CALCULATING LOAN DEMAND

by Steve Brown

Researchers have found evidence that perhaps as many as 1 in 20 people suffer from "dyscalculia" or dyslexia with numbers. In fact, brain scans of dyscalculic people find reduced grey matter in areas of the brain known to perform math calculations. Dyscalculics have difficulty accurately counting change, balancing a budget, using a PIN, understanding interest calculations, following exchange rates and even performing basic math. They are typically people who also cede all money issues to others, as a result of this affliction. Suffice it to say that community bankers right now are suffering from this condition when it comes to lending, as the overwhelming weakness in demand is tough to add up.

Sure, it is easy to see why loan demand is weak, when you consider the underlying economy. After all, gross domestic product (GDP) for the 1Q was 0.4% and the 2Q was only 1.3%. That is an average in the first half of the year of only 0.85%. It takes at least 2.0% GDP just to stay even on unemployment, so we are well below levels needed to reduce it. Clearly economic growth doesn't add up to very much loan demand.

The numbers also show small businesses just don't want to borrow right now. The latest National Federation of Independent Business survey finds a whopping 92% of small businesses say all of their credit needs were met or that they were not interested in borrowing. Further, of the pitiful few who did make capital expenditures, 35% bought new equipment; 17% purchased new vehicles; 13% improved or expanded facilities; 9% bought new fixtures or furniture and 6% acquired new buildings or land. The survey shows weak sales numbers continue to depress small business borrowing.

Next, consider the numbers from the banking agencies regarding C&I loans of $1mm or less to small businesses. These loans fell almost 9% from 2Q 2010 to 2Q 2011 and are down almost 25% in the past few years. Recessions certainly reduce loan demand, but the latest one has led to one of the largest declines in some time. The numbers indicate businesses have sufficient cash on hand or just do not need more credit, given current business conditions. This is also one key reason community bankers throughout the country are seeing unexpected payoffs on some loans that seemed to be going along just fine and paying as expected.

People are also a critical component of the small business landscape. Surveys find 60% to 70% of people are concerned about volatility in the market, leading them to hold increasing amounts of cash. One study even found 62% of people said cash is an important part of their investment strategy, up sharply from prior survey periods. Another area impacting the psyche of business owners is their home. Given that housing makes up about 33% of the average household budget, falling prices leads to unintended consequences. Prices are already back to 2003 levels in most states, but most analysts predict it will take 5Ys to 10Ys for depressed markets to recover enough to give homeowners gains and allow them to sell. Finally, the typical business owner is still carrying too much debt, exacerbating problems. Studies find 64% of people in their late 50's and early 60's carry mortgage or home equity debt (up from 49% in 1989) and credit card debt is up 26% in the past 5Ys among those 65 and older. It is certain that money worries at home have leaked into the business, increasing fear and leading to more conservative positioning by business owners.

As you work through the numbers around strategic planning this year, it is probably safe to expect loan demand to remain soft. More marketing efforts will be needed just to grow loans slightly and more effort will be required to keep your best customers from paying off their loan. Have a plan that calculates your options, to better prepare to respond to this environment.

BANK NEWS

Earnings

U.S. Bancorp posted a 40% gain in 3Q to a record $1.27B (slightly better than estimates). The Bank did this by increasing top line revenue by 4.5% (largely through additional marketing and sales), while reducing charge-offs and delinquencies. Bank of New York Mellon, the world's largest custody bank, released 3Q earnings that were 4.7% higher at $651mm (or very slightly ahead of analyst's estimates). While low rates hurt margins and caused the bank to waive mutual fund fees, an increase in market share and an expense cutting program helped boost net earnings.

Geithner on SBLF

The Treasury Secretary went before the Senate Small Business Committee to be held accountable for SBLF. Geithner shared their frustration that the Program was not as "extensive" as originally designed, that it took way too long to distribute capital because of the coordination with the regulators that had to take place and that the Treasury was legally constrained to the reasons it could give for denial for fear of causing a disclosable event.

Lower Reserves

Taking a closer look at Wells Fargo's 3Q earnings report, we find the allowance fell from 3.23% as of Sep 2010, to 2.83% in 2Q 2011 to 2.68% as of 3Q 2011. That is a 17% reduction year over year. Meanwhile, for comparison (also from 3Q results), Citigroup reduced reserves by 28