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Lenders Reveal a Positive Outlook for U.S. Economy in Near Term with Record High Results in Q2/18

By Michael E. Jacoby and Jessica Zwirzina
Phoenix Management Services

For over 20 years, Phoenix Management Services has been collecting, tabulating, and analyzing the results from its "Lending Climate in America" survey to evaluate national lending attitudes and trends. Each quarter Phoenix's proprietary "Lending Climate in America" survey is distributed to over 5,000 lenders nationwide. In the Q2/18 survey results we saw increasing confidence by lenders regarding the U.S. economy in the near-term. In the Q2/18 survey, their near-term expectations (i.e. how will the U.S. economy perform *during* the next six months) increased 9 points to a GPA of 2.83, and their long-term expectations (i.e. how will the U.S. economy perform *beyond* the next six months) fell 5 points to a grade point average (GPA) of 2.42. While there was a slight decrease in the long-term GPA, both sentiments continue to represent an overall 'B' grade. In our Q2/18 survey, lenders revealed a) an increase in the near-term GPA (setting a record high), b) a decrease in the diffusion indexes for loan losses and bankruptcies, and c) their belief that stability of the stock market and the instability of energy prices are the factors that have the greatest impact on the overall economy.

Near-Term Economy GPA Reaches New Record High

Each quarter we ask lenders "How do you expect the U.S. economy to perform in the next six months on a scale of A through F?" The Q2/18 survey results exhibited an increase of 9 points in the economic grade point average (GPA) to 2.83 from 2.74 in Q1/18. This GPA represents a new record high for near-term GPA in the history of the Phoenix "Lending Climate in America" survey. The majority of lenders

(67%) believe the economy will perform at a 'B' level, while only 25% of lenders expect the U.S. economy to perform at a 'C' level over the next six months. There was also an increase (8%) of lenders that expect the U.S. economy to perform at an 'A' level. The Q2/18 results continues the recent trend of a higher near-term GPA than long-term GPA. The near-term GPA of 2.83 remains at an overall 'B' grade, which is a positive indication for continued growth throughout 2018.

In addition, we ask lenders "How do you expect the U.S. economy to perform beyond the next six months on a scale of A through F?" Lenders continue to have an optimistic view about the U.S. economy in the long-term however its GPA decreased 5 points from a 2.47 in Q1/18 to a 2.42 in Q2/18. In Q2/18 we saw a decrease in the percentage of lenders (46%) that expect the U.S. economy to perform at a 'B' level beyond the next six months. While there was also a decrease (38%) of lenders that expect the U.S. economy to perform at a 'C' level, we saw an increase (12%) that expect the U.S. economy to perform at a 'D' level. This 7-percentage point increase is what ultimately caused the Q2/18 long-term GPA to decrease.

Lenders were also surveyed this quarter on whether they believe legislation will be passed in the next 12 months to materially change the United States' trade policy and how they expect this legislation to impact the U.S. economy. Of the lenders surveyed, 28% think legislation will be passed in the next twelve months to change the U.S.'s trade policy and the impact on the U.S. economy will be neutral. Furthermore, 24% of lenders believe a) material changes to the U.S. trade policy will be made in the next 12 months and the impact on the U.S. economy will be positive, b) material changes to the U.S. trade policy will be made in the next 12 months and the impact on the U.S. economy will be negative, and c) no material changes to the U.S. trade policy will be made through legislation in the next 12 months.

Bankruptcies and Loan Losses to Decrease with Interest Rates to Increase

One of the questions posed to survey respondents is whether they believe bankruptcies, loan losses, and interest rates will be up, down or remain at the same level over the next 6 months. Our survey utilizes the Diffusion Index to measure lender sentiment. The Diffusion Index is calculated by subtracting the percentage of negative expectations from the percentage of positive expectations. In Q2/18 we saw a decrease from lenders on bankruptcies and loan losses metrics when compared to the Q1/18 results. The diffusion index for loan losses decreased 10-percentage points to 29% from the Q1/18 results of 39%, and the diffusion index for bankruptcies decreased 9-percentage points to 29%. While lenders expect loan losses and bankruptcies to decrease versus Q1/18, 100% of the lenders surveyed expect interest rates to increase in the next six months. Of the lenders surveyed in Q2/18, 96% expect the Fed to raise interest rates by 50 basis points or more, which represents a 5-percentage point increase from the Q1/18 results of 89%, and only 4% expect the Fed to raise interest rates by 25 basis points within the next 6 months.

Stock Market and Unstable Energy Prices to Affect the Overall Economy

Another question routinely asked to lenders is to select the two factors that they believe could have the strongest potential to affect the economy in the next six months. The top two factors selected by lenders in the Q2/18 survey were the stability of the stock market and the instability of energy prices, each of which garnered 46% of the responses. This 46% represents a 41-percentage point increase for unstable energy prices as the Q1/18 results garnered only 5% of responses.

While lenders believe the stock market stability will be one the factors that most affects the economy in the next six months, when asked whether they agree with Fed Chairman Jerome Powell that market participants should worry less about the yield curve's current slope given recent economic growth, lenders only somewhat agree. Mr. Powell was quoted recently saying: "A lot of that was just situations in which inflation was allowed to get out of control and the Fed had to tighten and that put the economy into recession. That's really not the situation we're in now." Following this statement, we asked lenders, "Do you agree with Fed Chairman Jerome Powell that market participants should worry less about the yield curve's current slope given recent economic growth?" Of the lenders surveyed, 60% somewhat agree, and believe that while the flattening of the yield curve is concerning, a recession is highly unlikely given the current economic climate. Garnering the second highest responses (20%), were lenders that somewhat disagree and believe while market conditions are different now than before previous recessions, market participants should take note of the flattening of the yield curve despite the current economic climate.

Conclusion

The results from our Q2/18 survey indicate a positive outlook on the U.S. economy in the near-term as we continue throughout 2018, and while lenders continue to be optimistic about the U.S. economy in the long term, there has been a little more pessimism on how they expect the U.S. economy will perform in the next six to twelves months.

The Phoenix Management "Lending Climate in America" Survey is conducted quarterly. To see the full survey results for Q2 2018 as well as to view previous quarter results, please visit http://www.phoenixmanagement.com/about-phoenix/lending-survey