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Economics Group

Interest Rate Weekly

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Late-Cycle Signal: Tighter Consumer Credit Standards

The Federal Reserve's Senior Loan Officer and Opinion Survey signaled modest tightening in consumer credit conditions in Q4. Consumer loan standards tightened across the board, while demand weakened on balance.

Fed Survey Points to Late-Cycle Tightening

The Federal Reserve's January Senior Loan Officer Opinion Survey pointed to a modest tightening of consumer credit standards on balance. This barometer for overall credit market conditions has reported a steady decline in banks' willingness to lend over the past five years, with the series edging another notch down to 3.1 percent in the fourth quarter (top chart). The decline coincides with the cyclical trend witnessed over the past several business cycles, which shows banks' willingness to lend picking up early in economic recoveries and falling in the latter stages of the business cycle.

Auto and Credit Card Lending Tighten Up

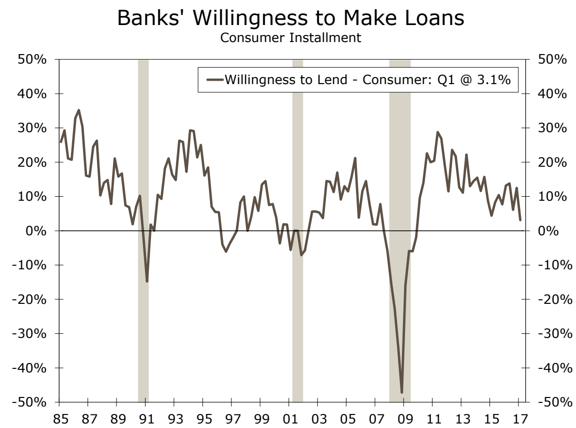
Lending standards for consumer loans tightened modestly across the board in the fourth quarter, as illustrated in the middle chart. A net 8.3 percent of banks reported tightening standards for credit cards, which marks the first quarter of net tightening since 2010. Similarly, standards for auto loans also constricted with a net 11.7 percent of lenders tightening standards, the largest share since 2011. Notably, banks expect to continue to tighten auto lending standards in 2017.

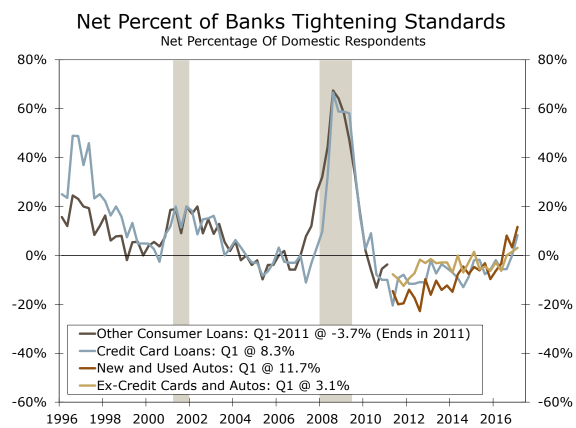
Despite the modest tightening of lending standards reported, household debt delinquencies have remained relatively low on balance (bottom chart). That said, while reports show steady or improving loan performance today, credit standards are also influenced by lenders' expectations about future loan performance, and, according to the survey's results, a significant proportion of lenders expect the asset quality of credit card and auto loans to deteriorate over the course of 2017.

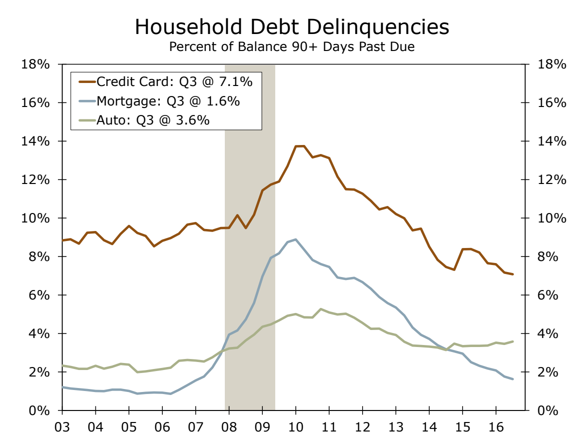
On the demand side, demand for consumer loans weakened across loan categories in the fourth quarter. Specifically, demand for auto and credit card loans edged lower on balance. The dip coincides with reports of modest tightening and, in some cases, stricter loan terms. Similarly, demand for residential mortgage loans fell over the quarter, despite relatively unchanged lending standards. Weaker demand is likely due, in part, to the higher interest rate environment witnessed following the U.S. presidential election. That said, the majority of banks expect to ease lending standards for mortgage loans over the year, which should help offset some of the drag from rising interest rates.

Outlook for the Consumer in the Face of Stricter Credit

Personal consumption expenditures have been the backbone of the current economic cycle, supported by a relatively strong recovery in employment and some help from real personal income growth, as commodity prices came down over the past several years. Despite the modest tightening in credit standards, we expect personal consumption to rise a healthy 2.7 percent in 2017 as gains in real disposable income and continued job growth support spending.







Source: Federal Reserve Board and Wells Fargo Securities

Wells Fargo U.S. Interest Rate Forecast

	Actual				Forecast							
	2016				2017				2018			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.75	2.00
3 Month LIBOR	0.63	0.65	0.85	1.00	1.05	1.25	1.25	1.50	1.50	1.75	2.00	2.25
Prime Rate	3.50	3.50	3.50	3.75	3.75	4.00	4.00	4.25	4.25	4.50	4.75	5.00
Conventional Mortgage Rate	3.69	3.57	3.46	4.20	4.22	4.24	4.26	4.30	4.33	4.41	4.47	4.54
3 Month Bill	0.21	0.26	0.29	0.51	0.57	0.78	0.84	1.02	1.10	1.30	1.50	1.76
6 Month Bill	0.39	0.36	0.45	0.62	0.69	0.88	0.94	1.12	1.20	1.40	1.61	1.87
1 Year Bill	0.59	0.45	0.59	0.85	0.86	1.03	1.08	1.38	1.46	1.66	1.84	2.05
2 Year Note	0.73	0.58	0.77	1.20	1.23	1.35	1.42	1.66	1.75	1.93	2.11	2.26
5 Year Note	1.21	1.01	1.14	1.93	1.95	1.99	2.06	2.21	2.29	2.40	2.52	2.66
10 Year Note	1.78	1.49	1.60	2.45	2.47	2.50	2.53	2.57	2.62	2.71	2.78	2.86
30 Year Bond	2.61	2.30	2.32	3.06	3.15	3.23	3.26	3.34	3.40	3.49	3.58	3.67

Forecast as of: February 8, 2017

Wells Fargo U.S. Economic Forecast and FOMC Central Tendency Projections

	2016	2017	2018
Change in Real Gross Domestic Product			
Wells Fargo	1.9	2.2	2.5
FOMC	1.8 to 1.9	1.9 to 2.3	1.8 to 2.2
Unemployment Rate			
Wells Fargo	4.7	4.6	4.5
FOMC	4.7 to 4.8	4.5 to 4.6	4.3 to 4.7
PCE Inflation			
Wells Fargo	1.5	2.0	2.4
FOMC	1.5	1.7 to 2.0	1.9 to 2.0
"Core" PCE Deflator			
Wells Fargo	1.7	1.9	2.2
FOMC	1.7 to 1.8	1.8 to 1.9	1.9 to 2.0

Forecast as of: February 8, 2017

NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation is the percentage rate of change in the price index for personal consumption expenditures (PCE). Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated.

Fed Data as of: December 14, 2016

Source: IHS Global Insight, Bloomberg LP, Federal Reserve Board and Wells Fargo Securities

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