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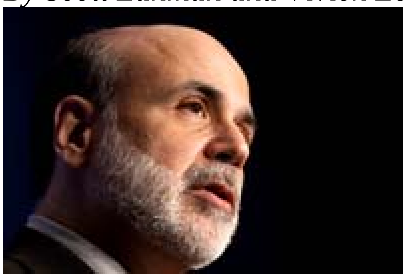
Bernanke Sees `Reasons for Optimism' on Bank Lending

By Scott Lanman and Vivien Lou Chen - May 06, 2010



Federal Reserve Chairman Ben S. Bernanke sees some optimism as banks may start making it easier for customers to get credit. Photographer: Andrew Harrer/Bloomberg

Federal Reserve Chairman Ben S. Bernanke said he’s optimistic that U.S. banks may start making it easier for customers to get credit after the financial crisis led lenders to tighten standards.

“Although bank credit remains tight, I see some reasons for optimism,” Bernanke said today in a speech in Chicago. The economy is recovering, and banks’ senior loan officers expect a “modest reduction in their troubled loans” over the next year, outside of commercial real estate, he said. “As a result, bank attitudes toward lending may be shifting.”

Fed policy makers last week reiterated their assessment that “tight credit” is restraining consumer spending, which represents about 70 percent of the U.S. economy. On the business side, banks’ commercial and industrial loans have declined to $1.27 trillion from $1.65 trillion in October 2008, according to data from the central bank.

The latest quarterly survey of banks’ senior loan officers, released May 3, showed that most banks reported unchanged lending standards over the past three months and “no net tightening” of standards for small businesses, Bernanke said in his remarks to an annual banking conference hosted by the Chicago Fed.

He devoted most of his speech to the Fed’s 2009 stress tests of the 19 biggest U.S. banks. Bernanke and other Fed officials say the project helped stabilize financial markets. Tomorrow marks one year since the examination showed that 10 firms needed to raise a total of $74.6 billion in capital.

Identifying Risks

Central bankers are trying to apply lessons from the project to better identify emerging risks in the financial system.

With the stress tests, "we hoped also to hasten the return to a better lending environment," Bernanke said today. "Clearly that objective has not yet been realized, as bank lending continues to contract and terms and conditions remain tight. Consequently, restoring the flow of credit through the banking system remains a central objective of the Federal Reserve."

Bernanke, 56, said credit demand remains "tepid" and the economy is "still under stress." He didn't elaborate on the outlook for the economy or monetary policy.

Last week, the Fed's Open Market Committee reiterated its pledge to keep the benchmark lending rate at a record low for an "extended period," saying that while the labor market is showing signs of life, employers remain reluctant to hire, and consumer spending is restrained by tight credit and limited wage gains.

Additional Capital

Many smaller banks across the country may need additional capital in the next few years because of potential losses from residential and commercial real estate loans, Bernanke said. "We will continue to work closely with smaller banks as they rebuild their financial strength," he said.

The Fed has approved many proposals over the past two years from private-equity investors to take stakes in regional and community banks, Bernanke said.

The central bank is fighting a measure in proposed Senate financial-overhaul legislation that would strip the central bank of oversight of 5,000 firms with less than $50 billion in assets. Republican Senator Kay Bailey Hutchison of Texas and Democrat Amy Klobuchar of Minnesota are sponsoring an amendment to the bill to let the Fed keep the powers.

Yesterday, Kansas City Fed President Thomas Hoenig and three other regional Fed presidents met with lawmakers to make their case. Nevada Senator John Ensign, a Republican, said the Fed officials "argued very vociferously" to retain oversight. "That concept certainly seemed to have a lot of merit," Ensign told reporters after the meeting.

Senate Banking Committee Chairman Christopher Dodd, the Connecticut Democrat who proposed removing the authority, has called the Fed's record on bank supervision "abysmal" and has said its reduced role would it allow it to focus on monetary policy.

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