Tighter credit conditions to hold back recovery

February 2021

Global bank credit standards tightened in the final months of 2020, despite a partial rebound in the world economy. The pace of tightening seems to be moderating in the US and the picture does not look alarming in most emerging economies, including China where credit conditions have eased. But credit tightening is accelerating in Europe. Overall, tighter credit and lower demand for credit, especially for investment purposes, are likely to hold back the global recovery in the quarters ahead.

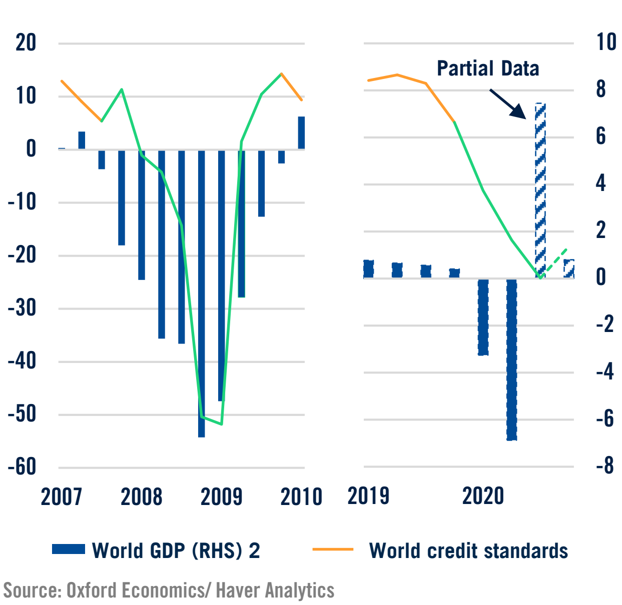
The global economy rebounded in the second half of 2020, but how has this affected global credit conditions? And how, in turn, are credit conditions likely to affect the path of the recovery in 2021 and beyond?

Surveys of bank credit standards run by central banks have a good record as leading indicators of activity. We now have a good picture from these surveys of how banks altered credit supply over recent months, and about what factors influenced supply and demand for credit.

The latest reading of our global corporate credit standards indicator (a GDP-weighted index based on surveys of 11 countries) shows credit supply tightened in both Q3 and Q4 of 2020. On the positive side, the pace of tightening eased in Q4, and the degree of tightening also looks less severe than in the global financial crisis: our indicator showed a net 15% of banks restricting credit in Q4, versus over 50% in late 2008 and early 2009 (see fig. 1).

Fig. 1: World corporate credit standards & GDP

%balance of banks tightening (-)/loosening (+) credit %qoq



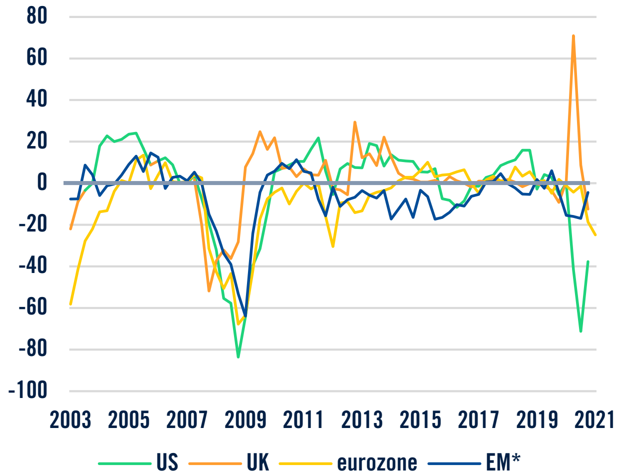
Source: Oxford Economics/ Haver Analytics

Less positively, we would note that it took a long time for banks to start easing credit again after the 2008-2009 trough, so there is a risk tight credit could retard the recovery into the medium term.

Detailed results for individual economies also give some cause for concern. In the US, the extent of credit tightening in recent quarters has been comparable to 2008-2009 suggesting a considerable squeeze even though the degree of tightening slowed in H2 2020. Meanwhile, corporate credit standards have started to tighten significantly in Europe, too, as the impact of government loan schemes wears off. For the eurozone, the latest survey shows a net 25% of banks tightening credit, a historically elevated level (see fig. 2). Conditions are tightening fastest for smaller firms.

Fig. 2: World credit standards by economy

%balance of banks tightening (-),loosening (+) corporate credit

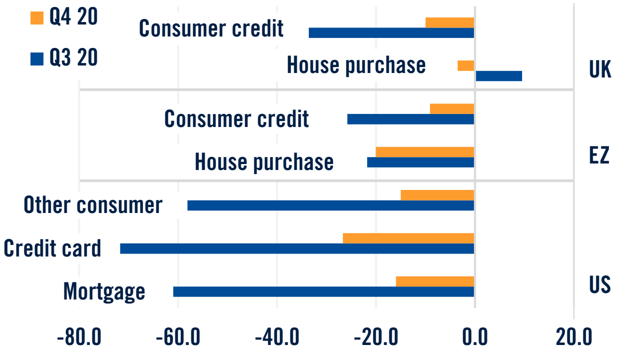


Source: Oxford Economics/ Haver Analytics *Simple average of six EM

Consumer lending standards have also tightened across advanced economies. The pace of tightening has mostly eased here, too, in recent months but remains significant enough to be a drag on consumer spending level (see fig. 3).

Fig. 3: Consumer credit standards

%balance (+=loosening, -= credit)



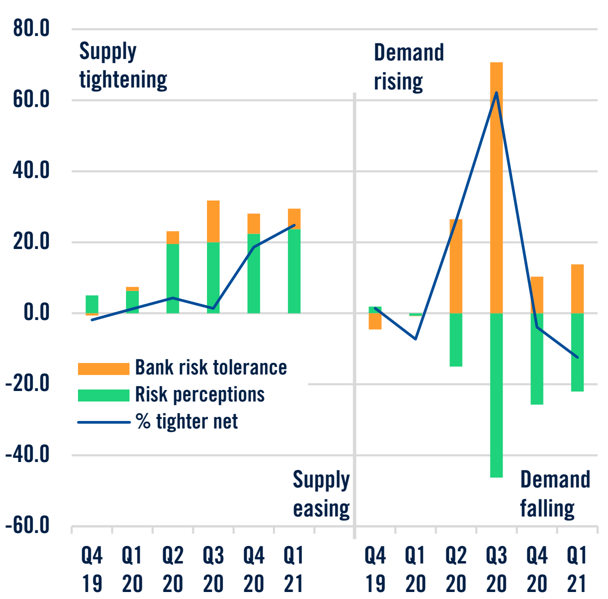
Source: Oxford Economics/Haver Analytics. UK Q4 data is banks' forecasts

Other details from surveys also point to a risk of persistent negative effects on growth. The eurozone survey shows that the tightening of corporate credit standards has been driven by rising perceptions of, and reduced tolerance for, risk on the part of banks (covering general economic conditions, sector-specific risks, and risks to collateral). Despite recent positive news on vaccines, it may take some time for this heightened risk aversion to dissipate fully.

Corporate credit demand has also started to shrink in the eurozone. On the positive side, this reflects reduced demand for inventory and working capital finance (due to some stabilization in economies). But more negatively, credit demand is being undermined by weak demand for investment finance (see fig. 4). The same picture is also visible in the US and UK surveys. This could damage productivity and potential growth (the Kansas Fed argues tighter credit was a big factor behind the drop in US productivity growth after the global financial crisis).

Fig. 4: Eurozone corporate credit solutions

%net balance of banks (+ve balance=tighter supply, higher demand)

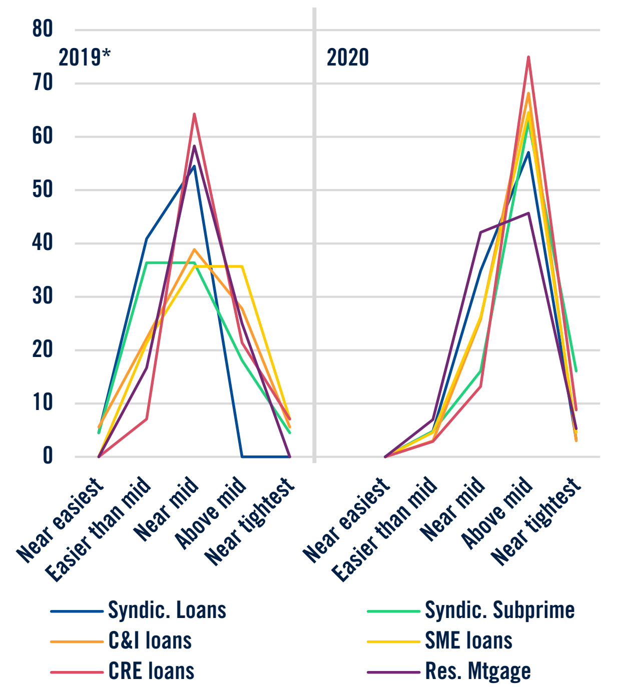


Source: Oxford Economics/Haver Analytics. UK Q4 data is banks' forecasts

US survey evidence also tells us about the level of credit standards as well as the direction of travel. In mid-2019, loan standards for most types of credit were primarily around their average levels since 2005 (or looser, e.g. syndicated loans). But by mid-2020 a large net balance of banks reported higher loan standards than average. For subprime syndicated, consumer loans, and commercial real estate, a significant proportion of banks reported standards close to the tightest they have been over the last fifteen years (see fig. 5).

Fig. 5: US Credit standards levels 2019-2020

% of banks



Source: Oxford Economics/Federal Reserve. Standard assessed with reference to mid-point since 2005, in July 2019/20 * 2016 for mortgages

These restrictive levels of credit standards are likely to be a drag on growth for several quarters at least – and possibly longer still based on past cycles. Credit in some sectors especially hard-hit by the coronavirus crisis (e.g. some services, tourism, and commercial property) might stay tight for some time.

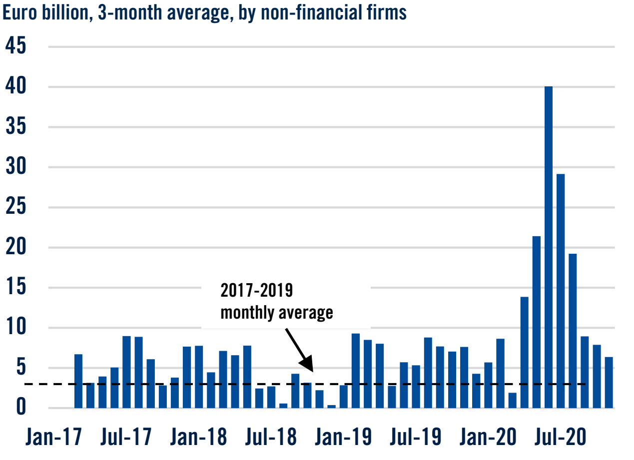
Over the coming months, economic weakness due to renewed coronavirus-related restrictions in some advanced economies may also feed into further tightening of bank credit standards.

Looking at broader credit conditions, it is notable that while bank credit seems to be tightening, the availability of bond finance remains good.

In the eurozone, non-financial firms issued an average of over 6 billion euros per month in the three months to November 2020, down from the very high levels of issuance seen in April-July of last year but still above the pre-crisis trend (see fig. 6). Corporate bond spreads also remain relatively narrow, so larger firms at least have the option to switch to bond finance if bank finance becomes scarce.

Overall, the evidence on global credit conditions points to a credit squeeze less serious than after the global financial crisis, but enough to be a significant drag on world growth in the quarters ahead. It also supports our forecast that world GDP will be significantly lower – by around 2% – over the long term than we thought at the start of 2020.

Fig. 6: Eurozone net bond issuance



Source: Oxford Economics/ Haver Analytics

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