U.S. Deposits and the Critical Lessons on Deposit Betas
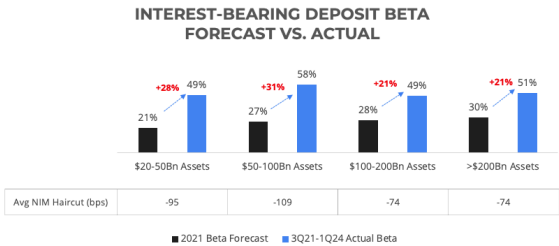
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In the unpredictable world of interest rate changes, understanding and managing **deposit betas** is crucial for financial institutions aiming to maintain profitability and competitiveness. However, as lessons from the U.S. deposit market reveal, analyzing deposit betas alone is not enough. Institutions must also address evolving customer behaviors and market dynamics to ensure sustainable success. This article examines these lessons, focusing on the limitations of relying solely on deposit betas and the broader strategies required to navigate volatile rate environments.

Key Lessons from the 2022-2023 Fed Rate Hikes

INTEREST-BEARING DEPOSIT BETA FORECAST VS. ACTUAL

| Avg NIM Haircut (bps) | -95 | -109 | -74 | -74 |

■ 2021 Beta Forecast   ■ 3Q21-1Q24 Actual Beta

Source: Beta estimates sourced from public sources including regulatory filings, investor presentations, and earnings transcripts in 3Q21 and 4Q21. Actual betas calculated using 3Q21 and 1Q24 filings. Results exclude Cullen/Frost, the only institution in our survey with a 2021 forecast beta higher than observed (50% forecast vs 43% realized).

Deposit beta measures the degree to which changes in market interest rates are reflected in a bank's deposit costs. For instance, a beta of 30% means that if market rates rise by 100 basis points, the bank's deposit costs increase by 30 basis points. While this metric provides critical insight into cost sensitivity, recent trends reveal its limitation.

Many U.S. banks entered the recent rising rate environment expecting deposit betas to hover around 20-30%. In reality, betas ranged between 50% and 60%, resulting in higher-than-expected costs and significant pressure on Net Interest Margins (NIM).

Institutions that based projections on past rate cycles failed to account for today's heightened customer access to competitive rate information through digital platforms, leading to outdated assumptions about rate sensitivity.

The gap between expected and actual deposit betas during this period reveals the need for agility in modeling and strategy. Digital tools have expanded the competitive landscape, enabling customers to shop for rates beyond their local markets. Successful institutions monitor both local and national rate trends, recognizing that rate comparisons alone are insufficient to capture customer loyalty.

Institutions must use real-time data to refine forecasting models and conduct frequent reassessments to ensure projections align with current market realities. Simply relying on rate adjustments to attract or retain deposits is no longer enough. Banks must develop comprehensive value propositions that combine competitive rates with non-rate benefits to create a stronger, more resilient foundation for customer relationships.

Building Resilience: A Multifaceted Approach

The 2022-2023 U.S. experience with deposit betas offers invaluable insights for institutions navigating volatile rate environments. By learning from these lessons and adopting data-driven, customer-focused strategies, banks can position themselves as leaders in deposit management. Investing in advanced analytics is crucial, as robust tools for deposit modeling and real-time insights can help anticipate shifts in customer behavior and market trends. Empowering frontline teams is another essential strategy; by providing customer-facing staff with actionable insights, banks ensure that these teams can address concerns effectively and reinforce customer loyalty. Furthermore, focusing on holistic value is key. Combining rate competitiveness with value-added services creates stronger, more durable relationships that go beyond transactional interactions and foster long-term trust.

In our next article, we'll explore the Canadian mortgage market and its unique customer dynamics, offering further insights into navigating rate volatility and customer expectations.

Ready to deepen your understanding of deposit strategies? Reach out to our team at **sales@nomissolutions.com** to schedule a conversation! You can also listen to the full **fireside chat** to learn more.

The Nomis Narratives Blog