FOR YOUR INFORMATION FYI
An Update on Emerging Issues in Banking

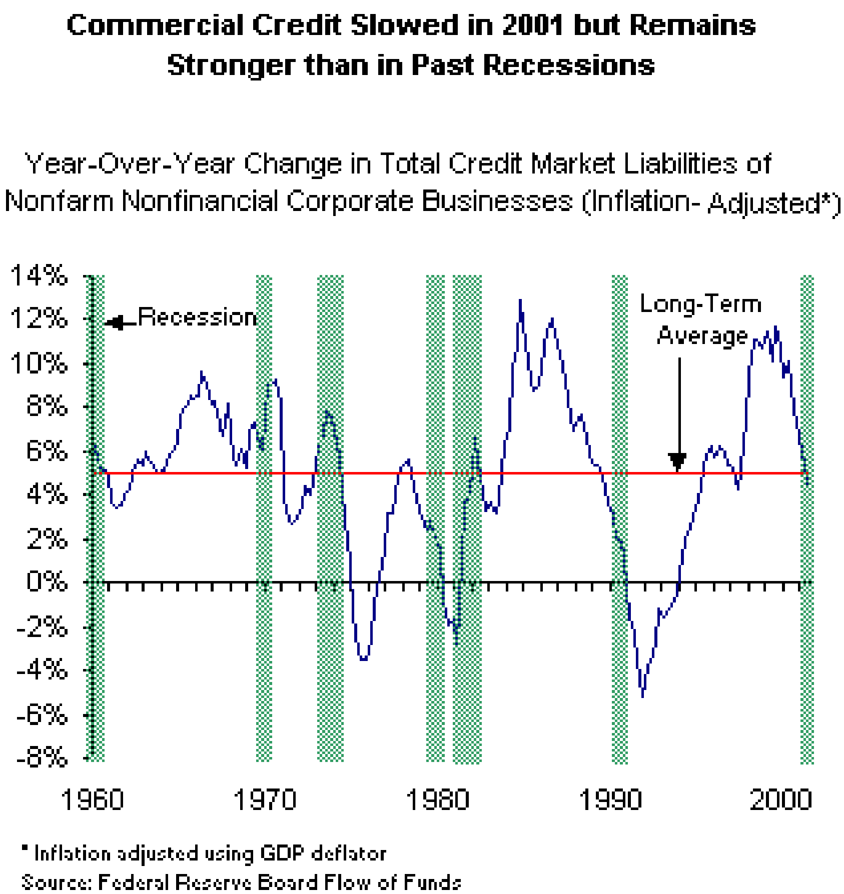
Business Credit Flowing Despite Recession

February 21, 2002

Business credit is more plentiful in this recession than in any other recessionary episode since the early 1970s, according to an FDIC report released today. The report cites a generally lower cost of capital, structural changes in banking and the financial markets, and a different regulatory landscape contributing to the current trend.

Measuring credit availability by focusing on business loans outstanding at commercial banks can be misleading. During 2001, for example, banks' commercial and industrial (C&I;) loan activity slowed sharply, but a more inclusive look at business credit conditions paints a different picture. In contrast to other recent recessions, commercial credit outstanding from all sources continued to grow in 2001 in real terms, albeit at a slower rate than in the three previous years of rapid credit expansion (see Chart 1).[1]

Chart 1

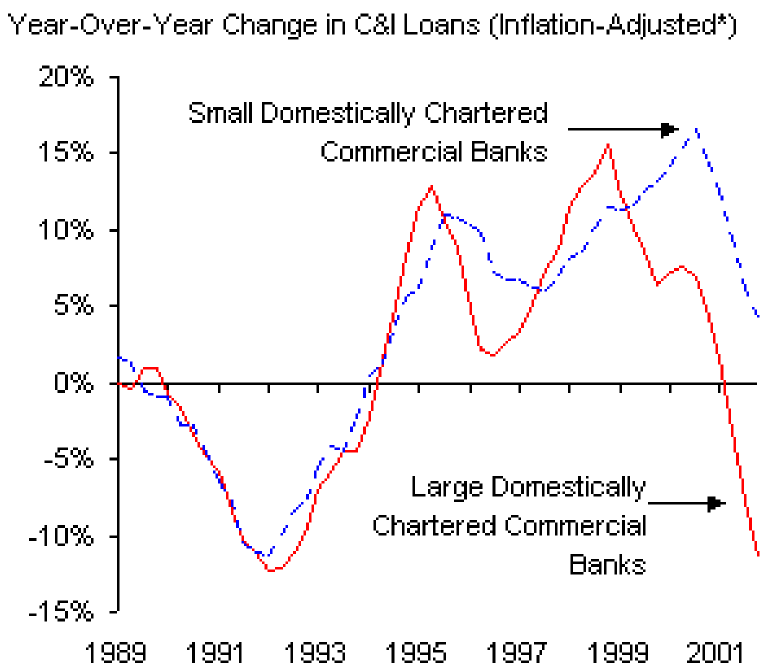


Large commercial banks have tightened C&I; loan underwriting standards in response to credit quality concerns. However, the current credit market environment is, in general, more favorable than it was in past recessions. Aggressive interest rate reductions by the Federal Reserve throughout 2001 helped reduce the cost of new capital and allowed many corporate borrowers to refinance debt obligations at lower rates. The average effective yield for investment-grade bonds fell by nearly 105 basis points between December 2000 and December 2001.[2]

Many businesses have greater access to the capital market than in the early 1990s, which has enabled these borrowers to diversify their sources of credit.[3] Partly reflecting this trend, C&I; loan growth at large banks has been more volatile than that of small banks since the mid-1990s (see Chart 2).[4] Faced with tighter bank underwriting standards, large borrowers have been able to meet their financing needs in 2001 by tapping the capital markets. Debt- and equity-underwriting capacity has helped business borrowers obtain financing through channels other than bank loans. In addition, a significant increase in bank loan sales in the secondary market in recent years has also reduced the usefulness of on-balance sheet C&I; loans as an indicators of banks' willingness to provide credit.[5]

Chart 2

C&I Loans Held by Large Commercial Banks Have Exhibited Greater Volatility Since the Mid-1990s



* Inflation adjusted using GDP deflator
Source: Federal Reserve Board H.8 Release (Haver Analytics)

Data show that smaller commercial borrowers have relied on bank credit throughout 2001 more than large corporate borrowers. In addition, a survey of small businesses by the National Federal of Independent Business shows that most of these small borrowers were able to obtain bank credit throughout 2001.[6]

While credit quality concerns reduced banks' willingness to lend to risky and highly leveraged borrowers, most banks have had the ability to continue to lend throughout this recession. Thanks to economic prosperity throughout the 1990s, the banking sector is significantly better capitalized today than it was at this point in the last recession. In addition, broad deregulation over the last two decades has eliminated regulatory constraints that limited credit availability in some past recessions.

For the full Bank Trends report, entitled "Business Credit in 2001: More Available than in Past Recessions," go to:
http://www.fdic.gov/bank/analytical/bank/index.html

Send comments on this FYI to:
Lisa H. Ryu LRyu@fdic.gov

Send feedback and technical questions about the FYI series to:
fyi@fdic.gov

---

1. Commercial credit outstanding from all sources refers to all credit market liabilities of nonfarm nonfinancial corporate businesses including commercial paper, municipal securities, corporate bonds, bank and other loans and mortgages.
2. Data from Merrill Lynch U.S. Corporate Master Index.
3. Johan V. Duca, "The Democratization of America's Capital Markets," Federal Reserve Bank of Dallas Economic and Financial Review, Second Quarter 2001.
4. Data from the Federal Reserve Board's H.8 release. Data for large commercial banks currently include assets and liabilities of 42 domestically chartered commercial banks, representing approximately 60 percent of the banking industry's total assets. Data for other domestically chartered commercial banks (small banks) are estimated based on weekly samples.
5. According to the Loan Pricing Corporation, the secondary trading volume for bank loans reached $117.6 billion in 2001, with distressed loans representing about 35 percent of the volume. In comparison, the secondary trading volume in 1991 was $9 billion.
6. Small Business Economic Trends, National Federation of Independent Business Educational Foundation, January 2002, p.9. http://www.nfib.com/PDFs/sbet/sbet1-02.pdf