

Peer Analysis and Balance Sheet Strategies Update



February 20, 2024

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Overview

- Markets & Economy Update
- Peer Analysis & Call Report Trends
- Balance Sheet Strategies

Predicting Interest Rates is like Predicting the Weather

Making predictions is very easy. Getting them correct is a whole other story.

What meteorologists were predicting for the
February 13 “snowstorm” in Boston



What actually happened



Markets & Economy Update

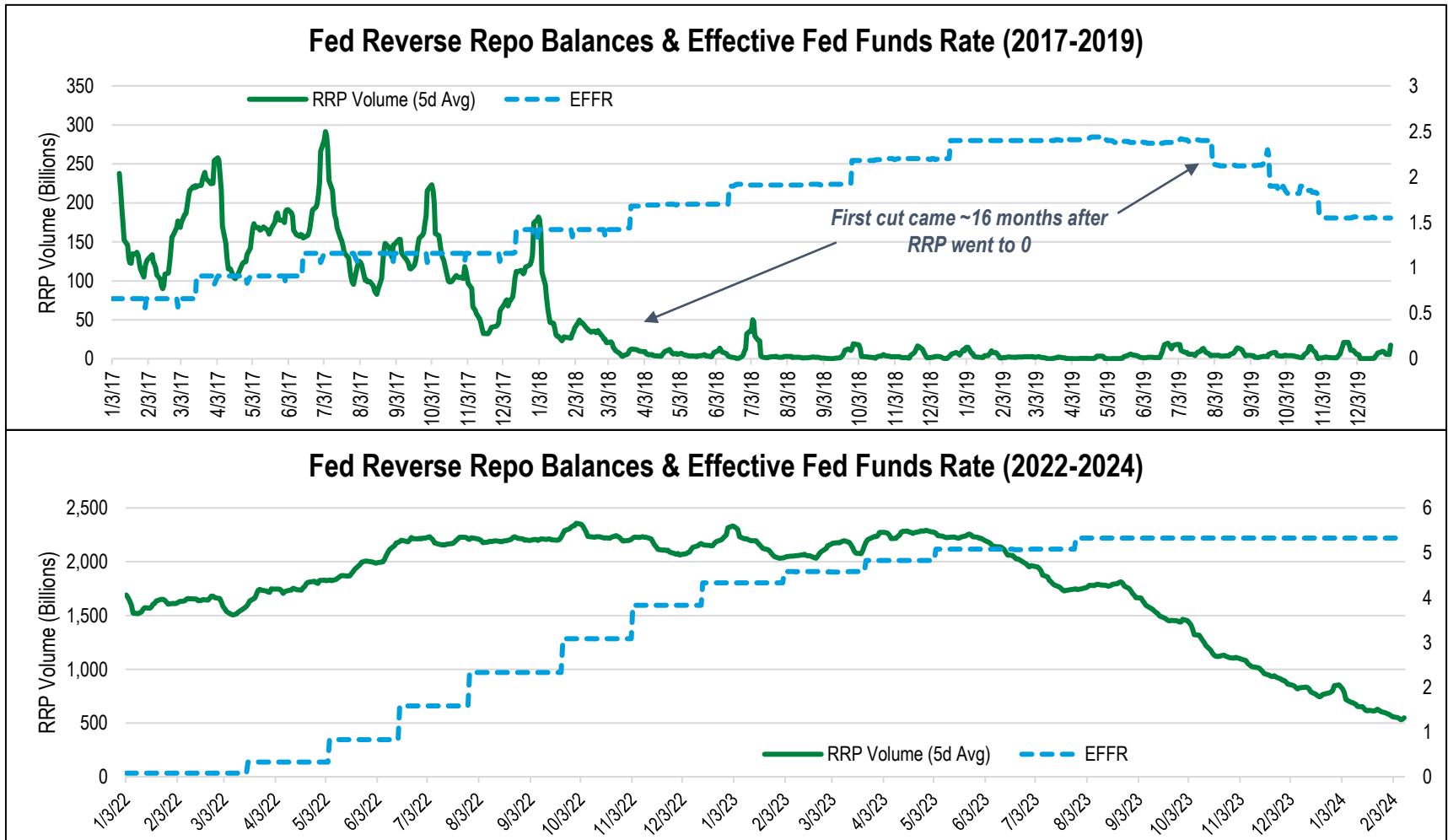


Markets & Economy Update

- Excess Liquidity in the Short-Term Markets
- Inverted Yield Curves
- Relative Wage Growth
- Forward Looking Inflation

Excess Liquidity & Rate Pivots

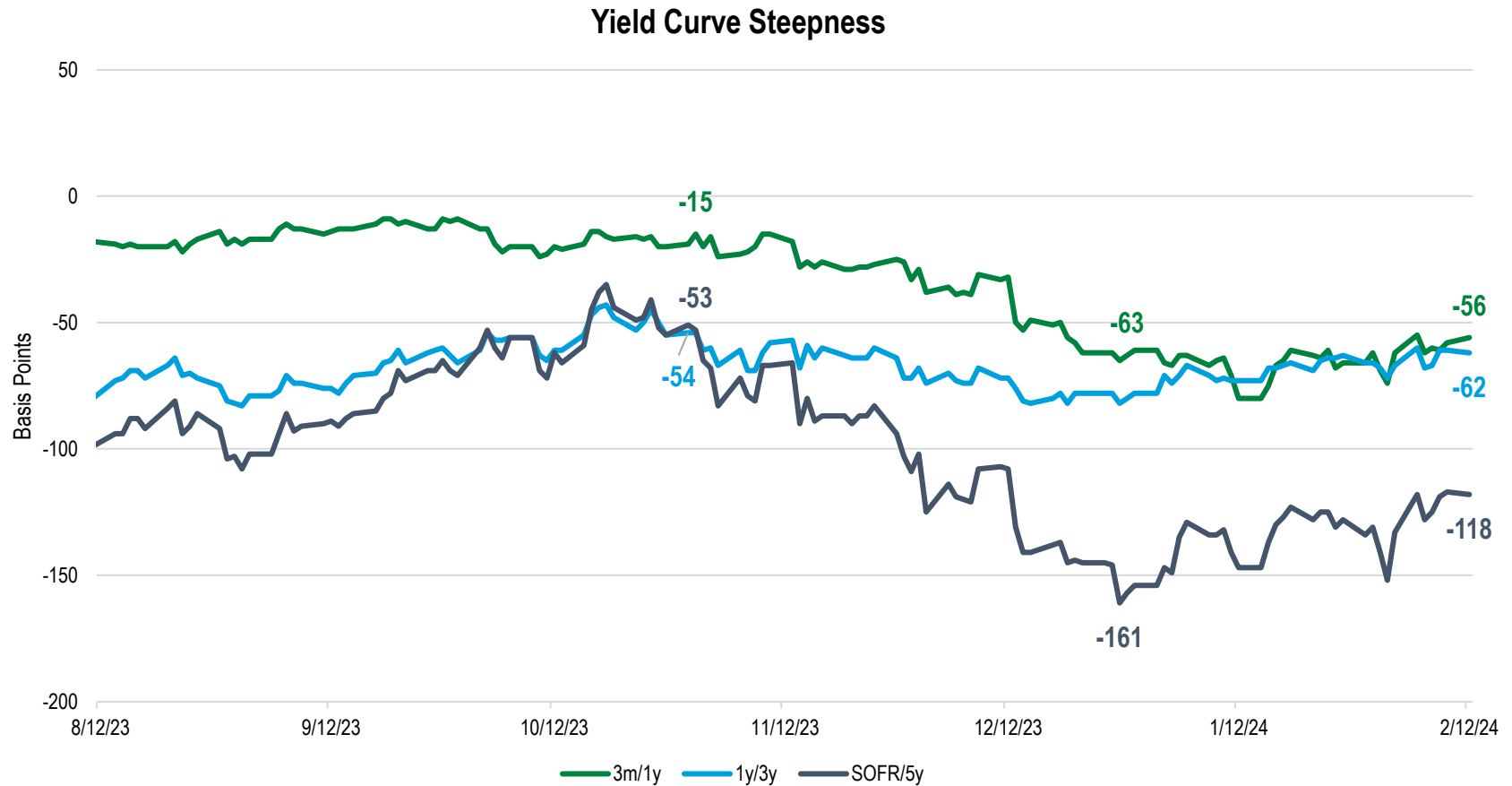
In the 2017-19 cycle, the first rate cut came over a year after RRP balances were exhausted. Absolute levels in the current cycle are much higher and trend towards (but have not yet hit) zero.



Source: Federal Reserve Bank of St. Louis, FHLBank Boston

Shape of the Yield Curve(s)

With the yield curve still inverted across most tenor pairings, we have seen market positioning swing back and forth recently between having conviction in a sharp pivot to lower short-term rates and a Higher for Longer environment.

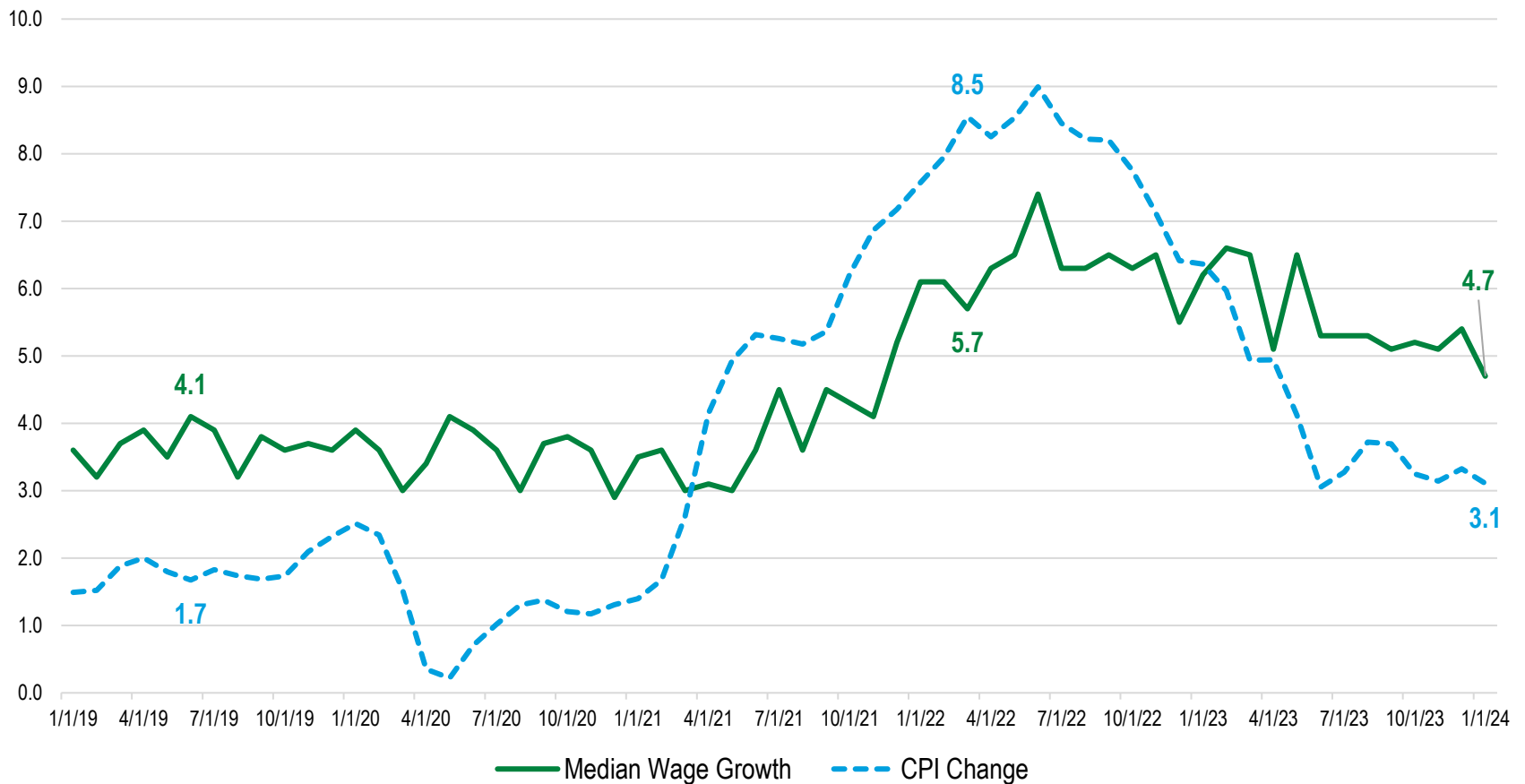


Source: Federal Reserve Bank of St. Louis, FHLBank Boston

Consumer Purchasing Power

Wage growth persisting above inflation has added to the positive wealth effect for the average individual.

Median Hourly Wage Growth vs. CPI Y/o/Y Change

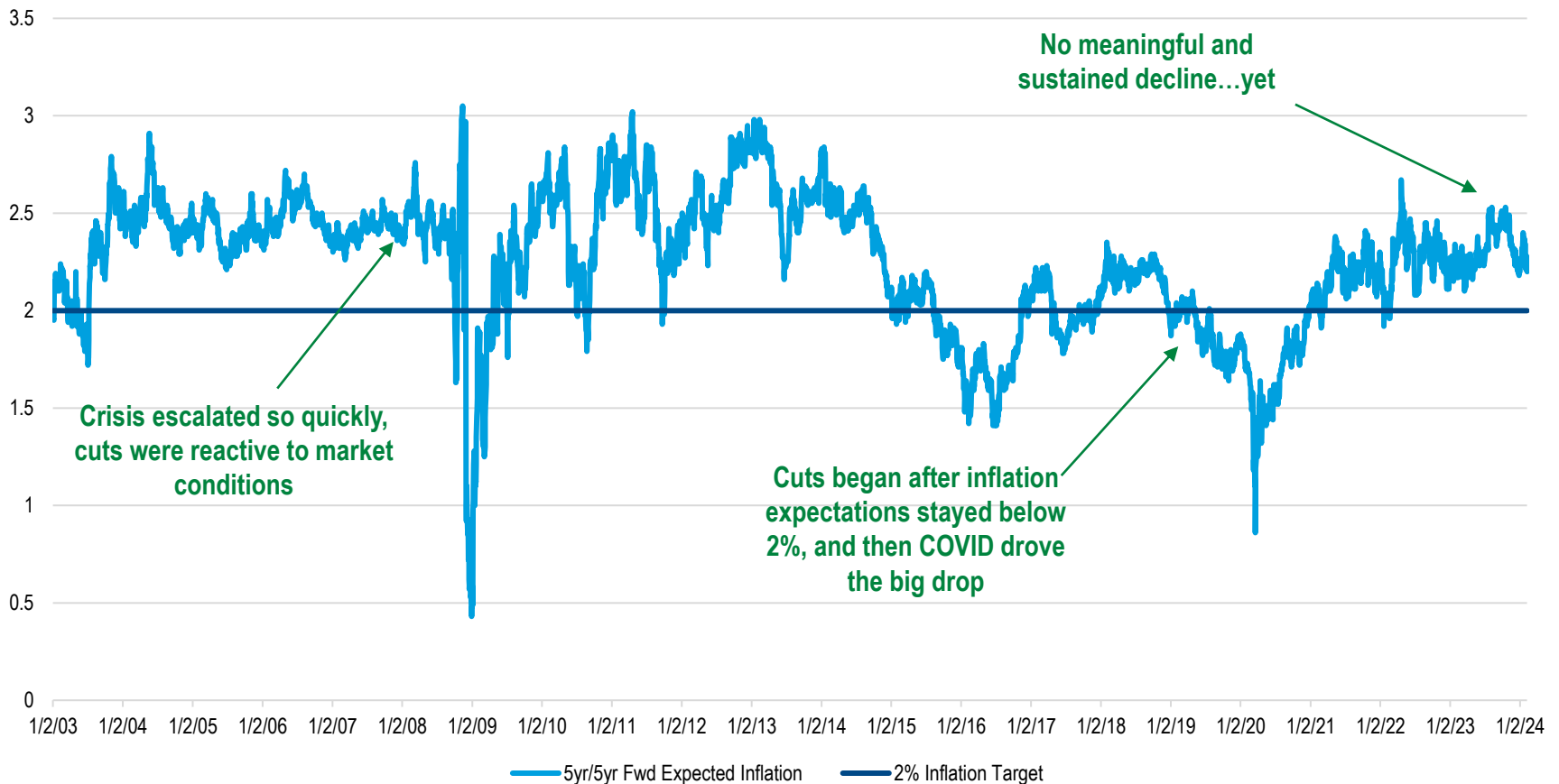


Source: Federal Reserve Bank of St. Louis, FHLBank Boston

Inflation Expectations

Long-term inflation prospects have been choppy and have not yet breached the important 2% target level.

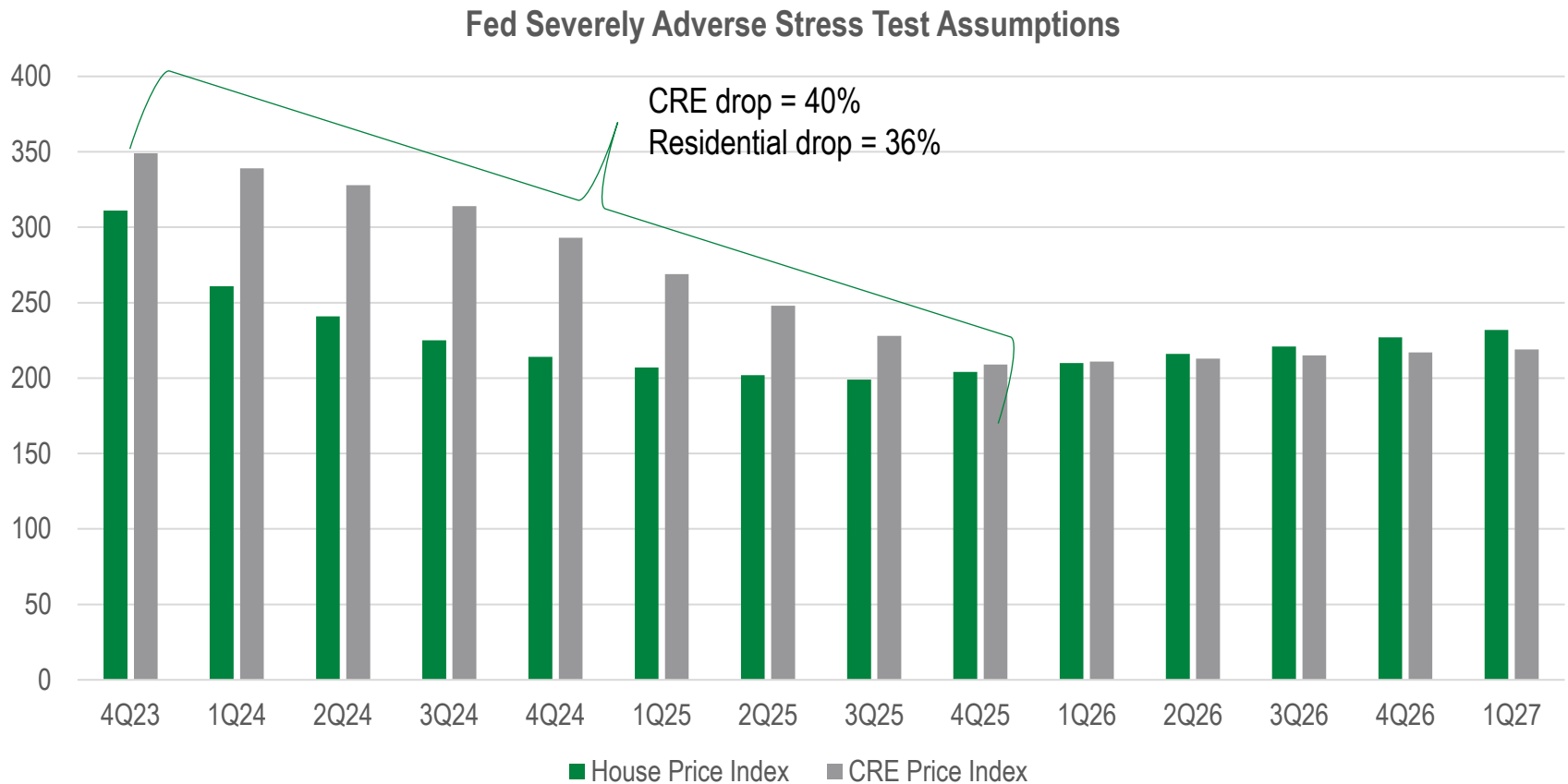
5- Year, 5-Year Forward Forward Inflation Expectation Rate



Source: Federal Reserve Bank of St. Louis, FHLBank Boston

Stress Test Assumptions

Similar to last year, the recently released Fed “Severely Adverse” stress test scenario prompts large banks to contemplate very serious drops in CRE and residential real estate values.



Source: Board of Governors of the Federal Reserve System, FHLBank Boston

Peer Analysis & Call Report Trends

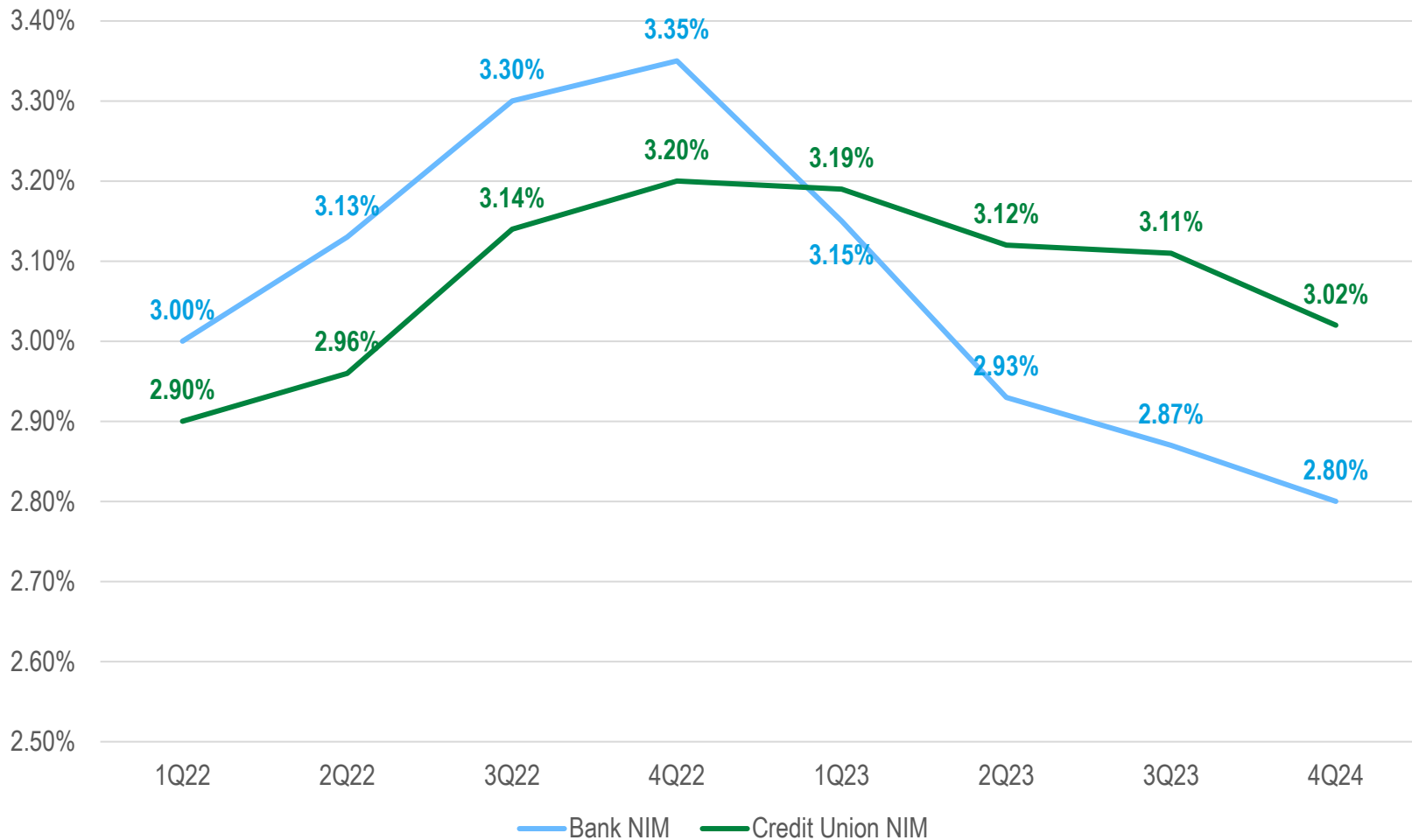


Peer Analysis & Call Report Trends

- Earnings & Interest-Rate Risk Profiles
- Where's the Growth?
- Shifts in the Deposit Portfolio
- Investment Trends
- Credit Stress?

NIM Cycle-to-Date History

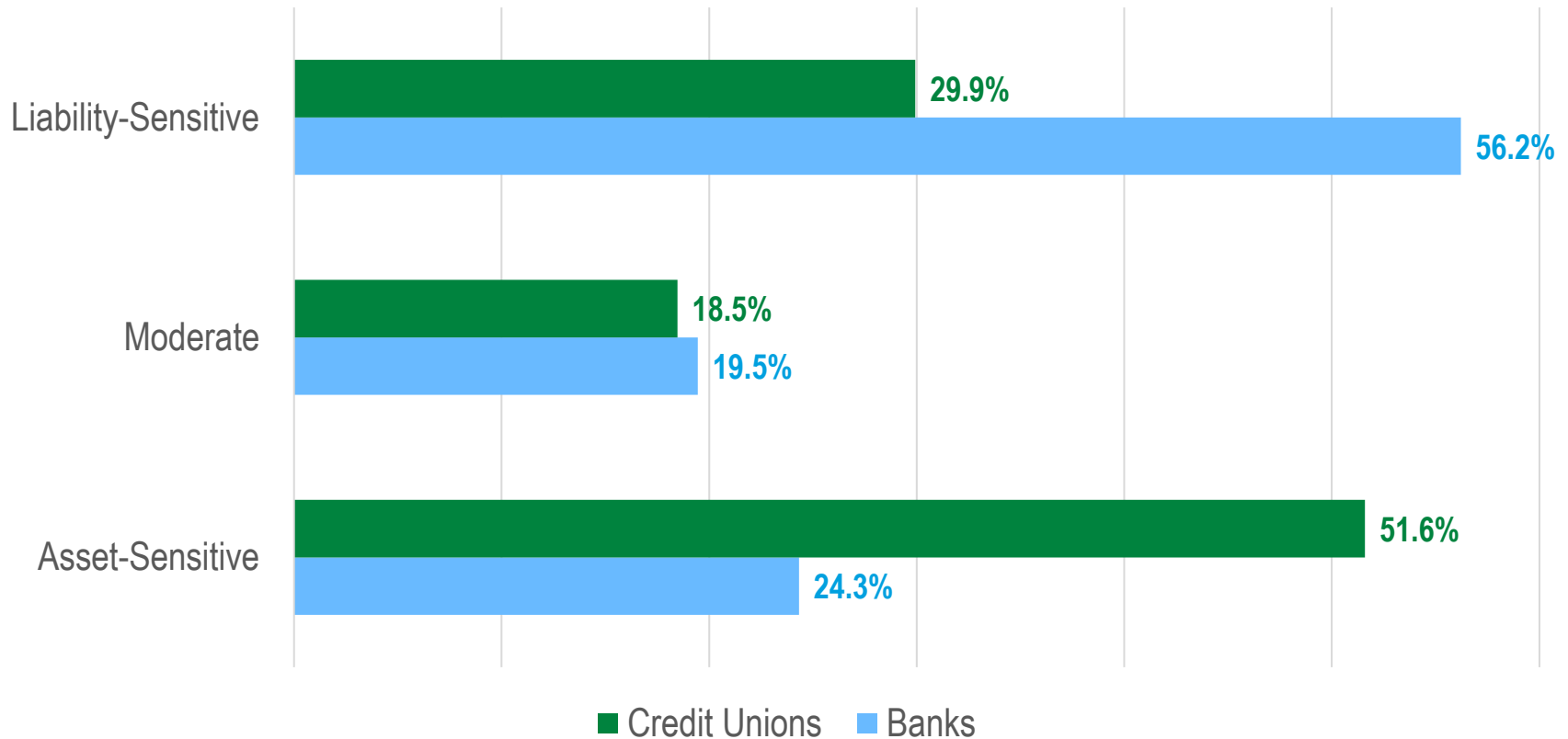
NIMs continue to bleed out as liability costs rise. Credit unions have kept a tighter lid on the cost of client funding than banks.



Member ALM Profiles

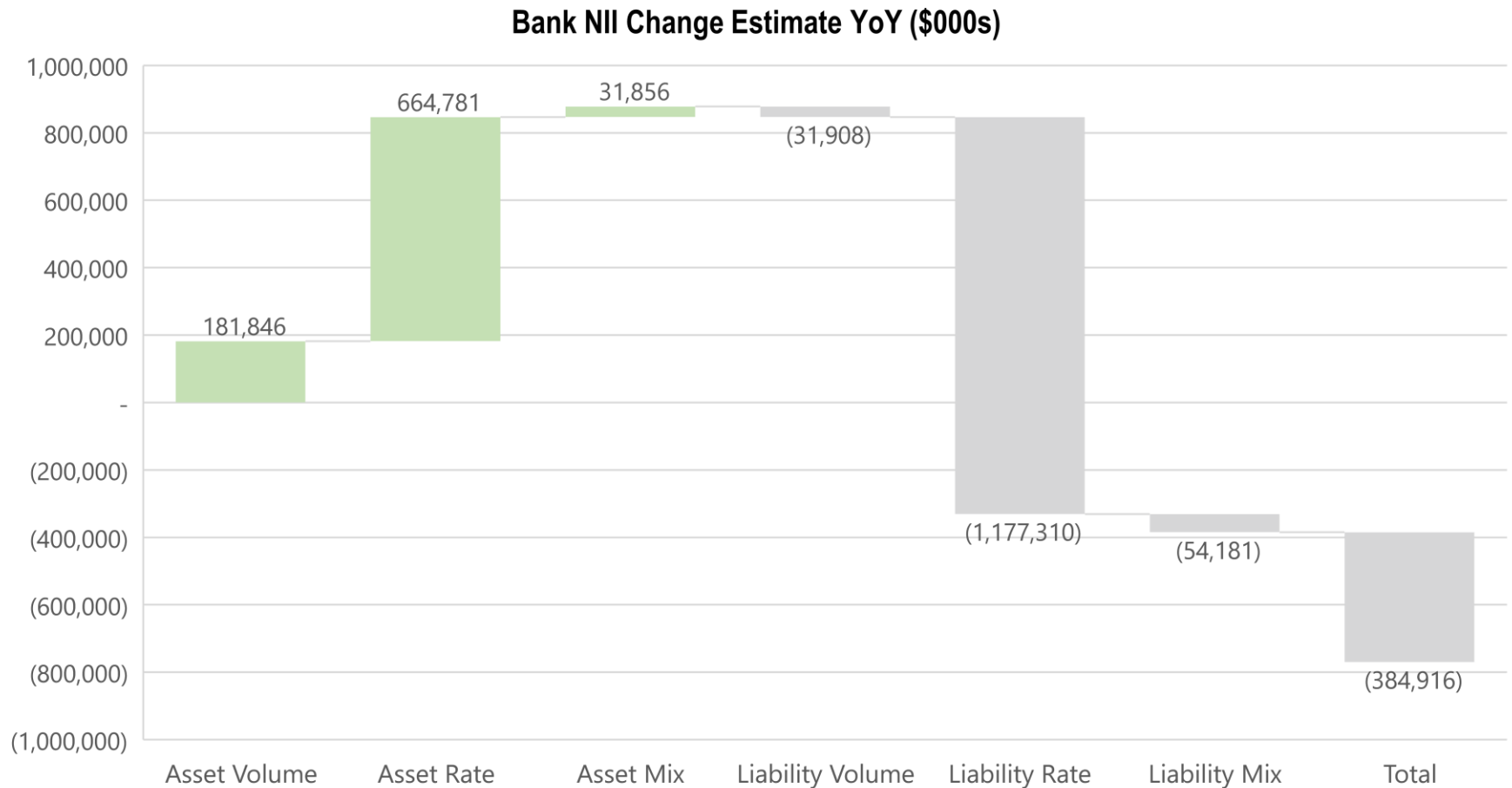
Credit unions have outperformed banks in terms of preserving net interest margin in the current rate cycle.

“Moderate” members have had NIMs stay within 20 bps of their 1Q22 baseline. Those with improvement > 20 bps are described as “asset-sensitive,” and those with reductions > 20 bps are “liability-sensitive.”



Bank NII Change Decomposition YoY

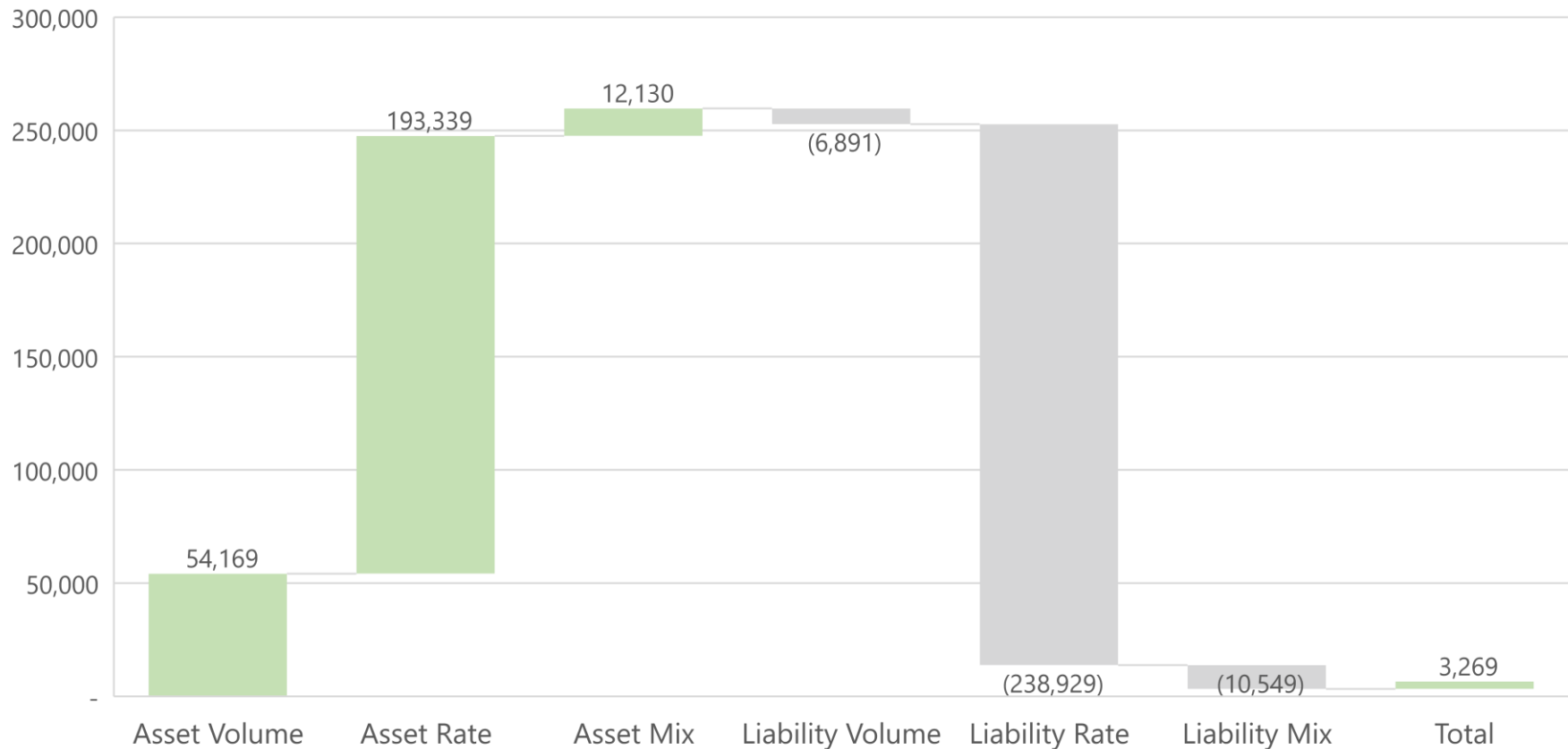
Although banks generally continued to grow in 2023, NIM declines more than offset volume increases.



Credit Union NII Change Decomposition YoY

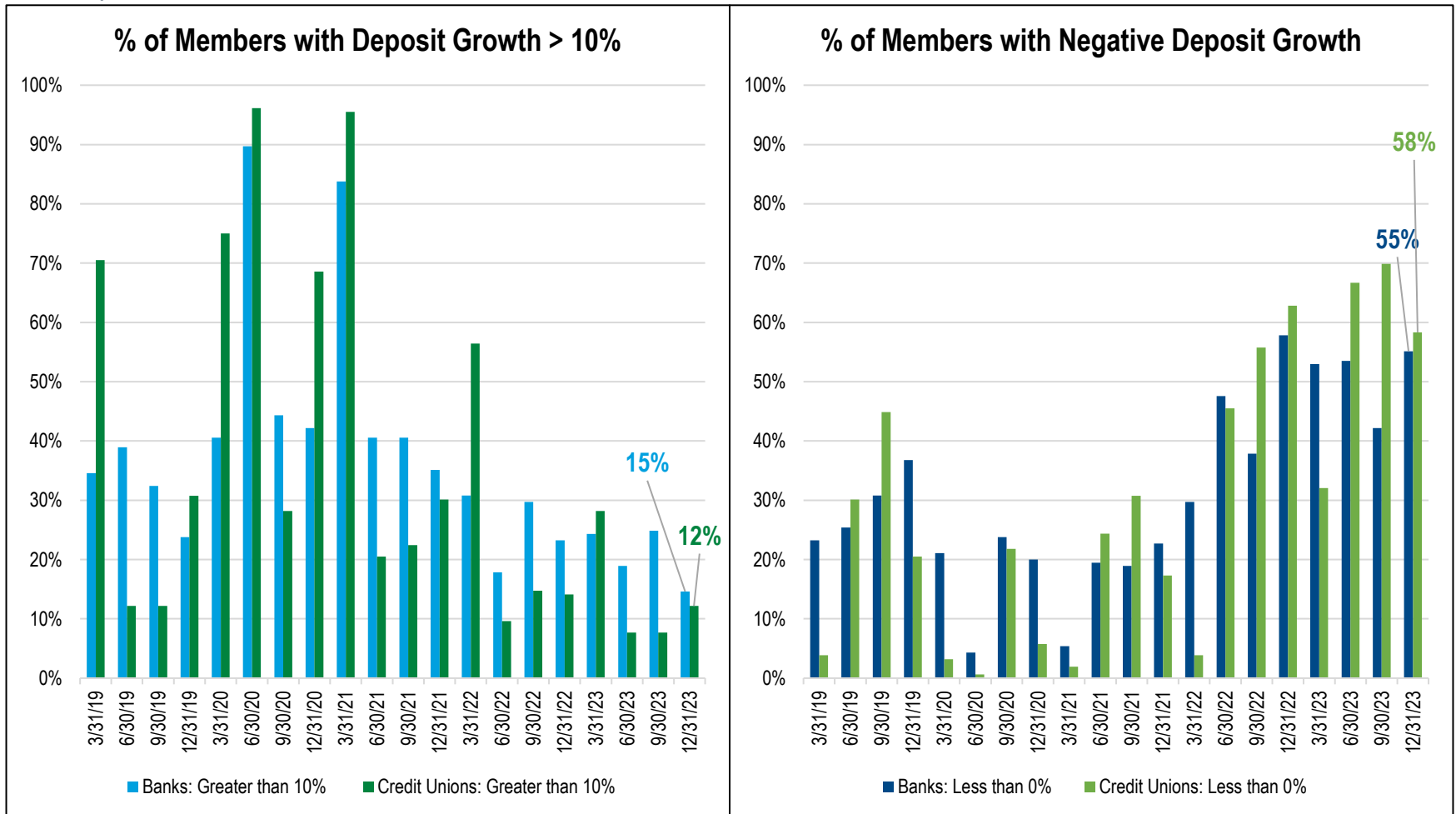
Although NIMs also declined at CUs, overall profits held steady with modest growth making up the difference.

Credit Union NII Estimate YoY (\$000s)



Deposit Growth

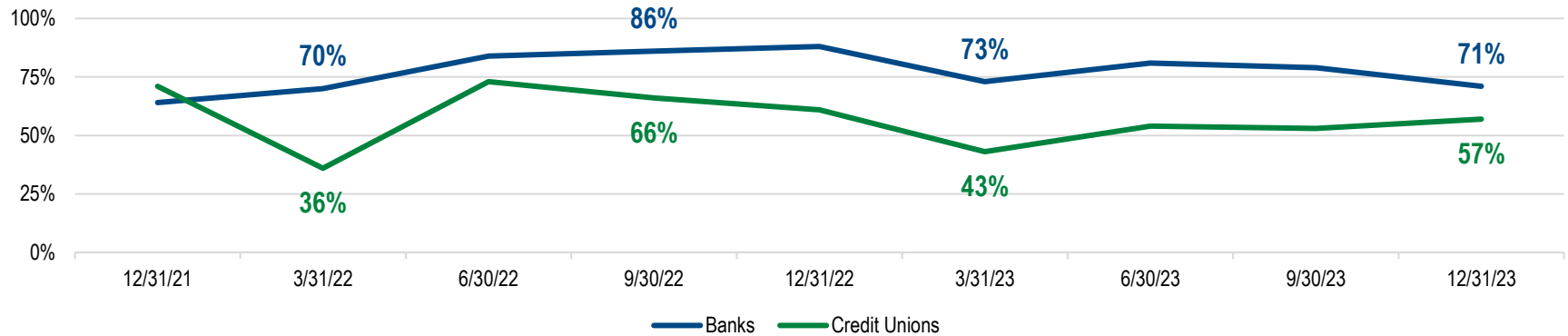
Banks have fared a little better than credit unions with deposit growth, with slightly more outperformers and slightly less underperformers.



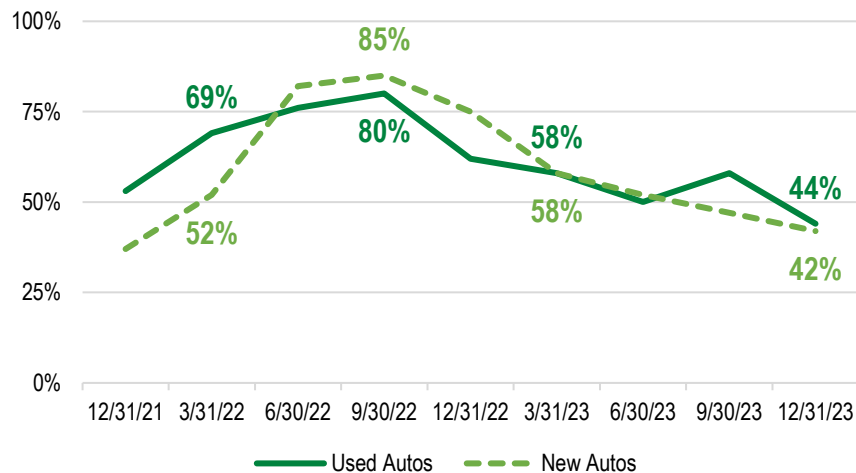
Loan Growth

Median loan growth was around 5%, with residential activity still robust despite the challenges posed by higher rates.

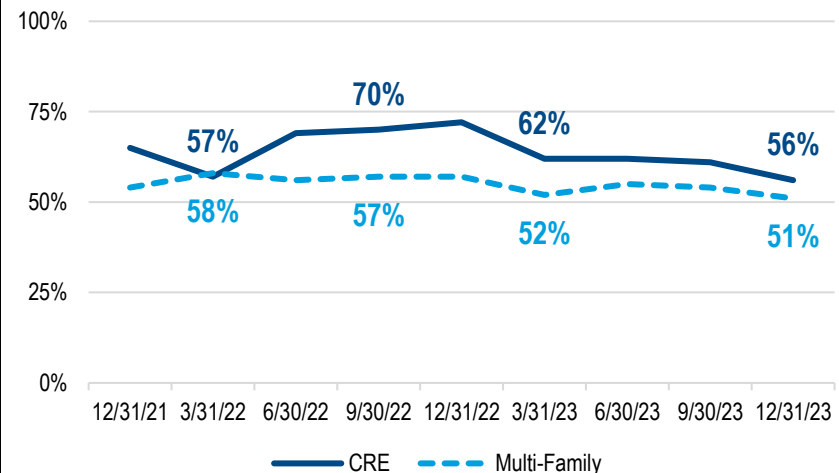
% of Members Growing 1-4 Family Loans Q/o/Q



% of CU's Growing Loans Q/o/Q

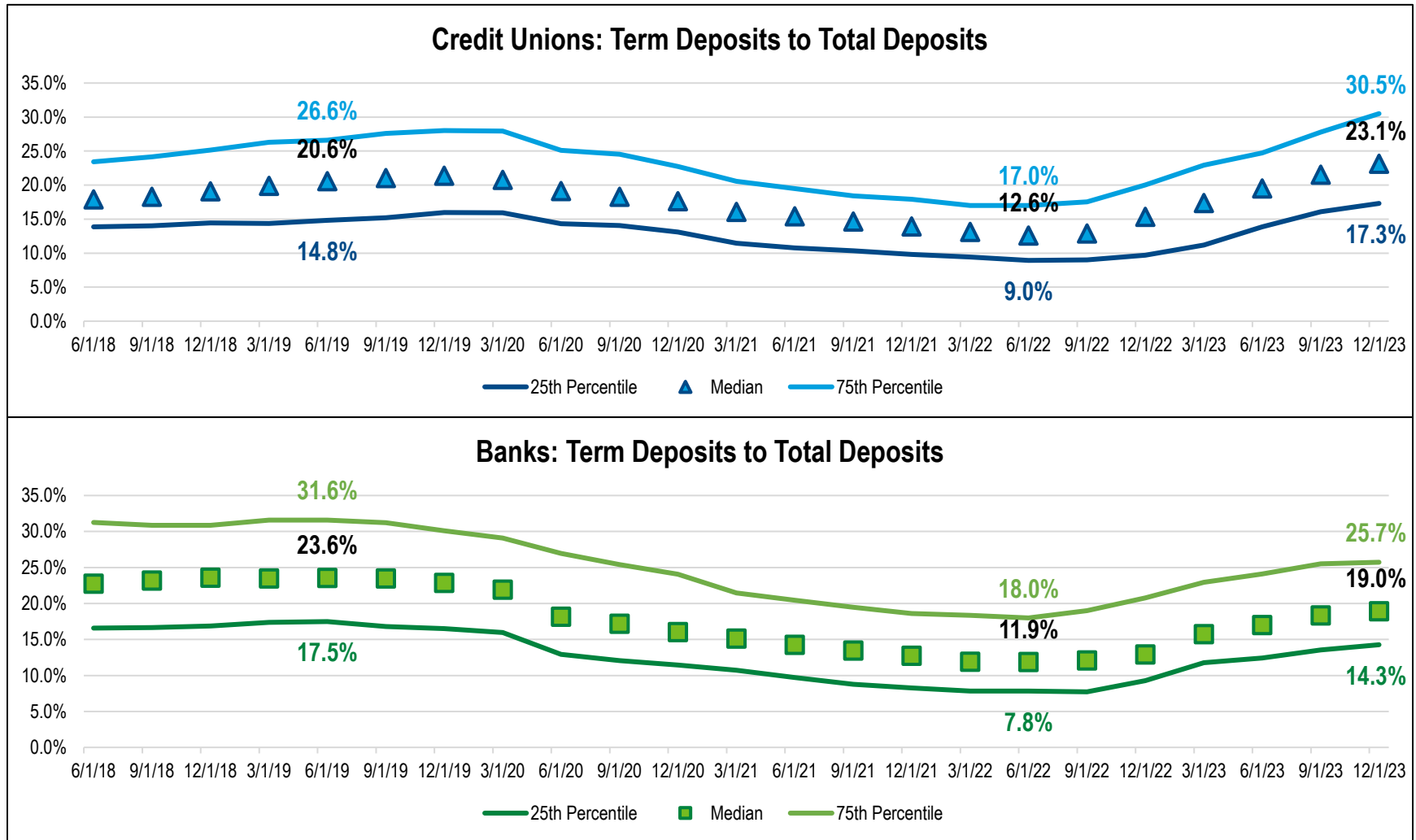


% of Banks Growing Loans Q/o/Q



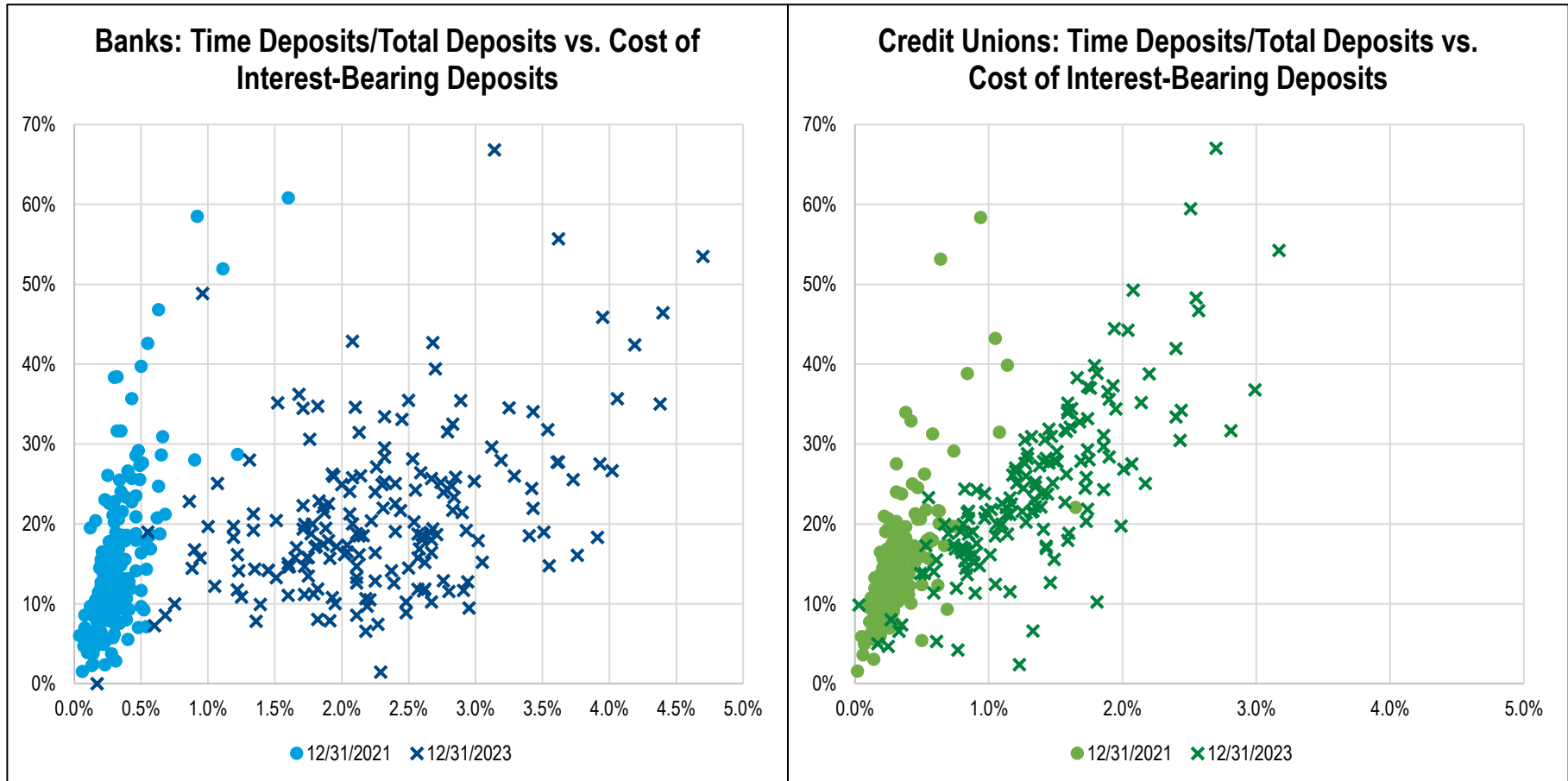
Growing Reliance on Term Deposits

It is no surprise, given where rates are, that term deposits continue to be where the deposit money is gravitating.



Upward Pressure on Deposit Costs Continue

Banks have seen less correlation between CD concentration and deposit costs than credit unions have experienced.

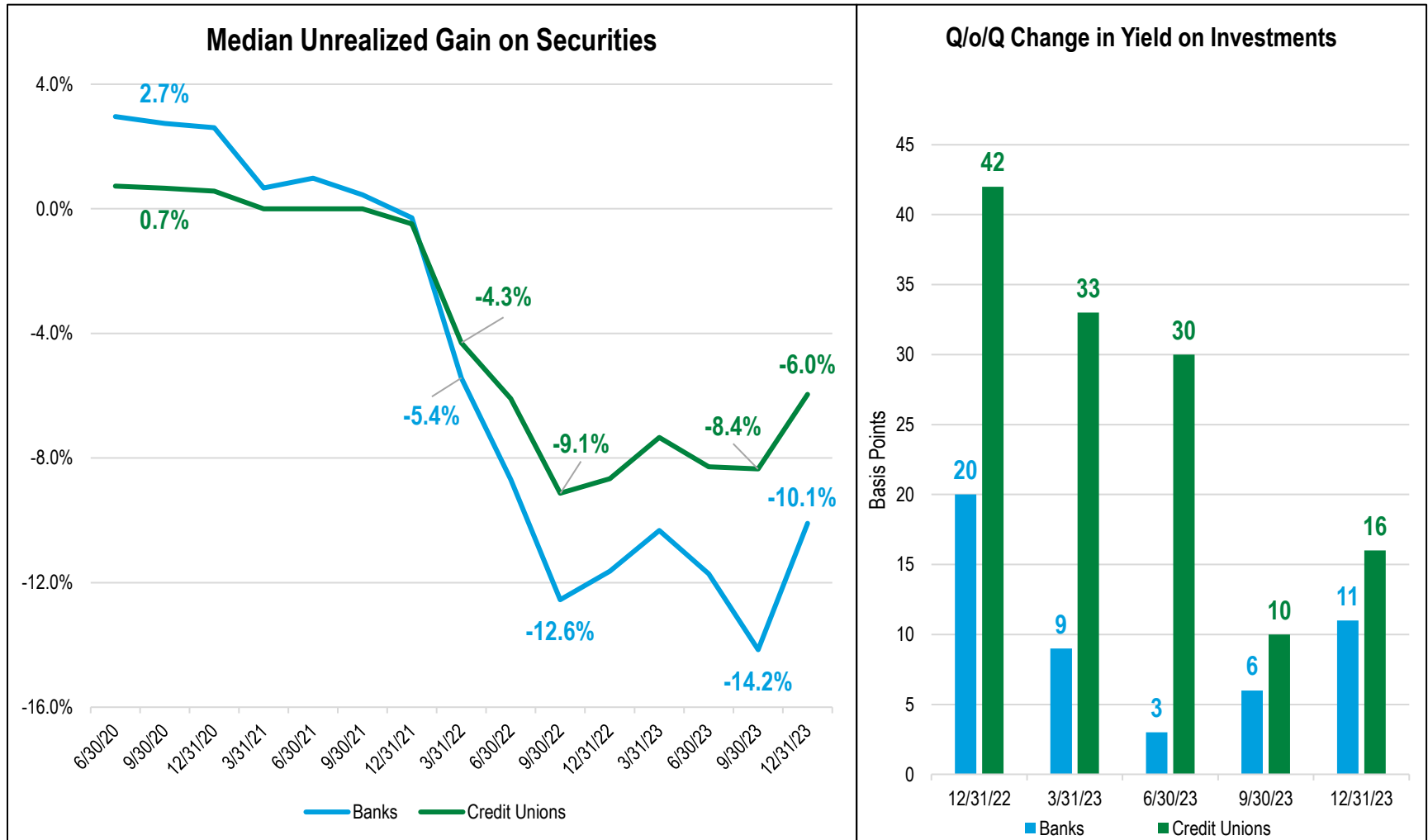


Correlation- 2021: 0.70, 2023: 0.44

Correlation- 2021: 0.68, 2023: 0.79

Investment Portfolio Yield & Market Value Changes

Unrealized losses have been dissipating and yield changes are on the upswing.

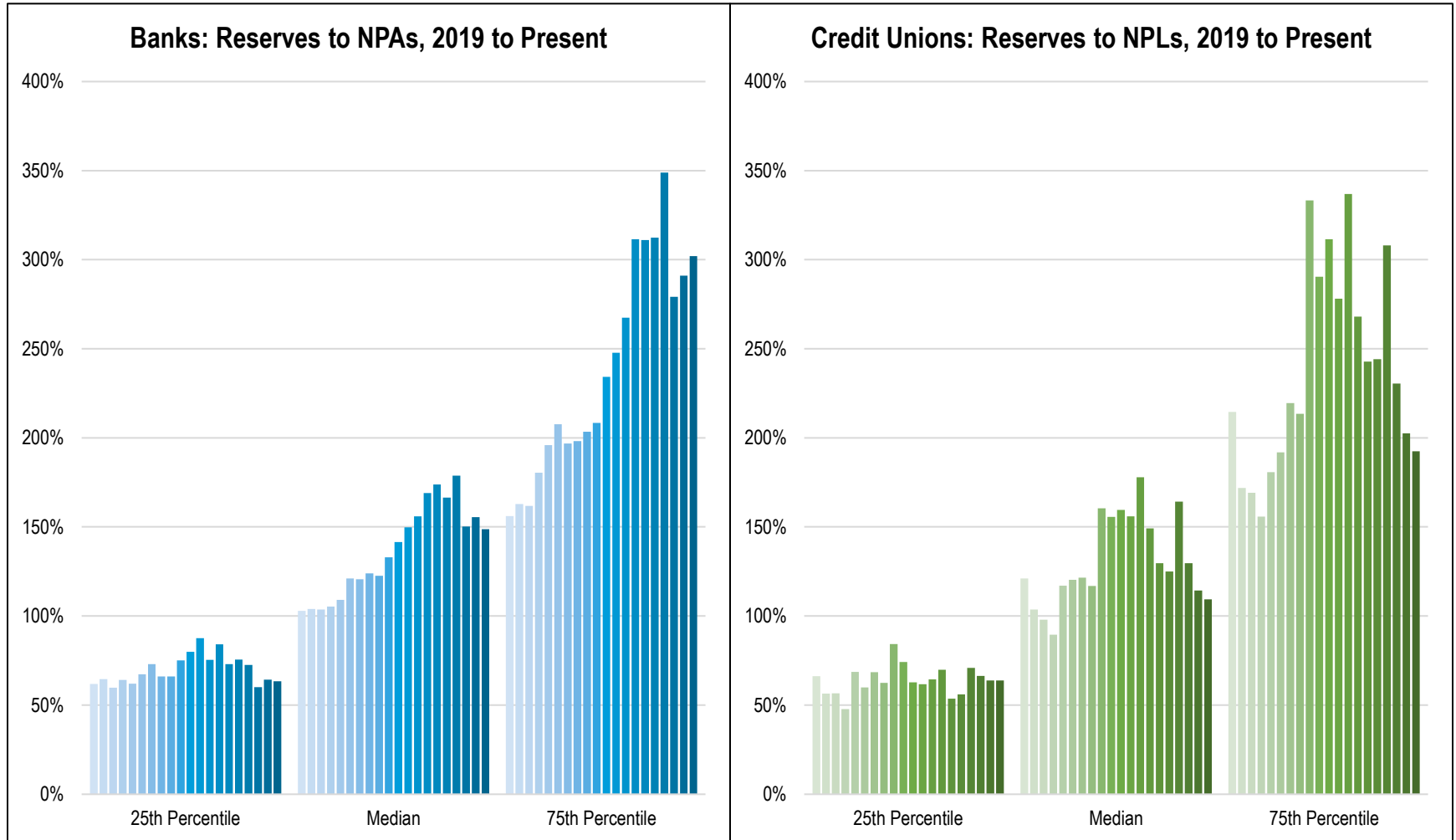


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Source: S&P Global, FHLBank Boston

Credit Stress

Coverage ratios have declined in recent quarters as non-performing assets have incrementally ticked higher at a faster rate than reserves have been building.



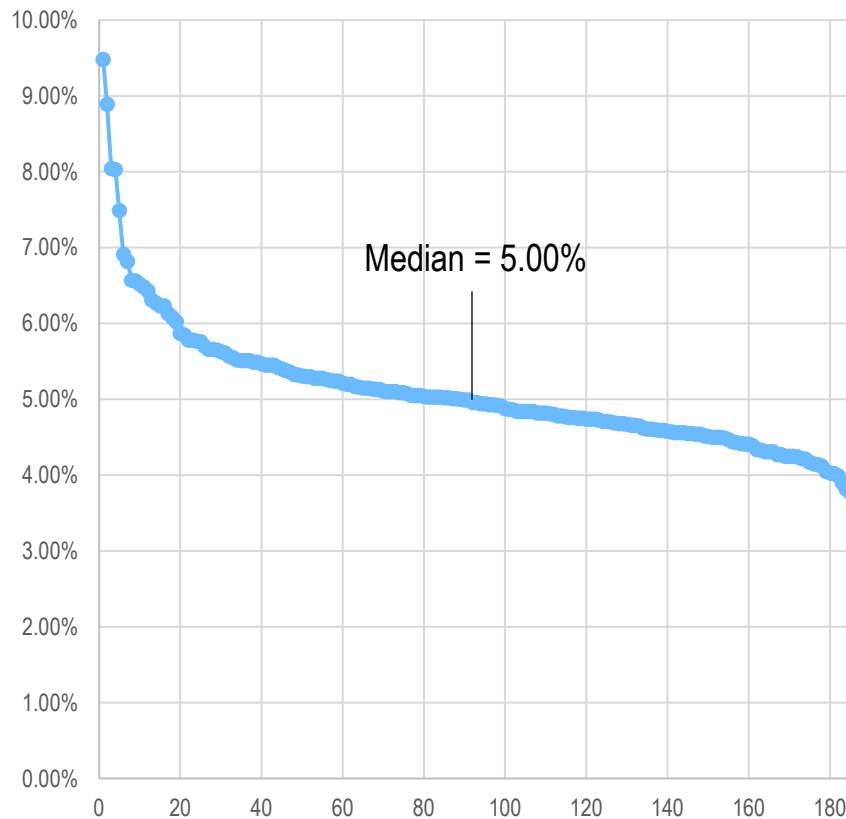
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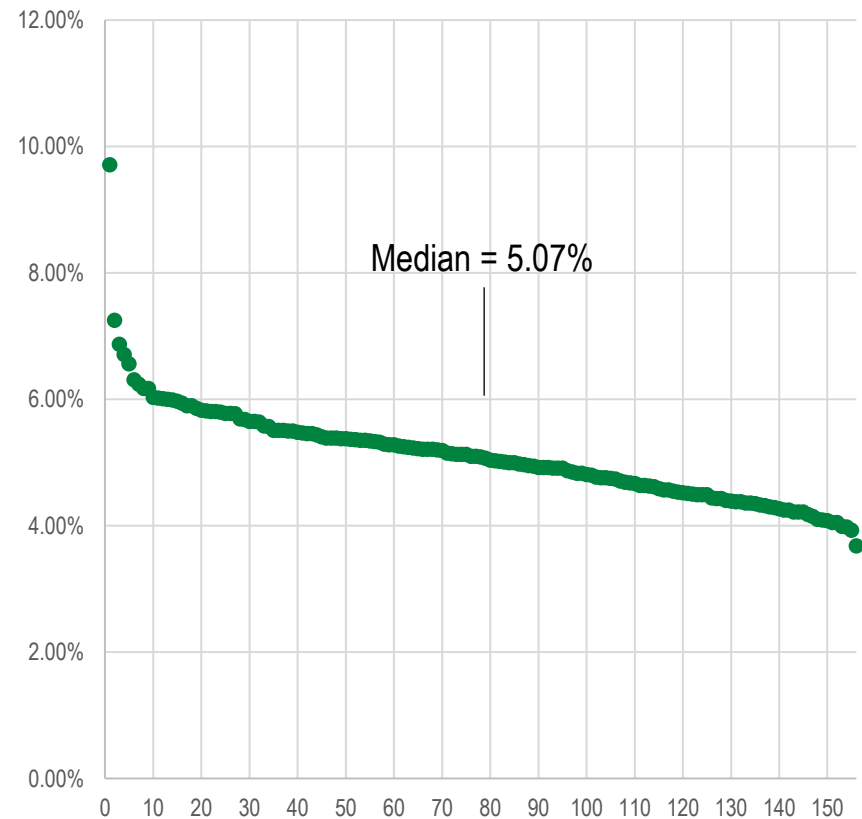
Loan Yield Distribution

The median loan yield at member financial institutions is just over 5%. Banks and credit unions are similar.

Distribution of Bank Loan Yields



Distribution of Credit Union Loan Yields



Balance Sheet Strategies

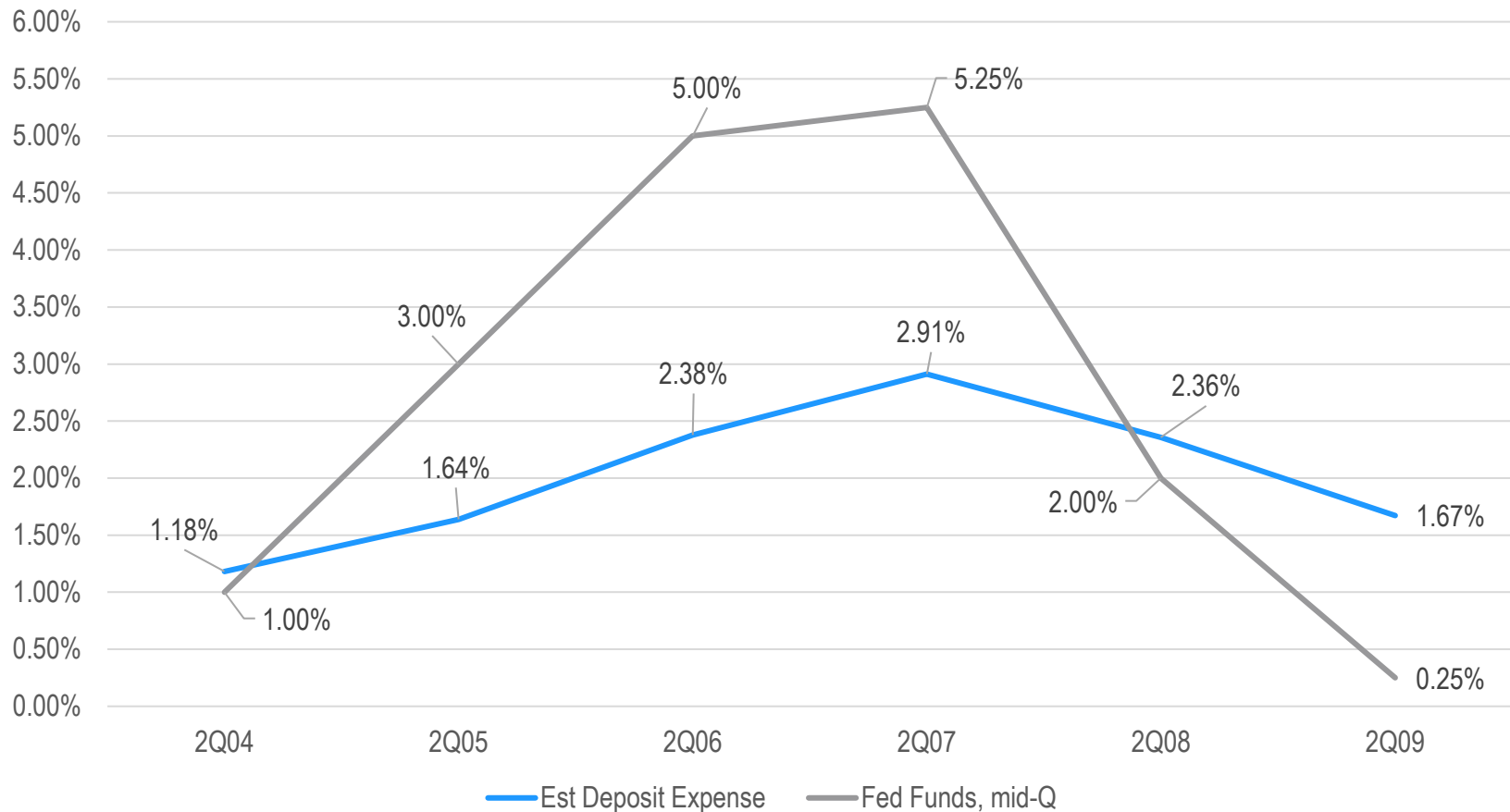


Balance Sheet Strategies

- Margin Headwinds
- Inverted Yield Curve Opportunities
- Funding Cost Relief
- Liquidity Metric Friendly Short-Term Funding
- Selling Seasoned Mortgage Loans

Is the Past Prologue?

The last time the Fed Funds rate was at these levels, member bank deposit expense was approaching 3%.
In 4Q23, estimated member bank deposit expense was 1.99% and rising.



Continued Near-Term Margin Pressure

Cycle-to-date, members have experienced deposit betas of approximately 34% compared to 41% in the 2004-2007 era. If that beta experience is duplicated in the first half of 2024, there is potential deposit repricing exposure of an additional 37 bps.

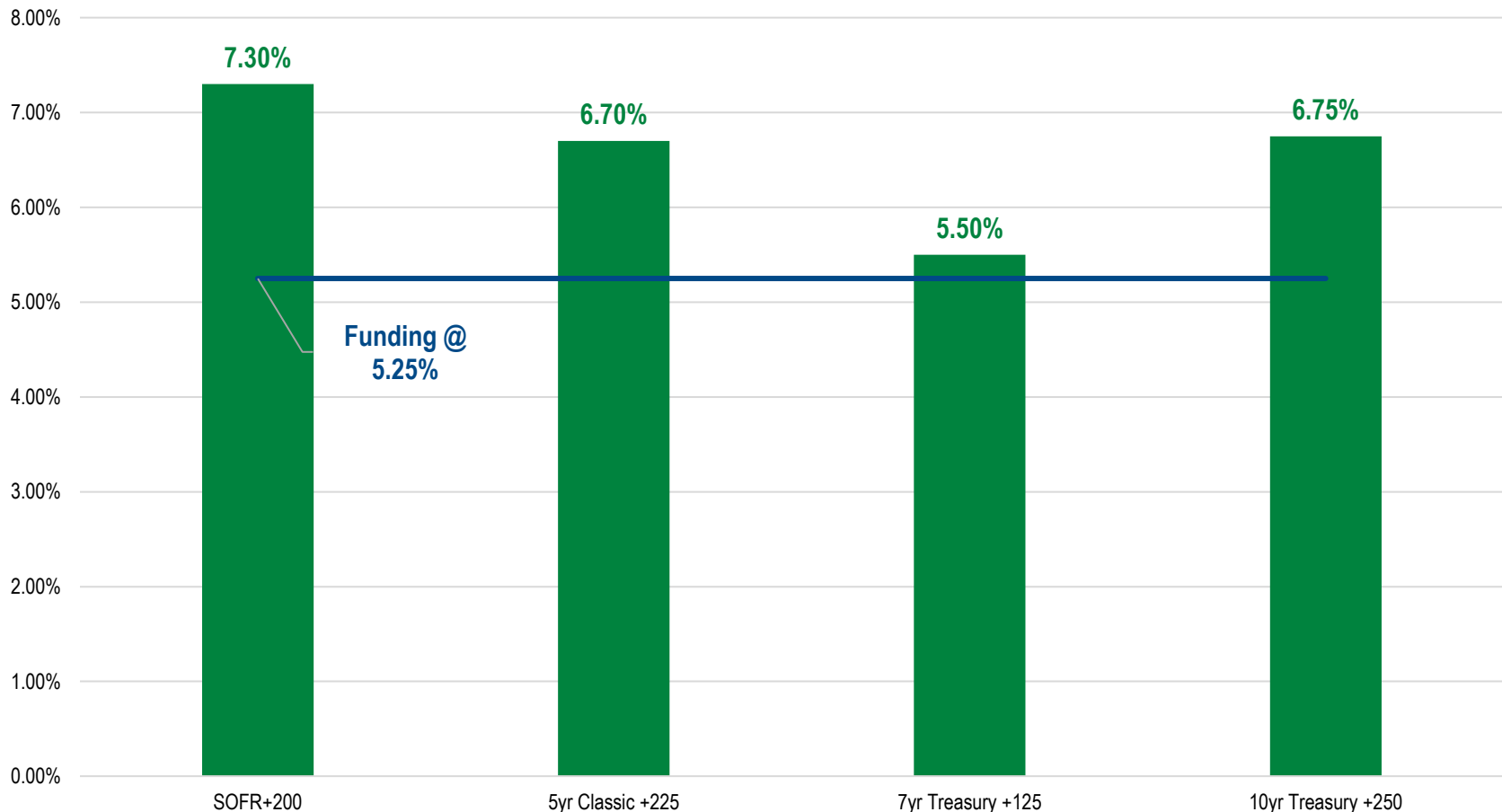
	Banks	Credit Unions	2004-2007, Banks
Start	0.22%	0.34%	1.18%
Today	1.99%	1.59%	2.91%
Change	1.77%	1.25%	1.73%
FF Move	5.25%	5.25%	4.25%
Effective Beta	33.7%	23.8%	40.7%
Potential Exposure	0.37%		

Source: FHLBank Boston

Earnings Headwinds

The inverted yield curve, strong loan pipelines and competitive deposit landscape all combine to make “set it and forget it” strategies difficult in the current environment.

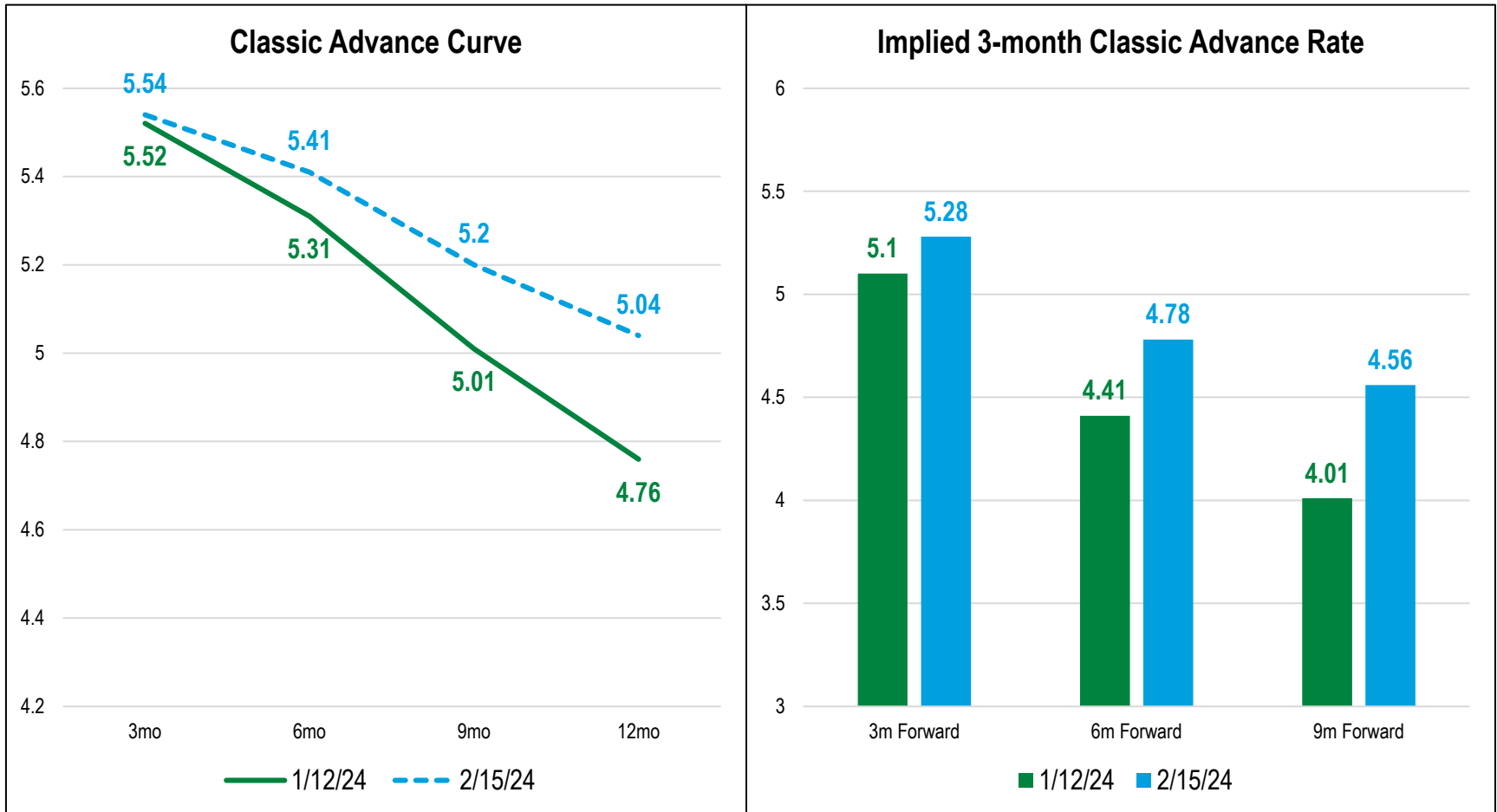
Examples of Incremental Asset Yields & Funding



Source: Federal Reserve Bank of St. Louis, FHLBank Boston

Taking Advantage of an Inverted Yield Curve

An inverted yield curve prices in the expectation that short-term rates will be lower in the future. If wholesale funding may be needed for a while, then extending to ~1 year can have value versus continually rolling short-term advances.

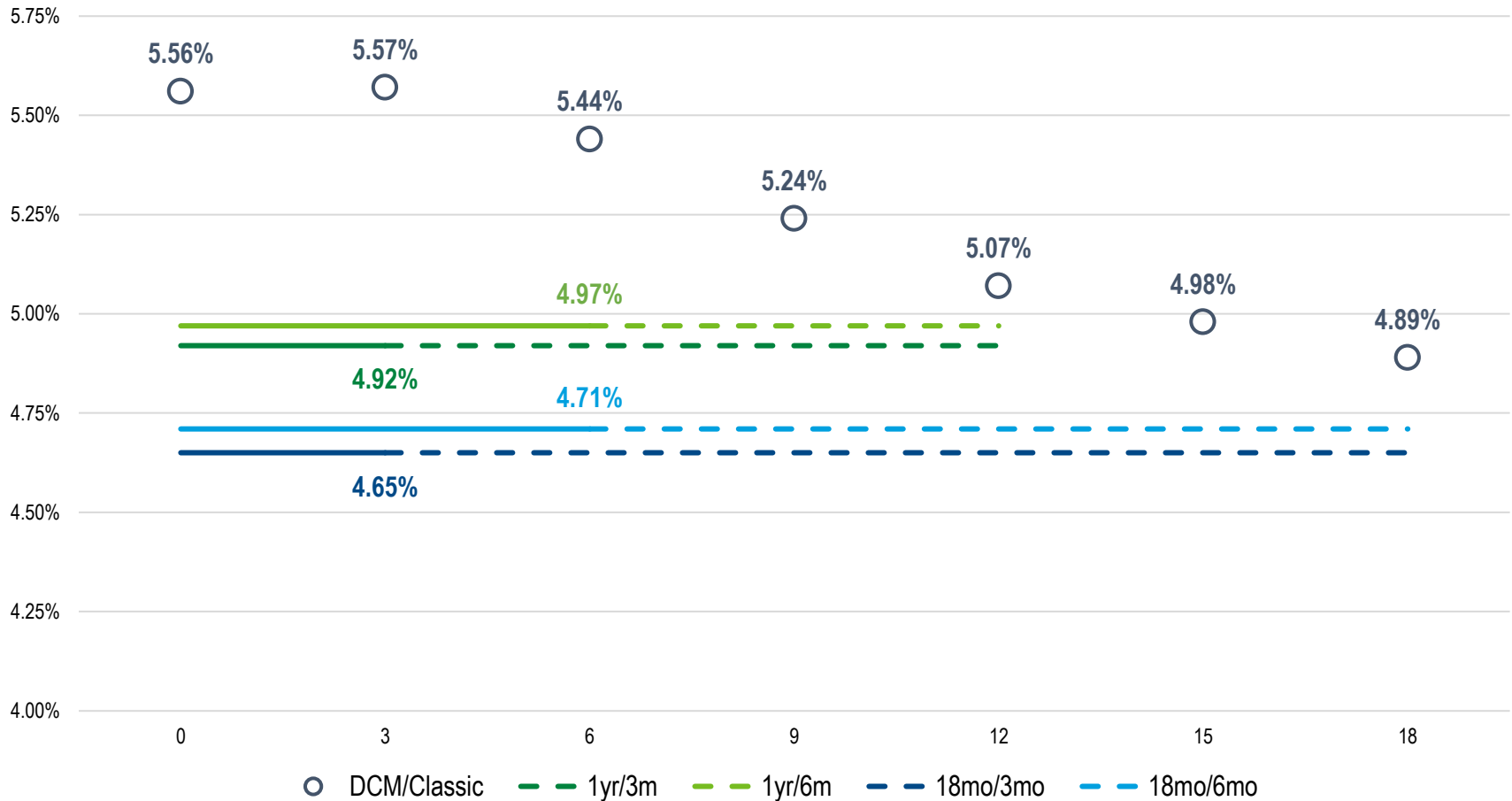


Source: FHLBank Boston

Shorter Maturity HLB-Option Advances

Rate uncertainty and volatility has persisted, creating opportunity for interest cost savings with reduced extension risk.

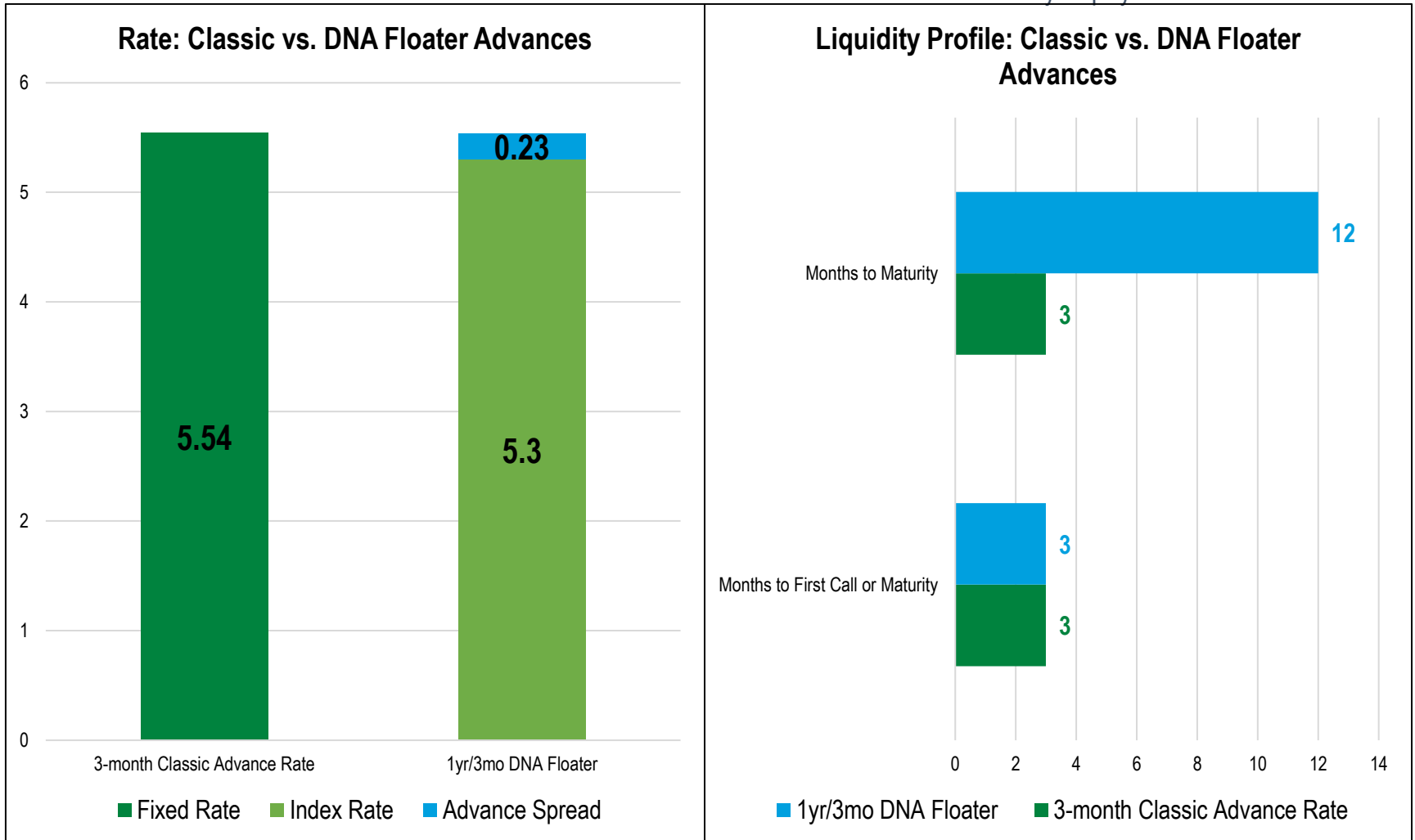
Short Final Maturity HLB-Option Advances



Source: FHLBank Boston

Long-Term Funding with Flexibility

Floating-rate advances offer short-term rate exposure with a long-term liquidity profile. The Discount Note Auction-Floater Advance and the Callable SOFR-Indexed Floater Advance offer the added benefit of flexibility to pay it off if not needed.

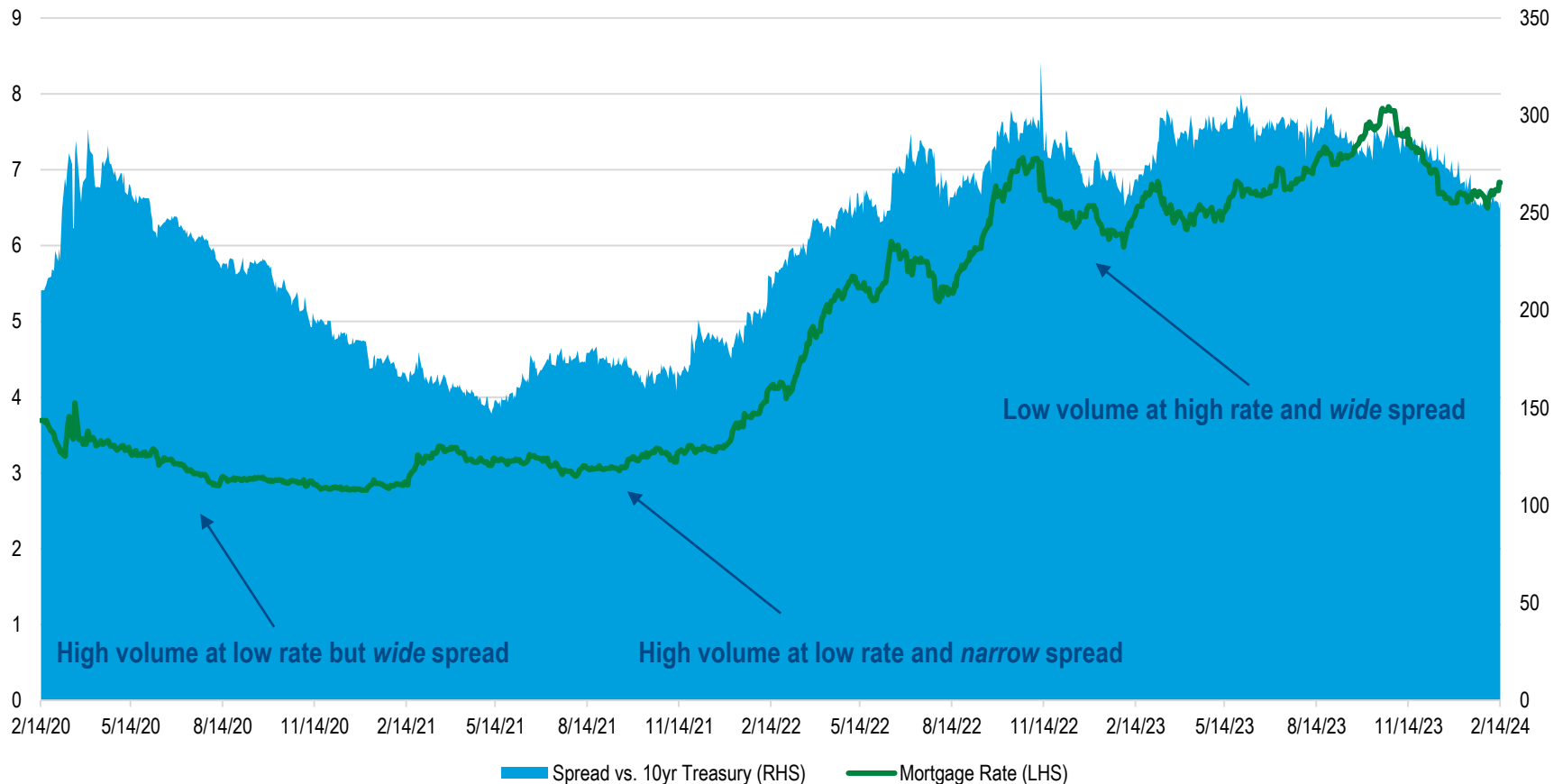


Source: FHLBank Boston

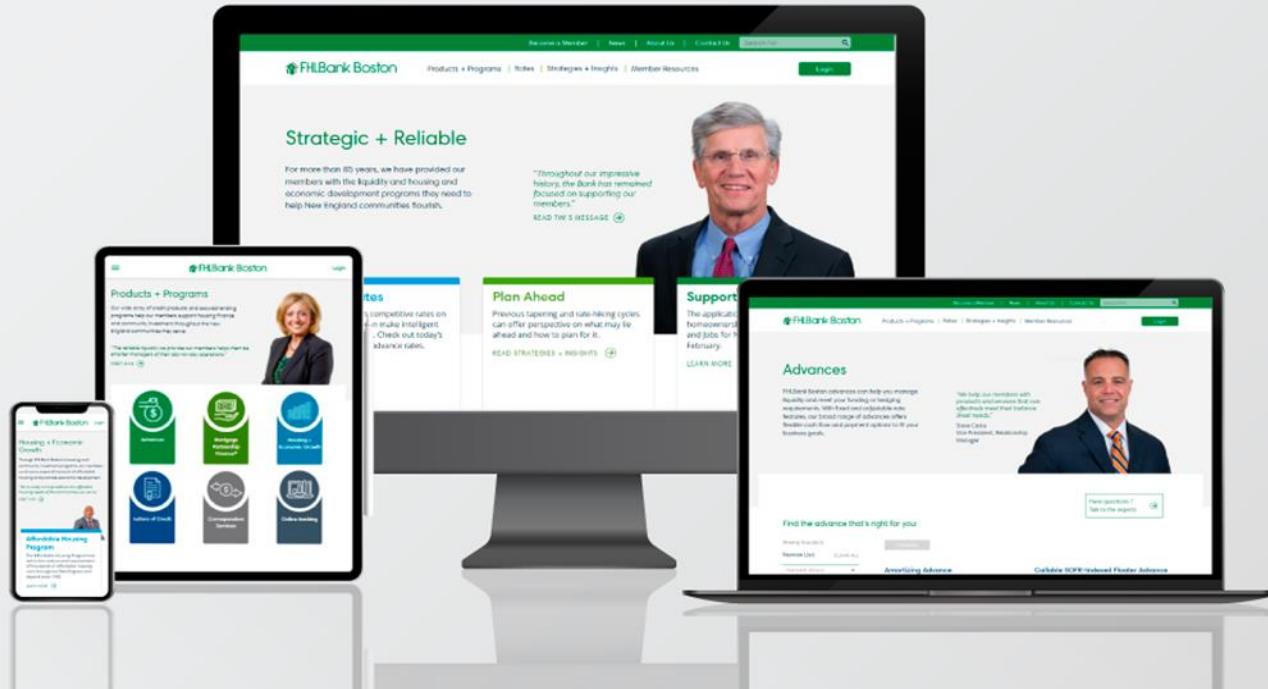
Selling Seasoned Mortgage Loans

It's a balancing act between capital levels, earnings forecasts, and rate sensitivity, but selling seasoned, low-coupon loans can be a way to raise liquidity and position the balance sheet for improved earnings and a more stable risk profile.

30-Year Mortgage Rate & Spread vs. 10-Year Treasury



Source: Optimal Blue, Federal Reserve Bank of St. Louis, FHLBank Boston



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Thank You



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