KfW Research
KfW Credit Market Outlook: March 2023

Corporate credit demand goes into reverse gear

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- In the final quarter of 2022, new lending to businesses and self-employed persons was up 19% year on year, marking continued strong growth. The pace of growth, however, slowed significantly.
- The easing of tensions in the energy markets and of supply bottlenecks has reduced crisis-related liquidity needs. The recent factor driving lending business has thus diminished.
- High credit costs and the slowing business cycle are dampening investment plans. However, sharp price increases are bolstering new lending business despite weak corporate investment in real terms.
- Declining credit demand, moderately tighter lending standards and base effects are likely to bring the growth of new bank loans to a near standstill in the spring. Nevertheless, the level of lending can definitely still be described as strong.

Figure 1: New lending by German banks and savings banks to domestic businesses and self-employed persons*
Variation on the previous year (moving two-quarter average), in per cent

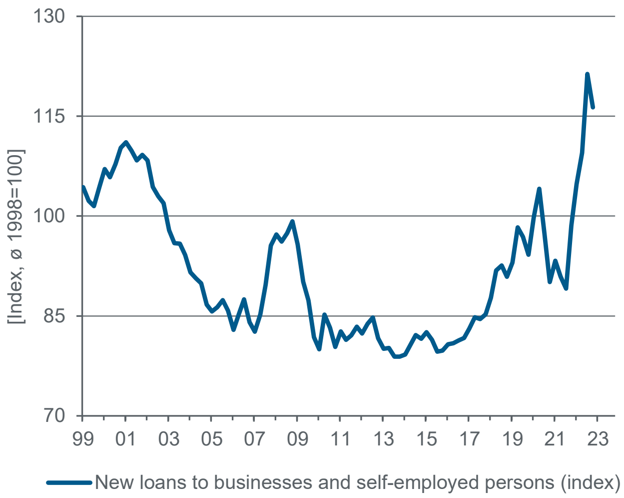
* non-public investment in equipment, industrial buildings and other facilities
** excluding commercial housing loans and excluding loans to financing institutions and insurance industry

After climbing to a record high, credit growth has (almost) halved
The situation in the credit market moderated in the final quarter of 2022. New lending from banks and savings banks in Germany to enterprises and self-employed persons, as calculated by KfW Research, continued to grow at a very strong annual rate of 19%. Still, that was half the record growth rate of the previous quarter (36.1%). Both the level and the volatility of the growth rates for business loans have been and remain unusual as a result of the concatenation of the COVID-19 crisis and the Ukraine crisis. It is useful to take a look at the long-term variations in the level of new lending business to be better able to assess the development. Figure 2 illustrates the pronounced weakness in lending in the second pandemic year, which lasted into the third quarter of 2021. That weakness is now omitted from the comparison with the previous

year. This alone accounted for roughly one third of the decline in the annual growth rate. The downturn in the corporate credit market is thus more gradual than the slowdown in the pace of growth alone would suggest.

Figure 2: Loans to enterprises and self-employed persons

Indexed development of new loan commitments (moving 2-quarter average)



Sources: KfW Research, Deutsche Bundesbank.

Credit demand is on the decline

Nevertheless, the fact remains that new lending has passed its peak for now. The reasons are currently to be found mainly on the demand side. The Deutsche Bundesbank's quarterly Bank Lending Survey shows that businesses are increasingly reluctant to take up new bank loans. For the first time since 2014, a majority of surveyed credit institutions reported a drop in credit demand from corporate customers in the final quarter of 2022. The net balance plunged to -32%, which was a level thus far seen only at the start of the 2000s. But there are also positive aspects behind this low figure. After the energy crisis peaked in the summer with record prices for electricity and gas in wholesale markets, the situation clearly eased from autumn last year. At the same time, problems in supply chains decreased. As a result, businesses require less finance to cover the resulting funding needs. The lower demand for KfW loans to energy companies towards the end of the year is a case in point. On the other hand, the impact of the interest rate turnaround is becoming increasingly clear. In February, average credit costs reached 3.86%. The last time interest rates were on a comparable level was in early 2009. A period of falling interest rates that lasted more than 10 years has thus been neutralised. Along with the somewhat brighter but still dim economic prospects[1], this reduces businesses' willingness to realise investment projects for which they incur debt. However, the high inflation rate is pushing up the funding amounts needed for investment projects and having a partly compensatory effect on new lending.

Access to credit remains more difficult than usual

Banks have tightened their lending criteria since the outbreak of the war and the resulting start of the energy crisis. After the record high KfW ifo Credit Constraint Indicator for small and medium-sized as well as large enterprises in the final quarter of 2022, the surveyed enterprises reported easier access to credit again at the start of the year.[2] The reduced economic risk since autumn is likely to have played a major role in this. The likelihood of energy shortages and persistent energy price extremes has dropped in the past months. Still, a dispropor-tionately high share of businesses still regard banks' lending policies as restrictive.

Forecast: credit growth will continue to fall

We expect the dampening factors on the supply and demand side of the loan market to persist in the first half of 2023. They will be compounded by the base effect described above, which will act as a brake in arithmetic terms into the third quarter. These factors are likely to bring the growth of lending to corporate clients to a standstill in the spring. If this is the case, it would still come with a relatively high level of lending activity. This forecast is subject to the risk that the events in the banking sectors in the US and Switzerland might still have ripple effects. Germany's banks are well capitalised. Should the entire banking sector be affected as a consequence of an increased capital requirement and higher refinancing costs, the result could be an additional tightening of lending standards and criteria, which would make the lending channel narrower yet again.

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.

[1] Cf. Borger, K. et al. (2023), Quasi-stagnation in 2023, KfW Business Cycle Compass February 2023, KfW Research.

[2] Cf. Schoenwald, S.(2023), Credit constraints decreased at the start of the year, KfW-ifo Credit Constraint Indicator Q1 2023, KfW Research, KfW Research.