CFIs Scramble To Keep Profits Up

profitability deposits

Summary: Deposit drains, rising interest rates, and tougher times for business loans put pressure on CFIs' bottom lines. Profits promise to be tougher to generate in 2023. We review the current state of deposit growth.

A lot can change in a matter of a few years. Digital media company BuzzFeed became a publicly traded company just last year, after years of positive growth. BuzzFeed News even won a Pulitzer Prize in 2021 for its reporting. Yet BuzzFeed announced late last month that it was shutting down its BuzzFeed News division and cutting 15% of its staff due to lack of funding.

Funds and profit are very much on the minds of bankers these days. The bank shakeout, along with ongoing financial pressures, may start taking a bite out of financial institution profitability. That situation would represent a reversal for community financial institutions (CFIs), which entered 2023 in much better shape.

The Slowdown of 2023

CFIs, which ended 2022 showing solid loan growth and positive returns on investments, are now facing challenges stemming from slowing deposit growth that could pinch the ability to expand loans. Those pressures could put a damper on profitability.

One possible catalyst for rising difficulties was the handful of financial institution failures this spring. Spooked by the collapses and lured by rising deposit rates by non-bank entities, depositors fled financial institutions, particularly smaller ones. This resulted in the shedding of $119B in deposits — the largest drop on record.

As a group, financial institutions with assets under $10B ended 2022 with improved performance YoY in average return on assets, as well as on net interest margins and efficiency ratios. As for deposits, these smaller institutions had higher deposit levels at the end of 2022 than levels from the previous year. However, deposit growth had already started slowing even before the spring financial crises.

Deposit Increase Attempts

Scrambling to stem the outflow of fleeing depositors, CFIs have been offering higher returns on deposits, which in turn undercuts profits. Smaller financial institutions (those outside the 25 largest banks in the country) have also borrowed more to build up their reserves, perhaps in case they experience runs on deposits, which contributed to the financial institution failures.

CFIs had been expanding their loan portfolios aggressively in 2022. That trend looks to slow considerably as financial institutions look to build up deposits. Some institutions are curtailing loan originations, while others are offering more certificates of deposit that pay higher rates. Seattle-based Home Street Inc. is taking a multi-tiered approach to the situation. They are not only sharply reducing loan originations and offering promotional rates on deposits, but also buying three branches in San Bernardino, California.

A Look Ahead

Further complicating matters is the prospect of a general economic slowdown (and possible recession) as the Fed tightens interest rates to try to calm inflation. One result of an economic slowdown would be a rise in problem loans. According to one report, provisions for anticipated charge-offs are expected to rise to 11.8% of net revenue in 2023, from 6.4% in 2022.

The hope is that the fallout has ended. Treasurer Janet Yellen offered some insight, noting that while some regional banks are seeing dips in stock prices, the market overall is secure and deposits have stabilized. While the message encourages optimism, it remains to be seen how much of an impact all this will have going forward.

Of course, there is still a lot of 2023 left to go. If pressures on local financial providers ease and the general economic picture improves, CFIs might get enough breathing room to go about their business of making money by extending credit to businesses and consumers. In the meantime, though, it is prudent to be cautious and protective about your bottom line.

Profits promise to be more elusive in 2023 as CFIs face a host of challenges. But if the fallout from recent bank failures is contained and the Fed gets inflation under control, then you may have an opportunity to start growing profits again.

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ECONOMY & RATES

Rates As Of: 05/16/2023 07:08AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.21	0.11	0.79
6M	5.24	0.18	0.48
1Y	4.74	0.01	0.04
2Y	4.02	0.01	-0.41
5Y	3.49	0.01	-0.51
10Y	3.54	0.11	-0.34
30Y	3.88	0.20	-0.09

FF Market	FF Disc	IORB
5.08	5.25	5.15
SOFR	**Prime**	**OBFR**
5.06	8.25	5.07