

Box 2

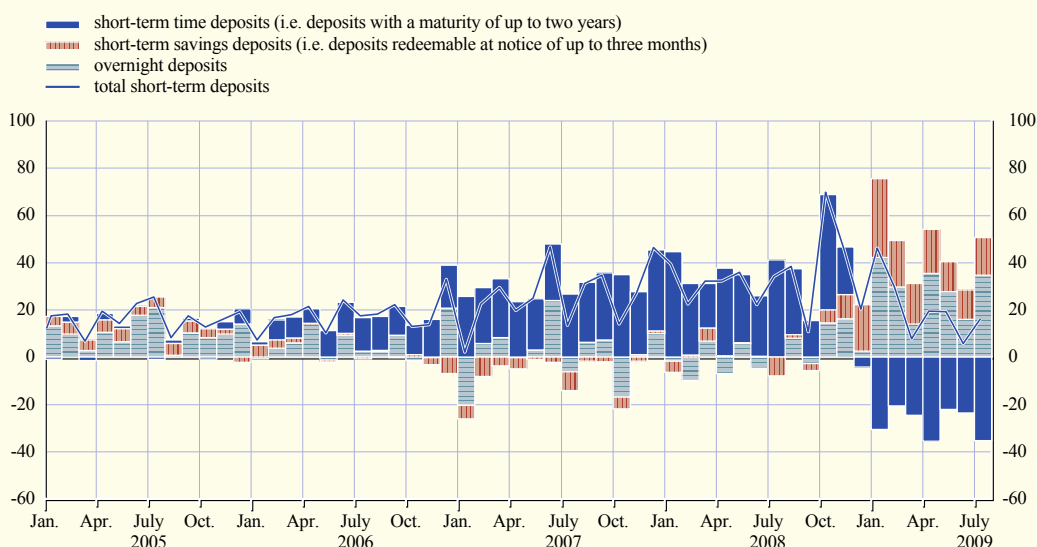
RECENT DEVELOPMENTS IN THE SHORT-TERM DEPOSIT HOLDINGS OF EURO AREA HOUSEHOLDS

Households' investment in short-term bank deposits included in M3 has, on balance, remained fairly robust since the financial turmoil intensified in September 2008. This overall robustness conceals a number of counterbalancing factors, such as the slower growth of disposable income on the one hand, and the rising savings ratio on the other; or the sharp steepening of the yield curve on the one hand (fostering investment in longer-term financial instruments outside M3), and continued high levels of financial uncertainty on the other (implying a general preference for liquid assets). Rather than assessing the extent to which such factors balance each other out, this box takes the overall robustness of households' investment in M3 deposits as a starting point and looks at the degree to which shifts within households' M3 deposit holdings can be explained by changes in the interest rates paid on the various types of short-term deposit.¹ This is of relevance in tracing the impact that monetary policy exerts on monetary developments through changes in the constellation of yields.

1 For a more comprehensive analysis of households' financial investment, see Box 2, entitled "Recent shifts between different categories of financial asset held by households", in the June 2008 issue of the Monthly Bulletin, as well as Box 4, entitled "Integrated euro area accounts for the first quarter of 2009", in the August 2009 issue of the Monthly Bulletin.

Chart A Households' short-term deposit holdings

(EUR billions; monthly flows; seasonally adjusted)



Sources: ECB and ECB estimates.

Chart A shows the monthly flows for households' various kinds of short-term bank deposit, namely overnight deposits, short-term time deposits (i.e. deposits with a maturity of up to two years) and short-term savings deposits (i.e. deposits redeemable at notice of up to three months). Between January 2005 and early 2006, households' investment in M3 deposits was accounted for mainly by flows into overnight deposits. This was consistent with the relatively small differential observed between the interest rates paid on overnight deposits and those paid on the other two categories of short-term deposit (see Chart B), implying that the opportunity cost of holding overnight deposits was relatively low.

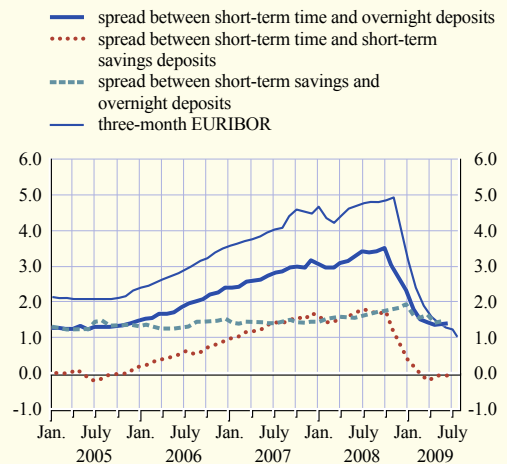
Between early 2006 and late 2008, households allocated a large amount of their investment in M3 deposits to short-term time deposits rather than overnight deposits. Indeed, some months it was even possible to observe outflows from

overnight deposits – i.e. shifts away from this category of deposit. This was consistent with the increase recorded in the spread between rates on short-term time deposits and those on overnight deposits during the tightening phase of the interest rate cycle. At the same time, modest outflows were also observed from short-term savings deposits in this period. This mirrored the increase in the spread between rates on short-term time deposits and those on savings deposits and was consistent with the pattern observed during the period of interest rate tightening in 1999 and 2000.² The spread between the interest rates on short-term savings deposits and those on overnight deposits remained unchanged during this period, suggesting that all shifts in the allocation of short-term deposits were directed towards time deposits.

Since late 2008, in a period of lower short-term interest rates, households' investment in M3 deposits has again mainly taken the form of flows into overnight deposits. This largely reflects the sharp decline recorded in the spread between rates on short-term time deposits and those on overnight deposits, which has fallen to a level last observed in 2005. In addition to the deliberate adjustment of portfolios in line with changes in remuneration, this could also reflect more passive behaviour. This would be the case, for example, if short-term time deposits agreed during the period of high and rising rates automatically became overnight deposits once they had matured, and then simply remained parked there, given that the spread vis-à-vis overnight deposits had declined strongly in the meantime. In this respect, the pricing behaviour of banks, in addition to passing on market rates, may also be influenced by changes in banks' broader funding conditions, such as a reduction in the – previously urgent – need to attract deposit funding by offering attractive rates as a range of public support measures began to be implemented in October 2008.

Chart B Relative rates of return on households' short-term deposits

(percentages per annum; percentage points)



Sources: ECB and ECB calculations.

Notes: Short-term time deposits comprise deposits with an agreed maturity of up to two years. Short-term savings deposits comprise deposits redeemable at notice of up to three months.

² See, for instance, Chart 6 in the September 2002 issue of the Monthly Bulletin.

Flows into short-term savings deposits have also turned positive since late 2008, in line with the strong decline seen in the spread between rates on short-term time deposits and those on savings deposits, as well as the slight temporary increase in the spread between short-term savings deposits and overnight deposits. Nevertheless, the flows into short-term savings deposits over the past nine months (i.e. since late 2008) have been larger than those observed in 2005 during the period of comparable remuneration spreads. This could reflect the fact that, in the period of considerable economic uncertainty at the end of 2008, when many countries introduced enhanced deposit guarantee schemes, the fact that these were “savings” instruments gave them added appeal over and above households’ concrete remuneration considerations. However, it could also reflect the fact that the spread between three-month EURIBOR rates – which can be seen as a proxy for the remuneration of marketable instruments – and rates on short-term savings and time deposits has turned significantly negative since January 2009, and thus the possibility that all types of short-term deposit benefit from shifts out of marketable instruments in such situations.

Overall, the composition of households’ short-term deposit holdings included in M3 appears to have been significantly influenced by changes in the relative levels of remuneration paid on the various types of short-term deposit in recent periods of interest rate tightening and easing. It should, however, be stressed that overall flows of short-term deposits do, of course, also reflect changes in actual and expected returns vis-à-vis long-term deposits and other non-monetary assets, which are not considered here.