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Talking Point

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Is lending tight? Financing conditions for German companies

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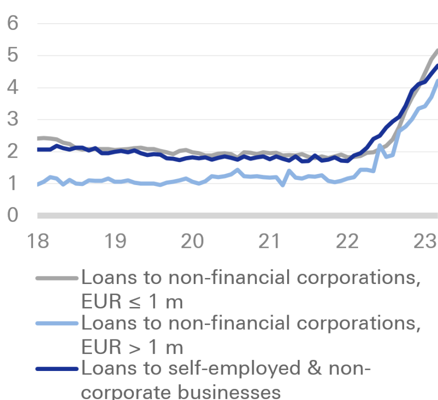
Corporate lending is slowing substantially but this is primarily a normalization and due to subdued demand at least as much as it is due to supply conditions, i.e. banks' tighter credit standards. At +8% yoy, credit expansion is still substantial. Only two industries are currently seeing a contraction. More worrying is the drying up of the corporate bond market where net issuance has collapsed since autumn. It is suffering from the double whammy of much higher interest rates and the disappearance of its dominant buyer of recent years, the ECB.

Have financing conditions for firms now become too restrictive, one year after interest rates started to rise in Europe? On face value, loan growth in Germany is indeed down sharply. For non-financial corporations, from a peak of 13 ½% yoy in September to 8% in March. The Q3 2022 figure had been boosted by a unique mix of inflation, recession fear and emergency loans to energy companies. These factors have been clearly abating in the meantime. Essentially, outstanding credit volumes have been flat over the past half year. On a side note, the development of residential mortgages has been somewhat similar, with the growth rate down from more than 7% in May 2022 to just 4 ½% currently.

Corporate lending rates, by loan size

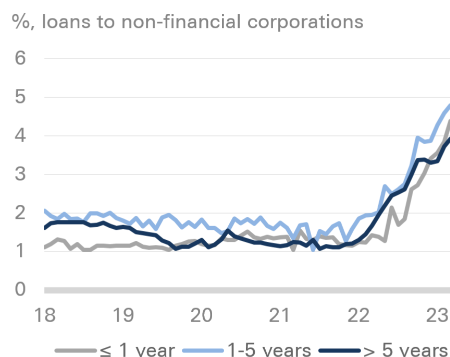


Source: ECB

Should this be a cause for concern?
So far, probably not too much, for several reasons:

1. The slowdown follows on a long boom. Corporate loans increased by 41% between 2016 and 2022, while the real economy grew by only 23% (in nominal terms). As a consequence, the total outstanding debt of the corporate sector – which also includes bonds or trade payables – rose from 64% of GDP to 73% (as of Q3 22). In that sense, a normalization in corporate lending, or even a temporary stagnation, does not need to sound the alarm bells.
2. Banks have tightened lending standards moderately in the past three quarters, yet lower demand may have had at least as big an impact. In the bank lending survey, a net 19% (Q3 & Q4 22) and 16% (Q1 23) of German banks reported stricter credit standards for companies, compared to the previous quarter. This is a meaningful share but far below the figures reached in the financial crisis (of up to 50%) and even then, Germany did not suffer a real credit crunch. Also, only 13% of banks expect to tighten lending standards further in Q2. Weaker demand may thus play no smaller role. In Q4 and Q1, 32% and 26% of banks, respectively, saw a reduction in demand from firms, which was even more pronounced for long-term loans.

… by rate fixation period

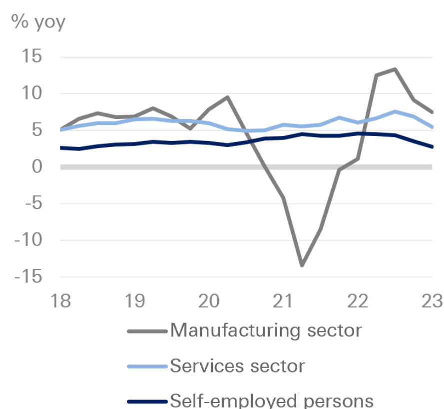


Source: ECB

This was mainly due to the dampening effect of higher interest rates and lower investment spending.

3. Speaking of higher rates: they have certainly contributed significantly to the moderation in lending. The increase over the past 12-15 months is unprecedented in modern times. However, it also began at an unprecedentedly low starting point, and the current level is nothing more than a return to the long-run, pre-financial crisis "normal". Indeed, banks have not even passed on the full size of the ECB's rate hikes to their customers (at least, not yet), shielding them somewhat from the tightening. While policy rates had climbed by 3.5 pp up to March, German banks' corporate lending rates rose by only about 3 pp.
4. More worrying than the gradual softening of bank lending may be the sharp deterioration in the corporate bond market. Net issuance by non-financial corporates in Germany fell to zero in Q1, the weakest start to a year since 2008. This follows an already anaemic Q4 (EUR 1.3 bn). The market has not only been hit by higher interest rates, but also by the disappearance of its preeminent backstop, the ECB, which ended its net purchases of corporate (as well as other) bonds last June after starting its first such quantitative easing programme in summer 2016. Over these years, the market may have got used to its buyer of last resort, who accumulated no less than EUR 391 bn in corporate bonds alone. On the other hand, the combined net issuance by non-financial corporations in the euro area amounted to only EUR 455 bn in that period.[1] Settling into a new free-market equilibrium without the central bank's "big helping hand" could turn out to be more difficult for the bond market (and therefore corporate issuers) than for banks' lending business. The silver lining may be that the latter continues to be more important than the former as a source of funding for European firms. Moreover, the weak issuance corroborates the assessment that lower corporate financing needs are an important driver of the slower corporate lending.

Loans to domestic companies and self-employed persons by industry



Sources: Bundesbank, Deutsche Bank Research

Regarding lending by sectors, Bundesbank data (slightly different from the ECB numbers above which do not include self-employed persons) indicate a broad-based slowdown, but no crash. Loans to the services sector expanded by a still solid 5.5% yoy in Q1, while loans to manufacturing firms were up by 7.5%, following a surge last year (as in 2020). In line with more moderate momentum in the past, loan growth with self-employed is modest currently (+2.8%). Nevertheless, across all industries, only rubber/plastics and agriculture are in an outright credit contraction, which together account for not more than 3.9% of the overall market. Even leaving aside the impact of the Q3 surge on yoy figures, loan growth in Q1 was substantially weaker than usual, but lending volumes rose in most industries compared to end-December.

[1] Both figures are not directly comparable though, as non-bank financial institutions accounted for a limited proportion of the bond purchases, but are not included in the issuance data of non-financial companies.

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