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Banks Are Lending More (to the Government)

"Quantitative easing" doesn't mean more credit for Main Street.

The Federal Reserve's open-market committee (FOMC) is widely expected to try a second dose of "quantitative easing" when they meet again in early November. Dozens of financial reporters have described this as an effort to "goose" the economy, but how that is supposed to work is even more unclear than usual.

Talk of "quantitative" easing makes it sound as if there will be a larger quantity of credit available to somebody somewhere. But the Fed is offering more credit only to Fannie Mae, Freddie Mac, and the U.S. Treasury. This may be terrific for lobbyists on K Street in D.C., and it may even stimulate some bond traders on Wall Street, but it's no help for Main Street. For that, we need more bank lending to the private sector. But this table shows that bank loans, despite rising heroically during the financial crisis in 2008, have fallen continuously since President Obama took office in January 2009. This is not necessarily a coincidence.

The first round of quantitative easing added $1 trillion to bank reserves, but the Fed simultaneously tightened credit by paying interest on idle excess reserves. Besides, banks do not have to lend a dime to make (or create) money. They can invest in securities instead. Unfortunately, those investments consist almost entirely of the same securities the Fed is so eager to buy — namely, Treasury IOUs or mortgage-backed securities from Fannie and Freddie.

Easing through open-market operations has always been "quantitative," since the Fed adds to bank reserves to pay for whatever securities it buys. But bank lending has not been falling since January 2009 because of any shortage of reserves; it has fallen because of a superabundance of regulations. The problem is regulatory, not monetary.

From December 2008 to October 2010, bank purchases of securities rose by $335 billion while bank lending fell by $455 billion. All of the regulatory pressures on banks from TARP, the Treasury's stress test, the regulatory-reform bill, and the Basel capital standards have pushed banks, quite conveniently, to buy up a big chunk of the Obama administration's soaring debt as an alternative to making more risky loans to consumers and small businesses. Since the Fed makes sure that banks pay savers next to nothing on deposits or CDs, the banks can make money even at the low rate rates offered on Treasury notes.

That makes the Fed and other regulators happy, so why lend?

The FOMC minutes in September noted that "bank loans continued to contract. . . . Commercial and industrial loans rose slightly in July, the first increase on a monthly basis since late 2008, and held steady in August. . . . However, both home equity loans and commercial real estate loans contracted further in August, while consumer loans fell sharply." It got worse in September, when all types of bank loans fell, at a 7 percent annual rate on average, while bank purchases of Treasuries and agencies expanded at a rate of nearly 30 percent.

In 2009, bank investments in Treasury and agency securities rose by 15.9 percent, while loans and leases to the private sector fell by 10.3 percent. In 2010, bank purchases of Treasury and agency securities rose at an 11.3 percent rate in the first quarter, 13.4 percent in the second and 18.6 percent in the third. Would-be private borrowers are being shoved to the back of the line though a regulatory form of "crowding out."

The next time you hear politicians or government officials complaining that banks are not lending enough to consumers or small businesses, just remind them that banks are much too busy lending tens of billions — to the U.S. government.

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