

»» New lending is on a bumpy path to growth

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- In Germany, new lending to enterprises and self-employed persons (as defined by KfW Research) grew by 1.0% year-on-year in the third quarter of 2016. That was the first increase since the spring of 2015.
- This comes as a positive surprise as after the Brexit vote lower growth over the summer would definitely have been plausible.
- Looking ahead, the high level of business confidence in Germany is an encouraging sign for new lending. However, enterprises' muted investment activity and political uncertainties on both sides of the Atlantic have a dampening effect.

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

Surprisingly positive momentum in the third quarter

KfW's estimates indicate that in Germany new lending from banks to businesses and self-employed persons (excluding residential construction and financial institutions) rose by 1.0% in the third quarter of 2016 compared with the same period last year (moving growth rate over two quarters). That was the first increase since spring 2015. This revival in new lending comes as a bit of a surprise as it falls on the months immediately following the Brexit vote. The obvious thing for businesses to do would have been to take this event as a reason to temporarily postpone borrowing decisions. Monthly ECB statistics (based on slightly different definitions) indicate

that this was in fact the case in July. But after the dust had settled over the UK referendum, lending evidently picked up, ultimately bringing new lending for the overall quarter a tad above the previous year's level. What is remarkable is that new lending was mostly in the form of long-term loans which businesses use primarily to finance capital expenditure. This could be a cautious sign that corporate investment is coming back to life at the end of the year after two weak quarters.

Borrowing environment remains very favourable

Another positive factor is that the situation on the credit supply side continues to be very good. This is illustrated by

the Ifo Credit Constraint Indicator, which was on a historically low level in autumn. Over the past months, only around 14.5% of the surveyed businesses reported having difficulties accessing credit. Furthermore, according to Deutsche Bundesbank's Bank Lending Survey, conditions were eased yet again in the third quarter. The surveyed credit institutions reported that lower margins were the main driver. Collateral requirements were also eased, as were covenants. Competition was cited as the strongest factor influencing these developments.

But investment activity leaves little room for fantasies

According to the Bank Lending Survey, banks continue to expect credit demand to pick up in the final quarter of 2016. In general terms we, too, are cautiously optimistic in this regard. Given the recent marked rise in business confidence – as reflected in the Ifo business climate indicator, for example – we expect Germany's GDP growth to accelerate and corporate investment to pick up. The latter, which correlates relatively closely with lending, however, was disappointing in the past two quarters and contracted in real terms. This shows that trees don't grow into the sky and that one should not read too much into this summer's growth in new lending business. Besides, the political uncertainty on both sides of the Atlantic has trended upward in the past weeks, which should have a dampening effect on credit market dynamics.

Loan portfolios: residential construction loans are still booming

As a cross-check, looking at the development of loan portfolios validates our analysis of new lending business. Loans to businesses and self-employed persons excluding residential construction and financial institutions show subdued portfolio growth (see figure). Once again, the strong expansion of the residential construction loan portfolio stands out among loans to enterprises and self-employed persons.

New lending to enterprises and self-employed persons

Indexed development of loan portfolio



Source: Deutsche Bundesbank, KfW Research

Conclusion: a bumpy ride to growth

New lending to enterprises and self-employed persons developed nicely in the third quarter as borrowing conditions improved further. Looking ahead, there is reason to be optimistic as the German economy is presenting itself in very robust shape. Nevertheless, the new lending growth last observed in the annual rate of change will likely become more muted again soon for two reasons (see also figure on page 1). The first reason is one of fundamentals: it does not fit the overarching, relatively meagre setting of corporate investment and heightened political uncertainty (surrounding the USA, the UK and Italy). The second reason is purely technical: the first quarter of this year was a particularly strong one – in absolute figures – for new lending business. It should therefore come as no surprise if its annual growth rate falls back into negative territory again in early 2017. The ride to growth thus remains a bumpy one. ■

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.