

# Macroeconomic framework and credit cycle in Europe

October 2014

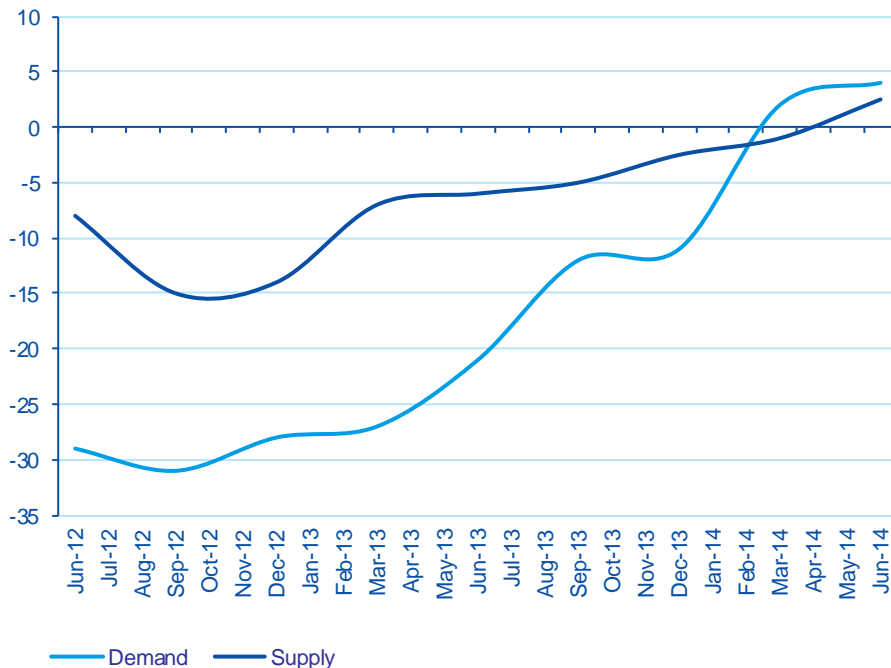
Jorge Sicilia

Chief Economist. BBVA Group

# The current economic context is affecting both the demand and the supply of credit

## Changes in demand and supply of loans to enterprises, Euro Area\* (net percentages of banks)

Source: BBVA Research based on ECB Bank Lending Survey, July 2014



## Why?

**Demand:** negatively affected mainly by the lack of fixed investment

**Supply:** negatively affected by risk perceptions, cost of funds and balance-sheet constraints

Expectations point to a gradual improvement of demand and supply

\* Positive values: Easing credit conditions (supply) or positive demand

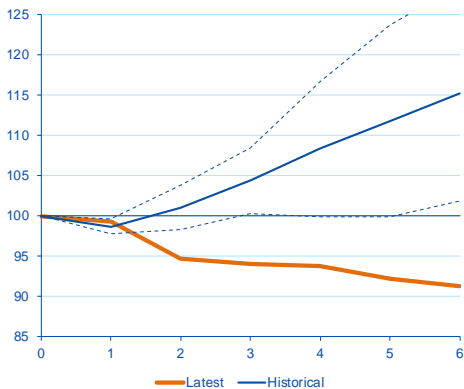
# Demand: weak cycle and low potential growth

## Economic growth, cyclical comparison GDP pc level

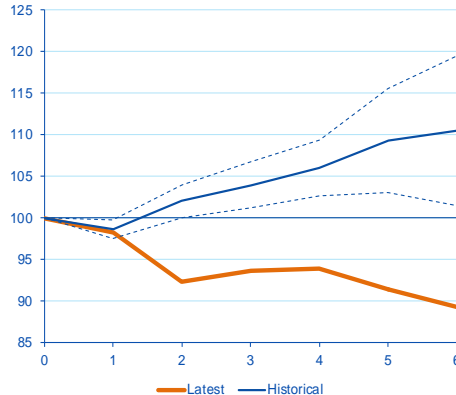
Initial downturn t=100; Historical: average cycle of recession and recovery since 1950; Latest: 0=2007 but Germany (2008).

Source: BBVA Research, World Bank, IMF and Angus Maddison

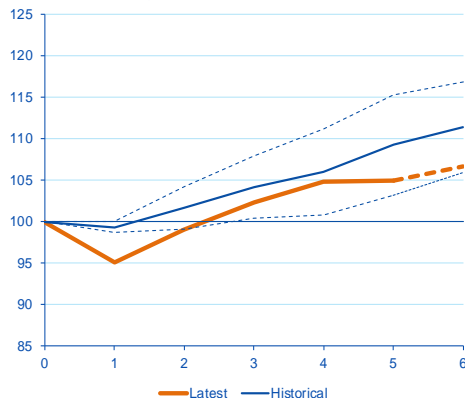
### Spain



### Italy



### Germany



Cyclical recovery is weak and bumpy (0.0% 2Q and 0.1-0.2% expected in 3Q)

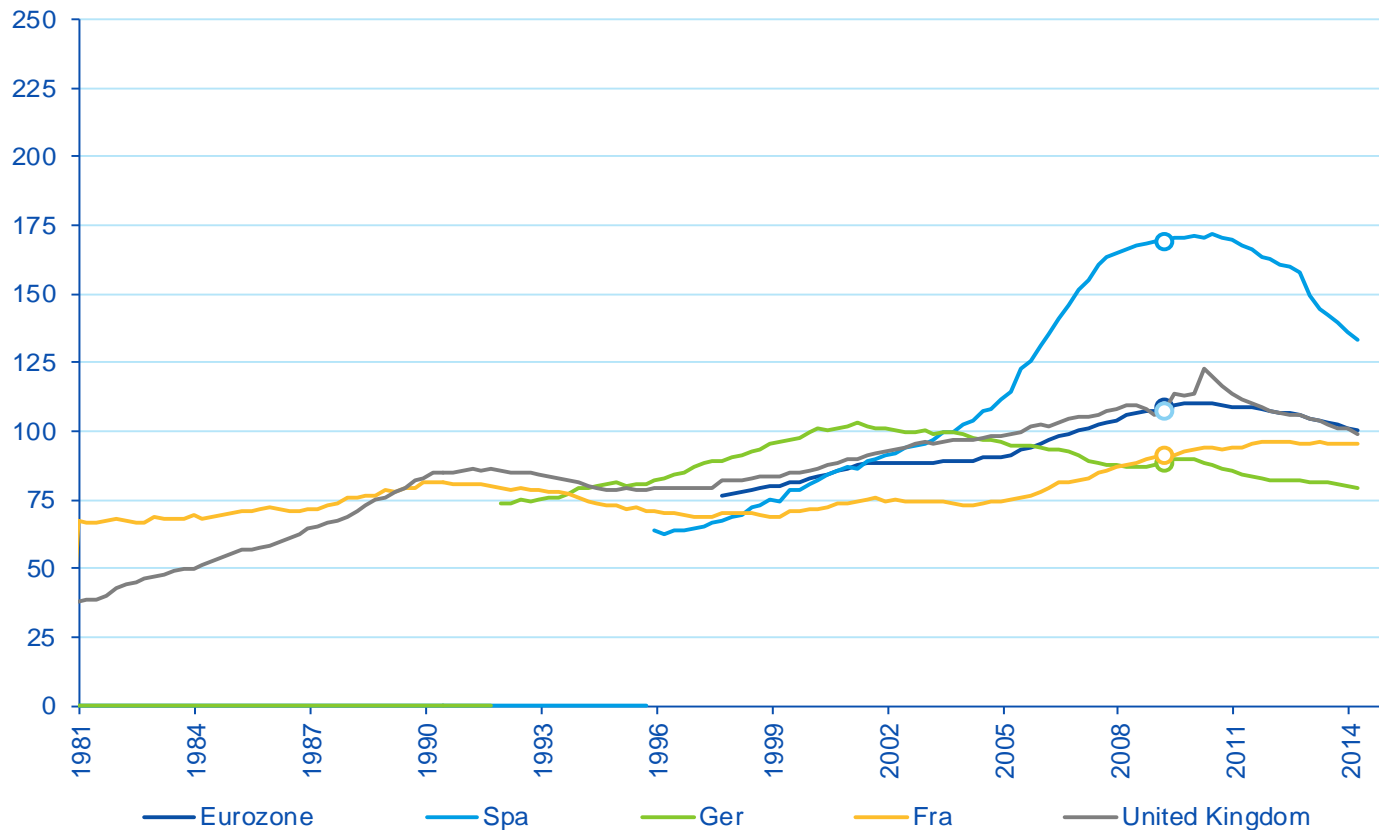
Few measures to increase trend potential growth

Demand stimulus lower than in other developed areas

# Demand: a deleverage process far from finished

## Debt of the Non Financial Private Sector from the Banking Sector, %GDP

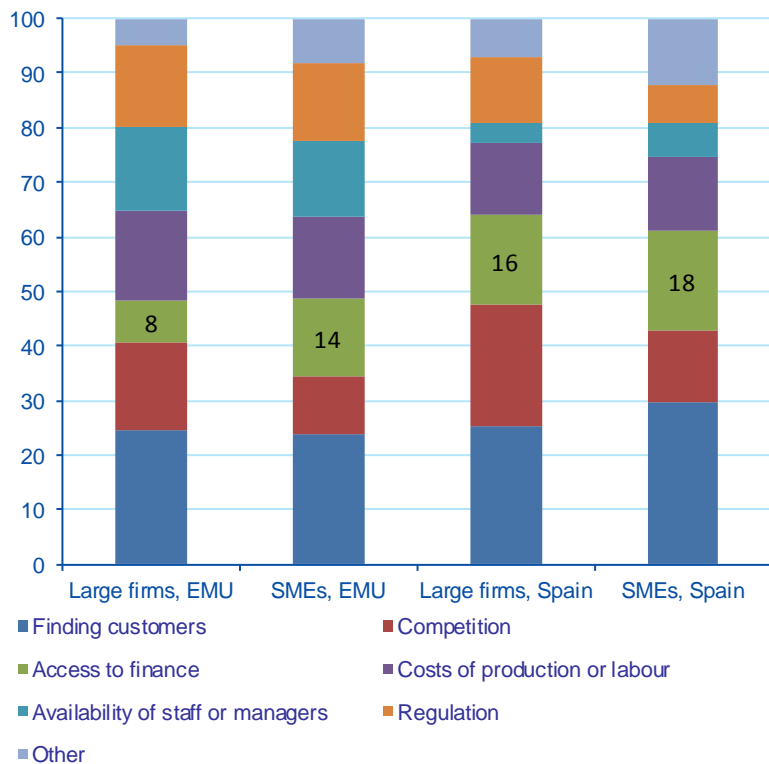
Source: BBVA Research, BIS and OECD



# Supply: Weak, in particular in some countries and for some types of credit

## Most pressing problem (% answers, by firm size)

Source: BBVA Research based on ECB Access to Finance of SMEs, April 2014



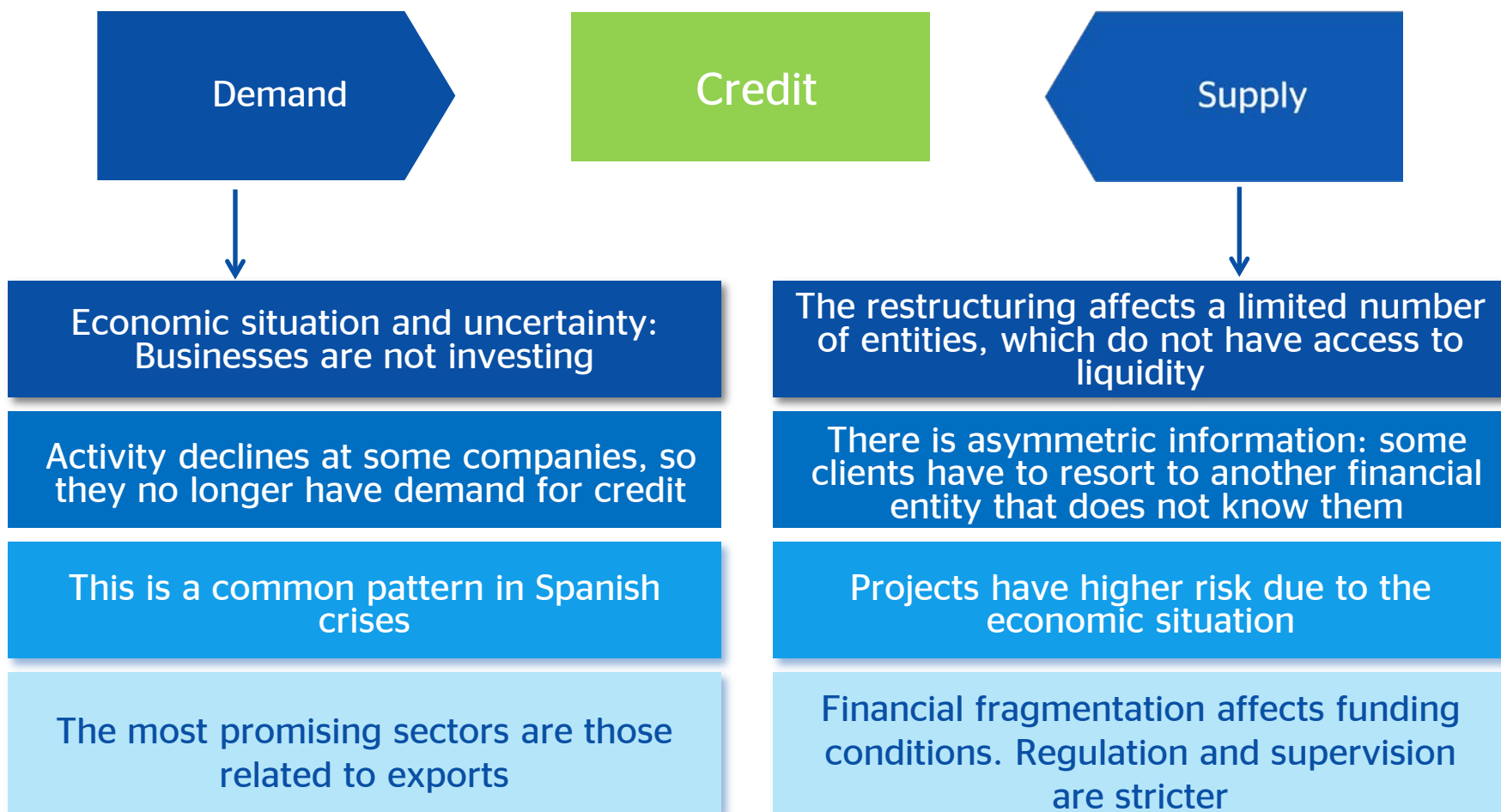
Supply constraints are more of an issue in peripheral economies than in core countries

Supply issues are more relevant in small companies than in large companies



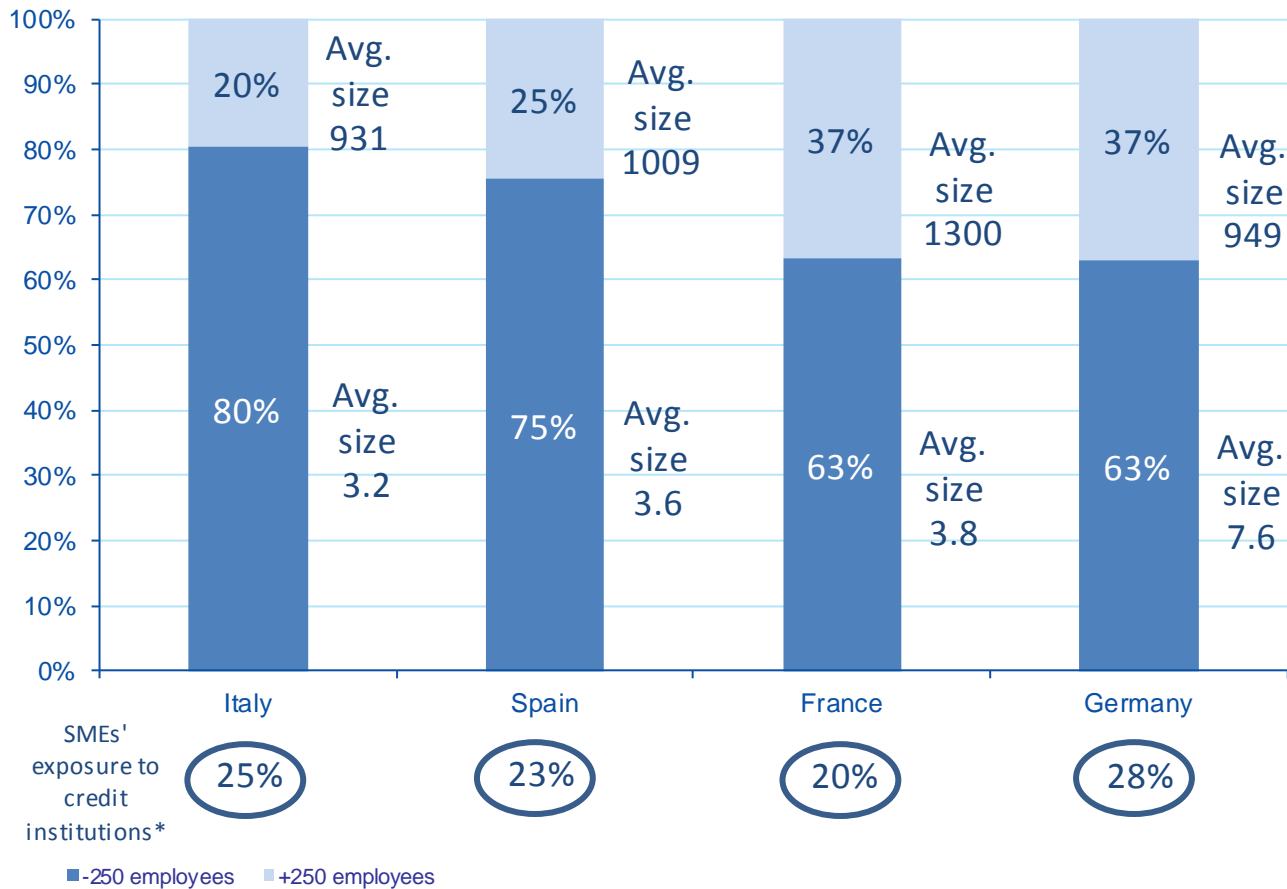
Are we sure that supply and demand factors are well identified?

# Supply and demand are affected by different factors..., What happened in Spain?



# Corporate size is negatively related to reliance on bank credit

## Employees per firm size



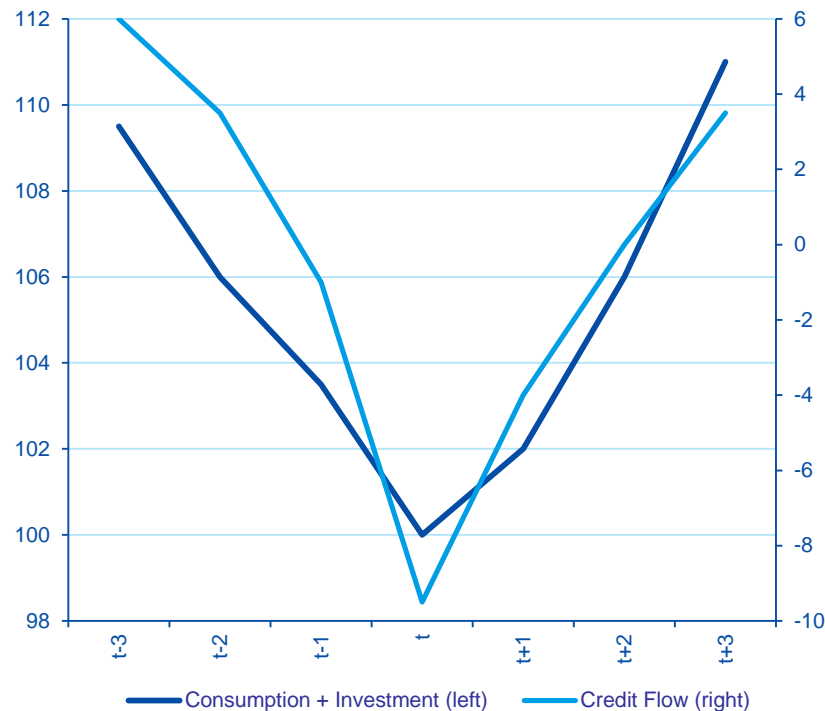
\* Liabilities with credit institutions (% of total balance-sheet)

# Careful: According to recent history, the flow of new credit improves first, followed by stocks

## Average evolution of consumption+investment vs. credit flow (new business)

(C+I=100 at the through of the cycle, average of crises in Finland, Japan, Norway, Spain and Sweden)

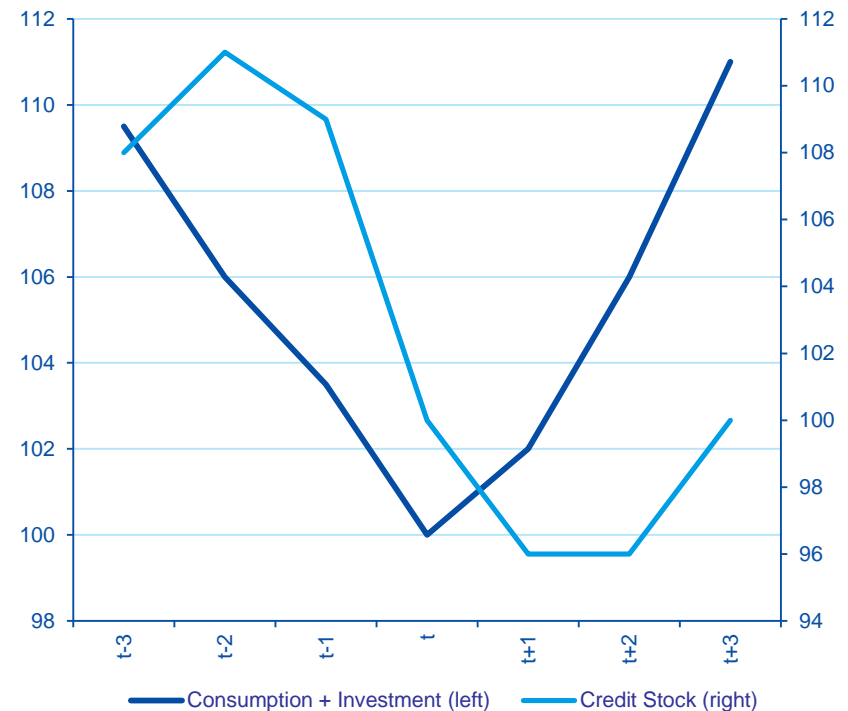
Source: Biggs et al (2009)



## Average evolution of consumption+investment vs. credit stock

(C+I=100 at the through of the cycle, average of crises in Finland, Japan, Norway, Spain and Sweden)

Source: Biggs et al (2009)



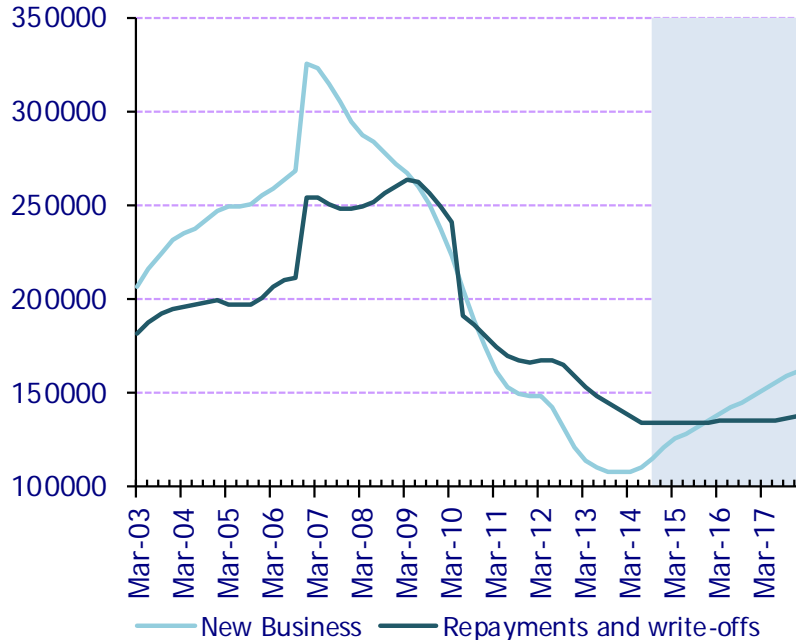


# In Spain, new loans are starting to increase, albeit gradually

## Spain, Private Sector: New Loans and Repayments

(Quarterly figures, EUR mn)

Source: Bank of Spain and BBVA Research



Data show that new lending transactions have bottomed in 4Q'13. Upward trend confirmed in 2014

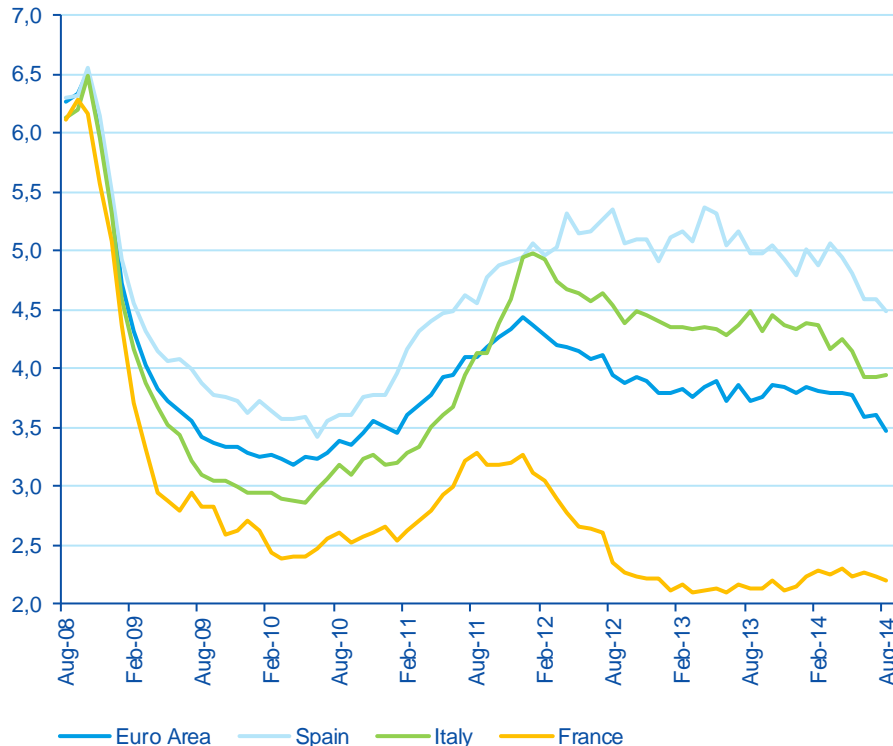
New lending will exceed repayments (outstanding credit will grow) by end-2015

# Legacy issues also affect credit conditions, in particular in peripheral countries

## Interest rates on new bank lending (%)

(to non-financial corporations, less than 1 million €, less than 1 year)

Source: ECB



## Determinants of interest rates on new bank lending (to non-financial corporations)

Source: BBVA Research based on ECB and Bloomberg. Working Paper to be published

	France	Spain	Italy
Commercial policy	0,5	--	--
ECB official rate	1,06	1,26	1,1
Spread 12 months (12m-Euribor)	0,74	0,66	--
Spread EMU (10y-Euribor)	0,24	0,25	--
Spread sovereign (10y country-10y EMU)	--	0,14	0,41
Firms default rate	--	0,11	0,22

-- Does not differ significantly from zero

Will ECB policies do the trick?

Should we think that the Say's law applies to credit?

# Alternative finance must be promoted, but it is, in any case, a long term process

Disintermediation is welcome but we must learn from experience: there are no free lunches



The less regulated shadow banking can bring about nasty surprises (as part of the financial system did)

Alternative sources of funding should be under similar scrutiny



Adequate regulation and oversight to avoid new sources of vulnerabilities and protect consumers (or inform them)

Structural changing to a more balanced funding pattern (including a capital markets union) will take time...



...Long legislative process (governing law, corporate law, transparency and information)

# A level playing field must be promoted

Today: Spanish issuance in MARF  
0.03% of private credit, MAB  
capitalization 0.12%, venture capital  
0.06% new funds per year...



Long term: a healthy system with  
alternative sources of funding

Size matters, probably due to  
transparency



Larger firms, more transparency, better  
competition, level playing field

Today: On-the-spot information on the  
firms matters a lot



Long term: It has to be less of an issue  
but needs to be worked now

In the meantime, we better have a  
healthy and resilient banking system  
ready to provide credit when demand  
starts



To ensure enough credit for the real  
economy in the years to come

# Financial Regulation: *"In medio, virtus"*



Times  
are  
hard

"Just between the two of us" – that **"I recently tried to refinance my mortgage and I was unsuccessful in doing so."** B. Bernanke

If regulatory activism continues, the uncertainty will linger and banks will likely factor this uncertainty in their decisions

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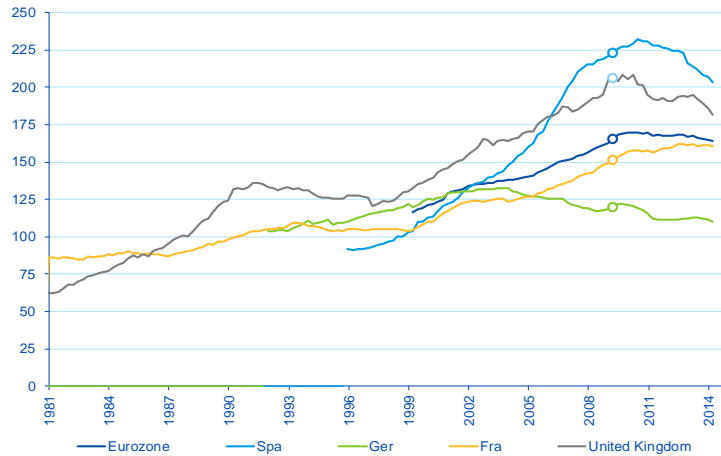
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# Demand: a deleverage process far from finished

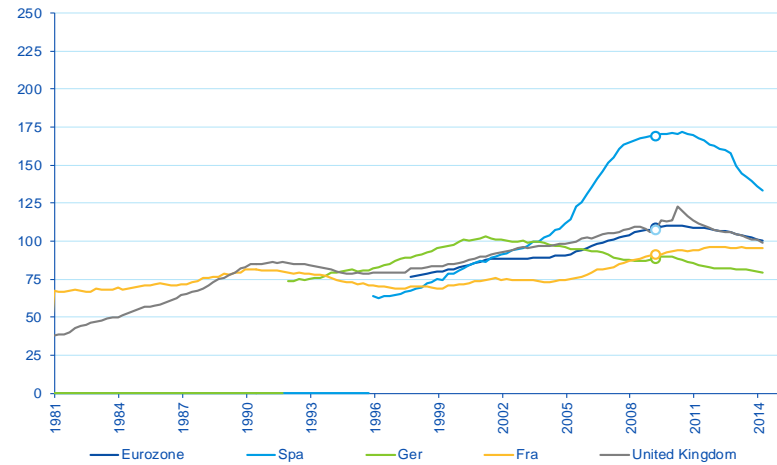
## Debt of the Non Financial Private Sector

Source: BBVA Research, BIS and OECD

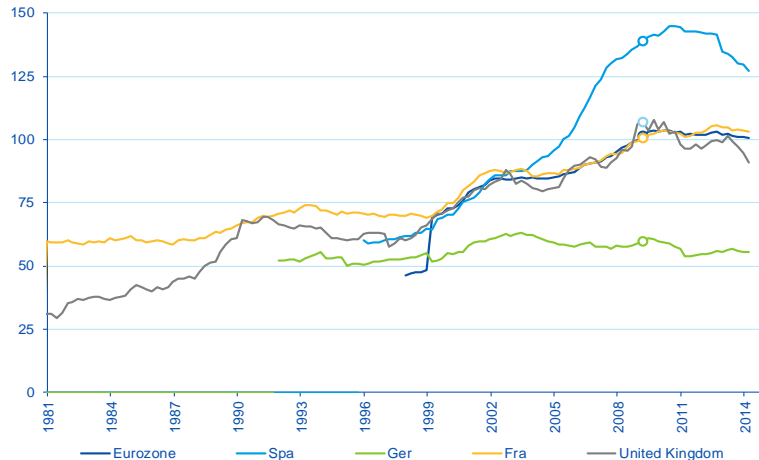
### Total, from all creditors, % GDP



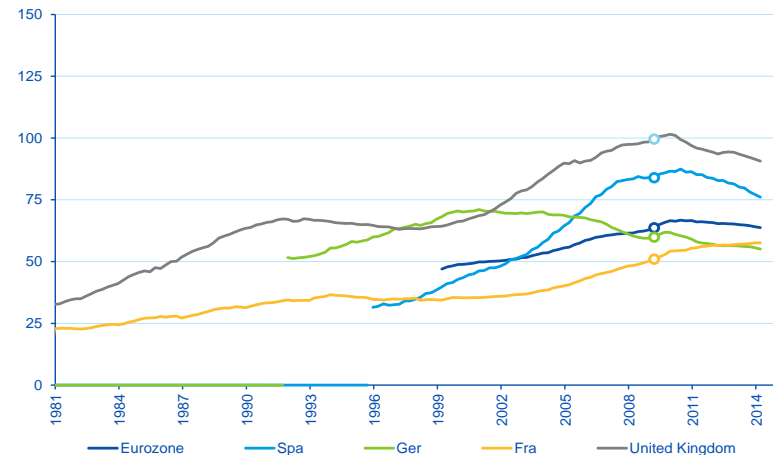
### Total, from the Banking sector, % GDP



### Non Financial Corporations, from all creditors



### Households Debt, from all creditors



# Recent data on new loans

	New Credit Operations							
	Total	Non financial Corporations			Total	Households		
		Total	Upto 1M	Over 1M		Housing	Consumer	Other
<b>Spain</b>								
Mar-14	-5,8%	-9,4%	5,1%	-16,7%	22,9%	40,9%	26,5%	0,1%
Apr-14	-9,2%	-11,1%	2,8%	-19,3%	4,4%	3,6%	11,5%	-0,3%
May-14	-11,0%	-13,2%	4,9%	-24,0%	3,8%	4,1%	11,5%	-3,3%
Jun-14	0,2%	-1,6%	10,0%	-6,3%	14,8%	26,0%	14,7%	0,1%
Jul-14	-6,4%	-9,1%	12,4%	-21,6%	12,1%	17,7%	16,1%	1,1%
Aug-14	-2,9%	-3,4%	5,5%	-9,5%	0,2%	-3,4%	-6,2%	13,5%
<b>Eurozone</b>								
Mar-14	-6,6%	-9,7%	-1,0%	-12,7%	2,4%	-0,1%	8,2%	3,6%
Apr-14	-3,4%	-3,5%	-2,9%	-3,7%	-3,2%	-5,4%	0,6%	-0,6%
May-14	-6,7%	-8,0%	-6,0%	-8,8%	-3,4%	-6,1%	2,4%	-0,7%
Jun-14	-5,3%	-5,7%	-0,3%	-7,4%	-4,1%	-4,5%	1,3%	-7,4%
Jul-14	-4,1%	-3,4%	1,4%	-5,1%	-5,9%	-7,5%	2,9%	-8,4%
Aug-14	-6,1%	-6,0%	-5,0%	-6,4%	-6,4%	-8,0%	6,8%	-12,7%

Source: ECB, Bank of Spain and BBVA Research



# Alternative finance in Spain

	Concept	EUR Million	Number	% Private	
				Sector Credit	% GDP
MARF	Issuance	381	5 bonds, 16 commercial paper	0,03%	0,04%
MAB	Market Cap	1.659	24 firms	0,12%	0,16%
Venture capital	New funds, 2013	872		0,06%	0,09%
	Public funds, endowment				
	Fond-ICO Global	1.200		0,08%	0,12%
	Fond-ICO Pyme	250		0,02%	0,02%
	Fond-ICO Infraestructuras	250		0,02%	0,02%
Business Angels	Investment 2013	63		0,004%	0,006%
Crowdfunding	Funds 2013	19		0,001%	0,002%

Source: MARF, MAB, IEE, Crowdfunding Spanish Association

MAB: Average turnover EUR 25 million

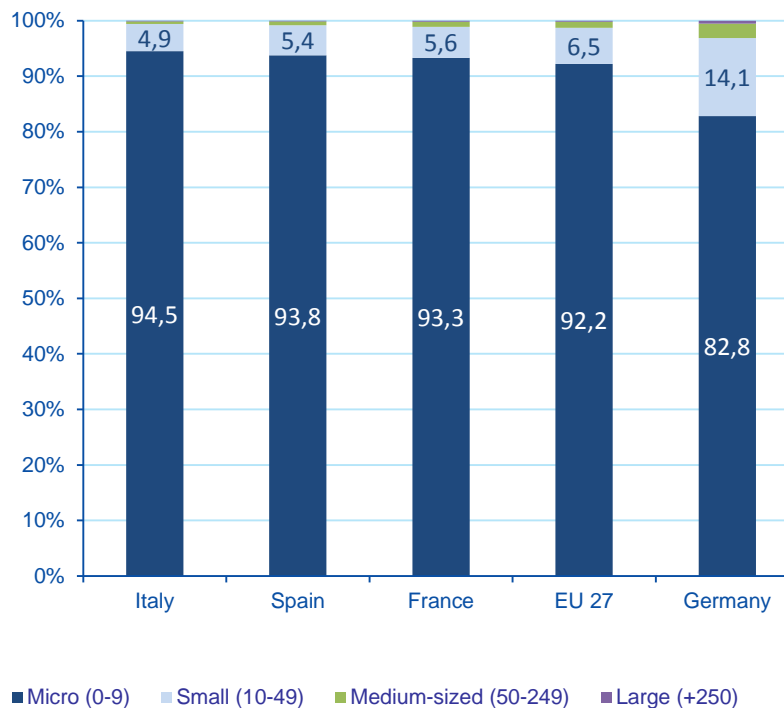
SMEs definition: less than 250 persons employed and annual turnover of up to EUR 50 million, or a balance sheet of no more than EUR 43 million

# The majority of Spanish SMEs have a limited size

## Proportion of firms per number of employees

(% number of firms in the country)

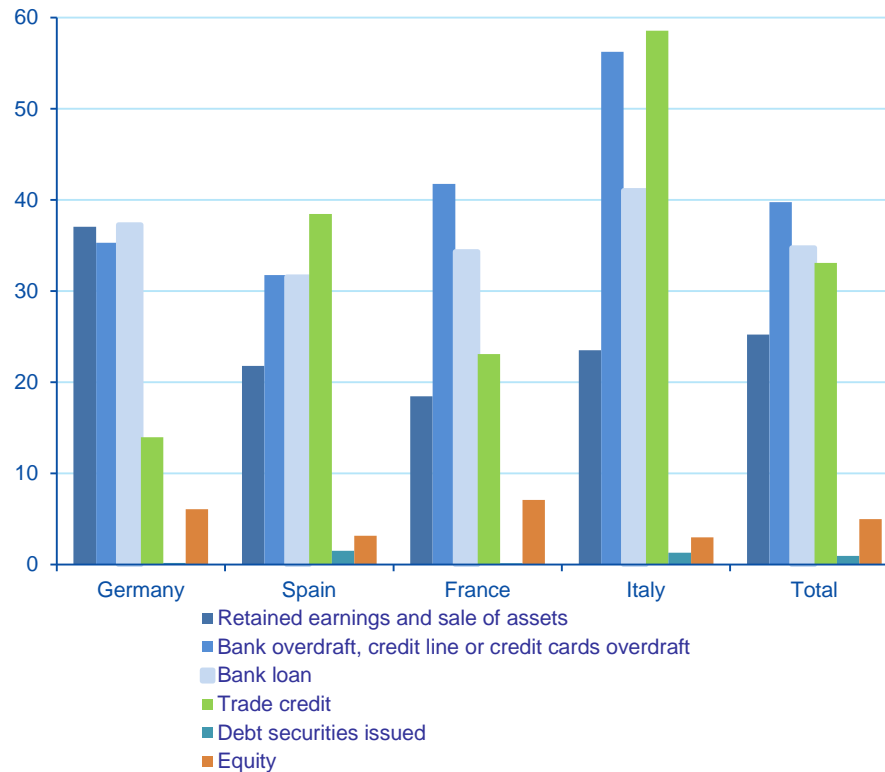
Source: Eurostat, 2009



# SMEs' sources of financing: mainly via banks

## SMEs: Funding source used in the last six months (% positive answers)

Source: BBVA Research based on ECB Access to Finance of SMEs, April 2014



# Regulation: New rules should balance efficiency and stability

