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Banking Watch

US

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Economic Analysis

US
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Retail Commercial Bank Deposit Trends for 2012

Remarkable flows in demand accounts over the past six months

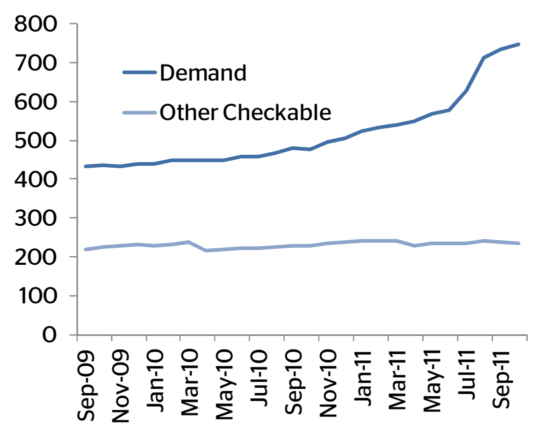
- **Consumers react to market volatility by bulking up on savings and demand accounts**
- **Low interest rate environment negatively impacting small and large time deposits**
- **IRA and Keogh deposits growing strongly from a low base**

Tracking the flows of deposits in the commercial banking system

Over the next sixth months, trends in retail commercial bank deposits will reflect the overarching mood of economic conditions at present, which are still tentative. With regard to individual deposit types, time deposits will remain unpopular due to low interest rates. Recent declines are attributable to foreign banks' dollar funding issues. Only time deposits of maturity greater than three years have shown any growth. Money market deposit balances at commercial banks are growing strongly and we expect this to continue over the next six months as consumers favor liquidity and safety. Savings deposits are similarly benefiting from consumer preference for safety and liquidity. IRA and Keogh plan deposits are growing strongly, but from a very low base. The push is the result of accounts of size less than $100k. Retirement deposits from accounts larger than $100k are not growing. This brief will review each of these categories, starting with some of the remarkable flows in demand accounts over 2011.

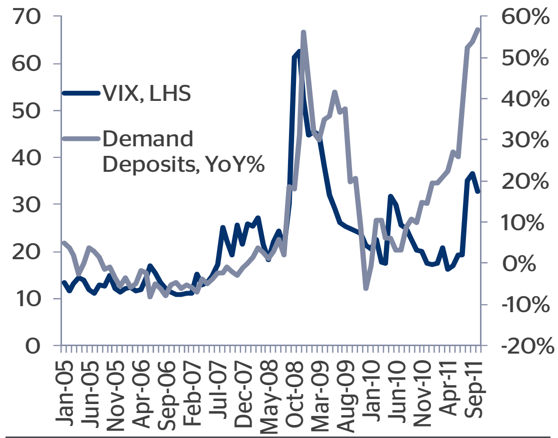
Between July 2010 and February 2011, total deposits at commercial banks grew at an average YoY rate of 3.2%, an extremely low result that when translated out of nominal terms represents a figure barely treading above water. However, over the summer of 2011 a shift occurred and deposits have been growing at an average YoY rate of 6.3%, or twice the July-February figure cited before. Much of the story of this shift is a flight to safety. Deposit growth in the past six months can be best described as a surge out of the stock market and into guaranteed deposits. Demand deposits increased by around $200bn since April, while other checkable deposits have remained steady around their established trend. The increases in demand deposits appear strongly correlated with shocks to the volatility index (otherwise referred to as the "fear gauge"). Other than the obvious trepidation-related precautionary desire to hold liquid deposits, as people exit their stock market positions, often the cleared balances are credited to a deposit sweep account. In one of the recent Federal Reserve minutes, the central bank noted an increase in money supply related to customers exiting securities holdings and dumping the proceeds into demand accounts. Given the US fiscal scares in August and the ongoing European sovereign debt issues, retail customers witnessed many reasons to exit some financial positions. The fear factor mentioned earlier is also evident in savings deposits, which have grown by around $400bn since April, representing an above-average rate. This figure of savings deposits also includes money market demand accounts (MMDAs).

Chart 1
Demand and Checking Deposits, in $bn



Source: Federal Reserve

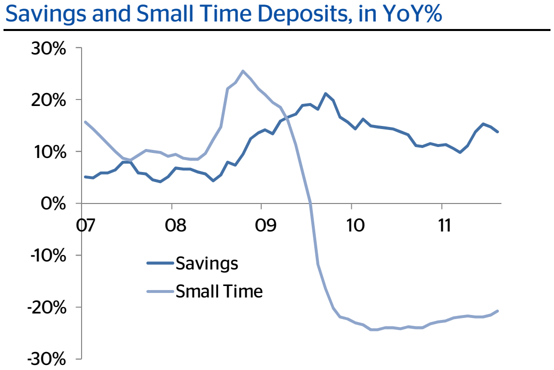
Chart 2
Stock Market Volatility and Demand Deposits



Source: Haver Analytics and BBVA Research

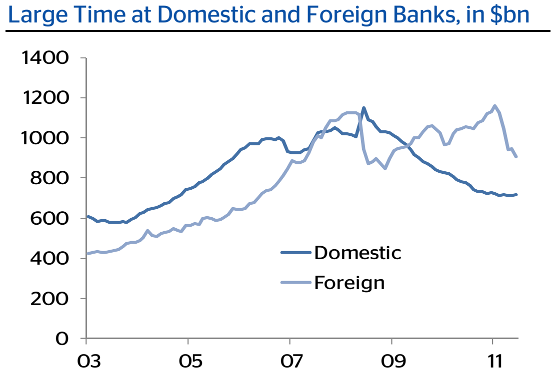
Although the desire to hold liquid deposits is a major factor driving growth, interest-sensitive deposit categories are suffering from the flattening of the yield curve over the past two years. Small time deposits (less than $100k in value) declined by $531bn since its peak in December 2008. Large time deposits (greater than $100k in value) declined by $569.7bn since its peak in June 2008. The typical retail customers of small time deposits face extremely low interest rates. These low interest rates provide little incentive to hold such deposits. Large time deposit customers tend to be businesses or financial entities. The interesting wrinkle in the large time deposit picture is the divide between domestic and foreign banks' deposits. Large time deposits at domestic banks tend to follow the trend of gradual declines similar to total small time deposits. However, large time deposits at foreign banks show sudden drops. A number of foreign banks use large time deposits to raise dollar funding. In two episodes of European fiscal duress in 2010 and 2011, large time deposits at foreign banks dropped sharply. Since a large time deposit is similar to a long-term loan to a bank, some holders of large time deposits decided to eliminate their exposure to foreign banks during these fiscal episodes. Most recently, large time deposits at foreign banks fell by some $212bn since March 2011. For large time certificates of deposits (CDs), the only maturity or repricing category that has seen any growth has been those large time CDs of three years or greater. This may indicate that a small niche exists for some very long-term investors' cash management.

Chart 3
Savings and Small Time Deposits, in YoY%



Source: Federal Reserve and BBVA Research

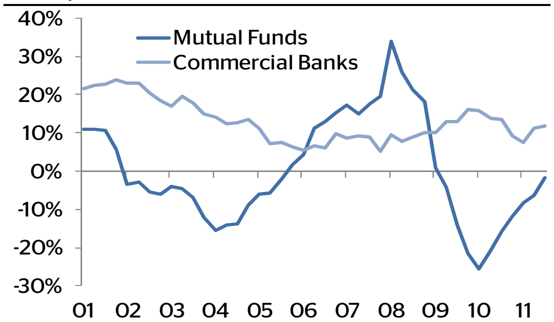
Chart 4
Large Time at Domestic and Foreign Banks, in $bn



Source: BBVA Research

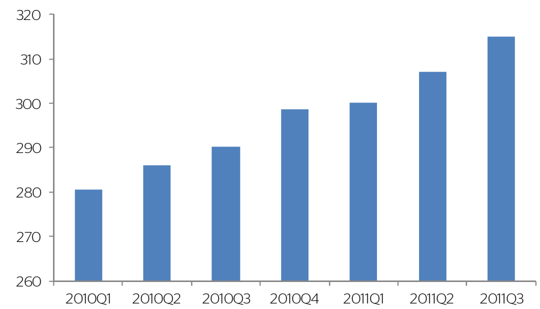
On the positive side, money market and retirement accounts at commercial banks are growing. While mutual funds' money market levels are volatile, commercial banks' money market accounts are more stable. Consumers perhaps may be finding more solace in the stability of banks' deposit insurance over fears of stability in the mutual fund market that occurred around the bankruptcy of Lehman Brothers. Greater technological interaction between banks, brokers and payment and processing systems may also be fostering growth in commercial banks' money market accounts. Banks also maintain deposits that are linked to investment retirement accounts (IRA) and Keogh accounts (a type of tax-deferred pension). These deposits are demonstrating high growth rates, but they start from a very low base, meaning their contribution to overall growth is low. Interestingly, the source of growth for these retirement-related deposits is entirely from those IRA and Keogh accounts of value less than $100k. In contrast, IRA and Keogh accounts of value greater than $100k have not grown considerably since the recession began.

Chart 5
Money Market Growth, YoY%



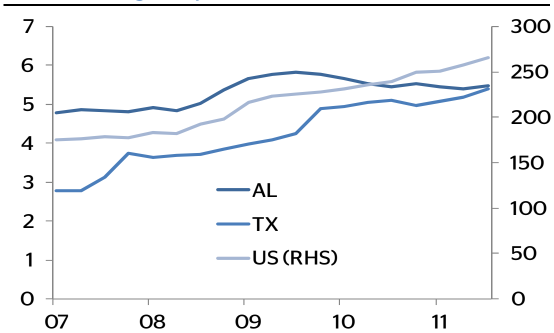
Source: Haver Analytics and BBVA Research

Chart 6
IRA and Keogh Deposits, in $bn



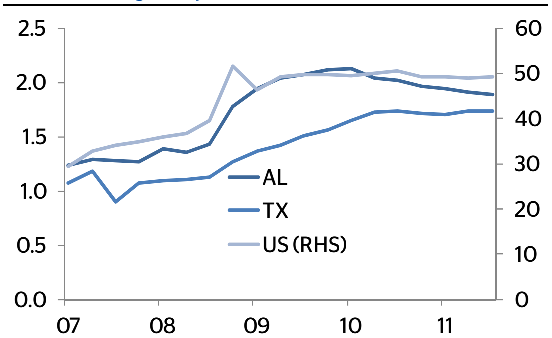
Source: SNL Financial

Chart 7
IRA and Keogh Deposits <100k, in $bn



Source: SNL Financial

Chart 8
IRA and Keogh Deposits >100k, in $bn



Source: SNL Financial

Bottom line

The trends outlined above are subject to risks both to the upside and the downside. A precipitous event in Europe would cause even more strong flows into liquid checking and demand deposits given the guarantee of deposit insurance. Large time deposits at foreign banks in this scenario would see even more rapid declines. However, if economic conditions improve or if a deal in Europe is quickly and efficiently cobbled together, it is possible that the trends outlined above could reverse. For example, expectations of strong returns in stock markets and other risky assets could finally compel retail customers to shift deposits out of the commercial banking system. This was somewhat the case during very low deposit growth in late 2010 and early 2011. Setting aside these upside and downside risks, we believe that over the next several months retail consumers will continue to shun time deposits and favor demand, checking and savings deposits.