THE VIEW

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EUROPEAN SMEs :
FILLING THE BANK FINANCING GAP

Allianz

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EXECUTIVE SUMMARY

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- The Small and Medium Enterprise (SME) bank loan financing gap in the Eurozone has reduced from 6% of GDP in 2015 to 3% of GDP in 2019, or EUR400bn, moving closer , but remaining higher than the 2% of GDP seen in the US, where corporate financing is much more diversified between bank credit and market financing.

- This is the result of record low bank loan interest rates and higher loan availability thanks to ECB support which have pushed up loan supply mainly in core countries (Germany, France, Belgium and the Netherlands), but also higher non-bank financing sources.

- At the same time, the decline in the financing gap is also linked to a significant downside adjustment in loan demand in Southern European countries, such as Italy and Spain. A delayed recovery in fixed capital formation and an improved self-financing capacity, notably since 2015, partly explain the trend.

- Country heterogeneity persists. The highest SME bank loan financing gaps are in the Netherlands (22% of GDP), Belgium (14%), France (9%) and Italy (4%). In the first three countries, the gap is essentially linked to the high SME debt stock but also higher economic activity, though the increase in debt has been higher than the one in activity. In Italy, the gap is mainly explained by the supply constraint.

- Since European SMEs depend on banks for 70% of their external financing (against around 40% in the U.S.), any gap between loan demand and supply could lead to lower investment growth if companies don't have the means to self-finance their investments. This could be a constraint for overall economic growth.

EUR400bn

The estimated SME bank loan financing gap in the Eurozone in 2019 (3% of GDP)

SMEs ARE CRITICAL TO EUROPE

SMEs[1] represent more than 99% of all European non-financial corporates and employ over 90 million people, accounting for almost 70% of total employment in the EU-28 non-financial sector. They also generate close to 60% of total gross value added[2].

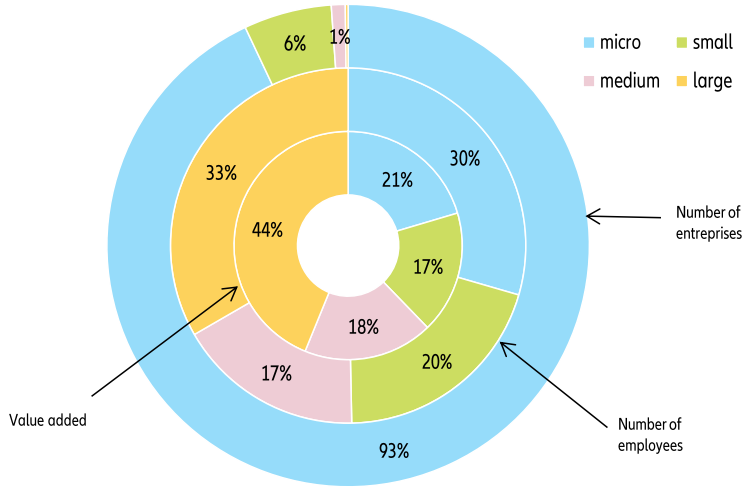
However, the specific characteristics of SMEs make them more vulnerable during crises (Chowdhury 2011[3]): Because they are often not rated, their sources of financing can diminish faster than those of larger companies. Moreover, since they tend to produce highly specific products, they are less flexible in adapting to crises. In 2009, SMEs were the first to suffer from the global economic crisis because of depressed demand and financing constraints.

Since European SMEs depend on banks for 70% of their external financing (against around 40% in the US), any gaps between loan demand and supply could lead to lower investment growth, which could be a constraint on overall economic growth in the future.

In this context, we estimate the bank loan financing gap for SMEs in the Eurozone as a whole and in six main countries: Germany, France, Italy, Spain, the Netherlands and Belgium using the methodology of Mc Cahery, J., Lopez de Silanes, F., Schoenmaker, D., & Stanisic, D. (2015 "The European Capital Markets Study: Estimating the Financing Gaps of SMEs". While the initial paper gives estimates for 2013, we look into the most recent 2018 data for the Eurozone and compare them with data from 2015, which was when the ECB began its quantitative easing program.

The ECB's very accommodative monetary policy, which now looks set to continue until at least Q4 2020, has helped the Eurozone reduce its SME financing gap. But country heterogeneity persists.

Figure 1: Small and medium enterprises (SMEs): share in total companies, employment and value added



Sources: European Commission, Allianz Research

[1] We take the definition of SME by turnover as follows:

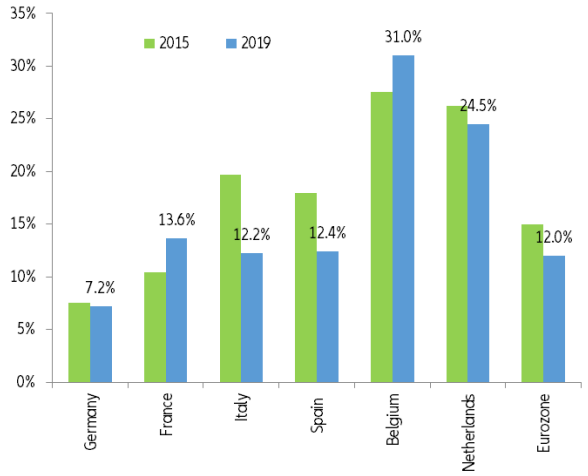
	Turnover
Medium-sized	≤ € 50 m
Small	≤ € 10 m
Micro	≤ € 2 m

[2] Gross Value Added is a measurement of Gross Domestic Product

[3] Chowdhury, S. R. (2011), "Impact of global crisis on small and medium enterprises", Global Business Review, 12(3), 377-399.

THE EUROZONE'S SME FINANCING GAP MOVES CLOSER TO THAT OF THE US

Figure 2: Potential loan demand based on the share of loans that are considered relevant for SMEs, % of GDP



Sources: ECB, Allianz Research

We look into the SMEs bank-financing gap, as a measure of the difference between bank loan demand and supply. We find that the Eurozone's SME bank-financing gap, which we calculate by taking into account the share of loans considered relevant by SMEs for their future activity minus the forecasted new bank loans for SMEs, has considerably reduced since 2015 when the ECB began its Quantitative Easing program. In 2019, it was estimated at 3% of GDP (or close to EUR400bn), -3pp lower compared to 2015. This is partly due to a strong increase in loan supply in the core Eurozone countries (Germany, France, Belgium and the Netherlands), as well as a significant decline in loan demand in Southern European countries, such as Italy and Spain, which we will explain below.

The ECB's very accommodative monetary policy and higher non-bank financing sources explain part of the decline in the financing gap. Non-financial corporations' bond issuances reached 23% of total external financing in 2017 (increase of over +4pp since 2015). But loan demand has also been impacted by the lower growth in Eurozone fixed capital formation in 2017-18 (+0.7% q/q) compared to 2015-16 (+1.3% q/q). As a result, the Eurozone's SME financing gap has converged towards that seen in the US (2% of GDP), where corporate financing is much more diversified between bank credit and market financing (40% SMEs reliant on banks in the US vs. 70% in the Eurozone on average).

In 2019, based on the share of loans that are considered relevant by SMEs for their future activity, SME bank loan demand in the Eurozone could reach a high of almost EUR1.4tn or 12% of GDP (see Figure 2). This compares to an estimated SME bank loan supply[4] of EUR1022bn (or 9% of GDP) in the Eurozone.

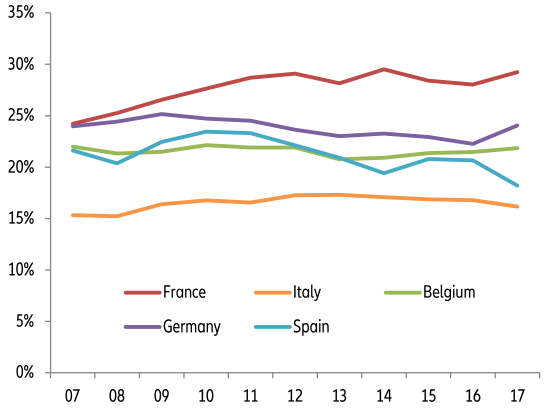
[4] We estimate the share of new SME bank loans by looking at the share of new bank loans below EUR1mn in total new bank loans, and we apply a rate of growth for total supply taking into account the forecasted rise in activity – a reason for loan demand – in line with nominal

From a country perspective, the highest bank loan financing gaps are in the Netherlands (22% of GDP), Belgium (14%), France (9%) and Italy (4%) - see Figure 3. While the bank loan financing gaps are expected to decrease in most countries in 2019, compared to 2015, they are likely to widen in Belgium and France, where the stock of corporate debt is the 4th and 5th highest in the Eurozone (SMEs tend to have higher debt ratios). In 2017, total SME debt as a % of the total balance sheet reached new highs in France (29%), Germany (24%) and Belgium (22%), partly due to very low interest rates and higher loan availability - see Figure 4. And the deviation from trends in Italy and Spain widened even further since 2015-16.

Figure 3: Comparison of the SME bank financing gap among Eurozone countries, % of GDP

Sources: ECB, Allianz Research

Figure 4: SMEs debt, % of total balance sheet



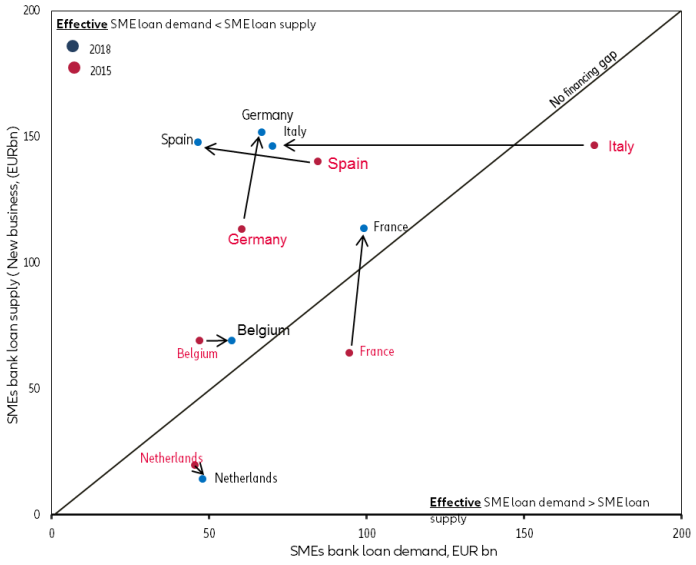
Sources: Bank of France, Allianz Research

HIGHLY INDEBTED SMEs BECAME MORE DEPENDENT ON BANK LOANS

We look at the evolution of the effective SME bank loan demand between 2015 and 2018 by taking into account the average loan size "used" by SMEs. We find that in four key Eurozone countries, effective SME bank loan demand in 2018 increased significantly since 2015 in core Eurozone countries: the Netherlands (+24%), Belgium (+22%), Germany (+11%) and France (+5%) - see Figure 5.

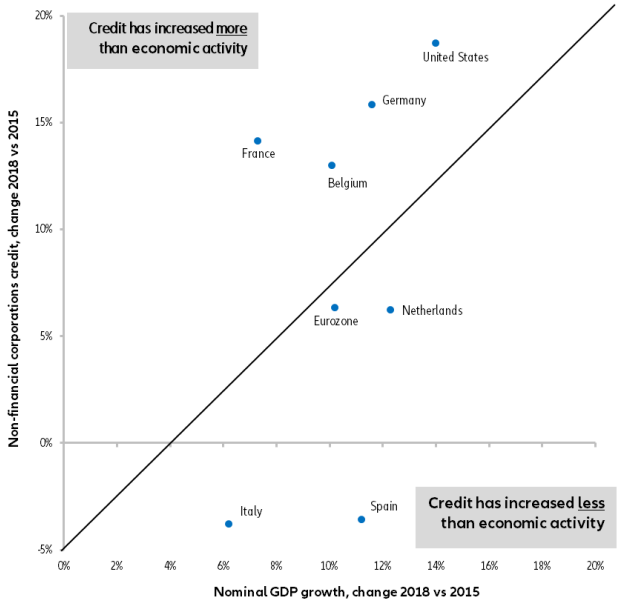
At the same time, looking at the share of loans declared as relevant for future activity in 2019 (potential SME bank loan demand), the increase has been even more evident in countries with high corporate debt levels, notably France (+40% since 2015), the Netherlands (+37%) and Belgium (+32%), indicating that SMEs require even more external financing. Looking at the growth in credit to corporates vs. the growth in economic activity, we can clearly see that the rise in debt has been more important than the rise in nominal GDP in France, Germany and Belgium (see Figure 6). This suggests that SMEs in these countries remain very dependent on bank loans. At the same time, the highest increases in bank loan supply were seen in France (+78% since 2015), the Netherlands (+38%) and Germany (+34%) as a sign that banks in these countries are in good shape.

Figure 5: Effective SME demand (based on the share of used loans by SME) vs bank loan supply to SMEs



Sources: ECB, Allianz Research

Figure 6: Total credit to non-financial corporates vs nominal GDP growth (2018 vs 2015)

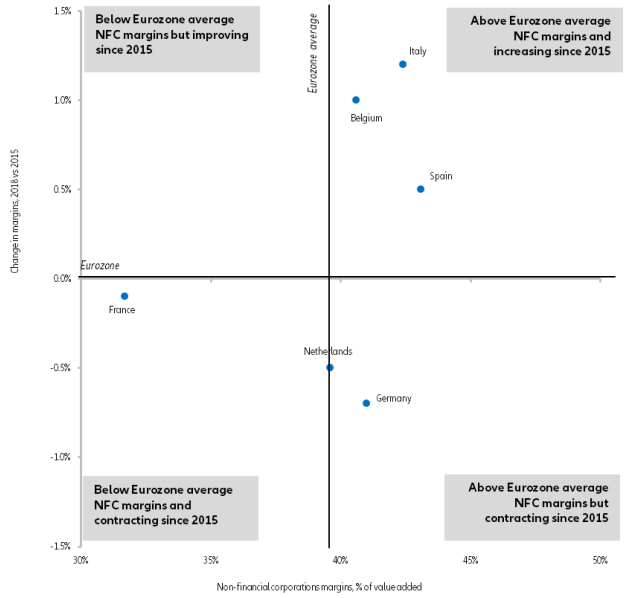


Sources: BIS, Eurostat, IHS Global Insight, Allianz Research

SMEs IN SOUTHERN EUROPE HAVE ADJUSTED THEIR LOAN DEMAND DOWNWARDS

Firms' profitability and hence their self-financing capacity have improved more in Southern European countries than in the Eurozone as a whole since 2015 (see Figure 7). However, SMEs in these countries have reduced their loan demand significantly between 2015 and 2018 (-59% in Italy, -45% in Spain – see Figure 5). Certainly, the more modest expansion in economic growth compared to core countries, as shown in Figure 6 (and delayed recovery in fixed capital formation) explains part of the demand downside adjustment. However, counter-intuitively, the lower loan demand came along with a record low cost of credit, notably since 2015, when the ECB began its Quantitative Easing program, and the spreads between SME bank loan interest rates in Southern European countries and the core reduced rapidly from above +200bp to only +40bp (see Figure 8).Bank loan supply has not increased much (+5% in Spain) and even slightly contracted in Italy (-0.2%). While loan demand has certainty played a role, the state of the banking sector has influenced these developments even more. Banks in these countries still struggle with the highest shares of NPLs (i.e. 6% in Italy and 5% in Spain against 3% in France) and have suffered the most since the crisis. The return on equity (ROE) in Italy and Spain has contracted more than the Eurozone average (-2.1pp), reflecting partially the need to provision for a high number of NPLs.

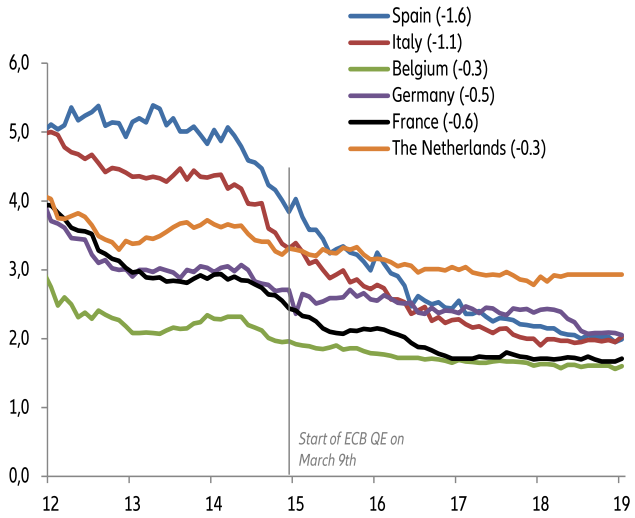
Figure 7: Non-financial corporates margins, level vs change 2018 vs 2015



Sources: Eurostat, Allianz Research

Figure 8: Bank interest rates on loans to SMEs, %

NB: Between brackets is the change in bank interest rates since March 2015 (in pp) when the ECB implemented its Quantitative Easing Program



Sources: ECB, Allianz Research


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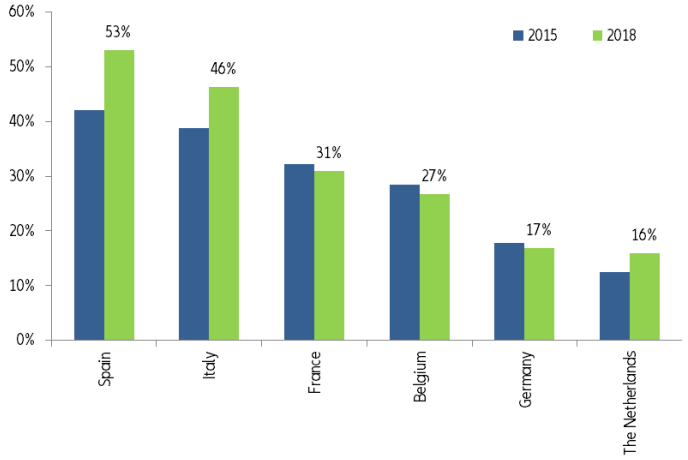
Figure 9: Credit lines to SMEs by country, % of total credit lines and bank loans



Sources: ECB, Allianz Research

As a result, SMEs have become much more dependent on smaller loans in Southern European countries since 2015. In Spain, for example, very small loans (below EUR25K) stood at 47% of total new loans, compared to just 10% in Germany. Small to medium loans (EUR25K to 1M) are mostly used in Italy and since 2015 also in France, where their share in total loans stands above the Eurozone average (20% and 14% vs 12%, respectively). This could be a sign that smaller loans are easier to obtain from banks, while investment plans have also been more modest compared to core Eurozone countries.

In addition, in Italy and Spain, the share of credit lines – usually used to finance working capital – is higher compared to core Eurozone countries and increased even further compared to 2015 (see Figure 9). In Italy in particular, credit lines are the financing sources considered as most relevant by SMEs (56%) which is not the case in the other Eurozone countries. In Italy, this could be the negative externality of an unmet bank financing demand and long payment terms (above 85 days in 2017, 15 days above the Eurozone average).

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