ECONOMIC UPDATE

REGIONS

May 8, 2023

Q1 Loan Officer Survey: Rising Lending Standards, Sagging Loan Demand Nothing New

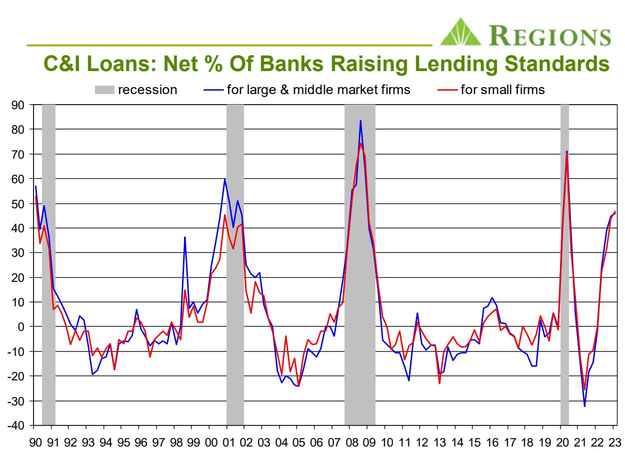
The Federal Reserve's quarterly Senior Lona Officer Opinion Survey on Bank Lending Practices (SLOOS) shows that banks further tightened lending standards across the commercial and consumer spaces in Q1 and at the same time reported further softening in loan demand. These changes do not come as a surprise and continue patterns seen over most of 2022, i.e., banks reporting tightening lending standards and slackening loan demand. These changes, however, were for the most part unnoticed until this March when stresses in the banking system rose to the surface and contributed to a few high profile bank failures. Since then, there have been growing fears that banks would continue tightening lending standards to the point of triggering a credit crunch that would tip the economy into recession. While that possibility cannot be dismissed out of hand, we have thought such concerns to be somewhat overdone. And while the headlines around the Q1 SLOOS data will no doubt focus on further tightening of lending standards, we remain big fans of context and, as such, find the details of the Q1 survey to be less dramatic.

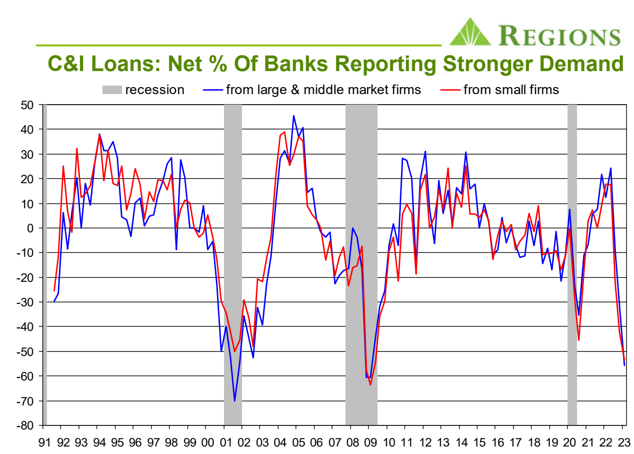
Before getting into those details, we think it helpful to explain the Fed's survey and how the results are reported. After all, though the SLOOS has been around, in one form or another, for over thirty years, it seems to largely escape notice other than in times of stress in the credit markets, and this is one of those times. Each quarter, the Fed surveys commercial bank lending officers and asks whether in the most recent quarter they have tightened lending standards, eased lending standards, or left lending standards unchanged, and whether demand for loans strengthened, weakened, or was "about the same." The survey covers commercial and industrial (C&I) loans, segregated into large/middle market firms and small firms, commercial real estate loans, and various forms of consumer loans, including auto loans, credit card loans, home equity loans, and mortgage loans. The results are reported as a net percentage; for questions on lending standards, the percentage of banks easing lending standards (either "somewhat" or "considerably") is subtracted from the percentage tightening lending standards (somewhat or considerably); any net percentage above zero indicates lending standards having tightened and any net percentage below zero indicates easing lending standards. For questions on loan demand, it is a similar calculation; any net percentage below zero indicates falling loan demand and any net percentage above zero indicates rising loan demand. Important to note is that the "net percentage" does not account for banks reporting lending standards/loan demand were basically unchanged, important because it is often the case that either a plurality or a majority of responses fall into this category.

In Q1, the net percentage of banks raising lending standards on C&I loans to large/middle market firms rose to 46.0 percent and to 46.7 percent for C&I loans to small firms. Over half of the banks, however, left C&I loan standards unchanged in Q1 which does not enter into the calculation of net percentages. The primary forms of higher standards were raising the costs of credit lines, raising spreads over banks' costs of funds, and raising premiums on riskier loans. A less favorable/more uncertain economic outlook, concerns over banks' liquidity positions, worsening industry-specific problems, and lower tolerance for risk were cited as the most common causes for raising lending standards on C&I loans.

Banks also tightened lending standards on commercial real estate (CRE) loans, with majorities reporting doing so in each of the CRE categories included in the survey. In contrast, the majority of banks report no changes in lending standards for residential mortgage loans, but what must be noted here is the extent to which mortgage lending standards were raised following the housing market debacle associated with the 2007-09 recession and that in years since there has been virtually no easing of those standards. While for other forms of loans to consumers – credit card, auto, and installment loans – the net shares indicate further tightening of lending standards, in each case the majority of banks report no change in lending standards, which for many follows tightening in prior quarters. Interestingly enough, most banks report little change in demand for the various forms of consumer loans despite higher interest rates, even as the net shares indicate weaker demand. In contrast, the majority of banks reported weaker C&I loan demand for firms of all sizes, which is consistent with patterns apparent for months in the data on core capital goods orders. That banks are raising lending standards against an increasingly uncertain backdrop should come as no surprise.

We cannot do justice to the full set of survey results here but hope to have at least given some needed context to the data. There is little in the survey we find surprising, and even less that would lead us to change our view on the likely path of the economy – listless real GDP growth – over coming quarters.





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