



Credit Eases 'My Pain' as U.S. Bank Lending Buoy Small Business

By Steve Matthews - Oct 18, 2010 7:00 PM ET



New York Fed President William Dudley said Oct. 10, "As time passes, we'll see a further improvement in credit availability, and as that happens, that will actually support economic activity going forward."

Khalique Rehman, who runs My Pain Clinic in McDonough, Georgia, got a \$1.8 million loan this month from Atlanta-based Private Bank of Buckhead to purchase a new building and construct offices.

"I was surprised because everyone said it would be so difficult," said the 46-year-old physician, who plans to double the space of his eight-employee practice and hire another doctor and possibly a nurse. "I am really happy."

The freeze in bank credit is beginning to thaw after two years, signaling more support for the U.S. recovery.

American banks increased credit in July, August and September, the first consecutive gains since October 2008, according to Federal Reserve data released Oct. 15. Commercial and industrial loans rose in July and August after dropping 25 percent, the data showed. Banks eased lending standards in the second quarter for the first time since the credit crisis began, the Fed reported Aug. 16.

The stabilization may help reduce the odds of a relapse into recession next year to less than 10 percent, said Neal Soss, chief economist at Credit Suisse Holdings USA Inc. in New York. That compares with a median estimate of 20 percent during the next 12 months among 48 econo-

mists surveyed by Bloomberg News this month.

"Lending is no longer collapsing," Soss said. "That is a very good thing compared to where we were. When you are in a hole, the first thing is to stop digging deeper. That is where we are: The credit system is not getting weaker."

Double-Dip Unlikely

Fed officials cited the improvement at their Sept. 21 meeting in finding a second recession unlikely, according to minutes released Oct. 12.

"Credit problems more broadly appeared to have mostly peaked," commercial loans "rose slightly in July" and "there were some signs that credit conditions had begun to improve for smaller firms," the minutes said.

Regional bank stocks are likely to benefit from any increase in lending, including Wells Fargo & Co. of San Francisco, PNC Financial Services Group Inc. of Pittsburgh and Fifth Third Bancorp of Cincinnati, said Richard Bove, an analyst at Rochdale Securities in Lutz, Florida.

Bank stocks have lagged behind the broader market this year as credit has contracted. The Financial Select Sector SPDR Fund, an exchange-traded fund that includes New York-based

JPMorgan Chase & Co. and Wells Fargo, has been hitting 52-week lows relative to the Standard & Poor's 500 Index.

Higher Yields

The pick-up in lending also may boost yields on U.S. Treasury 10-year notes to 3 percent by June and 4 percent by the end of 2011, said Mark Zandi, chief economist at Moody's Analytics. The yield fell to 2.33 percent on Oct. 8 from 4 percent in April as the economy slowed.

"This is a very positive sign for future growth," the West Chester, Pennsylvania-based economist said. "Nonfinancial corporations are no longer deleveraging. Increasingly it is no longer a question of whether businesses can invest and hire, but whether they are willing. This is a good reason for optimism."

An increase in bank lending may help the economy expand 2.9 percent next year, he estimates. Growth stalled to an annualized 1.7 percent pace in the second quarter from 5 percent in the last three months of 2009.

Rehman said his 4 1/2-year-old clinic, which specializes in pain, sports medicine and rehabilitation, will move to its new location in Stockbridge, Georgia, after the interior is rebuilt. Processing the loan



through closing took about two months.

'Definitely Eager'

"Banks are definitely eager," he said. "Everything went very smoothly. I am quite satisfied."

Pat Carroll, 31, received a \$300,000 loan from Wells Fargo in August to expand his Atlanta apartment-management company with additional properties in Georgia, North Carolina, Tennessee, Texas, Maryland, Virginia and Florida.

"You couldn't get a loan two years ago," he said. "Banks are back in business and lending again. Things are starting to loosen up."

Some borrowers still aren't seeing much change. Brian Rist, who runs a Fort Myers, Florida-based hurricane-protection company, said he's disappointed that a loan he's negotiating may require him to put up family assets as collateral, even though his business is profitable and has \$13 million in revenue. He wants to hire another 20 to 25 people to diversify into energy audits for companies and individuals.

"Banks are trying to fend off as much risk as they can," he said. "We have a 16-year track record and have never been late on any notes. I have no choice" but to guarantee the loan personally.

Weak Demand

Fed data show that most of the credit growth so far comes

from banks buying securities including mortgage-backed bonds rather than making loans, as demand, especially among consumers, is still weak. Commercial and industrial loans rose at an annual rate of 1.6 percent in July and 0.4 percent in August after 20 consecutive months of declines and fell 3.5 percent in September, as businesses slowly begin to reverse efforts to shed debt and hoard cash.

Purchases of securities other than Treasury and agency bonds have risen at an annual rate of more than 10 percent for three months, according to the Fed. That indicates lenders are willing to take risks and feel more comfortable about their capital levels, said Paul Kasriel, chief economist at Northern Trust Corp. in Chicago.

"When bank credit reaccelerates, it usually starts with the securities and then moves with a lag to the loan portfolio," said Kasriel, who worked as a research economist at the Federal Reserve Bank of Chicago. "This appears to be the first sign that banks are willing to commit risk-based capital. We are early in the game."

Looser Standards

Banks also are loosening standards on lending to businesses of all sizes, according to the Fed's most recent survey of senior loan officers, released Aug. 16.

"The good news is that the tightening of credit standards has passed," New York Fed

President William Dudley said Oct. 10 in Washington. "As time passes, we'll see a further improvement in credit availability, and as that happens, that will actually support economic activity going forward."

Bank of America Corp., the largest U.S. bank by assets, said Oct. 14 it plans to hire 1,000 employees in the next year to focus on companies with sales of \$3 million or less.

"For small business, a stabilization in lending is huge because the contraction has been such a drag," said UBS Securities economist Samuel Coffin. "Small banks are lending more increasingly," so there is "increased competition in a few areas."

Growing 'A Little Bit'

Zions Bancorporation's loan business is starting to stabilize, and the Salt Lake City-based bank's commercial portfolio may be "even growing a little bit," Chief Executive Officer Harris H. Simmons said Sept. 13 at a Barclays Capital investor conference in New York. "We are very much focused on increasing lending activity."

Huntington Bancshares Inc., based in Columbus, Ohio, last month signed a 15-year agreement to open branches in at least 103 Giant Eagle Inc. supermarkets in Ohio and West Virginia as part of a focus on small business.

"We're turning the corner on loan growth," Mary Navarro, senior executive vice presi-



dent, said Sept. 16 at an investor meeting in New York.

Some banks are taking more risks after repairing their profit performance since last year, when the Fed ordered 10 large U.S. lenders to raise \$74.6 billion after stress tests showed potential losses if the economy worsened. Second-quarter earnings of \$21.6 billion were the largest in almost three years, the Federal Deposit Insurance Corp. said Aug. 31. Bank capital relative to assets is the highest since 1935, Bove said.

Housing Bubble

While credit is stabilizing, no one is predicting a return to the 11 percent average annual increases in loans from 2005 to 2007 that helped fuel the housing bubble and a construction boom. And some types of lending, including commercial real estate and credit cards, continue to lag.

The Fed is considering buying more Treasuries and efforts to boost inflation expectations to stimulate the economy and reduce unemployment, according to the Sept. 21 meeting minutes. The central bank was prepared to ease monetary policy "before long," the minutes said, after finishing \$1.7 trillion in purchases of Treasuries, mortgage-backed securities and housing-agency bonds in March. The jobless rate has remained at or above 9.5 percent since August 2009.

New Capital Requirements

Banks also face risks that might derail their ability to boost credit. These include new requirements to raise capital levels under the Dodd-Frank financial overhaul and international Basel Committee on Banking Supervision rules, along with a possible further decline in U.S. home prices and problems with

improper documentation of foreclosures, according to Mark Vitner, a senior economist at Wells Fargo.

"This marks the end of the credit contraction," Vitner said. "We are likely to see bank lending increases but at a very modest pace. The recovery will be very slow. We have a long road back."