Banking Watch
US

Houston, February 4, 2014
Economic Analysis

U.S.
Michael Soni
michael.soni@bbvacompass.com

Senior Loan Officer Survey 2014Q1
Demand Increasing Across Majority of Loans

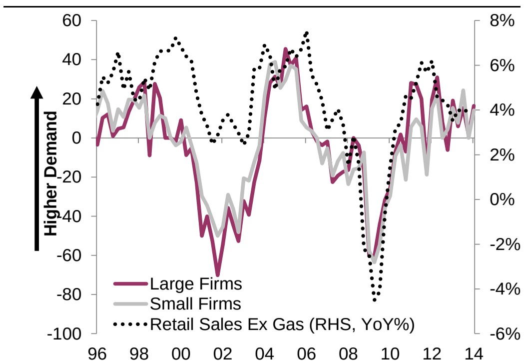
- C&I and CRE standards ease as business demand continues to rise
- Banks proceed somewhat cautiously with regards to residential loans
- Consumer lending standards ease on auto and credit card loans

C&I Credit: Standards eased as overall demand remains strong

The Federal Reserve's Senior Loan Officer Survey (SLOS) for 1Q14 tells much the same story as earlier reports – easing standards across the board for most borrowers as both consumers and businesses have regained much of the confidence lost in the financial crisis. The SLOS this quarter showed that domestic banks, on balance, continued to ease their standards for most categories of loans in large part due to increased competition. In regards to C&I loans, a modest number of banks reported having eased loans due to a combination of increased competition and growing demand, specifically to large and middle-market firms. Almost all banks reported easing terms for C&I loans, regardless of the size of the firm, and also noted that stronger demand for C&I loans has been mostly due to businesses looking to finance mergers or acquisitions or to invest in plants, inventories, equipment, and accounts receivable. Furthermore, close to half of all banks that reported stronger demand noted a shift among customers from other bank or nonbank sources to use their lending services. As for foreign counterparts with operations in the U.S, most reported having remained relatively unchanged on C&I loans over the past quarter. Additionally, a moderate net fraction of foreign banks noted that demand for C&I loans had strengthened through the last three months of the year.

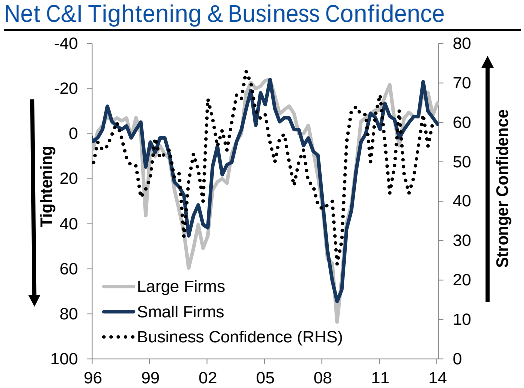
Supervisory guidance on leveraged lending was a special topic addressed in this SLOS, in which large bank respondents reported having tightened standards on applicable loans. Banks were also asked about their expectations for loan performance in 2014 with regards to delinquency and charge-off rates. Modest-to-large fractions of domestic banks forecast improvements in delinquency and charge-off rates for the year across most loan categories, other than subprime auto loans. With regards to the performance of business loans, 20-40% of domestic banks on net are expecting delinquency and charge-off rates of most C&I loans to decline in 2014, other than syndicated leveraged loans. Overall, banks' expectations are brighter in regards to lower delinquency and charge-off rates on loans than in 2013, holding consistent with recent data.

Chart 1
C&I Loan Demand & Retail Sales



Source: Federal Reserve & BBVA Research

Chart 2
Net C&I Tightening & Business Confidence

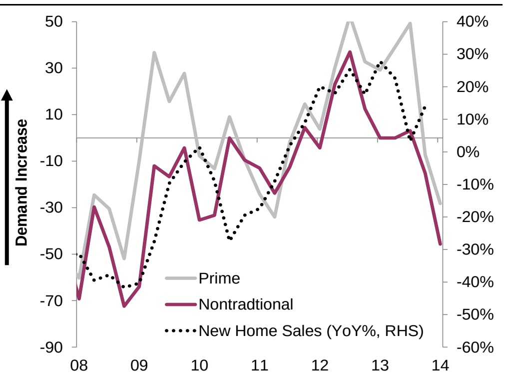


Source: Federal Reserve, CB, & BBVA Research

Real estate credit: Lenders ease standards as commercial and residential demand grows

The SLOS's real estate portion reported easing standards among domestic institutions for the majority of CRE loans while experiencing stronger demand in this area. The increased credit demand seen throughout the real estate market in 2013 had been focused primarily on multifamily units, with construction starts increasing at double-digit year-over-year rates. This influenced banks' willingness to lend but, overall, a small net fraction reported easing standards on prime residential mortgages over the past three months, while a modest net fraction noted they had tightened standards.

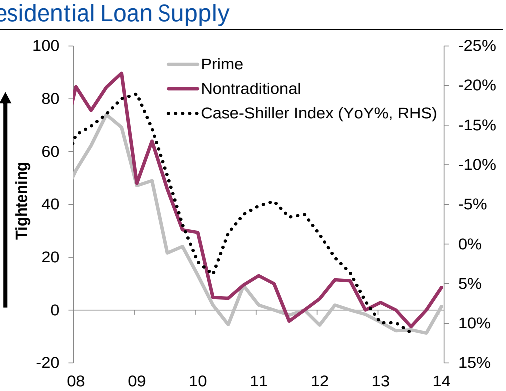
Chart 3
Residential Loan Demand Conditions



Source: Federal Reserve & BBVA Research

Over the fourth quarter, banks reported weaker demand for prime and nontraditional mortgages. Demand for home equity lines of credit remained mostly unchanged for the quarter. Much of this was reflected in the latest economic data for the housing sector, with construction and sales slowing in 4Q13. Housing starts have shown signs of a slowdown, possibly a result of many factors including weather and declining affordability due to rising prices and mortgage rates. This could have somewhat of an impact on demand for real estate loans in the coming year, although we expect that the dip in housing activity will be temporary.

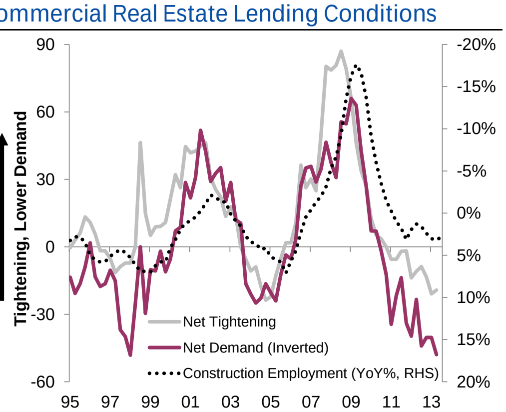
Chart 4
Residential Loan Supply



Source: Federal Reserve & BBVA Research

As mentioned above, the housing market had been on a tear through much of 2013, but banks appear to have become a bit more cautious in terms of lending standards. Although some banks reported having eased their standards on prime and nontraditional loans, an equivalent number of banks reported tightening their standards. The easing of standards may be attributed to banks trying to capture market share for home mortgages with individual credit worthiness steadily recovering from the financial crisis.

Chart 5
Commercial Real Estate Lending Conditions



Source: Federal Reserve & BBVA Research

One of the special questions in the survey was for CRE lending with regard to the easing of standards for three types of CRE loans: construction and land development, nonfarm nonresidential properties and multifamily residential properties. A small net fraction of respondents noted that over the past 12 months their standards had eased for all three of the categories. Furthermore, a small net fraction of domestic banks reported an easing of standards. Finally, a moderate net fraction indicated that they had experienced higher demand for all three types of CRE loans over the period.

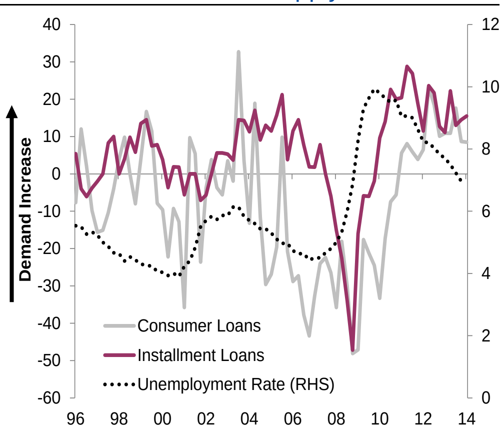
Consumer lending: Banks more willing to engage in lending activity amid credit recovery

Overall, it appears that banks are continuing to engage in consumer lending, a trend that has been gradually strengthening since the crisis. Banks reported having eased standards on auto loans, credit card loans, and other types of consumer loans. The majority of banks noted little difference in most terms on consumer loans, outside of credit card limits and rate spreads on auto loans, where a modest fraction of banks eased on balance. Few banks reported changing their standards for approving credit card applications. Other than credit limits, most terms on credit cards remained unchanged. Although the consumer credit recovery has been robust as of late, only a modest fraction of banks reported an increase in auto, credit card, and other consumer loan demand in the final quarter of the year.

Bottom line: Credit market still appears healthy with consumer and business demand holding strong

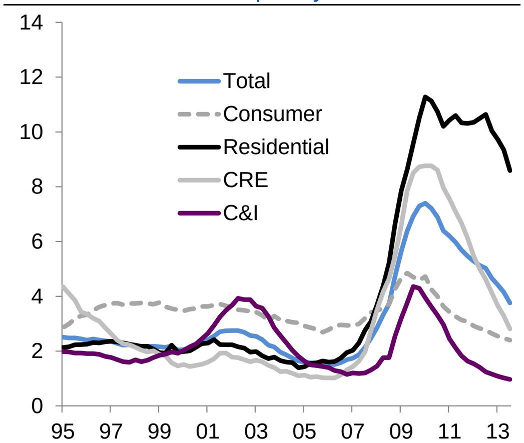
The SLOS survey for 1Q14 continued to show an overall optimistic tone for credit standards and demand. The majority of categories saw standards eased to some extent, particularly with regard to stronger commercial businesses and prime credit holders. Consumer loans for credit cards and other loans continue to remain relatively unchanged and terms were equally unaffected. Turning to real estate, activity appears to have slightly slowed down over the last months of the year, and this could be due to banks becoming more frugal in the wake of increased interest rates over the past few months. As consumers become more creditworthy we expect to see nontraditional loans ease slightly and demand continue to grow. Overall, the credit market seems to be moving along at a stable pace and remains healthy as business and consumer lending continue to gain footing post-recession. These latest trends point closer toward a turning point in the credit market as lenders find comfort with standard adjustments alongside growing willingness among borrowers to take on additional debt.

Chart 6
Consumer Loan Demand & Supply



Source: Federal Reserve & BBVA Research

Chart 7
Commercial Bank Delinquency Rates



Source: Federal Reserve & BBVA Research