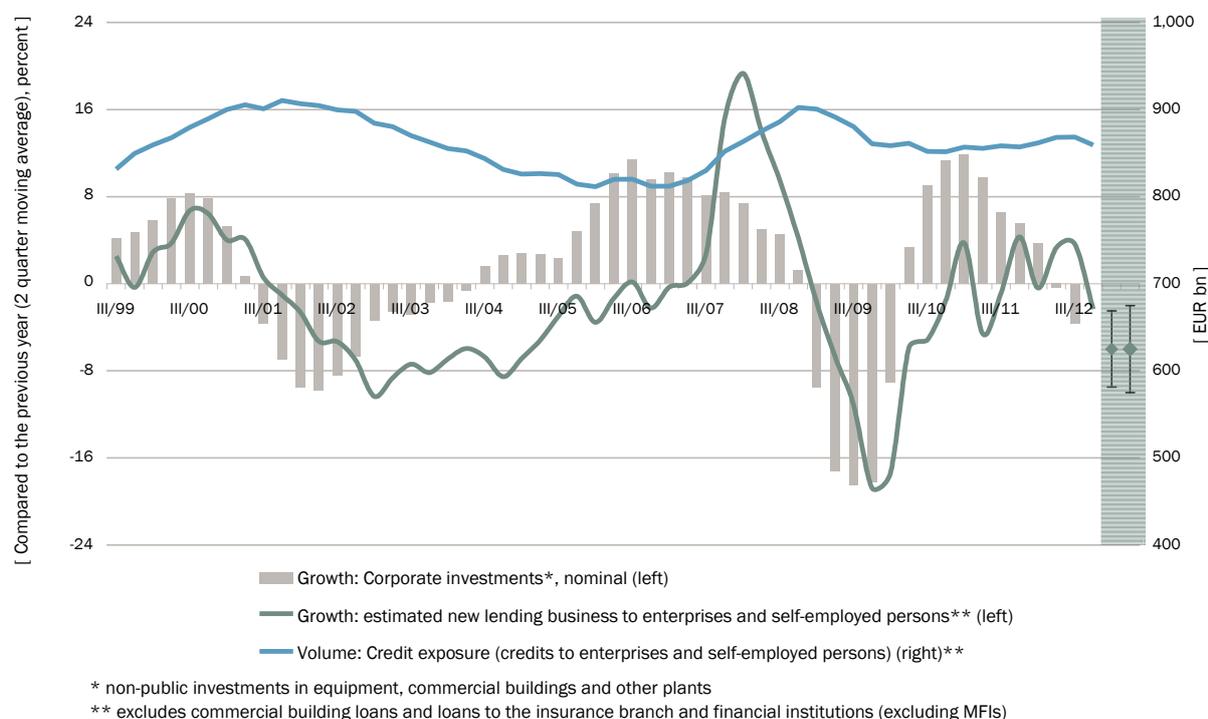


KfW Credit Market Outlook March 2013

New lending business in subdued mood after weak ending to the year



The new lending business by commercial banks with enterprises and self-employed persons¹ as calculated by KfW will continue to shrink at the beginning of the year by about 6 % compared to the first quarter of the previous year (moving average of growth rate over two quarters). Growth will remain at this level in the spring of 2013.

Demand for loans remains reserved

The weakness in the economy and in particular in investment of the fourth quarter 2012 is strongly affecting credit growth at the beginning of this year. The demand for credit remains low. Even the economic recovery we expect in the first quarter does not having any impact on this as credit demand responds to an economic turnaround with delay. According to the Bank Lending Survey, banks are currently observing that enterprises initially try to meet their financing needs through internal financing. Only after the recovery steadies and there is more investment will there be more demand for bank loans.

¹ This excludes commercial building loans and loans to insurance and monetary financial institutions.

Access to credit for companies that are actually looking for financing remains very good. The ifo credit hurdle is close to its historical low point and banks have hardly tightened their credit guidelines in the last three months. Neither is any significant upward movement planned in the next three months. Refinancing provides German banks no reason to limit their credit offers either, since there is adequate liquidity available. Not even the end of the flight of southern European deposits to Germany has changed the situation. The development of Target-2 balances since 2012 indicates that the money flows have reversed course. Even if this is a sign that the Euro crisis is quieting down, southern Europe continues to suffer from a credit crunch that must be vigorously confronted.

Economic slowdown visible in new lending business

In the past fourth quarter, new lending business with enterprises and self-employed persons shrank by 2.3 % (moving average of growth rate over two quarters). This decline may be attributed to the generally weak economy in the fourth quarter, with a GDP decline of 0.6 %. Equipment investment, which have a strong impact on demand for credit, was particularly weak in this quarter (-9.3 % compared to the previous quarter).

Another reason could be the considerable decrease in long-term project finance with duration of more than ten years. In the past year the volume of projects initiated and thus lending for their financing nearly collapsed.

Spring awakening most likely in summer

There are a number of indicators that suggest a return to credit growth in Germany for the second half of the year. In the KfW-ifo SME barometer, expectations have been judged positively for quite some time, even if there is still some catching up to do in terms of the assessment of the current situation. This positive assessment of the future will be reflected in an increase of corporate investment and after a certain delay will also lead to a higher demand for loans. There is no reason for lending guidelines to be significantly tightened so that higher demand is likely to be translated into actual credit growth.

Conclusion: Germany's credit market continues to shrink, compounded by a shrinking economy in the fourth quarter of 2012. However, in the course of the year the improving economy is likely to bring a recovery in investment. Thanks to continuing favourable terms of financing, new lending business will also increase.

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Annex

On the design of the KfW credit market outlook:

To calculate the new lending business, the quarterly change in the loan portfolio (data from the Deutsche Bundesbank on loans of German banks to enterprises and self-employed persons in Germany excluding home loans and loans to financial institutions and the insurance branch) is added to simulated repayment behaviour (per quarter) as planned. The publication is based on the rate of change of new lending calculated in this way compared to the same quarter last year, whereby the rate of change is presented in the sliding two quarter average.

The forecast of new lending business is based on a VAR model which includes the most important explanatory variables such as GDP, the twelve month rate on the money market and corporate investments. Corporate investments comprise all non-public investments in equipment, commercial buildings and other plants. They are calculated on a quarterly basis using the VGR data of the German Federal Statistical Office and forecast into the future using financial and real economy early indicators together with a vector autoregressive model.