

## Slump in credit growth has bottomed out

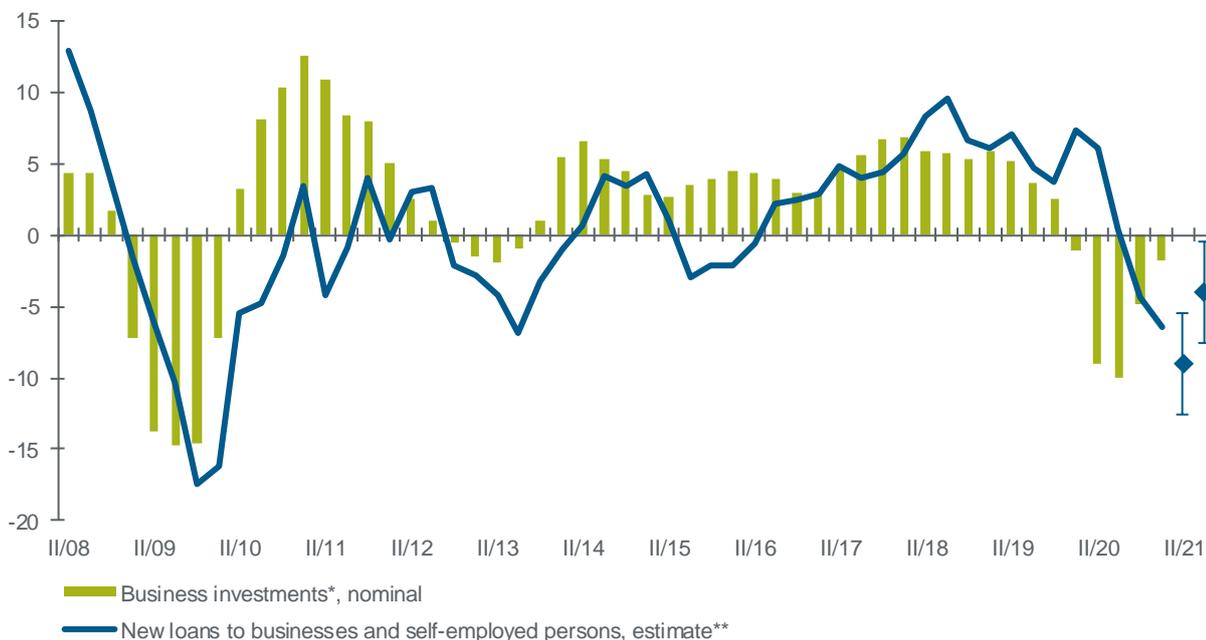
18 October 2021

Author: Stephanie Schoenwald, phone +49 69 7431-6446, stephanie.schoenwald@kfw.de

Press contact: Christine Volk, phone +49 69 7431-3867, christine.volk@kfw.de

- Calculations by KfW Research show that the growth of new lending business moved deep into negative territory in the second quarter. Lending by German businesses and self-employed persons was 12.7% lower year on year.
- The negative base effect created by high liquidity needs in the first half of 2020 remains a burden. But the weakness in the credit market goes beyond that. Although banks generally relaxed access to credit and offered more favourable conditions, lending only reached the level of the year 2018.
- Businesses mainly reduced their demand for short-term debt with maturities of a year or less. This is most probably due to the improved economic situation and accelerated disbursement of government support payments.
- Much indicates that the next quarter will see a trend reversal in the credit market as well. Financing needs will also rise again with the expected recovery of business investment. Credit institutions expect demand to rebound sharply in any case.

**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

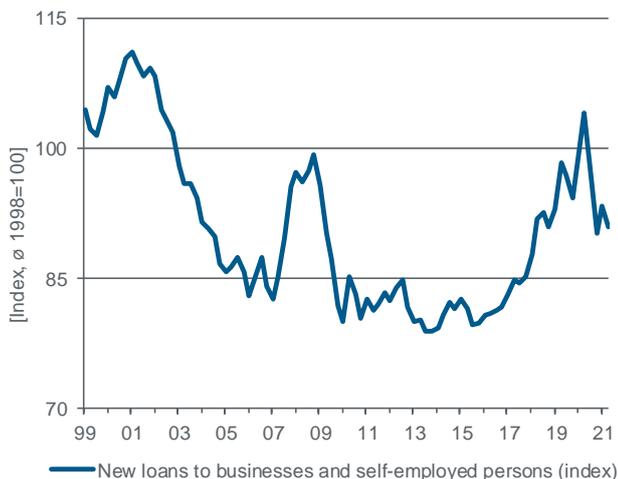
### Downturn in the business lending market continues

German businesses and self-employed persons borrowed significantly less in the second quarter than in the same period last year. According to calculations by KfW Research, new lending by banks and savings banks contracted by 12.7%. The speed of the downturn in the credit market since the beginning of the year has thus nearly doubled. The last

time there was a higher percentage drop was during the global financial crisis. As was already the case in the first quarter of 2021, a negative base effect again weighed on the growth rate of new lending in the second quarter because many businesses resorted to borrowing in the first half of 2020 as a precaution in order to strengthen their cash position or close liquidity gaps caused by the pandemic. But the

weakness in the credit market is more than a technical effect. A look at the longer-term development of new lending business illustrates this. It shows that borrowings by businesses have fallen to the average level of the year 2018 (see Figure 2).

**Figure 2: Loans to business and self-employed persons**  
Indexed development of new loan commitments



Source: Deutsche Bundesbank, KfW Research

### Banks are easing their lending criteria

The magnitude of the decline in lending raises the question whether it may have been caused by overly restrictive lending practices. But there are no signs of this. To be sure, German financial institutions have tended to moderately tighten their lending policy since 2019. But this cycle of tighter lending criteria should now come to an end. In the second quarter, at least, banks were again more accommodating towards their business clients. The KfW-ifo Credit Constraint Indicator<sup>1</sup> for the SME sector fell sharply, while there was only a minor reversal for larger companies after the sharp drop at the beginning of the year. In the recent

Bank Lending Survey (BLS), most of the institutions themselves reported having relaxed their criteria for accessing credit and made lending conditions more favourable. The cautious easing of lending terms is being facilitated by continuing low rates of bankruptcy.<sup>2</sup> Due to the comprehensive economic policy measures, bank balance sheets reflect the historic economic crisis to a limited extent only and, as the economic recovery continues, the likelihood of scenarios with high loan defaults will decrease, even if it is still too early to give the definitive all-clear.

### Businesses' credit demand is very subdued

The driving force behind the weakness of the credit market continues to be on the demand side. The share of businesses in loan negotiations with banks fell to a new low in all size classes in the second quarter.<sup>3</sup> The fact that new lending in the short-term segment of one year or less was particularly low indicates that businesses are now reducing the precautionary cash holdings which they had previously increased because of the pandemic in anticipation of the economic recovery. Besides, the disbursements from the government subsidy programmes (bridging assistance and other measures) accelerated to around EUR 15 billion in the second quarter. This, too, reduces the need for additional finance.

### A trend reversal is on the way for the lending market

Subject to all imponderables which the entails, we expect loan growth to have bottomed out. For one thing, the negative base effect is waning in the second half of the year. For another, businesses' capital expenditure is recovering, even if it is still a bit (around 1.5%) below the pre-crisis level. The resulting financing needs will translate into stronger new lending business and sooner or later the reduction of cash holdings will also come to an end. A very large majority of banks expect a rebound in credit demand in the summer quarter compared with the preceding three-month period. But it will take a bit more time for the annual rate to return to growth again. We believe this should be the case in early 2022.

### 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.

<sup>1</sup> Herold, J. (2021), SMEs can access credit more easily again – large enterprises, particularly construction firms, face problems, KfW-ifo Credit Constraint Indicator: July 2021, KfW Research.

<sup>2</sup> IWH (2021), IWH Bankruptcy Update: Ongoing Decline in Bankruptcy Statistics, press release 22/2021.

<sup>3</sup> Herold, J., loc. cit.