



Study on Credit Business Credit Business in a State of Flux – How Much Money is Required for Economic Growth?

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Prospects for economic growth in 2014 and 2015 are improving, especially exports and investment activities should accelerate

For the moment, credit demand still remains weak due to strong corporate cash positions and more extensive use of the bond market

No credit crunch, but a 'demand crunch': whereas credit growth of 1.1% was required for every 1% of GDP growth prior to the financial crisis, currently only 0.3% are needed

Erste Bank und Sparkassen expect however that in light of the accelerating recovery, **credit volume is going to rise over the coming two years** – especially in the corporate sector

71% of all external financing is funded with bank loans

Erste Bank und Sparkassen intend to contribute to the economic recovery and will do so by becoming more active in corporate financing. In the first quarter of 2014, the Sparkassen Group has extended almost 15% more in new loans than in the comparable period last year (Q1 2014: EUR 2.25 bn., Q1 2013: EUR 1.96 bn.)

The future of the credit business is often discussed in the context of an alleged credit crunch. Erste Bank und Sparkassen regard the reluctance of borrowers as the reason for weak credit growth. A study by Macro - Consult on behalf of Erste Bank und Sparkassen shows that prior to the financial crisis, 1.1% in credit growth was required to produce 1% in GDP growth. Today only 0.3% are needed. The reasons are strong cash flows, the still subdued willingness to invest on the part of companies, as well as increased use of the bond market. Bank credit still plays a dominant role though, as 71% of all external financing is comprised of bank loans.

Fresh momentum in Austria's economy

The global financial and sovereign debt crisis has been largely overcome, if not yet completely. After weak economic growth last year (+0.4% real), somewhat stronger growth is expected in 2014 and 2015: GDP is forecast to grow by 1.7% in 2014 and 2% in 2015, goods exports are to grow by around 5% in both years, and investment by 4%. Consumer demand is expected to expand at a moderate pace of 0.8% in 2014 and 1.1% in 2015. According to WIFO and IHS, price increases are likely to remain within the current range at approximately 1.8% (2014) and 1.9% (2015) respectively. Forecasts for the unemployment rate vary. WIFO predicts an increase to 5.3% in 2015 (2013: 2.9%), while IHS and the European Commission expect a decline to 4.7%.

Corporations are focusing on bank loans and bonds

In the fourth quarter of 2013, the total liabilities, of Austrian companies, i.e., owner's equity and debt, amounted to almost EUR 752 billion. In terms of external funding, companies focused mainly on long term bank loans. These amounted to EUR 224.3 bn., comprising 58.6% of external financing. 12.2% were comprised of short term loans amounting to EUR 47.1 bn. This means that overall, 71% of all external financing was covered by bank loans. In addition, corporate bonds have increasingly gained in importance over the past 15 years: While in 2000, financing through bonds amounted to EUR 17.4 bn., this has increased to EUR 64.3 bn. by 2013. Self-financing amounted to

EUR 368.9 bn. in total, resp. 49.1%. The largest share of this was comprised of other equity securities (shares in limited liability companies and stocks).

Due to strong corporate cash flows and the bond market, significantly less credit growth is currently required to produce economic growth than previously

Strong cash positions and the structural change of society due to globalization and the digitization of all spheres of life, have produced a remarkable discontinuity in the relationship between credit growth and economic growth. The elasticity of credit relative to gross domestic product, - this is to say, the ratio of credit growth to GDP growth – has decreased from 1.1% to 0.3% over the past five years – a decline of two thirds. This means that economic growth of 1% of GDP requires only 0.3% of credit growth today as opposed to 1.1% 5 years ago. Weak credit growth is not the result of a credit crunch, but the result of weak credit demand.



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“This is a snapshot of the current moment and certainly won't stay that way. Everybody is waiting for a strong recovery, but investment activity remains muted so far. Companies aren't exactly breaking down our doors just yet. However, in the first quarter of 2014, we have granted 15% more new loans than in the comparable period last year. Our doors are wide open, we are perfectly willing to provide financing”, says Peter Bosek. In the first quarter of 2014, the Sparkassen Group has extended EUR 2.52 bn. in new loans, in the comparable period last year the amount was EUR 1.97 bn. Credit demand by private households is inhibited by the weak trend in income growth and rising unemployment. Muted credit demand on the part of corporations can at the moment primarily be attributed to their strong cash flow situation and self-financing capacity. Large corporations are moreover increasingly relying on bond market financing or borrower's loan notes.

As the economic recovery gains pace, an increase in credit volume is to be expected

Based on expected nominal economic growth of 3.1% in 2014 and an elasticity of 0.3%, credit growth is calculated to amount to 1% in 2014 after a decline of 1.3% last year. The growth in credit volume should accelerate to 1.7% in 2015. Even stronger growth is expected for corporate credit in both years (2.6%, resp. 3.6%).

Lending conditions are especially favorable at the moment

Peter Bosek: “There is no credit crunch, that is utter nonsense. The Sparkassen Group is willing to and is going to provide a contribution to the economic recovery by becoming more active in corporate financing.” The Sparkassen sector's market share has increased from 15.7% in 2006 to 17.1% in 2013.

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