RESEARCH

Banking Watch
US

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Economic Analysis

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

Senior Loan Officer Survey 2014Q2
Overall Demand Resilient Across Most Loan Types

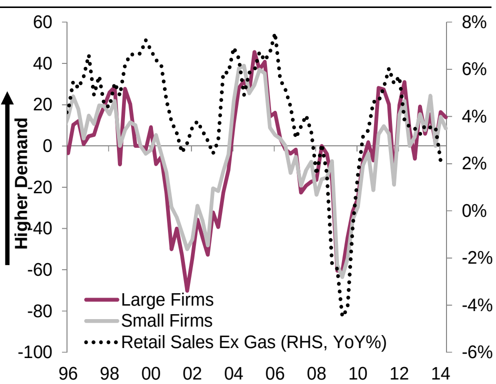
- **Relaxed C&I loan standards points to acceleration in business activity**
- **Residential loan demand sluggish as banks tighten lending conditions**
- **Auto and credit card loan growth should incentivize consumption in 2Q14**

C&I Credit: Increased competition forces banks to ease lending standards

The Federal Reserve's Senior Loan Officer Survey (SLOS) for 2Q14 continues to show that banks are easing loan standards for the majority of borrowers as overall loan demand has regained momentum lost due to the recession. Banks noted an increase in competition as a reason for easing standards, a positive sign that U.S. consumers are becoming confident enough in the economy and job security to take out additional debt. Specifically, non-traditional lenders were cited as a growing source of competition as they make it easier for firms, particularly smaller businesses, to obtain loans.

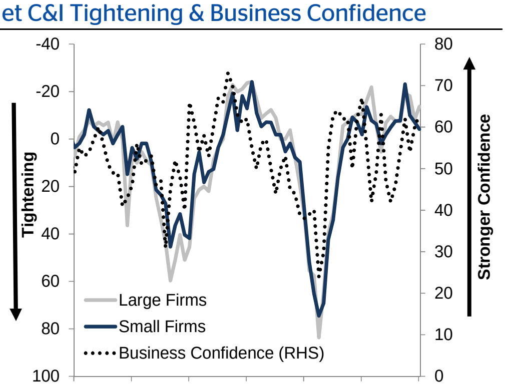
Overall, demand for commercial and industrial (C&I) loans strengthened for large, middle, and small-market firms through 1Q14, a positive sign for business activity going forward. Furthermore, the survey showed that banks are reducing risk premiums and dropping the cost of credit lines, which increases affordability for commercial borrowers. Rising competition and a more optimistic economic outlook both contribute to eased loan standards, and we expect that C&I loan activity should accelerate as lenders also become more risk-tolerant amid improving economic conditions. Demand for C&I loans accelerated slightly on net from both small and large firms who were looking to finance inventory, mergers and acquisitions, and other financing needs over the first quarter, which will continue to spur private investment for the economy.

Chart 1
C&I Loan Demand & Retail Sales



Source: Federal Reserve & BBVA Research

Chart 2
Net C&I Tightening & Business Confidence

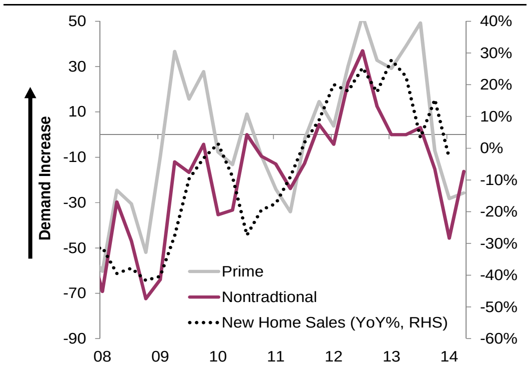


Source: Federal Reserve, CB, & BBVA Research

Real estate credit: Commercial demand outlook bright, but residential demand stalling

The SLOS's real estate portion reported easing standards among domestic institutions for all major commercial real estate (CRE) loans. However, the picture was not as upbeat for residential loans, as the survey noted instances of both easing and constraining for home equity lines of credit over the first quarter of 2014. Thus, as hinted by monthly housing data over the first three months of the year, residential housing demand struggled.

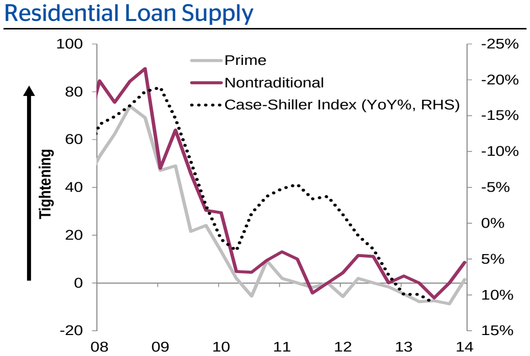
Chart 3
Residential Loan Demand Conditions



Source: Federal Reserve & BBVA Research

As noted above, demand for prime and non-traditional mortgages was a bit disappointing in 1Q14. Home equity lines saw a combination of tightening and easing of standards while non-traditional loans reported stricter standards for borrowing. Previously released economic data foreshadowed the slowdown in housing activity. Housing starts for 1Q14 averaged 923K per month, as opposed to 1008K for 4Q13. This is likely a reflection of declining housing affordability, as 30-year mortgage rates remain about 0.8 pp higher than one year ago. Additionally, it is unclear how weather-related factors may have adversely affected demand for real estate loans through the quarter.

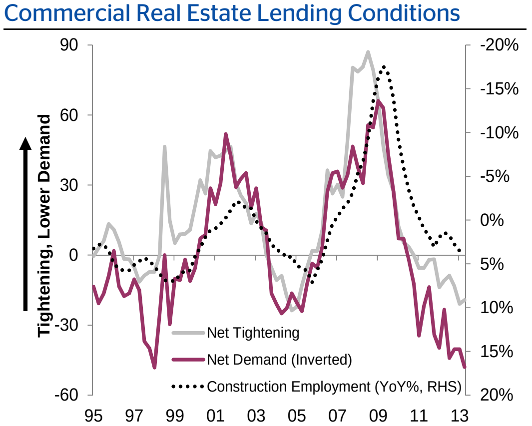
Chart 4
Residential Loan Supply



Source: Federal Reserve & BBVA Research

Despite the surge in housing market activity in 2013, banks have become a bit more cautious with regards to residential lending. In fact, banks have tightened standards for both nontraditional and prime mortgage loans. Thus, it is not surprising that banks have subsequently experienced reduced demand for mortgage loans in the wake of restricted supply. As labor market conditions improve, it is likely that banks will become more willing to make residential loans, as long as housing prices and mortgage rates remain relatively unchanged.

Chart 5
Commercial Real Estate Lending Conditions



Source: Federal Reserve & BBVA Research

The 2Q14 survey indicates that demand for CRE loans strengthened as banks eased lending conditions, making the loan acquisition process easier. The survey indicated that standards were reduced for construction and land development, nonfarm nonresidential structures, and multifamily residential structures. Furthermore, banks reduced spreads in comparison to last year, an indication of less perceived risk in the market by lenders. Hence, CRE activity should accelerate this year which should place upward pressure on prices in the market (See our CRE Outlook).

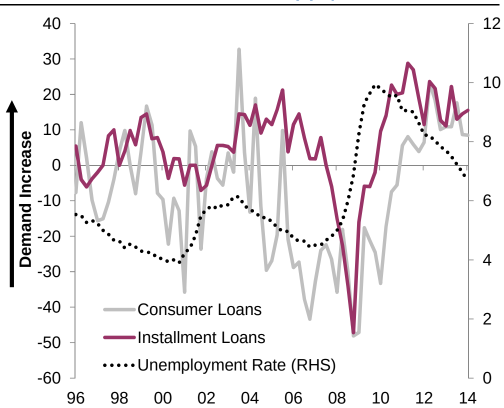
Consumer lending: Lending activity accelerating as consumer credit bounces back

Banks continue to increase consumer lending activity as confidence in the economy is gradually being restored. Notably, no banks reported being "less willing" to make consumer installment loans from the last survey, while several banks became more inclined to lend. Auto and consumer credit card standards remain mostly unchanged from the previous quarter. The easing of auto data is reflected in the strong auto sales data for March and April, as total vehicle sales hit 16.1m and 16.0m, respectively, both of which were higher than sales a year ago. As banks continue to ease standards on auto-lending, we should expect to see a further rise in demand for vehicles. With regards to credit cards, several banks indicated that they increased credit limits. This should be reflected by higher consumption in the coming months, further brightening the outlook for robust economic growth through the year.

Bottom line: Increased lending activity by banks signals bullish economy for 2014

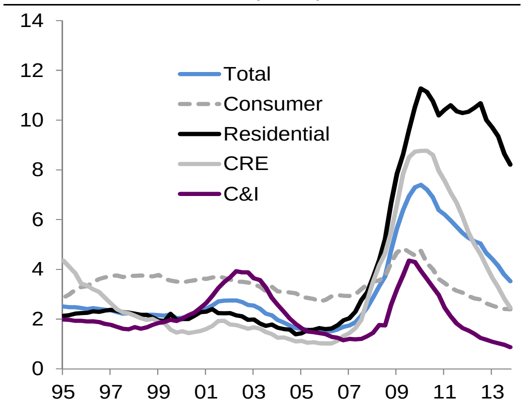
The SLOS survey for 2Q14 showed an overall positive atmosphere for consumer lending and demand as confidence in the economic recovery is restored. Most categories saw standards eased, and business lending activity in particular continues to accelerate which is a strong indication of growth moving forward. Additionally, consumer spending has been a bright spot in the last two quarters for GDP, and the relaxation of lending standards should further encourage consumers to purchase on credit. Looking ahead, the boost in consumption should facilitate economic expansion, and we reaffirm our forecast for 2.5% GDP growth through 2014.

Chart 6
Consumer Loan Demand & Supply



Source: Federal Reserve & BBVA Research

Chart 7
Commercial Bank Delinquency Rates



Source: Federal Reserve & BBVA Research