Deposit remuneration in Spain

The ultra-expansionary monetary policy in place until 2021 had the obvious benefit of providing official liquidity at a time when the banks were finding it hard to raise it privately. The disappearance of that official liquidity will foreseeably translate into higher deposit betas across the eurozone, including in Spain, where the process is already beginning to accelerate, albeit with a lag relative to the eurozone average.

Santiago Carbó Valverde and Francisco Rodríguez Fernández

Abstract: According to the Bank of Spain, rates on corporate deposit accounts increased from 0.03% in July 2022 to 0.46% in August 2023. Over that same timeframe, the average rate on term deposits from corporations increased from 0.60% to 2.67%. As for bank accounts for households, the rate offered on sight deposits increased from 0.01% to 0.12% during that period, increasing from 0.04% to 1.37% on term deposits. Assessing deposit pass through at the EU level, the European Central Bank's statistics reveal that remuneration on deposit accounts in Spain averaged 2.31% in August, compared to 3.03% on average in the eurozone. That gap is partly the result of a different financial reality for the Spanish financial institutions. The Spanish banks reinforced their liquidity buffers significantly in the wake of the financial crisis. Thus, their initial failure to pass the ECB rate increases on to deposit rates to a greater extent (a phenomenon we are witnessing at present) reflects, at least in part, the abundance of liquidity held by the Spanish banks that was provided by the ECB itself, curtailing the incentive to compete for deposits. That said, the deposit pass through already underway is set to intensify further in the coming months as the ECB continues to mop up liquidity, including through the unwinding of TLTROs.

Foreword

Newspaper headlines stating that market rate increases get priced into loans faster than deposits have become a common

> “In this new climate where we are witnessing the shift from abundant liquidity to scarcity, we will likely see faster deposit repricing, with evidence suggesting that acceleration is already materialising.”

phenomenon. Such asymmetries in the monetary policy transmission channels are habitual looking back in time and warrant an unhurried explanation. Having lived through a prolonged period of zero or negative rates followed by intense rate tightening (10 ECB rate increases since July 2022) over a short period of time has brought this issue into focus. Unlike what has happened in other European countries, until now, the Spanish banks had not been increasing the rates offered on sight deposits at anywhere near the same intensity. Recent evidence, however, suggests that market rates are now being passed through, and at an accelerating pace.

What are the reasons for the lag (relative to the eurozone) in passing through the increase in official interest rates to the price of bank liabilities? According to the European Central Bank's statistics, remuneration on deposit accounts in Spain averaged 2.31% in August, compared to 3.03% on average in the eurozone. That gap is partly the result of a different financial reality. The Spanish banks reinforced their liquidity buffers significantly in the wake of the financial crises. The failure to pass the ECB rate increases through to deposit rates to a greater degree reflects, at least in part, the abundance of liquidity held by the Spanish banks that was provided by the ECB itself. As a result of that monetary policy, deposits had not, in general, been contributing significantly to the level of banking margins. The banks' incentive to go after deposits in an environment of abundant liquidity has been weak. In parallel, after the intense provisioning and sale of assets impaired by the financial crisis, the Spanish banks have faced lower funding requirements than their European competitors, with credit and assets registering considerably lower growth. Meanwhile, in recent years, Spanish savers looking for higher returns have opted for other products such as investment funds and direct investments, often times marketed by the banks themselves. In sum, the monetary environment explains at least some of the trend in deposit remuneration irrespective of competitive dynamics.

That situation of abundant liquidity is currently making way for one of scarcity. The inflation ushered in by the war in Ukraine, coupled with other geopolitical events and post-pandemic supply chain issues, has forced the central banks to – swiftly – switch their interest rates policies and roll back their extraordinary liquidity instruments. In this new climate it is likely we will see faster deposit repricing. The evidence suggests that acceleration is already materialising.

The mechanism of deposit pass through

There are several proven facts about how official interest rates get passed through to bank deposit rates. The European Central Bank (Grodcicki *et al.,* 2023) highlights the following mechanisms:

Firstly, the sensitivity of banks' deposit rates to changes in policy rates depends on the type of deposit, bank-specific characteristics and the structure of the banking sector. Econometric analyses reveal that approximately 86% (68%) of the change in policy rates is transmitted to rates on new term deposits from non-financial corporations (households), whereas 23% (32%) is transmitted to rates on sight deposits from non-financial corporations (households). As shown further on in this paper, in Spain, as in the rest of the eurozone, the transmission of official rates to deposit rates began sooner and is proving more intense in the corporate segment, although things are beginning to accelerate in the household segment too.

> "The Spanish banks have gone from having 289.69 billion euros of long-term funding in July 2022 (when the ECB embarked on its rate tightening) to 96.18 billion by May 2023."

Secondly, interest rates on new deposits from non-financial corporations are more sensitive to changes in policy rates as firms are more likely to switch to alternative investments. Until recently, corporations were even charged negative rates in some instances. This phenomenon is also evident in Spain, in a context in which average returns on investment funds have been extraordinarily varied and the upward pressure exerted by market rates on fixed-income securities has translated into returns of over 2% (CNMV, 2023).

Thirdly, the ECB's findings also show a reduced proclivity to pass through policy rates in the case of the larger and more liquid banks. For example, a one-point increase in official rates leads to term deposit rates that are 12 basis points lower for larger banks and 10 basis points lower for the liquid banks (under less pressure to bring in deposits). In a study by Carbó, Cuadros y Rodríguez (2021), it was shown that during the years in which official interest rates were in negative terrain, the Spanish banks were hit relatively hard by the anomalous monetary situation on account of their relative size and liquidity, among other factors.

Fourthly, deposit outflows and TLTRO repayments could intensify competition in the deposit market, leading to faster and higher deposit repricing than observed recently. This is a relevant factor in Spain, which had garnered between 10% and 15% of those long-term funds. Their repayment has picked up significantly of late.

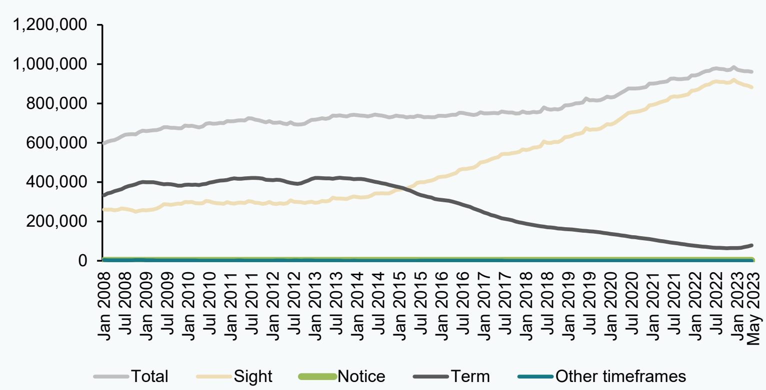
The Spanish banks have gone from having 289.69 billion euros of long-term funding in July 2022 (when the ECB embarked on its rate tightening) to 96.18 billion by May 2023.

Pass-through of interest rates in Spain

The Bank of Spain's statistics show that the transition described by the ECB for the broader eurozone is already materialising. Sight

Exhibit 1 **Deposit mix in Spain 2008-2023**

EUR mn



Source: Bank of Spain and authors' own elaboration.

deposits gained market share during the years of negative or ultra-low rates, representing 89.5% (862.2 billion euros) of all household deposits by September 2023 (Exhibit 1). Term deposits were in clear decline during those same years but have recovered in line with the rebound in rates, especially over the course of 2023, increasing from 64.9 billion euros in January to 101.23 billion euros by September.

The period of abundant liquidity has given way to a situation of greater scarcity in which the cost of bank deposits can be expected to increase. Indeed, there are some signs that this is already beginning to happen. Rates on corporate deposits are increasing significantly (always the first segment to benefit from the pass-through of official rates), as too are prices in the household segment of late. According to the Bank of Spain, rates on corporate deposit accounts increased from 0.03% in July 2022 to 0.46% in August 2023. Over that same timeframe, the average rate on term deposits from corporations increased from 0.60% to 2.67%. As for bank accounts for households, the rate offered on sight deposits increased from 0.01% to 0.12% during that period, increasing from 0.04% to 1.37% on term deposits. This pass-through is set to intensify in the coming months as the ECB continues to mop up liquidity.

Exhibit 2 **Deposit remuneration in Spain: Interest rates on new deposits**

Source: Bank of Spain and authors' own elaboration.

> It makes sense that in countries where inflation is higher, nominal deposit rates would be higher; nevertheless, deposit remuneration is higher in real terms in countries with lower inflation, like Spain, providing an additional possible partial explanation for the lower prevailing nominal rates on bank accounts.

S&P Global (2023) notes that deposit remuneration began to climb upwards in Spain at the end of 2022, calculating that the percentage of changes in market interest rates that banks pass on to their customers – the so-called deposit beta – had increased to 25% in the first quarter of this year.

The last matter of great importance is inflation. Differences in inflation from one country to another may also be having an impact on deposit remuneration since savings and investment supply and demand decisions are taken in real terms, discounting inflation. It makes sense that in countries where inflation is higher, like Germany and other central and northern European countries, nominal deposit rates would be higher. Nevertheless, deposit remuneration is higher in real terms (adjusting for inflation) in countries with lower inflation, like Spain, providing an additional possible partial explanation for the lower prevailing nominal rates on bank accounts. This impact should disappear as eurozone inflation rates converge.

In short, the ultra-expansionary monetary policy in place until 2021 had the obvious benefit of providing official liquidity at a time when the banks were finding it hard to raise it privately. However, that same policy has generated a lot of distortions (refer to Carbó, Cuadros and Rodríguez, 2021), including distortions in competition in the banking sector. The ultra-expansionary policy that gave rise to such abundant liquidity also curtailed the incentive to compete for deposits (particularly in the less profitable customer segments). As noted above, the disappearance of that liquidity (unwinding of the TLTROs) will normalise those incentives. A higher cost of opportunity for the banks around liquidity will foreseeably translate into higher rates on deposits.

References

Carbó, S. Hannan, T. and Rodríguez, F. (2011). Exploiting Old Customers and Attracting New Ones: the case of Bank Deposit Pricing. *European Economic Review,* Vol. 55, pp. 903-915.

Carbó, S., Cuadros, P. J. and Rodríguez, F. (2021). The Effects of Negative Interest Rates: A Literature Review and Additional Evidence on the Performance of the European Banking Sector. *The European Journal of Finance, Vol. 27,* No. 18, pp. 1908–1938 DOI:10.1080/1351847X.2021.1927784

Comisión Nacional del Mercado de Valores. (2023). CNMV Bulletin. Quarter I. https://www.cnmv.es/DocPortal/Publicaciones/Boletin/Boletin_I_2023_ENen.pdf

Grodzicki, M., Klaus, B., Pancaro, C. and Reghezza, A. (2023). Euro area bank deposit costs in a rising interest rate environment. *Financial Stability Review,* May 2023. European Central Bank. https://www.ecb.europa.eu/pub/financial-stability/fsr/focus/2023/html/ecb.fsrbox202305_04~7fbb3af52c.en.html

S&P Global. (2023). Spanish banks turn attention to deposits as interest expenses surge in Q4. https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/spanish-banks-turn-attention-to-deposits-as-interest-expenses-surge-in-q4-74526864

Santiago Carbó Valverde. University of Valencia and Funcas

Francisco Rodríguez Fernández. University of Granada and Funcas