Still Searching for a New Normal
The Outlook for Consumers and Banking

Federal Reserve Bank of Chicago, December 2014

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In aggregate, American consumers are in their best condition since the financial crisis
- Spending power has grown
- Leverage is under better control

Progress has, however, been very uneven
- The distribution of income and wealth has become more skewed

Bank positions and performance are sound
- The influence of low interest rates and regulation are visible
- Lending standards are easier, but not overly easy

New laws are addressing “Too Big to Fail”
- Dodd-Frank has its strong points
Spending Trends
• American spending remains critical to international economic performance

Source: Haver Analytics
Recent U.S. Consumption Trends

- Retail gains have been centered at 4% annually
- Auto sales have moved ahead nicely

Source: Haver Analytics
Wealth Restoration

- Equity markets have enriched those who own stocks
- New wealth spurs spending

Sources: Bloomberg, Federal Reserve
U.S. Unemployment

- Joblessness has fallen sharply in the last two years
- Little improvement in wage growth

Sources: Bureau of Labor Statistics, Bloomberg, Haver Analytics
• Part-time work is still elevated
• Some potential to boost labor force participation

Source: Haver Analytics
Demographics are having a significant impact on the labor markets.
Progress on Deleveraging

- Debt and debt service are at multiyear lows
- Saving rates have increased

U.S. Debt Trends

- Households: Financial Obligation ratio (left)
- Households: Debt/DPI (right)

Sources: Federal Reserve, Bloomberg, Haver Analytics
Surveys suggest an improving outlook

Sources: Haver Analytics, University of Michigan Survey
• Student loans are the only category which has grown meaningfully
• Home equity is no longer a “piggy bank”

Source: Haver Analytics
Credit Card Trends

- Standards have become more accommodative
- Households seem reluctant to take advantage

Banks Tightening Standards for Credit Cards

Credit Card Debt

Source: Federal Reserve
Divergence of Fortune
• Those with the greatest equity exposure have profited the most in recent years

Sources: Bloomberg, Federal Reserve
Income Growth and Expectations

- Only the uppermost deciles have gained
- Moderation in outlook could affect spending trends

Sources: Federal Reserve, University of Michigan
One Angle on Unemployment

- Decomposing trends by age and education is key
- Those with less than a college degree have fared worst

Sources: Haver Analytics, BLS
Ready for Retirement?

- Many households remain underprepared
- Will public pensions be honored in full?

Retirement Accounts

- Median Value (right)
- Percent with Accounts (left)

2013 State Pension Funding Ratio

- Number of States

Source: Federal Reserve, Bloomberg
Summary: Consumers

- In aggregate, organic sources of income provide reasonable support for spending
- Attitudes towards leverage have not approached pre-crisis levels
- The income distribution affects how much people buy, and what they buy
- Many households still have work to do to get ready for retirement
Bank Performance
U.S. Bank Performance

- Profitability limited by low interest rates, compliance costs
- Loan quality is excellent

Sources: Federal Financial Institutions Examination Council, Haver Analytics
• Solid growth in corporate lending
• Standards have eased somewhat in the last two years

Source: Haver Analytics
Balance Sheet Conservatism

- A lot of QE remains idle on bank balance sheets
- New liquidity rules require highly liquid assets

U.S. Banks: Cash and Reserves

U.S. Bank Holdings of U.S. Treasuries

Sources: Federal Reserve, FDIC
- New standards and stress testing have brought significantly more capital into the industry

Sources: Federal Reserve, Haver Analytics
Too Big To Fail: Where We Stand

- Few think that the failure of a large bank could be resolved in an orderly way today.
- Derided by many, the Dodd-Frank Act and new Basle rules have some very effective components.
- We’ll need to consider the unintended consequences of driving banks to be smaller.
How to Gauge “Bigness?”

- Acquisitions and asset onboarding account for a good deal of the added concentration of total assets

Should we consider:
- Operational concentration (triparty repo, primary dealership, etc.)
- Dominance in a particular business line
- Interconnectedness

Total Assets, Top 10 U.S. Banks

Source: FDIC
New Capital Rules: Belt and Suspenders

Requirements for Tier 1 Common Equity

- Base: 4.5%
- Buffer: 2.5%
- G-SIFI Surcharge: 2.5%

Percent of Risk-Weighted Assets

Proposed Leverage Ratio Minima

- Base: 3.0%
- G-SIFI Surcharge: 3.0%

Percent of Total Assets

Proposed Total Loss Absorbing Capacity for G-SIFIs

- Core Capital: 10.0%
- Convertible Debt: 10.0%

Percent of Risk-Weighted Assets
Impact on Mortgage Market

- Penalties and new regulations have slowed originations
- Servicing has moved outside of the banking system

Recent Mortgage Settlements

<table>
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<th>Settlement</th>
<th>Amount</th>
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<td>Joint Settlement</td>
<td>$25.0</td>
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<td>(2012)</td>
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<td>Bank of America</td>
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<td>(8/2014)</td>
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Mortgage Originations

Sources: WSJ, Bloomberg, Haver Analytics
Subtle Impacts

- Capital rules limit credit extension to non banks
- R&R plans prompt rationalization of org structures

Source: Ernst & Young, Federal Reserve Bank of New York
Summary: Banking

- Profitability has been firmly re-established
- Balance sheet composition has changed dramatically since the crisis
- Banks and regulators are still seeking the “new normal” in their interactions

Key risks:
- International uncertainties
- Cyber security
- Leveraged lending
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