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The collapse of bank lending

With oil, agriculture, and real estate shutting down, the banks are contracting their loans, for the first time since the 1930s.

Commercial bank loans fell nationally as a result of the banking crisis in the oil, real-estate, and agricultural sectors, Salomon Brothers reported April 25. That is an extraordinary conclusion, since total commercial bank lending has increased during every year since World War II, including every recession year. If the first quarter's $13 billion decline, brought on by banks' credit problems, were to continue through the year, the fairly modest decline in U.S. output during the first quarter will turn into a tailspin.

However, first-quarter results from Texas and Oklahoma institutions make clear that the worst has not yet hit. The first effects of the declining oil prices have already crippled those states' banking systems, ensuring that the credit contraction will worsen during succeeding quarters.

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According to a Salomon Brothers' report issued April 25, "In the first three months of the year, total loans and investments in the commercial banking sector fell by $13 billion. Since 1982, the smallest first-quarter increase had been $10 billion. This year's decline was concentrated in three Federal Reserve districts: Dallas, Minneapolis, and San Francisco. Behind this lack of steam were the impact of lower oil prices on banks, especially in oil-producing regions; the continued increase in the number of non-performing agricultural loans; and the effect of rising vacancy rates in commercial real estate properties on that type of lending in several regions. Unusual weakness occurred in business and consumer loans. More than half of the first-quarter downturn in business loans occurred in the Dallas Fed district. Of the falloff of total loans, 88% was in the three districts mentioned above."

The average first-quarter increase in bank lending during the preceding four years was $18.8 billion, compared to the $13 billion reduction during the first quarter of this year.

Business loans declined by $2.5 billion, while consumer loans were flat. The largest decline registered was in tax-exempt securities, due to "the ongoing uncertainty about the precise status of municipal securities, especially new issues," which "has prompted many institutions to allow tax-exempt holdings to run down with maturities."

All this explodes the myth that the crisis in oil and agriculture reduces to a sectoral problem. Banks' credit problems have forced a general reduction in outstanding bank credit.

This also suggests that the dominant influence upon interest rates during the first quarter was not the Federal Reserve's largesse, but the simple fact that the banking system was reducing its requirements for funds.

The worst victim of the credit crunch during the first quarter was, apparently, not the agricultural or oil sectors, but the overbuilt commercial real-estate sector. The chief economist for the F. W. Dodge company reports total new construction contracts down 8% in March, due to a drop in office construction and a slowdown in public-works projects. The March annualized rate of contraction was $209.9 billion, against February's $229 billion. Sharp declines in office and industrial construction were responsible for a 13% fall in nonresidential building, to $66.9 billion.

Dodge's chief economist said, "Homebuilding continues to provide good support in 1986, but not enough to compensate for some widening gaps in nonresidential construction. . . . Deficit reduction and tax reform have been creating a great deal of uncertainty about the future of both federal construction programs and local government bond financing of roads, sewers, and other public works."

The 13% fall in March brings the level of commercial construction down to a mere two-thirds of its 1985 monthly peak, and it is likely that the decline will continue much further. In our January analysis of the combined effects of the Gramm-Rudman legislation and the various tax-reform packages now on order, *EIR* warned of a disaster in the real-estate industry, which is apparently now underway.

The one sector that has held up is home construction, due to the temporary abundance of cheap mortgage credit. However, recent developments on the bond market suggest that mortgage rates have a long way to rise. Thirty-year Treasury bonds fell by more than 7 points the week of April 21, the largest one-week decline in history. But mortgage-backed securities, e.g., Government National Mortgage Association bonds, fell by only 2.5 points. The continuing problems which we expect in Treasury funding will force mortgage interest rates back upwards during the next two quarters.

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