

Big banks respond to pressure from Flaherty

Updated Fri, Dec. 19 2008 6:17 AM ET

The Canadian Press

TORONTO -- Big banks can't re-ignite the lending market on their own, despite government suggestions to the contrary, the head of the association for Canada's financial institutions said Thursday.

Nancy Hughes Anthony, president and chief executive of the Canadian Bankers Association, agreed that many sources for lending have been pulling back in the wake of the global credit crunch that has rocked financial markets around the world.

"Banks are working to fill the gap," she wrote in a statement, as Finance Minister Jim Flaherty stepped up the pressure on the banks to loosen up their lending practices to help revive the battered economy.

"But banks don't have the capacity to do it all."

Bank of Canada Governor Mark Carney and Flaherty are scheduled to meet with chief executives from the country's big banks in January to get an update on their lending practices.

"I expect (the banks) to make it evident to us that they are taking steps to make that more available in Canada," Flaherty said at a news conference Thursday in Saskatoon, where he was holding pre-budget meetings.

On Wednesday, Carney also urged the banks to pump more credit into the economy and he called on financial institutions to build up capital in good times and draw on it in bad -- the opposite of what is now occurring as bankers become more risk-averse in a shrinking economy.

"In this way, capital requirements would moderate the ups and downs of the credit cycle -- the reverse of what currently happens -- reducing the risk of a future crisis," Carney said in a speech in Toronto.

The two sides are increasingly clashing over how much responsibility the banks should have towards the broader economy.

While the recession is worsening because of mounting plant closures and workers' rising job insecurities across the country, credit is also drying up, preventing companies from raising capital to invest and expand and consumers from buying cars, houses and other big-ticket items.

"It's a real tug of war that's going on," said Patricia Croft, chief economist and vice-president of Phillips Hager and North, a Vancouver-based money manager acquired by the Royal Bank earlier this year.

` We live in an era of globalization. We should be very pleased that our banking system is sound... but we're heading into a recession, there's lots of uncertainty about loan losses."

Croft said that banks and businesses are stuck in a "negative feedback loop," which might be more commonly known as a vicious circle: banks are reluctant to lend, which means that businesses cut back on capital spending, resulting in job cuts. That makes consumers spend less and default on credit payments, which in turn causes the banks to become even more reluctant lenders.

Carney and Flaherty are trying to break that cycle and encourage the banks to do the same.

However, Hughes Anthony suggested that banks have already boosted the dollar value of their lending by 11.3 per cent over the 12 months ending in October, compared with a year earlier.

She said other areas of lending, like the bond market, commercial paper, initial public offerings and non-bank finance and leasing companies have pulled back in their willingness to lend to companies and consumers.

The banking industry has faced close scrutiny because credit markets are still locked up even though the federal government and the Bank of Canada have injected billions of dollars into the financial system to free up credit.

In recent months, many miners, oil companies, manufacturers and others have been forced to cancel deals, cut jobs and shelve expansion plans as their industries slumped and it became more difficult to raise money on the plunging stock market.

Automakers are also finding it increasingly difficult to finance car purchases and prospective homeowners face greater scrutiny when they seek new mortgages.

One source of past funds -- bank-to-bank lending in the wholesale market - has dried up around the world as banks scale back to preserve capital in uncertain economic times.

` Our Canadian banks have been lending and I think they've done a phenomenal job in staying active during this whole credit crisis," said Mario Mendonca, a bank analyst at Genuity Capital Markets.

He said lending is healthy, but it's also a risky move for the banks, especially if they end up unable to collect on the new loans if companies or individuals go bankrupt in a recession.

` If you're looking at a wall of unemployment... as a bank you're obviously going to be careful in your lending," he said.

`These are still commercial banks, they have to make money."

In a separate release late Thursday, the Bank of Montreal (TSX:BMO) said it increased its business loans in the \$1 million to \$5 million range by 12 per cent year over year in the fourth quarter.

`Because of our strong balance sheet and consistent underwriting standards, we tend to attract commercial customers during economic downturns," said Frank Techar, president of the bank's personal and commercial banking division.

Croft dismissed suggestions that the government might consider more capital injections or investment in the banking industry to get more credit flowing.

`I don't think we're going to go down the road of the U.K. or the U.S., which is essentially nationalizing large chunks of the financial system," she said.

`I don't think the banks would want that. If your major shareholder becomes the government of Canada, that's a different situation."