LIABILITY FORECASTS

by Steve Brown

For banks looking to do some deposit planning, we have updated our forecasts for 2007. Overall, liabilities will grow a little over 6%, a slower pace than 2006. For institutions looking to grow in excess of that number, plan on margins being further compressed, as there is little that can be done to prevent driving up cost of funds and making the bank more interest rate sensitive (although many tactics will certainly limit the degree of increased cost and sensitivity rise). Deposit growth is projected to slow due to competition from other alternatives (such as insurance and money market mutual fund products), as well as lower disposable income projections. Higher rates, inflation, slower sales and fewer cash-out mortgage refinancing will all affect cash balances held by households by an estimated 14%. As we look into different liability segments, expect another jump in wholesale funding to offset slower core growth. In particular, brokered CDs should be budgeted up, as they have added value in many cases over FHLB advances. For core funding, competition will continue to pressure rates higher, increasing funding costs for many banks. While most banks will remain fairly disciplined, the market will likely see greater competition for DDAs. Higher rates, more bells and whistles and a larger number of promotions will take place. As a result of higher costs, DDA volume growth is expected to increase 8%. This trend of greater promotions has already occurred in MMDAs, as we have seen unprecedented competition. Long an overlooked portion of liabilities, 2006 saw the largest jump in MMDA rates in the last several years. Banks that never paid more than 20% of Libor for such accounts have begun paying as much as 95% of Libor for larger balances (usually over $50k). Expect this trend of tiering rates by deposit amount to not only continue, but for some of the best rates to be paid on amounts as low as $25k. On the CD front, competition will abate somewhat, particularly past 2Y. This will occur as fewer banks take the risk of having high priced money locked-in, given the potential for lower interest rates. In addition, banks have shown more discipline in pricing in the last several months after largely panicking due to shrinking margins. As such, expect most of the issuance to remain within 18 months and slightly lower pricing to take hold over time as sanity and lower loan activity take hold. This should result in lower CD growth, probably around the 4% range. As for duration, look for maturities to shorten, but for effective duration (the measure of interest rate sensitivity) to increase by about 2 months (as non-maturity balances increase and banks have greater success at adding less interest rate sensitive balances). Finally, 2007 will go down as a similar year to 2006, albeit slightly more challenging. Greater competition and sophistication will continue to raise the bar, causing many banks to take a closer look at both products and offerings.

SALES FINANCE

For banks looking to diversify away from CRE exposure, we have a $6mm home improvement loan pool paying a 7% fixed rate. This approximate 2 year pool carries an "A" credit guarantee for almost 50% of the exposure, with the remaining risk to high FICO score borrowers. We have a long list of happy banks that have purchased this paper over the past 3 years, as the program is a conservative way to add bulk and diversification quickly. If you are interested in a yield better than securities to offset slowing loan growth, or are trying to diversify your current portfolio risk exposures, contact us for more information.

BANK NEWS

Competition

JPMorgan Chase said it will buy regional employee benefits and compensation consulting firm CCA Strategies LLC and its affiliates for an undisclosed sum.

Competition

H&R Block, which obtained a thrift charter in May, said it would offer bank accounts to its 3mm tax preparation clients.

Competition

Comerica Bank ($57B, MI) said it will add Saturday banking hours to branches in CA, as it seeks to expand in the state. Meanwhile, the bank also indicated it will open 10 new branches in the next 6 months in the state.

Worried Lenders

A new study finds 59% of lenders expect their loan portfolio to deteriorate over the next 6 to 12 months.

Weak Housing

The National Association of Realtors has updated forecasts and now expects building to drop nearly 10%, sales of existing homes to fall nearly 8% and new home sales to drop 16% from last year's levels.

Softer Housing

The National Association of Home Builders said homebuilder optimism has fallen to its lowest level in 15Y. Unsold home inventories have leapt 39% year to date through June. The supply of homes now sits at 6.8 months (based on current sales), a 55% increase over the same period last year.

NIM Compression

Statistics show the NIM for the banking industry has fallen in 12 of the last 13 years.

Job Cuts

A survey by HR firm Challenger Gray & Christmas finds layoff announcements at major U.S. employers soared 76% in August. The surge is alarming, particularly since layoff announcements usually drop in the summer months.