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Germany: Flash

Government support for German companies in the corona crisis

- The federal government's anti-crisis measures have been consolidated in a "Shield for Employees and Corporates".
- The government will support corporates by (1) broadening existing liquidity programmes – through potentially unlimited state guarantees – to facilitate firms' access to affordable loans (via their house banks, guarantee banks, the state development bank KfW), (2) easing the access for firms to a moratorium of tax payments, which could mean a temporary loss in tax revenue in the area of billions, (3) easing the conditions for short-time allowances ("Kurzarbeitergeld"), which cover 60% of a crisis-driven shortfall in working hours / compensation of employees.
- Furthermore, the government is currently drafting a law to suspend the normal three-week period a company has to file for insolvency when running into financial trouble (set to last until the end of September 2020) and Finance Minister Scholz has indicated that Berlin is considering measures to reduce companies from the increased debt burden resulting from using the liquidity measures.
- To mitigate potential liquidity shortages, the government is beefing up KfW programmes. Firms with a turnover \leq EUR 5 bn are eligible for loans, KfW takes up to 90% of the credit risk.
- In turn, KfW receives credit guarantees from the federal government to shield it from any losses it may incur.
- Loans are fully funded by KfW and only passed through by commercial banks which record them on their balance sheet, though.
- In extreme cases, the government may also inject equity capital into selected firms to ensure solvency.
- The looming recession is putting substantial pressure on corporate lending by German banks due to higher expected credit losses and increasing need for capital. Could countercyclical lending by government-owned development banks such as KfW help?
- Before and after the financial crisis, net new lending by German banks shifted quickly from expansion (by 2.4% yoy) to shrinkage (-1.1%). By contrast, despite remaining in negative territory, development banks' loan growth improved slightly, from -1.1% to -0.7%, providing for limited mitigation in the overall contraction of corporate lending.
- Risk assumption measures announced by the German government may be particularly helpful for medium-sized companies.

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Germany: Government support measures to the local economy

Overview

Finance Minister Olaf Scholz (SPD) and Minister for Economic Affairs Peter Altmaier (CDU) supplemented last Friday (13 March 2020) the previous coalition committee's decisions from March 8 by adding further emergency measures to fight the economic damage from the corona virus. The federal government's anti crisis measures have been consolidated in a "Shield for Employees and Corporates".

Focus of the federal government's protective shield are emergency liquidity measures to support corporates facing severe liquidity shortages by:

- **Broadening existing liquidity programmes** – through potentially unlimited state guarantees – to facilitate firms' access to affordable loans (via their house banks, guarantee banks, the state development bank KfW),
- **Easing the access for firms to a moratorium of tax payments**, which could mean a temporary loss in tax revenue in the area of billions,
- **Easing the conditions for short-time allowances ("Kurzarbeitergeld")**, which cover 60% of a crisis-driven shortfall in working hours / compensation of employees.

Further to the above steps, the federal government is currently drafting a law to **suspend the normal three-week period a company has to file for insolvency** when running into financial trouble (set to last until the end of September 2020). Moreover, Finance Minister Scholz has indicated that Berlin is considering measures to relieve companies from the increased debt burden resulting from using the liquidity measures (possibly some kind of a "reverse Treuhand").

Financial support measures to the corporate sector

The measures to corporates announced so far include both a temporary easing of conditions for firms to receive short-time allowances (for now until at least in 2020, possibly extended until 2021), as well as the granting of state guarantees to support banks to lend to solvent firms which are facing severe liquidity pressures because of a collapse in sales or disrupted chain values.¹

Broadening existing liquidity programmes through unlimited state guarantees

As a first step in its "protective shield", the government plans to broaden the existing liquidity programmes to facilitate firms' access to affordable loans. As such private banks should be stimulated to give large amounts of liquidity strengthening loans to corporates. In order to reach this goal, the government plans to open the various credit instruments available at its development bank KfW to an increasing number of firms. As regards existing guarantee programmes, the federal government said it will increase the upper guarantee limits for guarantee banks and

¹ See Federal Ministry of Finance and Federal Ministry for Economic Affairs and Energy. "[A protective shield for employees and companies. Package of measures to mitigate the impact of the coronavirus](#)". 13th of March 2020.



to open up its “large-scale guarantee programme granted to firms operating in laggard regions” also to firms outside such underdeveloped areas. Firms that are confronted with a serious liquidity crisis and which do not have access to the existing programmes should receive financial support through the introduction of new special KfW programmes. The government said it will grant the necessary guarantee volume to the KfW. Due to the high uncertainty and by intention, the government did not set an upper limit for its liquidity support. In this context, the government pointed towards a guarantee volume of EUR 460 bn (13.15% of GDP forecast for 2020), which would be accessible according to the federal government budget for 2020 (2019: EUR 456.2 bn or 13.3 of GDP).²

Easier access for firms to a moratorium of tax payments

Further government measures to support the corporate sector include easier access for firms to a moratorium of advance and supplementary tax payments (income, value added and corporate taxes) – which could involve billions of euros. Moreover, the government has also promised to give some smaller tax relief to corporates, e.g. through a depreciation allowance for digital goods or the option to non-incorporated firms to be taxed like corporate companies. Meanwhile, the government is thinking about further financial support measures aimed at small businesses as well as the roughly two million of self-employed persons (“Solo-Selbständige”), which do not benefit from the easing of short time allowance and/or publicly-guaranteed loans.

Easing of conditions for short-time allowances to protect the labour market

The easing of the conditions for short-time allowances (“Kurzarbeitergeld”) is a powerful labour market tool that helps firms to overcome a temporary economic shock. Under certain preconditions the Federal Employment Agency can reimburse 60% of a crisis-driven shortfall in working hours and compensation of employees. During the global financial and economic crisis, this tool is estimated to have saved 300k jobs. Based on the coalition committee’s decision from March 8, the Federal Employment Agency should already be allowed to pay short-time allowance to firms if they report one tenth to be affected by a crisis-induced reduction in working hours (before this hurdle was a higher one third). Moreover, affected firms will not have to pay any more social contributions on the amount of the short-time allowance. In addition, short-time allowance should be also made available to contract workers. The new regulations should come into effect already in April and will apply retroactively as of March 1.

Federal states (“Länder”) to give further support to their local economies

Apart from the federal government, various state governments have meanwhile also announced support for affected corporates in their local economies through their own liquidity/guarantee support programmes. For instance, the prime minister of the Free State of Bavaria, Markus Söder (CSU), said that the Bavarian government will at first suspend the state’s constitutionally binding debt brake for one year in order to increase the fiscal scope to fight the crisis – as in the remaining federal states, Bavaria’s debt brake was originally meant to come into effect in 2020. Making use of an emergency clause in the debt brake rules, the Bavarian state government announced it will give an additional EUR 10 bn (0.3% of national GDP projected for 2020) for emergency liquidity measures to help the local economy.

² In 2018, the federal government’s guarantee volume stood at EUR 487.2 bn (14.6% of GDP) and was utilised in the total amount of EUR 361.3 bn (c. 74.2% of the guarantee frame or 10.2% of GDP). See [Federal Board of Auditors](#).



Meanwhile, the state of Hesse said it will come up with a supplementary budget for 2020 to incorporate financial support of EUR 1 bn and to be able to raise borrowing by an additional EUR 5 bn. Hence, an aggregate significant government support might be also given on the level of the federal states.

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KfW programmes to support corporate Germany – A primer

- To mitigate potential liquidity shortages, the government is beefing up KfW programmes. Firms with a turnover \leq EUR 5 bn are eligible for loans, KfW takes up to 90% of the credit risk.
- In turn, KfW receives credit guarantees from the federal government to shield it from any losses it may incur.
- Loans are fully funded by KfW and only passed through by commercial banks which record them on their balance sheet, though.
- In extreme cases, the government may also inject equity capital into selected firms to ensure solvency.

To support firms, the federal government is mainly acting on two fronts – through tax relief (moratorium, lower upfront payments) and the provision of liquidity via the federal development bank KfW. With regard to the latter, existing support programmes will be beefed up and conditions relaxed and a new special programme will be set up.

How do these programmes work? In general, KfW is acting through commercial banks (incl. savings banks) which maintain the direct relationship with clients, do the risk assessment and thus decide whether a loan is granted. KfW itself is only operating in the background. With regard to the credit risk, KfW is sharing it with the commercial banks. The proportions depend on the programme and differ from case to case. With regard to the actual financing, the liquidity is solely provided by KfW and only passed through by the commercial banks. The latter receive KfW deposits and correspondingly lend to their corporate and small business customers on the other hand, thus increasing their balance sheet total by the full loan amount. However, they do not have to take the full credit risk nor fund the loan which is done entirely by KfW. The latter is refinancing itself in the capital markets, with the backing of the federal government and therefore a AAA rating. Depending on the uptake of the programmes, KfW will have to adjust its pre-corona funding plans, of course.

Three different programmes will be implemented in the next few days, with varying conditions (many details still have to be finalised though):

1. For companies with a turnover of up to EUR 2 bn: they can receive working capital loans of up to EUR 200 m. KfW takes up to 80% of the credit risk. For companies which are at least 5 years old, an effective interest rate from 1% on applies.
2. For companies with a turnover of up to EUR 5 bn, syndicated loans are on offer whereby KfW takes up to 70% of the credit risk.
3. New special programmes will be set up for SMEs and large enterprises covering working capital and investment needs, with KfW taking up to 90%



of the credit risk in the latter case. Syndicated loans will be on offer as well.

These loans are fully funded via guarantees provided by the federal government so that KfW is shielded from any losses it incurs. The total volume of the guarantees amounts to up to EUR 465 bn and EUR 93 bn can be added if need be. However, a substantial proportion of that has already been used (in 2018, EUR 361 bn, of a maximum of EUR 487 bn) and only EUR 120 bn were still available (EUR 6 bn of losses had occurred). Nevertheless, the government will most probably react quickly and decisively if circumstances require a further increase in these limits. In addition, on the *European level* (European Investment Bank) and the German *state level*, government-owned development banks may also introduce similar support programmes in the next few weeks.

On top of providing liquidity, if no other solution can be found, the government has signaled its preparedness to inject fresh *equity* into selected firms that are fundamentally sound but now are running into solvency problems. It has done so already in the Great Recession with several banks, which arguably was the single most important factor in stopping the financial meltdown.

Also, the Finance Ministry is reportedly preparing to set up a KfW fund to cover ongoing payment obligations such as rent for hard-hit self-employed and small enterprises. According to press reports (Spiegel), the fund may consist of EUR 10 bn in grants and EUR 30 bn in loans. Similarly, there will probably soon be discussions among public authorities about partially waiving the repayment of loans currently provided under the emergency assistance programmes. The likelihood and size of such waivers will increase the longer the economic shutdown continues.

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Corporate lending in a corona recession: Development banks as an anchor of stability?

- The looming recession is putting substantial pressure on corporate lending by German banks due to higher expected credit losses and increasing need for capital. Could countercyclical lending by government-owned development banks such as KfW help?
- Before and after the financial crisis, net new lending by German banks shifted quickly from expansion (by 2.4% yoy) to shrinkage (-1.1%). By contrast, despite remaining in negative territory, development banks' loan growth improved slightly, from -1.1% to -0.7%, providing for limited mitigation in the overall contraction of corporate lending.
- Risk assumption measures announced by the German government may be particularly helpful for medium-sized companies.

The looming recession triggered by the coronavirus is exerting a lot of pressure on the global and also German banking industry. For one thing, banks' revenues may decline: loan growth will probably shrink due to tighter credit standards and lower demand; interest margins may suffer from more expansionary monetary policy; payment volumes and associated fees are likely to decrease; assets under management, transaction volumes and associated performance and management fees may all head south. Second, loan losses and respective provisions are set to



rise due to sharply reduced forecasts for global growth. Third, the related rating migration will automatically result in higher risk-weighted assets which reduces risk-weighted (CET1) capital ratios. Fourth, as a consequence of lower revenues and higher loan loss provisions, profitability may well slump, as cost levels remain relatively resilient. Net losses, in turn, could reduce capital ratios further, both CET1 and the leverage ratio.

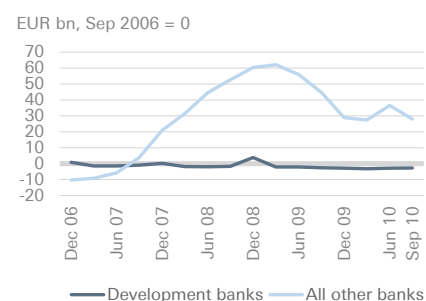
Typically, in such an environment, banks become much more cautious with regard to new loan commitments as these are capital intensive and it is more doubtful whether interest and notional can be paid (back) fully in time. Likewise, (especially corporate) borrowers become more reluctant to take on more debt as their cash flows weaken and the outlook for their businesses turns more cloudy. The resulting slowdown in lending is particularly pronounced if the recession follows an economic boom.

Currently, in Germany, this is the case, as it was in 2008 when the financial crisis hit. Loan growth with the corporate sector (including self-employed), which still stood at +4.9% yoy at the end of 2019, will probably deteriorate sharply over the coming quarters. The extent of the decline is, of course, uncertain, due to the lack of precedents for a pandemic in a globalised economy and society. However, policymakers are looking at options to mitigate economic repercussions and, in particular, prevent a credit crunch, i.e. a situation when viable companies are deprived of credit by a struggling banking system. One possibility being discussed is to counter, at least partly, the expected reduction in new lending by commercial banks through a countercyclical increase in lending by government-owned development banks, including KfW and various development institutions at the state level.

Could this help? The evidence from the 2008 crisis and its aftermath gives only limited comfort. The Bundesbank banking statistics provides a breakdown of lending by major banking group. We look at the two years before and after the failure of Lehman Brothers in September 2008 which triggered a dramatic acceleration of the financial crisis and the Global Recession. Loan flows to companies and self-employed in Germany (excluding other financial institutions) by public development banks were negative from September 2006 to September 2008: on average, they stood at -1.1% p.a. of the outstanding volume. At the same time, in this boom period, net new loans by all other banks reached +2.4% yoy. From September 2008 to September 2010, loan growth quickly reversed course. On average, all banks excluding development banks saw negative loan flows of -1.1% yoy, a heavy shift from the previous expansion. Somehow in contrast, the shrinkage of development banks' loan book slowed down, to -0.7% over this 2-year period. That is, unlike the other institutions, their lending standards probably became a bit more accommodative. Nevertheless, even development banks did not increase their absolute lending volume and their market share throughout this time remained moderate – below 7%.

In the unfolding coronavirus recession, similar patterns are likely to emerge, potentially with a larger though not outsize role for development banks in countercyclically providing credit to a shrinking economy. Still, they may not be able to fully compensate for the looming contraction in lending by commercial banks. On a side note: of course, development banks (or other public institutions) could also help in other ways, e.g. through asset guarantees/asset protection schemes similar to measures adopted in 2008. By taking on the credit risk which commercial banks are unwilling or unable to bear, they could allow for more

Figure 1: Cumulative loan flows to German non-financial companies and self-employed



Source: Deutsche Bundesbank, Deutsche Bank Research



liquidity to flow to the corporate sector. In this sense, the KfW risk assumption measures announced today by the German federal government may be particularly helpful for medium-sized companies, i.e. the backbone of the German economy.

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Appendix 1

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