GLOBAL LONG-TERM UNCONSTRAINED

Monthly Market Update

MARTIN CURRIE
A Franklin Templeton Company

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A tight squeeze

Tightening US credit lending conditions could pose a growing risk to US economic growth

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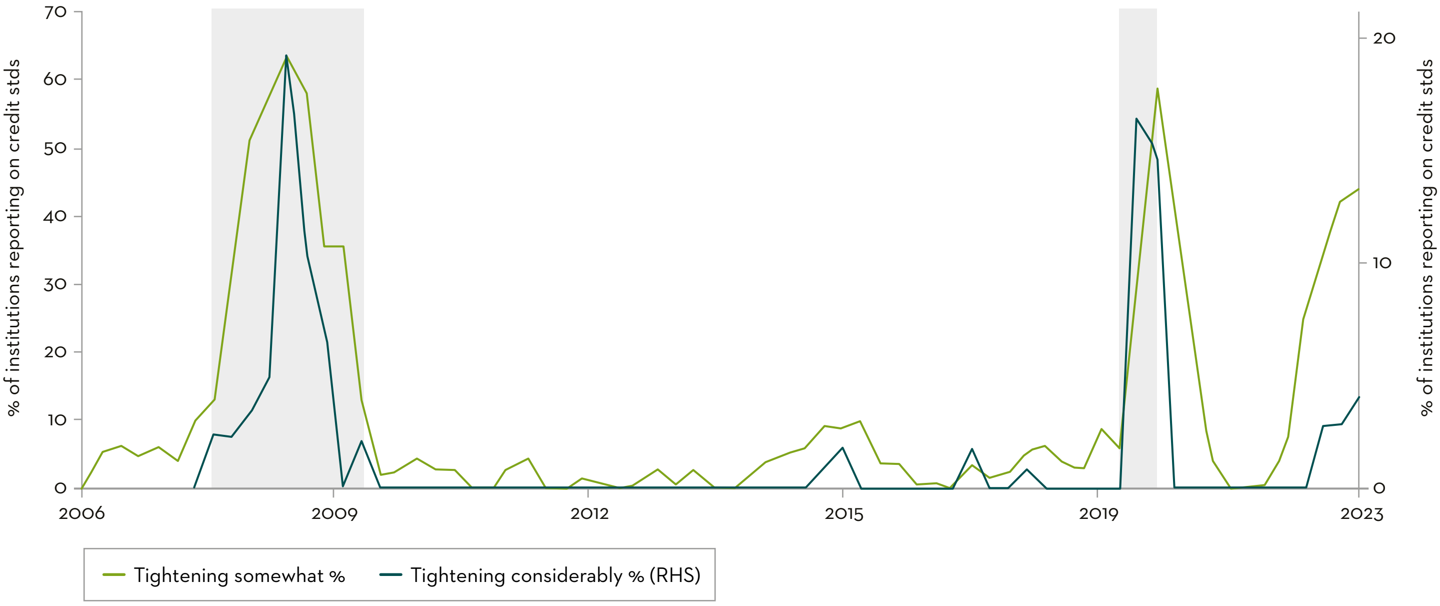
With the banking failures in the US regional banks in March and April, we highlighted at the time that credit lending conditions tightening could be a risk to watch out for, given that it would be the transmission mechanism that could lead to higher risk for the US economic activity. In this month's insights, we zoom in on the latest credit lending conditions, with the latest datapoint coming through in early May.

The chart below shows the tightening credit lending standards in the US, through the Senior Loans Officers' Survey. The market bears will focus on the spiking curve related to the "tightening somewhat" responses, shown in light green. Bringing in the black curve, the "tightening considerably" responses is important to do, as it shows a somewhat more measured picture of credit conditions, as it puts things into perspective, compared to previous significant tightening in lending conditions that have occurred around recessions, both in 2008-09 and in 2020.

Senior Loan Officers Survey

Credit lending conditions for large, middle market & small firms

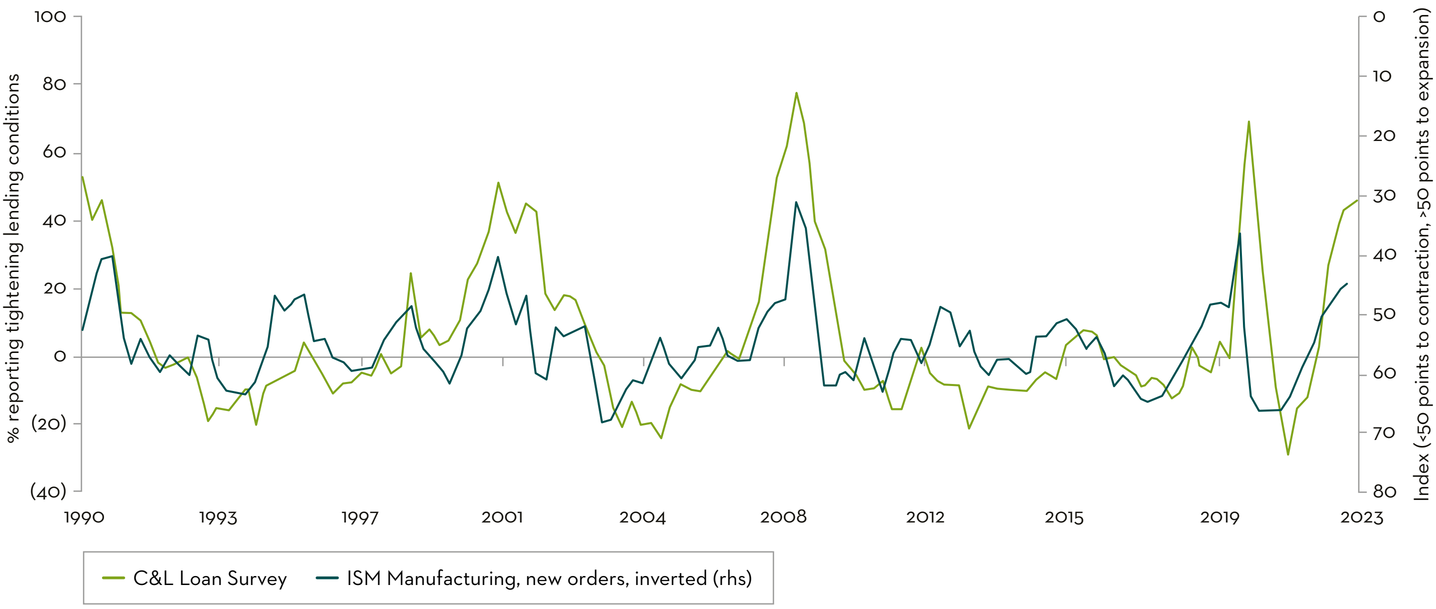


Source: State Street Global Markets, Bloomberg.

The conclusion so far is that whilst credit conditions are tightening, the proportion of responses showing significant tightening is nowhere near the levels of previous recent recessions. The trend does however need ongoing careful monitoring, as it could imply that tighter credit conditions will impact economic activity negatively, which could in turn increase the risk of a recession in the US.

The reason that the market has been particularly focused on credit lending conditions is the close relationship between those, and the ISM Manufacturing* new orders data, as can be seen in the chart below, this is the US purchasing manager index. There is a strong correlation between tightening credit conditions and deteriorating ISM manufacturing new orders. This is shown by the increasing number C&L survey respondents reporting tightening lending conditions (light green line).

C&L Loans Survey – banks tightening credit



Source: Refinitiv Datastream, Credit Suisse Research as at May 2023.

*Institute for Supply Management. Also known as ISM Manufacturing Purchasing Managers Index (ISM PMI), is a monthly gauge of the level of economic activity in the manufacturing sector in the United States versus the previous month.

Whilst we keep our probability of a recession in the US in 2023 at 30-35%, there is a risk that such probability could be increasing if credit conditions continue to tighten from here. Our core scenario remains one of a sharp slowdown, which we continue to assess at 60-65% probability, but we will be reviewing this in light of additional datapoints.

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