

»» New lending is still growing strongly

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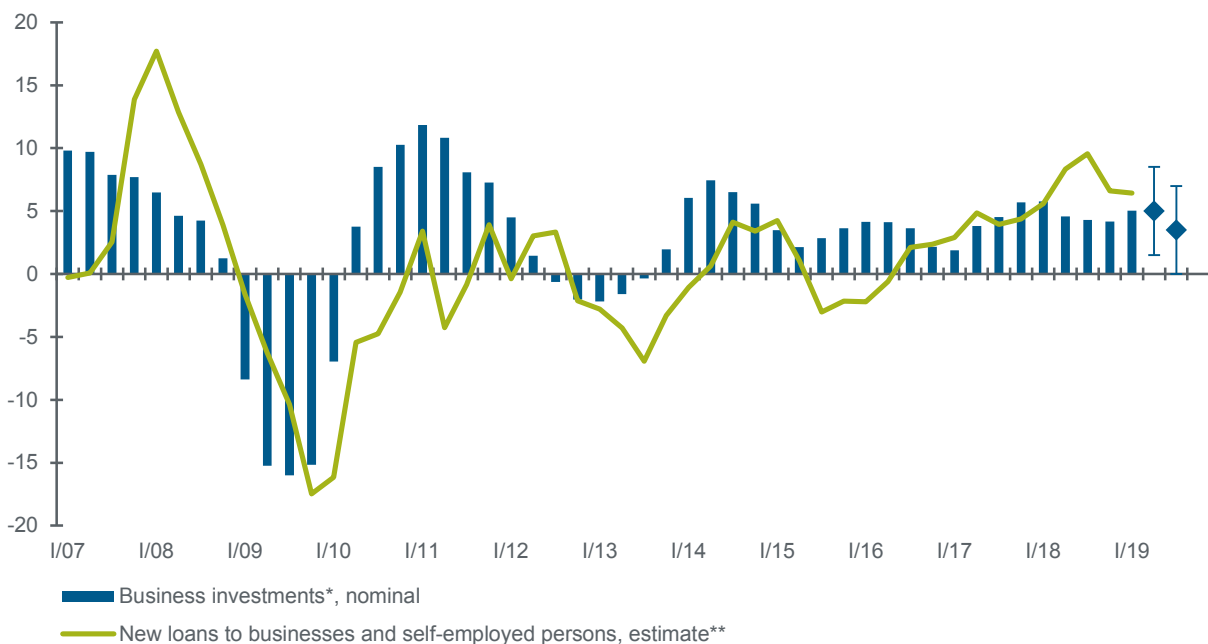
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- At the start of the year, new bank lending to businesses and self-employed persons posted above-average year-on-year growth of 6.4%, a similar increase to the previous quarter.
- Most recently, new long-term loans reached surprisingly high levels, as did the growth rate of corporate investment – positive signs in principle. However, this could be a temporary catching-up effect that may be related to the problems of the automotive industry last year.
- Given the rather weak business cycle, dampened expectations and ongoing high uncertainty fuelled by the trade conflicts and the Brexit farce, the likeliest scenario is that growth in new lending commitments will decline in the coming quarters.

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 business is still remarkably dynamic

According to estimates by KfW Research, new lending to businesses and self-employed persons in Germany (without residential construction and finance institutions) grew by 6.4% year-on-year in the first quarter of 2019. Growth in the first three months of the year therefore had almost the same momentum as in the final quarter of 2018, when it was up 6.6% on the previous year. What is particularly interesting is that new lending of longer-term loans was vigorous even though the economic trend in Germany from the second half of 2018 was actually quite disappointing overall. The slower

economic momentum and the muted business sentiment would have suggested that companies are increasingly avoiding longer-term exposures.

Have the special effects in the automotive industry impacted on the credit market?

A glance at the components of real gross domestic product (GDP) reveals that at the start of the year corporate investment in Germany grew at a surprisingly strong rate of 1.9% on the previous quarter – and this at a time of cyclical headwinds resulting mainly from persistently high uncertainty

caused by the trade conflicts triggered by the US and the as yet unresolved Brexit issue.

The most plausible explanation is this: there were problems in the automotive industry in Germany in the second half of 2018. The industry did not fully succeed in having its models certified for sale through the new WLTP testing procedure. This created production and sales bottlenecks. The backlog eased to some extent in the first quarter, which is reflected in the strong reduction in stocks evident in the GDP data. These data also show relatively strong growth in corporate investment. At the start of the year, businesses were obviously able to procure the vehicles they had wanted to buy for a longer period of time. And if these were credit-financed, this is likely to have boosted long-term loans as well.

Expansion investment makes little sense at the moment, and this will probably affect the credit market

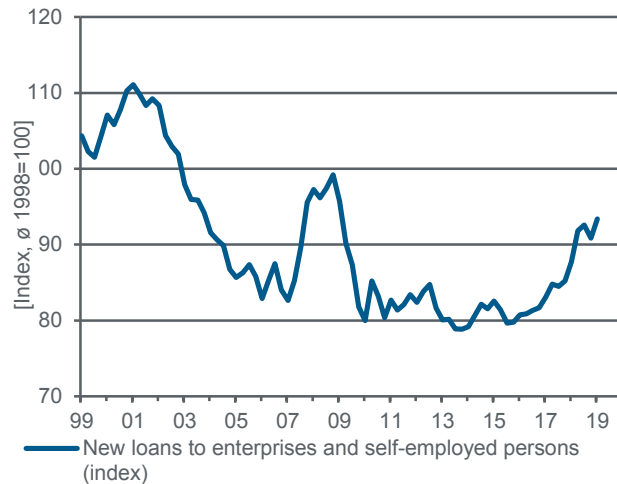
If the above observation is correct, growth in corporate investment is likely to weaken as the year progresses because the positive ‘automobile effect’ was probably only a one-off. In light of the ongoing uncertainties mentioned above (trade conflicts, Brexit), the investment motive – which has been intact so far, according to the ECB’s Bank Lending Survey – should become less of a driver for borrowing. The new Brexit ultimatum, which has been extended by just a few months, provides a good example of how such risks weigh on the business cycle. Why should a company with important links to the United Kingdom rush to decide about investments that rely on such business instead of waiting for the ultimatum to expire in October? It may even decide against such future involvement altogether. The most likely scenario for the coming quarters therefore appears to be a drop in new lending growth.

At the same time it has to be said that the risks also present opportunities. Should a solution to the trade conflict between the US and China be found, it will probably stimulate the Chinese economy and, thus, the global economy. Germany, the multiple ‘export world champion’, would also be very relieved, as withheld investments could then be made. The

same holds true for the Brexit issue. And then it would remain to be seen what is going to happen to the tariffs the US threatened to impose on European car imports ...

Figure 2: Loans to enterprises and self-employed persons

Indexed development of new loan commitments



Sources: Deutsche Bundesbank, KfW Research

Outlook: The era of strong credit growth may be over soon

After a brief surge at the start of the year, the growth trend of new lending is set to point downward again in the coming quarters. Above-average future growth rates can hardly be expected anymore. After all, the subdued economic outlook in what remains a highly uncertain environment is likely to dampen what so far has been very vigorous credit demand. Moreover, it can be assumed that banks will be slightly more cautious in their lending practices in such an environment. At the same time, it may well be that short-term borrowing will increase again – to finance stockpiles or bridge liquidity bottlenecks – owing to what is seen as short-term demand weaknesses. That would temporarily drive new lending upward again. But overall, the boom years in the credit market will probably be over soon. ■

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.