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Finance for Europe

Financing the Future – Perspectives from Germany

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Association for Financial Markets in Europe
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What is the challenge?

The German government has identified the challenge of financing the future. How can all the demands for investment in the sustainable and digital transformation be financed, and how can future pensions be safeguarded, in addition to addressing current problems such as in energy-intensive industries and in house-building.

In light of these challenges, AFME agrees that it is important to mobilise private capital to ensure that start-ups, growth companies, SMEs and listed companies can get the funding they need.

The German government is taking forward several worthwhile national initiatives, such as the Zukunftsfinanzierungsgesetz (Future Financing Act) and the Generationenkapital (relating to pensions).

Germany is also participating in the debate on capital markets at EU level, helping to shape the framework conditions to develop integrated EU capital markets. Finance Minister Christian Lindner and his French counterpart Bruno le Maire met in Berlin in September 2023 and presented a joint roadmap for the Capital Markets Union.

How much progress has been made so far towards a Capital Markets Union?

Despite some of the major improvements, the EU has not closed the large gap in capital markets financing and continues as a predominantly lending-based economy. Some long-standing ambitions continue such as establishing a unified insolvency framework, sounder withholding tax proceedings, and facilitating EU cross-border pensions savings. Changes to the securitisation framework were delivered at EU level. However, the recovery of the securitisation market has fallen short of expectations. Further work needs to be done to unlock the contribution of this important market segment for EU growth.

Beyond the changes to primary markets and in the post-trade space, we also need to place greater emphasis on improving the competitiveness of our secondary market ecosystem as this provides an essential ingredient in fostering an attractive market place, namely liquidity. The link between primary markets, where corporates raise financing, and secondary markets, where securities are traded, is too often neglected. Without a deep and liquid secondary market, it is much harder for issuers to place new debt in the primary market or for corporates willing to undertake an initial public offering to achieve the best valuations for the placement of their shares.

AFME publishes a research report every year to help quantify the progress towards a Capital Markets Union. The report, developed by AFME in partnership with several organisations, has become an industry reference point, appraising the changes that have actually taken place, and identifying where capital markets have deepened and become more integrated, and where there is still more work to do.

What is the situation in Germany?

We have analysed the situation in Germany using Key Performance Indicators. In this note, we summarise the findings for four key themes

- Financing the sustainable transformation
- Raising new risk capital for SMEs and larger corporates
- The digital transformation and fintech
- Household investment

1. Financing the sustainable transformation

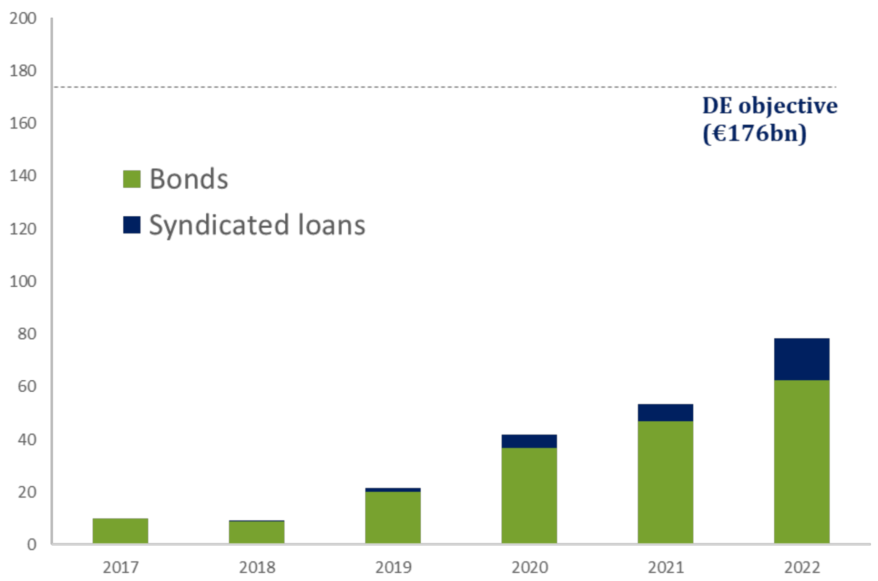
The KPI on ESG Finance compares the amount of new issuance of ESG bonds (based on the criteria set by the Climate Bond Initiative) with the total amount of new bond issuance (ie ESG bonds plus all other bonds).

Germany is the top issuer of green bonds and ESG bonds in the EU

- ESG markets in Germany continued to have strong levels of issuance, driven predominantly by a surge in green bond issuance, which was up 26% (annualised) from 2022. Sustainable bond issuance increased 40% (annualised) while social bond issuance decreased 44% (annualised) compared to 2022. Green bonds continued to be the most common ESG label in terms of volumes, making up 88% of total ESG bond issuance in Germany during H1 2023, up from 86% in 2022.
- Germany overtook France to become the largest issuer of total ESG (green+social+sustainable) bonds in the EU in H1 2023, accounting for 20.3% of total new EU ESG finance.
- Germany continued to issue the largest nominal volume of green bonds of any EU country for the fourth consecutive year with EUR 36.9 bn issued in H1 2023 , which represented 24.8% of the EU total. This follows Germany issuing the largest volume of any EU country in in 2022 (EUR 58.6 bn), in 2021 (EUR 48.8 bn) and 2020 (EUR 33.8 bn).
- In terms of issuer types, the sovereign sector issued the largest amount of green bonds in Germany during H1 2023 (EUR 14.1 bn) followed by non-financial corporates (EUR 10.4 bn).
- In 2023 so far, the German Government issued two new Green Federal bond references for €10.75bn, deepening the green government bond market and expanding the green German yield curve. This, in addition to tap issues of other references.
- Other large green bond issuers include KfW (€8bn), NRW.Bank (€2.2bn), Mercedes Benz (€2bn), Land Nordrhein-Westfalen (€2bn), Berlin Hyp AG (€1.9bn) Volkswagen (€1.7bn) and Siemens (€1.5bn).
- The data shows that the ESG market in Germany is deepening, and there is now a strong foundation for continued growth.

According to ZEB estimates, based on typical financing patterns, Germany needs €176bn per year until 2030 in external financing to achieve GHG targets. In 2022, capital markets (bonds and syndicated lending) contributed €78.4bn to finance green and sustainable projects.

German green and sustainable market-based finance (2017-2022) and GHG financing needs (EURbn). Excludes refinancing of debt.



2. Raising new risk capital for SMEs and larger corporates

The KPI on pre-IPO risk capital measures how well start-ups and non-listed companies are able to access finance for innovation.

The index compares the aggregate amount of annual risk capital investment (ie from venture capital, private equity growth funds, business angel investment and equity crowdfunding) with the total amount of annual investment (ie risk capital plus bank loans).

Start-up and SMEs raised more risk capital in Germany this year

Germany's ranking on pre-IPO risk capital moved up from the third quartile (rank 15) to the second quartile (rank 11).

The overall proportion of risk capital investment is now 5.4%, compared with 4.9% in 2022. The main drivers for this are strong investment from venture capital and private equity. This is an encouraging sign, because it shows that Germany is developing as a location for start-ups and growth companies.

It is important that when these companies grow, they will be able to access the capital market.

We can measure the strength of the capital market with the KPI on market finance. The index compares the aggregate amount of capital markets finance (ie new issuance of equities and bonds) with the total amount of finance (ie capital markets plus bank loans).

Capital markets financing in Germany increased by 22% during the year

The increase was driven by strong investment grade bond issuance and increased secondary equity issuance, which offset low activity in IPO markets.

Equity issuance

- German IPO markets had extremely low levels of activity in the first half of 2023, with EUR 0.4 bn issued as of June by non-financial corporates, a decrease of 91.5% compared to 2022, when EUR 9.1 bn was issued (almost exclusively due to the Porsche IPO, which was the largest European IPO in 2022).
- Secondary offering issuance increased by 247% during H1 2023, representing a significant revival in activity compared to 2022, when annual issuance volumes were the lowest since 2008.

Debt issuance

- During H1 2023, there was EUR 39.4bn of investment grade bond issuance, representing an increase of 17% compared to 2022 and 5% compared to 2021. However, compared to pre-pandemic levels, investment grade bond issuance is still down 22% (2019) and 28% (2018) on an annualised basis.
- High Yield bond issuance increased 182% (annualised) in H1 2023, with volumes rebounding from a record low volume in 2022, which represented the lowest annual HY bond issuance in Germany since 2008.

Bank loan issuance

- New bank loan origination remained stable in H1 2023, with volumes virtually unchanged compared to 2022. Volumes remain higher than pre-pandemic levels (up 10% vs 2019 and 18% vs 2018).

The data on German IPO markets emphasises the challenge of facilitating access to the capital markets for companies, especially for start-ups, growth companies and SMEs. The lack of activity also caused Germany's ranking on the market finance indicator to fall (rank 14 in 2023, compared with rank 11 in 2022).

3. The digital transformation and fintech

The KPI on FinTech seeks to measure the capacity to host a vibrant FinTech ecosystem.

Germany's ranking on FinTech stands in the middle of the pack

- The FinTech indicator for Germany stood virtually unchanged in H1 2023. There were challenging funding conditions for German FinTechs, but on the other hand there was a greater volume of M&A activity.
- Global funding for the FinTech industry saw a sharp decline in 2023, with total EU fintech funding falling by 55% in the first six months of 2023, compared to 2022 (vs a contraction in the UK and US of 59% and 29% respectively).
- Funding in Germany contracted at a lower rate than other regional peers, decreasing by 36% (annualised) compared to 2022.
- M&A volumes of German FinTech companies increased 130% (annualised) compared to 2022 (in contrast to an 89.0% reduction in the EU total over the same period).
- Some of the largest M&A deals include Blockchain technology companies, B2B technology (Northern Data AG)
- The valuation of German fintech unicorns decreased 19% against 2022. There are 5 German FinTech Unicorns, of which 4 are based in Berlin and 1 in Munich.

The data emphasises the importance of continued focus on the Fin Tech sector to support the development of innovation. Modernisation of the capital market by extending the Electronic Securities Act (eWpG) can be an important driver of further growth in the Fin Tech ecosystem in Germany.

4. Household investment

The household investment indicator in Germany (96% of GDP) is slightly higher than the EU average (90% of GDP).

Additional data shows that overall financial assets of households are split as follows: currency and deposits (42%), equities, investment funds and debt securities (29%), life insurance and funded employment-related pensions (29%).

There is a significant gap between the amount of investment by German households relative to GDP and that in some other European countries such as Denmark (187%), the Netherlands (174%) and Sweden (164%) which is partly due to the structure of the pension systems. The German Government has identified the potential for the capital markets to provide additional funding to support the German pension system.

Summary

Key findings from the research

- Germany has overtaken France to become the leading EU issuer of green and ESG bonds
- Start-ups and SMEs raised more risk capital from venture capital and private equity
- Capital markets financing increased by 22% overall
- IPO volumes were down relative to the high level from 2022 (Porsche IPO)
- Germany's ranking on FinTech stands in the middle of the pack

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