

# »» Lending is stabilising – but tangible growth is not in sight

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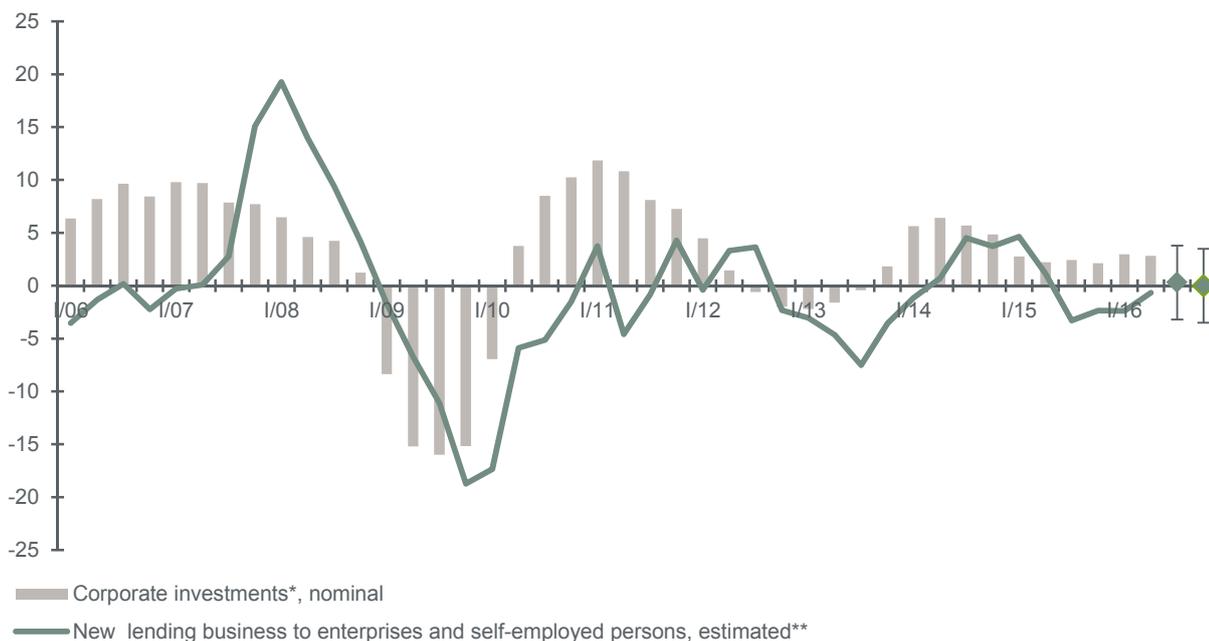
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- New lending to enterprises and self-employed persons (s defined by KfW Research) failed to reach the previous year's level in the second quarter of 2016 as well. However, the decline was significantly lower than before, at 0.7 %.
- Businesses still face hardly any barriers to lending on a broad front. However, access has not improved any further.
- Fresh impetus is not coming from the demand side either, as a result of the Brexit vote and because of attractive funding alternatives on the capital market. Corporate lending will merely move sideways in the latter half of the year.

## 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-governmental investments in equipment, commercial buildings and other products  
\*\* excludes commercial housing loans and loans to insurance and financial institutions

### Stabilisation on a low level

KfW's estimates indicate that new lending from banks to businesses and self-employed persons (excluding residential construction and finance institutions) fell only slightly in the second quarter of 2016. Compared with the same quarter of the previous year, new lending dropped by 0.7 % (moving average across two quarters). That signals an end to the most recent decline. The reduced downward momentum is largely a consequence of the already weak reference quarter

last year, however. Since then new lending business has stabilised at the 2013 level. We expect this sideways movement to continue until the end of the year. Significant increases in corporate financing are not likely. On the supply side, potential for further improvements to financing conditions seems to be largely exhausted, and the credit demand side is also generating insufficient stimulus.

**Loans are still easy to obtain – interest rates remain low**

So far, the increased regulatory requirements for banks have not visibly affected the availability of credit for businesses. Only few enterprises surveyed by the Ifo Institute complained in August about problems in accessing finance (14.6%). However, the Ifo Credit Constraint Indicator is now moving roughly sideways and the era of new record lows appears to be over for now. A look at credit conditions reveals a similar picture. In the past two years, most banks reported in the ECB's quarterly Bank Lending Survey that they had adjusted their lending terms to accommodate their customers, but in the second quarter of 2016 that was no longer the case. Available scope for further interest reductions, in particular, is likely to be limited as margins have narrowed. Nevertheless, corporate lending remains an attractive line of business for finance institutions, also for lack of worthwhile investment alternatives in the capital market. But there is no reason to expect the credit market to be stimulated by further rounds of improvements to lending terms given the stricter requirements and earnings problems in the banking sector.

**Credit demand lacks impetus**

The encouragingly strong start to the year had given rise to the expectation that businesses would now be increasingly willing to invest again. But after the weak second quarter and the UK vote to exit the EU, which has probably caused export-oriented firms in particular to exercise restraint, prospects for the second half of the year have dimmed. In addition, the ECB's bond purchases and the associated drop in interest rates have made it more attractive for large enterprises to raise funds in the capital market.

**Weak growth in loan portfolios**

The weak new lending is nevertheless sufficient to slightly expand loan portfolios in the bank balance sheets (+0.9%) in the segment analysed by KfW Research – loans to domestic non-financial enterprises excluding residential construction – as new lending exceeded repayments compared with the previous year. Lending to firms for housing construction is

looking much better, however. Despite a minor slowdown, which may be attributable to the introduction of the Mortgage Credit Directive, the volume of loans outstanding in the second quarter expanded by a good 3.4%.

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

Indexed development of loan portfolio



Source: Deutsche Bundesbank, KfW Research

**Conclusion**

The split in the German credit market will continue for the time being. Thriving residential construction activity finds its reflection in the credit market. It is here that the ECB's expansive monetary policy is having an invigorating effect. Lending by German banks to businesses domiciled in other euro countries is expanding vigorously as well. This contrasts with the stubborn weakness in lending to domestic non-financial enterprises operating outside the residential construction sector. Here even the best conditions are proving to be insufficient to unleash demand for credit and induce investment. ■

**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.