KfW Research
KfW Credit Market Outlook: October 2019

New lending business: all show and no go?

18 October 2019

Author: Dr Sebastian Wanke, phone +49 69 7431-9784, sebastian.wanke@kfw.de
Press contact: Christine Volk, phone +49 69 7431-3867, christine.volk@kfw.de

- Somewhat surprisingly, growth of new lending to businesses and self-employed persons picked up in the second quarter. It was up 7.1% year-on-year after a slightly downgraded 6.0% increase year-on-year in the first quarter.
- Moreover, new commitments for longer-term loans made a solid growth contribution to overall new lending. But the growing momentum is due to short-term loans – probably a temporary phenomenon.
- With the economic outlook dimming again and amid continuing high uncertainty which, as before, is due to the trade conflicts and the never-ending Brexit story, a decline in new lending growth will become increasingly likely, despite the most recent positive development.

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 has recently gained momentum

According to calculations by KfW Research, new lending to businesses and self-employed persons in Germany (without residential construction and finance institutions) grew by a surprisingly strong 7.1% yearonyear in the first quarter. Compared with the start of the year, when lending was growing only at a – now downgraded – rate of 6.0%, it shows renewed upward momentum that was already believed to be a thing of the past in this cycle. At first glance, new lending to businesses and self-employed persons thus appears to be in top shape. But a look at the details gives reason to doubt that this development is a sustainable one.

Longer-term loans are still growing strongly but short-term loans are the driver of the increasing momentum

According to our calculations, commitments for longer-term loans also grew strongly in the second quarter despite what has already been a rather sluggish business cycle in Germany over several quarters. This is a positive sign for a start. What has driven the increasing growth of overall new lending business compared with the previous year, however, are short-term loans. These are often used to bridge liquidity bottlenecks or to finance stockpiles, particularly in times of cyclical weakness. Should it turn out that the business cycle will not recover any time soon – and nothing suggests that this will happen –, businesses would probably stop applying for them. Instead, they would then lower their costs or reduce stockpiles and cut back production. Investment plans are also likely to be rolled back in such a situation, which typically dampens new long-term lending. The Deutsche Bundesbank's Bank Lending Survey cautiously points in this direction already. In the second quarter, business investment was already cited much less often as a motive for borrowing than at the start of the year.

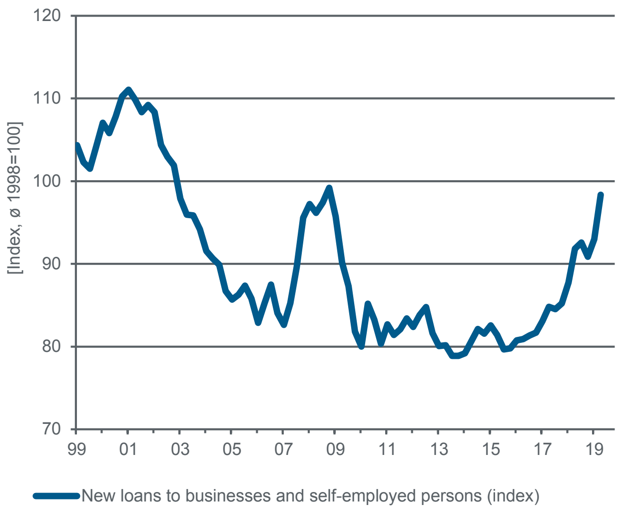
Forecasting is now much more difficult

The above observations should be understood as statements on current trends. What remains unclear is what will happen in each of the coming quarters. In the third quarter, for example, it is entirely possible that the undoubtedly still possible hard Brexit may have created strong demand from the United Kingdom, which would tend to deplete stockpiles in Germany and build them up on the other side of the English Channel. In the final quarter of this year, the reverse scenario could then occur. Demand from the UK could plummet as the buildup of stockpiles in Germany surges because production could not be cut back at the same pace. But there is also the possibility of a delay in Brexit and the expectation of its occurrence and, with it, the described variations in demand. And if a vigorous short-term build-up of stockpiles is also associated with short-term credit demand, the growth rate of overall new lending is also likely to fluctuate in the coming quarters – intensified by the trade disputes between the US and China and the problems of the German automotive industry, each of which also do not contribute to greater planning certainty.

Finally, let us look at the credit supply side. Here as well, new lending also shows signs of decreasing momentum. This is because the ongoing uncertainty about where the business cycle is headed amidst what has already been a significant cyclical downturn will probably cause banks to be more restrictive in their lending. The most recent Bank Lending Survey already shows signs of this.

Figure 2: Loans to enterprises and self-employed persons

Indexed development of new loan commitments



Sources: Deutsche Bundesbank, KfW Research

Outlook: Heading south with volatility

There is something positive about the currently anaemic business cycle and the lack of prospects for improvement, however. The general interest rate level has fallen once again and the ECB has returned to expansionary mode. Enterprises that are planning to apply for loans can continue to do so at historically favourable conditions. This circumstance may indeed create a situation in which the growth momentum of new lending business remains supported for the time being. However, when enterprises no longer see any prospects for growth, they cut back investments and, with them, demand for longer-term credit even in a low-interest environment. That is likely to be the fundamental driver of new lending, the growth of which we assume will start following a downward trend towards the end of the year.

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.