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Eurozone bank lending weakened further in April on monetary tightening

Monetary tightening is well underway and the effects on the lending and money channels are clear. April's weak monetary data adds to a sluggish economic outlook for the rest of 2023 and provides an argument for the doves at the European Central Bank's coming meetings

Bank lending broadly stagnated in April. New loans to households grew at a snail's pace (0.02%) and loans to non-financial businesses dropped slightly compared to March (-0.03%), which was the fifth outright decline in six months. Money growth also fell more than expected as year-on-year growth in broad money (M3) dropped to 1.9% in April with the more narrow indicator, M1, falling as much as 5.2%, the fastest decline on record.

Today's data incorporates the first full month after the start of the banking turmoil, which may add to weaker borrowing ahead but for now, there is no real break from trend visible in the lending data. The weakening has been gradual and seems affected by higher interest rates and weak investment prospects, but also by the change in trend around working capital from 2022. Last year, borrowing for working capital and inventory reasons was up, in part, to supply chain disruptions and economic uncertainty. But with supply chain problems fading and working capital costs higher as interest rates spiked, there seems to be a reversal. While that may be a temporary effect, the overall trend in borrowing is clearly down.

At the last ECB press conference, President Christine Lagarde indicated that monetary transmission is currently strong. The ECB's own bank lending survey had already indicated a quick weakening of demand for borrowing amid the current higher interest rates and tightening of credit conditions by banks. The April monetary developments data confirms this strong monetary transmission and dampens the economic outlook for the months ahead, as weak borrowing is set to weaken economic activity from here on. For the ECB, this provides more proof that its tightening policy is working and could give the doves a stronger argument to call for an end to rate hikes this summer.

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