It's Shrinking!

by Steve Brown

We regularly travel around the country visiting banks and attending banking conferences, so we know a thing or two about traveling. This is a big country, so air travel is required much of the time and while it is rarely a pleasure, we pretty much have the system down. Most regular business travelers know how to take only what is necessary and to be sure it fits into luggage that meets the carry-on requirements. So for all travelers out there, we wanted to weigh in on the unwelcome news last week from the IATA, an association of the world's big airlines. They announced new recommendations for a global standardized size for allowable carry-ons. It probably comes as no surprise that the new recommendation shrinks the size of what is allowed from an already small size to something about 20% less. This means that people will either be packing lighter or checking more bags, which at $25 per bag will be a nice fee generator for the airlines.

Similarly, there is a notably tighter supply of Treasury bonds of late and the lack of depth in the market has caught the eye of bond traders and fixed income strategists. Wait a minute, haven't bond yields been increasing lately and therefore the market is selling off? This is true, but the volume of Treasuries and mortgage backed securities (MBS) that are turning over is significantly less than what used to be typical. One NY trader characterized the market as "not functioning as normal".

Regulators seem to be content to just monitor things for now until fluctuations become even more significant, but they are paying attention. There has been a lack of supply for some time now, and at least part of its origin can be attributed to the enormous quantity of bonds that the Fed bought in its quantitative easing programs. In addition to Treasuries, the Fed purchased large quantities of MBS and many bank portfolio managers were impacted by that lack of supply in their efforts to purchase bonds that met bank policy guidelines. In addition to Fed purchases, foreign central banks have been buying Treasuries to bolster their currency reserves. Finally, higher corporate debt issuance, lower inventories and low interest rates have contributed to an increase in volatility.

How significant is the drop in volume? Deutsche Bank estimates that the average proportion of the market that changes hands on a daily basis has slumped about 70% since its peak before the crisis. JP Morgan estimates that Treasury volume for 10Y notes has averaged about $171mm daily over the last 8Ys including during the financial crisis, but over the course of the past year, has averaged only $116mm. This means is that the ability of investors to move large chunks easily without causing significant market moves is diminished. In fact, there was one day last week when PIMCO, the world's largest fixed income manager, sold large quantities of Treasuries and yields rocketed. Whether this was caused only by PIMCO's sales or by copycat investors as well, the effect on yields was greater than one would expect in what is considered the world's most liquid market. The rise in yields has made Treasuries more attractive to purchase for banks and for other investors though, and last week's auctions saw strong demand.

Community bankers mostly aren't actively trading the fixed income market, so daily volatility isn't an enormous concern at least at first glance. However, it should be noted that interest rate volatility will affect community banks as both lending and deposit rates move as the markets (and large banks in turn) move. Bankers should look beyond the noise, but expect both volatility and a general upward trend as the Fed prepares to begin a tightening cycle.

Who would ever think that the Treasury market would become like space on an airplane - in tight supply? If the new carry-on recommendations are implemented, we fear that we will be bringing fewer clean shirts to conferences, so it looks like we will have to be much more careful when eating.

BANK NEWS

NIM

If you use the NIM compression that has occurred over the past 1Y (Q1 2015 vs. Q1 2014) for large banks and assume the pace continues at the same percentage decline, NIM will break through the 2.00% floor level in 2Q or 3Q of 2018.

Huge Impact

Reuters reports 20 of the world's largest banks have paid more than $235B so far in fines and compensation in the past 7Ys related to issues around the credit crisis. Interestingly, Bank of America has paid out 2x as much as any other bank (at $80B).

Lower Gas Impact

The Fed indicates the annual savings in gasoline costs has been about $700 per household on average.

Risk Oversight

A Deloitte survey of global risk managers finds the Top 5 oversight activities performed by the institution's board or risk committee are: approving the enterprise level risk appetite statement (89%); reviewing regular risk management reports on the risks facing the organization (86%); reviewing and approving overall risk management policy and or enterprise risk management framework (84%); reviewing and approving the organization's formal risk governance framework (83%) and reviewing corporate strategy for alignment with the risk profile of the organization (80%).

Municipal Flows

The Municipal Securities Rulemaking Board (MSRB) reports as of Q1, municipal securities trading volume tanked 13% YOY.

Economy

The World Bank projects the US economy will grow 3.2% this year vs 2.4% in 2014.

Happy Employees

A survey by TINYpulse from employees at more than 500 companies finds 34% of the happiest employees say their peers and colleagues are what drive their workplace satisfaction. Having events now and then that allow employees to interact and have fun still make good sense it would appear.