

## Eurozone monetary developments show transmission is working

Sharp declines in private sector borrowing in December show that the ECB's sharp interest rate rises are starting to have the desired effect. In an already weak economy, this is another dampening effect for 2023 growth, but don't expect it to be enough to sway next week's ECB decision on rates. We expect another 50 basis point hike



The ECB's bank lending survey shows that tighter credit conditions are having a clear impact on borrowing

The decline in bank lending in December was seen across the board. Household borrowing growth had been trending down since early 2022 – when longer-term rates started to rise – but saw a particularly sharp monthly drop in December. The month-on-month growth was 0.1% down from 0.3% in November, indicating that household borrowing growth has now all but stagnated. This is especially important for the housing market as the majority of household borrowing is for mortgages.

The decline in non-financial corporate sector borrowing has been even more pronounced. Month-on-month growth turned further negative in December, falling from -0.1% in November to -0.3% in December. Business borrowing growth had been very strong in 2022 and even accelerated despite higher interest rates. The bank lending survey already indicated that this was mostly for working capital reasons and not for investment plans, which was actually a sign of weakness rather than

overheating. Now we see sharp declines in borrowing occurring, which is in fact more of a recessionary sign.

Given the hawkish stance that the ECB has taken recently, this release must be encouraging as it shows that monetary transmission is at work. At the same time, it comes at a time when a very weak eurozone economy is flirting heavily with recession. With a lot more rate hikes to come, the question is how well the economy can swallow substantially higher rates.

We expect that the ECB hike cycle will have a significant dampening effect on the economy over the course of 2023. With supply-side problems that caused inflation diminishing, the question is whether doves will become more vocal in coming meetings as we start to see monetary transmission at work. For next week, we don't expect much to change: another 50 basis point hike is in the making.

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