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EUROZONE: Lending Weakness Continues

Coming in below expectations once more, September M3 money supply growth slowed for a second successive month, albeit easing back only a further 0.1 percentage point to 2.7% Y/Y, thereby backing off additionally from a 3.6% July reading that was the highest since May 2009. This softer reading was less to do with base effects, instead reflecting a fresh M/M fall in M3 (of 0.2%). A similar fall was seen in the narrower money supply gauge (M1) which resulted in its Y/Y growth rate backing off from the two-year high of 5.2% seen in August to 5.0%.

However, *the focus will clearly be on the (continued) weakness in private sector lending this month. Indeed, weakness is even clearer this time around as the Y/Y pace of growth turned more negative, easing 0.2 percentage point to a three- year low of -0.8%*. Moreover, as with M3, this was less a result of base effects as the seasonally adjusted level in M/M terms fell (0.2%), the first in four months (having been flat in the interim). Of some note, even the rate adjusted for securitization (the preferred measure of the ECB Council) was a more negative, at -0.4% Y/Y.

More notably, the lending breakdown still showed that weakness remained broad based (save for mortgage lending) as underlying Y/Y corporate lending growth moved more clearly into negative territory while overall household loan growth hit a fresh cycle low of 0.1%.

Fragile Demand Only Partly To Blame?

The ECB has insisted, and will use the evidence of its quarterly Bank Lending Survey as corroboration, that it is weak demand that is causing the weakness in lending. If so, this surely demands that further conventional stimulus, ie lower interest rates, although there are few signs that this may be a key area of debate at the Council meeting next month.

However, *the ECB has implicitly admitted that credit supply is being hampered by acknowledging that the monetary policy transmission mechanism is damaged, the need to repair it being the rationale behind the creation of the OMT program* (something that President Draghi focused on in his speech to the German parliament yesterday). If so, then it is far from logical why the ECB insists that it has to wait for government action (ie requesting an official bail-out) before it starts to purchase bonds.

Fresh Outflows?

More disconcerting is the fresh outflows of overnight deposits, this being the prime factor behind the drops in M1 and M3 last month. Regardless, the combination of continued economic contraction and stalled private sector lending surely implies a clear risk that the Eurozone may be facing deflation risks, a risk that *President Draghi was a little more willing to acknowledge in Germany yesterday, and for reasons over and beyond a wish to temper the inflation worries in that country.*