

Tightening of Credit Availability May Suppress Capital Spending

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WASHINGTON -- While resilient consumers appear to be pulling the economy out of recession, new strains in the financial markets could delay the day when businesses join in.

Many small- and medium-sized firms complain that banks have tightened the screws on credit availability, and in the capital markets, Enron Corp.'s collapse and accounting worries have put a floor under borrowing costs for less-than-top-quality companies. These trends could damp companies' efforts to revive capital spending.

Tony Raimondo, chief executive officer of Behlen Manufacturing Co., said the company's bank demanded a \$75,000 penalty and boosted the interest rate on a \$50 million line of credit to three percentage points above the bank's prime-lending rate from just under prime -- all because of one money-losing quarter a year ago. He found a different bank to lend \$40 million at only 0.75 percentage point over prime, but it took four months of searching to find a bank to advance the additional \$10 million. One reason: A bank appraisal halved the value of the company's equipment used as collateral to \$7.5 million from \$15 million.

"Our capital-spending plans have been stifled," said Mr. Raimondo, whose company, based in Columbus, Neb., makes agricultural equipment and building systems. It will spend just \$1.5 million on capital improvements this year, compared with the \$4 million to \$5 million it usually budgets.

"There is an unfortunate structural decrease in the availability of credit on even terms in this recession," National Association of Manufacturers President Jerry Jasinowski said at a news conference Tuesday. It's "a trend that we think undermines the recovery." An association survey of small- and medium-sized manufacturers found 34% said credit is harder to get compared with last year, while 6% said it is easier. The remainder saw no change.

Federal Reserve surveys of bank-lending officers have also found that banks have been tightening lending standards on commercial and industrial loans since the second half of 2000. While the rate of tightening slowed a bit in the last survey, conducted in January, it remains faster than in the last quarter of the 1990-91 recession.

John Rutledge, an economist and private-equity investor, noted that banks' commercial and industrial loans have been shrinking for the past year while their holdings of securities such as Treasuries have grown. He said bank mergers and banks' efforts to channel lending activity to their investment-bank affiliates have played a role.

However, a recent Federal Deposit Insurance Corp. study said business credit has grown faster than in previous recessions, when all types of credit, including corporate bonds, are added together and adjusted for inflation.

Furthermore, some of the decline in bank lending is because of less demand, not supply, Fed surveys indicate, as companies pare inventories and expansion plans in response to weak sales.

Still, the capital markets show signs of rising nervousness by lenders. The spread between corporate bonds rated Baa by Moody's Investors Service and those rated triple-A, the highest ranking, has widened sharply in recent months. This "is unusual at a time that the prospects for an economic recovery appear to have improved markedly," Goldman Sachs economists wrote in a report. Several companies have also run into problems refinancing commercial paper -- a short-term corporate IOU -- and have had to turn to banks to refinance those debts.

These trends partly reflect lenders' losses in Enron, Global Crossing Ltd. and other bankrupt companies. "Everybody that's in the business of being a fiduciary is very concerned, and rightly so," said Mr. Rutledge.

"There's a witchhunt on, and it's likely to catch [both] the witches and a few of us sweeping our porches with brooms."

The deteriorating credit-worthiness of many companies provides ample justification for tighter lending standards. Though the recession was mild in terms of declining gross domestic product, it was among the worst for profits. Goldman estimates that cash flow is at its lowest relative to debt since World War II. Furthermore, before the recession, businesses had been drawing on outside funds to an exceptional degree -- equal to 3% of GDP -- to finance their investment, leaving capital-spending plans especially vulnerable to lender recalcitrance.

Goldman estimates that though the "financing gap" between cash flow and capital spending has narrowed, it remains wide by historic standards. "This means the path to a resumption of capital spending will be a slow one rather than a fast one," said Goldman economist Ed McKelvey.

