

»» Is corporate lending activity rising to new heights?

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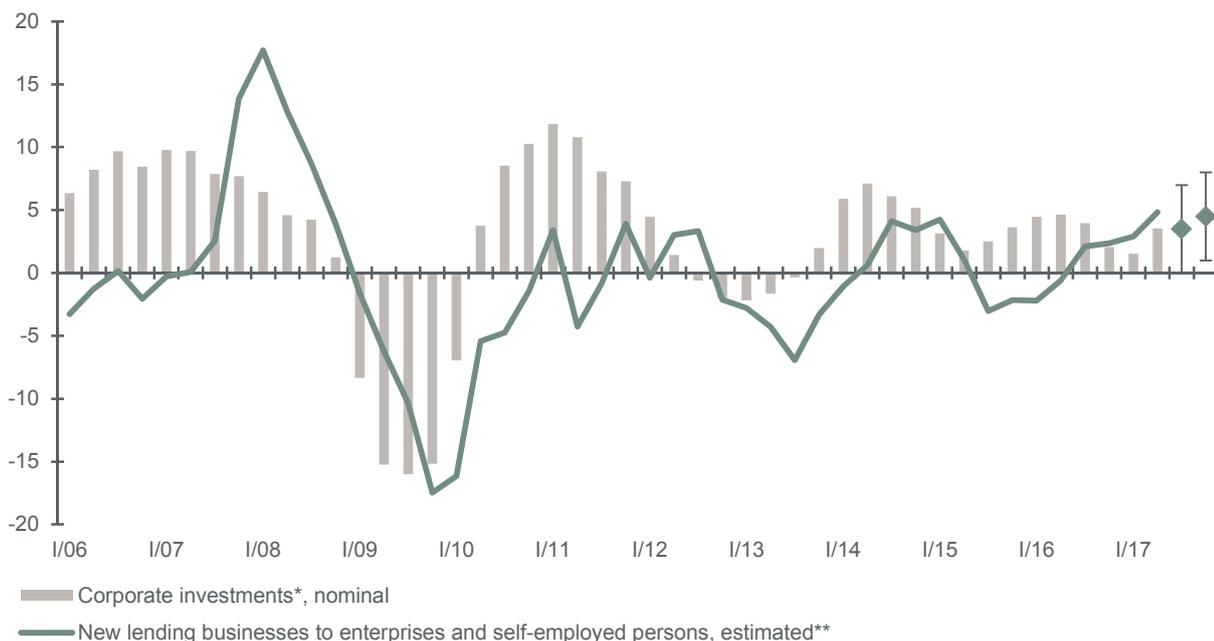
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- New lending to enterprises and self-employed persons (as defined by KfW Research) increased by 4.8 % year-on-year in the second quarter of 2017. That was the strongest growth since the financial crisis.
- Businesses continue to benefit from record-low interest rates, and only few have reported difficulties accessing credit.
- The prospects for corporate lending business remain good for the foreseeable future, driven by accelerating investment growth.

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

** excludes commercial housing loans and loans to insurance and financial institutions

Strongest growth since the financial crisis

KfW's estimates show that new lending from banks to businesses and self-employed persons (excluding residential construction and other financial institutions) picked up pace again in the middle of the year. In the second quarter it was up 4.8 % on the same period last year (moving growth rate across two quarters). Lending thus developed at a rate not seen since the beginning of the financial market crisis. At the time, the abrupt economic slowdown caused liquidity bottlenecks in businesses which they tried to bridge by taking up short-term loans. But the current revival of corporate

lending is of a fundamentally different nature. It reflects Germany's robust economic upturn, which is accompanied by continuing favourable financing conditions. There is a good chance that new lending business will grow at a vigorous pace into the year 2018. It remains to be seen whether the downward trend in the corporate lending market of the last 15 years will be broken on a sustained basis.

Borrowing costs remain low – terms and conditions have improved steadily

Businesses in need of credit currently have good bargaining

chips in their negotiations with banks. Credit is quite easily accessible: A mere 5% of businesses reported difficulties in the ECB's most recent SAFE survey. The terms and conditions of loan agreements are also exceptionally favourable. While the returns on German government bonds with longer maturities are now well above the lows they had tested in the middle of last year, the average costs of corporate loans remained on a record low level in the second quarter of 2017. For the remaining lending conditions such as maturities and ancillary borrowing costs, the banks made even better offers to their customers than at the start of year, according to their own responses to the Bank Lending Survey (BLS). This shows that the market for corporate loans is currently quite attractive for banks despite lower margins and the more stringent regulatory requirements of the last years. This is consistent with the fact that the banks reported intense competition for corporate customers in the BLS.

Businesses are investing more

Good lending conditions alone are not enough to stimulate lending as long as demand is not keeping up. For a long time, German companies were not drawn to the lure of low interest rates. This is now changing. The economic upturn is entering its eighth year, so production capacity utilisation is already high and rising. The very high business confidence levels should ensure that the urgently needed expansion of capital stock moves forward. We therefore expect corporate investment this year and next to accelerate noticeably. Businesses' financing requirements will also grow. The exit from the extremely loose monetary policy is drawing nearer at the same time, and so are higher financing costs. This should lend further impetus to credit demand, if only temporarily.

An end to the long-term downward trend in the credit market is not yet in sight

A glance at the long-term development of the credit market

shows that new loan commitments remain far below the level at the start of the millennium (see Figure 2). Since then, businesses have increasingly given preference to internal funding, strengthened their equity base, and avoided debt wherever possible. This trend is being accompanied with a lower investment-to-GDP ratio.

Figure 2: Loans to enterprises and self-employed persons

Indexed development of new loan commitments



Sources: Deutsche Bundesbank, KfW Research

It cannot be concluded that the current brightening has ushered in a fundamental trend reversal in the credit market. For that to occur, businesses would have to change their behaviour fundamentally. That remains to be seen. After all, they can continue to build on their great internal funding strength, especially since the tighter regulatory requirements combined with an economic slowdown might test the banks' lending propensity at any time. ■

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.