

UNITED STATES ECONOMICS UPDATE

7th Nov. 2011



US banks batten down the European hatches

- The Fed's Senior Loan Officer survey shows that in the three months to October banks took steps to protect themselves from the European debt crisis. Nevertheless, the survey is still consistent with a modest expansion in actual domestic bank lending.
- It is encouraging that just 35% of US banks have more than 5% of their outstanding value of commercial and industrial (C&I) loans tied up in US firms that are significantly exposed to Europe. Moreover, in the three months to October, 17% of domestic banks tried to further reduce their exposure by tightening standards on lending to such companies.
- US banks were even keener to reduce their exposure to European banks, with two-thirds tightening their lending standards to these institutions and their affiliates. US banks are not immune to the events in Europe. But at least they appear to be taking steps to protect themselves from any illiquidity and solvency issues that would be triggered by a sovereign debt default or the break-up of the euro-zone.
- Banks continued to relax their standards on other lending. That said, in response to the weaker economic outlook, domestic lending standards for commercial real estate and C&I loans were relaxed by less than in previous quarters while standards for mortgage lending were unchanged. (See Chart 1.) When taken at face value, the share of banks easing standards is still consistent with actual loans to businesses continuing to rise. (See Chart 2.)
- That suggests it is not the supply of credit that's holding the economy back. Instead, the problem is the demand for credit. For example, 16% of banks reported weaker demand for C&I loans, which was the most since the start of 2010. If sustained, there is a risk that actual C&I lending will stagnate sometime next year. (See Chart 3.) And even though 15% of banks reported that the demand for residential mortgage lending rose, this was probably driven by greater demand for refinancing. As such, it is not consistent with a spike in home sales. (See Chart 4.)

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Chart 1: % of Banks Reporting Tighter Lending Standards

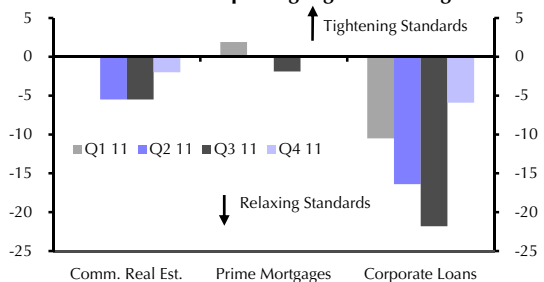


Chart 2: C&I Loan Lending Standards & C&I Bank Loans

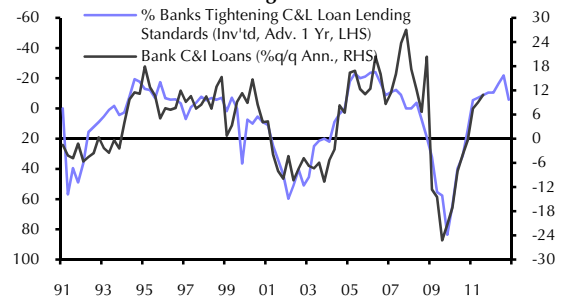


Chart 3: C&I Loan Demand & C&I Loans

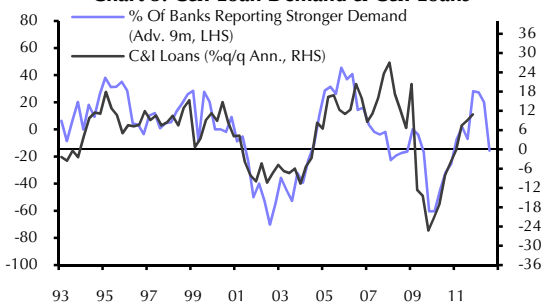
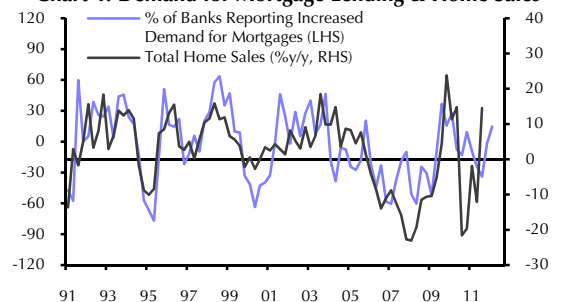


Chart 4: Demand for Mortgage Lending & Home Sales



Source – Thomson Datastream