[Q&A]

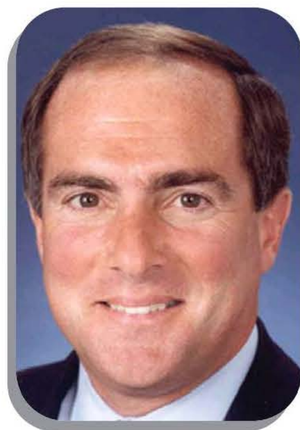
Reporter Michael de los Reyes asked a sampling of Orange County bank executives, presidents, managers and others in the banking and credit union industry what they're expecting in terms of further interest rate increases by the Federal Reserve and how their institutions are preparing for that possibility. Edited excerpts of their responses follow.

Doug Bystry
Chief Executive
Clearinghouse CDFI

We expect very minor interest rate increases this year in the range of 50 to 100 basis points [total]. However, should the stock market continue to struggle, we would not expect any further rate increases this year.

Because most of our lending is at fixed rates and is set at the time we originate the loan, any future increases would have a minimal impact on our operations or our profitability.

If interest rates were to go down significantly, that would have a different outcome.



Kevin Dunigan
OC Executive Vice President
City National

We expect the Fed to raise the overnight federal funds rate 50 to 75 basis points this year. This is a slower rate than the Fed's projection of a 100 basis point increase for 2016.

Historically speaking, a slow increase in Fed tightening has been good for strengthening the economic recovery and corporate profits. For bond portfolios, this slow rate of increases has minimal effect on the price of the bonds, since the bonds will be aging along a positively sloped yield curve while interest rates move up.

The long-term benefit for bond holders is that they will be able to reinvest in higher yielding securities. For equity portfolios, a slow rate of Fed rate increases has historically been correlated with positive stock returns.

Steve Gardner
President, Chief Executive
Pacific Premier Bank

I'll give you my personal views. I say that since I am on the board of directors of the San Francisco Federal Reserve Bank and, of course, do not speak for them.

The median forecast of the FRB Open Market Committee members is for four rate increases of 25 basis points (0.25%) each in 2016. My personal view is that it will be two 0.25% rate increases, given volatile equity markets, declining commodity prices, a slowing Chinese economy and overall low inflation globally.

Pacific Premier is well positioned for any scenario that may arise, be it higher, lower or unchanged interest rates.

Eric Hovde
Chief Executive
Sunwest Bank

The Federal Reserve will struggle to raise interest rates once, at best twice, in 2016. In fact, they may not even raise interest rates at all.

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Dwight Johnston
Chief Economist
California Credit Union League

After the Fed's first tightening in December, most analysts and economists expected three more rate increases in 2016, possibly four. But the way this year has started, those expectations are being lowered.

The gloom-and-doom crowd believe the markets, mostly through China as the instigator, are signaling a broad global slowdown that will eventually cause hiring and spending in the U.S. to slow. Moreover, the Fed has shown great sensitivity to market unrest, and the longer market turbulence persists, the longer the wait for the Fed to act regardless of economic data. The consensus now is the Fed will likely tighten twice this year, and there is a growing contingent of money managers and economists expecting the Fed will not only forgo tightening but could in fact reverse the December tightening.

My opinion is that after a volatile first quarter that will ding business spending, the Fed will stay on the sidelines. After that, I see a better market environment. More importantly, I believe we'll see some good economic reports and signs of an uptick in inflation. I think the Fed will have to play catchup in the second half of the year and tighten three times. I see longer-term rates rising after going nowhere the first part of the year. The 10-year note is about 2% now, and I think we'll see the yield over 3% by the end of the year.

Now that I've said all of that, it should not matter to credit unions whether I'm right or dead wrong—equal chances for that—when it comes to interest-rate risk. Credit unions monitor interest-rate risk very closely. Larger credit unions, such as Orange County's CU and Schools First, have sophisticated systems that "stress" the balance sheet under a variety of interest rate scenarios, including very low rates and rates that instantaneously jump by 300 to 400 basis points. These tests are often run monthly, at the least quarterly. Smaller credit unions also must provide interest rate testing. If the tests show any variance outside of acceptable limits, they take action to get back within prudent guidelines.

While a credit union might expect or hope for rates to follow a particular path, they have to make certain their balance sheets are not at risk, even under the most extreme circumstances.

Scott F. Kavanaugh
Chief Executive
First Foundation

Inflation is stagnant, and continued volatility in the financial markets is widespread. We know the Fed has stated plans to raise rates in 2016, but because of the aforementioned conditions, we believe it will be difficult for them to do so.

While the interest rate increases may or may not materialize, interest rate risk must be kept in check through sound balance sheet management—this is at the core of our approach. On the deposit side, we believe any potential interest rate increases will not necessarily remain coupled to the deposit rate increases. And on the loan side, our continued strong loan demand will help mute the effects of a higher interest rate environment on earnings, as/when the Fed decides to raise rates.

Ted Tragos
Business Banking Market Manager
Bank of America Merrill Lynch

The Federal Reserve has indicated any rate increase would be implemented slowly, so we don't see that as a deterrent for business.

In fact, during the economic downturn, a lot of businesses put their fiscal house in order and are keeping their balance sheets strong, which helps make access to credit easier.

Tom Vertin
President, Chief Executive
Pacific Mercantile Bank

We are not anticipating any additional interest rate increases this year. We think that the uncertainty in the global economy will keep the Fed on the sidelines. However, we aren't seeing the impact of the weakening Chinese economy or the decline in oil prices having any meaningful effect on our local markets.

We are seeing good loan demand and positive cash flow trends among our commercial borrowers. We think 2016 will be a good year for small- and middle-market companies to continue taking advantage of the historically low interest rates to fund the growth of their businesses.