March 08, 2017

Economics Group

Interest Rate Weekly

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Michael Pugliese, Economic Analyst
michael.d.pugliese@wellsfargo.com • (704) 410-3156

FDIC Quarterly Points to Healthy Turn in Credit Markets

The FDIC Quarterly Banking Profile showed total loans and leases grew steadily to end 2016. Noncurrent loan rates declined in the aggregate, with C&I delinquencies falling for the first time in eight quarters.

Delinquencies on the Decline: Welcome Sign

The Quarterly Banking Profile from the FDIC provides a comprehensive summary of the financial results for all FDIC-insured institutions. The delinquency data on bank balance sheets are one of the more useful segments of the report and provides insight into potential risks in financial markets. Noncurrent loan and lease balances declined for the 26th time in 27 quarters, falling by percent 1.8. The total noncurrent loan rate fell to 1.4 percent, the lowest since 2007, as the economy has continued to improve. In past reports, we have highlighted that, despite a falling aggregate noncurrent loan rate, the commercial and industrial (C&I) subcategory has seen a bit of deterioration over the past couple years (top chart). The decline in energy prices played a large role, but C&I delinquencies rose in all geographic areas over this period, not just in energy-centric areas.

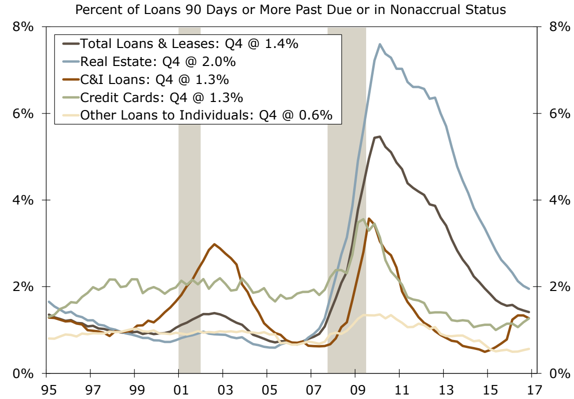
As a result, the apparent stabilization in this indicator of late is a welcome sign. Noncurrent C&I loan balances fell for the first time in eight quarters, declining 5.3 percent. Real estate delinquencies also continued to decline, dipping below 2 percent for the first time since 2007. Credit card and auto lending saw a modest increase in delinquencies but remain at a relatively low level. That said, this will be an area we will monitor closely for late-credit cycle signs. The consumer has been a key support to economic growth, and weakening credit demand or credit deterioration would be a threat to faster economic growth in 2017. Further, in the most recent Senior Loan Officer Opinion Survey from the Fed, banks responded that they on net expect to tighten standards on auto loans and expect to see asset quality of both auto and credit card loans deteriorate somewhat over 2017.

Lending Powder Still Relatively Dry

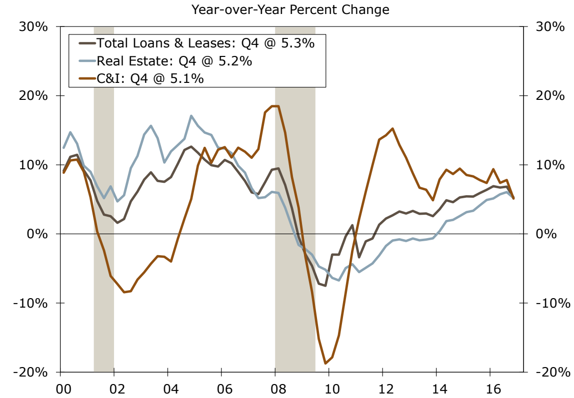
Total loans and leases grew by 0.8 percent in the fourth quarter, led by a 5 percent increase in credit card lending. For full-year 2016, total lending growth was 5.3 percent (middle chart), with gains in commercial and industrial (5.1 percent), nonfarm nonresidential real estate (7.5 percent) and residential mortgages (4.8 percent).

We expect real GDP to accelerate from 2016's pace and reach 2-2.5 percent in 2017. Coupled with the potential for deregulation under the Trump administration, lending opportunities may grow as the year progresses. As illustrated in the bottom chart, the loan-to-deposit ratio is historically low, a sign that banks may be well-positioned to spur an acceleration in credit if economic growth improves and financial regulation loosens somewhat. We expect a flatter yield curve through the end of our forecast horizon in 2018, which would likely keep pressure on banks' net interest margins, which at 3.2 percent in Q4 remain historically low.

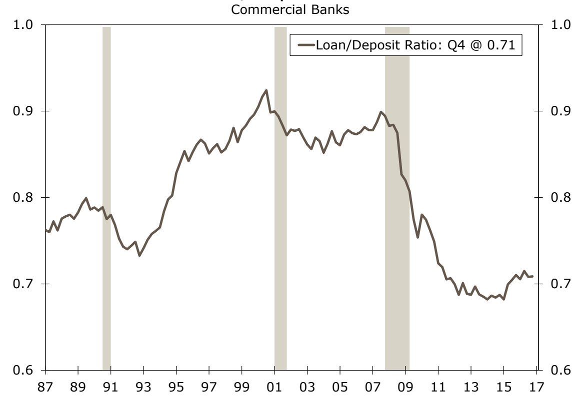
Noncurrent Loan Rates
Percent of Loans 90 Days or More Past Due or in Nonaccrual Status



FDIC Loan Growth
Year-over-Year Percent Change



Loan/Deposit Ratio
Commercial Banks



Source: FDIC 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

Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Anika R. Khan	Senior Economist	(212) 214-8543	anika.khan@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Julianne Causey	Economic Analyst	(704) 410-3281	julianne.causey@wellsfargo.com
E. Harry Pershing	Economic Analyst	(704) 410-3034	harry.pershing@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

WELLS FARGO SECURITIES