INTEREST RATE RISK: A WINDING ROAD

14th Annual Regional & Community Bankers Conference
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Federal Reserve Bank of Boston
INTEREST RATE RISK: Decision Criteria

- 2011
- 2015
- Balance Sheet Trends
- The Road Ahead
Share of Banks with Long-term Assets Representing 30% or More of Earning Assets

**YE 2006**

**Q1 2013 - Preliminary**

Share of Community Banks
- 0 to 10%
- 10 to 25%
- 25 to 50%
- 50 to 75%
- 75 to 100%

Source: FDIC
2011 Decision Factors

- GDP: Modest but Increasing
- Inflation: Minimal
- Monetary Policy: Low Rates
2011 Monetary Policy

• “Four years of 3 percent inflation [2004-2007] may not have been the worst of all possible outcomes, but I do not consider it a success. I hope we do better this time. In particular, I believe we need to heed the lesson of the last recovery that inflation is capable of rising even if the level of economic activity has not returned to its pre-recession trend.”

  Jeffrey M. Lacker, President, FRB Richmond, April, 2011

• “First, barring a sustained period of economic growth so strong that the economy’s substantial excess slack is quickly exhausted or a noteworthy rise in inflation expectations, the outlook implies that short-term interest rates are likely to remain unusually low for “an extended period.” The economy can be allowed to grow rapidly for quite some time before there is a real risk that shrinking slack will result in a rise in underlying inflation.”

  William C. Dudley, President, FRBNY, February, 2011
FOMC Projections of Change in Real GDP
September 2015

Source: FRED, FOMC September 17, 2015 Press Conference- Projections Materials
FOMC Projections of PCE Inflation
September 2015

Actual PCE inflation
Range of Projections
Central Tendency
Median

Source: FRED, FOMC September 17, 2015 Press Conference- Projections Materials
FOMC September, 2015 Fed Funds Target Levels

Source: Federal Reserve Open Market Committee September 17, 2015 press conference materials
What to do?

• Let’s run through some of the things we looked at to assess whether some strategies might present higher risk.
FRB Tools
Q2 2015 First District - EVE vs. EAR Results
(Up 200 b.p. Scenario)
New England Balance Sheet

Structure and Trends

- Long-Term Assets
- Residential Loans
- Long-Term Investments
- Commercial Loans
- Nonmaturity Deposits/CD Funding
- FHLB Borrowings
Long Term Assets / Total Assets
FD Banks with Assets < $10 bil

Share of Total Assets

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(LT Assets / Total Assets) vs. NIM

Year 1: 3Q04 – 2Q05
Year 2: 3Q05 – 2Q06
Year 3: 3Q06 – 2Q07
Year 4: 3Q07 – 2Q08
Residential Loans / Total Loans
FD R&C Banks with Assets < $10 bil

Share of Total Loans

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FEDERAL RESERVE BANK OF BOSTON™
Balance Sheet Composition and Trend

**Nation**

- OREO
- HTM Securities
- Net Loans
- AFS Securities
- IBBB

**First District**

- Percent of Average Assets (%)

FEDERAL RESERVE
BANK OF BOSTON™
Long-Term Investments / Total Assets
FD Banks with Assets < $10 bil

Share of Total Assets

0%  2%  4%  6%  8%  10%  12%  14%

1  2  3  4  1  2  3  4  1  2  3  4  1  2  3  4  1  2  3  4  1  2  3  4  1  2  3  4  1  2  3  4  1  2  3  4  1  2  3  4  1  2

Annual Percentage Growth - FD R&C Banks

Year 1: 3Q04 – 2Q05
Year 2: 3Q05 – 2Q06
Year 3: 3Q06 – 2Q07
Year 4: 3Q07 – 2Q08

Annual Percentage Growth - US R&C Banks
Earnings and Capital
Up200 Impact to Tier 1 Leverage Ratio

- T1 Leverage
- Up200 T1 Leverage
The Road Ahead

What is next?