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COMMENT

Letters

Lending restraint is here for a while

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From Mr **Daniel J. Aronoff**.

Sir, An environment where borrowers and banks are fearful of the future makes it difficult to disentangle forces generating a decline in bank lending (["The manager says no", Analysis, August 31](#)). Nonetheless, it is possible to identify three structural features of finance in the aftermath of the asset value bust that portend continued restraint on lending, whatever may become of "animal spirits".

First, banks will continue to have loans tied up with "zombie" borrowers who cannot repay. In the US, nearly half of commercial real estate loans are underwater, but bank regulators have amended the rules to allow banks to "extend and pretend" loans. This will divert lending away from new enterprises and it will depress the profit rate in industries dominated by zombie firms, which will further deter entry by new businesses.

Second, the existence of deposit insurance creates a formidable barrier to entry in banking, as potential entrants have limited scope to compete for deposits, and incumbents have existing depositor relationships and control the best branch locations. This barrier will deter entry by well-capitalised banks that are not plagued by non-performing legacy loans and impaired balance sheets, who would be able to expand lending to new enterprise.

Third, the collapse of securitisation markets severely limits alternative channels of financial intermediation for small to medium-sized enterprises. This places a further restraint on lending. The consequence will be a secular decline in new project finance and, consequently, a decline in trend economic growth. The effects will have a negative impact on the demand for labour and government fiscal balance.

The US and Europe have only to look at Japan since the early 1990s to gaze into its future. Unless, of course, they engage in more serious structural reform of the banking industry.

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