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Economics Group

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Bank Credit and Money in the Post-Great Recession Era

Bank credit and money growth have both exhibited a very typical cyclical pattern in the post-Great Recession era, but the amplitude of that pattern is consistent with the pace of a subpar recovery.

Business Lending and Inventories: A Basic, but Subdued, Cycle

Commercial and industrial (C&I) lending by banks has historically been closely tied to business inventories and that relationship has remained in place following the Great Recession (top graph). This comes despite all the changes in bank regulation and private business and bank strategies due to the recession. For this recovery, business inventory growth peaked in 2011 and C&I loan growth peaked in late 2012. Lending is still growing but the pace of growth has slowed.

While the pattern of lending/inventory build remains the same, the amplitude of growth in both series remains more modest compared to the 2006-2008 period. This likely reflects greater caution on the part of both businesses and bank lenders, and is one underlying explanation for the subpar pace of the overall economic recovery.

A Break from History: The Loan-to-Deposit Ratio

Another signal of caution in the bank credit process is the sharp decline in the loan-to-deposit ratio in the current recovery. This is in sharp contrast to the rise in the ratio evidenced in the middle graph during the 1987-1989, 1994-2000 and 2006-2008 periods. Typically, banks will increase the turnover of deposits as the economic expansion ages as banks seek new lending opportunities. Deposits are squeezed down to generate loans and thereby increase the credit multiplier in the economy for any given growth in deposits.

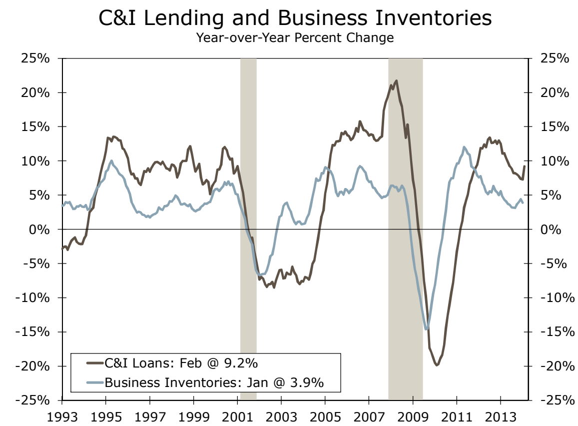
But this cycle has been clearly different. Banks have been far more cautious in their use of deposit growth and have retained a high level of deposits relative to loans than in the past. This more cautious loan-to-deposit ratio reflects a greater caution on the part of banks and helps explain why the pace of the recovery remains subpar this far into the current expansion.

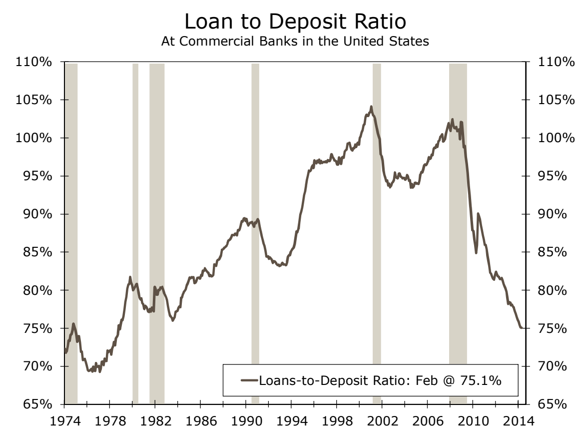
Money Growth: Modest Gains Despite Fed Liquidity

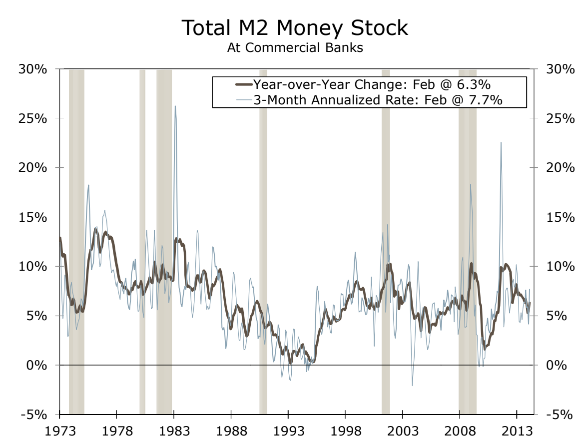
One result of bank caution has been the modest growth in the money supply despite the ample supply of liquidity provided by the Federal Reserve.

The rapid growth in Federal Reserve liquidity, measured by the growth of the monetary base—a standard measure of Fed liquidity employed by most economists—has grown by 20-40 percent at times during the current economic expansion. Yet money growth peaked at 10 percent in only Q1 2012 this cycle, and grew just 6.3 percent over the last year (bottom graph). The ratio of money growth to the monetary base is termed the money multiplier and the very low values for the multiplier reinforces the message that banks, as well as the public, remain cautious on the use of their funds.

All three measures reviewed in this note suggest a rather disciplined public and banking system in their deployment of Fed liquidity in the economy.







Source: Federal Reserve Board and Wells Fargo Securities, LLC

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