

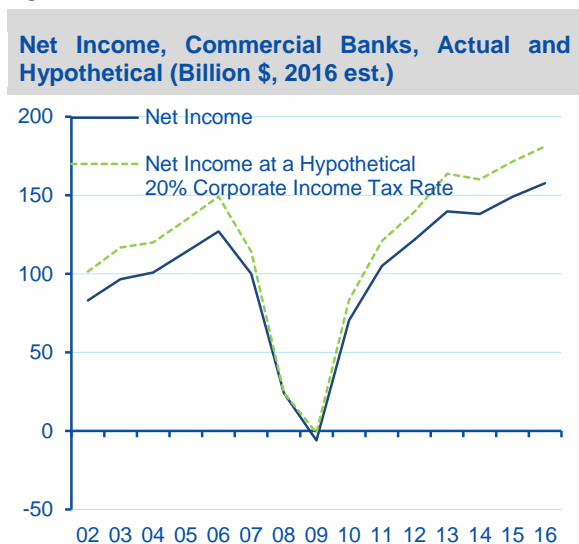
4. Banking Outlook

Banking on Trumponomics

For banking, the outlook is tilted to the upside. First, it is unlikely that there will be newer or tougher regulations in the pipeline. Second, there are soft indicators that the new administration will take a more lenient stance when it comes to rulemaking, regulations and enforcement. However, undoing banking regulation is not a priority for Congress or the White House. Third, the industry stands to benefit significantly from any lower corporate tax rates, as effective corporate tax rates for banks are generally higher than for other large corporations. In fact, a move to a 20% corporate tax rate could boost bank's net income by \$25.9 billion in 2018.

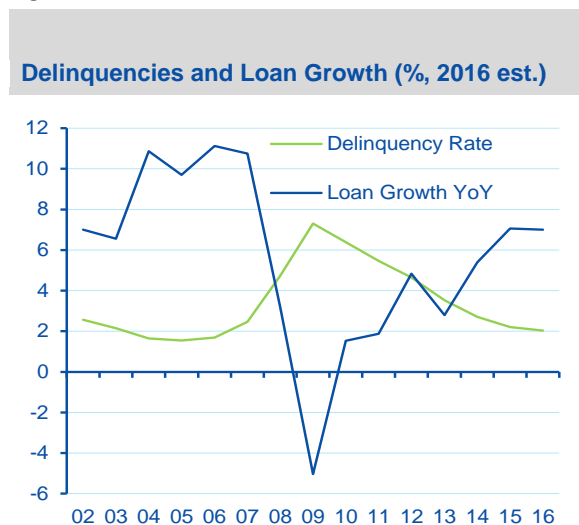
A 20% corporate tax rate could boost bank's net income by \$25.9B in 2018

Figure 4.1



Source: BBVA Research Calculations and FDIC

Figure 4.2



Source: BBVA Research, FDIC & Federal Reserve

In terms of retail banking, we expect consumer loans to increase at an average rate of 6.1% in 2017, compared to an estimated 6.5% in 2016, reflecting strong job growth and higher real incomes, but also tightening of lending standards, especially for auto loans. Although consumer optimism has increased after the election, the increase is unlikely to lead to significantly higher consumption or leverage. Despite strong consumer fundamentals, residential real estate loans are expected to slow to an average rate of 2.1% in 2017, compared to an estimated 3.7% in 2016, primarily due to lower refinancing rates. In the upside scenario that assumes large individual income tax reductions, supply-side reforms and deregulation both loan categories are likely to increase at a faster rate. That being said, in the downside risk scenario, increased protectionism, xenophobia, risk aversion, a

slowing economy and rising unemployment could pare loan growth and increase credit risks, leading to a rise in delinquencies.

On the commercial side, commercial and industrial loans are expected to grow at a similar pace to 2016 at around at 7.9%. Stronger growth in the energy sector and greater risk appetite could lead to even higher loan growth. For commercial real estate loans (including multifamily loans), headwinds from tighter lending standards will slow the pace of loan growth to 7.5%, which is lower than in the last two years (8.1% in 2015 and estimated 9.3% in 2016). Under the upside scenario, both loan categories are likely to increase at a faster rate as deregulation and stronger macroeconomic conditions support greater investment and leverage. Like consumer and mortgage portfolios, most of the effects from any deterioration in economic conditions and credit quality will likely be felt after 2017.

Ultimately, the outlook for banking will depend on the pace of real GDP growth, inflation, and interest rates. If demand for credit grows faster, the yield curve steepens and regulation eases, banks' profitability could improve at a faster pace. In an adverse scenario of prolonged low economic growth and low interest rates, loan demand will remain constrained while delinquency rates rise. This would produce weaker profits.

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