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Banking Watch

US

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Economic Analysis

US
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Senior Loan Officer Survey 2011Q3

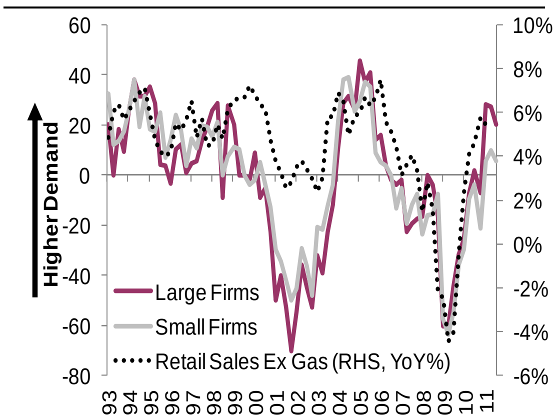
Loan officers remain vigilant of credit standards

- **C&I standards loosen QoQ, but at midpoint relative to historical range**
- **Residential loan conditions not changing quickly enough to spark demand**
- **Consumer demand limited, yet standards remain in loosening territory**

C&I Credit: Positive net demand from larger firms amidst eased lending standards

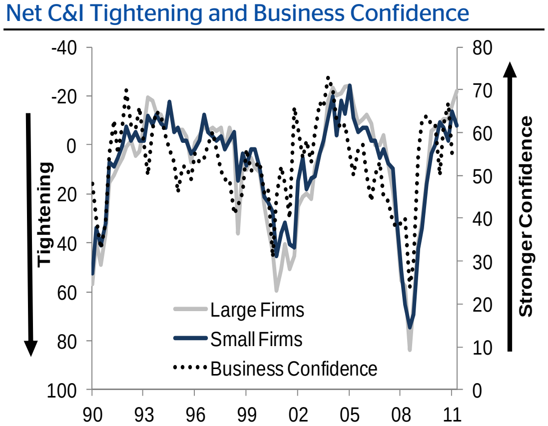
The July Federal Reserve's Senior Loan Officer Survey (SLOS) reveals continued easing of standards on commercial and industrial (C&I) loans throughout the past three months, mostly due to increased competition among other bank and nonbank lenders. Compared to the last survey, more domestic banks eased C&I loan standards for large and middle-market firms, while fewer eased standards on loans to smaller firms. According to the survey, domestic banks mostly undertook easing for price-related terms, including the use of interest rate floors and the cost of credit lines. Among the banks with tightened C&I lending standards, most were concerned with increased uncertainties regarding the effects of legislative changes and supervisory actions. Borrower credit quality classification, loan syndication status, and borrower size were factors that contributed to more banks having tighter standards compared to the midpoint since 2005. The survey suggests that demand for C&I loans increased for a "modest net fraction of domestic respondents," primarily for loans to large and middle-market firms. In general, most cited increases in clients' inventory financing needs as the reason for higher demand. Our outlook is for C&I loans to continue growing on a YoY basis, in line with expectations for slow growth.

Chart 1
C&I Loan Demand and Retail Sales



Source: Federal Reserve and Haver Analytics

Chart 2
Net C&I Tightening and Business Confidence

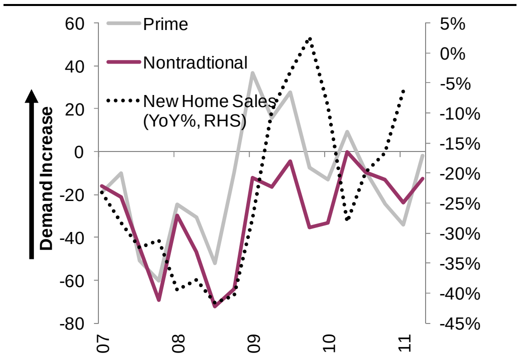


Source: Federal Reserve and The Conference Board

Real estate credit: Tightened standards and only minimal improvements in demand

Standards on commercial and residential real estate loans remained unchanged compared to the last SLOS survey, while negative demand for loans improved only slightly. Although commercial real estate (CRE) lending standards did not change from last quarter, they remain tight relative to historical standards since 2005, particularly for construction and land development loans. Despite this tight credit, more than one-third of large domestic banks indicated stronger demand for CRE loans, although demand among smaller banks was unchanged. As the residential market continues to suffer from discouraged consumer activity, we do not expect demand to grow significantly for the remainder of 2011.

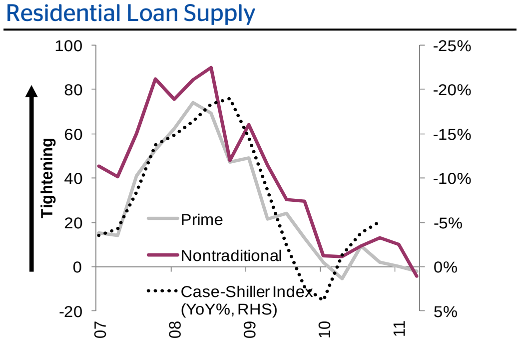
Chart 3
Residential Loan Demand Conditions



Source: Federal Reserve and Haver Analytics

Negative demand for prime and nontraditional closed-end loans and home equity lines of credit continues to challenge the residential market. Most survey respondents cited lack of demand from creditworthy borrowers and a less favorable outlook for the housing market. New home sales have improved YoY, however it appears that consumer interest in residential investment remains weak.

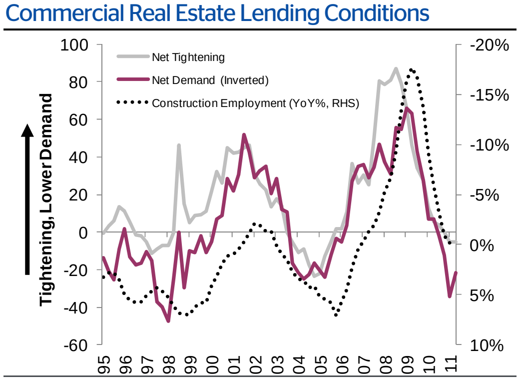
Chart 4
Residential Loan Supply



Source: Federal Reserve and Haver Analytics

Standards on prime residential loans and home equity lines of credit bordered net tightening and loosening territory. However, a significant portion of banks reported tighter credit than the midpoint since 2005, while only 10-15% have eased lending standards. Credit conditions are not adjusting quickly enough to positively impact demand for housing. Increased uncertainty over the housing price forecast will likely encourage banks to proceed with caution when setting limits and standards in their originations.

Chart 5
Commercial Real Estate Lending Conditions



Source: Federal Reserve and Haver Analytics

CRE lending conditions are threatened by lower net demand, delinquencies, and high charge-off rates, yet the market should see a gradual improvement over the next year. Low yields are generally expected to ameliorate CRE investment values. In line with the Fed's most recent statement for low interest rates through 2012, demand for CRE loans is likely to improve.

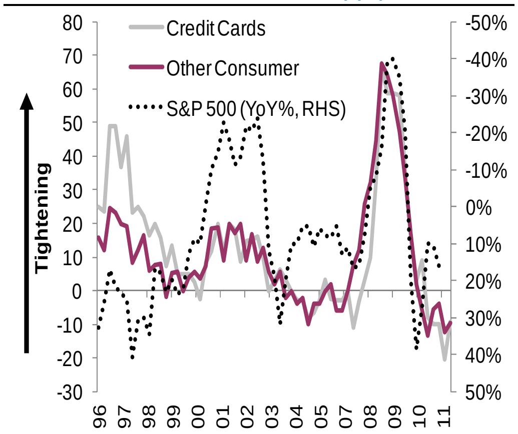
Consumer lending: Minimal easing of credit card standards not enough to incite demand

Easing of lending standards continued for consumer loans over the past three months for a "moderate net fraction" of banks. Loosening trends were more substantial for auto loans than for credit card loans, and despite QoQ easing, more than 50% of banks reported tighter credit card standards compared to the midpoint since 2005. Consequently, demand for auto loans increased slightly since the last survey while demand for credit card and other consumer loans was unchanged. Unfortunately, it appears that the dismal employment outlook continues to weigh on consumer willingness to take on more debt and we expect only slight improvements in the near future.

Bottom line: Survey respondents wary of uncertainty in economic outlook

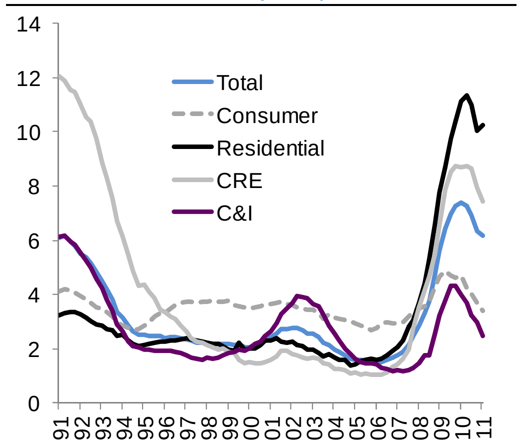
The theme of this quarter's SLOS points to loosened lending standards for all major types of loans except those backed by real estate. While demand has rebounded slightly for C&I loans (driven primarily by larger firms), demand for CRE loans saw little improvement. Consumer loan demand conditions remain mixed, with auto loans leading other categories as consumers remain hesitant to take on more credit card debt. We maintain our view that uncertainty over employment and home prices will continue to drag on demand for residential loans. In line with our outlook for slow growth in the coming months, we expect that demand for C&I and consumer lending will rebound faster than CRE and residential.

Chart 6
Consumer Loan Demand and Supply



Source: Federal Reserve and BBVA Research

Chart 7
Commercial Bank Delinquency Rates



Source: Federal Reserve