Top Predictions for CFI Trends in 2024

cyber security credit economy artificial intelligence liquidity

Summary: We interviewed industry expert and PCBB's President Mike Dohren about the key trends CFIs should look out for in 2024, including increased cyber risk, funding and liquidity struggles, and credit quality.

We can't know with 100% certainty what 2024 will bring to the banking industry, but a look at historical data and current trends can give us a more targeted and accurate sense of what the next year may bring. To get an expert point of view, we interviewed PCBB President Mike Dohren — who has 25Ys of experience with finance, accounting, and community banking — about the key trends he thinks will affect community financial institutions (CFIs) in 2024.

The Cyber Risk of AI

Artificial intelligence (AI) is gaining widespread use across multiple industries, including cybersecurity organizations, but not every entity taking advantage of its capabilities has good intentions. Among other still-evolving implications, we expect that AI will also enable cybercrime. AI is a huge advantage to anyone looking for account login information, as it can comb through more data at a higher speed than existing technology. Generative AI has also allowed for more sophisticated phishing attacks to gain access to sensitive information.

"Assume that your bank or credit union isn't perfectly impenetrable and that eventually someone will get in," Dohren says. "More sources are trying to get in than trying to keep thieves out, and scammers are learning from what they've already tried and refining their approach." CFIs should design safeguards to ensure that thieves can do as little harm as possible should they gain entry.

Other forms of online security, including secondary authentication, are also important protections. "We expect account and system security to rapidly evolve in the coming year," Dohren says.

Inflation and Long-Term Financing

Bank failures demonstrated just how quickly depositors can move their money; higher interest rates have given them a reason. "A large part of financial institutions' base has been trained to be more interest-rate sensitive," Dohren states. "They're more willing to shop around. That means smaller institutions are at more risk of losing deposits or may have to pay more to keep them."

It's difficult to know how regulators will look at liquidity during the next exam cycle. They may see once-stable deposits as iffy. CFIs should work to understand their true stable deposit base, as well as where they might seek contingent liquidity and under what circumstances.

As of mid-November, the Federal Reserve expects to make no changes to the current rate, although their next rate decision will come on December 13. This comes with an underlying inflation rate of 4%, still above the Fed's 2% target. Because of this, the chances that they will raise rates are low, but not zero — some Fed officials have hinted that a future increase might be possible in early 2024.

If that happens, it may mean that the interest rate curve will be inverted for some time. “This is the longest period on record with an inverted interest rate curve,” Dohren says, “which incentivizes borrowers to seek longer-term financing at a fixed rate, rather than shorter-term or floating-rate financing.” CFIs will find it difficult to base their margin on lending at long rates and paying for funds at short rates, which may squeeze profitability. Some financial institutions may even trim overhead. “That could be tough in a tight labor market,” Dohren adds.

Recession Vs. Soft Landing

Much ink has been spilled on the question of whether the economy will go into recession or come to a soft landing. “Recession is a technical term for economists,” Dohren says. “We’re in a slowing economy, and that’s what matters.” Consumer spending can’t continue at its previous speed, particularly as higher interest rates make buying on credit more expensive.

Financial institutions should plan for a slowing economy. “Look for opportunities in your own economic microclimate,” Dohren says. Many people have relocated or will relocate in the post-pandemic US, spurring investment and stirring the economic pot.

Business Lending Challenges and Opportunities

Economic uncertainty and higher interest rates mean that business lending is in a tough spot. Because workers have not yet fully returned to offices in the pre-Covid-19 capacity, loans to commercial landlords and owners of downtown businesses are both challenged. Some cities will find ways to get more people downtown again; others will not.

“Office lending is the hardest hit and we’re expecting defaults next year,” Dohren states. “Companies might need half the space they did before the pandemic.”

Dohren says he sees lending opportunities in industrial, medical, and the right retail, especially with anchor tenants. Consumers still want to shop in person, and retail stores are finding ways to thrive in different markets.

Spreads are wider than their historical norms in multifamily housing, an area with a lot of opportunity — and competition. Interest rates are higher, but landlords have been able to raise rents. This is historically a lending sector with low losses, a trend we think will continue in 2024.

Some financial institutions have moved away from growth as a primary objective and are loaning exclusively or mostly to existing customers. They are deploying the liquidity that they have, rather than looking for the deposit growth they’ve enjoyed over the past few years. “Financial institutions can’t deploy funds they don’t have,” Dohren says.

Financial institutions will see more and more nonbank competition for lending. “There’s so much money on the sidelines, looking for a place to invest. All the money that used to go downtown has to find a home," Dohren adds.

Private equity companies are now competing for loans and have identified opportunities in multifamily housing that have the potential for price appreciation when interest rates come down. The US housing shortage has created an environment where private equity firms can thrive, especially as they are not bound by the same rules that CFIs follow.

Private equity firms typically focus on the larger deals that CFIs used to dominate, which may make some of those loans less available to CFIs in some markets.

Taking Care of Small Businesses

In addition to the lending opportunities we've mentioned, we see room for CFIs to make up for some margin shrinkage and earnings compression by delivering more solutions either directly to small businesses or via banking as a service. Greater wallet share awaits CFIs that successfully evolve their existing high-touch service into the digital space.

Inventing new services for small businesses is also fertile ground. "Listen to your small-business customers. They may not be good at telling you what they need, but they're good at telling you what's currently driving them crazy," Dohren suggests. Solving that pain point can bring your CFI non-interest income and help cement customer loyalty.

Keeping up with an industry-wide revolution in domestic and international faster payments is both defensive and a way to earn new business. As a first step to offering faster payments, many CFIs will either adopt FedNow® Service or the Clearing House's RTP® for incoming payments. The ability to request payments can make business owners' lives simpler and put money in their accounts faster. CFIs that aren't considering this will miss an opportunity — and business could go to nonbanks instead.

Summing Up

A proactive, forward-thinking approach will be the right mindset to adopt as we turn the page to 2024. Embracing — and preparing for — AI and other technological capabilities, considering what partnerships could benefit your business, planning for a slowing economy, navigating nonbank lending competition, and devising small business solutions are some key areas to be mindful of. Creating the road map now will ensure that you are ready for what the future will bring.

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ECONOMY & RATES

Rates As Of: 12/12/2023 06:37AM (GMT-0800)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.47	0.02	1.05
6M	5.40	0.02	0.64
1Y	5.12	-0.01	0.42
2Y	4.73	0.05	0.30
5Y	4.26	-0.01	0.26
10Y	4.25	-0.08	0.37
30Y	4.34	-0.15	0.38
FF Market	**FF Disc**		**IORB**
5.33	5.50		5.40

SOFR	Prime	OBFR
5.32	8.50	5.32