
EU Business and Credit Cycles. Where Do We Stand?

Presentation for the HBA-EMF Conference

**“Current Developments and Challenges in the Mortgage
Market”**

Athens, June 10, 2011

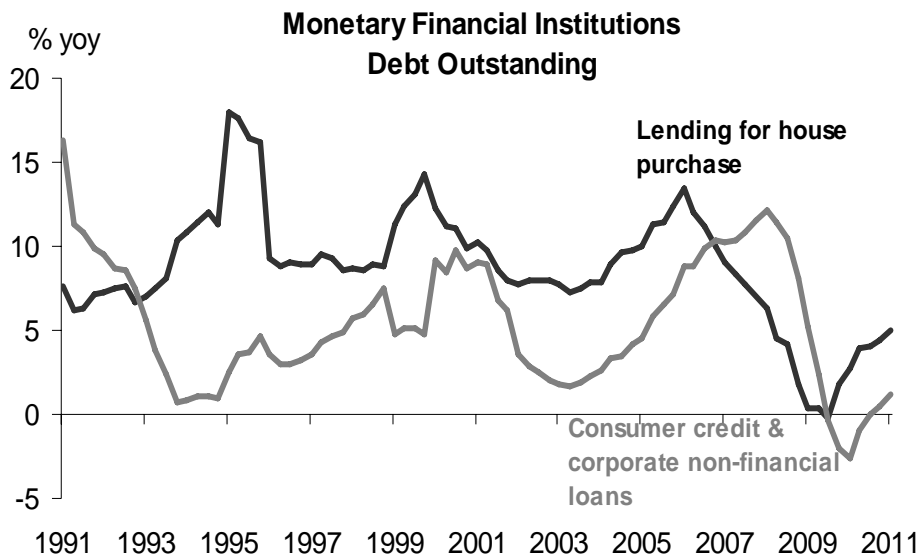
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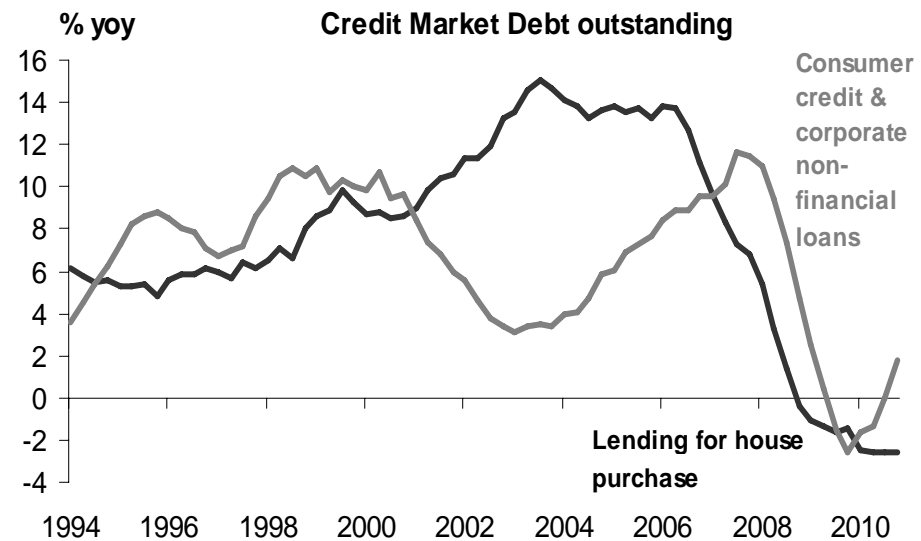
Credit markets: Normally recover slowly following financial crises

- Even though economies -both in the US and in the EU as a whole- have rebounded strongly over the past two years, credit growth remains very weak.
- In the EA, consumer and business credit has rebounded only modestly over the past year. Mortgage lending is currently increasing at about 5% y-o-y, less than half its speed of the pre-recession period.
- In the US, where the economy has rebounded stronger than in the EA since the 2nd quarter of 2009, credit creation is even weaker. Lending for house purchase continues to decline. Consumer and business credit has just started to show positive growth on a y-o-y basis.

EA Credit Growth



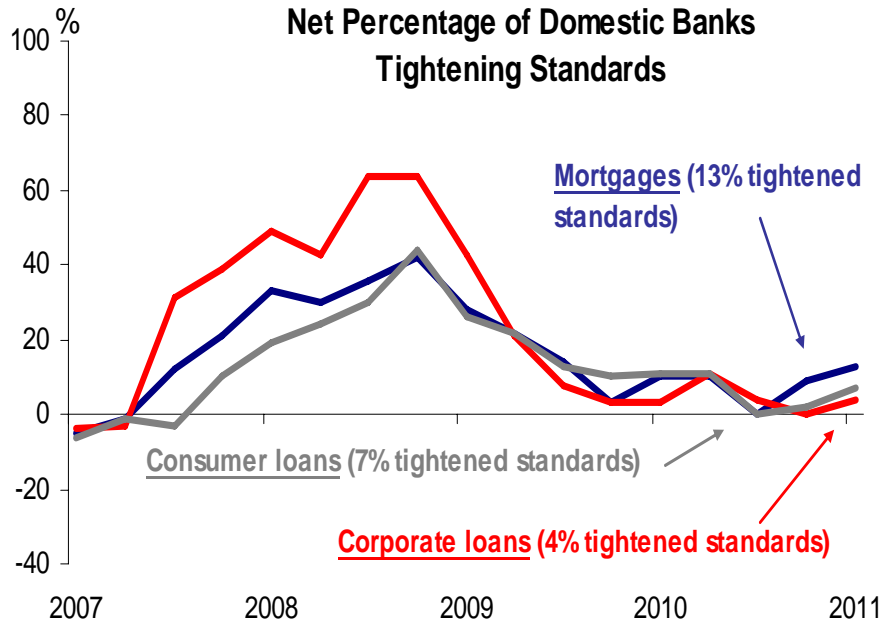
US Credit Growth



Bank lending standards remain tight

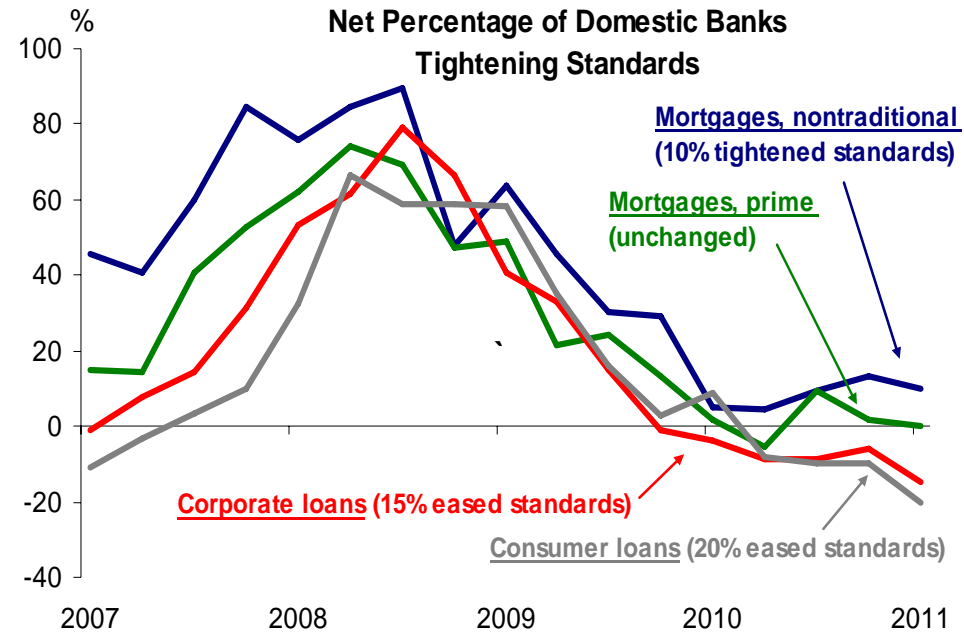
The Euro Area Bank Lending Survey

Net Percentage of Domestic Banks Tightening Standards



US: Senior Loan Officer Opinion Survey on Bank Lending Practices

Net Percentage of Domestic Banks Tightening Standards

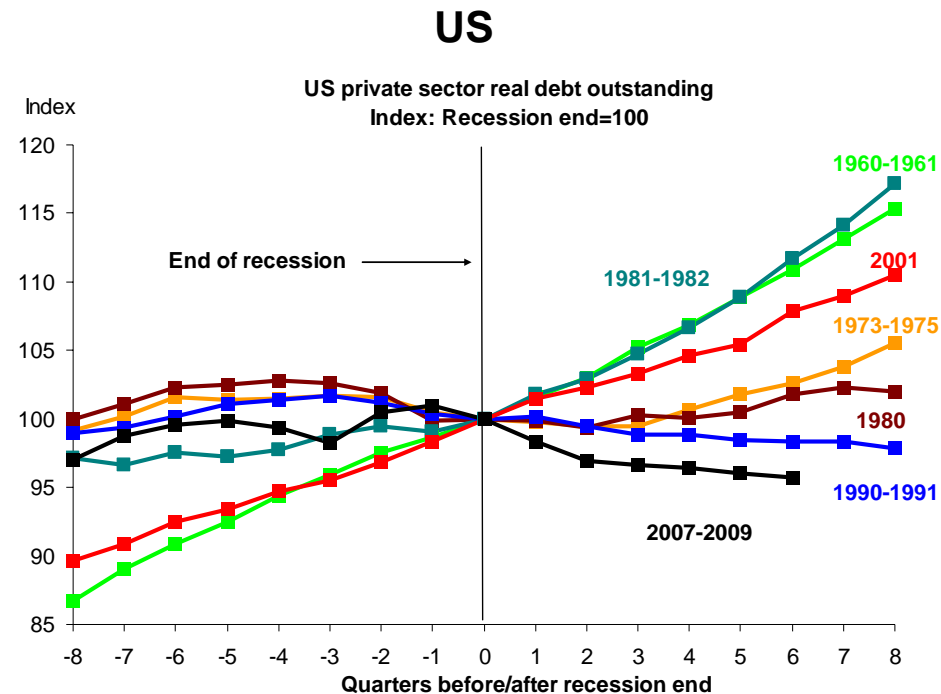
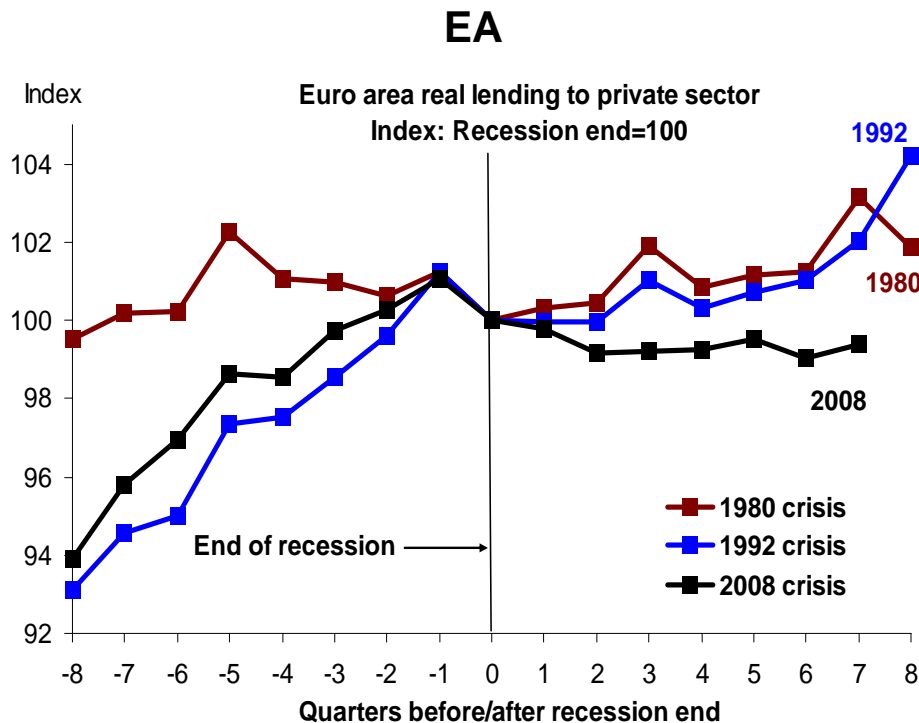


Source: Ecwin

Credit to the private sector: very weak compared to previous business cycle upturns

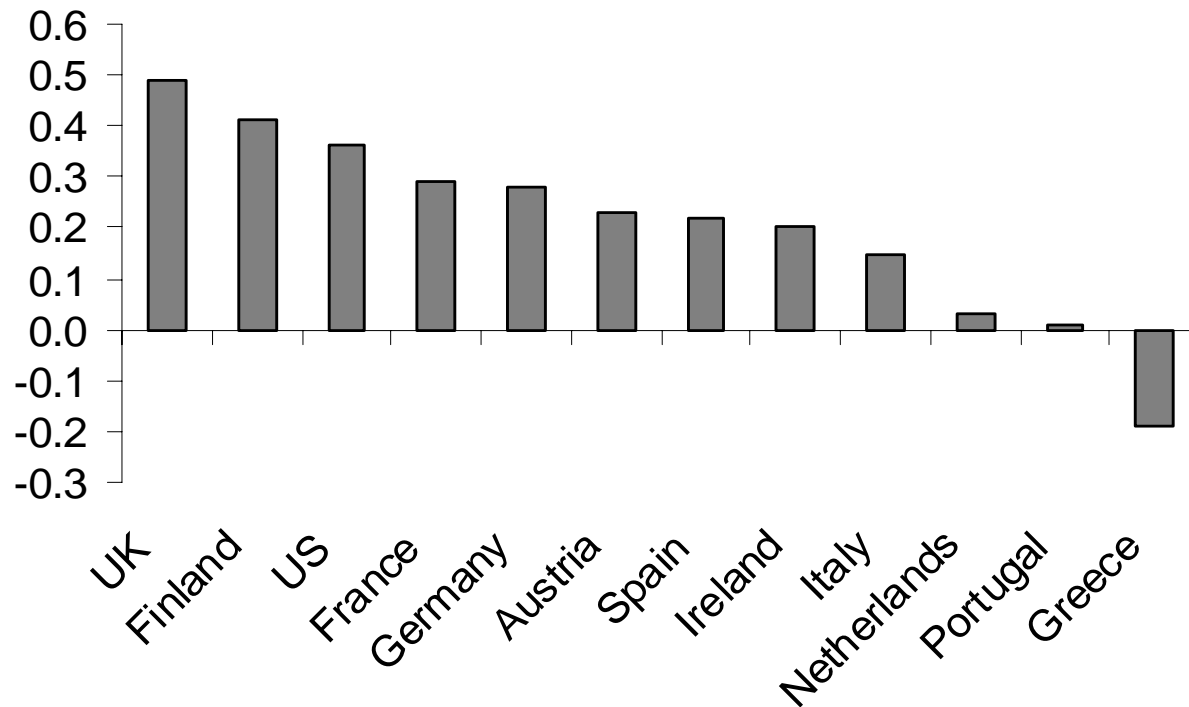
- Total credit creation in the EU remains weak for the stage of the business cycle we go through, compared to the two previous business cycles.
- In the US, even 6 quarters after the end of the recession, credit supply has just started to stabilize from its two and a half year decline.

Credit Growth During Economic Rebounds



Is there a causal link between bank lending and economic activity?...

Correlation between real GDP & credit growth, 1980-2010



- The comovement between credit growth and real GDP growth is particularly strong in the UK, Finland, the US, France and Germany and particularly weak in Greece, Portugal and the Netherlands. Hence, there is no uniform link between credit expansion and economic activity across countries.

...Is there a causal link between bank lending and economic activity?

Causality tests between credit and economic activity

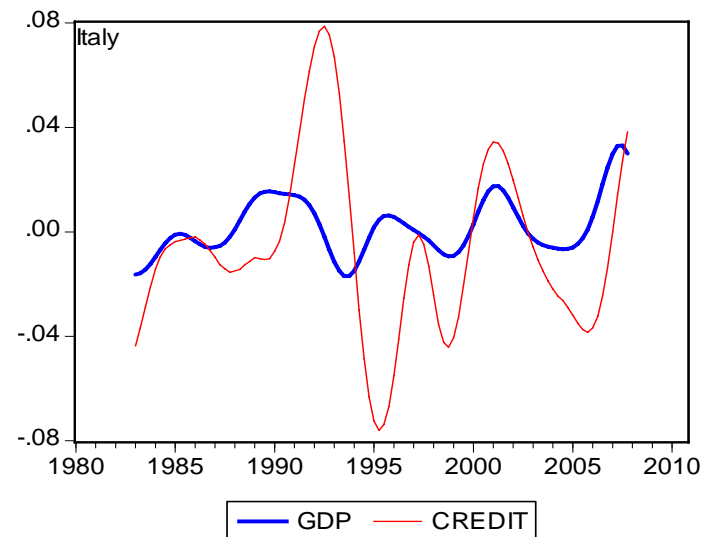
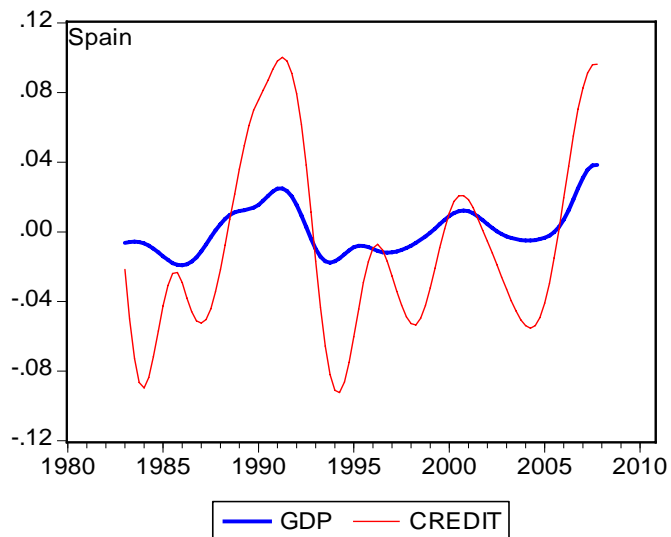
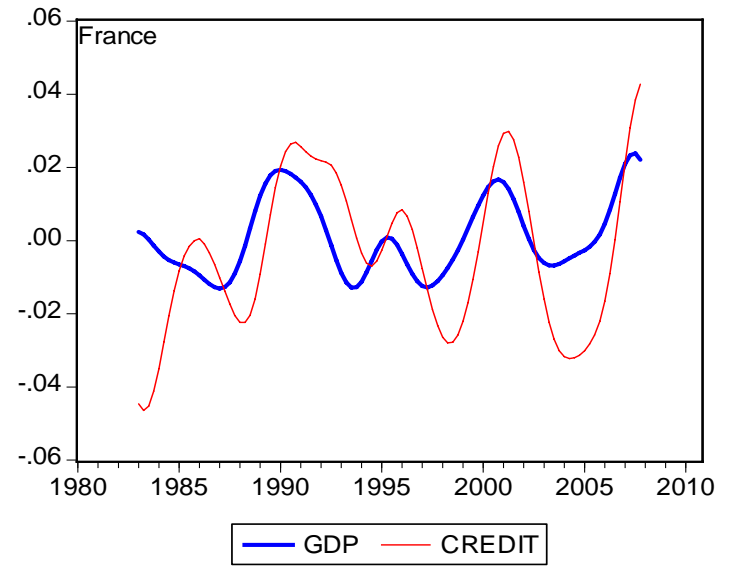
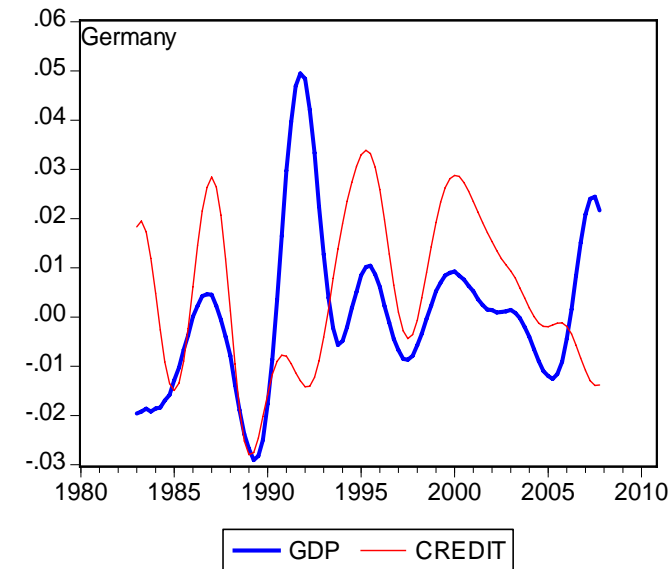
Granger causality tests		
	Order of VAR	Causality
Germany	4	GDP => CREDIT (***)
France	2	GDP => CREDIT (***)
Spain	2	GDP => CREDIT (*)
Italy	2	NO
Netherlands	1	NO
Austria	4	GDP => CREDIT (**) CREDIT => GDP (*)
Greece	1	GDP => CREDIT (**)
Portugal	1	NO
Ireland	2	GDP => CREDIT (**)
Finland	2	GDP => CREDIT (***)
UK	1	GDP => CREDIT (*) CREDIT => GDP (***)
US	4	GDP => CREDIT (**)

Notes: Significance levels:
 * : 10%, ** : 5%, *** :1%.
 GDP=> CREDIT means that lagged changes in GDP help predict changes in credit.
 Order of VAR was chosen based on the Schwarz criterion.

- The comovement between credit and economic activity does not imply unidirectional causality from credit to GDP or vice versa.
- In most countries, there is a causal relationship from GDP to credit in the sense that high GDP growth has been accompanied by faster credit expansion in the future.
- There is no country where credit expansions cause subsequent changes in real economic activity.

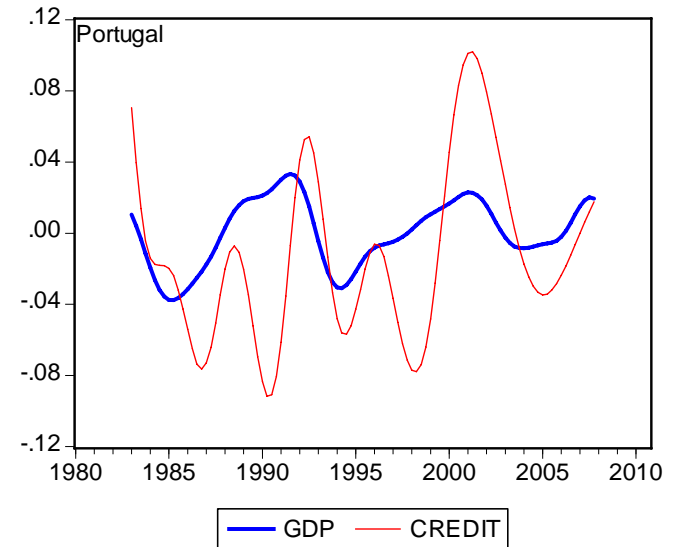
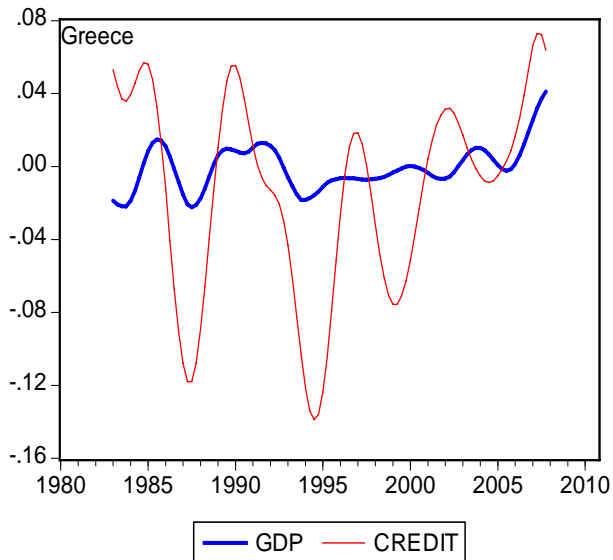
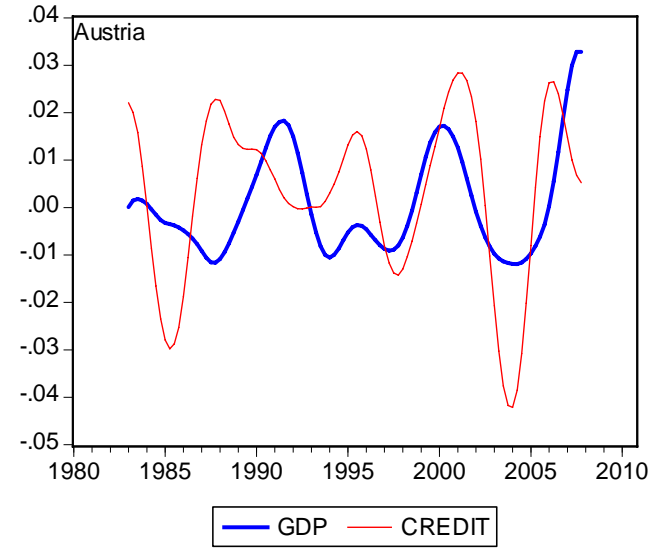
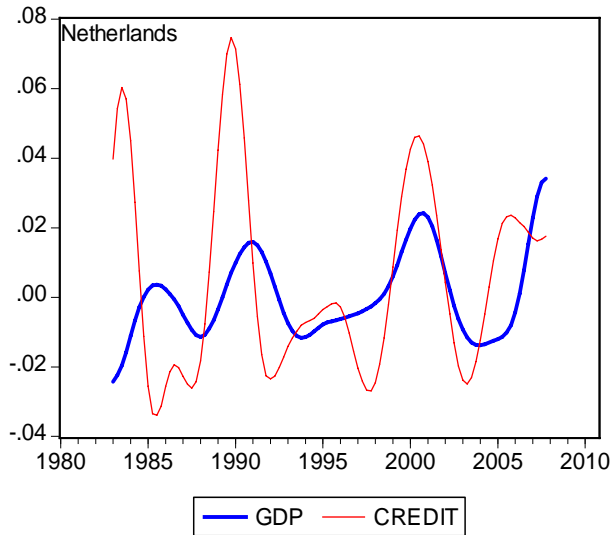
Business and credit cycles in European economies and the US...

Cyclical components of real GDP and real bank credit



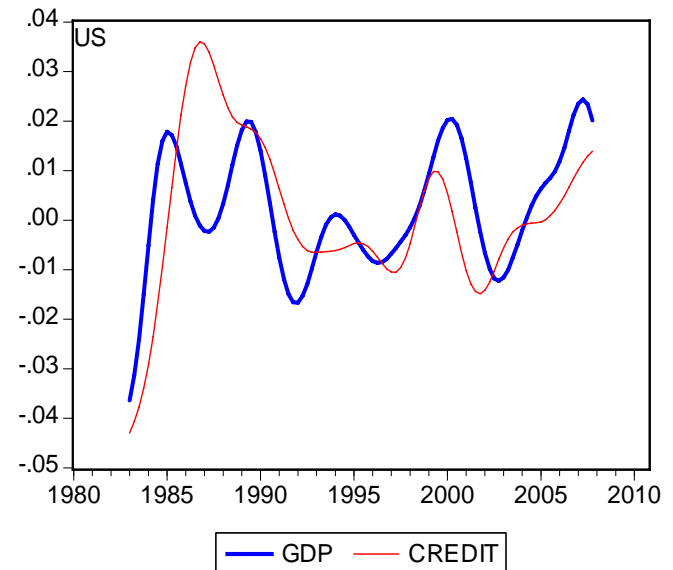
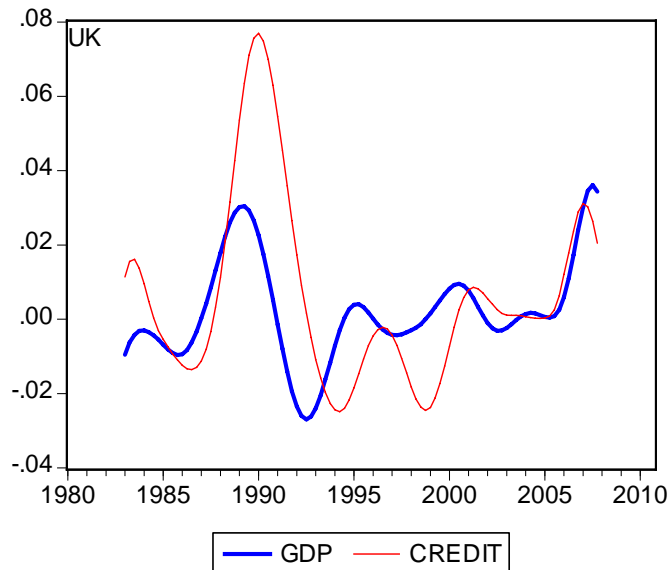
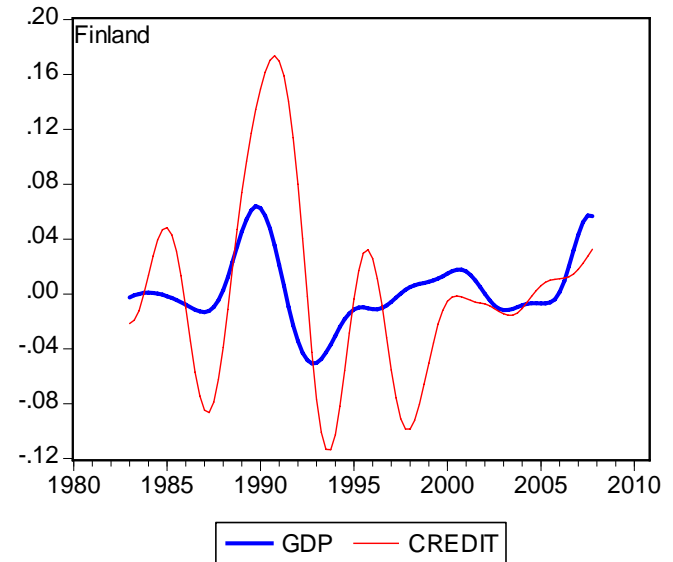
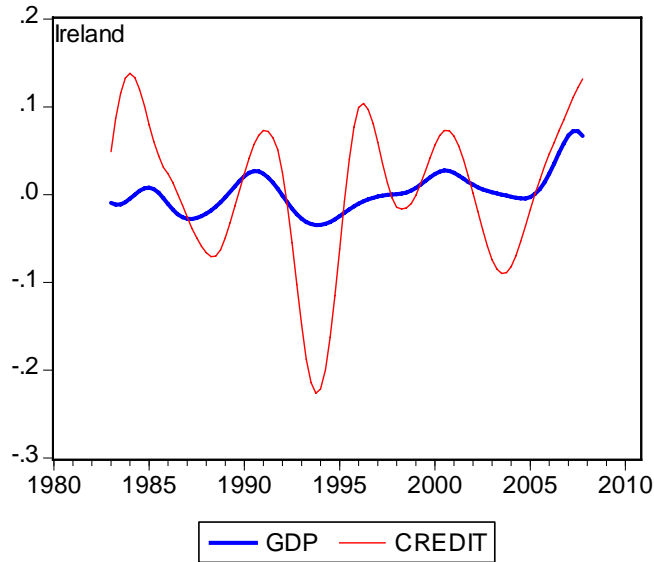
...Business and credit cycles in European economies and the US...

Cyclical components of real GDP and real bank credit



...Business and credit cycles in European economies and the US

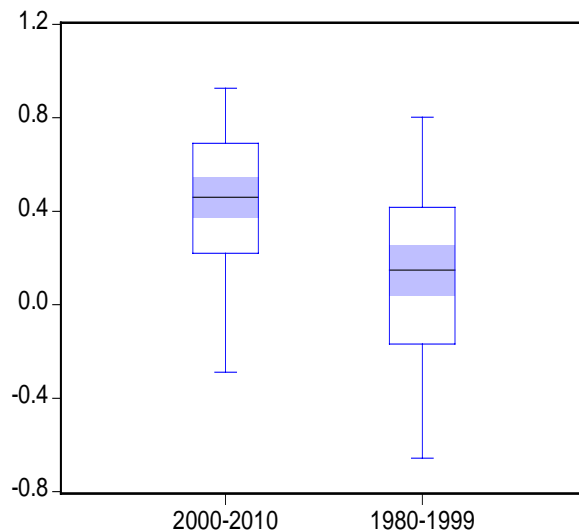
Cyclical components of real GDP and real bank credit



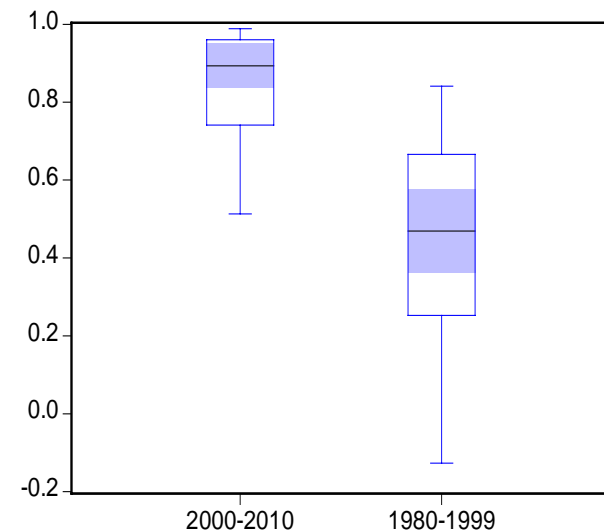
Main Findings

- The credit cycle appears to have a life of its own relative to the business cycle both in terms of synchronicity and amplitude.
- The amplitude of the credit cycle has decreased markedly in most countries since the second half of the 1990s. At the same time, the correlation between credit and economic activity has increased in half of the countries, suggesting that the link between the banking sector and the economy has become stronger over time.
- Stronger financial and economic integration over the past ten to fifteen years has been accompanied by stronger comovement of credit expansion across EU countries. Correlations have also become more uniform.
- Synchronization of business cycles among EU countries has increased substantially after 2000.

Distribution of cross-country correlations of cyclical component of credit



Distribution of cross-country correlations of cyclical component of GDP



Where do we stand now?

There are three issues that seem most likely to determine the amount of credit that will support the recovery as we emerge from the recent financial crisis:

- First, the condition of the banking system (including regulatory environment) will influence the capacity for lending.
- Second, the financial condition of borrowers will determine their capacity to repay as well as their appetite for additional debt.
- Third, the strength of the economy will influence both the willingness to lend and the desire to borrow.