THE CASE AGAINST MORE BANK LENDING

by Steve Brown

Listening to the Sunday morning news shows and 60 Minutes yesterday, viewers were consistently led down a path of pure economic illogic. Even Carly Fiorina, the ex-CEO of HP and now constant conservative economic news commentator, laid blame on banks for not lending (in order to stop unemployment and falling corporate earnings). Each show started with how bad the economy was and then transitioned to all the help banks are getting from the Treasury. Each news program attempted to conclude that the solution was to get banks to lend. The logic clearly does not follow, as the last thing the taxpayer should really want is for banks that receive TARP capital to loosen lending standards and take on more risk.

The debate over whether the economy stimulates lending or lending stimulates the economy is a classic one and has yet to be resolved (since it was first raised after the Great Depression). One aspect of this debate that was lost on every Sunday news show anchor was the fact that in an economic crisis, loan demand drops, particularly for creditworthy borrowers. The reality is that in difficult times, it is harder to lend - even if banks wanted to do so. If you look back over past downturns, most loan demand comes from borrowers looking to refinance existing mortgages, revolving lines of credit and balloon financings. Yes, more credit would help those households and businesses that are already in tough financial straights, but these borrowers are now far from creditworthy. In addition, refinancing these borrowers would do very little to stimulate GDP and job creation. To best spur the economy, credit must be extended to consumers and businesses that are looking to expand. However, the point lost on the media is the fact that creditworthy borrowers that are looking to expand are tough to find in this economy. Few households really want to take on new car debt if they could lose their job in a month. Few businesses will expand given waning demand. Unfortunately, not one news show mentioned the risk of loosening credit underwriting or lower loan demand.

The American public does not want banks to loosen credit standards and provide more capital to the marketplace. Lower credit standards and loose capital are what got us to this negative business cycle to begin with. Further, if the American public wants more involvement from the Treasury forcing lending efforts (as Congress strongly suggested last week), it should consider the Japanese and South Korean experience. In both cases, investment programs directed government capital to needed sources. The problem came when those borrowers hadn't fully disclosed the extent of their balance sheet value and the injected government capital met with greater credit losses. The result was a misallocation of capital and a longer than needed downturn. This is why it makes us nervous when bankers and regulatory officials call for a "relaxing" of mark-to-market accounting. Instead of the Treasury demanding banks to lend more, they should require banks to more accurately mark their balance sheets to market, recognize the losses and then get out of the way. Only after the losses are ascertained and confidence is restored, will prudent businesses and consumers alike move to invest and consume once again.

Banks should be left alone to manage the newly injected TARP capital the most efficient way possible, without regulatory interference. Of course, this is just our opinion, since we weren't invited to the news shows.

BANK NEWS

Banks Closed

The FDIC on Friday closed down 2 more troubled banks, pushing the yearly total to 25. Sanderson State Bank ($37mm, TX) was closed and its deposits were assumed by Pecos County State Bank ($116mm, TX). Pecos assumed all deposits (including those above deposit insurance limits) for a 0.55% premium and also purchased $3.8mm of assets. Sanderson had nonperforming assets to assets of 7.7%, a concentration of residential construction loans and an over-reliance on brokered deposits according to regulators. Meanwhile, Haven Trust Bank ($572mm, GA) was also closed and its deposits were sold to BB&T Corp ($135B, NC). BB&T assumed all deposits (including those above deposit insurance limits) for $112mm, 4 branches and $55mm of the failed bank's assets. Haven was undercapitalized, had nonperforming assets of 12% of total assets and booked a $12.5mm 3Q loss.

FHLB, Boston

Seeking to preserve capital (due to increased asset writedowns and "negative market trends"), the FHLB of Boston has informed its members it has placed a moratorium on all excess stock repurchases until further notice. In a letter to members, the FHLB also indicated it was having difficulty on the funding side, as spreads on its debt had widened to "unprecedented levels," further compressing margins.

FDIC Premiums

The FDIC Board will meet tomorrow to decide on 2009 premiums. At this point, it looks like they will approve at least a 7bp increase on well-capitalized banks; more than a 100% increase.