RESEARCH

Banking Watch

US

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Economic Analysis

US
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Senior Loan Officer Survey 2012Q1

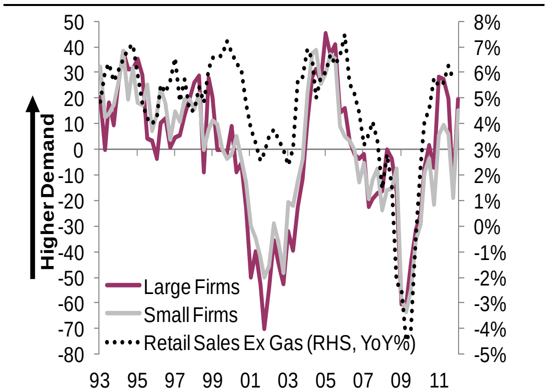
A Brighter Outlook for Domestic Lenders

- **Stronger C&I loan demand as business and consumer confidence climb**
- **Residential lending continues to weigh on bank balance sheets**
- **Stability in consumer credit likely to continue through 2012**

C&I Credit: Business confidence drives demand as lending standards remain tight

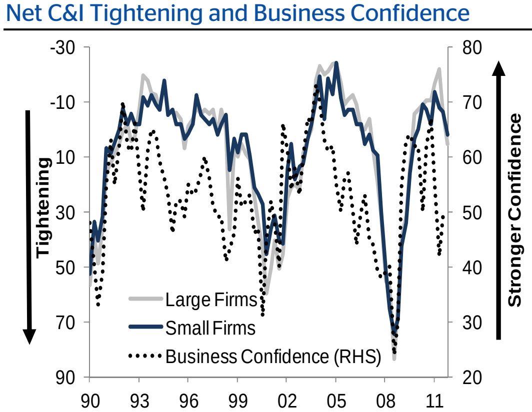
In the Federal Reserve's Senior Loan Officer Survey (SLOS) for 1Q12, commercial banks reported stronger demand for commercial and industrial (C&I) loans. Survey respondents reported a general increase in the number of potential borrowers due to a more optimistic business outlook. However, confidence levels remain near recovery lows as businesses maintain conservative hiring and capital expansion plans. Among the banks that reported weaker C&I demand, close to 85% noted a decline in business funding needs for capital investment. While the slowdown in Europe has hurt foreign demand, decreased competition from European banks has led to increased business over the past six months for about 50% of survey respondents. Demand was relatively unchanged from nonfinancial firms with significant exposure to Europe, although more banks tightened standards on loans to these firms compared to the previous report. In general, C&I credit standards remained tight and were relatively unchanged on net compared to last quarter's report. Increased uncertainty regarding the economic outlook caused a few banks to tighten standards, while others noted some easing of pricing terms or a reduction in the use of interest rate floors. Despite concerns about legislative and regulatory policies, the banking environment appears to be experiencing increased competitiveness across bank and nonbank lenders, a signal that credit standards could ease on net in the coming quarters. As expected with the ongoing crisis in Europe, foreign banks with operations in the US tightened their C&I lending standards for the second consecutive quarter. It is interesting to note that 80% of foreign respondents tightened standards due to current or expected liquidity concerns, an issue that domestic banks are unlikely to face in the near future.

Chart 1
C&I Loan Demand and Retail Sales



Source: Federal Reserve and Haver Analytics

Chart 2
Net C&I Tightening and Business Confidence

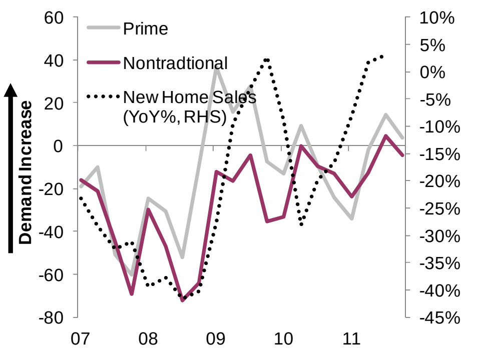


Source: Federal Reserve and The Conference Board

Real estate credit: "Housing finance" a problem for residential, CRE less discouraging

Details from the SLOS confirm the Fed's concern regarding the housing sector. Monitoring mortgage lending conditions is a top priority for the Fed in order to push housing activity out of this slump. However, Ben Bernanke has acknowledged the "problems in housing finance" as a deterrent to successful monetary policy. Despite extremely low mortgage rates and attractive home prices, demand for home equity lines of credit (HELOCs) has declined for four consecutive quarters. Outside of residential, commercial real estate (CRE) conditions appear to be on the brink of improvement. Some banks reported stronger demand for CRE loans, while a "modest net fraction" of domestic banks eased CRE standards throughout the past 12 months.

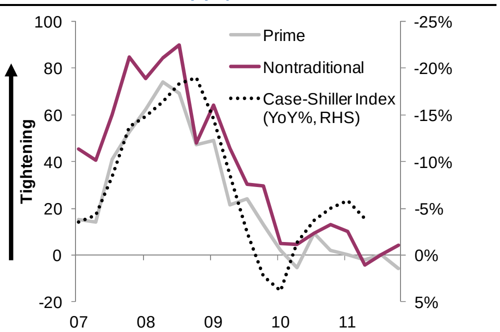
Chart 3
Residential Loan Demand Conditions



Source: Federal Reserve and Haver Analytics

Housing activity has been on the upswing in recent months, although fewer commercial banks reported stronger demand for prime and nontraditional mortgages compared to the previous survey. New home sales continue to grow on a YoY basis but levels have yet to jump above the recovery-low threshold. We expect that any intervention by the Fed will involve purchases of mortgage-backed securities in order to maintain downward pressure on long-term rates.

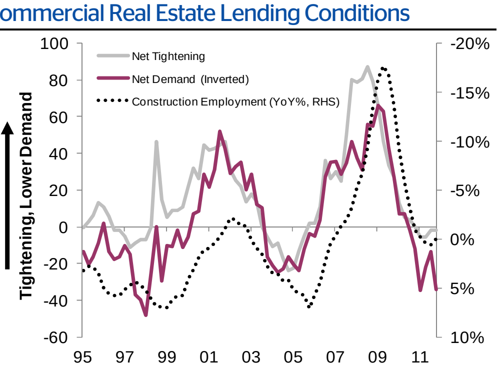
Chart 4
Residential Loan Supply



Source: Federal Reserve and Haver Analytics

Lenders appear to be adjusting credit standards in line with their expectations for the quality of borrowers in 2012. Delinquencies and charge-off ratios on prime residential and HELOCs are expected to remain similar to the previous year. However, more than half of all survey respondents expect the asset quality of nontraditional residential real estate loans to improve in 2012. On the downside, stubbornly low housing prices may limit banks' willingness to lend, even with limited interest rate risk.

Chart 5
Commercial Real Estate Lending Conditions



Source: Federal Reserve and Haver Analytics

Net demand for CRE loans rebounded from a drop in the previous survey, most likely due to low yields paving the way for opportunistic investment opportunities. Loan standards remain just below net tightening territory, and conditions are expected to ease as the year progresses. Accordingly, 60% of respondents expect the quality of CRE loans to improve in 2012. Although construction employment remains weak, gradual improvements in the labor market highlight modest expansion for the CRE sector.

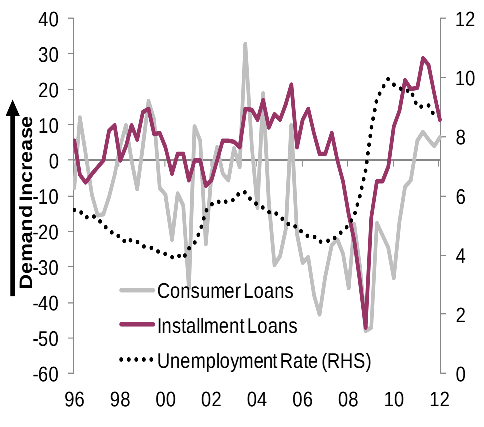
Consumer lending: Situation relatively unchanged despite gains in consumer data

Demand for most consumer loans was unchanged over the past three months, which is somewhat surprising given the fourth quarter's jump in consumer credit. The reports from survey respondents confirm our suspicions that the large gains in monthly credit data may be misleading. YoY growth for consumer credit is positive, and some banks did report increasing demand for credit card and auto loans. Only a "small fraction" of banks eased lending standards, and banks' willingness to lend to consumers declined slightly. This may be a consequence of respondents' asset quality outlook, with fewer banks expecting improvements compared to the previous report.

Bottom line: Outside of residential, the credit outlook is more optimistic

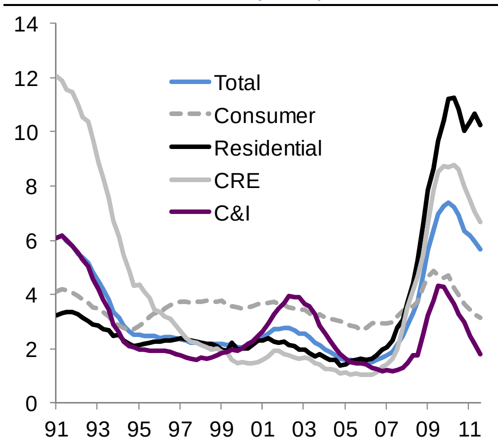
The SLOS for 1Q12 highlights the ongoing concerns related to the real estate sector. Specifically, weak residential activity continues to drag on the recovery, and financing issues have made it difficult for the Fed's interventions to translate through to the real economy. On a more positive note, it appears that the crisis in Europe has had less of an impact on domestic lenders compared to the previous report. Furthermore, survey respondents are becoming more optimistic in regards to their asset quality outlook, with more banks expecting declines in delinquencies and charge-off rates for most of the major loan categories. Improving trends are likely to continue throughout 2012, though risks are tilted to the downside as a result of pending housing adjustments.

Chart 6
Consumer Loan Demand and Supply



Source: Federal Reserve and BBVA Research

Chart 7
Commercial Bank Delinquency Rates



Source: Federal Reserve