Central Bank Actions Wake Up Banks

by Steve Brown

Did you know that when it comes to sleep, Americans get the following: 5 hours (12%); 6 hours (24%); 7 hours (30%); 8 hours (20%); 9 hours (4%); less than 5 hours or more than 9 (10%). Now that you know how you rank when it comes to hours slept, we thought you might also be interested to know that studies find 52% of Americans sleep partially clothed, 31% sleep fully clothed and 17% sleep naked. We wonder what these results look like when you go around the world.

Speaking of going around the world, today we take a look at central banks, and the amounts of cash and assets they have stockpiled over the years. Here we find that Bloomberg reports central banks have been compiling assets over the past year at the fastest clip since the European debt crisis and now hold a whopping $21.4T. That amount represents a 10% increase over the previous year, which is more than triple the annual rate of increase in 2014 and 2015. Summing it all up, central banks now hold assets worth 33% of the value of all the stocks in the world, according to Bloomberg.

As you might expect, most of those assets are held by just a few of the world's largest central banks. These are led by China ($5.0T); the US Federal Reserve ($4.5T); the Bank of Japan ($4.4T), and the European Central Bank ($3.9T).

As those central bank assets continue to pile up, it can become mind-numbingly unreal. It makes the assets held by a $1B community bank look like chump change. The question for this morning is whether it really matters to a community banker if the Fed holds $4.5T in assets.

The answer is that it certainly can matter. One of the key roles that modern central banks play is to provide some measure of economic stability and to stimulate growth when economic activity stalls. When central bankers actively load up on assets, they are taking action to reduce rates and stimulate the economy. When they eventually unwind these positions, rates should rise. The issue here is that we have never seen the US central bank (or others for that matter) hold such large positions so no one is quite sure what will happen when the unwinding begins.

Here in the US, most would say the economic recovery has been slow. That and a desire to keep volatility under control are key reasons why the Fed has reinvested cashflows into the assets it holds. The effect of this economic stimulus program has been to keep interest rates extraordinarily low, but now that trend has begun to slowly reverse itself.

Part of the impact of this shift has been for investors to move money out of fixed income assets and into the stock market, resulting in record levels for stock prices. That is good for community bank stock prices too, but to a lesser extent than highly liquid large bank stocks.

Rising rates can be good for community banks, but they can also be bad. If rates don't rise very quickly, as has been the case, loans sitting on floors don't move, while deposit costs slowly creep higher. This puts a squeeze on margins and can be bad for some banks. Further, banks that hold more fixed rate assets can also get squeezed in this scenario. These are also key reasons why bank regulators are so focused on interest rate risk, funding sources and how much asset duration has extended at banks.

As you ponder that, consider as well that the US Fed obviously also does not operate in a vacuum. Sluggish economic growth overseas and the actions those central banks take in response can have an impact here.

Increasingly optimistic speculation that the Fed may finally be ready to adopt some meaningful interest rate increases could provide needed relief to community banks. But the rapid rise in central bank asset purchases this year suggests it may take some time for real progress to occur. In the meantime, community banks should look for every opportunity to take advantage of this shift as central banks continue to influence the global economy. Hopefully our discussion today will also help you get some sleep.

BANK NEWS

Tech Advantage

Research by Korn Ferry finds 63% of CEO respondents believe technology will become their company's greatest source of competitive advantage in the future.

Retail Risk

Bankers should check their loan portfolios for extended exposures that could occur as a result of women's apparel retailer Limited Stores LLC saying it will close all of its 250 stores nationwide.

Nest Egg

Research by the Transamerica Center for Retirement Studies finds the typical baby boomer has a median total of $147,000 in all of their retirement accounts.

Flexible Working

It is estimated about 80% of all US companies now offer flexible work arrangements, including telecommuting, part-time work options and having flexible hours.

Director Replacement

PwC research finds 65% of surveyed directors say they do not have any board members who should be replaced, while 35% think otherwise. Of the group that felt a member should be replaced, reasons cited included: being unprepared for meetings (25%); not having the expertise required (17%); aging has led to diminished performance (12%); oversteps the boundaries of his/her oversight role (12%); and serves on too many boards (6%).