Top Five Trends For 2022

economy   digital banking   Mergers and Acquisitions

Summary: As we kick off 2022, let's look ahead at some of the key economic, regulatory, and market trends that may affect community bankers and their clients this year. The uncertainty surrounding inflation, potential interest rate hikes, and the outlook for M&A activity all are likely to play an impactful role this year. Others that we believe could begin to grow even more prominently are the digital race and ongoing changes to the ways of working. Here is our assessment of things to come in 2022.

Since ancient times, humans have tried using various types of divination in an attempt to predict the future. Felidomancy, also known as Ailuromancy, is one of the more unusual divination techniques used over the ages. Favored by the ancient Egyptians, Felidomancy practitioners claim to be able to predict the future by observing the behavior and movements of cats.

If you are expecting to hear our predictions based on cat behavior, we are sorry to disappoint you. Instead, we look for clues from economic indicators, recent events, and market forces. Here is our assessment of things to come in 2022.

1. Inflation uncertainty

In November, wholesale prices soared 9.6%, which is the fastest on record, causing a 39Y high in consumer prices. Fueled by a host of factors such as ongoing supply chain issues, higher house prices and rental costs, labor shortages and wage increases, and rising energy costs, it's proving difficult to predict what the inflation rate will do this year.

Some may still believe this increase is transitory; as consumer spending rebalances towards services and supply chain issues are resolved, inflation should be reduced throughout 2022. But the ongoing uncertainty regarding the pandemic's trajectory (particularly given the arrival of the new Omicron variant), continued labor shortages, and a continuing tight housing market mean that the inflation outlook is in the balance. After its December meeting, the Fed indicated that it is planning on pulling back on its bond-buying more quickly. "*Economic developments and changes in the outlook warrant this evolution of monetary policy, which will continue to provide appropriate support for the economy*," said Chairman Powell after the December meeting.

2. Rising interest rates

In its December meeting, the Fed decided to keep the fed funds rate at 0% – 0.25%. However, given the accelerated decrease in its bond-buying, interest rate hikes could be occurring earlier in the year. Some predictions suggest the first rate hike will happen within the first six months of 2022, while others, like JPMorgan, believe September 2022 is more likely for the first rate hike. JPMorgan economists say they expect increases of 25bp every quarter thereafter. The latest forecasts are for the interest rate to run between 0.5% and 0.75% in 2022.

With rate increases expected to be modest, they could have a limited impact on commercial borrowing and repayments. Even at 0.75%, rates are comparatively low, allowing businesses to still invest in equipment and expansions, as needed.

3. Intensifying digital race

Competition within the banking sector continues to intensify in 2022, with a key differentiator being technology solutions that offer a hyper-personalized, accessible, and seamless user experience. In November 2021, the Financial Brand's Digital Banking Report found that 57% of financial institutions surveyed had their digital services partially deployed or fully deployed and meeting customer expectations. That means 43% are in varying stages of digital transformation. The stakes are high to continue the digital journey.

Those community financial institutions (CFIs) that aren't already doing so may want to consider investing in technologies to support and improve their digital customer experience, back-office efficiencies, ability to innovate, and security. In 2019, 35% of banks and credit unions had invested in APIs, while in 2021, 47% had. This year, we agree with other experts that the number is expected to grow to 72%. Open banking, APIs, artificial intelligence and machine learning, cloud computing, and cybersecurity are just some of the areas that CFIs should be researching to retain their competitive advantage in 2022 and beyond.

4. Strong M&A

Given the tight market conditions and acceleration towards digital, it's no surprise that 2021 has seen an increase in partnerships and collaborations between CFIs and fintechs. This trend is expected to continue to provide innovative and personalized digital banking solutions alongside core in-person offerings. According to a Capco study, 72% of banking customers in the US consider "a personalized experience as highly important" and CFIs know this better than other institutions.

M&A activity within banking is expected to be strong throughout this year. Aggregate deal value during 2022 is predicted to be close to $60B. Further M&A activity will likely be driven by the continued pressure to evolve and meet the challenges of a low revenue and strengthened regulatory environment.

5. Remote work and labor shortages

Flexible, hybrid, and remote working are likely to persist during 2022 and beyond, particularly as the pandemic continues to ebb and flow. People are increasingly choosing to work from home on a permanent basis. Some large companies are planning to transition to remote working over the longer term. Employers in all industries and geographies need to continue monitoring this labor trend to best implement their own work schedules and policies, especially with the tight labor market. Citibank estimates it will get even tighter in 2022 — with 20MM US job openings vs. 15.7MM in November 2021.

With these continuing labor trends, we recommend that CFIs estimate how much these trends will affect their business customers, in addition to their own operations. Small businesses need to think about their business model carefully when looking for employees, remote or not. With a tight labor market, some creativity may be needed. Many small businesses have pivoted nimbly with the pandemic and can shift again as needed. Others may need to reassess their operations (and possibly add more automation) in order to accommodate new workforce expectations and continuing labor shortages. Watching how this plays out in different industries will help CFIs in their conversations with customers and mitigate potential loan risk.

We believe these five trends should be on bankers' minds as they enter 2022. While this year is expected to be less volatile than the past 2Ys, you never know what the Felidomancy practitioners and the cats may come up with to shake things up. Stay tuned with us throughout the year as events unfold.

PCBB NO LONGER USING LIBOR FOR NEW BUSINESS

As of January 1, 2022, in accordance with Fed guidance, PCBB is no longer entering into LIBOR-based transactions. Fed funds and SOFR are available for both scenario planning and transaction execution. Visit our SOFR Resource Center for more information on this new index.

ECONOMY & RATES

Rates As Of: 01/03/2022 12:14PM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.06	0.01	-0.03
6M	0.19	0.09	0.10
1Y	0.39	0.00	0.00
2Y	0.78	0.04	0.04
5Y	1.36	0.10	0.10
10Y	1.63	0.12	0.12
30Y	2.02	0.12	0.12

FF Market	FF Disc	IORB
0.07	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.07