

## »» Lending calms at the beginning of the year

24 April 2019

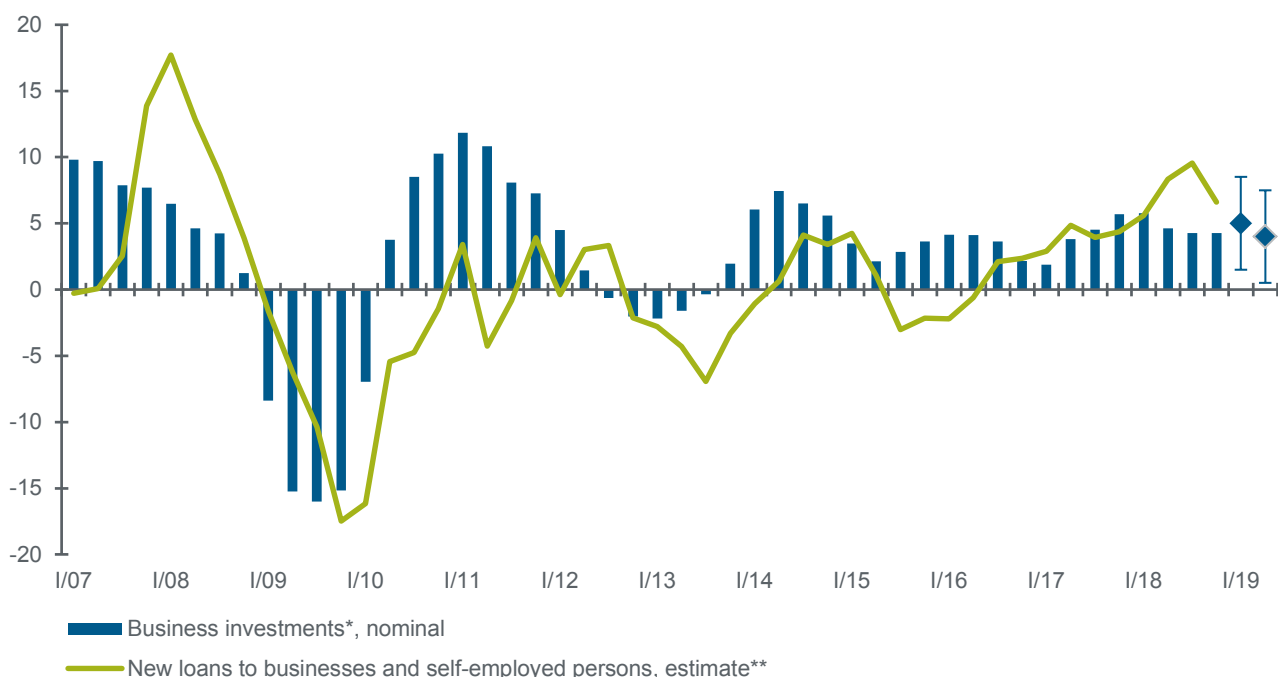
Author: Stephanie Schoenwald, phone +49 69 7431-6446, stephanie.schoenwald@kfw.de

Press contact: Christine Volk, phone +49 69 7431-3867, christine.volk@kfw.de

- As expected, new lending to businesses and self-employed persons slowed somewhat in the fourth quarter but remained strong, up 6.6% on the previous year.
- Businesses' investment expenditure and the associated demand for finance increased steadily, which is unusual for a period of cyclical weakness. Consistent with this, long-term lending even gained momentum again.
- Short-term lending decreased noticeably. This is probably largely attributable to reductions in inventories, which had swollen in the preceding quarters.
- Credit momentum has likely passed its peak and will probably decrease further in the months ahead. Businesses' current pessimism indicates increasing investment restraint, even if favourable financing conditions continue to set strong incentives.

**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 fixed assets

\*\* excluding commercial housing loans and excluding loans to financing institutions and insurance industry

### Credit momentum has begun to normalise

In general, the past year has been exceptional for the credit market. KfW estimates that new lending to businesses and self-employed persons in Germany (excluding residential construction and finance institutions) grew by 7.5% in 2018. Driven by short-term lending as an accompanying effect of the slowing business cycle, lending reached a new ten-year high in summer with growth rates of almost 10%. Towards

the end of the year, as expected, new lending returned to a somewhat slower pace. The growth rate in the fourth quarter dropped to 6.6% year-on-year (moving average over two quarters) and is now more aligned with the trend of nominal business investment. Nevertheless, credit expansion can still be regarded as clearly above the average of the recent past.

### Credit demand is motivated more by investment

Because of the unexpected economic slow down, enterprises were unable to sell as much as planned in spring and summer. This was compounded by the disruptions in the automotive industry caused by the conversion to the new WLTP emissions testing protocol. These two factors forced enterprises to expand their inventories and short-term financing. As we know from the national accounts on the fourth quarter, this trend is now reversing. Inventories were emptied towards the end of the year, which is consistent with the slowing momentum that is observable in new lending with shorter maturities.

In contrast, lending with maturities of more than five years has accelerated. This is due to the robust investment activity of businesses, which did not let the cyclical slow down deter them from realising their investment plans (see Figure 1). The findings of the January Bank Lending Survey (BLS) confirm this assessment. More of the financial institutions surveyed reported growing credit demand for investment purposes for the fourth quarter. This is unusual for an economic downturn and indicates that businesses believe the fundamental state of the German economy is sound. Furthermore, low financing costs and favourable credit conditions are good arguments for the decision to expand or modernise tight capacities now.

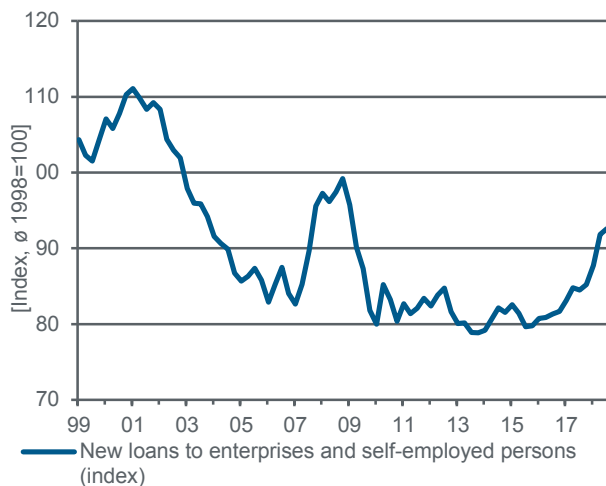
### Slower credit growth reduces concerns over financial stability

The episode of lively credit growth since 2016 has fueled concerns over growing and underestimated credit risks. As it presented its Annual Report in late February, the Deutsche Bundesbank pointed this out and indicated the possibility of imposing additional capital requirements in the form of an anti-cyclical buffer to dampen credit momentum. It will probably take some time before this may occur, however. The most important indicator for this decision is the credit-to-GDP gap, the difference between the credit-to-GDP ratio and its long-term trend. Only when the threshold of 2% is exceeded does the lending momentum signal the requirement of an anti-cyclical capital buffer in accordance with regulatory guidelines. Currently, however, there is still a

negative gap in the credit market after the lull of many years. A moderation in credit growth is nevertheless welcome for stability reasons. At any rate, we consider the level of new lending to be sound based on the long-term comparison (see Figure 2) and see a good chance of more moderate but sustainable growth.

**Figure 2: Loans to enterprises and self-employed persons**

Indexed development of new loan commitments



Sources: Deutsche Bundesbank, KfW Research

### Outlook: Lending will continue to grow but at a more leisurely pace

There is nothing to indicate a fundamental trend reversal in the credit market but growth is likely to be slower in the first half of the year. The BLS shows that banks expect credit demand to grow at a slower rate compared to the second half of 2018, a view that we share. After all, continuing uncertainties such as Brexit and trade conflicts have made businesses more pessimistic. We therefore must expect greater investment restraint. Besides, the growth slow down is making banks slightly more cautious as well. The easing of lending conditions has come to a standstill. ■

### 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.