Tough times

As uncertainty creeps into the economy, the state's financial institutions are ready to help

By: Martin Daks

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The Federal Reserve is hiking interest rates, home sales are slowing and the U.S. may be sliding into a recession. How prepared is the state's banking industry for what could be a tumultuous period?

Right now, "banks are very well capitalized and well-positioned to face anything that's coming," according to Michael Affuso, president and CEO of the **New Jersey Bankers Association**. Loan demand remains healthy, he noted, although "I wouldn't be surprised if demand pulled back, given the rise in interest rates, and concerns about inflation and a possible economic slowdown. Business borrowers will be cautious, but at the same time, well-capitalized companies may seek to expand."

On the consumer-lending side, "The boom in refinancing is over – at least for now – but there's still a lot of demand for [purchase] financing, since people still want to move here but New Jersey does not have a lot of housing inventory. It's a fluid situation and people will have to adjust."

Bankers, meanwhile, "are always concerned about interest rate risks, and at the same time are on the watch for a possible economic slowdown or even a recession," Affuso added. "But our institutions are well capitalized and have worked their way through recessions before — and unlike the last recession when real estate prices declined precipitously, borrowing metrics are a lot more robust so New Jersey homeowners tend to have higher levels of equity. We remain cautiously optimistic."

From his perch as **PNC Bank**'s market manager for business banking in New Jersey, John Zarrillo has a good view of the economic landscape, and he finds companies are taking the interest rate shifts in stride.

related loans for medical equipment, medical facility real estate purchase and buildout, and medical practice M&A – is all up."

Zarrillo

In general, Zarrillo noted that rising interest rates have helped drive an increase in demand for short-term working capital credit lines, equipment financing, and real estate financing. "We've also seen an uptick in demand for term financing as way to consolidate credit card and other variable-rate debt," he added.

He's also seen a significant increase in financing activity among veterinarians. "During the COVID-mandated lockdowns, and now with more people working from home, there has been an explosion in pet purchases," Zarrillo observed. "As a consequence, more veterinary practices have opened and expanded. We're seeing activity in building purchases and fit outs, so real estate loan activity in that space has increased significantly. Also, veterinarians tend to get paid in a timely manner, so we're not seeing as much demand for working capital loans, at least in that business segment."

Uncertainty about the economy's future means that it's "very important to match all customers with the right loan or other money-management product," he added. "You don't want someone getting in a pinch and grabbing a loan that doesn't fit. Our experienced relationship managers help customers to determine the appropriate loan or other structure to best serve their needs. Our RMs work with businesses, for example, to understand their operating cycle and cash flow, and then determine the best credit facility. This way no one is just guessing or trying to put a band-aid on a business."

Kemly

When **Columbia Bank** President and CEO Thomas Kemly surveys the economy, he sees a calm before the approaching storm. "Some leading indicators – like demand for business loans – are still healthy, but we see pockets of pullback," he says. "Like the refinance segment, which has almost disappeared. Rising interest rates affect loan pricing and will soon drive changes in deposit rates. The local and national economies are still okay, but the concern is that some employers are beginning to [illegible] a pause on hiring, and that could lead to a broad slowdown or possibly a recession."

Are Cracks Appearing?

And while demand for single-family purchase loans remains strong in suburban markets like New Jersey, Kemly sees some signs of weakness as rates rise. "A number of times, we've gotten through the approval process for a loan, but then the deal itself [between the home-seller and -buyer] fell through," said Kemly. "Demand for multifamily purchase loans and construction loans, however, continues to be robust."

Banking institutions, meanwhile, are being squeezed by the flattening yield curve, or difference between the interest rates that banks pay for money – from depositors and other sources – and how much they can charge long-term borrowers. "We live off our spread," Kemly explained. "If the curve flattens, those two numbers get closer."

If the yield curve does invert – so long-term rates drop below short-term rates – that spread could turn negative. "But we've been through that environment before," Kemly noted, referring to the 2008 recession. "We'll manage through this one, if it occurs, and will continue to assist our consumer and business customers."

They'll need to pay attention, since businesses are dealing with "a very unusual time," according to **1st Colonial Bank** President and CEO Robert White. "Interest rate increases and other headwinds associated with increased operating costs will likely increase. We're helping our customers in a variety of ways, including finalizing plans for local seminars to be held that will address ways businesses can navigate during a time of significant inflation. And to give immediate relief, we've reduced our overdraft and non-sufficient fund fees from $35 to $15 for all consumer and business clients. We will pay overdrafts up to $50 per day without assessing overdraft fees when an account is overdrawn by $50 or less at the end of the business day."

interest-bearing accounts."

At the same time, the one-two punch of rising interest rates and inflation appears to be taking some of the wind out of loan demand, he added. "Our loan team advises that individuals and businesses alike are extending their decision-making process when it comes to capital purchases," White noted. "At the same time, however, they're also reinforcing their credit lines and other availability. This is not unusual, given the economic environment. Everywhere we turn, businesses and individuals are facing higher operating costs, particularly related to energy."

Looking ahead, White anticipates that some of the constrained commercial loan demand will be at least partially offset as businesses continue to increase their on-hand inventories, "as a way to safeguard against shortages driven by supply-chain obstacles. We're pleased to note that our lending and other teams have longstanding relationships with business- and consumer clients, and we look forward to continuing to work closely with them, assisting them in navigating through these challenging times."

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