European Economic Comment
ECB: credit improving (but don't expect miracles)

Economics

Europe including UK

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Summary: Further improvement in Q2, some caution regarding Q3
The ECB's Q2 2015 Bank Lending Survey (BLS, conducted 9-24 June) shows that the broad-based recovery in European credit conditions remains on track, although the path towards a full normalisation is still long. Credit demand continued to recover across the board in Q2, for corporate loans, housing loans, and consumer loans – a trend that is expected to continue in Q3. Banks eased the supply of credit across all loan-segments in Q2, but – as a note of caution – signalled that credit standards for corporate loans might not be eased further in Q3, while credit standards for housing loans might even be tightened. Overall, while credit is gradually improving, confidence effects of the ECB's QE, the weak EUR, low inflation and oil prices, and the easing of austerity remain the more important drivers of growth for now. The credit recovery supports our case for European equities and higher core government bond yields.

Credit supply and demand continue to improve

For the fifth consecutive quarter, Eurozone banks eased the supply of credit (credit standards) for **corporate loans** in Q2 2015, both for larger firms and SMEs; the easing was stronger than banks had anticipated. In the bigger countries, credit standards were eased in France and Italy, remained unchanged in the Netherlands and Spain and tightened slightly in Germany. However, looking forward to Q3, banks do not expect a further easing in credit standards to corporates. Credit demand from corporates improved considerably in Q2, thanks to low interest rates, stronger fixed investment and increased demand for inventories and working capital. Banks expect a further pick-up in demand for Q3.

The demand for **housing loans** continues to rise more strongly than expected (particularly in the Netherlands and Italy), thanks to low interest rates, good housing market prospects and better consumer confidence, and banks expect a further substantial demand increase for Q3. After a tightening in credit conditions in Q1, banks eased supply again in Q2, but expect a considerable tightening in credit conditions for housing loans for Q3. In contrast, banks eased credit standards for **consumer loans** in Q2 and expect to do the same in Q3. Loan demand remains strong, particularly related to durable consumer goods, a trend that is expected to continue in Q3.

Equity strategy: The slower credit recovery in Europe compared to the US has been one of the key reasons for the underperformance of European equities relative to the US. But this is now changing, we think. Lending to households has turned positive and lending to corporates is close to doing so. There is also the opportunity for European corporates to re-gear with net debt/equity close to a 15-year low (for more details please see UBS: Q-Series®: Where Will $1Tn Per Year in Corporate Cash Go?, 24 Feb. 2015). We believe the improvement in credit is one of several factors that support better profit growth and higher European equity markets from here to year-end 2015.

Rates strategy: We expect the economic recovery in the Eurozone to continue to put upward pressure on 10-year core government bond yields in Europe. We look for 10-year German yields to rise to 2% by end-2016.

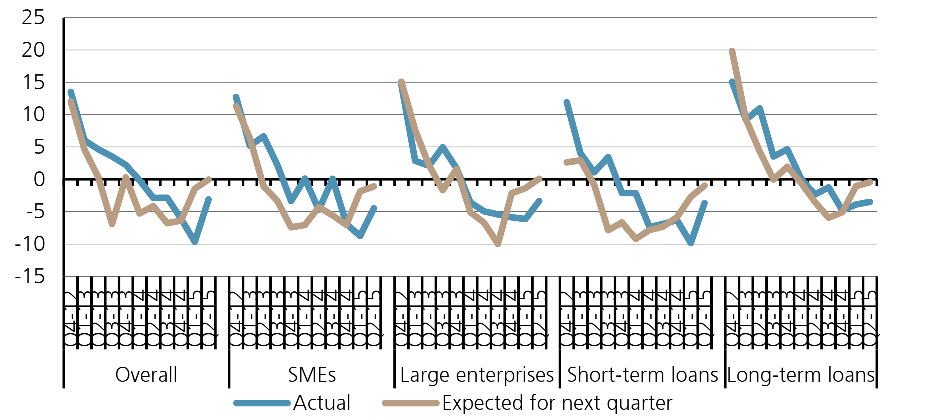
Figure 1: Latest developments in Bank Lending Survey results
(net percentages of banks reporting tightening credit standards or positive loan demand)

	ENTERPRISES						HOUSE PURCHASE						CONSUMER CREDIT					
	Credit standards**			Demand***			Credit standards**			Demand***			Credit standards**			Demand***		
	Q1-15	Q2-15	Av*	Q1-15	Q2-15	Av*	Q1-15	Q2-15	Av*	Q1-15	Q2-15	Av*	Q1-15	Q2-15	Av*	Q1-15	Q2-15	Av*
Euro area	-10	-3	12	1	13	-7	2	-9	9	30	49	-2	-5	-4	6	12	41	-4
Germany	-3	3	5	0	6	2	3	3	2	45	45	7	0	-3	0	13	29	8
Spain	0	0	12	30	20	-4	0	0	20	11	0	-13	0	-10	11	20	60	-14
France	-7	-2	9	-3	-6	-17	7	-15	4	-6	53	5	-14	1	-2	20	76	-5
Italy	-25	-25	21	0	38	0	-25	-38	5	63	88	7	-13	-13	11	25	50	9
Netherlands	-23	0	13	-57	40	-8	23	0	20	51	100	-19	0	0	15	-25	0	-2

Source: ECB, UBS. *Long-term average taken from the inception of the survey, excluding latest quarter. ** A positive net percentage balance indicates a larger proportion of banks have tightened credit standards (net tightening). A negative number would refer to a net easing of credit standards. *** A positive net percentage balance indicates an increase in loan demand, whereas a negative figure would indicate a decline in loan demand.

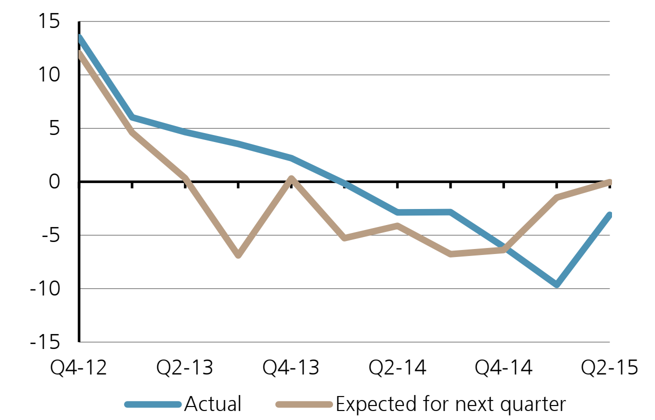
Supply of credit

Figure 2: Change in credit standards for loans to enterprises**



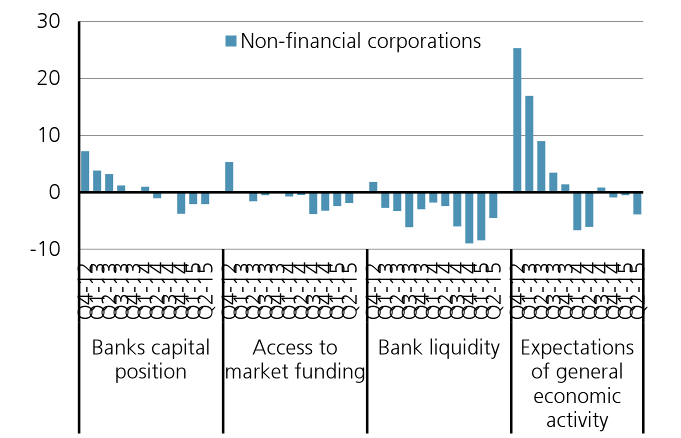
Source: ECB survey, Haver, UBS. ** A positive net percentage balance indicates a larger proportion of banks have tightened credit standards (net tightening). A negative number would refer to a net easing of credit standards.

Figure 3: Change in overall credit standards to enterprises



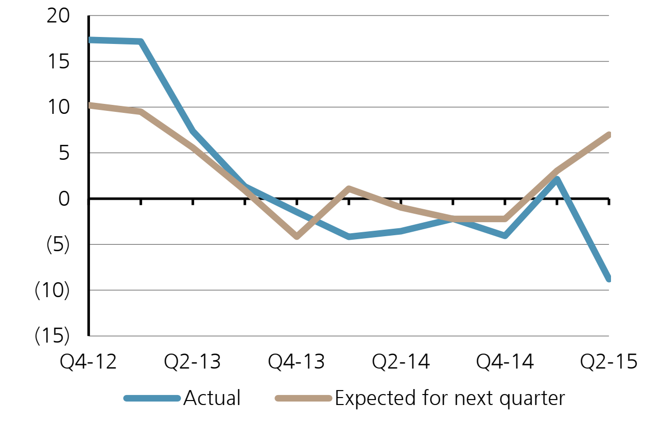
Source: ECB survey, Haver, UBS

Figure 4: Factors contributing to tighter credit standards



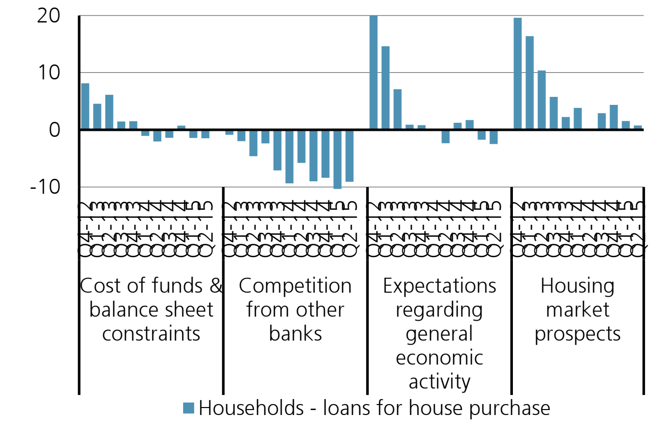
Source: ECB survey, Haver, UBS

Figure 5: Change in credit standards for housing loans



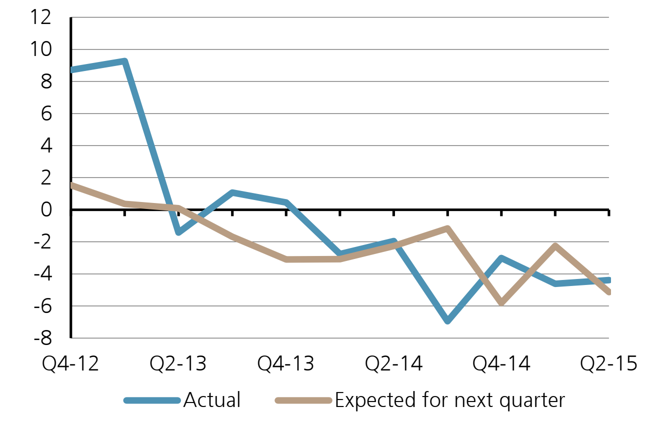
Source: ECB survey, Haver, UBS

Figure 6: Factors contributing to tighter credit standards



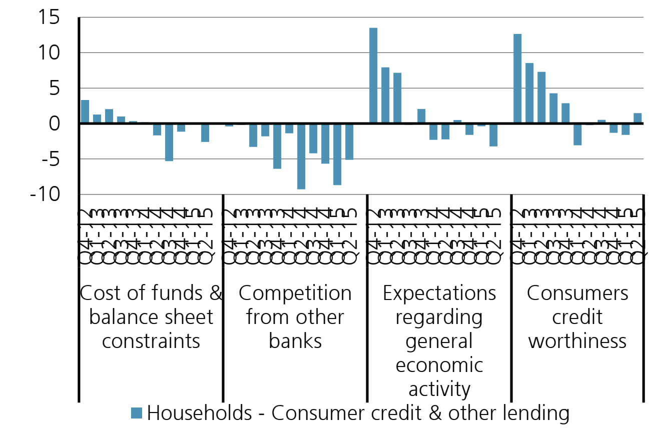
Source: ECB survey, Haver, UBS

Figure 7: Change in credit standards for consumer credit



Source: ECB survey, Haver, UBS

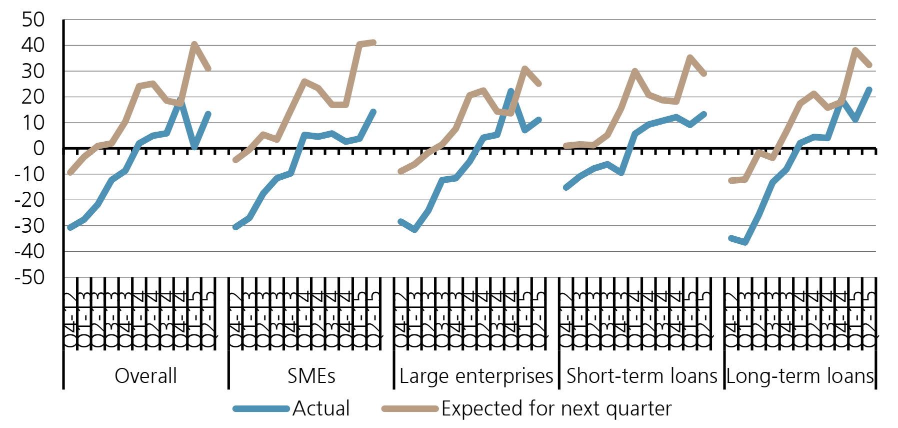
Figure 8: Factors contributing to tighter credit standards



Source: ECB survey, Haver, UBS

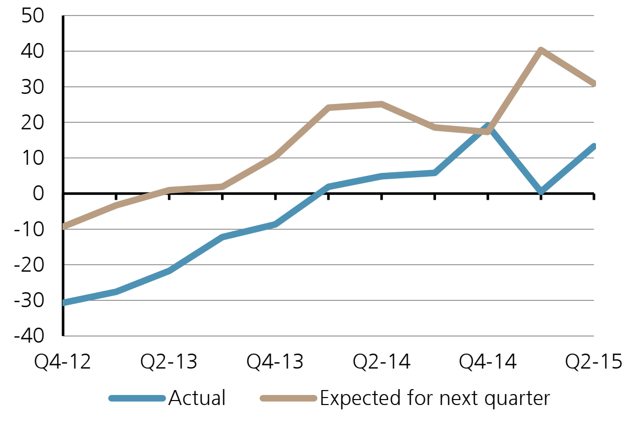
Demand for credit

Figure 9: Changes in demand for loans to enterprises***



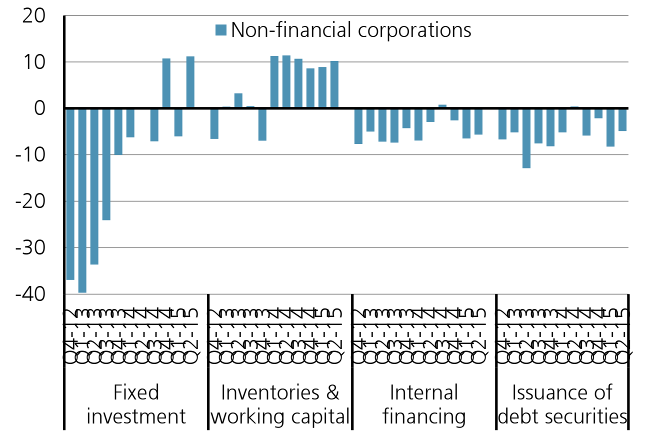
Source: ECB survey, Haver, UBS. *** A positive net percentage balance indicates an increase in loan demand, whereas a negative figure would indicate a decline in loan demand.

Figure 10: Change in demand for loans to enterprises



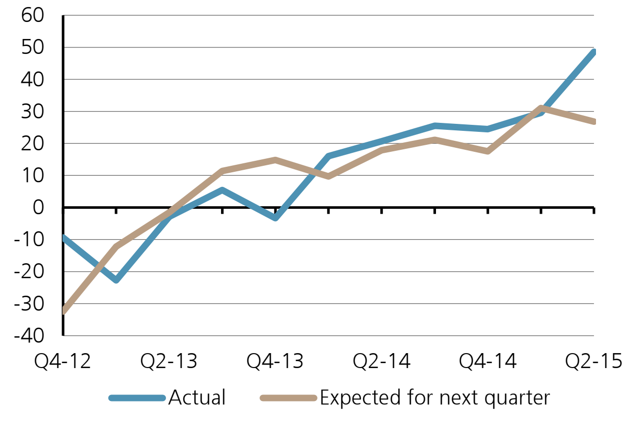
Source: ECB survey, Haver, UBS

Figure 11: Contributing factors to increasing demand



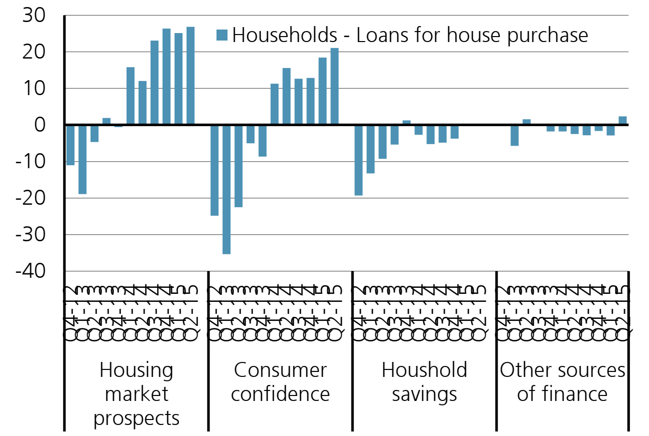
Source: ECB survey, Haver, UBS

Figure 12: Change in demand for housing loans



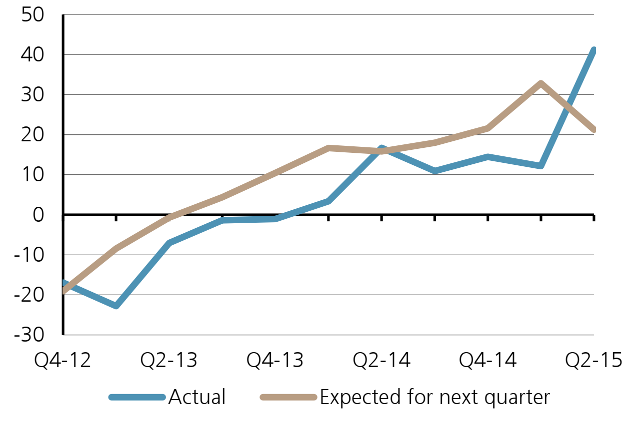
Source: ECB survey, Haver, UBS

Figure 13: Contributing factors to increasing demand



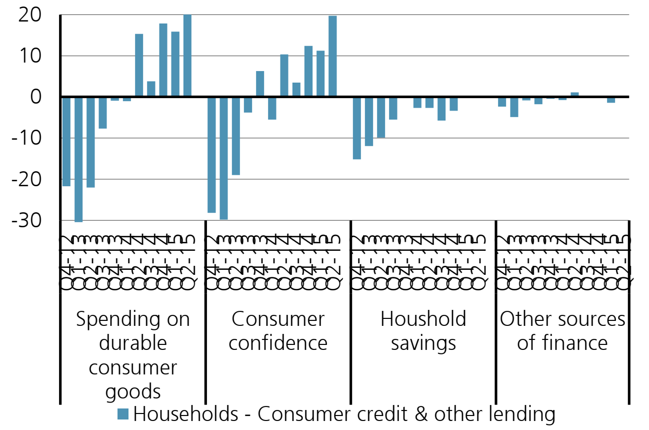
Source: ECB survey, Haver, UBS

Figure 14: Change in demand for consumer credit



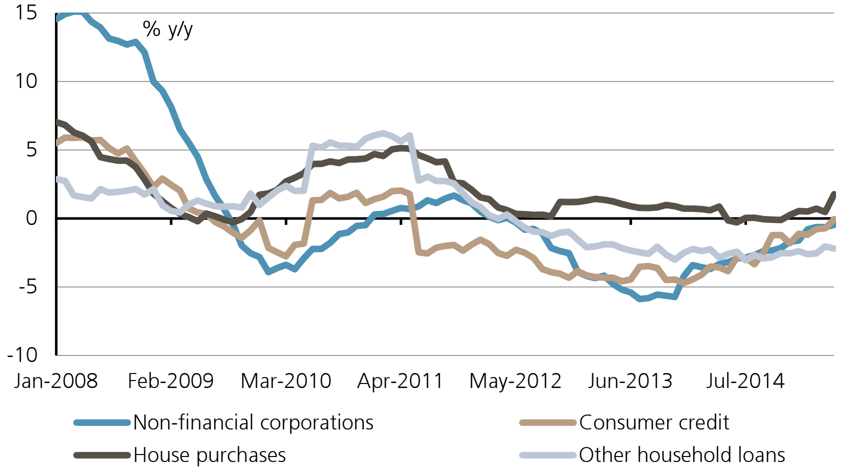
Source: ECB survey, Haver, UBS

Figure 15: Contributing factors to increasing demand



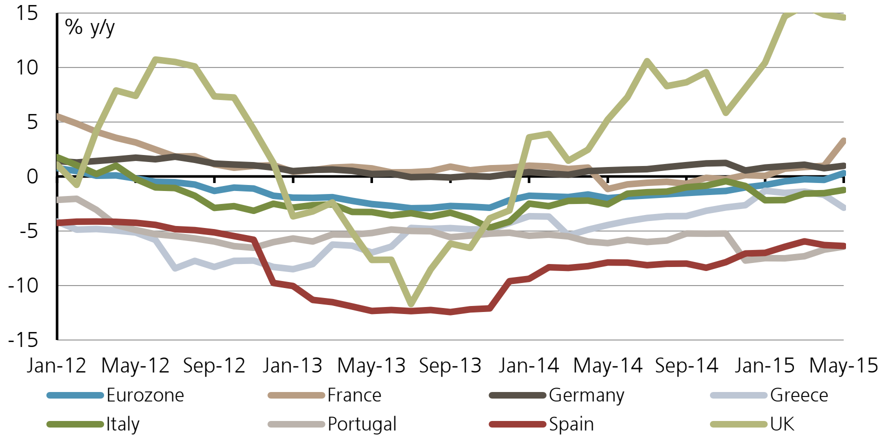
Source: ECB survey, Haver, UBS

Figure 16: Eurozone private sector credit growth, % y/y



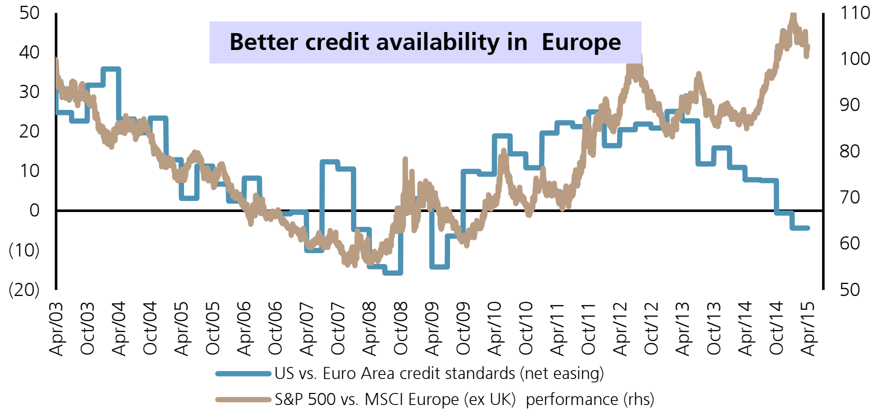
Source: Haver, UBS

Figure 17: Private sector credit growth, % y/y



Source: Haver, UBS

Figure 18: The euro-area is moving into a phase of easing more than the US but markets have lagged the 'catch-up' in the lending backdrop



Source: Haver, UBS.

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