



# Economics Group

## Interest Rate Weekly

**John E. Silvia, Chief Economist**  
[john.silvia@wellsfargo.com](mailto:john.silvia@wellsfargo.com) • (704) 410-3275  
**Mark Vitner, Senior Economist**  
[mark.vitner@wellsfargo.com](mailto:mark.vitner@wellsfargo.com) • (704) 410-3277  
**Michael A. Brown, Economist**  
[michael.a.brown@wellsfargo.com](mailto:michael.a.brown@wellsfargo.com) • (704) 410-3278

### Small Banks Step up to the Plate in the Lending Game

*Despite struggling to regain lost share of total banking assets, small banks have made considerable strides in ramping up their lending activity in recent years. Commercial real estate and mortgages have led the way.*

#### Small Banks Staging a Comeback

After losing a considerable share of total bank assets and total bank lending during the Great Recession, small banks have struggled to regain their prerecession share of total banking assets (top chart).<sup>1</sup> However, smaller institutions' share of total lending assets has recovered nicely, particularly in the past two years, and is now just 1.7 percentage points below its prerecession peak. Interestingly, small banks' lending assets as a share of total assets have not moved as drastically over this time period, but the same metric for large banks has trended downward (middle chart). However, the decline in lending assets as a share of total assets among large banks does not imply that these institutions are lending less; in aggregate, lending has actually grown at a fairly healthy clip among large banks over the past few years.

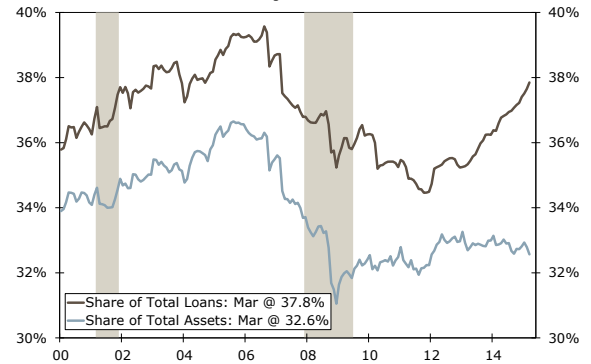
The stark divergence has been more a result of the Fed's quantitative easing programs, which have created a massive amount of bank reserves. Since the Fed transacted primarily with larger banks for these programs, smaller banks received relatively less cash assets compared with their larger counterparts during the implementation of these programs. Regardless, loan growth at small banks has outpaced growth at larger institutions in recent years (bottom chart). What has been driving this trend?

#### Commercial Real Estate and Mortgage Lending Lead the Way

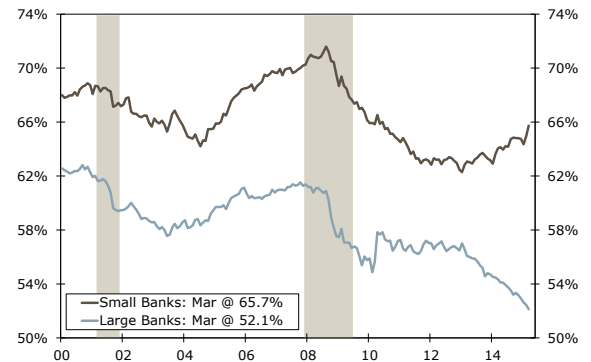
Small banks have shown robust growth in most lending categories, but the two primary drivers of loan growth since the end of the recession for these small banks have been the commercial real estate (CRE) and mortgage markets. Interestingly, small banks' market share in the CRE space has been steadily increasing since at least 2004. This likely reflects the fact that there are a large number of small banks that specialize in CRE lending, whereas larger banks tend to be more diversified in their lending activities.

Another market where small banks have seen a resurgence in lending activity is in mortgages. Despite a slow initial recovery, mortgage lending growth at small banks has been positive nearly every month for the past three years, while growth has lagged at larger banks. More stringent capital requirements have likely played a key role in this shift, as holding mortgages has become more costly for larger financial institutions. Growth in mortgage lending among these smaller players should support home buying activity, particularly in smaller communities where these banks tend to have their operations. Fortunately, we have seen delinquency rates in the mortgage and CRE markets continue to trend downward, thanks to tighter standards and healthier household and corporate balance sheets, which bodes well for the health of these small banks going forward.

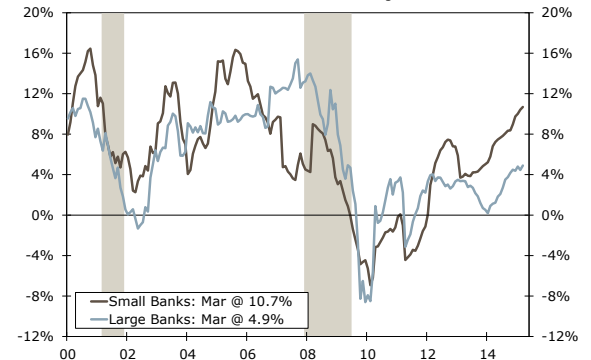
Market Share for Small Banks  
 Banks Not in Largest 25 Domestic Banks



Lending Assets as a Share of Total Assets  
 Percent



Total Loan Growth  
 Year-over-Year Percent Change



Source: Federal Reserve Board and Wells Fargo Securities, LLC

<sup>1</sup> We use the Federal Reserve's definition of a "small bank"—a bank not classified as one of the 25 largest banks by assets.

## Wells Fargo U.S. Interest Rate Forecast

	Actual				Forecast							
	2014				2015				2016			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.75	2.25
3 Month LIBOR	0.23	0.23	0.24	0.26	0.27	0.30	0.70	0.95	1.20	1.45	1.95	2.45
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.50	3.75	4.00	4.25	4.75	5.25
Conventional Mortgage Rate	4.34	4.16	4.16	3.86	3.77	3.95	4.15	4.23	4.28	4.37	4.63	4.75
3 Month Bill	0.05	0.04	0.02	0.04	0.03	0.13	0.55	0.86	1.15	1.43	1.81	2.28
6 Month Bill	0.07	0.07	0.03	0.12	0.14	0.27	0.63	0.91	1.22	1.52	1.85	2.35
1 Year Bill	0.13	0.11	0.13	0.25	0.26	0.30	0.69	0.99	1.24	1.57	1.89	2.43
2 Year Note	0.44	0.47	0.58	0.67	0.56	0.70	0.87	1.07	1.26	1.71	2.00	2.46
5 Year Note	1.73	1.62	1.78	1.65	1.37	1.68	1.78	1.89	2.01	2.19	2.31	2.59
10 Year Note	2.73	2.53	2.52	2.17	1.94	2.19	2.35	2.41	2.46	2.53	2.77	2.89
30 Year Bond	3.56	3.34	3.21	2.75	2.54	2.77	2.89	2.99	3.09	3.18	3.39	3.58

Forecast as of: April 24, 2015

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

	<u>2015</u>	<u>2016</u>	<u>2017</u>
<b>Change in Real Gross Domestic Product</b>			
Wells Fargo	2.3	2.9	N/A
FOMC	2.3 to 2.7	2.3 to 2.7	2.0 to 2.4
<b>Unemployment Rate</b>			
Wells Fargo	5.2	4.8	N/A
FOMC	5.0 to 5.2	4.9 to 5.1	4.8 to 5.1
<b>PCE Inflation</b>			
Wells Fargo	0.9	2.1	N/A
FOMC	0.6 to 0.8	1.7 to 1.9	1.9 to 2.0

Forecast as of: April 24, 2015

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 18, 2015

Source: Bloomberg LP, Federal Reserve Board and Wells Fargo Securities, LLC

## Wells Fargo Securities, LLC 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
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	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
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Erik Nelson	Economic Analyst	(704) 410-3267	erik.f.nelson@wellsfargo.com
Alex Moehring	Economic Analyst	(704) 410-3247	alex.v.moehring@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@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 ("WFS") 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. ("WFBNA") is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. WFS and WFBNA 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 © 2015 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

