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Economics Group

Interest Rate Weekly

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Shannon Seery, Economic Analyst
shannon.seery@wellsfargo.com • (704) 410-1681

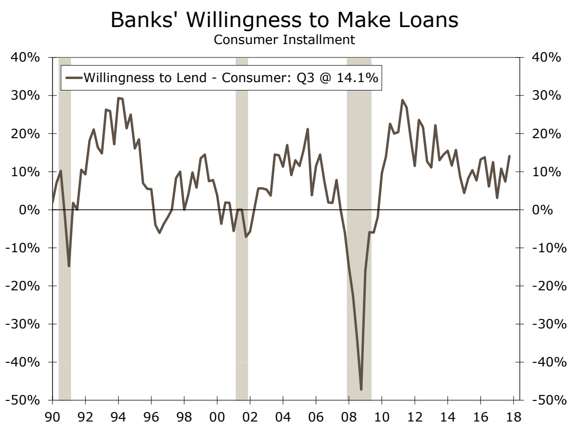
Mixed Credit Trends Among Businesses and Consumers

In the ninth year of the current economic expansion, credit standards point to a varied, but stable, outlook. Recent data suggest business lending demand has fallen, while consumer demand has seen modest gains.

Banks Optimistic (Yet Cautious) Approach to Lending

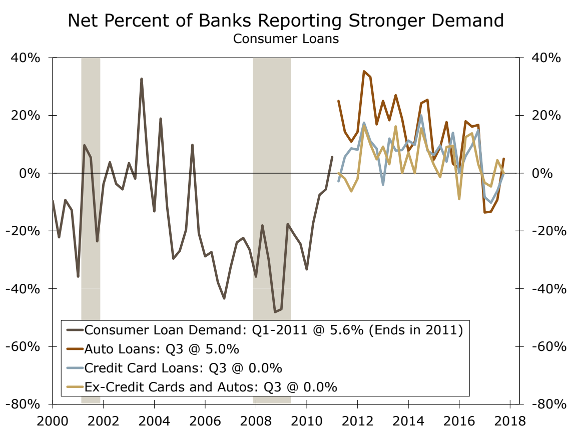
Banks continue to relax lending standards on business, commercial and industrial (C&I) loans and mortgages, as banks' willingness to make loans has gained some stability. A slowdown in banks' willingness to lend is customary with late cycle expansion. As seen in the top graph, banks' willingness to extend credit follows a cycle-like trend. At the start of an economic expansion, banks appear very willing to extend credit. But as the cycle matures, they become less willing to extend credit, and, in turn, tighten their standards in a cautionary nature.

Banks have reported increased competition from other bank and nonbank lenders, which in part, has led to the easing of standards. Continued loosening of lending standards of C&I and mortgage loans points to sustained confidence in the current state of the expansion. However, banks continue to tighten standards on credit card and auto loans, which may signal some caution in the consumer sector as the economic cycle ages.



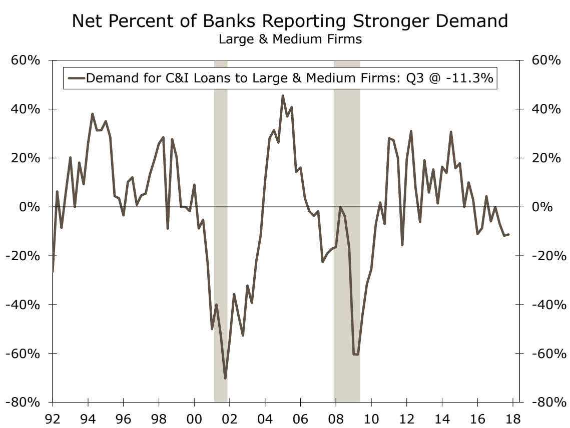
Slowly Growing Consumer Demand for Loans

With an unemployment rate of just 4.1 percent, and in an environment of modest income growth and surging consumer confidence, theory would suggest robust loan demand. Loan demand, however, remains muted, pointing to a change in consumer sentiment towards debt. Credit card demand has remained unchanged, while we have seen a recent uptick in auto loan demand (middle graph). The rise in demand for auto loans is likely attributable to rebound effects in auto-sales due to damage from the recent hurricanes in Texas and Florida. Consumer demand for mortgage loans has slowed, which is expected to reverse as existing home sales edge higher off a recent slowdown.



Without an increase in income growth, loan demand should continue to increase modestly. Our forecast calls for an uptick in disposable personal income in Q2 2018, due to the effects of the proposed tax reform, followed by a slowdown in disposable personal income growth through the last year of our forecast (2019). Such slowing in income growth suggests consumers may increasingly turn to borrowing to fund their consumption habits in the future.

Demand for business loans remains weak, yet increased strength in business investment suggests that firms have turned to other sources of funding to fuel capital spending (bottom graph). The loosening of lending standards, coupled with our positive outlook for business investment, should drive C&I loan demand higher in the near future. However, as the cycle continues to mature, we project equipment spending to slow, likely resulting in a reduction in business demand looking further ahead.



The current credit climate insinuates stability within lending practices as growth continues in the ninth year of the current economic expansion.

Source: Federal Reserve Board and Wells Fargo Securities

Wells Fargo U.S. Interest Rate Forecast

	Actual 2017				Forecast							
	2017				2018				2019			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	1.00	1.25	1.25	1.50	1.50	1.75	1.75	2.00	2.00	2.25	2.25	2.50
3 Month LIBOR	1.15	1.30	1.33	1.65	1.65	1.90	1.90	2.15	2.15	2.40	2.40	2.65
Prime Rate	4.00	4.25	4.25	4.50	4.50	4.75	4.75	5.00	5.00	5.25	5.25	5.50
Conventional Mortgage Rate	4.20	3.90	3.81	3.89	3.97	4.06	4.11	4.18	4.22	4.28	4.31	4.40
3 Month Bill	0.76	1.03	1.06	1.30	1.45	1.60	1.67	1.85	1.95	2.10	2.15	2.30
6 Month Bill	0.91	1.14	1.20	1.40	1.55	1.70	1.77	1.95	2.05	2.20	2.25	2.40
1 Year Bill	1.03	1.24	1.31	1.55	1.68	1.80	1.87	2.05	2.15	2.25	2.30	2.45
2 Year Note	1.27	1.38	1.47	1.72	1.83	1.93	2.00	2.15	2.23	2.33	2.38	2.50
5 Year Note	1.93	1.89	1.92	2.20	2.29	2.39	2.45	2.58	2.65	2.75	2.80	2.90
10 Year Note	2.40	2.31	2.33	2.49	2.57	2.66	2.71	2.78	2.82	2.88	2.91	3.00
30 Year Bond	3.02	2.84	2.86	3.19	3.29	3.41	3.49	3.58	3.64	3.71	3.75	3.85

Forecast as of: November 8, 2017

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

	2017	2018	2019
Change in Real Gross Domestic Product			
Wells Fargo	2.4	2.5	2.5
FOMC	2.2 to 2.5	2.0 to 2.3	1.7 to 2.1
Unemployment Rate			
Wells Fargo	4.1	3.9	3.7
FOMC	4.2 to 4.3	4.0 to 4.2	3.9 to 4.4
PCE Inflation			
Wells Fargo	1.5	1.6	2.0
FOMC	1.5 to 1.6	1.8 to 2.0	2.0 to 2.0
"Core" PCE Deflator			
Wells Fargo	1.4	1.7	1.9
FOMC	1.5 to 1.6	1.8 to 2.0	2.0 to 2.0

Forecast as of: November 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: September 20, 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
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
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Harry Pershing	Economic Analyst	(704) 410-3034	harry.pershing@wellsfargo.com
Hank Carmichael	Economic Analyst	(704) 410-3059	john.h.carmichael@wellsfargo.com
Ariana Vaisey	Economic Analyst	(704) 410-1309	ariana.b.vaisey@wellsfargo.com
Abigail Kinnaman	Economic Analyst	(704) 410-1570	abigail.kinnaman@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com