DEPOSIT RATE SENSITIVITIES

by Steve Brown

The other day when getting on an airline we were told to grab a "Bistro Meal." When you call something a Bistro Meal, you expect a little wine, some cheese and a croissant. What we got was a mushy apple, a high fat bag of chips and a sandwich that tasted like compressed stacks of the American Banker. We agree that a "Bistro Meal" sounds a lot better than naming it "Food Like They Serve in Jail," but the meal left much to be desired. However, as we looked around, everyone seemed happy - probably because they were either all picturing themselves in Paris or the airline industry has done a good job at lowering expectations to the point that customers are just happy to have any food.

When it comes to deposit rates, banking is in a similar situation. Right now, the public has a low expectation of rates and is making deposit choices for other reasons. Many items impact deposits, including where other banks set their rates, performance of the equity markets, inflation, the unemployment rate and Libor to name just a few of the biggies. In fact, these days, where a bank sets their deposit rates may only have a minor impact on overall deposit gathering.

Over the past couple of years, due to the flight to safety and the desensitization of customers to return, in many markets (like San Francisco) deposit balances are now inversely related to rates. That is, bank rates have gone down, while balances have trended up. Understanding rate sensitivities in your market may help you build a cheaper and more stable cost of funds.

For example, given the current state of rates, in many markets, often it is only the savings account that is positively correlated to rates. Raising rates here garners larger balances. However, in other products, such as checking, money markets and CDs; the relationship is inverted (for some banks, in some markets). Lowering rates often results in greater balances. The reason is that other factors, such as the general economy and demographics, have a greater impact on balances than rates. In fact, in many markets, rates are a byproduct of balances and not the other way around. Further, this effect is often exacerbated, as bankers usually don't move rates in all products in proportion to their rate sensitivities.

Here, the cross-effects of moving rates have an impact on balances. In inversely correlated products, dropping rates on CDs causes an increase in MMDA balances as money shifts. Drop rates for all deposit products by 5bp and regular CD balances may exhibit the largest decrease in balances, because they exhibit a greater rate sensitivity profile than all other accounts. In this example, other product balances (like checking), may increase when regular CD rates are dropped.

Understanding how your deposit base shifts with rates is important when attempting to restructure liabilities. As we have seen in the past quarter, some banks have lowered rates in some products in an effort to slow deposit growth, only to find deposit balances build. In fact, for 1Q, because of current inverse relationships, we project many banks will grow deposits even if they don't raise rates. Experiment with your rates and monitor what factors in your market have the largest influence on deposit balances. You might find that because of the current change in depositor expectations, rate is the least effective tool.

BANK NEWS

Bank Closures (3 YTD):

Regulators closed 1 bank on Fri: Oglethorpe Bank ($231mm, GA) and sold it to Bank of the Ozarks ($3.2B, AR). Ozarks gets 2 branches, all deposits (no premium) and nearly all assets (75% under loss share).

Citigroup

The Bank reported lower than expected earnings of $1.31, due to $1.1B in charges from credit spread tightening, and lower revenues from securities and banking operations.

M&A

Comerica ($55B, TX) will buy Sterling Bancshares ($5.1B, TX) for $1.03B in stock, about a 30% premium to Friday's closing price.

JPMorgan

The bank reported a 47% rise in 4Q profits to $4.83B, noting a 6% quarterly jump in loans - with loans to mid-size firms increasing 3.5%. Loan loss reserves dropped $3.2B to $3.0B over the 4Q.

Goldman Sachs

The bank released details of their losses related to trading and proprietary positioning during the 2008 crisis. For being good "numbers guys," it is funny that they now report they lost $13.5B, not the $8.5B originally reported.

New Coin

The Fed announced the Andrew Johnson $1 coin will be released to the on Feb. 17.

Bank Fraud Survey

A survey by Information Security Media Group on fraud in banking finds 75% of banks first learn of fraud from their customers; 82% of banks experienced credit and/or debit card fraud; 50% of banks have experienced phishing and vishing (social networks/VOIP) attacks; 68% of banks said they were not prepared to prevent online bank fraud; 55% of banks use manual reports to detect fraud; 70% say employee and customer education awareness programs need to be improved; and 44% plan to invest in intrusion prevention technologies.

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