

US Credit Crunch is Not Over, Despite Fed “quantitative easing”

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- The Fed is battling the credit crunch through what central bank officials call “credit easing,” although others prefer the name “quantitative easing.” Enormous injections of bank reserves through multiple programs have spurred accelerated growth in the monetary aggregates. M2 is up about 10% from a year ago.
- The US Treasury has started to publish detailed data on loan originations from banks receiving TARP capital injections. As of January, all told the US Treasury that they were increasing loan originations.
- However, more recent Fed data on bank assets show declines in most lending categories, indicating that the credit crunch is not over – and may be starting to spread to commercial real estate lending and other areas.
- Surveys of small and medium-sized companies tell us that credit market conditions are difficult and expected to get worse. Unless they improve pretty soon, the best we can hope for is a relatively unimpressive economic recovery, even after the steep recession the US is now in comes to an end.

Money supply up as Fed injects vast credit into the financial system

“Credit easing” or “quantitative easing” did not begin only in December 2008, when the Fed reduced the federal funds rate into a target range of 0% to 0.25%. The process of providing massive amounts of liquidity without regard to the effective fed funds rate actually began shortly after the Lehman bankruptcy sent the world’s financial markets into turmoil last fall. During October 2008, the Federal Reserve credit exploded from around USD 1 trillion to almost USD 2 trillion. It peaked at USD 2.2 trillion just before the year end. It has subsequently fluctuated somewhat lower to USD 2.1 trillion in the most recent reporting week ended March 25. The amount of credit to be provided to the financial system at large, not simply the banks, is likely to expand by another USD 1.5-2 trillion within the next year, largely because of continued purchases of mortgage-backed securities, the expanded TALF program, and the announced purchases of US Treasury securities.

One direct consequence of this massive injection of liquidity is a mammoth increase in excess reserves of the banking system (total reserve minus the slim amount of required reserves on checkable deposits). But an equally significant, though indirect, effect is an exceptionally fast increase in the size of the money aggregates. The Table below shows the most recent Federal Reserve official data on the monetary aggregates. Partial data for March indicates that the rapid increase in the money supply, however defined, has persisted.

FED “CREDIT EASING” SUPPORTS JUMP IN MONEY GROWTH

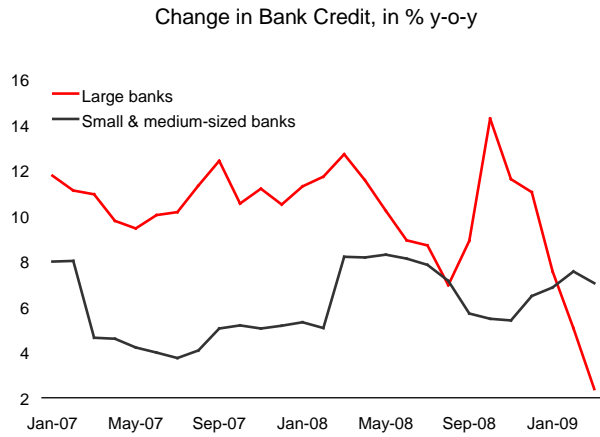
<i>% change at seasonally adjusted annual rate</i>	M1	M2
13-weeks, Dec 15, 08 to Mar 16, 09	16.9	15.1
6-months, Sep 15, 08 to Mar 16, 09	25.4	15.0
12-months, Mar 17, 08 to Mar 16, 09	15.0	10.1

But bank assets are no longer rising

Fed data on the assets and liabilities of commercial banks that appear on the weekly H.8 report show that the biggest domestically-chartered banks have been cutting back total assets since last fall. There was a brief spurt of lending in October and November that didn’t last. So far in 2009, aggregate bank credit has declined USD 64 bn to USD 5462 bn as of March 18, 2009. But it is worth noting that even in this more

restrictive environment, bank credit outstanding at the largest US banks is still 3.8% higher than at the end of February 2008. That is a little more than the estimated increase in nominal GDP over that same period.

SMALLER BANKS STAY ACTIVE, AS BIG BANKS PULL BACK



TARP BANKS TO TREASURY: WE ARE STILL LENDING

Loan originations of domestic banks and other financial institutions that are receiving capital injections under the Troubled Asset Recovery Program	USD bn for the largest commercial banks	USD bn for the other TARP recipients
Consumer lending		
First mortgages	71824	6980
Home equity lines of credit	3547	927
Credit card loans	13813	2478
Other consumer lending	15136	2871
Commercial & Industrial loans		
Renewal of existing accounts	43455	13644
New commitments	39070	15176
Commercial real estate loans		
Renewal of existing accounts	6530	4787
New commitments	3983	1966

Source: US Treasury Department

The information provided to the US Treasury goes beyond the data on originations to include brief statements on how the individual banks receiving TARP capital infusions assess lending conditions. It would be a little time-consuming to recount each bank's submission. But a few generalizations are warranted, based on the narratives provided by the largest banks in the sample: First, big banks insist they are willing to lend to creditworthy consumers and businesses borrowers. Mortgage refinancing spurred by the decline in mortgage interest rates was cited as a key factor behind higher first-mortgage originations. Second, where loan origination is down, the major factor is a decline in demand due to the recession. Third, several banks acknowledged that tighter credit standards have cut back approvals of new or expanded lines of credit. Fourth, the freezing up of secondary markets for loans and the lack of access to securitization has restrained enthusiasm for new lending.

Frustrated borrower syndrome

When demand for credit shrinks, part reflects normal adjustments by business corporations in response to lower sales and orders. Part also reflects the understandable desire on the part of many households to tighten their belts in response to lowered incomes and net worth from housing and financial assets. But a portion reflects perceptions among potential borrowers that lending terms and conditions have become so restrictive that it is not worth the trouble to apply for a loan (and sometimes to pay sizable application fees) when the probability of being refused appears high.

The number of these so-called frustrated borrowers is not readily available from the standard consumer confidence surveys. However, the monthly surveys of small businesses by the National Federal of Independent Businesses, NFIB, provides some measure of the dissatisfaction that small business owners face in trying to get a loan. Respondents are asked each month about their perceptions of credit availability. The net percent of those who say credit is easier to get minus those who say credit is harder to get stayed at -13% in the latest survey conducted in February. That represents the worst credit market conditions than at any time in the past 25 years in which the questions was asked. (The previous period of extremely restrictive lending standards was during the banking and thrift industry crisis of the early 1990s). The picture is a little less worrisome when asked whether the borrowing needs of respondents were satisfied or not. In February, 32% of respondents said their needs were satisfied, while 8% said they were not. That is only slightly worse than in earlier years. But when asked about future credit conditions, a record percentage expects that loans will become even harder to get over the next three months.

The bottom line is that the borrowers are unlikely to approach banks for loans until business conditions generally appear to be improving. Therefore, it will take several more months before we will see a distinct positive impact from the Fed's credit easing policy on new bank lending and loan commitments. Bankers

may tell the Treasury that loan originations are rising, but at least to small businesses the odds of getting a loan application approved are low and getting lower. And until that situation turns around, only a sub-par economic recovery can be expected even after the recession itself comes to an end later this year.

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