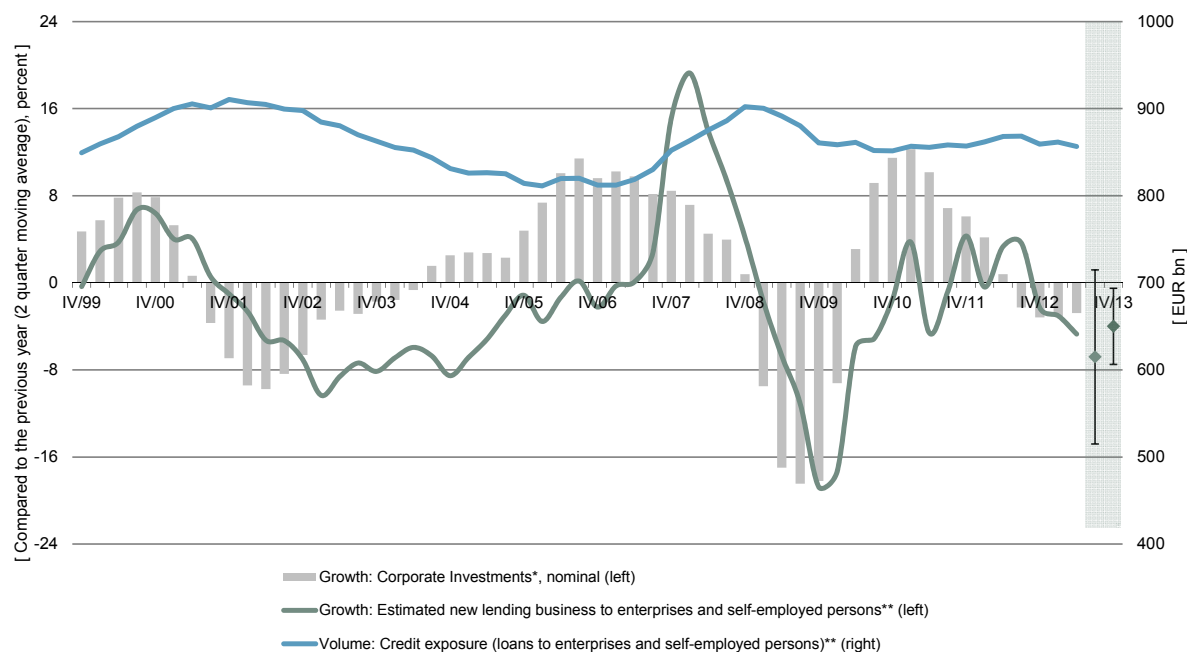


KfW Credit Market Outlook September 2013

New lending business: decline despite pickup in investment



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

The volume of new lending by banks to enterprises and self-employed professionals¹ is set to decline further in the third quarter by around 6.8 % compared with the third quarter of 2012, according to KfW's calculations (two-quarter moving average growth rate). However, this decline might be somewhat lessened by loans for the repair of flood water damage, which our model cannot accommodate. We expect the negative trend to reverse at the end of the year.

Loan demand still weak

Germany's economic recovery in the second quarter of 2013, which was stronger than expected, has not yet filtered through to new lending business. The modest increase in business investment during this early phase of a potential new economic cycle is still largely being financed by enterprises themselves. We therefore anticipate new loan commitments to decline year-on-year in the third quarter amid slower economic growth.

This forecast is supported by the Bundesbank's Bank Lending Survey, according to which the weak new lending business is attributable to weak demand for loans.

¹ Excludes commercial building loans and loans to the insurance sector and financial institutions.

Banks' willingness to lend to businesses looking for financing remains very good. The ifo credit hurdle is close to its historic low, and banks' credit standards are favourable (except for long-term loans).

Causes eliminated, symptoms persist

New lending to enterprises and self-employed individuals declined by a further 4.7 % in the second quarter of 2013 (two-quarter moving average growth rate). At first glance, this is surprising, as business investment increased over the same period. However, this was mainly due to investments in equipment. Investment in commercial construction, which is usually financed through borrowing, declined by 4 %, and thus could not play a role in bolstering demand.

Potential for year-end recovery

A turnaround in the dynamic of new lending business can be expected in the fourth quarter at the earliest, and we do not anticipate positive growth rates over 12 months until 2014. Only then will the economic recovery have gained enough momentum to push up demand for new loans to finance growing business investment. In these circumstances, some enterprises may also bring forward their planned borrowing if they expect interest rates to rise next year, for example if the Eurozone economy recovers.

Conclusion: Germany's credit market is still shrinking and is set to contract even more significantly in the third quarter than in the second. The turnaround is not likely until the fourth quarter at the earliest. The biggest risks for the credit market are US monetary policy and its impact on interest rates, as well as the ECB's planned asset quality reviews in 2014. Should some European banks have higher capital requirements than currently expected, it would be preferable if the corresponding funding were available when the results are announced.

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Annex

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.