

Economic SYNOPSES

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When Will Business Lending Pick Up?

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Bank loans to businesses typically fall during recessions and for a few months after recessions end. True to form, commercial and industrial (C&I) loans by commercial banks fell sharply during the recent recession and dropped by more than 10 percent in the second half of 2009, despite an upturn in gross domestic product (GDP) growth. The decline in C&I loans in the second half of 2009 was larger than in any six-month period following a business cycle trough since World War II.

Much of the recent decline in bank lending undoubtedly reflects the economic contraction, which by some measures was the most severe since World War II. Loan demand falls during recessions, and banks tend to tighten lending standards, which reduces loan supply. The Federal Reserve surveys banks quarterly to obtain information about changes in loan demand and lending standards.¹ Information from the surveys is useful in forecasting changes in loan volume and GDP.² The net percentage of surveyed domestic banks that reported tightening of lending standards from the previous quarter peaked in 2008:Q4 at 83.6 percent for loans to large- and medium-sized firms and 74.5 percent for loans to small firms. The chart shows that the net percentage of banks that tightened standards for C&I loans also peaked during recessions in 1990-91 and 2000-01.

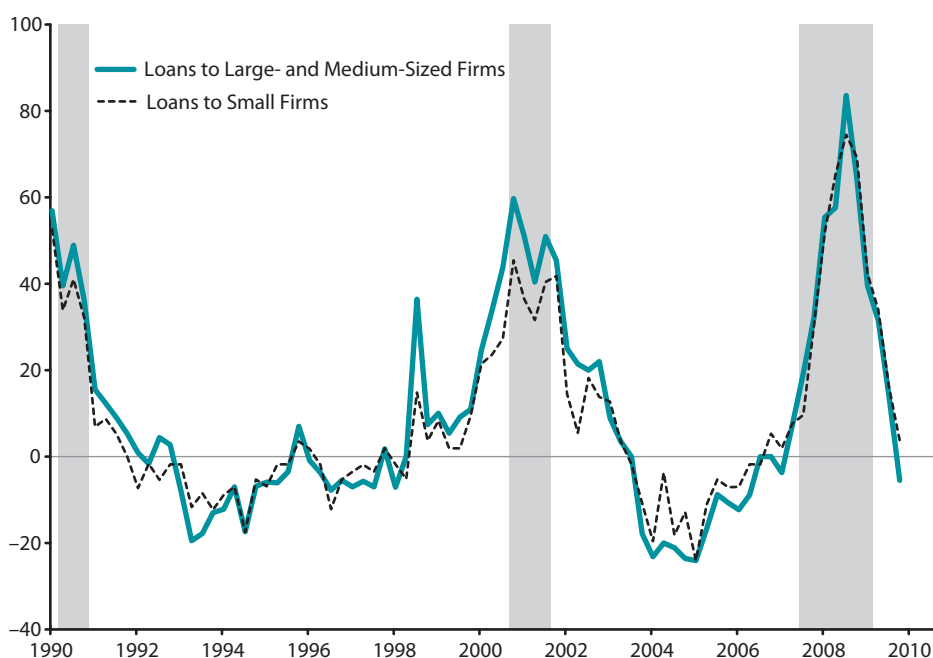
The percentage of respondents reporting tighter standards has declined in recent surveys. In the January 2010 survey, no banks reported tighter standards on loans to large- and medium-sized firms, while 5.5 percent reported that they had eased terms somewhat. This was the first survey by the Fed that reported a net percentage of banks easing terms for loans to large- and

medium-sized firms since 2007:Q2. Although 3.7 percent of responding banks indicated tightening of standards for loans to small firms, this was the lowest percentage since 2007:Q2.

The recent declines in tightening of lending standards suggest that business lending may be poised for a rebound.

Whereas the recession and the accompanying decline in loan demand undoubtedly explain much of the decline in business lending, surging delinquencies and loan losses

Net Percentage of Domestic Respondents Tightening Standards for Commercial and Industrial Loans



NOTE: Gray bars indicate recessions as determined by the National Bureau of Economic Research. The current recession end date of 2009:Q2 is used for illustrative purposes.

also likely contributed to the decline during the recession and early months of the recovery. Loan losses erode bank capital, which leaves banks less able or willing to extend new loans, and banks respond to rising business failures and declines in their own capital-to-assets ratios by tightening lending standards (Lown and Morgan, 2006). The January survey found current and prospective delinquency rates on C&I loans to small businesses were higher than those to large- and medium-sized firms. Thus, even though few respondents reported tightening of lending standards, the outlook for a significant increase in loan supply, espe-

cially for small firms, is clouded by a substantial overhang of delinquencies and possible losses on outstanding loans. Nonetheless, given the good track record of the survey in forecasting loan volume and GDP growth, the recent declines in tightening of standards suggest that business lending may be poised for a rebound. ■

¹ January 2010 Senior Loan Officer Opinion Survey on Bank Lending Practices (www.federalreserve.gov/boarddocs/SnLoanSurvey/201002/default.htm).

² See Lown, Cara and Donald P. Morgan. "The Credit Cycle and the Business Cycle: New Findings Using the Loan Officer Opinion Survey." *Journal of Money, Credit, and Banking*, September 2006, 38(6), pp. 1575-97.