Credit conditions: Some snap and crackle, but no pop

By RONALD A. WIRTZ
Editor

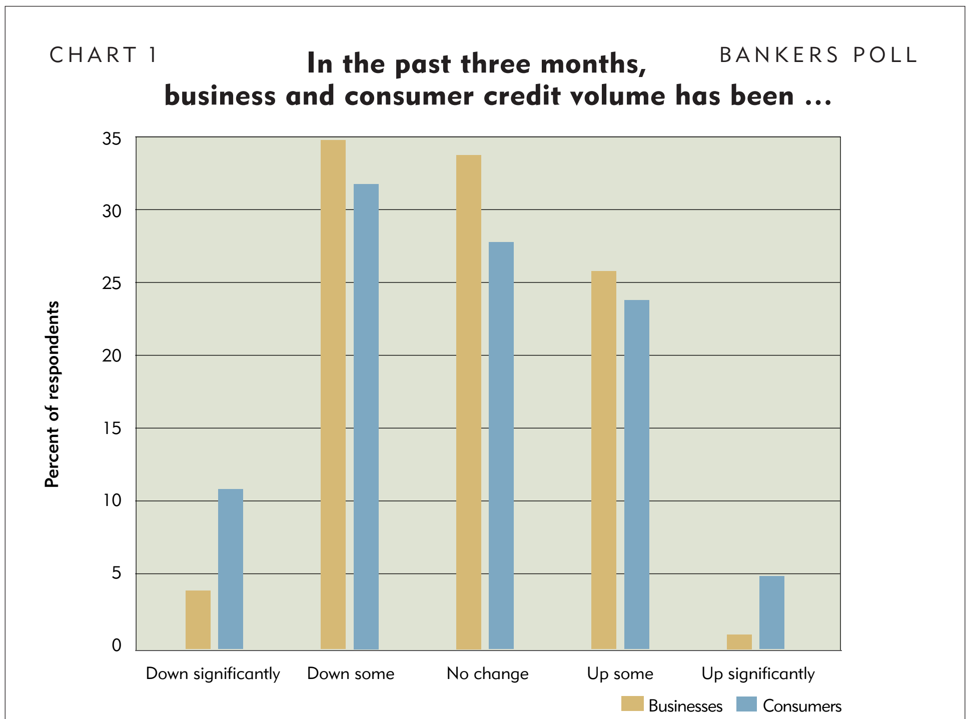
Hey, buddy, can you spare a dime of credit?

Back in October and November, financial markets teetered as they haven't for decades. Urgent claims of a credit crunch—that credit was simply not available, except at scandalous rates—were rampant. Though evidence of an actual credit crunch was sketchy, bankers and businesses alike were feeling a bit of credit vertigo: Easy credit conditions were replaced by credit standards that better reflected borrower risk, a matter complicated by an economic slowdown that pulled the plug on demand and besmirched borrowers' credit ratings in the process.

Fast-forward six months—has anything changed?

To get a glimpse into credit conditions in the Ninth District ahead of the release of official data, in late April the Federal Reserve Bank of Minneapolis conducted separate polls for financial institutions and businesses in the Ninth District. These are a follow-up to similar credit conditions polls conducted in November of last year (the results of which were published in the January 2009 *fedgazette*, available at minneapolisfed.org).

The results from the most recent polls show that credit conditions don't appear dramatically changed, save for the fact that people on both sides of credit transactions likely have a little better feel for and familiarity with the new credit environment. In general, credit volume to businesses and consumers continues to be weak, the result of tighter credit conditions and weaker credit quality among borrowers, but also because of weaker demand overall as borrowers wait out the recession.



Source: Financial Institutions Survey, Federal Reseve Bank of Minneapolis

Solitaire, anyone?

Banks and credit unions reported little problem with deposits; two of three respondents said insured deposits were up—about 20 percentage points higher than in the November poll. That finding jibes with national data showing a relatively sudden and positive shift in savings habits among U.S. consumers.

Despite the availability of credit, however, it's not flying out the door; over the previous three months, credit volume was down about 40 percent for both businesses and consumers (see Chart 1 above). A similar percentage of financial institutions said credit volume was down because both businesses and consumers were simply not seeking credit (see Chart 2 on page 10). That's not particularly surprising given the depth of the recession to date, though not a lot of attention is paid to the demand side of this supposed credit crunch.

A small Montana bank with $9 million in assets said, "Our (customers) are very conservative and have stopped asking for money. We have money to loan and very few applications."

A Minnesota regional bank with $145 million in assets echoed that theme. "Businesses we talk to are laying low," reducing short-term spending and investments, "which reduces their interest in borrowing." Consumers are worried about their jobs and retirement nest eggs "and are not borrowing for consumption purposes."

Another Montana financial institution with $45 million in assets noted that it was not seeing a significant economic slowdown in its region, "but our volumes indicate (borrowers) are trying to save more and spend and borrow less."

For those seeking credit, many were less qualified to receive it: More than half of respondents said that credit quality for both business and consumer credit applicants had declined in the previous three months; about one in five attributed the decline in credit volume at least in part to the fact that applicants could no longer qualify for loans.

The trifecta for weaker credit demand stems from the fact that banks and credit unions have continued raising the bar to qualify for credit. Banks have been tightening their credit standards across the board, and for some time, according to various quarterly Federal Reserve polls. That appears to be continuing, according to this poll: Over the previous three months, almost 60 percent of respondents said collateral requirements rose, and 44 percent said they required more documentation for credit approval.

Overall credit quality at a small Minnesota bank was still good, according to an official, in part because "less stable borrowers are deferring large purchases that require credit. It appears

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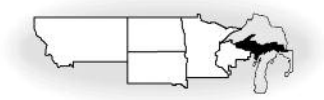
MICHIGAN



Fair crier: Do I hear $1?

In light of a large state budget deficit, Michigan Gov. Jennifer Granholm eliminated state funding for two state fairs, one in the Upper Peninsula and a counterpart in Detroit.

The U.P. fair is held in Escanaba, roughly in the southern middle of the U.P. The fair will go on as planned in August, as it has for more than 80 years, but future fairs will be the responsibility of local or regional parties, who will also have to reconstitute the state-based board of managers, which is being abolished.

The state Legislature still has to officially approve the elimination of fair funding, but reinstating that funding will be tough given fiscal conditions. Long-time vendors at the fairs have reportedly been receiving termination notices from the fair.

Some officials have already started looking forward. One bill being considered will transfer the U.P. fairgrounds to Delta County for $1 on the condition that the land be used only for public purposes. Related proposals are in the works to reorganize the fair's board of managers with representatives from the U.P.'s 15 counties.

That's no ordinary brook trout

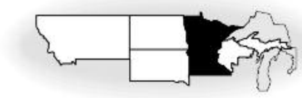
The coaster brook trout was once relatively widespread in the Great Lakes. But its presence has slowly narrowed to the point that environmental advocates believed it would end up on the endangered species list. But after a yearlong review, federal officials denied entry of the coaster to the list.

Once common in lakes Huron, Michigan and Superior, coasters today naturally reproduce in three lakes and 15 rivers, some of them in the U.P., and all of which feed into Superior. The fish gets its name from the fact that it likes to hug the shore. It also grows larger than its more common namesake.

The designation failure is a not-so-small matter for a proposed nickel and copper mine near Marquette by the mining company Kennecott. The mine would go under the Salmon River, which is home to the coaster. Opponents had hoped that designation on the endangered species list might require more burdensome habitat protection, which might force the mine to reconsider the project.

—Ronald A. Wirtz

MINNESOTA



With a stroke of the pen

The state's budget is in a world of hurt, and it appears many are going to share the pain, possibly via a scalpel wielded by Gov. Tim Pawlenty.

The state faced a $4.6 billion deficit even after $1.8 billion in federal stimulus funds came in. Lawmakers and the governor's office struggled to agree on cuts, and when all spending bills were in, a $2.7 billion deficit remained. State lawmakers approved last-minute measures to close the budget gap, including a hefty tax increase on high earners, which Pawlenty vetoed. He then invoked so-called unallotment powers, whereby he can take away any spending item that does not have funding—in essence, a line-item veto. The move is not unprecedented—it's the third time Pawlenty has used such powers—but the amount of money involved is.

In late June, Pawlenty announced reductions of almost $1 billion, including major cuts to local aid ($300 million), health and human services ($236 million) and higher education ($200 million), along with about $1.8 billion in an accounting shift that will push much of the problem to next year.

Shovel ready, and waiting

After a banner 2008 with record prices, the taconite industry is back in the proverbial hole, thanks to the global recession.

In May, most taconite mines had either slowed or shut down production as stockpiles lingered at Lake Superior loading docks. Last fall, Cliffs Natural Resources announced production cutbacks at mines in Silver Bay and Eveleth, and the company decided to stop all production from one mine until at least early July. In May, the Cliffs mine in Hibbing also began a 15-week shutdown. U.S. Steel closed its taconite mine in Keewatin in December, affecting 380 workers; after a first-quarter loss of $439 million, the company also cut back production at its mine in Virginia, laying off almost 600 workers in May. About half were called back in June on a short-term basis.

The industry received some good news in June, when a pilot program delivered 5,000 tons of crushed taconite for use as road aggregate. Taconite is harder than traditional dolomite and limestone and could extend the life span of highway and rail infrastructure, according to researchers.

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Fifty-nine percent said tighter credit came in the form of higher interest rates, almost half said their credit limits were lowered and about one-third said previously available credit was eliminated.

Credit from page 9

the people who don't qualify know it and are deferring credit requests."

Businesses down in the credit mouth

The main themes coming from bankers were largely reinforced, and amplified in some cases, by district businesses, according to a second poll conducted in partnership with state chambers of commerce.

Forty percent of business respondents said their access to bank credit has tightened to some degree over the previous three months (see Chart 3 at right). For those experiencing tighter credit, it manifested in several ways. For example, 59 percent said tighter credit came in the form of higher interest rates, almost half said their credit limits were lowered and about one-third said previously available credit was eliminated.

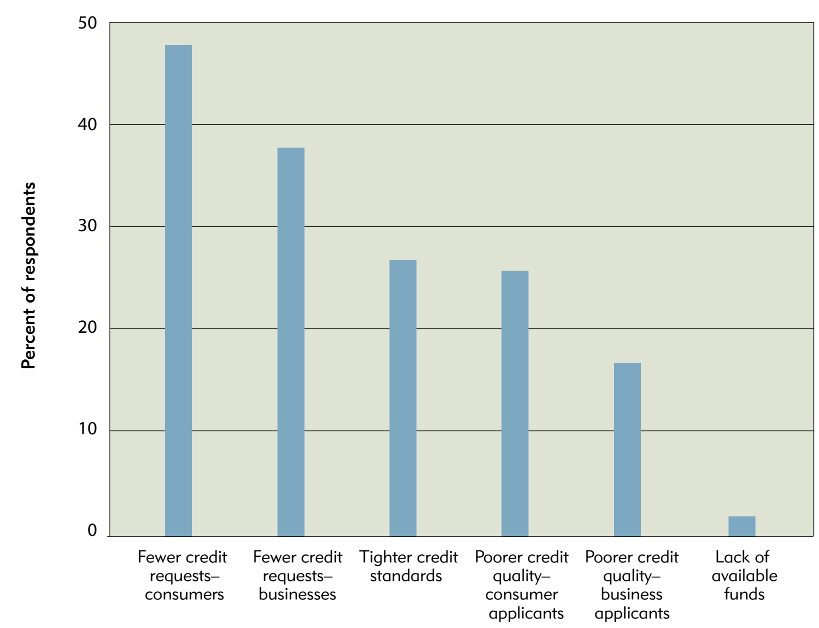
There were several reasons for tighter credit, according to business respondents. Almost 80 percent cited poor credit market conditions overall as a culprit. But about one-third acknowledged that credit had tightened as a result of their firm's own poor financial condition. As might be expected, tight credit was also affecting business operations. For those seeing tighter credit, 43 percent said they were curtailing capital expenditures and 31 percent said it would affect hiring decisions.

A Minnesota manufacturer with 45 employees said it was not having trouble getting credit—because it was simply not looking for any. "We actually do not need as much credit because we have stopped our capital investments, and we have stopped all unnecessary expenditures." That might not be good news to local bankers with cash to lend, but it has helped stabilize the company's financial position despite lower sales, an official reported.

Many businesses also deal with upstream and downstream credit markets—what nonbankers call suppliers and customers—and credit has been tightening there as well, according to the poll (see Chart 3). Close to half of business respondents said they have tightened credit to their customers and are doing so on multiple fronts, such as limiting new credit accounts, lowering credit ceilings and shortening pay periods.

CHART 2 BANKERS POLL

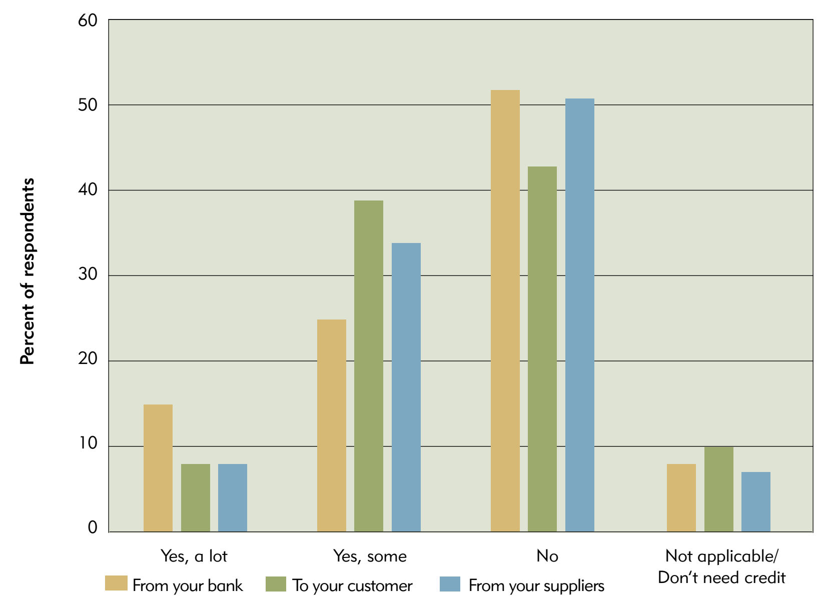
Why is credit volume down?



Source: Financial Institutions Survey, Federal Reseve Bank of Minneapolis

CHART 3 BUSINESS POLL

In the past three months, has credit tightened for your business?



Source: Chambers of Commerce Survey, Federal Reseve Bank of Minneapolis

A $65 million company in the oil and mining sector commented, "Customers want longer credit terms (and) suppliers want shorter terms. We are asking our suppliers and vendors for longer terms. All of our customers want price cuts of 10 to 30 percent, which is simply not realistic."

An official with a Minnesota manufacturer with $25 million in revenue said the firm was "very financially strong" and had very little debt. "This combination has allowed us to attract banks very willing to offer funding if we were to need it." At the same time, the company has had to take a "tougher stance" on credit to customers, stopping shipments for late payment and requiring advances from some customers that were in poor financial shape.

Firms in construction and manufac-

In the end, a familiar commentary among bankers and businesses was the current lack of confidence in the economy, and the role confidence plays going forward regarding the supply of and demand for credit.

turing were most likely to report difficulties accessing credit. A $30 million commercial real estate firm with sales in three states said it "is virtually impossible for developers to get financing. We have a national client with a solid business that we cannot move forward with because money is not available to build their building."

And it's not hard to see how credit problems for some firms cascade into other ones. A construction firm with 500 employees and $75 million in sales in five district states and Iowa said its own access to credit "has not been impacted, but our customers' access has been impacted severely." The company lost several contracts totaling approximately $10 million last year "due to financing issues facing our customers."

In the end, a familiar commentary among bankers and businesses was the current lack of confidence in the economy, and the role confidence plays going forward regarding the supply of and demand for credit. Even in areas not feeling the economic pinch so much, "there is a hunker-down mentality," said a small North Dakota bank. "Although the local economy remains reasonably strong, uncertainty about the national economy is impacting both borrowers and lenders."

A larger Montana bank with about $350 million in assets noted that "borrowers are being more conservative and waiting to see how the recession plays out. Loan volume will come back when borrowers are more confident in the economy." f

For information on the polls' methodology, go online at minneapolisfed.org.

Professional Services Survey

After tough times, professional services firms expect sluggish activity over the next year. Accountants, architects, engineers, market researchers and other firms that support businesses experienced a significant decrease in profits over the last year, according to the results of the annual survey of professional services firms, conducted in May and early June by the Federal Reserve Bank of Minneapolis and the Minnesota Department of Employment and Economic Development. See detailed survey results online at minneapolisfed.org.

District Voices *How have current credit conditions affected your business, community or industry?*

Upper Peninsula of Michigan

Consumers and businesses are both watching their money very closely. Loan volume is driven at its core by loan applications, which are down in both sectors.

—Bank with $192 million in assets

Minnesota

We are currently constructing a parking ramp ... and were planning to issue tax-exempt debt next week. That debt issue has been put off indefinitely due to high interest rates required by potential bondholders. We will have to internally finance or use an existing line of credit until rates and the markets begin to normalize. Additionally, we have a $60 million construction project that was planned to begin in May 2009 that will likely be put off months or a year.

—Engineering firm with 25 employees and $2 million in sales

Montana

Credit is taking longer to get than usual. More documentation is needed when it wasn't in the past; more of a down payment is needed, and my credit hasn't changed.

—Insurer with one employee and $135,000 in sales

North Dakota

Our bank keeps telling us that our credit availability has not changed over the last 12 months. We are, however, being more conservative on pulling the trigger on borrowing.

—Manufacturer with 380 employees and $52 million in sales

South Dakota

We provide government-relations services to businesses and business organizations, so we are impacted as businesses consolidate and fewer players are in the market for our services. The current credit market has accelerated this consolidation trend for several business types (financial services and auto dealerships, for example), decreasing both the number of businesses in the market and the number of businesses paying dues to an organization.

—Media company with 10 employees and $1 million in sales

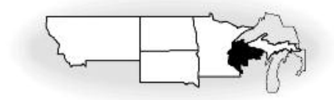
Wisconsin

Consumers, employees and businesses involved in the manufacturing sector seem to be the most affected. Consumer confidence of all others seems to be improving.

—Bank with $70 million in assets

(Note: Comments are from anonymous respondents to *fedgazette* surveys on credit conditions conducted in late April.)

WISCONSIN



Gotta light (up outside)?

Wisconsin joined the smokeless ranks when Gov. Jim Doyle signed legislation in May banning indoor smoking for most work places, including bars and restaurants.

There are a few exceptions to the smoking ban: Tribally run casinos are exempt from the ban because the state does not have regulatory authority over such places, thanks to tribal sovereignty; one other exemption includes cigar bars and tobacco shops.

The measure has been a priority for years for Democractic lawmakers, but past efforts were met with strong opposition, particularly from bar and restaurant lobbies. But over the past few years, about three dozen communities took matters into their own hands by passing local smoking bans. One bone being thrown to bars and restaurants: The ban will not go into effect until July 5, 2010, allowing establishment owners and patrons some time to prepare and adjust.

How do I get out of reverse?

The good news in Wisconsin these days is that things probably can't get a lot worse.

On top of a state budget deficit of $6.6 billion earlier this year, which required deep cuts and significant new fees, the state has watched unemployment continue to creep up. In the first quarter of 2009, the state saw more than 14,000 lose their jobs, more than twice the level from a year earlier. The state also experienced significantly more mass layoffs—events with 50 or more workers laid off for at least 31 days. In the first quarter of this year, there were 74 mass layoffs, almost triple the 27 that occurred in the same period of 2008.

Statewide job losses from April 2008 to this past April hit 128,000—the largest numerical decline in state history and the largest percentage drop in terms of total jobs since the late 1950s, according to the state Department of Workforce Development.

In hopes of helping workers, an effort is under way to consolidate and streamline the state's job creation programs. The Department of Commerce is collapsing five tax credit programs into a single, statewide program, thanks in part to a legislative audit that found a lack of accountability and coordination among the many state and regional economic development efforts.

—Ronald A. Wirtz