New lending to businesses on record level

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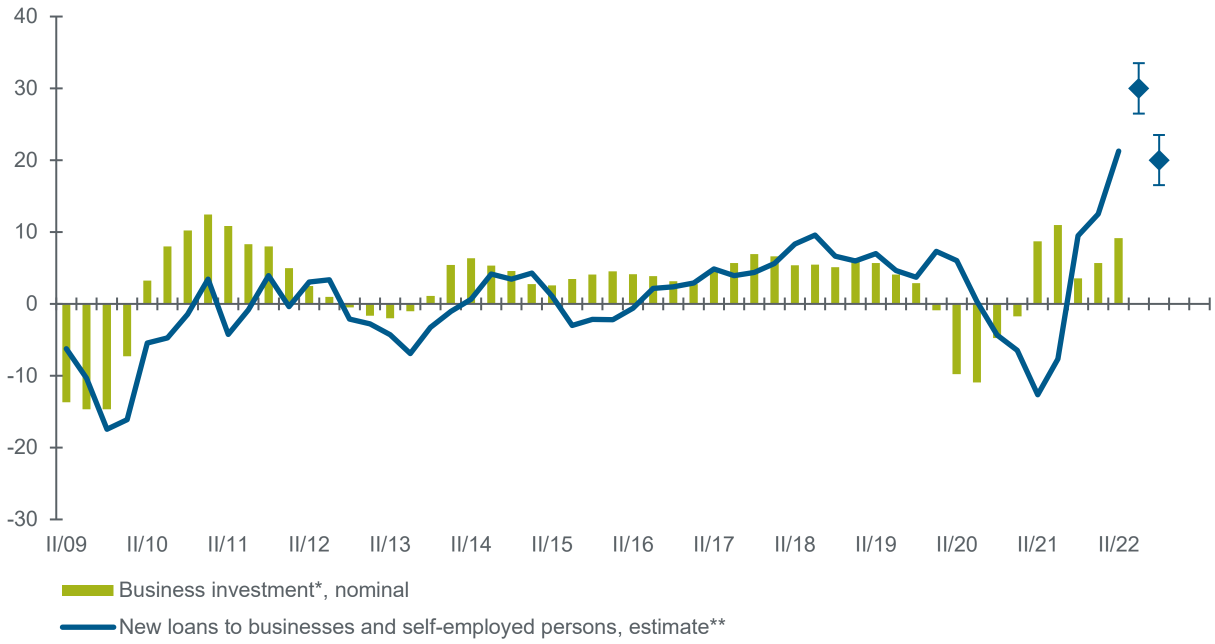
– German businesses and self-employed persons borrowed extensively from banks in the second quarter. KfW Research has calculated that new lending grew by a staggering 21.3% year on year, a new record high.

– The main driver was a combination of high funding requirements for working capital and inventories, as well as support for energy companies. Besides, lending at the same time last year was weak.

– At the same time, financing conditions for businesses are becoming increasingly difficult, with banks raising interest rates and significantly tightening their lending policies towards small and medium-sized enterprises.

– Along with a probable reduction in investment activity, these factors are putting a dampener on lending business. However, we expect high liquidity requirements to dominate the market until the end of the year and lead to new record high credit growth rates.

Figure 1: New lending by German banks and savings 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

Lending to businesses is growing at record speed
According to calculations by KfW Research, new lending to businesses and self-employed persons in Germany grew by a record rate of 21.3% year on year in the second quarter (see Figure 1). The previous high of 17.7% also occurred during a phase of economic crisis. The first quarter of 2008 already showed clear signs of the unfolding global financial crisis. At the time, worries over the future lending capacity of the banking system prompted businesses to secure sufficient finance as a precaution.[1] Given that banks are in good shape overall and have a sound capitalisation equity, such considerations are currently not likely to play a role. Rather, other factors are decisive, including the substantial loans KfW made to energy companies on behalf of the Federal

Government to secure gas supply. In particular, however, weak lending in the second quarter of 2021 pushed-up the year-on-year growth rate. But even without these two special effects, our estimates indicate that lending by German banks would still have grown very strongly by around 10%.

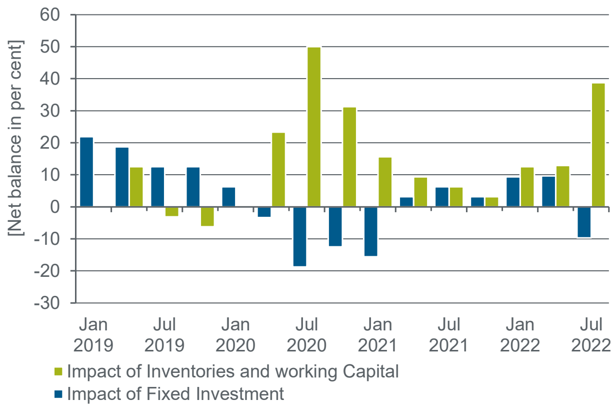
Opposing forces affect the credit market – driving factors have the upper hand

We are currently in an exceptional economic situation. This explains why businesses are taking on unusual amounts of additional debt despite the imminent recession. According to the banks surveyed under the Bank Lending Survey (BLS), increased funding requirements for working capital and inventories are the primary motive for borrowing (see Figure 2). This mainly reflects the continually increasing costs of intermediate goods and the massive rise in energy prices, which are putting a strain on businesses' liquidity planning. Moreover, in contrast to the international trend, material shortages remain acute in Germany,[2] making it more important to increase stockpiles to ensure a smooth production process. This, too, creates further funding requirements.

On the supply side, however, the imminent tightening of financing conditions is becoming increasingly apparent. Loan interest rates are rising continuously in the course of monetary tightening and amid expectations of growing default risks. In August, for loans with long maturities (>5 years), banks were already charging around 3% interest on small amounts (≤1 million) and around 2.6% on large amounts (>1 million). That was an increase of 150 basis points within a year. Besides, banks are becoming increasingly cautious in their lending. As the KfW Credit Constraint Indicator shows, small and medium-sized enterprises (SMEs) are already having major difficulties accessing credit. Thus, the share of SMEs that described the conduct of banks as restrictive climbed to a new high.[3]

Figure 2: Drivers of credit demand

From the Bank Lending Survey



Source: ECB Bank Lending Survey, KfW Research

New peak levels likely in the second half-year

We expect a strong need for liquid funds to adapt to the profound changes in economic conditions to shape the corporate credit market in the second half of 2022 as well. This is especially true of the energy sector. New lending could grow by as much as 25% to 35%. In the longer term, however, the more persistent influencing factors weighing on the development of lending activity are likely to prevail. Furthermore, the weak performance of the economy and the energy crisis are poison for investment activity. This is evident from the weakening demand for investment finance revealed by the BLS and from the significant reduction in planned investment by SMEs of around EUR 60 billion this year estimated by KfW Research.[4] Given the volatile crisis-laden environment and the dynamically evolving policy responses, forecasting the growth of lending is currently fraught with more uncertainty in than usual.

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] Cf. Rehbock, T. and S. Schoenwald (2008), Kreditmarkt spürt die Finanzmarktkrise – und expandiert… (Credit market is feeling the financial market crisis – and expanding… (in German), KfW Credit Market Outlook February 2008, KfW Research. Owing to a change in the statistical definition, the growth rate of new lending at the time cannot be directly compared with the growth rates mentioned in the text.

[2] ifo Institute (2022), Materialknappheit wieder leicht verschärft (*Material shortage has slightly worsened again* – our title translation, in German), press release of 30 September 2022.

[3] Schoenwald, S. (2022), Credit access has become significantly more difficult for SMEs, KfW ifo Credit Constraint Indicator Q3 2022, KfW Research.

[4] Schwartz, M. (2022), SMEs have largely digested the pandemic, but the war in Ukraine and the energy crisis are clouding the business outlook, KfW SME Panel 2022, KfW Research.