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Eurozone banks step up private sector lending

By Ralph Atkins in Frankfurt

Eurozone bank lending to the private sector accelerated last month, providing unexpected relief for the European Central Bank as it mulls fresh action to prevent financial sector weaknesses pushing the region deeper into recession.

Loans to the private sector expanded at an annual rate of 3 per cent in October, the fastest since February, according to ECB figures on Monday. The pick-up was driven by stronger lending to businesses, which offset a deceleration in mortgage lending.

However, the pace of growth remained modest by historic standards, hid regional variations and did little to dispel fears that eurozone banks' shrinking balance sheets and funding difficulties could restrict severely the flow of credit to the real economy in coming weeks and months – in turn, hitting economic activity.

"Banks are really only just starting to respond to the latest regulatory intervention," said Julian Callow, European economist at Barclays Capital.

Eurozone economic activity has slowed markedly in recent months and the ECB has predicted a recession by the end of the year. With the region's debt crisis escalating, and borrowing costs surging for countries such as Italy, attention has focused on whether the ECB will ramp up dramatically its purchases of government bonds.

But behind-the-scenes the ECB is considering less controversial steps that would make it easier for banks to obtain its liquidity by broadening the range of assets it accepts as collateral. The ECB may also offer banks loans lasting as long as two or three years. Such moves – the ECB's equivalent to "quantitative easing" – would be in addition to an already announced offer of 13-month liquidity in December.

The central bank could also cut official interest rates again in an attempt to brake the pace of economic contraction. German data showing annual inflation dropping from 2.9 per cent October to 2.8 per cent this month, on a European harmonised basis, on Monday added to evidence that price pressures across the eurozone were moderating.

But the ECB could decide to forgo an interest rate cut at its next meeting on December 8 in order to focus attention on its support for banks and to keep open the option of rate cuts early in

2012. Earlier this month, Mario Draghi, the ECB's new president, announced a cut in the ECB's main interest rate from 1.5 per cent to 1.25 per cent.

Revised ECB forecasts, to be published after its December meeting, will entail additional uncertainty because the impact on economic activity of bank sector deleveraging is hard to predict. But Dirk Schumacher, economist at Goldman Sachs in Frankfurt, warned: "The longer it takes to stabilise the situation in the banking sector, the greater the risk that bank lending behaviour will at some point lead to a sharp decline in economic activity."

Details of the ECB figures suggested companies were reacting to the crisis by switching to shorter term borrowing. Bank lending to business for periods of up to a year increased at an annual rate of 4.6 per cent in October, up from 4 per cent in September, while loans lasting between one and five years contracted by 3.2 per cent in October. Lending to households for house purchases decelerated to 3 per cent in October from 3.9 per cent in September.