Box 3

IS DISINTERMEDIATION BY EURO AREA CORPORATES WITH RESPECT TO THEIR EXTERNAL FINANCING POSSIBLE IF BANKS REDUCE THE SUPPLY OF LOANS?

Non-financial corporations rely on two main sources of external financing: borrowing from banks and direct issuance of securities (such as shares and bonds) on the capital market. A traditionally higher reliance on bank financing in the euro area contrasts with a generally more important role for capital market-based funding in the United States.[1] This has implied a particularly acute vulnerability of euro area non-financial corporations to reductions in the supply of bank loans. At the same time, the ongoing structural deleveraging that is taking place in the banking sector as a general process of adapting bank business models to a post-crisis operating environment has implied scope for a disintermediation of banks and – by extension – growing room for euro area non-financial corporations to increasingly seek access to direct market funding. This box examines corporate financing developments during 2009-10 in order to assess the extent to which euro area corporates have already engaged in such financial disintermediation.

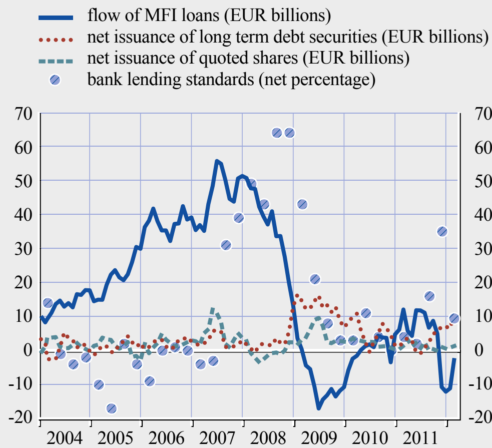
The growth of lending by monetary financial institutions (MFIs) – a category comprising mainly banks – to euro area non-financial corporations decelerated sharply throughout 2008, and lending subsequently even contracted in parts of both 2009 and 2010 (see Chart A). This movement reflected reduced demand for loans – in a period of weak economic activity – but also some supply-side developments.[2] Indeed, according to the ECB's bank lending survey, euro area banks reported a substantial tightening of lending standards on corporate loans throughout the period from the second half of 2007 to the middle of 2009 (see Chart A).

The negative correlation between MFI loans and securities issuance at the euro area level over this period could indicate that corporates were able to fill the financing void left by banks by increasing their direct tapping of debt markets (see Chart A). This would suggest that a reduced supply of bank loans need not necessarily result in financing difficulties for corporates that can turn

1 See ECB, "The external financing of household and non-financial corporations: a comparison of the euro area and the Unites States", *Monthly Bulletin*, April 2009.
2 See ECB, "Recent developments in loans to the private sector", *Monthly Bulletin,* January 2011.

Chart A Non-financial corporate financing and bank lending standards in the euro area

(Jan. 2004 – Apr. 2012)



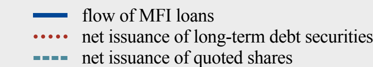
Sources: ECB and Moody's.
Note: Data for MFI loans and long-term debt and quoted share issuance are three-month moving averages.

to capital markets for financing – although such opportunities would be limited for the SMEs, which account for a large proportion of the euro area corporate sector. Cross-country disparities may cause the scope for disintermediation to vary – not only because corporates in some countries are more dependent on bank lending than others, but also because large and liquid corporate bond markets exist in only some euro area countries (such as Germany, France, Italy, the Netherlands and Belgium). As a result, in countries such as Spain, Ireland, Greece, Slovenia and Cyprus, capital market-based financing did not fill the gap left by the reduction of bank lending in 2009-10 (see Chart B).

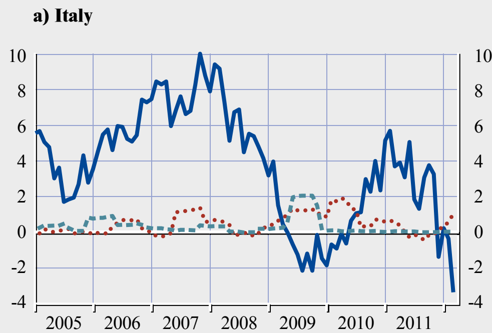
At the aggregate level, a more systematic empirical analysis for the euro area supports the notion that tightening bank lending standards

Chart B Euro area corporations' MFI loan transactions and issuance of long-term debt securities and shares

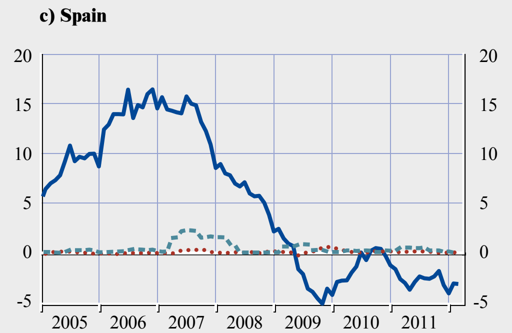
(Jan. 2005 – Apr. 2012; EUR billions; six-month moving averages)



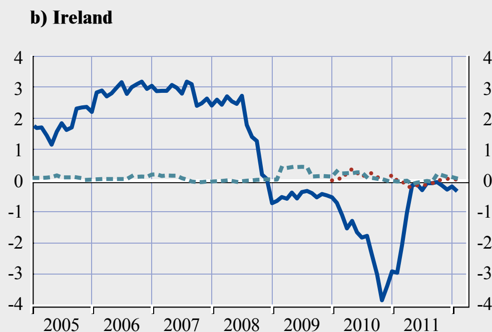
a) Italy



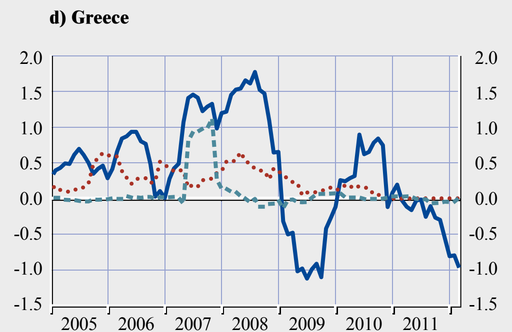
c) Spain



b) Ireland



d) Greece



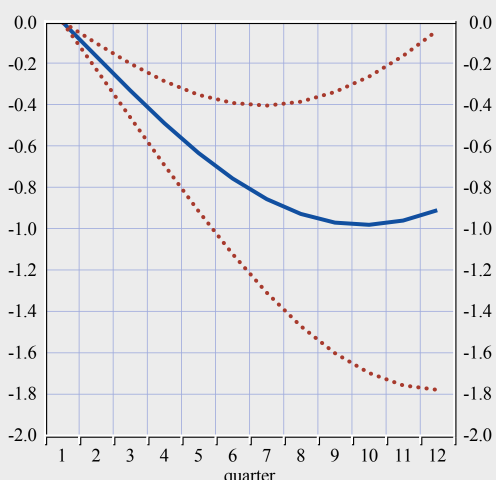
Source: ECB.

Chart C Estimated impulse response function of a shock to market-based debt and loans of non-financial corporations in the euro area

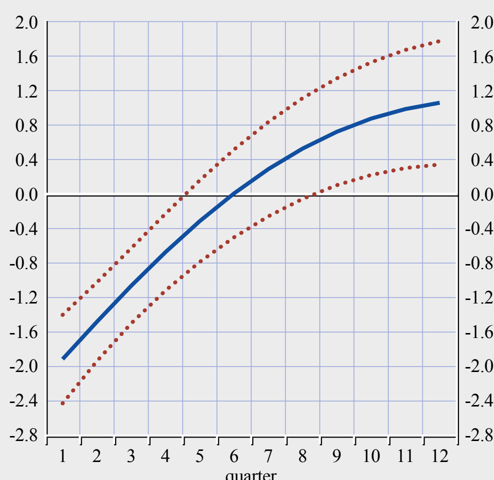
(percentages; deviation from annual baseline growth rate)

point estimate
90% confidence band

a) Response of MFI loans to a market-based debt shock



b) Response of market-based debt to a loan shock



Sources: ECB and ECB calculations.
Notes: The VAR model is estimated on the basis of quarterly data covering the period from the first quarter of 1991 to the last quarter of 2011. The number of lags is selected with an Akaike information criterion. The residuals are orthogonalised through a Choleski identification scheme where entrepreneurial income comes first, followed by real bank lending rates on loans to non-financial corporations (NFCs), then MFI loans to NFCs, then NFC debt and, finally, business investment.

have tended in the past to be associated with episodes of relatively higher corporate issuance of debt securities. Specifically, a VAR model estimated over a longer sample that included two recessions (1992-93 and 2008-09), as well as a downturn (2002-03), provides some evidence of substitution between bank finance and securities issuance. The results indicate that a positive shock to bank loans tends to depress market debt issuance for up to one year (see Chart C), with the converse holding true for negative shocks to bank loans. Hence, a negative shock to loans is to some extent compensated for by a rise in securities issuance. Tighter lending standards in the form of negative loan shocks may explain part of the recent acceleration in debt securities issuance at the euro area level. The uncertainty surrounding the substitution effect is large, however, as shown by the width of the confidence bands. In addition, it cannot be excluded that specific factors played a role in the period 2009-10, such as the very large issuance volumes of a few corporations.

Looking ahead, with corporate bond yields below their long-term average and close to bank lending rates, current price conditions appear favourable for corporate bond issuance. Indeed, most recent data show an increase in debt securities issuance, accompanied by a contraction of the flow of MFI loans to euro area corporates (see Chart A). However, as discussed in this box, corporate bond markets in the euro area are dominated by larger corporates in a limited number of euro area countries. Smaller companies and companies located in countries with less developed corporate bond markets are therefore more vulnerable to tightened bank lending standards.