

The US economy: topic of the month

What does the slowdown in C&I loan growth in U.S. tell us?

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In the United States, the growth of commercial and industrial (C&I) loans, made in order to provide either working capital or to finance business investment, is slowing down significantly. While the growth of loans for commercial real estate also appears to be peaking out, the slowdown of C&I loans is by far striking, quickening the pace of deceleration particularly since the second half of 2016.

These developments do not seem to be having an adverse impact on corporate management, however. According to a survey on small to midsize business managers by the National Federation of Independent Business (NFIB), since 2016, there has been no significant rise in the percentage of firms that found it more difficult to take out loans in the most recent instances than before or in the percentage of firms that could not borrow funds in the past three months.

Turning attention to the corporate side, data on corporate bonds do indicate that fund demand is not strengthening. Based on the flow-of-funds statistics released by the Federal Reserve Board (FRB), the outstanding balance of corporate bonds issued by non-financial companies in January-March 2017 showed a year-on-year rise of 5.0%, with the growth nearly halved from the most recent peak of 10.1% in July-September 2015. This change in the growth of corporate bond balances makes less convincing the common belief that the slowdown of the C&I loan growth reflects the funding shift to corporate bond issuance.

At the same time, however, loan demand by U.S. companies is not weakening so much as indicated by the slowing increase in C&I loans. According to the FRB's Senior Loan Officer Opinion Survey on Bank Lending Practices, corporate demand for C&I loans has not shown any particular change since 2016. This trend is common regardless of size of potential corporate borrowers or category of lending banks (large U.S. banks, other U.S. banks, and foreign banks operating in the United States).

Looking at developments with business investment and working capital, the common uses of C&I loans, based on the aforementioned flow-of-funds statistics, non-financial companies have maintained certain levels of business investment, making it difficult to explain the significant slowdown in the C&I loan growth by business investment trends. On the other hand, demand for working capital has shown cyclical change in inverse correlation to C&I loans. Usually, when working capital increases, demand for external financing increases accordingly, showing a positive correlation. The inverse correlation observed since 2011 is an apparent anomaly, and thus it is difficult to make a further analysis of the background using the flow-of-funds statistics.

With that, we focused our attention on quarterly reports filed by individual financial institutions and picked out financial institutions with notable changes with their C&I loans. We used the database of the Federal Deposit Insurance Corporation (FDIC), and compiled data by dividing financial institutions operating in the United States, including foreign banks, into “financial institutions that increased C&I loans outstanding” and “financial institutions that decreased C&I loans outstanding.” The results show that in the January-March quarter of 2017, the former group of financial institutions moderated the pace of loan expansion, while simultaneously the latter group of financial institutions quickened the pace of loan reductions.

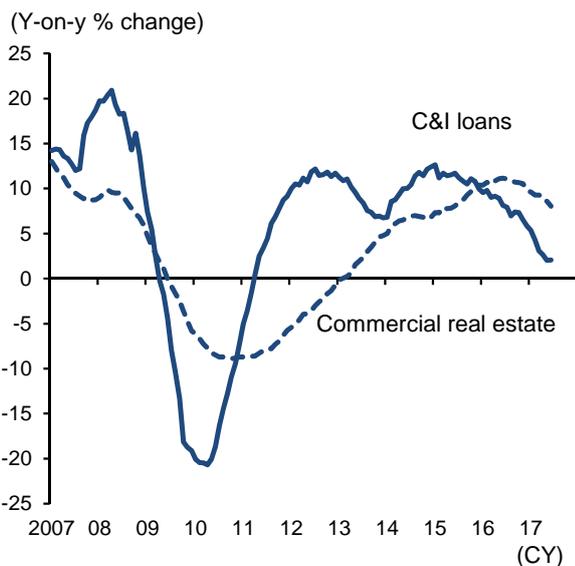
Next, we picked out the top 20 banks that increased the balance of C&I loans most in January-March 2017 over the year-before period and the lower-ranking 20 banks that decreased the balance of C&I loans most in the same period. This practice shows that changes in the C&I loans outstanding are concentrated on the small number of these banks. Furthermore, looking at the year-before period, not only the top 20 banks but also the lower-ranked 20 banks did increase C&I loans in that period.

Then, what happened to these lower-ranked banks? When we narrow this group down further to the lowest 10 banks, eight of them showed declines in loans to companies in the energy industry in their quarterly reports (10Q). This suggests that the review of lines of credit for reserves-based lending (RBL), which peaked from October-December 2016 to January-March 2017, led to the declines in C&I loans.

Given the recent recovery in crude oil prices, the slowdown of the C&I loan growth is likely to have a breather going forward. With the anomaly mentioned above fading, a growing demand for working capital may even lead to an expansion of C&I loans.

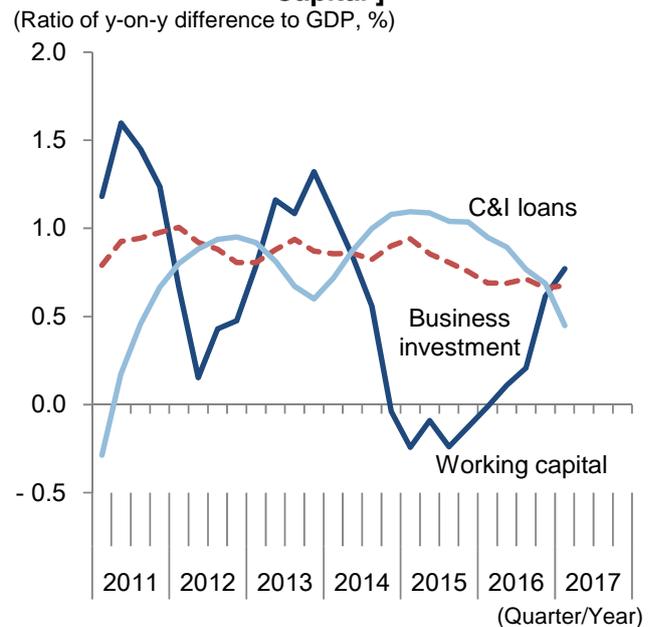
Essentially, C&I loans are a lagging indicator of economic activities. The U.S. economy is perking up after a slowdown in the January-March 2017 quarter. The sharp slowdown witnessed in the C&I loan growth should not necessarily be taken as a negative factor in considering the near-term U.S. economic outlook.

[Chart 1: C&I Loans by U.S. Commercial Banks]



Source: Made by MHRI based on FRB

[Chart 2: Business Investment and Working Capital]

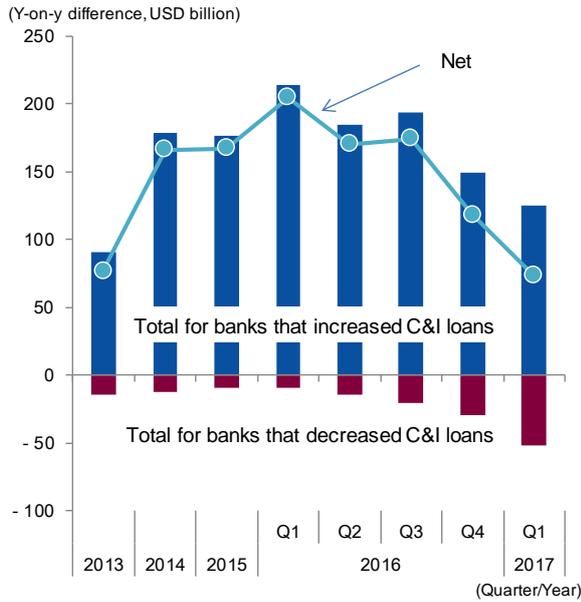


Note: Working capital = Accounts receivable + inventories – accounts payable
 Business investment and working capital for non-financial firms

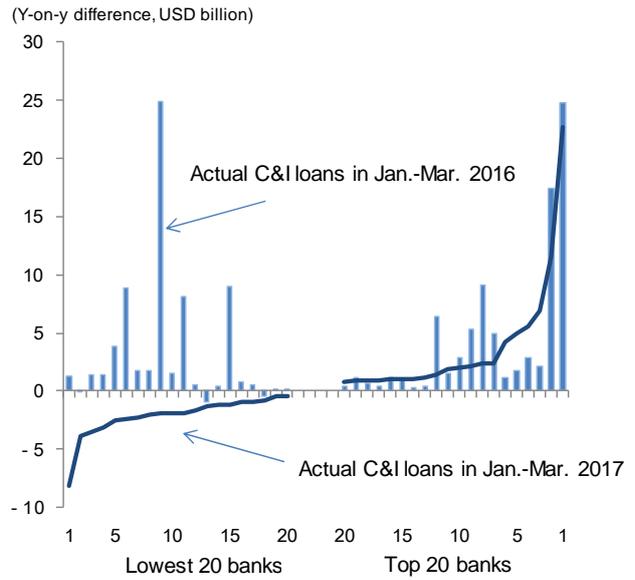
Source: Made by MHRI based on FRB

[Chart 3: Distribution of Changes in C&I Loan Balance]

[Time Series]



[Rankings in January-March 2017]



Note: Based on panel data of 5,865 financial institutions operating in January-March 2017 with historic data on C&I loans that can be traced back.

The line graph in the Rankings chart shows actual loans in January-March 2017. The bar graph shows actual loans a year before of the same panel.

Source: Made by MHRI based on FDIC

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