BBVA | RESEARCH

Banking Watch
US

Houston, February 8, 2013
Economic Analysis

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

Alejandro Vargas
alejandro.vargas@bbvacompass.com

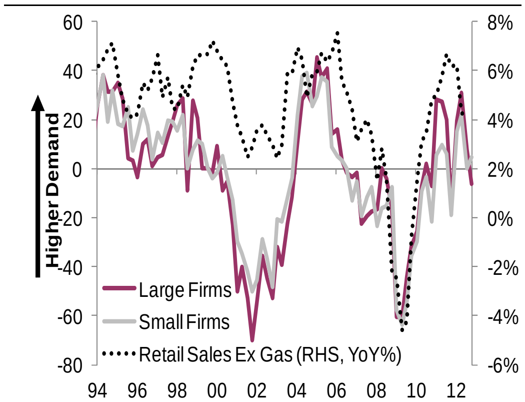
Senior Loan Officer Survey 2013Q1
Standards Ease on Higher Loan Demand in 1Q13

- **C&I loan demand increases as lenders ease rates on stronger demand**
- **Banks remain wary of past but seem to be easing on residential loans**
- **Consumer credit still on the rise as auto loan demand grows**

C&I Credit: Easing of loan terms and standards and a rise in C&I loan demand

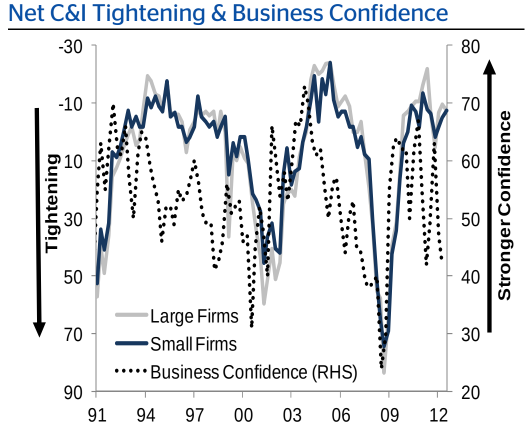
The Federal Reserve's Senior Loan Officer Survey (SLOS) for 1Q13 points to a continuation of the easing of standards and a loosening of terms but with a more positive result compared to the past report. According to the SLOS, a significant portion of domestic respondents stated that Commercial and Industrial (C&I) lending standards had eased somewhat for firms of all sizes within the past three months. Additionally, C&I loan terms were also relaxed, regardless of the firms size. A majority of the respondents stated that more aggressive competition from competitors, both bank and nonbank lenders, were what lead to the easing of standards and terms on C&I loans. A moderate fraction of the domestic respondents also reported having reduced spreads on loan rates of their banks' cost of funds, use of interest rate floors, and the cost of credit lines for all firms they dealt with. As for demand of C&I loans, a moderate fraction of the domestic respondents indicated that there was a stronger demand for C&I loans from firms of all sizes due to their customers increase in plant and equipment purchases. They also cited financing of mergers and acquisitions and accounts receivables as reasons for increased loan demand. As for foreign banks, C&I loan standards remained about the same but a small fraction of the respondents did state that their lending terms had changed. As with their domestic colleagues, foreign banks stated that they had reduced loan spreads over their cost of funds. Foreign banks also noticed an increase in loan demand: some 20% of respondents replied that, on net, loan demand had increased due to customers' increased merger and acquisition needs. A special question dealt with lending and competition from European banks. 10% of domestic banks reported tightening their standards for European bank loans, a smaller fraction than the 4Q12 survey. Domestic banks noticed a decrease in competition from European banks within the last three months but the decrease did not boost their own business. However, one-third of respondents who reported competing with European banks noted an increase in businesses to some extent.

Chart 1
C&I Loan Demand & Retail Sales



Source: Federal Reserve & BBVA Research

Chart 2
Net C&I Tightening & Business Confidence

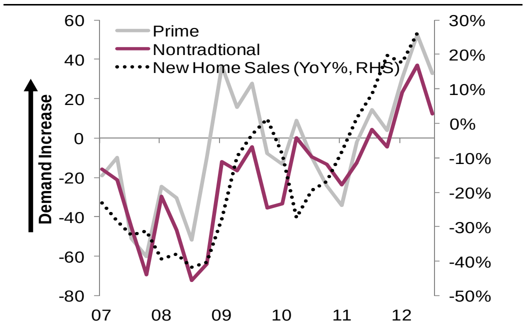


Source: Federal Reserve, CB, & BBVA Research

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

The SLOS's commercial and residential real estate survey showed that the situation has improved since last quarter. For commercial real estate (CRE), domestic banks reported an easing of standards over the past three months. Furthermore, the demand for these loans had increased since the last survey. From foreign respondents, a similar trend was taking shape: a small fraction reported having eased standards while a larger fraction reported an increase in the demand for CRE loans. This overall increase in the demand for CRE loans can be attributed to the strengthening recovery in the real estate market along with perpetually low interest rates and a growing sentiment that activity is becoming more sustainable.

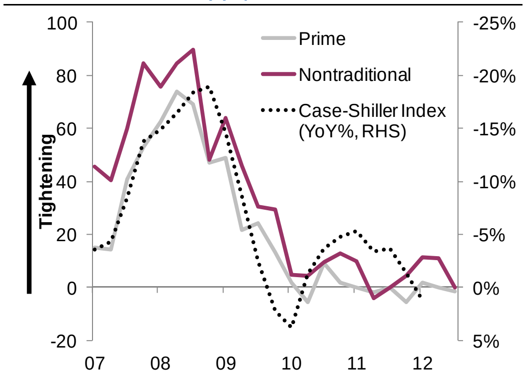
Chart 3
Residential Loan Demand Conditions



Source: Federal Reserve & BBVA Research

The fact that loan demand has increased does not mean that banks were any more willing to lend to those who they deem to have less than credit-worthy status. Within the residential loan sector, things were slightly different than the CRE market. Respondents stated that there was little change in their standards for prime and nontraditional real estate loans but demand had risen for the prime level of loans. Standards for home equity lines of credit were also unchanged and a small fraction of respondents that dealt with those loans stated a slight decrease in their demand.

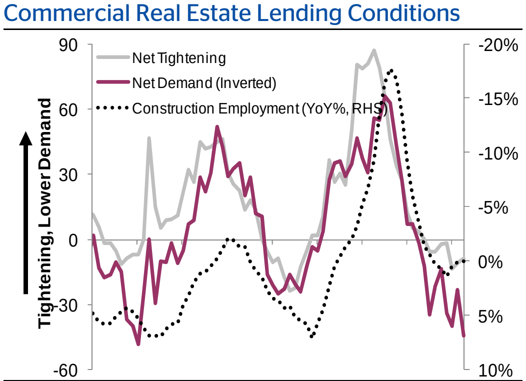
Chart 4
Residential Loan Supply



Source: Federal Reserve & BBVA Research

The special real estate-related question asked about the specific lending policies tied to CRE loans within the past 12 months. Many domestic lenders reported having reduced the spreads on CRE loans while several others had eased policies regarding the maximum size and maturity of the aforementioned loans. However, when it came to the debt service coverage or loans-to-value ratios, banks indicated that they had not changed their standards. This leads us to believe that there is still some hesitation to open the flood gates with residential and commercial loans but that steps are being taken to engage buyers that are reentering the market.

Chart 5
Commercial Real Estate Lending Conditions



Source: Federal Reserve & BBVA Research

Foreign respondents to the special question regarding CRE loans had the same hesitations as domestic. They had eased their policies on the spreads and maximum loan size for CRE loans but were less inclined to change much else in terms of standards. For the most part this resonates with the overall market sentiment for CRE as opposed to residential. While demand has grown for CRE loans as well as residential, banks are still unwilling to fully ease standards and will presumably not do so until economic stability can be more fervently guaranteed.

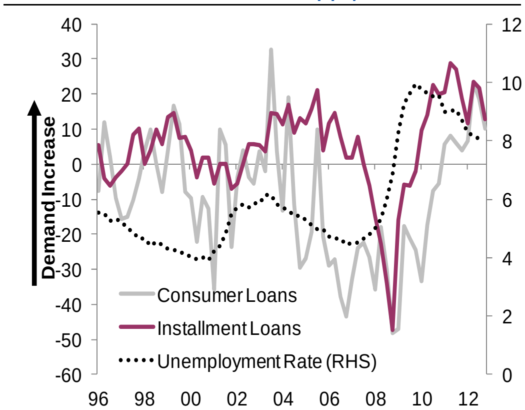
Consumer lending: Auto loan environment improving but credit card strength ailing

Consumer lending carried the same tone as in the prior SLOS and points to an easing of standards for only certain types of loans. Domestic banks reported that they again eased the standards on auto loans over the past three months but credit card loans and other types were left unchanged. Of the respondents, several had reported that they had reduced the spreads on all consumer loans except credit card, which remained the same yet again. A modest fraction of the domestic respondents also increased the maximum maturity on auto loans to entice borrowers as the auto market continues to grow. With this easing of certain standards, banks reported an increase in the demand for auto loans while credit card loans remained relatively unchanged. However, despite the lackluster growth in credit card loan growth, a modest fraction of banks reported other types of consumer loan demand were on the rise.

Bottom line: Credit market experiencing stronger demand, but lenders still hesitant to ease standards for all loan categories

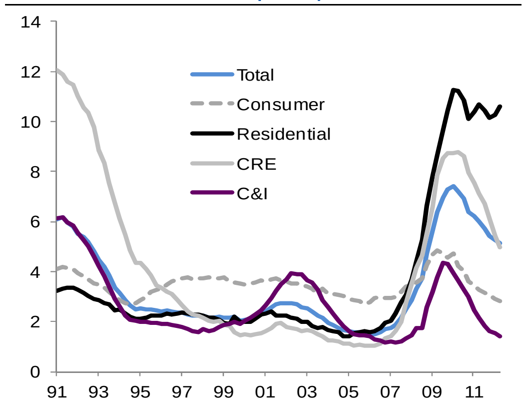
The SLOS survey for 1Q13 hints at the improved sentiment that has arisen as both businesses and consumers prepare for a stronger recovery. In terms of loan standards, it seems as though most loan standards have been eased, at least slightly, except for credit card loans, which reflects the growing ability of consumers and businesses to afford to borrow in order to increase capital or find a new home. Auto loans are also increasing as the consumer credit market picks up, although with the expiration of the payroll tax it is unlikely that credit card loans will match the auto sector in loan demand soon. As the Fed continues to keep rates low we expect the current situation to proceed as consumers become more optimistic about the economic situation and the housing market brings more families and prospective home buyers back into the market. Although the fiscal situation in Washington is unlikely to directly affect the credit market, there are signs that certain outcomes could affect growth in the consumer market and therefore affect credit or even the housing recovery. Barring any political hiccups however, credit should continue to grow and standards on most loan types ease as lenders open their spigots to a growing number of potential borrowers.

Chart 6
Consumer Loan Demand & Supply



Source: Federal Reserve & BBVA Research

Chart 7
Commercial Bank Delinquency Rates



Source: Federal Reserve & BBVA Research