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SECTOR COMMENT

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Banks and Finance Companies - United States

Underwriting standards for credit cards and auto loans tighten modestly, a positive

Summary

The latest Senior Loan Officer Opinion Survey (SLOOS), released today, 8 May, reveals a modest tightening of bank underwriting standards for approving credit card and auto loan applications during the first quarter of 2018, a mild credit positive. Standards for residential mortgages were largely unchanged.[1]

Consumers are in better shape than they have been in quite some time, but there is a risk that they will take on too much credit in the present accommodative environment. Auto loan underwriting remains weak, and we expect credit card underwriting to deteriorate, despite the modest tightening indicated by the SLOOS survey. Our concern stems from lenders' tendency to grow complacent and increase the risk in their consumer loan portfolios, thinking they have plenty of time to tighten before the next downturn. Time and time again, lenders have proved unable to tighten in time.

Exhibit 1 summarizes underwriting standards and trends for credit cards, auto loans, and residential mortgages, including the current quarter SLOOS results and our projections.

Exhibit 1

Auto underwriting remains weak; cards and residential mortgages expected to loosen

Current underwriting standards compared to historical standards

	Current underwriting standards vs. historical standards*	Trend over last two years	Current quarter's Senior Loan Officer Opinion Survey results	Moody's projected trends
Credit cards	Looser end of historically average standards	Very modest tightening	Modest tightening	Loosening to moderately weak standards
Auto loans	Weak	Modest tightening	Very modest tightening	Remains weak
Residential mortgages	Tighter end of historically average standards	Modest loosening	Largely neutral	Loosening to average standards
Legend:				
Credit negative	Modest credit negative	Neutral	Modest credit positive	Credit positive

*Historical standards from the last twenty-five years or so.

Source: Federal Reserve, Moody's Investors Service

Credit Cards: continued modest tightening of average underwriting standards

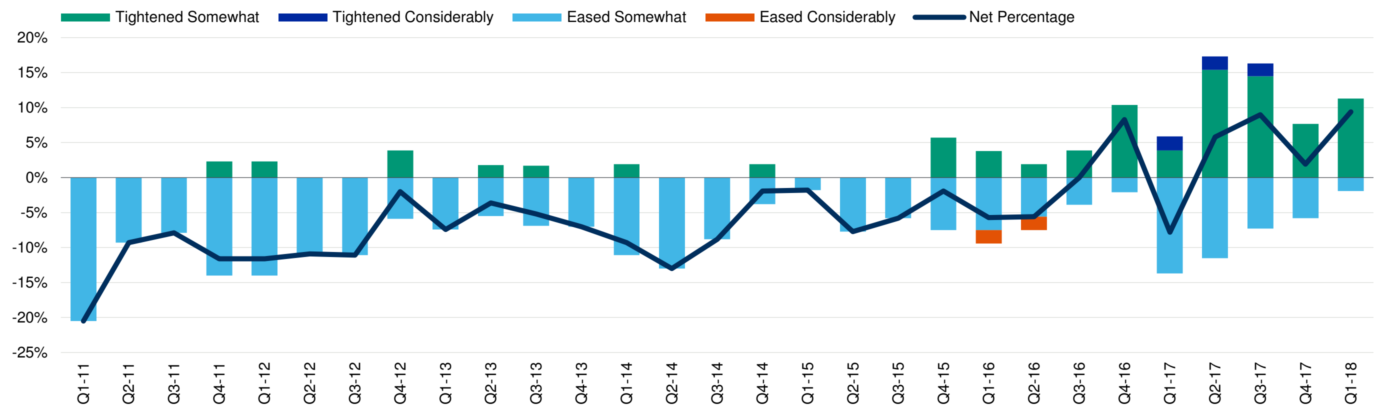
As shown in Exhibit 2, first quarter results indicate continued modest tightening of credit card underwriting standards. Of particular significance is that only one bank out of 53 surveyed reported modest loosening. The banks indicated that they had tightened standards with respect to minimum credit scores. Despite these results, we forecast a net deterioration in standards over the next 12-18 months.

We have been flagging a deterioration in credit card underwriting over the last several years, which resulted in the change of our credit card outlook to stable from positive in July 2017. We believe credit card underwriting is still at the looser end of average historical standards over the last twenty-five years or so. Given the solid employment market, high consumer confidence, and the strong profitability reported by bank's credit card segments, we expect underwriting standards to again begin deteriorating despite the modest tightening reported in the first quarter.

Exhibit 2

Credit cards: Average underwriting standards tighten moderately

Underwriting standards for application approvals for credit cards

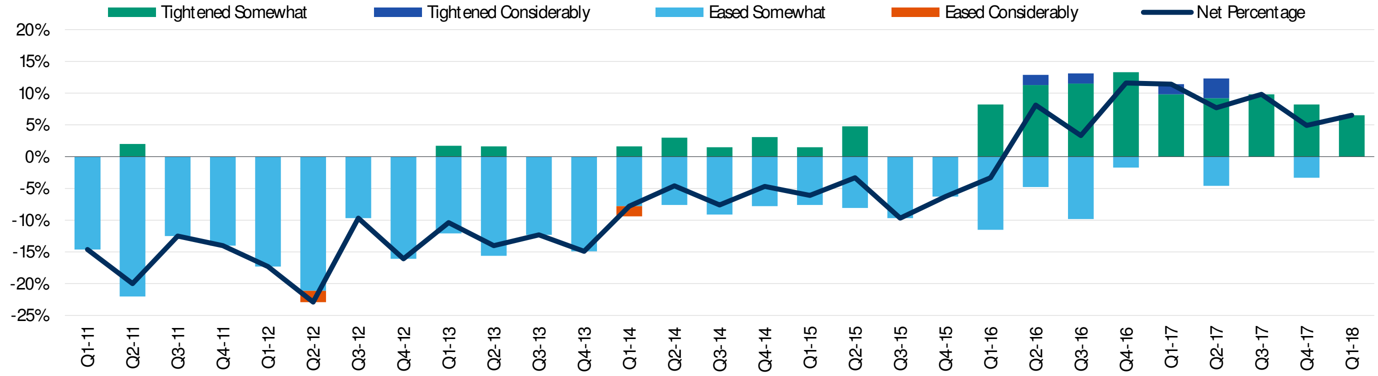


Source: Federal Reserve

Auto Loans: continued modest tightening of weak underwriting standards

As shown in Exhibit 3, first quarter results indicate auto loan underwriting continued to tighten, but only very modestly. We continue to believe that auto loan underwriting is weak. Loan losses have been only slightly above historical averages from the last twenty-five years or so, but they should be much lower given the strong economy. This points to underlying risk in the loan portfolios that is well above historical standards. Over the last two years, auto loan underwriting has tightened somewhat and loan growth has also slowed, a credit positive. But underwriting is unlikely to tighten sufficiently to reflect underlying risk because of the solid employment market and high consumer confidence.

Exhibit 3
Auto: Underwriting standards are weak despite modest tightening
Underwriting standards for application approvals for auto loans



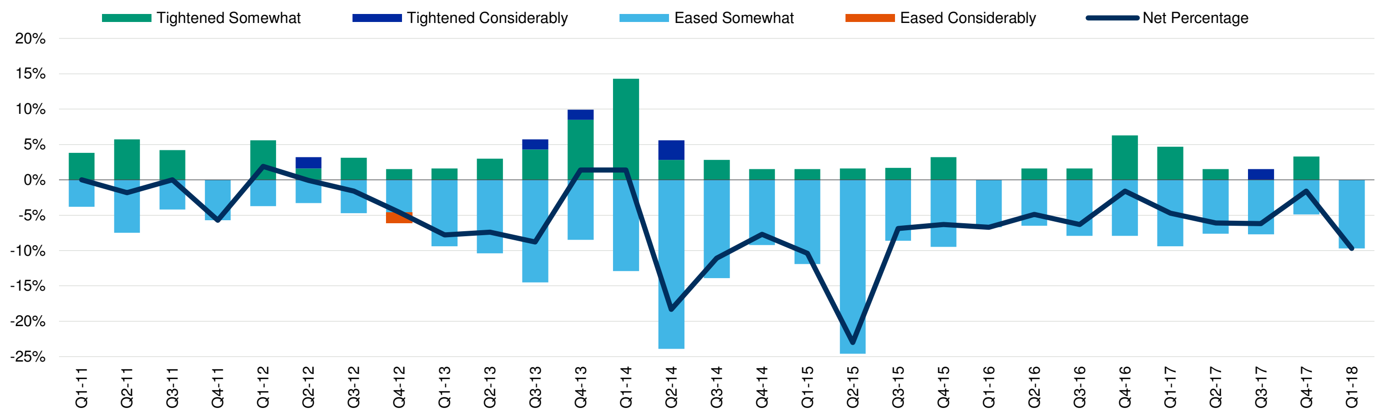
Source: Federal Reserve

Residential Mortgages: largely unchanged solid underwriting standards

Banks reported little change in underwriting standards for most residential mortgages. However, as shown in Exhibit 4, first quarter results indicate that underwriting standards modestly loosened for qualified mortgage (QM) jumbo mortgages, continuing the trend of the last several years. Of interest is that no surveyed bank reported a tightening of standards for QM jumbo mortgages.

Outstanding residential mortgage loan balances have recently increased a bit as purchase origination volume has increased and as underwriting standards have been loosening. Nonetheless, residential mortgage underwriting is on the tighter end of historically average standards from the last twenty-five years or so. Given the generally tight underwriting standards, we expect residential mortgage underwriting to continue loosening over the next 12-18 months, normalizing toward historical average underwriting standards.

Exhibit 4
Residential mortgage: Solid underwriting standards continue despite modest loosening
Underwriting standards for application approvals for prime/QM jumbo residential mortgages



Source: Federal Reserve

Endnotes

1 Two caveats to the implications of the survey responses, however, are that they reflect only the banks' own view of their underwriting and that non-banks, which are not surveyed, have meaningful market shares in auto loans and residential mortgages.

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