

SUMO BANKING

by [Steve Brown](#)

Sumo wrestling is a crazy sport but it also has a rich history thousands of years old (despite the fact that combatants wear only a diaper). In sumo, two athletes do battle as they try to push the other out of a circular ring. Many bankers tell us they have felt like sumo wrestlers lately, as they wage a battle of their own (probably not while wearing a diaper). The economy has been slowing markedly and risks continue to rise. One question we address today that we get asked often is just when do we expect things to settle down and begin to get better? Basically, everyone wants to know how long they will have to fight, trying to avoid getting knocked out of the ring.

To understand that better we focus on bank failures. Two more banks failed on Friday, taking the 2008 total to 19. At an average recent pace of about 4 per month, we project 2 more in Nov. and 4 or 5 more in Dec. If the trend holds, 2008 will deliver about 26 total bank failures. While 2009 failure projections vary, a little history might provide a guide. According to the FDIC, the year with the most bank failures was 1989, when 534 institutions were closed. At the peak of the S&L crisis (1988-1989), some 1,004 banks failed - producing a failure rate of 1 every 1.38 days. During 2009, some predict failures could reach 1,000 banks. We think that number is much too lofty, particularly given higher industry capitalization levels this time around. That is why we expect 2009 and 2010 to deliver somewhere on the order of 500 bank failures in total. Historically speaking, if 300 closures occur in 2009, it would be the worst year since 1990 (382 closures) and rank it in the top 5 overall over the past 40Ys. Next year is projected to be one of the toughest years bankers have faced in decades. As such, bankers should expect to have to fight even harder to stay within an ever-tightening ring.

Next, we take a look at the economy and more specifically - the unemployment rate. Last Friday, we saw the unemployment rate for Oct. rise to 6.5% (roughly a 6.6% increase over Sep. and a 35% jump from the lowest level of the year). Economists currently predict unemployment in 2009 could rise to somewhere around 7.5% to 9.5%. Again, working backwards and using history as a guide, we review recessionary periods with similarly lofty unemployment rates. We begin at the peak rate of 7.8% hit during Jun. of 1992 and find it climbed for 39 months prior to reaching that level. Going back even further in history from the peak of 10.8% reached in Dec. 1982, we see the rate climbed for an even longer 41 months. By assuming the same time periods hold true this time (since it appears we will spike to similar levels) and taking the middle ground of 40 months from trough to peak, projections show we will not hit the peak in unemployment (from the trough that began in May 2007) until Aug. of 2010. As such, bankers can expect that in 2009 they will be forced into the ring with a 400 pound opponent that is well rested, highly skilled and ready for a long fight.

Finally, we close by examining GDP, which came in most recently down 0.3% on an annualized basis in 3Q. Experts currently predict GDP will contract in 4Q of 2008, as well as 1Q and 2Q of 2009, before slowly moving higher. In all, expectations are for 2009 annual GDP to come in at a mere 0.5%. While GDP is predicted to rise slowly in 2010, growth is expected to be tepid, eventually reaching 1.5% to 2.0% when all is said and done. Simply put, general economic conditions do not look great for the next few years. Despite multiple congressional stimulus programs, housing is not expected to hit bottom until mid-2009, so it will take some time after that for the consumer to begin to rebound. We

project that reasonable economic growth will begin to return in late 2010. Again, bankers should prepare to battle it out for a longer period of time.

Whether you are a fan of sumo wrestling or not, it is important to recognize that when you enter the ring in 2009 the fight will be difficult and rest periods will be short. We bring this to your attention for one specific reason - understanding what lies ahead will help prepare your bank for the myriad of opportunities that will surely surface when such strains are placed upon the industry and the economy. If nothing else, you may want to consider renting inflatable sumo-style wrestling suits. At least when things get too stressful, employees can suit up and enter the ring to work off a little stress.

BANK NEWS

Closed

Franklin Bank, SSB (\$5.1B, TX) failed Friday marking the 18th closure this year. Prosperity Bank (\$6.8B, TX) will assume Franklin's deposits, 46 branches and only \$850mm in assets. This is the first bank to close in TX since the beginning of 2002. The expected hit to the FDIC fund is approx. \$1.5B. This bank had high concentration in residential mortgages and residential construction in addition to a high cost of funds.

Closed

Pacific Western Bank (\$4.3B, CA) acquired Security Pacific Bank (\$590mm, CA) under FDIC receivership. Security Pacific had almost 1 out of every 5 loans go into default. Back in 2006, margins were fantastic 6%+ and this bank racked up an impressive 30% ROE to be named as one of the top performing banks. More than 60% of their loans were in construction with the remaining in CRE.

Extended Comment

The FDIC has extended the comment deadline to 12/17 for part of the proposed calculation of new premiums that deal with risk. Since these calculations include a brokered CD surcharge, bankers are having much to say.

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