EUROPEAN CENTRAL BANK

EUROSYSTEM

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President

Mr Fabio De Masi
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

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L/CL/24/208

Re: Your letters (QZ-010 and QZ-011)

Honourable Member of the European Parliament, dear Mr De Masi,

Thank you for your letters, which were passed on to me by Ms Aurore Lalucq, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 5 November 2024.

Regarding your question on the roles of demand and financial constraints as factors limiting production, the ECB monitors the situation closely on an ongoing basis as part of its regular analysis of monetary policy transmission. The specific indicators you mention are maintained by the European Commission.[1] At the ECB, we carry out several surveys, including the bank lending survey and, together with the Commission, the survey on the access to finance of enterprises, which provide valuable and complementary information from the perspective of both lenders and borrowers.[2]

Our bank lending survey shows that there was a substantial slowdown in bank lending during the monetary policy tightening cycle, which was driven by both supply and demand factors. On the supply side, banks were reporting a substantial tightening of credit standards for firms (that is, internal guidelines or loan approval criteria), largely reflecting banks' perceptions of higher risks and lower levels of risk tolerance. On the demand side, banks reported a decline in the demand for loans, reflecting higher interest rates, weakened investment and subdued consumer confidence. The survey on the access to finance of enterprises confirmed that this was what firms were observing, as they reported low numbers of applications and a reduced need for bank loans.

1 See "European Business Cycle Indicators 2nd Quarter 2024: Low consumer confidence and the economy – Insights from the euro area", European Commission, *Technical Paper*, No 074, July 2024.

2 For more information, see "The euro area bank lending survey: Third quarter of 2024", ECB, October 2024 and "Survey on the Access to Finance of Enterprises in the euro area: Third quarter of 2024", ECB, November 2024.

Over time, the gradual reduction in the degree of monetary policy restriction, which began in June, will contribute to lowering the cost of borrowing for households and firms, which should, in turn, increase demand for bank lending. Furthermore, in the third quarter of this year, credit standards for firms were unchanged, after more than two years of consecutive tightening. Meanwhile, firms still reported a moderate tightening in perceived overall financing conditions.

As regards the link between financial constraints and capital markets union (CMU), I would like to point out that the CMU agenda focuses on deepening capital markets, removing cross-border barriers to financial investment, diversifying sources of funding and increasing access to finance across the European Union. This would contribute to the broader objectives of supporting innovation, the twin transitions of climate change and digitalisation, and long-term growth. As such, CMU is crucial for Europe's long-term prosperity and productivity, and it will contribute to our resilience. As the policies required to fulfil this agenda will take time to implement, we will see the benefits of CMU beyond the business cycle horizon – benefits which are of a structural rather than cyclical nature. Over the long term, the CMU agenda will have a positive impact on both supply and demand. Savers will increase their wealth via higher returns from their financial investments, and the industrial sector – as well as companies in general, in particular young and innovative ones – will benefit from deeper and more developed capital markets to enable them to invest in innovation, ultimately resulting in productivity growth. It is true that current insufficient demand, at least in the industrial sector, is determined by structural and cyclical factors. Nonetheless, delivering on the CMU agenda is essential to achieving a true single market for capital in Europe and fostering EU competitiveness.

Turning to your question about the monetary policy response to fiscal contraction, the ECB welcomes a full, transparent and speedy implementation of the EU's revised economic governance framework. This would bring down government budget deficits and debt ratios in a sustainable way, while incentivising much-needed investment and structural reforms. Under the revised framework, fiscal adjustment paths can be extended from four to seven years, contingent on the implementation of growth-enhancing investments and reforms which, in turn, further strengthen debt sustainability by increasing potential growth. Fiscal consolidation measures could reduce aggregate demand in the euro area and subsequently affect price pressures. The extent to which this happens depends on several factors, related not only to fiscal consolidation (scale and composition of consolidation, for instance) but also to how other determinants of economic growth and inflation will develop. Our macroeconomic projections routinely incorporate the impact of fiscal policy measures on the economic and inflation outlook. But there is no direct, automatic relation between fiscal policy and the monetary policy stance.

Yours sincerely,

[Signed]

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