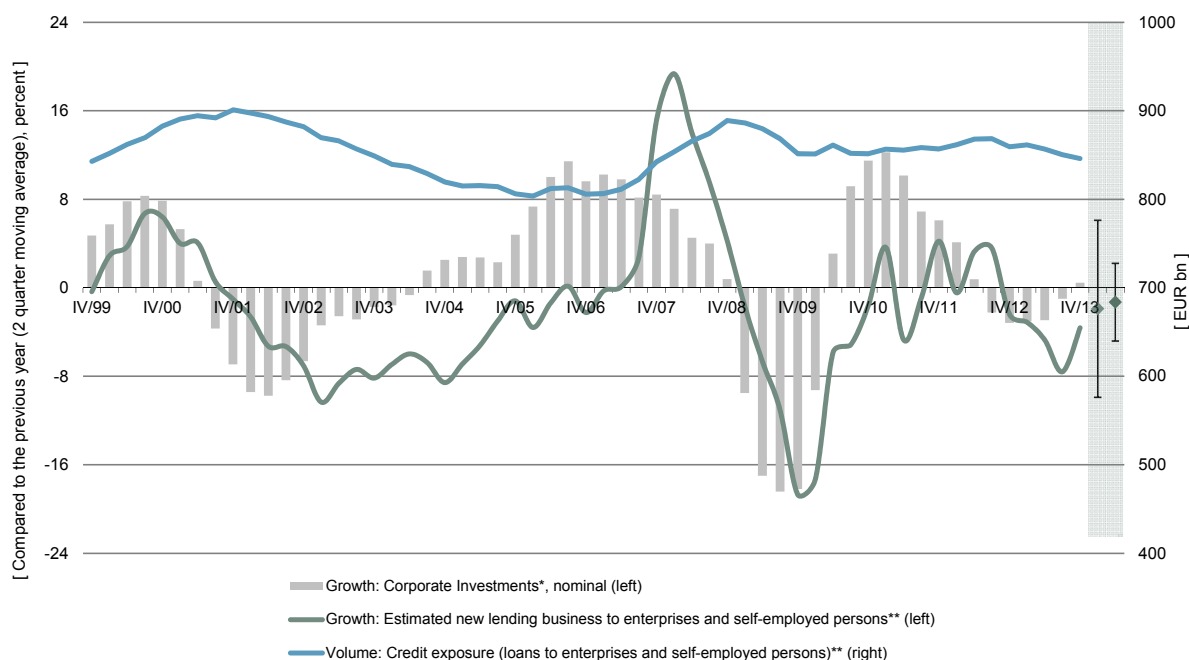


KfW Credit Market Outlook March 2014

New lending: crossing the valley of low demand at walking pace



* 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 the self-employed ¹ in Germany, as estimated by KfW, fell by 3.6% in the fourth quarter of 2013 compared with the previous year. However, this fall is not as severe as feared. New lending will ease in the first quarter of 2014. Even so, it may still be around 1.9% below the previous year's level (based on moving average of growth rate over two quarters).

Investment on the rise, credit demand halting

In the fourth quarter, businesses were able to invest more due to the unusually mild weather. Investment in commercial buildings in particular rose considerably compared with the previous year. As a result, overall corporate investment increased again for the first time in five quarters. However, this growth was still too restrained to translate into a significantly stronger demand for lending. Businesses continue to favour relying on their own funds.

¹ Excluding residential property loans and loans to insurance companies and financial institutions.

At the same time, lending terms and loan availability remain excellent. In Germany, unlike in Southern Europe for instance, the ECB's low headline interest rates have led to all-time low interest rates for corporate loans. Banks' lending conditions are extremely favourable, and the banks state that they are planning to relax these conditions even further. The Ifo Credit Constraint Indicator also suggests excellent access to loans, with a new historical low being reached in January 2014.

2014: the brakes are off

At present we still anticipate a lower level of new lending for the first and second quarters of 2014 than in the first half of 2013. Companies are certainly looking to the future with confidence and expect substantially higher sales. However, according to survey results, only slightly more investment is planned compared with last year. We expect an increase in real terms of around 5%. At this level, additional investment can largely be financed using companies' own funds. In addition, working capital can increasingly be financed without borrowing, and as a result the credit market will not experience any demand-driven stimulus for the time being.

If the economy grows by 2% this year as we expect, capacity utilisation is likely to increase considerably by the end of the year, necessitating greater investment. This would increasingly need to be financed through loans. We therefore expect to see positive growth in new lending during the second half of the year.

Conclusion: After bottoming out, new lending is on the road to recovery. Corporate investment is already increasing cautiously and the credit market is expected to follow suit this year. Downward risks mainly relate to the threat of economic setbacks in Germany and the euro zone. At the present time, these most likely stem from some emerging markets, especially Russia.

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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.