



# Weekly Market Commentary

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## Giving Credit

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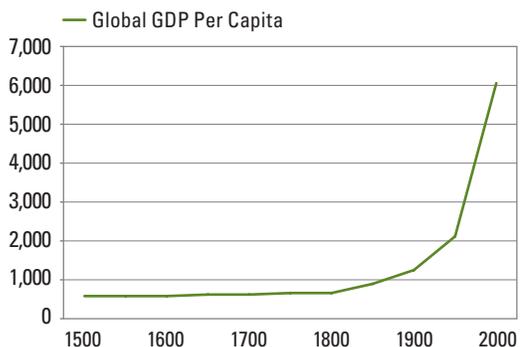
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#### Highlights

Certainly, too much debt is a bad thing for anyone. But too little can be equally disastrous. Tight credit and an unwillingness to borrow in Europe is exacerbating that region's recession.

Bank lending data in China is beginning to accelerate, and in the United States lending is now growing at a normal pace.

#### 1 500 Years of Global GDP Per Capita



Source: LPL Financial, IMF, Angus Maddison 07/13/12

Most of the Spring Slide indicators that we defined back in March 2012 are still pointing to the weakness that they signaled ahead of this year's stock market slide that began in April 2012. However, some bright spots are beginning to emerge that deserve some credit. One of them is credit.

Credit, or the ability to borrow, has earned the honor of being recognized as the underlying force for growth of the past 250 years. Industrialization is often cited as the source of growth and massive improvement in health and wealth of the world since the mid-1700s [Figure 1]. This is true, but what made industrialization possible? The answer, of course, is the expansion of credit to businesses and individuals who employed it productively. European colonialism in the 1600s and 1700s expanded international trade and fostered the creation of financial markets that then supported and enabled industrial growth in the 1800s and 1900s. As credit became more plentiful, economies began to grow more rapidly and living standards improved.

It may seem odd to praise taking on debt in the current environment. Certainly, too much debt is a bad thing for anyone. But too little can be equally disastrous. Lack of spending and investment can become a self-reinforcing downward spiral for an economy. Borrowing can be a good indicator of growth. It is measurable and reported frequently (weekly in the United States). The pace of loan growth is often a precursor to business spending and hiring that drives growth and the markets. Where we see borrowing, we see hope for a brighter future.

### Europe

Tight credit and an unwillingness to borrow in Europe is exacerbating that region's recession. The latest figures from the European Central Bank (ECB) show that private sector lending in the Eurozone was flat over the one-year period ending May. Despite the vast amounts of cheap cash banks in the region borrowed from the ECB earlier this year, loan growth has stalled.

However, the ECB's unprecedented July 5th deposit rate cut to zero may begin to spark more lending, since banks get nothing if they keep deposits at the ECB. As it came into force, banks cut the amount of cash parked at the ECB by more than half. We will watch the bank lending data to see if banks begin to seek a better return by lending to business or consumers or other banks in need of funding.

## 2 Business Lending Growth Back to Pre-Crisis Levels



Source: LPL Financial, Federal Reserve 07/13/12

## China

Bank lending data in China is beginning to accelerate, showing that the rate cuts may be starting to take effect at changing the trajectory of economic growth. China's total bank lending rose in June, following the government's recent easing of monetary policy to reverse the economic slowdown. Bank lending in June was up 45% from a year ago and above expectations.

The People's Bank of China cut interest rates for the second time (on July 5, 2012) in less than a month, seeking to make loans more affordable to businesses.

(Please see today's *Weekly Economic Commentary* for more details on credit in China and the United States.)

## United States

In the United States, paying down debt has been taking place among corporations and consumers in recent years, as opposed to the Federal government. Fortunately, private sector borrowing has been on the rise, and is now growing at a normal pace much like what we saw in 2005–2007 [Figure 2]. The dollar amount of lending is also on par with the beginning of that period.

Business lending is one of the few bright spots in recent economic data. We hope to see more signs of lending accelerating in China and turning around Europe to help drive innovation and growth. ■

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Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

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