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What Economic Concerns are Critical for 2020 Planning?

As financial institutions finalize their 2020 plans, it's critical to remain current on key economic trends. This article includes key takeaways from the recent Economic Update presented by Jason Haley, Managing Director of ALM First's Investment Management Group, during ALM First's Financial Forum, which was held September 23-25 in San Antonio, Texas.

Trade Concerns

After an extremely volatile August driven by trade concerns, markets remain most sensitive to U.S./China trade tensions. Even if a comprehensive trade deal is reached in the near-term, will it be too late for the global economy to avoid recession? That is a key question as we evaluate current economic themes.

The current expansion is now the longest in modern history with a strong labor market, higher wage growth and Core CPI at a current cycle high. However, trade tensions continue to present great uncertainty for the global economy. Late-cycle symptoms have also emerged recently with downward revisions to estimates of economic growth, corporate profits, and employment growth.

Potential for Negative Rates

Another question looming over the markets is whether the Fed will commit to a new easing cycle and, if so, will negative interest rates in the U.S. become a reality? Officials have said they will do what it takes to support the current expansion. However, while Hawks focus on the domestic economy (low unemployment, strong payroll growth, and solid consumption), Doves are focused on global risks, particularly trade and manufacturing.

Fed leaders are under pressure from external sources, both market & political, to provide additional stimulus. The European Central Bank (ECB) has pushed the deposit rate more negative and European banks are trying to adjust to the extraordinary environment. Former Fed Chair Alan Greenspan said negative rates in the U.S. are "only a matter of time." However, current Fed leaders have been more critical of negative rates as a monetary policy tool.

Implications for Financial Institutions

ALM First advised Financial Forum attendees to avoid speculation and reactionary decisions. Several opportunities, along with potential risks, were also noted. In general, financial institutions can expect higher mortgage origination. While this leads to more reinvestment risk, it also presents an opportunity to use excess capital to leverage current mortgage production on a hedged basis at historically wide, risk-adjusted spreads

Downward pressure on net interest margins and deposit franchise values will make profitable risk management more critical as it relates to asset pricing, funding mix, and liquidity management. Depositories should also place greater focus on non-interest items (fees, efficiency ratios, etc.).

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