Fed rule change could push deposit growth downstream as new surge builds

Bank deposits have continued to accumulate ahead of what could be a second epic surge during the pandemic era. But the Federal Reserve's decision to sunset an emergency relaxation of capital rules could channel some of the growth away from the biggest banks to smaller competitors and money market funds.

The Treasury Department, which had about $1.6 trillion in its account at the Fed at the beginning of the year, has started drawing funds as it distributes aid under President Joe Biden's $2 trillion relief package — including roughly $250 billion in direct checks to households that the government said had already gone out the door by March 17th. Along with $120 billion of bond purchases by the central bank each month, commercial banks' holdings of reserves, and their balance sheets, could pop again in the coming months.

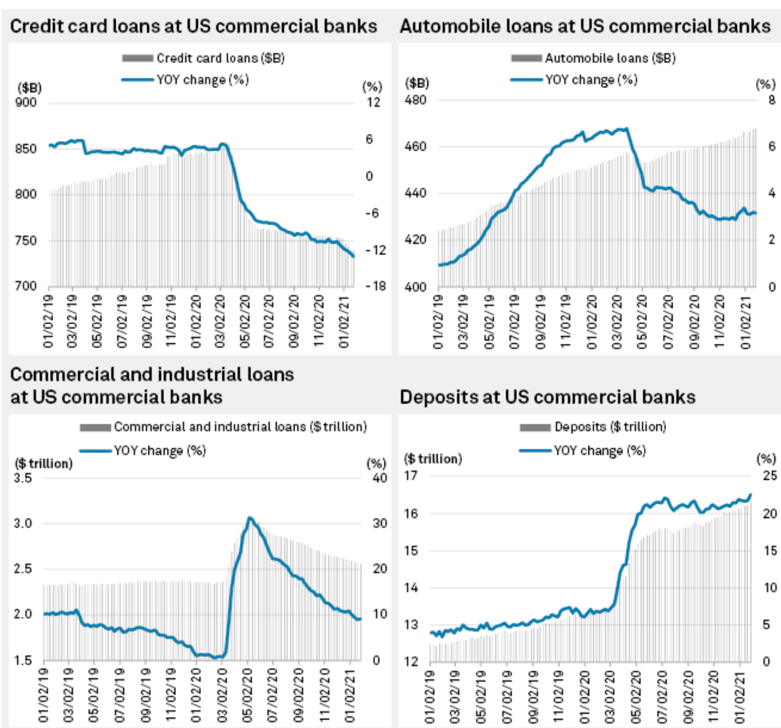
A burst in growth would echo the initial months of the pandemic in 2020, when the Fed lifted its securities holdings by about $2 trillion from early March to about $6 trillion in late May in an effort to calm markets and support the economy. Commercial bank deposits and balance sheets also grew by about $2 trillion over the same time.

Since then, the growth has been slower, but steady. Seasonally adjusted deposits at commercial banks are up about $500 billion so far in 2021, hitting $16.615 trillion at March 10th, according to the most recent weekly data from the Federal Reserve. Loans, meanwhile, had increased by about $55 billion to $10.438 trillion.

Estimated loans and deposits at US commercial banks
For the week March 10, 2021

	As of March 10, 2021 ($B)	Change (%) From previous week	Change (%) YOY
Commercial & industrial loans	2,638.97	1.0	10.0
Real estate loans	4,654.30	0.0	-0.1
Residential real estate loans	2,233.76	0.1	-3.1
Commercial real estate loans	2,420.54	0.0	2.9
Consumer loans	1,532.31	0.2	-4.9
Credit card and other revolving	747.83	0.3	-12.7
Automobile	469.74	0.0	2.9
Total loans and leases	**10,437.76**	**0.4**	**2.4**
Deposits	**16,615.18**	**0.6**	**22.5**

Data compiled March 22, 2021.
Analysis based on the H.8 report released by the Federal Reserve on March 19, 2021, for the week ended March 10, 2021, and is seasonally adjusted. The data is estimated by benchmarking weekly data provided by a sample of banks to quarter-end reports of condition (call reports).
Year-over-year numbers are compiled using data for the week ended March 12, 2020.
The components listed are not representative of the banking industry's entire loan portfolio.
Source: Federal Reserve



Data compiled March 22, 2021.
Analysis based on the H.8 report released by the Federal Reserve on March 19, 2021, for the week ended March 10, 2021, and is seasonally adjusted. The data is estimated by benchmarking weekly data provided by a sample of banks to quarter-end reports of condition (call reports).
Source: Federal Reserve

Credit Suisse analyst Zoltan Pozsar estimated that JPMorgan Chase & Co., Bank of America Corp. and Citigroup Inc. absorbed about 75% of the growth in reserves in 2020. But with the emergency exclusion of banks' Treasury holdings and reserves from the supplementary leverage ratio — a key measure of capital adequacy — approaching its end on March 31st, some big banks could be nearing capacity constraints.

Among the "big six," JPMorgan Chase would have been closest to its 5% minimum without the exclusions with an SLR of 5.8% as of Dec. 31, 2020, followed by Citi at 5.9%.

Jefferies analyst Ken Usdin calculated that JPMorgan Chase could have still added about $651 billion of assets before breaching its 5% SLR minimum, and Citi could have added about $514 billion, though he noted that banks are likely to try to maintain buffers above their floors.

"If the biggest banks potentially have to push away certain deposits, some could flow to other institutions," Usdin said in a note on March 19th. "The regionals would have the most room," with super-regionals such as U.S. Bancorp, Truist Financial Corp. and PNC Financial Services Group Inc. having a lower SLR minimum, at 3%, and smaller regionals subject to no SLR minimum at all. The trust banks Bank of New York Mellon Corp. and State Street Corp. also have more room relative to their global, systemically important peers, Usdin said, in part because their reserves are already excluded from their SLRs.

JPMorgan Chase has been vocal about the potential impact of the SLR, saying in January that it might be forced to turn away deposits, or retain more common equity or issue preferred stock. Banks appear to have already been taking steps to curb deposit growth amid low interest rates and weak loan demand.

Keefe Bruyette & Woods analyst Brian Kleinhanzl has estimated that absorbing reserve inflows by issuing preferred could be profitable for the big banks, assuming a net interest margin of 12.5 basis points on the incremental growth. "The cost of issuing preferreds would be offset by additional net interest income being generated if that is the route that bank managements choose to go down," he said in a note on March 19th.

BofA, which has said it did not need the SLR relief, reiterated the message in a filing on March 19th, saying the expiration would not impact its ability to serve customers or hinder its capital return plans.

JPMorgan Chase shares fell 1.6% on March 19th, the day the Fed announced that the SLR exclusions would expire as planned, compared with a 1.3% decline in the S&P United States BMI Banks Index. The Fed also announced that it would seek comments on potential long-term changes to the SLR, citing "recent growth in the supply of central bank reserves and the issuance of Treasury securities."

In addition to potentially shifting deposit growth away from some of the biggest banks, SLR constraints could also redirect cash into money market funds. The Fed announced on March 17th that it would raise the limit on overnight repurchase transactions with individual counterparties from $30 billion to $80 billion, enabling money market funds to park larger pools of funds with the central bank and earn a modest return. Under these transactions, the Fed's holdings of bonds would be funded by household and institutional shares in money funds, instead of bank reserves.

Pozsar, the Credit Suisse analyst, called the step "the right move to deal with the 'tsunami' of reserves that was finally unleashed this week with the disbursement of stimulus checks." In a note on March 17th, he interpreted it as a way of "'foaming the runway' for the end of SLR exemption."

Broadly, however, analysts expect that for the for the foreseeable future, banks will have all the deposits they want, or can handle.

Source: Credit Suisse