The Dramatic Tightening in Commercial Bank Lending Standards Portends Recession

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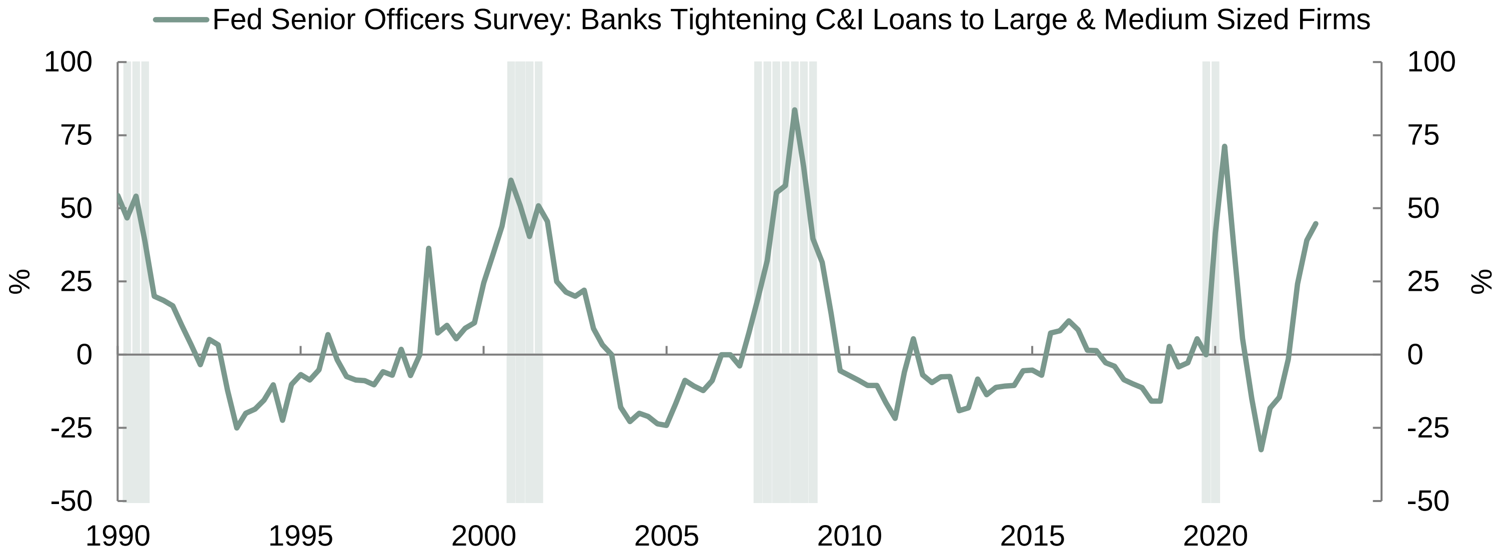
Tightening C&I Standards Signaling Factory Downturn

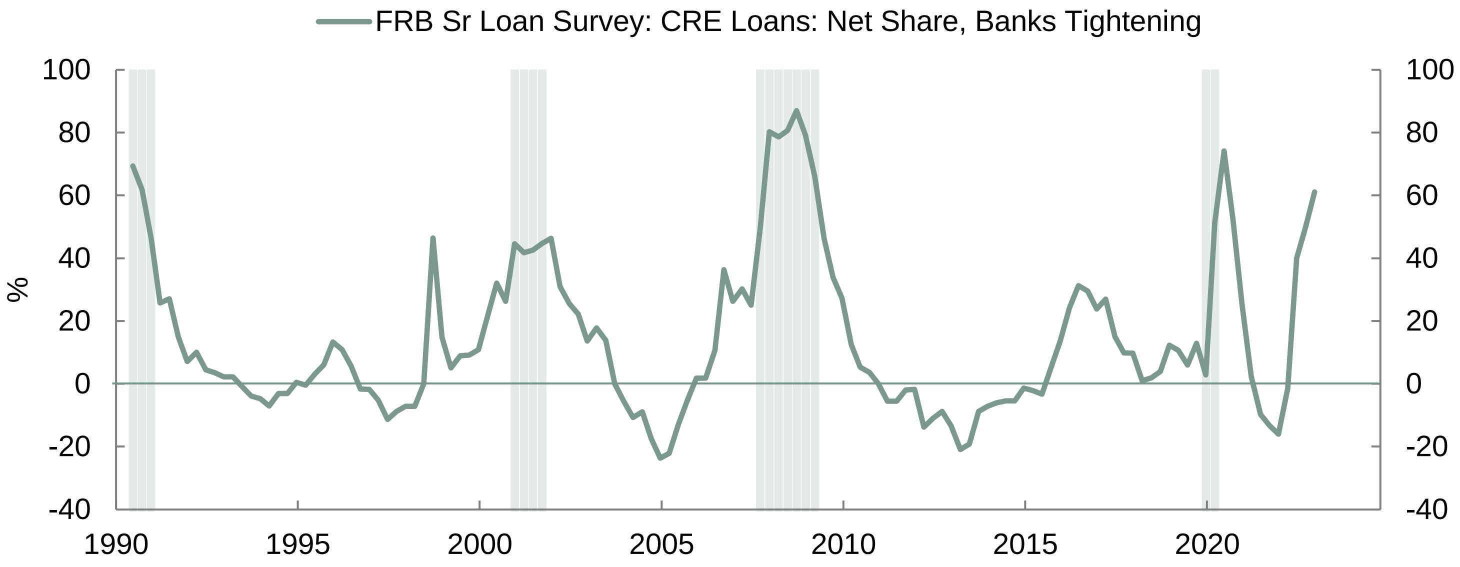
The net percentage of banks that tightened lending standards on commercial and industrial loans (C&I), a leading indicator of the manufacturing sector, rose to 44.8% last month up from 39.1% previously. Every time C&I standards have been this tight, the economy was either in recession or on the cusp of one. This time is unlikely to be different, and these data probably explain why Chair Powell was so dovish last week.



Source: Bloomberg, Federal Reserve, SMBC Nikko

Tightening on CRE Loans Even More Dramatic

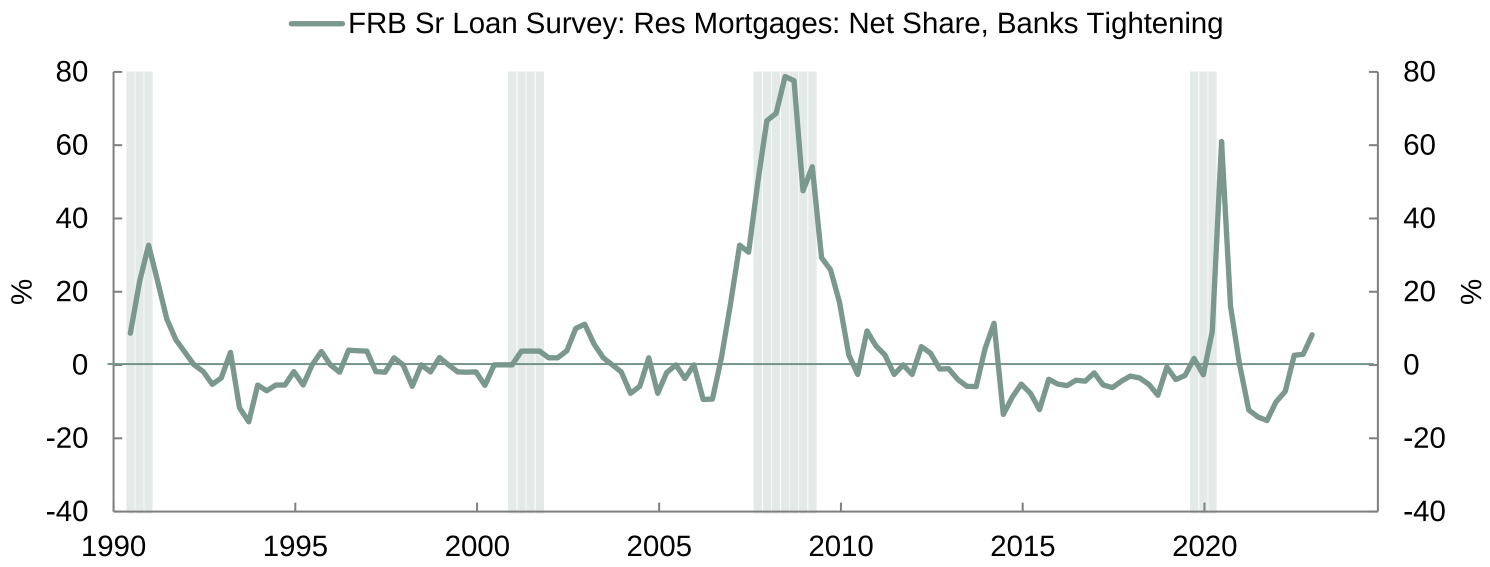
The situation is even worse for commercial real estate (CRE) loans where 61% of banks tightened standards. This, too, is a level consistent with recession. Within the CRE details, all three lending categories (construction & land development loans, nonfarm residential properties, and multifamily residential properties) experienced dramatically more stringent loan criteria. These figures point to an imminent pullback in construction payrolls.



Source: Bloomberg, Federal Reserve, SMBC Nikko

No Need to Tighten When No One Wants to Borrow

On the surface, it is surprising that standards on residential mortgages have tightened by only a little considering what has happened for C&I and CRE lending. But this reflects the fact that residential loan demand has collapsed because of a record large increase in mortgage rates. Look for banks to become more stringent only after mortgage rates decline in response to a Fed pivot.



Source: Bloomberg, Federal Reserve, SMBC Nikko

Less Lending Equals Less Demand

Lastly, Senior Loan Officers also have been less willing to extend credit to households. This is evident from a plunge in banks willingness to make consumer installment loans, which declined to -12.5% from -6.8% previously. This is a level that has always been consistent with recession. The bottom line: With bankers dramatically tightening lending standards on C&I, CRE and consumer loans, it is difficult to see how a 2023 economic downturn can be avoided.

Source: Bloomberg, Federal Reserve, SMBC Nikko

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