BBVA Research

U.S.

Banking Watch

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Economic Analysis

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Senior Loan Officer Survey 2011Q1

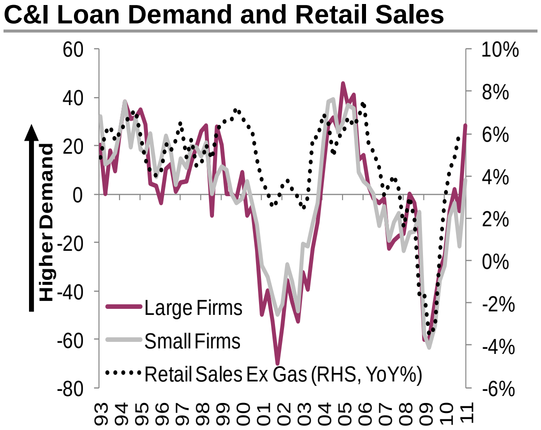
Corporate lending tries to find a rhythm

- **Fed survey upgrades commercial and industrial loan demand to "moderate" levels**
- **Prime residential loan demand is still registering negative indicators**
- **Credit card standards mostly unchanged, CRE shows slightly more demand**

C&I Credit: Loans to large and middle-market firms getting warm, but still not hot

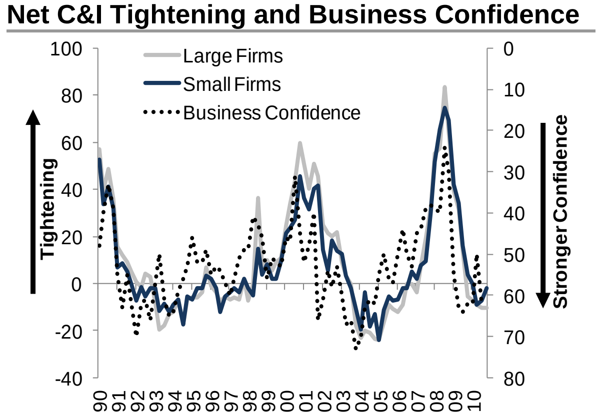
In tandem with business confidence, net tightening for commercial and industrial (C&I) loans did not move appreciably as compared to the last survey of Senior Loan Officers. The tightening stance for large and small firms remains in net loosening territory with an improvement for small firms. Commercial banks generally reported tighter spreads and eased standards arising from increasing competition from other banks and nonbank entities. Demand for loans from large firms is now at a "moderate" level according to the survey. A contributing factor is a more favorable and less uncertain economic environment. The change in the survey demand indicators is sharp from last quarter to this quarter, with a reading of -7.0 to 28.1 for large firms' demand. This is the highest reading for large firms since 2005Q3. In the previous survey banks expressed a reduced need for financing from clients. However, the most recent survey indicated that 75 percent of respondents attributed this quarter's increased need for financing to greater demand for mergers and acquisitions. In the special section of the survey on asset quality, a large majority of banks replied that the quality of C&I loans to large and middle-market firms would improve "substantially". On a forward-looking basis, we expect higher levels of C&I credit over the year (see our previous monthly Banking Watch on credit and deposits), more robust competition and tighter spreads. An added issue will be the increasing health of the nonbank portion of the financial system and its relation to competition with bank-centered financing.

Chart 1
C&I Loan Demand and Retail Sales



Source: Federal Reserve, Census

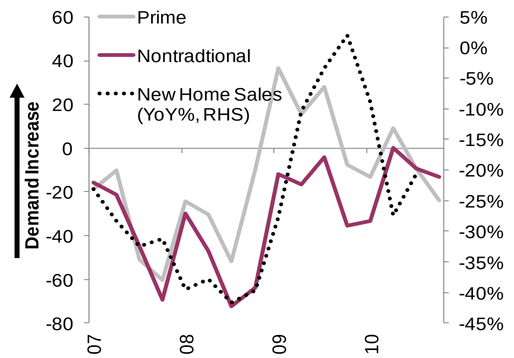
Chart 2
Net C&I Tightening and Business Confidence



Source: Federal Reserve, The Conference Board

Real estate credit: Prime loan demand still moving in the wrong direction
Although the survey reported no major changes in residential loan standards, the direction of the marginal changes in standards is in an unsavory orientation towards tightening for nontraditional loans. The major concern is the continuing lackluster demand for residential loans registered in the survey results, with prime loan demand falling deeper into negative territory (Chart 3). While commercial real estate (CRE) standards remain unchanged, the resting point for such standards is most likely at highly stringent levels. Demand for CRE staged the largest increase in the survey since the beginning of 2006, but this does not change our outlook for CRE loan growth.

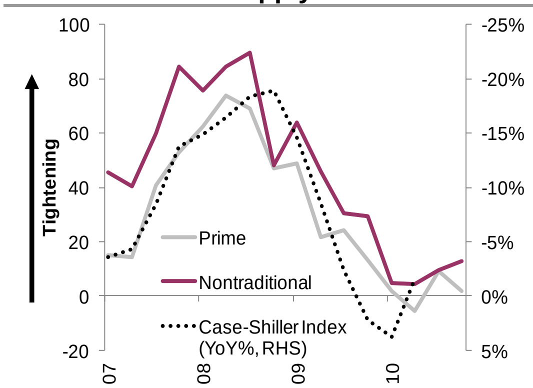
Chart 3
Residential Loan Demand Conditions



Despite improvements in residential loan charge-offs and delinquencies, demand for residential loans is weak. This is a refrain we have mentioned repeatedly for some time and the answer is repeatedly in the outlook and degree of confidence for employment and housing prices. New home sales are still positioned at extremely low levels. Our longer-term outlook for total mortgages outstanding going forward is for continued deleveraging, as discussed in our previous Economic Watch.

Source: Federal Reserve, Bloomberg

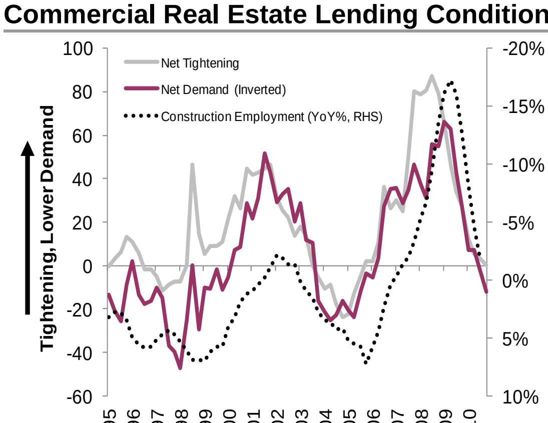
Chart 4
Residential Loan Supply



Prime loan standards bounced along the border between net tightening and loosening territory, but standards for nontraditional loans tightened over the last quarter. Uncertainty over the housing price forecast most likely declined over the period spanning the last Senior Loan Officer survey, but enough uncertainty exists for banks to proceed with caution when setting limits and standards in their originations.

Source: Federal Reserve, Bloomberg

Chart 5
Commercial Real Estate Lending Conditions



As mentioned above, CRE demand staged an important improvement, but we remain nonplussed by developments in CRE standards and demand. We continue to stress that delinquencies and charge-off rates for CRE are high, although we do expect a gradual improvement over the next year. Nonetheless with outsize inventory and a frail service employment outlook we can expect demand to remain low. Some of the demand increase may represent opportunistic investment. The survey in general did not extensively discuss CRE.

Source: Federal Reserve, Bloomberg

Consumer lending: Credit card standards stable in net loosening territory

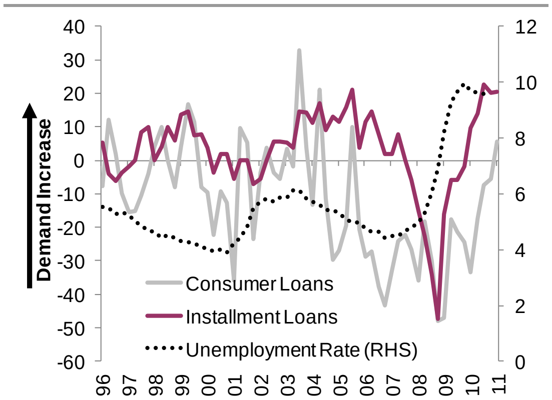
Consumer lending unfolded worse than the “feeble” growth we expected in the previous survey. Part of this is due to data revisions and deciphering the trend after FASB accounting changes. The lag effects of standards and macroeconomic changes on consumer credit are shorter for this credit than for all other loan types. Even though some improvements in supply conditions are visible from the survey, we believe the overriding insufficiency of job creation to take precedence. Higher savings rates and a greater reliance on cash are also contributors to lessened demand for consumer credit. We do not expect rapid net loosening trends in credit cards in the near future.

Bottom line: Real estate categories still on probation, C&I released for good behavior

In our previous analysis of the survey, we pointed to deficient demand and unstable home prices as drivers of standards in C&I and residential real estate. This quarter’s survey suggests deficient demand for corporate lending is becoming less of an issue, but C&I loans are far from flourishing. The outlook for 2011, however, is becoming more auspicious and commercial banks appear increasingly focused on this particular segment, as suggested by the extremely favorable views for C&I asset quality revealed in the survey’s special questions. Our view of residential lending still holds: uncertainty over employment and home prices continues to drag on demand for loans, even though a majority of firms in the survey positively reviewed the risk-adjusted returns on these loans compared to other loans.

Chart 6

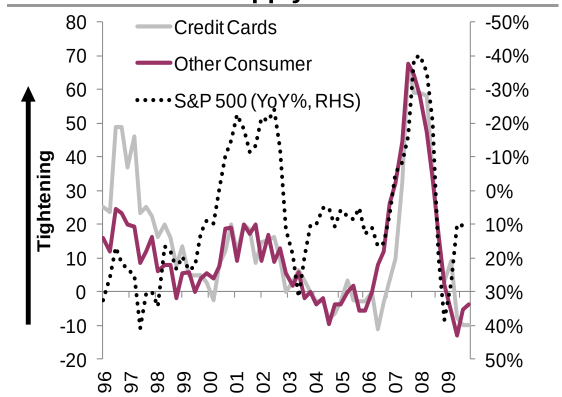
Consumer Loan Demand Conditions



Source: Federal Reserve, BLS

Chart 7

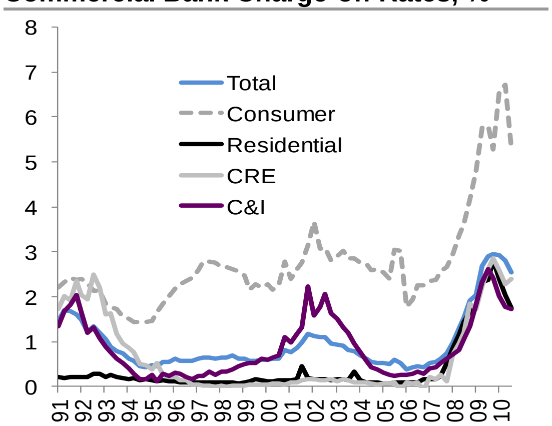
Consumer Loan Supply Conditions



Source: Federal Reserve, Bloomberg

Chart 8

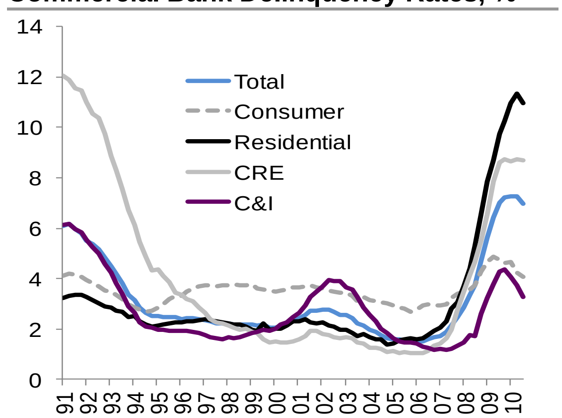
Commercial Bank Charge-off Rates, %



Source: Federal Reserve

Chart 9

Commercial Bank Delinquency Rates, %



Source: Federal Reserve

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