

»» Momentum on Germany's corporate lending market remains strong

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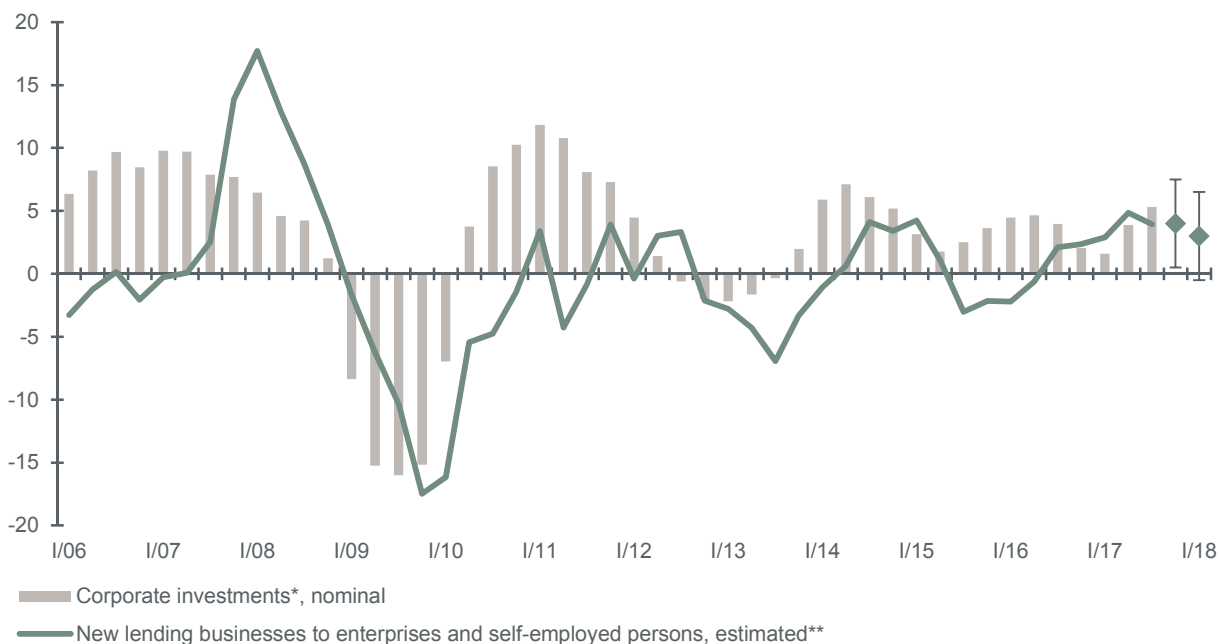
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- In the third quarter of 2017, new lending to enterprises and self-employed persons (as defined by KfW Research) increased by 3.9% year-on-year.
- New lending growth has thus slowed somewhat recently. Nevertheless, the trend on the corporate lending market can still be described as dynamic.
- The outlook remains good. This is due to the combination of a strong business cycle with increasingly tighter capacities and continuing outstanding lending conditions amid predictably rising lending costs.

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

Growth dips slightly, but remains on a high level

KfW's estimates for Germany indicate that new lending from banks to businesses and self-employed persons (excluding residential construction and finance institutions) rose by 3.9% year-over-year in the third quarter (moving growth rate across two quarters). Lending was therefore slightly less dynamic than in the previous period, when the rate was 4.8%. Still, the growth of new lending to enterprises remained clearly above-average for the post-financial crisis period. We also expect final quarter dynamics to be as strong as or slightly stronger than in the previous quarter. In early

2018 though, the year-on-year growth rate should slow. But that would not result from a drop in momentum at the current juncture but from the strong development last year: new lending had picked up sharply in the first quarter of 2017. That created a noticeably higher base which will generate a dampening effect on the annual rate.

Conditions are almost too good to be true

How do we arrive at this assessment? If we had to put it into a few words we could say: all signs are pointing upward. On the credit supply side, lending conditions remain outstanding.

Note: This paper contains the opinion of the authors and does not necessarily represent the position of KfW.

Despite the cautious interest turnaround on the capital market since autumn 2016, enterprises' borrowing costs remain on record low levels. At the same time, the Bank Lending Survey indicates that credit institutions are tending to further loosen their criteria when granting loans in response to high competition.

A number of factors point to continuing high new lending momentum on the demand side as well. One of them is the strong business cycle, perhaps best reflected by the ifo business climate index, which is smashing records. Another reason is that capacities are being increasingly stretched. The unemployment rate of 5.6% has dropped to a level not seen since Germany's unification and the capacity utilisation rate is above its long-term average. In such a situation, in which businesses also have positive expectations (see also the Ifo survey), investing is an obvious choice in order to create necessary capacity. If such investment is to be loan-financed, the current phase looks almost ideal. The interest turnaround has already set in cautiously and should pick up soon as a result of the ECB's exit from its asset purchase programme. But as mentioned, borrowing costs remain, for the time being, on record low levels.

Own funds reduces lending momentum

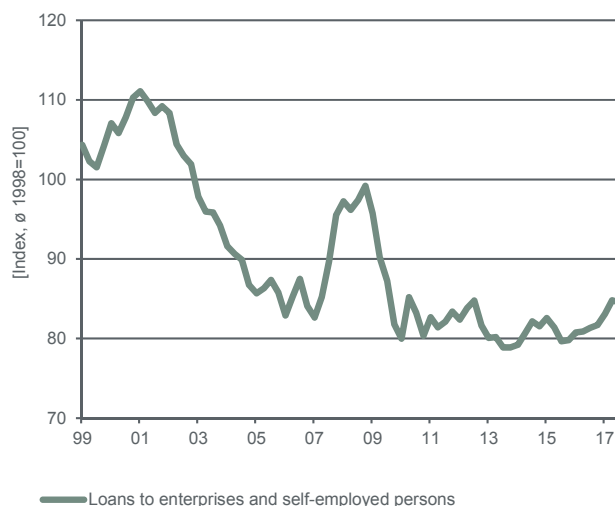
In what is outlined here as the best of all credit market worlds, there is only one catch: enterprises' abundant own resources. It makes them relatively independent of loans to finance their investments. Own funds should thus be a major reason new lending growth has not turned out even higher in light of the excellent conditions described above. But there is also an upside to this slightly muted development: There can be no talk of a bubble on the corporate lending market despite the booming business cycle. Rather, the growth rate currently looks very healthy.

Long-term trend in the credit market is bottoming out

At this point we have recently asked ourselves whether the long-term downward trend of new corporate lending has ended (see Figure 2). Our verdict at the end of summer was mixed, particularly with a view to using own resources for investment finance.

Figure 2: Loans to enterprises and self-employed persons

Indexed development of new loan commitments



Sources: Deutsche Bundesbank, KfW Research

The renewed positive figures in the third quarter have boosted our confidence that, in a long-term analysis, the trend has at least entered a phase of stabilisation. And if this assessment remains fraught with some uncertainty, we can nevertheless say with a relatively high degree of confidence: At least in the near future, new corporate lending will remain vigorous! ■

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.