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Talking point

Five years after subprime: Lending trends in Europe and the US

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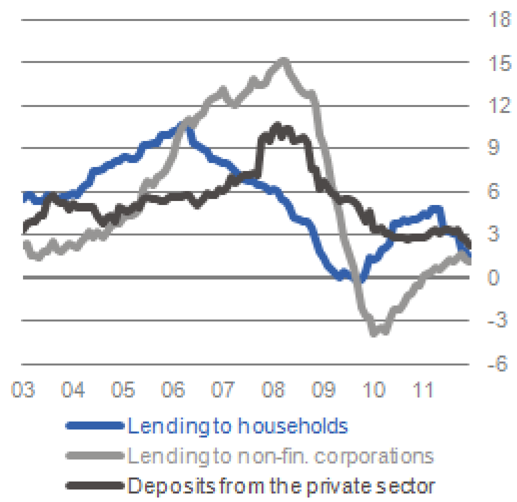
Lending trends in Europe and the US are currently diverging. Indicators point to a further slowdown in the euro area, even though a credit crunch has so far not materialised. In the US, by contrast, the outlook has considerably improved in recent quarters and loan volumes are growing again.

In recent years, it has been feared repeatedly that troubled European banks could trigger a credit crunch and thereby curtail economic growth. So far, such a credit crunch has not materialised. In the euro area, loan volume with companies at the end of 2011 was 1.1% higher than a year earlier; loans to private households were up by 1.4%. Even in the financial and economic crisis of 2008/09, lending hardly declined at all. Admittedly, given inflation of about 2.5% yoy, current growth rates amount to a deleveraging in real terms – and most of the factors driving lending volumes signal a further deterioration. The euro area may fall back into recession this year, which is likely to suppress credit demand especially in the peripheral countries. In addition, banks have tightened their lending criteria in response to a wholesale funding squeeze in the second half of 2011. With the ECB flooding the sector with medium-term liquidity and private funding markets partially reopening this year, the worst has probably been averted but banks may remain cautious about committing themselves to significantly higher lending volumes. Pressure from the authorities to increase capital ratios much faster and further than previously anticipated has triggered a renewed wave of restructuring and deleveraging particularly at the most-affected institutions. Though banks intend to mainly cut back their foreign and capital-markets exposure, scope for expanding loan volumes with the domestic private sector may also be limited.

Euro area lending & deposit volumes



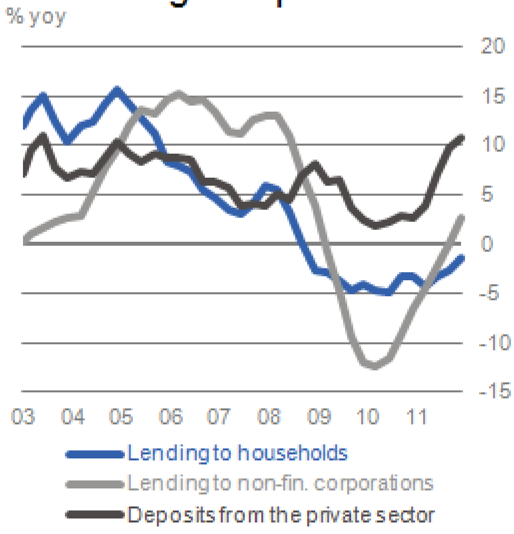
Sources: ECB, DB Research

As refinancing constraints persist, it is of little help that deposit trends stayed weak after the end of the recession. Private-sector deposit growth of now 2.3% yoy is the lowest on record since statistics began in 1999, despite efforts by banks to enlarge this stable source of funding which is also treated favourably by new regulation. The most important reason for this may be the sluggish recovery, which already seems to be over again: it is keeping wage (and therefore disposable income) growth down and unemployment high, forcing many households to draw on their savings to make a living. Record-low interest rates are doing their bit as well. It may take a few years – once the ongoing painful economic adjustment process in several European countries has largely been completed – before both deposit and lending volumes can again rise appreciably.

The other side of the Atlantic is showing some remarkable differences compared to Europe. In the US, deleveraging has been much more pronounced, with lending to enterprises shrinking by a cumulative 19% or USD 600 bn from peak to bottom (Q3 08-Q1 11, ten consecutive quarters) and lending to households declining by a total of 12% or more than USD 500 bn (13 quarters in a row between Q4 07 and Q1 11). The US is thus the only major developed country so far where households have substantially reduced their indebtedness.

However, in line with the improved macroeconomic outlook, recent developments clearly point upwards. Household lending has increasingly improved since last spring, though the expansion is still weak and levels are down yoy. Corporate lending has staged a classic V-shaped recovery and is now back in positive territory. Apparently, lending in America has turned the corner.

US lending & deposit volumes



Sources: FDIC, DB Research

Even more striking is the fact that private-sector deposit volumes have continuously outpaced lending since the demise of Lehman Brothers. Growth rates have recently entered the double digits and are at their highest level for the past two decades. Most of the growth, however, has come from flows into large non-interest-bearing transaction accounts that are fully government-insured (beyond the normal USD 250,000 threshold). This crisis-induced measure, a part of the FDIC's Temporary Liquidity Guarantee Programme, is due to expire at the end of the year. It therefore remains to be seen whether the strong rise in deposits can be sustained. Moreover, the bulk of the funds probably relates to the build-up of liquidity by highly profitable businesses in an unsteady macroeconomic environment, while household savings rates continue to be low. Hence, once brighter corporate sentiment prompts firms to increase investments, banks may experience deposit outflows. This could lead to lending and deposit growth rates converging again – and possibly even before the end of this year.

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