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Where US bank tech spending is headed as economic uncertainty looms

Article

The trend: We expect **US banks' investment in technology to increase 10.6% year over year in 2022, faster than in any previous year**—despite the looming threat of a recession and financial market turmoil, which will compound internal and external pressure on banks to curtail their budgets.

Our report on US Bank Technology spending looks at why **US bank technology spending will hit nearly $86 billion in 2022** and grow to almost $112 billion by 2026.

The risk of recession: Banks currently face an inverted yield curve, rising interest rates, high inflation, and uncertainties surrounding Russia's invasion of Ukraine. 28% of economists surveyed by the Wall Street Journal expect the US to be in recession some time in the next 12 months, a marked jump from 18% in January, and 13% a year ago.

In the past, when the economy constricted, firms responded with cost-cutting measures. But this may not be the best strategy now, when much of the banking industry is still in the middle of extensive digital banking transformation efforts.

Where are banks spending? There's an arms race going on among neobanks and incumbents for **the best digital customer experience.** A majority of consumers, or 54%, are using digital banking tools more now due to the pandemic, according to the 2021 digital banking attitudes study by JPMorgan's consumer banking arm. Meanwhile, 99% of Gen Z and 98% of millennials use a mobile banking app, according to a 2021 Chase study.

Back-office operations also have benefited from digital transformation. To accommodate more data-intensive strategies, banks are modernizing their core banking systems technology. US bank executives said 40.0% of their bank's FY 2021 technology budget went to core systems technology, per Bank Director's "2021 Technology Survey."

Industry executives we've spoken with for our reports have said that **upgrades to core banking are essential to making open banking and banking as a service (BaaS) partnerships work,** so we expect banks to continue allocating resources to this area.

Tech spend growth varies across the industry: Our forecast shows overall growth settling to moderate levels after hitting a five-year high in 2022.

- The share of total US bank technology spending at t**he four largest banks—Wells Fargo, Bank of America (BoA), JPMorgan Chase,** and **Citibank**—will decrease to roughly 38% of market-wide technology spend by 2024, down from about 46% in 2017.
- Midsized banks like **PNC, U.S. Bank, Truist, KeyBank,** and **Regions** will see their share of total US bank technology spending increase to 12.6% in 2022.

- The "other" category of banks—which includes **regional banks, community banks, credit unions, and neobanks—will make up 48.5% of total US bank tech spending in 2024**. Neobanks will play an outsized role in driving up the "other" category's share of tech spending among US banks.

How a downturn could affect tech spending: Our US tech spend report highlights the issue of mounting shareholder pressure—which is unlikely to let up in the face of an extended downturn or recession. Investors are concerned about profitability and transparency over spending plans. Banks will continue to face demands to justify their spending level.

But banks could also benefit from the bursting tech bubble.

An influx of talent: Research firm CB Insights reports fintech funding fell by 18% between Q4 2021 and Q1 2022. That's the biggest percentage drop since 2018. Fintechs that aren't getting the required outside funding to sustain an inflated cost of labor have started layoffs. Banks may be able to pursue strategic hiring among these released staff and position themselves for future growth. The economic downturn could also slow the rising compensation trend as firms reduce staff or start offering lower salaries.

Lower tech costs: Other organizations that scale back their tech investments affect the balance sheets of solution providers. Banks that are still spending may be able to lock-in lower technology costs with improved terms for hardware and software purchases.

Mergers and acquisitions: With fintech funding drying up, we've predicted in our The Era of Uncertainty report that unsustainable fintechs won't last. The companies left standing will be stronger, more sustainable, and priced at more attractive multiples. We expect banks to, as Warren Buffett once said, "be greedy when others are fearful," and seize the opportunity to buy high-profile fintechs.

What's next? Consumer banking is a cyclical industry affected by falling consumer confidence during economic downturns. Many fintechs haven't yet proven they can last through those ups and downs. But incumbent banks have. If a recession occurs, they'll benefit from the stricter capital requirements and annual stress testing they've undergone since the 2008 financial crisis. Banks that resist slashing their tech budgets and stay focused on enhancing their customer experience will be better able to minimize attrition—and could even attract disenchanted customers from their struggling competitors.

US Banks' Technology Priorities, Dec 2021

% of respondents

	2020	2021	2022
Improve customer experience/service delivery	67%	67%	61%
Get more value from tech and vendor relationships	53%	53%	43%
Improve efficiency	36%	41%	41%
Invest in new systems	29%	30%	28%
Better address fraud and risk management	15%	13%	23%
Increase revenue generation opportunities	17%	25%	23%
Invest in infrastructure upgrades	21%	17%	19%
Pursue partnerships with fintech startups	-	5%	15%
Evaluate and possibly replace critical systems	12%	17%	14%
Internal system development and integration	12%	14%	14%
Migrate applications and systems to the cloud	10%	7%	12%

Note: 2020 n=300; 2021 n=260; 2022 n=300
Source: Cornerstone Advisors, "What's Going On in Banking 2022," Jan 25, 2022

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