FRBSF Weekly Letter

Number 94-37, October 28, 1994

Bank Business Lending Bounces Back

Bank lending to businesses is on the rebound. After falling during much of the recession and most of the recovery, business or commercial and industrial (C&I) loans have increased at a 13.1 percent annual rate for the first nine months of 1994. Even in California, which was hit by a prolonged recession, C&I loans at banks have risen sharply since March 1994.

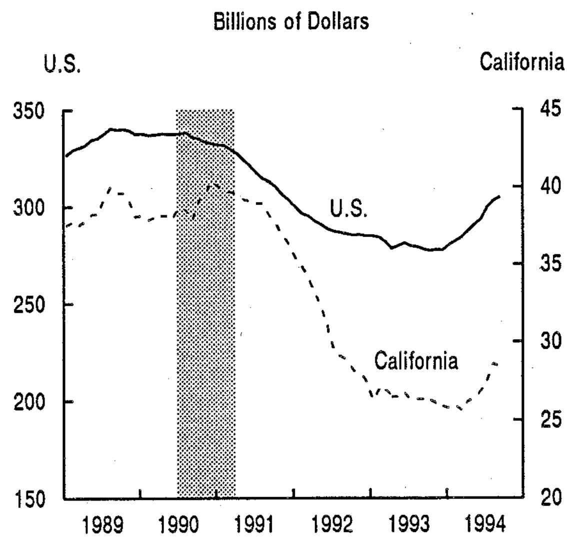
For the U.S., the upturn in business loans came later than usual in the recovery. Nevertheless it appears to be broad-based and to reflect the combination of strong demand for credit on the part of businesses and a shift by banks from generally tight credit standards to more relaxed terms following improved economic conditions. For California, the turnaround is another indication that the state is on the path to recovery.

Tracking the upturn

The Federal Reserve's Weekly Consolidated Condition Report of Commercial Bank Assets and Liabilities is a timely source of published bank loan data. The 140-plus large banks reporting these data account for over 63 percent of the business loans at domestically chartered banks. In this *Letter,* data from this report and lending practices surveys are used to examine the turnaround in C&I lending.

The recent surge in business lending shown in the Figure contrasts sharply with the long decline in C&I lending during most of the recovery (the shaded area denotes the last recession, which ended in March 1991). For the sample of large banks in the U.S., seasonally adjusted business loans grew at a 13.1 percent annual rate between December and September. On the strength of nine consecutive monthly advances, C&I loans at the large banks are up by over $27 billion since year-end 1993.

Figure 1
Business Loans Outstanding at Large Banks



Even in California, where the economy has been languishing following a prolonged recession, business loans have taken off. Since their low point in March 1994, C&I loans rose for five months in a row before dipping slightly in September. During the six-month period beginning in March outstanding business loans at the sample of California banks climbed by $2.8 billion, an annual rate of growth of 21.6 percent.

The strong turnaround in business lending nationally accompanied by increased demand for loans and more relaxed lending standards is a positive sign that the banking system is providing credit for a growing economy. While the surge in business loans in California in recent months could prove to be an aberration, it is consistent with other signs of recovery in the state.

Western Banking

Western Banking is a quarterly review of banking developments in the Twelfth Federal Reserve District. It is published in the *Weekly Letter* on the fourth Friday of January, April, July, and October.

Lagging indicator

In a recovery, a delay of one or two years in the upturn of business loans is typical, which is one reason the U.S. Department of Commerce classifies C&I loans outstanding as a lagging economic indicator. This means that, in the aggregate, business loans at banks do not begin to fall until after the peak in the business cycle has been reached and a recession has begun, and that they typically continue to decline after the trough in the business cycle and the onset of a recovery.

The behavior of business loans in the most recent recession follows the pattern for a lagging indicator. But this time the turnaround in business lending has lagged the trough in the economy by much longer—more than 2½ years.

Several factors may help explain the longer lag in this cycle. First, the economic recovery was relatively weak in the early stages. Second, demand for business credit also may have been reduced by the need for some borrowers to reduce their debts from their elevated levels of the 1980s. Third, with the fall in interest rates earlier in the 1990s, many larger businesses shifted to bonds and equities for long-term financing.

Stronger demand

While the lag has been longer than usual, the upswing in the U.S. economy since March 1991 has stimulated demand for new orders for plant and equipment and for durable consumer goods that have spurred the demand for business credit. Stronger loan demand for inventory financing and new investment both have been cited by large banks surveyed in the Federal Reserve's Senior Loan Officer Surveys as reasons for the increased borrowing.

Survey data also indicate that the increase in demand for bank business loans has been strongest from the small- and medium-sized commercial borrowers that must rely more heavily on banks for their financing. Finally, the August 1994 Senior Loan Officer Survey did not find evidence that the increase in demand was a result of a shift from nonbank and capital market sources following the recent increases in interest rates, although that perhaps was because ". . . banks are more aware of the purpose of a loan than their customer's alternative sources of funds."

Increased supply

Increased demand is not the only factor driving bank lending, as banks also have reasons for expanding the supply of credit. Before the upturn in business lending, banks generally were flush with funds. Many banks built up their securities portfolios rather than make loans because they were following relatively tight lending practices brought about by a combination of the recession, concerns about loan quality, and capital requirements.

The change is that the economic recovery has helped bring about a clear improvement in banks' loan quality. Since problem business loan ratios for large banks peaked at 6.21 percent at the end of the recession in March 1991, they have improved markedly, dropping below 3 percent by December 1993, lower than at any time in the last ten years; and by June 1994 it fell to only 2.09 percent. Such dramatic improvement freed many banks to adopt a more accommodative lending stance.

The Senior Loan Officer Surveys indicate that since mid-1993 more banks have relaxed their business lending standards than have tightened them. The surveys also indicate that banks have reduced interest rate spreads over reference rates (like the prime rate), relaxed collateral standards, and lowered the cost of credit lines to be competitive and to respond to the "more favorable economic outlook."

Trend: more competition

The rapid increase in business lending in 1994 is not likely to overcome the broader trend, in which banks are losing market share in business lending. While banks remain a key source of credit for the business sector, especially for those firms without access to the financial markets, banks' market share of traditional non-mortgage business lending has fallen from 31 percent to 22 percent over the last decade. The decline in market share is mirrored by the decline in relative importance of C&I loans in banks' loan portfolios. Once the mainstay of bank lending, business loans have fallen from almost 35 percent of banks' domestic loans ten years ago to only 23 percent today.

This broader trend reflects increased competition, which no doubt will remain intense, both from nonbank financial institutions, like finance companies, which also supply business credit, and from the financial markets, which allow larger firms the opportunity to borrow directly by issuing commercial paper or corporate debt. In this environment banks likely will continue to suffer from an erosion of their base of larger corporate borrowers and will be left to focus more on smaller and middle market business borrowers.

Gary C. Zimmerman
Economist

REGIONAL BANK DATA

JUNE 30, 1994

(TABLE HAS BEEN REVISED TO REFLECT RECENT CHANGES IN BANK REPORTING)

		DISTRICT	ALASKA	ARIZ.	CALIF.	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH.
ASSETS AND LIABILITIES -- $ MILLION (ALL COMMERCIAL BANKS, NSA)											
ASSETS	TOTAL	519,518	5,215	38,643	336,280	22,230	11,443	17,762	27,539	17,208	43,199
	FOREIGN	40,585	0	0	38,138	2,402	0	0	25	0	20
	DOMESTIC	478,933	5,214	38,643	298,142	19,828	11,443	17,762	27,514	17,208	43,179
LOANS	TOTAL	341,241	2,757	22,975	219,541	14,378	8,362	10,488	19,782	10,204	32,754
	FOREIGN	31,119	7	0	29,685	1,390	0	0	19	0	18
	DOMESTIC	310,122	2,751	22,975	189,856	12,988	8,362	10,488	19,763	10,204	32,736
	REAL ESTATE	163,617	1,280	9,053	112,715	7,894	2,686	2,721	8,271	4,561	14,437
	COMMERCIAL	62,545	851	2,833	37,743	3,168	1,748	817	5,241	1,693	8,451
	CONSUMER	56,379	464	7,300	23,414	1,088	2,600	6,550	4,126	3,200	7,636
	AGRICULTURAL	6,382	3	349	3,302	36	896	14	494	169	1,119
	OTHER LOANS	21,200	153	3,440	12,682	801	432	386	1,632	581	1,093
SECURITIES	TOTAL	87,653	1,826	9,976	52,628	5,145	1,780	4,113	3,970	3,611	4,603
	U.S. TREASURIES	26,631	998	2,495	15,561	2,321	467	1,378	1,301	743	1,367
	U.S. AGENCIES, TOTAL	23,265	349	2,951	13,844	1,575	514	961	905	1,404	761
	U.S. AGENCIES, MBS	16,468	294	2,389	10,159	999	260	587	668	736	378
	OTHER MBS	4,619	89	558	3,520	24	39	74	16	122	177
	OTHER SECURITIES	33,137	391	3,972	19,703	1,225	760	1,699	1,748	1,342	2,298
LIABILITIES	TOTAL	474,316	4,536	35,250	308,184	20,389	10,565	15,391	25,037	15,708	39,257
	DOMESTIC	433,731	4,536	35,250	270,047	17,986	10,565	15,391	25,012	15,708	39,237
DEPOSITS	TOTAL	401,969	3,825	31,371	267,142	14,148	8,424	9,943	21,359	11,644	34,114
	FOREIGN	35,234	0	0	32,933	2,168	0	0	13	81	39
	DOMESTIC	366,735	3,825	31,371	234,209	11,980	8,424	9,943	21,346	11,563	34,075
	DEMAND	96,102	1,148	7,285	64,907	2,385	1,582	2,989	4,808	2,638	8,358
	NOW	41,905	373	3,668	24,213	1,438	1,069	1,468	3,438	1,639	4,599
	MMDA & SAVINGS	140,148	1,302	11,706	91,931	4,710	2,811	3,961	7,147	4,070	12,511
	SMALL TIME	61,996	447	7,367	35,214	1,937	2,127	913	5,100	2,346	6,545
	LARGE TIME	26,224	505	1,344	17,723	1,507	835	611	834	867	1,997
	OTHER DEPOSITS	360	49	1	221	3	0	0	18	3	65
OTHER BORROWINGS		39,117	672	3,080	13,299	5,298	1,983	4,112	2,999	3,620	4,054
EQUITY CAPITAL		45,201	679	3,393	28,095	1,841	878	2,372	2,502	1,500	3,942
LOAN LOSS RESERVE		9,673	40	473	7,080	246	119	460	433	216	606
LOAN COMMITMENTS		226,403	680	35,980	119,373	7,269	3,727	18,393	14,416	9,006	17,559
TIER1 CAPITAL RATIO		0.098	0.194	0.114	0.092	0.107	0.095	0.153	0.098	0.120	0.090
TOTAL CAPITAL RATIO		0.126	0.205	0.136	0.125	0.126	0.112	0.166	0.114	0.136	0.113
LEVERAGE RATIO		0.080	0.133	0.076	0.076	0.078	0.076	0.127	0.084	0.086	0.082
QUARTERLY EARNINGS AND RETURNS (ANNUALIZED) -- $ MILLION (ALL COMMERCIAL BANKS, NSA)											
INCOME	TOTAL	11,256	107	788	6,930	427	235	767	644	389	969
	INTEREST	8,521	89	639	5,348	363	198	353	475	301	755
	FEES & CHARGES	763	6	57	498	13	16	18	54	23	78
EXPENSES	TOTAL	8,648	80	620	5,480	331	173	443	505	299	718
	INTEREST	2,710	27	206	1,692	144	73	86	144	111	228
	SALARIES	2,313	27	151	1,537	88	33	70	148	67	193
	LOAN LOSS PROVISION	487	2	32	357	11	5	48	10	3	20
	OTHER	3,138	25	232	1,894	88	62	239	204	118	277
TAXES		1,071	8	66	655	37	22	115	50	32	86
NET INCOME		1,526	19	101	789	60	39	207	88	58	165
ROA (% ANNUALIZED)		1.20	1.46	1.07	0.95	1.07	1.40	5.02	1.29	1.38	1.55
ROE (% ANNUALIZED)		13.51	10.92	11.94	11.23	13.02	17.93	34.99	14.13	15.42	16.71
NET INTEREST MARGIN (% ANNUALIZED)		4.55	4.88	4.57	4.42	3.94	4.43	6.47	4.82	4.56	4.96
ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS, NSA)											
LOAN LOSS RESERVE		2.90	1.38	2.03	3.31	1.71	1.39	4.55	2.27	2.00	1.92
NET CHARGEOFFS, TOTAL		0.65	-0.06	0.46	0.80	0.00	0.08	2.09	0.10	0.06	0.27
	REAL ESTATE	0.54	-0.25	0.02	0.76	0.18	0.00	0.62	-0.18	-0.02	0.07
	COMMERCIAL	0.22	-0.03	-1.02	0.48	-0.41	-0.09	-3.45	-0.45	-0.18	0.08
	CONSUMER	2.15	0.40	1.73	2.94	0.92	0.31	3.34	1.39	0.52	0.92
	AGRICULTURAL	-0.41	0.00	0.03	-0.48	-18.90	0.08	0.00	0.39	-0.11	-0.45
PAST DUE & NON-ACCRUAL, TOTAL		3.23	2.12	1.97	3.96	2.34	1.28	4.13	1.13	1.36	1.73
	REAL ESTATE	4.77	2.02	2.26	6.01	2.53	1.00	2.90	1.41	1.18	2.13
	CONSTRUCTION	15.97	8.72	3.93	23.25	6.10	1.81	2.45	5.12	2.15	7.81
	COMMERCIAL	7.23	1.99	6.00	9.68	2.05	1.00	4.51	2.06	1.53	1.79
	FARM	4.93	0.00	9.45	5.23	1.28	6.03	0.00	6.26	11.19	1.41
	HOME EQUITY LINES	1.10	0.89	0.53	1.20	1.37	0.26	0.58	0.16	0.63	1.32
	MORTGAGES	2.57	1.75	1.23	3.07	3.05	0.95	1.59	0.82	0.83	0.96
	MULTI-FAMILY	6.87	0.27	0.74	9.82	0.84	0.00	1.02	0.00	0.09	0.76
	COMMERCIAL	1.94	1.95	1.62	2.08	2.70	1.04	4.69	0.58	2.20	1.51
	CONSUMER	2.41	1.98	2.61	2.55	2.27	1.13	4.72	1.08	1.29	1.28
	AGRICULTURAL	2.10	0.00	1.78	1.57	23.96	3.41	1.30	1.76	1.34	2.22
NUMBER OF BANKS		692	8	34	415	17	20	21	45	44	88
NUMBER OF EMPLOYEES		237,933	2,865	18,757	149,540	8,623	4,968	7,869	16,643	7,785	20,883

Research Department

Federal Reserve Bank of San Francisco

P.O. Box 7702
San Francisco, CA 94120

BULK RATE MAIL
U.S. POSTAGE
PAID
PERMIT NO. 752
San Francisco, Calif.

Printed on recycled paper with soybean inks.

MARKET SHARE STATISTICS

DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS

PERCENT OF COMBINED MARKET TOTAL FOR AUGUST 1994, BY REGION

	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	56	36	8	72	3	24	91	1	8	50	44	7	62	30	8
DEMAND	90	7	3	98	0	2	98	0	2	89	8	3	90	7	4
NOW	65	27	9	62	5	33	88	0	12	58	35	7	62	34	4
SAVINGS & MMDAS	61	28	11	56	4	39	88	0	11	58	34	8	55	34	11
SMALL TIME	32	64	4	76	6	18	94	2	5	23	73	4	51	45	3
LARGE TIME	44	45	11	95	2	3	90	1	9	35	52	13	70	20	10

	IDAHO			NEVADA			OREGON			UTAH			WASH		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	91	5	4	78	18	5	83	7	10	79	5	16	56	34	10
DEMAND	97	0	2	98	2	0	95	2	3	91	4	5	90	9	2
NOW	89	4	7	78	14	7	85	5	10	82	1	16	65	22	13
SAVINGS & MMDAS	90	4	6	76	15	9	79	6	14	74	3	24	55	27	18
SMALL TIME	88	10	2	44	51	5	79	13	8	80	11	9	38	56	6
LARGE TIME	93	4	3	88	12	0	77	10	13	69	10	21	46	51	2

CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND SAVING BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING

INTEREST RATES ON DEPOSITS AND LOANS

TYPE OF RETAIL DEPOSIT ACCOUNT OR LOAN		AUG 1992	NOV 1992	FEB 1993	MAY 1993	AUG 1993	NOV 1993	FEB 1994	MAY 1994	AUG 1994
SAVINGS ACCOUNTS AND MMDAS	U.S	3.14	2.90	2.80	2.65	2.55	2.48	2.43	2.50	2.63
	DISTRICT	3.29	3.05	2.96	2.78	2.67	2.58	2.56	2.65	2.81
92 TO 182 DAYS CERTIFICATES	U.S	3.36	3.14	3.08	2.98	2.96	2.92	2.93	3.28	3.61
	DISTRICT	3.34	3.14	3.01	2.88	2.85	2.81	2.83	3.03	3.34
2-1/2 YEARS AND OVER CERTIFICATES	U.S	4.87	4.70	4.59	4.45	4.40	4.28	4.35	4.89	5.33
	DISTRICT	4.75	4.49	4.41	4.27	4.19	4.09	4.13	4.58	4.96
COMMERCIAL SHORT TERM FIXED*	U.S	4.42	4.17	4.16	3.91	4.02	3.95	4.03	4.68	5.28
	DISTRICT	5.38	4.79	4.28	4.19	4.75	4.43	4.95	6.78	5.39
COMMERCIAL SHORT TERM FLOATING*	U.S	5.95	5.91	5.85	5.58	5.53	5.56	5.49	6.32	6.83
	DISTRICT	6.29	6.59	6.36	5.40	6.48	6.46	6.36	6.38	7.34
COMMERCIAL LONG TERM FIXED*	U.S	6.28	5.97	6.43	6.02	6.21	5.38	5.41	6.17	6.66
	DISTRICT	8.20	6.44	9.19	10.86	8.05	6.62	6.58	N/A	9.82
COMMERCIAL LONG TERM FLOATING*	U.S	6.60	6.53	6.38	6.47	6.05	5.70	5.98	6.61	6.99
	DISTRICT	7.63	8.09	8.43	8.55	8.77	7.68	8.16	N/A	N/A
CONSUMER, AUTOMOBILE	U.S	9.15	8.60	8.57	8.17	7.98	7.63	7.54	7.76	8.41
	DISTRICT	9.39	8.76	8.98	8.23	8.09	7.70	7.68	7.86	8.15
CONSUMER, PERSONAL	U.S	13.94	13.55	13.57	13.63	13.45	13.22	12.89	12.96	13.33
	DISTRICT	13.68	12.83	12.67	13.87	12.69	13.00	12.02	12.26	13.37
CONSUMER, CREDIT CARD	U.S	17.66	17.38	17.26	17.15	16.59	16.30	16.06	16.15	16.25
	DISTRICT	18.46	18.29	17.76	17.60	17.58	17.00	17.17	17.61	17.34

SOURCES: MONTHLY SURVEY OF SELECTED DEPOSITS, SURVEY OF TERMS OF BANK LENDING, AND TERMS OF CONSUMER CREDIT
MOST COMMON INTEREST RATES ON RETAIL DEPOSITS, WEIGHTED AVERAGE INTEREST RATE ON LOANS
* DATA ARE COMPOUNDED ANNUAL RATES