Eurozone monetary tightening progresses at the start of the year

The January snapshot of monetary policy at work continues to show that tightening efforts are having a clear effect on money supply and private-sector borrowing, which will have a dampening impact on economic growth and inflation in 2023. We consider the impact of the hike cycle an underappreciated downside to economic activity for this year

Looking at the January numbers in more detail, we see continued rapid declines in the growth of the money supply. Broad money (M3) grew by 3.5% year-on-year, down from 4.1% in January. The more narrow money aggregate M1, which is considered to be a good leading indicator of economic activity, contracted for the first time in the history of the series, by -0.7%.

Business (non-financial corporate) borrowing saw a sharp contraction in December and stagnated at that level in January (month-on-month growth of 0%). Business borrowing continued to remain strong in the second half of 2022 as working capital needs caused lending to surge, but we now see a correction that is more in line with recession worries and higher rates as supply chain problems are fading.

Household borrowing slightly ticked up in January but remains on a strong downward trend. Year-on-year growth rates fell from 3.8 to 3.6% as borrowing demand for house purchases continues to weaken. The monthly growth rate is just 0.2% at the moment.

Overall, this shows that the impact of monetary tightening is steady so far and is set to continue from here on. The ECB's own bank lending survey indicated a further tightening of credit standards and weaker demand for borrowing going forward. Also, the bank will start quantitative tightening in March, which will have a further dampening effect on the money supply. With more interest rate hikes to come, expect the impact of tightening efforts on economic activity to be felt more as 2023 progresses.

Author

Bert Colijn
Senior Economist, Eurozone
bert.colijn@ing.com