The CB Bulletin™

CB Resource, Inc. RISK MANAGEMENT & PLANNING

CB Resource, Inc. (877) 367-8236 | Finance 500, Inc. (800) 477-6266

Finance500 INVESTMENT & BROKERAGE SERVICES

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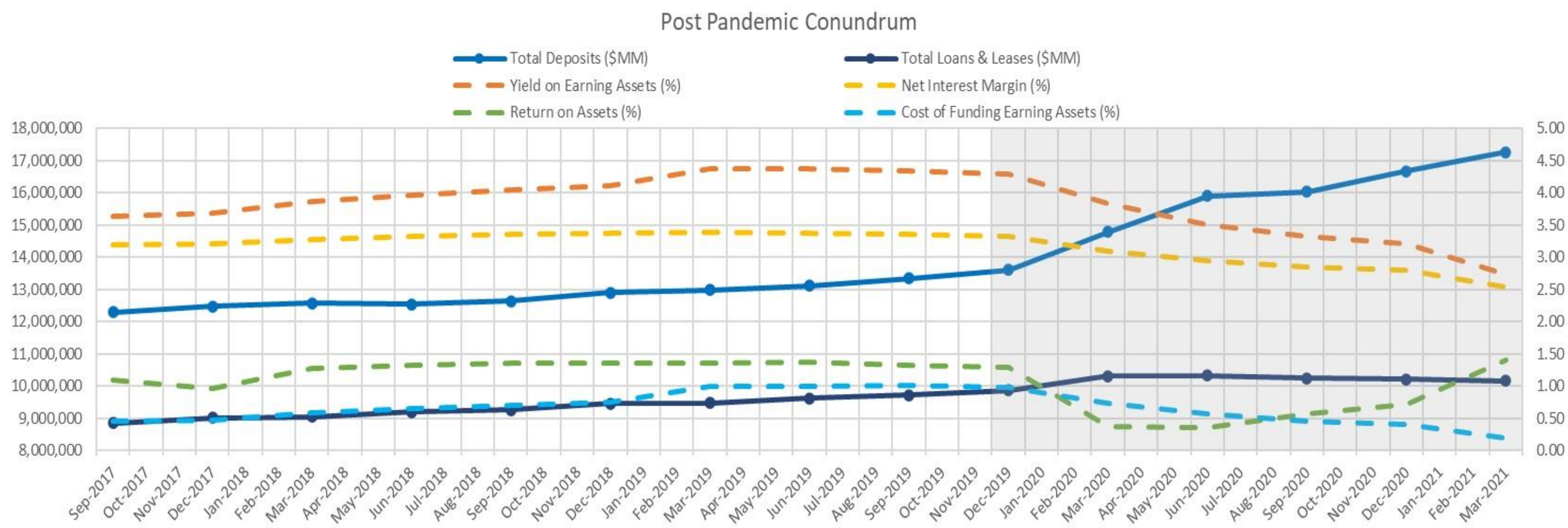
Market & CD Rate Indications

Excess Liquidity: The Community Bank Post Pandemic Conundrum by Jeff Rigsby

Leading up to the pandemic, we had this relatively nice relationship between deposit growth and loan growth. One year a little more loan growth, then one year a little more deposit growth. And yes, we were dealing with some degree of margin compression, with a downward pressure on yields, but that was offset by declining cost of funds. All in all, we knew we were at the long end of a great economic recovery period, post the Great Recession. During the pandemic we have created some records; highest level of deposits, lowest net interest margin, lowest cost of funds, and lowest yield on earning assets.



Source: FDIC data as March 31,2021

So without repeating the blow-by-blow occurrences of 1Q2020 – 1Q2021, we experienced a steep decline in general spending, massive government stimulus (PPP, bond investments, etc.), lockdowns, reopening, adverse impact to retail, hospitality, travel, and a surge in everything digital (i.e. online purchases, zoom conferences, digital delivery, etc.). For community banks in the end, we had to revalidate or reshape our strategy. The role of technology, branches, customer experience, partners, fintech, and the list goes on. For some, the post pandemic is generally a continuance of business as usual – for others a significant level of reengineering. But for almost everyone, it is: "what to do with all this excess liquidity"?

I think the post pandemic conundrum is more strategic than tactical.

What are the alternatives: 1. Hunker down and await better times (tighten expenses, reduce workforce, etc.)? 2. Revisit investment policies and strategies, like Increasing securities portfolio (higher yielding securities such as corporates, bank senior and sub debt, or other more exotic alternatives)? 3. Run off those pesky higher cost deposits or non-relationship deposits? 4. Bring back loan participations or expand on other new loan products? 5. Go all-in on non-interest income (i.e. expand secondary market alternatives like SBA, mortgage, etc.), wealth management, trust, or insurance? Reevaluate analysis fee income/waived fees, etc. 6. Or perhaps the newer age fee income fintech opportunities like payments, BaaS alternatives, digital currencies, digital banking, nationalizing your platform, new age partners, …? 7. Do you leverage what you do today, or do you learn new things and reinvent your model? 8. Do you buy or sell?

In this post pandemic world excess liquidity may be the challenge, but defining the community bank model of the future is the conundrum. Where do you go from here? It may be time to brush off the "Eisenhower Urgent vs. Important Principle". The "Urgent" in this case is reducing the adverse impact or consequences of excess liquidity. The “Important” is to ensure your near and long term strategy/business model is sustainable in good times and bad. The post pandemic consequences may prove to be the catalyst to shaping the community bank industry of the future.

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CB Resource, Inc.
584 Wald, Irvine, CA 92618
www.CB-Resource.com
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