

Tracking bank lending

The Fed's weekly commercial bank report offers a timely source of information on lending activity, but it needs to be adjusted for known biases to obtain an accurate picture.

With policymakers focused on shoring up the nation's financial system and getting credit flowing again, investors have naturally become interested in measuring their progress. While borrowing costs for many credit products are relatively easy to observe in real time, gauging the volume of credit growth at a high frequency is more challenging. One weekly report from the Federal Reserve – the H.8 report on the assets and liabilities of commercial banks – provides a potentially valuable source of information. But it needs to be adjusted for several known biases.

The Fed's weekly bank data are valuable...

The commercial bank balance sheet report, released each Friday at 16:15 New York time, details the total amount of loans, securities and other assets held by commercial banks in the US, as well as the composition of banks' liabilities. Assets are broken down into relatively fine detail, with totals for commercial and industrial, commercial real estate, residential real estate loans, and interbank loans, as well as other categories. Banks are divided into three subgroups: large domestic banks, small domestic banks and branches of foreign banks operating in the US. The report indicates outstanding amounts as of the Wednesday one week prior to its release. It is therefore a rich and timely source of information on commercial bank balance sheets.

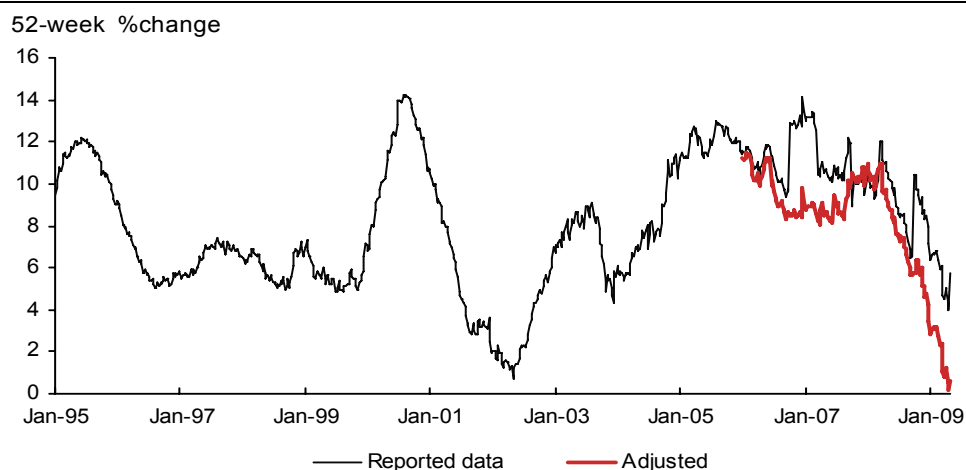
... but need to be adjusted

Unfortunately, the data are distorted by a number of technical factors that complicate its interpretation. Most important, because it does not include non-bank depository institutions, it misses a substantial portion of bank-like lending in the economy. This setup also leads to problems in the commercial bank data themselves: because banks occasionally acquire large portfolios of loans from failed thrifts (e.g. JP Morgan's purchase of Washington Mutual's assets last October) and sometimes even convert themselves into thrifts, the time series is subject to periodic "jumps" that are meaningless from an economic standpoint. Accounting rule changes can also cause one-time shifts in the measured level of bank assets.

Doing so shows bank loan growth to be weaker than it appears

With a little effort, however, the data can be adjusted for these problems. We applied information on transactions between banks and thrifts and other distortions to the level of bank loans from December 2005 to the present, the period for which these data are available (more details available upon request). Figure 1 shows the 52-week growth rate in bank lending reported by the Fed alongside the adjusted series. The historical data shown in the chart are, of course, still subject to bias. Because loan assets have mostly shifted to commercial banks from other lenders over this period, the adjustment shifts the growth rate down significantly. We estimate that commercial bank lending grew by just 0.7% over the past year, while the unadjusted data suggests a relatively healthy 5.8% y-o-y growth rate. Bank lending activity is thus much weaker than the raw data suggest. However, as we have emphasized in the past, lower credit growth does not necessarily imply that policy efforts have failed: high household leverage and a deep recession are both good reasons for credit demand to decline.

Figure 1. Commercial bank loan growth



Source: Federal Reserve, Nomura Global Economics.