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Western European Indicators and Insights

February 27, 2012

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EUROZONE: Mixed monetary weakness?

Banks increasing government debt holdings

Coming in above expectations for once, January M3 money supply growth picked up clearly, rising a full percentage point to 2.5% Y/Y, albeit only recovering from a cycle-low to a three-month high. This came on the back of a 0.7% M/M rise in adjusted M3, an increase that came after three successive drops. In addition, the narrower money supply gauge (M1) saw its Y/Y growth rate recover afresh (but to 2.0% from 1.6%).

There was also a pick-up, albeit less notable, in terms of the private sector lending growth picture. Indeed, the adjusted pace of growth rose 0.3 percentage point to 1.5%, up from the 18-month low in December but still only half the cycle-high pace of 3.0% set in October. Even so, the pick-up was little to do with base effects, instead being a reflection of a clear M/M rise of 0.4%, the first positive in three months. Notably, the lending breakdown showed this pick-up not to be broad-based. Indeed, underlying Y/Y corporate lending growth slowed further to a new low of 0.8%, undermined by a M/M drop. Instead, the overall pick-up came on the household loans side as the adjusted growth figure rose 0.2 percentage point to 2.1%, albeit mainly due to less weak consumer credit growth.

Some less downbeat signs

Overall, these figures continue to highlight the on-going problems facing the Eurozone banking system that have become only too apparent in the last few months. However, there are some less downbeat signs, possibly emanating from the boost to liquidity and confidence that recent ECB actions of late may have precipitated. Indeed, the jump in overall M3 growth is very much predicated around a marked swing into the positive in terms of repo activity, alongside a swing in shorter-term deposits. Regardless, M3 growth is still negative in real terms as is that for M1. Indeed, the relatively greater weakness in M1 growth (compared to M3) also corroborates the picture of a weak 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.

Credit crunch still evident

More worrisome is the still weak lending backdrop, highlighting that whatever improvement in liquidity has occurred of late has yet to translate in banks being able or perhaps willing to increase their lending. This of course should be no surprise in the wake of the ECB Bank Lending Survey released at the beginning of the month which confirmed a tightening in credit standards had occurred into late-2011 with a further rise on the cards. With this in mind, the question is the extent to which the soft consumer and company lending backdrop may be a reflection of a building 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, the ECB, under the direction of President Draghi, does seem to be more open to admitting such credit constraints risks in some parts of the Eurozone, possibly one reason why the central bank earlier this month took the unprecedented step of allowing national member banks to use varying criteria in establishing collateral in credit operations.

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Regardless, there are more promising signs elsewhere in the monetary data, most notable in terms of clearly stepped-up government bond purchases by banks through January (of circa € 50 bln). This is the largest rise in over a year and a clear contrast to the falls seen between last summer and November, in turn, suggesting that banks may have been using the cheap ECB liquidity provided to them to purchase peripheral debt.