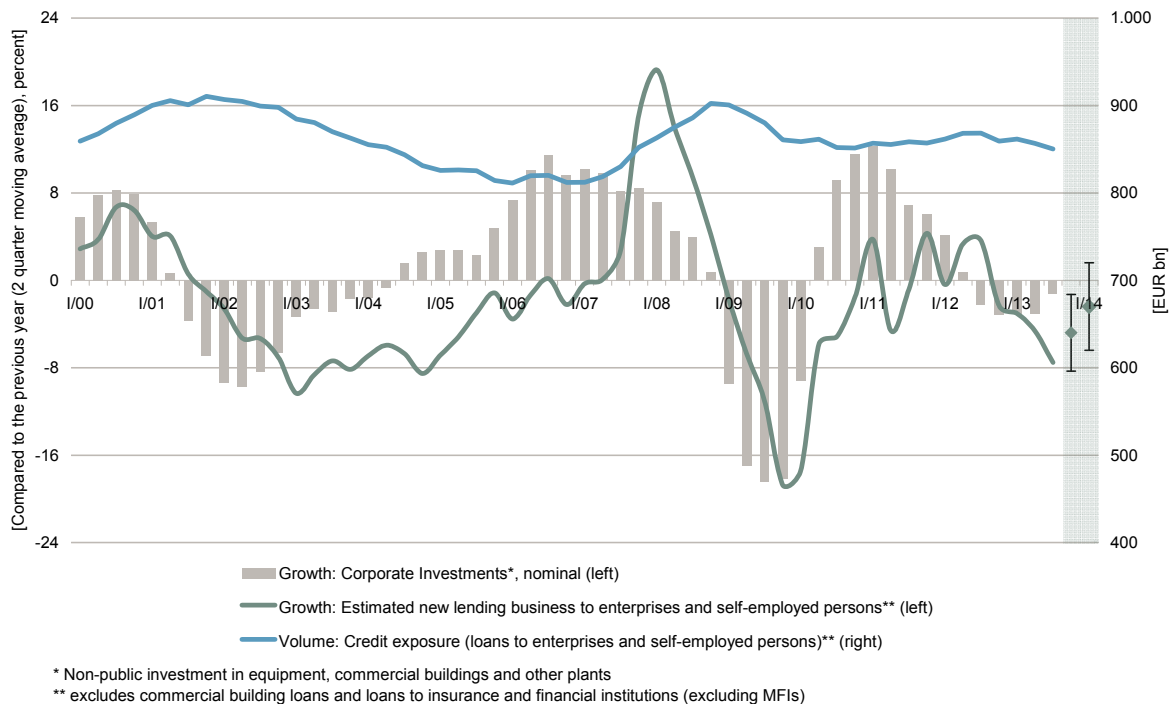


## KfW Credit Market Outlook December 2013

### New lending in hibernation



KfW estimates that the volume of new bank lending to companies and the self-employed<sup>1</sup> was down 7.5 % year-on-year in the third quarter of 2013, hitting a three-year low. The festive spirit was conspicuous by its absence in the fourth quarter, with new lending business coming in approximately 4.8 % lower than in 2012 (two-quarterly moving average). Overall, new lending declined by around 5 % in 2013.

#### Muted demand for investment and borrowing

As before, the lack of volume growth reflected low levels of investment activity among businesses. Companies continued to focus on replacements and modernisation, with little commercial construction activity. As a result, demand for finance was muted.

The economy has been improving since the summer. However, at this early stage of recovery, companies' capacity utilisation is still too low and uncertainty is too high for there to be a significant upturn in investment activity.

<sup>1</sup> Excluding commercial construction loans and loans to insurance companies and monetary financial institutions (MFIs)

Corporate investment remains around 2 % lower year-on-year. Where companies are increasing investment, they are still mainly using equity. Medium-sized enterprises started the year with a sizeable equity base – around 30 % – making this an option. Small companies began the year with a much more modest equity base of around 19 %, and were therefore more likely to apply for loans. As a result, lending volumes were low (see also *KfW SME Panel 2013*, published in October).

Weak inflation in Germany and Europe also contributed to the lack of growth in nominal new lending. Inflation on capital goods (GDP deflator) was unusually low in the third quarter, advancing just 0.3 % year-on-year.

The modest demand for finance was met by ample supply. Banks are still unusually willing to lend to companies. Liquidity is good in the German banking sector due to the combination of the ECB's expansionary monetary policy and Germany's status as a safe haven within the eurozone. The ifo credit constraint indicator remained close to record lows, while banks continued to offer attractive lending conditions.

### **Low point has been and gone**

Weak figures in the third and fourth quarters of 2013 marked the bottoming out of the lending market. As winter draws to an end, the gradual economic recovery should begin to affect the lending market, with demand for finance slowly picking up. We expect growth to move into positive terrain, possibly as early as the first quarter of 2014, but more probably in the second quarter. The recovery may be more pronounced if we see the precursors of an interest rate change next year, as companies will preempt gradual rises in interest rates and bring their lending plans forward. However, if the recovery in Germany or the eurozone undershoots current expectations, the lending market may have to wait a little longer for growth to rally.

**Conclusion:** The lending market in Germany is currently in hibernation mode, having posted the biggest decline in new lending volumes for three years. However, it looks as though a turnaround may be on the cards. We anticipate positive growth rates in the first half of 2014. An economic downturn in Germany and Europe and the ECB's plans to review asset quality in the banking sector in 2014 constitute the greatest downside risks.

Author: Christian Hornberg, christian.hornberg@kfw.de

Press contact: Christine Volk, +49 (0) 69 7431 3867, christine.volk@kfw.de

## **Appendix**

### **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 a VAR model in which the 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.