THE WEAKENING OF LENDING TO NON-FINANCIAL CORPORATIONS IN THE RECENT MONETARY TIGHTENING CYCLE

After peaking in September 2022 (8.9 per cent year on year), bank loans to euro-area non-financial corporations have gradually weakened following the increases in the key ECB interest rates and the reduction in the Eurosystem's balance sheet, and have stagnated since the autumn of last year. The magnitude and speed of the slowdown suggest that some of the determinants of credit developments may have played a more important role than in the past, amplifying the transmission of monetary policy impulses.

To test this hypothesis, counterfactual simulation exercises for business lending growth in 2022 and 2023 were carried out. The study estimated the relationship between lending and its main determinants prior to the start of monetary tightening (in the period 2003-21).[1] The values actually observed for some of these determinants were then used to run a simulation starting from the first quarter of 2022, in order to assess whether loan trends during the recent monetary policy tightening were consistent with historical regularities.

In the first exercise, lending to non-financial corporations is simulated by considering only observed short- and long-term interest rates, GDP and consumer prices. Historically, the developments in these variables were sufficient to capture loan trends appropriately. However, the findings show that in the second half of 2022 and for most of 2023, actual credit growth was significantly lower than the counterfactual one (see panel (a) of the figure).

Growth in lending to firms was much closer to that actually recorded in a second simulation which, in addition to changes in the variables previously considered, also took account of the decline in demand for loans for fixed investment and, above all, of the tightening of credit standards due to banks' higher risk perception (see panel (b) of the figure and the box 'Credit supply and demand since the start of monetary policy normalization', *Economic Bulletin*, 4, 2023).[2] This evidence suggests that banks' transmission of monetary policy impulses to lending to non-financial corporations has been particularly strong during the recent phase of monetary policy tightening. Banks' higher risk perception contributed not only to a slowdown in lending volumes, but also to amplifying the pass-through of the policy rate increases to the cost of credit.[3]

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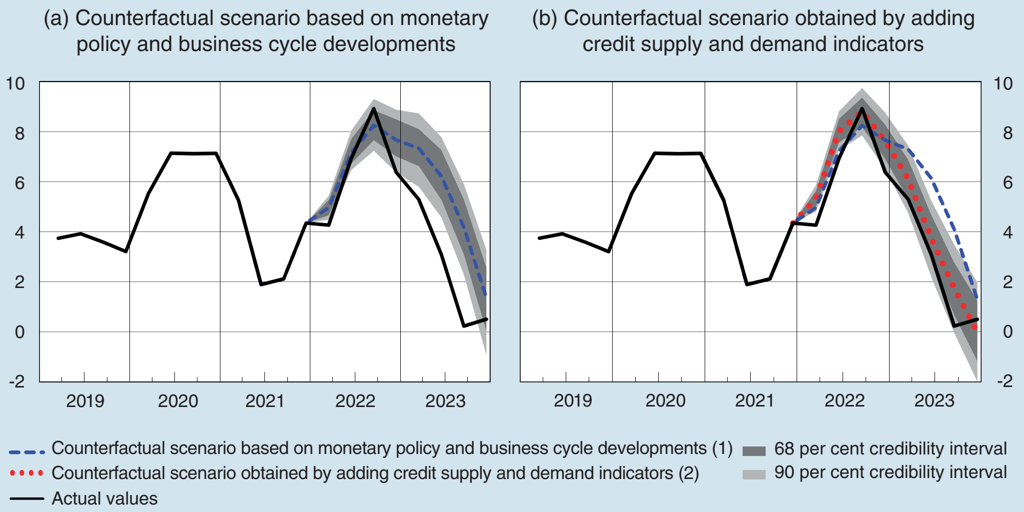
1 S. Auer and A.M. Conti, 'Bank lending in an unprecedented monetary tightening cycle: evidence from the euro area', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming. A vector autoregression model based on quarterly data was built for the period 2003-21, which included phases of both monetary policy tightening and easing. The model links loan volumes to their cost, to consumer prices, GDP, short- and long-term interest rates and to BLS indicators of credit supply and demand (i.e. banks' risk perception and firms' demand for loans for fixed investment, respectively).

2 The performance of credit supply and demand indicators differs from that obtained in the first counterfactual simulation, which was based only on observed short- and long-term interest rates and economic cycle variables: the weakening of demand for loans for fixed investment and the increase in risk perception are more marked. The latter was also affected by geopolitical tensions and higher energy prices.

3 M. Bottero and A.M. Conti, 'In the thick of it: an interim assessment of monetary policy transmission to credit conditions', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 810, 2023.

Figure

Actual and counterfactual annual growth in lending to non-financial corporations
(quarterly data; percentage changes)



Sources: Based on ECB, Eurostat and LSEG data.
(1) This counterfactual simulation is based only on observed trends in short- and long-term interest rates, GDP and consumer prices. – (2) This counterfactual simulation is based on the variables listed in the previous footnote and on changes in the credit supply and demand indicators obtained from the Bank Lending Survey (BLS).

Looking ahead, monetary conditions will remain tight for some time after the start of the policy rate cuts as well,[4] and will continue to affect firms' borrowing costs and economic activity. Should this contribute to a persistently high risk perception on the part of banks, according to the findings of this study, loans to non-financial corporations would be affected, thereby dampening the expansionary impulse arising from lower interest rates.

4 'Monetary policy in a shifting landscape', speech by Fabio Panetta, Governor of the Bank of Italy, at the Inaugural Conference of the Research Network on Challenges for Monetary Policy Transmission in a Changing World, Frankfurt, 25 April 2024.