The Daily Dish

The Banks are Failing, Banks are Failing!

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Eakinomics: The Banks are Failing, Banks are Failing!

So, I read the headline on Bloomberg, "Banks Must Act Now or Risk Becoming a 'Footnote': McKinsey," which was followed by the sub-head "Half of firms are ill-prepared for a downturn, report finds," and I immediately jumped to the conclusion that McKinsey had found such vast problems in safety and soundness that over 60 percent of banks would not survive the next recession. Yowzer! Seemed like a pretty big indictment of the Dodd-Frank reforms.

Uh, wrong. Instead, the report simply notes that loan growth is low, yield curves are flattening, and return on tangible equity (ROTE) has "flatlined," in what McKinsey calls "the late phase of the economic cycle." McKinsey itself is not immune to passionate reporting, noting that banks face becoming "footnotes to history."

So, the McKinsey report is not about the resilience of banks or their capital position in the event of a downturn. Instead, it is simply a comment on global banking growth and what McKinsey views as the shaky state of research and development. So, excuse me if I'm not blown away by the twin insights that a) firms must innovate or they will die; and b) everyone struggles in a downturn.

Let us begin with the basic business. McKinsey's own figures note that although global ROTE has flatlined at 10.5 percent for 2018, North American banks actually reported ROTEs of 16 percent by comparison to ROTEs for European banking competitors of just 6.5 percent. The relative health of the U.S. banking system is clear. The Federal Reserve's November supervisory report noted that "the financial condition of the U.S. banking system is generally strong" and that "The strong economy has contributed to improvements in the financial condition of banks. Two important measures of profitability—return on equity (ROE) and return on average assets (ROAA)—have seen steady gains over the past several years and attained a 10-year high in the second quarter of 2018. Earnings for firms of all sizes have been bolstered by rising net interest income. Moderately rising interest rates have been positive for bank earnings and have helped drive increases in net interest income." So, the presumption is that banks are beating the curve.

In making suggestions as to how banks might weather any putative crisis, the McKinsey report points to Amazon and China's Ping An as firms that have both diversified their offerings and invested in their IT infrastructure. McKinsey note that banks allocate only 35 percent of their IT budgets to innovation, while fintechs devote more than 70 percent. Fintech is the flavor of the month.

Consider the news on Monday that a federal judge, ruling in favor of the New York Department of Financial Services, held that the Office of the Comptroller of the Currency does not have the legal authority to grant a bank charter to any non-bank that is not eligible for federal deposit insurance—in other words, to a non-bank that does not take deposits and provide deposit insurance. Fintechs and other non-banks (most notably Rakuten, Square, and earlier Walmart) had hoped to obtain the federal charter as a way to offer more bank-like services without a deposit business and to circumvent the requirement to obtain a banking license in all 50 states. This ruling puts a severe dent in the prospects of any future Amazon Bank or other fintech bank.

Maybe banks are not an endangered species after all.