



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

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Themes

- **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





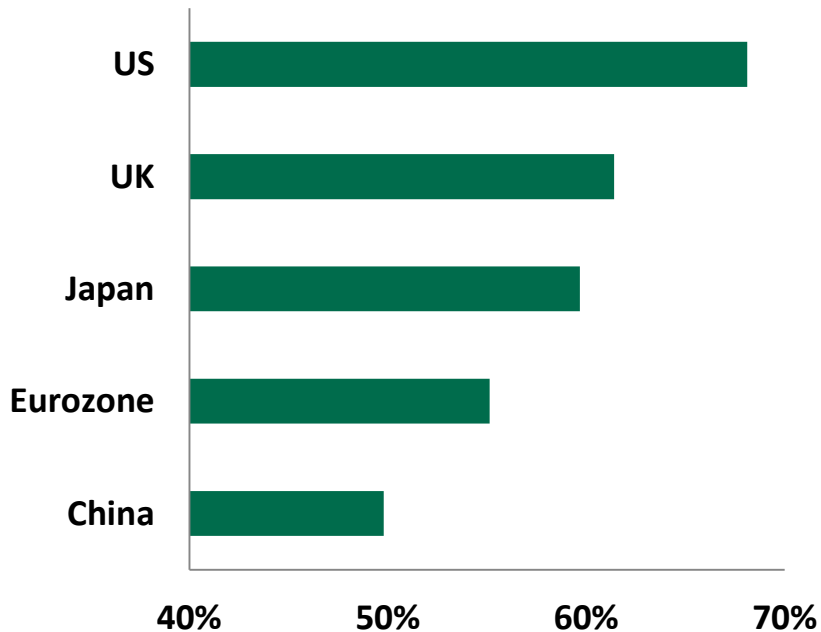
Spending Trends



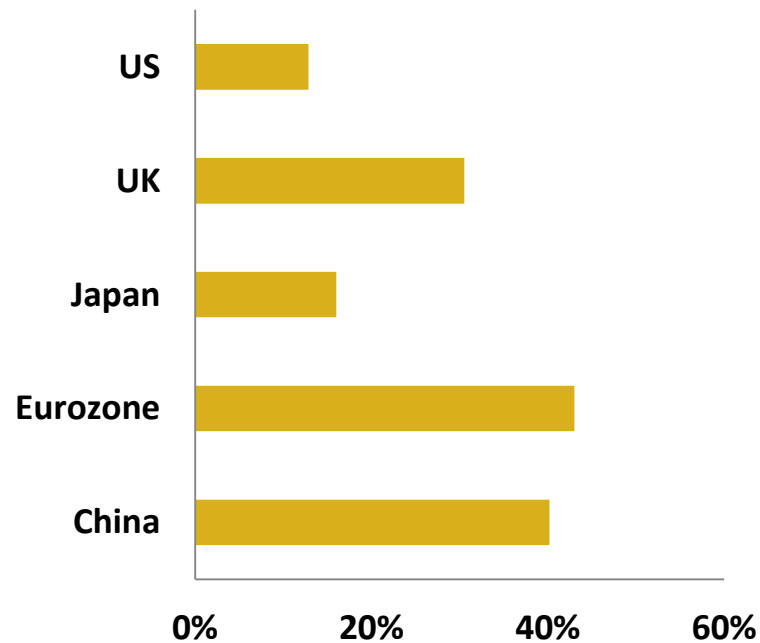
Still the Consumer of Last Resort

- American spending remains critical to international economic performance

Consumer Spending as a Percent of GDP



Exports as a Percent of GDP



Source: Haver Analytics



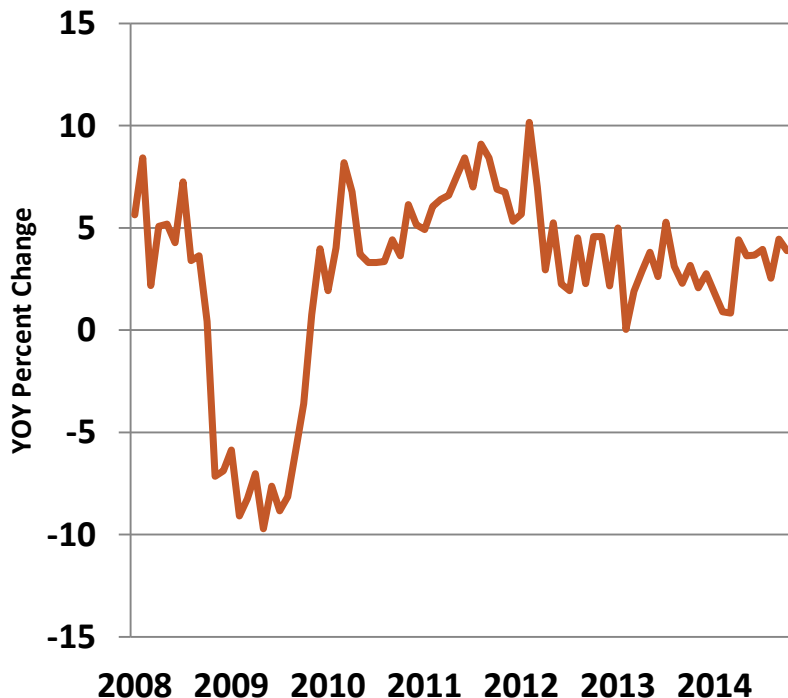
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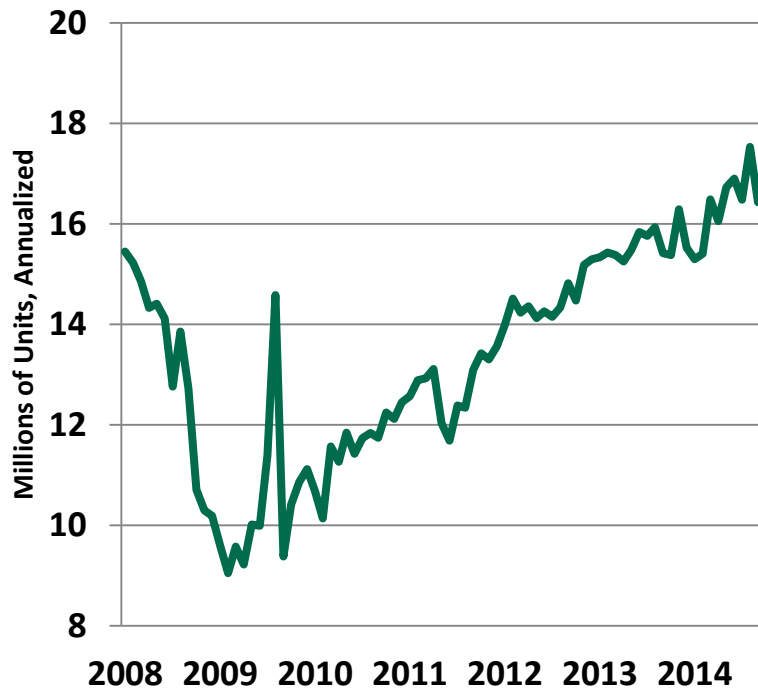
Recent U.S. Consumption Trends

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

U.S. Retail Sales Excluding Autos



U.S. Auto Sales



Source: Haver Analytics



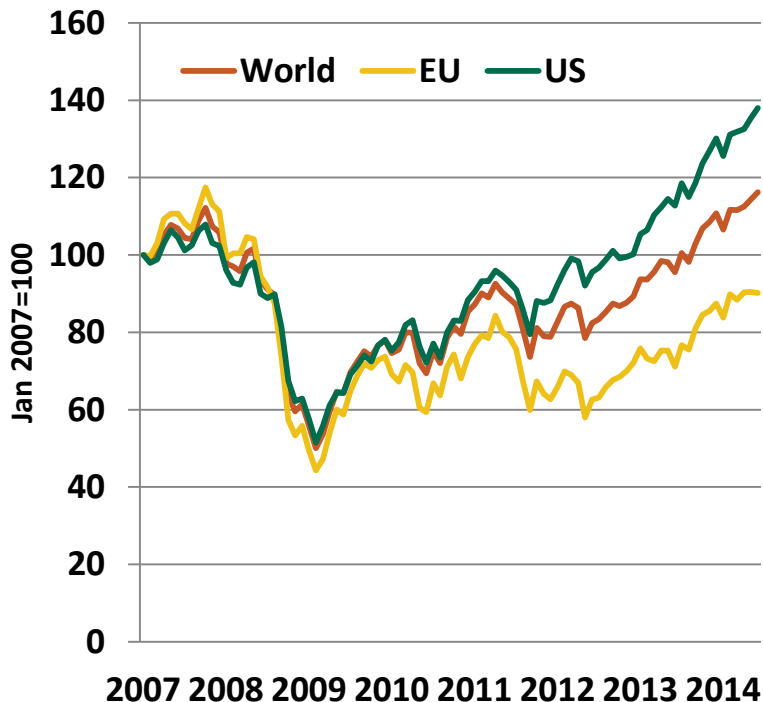
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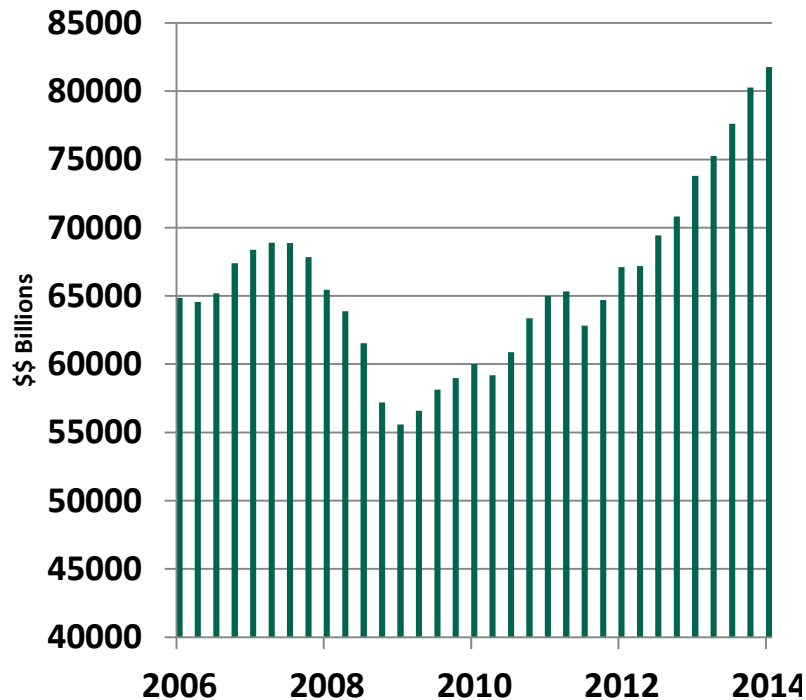
Wealth Restoration

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

MSCI Equity Indices



US Household Net Worth



Sources: Bloomberg, Federal Reserve

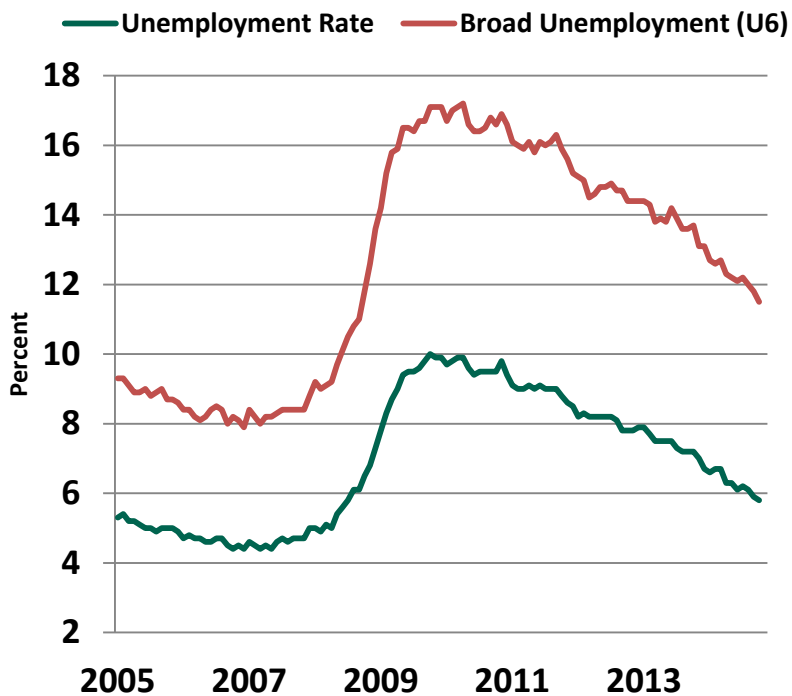




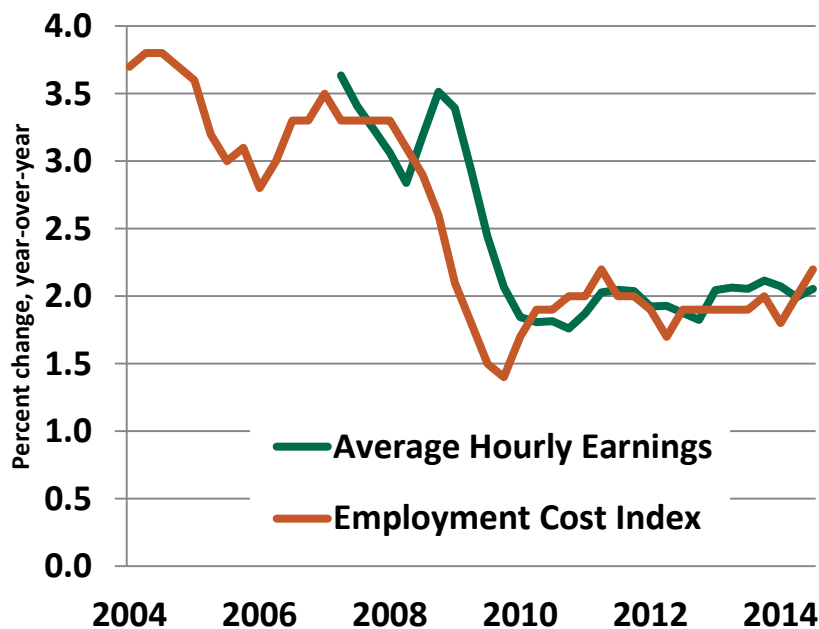
U.S. Unemployment

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

Unemployment Trends



Measures of Change in Employment Compensation



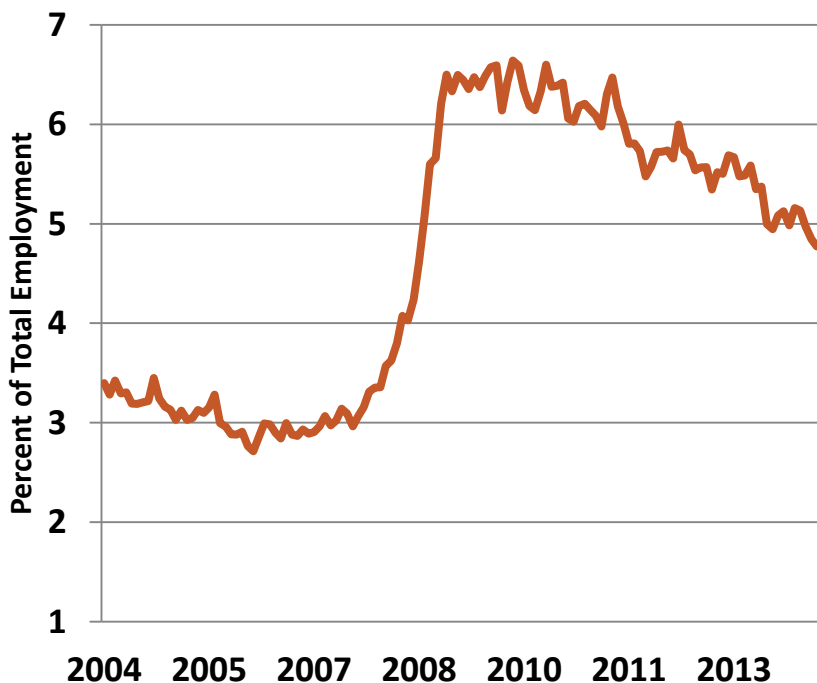
Sources: Bureau of Labor Statistics, Bloomberg, Haver Analytics



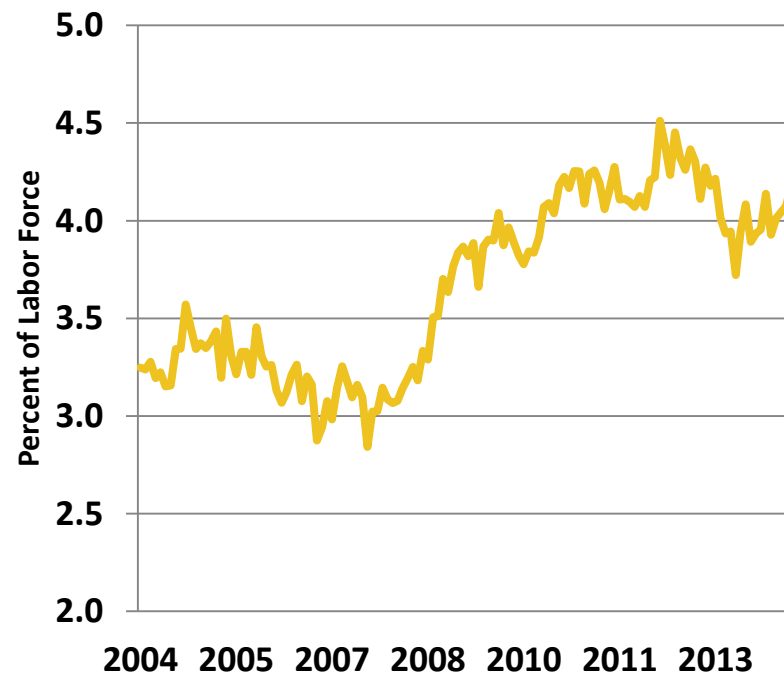
Labor Market Slack

- Part-time work is still elevated
- Some potential to boost labor force participation

U.S. Part-Time Employment



Persons not in the labor force but who want a job



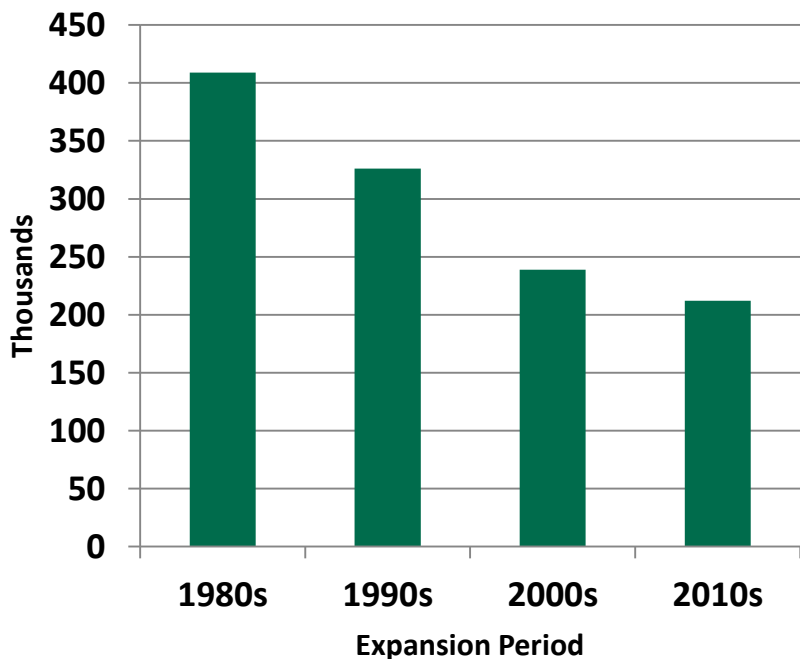
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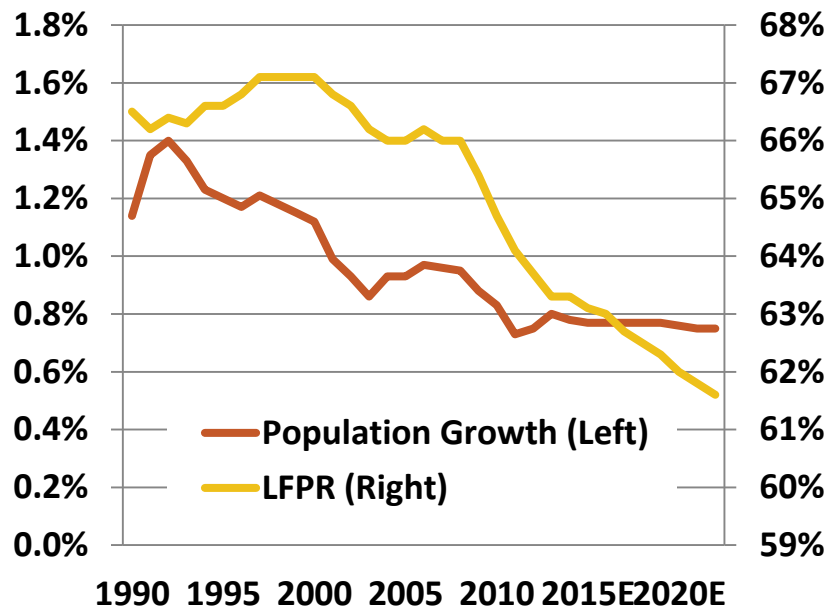
Not Your Father's Expansion

- Demographics are having a significant impact on the labor markets

Best 12-Month Average Payroll Increase



Labor Force Trends



Sources: Bloomberg, Census Bureau, BLS

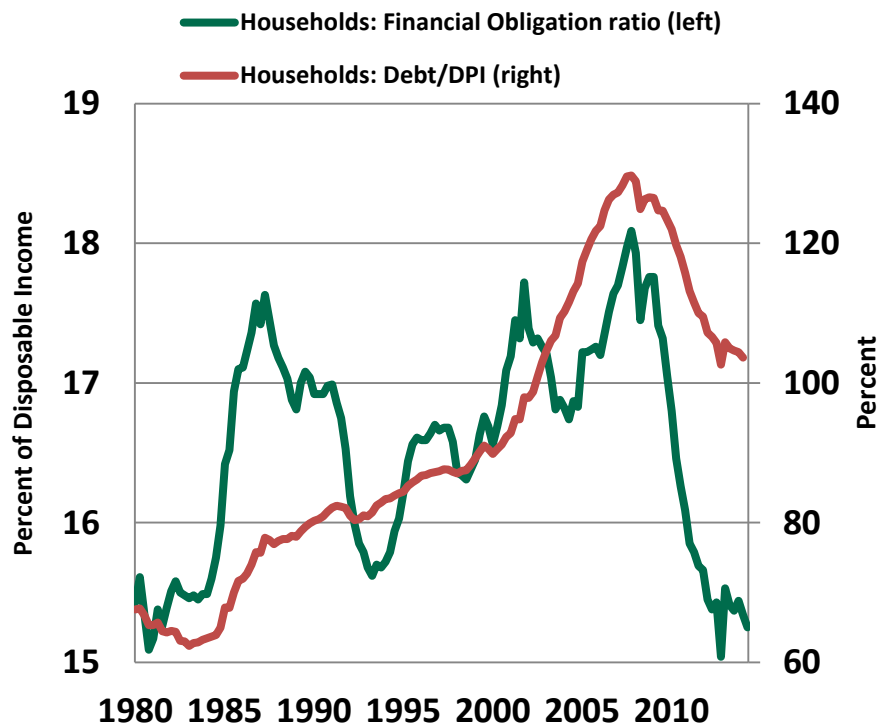




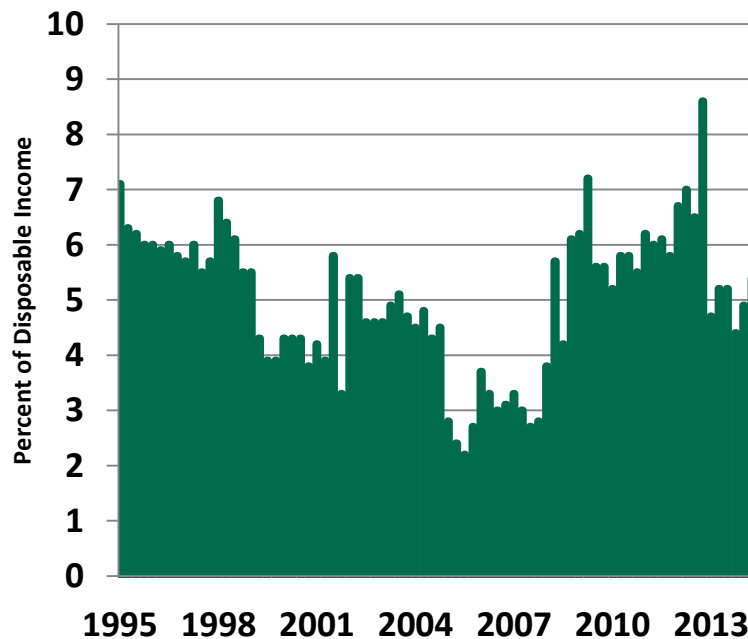
Progress on Deleveraging

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

U.S. Debt Trends



U.S. Saving Rate

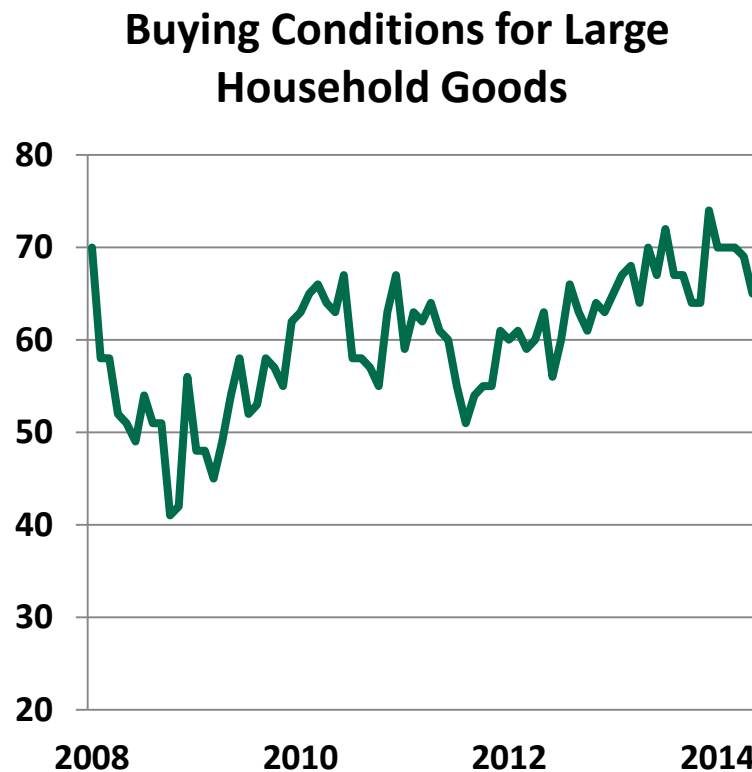
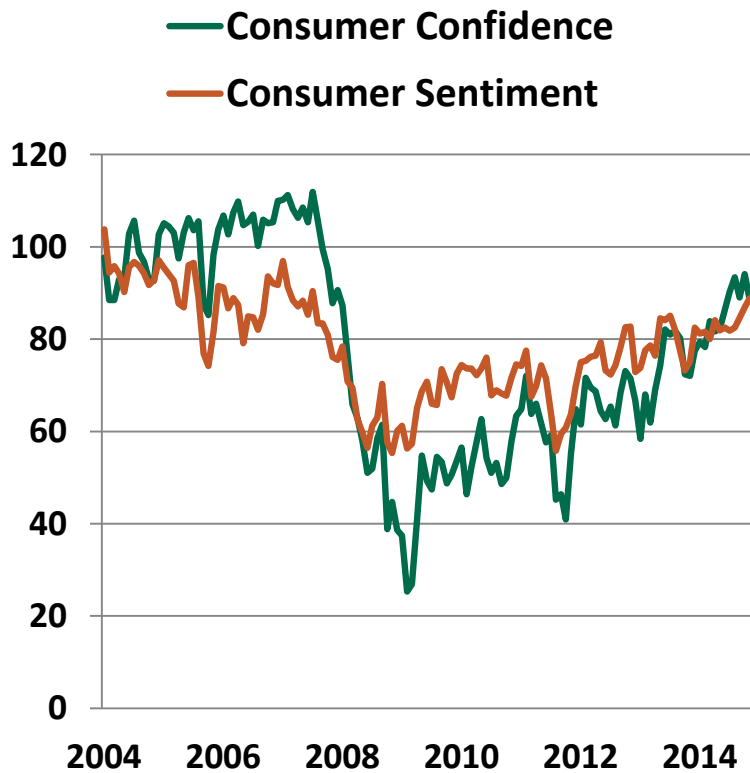


Sources: Federal Reserve, Bloomberg, Haver Analytics



Consumer Attitudes

- Surveys suggest an improving outlook



Sources: Haver Analytics, University of Michigan Survey

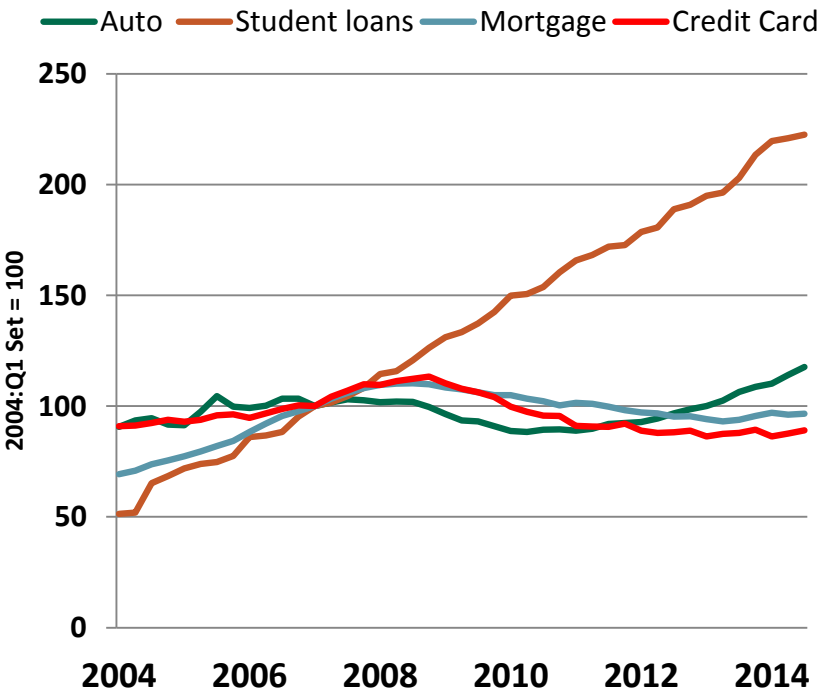




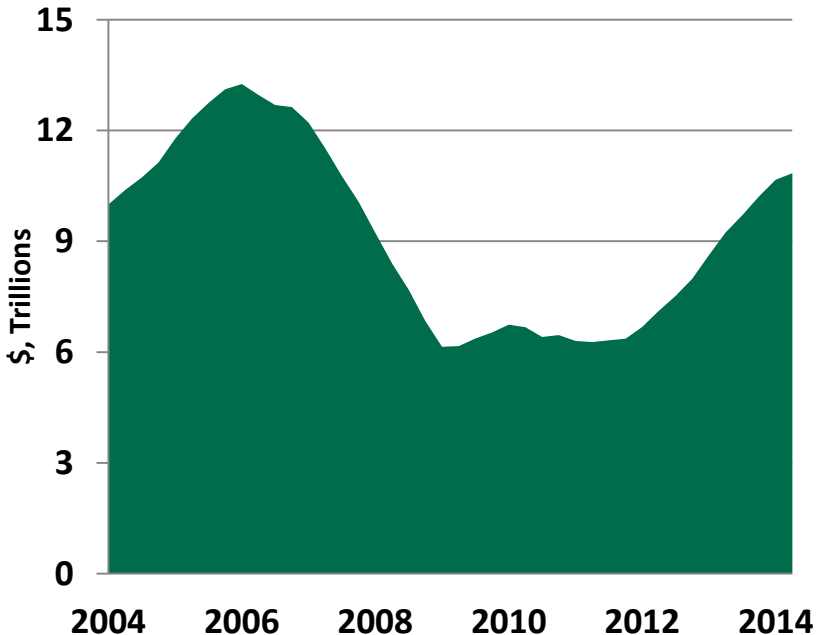
Use of Credit

- Student loans are the only category which has grown meaningfully
- Home equity is no longer a “piggy bank”

Trends in U.S. Consumer Debt



Net Home Equity



Source: Haver Analytics

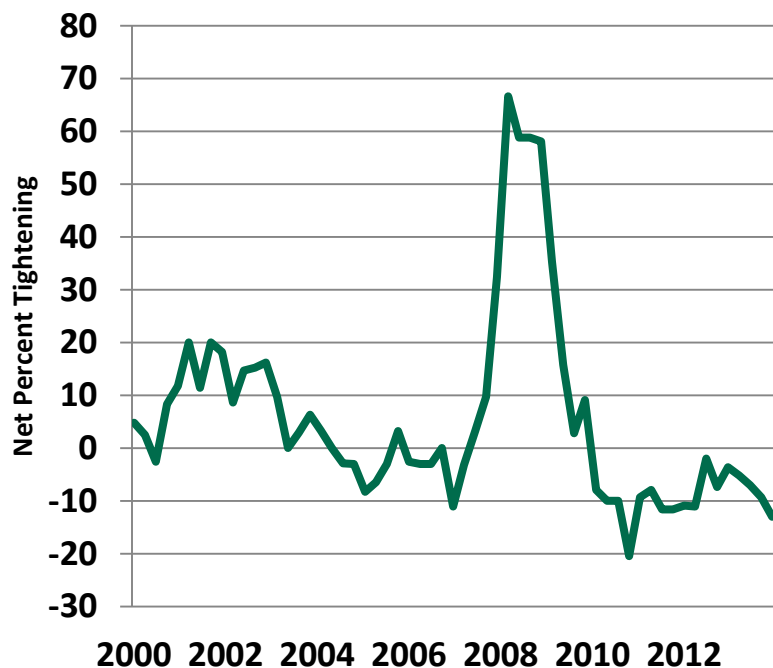




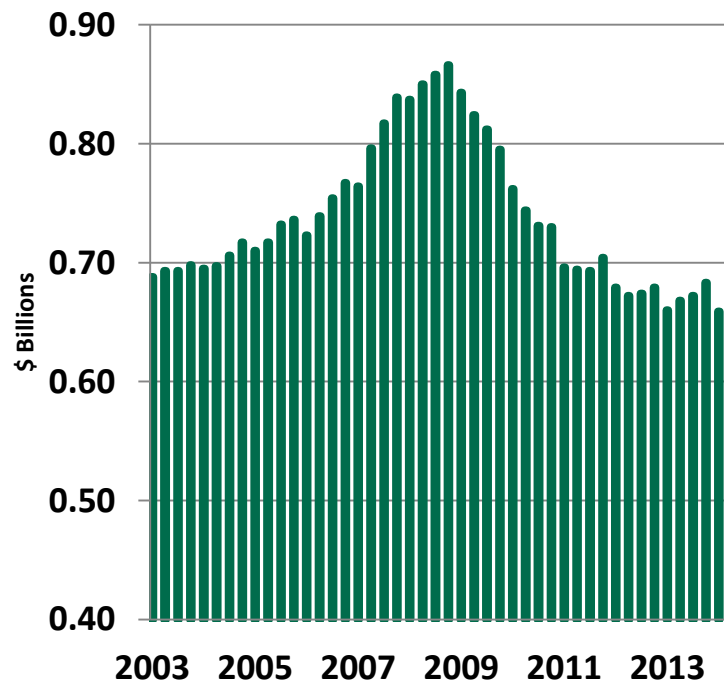
Credit Card Trends

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

Banks Tightening Standards for Credit Cards



Credit Card Debt



Source: Federal Reserve



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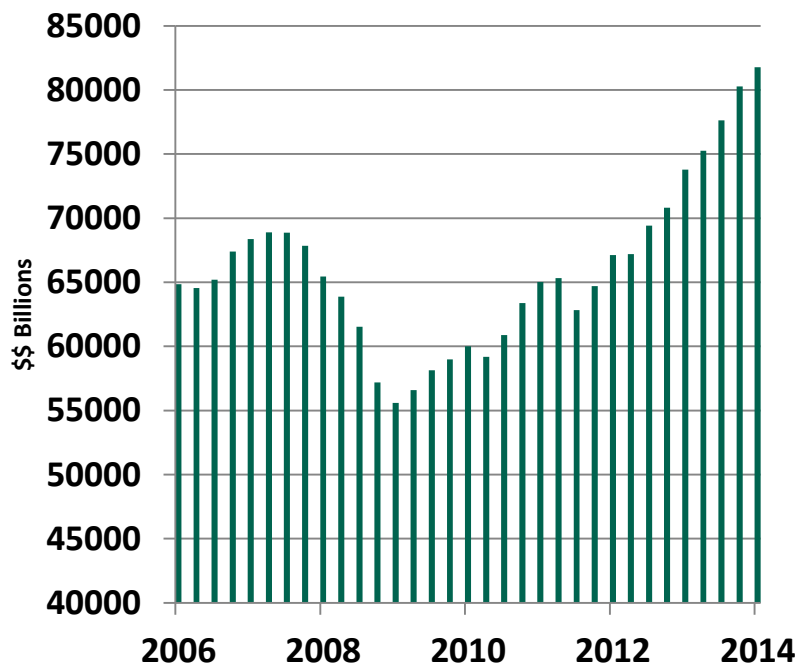
Divergence of Fortune



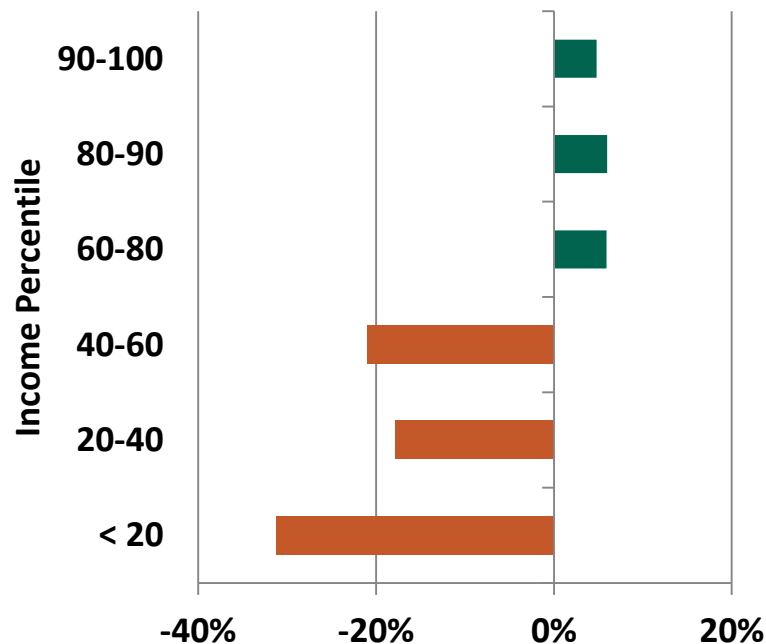
Wealth Gains

- Those with the greatest equity exposure have profited the most in recent years

US Household Net Worth



Change in Mean Net Worth, 2010-13



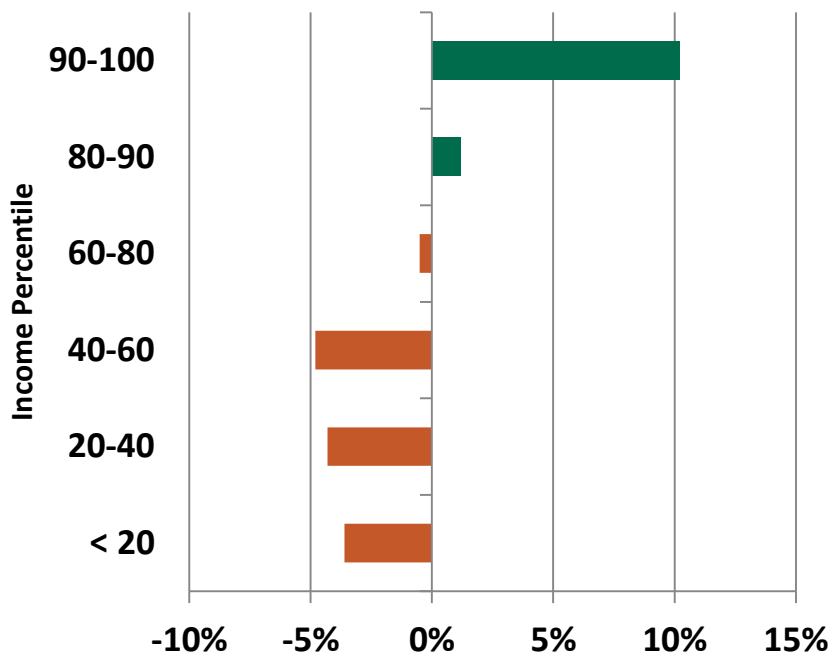
Sources: Bloomberg, Federal Reserve



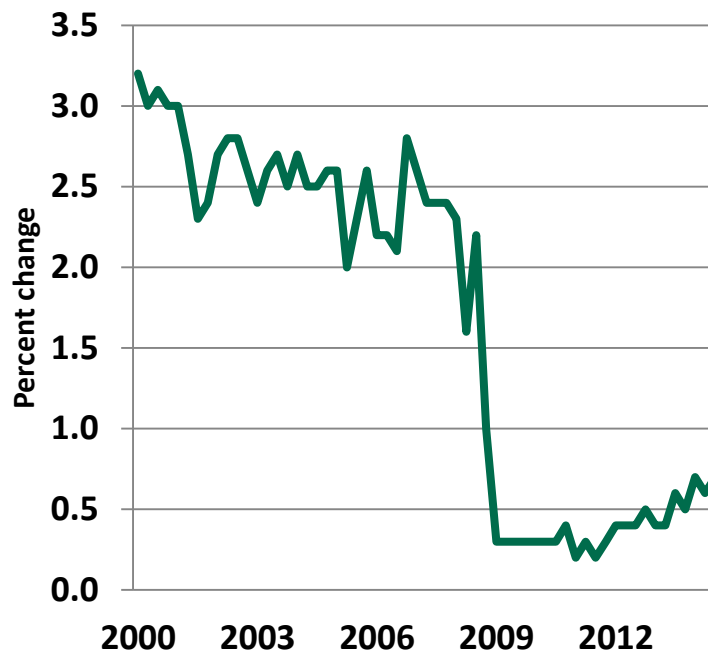
Income Growth and Expectations

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

Change in Mean Family Income, 2010-13



Expected Household Income Change in the Next Year



Sources: Federal Reserve, University of Michigan

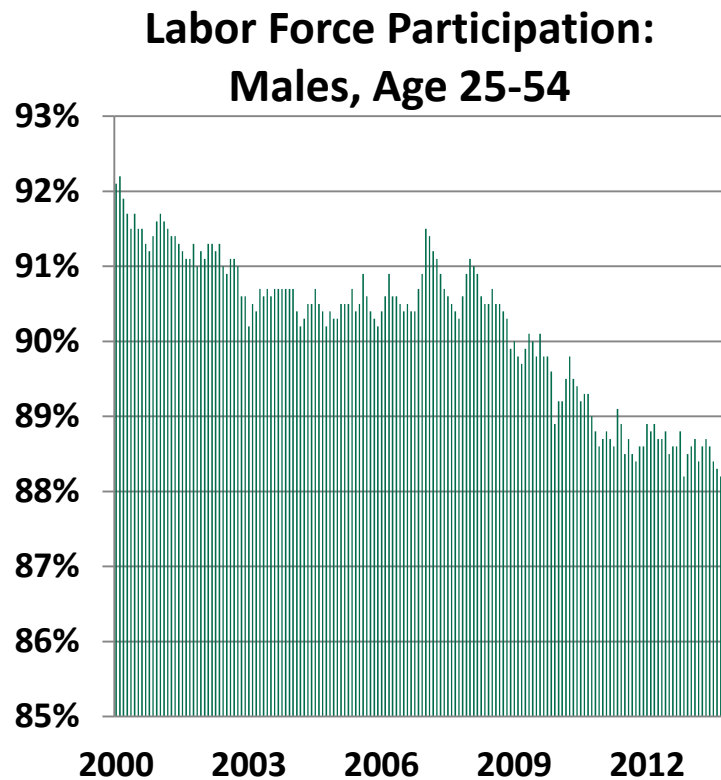
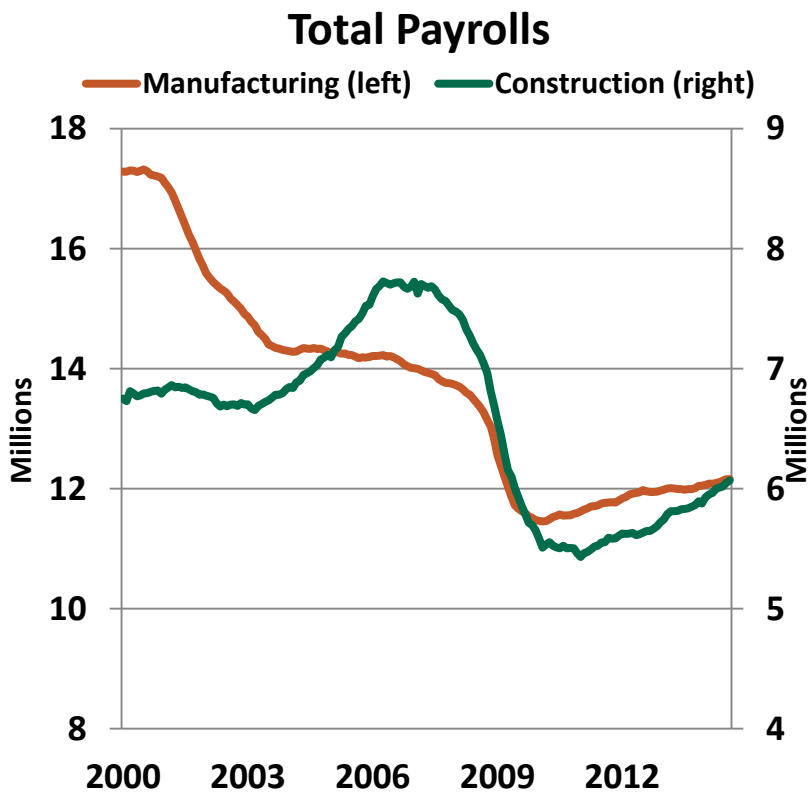


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One Angle on Unemployment

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



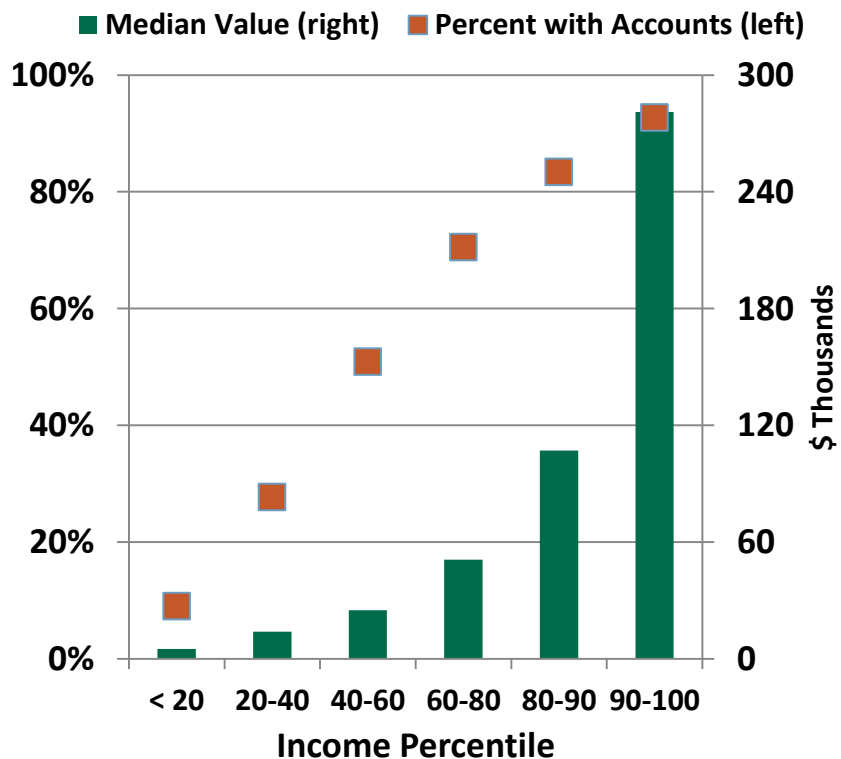
Sources: Haver Analytics, BLS



Ready for Retirement?

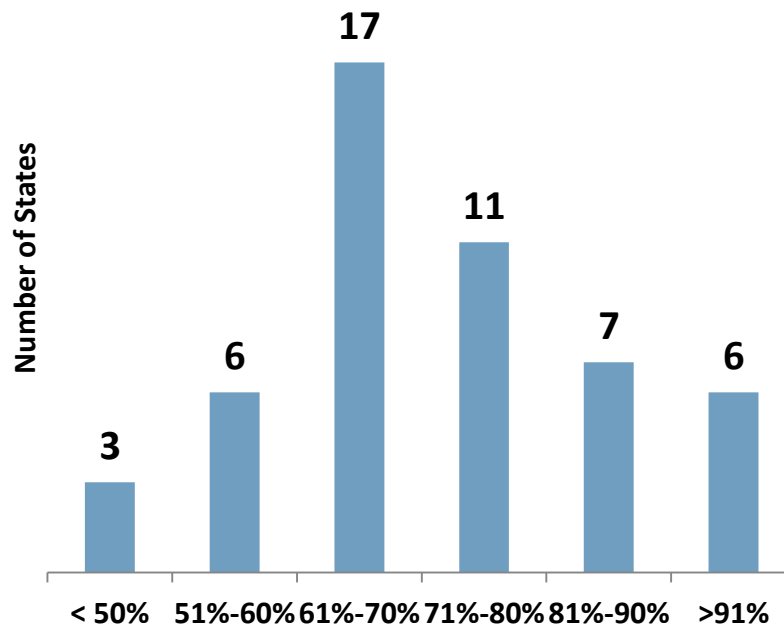
- Many households remain underprepared
- Will public pensions be honored in full?

Retirement Accounts



Source: Federal Reserve, Bloomberg

2013 State Pension Funding Ratio





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





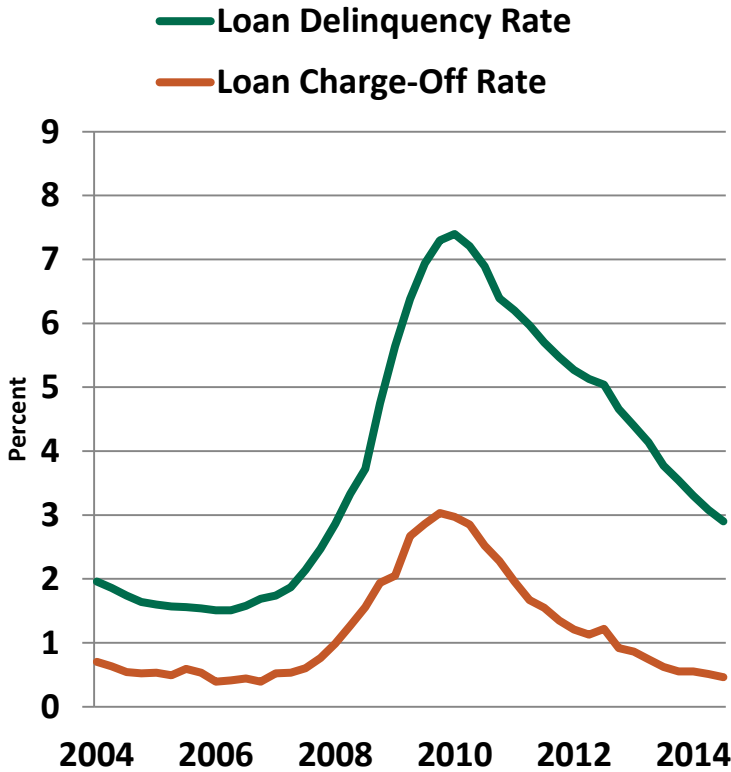
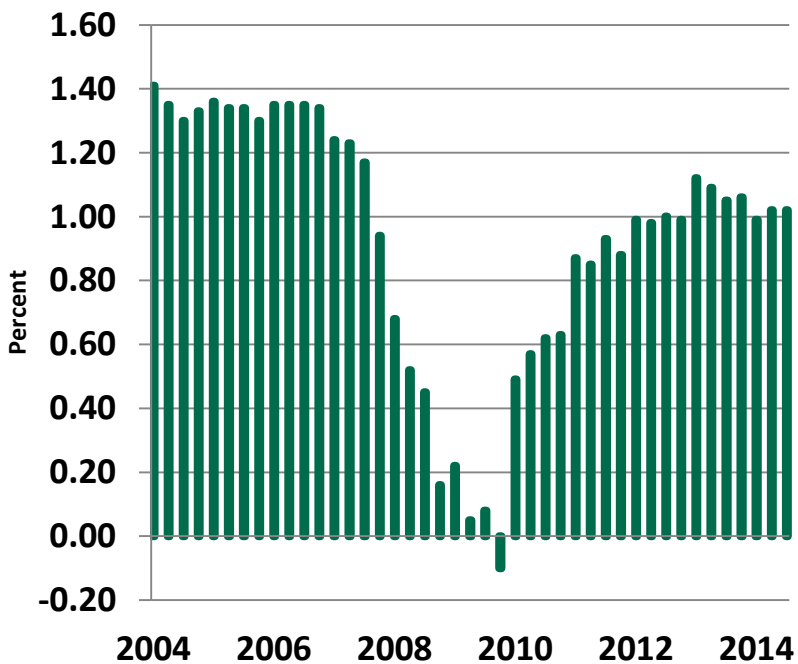
Bank Performance



U.S. Bank Performance

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

Return on U.S. Bank Assets



Sources: Federal Financial Institutions Examination Council, Haver Analytics

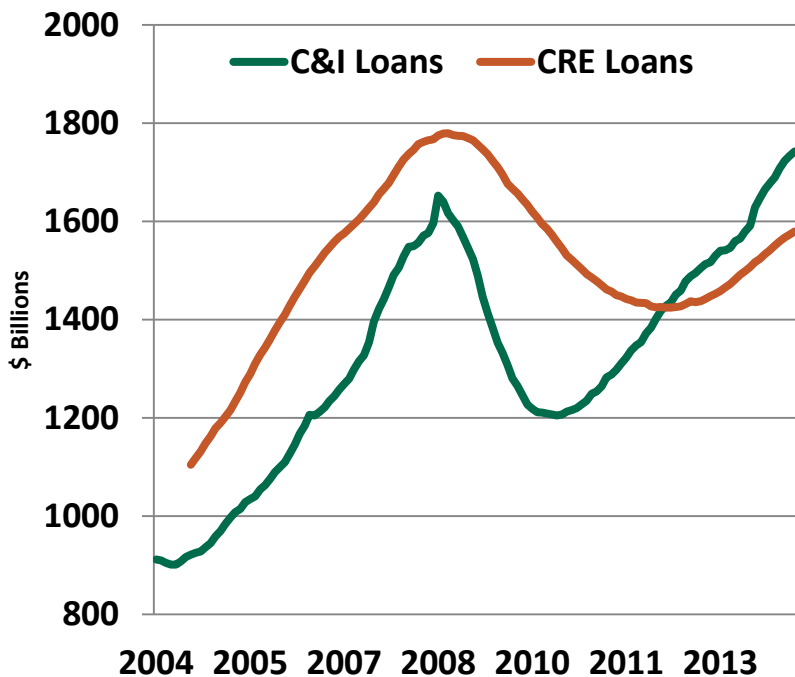




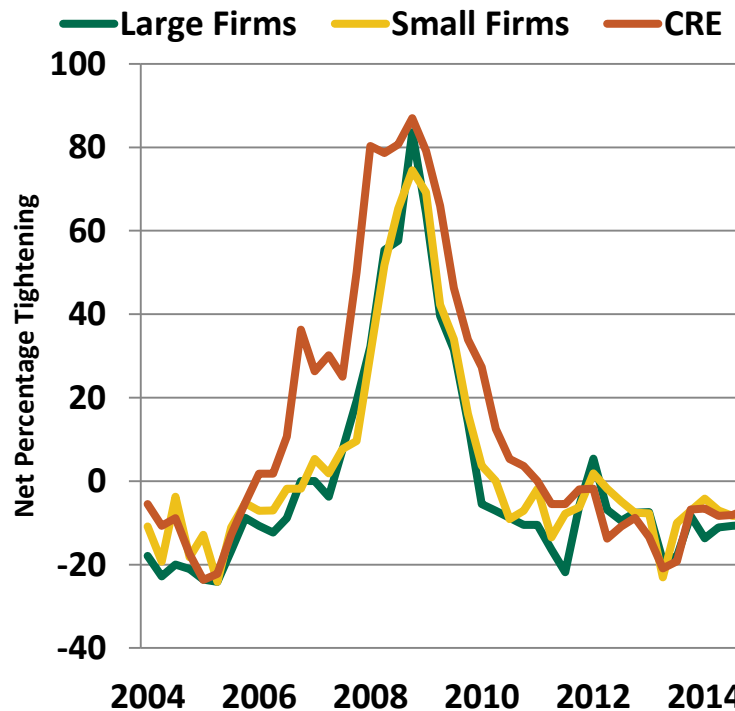
U.S. Lending Trends

- Solid growth in corporate lending
- Standards have eased somewhat in the last two years

Business Lending



Lending Conditions



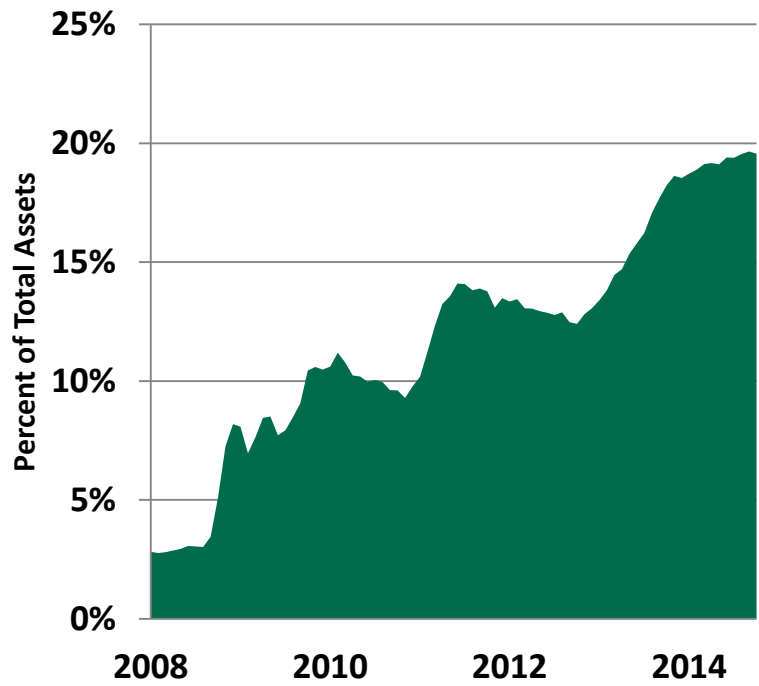
Source: Haver Analytics



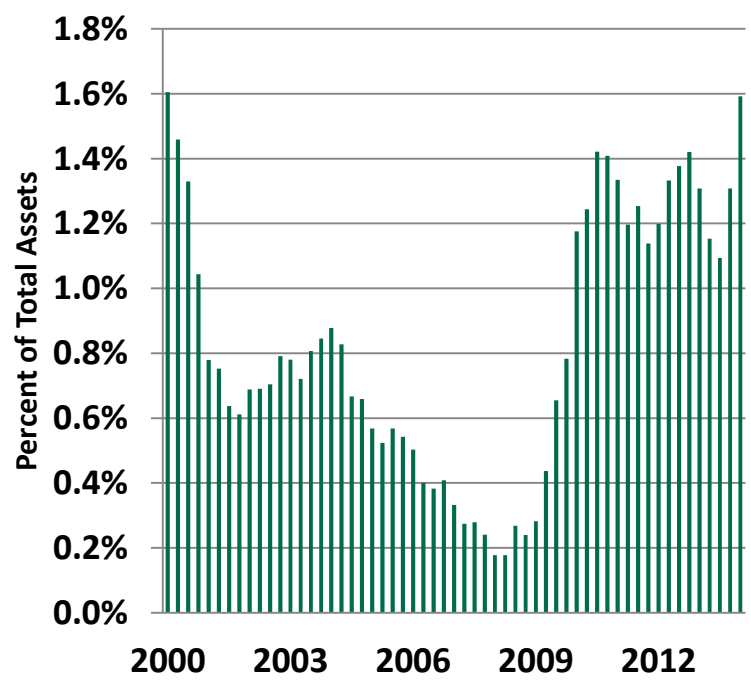
Balance Sheet Conservatism

- 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

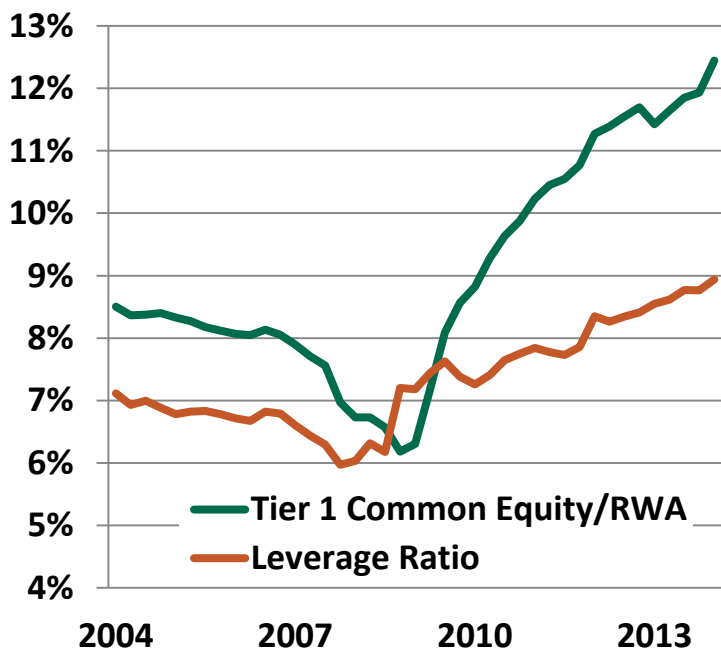




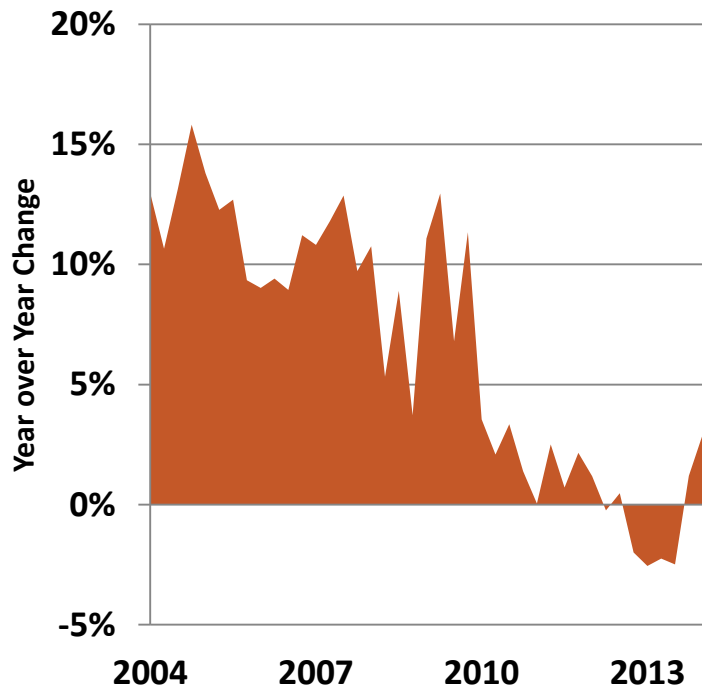
Capital Accumulation

- New standards and stress testing have brought significantly more capital into the industry

U.S. Bank Capital Ratios



U.S. Bank Asset Growth



Sources: Federal Reserve, Haver Analytics



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Too Big To Fail: Where We Stand

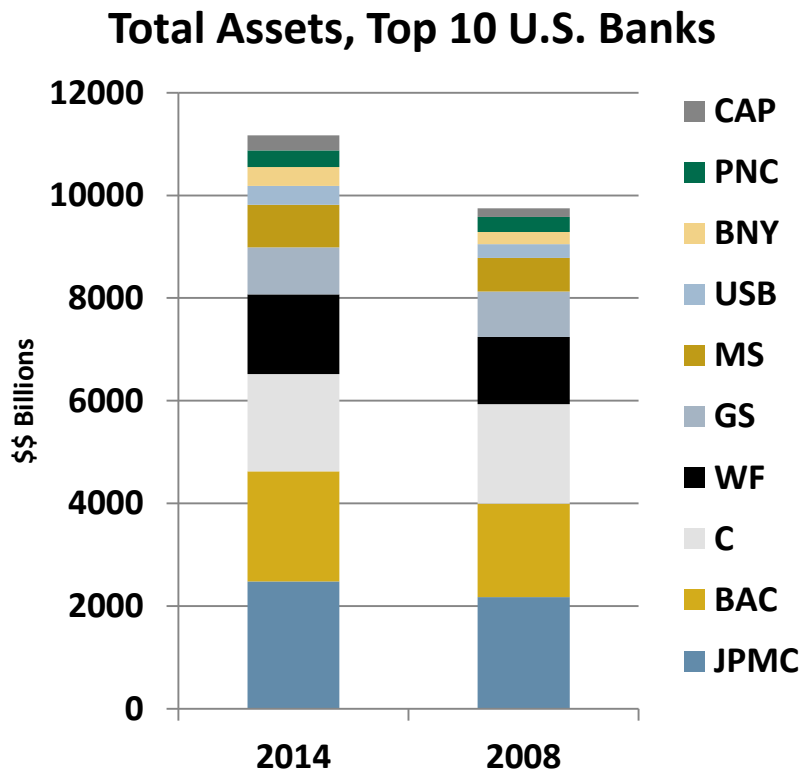
- **Few think that the failure of a large bank could be resolved in an orderly way today**
- **Derided by many, the Dodd-Frank Act and new Basle rules have some very effective components**
- **We'll need to consider the unintended consequences of driving banks to be smaller**





How to Gauge “Bigness?”

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



Source: FDIC

■ Should we consider:

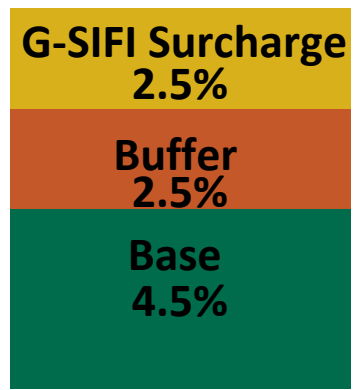
- Operational concentration (triparty repo, primary dealership, etc.)
- Dominance in a particular business line
- Interconnectedness



New Capital Rules: Belt and Suspenders

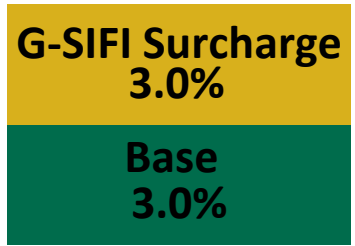
Requirements for Tier 1 Common Equity

Percent of Risk Weighted Assets



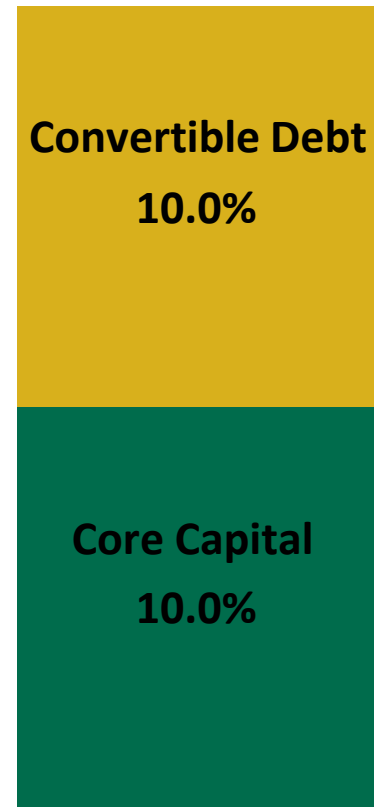
Proposed Leverage Ratio Minima

Percent of Total Assets



Proposed Total Loss Absorbing Capacity for G-SIFIs

Percent of Risk-Weighted Assets

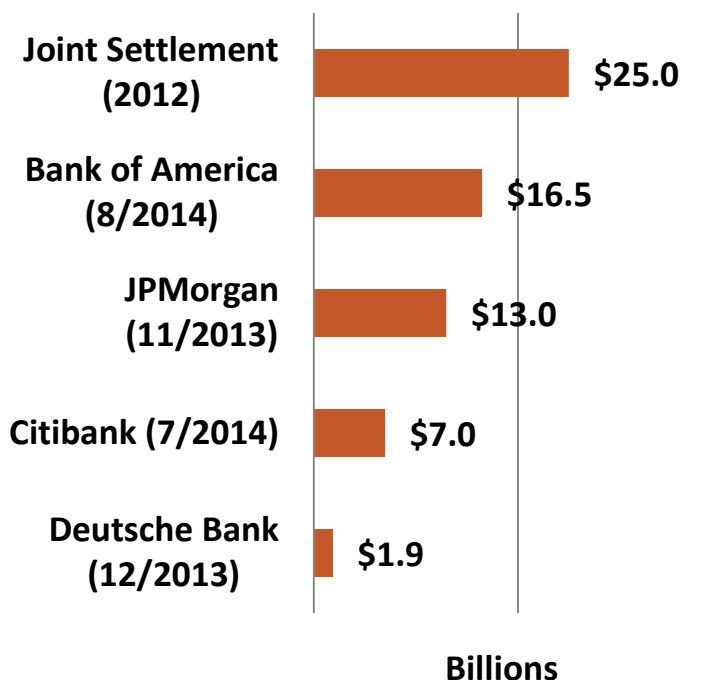




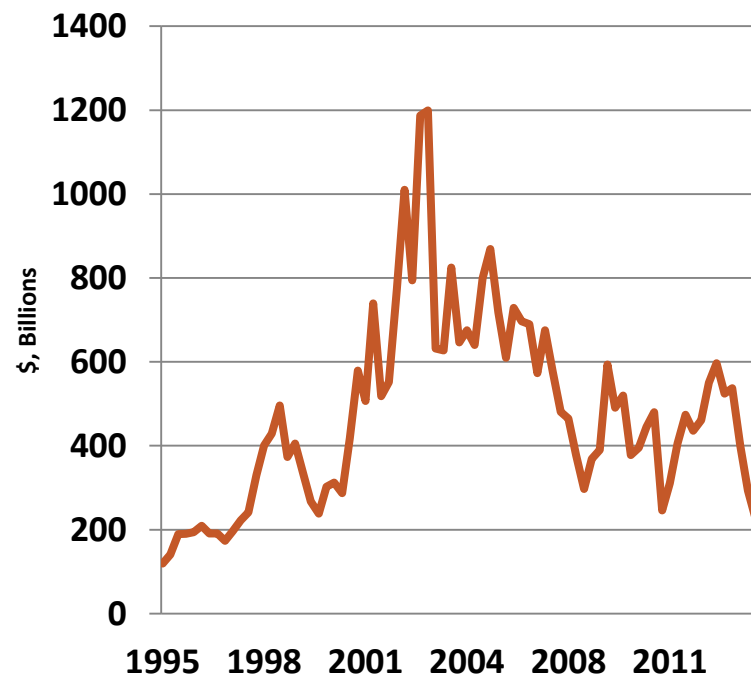
Impact on Mortgage Market

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

Recent Mortgage Settlements



Mortgage Originations



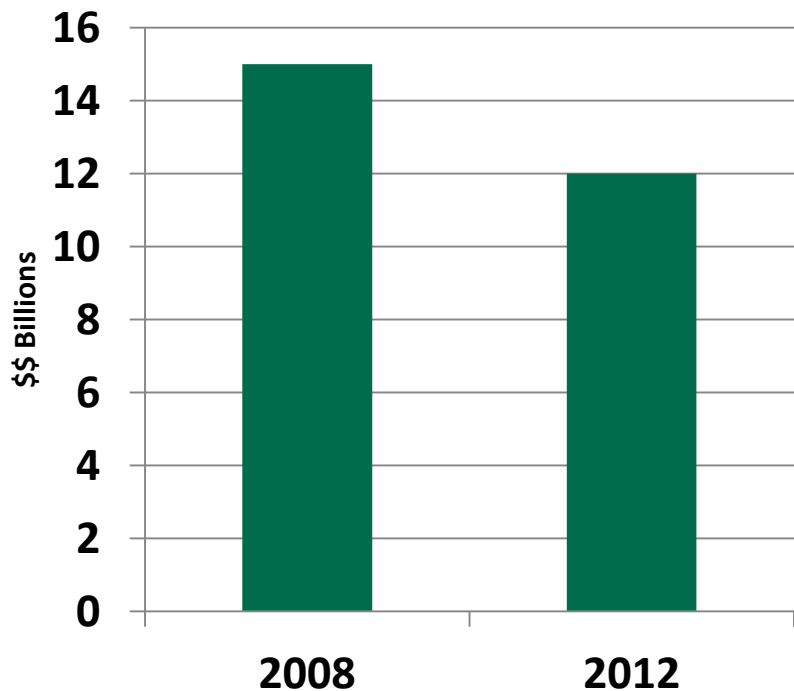
Sources: WSJ, Bloomberg , Haver Analytics



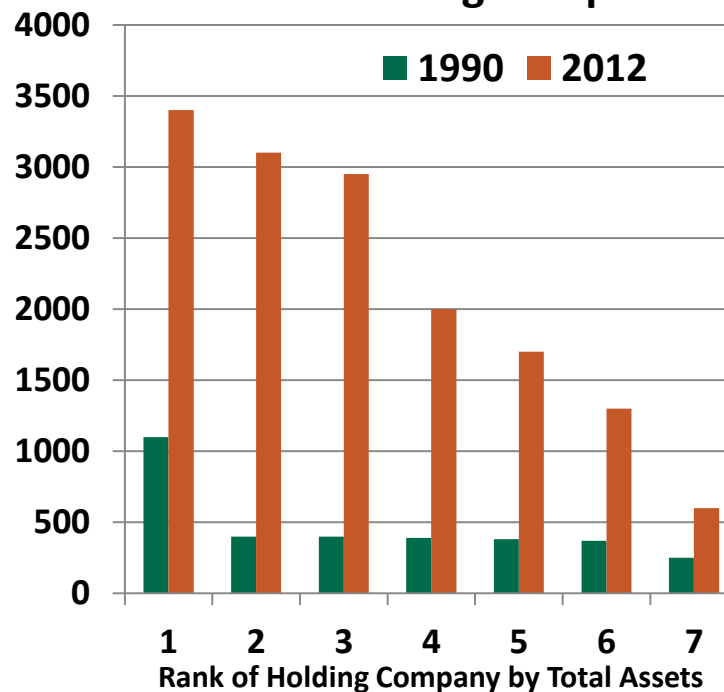
Subtle Impacts

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

Global Prime Brokerage Revenue



Number of Subsidiaries in Top U.S. Bank Holding Companies



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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