

2017: Rounding Second and Headed to Third

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CBInsight (Originally published on CBInsight.com, July 14, 2017)

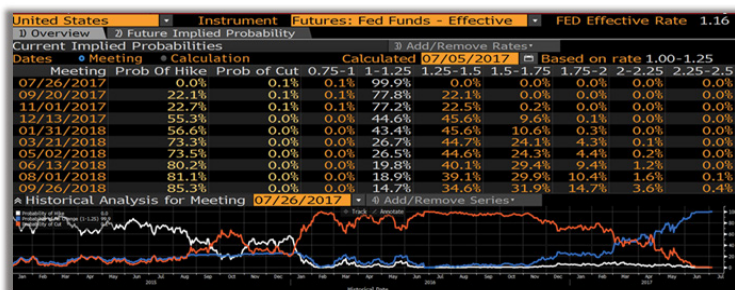
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During the second quarter of 2017, the economy grew 1.4 percent, with the Fed's key inflation indicator dropping to 1.4 percent in May (this after reaching as high as 2.1 percent in February.) Unemployment remained at 4.3 percent, and initial jobless claims continued to hover around 250k as of the end of June.

With the FOMC rate increase in June by 25bps, to a target rate of 1.25, the yield curve is further flattening out. The below graphic depicts where we are today versus last quarter (2-10 year note spread dropped from 92 to 88bps.) The Fed had previously indicated that there would be an additional rate hike before the end of the year, but those odds have dropped after weaker than expected inflation data, which the Fed is attributing to "idiosyncratic factors." No further explanation was provided. The odds of a September rate hike are currently 22 percent per Bloomberg, and December is 55 percent (as of July 7, 2017.)

The June Fed Minutes revealed that the Fed is still reviewing the best approach for changing reinvestment policy for the securities on its balance sheet, as well as the scope and timing of its balance sheet reduction. Markets are expecting the Fed will begin reducing the size of its balance sheet starting in September. There is also some debate regarding whether balance sheet normalization should impact the Fed Funds target rate.

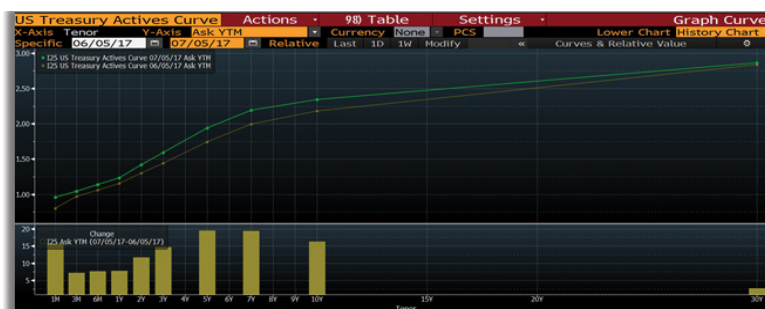
Inflation readings, asset prices and economic growth will impact how aggressively the Fed will continue to tighten for the remainder of the year.



Source: Bloomberg

In the face of this economic news, Mid-May we witnessed financial institutions across the spectrum aggressively seeking wholesale funding. When questioned on the contributing factors, the main themes were 1) to fund new loan growth, 2) balance sheet adjustments with quarter-end approaching, and 3) secure funding in advance of the anticipated fed increase. The common request has been to secure larger blocks of non-brokered deposits without having to pledge securities.

We continue to see an increasing trend among financial institutions seeking to grow deposits by predominately raising DDA and MMA balances. In order to attract institutional deposits, (depositors with significant investment potential) financial institutions have to offer competitive deposit account rates that "actively" adjust with the market to entice depositors from investing in term structures. In return, the understanding is that the institutional depositor will maintain stable balances as long as they are compensated with a market rate.



Source: Bloomberg

Having said this, there are only so many relationships each institutional depositor can develop with various financial Institutions until there's no more stability or the programs are so small in nature that it does not achieve the desired outcome for the financial institution.

With the flattening of the yield curve, and the potential for continued increases in overnight rate and desire for liquid deposit accounts over term structures, financial institutions need to plan now

to secure stable deposit programs. The main goal of institutional depositors (those who have large balances and, in aggregate, can cause volatility in your deposit portfolio quickly) is to achieve a sufficient rate of return without taking on credit risk. By identifying who these depositors are, and providing them market-based pricing that re-prices in an appropriate time frame, financial institutions can lay the foundation of deposit stability.

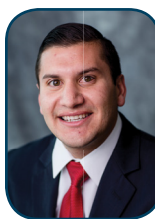
About D. James Lutter



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

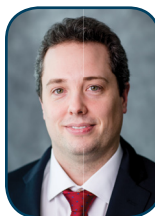
institutions with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities, Inc. and Investment Advisor Representative with Prudent Man Advisors, Inc. Mr. Lutter has the following FINRA licenses with PMA Securities, Inc.: Series 7, 24, 50, 53,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

About John T. Vaci



John Vaci manages the PMA Trading team, which supports investment advisory and broker dealer services. He is responsible for all broker dealer functions for PMA Securities, and trade support for Prudent Man Advisors, Inc. His FINRA licenses include Series 7, 63 and 24. John joined PMA in 2009 after working at Lionhart Investments where he was responsible for hedge fund trade support and accounting. Prior to that, he worked as an analyst for a third party logistics company. John earned a BA in Communications and an MBA from Benedictine University.

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