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Connecting the Dots

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Banks expect to tighten lending standards should the Treasury curve invert next year, according to survey data released by the Federal Reserve on Tuesday. Curve inversion is not an idle concern since the Fed looks set to hike short-term rates three times next year (in addition to going in December), and the Treasury intends to meet a significant share of its nearly $1.5 trillion deficit funding need by issuing T-bills.

Consensus estimates have T-bill issuance increasing 30-40% in 2019 from what has already been a heavy 2018. Rate hikes plus heavy supply at the front end of the curve may push short-term rates up faster than longer term rates. In fact, looking at the forward curve, the market anticipates that the ten-year Treasury will yield only 6 bps more than the two-year by this time next year.

Regional banks may be handed a win in the proposed revised framework for prudential standards recently put forward by bank regulators. The two proposed rulemakings would particularly benefit firms with $100 to $250 billion in total assets. (See Cadwalader's *Rightsizing Regulation: U.S. Banking Agencies Release "Tailoring" Proposals and Regional Banks Are the Winners.)*

Loan demand from traditional bank borrowers continues to sag. The Fed's Senior Loan Officer Survey data released on Tuesday pointed to weakening loan demand in the commercial and industrial loan category, in residential mortgages, consumer debt, and across the board in commercial real estate.

Connecting the dots: We're lawyers, not research analysts, but we can easily envision a 2019 environment wherein banks gravitate to floating-rate assets because of the flat Treasury curve, and regional banks are ready to grow balance sheets but face weak loan demand from traditional commercial and industrial and real estate borrowers. That makes us optimistic about the outlook for subscription finance—a floating-rate product with robust new deal volume—and about the prospect of new lenders entering the space.