BANK LOANS SURGE IN FIRST HALF OF 1978

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During the first half of 1978, credit (loans and investments) at U. S. commercial banks grew rapidly. As shown in Table 1, bank credit was up $51.4 billion from the beginning of the year through the end of June, an 11.7-percent increase at an annual rate. Although this gain surpassed the huge dollar advances in the first halves of 1973 and 1974, it represented a slower rate of growth than the 15- to 16-percent annual rate of those two earlier years.

The first semester's increase in bank credit can be traced primarily to a surge in bank loans, whereas last year, bank purchases of securities, particularly U. S. Government obligations, contributed a large part of the first-half advance. Bank purchases of U. S. Government securities through June 1978 decelerated for the third consecutive year following a record $23½-billion rise in the first half of 1975, near the trough of the last recession.

The increased loan demand was broadly based, but much of the acceleration came from a surge in loans to business borrowers. Business loans were up by $18.4 billion, or at an 18-percent annual rate, in the first half of 1978, nearly twice the increase of the same period last year.[1] Adjusted to exclude bankers acceptances, which declined by $3.0 billion through June, bank loan growth in the first half of 1978 approached the rapid rate of the same period in 1974 but was still well below the record pace set in the first half of 1973. Net extensions of real estate and consumer instalment loans through June 1978 equaled $15.0 and $10.2 billion, respectively, somewhat more than in the comparable period last year.[2]

Loans Surge at Large Banks. An analysis of the first half 1978 business loan surge

[1] Toward the end of 1978's first half, total bank loan growth moderated as business loan growth slowed to a 6-percent annual rate in June; data for July and August indicate a return to rapid loan growth, led by a pickup in business loans.

[2] Data for July and August indicated continued rapid growth in real estate and consumer instalment loans.

TABLE 1

INCREASES IN BANK CREDIT IN THE FIRST HALVES OF SELECTED YEARS

(billion $, seasonally adjusted; annual rates of growth, seasonally adjusted)

All Commercial Banks	1973		1974		1975		1976		1977		1978	
Bank Credit	$46.5	16.1%	$47.7	15.0%	$17.8	5.1%	$27.7	7.6%	$45.6	11.5%	$51.4	11.7%
Total Loans	43.4	22.8	37.8	16.7	-8.4	-3.3	12.4	5.0	33.2	12.2	43.8	14.1
Business Loans	19.0	28.9	19.1	24.1	-6.1	-6.6	-4.8	-5.3	10.5	11.5	18.4	18.0
Real Estate Loans	10.2	20.8	8.1	13.8	1.4	2.2	6.8	10.1	12.1	16.2	15.0	17.0
Consumer Loans	5.7	16.2	2.0	4.9	-2.9	-6.7	2.3	5.1	7.1	14.0	10.2	17.3
Investments	3.1	3.5	9.9	10.8	26.2	27.7	15.3	13.6	12.4	10.1	7.6	6.0
Treasury Securities	-0.3	-1.0	3.6	13.6	23.6	96.7	15.3	38.5	7.8	16.0	2.8	5.9
"Other" Securities	3.4	5.8	6.3	9.7	2.6	3.7	0.0	0.0	4.6	6.2	4.8	6.1

Source: Federal Reserve Board.

TABLE 2

CHANGES IN LARGE BANK BUSINESS LOANS IN THE FIRST HALVES OF SELECTED YEARS

(billion $, not seasonally adjusted)

	1973	1974	1975	1976	1977	1978
By Location[1]	15.2	14.1	-10.0	-4.7	5.9	12.2
New York City	4.1	5.5	-4.0	-2.6	1.1	2.1
Outside New York City	11.1	8.6	-6.0	-2.1	4.8	10.1
By Industry[2]	15.0	14.8	-9.4	-6.5	2.7	9.2
Durable Manufacturing	3.2	4.1	-2.8	-1.6	1.3	2.1
Nondurable Manufacturing	2.0	2.2	-2.1	-0.2	0.6	1.9
Trade	1.7	1.8	-2.3	0.7	1.0	2.6
Public Utilities	1.4	1.8	-1.4	-1.1	-0.2	0.0
Bankers Acceptances	-0.2	0.7	0.6	-1.8	-3.2	-3.0
Other Classifications[3]	5.3	3.2	-0.9	-1.6	1.0	3.4
Unclassified	1.6	1.0	-0.5	-0.9	2.2	2.2

[1] Excluding bankers acceptances and adjusted for loans sold to affiliates.
[2] Including bankers acceptances and adjusted for loans sold to affiliates.
[3] Includes mining, construction, services, and foreign loans.

Source: Federal Reserve Board.

(net of acceptances) by class of bank (see Table 2) reveals that large weekly reporting banks accounted for over $12 billion, or nearly three-fifths, of the total increase.[3] That's double the rise during the same period last year and a marked difference from 1975 and 1976, when large banks' business loans fell substantially during the first half of each year. A part of the recent strength in business loans at large banks can be attributed, in turn, to growing demand at the large New York City banks. After declining during the first halves of 1975 and 1976 and rising only $1.1 billion during that period last year, business loans (net of acceptances) at these banks climbed more than $2.0 billion in the first six months of 1978.

Although a notable improvement, the advance was much less than the gains from even smaller amounts outstanding experienced in 1973 and 1974. One of several important differences between then and now is the spread between the bank prime interest rate and the 90-day commercial paper rate, an important consideration for many of the large New York City banks' prime business borrowers. In the first half of 1973, the bank prime interest rate averaged about a ¼ percentage point *below* the commercial paper rate, making bank loans relatively attractive. The prime rate averaged a ½ percentage point *above* the commercial paper rate in the first half of 1974, but the gap was nearly closed by the end of June. In contrast, the bank prime rate exceeded the commercial paper rate by nearly 1¼ percentage points in each of the first six months of 1978, steering many potential customers of large New York City banks into the commercial paper market. The amount of commercial paper outstanding rose by nearly $9.5 billion, or at a 29-percent annual rate, in the first half of this year.

At the same time that large New York City banks were finally feeling increasing loan demands, large banks outside the City experienced an even stronger growth in borrowings, posting a near record $10-billion increase in business loans (net of acceptances). That's over twice

[3] Large banks financed a sizable part of the rapid first-half advance in business loans by issuing nearly $9½ billion (net) in large negotiable certificates of deposit. As large banks' business loans flattened in June and July, the growth of negotiable CDs dropped off sharply.

the $4.8-billion gain in the comparable months last year and compares very favorably with declines in 1975 and 1976 but is still shy of the $11-billion advance from an even smaller amount outstanding in 1973.

The strength of large banks' commercial and industrial loans through June 1978 was fairly broadly based among different categories of business borrowers. As shown in Table 2, trade loans to retailers and wholesalers continued to show the most rapid growth. Loans to durable and nondurable goods manufacturers rose by $2.1 and $1.9 billion, respectively, much more than in the same period last year and in contrast to sizable declines in 1975 and 1976. However, neither advance matched the robust dollar gains of the first halves of 1973 and 1974. Loans to public utilities were unchanged, on net, through June 1978, after declining during that period in each of the past three years. Within the "other" category, mining loans and loans to companies providing various types of services were quite strong in the first six months of this year. Finally, large banks, mainly those in New York City, continued to run off sizable amounts of bankers acceptances, as was the case in the first halves of 1976 and 1977.

Interest Rates Rise. To accommodate the rapid growth in loan demand that accompanied the strong first-half advance in nominal economic activity, banks were willing to supply greater volumes of funds but only at progressively higher interest rates. As the year began, the commercial bank prime interest rate stood at 7¾ percent; it gradually rose to 9½ percent by mid-September. Most of this run-up occurred in the second quarter, the period of heaviest demand for loans.

Opinion surveys at selected large banks suggest that more stringent nonprice lending practices accompanied the increase in bank loan rates. Senior loan officers confirm that policies were moderately firmer in the following areas: standards of credit worthiness required to qualify for loans at a given spread above prime, reviews of loan applications for new and nonlocal customers, and requirements for compensating balances on business loans. The survey also suggests that large banks were somewhat less willing to make business loans with more than five years to maturity.

As the volume of bank loans expanded rapidly in the first half of 1978, the nation's money supply (M_1) grew at a 7¾-percent annual rate, nearly the same rate as in the previous six months. The continued brisk rise in M_1 and the accelerated pace of bank lending, particularly to business borrowers, were supported by a 9¾-percent annual rate of increase in the monetary base.

Summary. During the first half of 1978, bank credit rose sharply as strong growth in nominal economic activity boosted loan demand. Business loans, particularly at large commercial banks, along with real estate and consumer instalment loans, surged during this period. Even the large New York City banks experienced a pickup in business loans (net of acceptances). The increased demand for bank loans triggered several upward adjustments in the interest rates banks charge and firmer nonprice lending terms. Commercial banks greatly scaled down their purchases of U.S. Government securities but continued to acquire moderate amounts of municipal securities. ■