Eurozone monetary transmission remains fast at work

Bank lending and money growth continue to weaken as the European Central Bank's historic hiking cycle continues to have a significant effect. While this will further dampen an already weak economy, today's data is unlikely to sway the ECB's thinking on further rises

ECB President Christine Lagarde in Paris last week

Today's monetary developments will be monitored intensely by ECB members, currently away at their annual gathering at Sintra in Portugal. The hawkish tone from the European Central Bank thus far is supposed to prepare markets for a higher-for-longer scenario, but the pace of monetary transmission will be an important driver of how high and how long that will actually be. Today's data show that transmission remains significant for the moment as yearly growth in bank lending to the private sector fell from 2.4% in April to 2.1% in May, and money growth right now is negative. Yet again, there are no big swings in today's numbers that would make the hawks on the ECB governing council nervous.

Further declines in borrowing can not be ruled out

Bank lending to non-financial corporates picked up ever so slightly in May, Month-on-Month, but the small uptick can better be qualified as broad stagnation. The annual growth rate of corporate borrowing is, therefore, down from 4.6% in April to 4%. While we don't see a prolonged dip in borrowing materialising for the moment, it is important to note that stagnation in borrowing happens much sooner than in previous hiking cycles. The ECBs own bank lending survey expects demand for borrowing to remain weak and credit conditions to tighten further in the months ahead, which means that further declines in borrowing can not be ruled out.

Bank lending to households maintained its downward trend, and May brought the first Month-on-Month decline in household borrowing since the first lockdown in 2020. That was exceptional, of course, and before then, we only witnessed monthly declines in household borrowing in the depth of the euro crisis. The impact can be seen in housing markets where prices and transaction volumes are trending down and will feed through to the rest of the economy.

Deposits by households increased by 1 billion in May, after declines in March and April. This suggests that the effects of the banking turmoil in the eurozone have remained very limited. Broad money growth was down again in May, bringing the annual growth rate down from 1.9% in April to 1.4%. Narrow money growth (M1) saw the annual downturn deepen from -5.2 to -6.4%, the sharpest drop in history. While there are circumstances that make the impact of this smaller or more dragged out than in previous episodes of monetary contraction, it remains a signal that tightening is well under way.

Overall, the eurozone economy is currently in a roughly stagnant growth environment. The fast-paced rate hikes are set to still have a further dampening effect on economic activity as monetary transmission continues to work its way through the system. This leads us to believe that growth is set to remain sluggish at best for the foreseeable future. Still, today's numbers do not show a cliff-edge drop that would change the ECBs thinking on further rate hikes.

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