

Euro Area

No Pickup in NFC Net Borrowing in Q1

- **EA NFC Net Borrowing at all-time low in Mar 14...** Our [proxy of Non-Financial Corporate \(NFC\) net borrowing](#), based on borrowing from banks and securities issuance, confirmed that credit conditions in the EA remained very weak in Q1. Total debt issuance (i.e. bank lending adjusted by securitisation and sales + net securities issuance) fell by €62.9bn YY (1.1%) in the 12-month period ending in March, the lowest level since the data began (2004), and still weaker than the 0.9% average decline in 2013 (Figure 1). Positive NFC net debt securities issuance (€76bn in the 12 months ending in March, +7.5% YY) only partially compensated for the €139bn (-3.1% YY) drop in bank lending (largest-ever drop since 2004) in March. Overall, the figures suggest that lending has still not bottomed at the start of 2014, despite historically low policy and market rates and much more favourable funding conditions for banks. In our view, very weak credit flows could generate additional pressure for the ECB Governing Council to [change its monetary policy stance in June](#), potentially by creating a new lending-focused LTRO facility in addition to cutting policy rates.
- **... driven by still falling bank credit flows and some slowdown in net securities issuance.** Bank lending (adjusted by securitisation and sales) to EA NFCs fell by 3.1% YY in March, falling from an average 2.8% decline in 2013. Both demand and supply factors are probably behind the further deterioration in bank credit flows, as real lending rates remain high and non-performing loans are still rising (although lending standards have improved, see Figure 3-4). Rising securities issuance has partially compensated for the decline in bank lending, but the March data showed that NFC net securities issuance rose *'only'* by 7.5% YY, easing from 9% and 8.1% average increases in Jan-Feb 14 and 2013, respectively.
- **The periphery still leading the fall.** Across countries, NFC net borrowing dynamic remained close to all-time lows in Slovenia (-9.3% YY), Spain (-9.1%), Greece (-5.4%), Ireland (-5.4%), and Portugal (-2.3%), while in Germany (-1.1%) and the Netherlands (-0.4%) NFC net borrowing is now also negative. However, in Italy, the fall in NFC net borrowing eased from an average 2.7%YY decline in 2013 to a 1.9%YY decline in Q1, mostly driven by a strong (19% YY) pickup in debt securities issuance. Overall we expect net debt issuance to show some improvement in terms of the YY growth rates in the coming months, but expect bank credit to remain weak, as NFC debt levels remain high and banks go through the AQR/stress test.
- **Private deleveraging is likely to continue but should hurt less.** Based on our proxy, we estimate that total Flow of Funds-based NFC net borrowing (which also includes intercompany borrowing) fell by 0.6% YY in Q1 14, a record low after a flat reading in Q4 (the data are due on 29th July). Private deleveraging is continuing at a quite fast pace in the EA, but [in our view it probably has less of a negative effect on growth](#) now that fiscal policy is less restrictive and the liquidity position of the EA private sector has improved significantly.

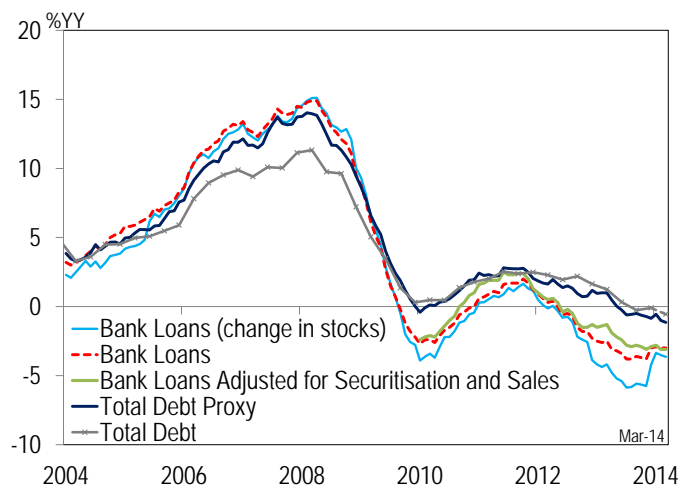
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Figure 1. EA – Non-financial Corporate Debt Growth (% YY), 2004 – Mar 2014



Note: Total debt proxy is based on bank loans (adjusted for sales and securitisation) and debt securities issuance. YY change calculated as 12-month sum of flows divided by previous year stock (except for change in stocks). Data for total debt in Q1 corresponds to Citi Research forecasts.
Sources: ECB and Citi Research

Figure 2. Selected Countries – Proxy of Non-financial Corporate Debt Growth (% YY), 2004 – Mar 2014

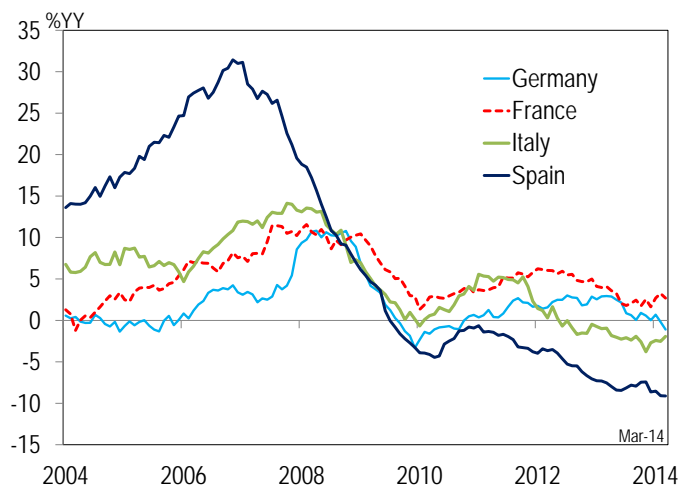
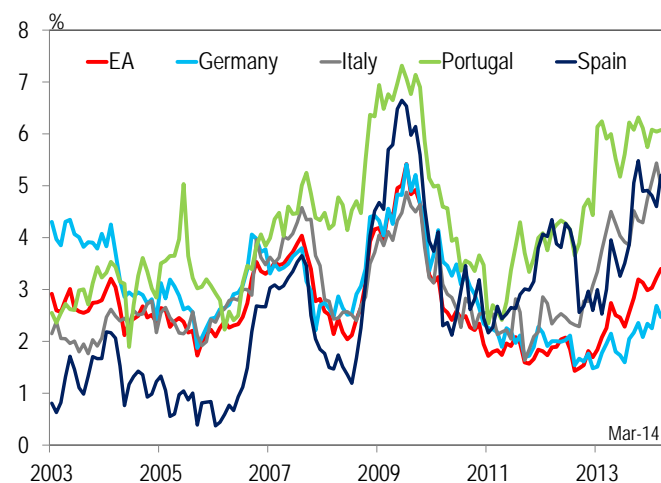
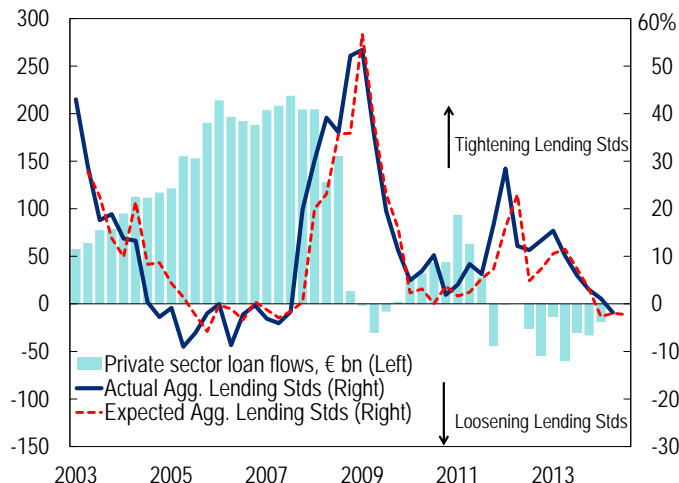


Figure 3. Selected Countries – Real Interest Rates on Loans < €1m to Non-financial Corporations (%), 2003 – Mar 2014



Note: For new loans with maturity between 1 to 5 years. Deflated by CPI inflation
Sources: ECB and Citi Research

Figure 4. EA – Private Sector Loan Flows (€ bn) and Aggregate Lending Standards (net % balance), 2003 – 2Q 2014



Sources: ECB and Citi Research

Appendix A-1

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