BANKERSDIGEST

TEXAS BANKING NEWS, PEOPLE and IDEAS

FEATURE

The Battle for Deposits is Heating Up: Are You Ready?

AUGUST 9, 2022

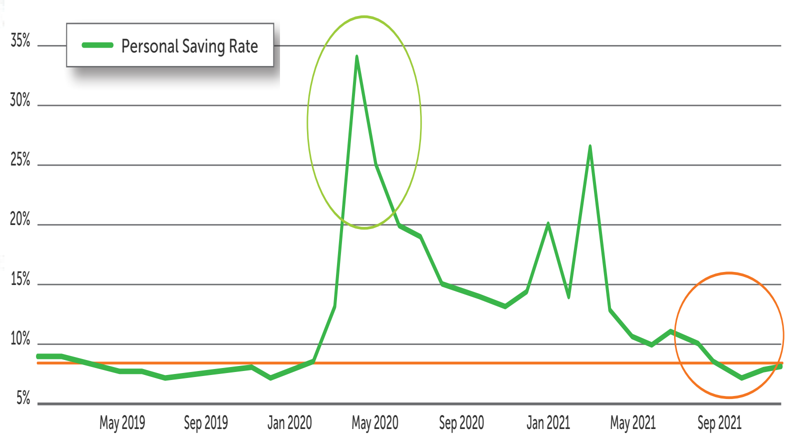
By ACHIM GRIESEL and DR. SEAN PAYANT

Core deposits, especially low-cost core deposits, have long been the key driver for franchise value in the financial services industry. That said, with the start of the pandemic and the ensuing influx of cash from stimulus checks and increased personal saving rates, financial institutions saw so much excess liquidity that bankers began to question the value of any deposits, including low-cost core deposits.

Total deposits in FDIC-insured banks grew by more than 5 trillion from the end of 2019 to the end of 2021. In the two years prior, deposits had grown just over 1 trillion. These same trends on a smaller scale held true for credit unions.

Peak deposit growth happened in 2020. By September 2021, the personal saving rate was back to pre-pandemic levels. Deposits at financial institutions continued to grow, but at a much slower rate than in 2020. Finally, starting in March 2022, the data showed personal checking account balances drop for the first time since the third quarter of 2021.

In addition, consumer spending is now soaring. According to a recent article in *Bloomberg*, the top four banks in the nation have seen a 27 percent average increase in consumer credit card spending for the first quarter of 2022 versus the first quarter of 2021.



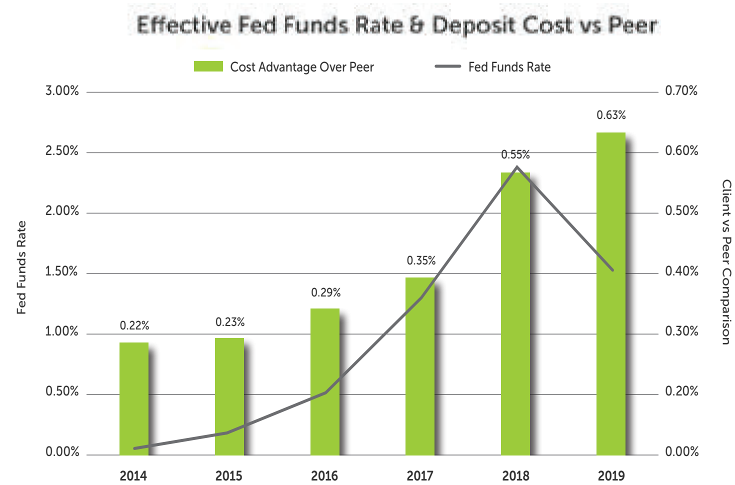
Source: U.S. Bureau of Economic Analysis

Inflation is at record highs, and Federal Reserve Chairman **Jerome Powell** indicated early in 2022 that multiple 50bp rate hikes should be expected in the remainder of the year. This actually translated into the most recent 75bp rate increase.

Unlike in previous rising-rate environments, financial institutions until recently haven't felt the same pressure to raise rates in light of the excess liquidity in the system. That said, financial services analysts expect deposit betas in the 25 percent to 50 percent range over the next two to three years. For financial institutions, that means passing 25 percent to 50 percent of these rate increases on to our depositors. That is significant, and the response will not be the same for all institutions.

Given this variety of possible responses, we anticipate seeing rate offers from financial institutions—most likely led by online and digital banks, with community-based financial institutions following at a slower pace and on a smaller scale. Assuming the bulk of this effort won't happen until late 2022 and beyond, the question financial institutions must ask themselves is, "What should we do now?"

Institutions with low-cost and less rate-sensitive funding are well positioned for any rate environment, but especially for the one we are experiencing. The chart at right illustrates what the deposit cost advantage looks like when a financial institution has a lower cost of funding. The rate environment we are entering is similar to what we saw in 2016–18. As rates were rising, the deposit cost advantage over peers changed dramatically. In a low-rate environment, it was small, but grew to 63bp when rates were at the level we expect to see again in late 2022–24.



Strategically growing low-cost funding today is the key to successfully positioning your organization for tomorrow.