

2016: A Brief Recap and the Effect on Financial Institutions

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By: D. James Lutter

Co-author: Todd A. Terrazas



The 2016 year was truly one for the record books. It began with the first Fed increase in over a decade and was swept out in the same fashion. Meanwhile, the world was witness to some of the largest geopolitical disturbances in recent history. U.S.-Russian relations continued their downward spiral, England voted to leave the European Union and the U.S. witnessed one of the greatest political upsets in modern history – to highlight a few. However, with this disorder and uncertainty, Main Street America continued to chug along at a pace worthy of a year-end rate increase. Furthermore, the Federal Open Market Committee (“FOMC”) suggested the possibility of an additional three increases over the course of 2017.

The Fed’s first increase in December 2015 was not a surprise; however, it was not reflected in the market until just prior to the rate increase. Throughout 2015, the FOMC continually discussed the desire and need to increase rates, yet the economy did not show consistent signs of stable footing that could withstand an increase. The result was a “wait-and-see” approach, which was reflected throughout the markets.

Throughout 2016, the economy maintained consistency, providing the Fed confirmation that another rate increase may be in order. The markets began to plan for an increase, but the big question remained: to what degree? In the late summer, the expectation of a rate increase gained momentum throughout markets as short-term fixed income options began to see upward pricing well in advance of the eventual Fed movement.

Although both rate increases were similar by timing and value, the anticipation and short-term deposit pricing results were drastically different. During the pre and post increase in 2015, large regional and money center institutions reacted with apathy. These institutions did not move in advance of the Fed increase and were essentially the last ones to respond; which traditionally has not been the case. During this time, institutional depositors saw larger community banks and credit unions fill a void by offering market-based rates to attract and maintain institutional depositors.

On the contrary, with the latest 2016 rate increase, large regional and money center institutions began to respond in a more traditional way in advance of the Fed movement, but still not to the pre-crisis levels. Whereas larger community banks and credit unions continued the market-based approach.

The Fed is motivated to continue normalizing rates throughout 2017 in order to retool for the later stages of this economic cycle. If the Fed does move in a more predictable fashion over the course of this year, larger regional and money center institutions will likely migrate back to a market-based pricing model; narrowing the competitive edge community banks and credit unions have experienced over the past couple of years.

About D. James Lutter



D. James (Jim) Lutter is the Senior Vice President of Trading and Operations at PMA Financial Network, Inc. and PMA Securities, Inc. where he oversees PMA Funding., a service of both companies that provides over 1,000

financial institutions with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities, Inc. and Investment Advisor Representative with Prudent Man Advisors, Inc. Mr. Lutter has the following FINRA licenses with PMA Securities, Inc.: Series 7, 24, 50, 53, 63, 65 and 99.

About Todd A. Terrazas



Todd joined PMA Financial Network, Inc. in 2014 as a Financial Analyst for the firm's Credit Risk Management team. He now serves as Business Development & Product Manager for PMA Funding, where he is responsible for developing financial institution partner relationships and managing funding product solutions and association affiliations. Mr. Terrazas also engages in strategic planning and identifying market trends through extensive market research. Prior to joining the firm, he was a Market Research Analyst at Common Goal Systems, Inc. Mr. Terrazas earned his Bachelor of Arts in Finance from Calvin College.

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