

Weak investment activity is limiting the recovery of lending

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- The slump in business investment hampered the recovery of lending to corporates in the second quarter. Estimates by KfW Research show that new lending from German banks to enterprises declined by 2% from the previous year's level, after falling by 3% in the previous quarter.
- The renewed decline in confidence across the economy and the reluctance of businesses to invest will dampen new lending in the future as well. Lower financing costs enabled by the monetary easing cycle, on the other hand, are a factor that will support the recovery of new lending.
- Given the low volume of lending during the reference period, moderately positive lending growth can be expected again for the first time in the third quarter.

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

Recovery of new lending has slowed

The recovery of lending to businesses stalled in the second quarter of 2024. KfW Research has calculated that new lending from German banks to businesses and self-employed persons fell by 2% on the previous year and therefore contracted at a slightly lower rate than in the first quarter (-3%). The downward trend seen since the low of autumn of 2023 thus continued at a slow pace, just as KfW Research had expected.¹ The volume of new lending grew for the second

straight quarter. But a clear trend reversal is still far away. After the hopeful start at the beginning of the year, the German economy has slowed down again. Business sentiment has clouded over again noticeably since May.² Subdued aggregate demand at home and from abroad, associated sales difficulties and cost increases from wage adjustments have put businesses under pressure. In this environment, corporate investment collapsed in the second quarter. Price-adjusted businesses' investment expenditure was down 2.8%

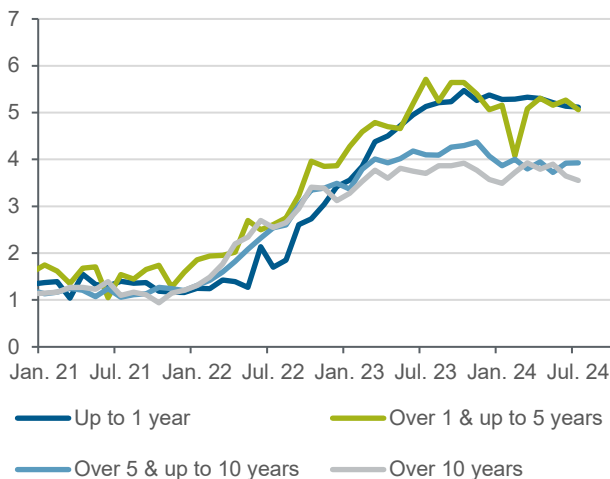
compared with the previous quarter. Lending activity has remained steady despite the low financing requirements for investments, a possible sign that businesses have experienced a growing need for funds to finance inputs for consumables and stockpiles.

Declining investment appetite and economic weakness are limiting financing needs

According to survey findings by KfW Research, macro-economic factors and structural challenges currently play a particularly important role in businesses' investment decisions.³ The weak external environment and meagre business prospects will dampen businesses' investment activity in the second half of the year as well. Furthermore, economic uncertainty around challenges such as skilled labour shortages, high energy prices and the need to decarbonise will prompt businesses to defer investment decisions.⁴ A clear and reliable framework can help to improve the investment climate in the longer term. Overall, businesses' investment expenditure can hardly be expected to act as a stimulus for lending until the end of the year. Still, the economic rebound expected for next year is also likely to lead to a relevant increase in business investment.

Figure 2: Credit interest rates for non-financial corporations

Effective interest rates on different maturities, in per cent



Source: ECB, 2024

Financing conditions are improving as a result of the interest rate reversal

Even after the monetary easing began, credit interest rates for businesses remained on a high level up until July. Only the very long-term credit interest rates (>10 years) fell slightly. The declining inflation rate in August will likely prompt the ECB to make further rate cuts up until the end of 2024 and bring about reductions of medium and short-term interest rates in particular, which are still well above the longer-term interest rates (>5 years). Falling financing costs are likely to provide a moderate boost to credit demand from businesses. However, the banks' supply policy with regard to passing on key interest rate cuts remains decisive for companies when it comes to interest rate conditions.

Banks are leaning towards more restrictive lending policies again

After adopting stricter lending criteria during the monetary tightening last year, banks reported in the Bundesbank's July Bank Lending Survey (BLS) that they had tightened their conditions only minimally. However, there are signs that this trend towards looser criteria is reversing and lending standards for businesses may become more stringent again in the third quarter. Credit risks are growing as a result of the economic downturn and the share of non-performing business loans in the bank books has already increased significantly, because of increased insolvencies.⁵ Banks are generally well capitalised but the increase in businesses facing payment difficulties is likely to prompt them to adopt a more cautious approach to lending.

New lending is stabilising, a stronger rebound is unlikely until 2025

The prospects for a swift recovery in new lending clouded over in the third quarter. The macro environment as a decisive influencing factor for credit demand from businesses⁶ deteriorated in the summer. Businesses will remain hesitant to borrow until the economic situation brightens noticeably. In particular, their reluctance to invest will continue to prevent a strong rebound in lending. But the increased need for liquidity which businesses typically have in a phase of economic weakness is likely to prevent a slump in new lending. Given the low volume in new lending in the reference period of 2023, new lending in the third quarter will grow by one per cent on the previous year's quarter. In the final quarter of the year, the monetary policy easing measures will favour the growth of new lending and enable growth in a similar order of magnitude. Risks to the forecast of lending business are, in particular, the widening of the geopolitical conflict in the Middle East, the outcome of the upcoming US elections and a deep recession.

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 Körner, J. (2024) New lending slowly recovers, [KfW Credit Market Outlook July 2024](#), KfW Research.

² Borger, K. (2024) SME sentiment: a bit of light and still a lot of darkness, [KfW-ifo SME Barometer August 2024](#), KfW Research.

³ Schwartz, M. and Gerstenberger, J. (2024), Zinswende mit überschaubarem Zusatzeffekt auf die Investitionen im Mittelstand (Interest reversal with moderate additional effect on SME investment – in German only), [KfW Research, Focus on Economics May 2024](#), KfW Research.

⁴ Nagel, J. (2024) Deutsche Wirtschaft: Herausforderungen meistern (*German economy: Mastering the challenges* – our title translation, in German), [Speech at the invitation of the Verband Die Familienunternehmer](#) 24 September 2024

⁵ European Banking Authority (EBA) (2024), [Risk Dashboard Q2 2024](#).

⁶ Deutsche Bundesbank (2024) Developments in loans to enterprises in Germany since the start of the monetary policy tightening cycle, [Monthly Report July 2024](#).