

CEO, CCO, CFO  
Top Banker Panel 2019



CALIFORNIA COMMUNITY  
BANKING NETWORK

## **Industry Thoughts**

*By Steve Brown, PCBB  
November 4, 2019*

# First – Thank You and Congratulations!

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- Thank you!

- *To David, Kandy and the team at California Community Banking Network for hosting such a great event*

- Congratulations!

- *To everyone here for being identified as a Top Community Banker*



# A Different Type of Metal

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- What is the strongest natural metal?
  - Tungsten – highest melting point, highest tensile strength
- What is the hardest metal?
  - Chromium – best scratch resistance of all the metals
- What is the most useful strong metal?
  - Titanium – highest strength to weight ratio all the metals
- Community banking takes ‘mettle’ of a different sort
  - Spirit, fortitude, tenacity, resolve, fearlessness, grit...

# Still A Good Underlying Economic Engine

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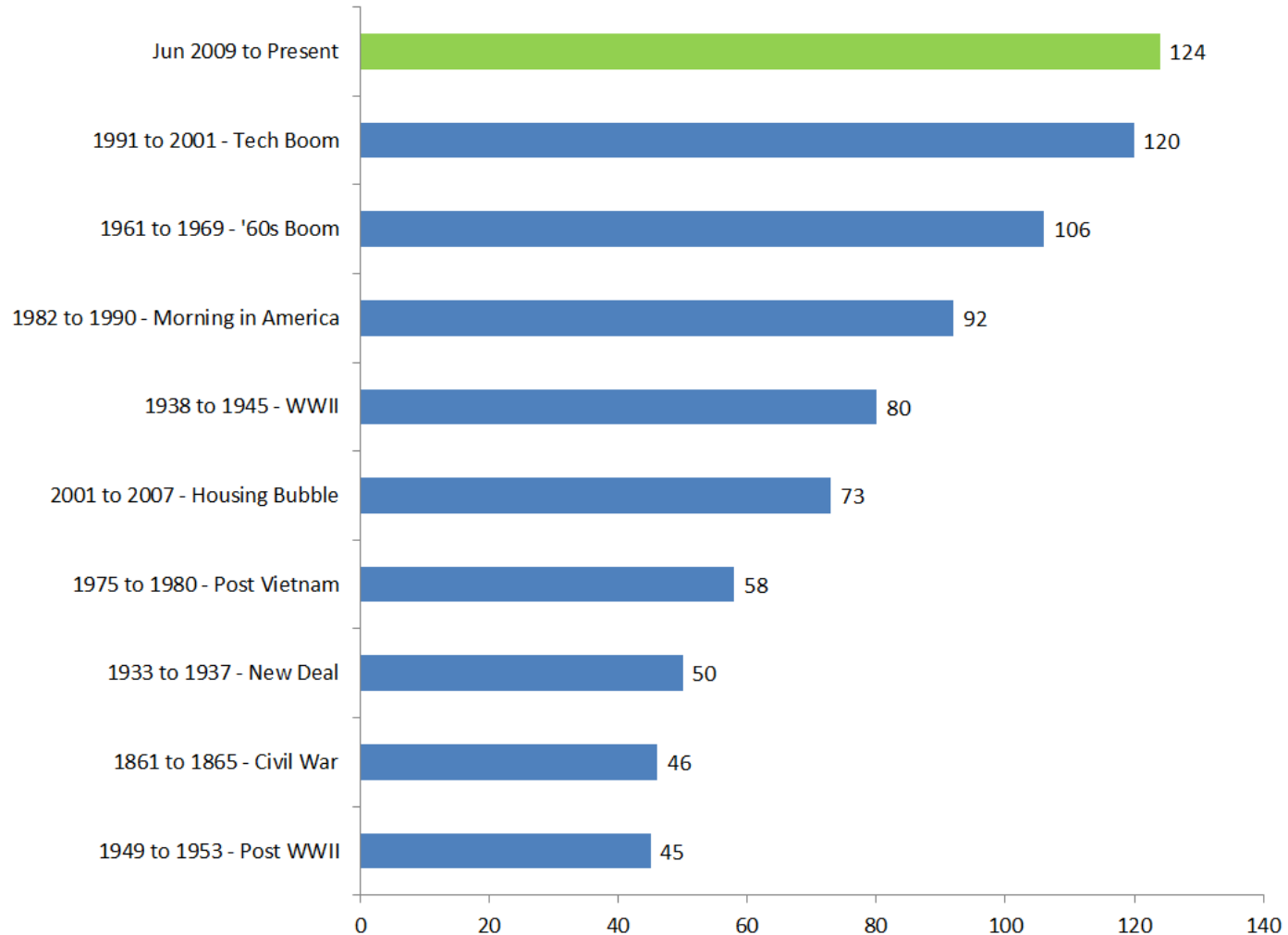
- US economy is slowing but still expanding
  - Annualized GDP rate of 1.9% for Q3 vs. 2.0% in Q2
- Consumer spending is two thirds of the economy
  - But it is 91% correlated to economic growth and it continues to show resilience and underlying strength
- Consumer unemployment is at a 50Y low of 3.5%
  - Supports higher wage growth, which are at the best levels in 10Ys+

# But Cross Currents Continue

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- Manufacturing is weak due to trade war, slowing global economies, Boeing issues and GM auto strike
  - But, it is only 11% of GDP and 8% of employment AND
  - China/US trade war is making good progress/less tense
  - Boeing issue looks to be in 8<sup>th</sup> inning now
  - GM strike has ended and Ford/Chrysler will soon match
- So – that leaves slowing global economies, geopolitical and political risks
  - Should improve some with China/US trade deal
  - But Middle East and Hong Kong remain dicey
  - US politics remains very heated

# Longest US Expansions (months)



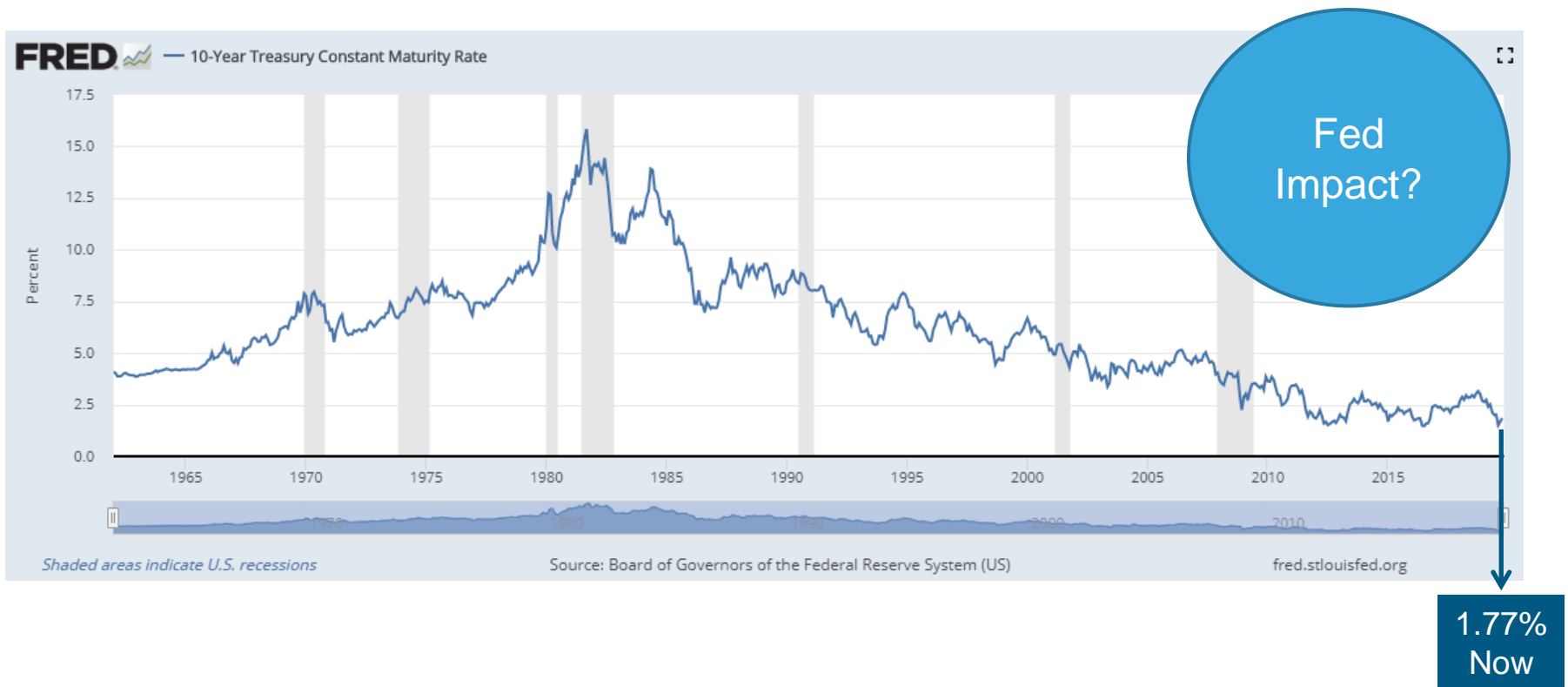
# Demographic Impact is Huge

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- Millennials – 2019 became biggest living US generation:
  - Next year = 50% of workforce
  - Biggest group is now just over 30Ys old
  - Recession and student debt delayed big ticket spending
  - Waited to get married, buy a house, car, and have children
  - Wave is just starting and should rise through 2025
  - PLUS this group is 45% more likely to say they ‘love to shop’ than other generations
  
- Boomers – 2019 fell to 2<sup>nd</sup> biggest living US generation :
  - Retirement wave continues
  - Spend money on travel (4-5 trips per year), pets, housing, food
  - 70% pay some portion of children’s college tuition

# Demographic Impact on 10Y Rates

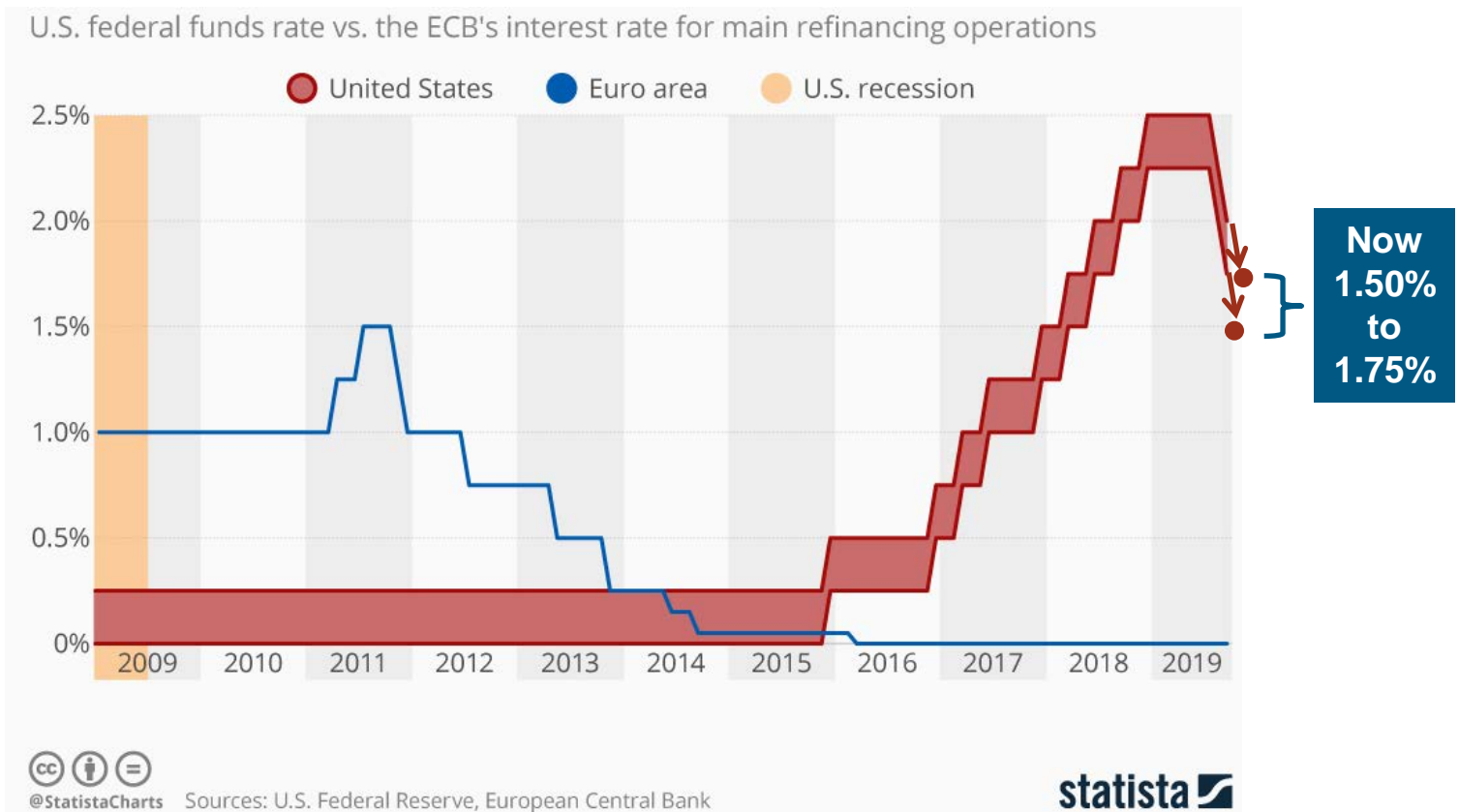
- Increasing life expectancy keeping rates lower for longer, boosting saving, and keeping inflation down





# Fed Action on Short Rates

- Mid cycle adjustment done as of this week's meeting (now 1.50% to 1.75%) so will wait and see



# Good Stuff, Bad Stuff

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**Good:** Economy, banking industry, consumer, demographics...



**Bad:** Trade wars, volatility, Twitter effect, ignoring fundamentals, Europe weakness...

# Thought Bubbles to Ponder

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- Can rates go negative in US?
  - Is it likely – short and long?
- What is bottom on 10Y for community bank profits?
  - What happens below that level?
- What is the current cost of capital for community banks and what is the expectation for 2020?
  - What actions will banks have to take as a result?
- Others for discussion?



# Bank Concerns 2020+

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- Acquiring new customers
- Margin compression
- Recruiting and retaining talent
- Funding costs, pricing and growth
- Liquidity
- Quality loan growth
- Cybersecurity

*...Any others missing?*

# Likely 2020 Bank Actions – Part I

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- Belt Tightening – job cuts likely as fine tuning picks up, rates decline and NIM gets compressed – big banks are already doing this
- M&A – more selling expected particularly if rates stay soft or decline further – activity is picking up
- More Technology – spending will continue as banks work to keep up with customers – this comes at a cost so need to get results

# Likely 2020 Bank Actions – Part II

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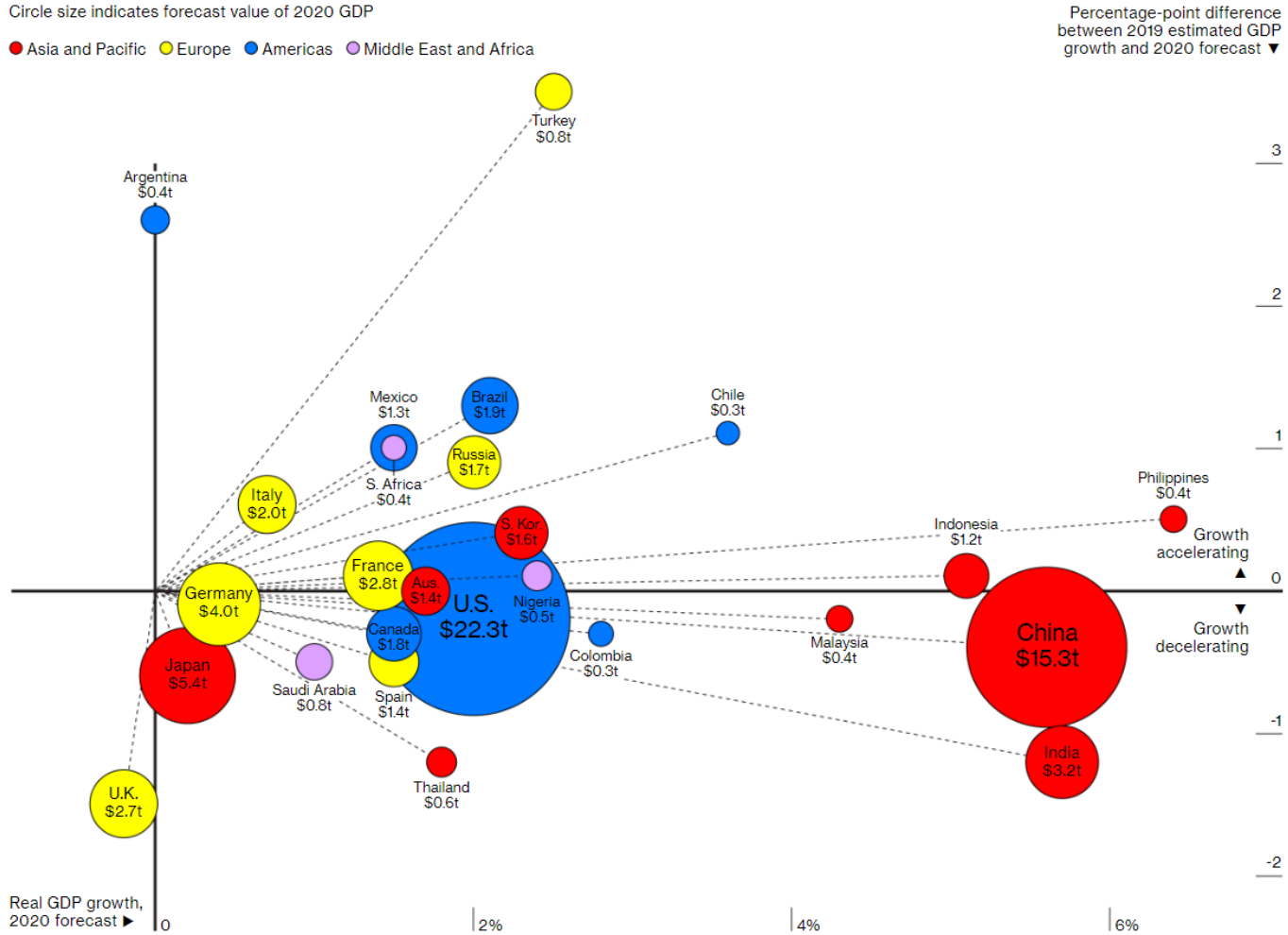
- Demographics – difficult to find staff as retirements occur and job requirements change – expect costs to rise for employees over time
- Model Flexibility – need to make changes to the structure of the business model to give your team more time to adjust when conditions change or volatility spikes
- US elections – this could sharply impact banks, customers and employees depending on who wins

# Active Risk Management is Critical

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- You should be analyzing the impact of very low and even negative rates on your business model
- Challenge your teams to identify and offload all tasks that aren't the highest and best use for them
- Loan prepayments will surge in 2020 given how much rates have declined in the past 12 months
- Recessions increase defaults and workload, so be sure reserves are adequate and staffing is ready and prepared to react with a pre-staged plan

# Keep One Eye Focused Overseas - 80/20



Data: GDP growth estimates and forecasts from Bloomberg Economics; nominal GDP value forecasts from the International Monetary Fund



# 'Fatigue' Is A Real Risk

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- Bending a metal over and over leads to something known as “fatigue” and ultimately causes it to break
- Community bankers will need to be sure their mettle does not bend so much that it fatigues over the next few years given such a high level of uncertainty

# Contact Information

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