

## »» Lending growth appears to have peaked

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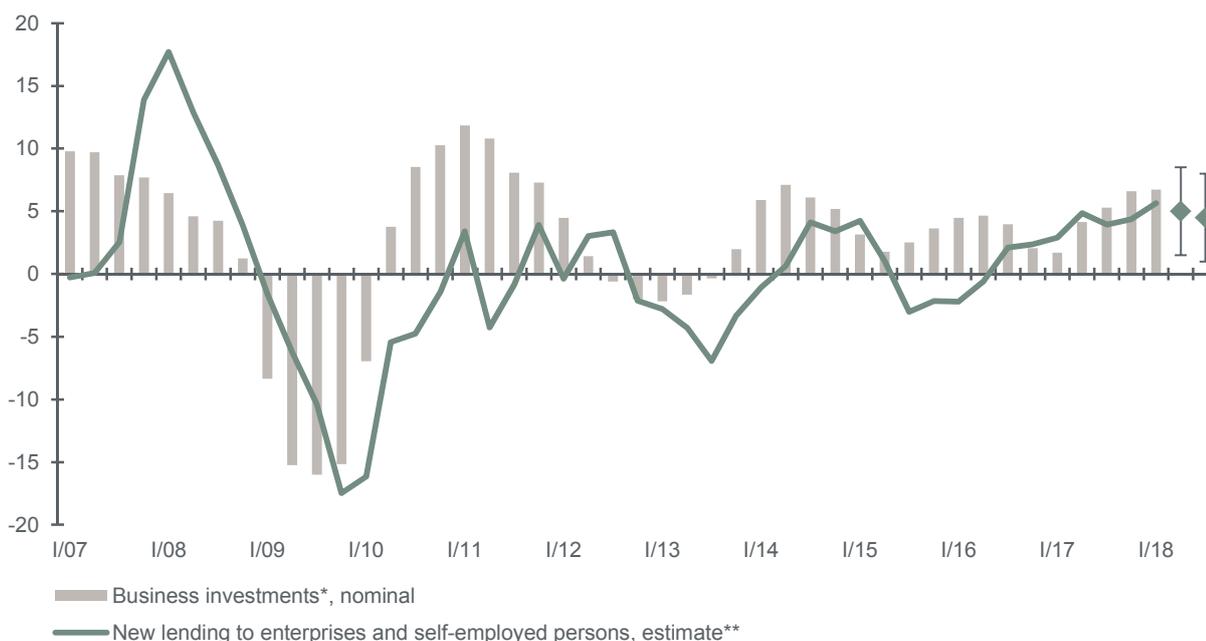
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- In the first quarter of 2018, new lending to businesses and self-employed persons (as defined by KfW Research) rose again sharply by 5.6% year-on-year.
- But prospects have dimmed in the past few months. The economy has lost momentum. Risks to the business cycle and, hence, to lending business are also increasing.
- The expansion rate of new lending business has probably reached its peak in this growth period.

**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 commercial housing loans and excluding loans to financing institutions and insurance industry

### Lending growth is at the highest level since 2008

KfW's estimates for Germany indicate that new lending from banks to businesses and self-employed persons (excluding residential construction and finance institutions) was up 5.6% in the first quarter year-on-year (moving growth rate over two quarters). Lending growth thus accelerated once again on the last three months of 2017, when the rate was +4.4% (revised downward). A look at past growth rates shows the significance of this figure. The last time new lending to businesses and self-employed persons grew at a faster pace year-on-year was in the third quarter of 2008.

### The outlook is no longer quite as good

But a lot indicates that growth has peaked for now – perhaps not just for now but even for the entire current business

cycle, which is in its late stage in Germany. The domestic economy has clearly lost momentum in the first months of this year, as it has in the entire euro area as well. Sooner or later this will probably reduce businesses' appetite for investment, which for its part should lead to more muted lending growth. Economic risks have also increased of late. Concerns over escalating trade disputes have grown as the US imposed punitive tariffs on aluminium and steel imports from the EU. Besides, financial markets have responded less than favourably to the formation of the new government in Italy. This could increase funding costs for businesses in Italy and then have a dampening effect on economic momentum in the euro area's third-largest economy.

Neither of the two risks, however, has to materialise to put

pressure on the business cycle. The mere uncertainty they generate may be enough to cause businesses to defer or cancel investments they planned, or to choose not to make other conceivable investment decisions. In this context, some hope can be found in the fact that in the past years the economic actors have apparently allowed themselves to be influenced only little by such political uncertainty. Despite the Brexit vote, despite the uncertainty over the direction of the US administration that prevailed already last year and despite Catalonia's secession drive, the euro area economy grew more strongly in 2017 than at any time in the past ten years. And in Germany, corporate investment has picked up significantly well into the first quarter of this year.

### Trend is still pointing upwards

It is also worth noting that the economic environment remains better than average despite the loss of momentum and the changed risk situation. According to the Bank Lending Survey, banks in Germany loosened their lending criteria once again at the start of the year, the general interest level remains very favourable for borrowers and, finally, the German economy still appears to be growing even above its potential as capacity utilisation rises to increasingly higher levels. So even expansion investments (along with replacement and rationalisation investments) still appear to be expedient from a macroeconomic point of view. All of this means that we will continue to see growth in lending to businesses and self-employed persons in the coming quarters. This growth will most likely remain below the fast pace seen recently – also bearing in mind that as the business cycle matures, businesses tend to use more loans to finance investment projects (and relatively fewer funds of

their own). In short, the growth cycle appears to have reached its peak.

The level of new lending to enterprises and self-employed persons also suggests that we will continue to see it growing – despite the more moderate outlook. Indeed, after many years the downward trend in lending has finally been broken in the past quarters (see Figure 2). That can indeed be interpreted as a structural recovery of the market. ■

**Figure 2: Loans to enterprises and self-employed persons**

Indexed development of new loan commitments



Sources: Deutsche Bundesbank, KfW Research

### 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.