Banking Sector Analysis

Senior Loan Officer Survey 2015 Q4

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Not a lot of change and positive on the whole

- **C&I and CRE loan demand still growing, but lending standards might be starting to tighten.**
- **Residential loan demand slowed, which is likely transitory. Lending criteria kept on slightly easing except for subprime mortgages.**
- **Demand for home equity loans is rising and is solid for consumer loans, supported by recovered consumer confidence and improving employment.**
- **Banks are getting more sensitive and scrutinizing when it comes to higher risk loans, while at the same time facing increased competition from other bank and non-bank lenders.**

The Federal Reserve's Senior Loan Officer Survey (SLOS) for 4Q15 gave no indications of large changes in lending throughout the past three months. Most of the respondents reported unchanged demand, standards, and terms of lending. Where changes were reported, they supported ongoing trends such as continued growth in demand for loans. The most interesting new development is the greater attention paid by banks to riskier types of loans like riskier commercial and industrial (C&I) loans, some types of commercial real estate (CRE) loans, and subprime mortgages. There were also indications of increased competition in the industry.

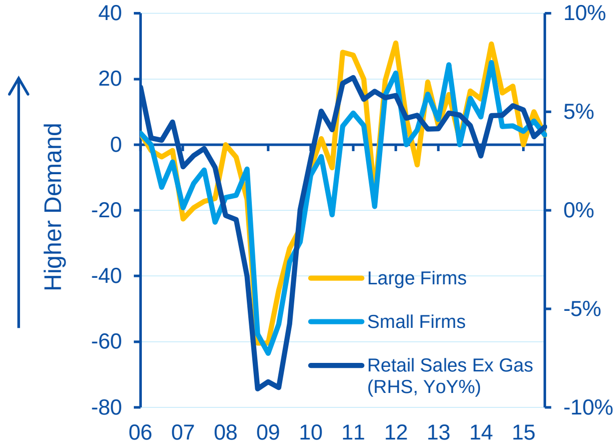
C&I Credit: Standards start to tighten, but terms keep on relaxing

While most respondents reported unchanged demand, the ones that did report changes were more on the side of higher demand (Chart1). The reasons for this in order of importance were: (1) increased merger or acquisition financing needs of clients, (2) increased accounts receivable financing needs, and (3) increased investment in plant or equipment needs. The net balance, while still positive for three straight years, has been slowing throughout 2015. Furthermore, the number of reported inquiries for additional or increased C&I lines was almost unchanged for the last quarter, after a period of continuous increases in each quarter starting in Q1 2012. C&I loans have been the strongest growing category of loans for the commercial banking industry in the last several years and the slowdown coincides with the decline in business confidence in Q3. The possible slowdown is likely transient and related to the slowdown in some industries that have been growing quickly in the past, like for example oil and gas. We expect further solid expansion of C&I lending supported by the continuing expansion of the economy in the coming period.

The few respondents that reported changes in lending standards reported slight tightening. This happened for the first time since 2011, which coincides with the recent decrease in business confidence (Chart 2), driven by decreased confidence in some manufacturing industries – Machinery, Metals, and Chemicals, Petroleum and Rubber, industries affected by the rise in value of the U.S. dollar as well as the decline in oil prices. The reasons reported for the tightening were: (1) worsening of industry-specific problems, (2) less favorable or more uncertain economic outlook, (3) increased concerns about the effects of legislative changes, supervisory actions, or changes in accounting standards, and (4) reduced tolerance for risk. The banks that reported easing standards or terms (mostly terms) cited more aggressive competition from other banks or nonbank lenders as the most important reason.

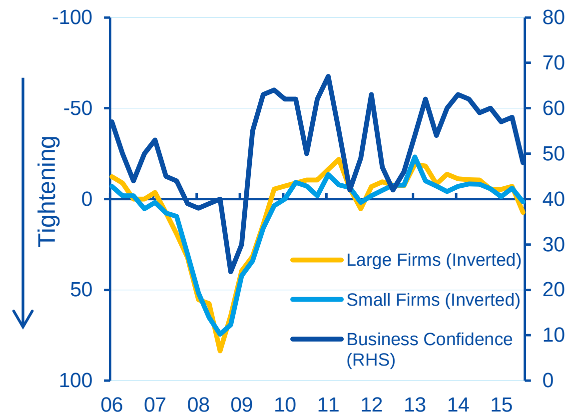
While the loan standards tightened, the terms of the loans generally eased, except for premiums charged on riskier loans for large and middle market firms. This indicates that the banks are willing to lend and meet the growing demand, but are becoming more discerning when it comes to some clients.

Chart 1
C&I Loan Demand and Retail Sales



Source: Federal Reserve, Census, Haver and BBVA Research

Chart 2
Net Tightening of C&I Loan Standards and Business Confidence

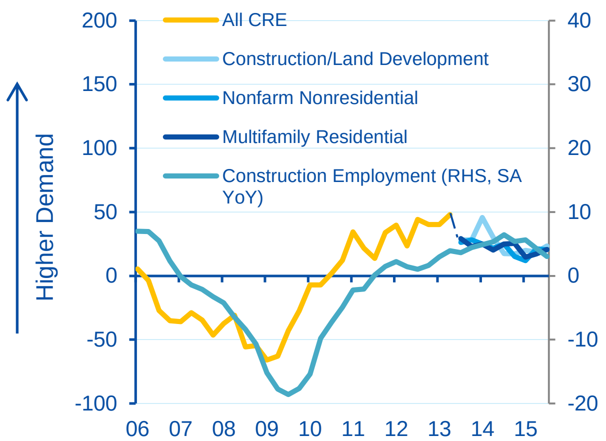


Source: Federal Reserve, Conference Board, Haver and BBVA Research

CRE Credit: Resilient growth in demand as banks start to be more scrutinizing

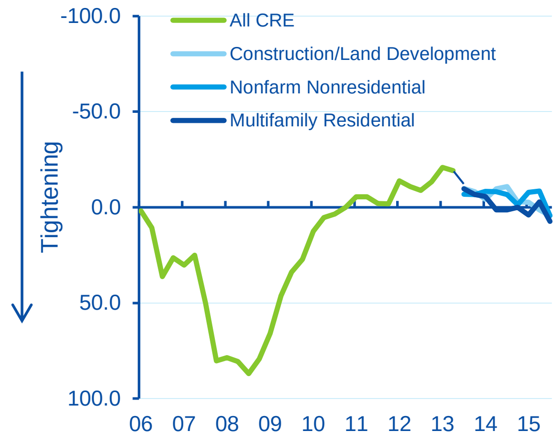
The number of banks reporting higher demand for CRE loans in the last quarter was significant (Chart 3), especially for construction and land development. The growth in demand has been resilient over the last year and increased in Q3 2015, coinciding with the favorable environment in the industry, especially the attractive cap rate risk premiums and the increasing demand for residential construction and industrial CRE. While most of the banks reported unchanged credit standards, the net balance of the ones that did pointed in the direction of tightening (Chart 4). The trend in tightening standards is expected to continue as CRE valuations have started to raise red flags, as banks will be more careful lending in locations where there has been strong supply of new inventory or have been adversely affected by local factors such as the slowdown in oil and gas, and as it is unclear how the likely increases in interest rates are going to affect CRE in general.

Chart 3
CRE Loan Demand



Source: Federal Reserve, Haver and BBVA Research

Chart 4
Net Tightening of CRE Loan Standards and Business Confidence

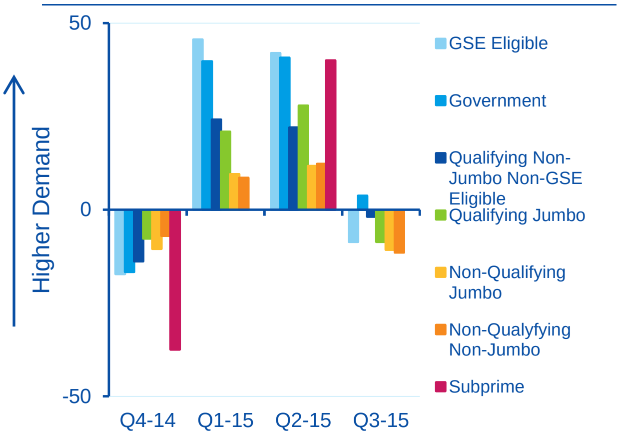


Source: Federal Reserve, Haver and BBVA Research

Residential Mortgage Loans: Decrease in demand, likely transitory

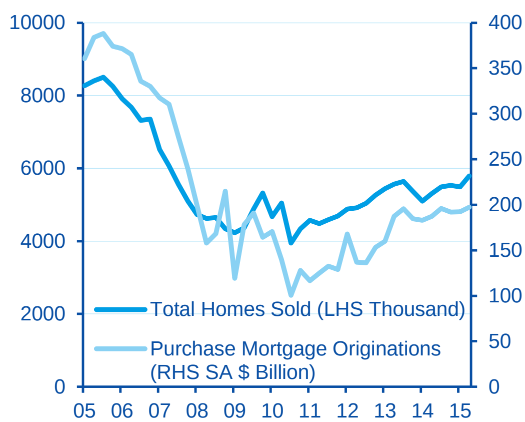
After the strong growth in residential mortgage loans in the first half of 2015, demand slowed in Q3 (Chart 5). The gains in the first half coincide with the increase in the number of total homes sold (Chart 6). The decrease in the third quarter coincides with the stalling of existing home sales in August. However, as existing sales regained momentum in September, and there has been a surge in building permits, it is likely that this decrease will be transitory. As the recovery in the housing market progresses, we expect the demand for mortgages to pick up again. Lending standards kept on easing (Chart 7), except for subprime mortgages, which points to increased scrutiny of riskier clients. The demand for home equity loans kept increasing as the credit standards remained roughly unchanged (Chart 8).

Chart 5
Residential Loan Demand



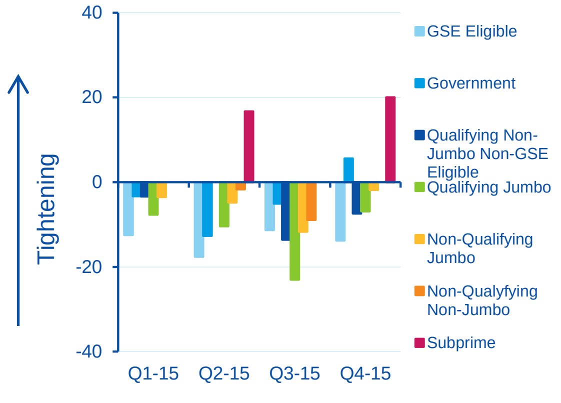
Source: Federal Reserve, Haver and BBVA Research

Chart 6
Mortgage Originations and Home Sales



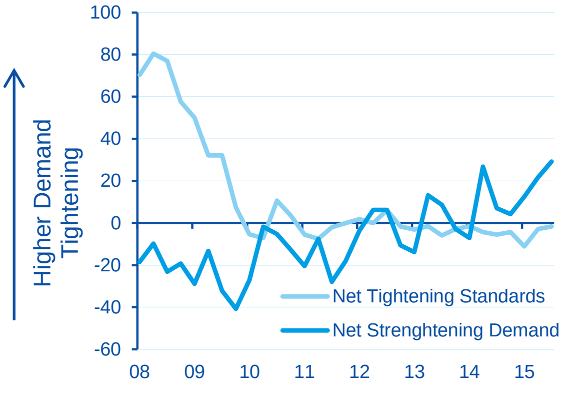
Source: Census, NAR, MBA, Haver and BBVA Research

Chart 7
Net Tightening of Residential Loan Standards



Source: Federal Reserve, Haver and BBVA Research

Chart 8
Home Equity Loans Demand and Net Tightening of Loan Standards

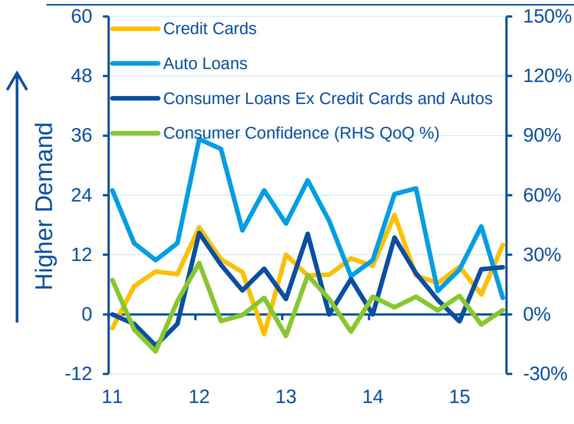


Source: Federal Reserve, Haver and BBVA Research

Consumer Credit: Strong demand and supportive credit standards

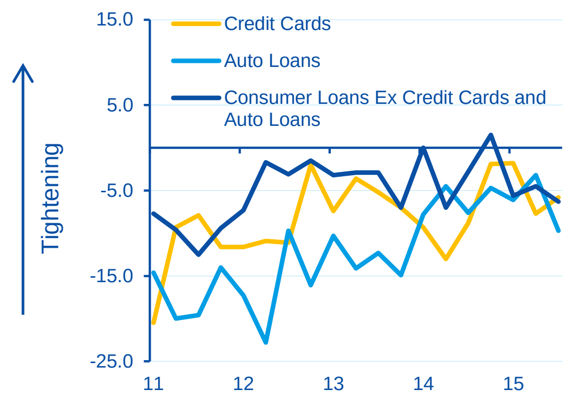
Like for home equity loans, the demand for credit card loans and consumer loans other than credit cards and autos increased in Q3 2015 (Chart 9). This increase has been driven by solid consumer confidence, which further improved in the third quarter, as well as by the solid and improving unemployment levels. The growth in consumer credit that started in 2014 is set to continue in the coming period, especially for revolving credit. The demand for auto loans is on a slight downward trend, but should remain positive for some time. Sustained economic growth and low energy prices will continue to support the demand for light motor vehicles, and financing will continue to be favorable, even with the gradual rise in interest rates. While some banks reported that standards were easing for consumer credit (Chart 10), the overwhelming majority of the respondents reported that standards have remained basically unchanged, which after being relaxed somewhat in the last couple of years are now supportive to further growth of this credit category.

Chart 9
Consumer Credit Demand



Source: Federal Reserve, Conference Board Haver and BBVA Research

Chart 10
Net Tightening of Consumer Loan Criteria

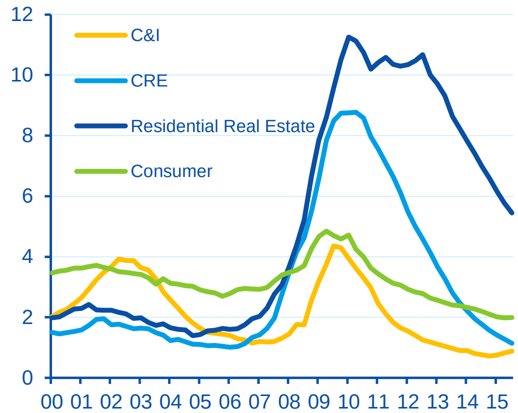


Source: Federal Reserve, Haver and BBVA Research

Bottom Line

While there was not much new in the latest survey, the most interesting takeaway is that banks are ready to meet the growth in demand, but are becoming more careful when it comes to riskier loans. As delinquency rates, except for residential loans, are at or below their pre-crisis levels (Chart 11), and as banks are trying to generate more income in a very competitive environment, it is inevitable that they will be paying more and more attention to risk. As the industry is becoming used to operating at a lower level of profitability than before the crisis, it will be much more careful in managing any potential for growth in delinquencies going forward. We see that with the tightening standards for C&I loans driven by decreased business confidence in industries experiencing headwinds, beginning of tightening standards for CRE loans, and tightening standards for subprime mortgages.

Chart 11
Delinquency Rates



Source: Federal Reserve, Haver and BBVA Research