healthy pace (+EUR10 bn). The slowdown in annual growth of the broad monetary aggregate M3, from 5.1% to 4.4% y-o-y in October, was largely due to base effects.

The rebound in credit flows to the private sector was particularly strong in France, and to a lesser extent in Germany. Credit flows were weaker in Italy and Spain, leaving the 3-month average in negative territory.

The ECB will welcome the rebound in credit flows in October, but we see little reason to celebrate as the credit impulse remains subdued, pointing to a slowdown in aggregate private demand. We continue to expect the ECB to extend its QE programme by 6 months at the 8 December meeting, at the current EUR80 bn monthly pace.

AUTHOR

Frederik DUCROZET
fducrozet@pictet.com
+41 58 323 45 82

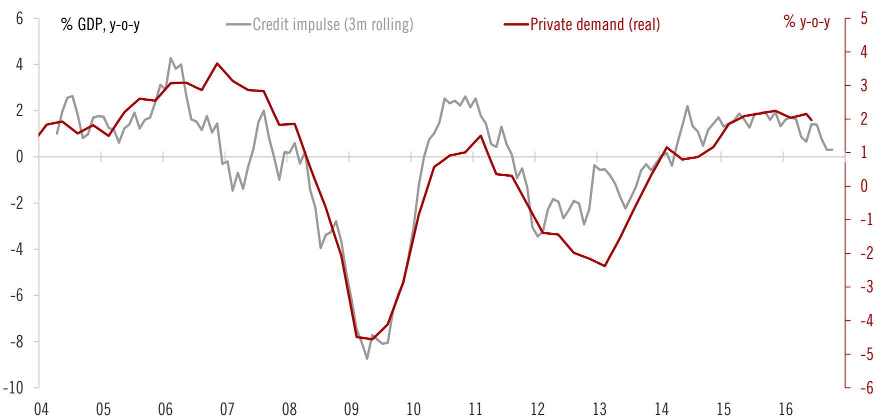
Nadia GHARBI
ngharbi@pictet.com
+41 58 323 3543

Pictet Group
Route des Acacias 60
CH - 1211 Geneva 73
www.pictet.com

Euro area bank credit data were pretty strong in October, **in addition to net positive revisions to** the previous months. Nevertheless, credit flows were not strong enough to prevent the credit impulse from softening further.

As previously mentioned, a weaker credit impulse poses some downside risks to our euro area GDP growth forecast of 1.3% for 2017, although the cyclical economic momentum appears to be firming, as reflected in the latest PMI indices and national surveys. Moreover, non-financial corporations are becoming less dependent on bank credit as suggested by increasing debt issuance and record high amounts of cash on their balance sheets.

Chart 1: euro area credit impulse and private demand



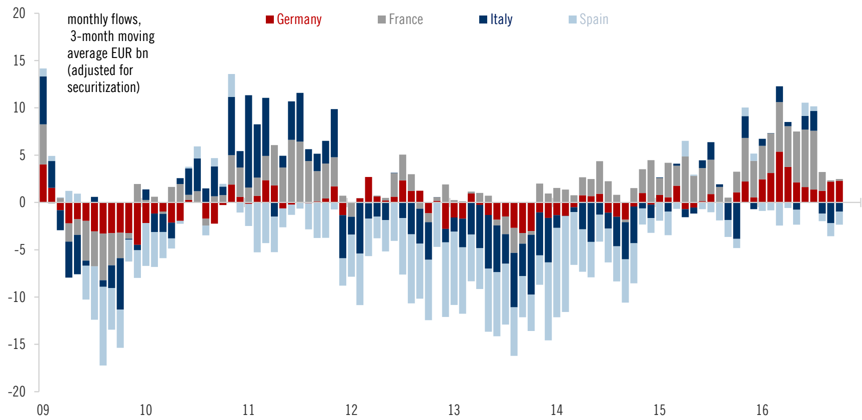
Source: Pictet WM – AA&MR, ECB

Sharp rebound in NFC credit flows

Bank credit flows to euro area NFCs (adjusted for sales and securitisations) **rebounded sharply in October** (+EUR11 bn). It is worth mentioning that the whole history of the series has been revised quite significantly, resulting in a net revision of EUR2.5 bn in 2016. **On a country-by-country basis, the rebound was particularly strong in France** (+EUR5.9 bn), **and to a lesser extent in Germany** (+EUR2.0 bn). Flows to NFC were also positive albeit weaker in Italy (+EUR0.6 bn) and Spain (+EUR0.1 bn), leaving the 3-month average into negative territory (*see Chart 2*).

Credit flows to euro area households rose strongly again in October (+EUR10 bn), posting a 26th straight month in positive territory. The increase was driven by lending for house purchases and credit for consumption.

Chart 2: loans to non-financial corporations

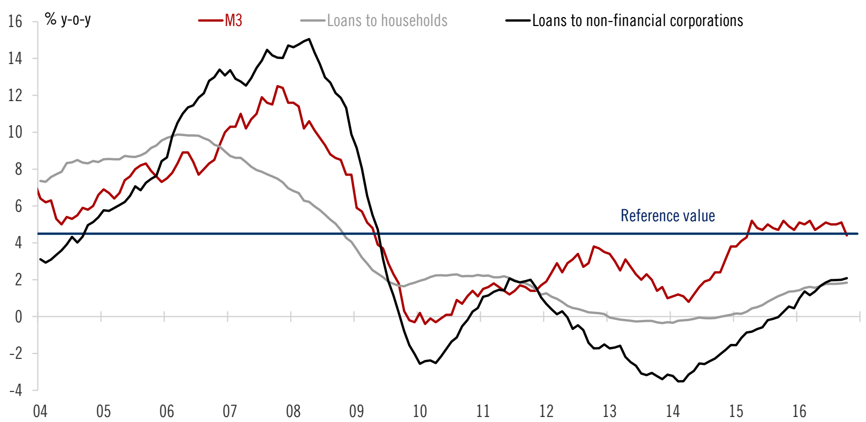


Source: Pictet WM – AA&MR, ECB

Meanwhile, the annual rate of expansion of broad money supply (M3) in the euro area decelerated sharply in October, to 4.4% y-o-y from 5.1% in September, on the back of unfavourable base effects. Annual growth of the narrow aggregate M1, which includes currency in circulation and overnight deposits, slowed down as well, from 5.1% y-o-y to 4.8% in September.

Bank loans to the private sector (adjusted for sales and securitisations) **rose to 2.2% y-o-y in October,** from 2.1% in September. Broken down by sector, loans to households grew at 1.8% in October, unchanged from the previous month, while annual growth **in loans to NFCs rose to 2.1% in October,** from 2.0% in September.

Chart 3: annual growth in euro area M3 and credit to the private sector



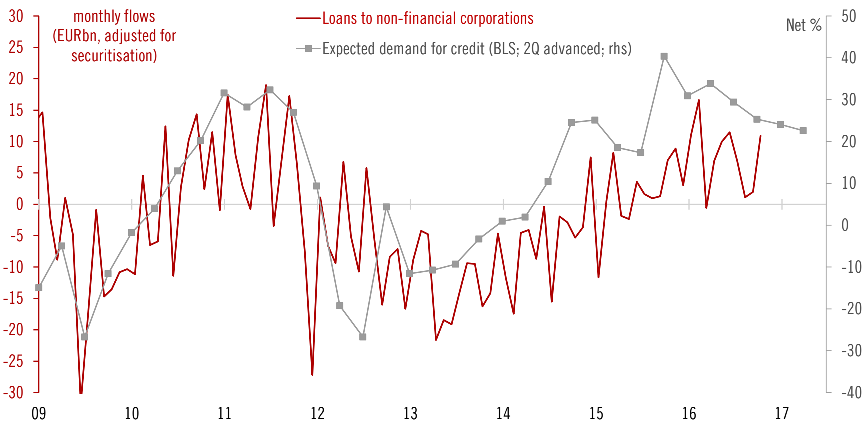
Source: Pictet WM – AA&MR, ECB

Credit impulse pointing to domestic demand slowdown

The credit impulse – the 3-month moving average as a percentage of GDP – has been softening over the past few months, **pointing to weaker domestic demand in the quarters ahead** (*see Chart 1*). Base effects will become more favourable again but a strong rebound in credit flows to enterprises will be needed for the impulse to rise significantly from here and remain consistent with a rate of GDP growth that remains stable.

Last but not least, our cautious assessment of the credit cycle is also underpinned by the latest Bank Lending Survey pointing to **modest gains in credit flows** in the next few months in what remains a very challenging environment for commercial banks.

Chart 4: euro area credit flows to non-financial corporations and expected demand from the Bank Lending Survey



Source: Pictet WM – AA&MR, ECB