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Tell Me Again

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Tell me again: Why did we bail out the banks? To get credit flowing again? To stabilize the housing market? To revive our faltering economy? If so, the following Wall Street Journal report,

"Loans Shrink as Fear Lingers," suggests the strategy has not been been particularly effective: Lending continues to slow as bankers and borrowers refrain from taking risks, in a bearish sign for the economy.

The total amount of loans held by 15 large U.S. banks shrank by 2.8% in the second quarter, and more that half of the loan volume in April and May came from refinancing mortgages and renewing credit to business not new loans, an analysis by The Wall Street Journal shows.

The numbers underscore two related trends weighing on the economy. Financial institutions are clamping down on lending to conserve capital as a cushion against mounting loan losses. And loan demand is falling as companies shelve expansion plans and consumers trim spending to ride out the recession.

That combination is making it harder for the U.S. economy to rebound, and some analysts predict that loan portfolios won't start growing until the second half of 2010.

"I think it is good for banks if we continue to be prudent as an industry and not reach to get loan growth by reducing our underwriting," Richard Davis, chief executive of U.S. Bancorp, said last week. The Minneapolis regional bank's overall loan portfolio declined 1.2% to $182 billion from March to Jun despite issuing $16 billion of mortgages. Most of the mortgages came from refinancing existing loans.

The loan figures reviewed by the Journal include giants such as J.P. Morgan Chase & Co., Bank of America Corp. and Citigroup Inc., as well as regional banks such as Fifth Third Bancorp, based in Cincinnati, and Regions Financial Corp., of Birmingham, Ala. The 15 banks hold 47% of federally insured deposits and got $182.5 billion in taxpayer-funded capital infusions through the Troubled Asset Relief Program. As of June 30 the banks had $4.2 trillion of loans on their balance sheets, down from $4.3 trillion as of March 31.

Loan portfolios shrank at 13 of the big banks, with the steepest decline at Comerica Inc., Dallas, where the loan total was down 4.3% to $46.6 billion in the latest quarter. Just $1.6 billion of the $10.2 billion in credit extended by Comerica in the second quarter came from new commitments. A bank spokesman said many borrowers "are being cautious."

Bank of America, Charlotte, N.C., reported its loan portfolio slipped 3.6% to $942.2 billion in the second quarter. A spokesman for the largest U.S. bank by assets said the decrease reflects higher loan losses and lower loan demand as borrowers pay off outstanding debts. "There were fewer opportunities to make high quality loans because of the recession," he added.

Some borrowers complain banks aren't trying hard enough to expand credit. Ernie Cambo, a principal with Miami real-estate developer CPF Investment Group, had to halt work earlier this year on a 2.5-million-squar foot project called Ave Aviation and Commerce Center because he couldn't line up financing beyond the initi phases.

Now he isn't certain he will be able to find bank financing for a planned $4 million building for a South Florid auto auctioneer, despite having a signed lease. "You will find no more frustrated borrower than me right now," said Mr. Cambo, 39 years old. "I am growing in this downturn, and I can't get any incremental debt."

The slow pace of lending has created political heat for the Obama administration. On Friday, Rep. Spencer Bachus (R., Ala.) pressed Treasury Secretary Timothy Geithner to "tell me why we didn't really see that multiplier effect" from banks funneling their TARP money into lots of loans.

"I think you did," Mr. Geithner responded. Each dollar of taxpayer-funded capital gave banks $8 to $12 of lending capacity, and the initial $200 billion infusion by the Bush administration prevented a decline of more than $1 trillion in the overall loan supply, the Treasury secretary said.

Supporters of the bank bailout concede that lending has dipped, but note that the program wasn't meant to expand loan volume, but rather to prevent a collapse -- and has succeeded on that score.

Richard Neiman, a member of the committee formed by Congress to assess the effectiveness of TARP, said in an interview that "you need to be cautious in reading too much into these numbers." Congress intended to "stabilize the financial markets, he added, and there "is no specific reference to increasing lending" in the rescue-program legislation that was signed into law last yea

The 15 banks reported about $803 billion in loan volume in the second quarter, up 12.7 from the first quarter. But nearly 60% of the increase in April and May came from refinancing mortgages and renewing business loans, according to data Treasury collected from the banks. In contrast, new home purchases accounted for just 23% of all mortgage loans.

May is the latest month for which the government's figures are available.

At BB&T Corp., of Winston-Salem, N.C., a surge in mortgage refinancing fueled the regional bank's increase of 0.1% in the size of its overall loan portfolio, which hit $100.3 billion as of June 30. Mortgage lending "is really booming," CEO Kelly King said, but loan growth slowed in May and June, "especially in the commercial area."

Banking analysts said the fact that less than half of loan volume is coming from new loans shows how far the economy still has to go to dig out of the recession. "You are looking for net new loans in the marketplace to be a signal of true change, and we have not seen that yet," said Christopher Marinac, research director at F Partners in Atlanta.

"You've got to have fewer people paying down loans...and you've got to get banks to loosen underwriting standards," said RBC Capital Markets analyst Gerard Cassidy. "That is when you will see loan balances in the U.S. banking system expand from where they are today. When that happens, you will see the economy really start to blossom."

On a year-over-year basis, total loans held by the 15 big banks rose 17% from $3.6 trillion in 2008's second quarter. The increase was skewed by the impact of acquisitions that included J.P. Morgan's takeover of the banking operations of Washington Mutual Inc. and Wachovia Corp.'s purchase by Wells Fargo & Co. Excluding purchases, loan portfolios shrank by about 10% as of June 30 from a year earlier.

The figures are a strong but imperfect indicator of loan activity. For example, loans sold to other institutions aren't counted on a bank's balance sheet at the end of the quarter. Since the financial crisis erupted, though sales of loans have withered.

Then again, maybe I misunderstood. Maybe there was some other motive driving Washington's taxpayerfunded largesse. Perhaps, as some might surmise after reading another story in today's Journal, "Banks Pro From U.S. Guarantee." we squandered those trillions on the financial industry so things could return to normal -- that is, where the moneyed interests are free to keep milk the system and avoid paying the price for greed, recklessness, and incompetence?

Lenders' Earnings Reap the Benefit of FDIC Backing on Company Debt It is the gift that keeps on giving.

The government's guarantee since November on new debt issued by financial firms such as Citigroup Inc. a General Electric Co. will save those companies about $24 billion in borrowing costs during the next three years, according to an analysis by The Wall Street Journal.

In the second quarter alone, the eight largest issuers of corporate debt under the Federal Deposit Insurance Corp.'s Term Liquidity Guarantee Program cut their interest costs by about $2.2 billion, increasing their profits and delivering an extra jolt to the stock market's two-week rally.

Citigroup saved nearly $600 million in the latest quarter on the $44.6 billion in medium-term FDIC-backed debt it has issued, or about 14% of its overall profit of $4.28 billion. Goldman Sachs Group Inc., which post record quarterly profit of $3.44 billion, is cutting financing costs by roughly $205.5 million every three months by selling corporate debt through the government-assistance program instead of on its own.

"You can't ignore the TLGP when you look at bank earnings," says Daniel Alpert, managing director at investment bank Westwood Capital LLC. "It has reduced their cost of funding and ensured that the market has the kind of liquidity required so that trading revenues have been so high."

The guarantees were dangled after credit markets seized up last fall, giving financial institutions a way to float short term debt at low interest rates. Since then, about $339 billion in corporate debt of all durations has been issued under TLGP.

The stabilization that is allowing financial giants to again issue debt without a government safety net is evidence of the program's success, many analysts say. Without federal assistance, companies that rely on short-term financing to fund operations would have been unable to roll over their debt without paying exorbitant interest rates.

"If we had gotten into rollover death watch on some of the large financials, then that would have interfered with a whole host of things that were much more important to work out in the financial system," says Jim

Vogel, an analyst at FTN Financial Capital Markets. "The TLGP took that off the board, and in that sense was complete success."

But the bonanza could be fresh ammunition to critics who say taxpayers are subsidizing runaway earnings - and bonuses that are on track to rebound sharply this year -- at financial firms that are at least partly to blame for the financial crisis and recession. The lower corporate-financing costs will last until debt issued through the government program matures, typically two or three years.

To estimate the savings that will flow to the eight largest users of FDIC guarantees, the Journal compared interest being paid on each slice of $238 billion in medium-term debt issued under TLGP with the trading level of existing bonds having a similar maturity. Fees and surcharges were subtracted. The difference represents what the companies likely would have paid had the debt not been backed by the FDIC.

For GE Capital, the GE unit that issued about $50 billon in guaranteed medium-term debt, more than any other company, the savings likely will reach $3.3 billion, according to the calculations. A GE spokeswoman said in an email that the difference is "something much less" than that amount. Representatives at other companies either declined to discuss the matter or didn't return calls seeking comment.

One example of the lower financing costs made possible by federal assistance: On Nov. 25, Goldman issued $5 billion in debt maturing in June 2012. The debt has an annual interest rate of 3.25%. On the same day that the government-backed bonds were sold, outstanding Goldman debt maturing in September 2012 was yielding 8.51% in the open market.

Based on the gap between the two interest rates, Goldman will save about $754 million over the life of the FDIC-guaranteed bonds. It will reap lower interest costs of about $2.33 billion for all the corporate debt sold under the government program.

At J.P. Morgan Chase & Co., the total reduction in financing costs is likely to be $3.1 billion, or $246 million per quarter. In the second quarter, J.P. Morgan made a profit of $2.7 billion.

An executive at one of the largest issuers of FDIC-backed debt says market rates for bank debt surged when the guarantees were most popular, largely because investors were dumping bonds to raise money.

The FDIC would be on the hook if any company were to default on its guaranteed debt, but that is considered a remote possibility as long as the economy doesn't get much worse. So far, the federal agency has collected about $6.9 billion in fees from companies using the program.

TLGP is slated to end at the end of October. Bank of America Corp., Goldman and Morgan Stanley haven't issued medium-term guaranteed debt since March. GE Capital's application to exit the program was approved last week. The firm also issued non-guaranteed debt at yields roughly comparable to those in the open market, after including FDIC fees, according to Banc of America Securities-Merrill Lynch analyst Jeffrey Rosenberg.

FDIC surcharges on any guaranteed debt issued after April 1 have reduced the potential savings. More important, interest rates on bank debt have fallen sharply, reflecting less worry about the financial firms and the overall system.

Hmmm, I wonder....