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Credit in America

Slim pickings, no appetite

Oct 15th 2009 | NEW YORK
From The Economist print edition

Constrained lenders and wary borrowers explain falling levels of credit

Illustration by S. Kambayashi



THE worst may be over for America's financial markets, but they are still abnormal. Bill Dudley, head of the Federal Reserve Bank of New York, captured the mood in a recent speech, bluntly titled "A bit better, but very far from best". In a survey released this week, members of the National Association for Business Economics said markets would keep dragging on growth until at least mid-2010.

For many the big question is whether a lack of credit is holding back America's nascent recovery. In a sign of easing conditions, usage of the Fed's special liquidity facilities has fallen markedly and the central bank is gradually winding down its asset purchases. Securitisation markets are thawing, with volumes approaching pre-crisis levels in credit-card debt and car loans—though not in mortgages, which remain dependent on government support.

But at the same time the overall level of credit is dropping. Bank lending expanded in the thick of the crisis as companies tapped pre-agreed credit lines. But it has since fallen back sharply, from \$7.14 trillion in May to \$6.78 trillion in September, with the decline accelerating recently. Is this down to a reluctance to lend, or to borrow?

Both. With loan losses still climbing, banks are loth to throw money around. True, some large banks have regained their footing, thanks largely to robust capital markets. JPMorgan Chase posted a \$3.6 billion third-quarter profit on October 14th, helping the Dow Jones Industrial Average above 10,000 points for the first time in a year. Others, including a still-frail Citigroup, were due to report after *The Economist* went to press (see [article](#)). But smaller banks in particular fear losses in commercial-property and construction loans, to which CLSA, a

broker, thinks they have exposure of \$1.5 trillion.

The latest Fed survey of loan officers, in July, showed them continuing to tighten underwriting standards across the board. Banks have record levels of reserves parked at the Fed. Even those in good shape may want to hold back given uncertainty over capital requirements and accounting rules for off-balance-sheet assets.

But companies are also seeking fewer loans, as they think twice before hiring or investing in equipment. Demand for “commercial and industrial” loans has fallen in every quarter since mid-2006, according to the loan-officer survey.

A similar synchronised decline in supply and demand is visible in consumer credit. The total outstanding fell at an annualised rate of 5.8% in August, the seventh straight monthly drop—and the decline would have been steeper but for the cash-for-clunkers car-sales programme. Lenders have pulled back most from “revolving credit”, such as credit cards, where they have more flexibility to cut. In the past two years credit-card lines have been cut by a whopping \$1.25 trillion and another \$1.5 trillion will disappear by the end of 2010, estimates Meredith Whitney, an analyst.

But borrowers are pulling back too. Over-extended households are saving more as they adjust to the shock of seeing their net worth fall by \$11 trillion. Balance-sheets need to be repaired but the effects are painful. Weak demand from consumers, whose spending accounts for two-thirds of output, is one of the strongest headwinds facing the economy. With household debt still at 129% of disposable income, deleveraging could go on for some time. A ratio above 100% is generally considered unsustainable.

Nonetheless, parts of the economy may still be caught in a genuine credit squeeze. Take corporate finance. Big public firms have relatively easy access to loans and equity once again. Corporate-bond issuance is on track to shatter records this year. “For investment-grade companies, it’s almost as much as you can eat,” says Charles Himmelberg of Goldman Sachs.

But only a quarter of America’s listed companies can tap bond markets. Beneath them is a mass of small and medium-sized firms that collectively employs about half of American workers and is heavily reliant on banks. Ms Whitney argues that small-business owners—big users of credit cards and home-equity lines—face a severe credit crunch as these crutches get yanked away. Loans are harder to come by than at any time since the early 1980s (see chart). Surveys suggest they will get even scarcer.

It hardly helps that one of America’s biggest small-business lenders, CIT, has run aground. With the firm seemingly sliding towards bankruptcy, its boss, Jeff Peek, said on October 13th that he would step down at the end of the year. Nor have corporate minnows been able to count on much help from taxpayers. In the year to September, a mere \$9.3 billion of loans were guaranteed by the Small Business Administration, a government agency.

Not everyone thinks credit is so constrained. Small businesses are hampered less by a lack of loans than a shortage of customers, argues Bill Dunkelberg, chief economist of the National Federation of Independent Business (NFIB), a trade group. In the NFIB’s latest survey of its members, conducted in September, only 4% saw financing as their biggest problem, compared with 32% citing weak sales. With so much uncertainty, capital-spending plans are at 35-year lows. “The only ones trying to get loans are those struggling to stay in business, not those looking to grow their business,” says Mr Dunkelberg.

He may be right. But when recovery seems more assured, firms will want to borrow to beef up inventories and buy new equipment. Mr Dunkelberg thinks banks will be ready to help them. Others are less sure. With loan losses unlikely to peak until well into 2010 and banks likely to keep failing until at least 2011, the real credit crunch may still lie ahead.

