# Mix of light and shade

11 July 2016

Author: Dr Sebastian Wanke, +49 69 7431-9784, sebastian.wanke@kfw.de
Press contact: Christine Volk, +49 69 7431-3867, christine.volk@kfw.de

- In the first quarter of 2016, new lending to businesses and self-employed persons (as defined by KfW Research) was lower than in the previous year for the third time in a row. However, the rate of decline has stabilised at -2.4 %.
- In contrast, the commercial housing loan portfolio continues to grow significantly.
- The outlook is a mix of light and shade: While developments in recent months suggest that new lending to businesses and self-employed persons is likely to return to growth, the Brexit vote may mean that such hopes could once again prove to be unfounded.

**New lending to businesses and self-employed persons***

Change relative to previous year (moving two-quarter average), in per cent


* non-governmental investments in equipment, commercial buildings and other assets
** not including commercial housing loans and loans to financial institutions and the insurance industry (excluding MFIs)

**Latest developments better than previously expected**

KfW's estimates indicate that new lending to businesses and self-employed persons (excluding residential construction and financial institutions) in the fourth quarter of 2016 remained below the previous year's level for the third time in a row. It declined by 2.4 % compared with the same quarter in the previous year (moving growth rate across two quarters). On a positive note, the rate of decline remained stable. There is also a base effect in play that makes the results look worse than they actually are. This is because the first quarter of the previous year was exceptionally strong.

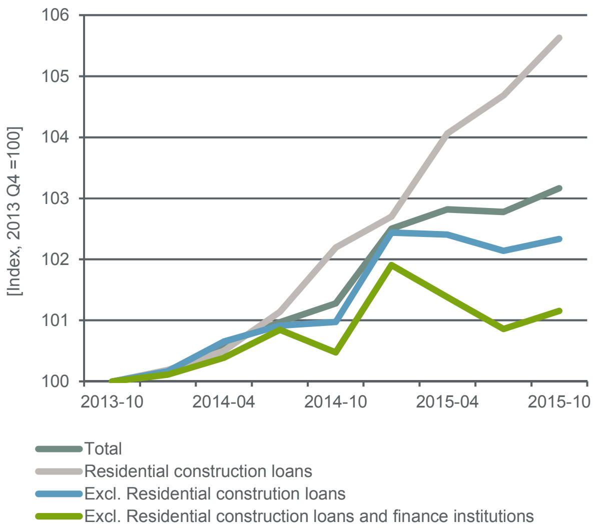
In view of this, our forecasts had also tended to show a worse figure for the start of 2016. In short, the current trend in itself gives cause to hope that the recent negative growth rates will resolve themselves as the year progresses. This appears all the more likely given that business investments picked up between January and March (see figure above). And even though German companies continue to hold ample means with which to finance their investments, the trend still points to a modest upturn in new lending to businesses and self-employed persons.

### Brexit increases uncertainty and caution

However, this cautiously optimistic view contains a flaw that must not be overlooked. While in spring, after a turbulent start to the year (concerns about the economy in China and the world as a whole), it looked as if the economic trend might move into calmer, rather stress-free waters, as soon as the summer began Britain confounded expectations by voting to leave the EU. This gives rise to increased uncertainty about future economic developments, particularly among businesspeople, on both sides of the Channel. As a result, at least a portion of previously planned investments is likely to be put on ice for now, which in turn will limit demand for loans.

### Figure: Loans to businesses and self-employed persons

Indexed movement in loan portfolio




Source: German Bundesbank, KfW Research

Even so, we anticipate that the Brexit 'Yes' vote will only lead to short-term difficulties, and Germany's economy, which in itself is very robust, will suffer only a small dip rather than slide into a recession. Accordingly, although the anticipated return to positive growth rates for new lending business is likely to be somewhat delayed, it will still come. For that to happen, though, there needs to be less uncertainty so that the demand side can recover, and demand is currently the only factor holding back growth in lending. Meanwhile, on the supply side, conditions are better than ever. This is illustrated, for example, by ifo's credit hurdle. In May, this indicator reached again a record low since its inception in 2003. German companies' access to credit is thus excellent at the moment.

### Commercial housing loans remain strong

There is another side to lending business that we do not cover in our consideration of new business – one that continues to be much more dynamic – namely commercial housing loans (see figure on the left). Strong growth in loan portfolios in this area which, along with new business, can also be affected by repayments, remains undiminished. The robust domestic economy, low interest rates and the search for alternative investments continue to be beneficial here. At the same time, as the figure shows, growth in loan portfolios excluding commercial housing and financial institutions remains relatively sluggish – in spite of the recent encouraging rise. This, in turn, is in line with the trend in new lending business, which is the main focus of this publication.

### Conclusion

New lending to businesses and self-employed persons (excluding residential construction and financial institutions) remained below the previous year's level during the first quarter. More recently, however, new lending has actually performed better than the annual growth rate suggests. In view of this, it appears possible that positive growth rates in this segment may once again be achieved this year. However, the Brexit vote at the end of June is now causing greater uncertainty for all participants in the economic process. This is likely to restrict investment activity and have a negative impact on new lending business in the months to come, in spite of the fact that financing conditions are currently excellent. Consequently, a marked recovery beyond the segment of commercial housing loans seems to be put on hold until around the end of the year. ■

### 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.