

Economics Group

Interest Rate Weekly

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Misa Batcheller, Economic Analyst
misa.n.batcheller@wellsfargo.com • (704) 410-3060

Fed Survey Points to Slowing Loan Demand

The Fed’s Senior Loan Officer and Opinion Survey showed cooling loan demand for businesses and consumers in Q1. Citing uncertainty and lower risk tolerance, banks continued to tighten standards for CRE loans.

Business Loan Demand Tails Off

The Federal Reserve’s April 2017 Senior Loan Officer Opinion Survey (SLOOS), which roughly corresponds to Q1 2017, points to a general slowdown in loan demand for businesses and consumers. Reports of tightening lending standards varied across loan categories, however.

As shown in the top chart, large and small businesses demand for loans has been moderating since the start of 2016. Domestic and foreign banks reported weaker loan demand on net over the first quarter. Notably, the slowdown in commercial & industrial (C&I) loan growth does not appear to be due to stricter lending standards, as banks reported no significant net tightening. The survey showed a modest net easing for C&I loans by domestic banks, but a slight tightening by foreign banks.

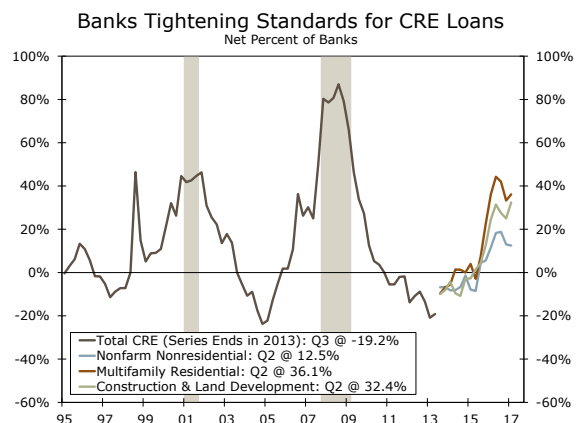
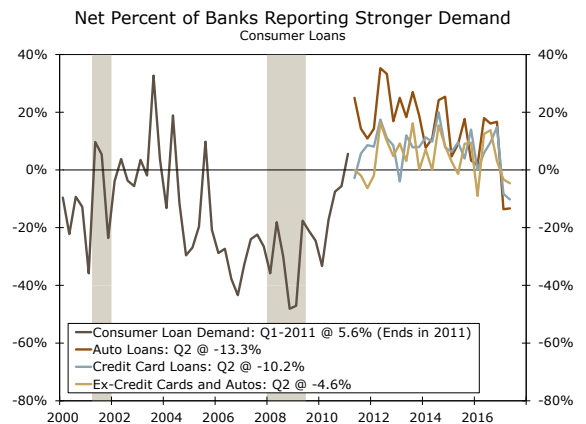
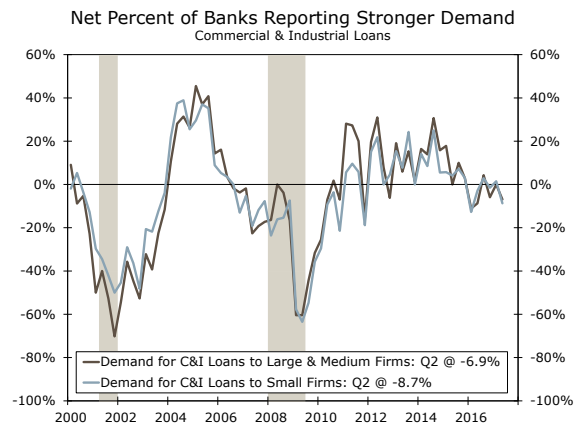
The SLOOS C&I lending data are contrary to the details within the GDP release. While the survey data point to a slowdown in business loan demand in Q1, the GDP report indicated a strong pickup in business fixed investment with outlays rising at a solid 9.4 percent annualized rate. The strength in business investment may reflect firms’ use of other sources of funding, such as bond issuance and stronger profits.

Consumer Loan Demand Cools

The Fed survey also showed a cooling in consumer loan demand, a finding consistent with the weaker pace of consumer spending in Q1. Lenders reported reduced demand for most consumer loan categories over the quarter, with particular softness in demand for credit card and auto loans (middle chart). A moderate share of banks reportedly tightened auto loan standards in Q1, marking the fourth consecutive quarter of net tightening. Banks stated widening spreads of loan rates over their cost of funds and raised the minimum credit score threshold over the quarter. For credit card loans, a modest share of banks reported easing lending standards, while terms on other consumer loans remained unchanged on balance. We do not take the softer consumer lending report as the start of a new trend and look for consumption to re-emerge in Q2.

CRE Lending: Continued Tightening

The April SLOOS showed that lenders are continuing to monitor pockets of risk in the commercial real estate (CRE) sector, as a significant net share of banks reported further tightening in most CRE loan policies (bottom chart). In fact, a major share of banks cited a more uncertain outlook for CRE property prices, vacancy rates and other fundamentals, and reduced risk tolerance as reasons for tightening credit standards. In a recent speech, Boston Fed President Eric Rosengren noted that while a handful of favorable factors have helped support CRE valuations, “positive trends can sometimes evolve into prices that increase more than fundamentals justify.”¹ Banks’ continued tightening of CRE credit should help ease financial regulators concerns of elevated pricing.



Source: Federal Reserve Board and Wells Fargo Securities

¹ <https://www.bostonfed.org/news-and-events/speeches/2017/trends-in-commercial-real-estate.aspx>

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	1.00	1.25	1.50	1.50	1.50	1.75	2.00	2.25
3 Month LIBOR	0.63	0.65	0.85	1.00	1.15	1.45	1.70	1.70	1.70	1.95	2.20	2.45
Prime Rate	3.50	3.50	3.50	3.75	4.00	4.25	4.50	4.50	4.50	4.75	5.00	5.25
Conventional Mortgage Rate	3.69	3.57	3.46	4.20	4.20	4.29	4.45	4.46	4.47	4.48	4.55	4.62
3 Month Bill	0.21	0.26	0.29	0.51	0.76	1.02	1.30	1.40	1.45	1.50	1.75	2.02
6 Month Bill	0.39	0.36	0.45	0.62	0.91	1.19	1.45	1.56	1.60	1.66	1.92	2.18
1 Year Bill	0.59	0.45	0.59	0.85	1.03	1.35	1.65	1.80	1.85	1.90	2.10	2.31
2 Year Note	0.73	0.58	0.77	1.20	1.27	1.55	1.90	2.00	2.05	2.11	2.26	2.41
5 Year Note	1.21	1.01	1.14	1.93	1.93	2.10	2.40	2.46	2.49	2.52	2.66	2.80
10 Year Note	1.78	1.49	1.60	2.45	2.40	2.55	2.72	2.75	2.76	2.78	2.86	2.94
30 Year Bond	2.61	2.30	2.32	3.06	3.02	3.18	3.44	3.54	3.56	3.58	3.67	3.76

Forecast as of: May 10, 2017

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

	<u>2017</u>	<u>2018</u>
Change in Real Gross Domestic Product		
Wells Fargo	2.2	2.7
FOMC	2.0 to 2.2	1.8 to 2.3
Unemployment Rate		
Wells Fargo	4.4	4.3
FOMC	4.5 to 4.6	4.3 to 4.6
PCE Inflation		
Wells Fargo	1.8	2.2
FOMC	1.8 to 2.0	1.9 to 2.0
"Core" PCE Deflator		
Wells Fargo	1.8	2.2
FOMC	1.8 to 1.9	1.9 to 2.0

Forecast as of: May 10, 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: March 15, 2017

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 Viloría, 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	edward.h.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 Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2017 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. The content of this report has been approved by WFSIL a regulated person under the Act. For purposes of the U.K. Financial Conduct Authority's rules, this report constitutes impartial investment research. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the "Materials") are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE

WELLS
FARGO

SECURITIES