Global credit standards are on the turn

July 2022

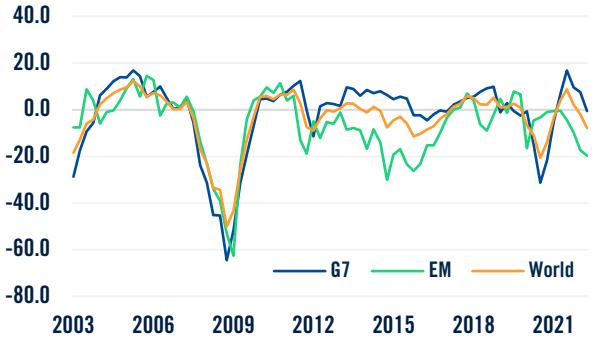
Central bank surveys of bank credit standards suggest credit conditions are shifting from loosening to tightening. This is especially marked for corporate credit standards, mortgages in some parts of the G7 including the eurozone and UK, and in emerging economies. With QE going into reverse, the result is that global monetary growth could slow very sharply over the coming quarters. This would in turn imply an easing of inflation and downside risks to growth.

The message from the latest round of central bank surveys of banks is that global credit conditions are on the turn. In late 2021, banks were generally loosening credit but a significant turnaround has taken place in recent months.

Our global credit conditions indicator, constructed as a GDP-weighted average of central bank surveys across a range of economies, now points to tighter corporate credit standards. This shift has been led by emerging economies, where the latest reading is the most restrictive since 2016. In the G7, corporate credit standards are now just slightly restrictive having been loosening strongly as recently as Q3 2021 (Fig. 1).

Fig. 1: Corporate credit standards

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



Source: Oxford Economics/ Haver Analytics – Regions weighted by GDP
As of June, 24 2022

A more detailed look across the advanced economies shows that corporate credit standards are tightening particularly strongly in the eurozone, with a net balance of 21% of banks reporting tighter standards over the next three months. Consumer credit standards are more mixed, with banks still loosening in some areas, but mortgage credit standards are tightening in the eurozone and especially the UK. Demand for credit, meanwhile, is generally holding up better but a notable exception is mortgage credit in the eurozone and especially the US, where a net 35% of banks report lower demand (Fig. 2).

Fig. 2: Credit supply and demand by sector

%, weighted two-monthly annualised rate*

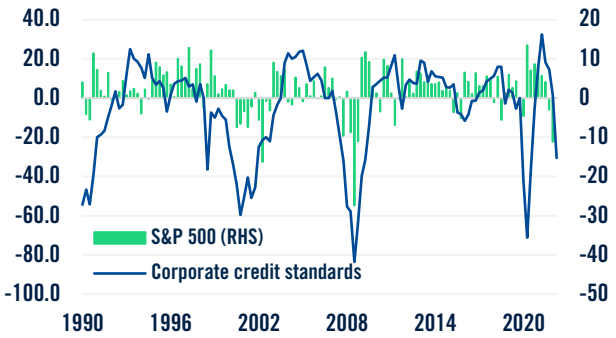
	MORTGAGES	CONSUMER CREDIT	CORPORATE LOANS
Credit supply			
eurozone	-8.1	-6.5	-21.4
UK	-22.3	29.7	-1.3
US	7.2	4.5	1.5
Credit demand			
eurozone	-9.6	0.6	12.1
UK	17.3	18.5	17.2
US	-34.9	15.9	12.3

Source: Oxford Economics, national central banks
As of June 24, 2022

Recent developments suggest that the tightening of credit standards may have further to run. Movements in credit standards have a historic relationship with stock prices, with stock sell-offs tending to spark a sharp tightening in corporate credit standards (movements in the S&P 500 explain about a quarter of movements in credit standards with a one-quarter lag). Based on the historic link, the sharp drop in US equities in recent weeks, unless reversed, could see a substantial net 30% or so of banks tightening standards in Q3/Q4 of this year (Fig. 3).

Fig. 3: US credit standards and stock prices

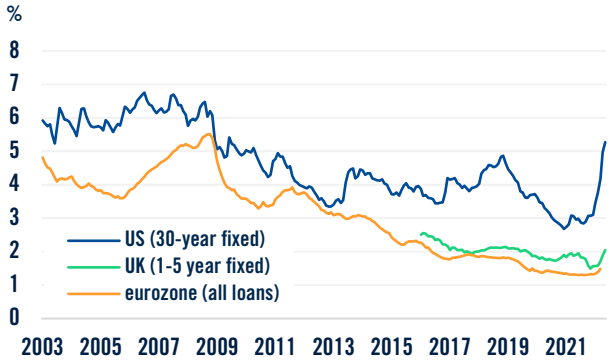
%, balance of banks loosening (+)/tightening (-) credit



Source: Oxford Economics/Haver Analytics
As of June 24, 2022

Demand for credit in the US and Europe is also likely to be curbed by rising interest rates in the months ahead. This is especially the case in the US for mortgage credit given the more than 200 basis point rise in 30-year mortgage rates in recent months to the highest level since 2008. Mortgage rates are also rising in the UK and eurozone, albeit much less dramatically (Fig. 4).

Fig. 4: Mortgage rates in US & Europe



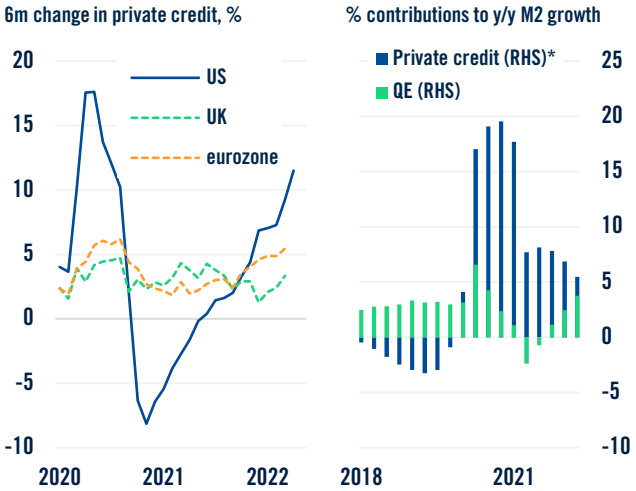
Source: Oxford Economics/ Haver Analytics/Moneyfacts
* UK April/May data estimates
As of June 24, 2022

Credit standards could also tighten further in emerging markets (EM). Standards in EM tend to be sensitive to rises in the dollar and higher dollar interest rates due to EM banks often funding in dollars. The recent dollar surge risks a return to the 2015-2016 period of substantial EM credit tightening, especially in economies that are particularly sensitive to dollar financing costs. These include economies in Latin America, such as Brazil and Chile (where a net 46% of banks are already reporting tighter credit standards). Credit extension in EM is also weakening due to the slowdown in China.

The above developments point to weaker credit growth ahead, although this will not be visible in the data for some time. Actual credit flows only react to changes in bank standards with a lag and currently credit flows are still benefitting from the loosening of bank standards during 2021. In particular, the 6-month annualized growth of US loans and leases is running at a very robust 11%, meaning that private credit growth has started to have a considerably positive influence on overall money supply growth just as the contribution from quantitative easing – dominant in 2020 and 2021 – has started to ease off. Private credit flows have also picked up in the UK and eurozone in recent months (Fig. 5).

Historically, commercial and industrial loans in the US tend to follow credit standards with a roughly four-quarter lag. On that basis, assuming that US credit standards do tighten on a sustained basis to the degree implied by their past relationship with stocks, we would expect bank lending to corporates in the US to slow very sharply or even start contracting at the start of 2023. The same would be likely in the eurozone given the already negative readings for corporate credit standards there.

Fig. 5: Credit growth in the US & Europe



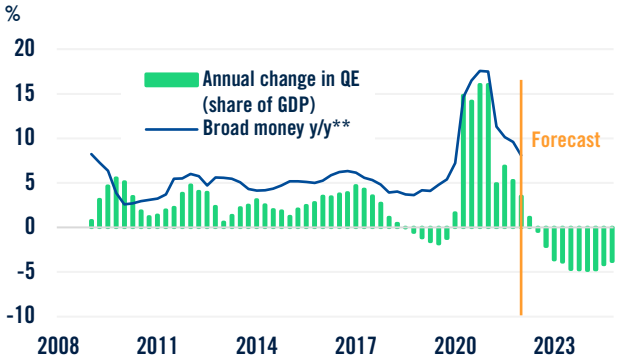
Source: Oxford Economics/ Haver Analytics *Bank loans and leases
As of June 24, 2022

If so, then private credit is set to start weakening at the same time as quantitative tightening (QT) by central banks is already having a large tightening effect on monetary conditions. Our forecasts show that QT is set to reach 2% of GDP in advanced economies by late 2022 and 4%-5% of GDP in 2023 (Fig. 6). Even with some leakages (e.g., some central bank sales of assets are likely to be bought by banks, meaning no net effect on monetary aggregates), this will subtract a significant amount from monetary growth. If private credit extension is also growing very slowly or shrinking, then monetary conditions could tighten very sharply.

Our estimates suggest that tightening in US corporate credit standards to the degree implied by the recent sell-off in stocks would be consistent with US GDP growth dropping to 1% to 1.5% at an annualized pace – slightly weaker than we already anticipate in our baseline US forecast for H1 2023. A similar slowdown could be expected elsewhere in the G7 and, based on the trends already visible, a bigger one in some EM.

Fig. 6: Advanced economics*:

QE and broad money growth



Source: Oxford Economics * US, Uk, Eurozone and Japan ** GDP-weighted
As of June 24, 2022

This update was researched and written by Oxford Economics, 121 St. Aldates, Oxford, OX1 1HB, England, as of June 24, 2022.
prudentialprivatecapital.com