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SFA Research Corner

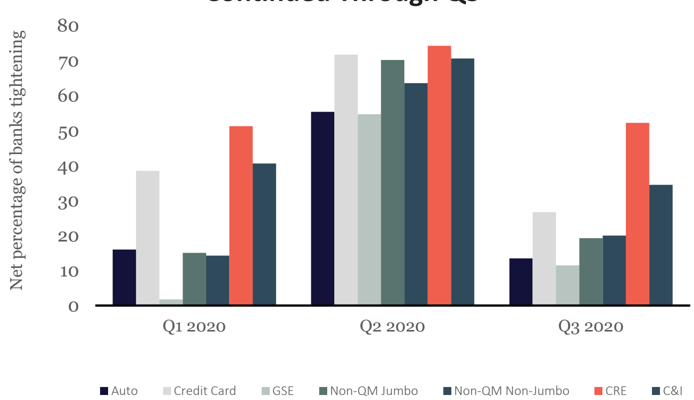
Tightening Standards Continue Amidst Firming but Uneven Demand – *A Look at the October Senior Loan Officer Fed Survey*

November 16, 2020

WHAT WE'RE WATCHING

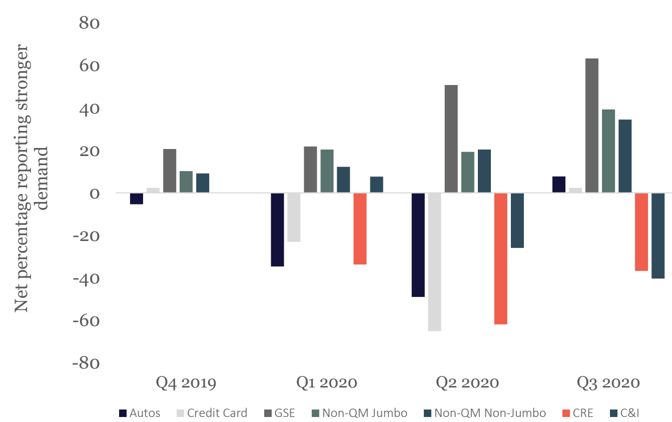
Last week, the Federal Reserve released the October 2020 *Senior Loan Officer Opinion Survey on Bank Lending Practices,* a quarterly survey of selected large banks that provides an indication of the willingness of banks to lend and desire for consumers and businesses to borrow relative to the previous quarter. The survey shows that tight lending policies, which became evident in the first quarter across consumer and business loans, continued through the third quarter. The survey also shows that while demand for consumer loans strengthened, indicating strength in the consumer recovery, demand for commercial and industrial loans and commercial real estate (CRE) loans continued to weaken, indicating that businesses remain cautious. This discrepancy implies an uneven recovery. As the U.S. prepares for winter closures and more pandemic-related lockdowns, these trends may have implications for the progress of the nascent economic recovery going forward. We look closer at these trends below.

Net Percentage of Banks Reporting Tightening Standards Shows That the Tightening Trend That Began in Q1 Continued Through Q3



Source: *Federal Reserve*

Banks Reported Stronger Demand for Auto and Mortgage Loans, but Weaker Demand for CRE and C&I Loans



Source: *Federal Reserve*

Tighter bank lending policies became apparent in the first quarter with the onset of the pandemic and became most pronounced in the second quarter as pandemic-related uncertainty froze the U.S. economy. In the second quarter, 55% to 72% of banks, on net, reported tighter standards across consumer and residential loans. On the commercial side, on average, 74% of banks surveyed had tightened their lending policies for all types of CRE loans, as 70% of banks had tightened lending across commercial and industrial (C&I) loans.

As the labor market improved and green shoots of economic growth appeared over the third quarter, the majority of banks remained cautious and left lending standards unchanged; only a handful eased standards somewhat. Some tightened further. For auto loans, 13.5% of banks reported tighter standards versus second quarter. This was reflected in higher interest rates and higher required minimum credit scores primarily. For credit card loans, 26.7% of banks, on net, reported tighter standards, reflected in lower credit card limits and higher minimum required credit scores. The survey also reported moderate net shares of banks tightened lending standards for most mortgage loan categories, including for government-sponsored enterprise (GSE)-eligible mortgages.

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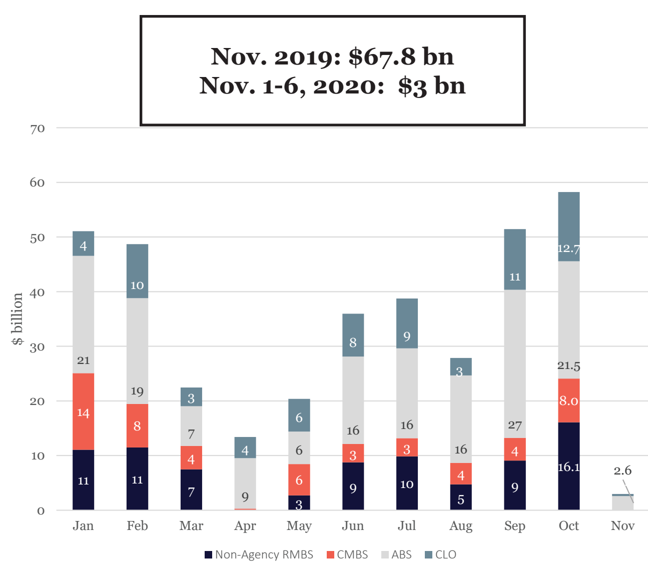
Demand for loans also changed during this period. In the second quarter, the net share of banks, on average reporting stronger demand for credit card and auto loans was -57%, which means more banks experienced weaker demand rather than stronger demand for these loan products. For mortgage loans, a net share of banks reporting stronger demand was positive at 30%, as historically low interest rates fueled refinancing and home buying activity. For CRE and C&I loans, the number of banks reporting weaker demand outnumbered the number of banks reporting stronger demand as business put expansion activity on hold - the net share of banks reporting stronger CRE loan demand was -62%. For C&I loans, this number was -26%. Over the third quarter, stronger demand for some consumer loans became evident as demand for commercial loans continue to flounder. For auto loans, the number of banks that reported stronger demand outnumbered those that reported weaker demand as the net percentage turned positive to 7%. The net percentage of banks reporting stronger demand for credit card loans was also positive but minimal at 2.3%. For mortgage loans, the net share of banks reporting stronger demand was a robust 45%. For C&I and CRE loans, the picture is very different. Over the third quarter for C&I loans, the number of banks reporting weaker demand outnumbered those reporting stronger demand resulting in -40% net share of banks reporting a stronger demand. For CRE loans, this measure was -37%. In a just-released "Pulse of the Consumer Credit report" Moody's expects "expect further tightening in underwriting standards over the next couple of quarters, but the bulk of tightening is likely done unless employment weakens significantly more, which we do not currently expect." To read more, we encourage our readers to read the full report.

MARKET SUMMARY

After a deluge of new issuance over the past two months, the securitization market slowed to a trickle in November, with four ABS deals and one CLO deal for a grand total of $3 billion. With limited supply in the new-issue market to choose from, investors turned to the secondary markets for inventory. Heightened election uncertainty notwithstanding, investors remained comfortable with securitization risk and pushed prices higher, and bid-ask spread tighter, for highly-rated and higher-yielding RMBS and CMBS products.

NEW ISSUE ACTIVITY

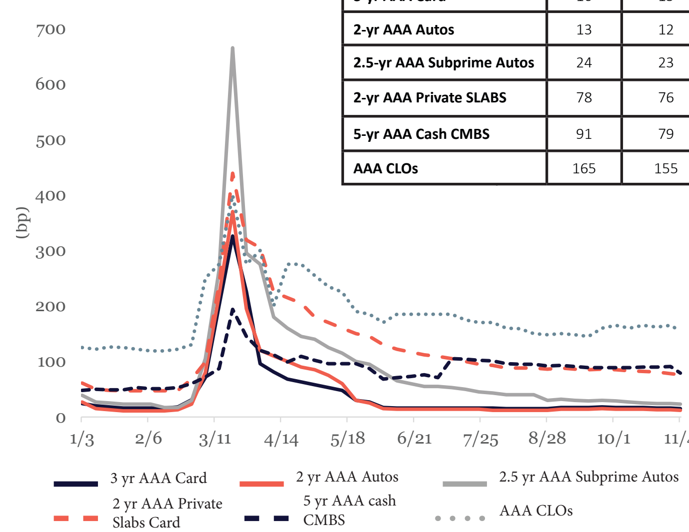
New-Issue Activity Slows to a Crawl



Source: Bloomberg, Deutsche Bank Research

Secondary Market Spreads

(bps)	Last Week	This Week
3-yr AAA Card	16	15
2-yr AAA Autos	13	12
2.5-yr AAA Subprime Autos	24	23
2-yr AAA Private SLABS	78	76
5-yr AAA Cash CMBS	91	79
AAA CLOs	165	155



Source: Bloomberg, Deutsche Bank Research

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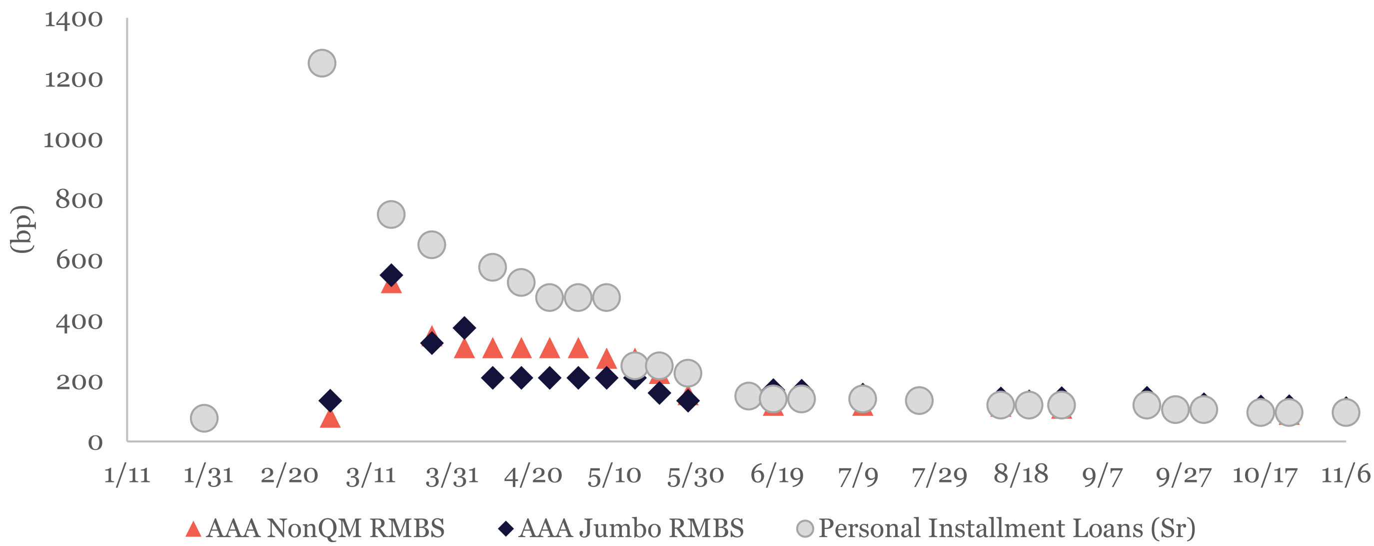
SECONDARY MARKET SPREADS



Source: Market Compilation