KfW Research
KfW Credit Market Outlook: August 2023

New lending to businesses has stagnated

17 August 2023

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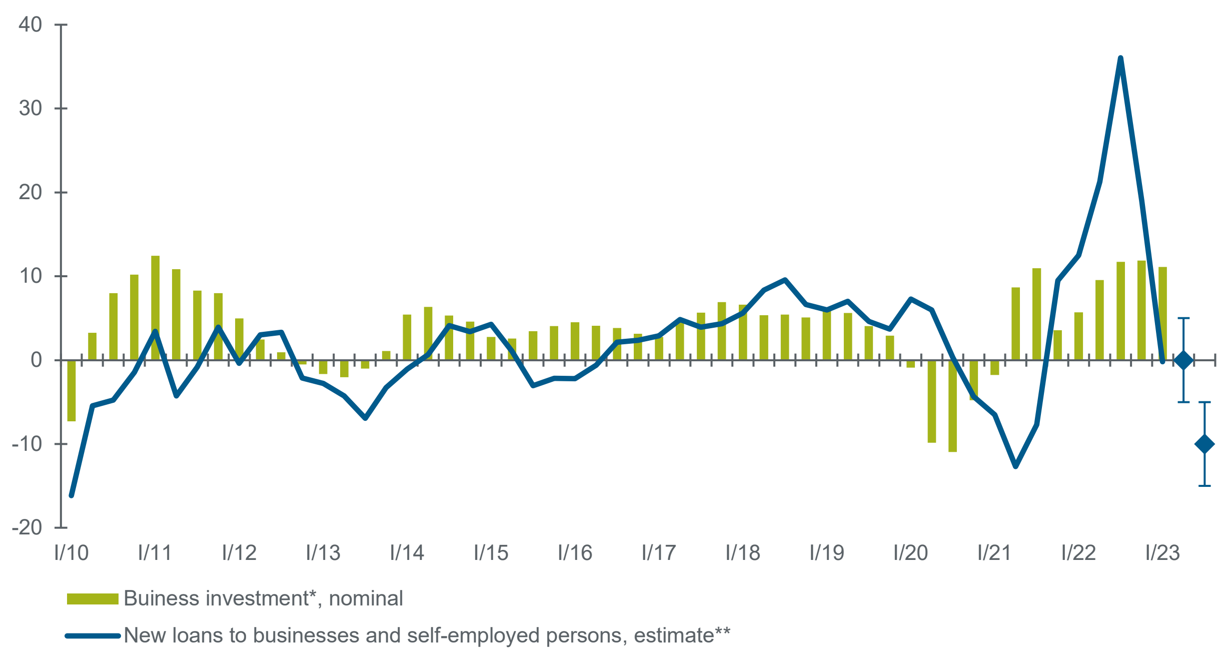
– The strong volume growth rates seen by German banks in their lending to corporate customers are over for now. Lending to businesses and self-employed persons stagnated on the previous year's level in the first and likely in the second quarter as well.

– Banks remain cautious in their lending practices but an end to the tightening of lending criteria appears to be in sight.

– Credit demand is restrained, crisis-related liquidity requirements have largely decreased. High interest rates and a weak economic outlook are dampening the appetite for investment finance.

– For the third quarter we expect new lending to be 10% lower than in the extraordinarily strong third quarter of last year. However, if investment activity by businesses turns out weaker than we expect, lending could contract even more sharply.

Figure 1: New lending by German banks and savings banks to domestic businesses and self-employed persons*
Variation on the previous year (moving two-quarter average), in per cent



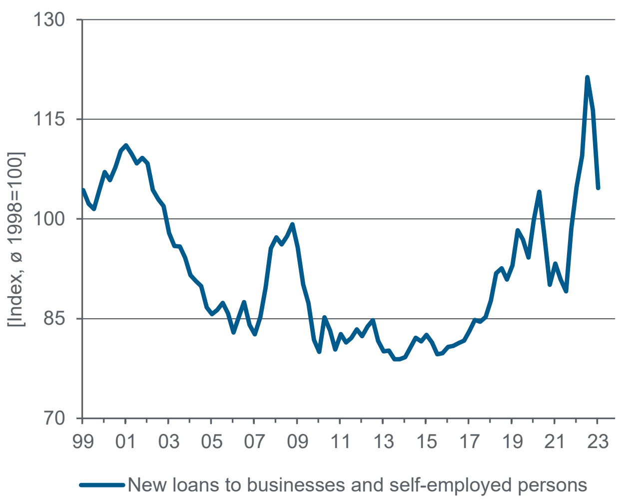
* non-public investment in equipment, industrial buildings and other facilities
** excluding commercial housing loans and excluding loans to financing institutions and insurance industry

Credit growth has come to a standstill

The credit market in 2023 is thus far developing in line with our expectations. KfW Research has calculated that new lending from German banks to enterprises and self-employed persons in the first quarter remained just barely below the level of the same quarter last year (-0.2%), after record growth rates in the past year. Credit market data[1] already available indicates stagnation for the second quarter. As new commitments are fluctuating strongly because of ongoing crises, in assessing credit supply in the real economy it is important to monitor not just changes in annual growth rates but long-term trends as well. Enterprises continued to borrow new funds on quite a high level in the first three months of the year (see Figure 2). In combination with the weak credit demand discussed in greater detail below, this indicates that, in broad terms, the credit channel remains sufficiently open. Nevertheless, banks are taking a close look at loan applications.

Figure 2: Loans to enterprises and self-employed persons

Indexed development of new loan commitments (moving 2-quarter average)



Source: KfW Research, Deutsche Bundesbank.

Lending criteria remain tight

As measured by the KfW ifo Credit Constraint Indicator[2], there was no further easing in lending policy in the second quarter, after criteria were relaxed at the beginning of the year. Large enterprises in particular viewed banks' practices as more restrictive again. Furthermore, in the Deutsche Bundesbank's July Bank Lending Survey most finance institutions reported that they tightened their credit policies for business loans again. However, the net balance was only a low 10%, and banks do not expect any further tightening for the summer quarter. The restrictions on lending to corporates thus continue to be quite moderate compared with the financial market crisis of 2008/2009.

Credit demand is subdued

The development of new lending business is currently being decided primarily on the demand side. The influencing factors already weighing on the first quarter are still in place. For one thing, crisis-related funding requirements are likely to have largely decreased. The situation in energy markets is calm, amid largely steady wholesale prices. At the same time, supply chain problems continue to ease. The share of manufacturers reporting material bottlenecks last stood at only 31.9%. That was a drop of around 20 PP since the start of the year.[3] For another, interest rates on business loans continued to rise steeply in the wake of the monetary policy reversal. At 4.81% in May, the average costs of loans identified by the ECB for corporate customers rose to a level last seen around 15 years ago. This has generally discouraged the appetite for debt, in particular for investment projects, which are also suffering from the dismal economic outlook.

Surveys with mixed signals

Whereas the data consistently indicate persistently weak demand for bank loans, statements on the severity of the weakness are more difficult to interpret. This is also due to the fact that relevant surveys currently provide mixed signals. Under the BLS, the vast majority of Finance institutions (32% for the second quarter) now reported a drop in demand for loans from corporate customers, the cause of which they believe originates mainly in the investment finance segment. On the other hand, the responses received from businesses to the KfW ifo Credit Constraint Indicator survey paint a friendlier picture. They signal a moderate increase in their appetite for loans, albeit on a low level.[4] The actual development of corporate investments (without residential construction) makes the banks' pessimism with respect to investment activity currently appear exaggerated. To be sure, the recovery of real corporate investment since the pandemic is unsatisfactory and still lags behind gross domestic product. But the trend is pointing upward and, owing to the strong increases in the prices of capital goods, increases in investment expenditure have remained steady at around 10% in the past quarters (see Figure 1).

Forecast: double-digit drop in new lending in the second half of the year

Given the pent-up demand and level of investment required for digitalisation and the green transformation, we expect price-adjusted business investment in 2023 to remain roughly on the level of the previous year despite the dampening effect of high interest rates. Under the further assumption that there will be no new distortions that could abruptly lead to new economically relevant liquidity requirements, we expect new lending commitments to stabilise on the current level in the second half of the year. Owing to the crisis-induced extreme credit expansion in the summer of 2022, translated into annual growth rates this nevertheless means a drop of around 10% for the current quarter. Our expectations on the development of investments constitute a major downside risk to this forecast. Given the current downward trend in economic sentiment[5], there is a relevant probability that corporate investments and associated financing transactions might trend weaker than anticipated.

The structure of the KfW Credit Market Outlook

New lending business is determined by adding to the quarterly variation of existing loans (data from the Deutsche Bundesbank on loans extended by German banks to domestic enterprises and self-employed professionals without housing construction loans and without loans to financial institutions and the insurance industry) a simulated on-schedule repayment behaviour (per quarter). The publication is presented in the form of the thus determined new lending business variation rate against the prior-year quarter, with the variation rate expressed as the moving two-quarter average. The forecast of new lending business is performed on the basis of the VAR model in which GDP, the twelve-month money market rate and business investments are taken into account as the most important explanatory variables. Business investments comprise all non-public investment in equipment, industrial buildings and other facilities. They are calculated by KfW quarterly on the basis of the national accounts data from the Federal Statistical Office and, using leading financial and economic indicators, are projected into the future with the aid of a vector autoregressive model.

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[1] Overall monetary surveys, Germany's contribution, variations in adjusted loans to non-financial corporations, ECB time series: BSI.M.DE.N.A.A20T.A.4.U6.2240.Z01.E.

[2] Cf. Schoenwald, S. (2023), Access to credit remains challenging for businesses, KfW ifo Credit Constraint Indicator Q2 2023, KfW Research.

[3] Ifo economic surveys, June 2023.

[4] Cf. Schoenwald, S. (2023),loc. cit.

[5] Cf. Borger, K. (2023), The mood at the start of the summer quarter has turned sour, KfW-ifo SME Barometer, July 2023, KfW Research.