PICTET 1805

Flash Note

Euro area: bank lending survey

Survey points to a pick-up in bank lending to corporates

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Euro area commercial banks reported that credit standards for loans to enterprises eased slightly in net terms in Q2 2017, despite expectations in the previous survey round that they would tighten slightly.

Demand for credit continued to rise, albeit at a slower pace than in the previous quarter for households.

The BLS is still consistent with a rebound in bank credit flows in the next few months and quarters. However, increased use of alternative sources of finance by corporates, as well as elevated corporate cash balances, are likely to remain drags on demand for bank loans.

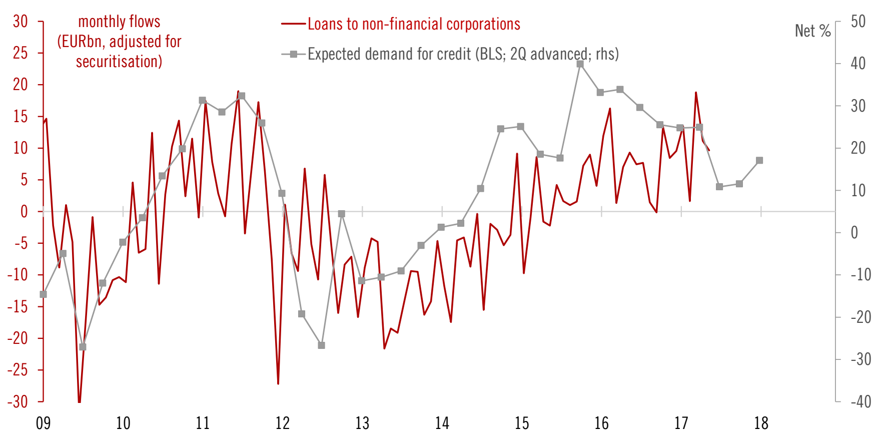
All in all, financing conditions in the euro area remain favourable, which bodes well for domestic demand. We are keeping unchanged our GDP growth forecast of 1.9% in the euro area for 2017 as a whole.

The July Bank Lending Survey (BLS), released by the ECB today, showed that **bank credit standards for loans to enterprises eased slightly in Q2 2017**, following a net easing in the previous quarter. This came despite expectations in the previous survey round that these standards would tighten slightly. Competitive pressure remained the main factor explaining the loosening. Looking ahead, **banks expect a net easing of credit standards in Q3 for loans to enterprises and loans to households**.

On the demand side, **demand rose across all loan categories**. The rise in demand for loans to enterprises in the second quarter of 2017 was mainly driven by fixed investment and by mergers and acquisitions (M&A), while low interest rates and favourable housing market prospects were the main factors explaining the increase in loans to households.

All in all, financing conditions in the euro area remain favourable, which bodes well for domestic demand. **The BLS is consistent with a pick-up in bank credit flows to non-financial corporations in the next few months and quarters** (*see Chart 1*). However, the increased use of alternative source of finance by corporates, as well as elevated corporate cash balances, will continue to act as drags on demand for bank loans. **We are keeping unchanged our GDP growth forecast of 1.9% in the euro area for 2017 as a whole.** We continue to see a number of headwinds that could lead to a modest slowdown in the pace of economic expansion for the rest of this year.

Chart 1: euro area loans to non-financial corporations and Bank Lending Survey



Source: Pictet WM – AA&MR, ECB

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Credit Standards: eased in Q2, against expectations

The **Q2 BLS** was conducted among 142 banks (out of the 143 sample banks) between 12 and 27 June 2017. The results relate to changes during the second quarter of 2017 and expectations for the third quarter of 2017.

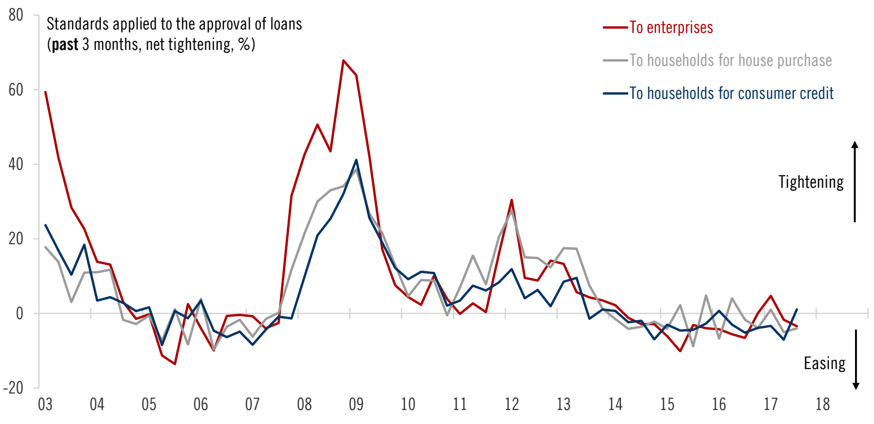
Euro area commercial banks reported that credit standards for loans to enterprises eased slightly in **net terms** (net percentage -3% after -2% in the previous quarter) **in Q2 2017** *(see Chart 2)*, despite expectations in April's BLS that they would tighten slightly. Credit standards eased for both loans to small and medium-sized enterprises (SMEs) and loans to large firms. Competitive pressure was the main factor contributing to the net easing of credit standards, while risk tolerance had a broadly neutral effect.

Across countries, developments in credit standards were mixed, easing in Germany and Italy but broadly unchanged in France, Spain and the Netherlands.

Meanwhile, credit standards on loans to households (-4% after -5% in Q1 2017) for house purchases eased in Q2 2017, against expectations of no change in the previous survey. By contrast, credit standards for consumer credit to households tightened slightly.

The BLS also indicated that banks expect an easing in credit standards across all loan categories during Q3 2017.

Chart 2: net easing or tightening of standards applied to new bank loans



Source: Pictet WM – AA&MR, ECB

Credit demand: increasing but at a slower pace

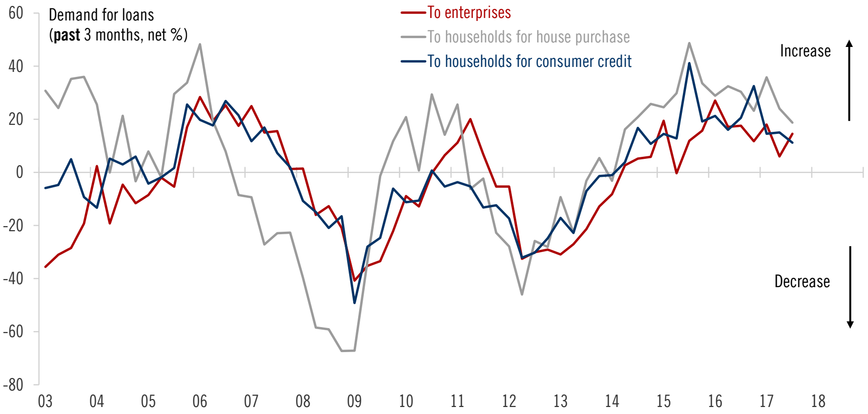
Net demand for bank loans to enterprises increased further in Q2, broadly in line with bank's expectations**.** Demand rose for both loans to SMEs and large firms. At the country level, net demand for loans to enterprises increased in Germany, France, Italy and the Netherlands, whereas it remained unchanged in Spain.

M&A activity and fixed investment were the key factors behind the rise in corporate loan demand. The general level of interest rates as well as inventories and working capital continued to have a positive impact on demand. By contrast, the report mentioned that "*the use of alternative finance* *driven by firms 'internal funds, continued to have a slight dampening effect on net loan demand."*

Meanwhile, net demand for household loans continued to increase robustly, although at a slower pace (*see Chart 3*).

Looking ahead, **banks expect credit demand to rise further in Q3 for all type of loans.**

Chart 3: demand for loans over the past three months



Source: Pictet WM – AA&MR, ECB

Ad hoc questions on TLTROs

While a stronger economic recovery should remain a key driver of rising demand for bank loans in the future, other factors are also expected to help boost the credit cycle. In particular, demand was larger than expected in the ECB's fourth and final TLTRO II operation in March 2017. This was mainly for profitability reasons, according to BLS. Banks continued to report that they used funds mainly for granting loans. Importantly, the report mentioned that "*the main reported effect of the TLTROs continued to be an easing of credit terms and conditions, but an increased share of banks also reported an easing impact on credit standards for loans to enterprises and consumer credit in the most recent survey*". This was not mentioned in the previous BLS.

All in all, **financing conditions in the euro area remain favourable, which bodes well for domestic demand. We are keeping unchanged our GDP growth forecast of 1.9% in the euro area for 2017 as a whole**. We continue to see a number of headwinds that could lead to a modest slowdown in the pace of economic expansion for the rest of this year, which should nonetheless remain comfortably above potential (around 1.75% in annualised terms). Despite improving credit conditions, the banking sector remains vulnerable to adverse shocks, which is why **the ECB will have to tread carefully when it comes to reducing monetary accommodation**