KfW Research
KfW Credit Market Outlook: June 2021

Sharp drop in lending – base effect overstates weakness

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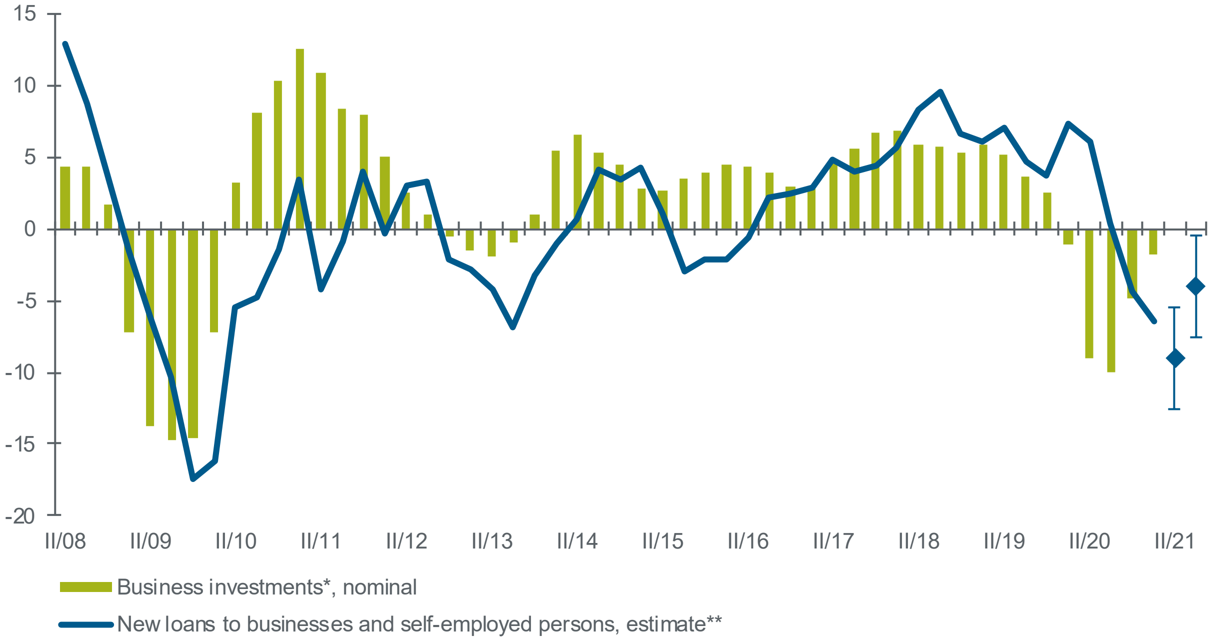
- The downward trend in the business lending market has deepened. According to KfW Research, new lending was down 6.5% year-on-year in the first quarter. Lending momentum should pass through the trough in the second quarter.
- In the first coronavirus wave last year, a particularly large number of businesses resorted to bank loans to close liquidity gaps. This negative base effect overstates the drop in loan demand by roughly one third.
- The main factors putting the brakes on loan demand, however, are companies' low investment activity and government support payments.
- Financing conditions have developed unevenly. While credit has become more difficult to access for SMEs, the situation eased for large enterprises. A new record low interest rate level in March also suggests lending institutions may be willing to lend more – at least temporarily.

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 loans for residential constructions and excluding loans to financing institutions and insurance industry

New bank loans are down sharply

As expected, Germany's financial institutions extended significantly fewer loans to domestic businesses and self-employed persons year-on-year in the first quarter. KfW Research has identified that new lending declined by 6.5%. However, this drop must be viewed against the background of strong lending activity in the spring of 2020. Taking out additional bank loans was often the chosen response of businesses to mitigate the abrupt turnover losses in the early phase of the pandemic and remain solvent. In order to quantify the resulting negative base effect, we have to adjust the volume of new lending at the time for the effect of the coronavirus pandemic. A simple way of doing this is to extrapolate the average lending growth in the preceding five-year period (2014–2019). Under this assumption, roughly one third of the current rate of contraction of new lending is attributable to the base effect. Fundamental factors, however, remain dominant for the weakness in the credit market.

Demand for credit remains below average

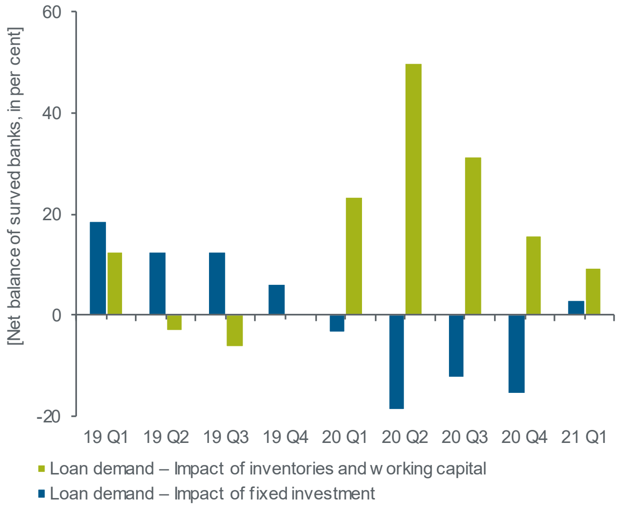
In the first quarter, only a low share of enterprises again reported being in loan negotiations with banks.[1] For one thing, businesses remain reluctant to invest due to pandemic uncertainty. At the start of the year, business investment was a good 4% below the pre-crisis level. Even so, the most recent Bank Lending Survey (BLS) points to cautious improvements (see Figure 2), which are urgent given the transformative challenges, especially climate neutrality and digitalisation. For another, our supplementary coronavirus surveys have shown that the pressure on enterprises from turnover losses and short-term liquidity concerns is gradually easing.[2] Not only is the economic situation improving for broad segments of the economy, the increasing disbursement of government support payments is also likely to have reduced the need for additional external finance. From January to March, EUR 10 to 15 billion was paid out to businesses under various support programmes.

Lending conditions show a mixed picture

While banks tightened their lending policy gradually but steadily last year, that trend has recently weakened. To be sure, under the BLS a small minority of institutions again reported tightening their lending criteria and the KfW-ifo Credit Constraint Indicator[3] rose again for SMEs. But large enterprises found it easier to access bank loans again. Furthermore, average interest costs for new financings fell sharply to a new low in March. It is reasonable to assume that banks were temporarily more accommodating in response to the expiry of the benchmark period for the ECB's targeted longer-term refinancing operations on 31 March 2021 in order to meet the conditions for the particularly favourable ECB refinancing.

Figure 2: Demand for investment finance halts downward trend

in EUR bn



Source: Bundesbank, Bank Lending Survey April 2021

Outlook: Slump will bottom out in the second quarter

We expect the variation in new lending to reach its low point in summer before it starts to recover in autumn as the negative base effect vanishes and the economic rebound gains momentum. But positive surprises in lending growth are definitely possible, as investment activity may recover more quickly than currently expected given that economic sentiment has recently brightened and capacity utilisation is already on a high level. But there are also downside risks to our forecast. After the coronavirus crisis, businesses will have to shoulder more debt than before. That could weigh on demand for investment financing for some time to come.

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] Herold, J. (2021), Large companies find it easier to access loans again – banks remain restrictive for SMEs, KfW ifo Credit Constraint Indicator: April 2021, KfW Research.

[2] Gerstenberger, J. (2021), Light at the end of the tunnel – the situation of SMEs is easing (in German only), Focus on Economics No. 333, June 2021, KfW Research

[3] Herold, J., loc. cit.