

European Banks Strategy

ECB Bank Lending Survey: it's a demand thing

Industry Overview

A demand shock

The ECB released the 3Q 23 Bank Lending Survey on 24 October. It shows tightening credit standards, but no sign of a bank-driven credit crunch (Exhibit 3). What struck us was the sharp reduction in loan demand (Exhibit 4, Exhibit 5). After a slow start, the rate hike cycle is biting consumer and corporate behaviours.

Bank profits set to grow further

Banks expect to remain significant net beneficiaries of the higher interest rate environment in coming months (Exhibit 2). We concur, as discussed in [European Banks Strategy: The Restoration 09 October 2023](#) (report link) and see further revenue benefits from higher bond yields. And from a credit perspective, banks have never had this little risk – see [Peak nothing 01 September 2023](#) (report link), meaning that revenue upgrades do not leak away in impairments.

Behaviours impacted by ECB balance sheet discussions

Banks have enjoyed stable funding conditions (Exhibit 6) even as the ECB cut its balance sheet by €1.8 trillion. The ECB has therefore enjoyed a strong and smooth transmission of monetary policy (Boxes 1 and 2). However, as we discussed in [Minimum reserves, maximum uncertainty 29 September 2023](#) and [A peculiarly European but real challenge 15 October 2023](#) (report links), the eurosystem debate over mandatory reserves and the ECB's retrospective changes made to the Targeted Longer Term Refinancing Operations in 2022 may cause banks to hoard liquidity in coming quarters – should the ECB press ahead with further innovations and balance sheet reduction. Exhibit 1 shows banks have held onto their High Quality Liquid Assets; Exhibit 10 their strong cash preference. Banks are robust to ECB balance sheet cuts, but their appetite to lend may be less so.

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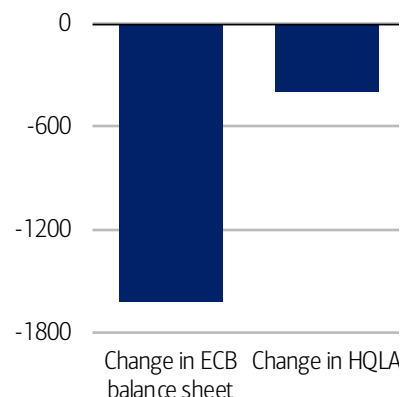
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Exhibit 1: banks only cut High Quality Liquid Assets by 25% of the ECB balance sheet reduction

Change in ECB assets and bank HQLA, year to June 2023 (€ bn)



Source: BofA Global Research estimates, ECB
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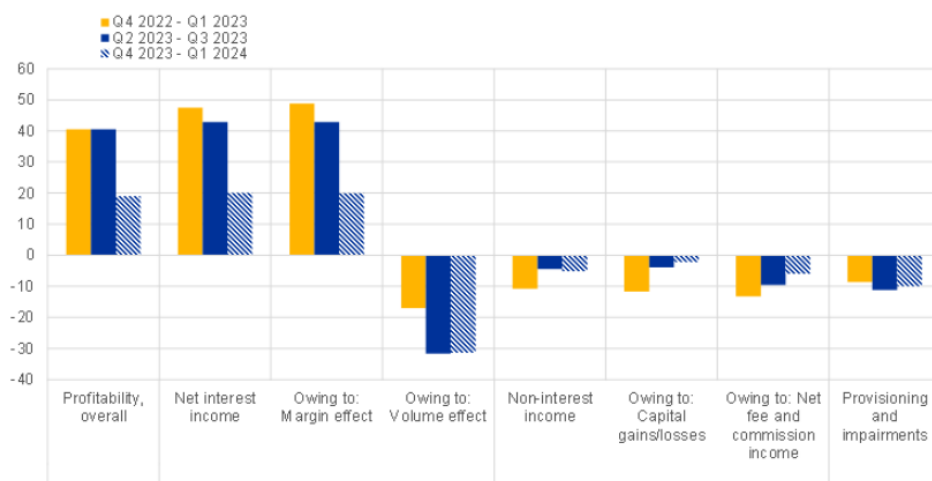
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Key charts

Exhibit 2: Rate hikes are good for banks

Impact of ECB interest rate decisions on euro area bank profitability, (net percentages of banks; over the past six months and the next six months)

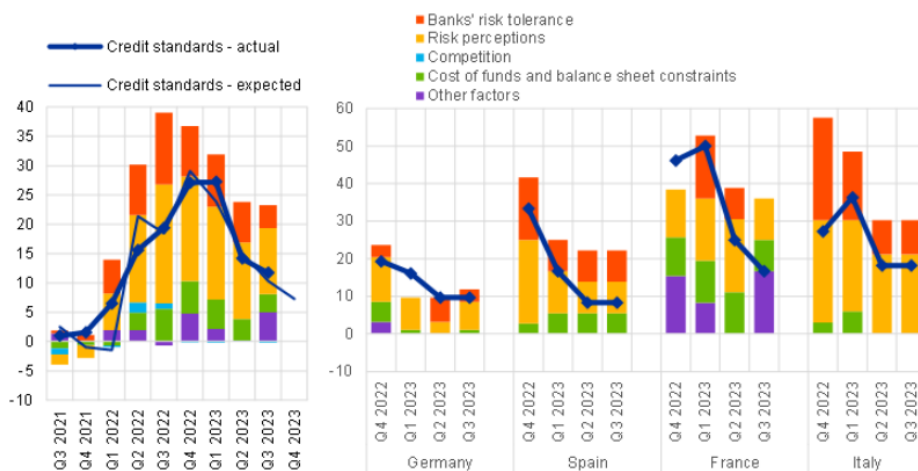


Source: ECB Bank Lending Survey

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Exhibit 3: Rate of credit tightening to corporates is slowing quickly

Changes in credit standards applied to the approval of loans or credit lines to enterprises, net percentages of banks reporting a tightening of credit standards and contributing factors



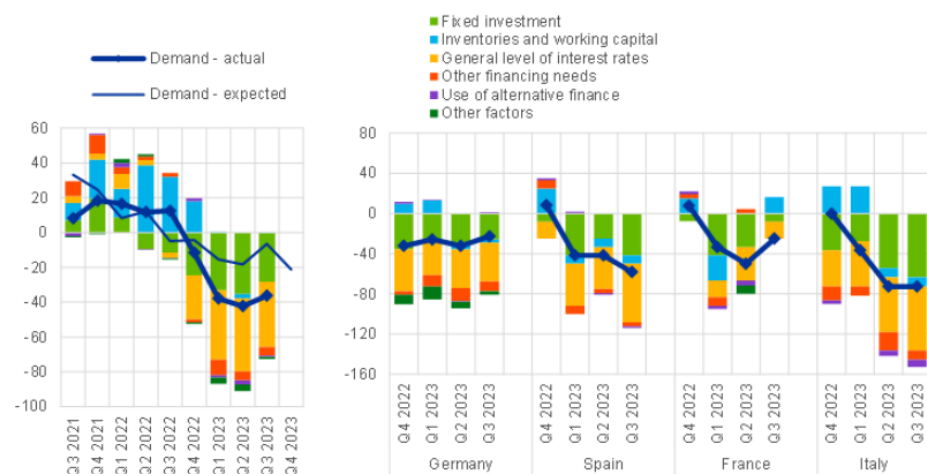
Source: ECB Bank Lending Survey

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Exhibit 4: Corporate loan demand is notably weak though

Changes in demand for loans or credit lines to enterprises, net percentages of banks reporting an increase in demand, and contributing factors

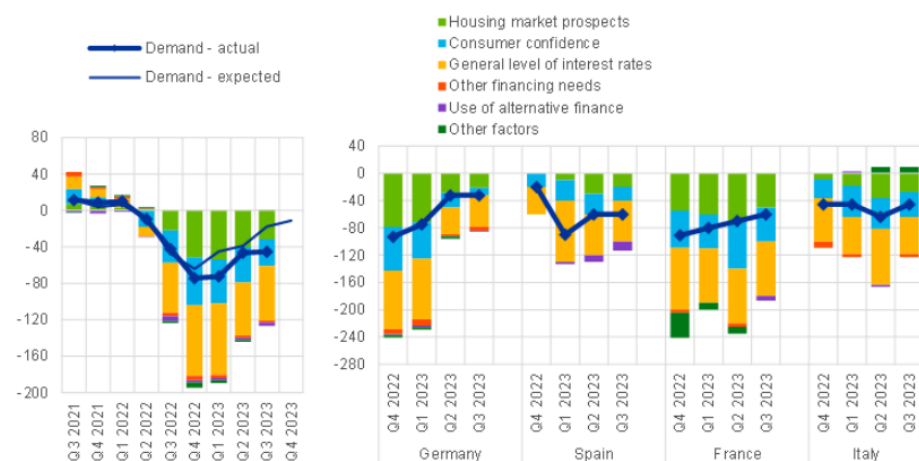


Source: ECB Bank Lending Survey

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Exhibit 5: Household loan demand also poor

Changes in demand for loans to households for house purchase, net percentages of banks reporting an increase in demand, and contributing factors

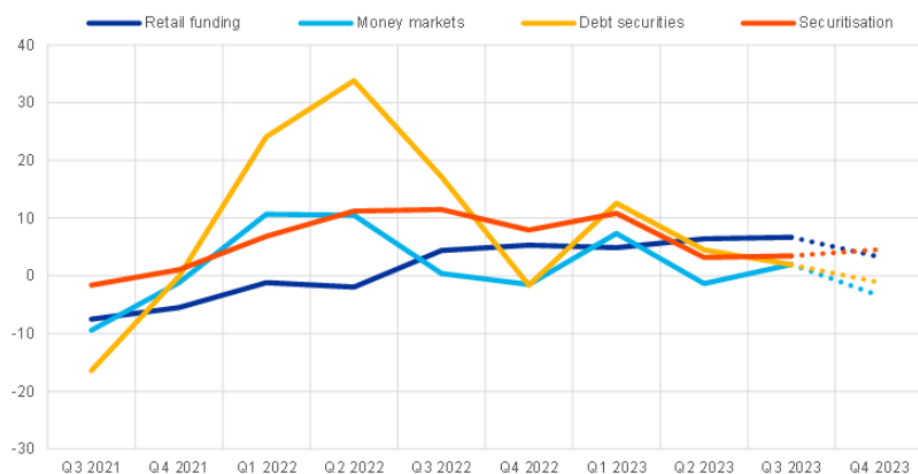


Source: ECB Bank Lending Survey

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Exhibit 6: Bank funding experience has been very stable

Banks' assessment of funding conditions and the ability to transfer credit risk off the balance sheet (net percentages of banks reporting a deterioration in market access)

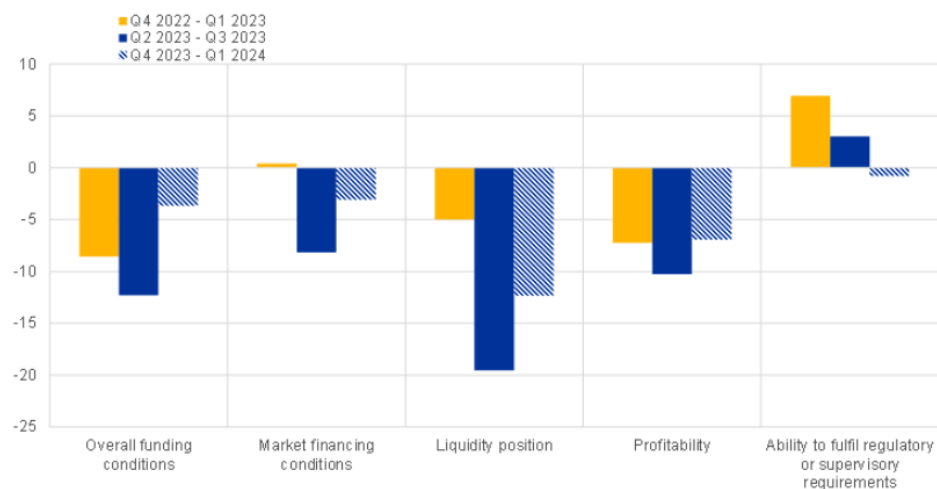


Source: ECB Bank Lending Survey

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Exhibit 7: Impact of targeted longer-term refinancing operations (TLTRO) III on banks' financial situation

Net percentages of banks reporting



Source: ECB Bank Lending Survey

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Box 1: strong monetary transmission

Members concurred that there was ample evidence that policy tightening was being transmitted strongly to broader financing conditions, including bank lending rates and money and credit flows.
ECB: minutes of the September 2023 meeting

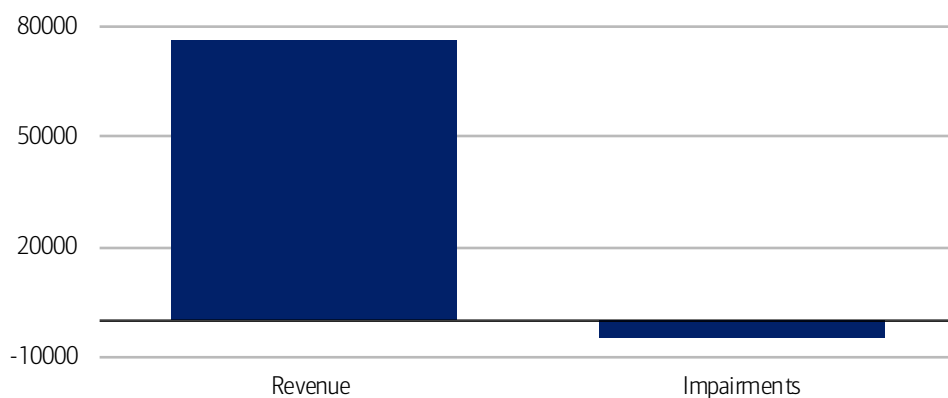
Box 2: managed smoothly so far

The historically large decline in excess liquidity at the end of June owing to the maturing of a TLTRO III operation had not resulted in any upward pressure on money market rates.

ECB: minutes of the September 2023 meeting

Exhibit 8: Almost €80bn in revenue upgrades since the start of the rate cycle while impairment forecasts have also improved, by €4bn

Change in 2023E revenue and impairment forecasts since September 2021

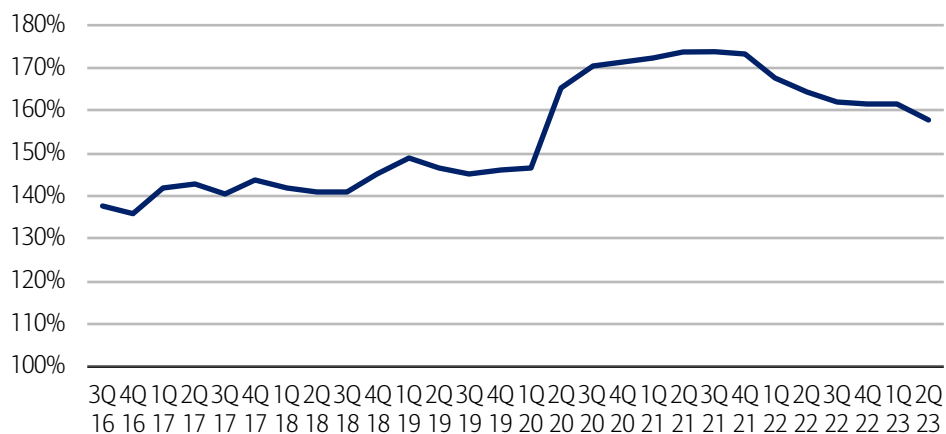


Source: BofA Global Research estimates

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Exhibit 9: Euro area banks have kept their LCR high

Euro area banks: Liquidity Coverage Ratio relative to 100% requirement, 2016-23

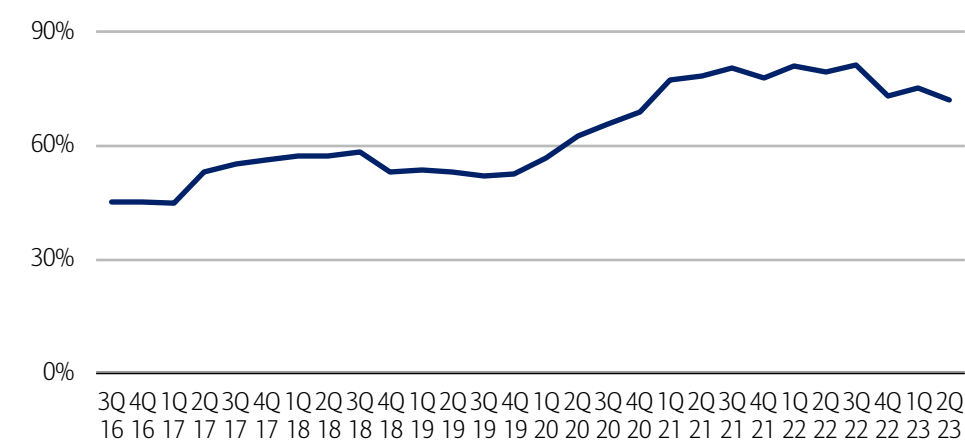


Source: BofA Global Research estimates, ECB

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Exhibit 10: Euro area banks have kept cash the dominant part of HQLA

Euro area banks cash balances, % High Quality Liquid Assets, 2016-23



Source: BofA Global Research estimates, ECB

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