Businesses are borrowing less

14 December 2023

Author: Stephanie Schoenwald, phone +49 69 7431-6446, stephanie.schoenwald@kfw.de
Press contact: Christine Volk, +49 69 7431-3867, christine.volk@kfw.de

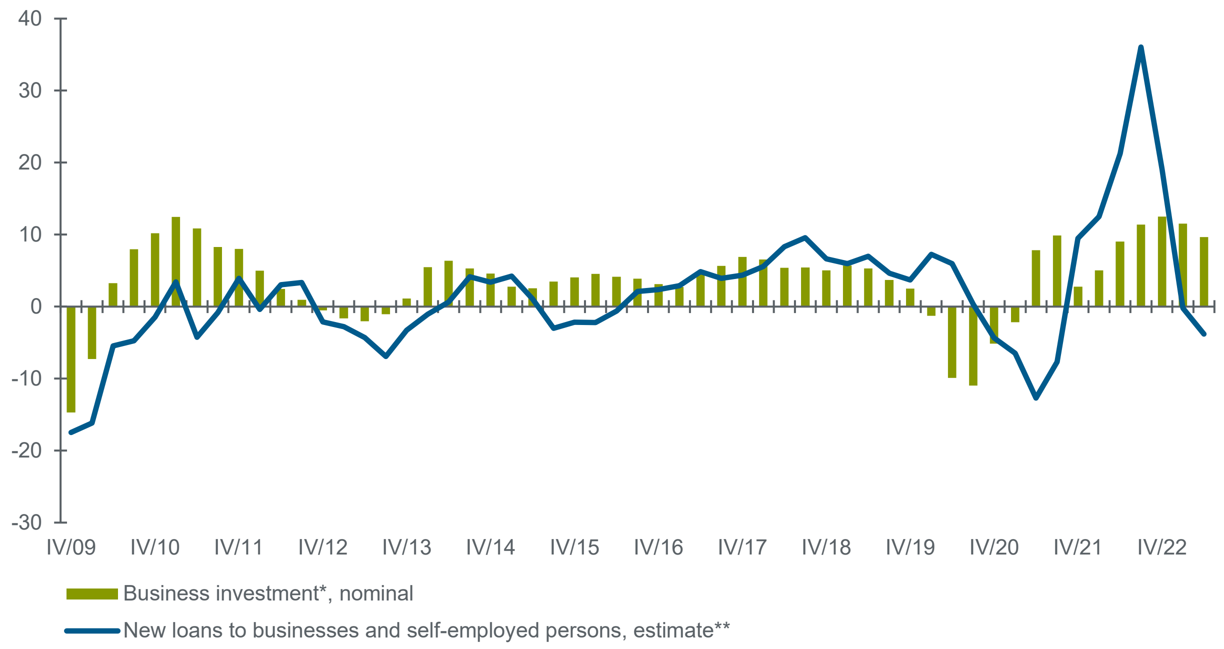
– New lending by German banks to businesses and self-employed persons in the second quarter remained 3.8% below the previous year's level. Third-quarter data points to a sharp drop of around 15% from the high lending volume in the same period last year.

– Surveys demonstrate that businesses remain reluctant to apply for new loans. While the easing of supply chain disruptions facilitates a sparing use of debt, rising investment expenditure has so far prevented a deep slump in credit demand.

– Financing conditions continued to tighten in the summer. Rising interest rates and slightly stricter lending criteria made it harder for businesses to obtain loans from banks.

– The decline in credit growth probably bottomed out already in the third quarter. Nonetheless, a double-digit contraction must also be expected in the autumn. In addition, the mix of high interest rates, weak growth and predominantly bad sentiment suggest that new lending will remain lacklustre into the new year.

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



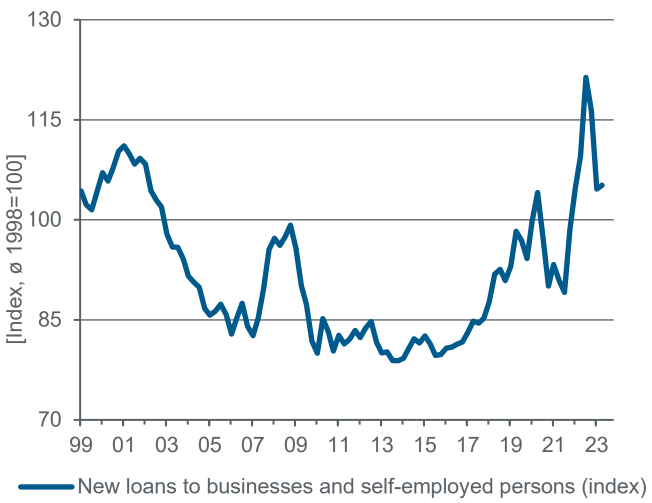
* non-public investment in equipment, industrial buildings and other facilities
** excluding commercial housing loans and excluding loans to financing institutions and insurance industry

Downturn in credit growth bottomed out in the third quarter

Lending from German banks to businesses and self-employed persons has continued to decrease. According to calculations by KfW Research, new lending from banks to corporate customers fell by 3.8% year-on-year in the second quarter of 2023. Thus, lending activity turned out slightly weaker than forecast. The downward trend looks to have accelerated significantly once again in the third quarter. Available monthly data on the credit market allows the conclusion that new lending plunged by around 15% on the previous year's period.[1] But most of this slump, which appears substantial at first glance, is due to the exceptional situation that prevailed in the comparison period. In the summer of 2022, the energy crisis in combination with supply chain disruptions had led to high financing requirements and record-high lending activity.[2] The indexed development of new lending commitments shows that although businesses have since then significantly reduced their borrowings, the downward correction at least bottomed out in the second quarter (see Figure 2).

Figure 2: Loans to enterprises and self-employed persons

Indexed development of new loan commitments (moving 2-quarter average)



Source: KfW Research, Deutsche Bundesbank.

Rising investment expenditure has so far been a stabilising factor for loan demand

Surveys among businesses and banks indicate that credit demand remains persistently weak or is even weakening further. Thus, the share of businesses that reported having been in negotiations on new loans with banks in the third quarter as part of the survey for the KfW ifo Credit Constraint Indicator dropped slightly from an already below-average level.[3] Financial institutions noted an even steeper decline in demand. In the Deutsche Bundesbank's Bank Lending Survey (BLS) a clear majority of banks recorded weakening interest in loans for the fourth consecutive quarter, with a net balance of around 23 percentage points. High financing costs likely reduced businesses' appetite for new debt. The rise in average loan interest rates continued in the summer, and in September, at 5.3%, interest rates were around three times as high as at the start of the year 2022. This presented considerably stronger incentives for businesses to optimise their financial and liquidity planning. The continuing improvement in the supply of raw materials and inputs is creating scope for keeping the financing of stockpiles and working capital on low levels. The share of German industrial enterprises with supply problems fell to 24% in September.[4] In the face of rapidly rising interest rates and difficult overall economic situation, business investment in the first half of this year showed itself to be quite resilient. During this period, businesses' investment expenditure increased by 9.7% compared with the previous year. In addition to increased prices, this was also supported by real growth in investment activity, which still remains below the pre-pandemic level.[5] Even if it must be assumed that companies are reducing the share of new loans in their funding mix wherever possible, the rebound in corporate investment should nevertheless have slowed down the decline in credit demand.

Banks tightened their lending criteria again

Contrary to what finance institutions themselves expected in July, according to the BLS, a majority of banks ended up tightening their lending policies for corporate loans again since the previous survey. The net balance remained on a moderate scale of around 10 percentage points. The sharp drop in the economic climate in the course of the third quarter likely played a pivotal role. Sentiment indicators embarked on a downward trend during that period. The development of the KfW-ifo SME Barometer is only one example of this.[6] Weaker economic assessments are causing banks to become more cautious in their lending. This is consistent with the development of the KfW ifo Credit Constraint Indicator, which surged for both large and small and medium-sized enterprises.[7]

New lending continues to drop, but the pace is slowing

The overall environment for the corporate credit market does not favour a rapid revival of new lending business. We expect the first interest rate cuts by the ECB not before the second half of 2024, and it will probably take a few months yet for economic growth to pick up pace again. In light of the predominantly bad sentiment, there is much to suggest that corporate investment activity is now losing momentum. There is little to stimulate lending activity. We therefore expect a sideways to slightly downward movement in new lending commitments to corporate customers. That will be sufficient to allow lending growth to rebound from the low of the summer quarter. However, a return to positive territory cannot be reasonably expected until sometime in 2024.

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] Overall monetary surveys, Germany's contribution, variations in adjusted loans to non-financial corporations, ECB time series: BSI.M.DE.N.A.A20T.A.4.U6.2240.Z01.E.

[2] Cf. Herold Estevez, J. (2022), Multiple shocks are driving record-high growth in new lending to businesses, KfW Credit Market Outlook 2022, KfW Research.

[3] Cf. Schoenwald, S. (2023), Challenges are mounting for businesses negotiating loans, KfW-ifo Credit Constraint Indicator Q3 2023, KfW Research.

[4] ifo economic survey, September 2023.

[5] Borger, K. (2023), Unternehmensinvestitionen 2023: trotz Anstieg noch unter Vor-Corona-Niveau (Business investment in 2023: still below pre-COVID level despite rise – in German only), KfW Research.

[6] Borger, K. (2023) KfW-ifo SME Barometer September 2023 – SME business sentiment is bottoming out, KfW Research.

[7] Cf. Schoenwald, S. (2023), loc. cit.