New lending slips into negative territory

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Author: Stephanie Schoenwald, phone +49 (0)69 7431-6446, stephanie.schoenwald@kfw.de
Press contact: Christine Volk, phone +49 (0)69 7431-3867, christine.volk@kfw.de

– Despite renewed public health restrictions, demand for bank loans was lower in the final quarter of 2020. KfW Research estimates that new lending to enterprises and self-employed persons dropped by 4.3% on the previous year.

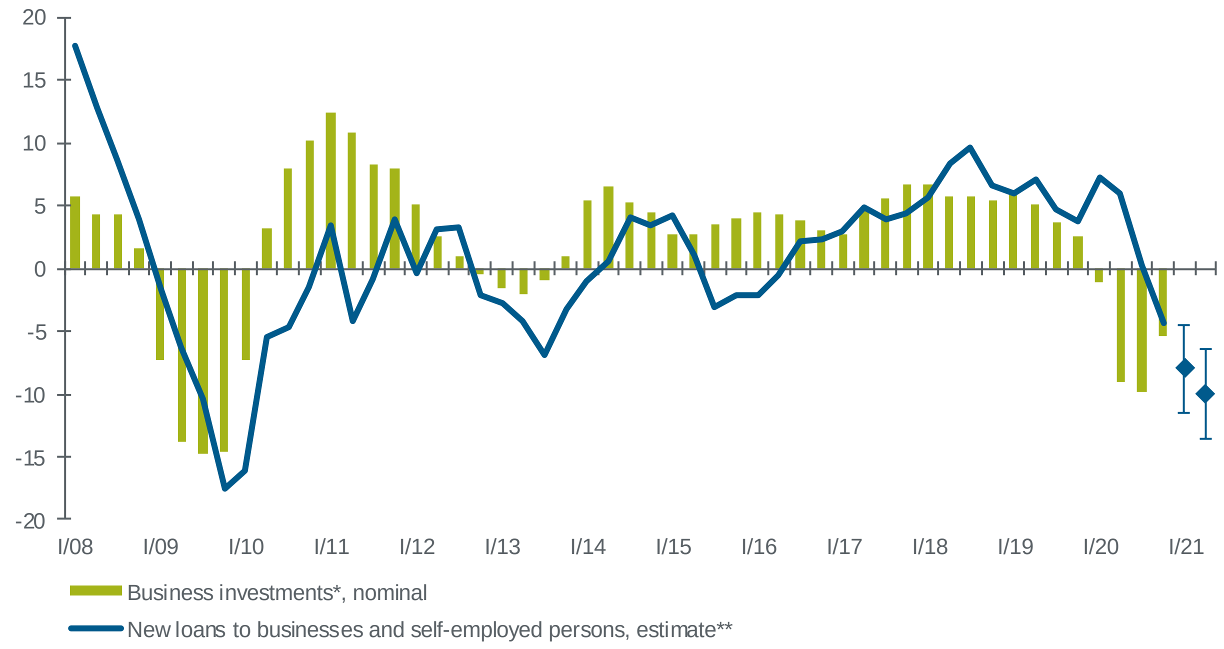
– Factors dampening demand include the low propensity to invest and an overall stable liquidity situation of companies, in sharply increased bank deposits. However, it must be kept in mind that these are likely to vary significantly from one sector and company to another.

– On the supply side, banks are continuing to gradually tighten their lending policy.

– We expect lending business to decline significantly in the first half of 2021. Cautious relaxations of restrictions and the financial support available to affected businesses reduce the need for funding amid weak investment activity. At the same time, banks are probably becoming more cautious, especially towards ailing businesses.

Figure 1: New lending by German 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 loans for residential constructions and excluding loans to financing institutions and insurance industry

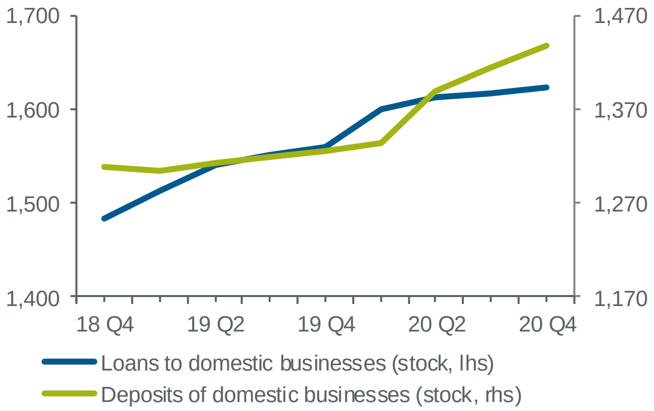
Downward trend accelerated already in the final quarter

Towards the end of the year, banks' lending to domestic enterprises and self-employed persons dropped below the previous year's level. The growth rate of new lending as calculated by KfW Research fell to -4.3% year-on-year, slipping into negative territory earlier than expected. Demand-side factors continue to be the main reason for the weakness in the credit market. The findings of the survey conducted as part of the KfW-ifo Credit Constraint Indicator[1] signalled a downright slump in demand: In December the share of enterprises that were in loan negotiations with banks fell significantly and to the lowest level ever recorded in the time series – irrespective of company size.

In other words, the second coronavirus wave and associated restrictions failed to have a noticeable expansionary effect on credit demand across the broad market. This is probably mostly due to the fact that the macro-economic impact of the second wave of infections has been less severe. To be sure, the lockdown 'light' imposed in autumn and its tightening from mid-December put renewed pressure on many businesses. This is particularly the case in sectors directly affected by closures. Nevertheless, the fourth quarter still saw positive economic growth of 0.3% on the previous quarter.

Figure 2: Corporate bank deposits show strong growth

in EUR bn



* Broad definition: including self-employed persons, loans for commercial residential construction and other financing institutions.

Source: Deutsche Bundesbank

Companies' financial position overall stable in the second lockdown...

The combination of a relatively stable economic situation, government financial support and businesses' ability to adapt their offerings and costs has enabled them to consolidate their financial position. This was illustrated by the findings of the fourth supplementary coronavirus survey conducted as part of the KfW SME Panel in early January.[2] A large number of SMEs (45%) still reported suffering turnover losses as a result of the coronavirus crisis, but significantly fewer than in the spring of 2020. Overall, businesses are also in a stable liquidity situation. The share of SMEs with short-term liquidity concerns has decreased continuously since March of last year. The development of bank deposits also shows very impressively that the business sector has now built up a strong liquidity buffer (see Figure 2). Deposits with banks have grown by more than EUR 100 billion since the end of 2019, much more strongly than outstanding loan volumes. To be able to better compare the two variables, our count also includes the continuously growing housing construction loans to businesses and self-employed persons. Taken together, these developments suggest that the need for new loans to maintain business operations in the pandemic has fallen. Furthermore, the continuing high uncertainty still makes enterprises very reluctant to ask for loans to finance investment expenditure. According to the ECB's Bank Lending Survey (BLS), that has been the main factor weighing on credit demand.

... but heterogeneity must be taken into account

However, the finding of a stable liquidity situation for the corporate sector as a whole must be interpreted with caution. The financial situation between individual sectors and businesses is likely to vary considerably, as there are now wide divergences in the impact of the pandemic. Thus, the manufacturing sector remained unimpressed by the rising rates of infection and remained on a path of recovery in the final quarter, growing 6.7% on the previous quarter. That is consistent with the fact that manufacturers in particular paid down their bank debts considerably, repaying more than EUR 10 billion net, while the hospitality sector borrowed more.[3] Government loan guarantee schemes and financial support as well as the provision of favourable financing terms by the ECB therefore remain important for sectors that have been hit hard by the pandemic.

Shift towards tighter lending policy continues

Banks have been tightening their lending conditions in small steps since the beginning of the crisis, including in the past quarter. Under the BLS, a small majority of institutions again reported having raised their lending standards. In terms of lending conditions, interest margins were raised to account for risk, and demands on collateral increased in particular. The KfW-ifo Credit Constraint Indicator[4] also rose slightly. Across the SME sector, 22.1% of businesses in search of credit encountered sceptical banks. Although the level of lending conditions appears to be generally commensurate with the risk situation as average interest costs remained at a low level, access to credit may become noticeably more difficult if the tightening trend continues.

Outlook: New lending is stuck in reverse gear

We expect lending to be considerably lower in a year-on-year comparison in the first half of this year as well. This is already the result of a pronounced base effect that results from the pandemic-driven strong lending activity in spring and summer 2020. The continued and expanded state financial support schemes are also helping to ease pressures. At the same time, the liquidity situation is set to ease further as a result of the global economic recovery, cautious relaxations of restrictions and vaccinations. But with the new, more infectious virus variants, setbacks in the fight against the pandemic cannot be ruled out. This uncertainty will continue to adversely impact businesses' investment appetite and corresponding demand for credit. In addition, banks' reluctance to lend is likely to increase given the difficulty of assessing the extent of credit risk.

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.

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[1] Schoenwald, S. (2021), Credit demand by businesses is down sharply – banks are becoming more restrictive, KfW-ifo Credit Constraint Indicator: January 2021, KfW Research.

[2] Gerstenberger, J. and Schwartz, M. (2021), Zwar belastet die Corona-Krise den Mittelstand auch zu Jahresbeginn, allerdings bleibt die Lage trotz des Lockdowns stabil (The coronavirus crisis is weighing on SMEs at the start of the year too, but the situation is steady despite the lockdown – only in German), Fokus Volkswirtschaft Nr. 315 KfW Research.

[3] Deutsche Bundesbank (2021), Bankenstatistiken, Table I.8, pages 42–43.

[4] loc. cit.