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Economics Group

Interest Rate Weekly

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Secular Trends in Bank Lending

Continued improvement in loan performance has supported income of FDIC insured institutions. We investigate secular trends in the net interest margin and the loan-to-deposit ratio.

Net Income Jumps in Second Quarter

FDIC insured institutions showed continued strength in the second quarter. Net income came in at $43 billion in the second quarter, a 7.3 percent increase from a year ago ($2.9 billion). The gains were driven by increased revenues and lower noninterest expenses. Improvement has been relatively broad-based. The share of unprofitable institutions has come down markedly since the recession, with only 5.6 percent of institutions being unprofitable in the quarter. Loan performance continues to improve as well, with the noncurrent loan rate reaching another cycle low in the second quarter. The noncurrent loan rate, however, still remains above levels seen in the two decades leading up to the crisis. In addition, there are several underlying trends in the industry that are worth noting.

Net Interest Margins: Secular Decline

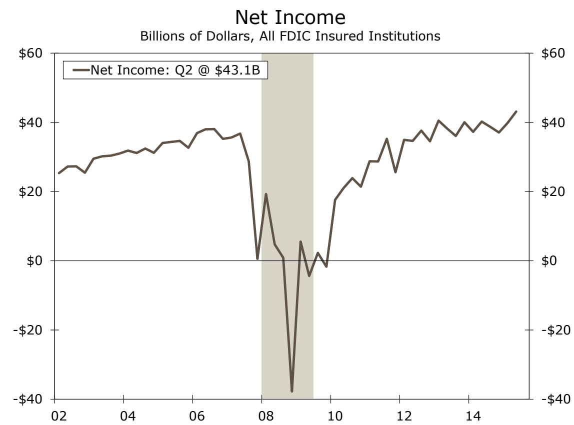
Intuition would suggest that the net interest margin should move lock-step with the yield curve. Recall the net interest margin is the difference between interest earned on interest-bearing assets and interest paid to creditors as a percentage of the average earning assets. This measure highlights banks' traditional function of maturity transformation, where they earn the difference in the yield curve by borrowing short term and lending long term. It is, therefore, notable that the net interest margin has declined much faster over the past several years than would be suggested by the yield spread. As higher-yielding assets matured in a persistently low interest rate environment, the net interest margin may have been squeezed.

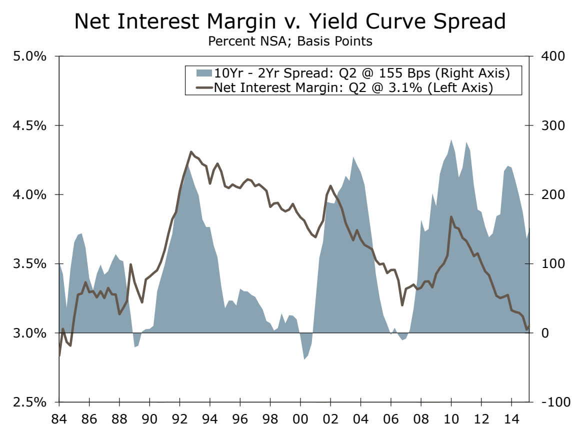
Loan-to-Deposit Ratio Has Stabilized

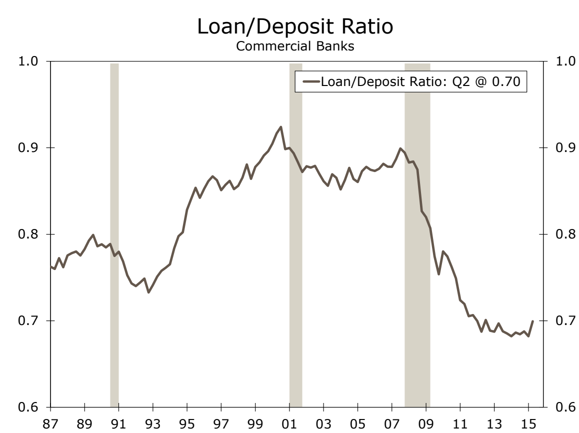
The loan-to-deposit ratio for commercial banks has yet to show much of a bounce-back from the large declines during and after the Great Recession (bottom chart). During the recession, the growth rate of total loans slowed and even turned negative for a period. Deposits, however, continued to increase and this divergence pulled the loan-to-deposit ratio down further. Historically, this ratio has increased when the Fed is raising interest rates and the economy is expanding. The ratio ticked up in the second quarter as loan growth outpaced deposit growth, which has only happened on a year-over-year basis in two previous quarters since the recession began.

Credit Conditions Remain Favorable

Improving loan performance has supported incomes despite a falling net interest margin. We expect that improvement in economic fundamentals should maintain the positive trends in loan performance. That said, as cautioned in our monthly consumer credit report, a material downshift in economic growth could have negative consequences for delinquencies. In addition, our forecast for a flatter yield curve when the Fed moves should put further pressure on the net interest margin.







Source: Federal Deposit Insurance Corporation, Federal Reserve Board and Wells Fargo Securities, LLC

Wells Fargo U.S. Interest Rate Forecast

	Actual			Forecast								
	2015				2016				2017			
	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	0.50	0.50	0.75	1.00	1.25	1.50	1.75	2.00	2.00
3 Month LIBOR	0.27	0.28	0.33	0.65	0.70	0.95	1.20	1.45	1.70	1.95	2.20	2.20
Prime Rate	3.25	3.25	3.25	3.50	3.50	3.75	4.00	4.25	4.50	4.75	5.00	5.00
Conventional Mortgage Rate	3.77	3.98	3.89	3.92	3.94	3.99	4.11	4.25	4.35	4.42	4.48	4.55
3 Month Bill	0.03	0.01	0.00	0.09	0.21	0.60	0.86	1.19	1.27	1.60	1.85	1.89
6 Month Bill	0.14	0.11	0.08	0.20	0.28	0.69	0.95	1.28	1.36	1.69	1.94	1.98
1 Year Bill	0.26	0.28	0.33	0.53	0.62	0.98	1.16	1.43	1.51	1.84	2.07	2.10
2 Year Note	0.56	0.64	0.64	0.85	1.01	1.28	1.55	1.80	2.01	2.28	2.35	2.40
5 Year Note	1.37	1.63	1.37	1.58	1.72	1.81	1.94	1.97	2.20	2.32	2.38	2.42
10 Year Note	1.94	2.35	2.06	2.08	2.10	2.15	2.25	2.37	2.45	2.50	2.54	2.59
30 Year Bond	2.54	3.11	2.87	2.89	2.88	2.90	2.92	2.94	2.96	2.96	2.98	2.98

Forecast as of: October 16, 2015

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

	2015	2016	2017
Change in Real Gross Domestic Product			
Wells Fargo	2.1	2.6	2.3
FOMC	2.0 to 2.3	2.2 to 2.6	2.0 to 2.4
Unemployment Rate			
Wells Fargo	5.0	4.6	4.4
FOMC	5.0 to 5.1	4.7 to 4.9	4.7 to 4.9
PCE Inflation			
Wells Fargo	0.8	1.9	1.9
FOMC	0.3 to 0.5	1.5 to 1.8	1.8 to 2.0

Forecast as of: October 16, 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: September 17, 2015

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

Wells Fargo Securities, LLC Economics Group

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