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S&P Global
Market Intelligence

Blog:
How much deposit costs increase is anyone's guess

By Nathan Stovall **February 13, 2017**

Deposit costs across the banking industry will increase, but by how much is debatable.

Banks of varying sizes and in different markets have included a variety of deposit betas — or how much of the changes in market rates they will have to pass onto customers — in their assumptions. Many investors expect higher short-term rates will lead to higher net interest margins. But ultimately the actual deposit beta that a bank incurs will dictate just how much an institution benefits from increases in short-term rates.

A panel of Keefe Bruyette & Woods bank analysts at the Winter Financial Services Symposium on Feb. 9 outlined their expectations for deposit betas and how higher rates may impact the industry's deposit bases.

"We're all trying to figure out deposit betas and the banks are too," KBW analyst Jefferson Harralson said at the event. "If you have a high loan-to-deposit ratio, it's a risky year for you." He added that any institution with a levered deposit base might decide to shrink their loan book instead of securing more funding if the cost is unclear.

Some banks have provided their deposit beta assumptions over the next few possible hikes in short-term rates. Right now, fed futures are assigning a 60% probability of the central bank raising short-term rates two to three times in 2017.

National players like Bank of America Corp. and Wells Fargo & Co. expect deposit betas in the range of high 40s to low 50s. Expectations among sizable regional banks vary more, with Fifth Third Bancorp and Comerica Inc. expecting a 20% to 25% beta from the recent hike in December 2016. Other institutions like BB&T Corp. and Regions Financial Corp. are modeling a nearly 60% beta over the long-term. Smaller institutions have provided even more specific information, with Umpqua Holdings Corp. offering betas on money market accounts and time deposits of 60% to 65% and 90% to 100%, respectively.

The KBW bank research team tracks all those assumptions. It provides investors with their own forecast for deposit betas from the third quarter of 2016 through the fourth quarter of 2018. KBW expects the average beta on interest-bearing deposits of 17% for universal banks, 43% for regional banks and 35% among small-cap and mid-cap banks.

Comparatively, the industry had deposit betas of 41% and 62% in 2005 and 2006, respectively. That was when the Federal Reserve last raised short-term rates in a series of moves.

KBW analyst Catherine Mealor noted that deposit bases will likely behave differently from market to market. She expects costs to rise more quickly in faster-growing areas such as the Washington, D.C., area, where many banks boast high loan-to-deposit ratios. She said some large commercial customers in the D.C. area have demanded a higher rate on their deposits, and those actions could move market rates up.

KBW analyst Collyn Gilbert said many banks in her coverage of the New York area carry high loan-to-deposit ratios as well but have not had notable changes in their deposit costs yet. She said those banks feel comfortable taking their loan-to-deposit ratios up to 120% and seem to expect deposit costs will not rise materially until a few more rate increases take place. Gilbert said the New York market should serve as a good proxy for deposit betas.

Meanwhile, Mealor said some institutions are actually "sneaky" asset sensitive. This means that their assets will reprice faster than liabilities and possibly by greater amounts than many bank observers expect. Mealor said WesBanco Inc. is a good example of this, since it carries a low loan-to-deposit ratio and has a low-cost core deposit base, which is primarily tied to more rural markets.

When costs began moving higher, KBW's Harralson said institutions are unlikely to just increase rates on certain products, like money market accounts. He said institutions will first react by changing tiers on accounts and offering higher rates for depositors willing to park large amounts of cash in the bank. He expects banks will also offer longer-dated CDs with slightly higher rates and market deposit specials before raising all rates on its products.

The KBW analyst team seem to believe short-term rate increases will change the deposit business, but the changes will be nuanced. They also seemed to think banks will be able to lag the increases in rates, possibly substantially, during the first few rate hikes. KBW analyst Brady Gailey noted in his coverage, however, that one Florida-based bank with a higher loan-to-deposit ratio has driven up deposit costs for others in its market.

Sometimes, it “only takes one” to move the market, he said