

## Why a lending surge won't work

Congress has become increasingly strident in insisting that banks that received capital from Treasury lend that money.

The fact that the Capital Purchase Program was not intended to be used only for lending has been lost in the rhetoric. Hardly surprising since the program was a complete about-face from what Congress had authorized. Furthermore, the public, thanks to the consistent media labeling of the program as a bailout, which it's not, is angry at banks for not lending.

This is a myth. Data show that banks are lending.

The problem is that the economy is in steep decline, and people expect Washington to "do something about it." They should do whatever is possible and makes sense, but insisting that banks must lend more is folly.

There are two reasons why.

First, most of the brain-dead residential mortgage lending that touched off the economic free-fall was done by nonbank, largely unsupervised parties. The proper response to that is to try and contain the damage as much as possible, and then bring the unregulated under the kind of prudential supervision that banks are under. Not just mortgage brokers, but other key parts of the huge unregulated financial system created over decades.

The very rules that have helped make banks more stable are a check on reckless lending. Clearly there are cases where banks made marginal loans, and regulators were slow to question them—hence the increase in failures. Bankers are not perfect. But the banking system works.

Well-managed banks, like the two we wrote about in this space last month, want to make loans and are making loans. But they want to make good loans. To insist that banks like that do more is to say, "Make loans you normally wouldn't make—risk be damned." That's a recipe for disaster.

The call for more lending is appropriate in cases where an institution overreacts to the current situation and cuts back more than is necessary. Keep in mind, though, that some of those banks may not have a choice if they are on a watch list for low capital/high delinquencies.

By far, most of the credit crunch has come from the shutdown of the money markets—commercial paper and the now dysfunctional securitization process in particular. There is no way portfolio lenders can make up for that in the short term.

The various alternatives to bank lending have evolved over 40 years. That is why the Federal Reserve has taken such bold steps to prop up or replace those markets.

Second, the calls to "lend, lend" presuppose that people and businesses want to borrow. Businesses need working capital to operate, of course, but beyond that, many of them have become cautious of adding more debt. Individuals, likewise, are hunkering down.

People say you can talk yourself into a recession. That's true. But ask those people if they are spending as much as they were 18 months ago. Encouraging people to take on debt right now is irresponsible.

What then?

Lower expectations. The government will spend \$1 trillion on a jobs creation/stimulus program. It really has no choice. But no one should expect a quick turnaround. The excesses in our economy, and the economies of many other countries, were long in the making and not just related to home loans. The correction will take some time.

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