Upswing and low borrowing costs stimulate corporate lending

New lending to enterprises and self-employed persons (according to the distinction made by KfW Research) grew by a vigorous 5.2% year-on-year in the fourth quarter of 2017.

The year 2017 as a whole was also exceptionally good for the German corporate lending market. Since the start of the millennium there have been only two years with higher growth.

The conditions are favourable for continued dynamic growth over the coming quarters. Businesses’ growing readiness to invest, combined with favourable conditions, suggests demand for lending will continue to rise.

Figure 1: New lending by German banks to domestic businesses and self-employed persons*

* non-public investment in equipment, industrial buildings and other facilities
** excluding commercial housing loans and excluding loans to financing institutions and insurance industry

Corporate lending surged at the end of the year

According to KfW’s estimates for Germany, new lending from banks to businesses and self-employed persons (excluding residential construction and finance institutions) grew by 5.2% year-over-year in the final quarter (moving growth rate across two quarters). Lending thus gained momentum once again at the end of the year after developing vigorously in the preceding quarters. The result for the year 2017 is therefore positive as well. All in all, German credit institutions succeeded in expanding their corporate lending business by 5% last year. Only two years posted higher growth rates since the turn of the millennium. Admittedly, this looks more spectacular than it is. Given the many years of structural weakness in the German credit market, the bar that had to be overcome was not too high. By our estimates, the current upward trend should continue with stable growth rates in the first half of 2018. The continuing outstanding economic environment supports this expectation. Lately, however, the political risks to the global economy have risen significantly again. An escalation of protectionist measures would also not remain without consequences for the credit market.
Attractive terms and conditions meet growing financing requirements

As we already stated in the last two editions of our credit market outlook, at present there are good arguments in favour of borrowing from a business perspective. Germany is in a prolonged upward business cycle that has even gained momentum of late. Business confidence, as measured by the ifo business climate, remains excellent despite the most recent corrections. And the high numbers of incoming orders in the final quarter demonstrate that this optimism is justified. At the same time, capacities are being increasingly stretched. Industrial capacity utilisation reached a multi-year high in the first quarter and was significantly above the historical mean. We therefore anticipate that enterprises’ readiness to invest will continue to increase and with it their financing requirements. Our view is also corroborated by the responses given by credit institutions under the Bank Lending Survey (BLS), which mention the financing of fixed capital expenditure as the primary motive for rising credit demand.

Companies willing to invest are also benefiting from extraordinarily favourable borrowing terms. According to the ECB’s most recent SAFE survey, access to credit for enterprises has improved yet again. The share of small and medium-sized enterprises reporting difficulties in obtaining credit has fallen to just four per cent. And in contrast to the interest rate increases now being felt at the long end of the capital market, average borrowing costs remain unchanged at record low levels. This is likely due to the intense competition in this market segment which banks have been reporting in the BLS for some time now. What might also play a role in this context is the increased involvement of foreign banks on the German credit market, as they are continuously expanding their market share.

Long-term view: no sign of a credit bubble

The long-term development of new lending to enterprises (see Figure 2) shows that the recent surge on the credit market does not signal the start of excessive debt in the German business sector. Compared with the many years of restraint in new borrowing among businesses, the revival that started some two years ago is very moderate and the debt ratio of German businesses remains low in an international comparison.

Figure 2: Loans to enterprises and self-employed persons

Indexed development of new loan commitments

That is the result of the increased weight which internal financing has gained over the years. Companies’ own resources (retained earnings, depreciations) also exceeded their investment expenditure in 2017 but the resulting formation of financial assets declined slightly. Against this background, higher borrowing should be seen as a healthy development.

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 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.