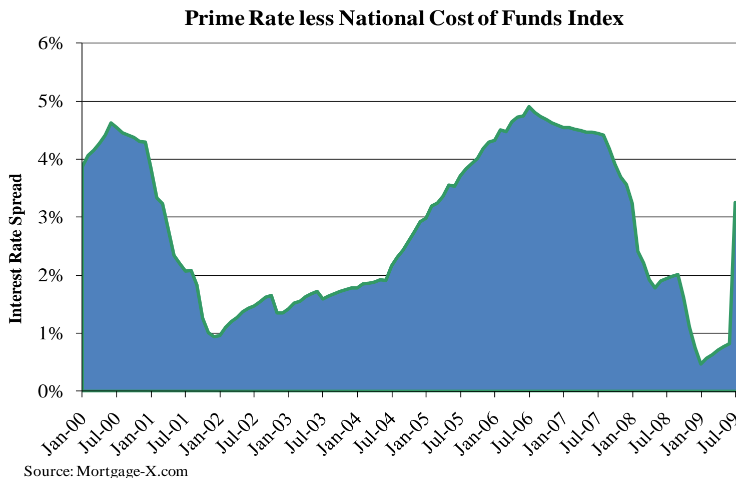
The Hutchison Company

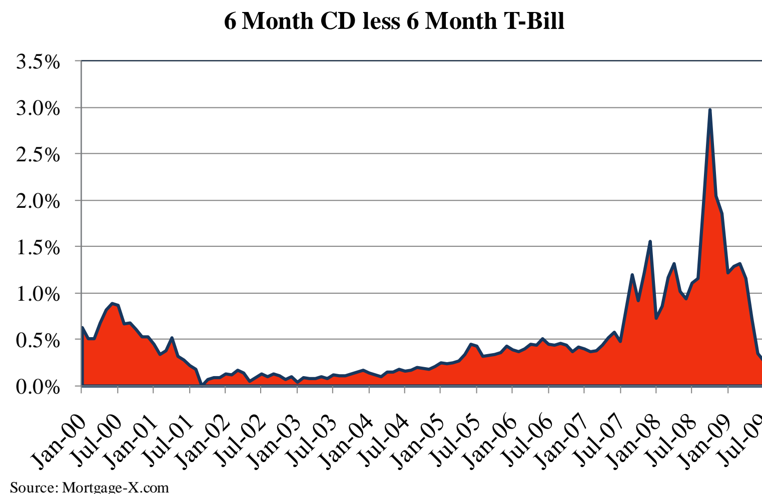
Investment Banking
Member FINRA Member SIPC

Since the beginning of 2009, we have seen steady improvement in core interest margins primarily resulting from more rational deposit pricing. Some, if not all, of this improvement is being masked by the high level of non-performing assets which reduces interest income and therefore the net interest margin. The return to more rational deposit pricing is helping banks absorb loan losses and bodes well for bank profitability when the credit cycle begins to turn.



Source: Mortgage-X.com

The extreme divergence of deposit rates and short-term treasury yields which we began to see in the 3rd quarter of 2008 has been a major contributing factor (and of course a symptom) of the severe financial stress that most banks have been experiencing. T-Bills and insured CDs of comparable maturity tend to have similar yields given the explicit government guaranty, implying a spread between the two of near 0%, which in a normal environment is generally the case. The widening of this spread to 3% in the third quarter of 2008 decimated interest margins and profitability that was needed to absorb rising loan losses. Had the Federal Reserve been sufficiently bold in its open market purchases of securities, they could have prevented the severe collapse of the money supply which caused much of the liquidity crisis resulting in the seemingly irrational deposit pricing.



Source: Mortgage-X.com

In fact the Federal Reserve unintentionally exacerbated margin pressure on banks when they began to push interest rates sharply lower in 2008, with the consequence that asset sensitive banks, especially community banks, experienced severe margin erosion. Asset sensitivity could be an advantage as rates rise, but that will depend on proper positioning of the balance sheet and continued rational deposit pricing. Some of the credit for the recent improvement and more rational deposit pricing goes to regulators who have put stringent limits on the ability of troubled institutions to overpay for deposits which has tempered some of the extremes in deposit pricing. Credit also goes to the Federal Reserve's monetary policy where moves to increase the money supply through open market purchases and other means has begun to take hold.

With the economy showing some signs of stabilization, possibly improvement, and as the Federal Reserve begins to provide less monetary stimulus, it is not too early for bankers to think about how they are positioned with regard to interest rate risk when rates begin to rise.

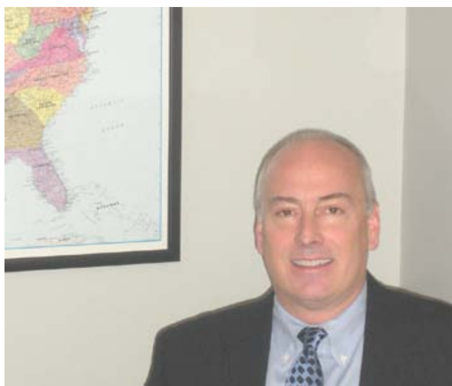
FINRA and SIPC Membership

The Hutchison Company is a member of the Financial Industry Regulatory Authority (FINRA). The Hutchison Company is also a member of the Securities Investor Protection Corporation (SIPC). The Financial Industry Regulatory Authority (FINRA), is the regulator for all securities firms doing business in the United States. FINRA was created in July 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange. To learn how SIPC protects customers of SIPC member broker-dealers please go to SIPC.org or call (202) 371-8300.

The Hutchison Company
1200 Broad Street, Suite 205
Durham, North Carolina 27705
Main number: 919-286-1314
Fax: 919-585-5326

Core interest margins are much improved, but the gain is being masked by high non-performing assets.

Mr. Huber is a Chartered Financial Analyst™ and a 1982 graduate of Duke University in Economics. He has spent the last twelve years in investment banking for community-based financial institutions, focusing on strategic planning, mergers and acquisitions and capital raising. Prior to this, Mr. Huber was a bank examiner with the North Carolina Office of Commissioner of Banks for six years. Before moving to North Carolina from New York, he was principally responsible for the credit analysis function on the corporate bond desk of a mid-sized New York investment banking/brokerage firm. He spent the first four years of his career as a financial analyst with a large New York-based multi-line insurance company where he specialized in portfolio management, credit analysis and asset/liability management for the fixed income portfolios.



Phillip D. Huber, CFA
Managing Director
The Hutchison Company