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Eurozone: monetary dynamics deceptively strong

M3 growth in the eurozone increased to 8.9% year-on-year in May, backed by strong domestic credit growth. However, this figure reflects financial distress and precautionary savings rather than economic strength

Strong money and credit growth

Eurozone year-on-year money growth (M3) accelerated to 8.9% in May from 8.3% in April, with the most liquid component M1 showing a whopping 12.5% year-on-year increase. Credit to the general government increased to 9.8% in May from 6.2% in April, while the annual growth rate of adjusted loans to households remained at 3.0% in May, unchanged from the previous month. The annual growth rate of adjusted loans to non-financial corporations rose to 7.3% in May from 6.6% in April.

Liquidity hoarding

Although the easy financing conditions created by the ECB's very accommodative monetary policy certainly help to boost credit, it would be wrong to see in the current figures a sign of economic strength. On the contrary, because of the Covid-19 pandemic, firms have drawn on their committed credit lines to avoid any liquidity shortages in the coming months. Indeed, the annual growth rate of deposits placed by non-financial corporations increased to 17.6% in May from 13.7% in April, a sign of liquidity hoarding. At the same time, the bank lending survey shows that credit demand for investment purposes is falling rapidly.

A similar story holds true for households: confronted with rising uncertainty on the labour market, they have probably increased their precautionary savings, held in liquid assets. Indeed, the annual growth rate of deposits placed by households rose to 7.0% in May from 6.7% in April.

Weakness, rather than strength

For some, the strong monetary growth figures will probably be a sign that inflation will pick up rapidly in the coming years. But don't be fooled: a big part of this increase is due to financial distress and precautionary savings. So for the time being, the information content of monetary aggregates is ambiguous to say the least and reflects weakness rather than strength.

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