Happy Anniversary

by Steve Brown

We imagine bankers everywhere had a little cake and punch to celebrate last week. There seems to be a bit of confusion though because no one can recall the reason for a celebration. We wonder how anyone could miss the 5th anniversary of the beginning of the current economic recovery! Ok, we hear your grumbling in the background and a snide remark: 60 months of expansion must be taking place in some market other than mine. There is no question that the recovery has been lackluster in most every way.

Stepping back for a moment, we remind our readers that the standard definition of a recession is two successive quarters of negative GDP growth, but the most recent recession was far longer. The Great Recession lasted from December 2007 to June 2009 and was by most measures the worst economic downturn since the Great Depression. Since then, the pace of the recovery has been slow and uneven, even with massive efforts to rescue and pump up the financial system by the Federal Reserve.

The post-recession economic expansion as measured by GDP during this period has been the weakest of the post-WWII era. In fact, it has only risen by about 50% of the average. When comparing both economic output and employment changes, we further find that 60 months after the recession began, the recovery by either measure is significantly weaker than the 10 other post-war recessions.

Job losses as well have been unprecedented and the economy has only recently recovered the 8.7mm jobs that were lost. One could argue that even this is hardly a measure of a return to normal when one considers population growth over that period. For its part, the unemployment rate rose higher than in the last two recessions, but the subsequent drop to its current level does not take into account underemployment (people who have taken part time jobs but want to be employed full-time). Finally, consider the participation rate or the ratio between the labor force and the overall size of the population. It has remained at its lowest levels since the 1970s. In summary, the labor market remains weaker than it was at the beginning of the recession and the Fed knows this.

If this isn't enough to consider, we note the financial press is even beginning to focus on the average period of economic expansion between recessions. As with most arguments, choosing the data to make a point is important and in this case, how far to go back in history is the question. For instance, the average duration of an economic expansion if one goes back to 1854 is 39 months, while the average post-WWII expansion has been 58 months. By either measure, our current recovery now at 60 months may be getting long in the tooth.

Before things get too negative, however, we note that there have been much longer periods of economic expansion if history is any guide. Certainly many of them have been associated with major wars and the following periods of reconstruction, but others have not. Consider that one of the most recent long runs was 120 months from 1991 to 2001. Certainly, the final Q1 2014 GDP number at negative 2.9% was an eye-opener, so concerns are bubbling around but everyone is hopeful Q2 will bring much better news. There are places in the U.S. now seeing strong growth, most notably those involved in oil and gas or with the technology industry. Still others are making slow progress while some are still bumping along the bottom.

Since we as a country have never been here before and since there is so much noise in the system from Fed actions to prop up and stimulate things, it could be strange for awhile. In the meantime, we sincerely hope that the next recession is not just around the corner and frankly, we don't believe it is. As always, we suggest community bankers focus efforts on providing quality products and services to business and individual customers and let the pundits worry about the rest. That said, as prudent risk managers, we would be remiss if we didn't also remind community bankers to stay flexible, monitor conditions and remain prepared just in case. It may not come for awhile, but history has provided us with the examples above that are worthy of considering.

BANK NEWS

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Towne Bank ($4.8B, VA) will acquire Franklin Financial ($1.1B, VA) for about $275mm in stock.

Q2 Earnings

JPMorgan Chase reported net income for Q2 of $6.0B vs. $6.5B for the same period last year. Net income changes YOY: net revenue (-3%), pre-provision profit (-3%), noninterest income (-6%), interest income (-2%), interest expense (-13%), allowance for loan losses (-21%). Balance sheet changes YOY: assets (+3%), loans (+3%), securities (+2%), deposits (+10%), preferred stock (+61%), common stock (+0%). Other metrics YOY: Return on common equity 11% (-15%), ROA 0.99 (-9%), LTD ratio 57%, employees (-3%), compensation expense (-5%), technology (+5%), marketing (+12%) and NIM 2.11%.

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SNL Financial reports negotiated transactions accounted for 68% of volume in 2013.

M&A Targets

Deloitte research finds once interest rates begin to rise, banks that have strong deposit franchises and weaker loan growth are likely to become targets.

Risky M&A

Cornerstone Research reports that 90% of all mergers and acquisitions at publicly traded companies result in lawsuits.