MACROCOSM

Not a Big Bang, But It Could Work

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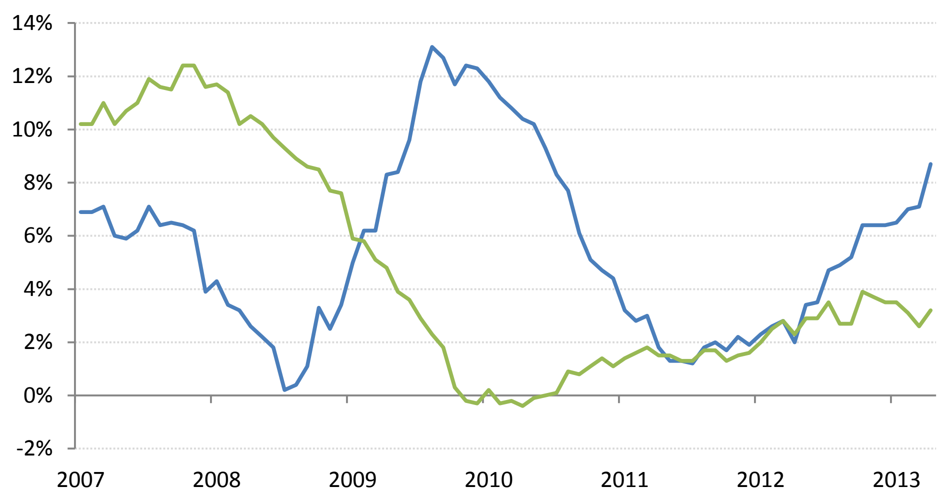
Business credit languishes in the euro area, but there's a better solution than negative rates.

This morning's M3 data published by the European Central Bank shows that broad money growth in the euro area continues to be sluggish -- at best (please see the chart below).

M3 **M1** YOY growth



Source: ECB, TrendMacro calculations

- The spike in M1 -- currency in circulation and overnight deposits -- is no comfort. It has been almost exclusively driven by increases in overnight deposits -- perhaps, given that this data is from month-end April, a reaction to the uncertainty caused by the Cyprus bailout.

Further, data from the ECB shows that there is still no improvement -- Greece aside -- in lending to non-financial businesses in the periphery of the euro area (please see the chart on next page).

As we discussed last week (see "ECB: It Takes Whatever" May 22, 2013), this latest data shows the persistence of what has become the major choke-point in the euro area -- credit to businesses in the periphery, especially small and medium enterprises (SMEs).

Update to strategic view

EUROPE MACRO, EUROPE STOCKS, ECB: Another round of disappointing money supply data from the ECB today again points to the central choke-point for euro area growth -- credit to businesses in the periphery. Fortunately, the plan by the ECB and the European Investment Bank to develop a securitized market for SME credits seems to be progressing. This is the right solution -- assuming it can be implemented -- to the right problem. The return on investment will take longer to realize than that from a QE-style "big bang," but it will be more sustainable as it will be based on bottom-up growth rather than top-down monetary policy. Meanwhile, we are ignoring the talk about the ECB imposing negative interest rates -- too risky, and of dubious use.

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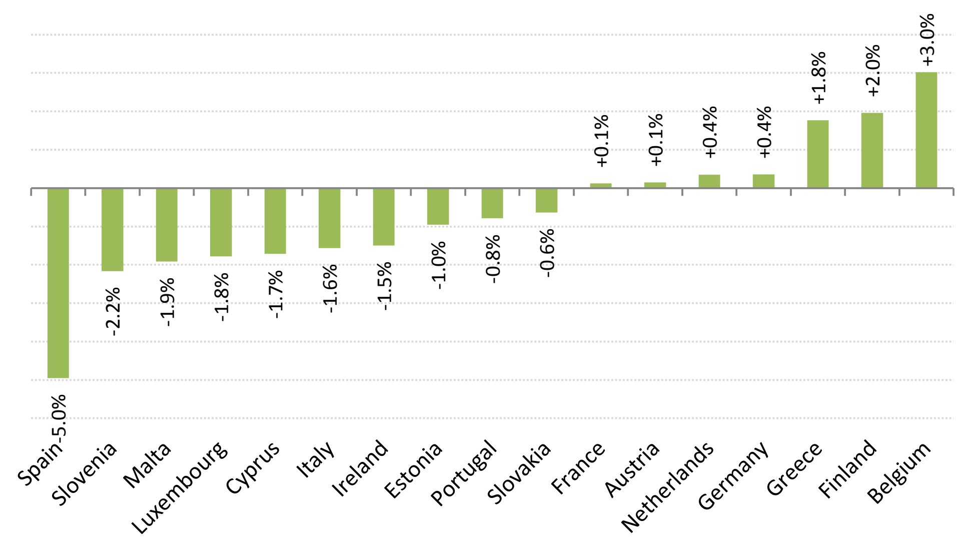
Loans to euro area non-financial companies QOQ growth



Source: ECB, TrendMacro calculations

- This problem is not one that can be solved by an interest rate cut, which at this point would most likely entail a negative deposit rate. We still do not think that the ECB will move to negative rates unless other readings -- in particular, a further fall in inflation -- get considerably worse.
- The ECB is very aware of the problem -- President Mario Draghi has highlighted it at the last few monetary policy meetings (see, among others, "The EIB, Not the ECB" April 12, 2013).
- Unfortunately there is no quick fix to the lack of SME credit.
- But this does not mean that there is not a solution.

In an interview yesterday Governor of the Banque de France Christian Noyer again highlighted the securitization route as the preferred method for increasing access to credit for business.

- Noyer said that banks account for three quarters of lending in the euro area, with the rest coming from markets -- while in the US the proportion is roughly reversed.
- Securitization of SME loans would allow credit to still be sourced within the banking sector, but then securitized and sold to the market.
- Noyer assured that securitization would be "clear transparent, plain vanilla" -- but his assurances are probably not enough to encourage the market to buy into the idea in size.
- In order get SME securitization to do some of the real heavy lifting for peripheral credit growth, an enhancement would be needed. For that, currently the ball is in the court of the European Investment Bank (again, see "The EIB, Not the ECB") -- who, intriguingly, have recently been trying to recruit a structured finance credit risk officer.

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So the ECB knows where the problem lies, and it is trying -- with other institutions -- to formulate a solution. This is all good.

- But increasing credit availability in the periphery by constructing -- basically from scratch -- a securitization market in business loans is not going to be a quick process.
- It lacks the mediagenic "big bang" of a QE announcement, or negative interest rates -- although in the case of negative interest rates, it is very unclear what the actual bang for the buck would be once the publicity died down.
- Even if the securitization exercise is successful -- and there is no guarantee that it will be -- the slow pace of the transmission of increased credit into economic growth means that 2013 in the euro area is still shaping up to be a year of low to no growth.

This does not disturb our long-term bullish outlook on peripheral equity markets. If the ECB has correctly identified the problem and has formulated an effective solution, then our bull case is only strengthened.

In the shorter term, talk of negative interest rates will continue. However, as they are usually used as an FX strategy to prevent capital inflows and currency appreciation -- as in Denmark -- it is unclear what their effect would be in the world's second-largest currency. We feel it is safe to ignore it ahead of the ECB's June monetary policy meeting.

Bottom line

Another round of disappointing money supply data from the ECB today again points to the central choke-point for euro area growth -- credit to businesses in the periphery. Fortunately, the plan by the ECB and the European Investment Bank to develop a securitized market for SME credits seems to be progressing. This is the right solution -- assuming it can be implemented -- to the right problem. The return on investment will take longer to realize than that from a QE-style "big bang," but it will be more sustainable as it will be based on bottom-up growth rather than top-down monetary policy. Meanwhile, we are ignoring the talk about the ECB imposing negative interest rates -- too risky, and of dubious use.