100 Years Of The Fed

by Steve Brown

We are exploring some history in celebration of the 100th birthday of the Federal Reserve. Yesterday's discussion brought us through the time of dubious currency and numerous financial panics of the 1800's. In 1893 and in 1907, speculation borne crises were so serious that financier JP Morgan had to intervene to prevent a collapse of the economy.

By then, Americans were calling for major reform and were ready for a central bank with enough authority to ensure a healthy banking system. Congress established a commission to come up with a non-partisan solution in 1907. There were vastly differing views on how it should be structured. The money trusts in big eastern cities wanted banker control and progressives wanted public control.

The first draft, the Aldrich plan, was a banker-controlled, de-centralized bank meant to avoid the resentments that had brought about the demise of the First and Second Banks. President Woodrow Wilson added a central Federal Reserve Board appointed by the president and reporting to the US Senate that would control the regional banks. The result was a de-centralized central bank, with both public and banker controls. The Federal Reserve System ended up as a central board with 12 regional Reserve Banks. Just before Christmas in 1913, Congress and President Woodrow Wilson signed the Federal Reserve Act into law.

The initial function for the Federal Reserve was to be a money creator of last resort, the discount window was to assist troubled banks and prevent the type of financial panic that had come to dominate the US economy. But then World War I broke out and the Fed was ironically in a better position to issue war bonds than the Treasury so it did so under the direction of the Treasury.

During the 1920's the Fed began using Open Market operations, controlling the money supply as its primary monetary policy tool. A recession was averted in 1923, but there were not controls enough to avert the stock market crash of 1929 and the following Great Depression. The Fed was blamed for not stemming the speculative lending that led up to the crash and for not acting enough to lessen the depths of the Depression.

Numerous regulations came into place in the aftermath: the Glass-Steagall Act which separated commercial and investment banking, the establishment of the FDIC and creation of depositor insurance and the requirement that bank holding companies were to be examined by the Fed.

There have been variations of the role of the Fed since then, but most notable was the addition of the dual mandate of maximizing employment and stabilizing prices. The Fed works to achieve this primarily through setting short term interest rates, but in our very recent history we have seen long term asset purchases and other means employed.

The Fed has not managed to avert all speculation borne bubbles, though the 1800's certainly add perspective. Financial markets continually innovate new ways to create money, both prudent and not so prudent, so the Fed has its work cut out to anticipate and try to control those forces.

At its 100th birthday, the Fed begins a new chapter with a new chairman. Ben Bernanke has been in charge since 2006 and his term will expire at the end of this month. Janet Yellen will take over and we wish her well as she continues their important work.

BANK NEWS

M&A

Bay Commercial Bank ($327mm, CA) will acquire Community Bank of San Joaquin ($119mm, CA) for about $4.8mm.

M&A

Industry Bancshares ($2.4B, TX), the holding company of five TX banks, will acquire Bank of Brenham ($100mm, TX) for an undisclosed sum.

Earnings

PNC reported full year net income of $4.2B, up 41% from 2012. Other metrics on a year over year (YOY) basis: ROA 1.34% (+41%); ROE 10.55% (+41%); efficiency ratio 61% (-10%); revenue (+0%); loans (+5%); NIM 3.38% (-12%); allowance to loans 1.84% (-15%); non-branch deposit transactions via ATM and mobile 30% of total (+67%); consumers using non branch channels for majority of transactions 39% (+8%); ATMs 7,445 (+2%); branches 2,714 (-6%) and FTE employees 49,921 (-2%). Huntington reported full year net income of $639mm, down slightly from 2012. Other metrics on a year over year (YOY) basis: ROA 1.13% (-2%); ROE 11.0% (-4%); efficiency ratio 62.9% (-1%); revenue (-3%); loans (+6%); NIM 3.36% (-1%); allowance to loans 1.65% (-17%); ATMs 1,500 (+0%); branches 711 (+1%) and FTE employees 11,765 (flat).

Good News

Wells Fargo's CEO indicates he is hearing customers talk more about expanding their business and expects loan growth in 2014 to surpass 2013 as a result.

For Sale

The Treasury said it plans to sell $3B of Ally Financial stock, reducing taxpayer ownership to 37% after the sale.

Job Cuts

Flagstar Bank ($11.8B, MI) said it will fire 600 people as it seeks to reduce expenses.

No More

Regions Bank said it will stop offering its short term line of credit Ready Advance program to new customers next week and shut it down entirely by the end of the year. The bank was facing increased regulatory scrutiny over the program.

New Requirement

JPMorgan said it will require all customers making cash deposits into accounts held at its bank to provide identification and be listed on the account. The move tightens up money laundering risk controls. Community banks may want to consider this as well if you are not doing so already.