

## ECB bank lending survey: The anti-fragmentation edition

The BLS shows some signs of fragmentation but does not provide a smoking gun. It does signal even more warning signs about a slowing economy



The European Central Bank meets later this week to discuss the first rate hike since 2011 and the already notorious anti-fragmentation tool, which is supposed to make sure that the normalisation of monetary policy does not have an uneven effect on financial conditions in the eurozone.

There is not one smoking gun to determine whether this is the case or not. Bank lending rates are notoriously difficult to interpret given different financing preferences across countries and borrowing growth does not give an accurate view either. Also, neither are very timely. The ECB's own bank lending survey does provide some interesting insights, allowing for a qualitative assessment into whether changes in lending conditions (cost of borrowing) and credit standards (for the approval of loans) are happening.

### Some evidence on fragmentation, but is that a smoking gun?

Today's data shows a considerable tightening of credit standards for enterprises in France and Italy, while in Germany and Spain, the percentage of banks reporting tightening was flat or

declined. In France, this was mainly due to lower risk tolerance and higher perceptions of risk, while in Italy, the cost of funds and balance sheet constraints played a role. The latter seems to be the main factor to look at when considering financial fragmentation. Also important is that the terms and conditions for loans to enterprises have tightened. This was mainly visible in Italy and Spain where margins, on average, and riskier loans compared to the benchmark have increased.

For mortgages, the picture is mixed. In terms of tighter conditions, Germany and Spain saw much stricter conditions to provide home loans while rates went up most in Spain and Italy, where most banks indicated a strong increase.

So there are some differences in tighter credit conditions and standards between the larger countries with Italy and Spain both seeing above-average tightening overall. The reasons for tighter conditions and whether this makes it necessary to act are fuel for debate. It is also questionable whether the ECB needs a smoking gun; it could decide to be ahead of the curve on this to make sure it raises rates adequately to fight inflation regardless of how fragmentation develops in the months ahead.

## Tighter standards and slowing demand for loans are a warning sign for the ECB

The overall outcome from the survey is perhaps more worrisome for the ECB. Considerable tightening of credit standards and increased borrowing costs indicate that investment is set to suffer in the months ahead, especially as the survey indicates that demand for borrowing for fixed investment dropped dramatically in 2Q. With significantly tighter standards and lower demand for mortgages as well, the impact of tighter conditions will be felt throughout the economy and is set to contribute to the economic slowdown.

Just ahead of the ECB's first rate hike in more than a decade, financial conditions have already tightened significantly and this is contributing to an economy already slowing down. This tells us something about neutral rates – which are likely to be much lower than most expect – and how much the ECB can ultimately raise rates this cycle. We expect the ECB to raise rates by no more than 100 basis points as a recession is coming closer.

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