What explains the ongoing credit slowdown in advanced economies?

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Credit conditions across OECD countries have tightened sharply in recent quarters, with rising policy rates quickly reflected in bank lending rates and bank lending standards becoming more restrictive. Credit growth has slowed, especially to households. New mortgage lending to households has fallen by around 30% year-on-year in the euro area and in the United Kingdom in 2023. A key question is whether this reflects the impact of more restrictive lending conditions or whether demand for borrowing has just declined sharply.

Credit growth is shaped by a range of factors that affect credit demand and supply conditions. Estimates of the impact of these factors on total credit growth to households and non-financial corporations have been obtained for Germany, France, Italy, the United Kingdom and the United States (Quaglietti, 2023). The technique used (structural VARs) permits four types of shocks to be identified: aggregate demand shocks, aggregate supply shocks, monetary policy shocks and credit supply shocks. The contribution of these different shocks to the annual rate of credit growth in 2022 and 2023 is shown in

Figure 1, with a longer-term perspective provided in Figure 2. For simplicity, shocks to credit demand are shown as the combined impact of all identified shocks other than credit supply shocks.

- The results suggest that the recent sharp slowdown in credit reflects a combination of tighter credit supply and falling demand, with the balance of these factors differing across economies (Figure 1).
- Tighter credit supply has been a more important driver of recent credit dynamics in the United States than weaker credit demand, although other (non-identified) factors have also contributed to credit growth developments (Figure 1).
- Weaker credit demand accounts for the bulk of the slowdown in Germany, Italy and the United Kingdom. The impact of deteriorating demand conditions appears to be particularly sizeable in Italy, reducing average annual credit growth by 7 percentage points in 2023 (Figure 1). Over the same period, in Germany and the United Kingdom credit demand shocks appear to have lowered average annual credit growth by 1.5 percentage points.
- The current slowdown in credit growth is comparatively mild relative to that seen during the global financial crisis in many countries, with the exception of Italy (Figure 2). In 2009-10, credit supply and credit demand both contracted sharply. This also occurred in Germany and Italy during the subsequent euro area crisis.

Bank lending surveys broadly corroborate these findings. Banks overwhelmingly report a tightening of credit standards (a supply shock) in the United States, especially for mortgage lending, and a sharp decline in credit demand in the euro area, especially for house purchase.

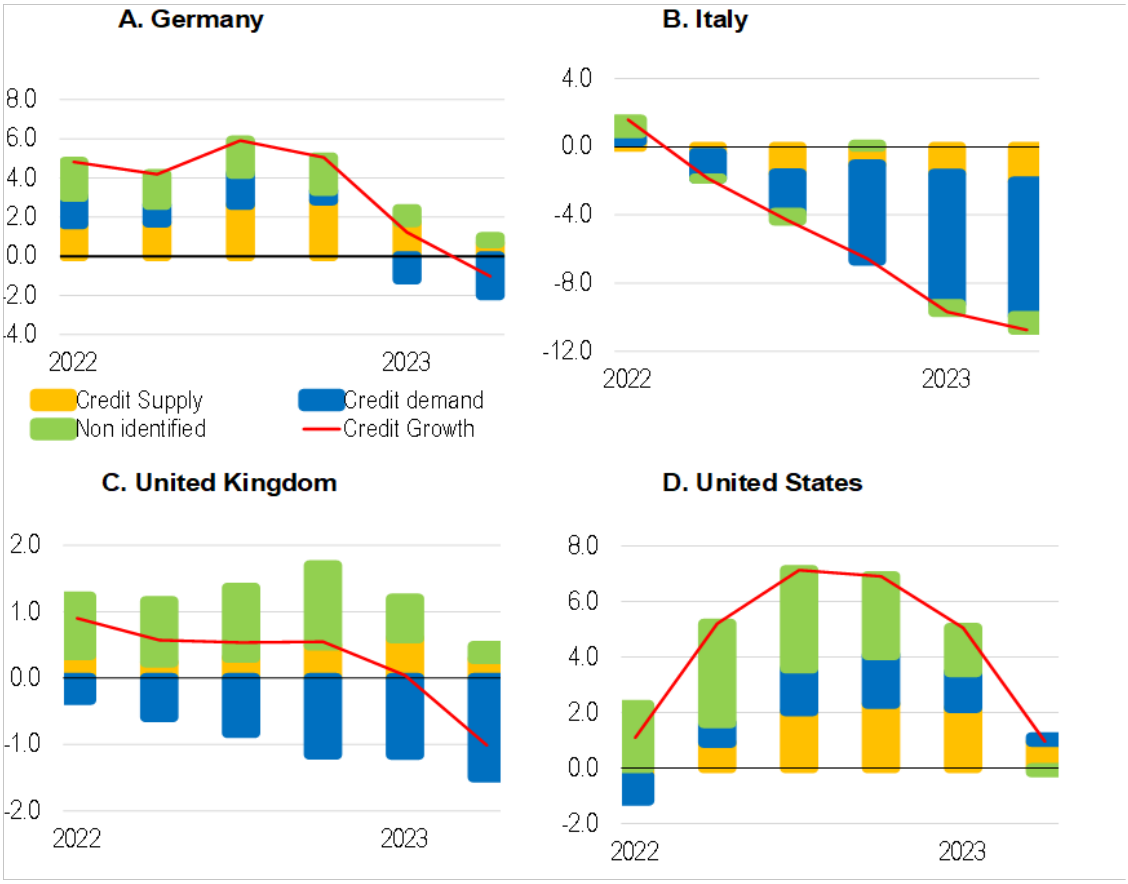
Higher interest rates, low consumer confidence and falling

real disposable income have weakened credit demand by households and firms. The banking sector now is better capitalised than prior to the global financial crisis, and credit supply shocks were still marginally boosting credit growth in most countries as of mid-2023. Even so, banks have tightened credit standards due to rising risk aversion, higher funding costs and balance sheet constraints. In the euro area, the decrease in liquidity following TLTRO (targeted longer-term refinancing operations) repayments may also have contributed to weaker credit supply (Lane, 2023).

So far, there are few signs of a severe and widespread credit shortage of the type seen in the global financial crisis. Ample capital and liquidity buffers and low levels of non-performing loans currently allow banks to continue supplying credit to households and firms, enabling an orderly transmission of monetary policy. But risks remain, especially if the current economic slowdown were to deepen. As banks continue to pass through past increases in policy rates to households and corporates, delinquency rates and non-performing loans could rise, potentially generating credit losses that would weigh on the supply of new credit to the economy. Credit demand could also weaken further in the event of a sharp economic downturn or a swift repricing in asset prices.

Figure 1. Contributions of demand and supply shocks to recent developments of credit growth

Decomposition of the year-on-year percentage change of credit growth relative to its long-term trend



Note: The decomposition is based on the moving average representation of the estimated VARs, and shows in each quarter the contribution of contemporaneous and past structural shocks to credit growth expressed as a deviation from its long-term trend over the period 2000Q1-2023Q2. This trend broadly corresponds to the sample average. Credit demand shocks are obtained as the sum of aggregate demand, aggregate supply and monetary policy shocks. The green bars correspond to unidentified factors [1}.

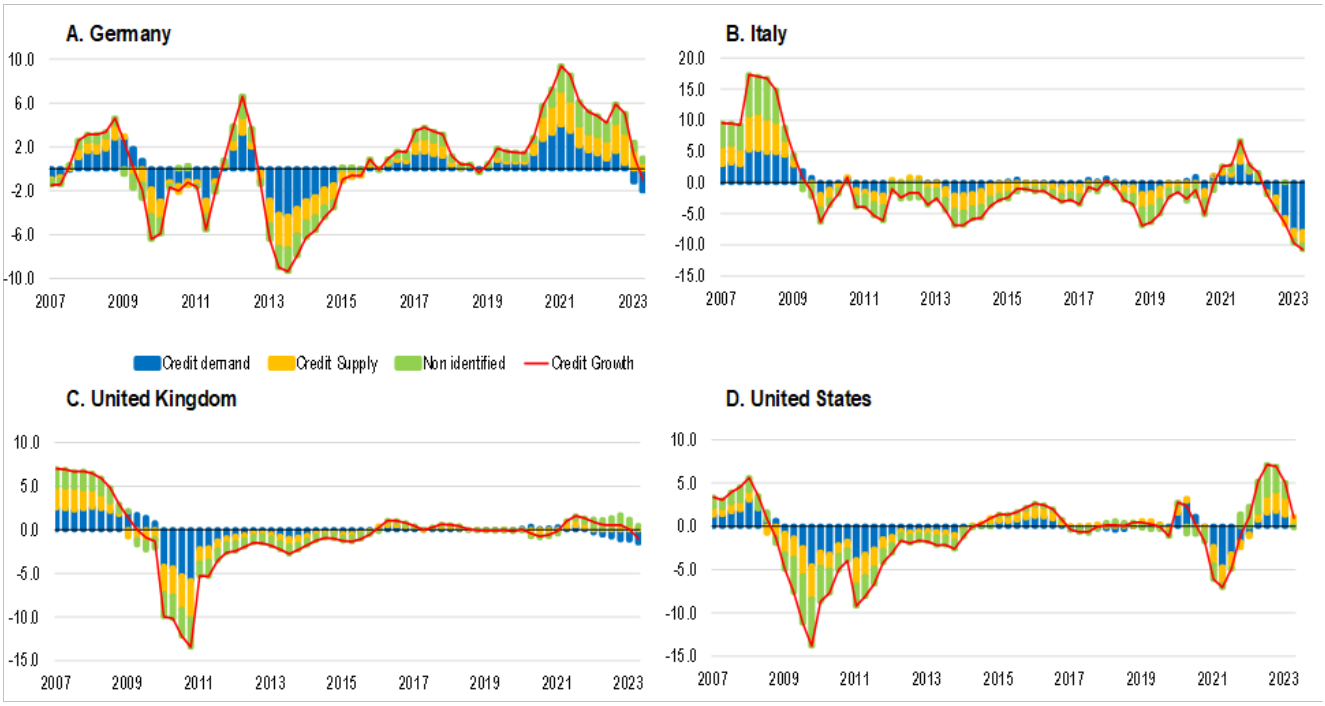
Source: Bank of England, European Central Bank, Federal Open Market Committee and OECD calculations.

[1] The VAR for each country is estimated by Bayesian techniques, with shocks identified by sign restrictions based on standard theoretical models (Gambetti and Musso, 2017). Aggregate supply shocks are assumed to drive real GDP and inflation in opposite directions; aggregate demand shocks move real GDP, inflation, policy rates, bank lending rates and credit growth in the same direction; positive (i.e., rate-

increasing) monetary policy shocks negatively affect both GDP and inflation; and expansionary credit supply shocks are assumed to lead to an increase in output, inflation and (due to the central bank policy reaction) policy rates but make bank lending rates and credit growth move in opposite directions. The VARs are estimated with one lag and sign restrictions are imposed on impact only (first quarter).

Figure 2. Contributions of demand and supply shocks to credit growth in the period 2007-2023

Decomposition of year-on-year percentage change of credit growth relative to its long-term trend



Note: See note to figure 1.
Source: Bank of England; European Central Bank, Federal Open Market Committee; and OECD calculations.

References

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