Note: Below are extracts from an article published by RTE(4th June, 2023) and as referenced below.

Why are deposits growing when the rate of return is so low?

According to the RTE website, Finn (2023), we Irish have demonstrated an ability to save, large amounts, particularly as a result of the Covid pandemic:

> Households saved approximately 20% of their disposable income in the final three months of last year, according to the CSO. Anyone who grew up in Ireland in the eighties will likely be familiar with Henry Hippo - Ulster bank's attempt at instilling a savings mindset in the young. Or even Cyril Squirrel - An Post's version of the same endeavor.
> It could be argued that both achieved their objectives in spectacular fashion.
> Barring a brief period in the early to mid-2000s when we appeared to go on a debt-fueled spending binge, by and large, in Ireland we're rather conservative when it comes to saving money and it's a habit we appear to have taken to with considerable zeal.
> It's a practice that we further mastered during the pandemic when, faced with a reduced opportunity to spend, we squirrelled away billions collectively. But despite the onset of a cost-of-living crisis, which has seen thousands pinned to the collar, there are those who continue to put money aside - in quite significant quantities - despite the banks offering us meagre returns.
>
> (Finn, 2023)

This RTE online article by Finn (2023) continues to outline just how much money Irish consumers are saving and in fact how households here continue to save, despite inflationary pressures and rising cost of living:

Nearly €8 billion in the year to April, according to Central Bank figures published this week, including over €830 million in the month of April itself. That takes the total amount on deposit by households in Ireland to in excess of €150 billion. According to a recently published report from the Central Statistics Office, households saved approximately 20% of their disposable income in the final three months of last year. That's up from a savings rate of 10% prior to the pandemic.

There had been an expectation that the wall of pandemic savings would have been gradually eroded - firstly, by choice, with people opting to spend more to make up for lost opportunities during the pandemic, and secondly, by natural erosion from cost- of-living increases. That has not materialised at all.

"Irish households built up a lot of savings over Covid-19 and they are not winding them down," Peter Culhane of the CSO said.

"This means that far from making up for missed opportunities to spend, households are now saving more than they did before the pandemic," he added.

It could be the case that the inflationary environment is instilling a sense of caution, even in people who may have high savings rates already and those who are managing to secure pay increases to combat inflation. Extra cash may be ending up in bank accounts in preparation for further uncertainty in the pricing environment.

(Finn, 2023)

Finn (2023) in his RTE web article highlights how no account offers anything close to the 3.25% that the ECB pays the banks for depositing their excess cash in its overnight facility:

Despite interest rates rising by almost 4 percentage points in the past year, we are still getting next to nothing for our savings from the main banks. The average interest rate offered by the three pillar banks on easy-to-access overnight deposit accounts stood at 0.03% in March, according to Central Bank figures. An estimated €9.40 out of every €10 on deposit here is sitting in these low interest accounts.

Savings accounts with agreed maturity offered an average return of 1.14% in March. The equivalent rate in the euro area stood at 2.11%. These average rates will likely nudge upwards over time, but no account offers anything close to the 3.25% that the ECB pays the banks for depositing their excess cash in its overnight facility.

To put it bluntly, why would they bother when we're cramming banks accounts with our excess cash as it is. They don't have to incentivise us.

"The rates that the banks pay on their deposits is their cost of buying money," John Finn, Managing Director of Treasury Solutions explains.
"They take money in from depositors, they add a margin, and they lend it to borrowers," he adds.

Right now, that source of funding is cheap because deposits are plentiful. Another reason for the poor return may be that the banks are making up for the years during which they essentially absorbed negative interest rates on behalf of most of its customer base. Deposit rates at the ECB level remained in negative territory for around eight years but the banks only latterly started to apply that negative rate to very high net-worth depositors with balances in excess of €1 million.

For most of that time, the negative rate that the ECB applied amounted to 0.5%, or put another way, €5,000 for every €1 million deposited there.
"Yes, deposit rates were slashed to near zero, but in most cases, banks did not charge ordinary savers for holding their money," Daragh Cassidy of bonkers.ie points out.

"So, in some ways Irish savers are now having to repay this previous 'generosity' of the banks," he suggested.

Finally, there's the 'swings and roundabouts' nature of the regime. Depositors are effectively taking the hit in return for lower rates for borrowers. Although interest rates have climbed by 3.75 percentage points at the ECB level, the main banks have only added an average of around 1.5 to 2 points to their fixed rate mortgage products, with some variable rate mortgage rates only moving marginally higher. (Trackers automatically get the full brunt of all rate hikes). And the banks can then deposit their surpluses with the ECB where they will get the full 3.25% on offer, more than offsetting the losses they made in recent years on negative rates as well as being able to keep their mortgage products competitive.

(Finn, 2023)

What's the future for deposits?

An important point that should be borne in mind when it comes to deposits is that the value is persistently being eroded by inflation. Even with an inflation rate of 2% - about one third of the current rate of price increase across the economy - a lump sum of €50,000 (not accounting for any interest) would effectively lose around €9,000 of spending power over the course of a decade.

That sum would have to attract quite a handsome rate of interest to make up for that effective loss in spending power. What's more, any interest gained is subject to tax (DIRT) at a rate of 33%. However, there is the security attached to deposits and that is why we continue to pile money into banks and credit union accounts.

The banks are starting to respond to public and political unease around the low rates of return currently offered, as exemplified by Bank of Ireland's recent maneuver.
"I think they'll come under more pressure as the year progresses," John Finn said.
"I can't see them keeping them at these levels, but it [an increase] will be modest," he suggested.

He said that corporates had started to look at other options and were investing in government bonds which were now offering more attractive rates of return on secure investments. As consumers, we may have to get similarly creative if we're to make our hard-earned cash work harder for us.

(Finn, 2023)

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