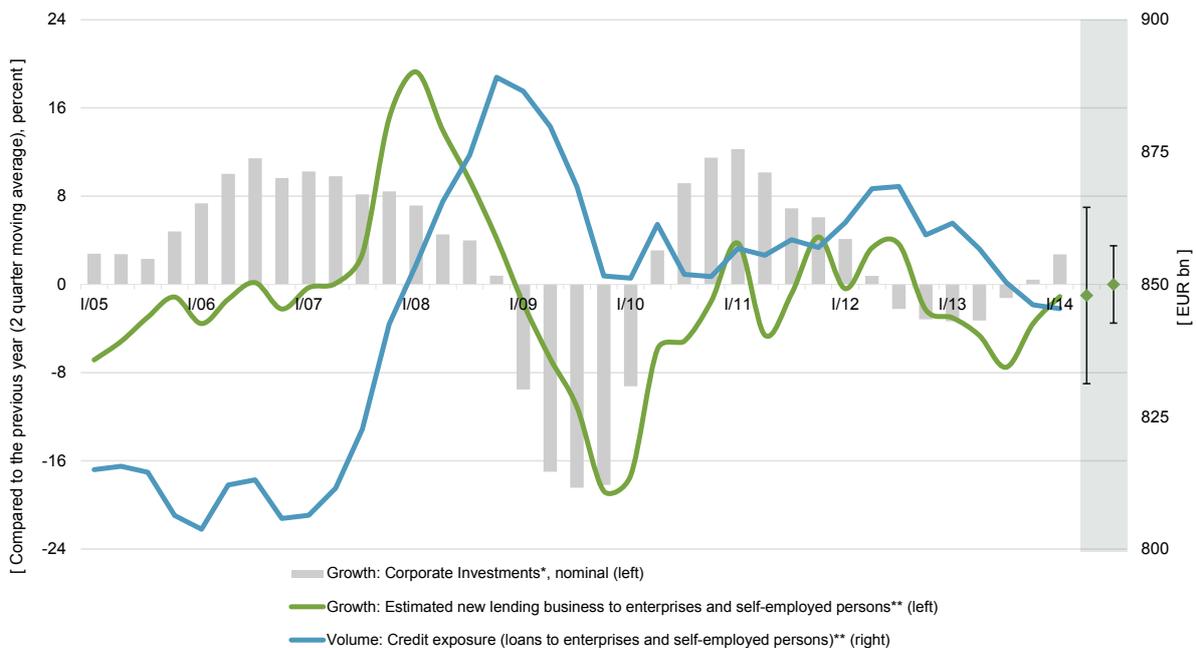


KfW Credit Market Outlook June 2014

New lending: economy recovering, but lending still stuck in the doldrums



* non-public investments in equipment, commercial buildings and other plants
 ** excludes commercial building loans and loans to insurance and financial institutions (excluding MFIs)

New lending by banks to enterprises and the self-employed¹ as estimated by KfW continued to fall in the first quarter of 2014, ending the quarter down around 1.1% year-on-year. This renewed decline was smaller than expected. We are not expecting an upturn yet in the second quarter. New lending should remain 1.0% below the previous year's level (2-quarter moving average).

Investment growing robustly, but still not fuelled by lending

Investment by the corporate sector continued to grow in the first quarter of 2014, by an estimated 1.6% compared with the previous quarter. This unusually fast pace of growth in the first quarter was partly due to the mild winter and it would therefore not be surprising if the pace of growth slows in the second quarter. We continue to expect business investment to grow by around 5% in 2014 as a whole.

¹ Excluding commercial housing loans and loans to insurance companies and monetary financial institutions (MFIs).

Loan demand is likely to stagnate in the second quarter as well. This is a reflection of the financial independence that many companies currently enjoy: the corporate sector as a whole has become a net saver in recent years. Corporate bank deposits amount to around EUR 500 billion and as a result companies can often finance smaller investment projects from their own funds.

The availability of credit, on the other hand, continues to be excellent. The IFO credit constraint indicator continues to fall from one historic low to another and only 17.4% of companies are currently reporting problems in obtaining bank credit. Interest rates on loans to companies are also at low levels. The ECB's planned monetary interventions in the autumn are expected to push interest rates down further, which is tending to weaken loan demand before then. The banks' lending criteria are unchanged.

Loans for capacity-expanding investments only in the second half of the year

We expect new lending to pick up slightly in the second half of the year. The robust economy means that business investment will continue to grow, which should feed through to loan demand by the end of the year. The capacity utilization of German companies is already slightly above its long-term average and is likely to rise further given the strong economy. Sooner or later companies will need to invest to expand their capacity, and such investments are typically more difficult to finance from own funds than ongoing operations.

Conclusion: New lending should pick up slightly in the second half of the year, with the robust economy and rising capacity utilization giving good reasons for optimism. The biggest downside risks are the economic outlook for Germany and Europe and a sharp downturn in business sentiment.

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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.