Managing the Balance Sheet in a Low-Rate Environment

December 8, 2011

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Banks and credit unions can enhance earnings — even in the current environment — by using leverage to grow the balance sheet.

An asset-sensitive institution could benefit from a leverage transaction with a maturity mismatch to increase earnings and position the balance sheet towards a more neutral stance. Recent short-term advance specials on maturities between one and six months have priced from 15 to 20 basis points, providing the opportunity to fund long-term assets at an attractive spread.

An asset-sensitive member offering aggressive mortgage rates could fund 15-year fixed-rate mortgage originations with a rate of 3.25 percent, enhancing earnings while shifting balance sheet sensitivity. Alternatively, if lending is weak in your area, a Ginnie Mae 30-year mortgage-backed security with a coupon of 3.50 percent, where principal and interest payments are fully guaranteed by the U.S. Government, is yielding about 2.80 percent. Investing in a long-term asset funded with short-term borrowings or putting excess cash to work could increase income, move the balance sheet sensitivity towards neutral, and provide steady cash flow to reinvest at higher rates when the economy strengthens.

With rates near historic lows, liability-sensitive institutions with an exposure to rising rates have the opportunity to fund with a ladder of long-term advances to support long-term fixed-rate mortgage originations or mortgage-backed-security investments. With short-term interest rates projected to remain at record lows for an extended period, it may be beneficial to put low-yielding excess cash to work and move towards a net borrowing position to take advantage of the very low rates available in today's environment. Understanding the sensitivity of your balance sheet to changes in rates should guide your lending, investment, and funding decisions.