Banking Sector Analysis

Senior loan officer survey, April 2016

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Lending remained resilient in 1Q16, and O&G exposure seems manageable

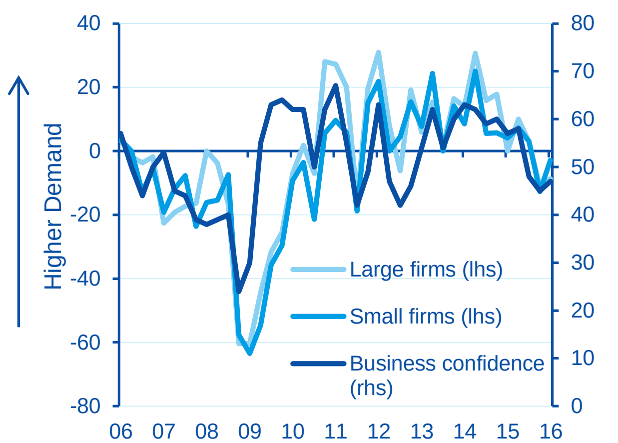
- **Lending standards for C&I and CRE loans continued tightening for the third quarter in a row**
- **Residential loan demand increased, reflecting solid housing market, while standards relaxed**
- **Demand for consumer loans increased and standards kept easing, but less so for auto loans**
- **Banks are confident in the economy but also risk aware, especially when it comes to O&G**

The most recent Federal Reserve Senior Loan Officer Survey (SLOS) reflects many of the developments in the economy in the first quarter of 2016--slow growth, lower fixed investment, and ongoing challenges for commodity producers, but also a healthy labor market and still solid consumer confidence.

C&I credit: Demand slowdown eased, while standards continued to tighten

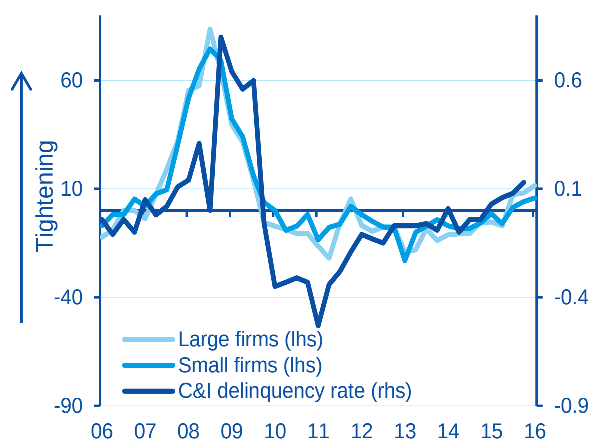
Survey respondents reported that the demand for C&I loans continued weakening, but at a slower pace than in 4Q15, which coincides with an uptick in business confidence (Chart 1). This trend should continue as the volatility of the first quarter is behind us and the oil and gas (O&G) industry continues to receive support from somewhat improved oil prices. In addition, the relative weakening of the U.S. dollar since late January is already helping exports recover, even though demand from abroad is still tepid. On the other hand, loan criteria kept tightening for the third quarter in a row, coinciding with the rise in delinquencies (Chart 2). Both trends are expected to continue in the short term. Banks also reported an increased use of premiums on riskier loans and higher use of loan covenants.

Chart 1
C&I loan demand and business confidence (Net % balance and index)



Source: FRB, Conference Board, & BBVA Research

Chart 2
C&I lending standards and delinquency rate (Net % balance and QoQ p.p. difference)



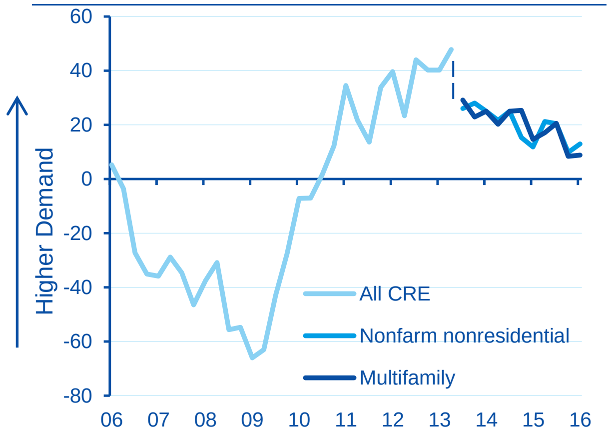
Source: FRB & BBVA Research

The most recent survey contained special questions on O&G-related loans. The responses indicated that most banks are not highly exposed to these loans–86.6% of respondents said that O&G loans account for less than 10% of all C&I loans–and smaller banks seemed the most insulated. However, further deterioration in the quality of O&G-related loans is expected, although almost all respondents expected this deterioration to be moderate and not substantial.

CRE credit: Demand remained solid, as banks became more cautious

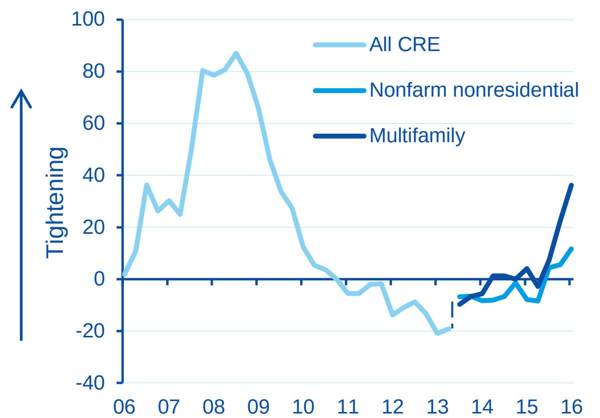
While demand for CRE loans remained solid, its growth rate is lower compared to the first half of last year (Chart 3), coinciding with the slowdown in private nonresidential construction (excluding manufacturing) in the second half of 2015. That said, the survey also indicates an uptick in demand for multifamily and nonfarm nonresidential loans in 1Q16 compared to 4Q15, coinciding with the increase in construction spending on offices and multifamily properties. Like with C&I loans, CRE credit standards also tightened for the third quarter in a row (Chart 4). The tightening is especially noticeable in multifamily properties. The investment in this asset class has been particularly strong over the last five years, which has resulted in new inventory coming to the market and the vacancy rate starting to inch higher in the last two quarters. The tightening is also likely affected by higher risk aversion in regions of the country affected by the downturn in the oil and gas industry.

Chart 3
CRE loan demand and construction employment (Net % balance)



Source: FRB & BBVA Research

Chart 4
CRE credit standards (Net % balance)

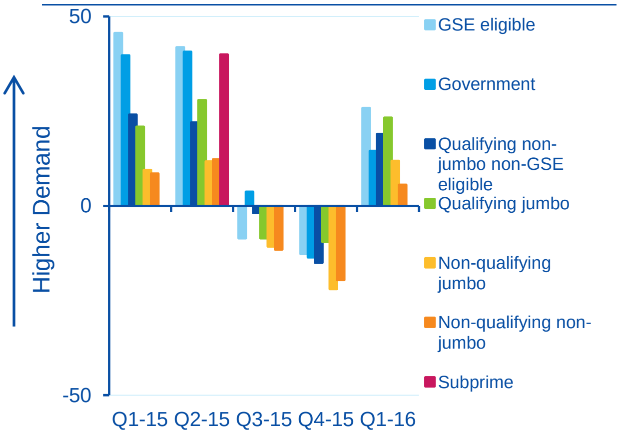


Source: FRB & BBVA Research

Residential loans: Stronger demand in time for the spring buying season

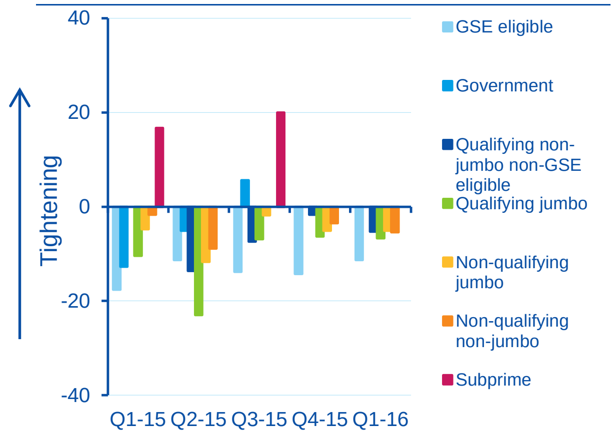
The demand for mortgages increased in the first quarter because of the continuing solid performance of the housing market as well as the coming of the spring buying season (Chart 5). While the survey asks respondents to provide an estimation of the situation setting aside normal sesonal fluctuation, the results still exibit seasonality; therefore, it is best to compare the current survey responses to the same period last year. Using this method, the demand for GSE-eligible and government loans increased slightly less, likely due to the inability of lower-end or first-time buyers to afford homes in many places due to high prices. Demand for other loan classes exhibited increases similar to those seen in the first quarter of last year. Meanwhile, lending standards (Chart 6) kept easing for all residential loan categories (responses on subprime mortgages were not reported). Also, the survey indicated that the demand for home equity lines of credit (HELOC) kept increasing, while the lending standards continued to relax. That said, the actual volume of HELOCs outstanding is still shrinking.

Chart 5
Residential loan demand (Net % balance)



Source: FRB & BBVA Research

Chart 6
Mortgage originations and home sales (Net % balance)

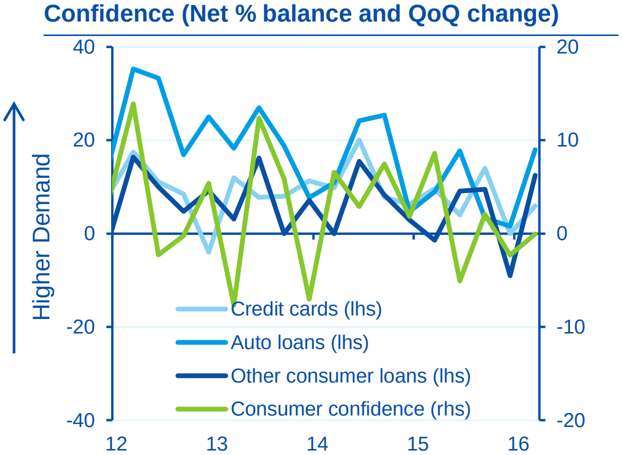


Source: FRB & BBVA Research

Consumer credit: Unchanged demand and supportive credit standards

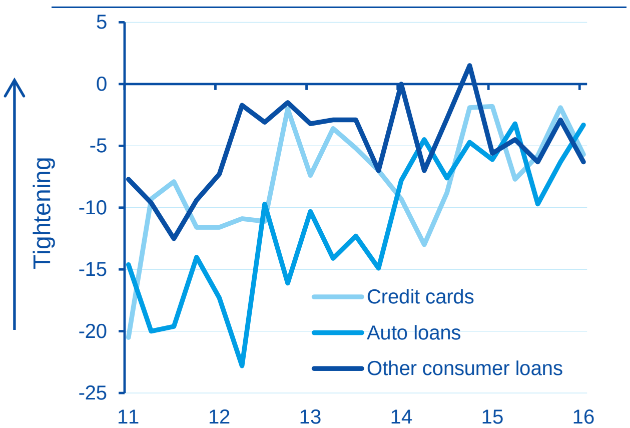
The survey showed that demand for all types of consumer credit increased compared to last quarter (Chart 7). This was likely driven by consumer confidence, which stabilized at a relatively solid level after posting a significant decline in November. Consumer confidence was supported by the solid performance of the labor market, which is likely to continue, thus positively affecting the demand for consumer credit. Credit standards for consumer credit kept easing (Chart 8). However, on net, a lower percentage of respondents reported that this was the case for auto loans, which is not entirely unexpected as this category of loans has grown particularly fast and subprime auto loan delinquencies have increased substantially. Delinquencies on U.S. subprime auto ABS stood at 4.15% in March, down from February's 20-year high of 5.16%--a reprieve, which according to Fitch, is not likely to last.[1]

Chart 7
Consumer Credit Demand and Consumer Confidence (Net % balance and QoQ change)



Source: FRB, Conference Board, & BBVA Research

Chart 8
Net Tightening of Consumer Loan Criteria (Net % balance)



Source: FRB & BBVA Research

[1] Fitch: Reprieve for U.S. Subprime Auto Delinquencies Likely Short-Lived. https://goo.gl/Ic8Ajy

Bottom line: Lending outlook remains solid, but O&G loans weigh it down

Like the previous two surveys, the latest SLOS showed that banks are becoming increasingly watchful for riskier loans, especially C&I loans, for which delinquency rates have already started increasing, primarily due to the difficulties that O&G companies have been facing since the second half of 2014, but also CRE loans. On a positive note, banks in the last quarter benefited from the continued solid performance of the housing market, which we expect to persist for some time. Consumer confidence has held up so far, and we expect this to continue, particularly supported by the labor market, which should continue to deliver jobs and higher incomes, translating into positive news for consumer loans. Overall, the latest SLOS is in line with our view of 2016, in which we expect the banking industry to benefit from the overall growth of the economy, despite the slowdown in the O&G sector.

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