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## Economics Group


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# Bank Lending: A Perspective on Credit

***Business lending by all types of banks has approached the prior peak before the recession and yet, in perspective, the changes in finance over the past 30 years provide a valuable perspective to credit today.***

### Bank Lending: Reaching Old Highs—in a Different Context

Commercial and industrial (C&I) loans outstanding have nearly returned to the highs of the prerecession period. Two points are worth noting. First, there is a clear cyclical pattern to business lending as the declines post the 2001 and 2008 recessions are clear. Second, the recovery in C&I lending has been driven by small and large domestic banks, while lending at foreign-related banks in the United States has yet to recover.

This cyclical improvement in lending has been accompanied by a decline in the net percentage of banks tightening standards on C&I loans to large and medium firms as well as to small firms as reported in the Fed's Senior Loan Officer Survey through the third quarter. Meanwhile, lending spreads have steadily declined since the early 2010.

### Perspective: The Evolution of Debt Finance

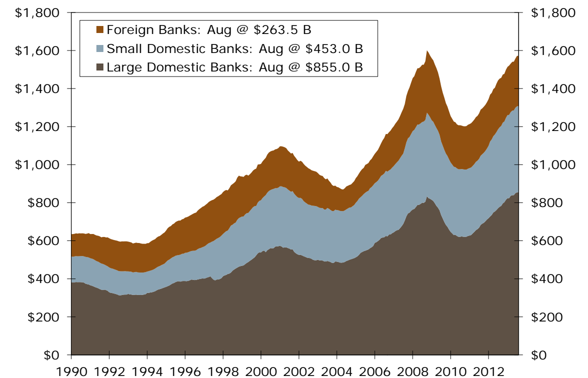
While bank lending has improved during this recovery, the supply of credit continues to evolve, as illustrated in the middle graph. Since the early 1980s, bank loans have lost favor as a share of credit, while commercial paper has become less prevalent since the late 1990s. Instead, corporate bonds have become an increasingly popular credit market instrument as long-term interest rates have declined. Mortgages and other loans evidence a cyclical pattern but have also lost share since the early 1980s. This shift to bond debt has been an evolving movement and a challenge to regulators as non-bank finance in the United States takes on greater importance.

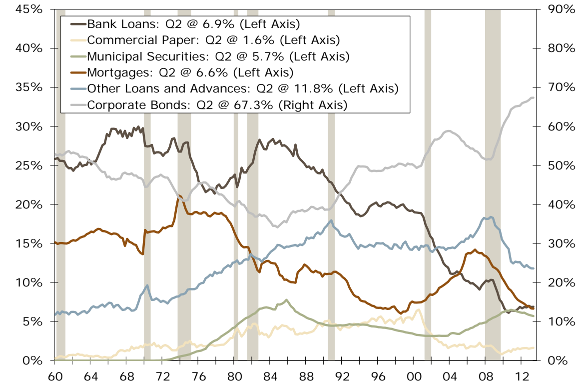
### The Big Picture: The Big Shift

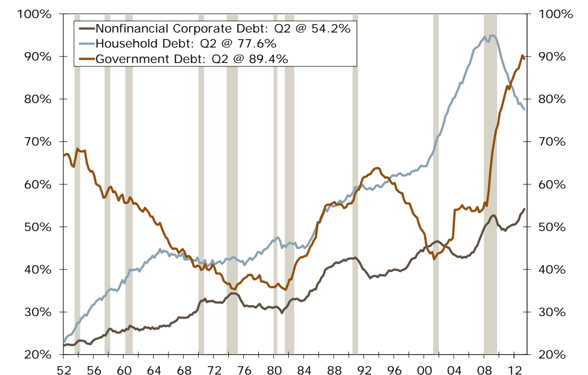
While we have focused here on business finance, the shift in debt has moved dramatically toward greater household and government debt (bottom graph). This move represents a different perspective on interest rate risk than commonly perceived in the past.

Since the early 1980s there had been a steady rise in household debt. During this same period, interest rates trended lower and credit availability increased as credit standards were eased and new methods of judging credit quality became available. However, in the 2007-2009 period this all changed as the rubber band of credit was stretched too far and the underlying assumptions on growth, home prices and interest rates conspired to break the most stable of glass houses.

In a similar manner, the rise of government debt since the early 1980s and especially since 2004 rests on a set of economic and credit market assumptions that create a vulnerability to investors. Can the government debt survive in a world of 2-2.25 percent growth? How long will interest rates stay this low and enable the federal government to finance its debt at a relatively small cost? Finally, what is the marketability of Treasury debt if central banks take their appetite away?

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