

California Bankers Association

Global Economic Review: Why it matters to your bank

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SEPTEMBER 13, 2023



OVERVIEW



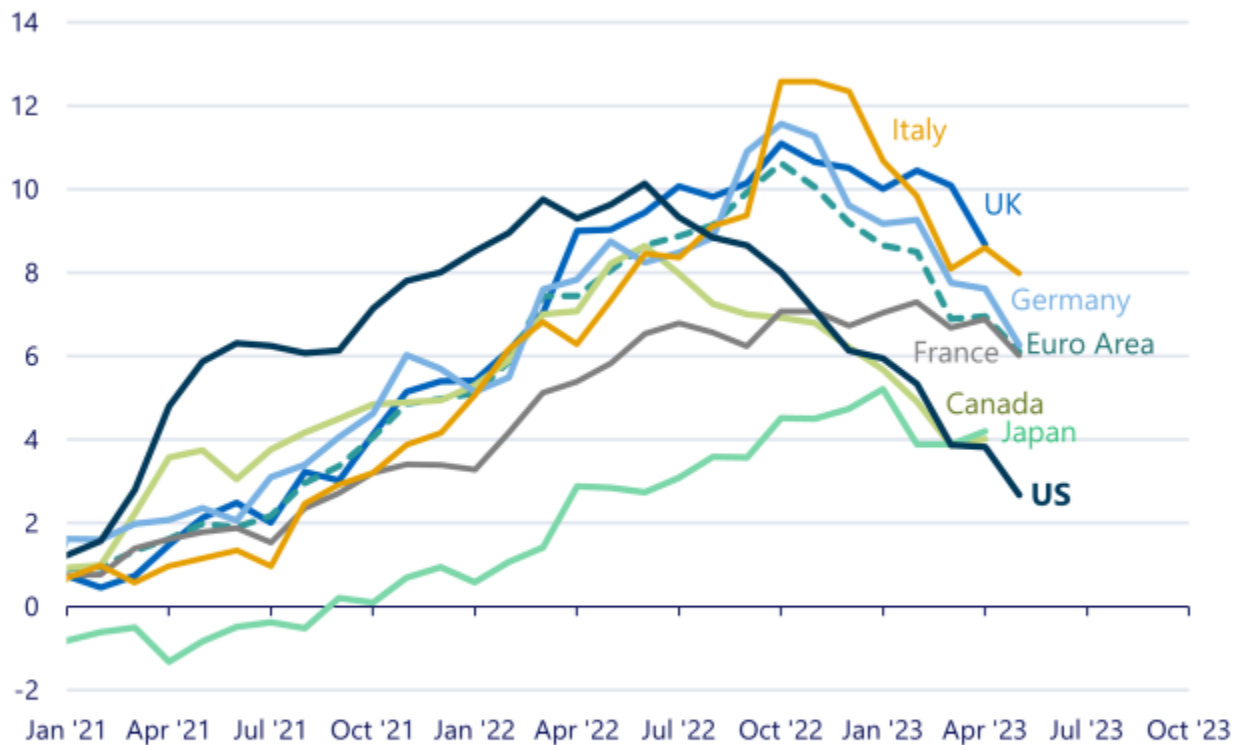
- I. Economic Backdrop: US, EU, UK, China, Japan
- II. Increase Bank Capital Requirements: Basel 3.1 (Basel IV)
- III. Global Monetary Policy Considerations
- IV. What this means to U.S. Banks

G-7 INFLATION



Figure 1. Harmonized Headline HICP Inflation in the G7

All items, HICP basis (Year-on-year percent)



Council of Economic Advisers

Sources: Eurostat, ONS, BLS, Statistics Canada, MEI, CEA analysis.

Note: Euro Area: HICP; UK: CPI; US: R-HICP-U; Canada: CPI ex. Mortgage Interest, Replacement Cost, & Property Taxes; Japan: CPI ex. Imputed Rent.

As of June 20, 2023 at 6:00pm.



I. CENTRAL BANK OBJECTIVES AND TOOLS

- FED: Price Stability (2% target) and Full Employment (levels seen in normal economic conditions)
 - Fed Funds Rate, Discount Window, Reserve Requirements
- ECB: Price Stability (2% target)
 - Main Refinancing Operations, Marginal Lending Facility, Deposit Facility
- BOE: Price Stability primary goal (2%), Growth and Unemployment (secondary)
 - UK Bank Rate, Quantitative Easing
- PBC: Price Stability, Economic Growth, Promoting Employment, Maintaining Balance of Payments (Foreign Exchange Rate)
 - PBC Reserve Requirement Ratio, Medium-term lending facility, Discount Rate (open market operations) Heavily export-dependent economic system: focus monetary policy on FX rates and printing currency.

HIKING CYCLE COMING TO AN END SOON



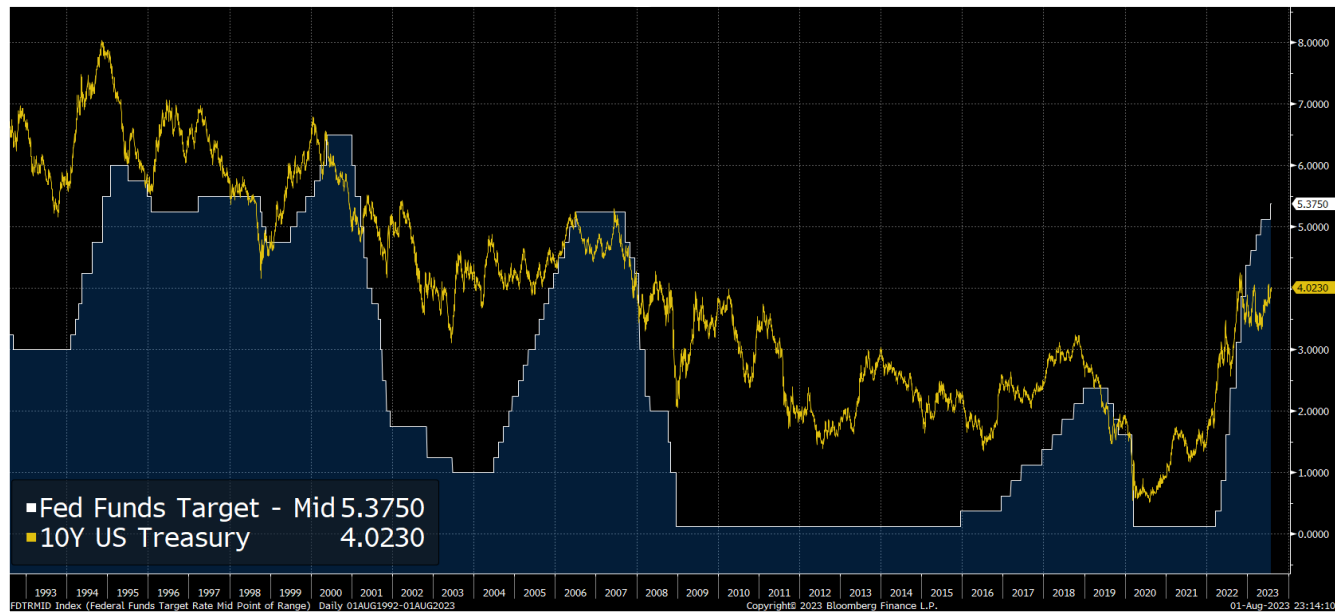
10y Euro Bond vs. Euro Benchmarking Rate



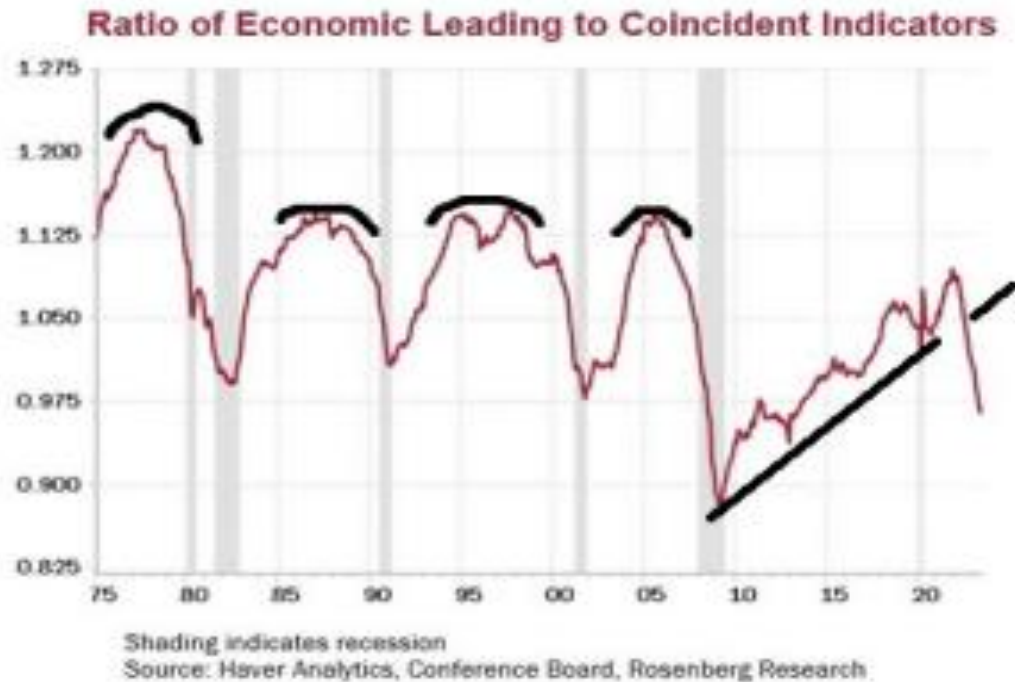
10y UK Gilt vs. Bank Rate



10y US Treasuries vs. Fed Funds Target



US Leading Indicators to Coincident Indicators





GDP growth

% change in real GDP

updated 11 Aug

	% change on previous quarter				% change on a year ago			
	Q3 22	Q4 22	Q1 23	Q2 23	Q3 22	Q4 22	Q1 23	Q2 23
UK	-0.1	0.1	0.1	0.2	2.0	0.6	0.2	0.4
Eurozone	0.4	-0.1	0.0	0.3	2.4	1.8	1.1	0.6
USA	0.8	0.6	0.5	0.6	1.9	0.9	1.8	2.6
Japan	-0.4	0.1	0.7	..	1.6	0.4	1.8	..
Germany	0.4	-0.4	-0.1	0.0	1.2	0.8	-0.3	-0.1
France	0.2	0.1	0.1	0.5	1.2	0.7	0.9	0.9
G7	0.5	0.3	0.4	..	1.9	0.9	1.4	..
OECD	0.4	0.2	0.5	..	2.5	1.3	1.6	..

Sources: OECDstat and ONS



US Credit Rating Downgrade

Country	Moody's	S&P	Fitch	GDP Estimate (IMF, as of 2023)	Debt (% GDP)	10- year Bond Yield (%) as of 8/1/23	GDP Growth (YoY %)	Short Term Interest Rate (%)
Australia	Aaa	AAA	AAA	1,707,548	62.17	4.02	2.3	2.30
Denmark	Aaa	AAA	AAA	405,626	31.54	2.81	1.9	3.76
Germany	Aaa	AAA	AAA	4,308,854	59.62	2.53	-0.2	-0.20
Netherlands	Aaa	AAA	AAA	1,080,880	46.26	2.87	1.9	3.84
Singapore	Aaa	AAA	AAA	515,548	136.83	3.00	0.7	4.09
Sweden	Aaa	AAA	AAA	599,052	29.96	2.54	0.8	3.94
Switzerland	Aaa	AAA	AAA	869,601	31.70	0.97	0.6	-0.75
United States	Aaa	AA+	AA+	26,854,599	136.22	4.07	2.6	5.63
New Zealand	Aaa	AA+	AA+	251,969	34.87	4.74	2.2	5.66



II. INCREASE BANK'S CAPITAL REQUIREMENTS: BASLE IV

- Fitch Downgrade
 - US Debt Downgrade: Fitch (Aug 1, 2023)
 - UK Debt Downgrade: Fitch (Oct, 2022)
 - EU EFSF Downgrade: Fitch (May 2023)
- BASEL 3.1 (BASEL IV)
 - History: International agreement developed by the Basel Committee on Banking Supervision in response to 2007-2009 financial crisis.(Basel III)
 - Basel 3.1 (Basel IV) Final wave of reform
 - UK and EU began change over the past 24-36 months
 - US (July 2023) Bank Regulators advance proposals around bank's capital requirements after three regional bank failures earlier this year.
Proposal (1000 pages) include:
 - Level of capital held by banks over \$100.0 billion in assets. (full implementation by 2028) Fed, FDIC, Office of the Comptroller of the Currency all in agreement
 - Capital Measurement Calculation Uniformity
 - Accounting for unrealized gains and losses
- Fed Supports Placing Proposals Out for Comment (Nov 30, 2023)

Community Bank Considerations from Basel IV



Possibility for trickle down effects on capital requirements to community banks



Potential for higher cost of capital for the big banks which could be passed along to consumers or community banks.



Another situation where we can watch the international landscape to see impacts



Key takeaway: Basel IV, which is an international proposal out of the International Bank of Settlements, is something to keep your eye on.

III. GLOBAL MONETARY POLICY CONSIDERATIONS



History of Fed coordination with other Central Banks.



Does the Fed lead or follow?



The US as the World's Reserve Currency.

III. HISTORICAL COOPERATION



Does the Fed lead or follow?

- The Fed is flexible and very cooperative.
- Currently Fed's peers have been unwilling or unable to match the full extent of U.S. tightening cycles.

Federal Reserve Degrees of Coordination

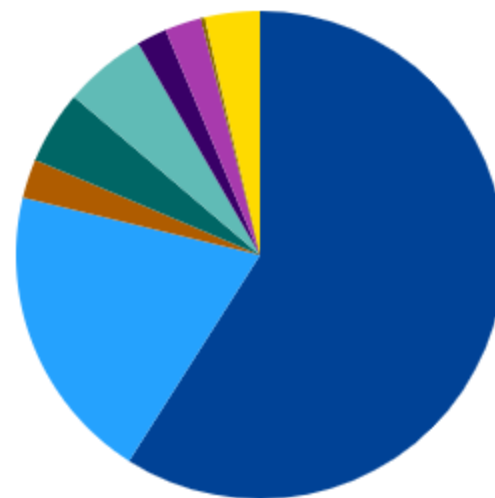
- Level I: Central Banks notification/communication.
- Level II: Swap lines between Fed and Central Banks.
- Level III: Coordinating interest rates with other countries.

US DOLLAR AS THE WORLD'S RESERVE CURRENCY



World - Allocated Reserves by Currency for 2023Q1

- What does it mean to be a Reserve Currency of the World?
- How did the US get to be the Reserve Currency of the World?
- BRIC's (and other countries) currency arrangements and what that means to the US dollar and economy?



■ U.S. dollars ■ Euro ■ Chinese renminbi ■ Pounds sterling
■ Japanese yen ■ Australian dollars ■ Canadian dollars ■ Swiss francs
■ Other currencies

IV. CONSIDERATIONS FOR COMMUNITY BANKS



1. Global interconnectivity of Central Banks will prolong a Fed easing as the Fed helps contribute to the global price stability environment.
2. Any easing by the Fed to react to a cooling U.S. economy will be drawn out and much slower than anticipated.
3. Investor expectations will cause uncertainty and moderate turbulence within the financial markets (equities) while the yield curve will change little over the next 3 years.
4. Expect a soft landing, but much slower to develop.
5. Bank liquidity profile will be center for the foreseeable future.
6. Other major global economies will lag the US by at least 18 months.

Takeaways for Community Banks



**Basel IV
proposal out
for comment
coming –
International
markets are
already
accepting**

**Commercial
customers, and
consumers but at
a lesser extent,
are impacted by
global trends
caused by
international
fiscal policy**

**Connection
between US Fed
Policy and other
major Central
Bank Policy
should be
considered to
manage balance
sheet risk**

Discussion



Q & A

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