

Credit financing during the COVID-19 crisis demonstrates the efficiency of locally active banks

- „House” banks stand by their customers even in times of crisis.
- They thus soften capital market volatilities and stabilize the economy.
- Sparkassen and Landesbanken act under market conditions and apply strict standards of risk assessment.

The current disruptions to the real economy provoked by the COVID-19 outbreak have proven that businesses cooperate closely with the locally rooted banks in their region – just like they did in 2009. The short-term solvency and long-term viability of successful business models, in particular those operated by small and medium-sized enterprises, can only be ensured by bilateral loan agreements and a nationwide network of locally active banks (“house banks”).

Loans are the most important source of finance for European businesses. This is demonstrated by the ECB’s latest Bank Lending Survey (BLS)¹, which showed that many eurozone countries witnessed an increase in demand for loans in the first quarter of 2020; this demand is expected to increase further in the second quarter.

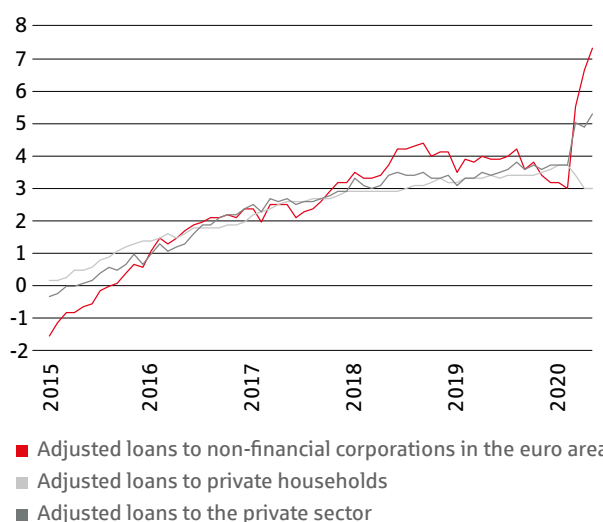
The concept of principal banks is proving its worth in times of crisis

In Germany too, the demand for loans has grown significantly. The expansion of new lending activities with enterprises and self-employed individuals accelerated considerably in Q1/2020. In Germany, credit institutions granted 7.3 percent more loans than in the previous year.²

Between March and May, Sparkassen provided a total of approx. EUR 30 billion in new loans to their SME clients. Loan commitments made to enterprises since the beginning of the year are 22 percent above the previous year’s level. In April and in May, commitments were even 39 percent and 35 percent higher year-on-year. Loan commitments made since the beginning of the year thus amount to EUR 44.6 billion to support local SMEs.

In lending operations, it is important to protect borrowers from becoming financially overstretched. This applies, for instance, to enterprises that heavily depend on cash flow. It also applies to self-employed individuals who directly depend on the income they earn for their living. They are among the groups who can quickly reach their financial limits when they have to keep up

Lending business by type of credit in the euro area, year-on-year percentage changes, seasonally adjusted



Source: ECB

regular redemption payments. It is therefore important and right to provide relief with the help of government programmes by KfW (Kreditanstalt für Wiederaufbau).

A total of 29,000 applications for COVID-19 emergency assistance were filed to KfW, which equates to a volume of nearly ten billion euros (as of 2 June 2020) in promotional loans. Sparkassen disbursed nearly half of this amount. By no means a partial or full release from liability in connection with a KfW loan should be confused with a subsidy to the lender. Because house banks pro-

vide extensive advice to their clients when the latter apply for a promotional loan. Moreover, they subsequently continue to support their clients, as set out in the agreement, throughout the duration of the loan, which may be up to ten years. In addition, prior to processing loan applications, locally active banks check that the loans will be used in line with the funding purpose. They take an active role in all of these steps, not least in the interest of taxpayers.

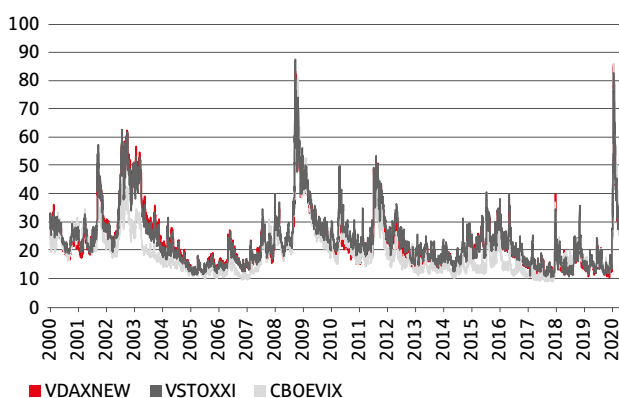
Customer relationships with locally active banks are more robust than capital market finance

The High-Level Forum (HLF) on the capital markets union, set up to advise the EU Commission, argues that credit institutions might not be able to grant sufficient loans in the current economic environment. The warning given in this report is unfounded in most Member States of the European Union. To the contrary, the overwhelming majority of credit institutions have made adequate provisions in terms of their equity and liquidity.

During a crisis, there is often a high degree of uncertainty among investors leading to increased volatility. Unlike in the relationship between house banks and borrowers deferrals and payment moratoria for instance, are not available in the capital markets as a rapid crisis response.

The following chart illustrates the extreme volatility of stocks in the capital markets.

Volatility of stocks in the capital markets:



Source: Thomson Reuters Datastream

In the first few weeks of the crisis alone, Sparkassen provided advice to approx. 1.4 million business clients. Interest and principal payments were suspended in more than 350,000 cases (as of 2 June 2020). The duration of many of the moratoria implemented by Sparkassen and Landesbanken goes beyond the statutory provisions (which are limited to April to June 2020), enabling enterprises to suspend repayments for up to twelve months.

Sparkassen and Landesbanken know their customers and the business environment they work in. They act as shock absorbers and help enterprises to weather jolts in times of crisis. They provide what customers need – quickly, comprehensively, reliably and in a targeted manner: advice, flexibility, liquidity, and medium- or long-term finance.

Capital market finance can be a useful complement to corporate finance in Europe. However, credit financing will remain the main pillar. This is underpinned by:

- **Reliability:** Capital markets are highly volatile – investors often withdraw quickly from the capital markets in times of uncertain economic prospects, while principal banks are well informed about their customers and remain by their side.
- **Flexibility:** Because of the bilateral relationship between lenders and borrowers, loans can be adjusted more flexibly. Deferrals, moratoria and short-term substitutes for loan collateral can be implemented more swiftly. Given the large number of investors, adjusting capital market finance is much more complicated.
- **Sufficient capital:** Owing to regulatory requirements, Sparkassen and Landesbanken have increased their capital and can reliably provide finance for enterprises.

¹ ECB: *The euro area bank lending survey. First quarter of 2020.*

² KfW-Kreditmarktausblick: *June 2020.*