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Bank Credit Highest Since Before Lehman as U.S. Growth Continues

By Steve Matthews and Ilan Kolet **December 12th, 2011**

U.S. bank credit is growing at the fastest pace in three years, giving the Federal Reserve confidence in the economic expansion's staying power.

Financial institutions increased commercial and industrial loans by an average annual pace of almost 10 percent in the third quarter, the highest since the comparable quarter in 2008, compared with a 1.7 percent decline in the past four years, according to Fed data. The latest numbers show loan growth of 15 percent, seasonally adjusted, in October and 6.1 percent in November.

The resumption in lending means a projected fourth-quarter pickup in gross domestic product may be sustained next year even amid Europe's sovereign-debt crisis, said Robert McTeer, former Federal Reserve Bank of Dallas president. He predicts the central bank's policy group, which has moved to push down long- term interest rates and pledged to keep its benchmark federal funds rate near zero through mid-2013, probably won't approve new monetary easing at its Dec. 13 meeting.

“The bank-credit statistics argue that more stimulus isn't needed,” said McTeer, 69, a distinguished fellow at the Dallas- based National Center for Policy Analysis. The Fed considers loan data an “important” indicator reinforcing its forecast for growth to accelerate, so the trend “is very encouraging.”

Banks have eased lending terms this year after raising levels of equity capital following 2009 Fed stress tests and reducing losses stemming from the housing slump and deepest recession since the 1930s. Credit markets froze and financial institutions tightened standards after the bankruptcy of Lehman Brothers Holdings Inc. in 2008.

‘Improved' Demand

The “improved loan demand” is “encouraging,” agreed Federal Reserve Bank of Atlanta President Dennis Lockhart, a former commercial banker. “Businesses are more of a mind to expand,” he said Nov. 29 after an economic-outlook conference in Atlanta.

General Dynamics Corp., a defense contractor, increased its long-term borrowings to $3.9 billion in the third quarter from $2.4 billion in the previous quarter. Part of this went to new plant and equipment spending, including a $500 million expansion plan over seven years at Gulfstream Aerospace, a business-jet maker in Savannah, Georgia, spokesman Robert Doolittle said.

Magnum Hunter Resources Corp., an oil and natural-gas exploration and production company in Houston, increased its long-term borrowings to $209.5 million in the third quarter from $145.8 million three months earlier.

“Our available credit with our banks this year” has increased five times “based on the success of our drilling programs,” Chief Financial Officer Ronald Ormand said in a statement.

Bright Spot

Fed officials cited commercial lending as a bright spot during the Nov. 1-2 Federal Open Market Committee meeting, saying it “accelerated” beyond “strong increases” in the first half of the year, based on the minutes published Nov. 22. Domestic banks have loosened standards for eight consecutive quarters, according to the Fed's October 2011 survey of senior loan officers released Nov. 7.

“We are looking at a clear upward trend in bank lending to businesses, and that to me has been the missing link,” said Ian Shepherdson, chief U.S. economist at High Frequency Economics Ltd. in Valhalla, New York. “If that continues, and I think it will, then I think that the small-business sector, which has been in a horrible, horrible state, will really contribute strongly to growth next year.”

Housing, which has aided every post-World War II recovery except the one after the 2007-2009 recession, hasn't rebounded from a five-year slump, so the improvement in business investment is helping to pick up the slack.

Fourth-Quarter Expansion

Shepherdson predicts GDP will expand more than 3 percent in the fourth quarter, the fastest this year, and 3 percent in 2012. That compares with the 2.8 percent and 2.1 percent median forecasts of economists surveyed by Bloomberg News from Dec. 2 to Dec. 8. The Fed's governors and regional-bank presidents project 2.5 percent to 2.9 percent growth next year.

U.S. lenders had net income of $35.3 billion in July- September, the best performance in four years, as loan-loss provisions and net charge-offs fell, Federal Deposit Insurance Corp. data showed Nov. 22. They put aside 47 percent less money for bad loans, and charge-offs fell by 39 percent, the FDIC said in its Quarterly Banking Profile released in Washington.

“Every bank in the U.S. benefits” when loan demand strengthens, since lending is “very profitable,” said Richard Bove, an analyst at Rochdale Securities LLC in Lutz, Florida. Most corporations borrow at rates higher than the prime rate of 3.25 percent, while 10-year Treasury notes yielded 2.06 percent at 4 p.m. on Dec. 9 in New York.

‘Buy' Ratings

Bove rates Bank of America Corp., Citigroup Inc., JPMorgan Chase & Co., Wells Fargo & Co. and U.S. Bancorp as “buy.”

Commercial lending is “very strong for us,” U.S. Bancorp Chief Executive Officer Richard Davis said at an investor conference Dec. 7. “Our growth last quarter was very good. Our growth this quarter is better than last quarter, and so the momentum continues.”

Lending also supports greater investment in equipment and software, which increased by more than 15 percent in the third quarter after an almost 15 percent rise in 2010, Bureau of Economic Analysis data show. This investment -- for goods ranging from calculators to aircraft -- contributed about a full percentage point to the quarter's 2 percent growth.

During the recession, the share of business investment in GDP fell to about 9.2 percent, the lowest since the mid-1960s.

‘High Correlation'

“There is a very high correlation between growth in bank credit and growth in demand in the economy,” said Paul Kasriel, Northern Trust Corp. chief economist and a former Fed staffer. “The FDIC data suggest banks -- and perhaps bank regulators -- are more comfortable with bank-capital positions in order to support new lending,” he said.

While credit creation is positive, he said he worries about the impact of shocks from the European Union and other regions.

“We now are faced with a weakening in foreign demand, as the EU likely has entered a recession and the economic growth in the developing economies, such as China, is slowing because of prior monetary tightening there.”

Some companies also don't have access yet to lenient terms, said Diane Swonk, chief economist and senior managing director at Mesirow Financial Inc. in Chicago. “The best borrowers are getting solicited like crazy,” she said. “They have cash on their balance sheets and are getting low and easy credit. Everyone else is pretty much shut out.”

Repeated Rejection

Alan LeBlanc, 49, president of Brewed to Serve Restaurant Group Inc., which owns Max Lager's Wood-Fired Grill & Brewery in Atlanta, said borrowing remains tough. He spoke with “probably two dozen banks” over more than a year and was repeatedly rejected before a Georgia community bank approved an $800,000 loan this month for a new restaurant that will employ 60 people.

All this means economists aren't predicting a return to the 10.5 percent average annual increases in loans from 2005 to 2007 that helped fuel the housing bubble and a construction boom. Lending other than to businesses isn't recovering much. Bank real-estate loans declined 2.4 percent in the third quarter, while consumer loans rose 2.2 percent, Fed data show.

Responding to complaints that small companies still have trouble getting funding, Fed officials have held forums in Atlanta, Chicago and Denver to look at “frictions that impede the flow of credit to creditworthy borrowers,” Chairman Ben S. Bernanke said Nov. 9.

New York Fed President William C. Dudley, in a Nightly Business Report interview Nov. 16, said he recently had “probably the most positive meeting” with his small-business advisory group that he's had “in terms of the willingness of banks to engage with them.”

Loan Availability

Overall, the availability of loans improved by more than 25 percent between March 2010 and October 2011, according to data from the National Federation of Independent Business in Nashville, Tennessee.

Custom Cable Assemblies Inc. of Warner Robins, Georgia, had “no problem” borrowing $300,000 recently from BB&T Corp. to double its office and warehouse space, an expansion now under construction, Chief Financial Officer Terry Di Diego said. Di Diego, 56, and her husband, Joseph, 58, who is president, run the 17-employee maker of cables for the aerospace industry.

Their company, which has operated with an “extremely conservative” use of debt, benefited from a 26-year history, Di Diego said. “We had three banks competing over us.”

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Text: **Bloomberg Businessweek:**

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