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DATA DISPATCH

Excess liquidity continues to smother US bank margins

Thursday, February 18, 2021 7:39 AM CT

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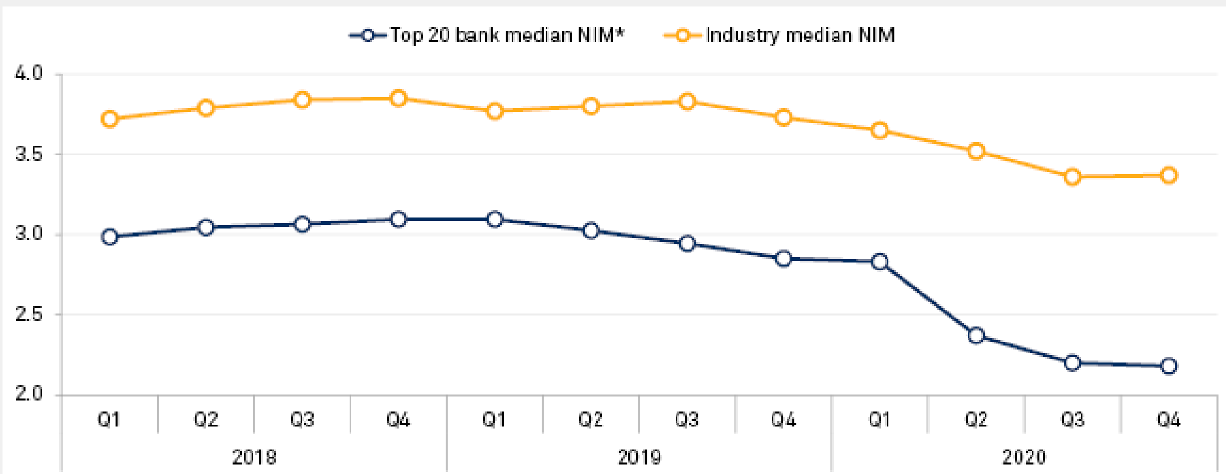
Market Intelligence

U.S. bank margins remained near historical lows in the fourth quarter as excess liquidity continued to build on institutions' balance sheets.

The banking industry's aggregate taxable equivalent net interest margin held steady at 2.63% in the fourth quarter, flat with the prior quarter but down notably from 3.25% in the year-ago period.

Banks recorded explosive deposit growth in 2020, while loan growth outside of the government's Paycheck Protection Program, or PPP, remained hard to come by as banks tightened underwriting standards and weak borrower demand persisted.

Median net interest margin trends at US banks (%)



Data compiled Feb. 8, 2021.
NIM = net interest margin
Analysis includes U.S. commercial banks, savings banks, and savings and loan associations. Excludes nondepository trusts and companies with a foreign banking organization charter.
* The 20 largest U.S. banks by total assets as of Dec. 31, 2020, are: JPMorgan Chase Bank NA, Bank of America NA, Wells Fargo Bank NA, Citibank NA, U.S. Bank NA, Truist Bank, PNC Bank NA, TD Bank NA, Bank of New York Mellon, Capital One NA, Charles Schwab Bank SSB, State Street Bank and Trust Co., Goldman Sachs Bank USA, Fifth Third Bank, HSBC Bank USA NA, Citizens Bank NA, Morgan Stanley Bank NA, Ally Bank, Northern Trust Co. and KeyBank NA.
Data is fully taxable equivalent, adjusted for major intercompany consolidations and based on regulatory filings.
Source: S&P Global Market Intelligence

Through the fourth quarter, deposits jumped 22.6% from a year earlier. Loan balances rose 3.3% year over year but actually declined 0.6% when excluding loans made through the PPP.

As banks failed to put deposits to work, the industry's loan-to-deposit ratio plunged to 60.94% from 72.36% a year earlier.

Some bankers had expected excess liquidity to abate late in 2020 as customers, including borrowers in the PPP, utilized deposit balances, but that did not occur and has shown no signs of letting up. Since the end of the fourth quarter, the Federal Reserve's H.8 report, which tracks commercial bank balances, shows that deposits continued to grow through the week ending Feb. 3.

Deposit growth has been supported by the Fed's efforts to flood the markets with liquidity through quantitative easing, which in turn has increased the level of reserves in the banking system. The Fed has maintained that it will continue asset purchases until its employment and inflation goals are met. Fed Chairman Jerome Powell said in mid-January that "now is not the time to be talking about an exit" from its bond purchases.

Government stimulus has supported deposits as well, sending U.S. savings rates above 12% in every month since April 2020. Before the pandemic began, the monthly savings rate exceeded 10% just once since January 2000. Deposit growth also likely benefited from PPP borrowers and corporates that drew on existing lines of credit early in the pandemic parking the funds they received.

Excess liquidity on bank balance sheets

	Dec. 31, 2020 ($B)	QOQ change (%)	YOY change (%)
Total loans	10,860.44	-0.5	3.3
Total loans (excluding PPP loans)	10,453.22	0.3	-0.6
Total securities	5,112.08	6.7	28.4
Total fed funds and repos	267.16	-8.2	14.9
Interest-bearing balances	2,923.82	12.8	101.4
Total deposits	17,820.43	4.1	22.6

Data compiled Feb. 8, 2021.
PPP = Paycheck Protection Program
Analysis includes U.S. commercial banks, savings banks, and savings and loan associations.
Excludes nondepository trusts and companies with a foreign banking organization charter.
Data based on regulatory filings as of Dec. 31, 2020.
Source: S&P Global Market Intelligence

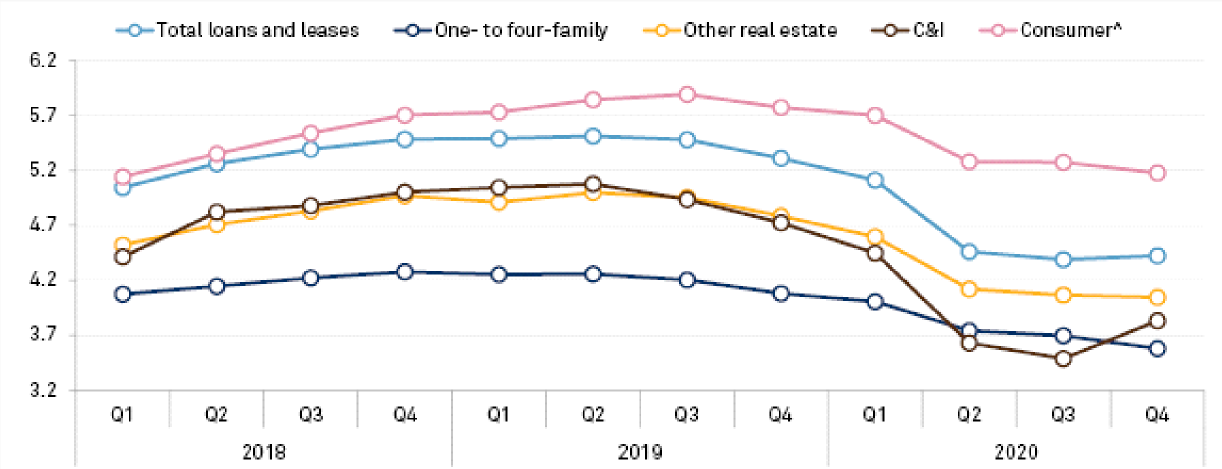
M&T Bank Corp. CFO Darren King said at a recent investor conference in early February that many depositors are holding cash in their primary operating account opposed to money market accounts or CDs since the latter offer such low rates today. The executive said it is not clear how sticky those deposits will be, but they are "probably stickier than people think."

"The reason I say that is, if businesses are going to spend their cash on hiring, it's going to end up in consumers accounts in the form of wages, right? If they're going to spend that money in retail, then it's going to end up in retail accounts and not end up in the banking system," King said at the event. "So it's hard for that cash to get taken out of the system easily, and so I think it's going to be around a little bit longer than people think."

Banks do not appear to have deployed much of the excess liquidity since the end of 2020, reporting that demand for commercial and industrial credits and commercial real estate loans continued to decline in the fourth quarter, according to the Federal Reserve’s latest Senior Loan Officer Opinion Survey published January.

The Fed's H.8 data also shows that loans dipped lower since the end of the fourth quarter through the week ended Feb. 3.

Yield by loan type across US banks (%)



Data compiled Feb. 8, 2021.
C&I = commercial and industrial
Analysis includes U.S. commercial banks, savings banks, and savings and loan associations. Excludes nondepository trusts and companies with a foreign banking organization charter.
Data is adjusted for major intercompany consolidations and based on regulatory filings.
Yield is calculated on average balances for each loan type.
^ Consumer loans do not include credit cards.
Source: S&P Global Market Intelligence

The few newly originated credits coming on banks' books have carried low yields due to historically low interest rates. The pressure on loan yields has been exacerbated since PPP loans have been responsible for much of the recent loan growth and those credits carry rates of just 1%.

The program offered small businesses low-rate, forgivable financing provided that borrowers use a majority of the funds for payroll. While the loans carry low rates, the credits are expected to bring fees of about 3% on average once loans are forgiven.

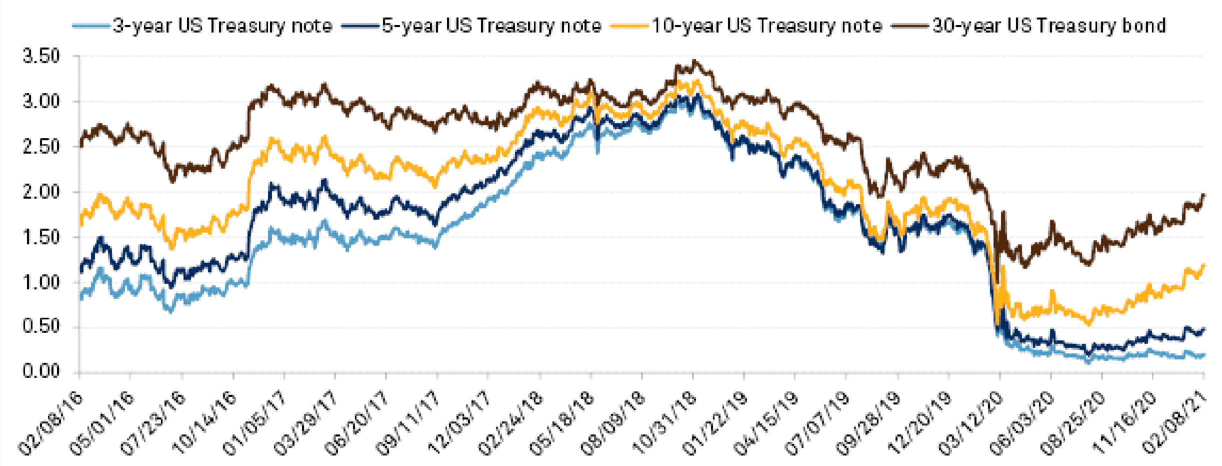
As the PPP forgiveness process began and long-term interest rates rose in the fourth quarter, loan yields stabilized. The industry's loan yield rose to 4.42% in the fourth quarter from 4.39% in the third quarter but remained down notably from 5.31% a year ago. Yields on most asset classes remained under pressure, save for commercial and industrial loan yields, which jumped to 3.83% in the fourth quarter from 3.48% in the prior quarter, likely due to the recognition of fees on PPP loans.

While loan yields stabilized, banks continued to put funds to work in low-yielding assets like interest-bearing balances due — deposits at other banks— which have jumped close to 101% year over year and increased nearly 13% from the prior quarter.

Banks put more cash to work in securities in the fourth quarter, growing those portfolios 6.7% from prior-quarter and 28.4% from year-ago levels. Yields on new investments likely improved as the average yield on the 10-year Treasury rose nearly 21 basis points in the fourth quarter from the linked quarter. Long-term rates have risen further since then, with the 10-year Treasury reaching 1.20% on Feb. 12, up nearly 70 basis points from the lows in early September 2020.

The recent increase in long-term rates should help banks mitigate further margin pressure. Continued recognition on fees associated with PPP loans made in 2020 will also bolster loan yields in the coming quarters, but bank margins seem unlikely to rise materially until loan demand returns in force, allowing institutions to deploy excess liquidity.

Yields on Treasury notes and bonds (%)



Data compiled Feb. 8, 2021.
Rate information is from Feb. 8, 2016, to Feb. 8, 2021.
Source: S&P Global Market Intelligence

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