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Credit Crunch Shows No Sign Of Easing As Banks Keep Turning Back Loan Spigot

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Posted 8/11/2008

A majority of banks tightened credit to businesses and consumers in the three months through July, and many plan to restrict lending well into 2009, according to a Federal Reserve survey on Monday.

A record share of banks tightened standards for all types of mortgage loans — from subprime to prime — and for commercial real estate loans and loans to small businesses, according to the Fed's survey of senior loan officers. Even big companies are having trouble raising funds, it said.

The reluctance of banks to lend defies Fed efforts to pump billions of dollars into the financial system to encourage lenders to keep extending credit.

"It's clear that the credit crunch has not gone away," said Nariman Behraves, chief economist at Global Insight. "That's a big problem for the economy."

Tighter credit could keep businesses from investing in new equipment and throttle consumer spending. It could delay a recovery for housing and the overall economy.

A record 74% of banks tightened standards for prime mortgages, up from 62.3% in the April survey. A record share of banks also curbed lending for nontraditional mortgages such as Alt-A loans that don't require income verification, and for subprime home loans to borrowers with poor credit.

"For the economy to bottom out, housing has to hit bottom," Behraves said. "The worry is that with the tightening in credit conditions for the typical household, that bottoming process will be delayed."

Respondents said they tightened standards for business loans due to a gloomy or cloudy economic outlook and a reduced risk tolerance.

A record 65% of banks tightened standards on loans to small firms in the May-July period, up from 51.8% in the prior survey. The figure for midsize and large companies was 57.6%, up from 55.4% and the highest since the 2001 slump.

Marlin Steel Wire, Baltimore-based maker of steel baskets, recently faced delays getting a loan for a new robot after receiving the biggest order in its history.

"In my world, you can't have these things drag on — our customers are demanding quick delivery," Marlin Steel President Drew Greenblatt said.

"I think they're clamping down even if you're profitable, even if you're growing, even if you got the biggest order in company history," he said. "I can't imagine what it's like for the guys who aren't doing so well."

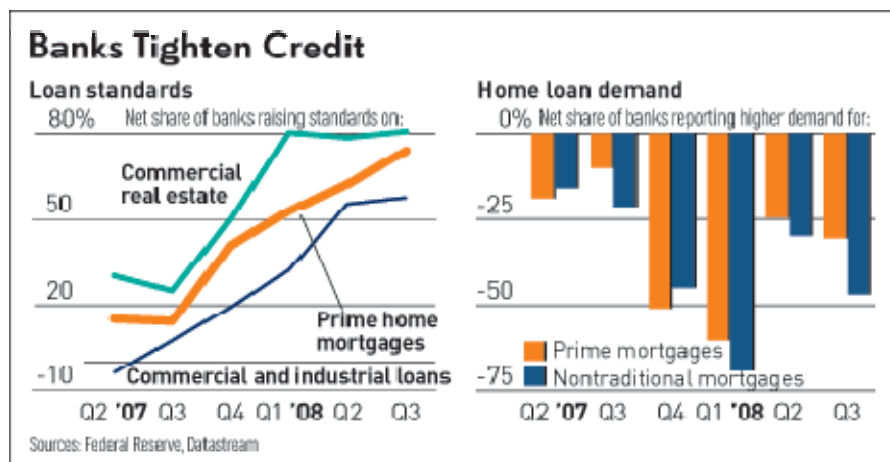
Businesses and consumers have lost their debt appetite, with loan demand falling across the board.

Most banks are expected to tighten credit standards on all major loan categories in the second half of this year while a "smaller, though substantial," percentage likely will tighten standards in the first half of 2009, the survey said.

Stocks pared their gains after the Fed survey's release and oil prices pared losses, but still finished in the black. The Nasdaq rose 1.1%, the S&P 500 0.7% and the Dow 0.4%.

Many economists said they expect the economy will weaken further before starting to recover around early to mid-2009.

"A lot of people had expected that the worst was over but I don't think that is the case," said Marisa di Natale, an economist at Moody's Economy.com.



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