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Banking Watch

United States

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Economic Analysis

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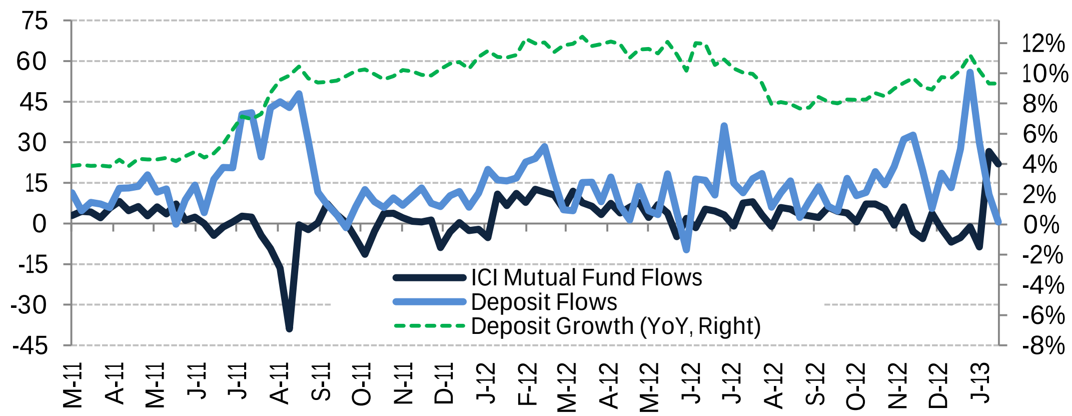
Deposit growth to moderate as economy expands

- January outflows of domestic commercial bank deposits top $103bn
- Declining policy uncertainty and financial volatility are behind this trend
- Expiration of FDIC's unlimited guarantee (TAG) drives short-term outflow

The flight to safety during the 2008 financial crisis led to a historic rise in deposits at the largest commercially chartered banks. Subsequent slow economic growth, tepid employment creation, unclear fiscal policy and volatile financial markets have caused deposits to swell further during the past two years, particularly during the debt-ceiling negotiations in August 2011. Throughout late 2012, as fiscal policy uncertainty rose to high levels on the fiscal cliff discussions, deposits swelled by $224 billion in December alone. The underlying trend was further reinforced by the liquidity stabilization program known as the transaction account guarantee (TAG) program for businesses that secured over $1.4tr in deposits above the general $250k threshold.

This year, January has seen a reversal of that rapid deposit growth, as policy uncertainty declined, volatility in financial markets stabilized at low levels and the TAG program expired at the end of December. These factors along with stronger market performance are all contributing to an outflow of deposits to higher risk assets. In the first 16 days of January, deposits declined by $103bn. Although we expect that the outflow of deposits will slow, strengthening market expectations and economic improvement will accelerate the search for higher yields and push investors into riskier projects. In the last two weeks alone, $49bn has flowed into equity and bond mutual funds. Thus, in our baseline scenario, we expect the deposit growth to moderate throughout 2013.

Chart 1
Deposit Flows (4-week moving average, SA) vs Weekly Mutual Fund Flows ($bn)
Deposits (year-over-year % change, right)

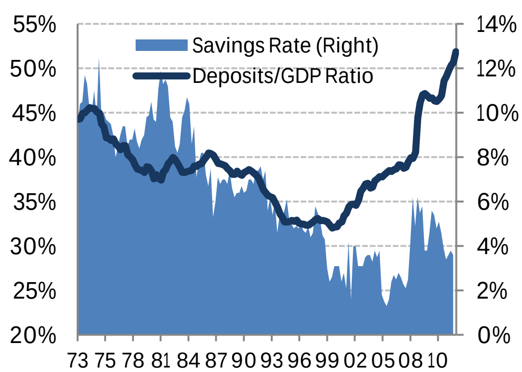


Source: BBVA Research, Federal Reserve, ICI / Haver Analytics

Uncertainty and Volatility Propel Deposits

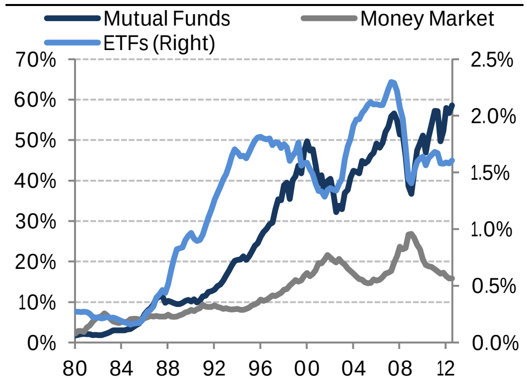
Since the start of the recession in January 2008, deposits at domestically chartered banks have grown by 48%; in contrast, over the entire decade beginning in 1990 deposits only grew a total of 42%. Relative to GDP, the ratio of deposits to GDP has reached a historical high. For example, in 1995 deposits-to-GDP averaged 33%, which suggests that for every $3 of economic output there was one dollar in bank deposits. In 4Q12, this ratio peaked at a historical high of 52% and is projected to decline in 1Q13. In our baseline scenario of lower financial market volatility and uncertainty, we expect this ratio revert toward its historical average during the next several years.

Chart 2
Deposits-to-GDP ratio, Domestically Chartered Commercial Banks and Personal Savings Rate



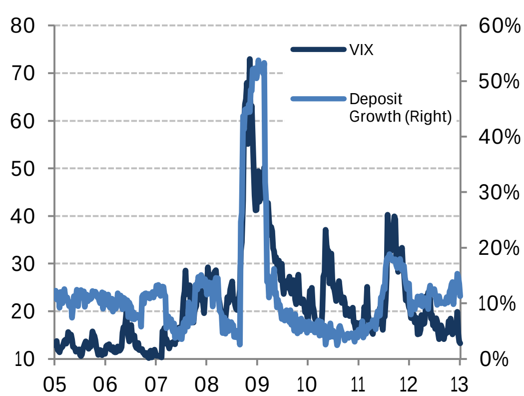
Source: Federal Reserve, BEA / Haver Analytics

Chart 3
Investment Product Balances-to-GDP Ratio



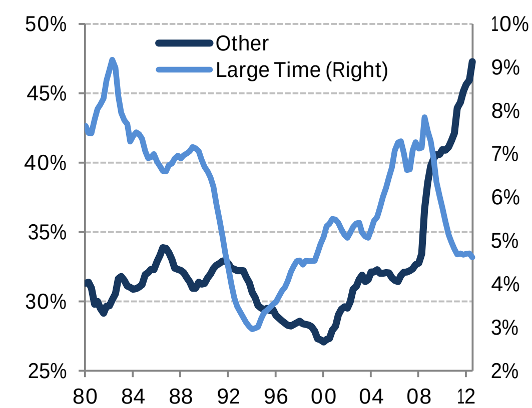
Source: Federal Reserve Flow of Funds, BEA / Haver Analytics

Chart 4
Market Volatility (VIX) and 6-month Average Annualized Deposit Growth Rate



Source: CBOE, Federal Reserve / Haver Analytics

Chart 5
Deposits-to-GDP Ratio by Duration, Domestically Chartered Commercial Banks



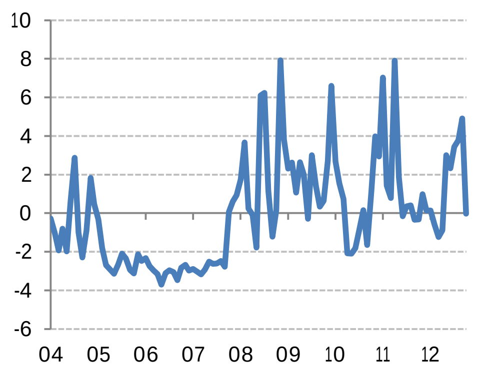
Source: BBVA Research & Haver Analytics

The heterogeneous effects of the financial crisis, recession and ongoing recovery caused disparate growth patterns among financial products. As anxiety rose, both consumers and businesses preferred to maintain liquid assets to buffer economic shocks and hedge against uncertainty. This desire for liquidity led to exceptional growth in demand deposits. Based on our analysis, deposit growth during the past decade has been influenced by financial volatility and policy uncertainty.

The correlation between the Chicago Board Options Exchange (CBOE) VIX and deposit growth is striking. Between 1990 and January 2013 the correlation between the six-month moving average growth rate of deposits and the VIX is 50% and remains fairly stable over different estimation periods. The correlation between deposit growth and our BBVA Research Policy Uncertainty Index increased dramatically during late 2011 through 2012. Since 2004, this correlation is around 14%, rises to around 40% since 2011, and jumps to over 80% in 2012. Thus, heightened policy uncertainty underlies last year's rapid deposit growth.

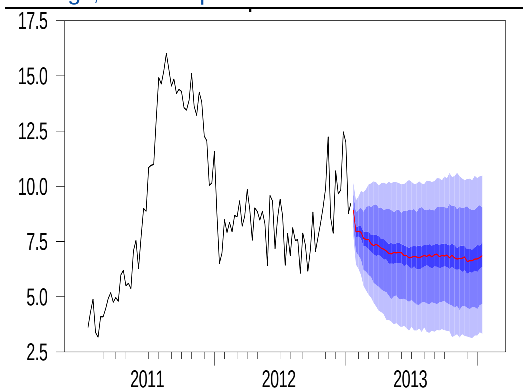
Large-time deposits, however, have contributed little to overall deposit growth during the recovery period. Going forward, in a low interest rate environment, demand for large time deposits will remain soft as economic conditions strengthen and risk appetites increase. This trend will further compound any outflows of demand deposits.

Chart 6
BBVA Research Policy Uncertainty Index



Source: BBVA Research

Chart 7
Deposit Growth, %, Annualized 24-Week Moving Average, 20^{th}-80^{th} percentiles



Source:

Bottom Line

As the economic outlook brightens, dollars are flowing back into equity and bond markets at the expense of low-yield bank deposits. Absent a government shutdown due to pending fiscal issues, lower policy uncertainty will slow deposit growth in 2013. In addition, lower financial market volatility will contribute to slower deposit growth. Under these assumptions, the ratio of deposits to GDP will tend toward its long-run average, and thus deposit growth will necessarily be lower than nominal GDP growth. Furthermore, better-than-expected data for 4Q12 and visible improvements in 1H13 could accelerate the outflow of deposits at commercial banks.