Growing Deposits Wisely

By Steve McHugh, *Vice President, Sales and Business Development Manager*

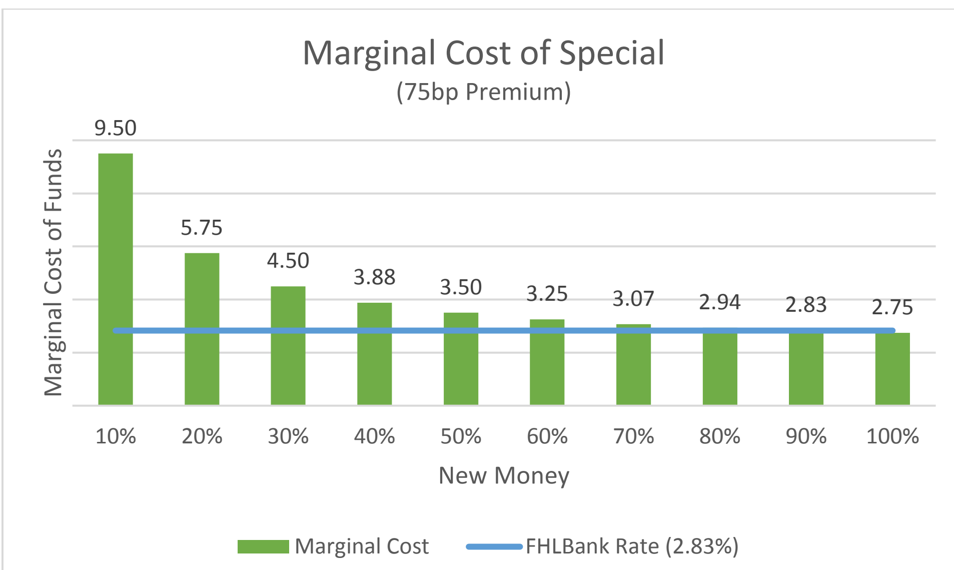
Deposit competition has been fierce lately. Growing banks and credit unions are scrambling to secure funding for new loans. Every week brings new ads for CDs offering rates of 2.75 percent, 3.00 percent, or even higher. It's a great deal for consumers, but what about banks and credit unions?

No doubt, deposits are the lifeblood of the industry. Still, investors hounding after the last basis point can wreck your net interest income. How do you compete without giving away the store?

Savvy institutions rely on FHLBank Boston to relieve deposit pricing pressure. When you use advances wisely, you can hold onto your strongest relationships and let the rate shoppers pass you by. You may increase your borrowings temporarily and fill in with more stable deposits later when the market cools off.

For example, a New England bank recently advertised a seven-month CD for 2.75 percent. The equivalent FHLBank Boston advance rate is 2.83 percent. The CD is available for "new money" and maturing CD balances. The "non-special" rate at the bank is 2.00 percent. Is this a good deal for the bank?

It depends on how much new money the offer brings in. Inevitably, some customers will move funds already at the bank to the special offer, cannibalizing existing lower-rate deposits. The real cost of the special is the change in rate on the shifted accounts plus the rate on the new funds. The chart below indicates that for this special, if less than 90 percent of funds in this CD special represent new money to the bank, advances would be cheaper. If 40 percent of the funds shift from existing accounts and the bank meets their $10 million campaign target, the "special" will cost 3.25 percent at the margin, or $15,000 more interest expense than advances over seven months. Keep in mind that when you consider the net effect of the current FHLBank dividend, which reduces the advance cost by approximately 12 basis points, the all-in differential in this example is closer to $19,000.



Growing deposits is an excellent goal, but the market timing may not be right. Banks and credit unions with sufficient collateral and room within their regulatory ratios find FHLBank Boston an excellent alternative. You can't "cross-sell" a wholesale borrowing, but you can save unnecessary interest expense while holding on to high-quality, stable funding.