RESEARCH

Banking Watch
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Economic Analysis

U.S.
Kim Fraser
kim.fraser@bbvacompass.com

Alejandro Vargas
alejandro.vargas@bbvacompass.com

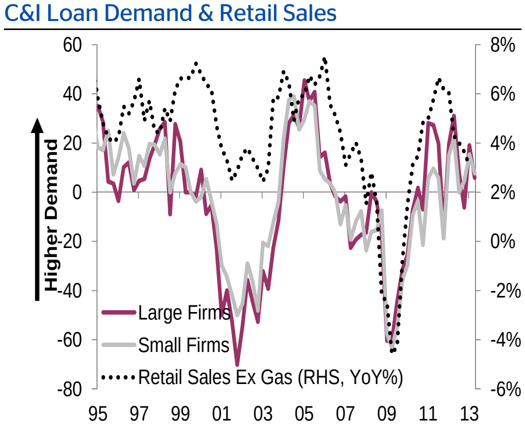
Senior Loan Officer Survey 2013Q2
Standards Ease on Escalating Loan Demand in 2Q13

- **C&I loan standards ease as demand strengthens across most firm sizes**
- **Residential loan activity mixed, with loan standards shifting both directions**
- **Consumer lending standards ease on auto and credit card loans**

C&I Credit: No reports of tightening loan standards as economic uncertainty subsides

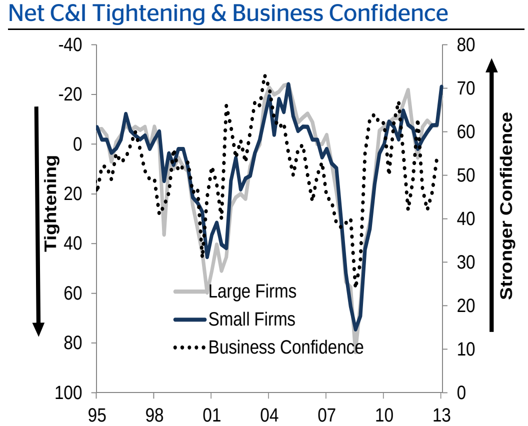
The Federal Reserve's Senior Loan Officer Survey (SLOS) for 2Q13 continues to show an overall easing in lending standards as a result of increasing business and consumer demand. This is in line with recent economic reports as consumers and firms find more solid footing in terms of debt, and further deleveraging aids in relieving some debt holders of less agreeable credit scores. According to the survey, Commercial and Industrial (C&I) lending standards continued to ease and there were no reports of terms being tightened which is rare given the tempered response to credit easing from banks in previous surveys. More specifically, there was a mixed response with regard to what terms were eased from different banks. In addition, the report showed that a rather large fraction of banks had decreased the spreads on C&I loan rates over bank's cost of funds across all firm sizes. A large net fraction also reported reducing the cost of funds for firms of all sizes. About 50% of large banks that responded eased loan covenants for large and middle market firms, up from the 30% that had reportedly done so in the last report. Of those domestic banks that reported easing their standards, all but one citied more aggressive competition from bank and nonbank lenders as reasons. Forty percent also citied better economic conditions and a less uncertain outlook as very important reasons. Demand for C&I loans emerged mixed throughout first quarter as large banks reported weaker demand for C&I loans and fewer inquiries from potential borrowers about new or increased credit lines. Other banks, however, reported stronger demand and net increase in inquiries as economic conditions are impacting firms' needs in different ways. Some customers cited a decreased need for funding investment while other firms stated the reverse and required further funding for investment in plant or equipment needs. A special question similar to the last survey question asked about lending to European banks. Surprisingly, there was no tightening in lending standards and two banks even cited increased competition from European banks.

Chart 1
C&I Loan Demand & Retail Sales



Source: Federal Reserve & BBVA Research

Chart 2
Net C&I Tightening & Business Confidence

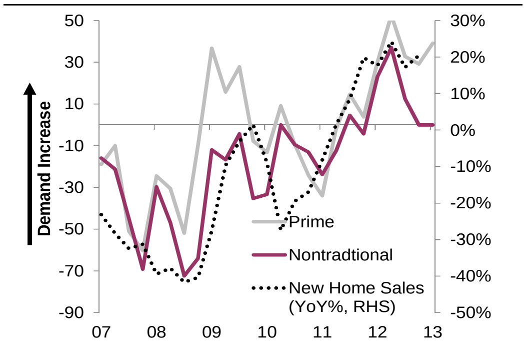


Source: Federal Reserve, CB, & BBVA Research

Real estate credit: On the rise as lenders ease credit standards, mostly for CRE

The SLOS's commercial and residential real estate portion showed some improvement in the housing situation over the last quarter. With regard to commercial real estate (CRE), a moderate portion of domestic banks stated that they had eased standards over the period while foreign banks' standards remained unchanged. A moderate to significant portion of domestic and foreign banks reported an increase in demand for CRE loans over the period which is in line with the considerable recovery that has taken shape in the commercial market. With interest rates expected to remain low for the time being the expectations are for demand to continue to increase.

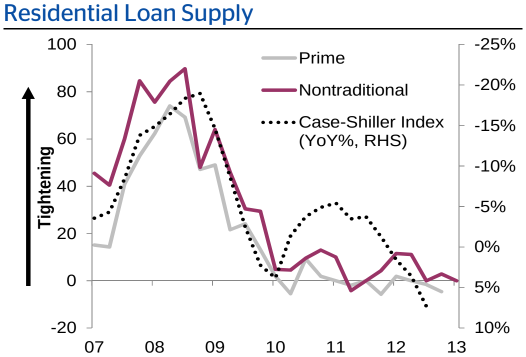
Chart 3
Residential Loan Demand Conditions



Source: Federal Reserve & BBVA Research

The situation in residential real estate remains quite different compared to CRE. No surprisingly, only a small number of respondents reported a change in their standards for any type of residential loans. While a significant number of respondents reported an increase in the demand for prime mortgages, only a small number of banks stated a change in demand for other types of residential loans. This potential slowdown in loan demand could reflect the waning supply of homes that has reduced the overall demand for mortgages. As home prices rise the supply of homes is expected to increase, potentially creating opportunities for buyers and therefore increasing loan demand.

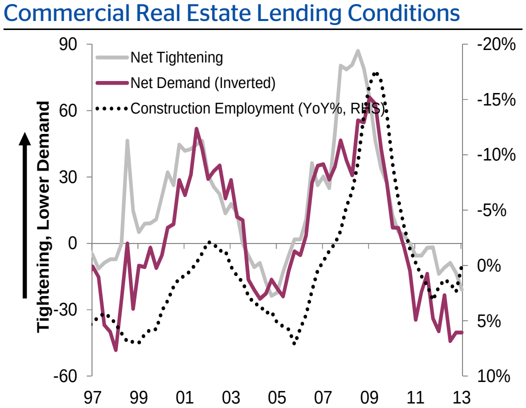
Chart 4
Residential Loan Supply



Source: Federal Reserve & BBVA Research

A special question in the 2Q13 SLOS asked how likely a bank would be, in comparison to a year ago, to lend to a borrower with a FICO score of 620, 680, or 720 with a down payment of 10% or 20%, creating six possible borrower types. A modest to moderate fraction of banks reported being less likely to approve such loans for the borrower with a FICO score of 620 depending on the down payment. For most other borrowers with higher FICO scores, most banks reported the likelihood to be unchanged from a year ago. However, at the tail ends, a moderate fraction of banks were more likely to lend to borrowers with a score of 720 and less likely for those with scores below 620.

Chart 5
Commercial Real Estate Lending Conditions



Source: Federal Reserve & BBVA Research

Banks were also asked what factors were currently restraining their willingness or ability to approve either conforming or nonconforming home-purchasing loans and whether their importance had changed over the year. Close to 75% viewed the outlook for home prices or economic activity as at least somewhat important factors causing some restraint. Also, 75% cited the risk of putback of delinquent mortgages by the GSE's as a restraint, a factor that had increased in importance over the past year. We continue to expect banks to feel constrained in residential lending, though this will be offset by increasing strength in the CRE market.

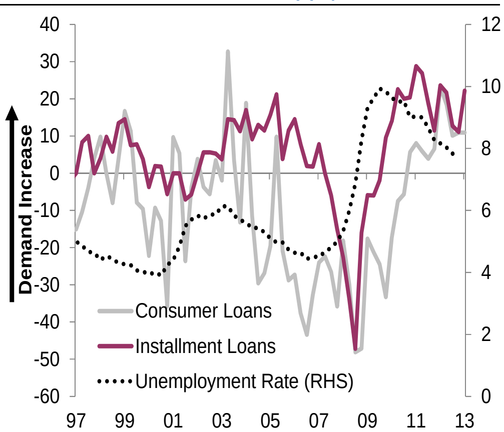
Consumer lending: Auto loans see most adjustments, student loans on the SLOS radar

Generally, responses from domestic banks indicated that they were more willing to make consumer loans now as opposed to the prior period. However, this did not directly translate to eased standards across the board. Only a small fraction of banks reported an easing of standards on credit card and auto loans while the remaining loan types were, on net, unchanged. There were some changes to auto loans in particular as several banks reported having increased the maximum maturity and reducing spreads on such loans, possibly in response to the growing demand for new vehicles. However, across the three categories of consumer loans, terms remained little changed from the period prior. Demand for credit card loans was reportedly stronger on net while demand for other types of consumer loans was reportedly unchanged. A set of special questions asked specifically about private student loans given the rapidly increasing outstanding volume. Surprisingly, only 14 of 68 domestic respondents indicated that they were holding private student loans. Overall, banks that are active in the student loan market reported little change in lending policies over the past year, and most expect the situation to remain the same over the coming year.

Bottom line: Credit market experiencing stronger demand, with lenders more optimistic on potential for stronger borrowers

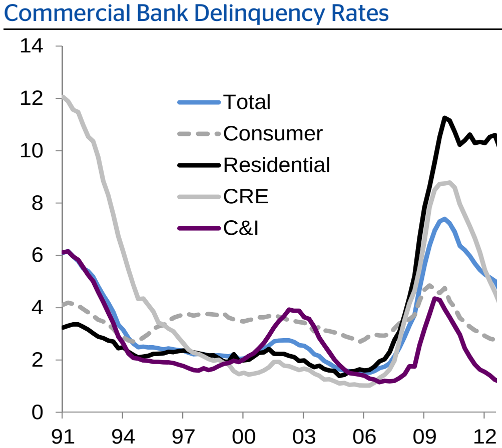
The SLOS survey for 2Q13 showed some improvement in the sentiment of lenders as demand for an array of loans has risen. With regard to lending standards, there seems to be a continuing easing in terms of real estate loans, both commercial and residential, but remaining out of reach for those with no or damaging credit worthiness. Terms and standards also seem to be easing in C&I lending as cash filled companies remain slow to spend but have picked up the pace over the past three months. The individual consumer also seems to be faring well as easing in the consumer lending market, including some credit card terms, are inviting some borrowers who may have been rejected in prior months. As demand for both residential and auto loans continue to rise, we expect banks to carefully ease their standards to accommodate the increasing demand. Recent data, however, is indicating a slowdown in the manufacturing sector and due to low supply, a slow churn in the real estate market too. This could negatively affect the credit market as buyers struggle to actually find homes and businesses employ a careful attitude in terms of expansion. For the coming months we do, nevertheless, expect banks to continue to ease standards for certain types of loans as consumers and firms become more creditworthy with a more prosperous economic outlook.

Chart 6
Consumer Loan Demand & Supply



Source: Federal Reserve & BBVA Research

Chart 7
Commercial Bank Delinquency Rates



Source: Federal Reserve & BBVA Research