

»» Corporate lending lull continues

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- New lending to businesses continued to fall in the final quarter of 2015.
- As expected, the decline has slowed only slightly, with new lending 2.3 % below the previous year's level.
- Commercial housing loans, however, increased significantly.
- KfW Research expects the decline on the corporate lending market to continue over the first half of 2016 – a bleak outlook.

New lending to businesses and self-employed persons*

Variation on the previous year (moving two-quarter average), in per cent



* non-governmental investments in equipment, commercial buildings and other products

** excludes commercial housing loans and loans to insurance and financial institutions (without MFIs)

No prospect of upturn on the corporate lending market for the time being

KfW's estimates indicate that new lending from banks to businesses and self-employed persons (excluding residential construction and financial institutions) remained weak in the final quarter of 2015. The decline was 2.3% on the same quarter of the previous year (moving growth rate across two quarters). Although the pace of the decline slowed as expected, there are no signs of a trend reversal. Demand for credit would need a strong boost in order to induce such a reversal in the short term. We do not expect this, so the decline in new lending should continue in the first half of

2016. Owing to unfavourable base effects, the downward trend will likely have accelerated once again at the beginning of the year. This time last year, the banks were enjoying strong increases in lending business. We forecast a drop in new lending of some 4% on the previous year's level in the first quarter of 2016.

Little impetus for loan demand

Demand for loans is weak on a structural level because enterprises dispose of ample own funds. Uneasiness over the global economy, which intensified abruptly after the turn of the year, also weighs on demand. This caused turmoil on

the financial markets initially but the drop in economic confidence indicators showed that the uncertainty has spilled over to the real economy. In such an environment enterprises typically cut back their investment activity, which also reduces their need for financing. It can be assumed that the harrowing Brussels terror attacks have reinforced and/or prolonged their reluctance to invest.

Figure: Loans to enterprises and self-employed persons

Indexed development of loans outstanding



Source: Deutsche Bundesbank, KfW Research

The ECB's most recent measures are not likely to have any significant effect on the German corporate lending market either. Liquidity is abundant and, as expressed by the ifo credit hurdle, already only few businesses have restricted access to bank loans. In February just 14.5% of commercial enterprises confirmed having problems obtaining bank loans. Lending could receive fresh impetus if financial institutions lowered their interest rates again significantly. That could

motivate businesses to accept more debt, similarly to the year 2014. We are sceptical that this might occur because the potential cost reduction from participating in the TLTRO II-Programme is limited given the German banking sector's low level of liabilities to the central bank (EUR 54 billion in January 2016). Furthermore, such cost reduction would be thwarted by the further reduced interest on central bank deposits, which German banks hold plenty of (claims on the central bank: EUR 199 billion in January 2016).

Commercial housing construction loans are a bright spot for the banks

The development of loans outstanding since late 2013 illustrates the current split in the German credit market (see figure). Not only are residential construction loans to private households (economically dependent and other private individuals) flourishing but residential construction loans to enterprises and self-employed persons are also growing steadily at quite an impressive pace. They mirror the robust domestic economy, the growing need for housing and the search for worthwhile investment opportunities. Loans outstanding to enterprises of the remaining sectors of the real economy (light green line), on which we focus in estimating new lending business, however, have declined since the beginning of last year and is thus in line with the weak development of new lending ascertained by KfW Research.

Conclusion

The uncertainty that emerged at the beginning of the year is putting another dampener on credit demand by businesses and self-employed persons in Germany. In our assessment, the ECB's measures will not lead to any significant revival either. Enterprises will not invest more until confidence in the global economy picks up in the course of the year. That will offer a chance for the credit market to gather strength in areas other than commercial housing construction. ■

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.