

DAILY GLOBAL  
COMMENTARY

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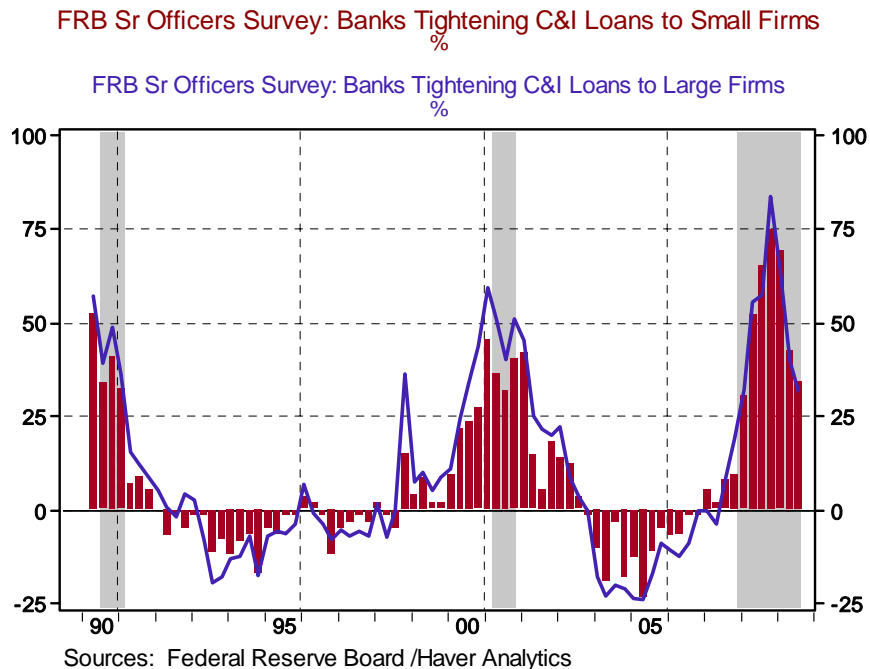
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## Senior Loan Officers Survey – Small Positive Signals but Several Aspects Remain Bothersome

August 17, 2009

The latest Senior Loan Officers Survey reports a small but notable easing of loan underwriting standards but demand for loans was weak with the exception of residential mortgages. The number of banks tightening underwriting standards for commercial and industrial (C&I) loans to large firms was smaller in July (30%) compared with the results of the April survey (40%); the peak was a little over 80% of bankers reporting strict terms for borrowing in the fourth quarter of 2008 (see chart 1).

Chart 1



The cost of borrowing also fell slightly for commercial and industrial loans but the elevated level of spreads suggests that credit conditions remain tight (see chart 2). This is running counter to the fact that credit market spreads have eased considerably (see chart 3).

Chart 2

FRB Sr Off Survey: Banks Incr Spreads of Loan Rates to Large Firms %

FRB Sr Off Survey: Banks Incr Spreads of Loan Rates to Small Firms %

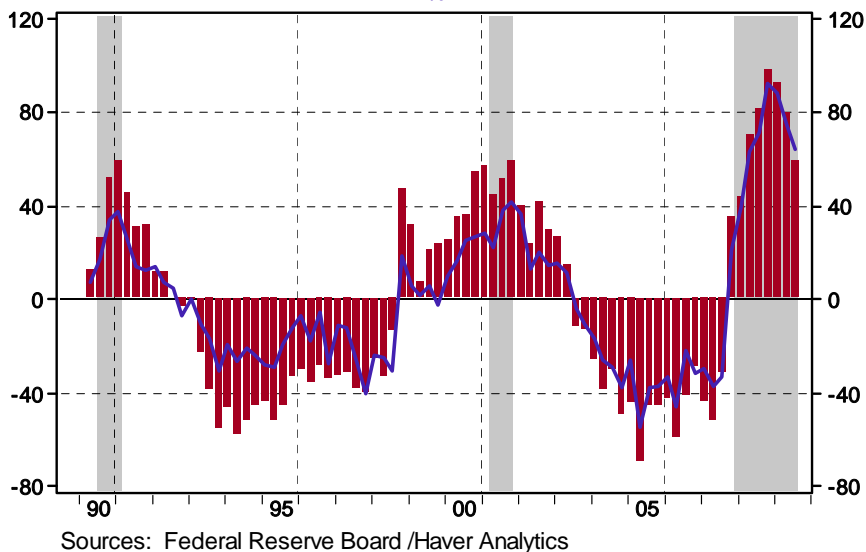
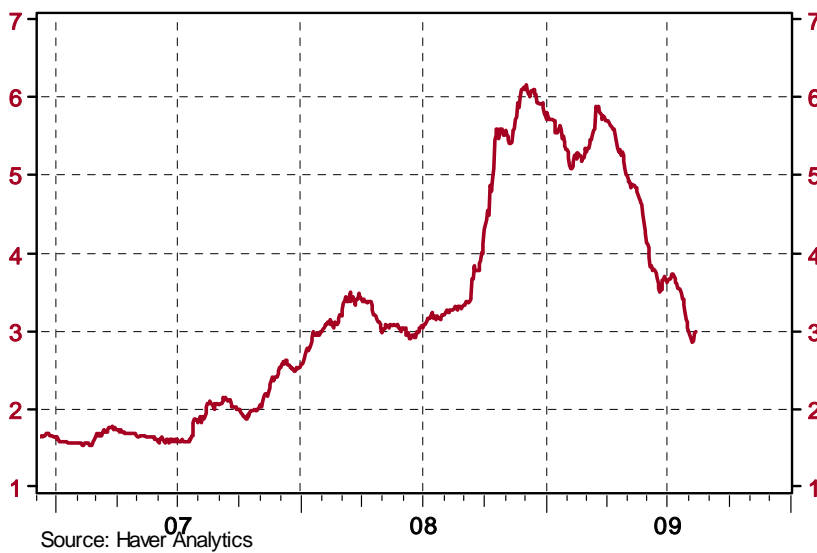


Chart 3

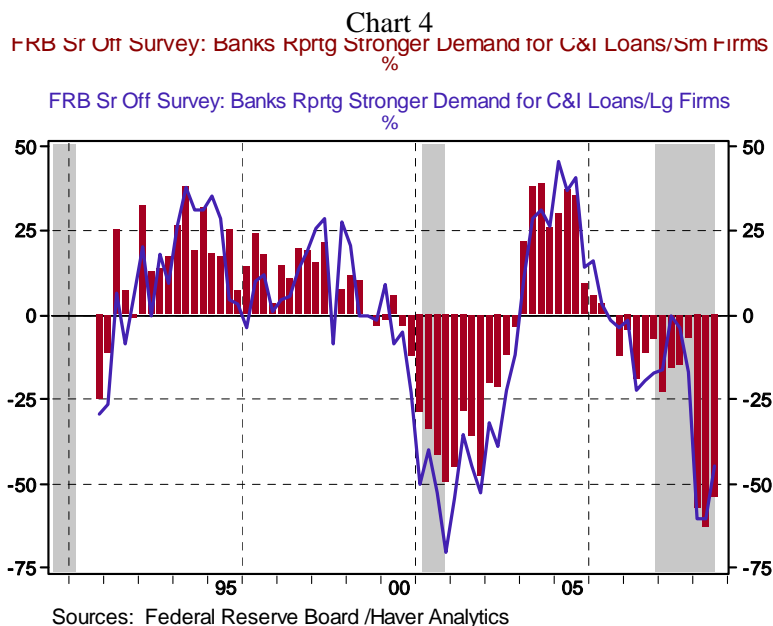
Moody's Baa less 10-year U.S. Treasury Note Yield

percent



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Chart 4 indicates that the demand for loans is weak. The survey included special questions about the reasons for the decline in loan demand. Bankers indicated that decreased loan demand and reduction in credit quality were the main reasons for weakness in lending.



The excerpt from survey that is troubling runs as follows: *“In response to a second special question, most banks reported that they expected their lending standards across all loan categories would remain tighter than their average levels over the past decade until at least the second half of 2010; for below-investment-grade firms and nonprime households, the expected timing is later, with many banks reporting that standards for such borrowers will remain tighter than average for the foreseeable future.”* The credit machine is the life blood of a modern industrial economy. This response leads one to reconsider the prediction about the growth path of the economy.

The reasons bankers gave for tightening credit standards or terms for C&I loans not only matched those reported in the previous two surveys but also enhance the concerns cited above – *“Both domestic and foreign respondents nearly unanimously cited a less favorable or more uncertain economic outlook, and large majorities cited a reduced tolerance for risk. Domestic respondents also widely noted a worsening of industry-specific problems, while foreign respondents were more likely to cite an increase in defaults by borrowers in public debt markets, as well as deterioration in their banks' current or expected capital positions.”*

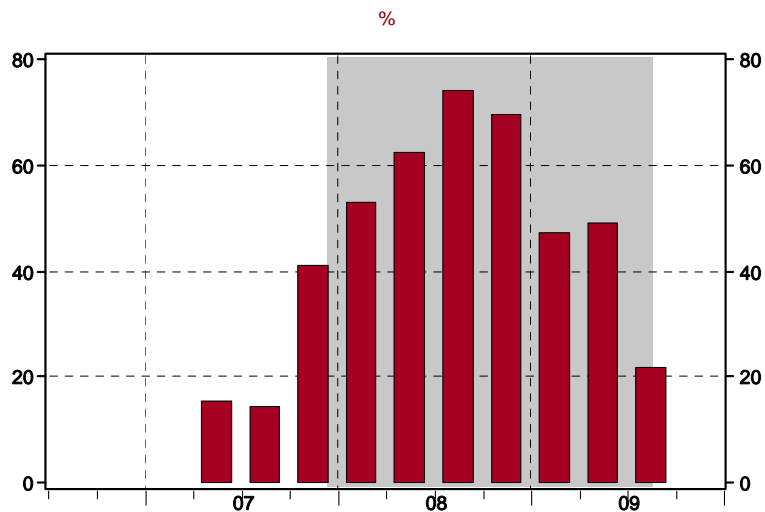
After holding nearly flat in the April survey, the net percentage of domestic banks that tightened standards on prime residential real estate loans has declined to 20% from a peak level of about 75% one year ago (see chart 5).

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Chart 5

FRB Sr Off Survey: Banks Tightening Standards for Prime Mtges to Individuals

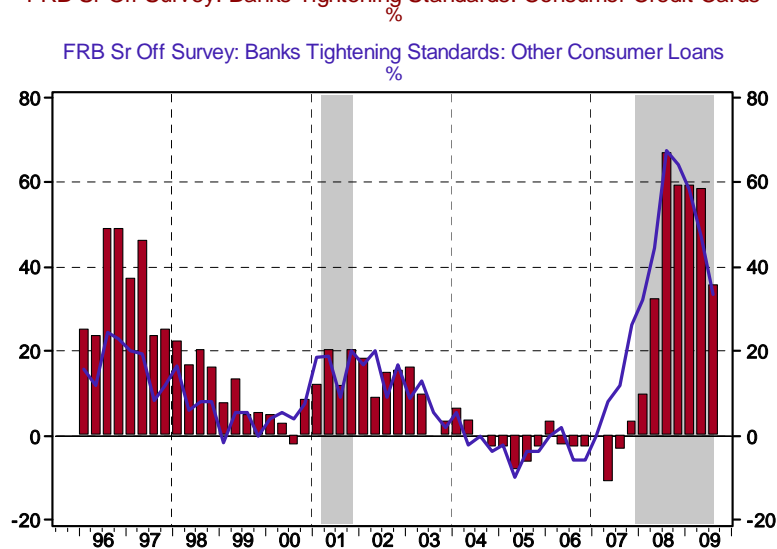


Source: Federal Reserve Board /Haver Analytics

The net fraction of respondents that tightened standards on nontraditional residential mortgages dropped to about 45% from 65% in April. Fewer respondents indicated they were tightening standards for consumer loans (see chart 6).

Chart 6

FRB Sr Off Survey: Banks Tightening Standards: Consumer Credit Cards



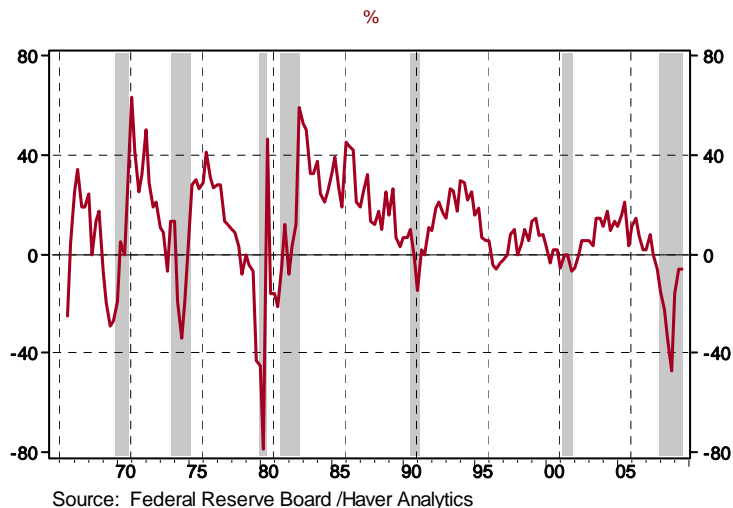
Sources: Federal Reserve Board /Haver Analytics

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The willingness of banks to make consumer installment loans held nearly steady in the July survey (see chart 7).

Chart 7

FRB Sr Officers Survey: Banks Willingness to Lend to Consumers



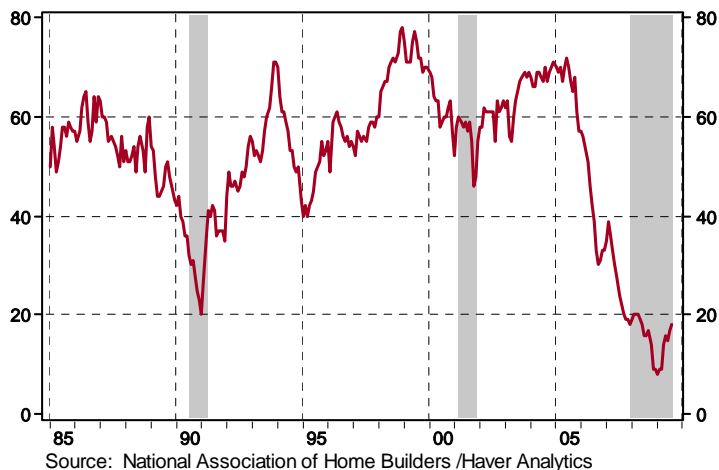
### Housing Market Index Shows Noteworthy Improvement

The Housing Market Index (HMI) of the National Association of Home Builders rose to 18 in August from 17 in the prior month. The level of the HMI is the highest since June of 2008. The cycle low for the index (8.0) was recorded in January 2009.

Chart 8

Home Builders: Housing Market Index {Composite}

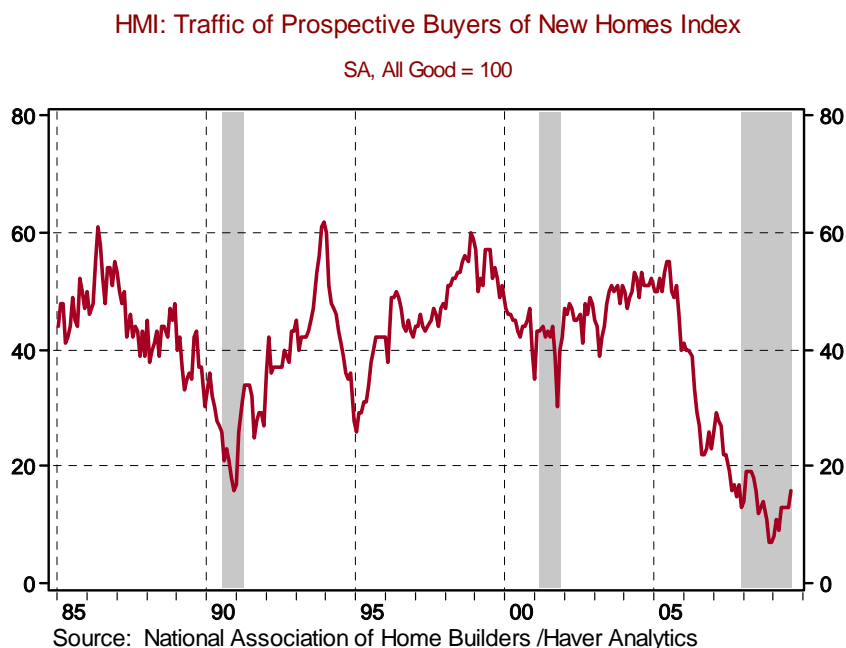
SA, All Good = 100



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The index measuring current sales of new single-family homes held steady at 16. But, the index measuring sales of home six months ahead rose to 30 in August from 26 in the prior month. The cycle low for this index was 15 in February 2009. The index tracking traffic of prospective buyers of new homes moved up to 16 in August from 13 in the prior month. The cycle low for this index was 7 in December 2008. The main conclusion from this report is that the market for new homes is recovering.

Chart 9



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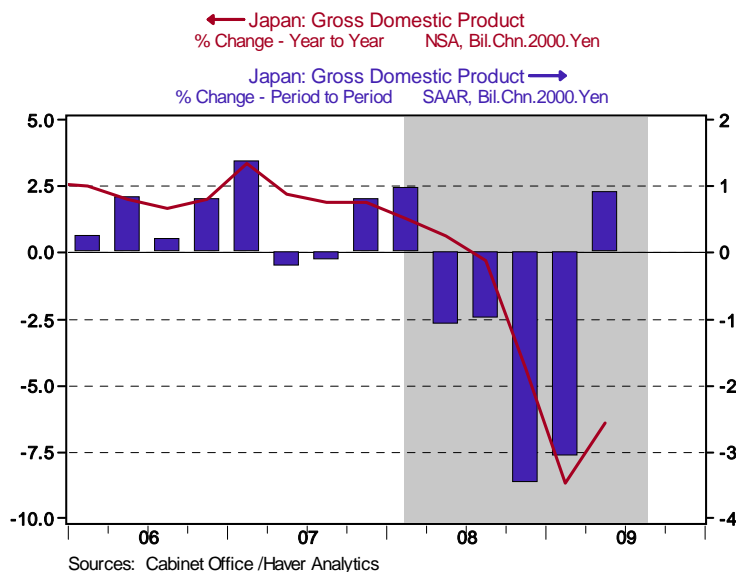
### Japan: The End Of The Latest Recession?

In line with most of the major industrialized economies (with the glaring exception of the US), the Japanese economy posted modest positive growth in Q2. The 0.9% gain breaks a four-quarter streak of economic contraction and allows politicians to declare the worst of the recession is over. But before anyone breaks out the sake, we should take a sobering look at what the rest of the year holds for both the economy and policymakers alike.

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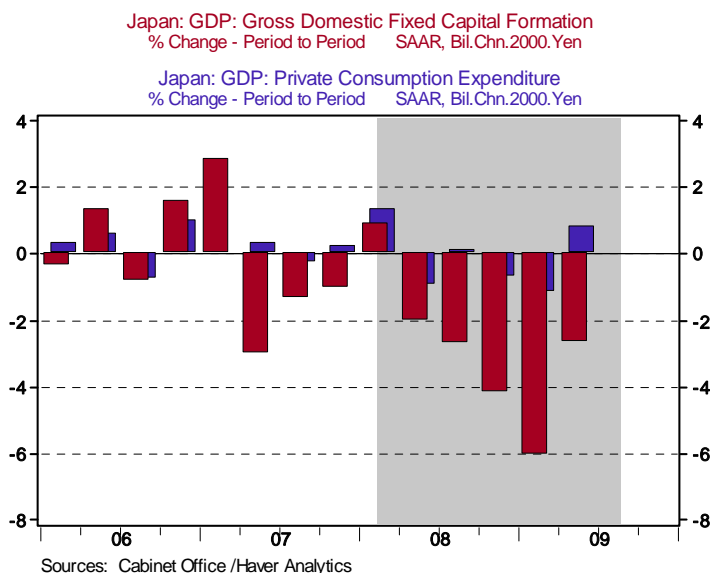
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Chart 10



First, a quick review of the GDP figures shows growth coming from government investment (+8.1%) and from net exports (+¥6.6 trillion). Private consumption only grew by 0.8% and private fixed capital formation contracted by 2.6%. In an ideal recovery, the government and foreign consumers would not factor as heavily while private consumption and investment would lead, but few things have been ideal lately. Without the government's contribution, the overall figure would have been negative for the fifth quarter running.

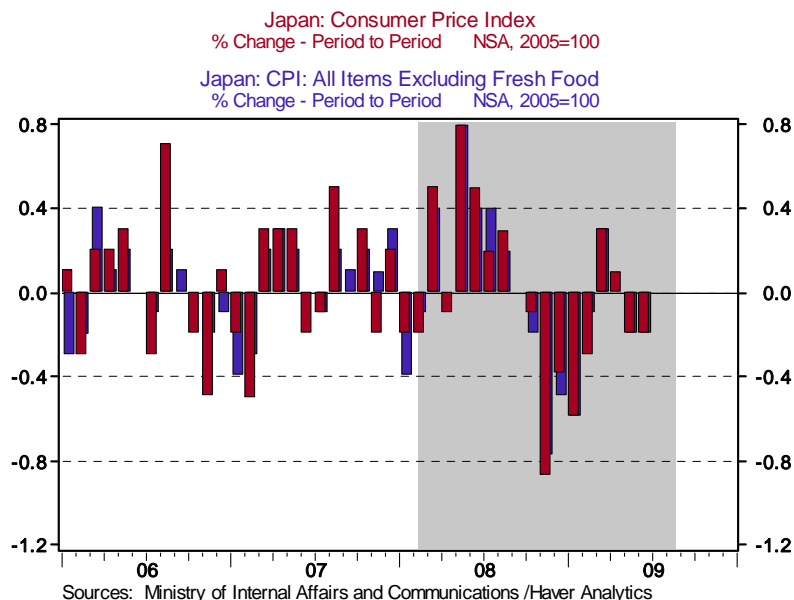
Chart 11



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Not surprisingly, weak demand figures have translated into deflation at the consumer level. On a month-to-month basis the CPI is not diving as fast as it was at the end of 2008, but the overall index is still posting negative comparisons, and has had only two monthly increases since August 2008. The year-over-year inflation figure will likely bottom out at around -2.0% next month, but without any lasting stimulation of demand deflation will again entrench itself in the economy.

Chart 12



It is hard to determine where policy will go in the coming months because the Japanese government could very well change hands. With national elections on August 30, the opposition DPJ looks set to kick the ruling LDP out of office and push through its own agenda. Today's GDP indicators are the last economic figures that LDP politicians can trumpet as 'proof' of recovery, and will likely not be enough to persuade the voting public. This being said, the DPJ is promising far more populist measures heavy on the public spending and generous on the tax breaks – public debt be damned – that all sound great in the short-term. If the new government pushes these through quickly, it could offer a quick burst of economic stimulus and sustain growth for another quarter or two. However, at some point those debts will have to be paid, and the DPJ could find itself creating yet another recession in the wake of its own recovery.

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