The New York Times

August 18, 2009

U.S. Extends Effort to Ease Tight Credit Into 2010

By EDMUND L. ANDREWS

WASHINGTON — With banks still tightening their lending standards, and borrowers skittish about taking on debt, the Federal Reserve and the Treasury extended one of their main emergency credit programs — the Term Asset-Backed Securities Lending Facility, or TALF — for several more months.

Despite signs of an economic recovery, and vast government assistance to financial institutions, the Fed reported on Monday that banks were still tightening their lending standards and did not expect to reverse course until the second half of next year.

In the Fed's latest survey of senior loan officers, about 30 percent of banks said they were still tightening standards for both consumer and business loans. That was a smaller percentage than the Fed's survey in April, but it meant that, on balance, banks were still clamping down as they worried about the economic outlook and tried to conserve capital.

About 55 percent of banks said their lending standards for business loans would remain tougher than long-term average levels until the second half of 2010. A similar percentage predicted that standards for prime home mortgages would remain tougher than average for another year, and about 40 percent said mortgage standards would be stricter than average for the foreseeable future.

At the same time, consumers and businesses are still reluctant to borrow. About 40 percent of banks reported that demand for loans by big corporations was weakening, though that was a smaller percentage than in April. More than half of banks said demand for loans from small businesses was weakening.

On the consumer side, low interest rates have spurred demand for home mortgages, mostly by people refinancing their loans. But the Fed reported that mortgage demand increased much more slowly in July than in April — probably because mortgage rates inched slightly higher.

"While banks appear more willing to lend, borrowers are less willing to borrow," said Paul Dales, an economist at Capital Economics. "This may be the economic equivalent of leading a horse to water, but not being able to make it drink."

A separate report by the Treasury Department reinforces the impression that nervous banks and nervous borrowers are still holding back. In its survey of 22 big banks that received money from the government's bailout program, the Treasury said that loan originations jumped 13 percent in June but that total loan balances declined by 1 percent.

"Consumers focused on paying down debt and reducing spending," the Treasury said, while businesses continued to "downsize, cut costs and reduce inventories."

So the Fed and the Treasury announced that they would extend TALF, one of their biggest efforts to finance both consumer and business loans, by at least three more months. The program had originally been scheduled to expire at the end of 2009.

Under the program, the Federal Reserve buys up securities backed by automobile loans, credit card debt and business debt including equipment leases and commercial real estate mortgages.

The program was started earlier this year as a way to fill the gap created when the capital markets stopped functioning. Though Fed officials originally thought that they might finance as much as $1 trillion in lending through it, the program has thus far financed only about $30 billion.

Fed officials have made it clear they want to start unwinding some of the emergency lending programs they created in response to the financial crisis last year. But they do not want to remove their temporary supports too quickly, and financial institutions had implored the policy makers to keep the program in place beyond the end of this year.

In a joint announcement, the Fed and the Treasury said they would extend the program but they also announced pointedly that they would not expand the program to finance lending backed by additional kinds of collateral.

Most of the program's consumer and business loans will be extended through the end of March. But the Fed said it would extend its program to buy up new commercial mortgage-backed securities through the end of next June.

"Conditions in financial markets have improved considerably in recent months," the Fed and the Treasury said. "Nonetheless, markets for asset-backed securities (ABS) backed by consumer and business loans and for commercial mortgage-backed securities (CMBS) are still impaired and seem likely to remain so for some time."