

BANKING LANDSCAPE

by [Steve Brown](#)

Landscape painting, which depicts scenery such as trees, rivers, forests and mountains, began in the 15th century. We will never know what is inside a painter that allows them to capture a spectacular landscape on canvas, but the beauty of such a painting is what also makes them one of the biggest selling subjects. In the banking landscape, things have also been changing rapidly, so this morning we try our best to use our palette to paint a picture.

We begin with funding. Many banks we talk to tell us they remain challenged and are having a hard time getting their deposit costs down. Despite multiple FRB rate cuts, there are still too many large banks (i.e. Countrywide, IndyMac and others) that are paying high rates and don't seem willing to go lower. Whether it is overriding pressure to fund their balance sheet or just customers demanding more for their deposit money, funding costs remain an issue for many community banks. In addition to competitive pricing for deposits, the underlying structure of deposits has been changing for the worse. Customers have now been trained to ask bankers for higher rates, while converting non-interest bearing accounts into interest bearing.

Along the same lines, but with a slightly different paint color, we see quite a few more banks shifting to short-term brokered deposits over FHLB advances as of late. While longer-term advances still remain cheaper than brokered CDs, the short-end of the curve is one way community banks are holding onto profitability. Interest rate risk comes into play the shorter banks go, but given that most loans still remain floating, this is not considered to be a huge risk at the present time.

Shifting to yet another hue, we examine loan growth. While conduits have largely disappeared, competition among community banks remains fierce. Many bankers report they have seen an overall slowdown in business loan activity, but those that do surface seem to drive interest from multiple competitors. In short, loan growth has slowed.

Loan quality is another matter entirely. Most bankers report they are struggling with a handful of problem loans at this time and are also under increasing pressure to boost writedowns. Even experienced bankers are finding the level of delinquencies and charge-offs are now bumping up against levels not seen since the 1990's. It is clear from the 1Q data that we have not yet seen the end of the credit cycle and that losses are likely to get worse before they get any better. Our analysis shows that some sectors and geographic areas probably won't see a recovery for as long as 7Ys.

Capital is another area where many community banks have looked to apply a fresh tint of paint. Higher loan losses and credit issues are driving a corresponding surge in the search for capital. Unfortunately for community banks, the TRUPs market is now officially dead and few options exist. Regulatory and board pressure to get capital back to acceptable levels are adding additional pressure to management teams. As a result, some bankers seeking to avoid shareholder dilution have once again focused in on bank holding company loans or lines.

As we paint our final strokes on this canvas, we look to net interest margin. Many of our community bank customers are reporting tighter margins and some bankers are even dipping below 3% levels.

Unless and until funding converts back to some semblance of normalcy, this trend is likely to continue.

As we frame this picture and get set to hang it on the wall, remember that many painters had to overcome long odds, ridicule and heavy obstacles to become famous. As with painters, there are also many community bankers who know that will come out of the back end of this latest crisis stronger, faster, more nimble and more profitable than ever before.

BANK NEWS

Farm Bill

President Bush signed the 6th extension of the 2002 Farm Bill that will bring it to May 16th.

Customer Acquisition

Banks interested in capturing more customers should know a recent study finds the top 5 things business owners want from their bank are high quality customer service, help with personal banking, quality branch personnel, flexible loan terms and a fast response to credit requests.

Competition Update

The latest estimates indicate Bank of America has captured \$400mm in new deposits, 800k new checking accounts, 1mm new savings accounts and 4mm new customers from its "Keep the Change" program.

Online Customers

Studies find online customers are 27% more profitable than traditional customers, leave 15% higher deposit balances and 28% higher loan balances.

Recession

While the rule of thumb for a definition of a recession is 2 consecutive quarters of negative GDP growth, officially it is when the National Bureau of Economic Research ("NBER") says it is. The gov't agency uses GDP plus a number of additional factors such as personal income. NBER's hasn't made a decision yet, but is expected to shortly.

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