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EUROZONE: Fresh monetary weakness?

Credit crunch worries continue

Coming in below expectations this time around, October M3 money supply growth slowed by 0.4 percentage point to 2.6% Y/Y, thereby easing back from a September pace which had been the strongest since mid-2009. This came on the back of a 0.6% M/M increase in M3, the latter reflecting broad based weakness, including a fall in the narrower money supply gauge (M1), whose Y/Y growth rate slowed back from 2.0% to1.7% as a result.

More worrisome was the still soft private sector lending growth picture. Admittedly, the headline pace of growth picked up 0.2 percentage point, matching the cycle-high of 2.7% set in May. However, the pick up was a reflection of a strong recovery in lending to financial intermediaries. Notably, while the lending breakdown showed a further Y/Y pick-up in underlying (ie ex sales and securitization) corporate lending to 2.3%, lending in M/M terms was flat. More disturbing was the fall in underlying household loans growth actually down a notch to 2.5%, with broad based weakness across all sectors including mortgage lending and with a very clear M/M fall evident.

Lending backdrop weaker

A familiar set of mixed messages is again evident in this monetary update, but with the underlying theme still being one of fragility, the latter very much indicative of the on-going problems facing the Eurozone banking system that have become only too apparent of late. Indeed, fresh M3 weakness reflected sharp swings in overnight deposits and repo activity hinting that financial market turmoil distortions may be the underlying cause, the latter also possibly behind the jump in lending to financial intermediaries. Regardless, M3 growth is negative in real terms. In addition, the continued weakness in M1 growth also corroborates the picture of a slowing economy evident in the business and consumer surveys as it is this aggregate which seems to be better than the broader M3 numbers in tracking the economy. Perhaps more emphasis should be placed on the still very soft private sector lending data, where the likes of the continued drop in consumer credit provide corroboration of the weaker consumer spending signals now being seen increasingly across the whole of the Eurozone.

The question is the extent to which the softer consumer and company lending backdrop may be a reflection of an emerging credit crunch, a development that is being accentuated by financial market turmoil but which is manifesting itself ever-more adversely on real economic activity. Crucially, new ECB President Draghi seemed to be more open to admitting such credit constraints risks at his first press conference earlier this month. All of which is crucial to markets looking for the ECB to step up its bond purchase.

ECB has rationale for more action

So far the ECB has shown no appetite to do so, wishing to resist more blatant political pressure for such action as well as to continue the implicit coercion on governments to rectify adverse budgetary positions that comes from bond market pressure. There are even arguments put forward about the illegality of bond purchases. However, with the ECB explaining that its existing bond purchase program is designed to ensure that the monetary policy transmission mechanism continues to work, signs that the latter may be in a deepening state of disrepair surely argue for more sizeable bond purchases possibly with some added goal of targeting certain national bond yield levels. In other words, the ECB can very clearly provide a support to bond markets clearly within existing Treaty guidelines, arguing too that it is merely acting in accordance with its monetary remit.