More loans for businesses in the coronavirus crisis – new lending up sharply

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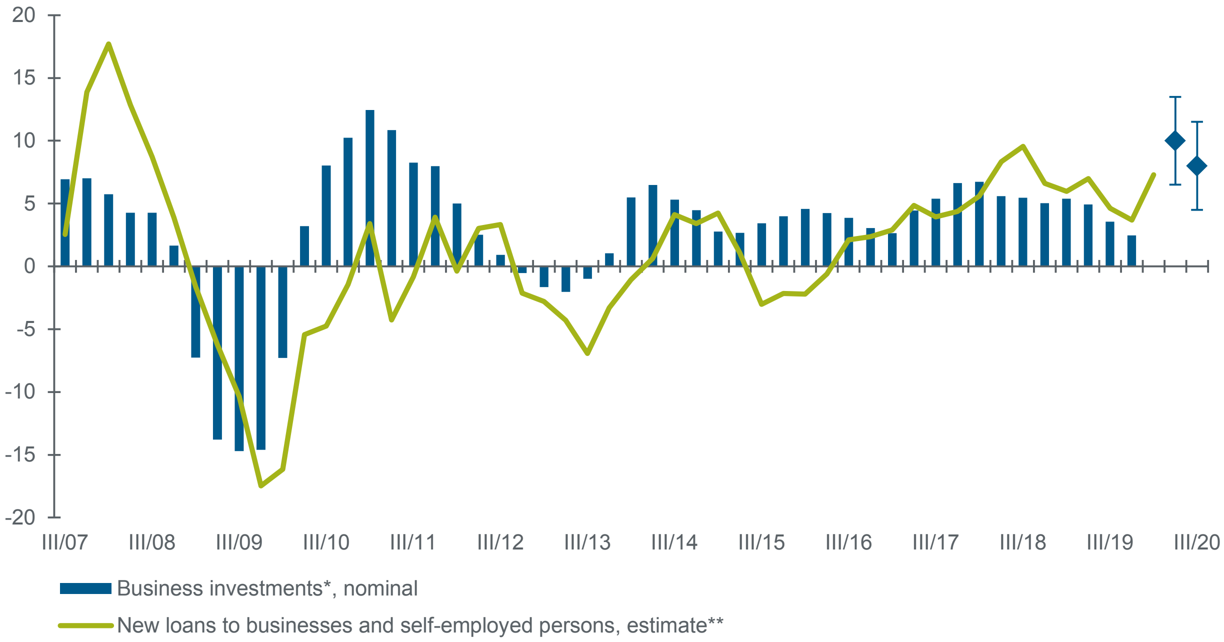
- The coronavirus outbreak left a clear imprint on the credit market in the first quarter. The growth of new lending to enterprises and self-employed persons accelerated noticeably. Banks extended 7.3% more loans year on year, after just 3.7% growth in the final quarter of 2019.
- As expected, the lending boost came from short-term loans. This is a reflection of the high liquidity requirements of businesses due to the earnings losses caused by the pandemic.
- We expect the lending dynamic to continue building for the time being. Although the lifting of restrictions has already begun, the pandemic will lead to a dramatic economic downturn and further significant funding requirements of businesses in the second quarter. Expansionary monetary policy, government loan guarantees and the economic stimulus package also make it easier for banks to largely keep credit access open.

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

New lending rate has doubled

The drastic impact of the coronavirus outbreak in Germany affected only a few weeks of March. But that was enough to heavily influence the lending dynamic in the first quarter. According to KfW Research, the growth of new lending to domestic businesses and self-employed persons (without residential construction and finance institutions) almost doubled at the start of the year after continuously weakening since the end of 2018. New lending to business customers was up 7.3%, after reaching a growth rate of just 3.7% between October and December. The acceleration was driven by short-term loans, while long-term loans, which are primarily used to finance investment projects, hardly increased anymore. This reflects the sharp increase in funding requirements resulting from earnings losses caused by the pandemic. As illustrated by a special survey conducted by KfW Research[1], SMEs lost an average of 53% of their usual turnovers in March. This has likely prompted them to first draw on existing credit lines[2] in order to quickly cover ongoing costs.

Liquidity requirements continue to bolster credit demand

It is clear that the pandemic and the disruptions it has brought to business activity will dominate developments in the corporate credit market until the end of the year. KfW Research estimates that economic output during the weeks of the lockdown in the second quarter was a mere 75–80% of its normal level. Even if the recovery has since begun, it is unlikely to climb back to the pre-crisis level until 2021. The funding requirements of businesses to overcome the shock therefore continue to rise, as does their demand for bank loans as the most important borrowing instrument. This view is supported by the very clear findings of the most recent Bank Lending Survey (BLS). A record majority of 40% of surveyed German financial institutions reported rising demand for credit from businesses and 60% (net balance) expect it to continue rising. There is also agreement on what is motivating the demand for credit. According to the banks, working capital financing is the dominant driver.

There is a good chance that credit access will remain open

The pandemic is putting enormous strain not just on businesses of the real economy but on banks as well. So it is legitimate to ask whether the abrupt increase in credit risks and the associated value adjustments could lead to restrictions on credit supply. However, we see good chances that credit will remain broadly accessible. It is not just the banks' good equity and liquidity position combined with regulatory relief that makes us optimistic.

A whole gamut of economic policy measures has been adopted to directly or indirectly help banks expand their credit supply. Among other things, the ECB is providing abundant liquidity as well as attractive funding conditions to make lending more profitable. The central bank has lowered the interest rate for targeted longer-term refinancing operations below the deposit rate between -0.5 and -1%. Under the KfW programmes the banks are largely exempted from additional risks of new loans. The liquidity assistance being provided by the federal and state governments in the form of grants reduces the risk of insolvency. Finally, the recently adopted economic stimulus programme will improve the medium-term business outlook for many enterprises and, therefore, the probability of loan repayment.

Lending dynamic will peak in the second quarter

All quantitative assessments continue to be fraught with higher forecast uncertainties than usual because of the uniqueness of the coronavirus crisis. Having said that, and on the basis of growing demand and open credit access, we expect new lending to accelerate in the current quarter. In addition to drawing on credit lines, newly negotiated bridging loans – which include the KfW support programmes – are likely to become more important as is the suspension of repayments. Overall, we expect new lending to grow by around 10%. That is slightly lower than the previous maximum rate at the start of the financial market crisis. Our careful estimate takes into account that new lending had already reached a high initial level before the crisis began. Besides, large-scale enterprises are increasingly tapping the bond market to seize on favourable funding conditions, while liquidity grants are available to small businesses. As the year progresses and the economy continues to recover, new lending can then be expected to slow.

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] Gerstenberger, J. and Schwartz, M. (2020) **SMEs are firmly in the grip of the coronavirus crisis but (still) holding on strong**, Focus on Economics No. 286, KfW Research.

[2] This view is supported by the findings of the supplementary coronavirus questions included in the ifo economic surveys of April 2020. Cf. Litsche, S. et al. (2020), Business Surveys in Focus: Coronavirus Crisis Strikes German Economy with Full Fury, ifo Schnelldienst, No. 05, 57–61.