Consumer Morsel

Do deposit buffers still matter?

23 August 2023

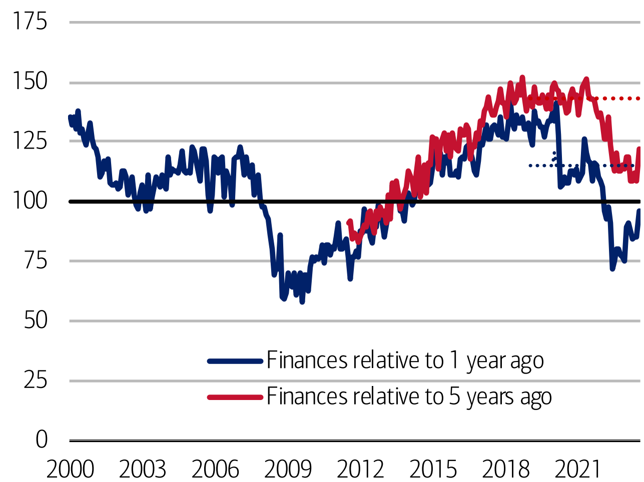
Key takeaways

- Despite continued robust spending growth, US consumer's perceptions around their finances appear to have deteriorated somewhat over 2022-23. Given households' deposits are still high relative to 2019, why is this?
- Partly it is timing - while higher than before the pandemic, these deposit buffers have been coming down from their peaks. Households have been living with high inflation and some are experiencing higher borrowing costs.
- But a longer term view shows deposits are still elevated compared to incomes. And these buffers have helped keep consumer spending relatively high compared to after-tax wages and salaries. Lower- and middle-income consumer spending in particular is likely to continue to gain support from them. But as the boost from these deposit buffers fades, the overall consumer outlook is likely to hinge ever more closely to labor market developments.

People have been reporting that their finances are under pressure...

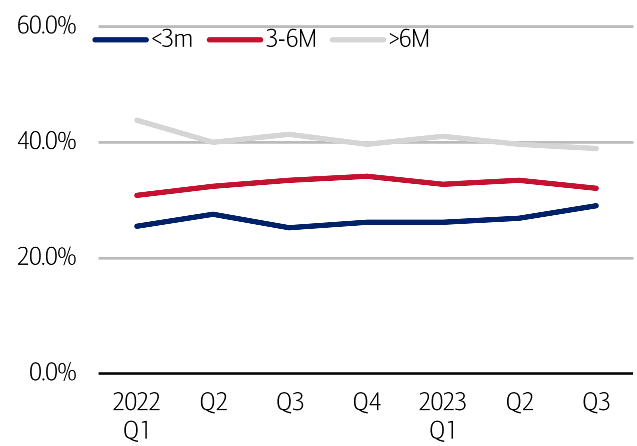
Consumer spending has been relatively strong over the last year and continues to look robust. But, despite this, consumers' assessment of their own financial position deteriorated over 2022 and, despite some bounce in 2023, there appears to be continued weakness. Exhibit 1 shows the University of Michigan Survey of Consumers responses to a question on how people see their personal finances relative to 1 and 5 years ago. A number above 100 indicates more people see an improvement than a deterioration. While the good news is that people generally think their finances are in better shape than 5 years ago, most still appear to view them as in worse shape than a year ago.

Exhibit 1: Assessment of current financial position relative to 1 and 5 years ago, University of Michigan (Index Score)
Consumers' assessment has fallen from 2019-2021 levels



Source: Haver Analytics. Dotted lines represent 2019-2021 averages for respective series. Index score is calculated as percentage reporting finances have improve minus percentage reporting finances have deteriorated plus 100.

Exhibit 2: Survey response to question, 'How long would the funds in your "rainy day" or emergency fund last to cover your living expenses?' (%, months)
There is some rise in the proportion of people saying their rainy day fund will last less than 3 months



Source: Bank of America Proprietary Insights Study

A recent survey commissioned by the Bipartisan Policy Center (BPC) finds something similar. One third of respondents reported doing worse financially, compared to 25% reporting doing better. Twice as many people report they are saving less than a year ago than those that say they are saving more.

The Bank of America Proprietary Market Landscape Insights Study (see methodology for details) also provides related evidence here. In particular, the survey asks people who have an 'emergency' or 'rainy day' fund how long they think it would cover their living expenses. As of June, the survey is showing a rise in the proportion of respondents who say their fund would last them 3 months or less, with a commensurate fall in people saying they have 3 to 6 months or over 6 months' worth of savings.

A key reason people are finding their financials under pressure is likely to be the impact that high inflation has had on people's spending power and their perception that a given amount of dollars no longer stretches as far. Additionally, the rise in interest rates have impacted some households' borrowing costs.

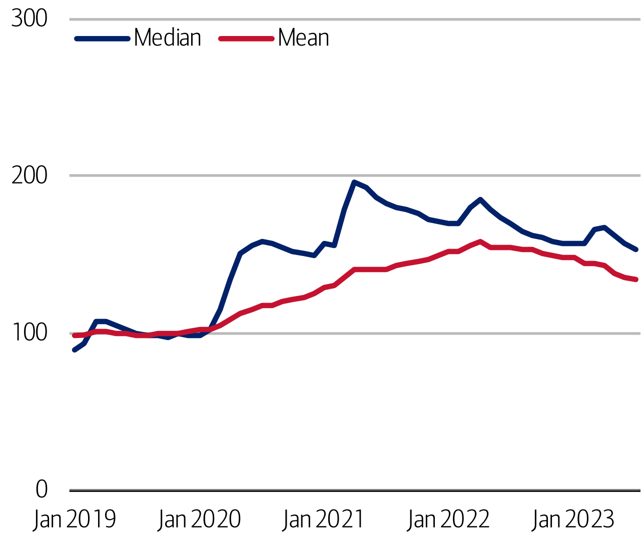
...which makes sense given money in deposits has fallen from its peak

As we have discussed in our Consumer Checkpoints, including the latest August edition, households still appear to have significantly more cash in their checking and savings accounts than before the pandemic. Across all income cohorts in July 2023 the median checking and savings account was 54% higher than the average in 2019 (Exhibit 3).

Why don't people feel like they are in a better place financially given these deposit 'buffers'? One answer is that the levels of savings and deposits have come down from their peak in the first half of 2021. Lower and middle income groups saw the biggest percentage rise in their buffers relative to before the pandemic but have seen the largest decline in their balances since then, according to Bank of America deposit data.

Exhibit 3: Monthly median household savings and checking balance (2019=100) for a fixed group of households

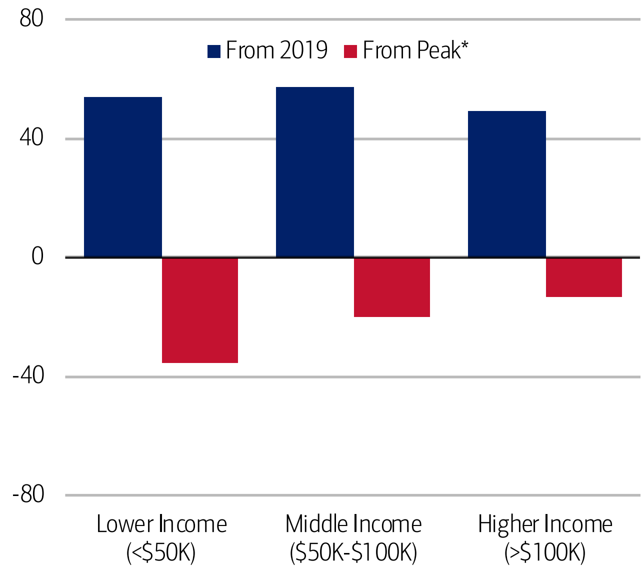
Across all income cohorts, median household savings and checking balances are around 54% higher than before the pandemic



Source: Bank of America internal data. Monthly data includes those households that had a consumer deposit account (checking and/or savings) for all months from January 2019 through July 2023

Exhibit 4: Change in monthly median household savings and checking balances from 2019 and from 2021 H1 peak, by income (%)

The biggest rise in savings and checking balances relative to pre-pandemic is among lower-income households



Source: Bank of America internal data. *Peak lower occurred in April 2021.

So, do comparisons with 2019 still matter?

With 2019 increasingly in the 'rear-view mirror,' might the declines in buffers from their peak start to matter more for consumer behavior than the fact they are still higher than the pre-pandemic era?

What matters ultimately for checking and savings balances is where they stand relative to people's overall economic and financial goals. They are by their nature very liquid financial assets, usually closely tied to day-to-day spending requirements. As such, what people view as the appropriate amount of these balances will likely depend in the medium term on how much they earn and spend. As people earn and spend more, they are likely to want to run higher savings balances, both to cover 'rainy day' contingencies and to support their standards of living when they draw upon their savings.

We can get an idea of where deposits stand relative to disposable income[1] by using Federal Reserve data (Exhibit 5). This data is useful as it goes back a long way, allowing a longer-term perspective. It does, though, only go through to 2023 Q1, but we can estimate a value for 2023 Q2 based on Bank of America internal data on a fixed group of households' deposits.

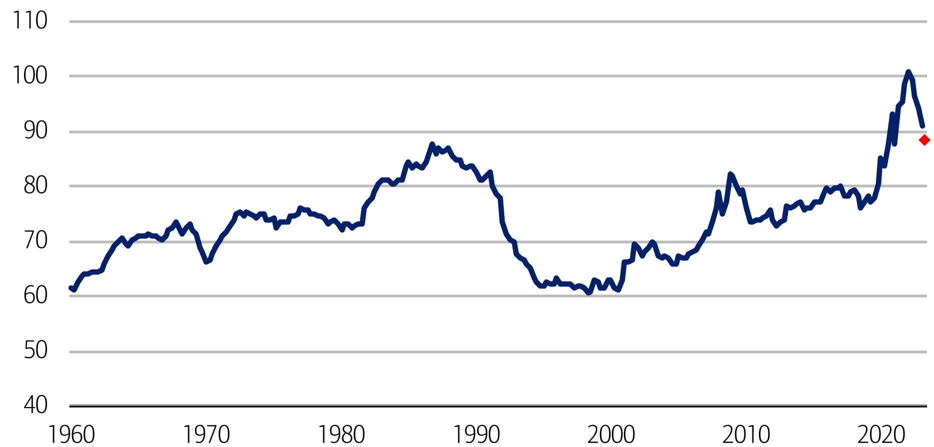
[1] Disposable income is personal income (which will include wages and salaries) less personal current taxes.

It's clear from Exhibit 5 that the ratio of deposits to disposable income is currently relatively high, at least compared to over the past 30 years. Our estimated ratio of deposits to disposable income in 2023 Q2 would be around 9.8 percentage points above the average in 2019 and around 11.5 percentage points higher than the average over 2010-19.

This ratio of deposits to disposable income has moved around a lot in the past and we need to be careful about claiming we know what people would be comfortable with right now. After all, where people feel their personal deposits to income should be is influenced by many complexities, including how they view returns on liquid savings versus less liquid investments such as equities and even property. But, in our view, the overall ratio of households' deposits to disposable income since 2019 still looks high.

Exhibit 5: Deposits as a % of personal disposable income

Deposits relative to income likely remained elevated in 2023 Q2



Source: Federal Reserve (Financial Accounts of the United States), Bank of America Institute estimates for 2023 Q2 (red diamond). Estimate for 2023 Q2 uses observed change in average deposits in Bank of America internal data.

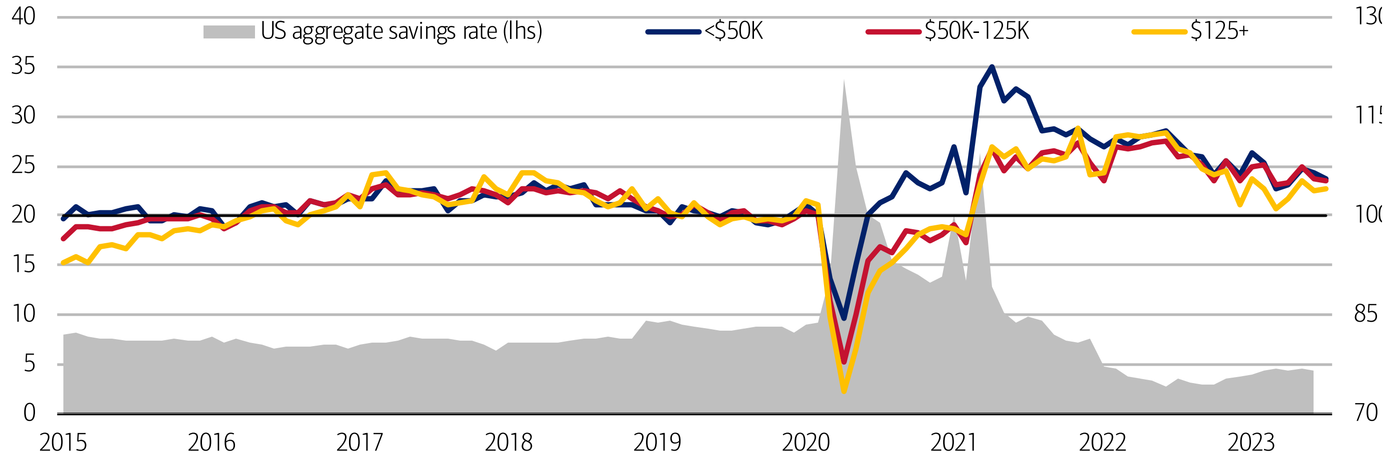
Buffers still appear to support spending

How much support can these elevated, but now declining levels of deposits, give to the consumer going forward?

Exhibit 6 illustrates that they have likely been very important over the past few years. According to Bank of America internal data across all income cohorts, total card spending was elevated relative to after-tax wages and salaries over 2021-2023. Government stimulus payments and foregone spending over the start of the pandemic led to an accumulation in households' savings, which allowed them to spend well ahead of what their labor income may have implied. Reflecting these same trends, the US aggregate savings rate (which would include stimulus checks as income whereas our after-tax wages and salaries measure would not) has been below pre-pandemic in 2022 and 2023 as households have been able to save less and spend more of their income.

Exhibit 6: Total card spending per household relative to after-tax wages and salaries by income group, and the US savings rate (rhs Index 2019=100, lhs %)

Spending was elevated relative to after-tax income over the pandemic and remains so, though to a diminishing extent



Source: Bank of America internal data, Haver Analytics

So, we believe household spending should continue to receive support from the elevated deposit buffers relative to income for some time, though the size of this support is likely to diminish as deposit buffers trend lower.

Who holds the buffers is important

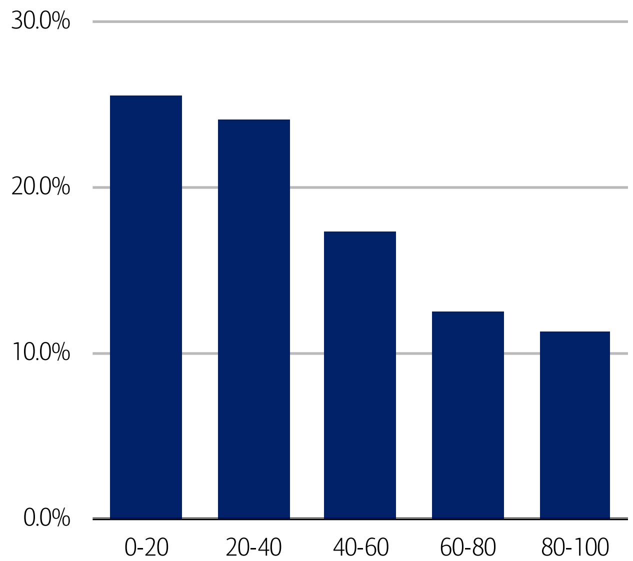
The size of support to household spending also varies across the income distribution. As Exhibit 7 shows, lower- and middle-income cohorts tend to hold a greater share of their financial assets in deposits. So potential movements in deposit balances may impact these consumers more, as they may reflect larger proportionate moves in overall financial assets.

Using Bank of America internal data, we can estimate where the overall rise in deposits relative to 2019 is currently (as of 2023 Q2) held across the income distribution. On this basis, just under a quarter of the rise in total deposits is held by those households on incomes of less than $50,000, with another 30% of households on incomes between $50,000 and $100,000.

Therefore, a reasonably large proportion of the remaining deposit buffers appears to be held by middle- and lower-income households, which implies they can still make a meaningful contribution to overall consumer spending.

Exhibit 7: Proportion of total financial assets held as deposits by income quintile (%)

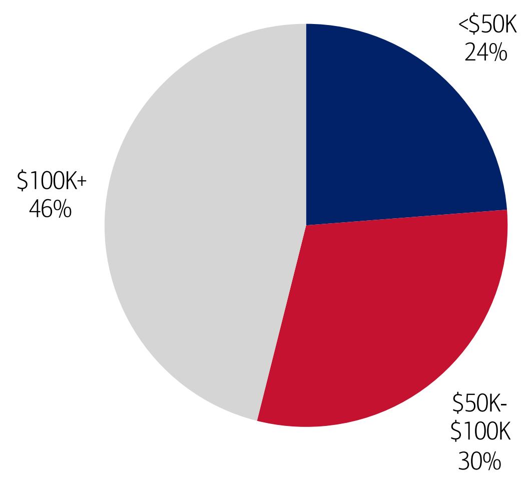
Lower-income cohorts hold more of their financial assets as deposits



Source: Federal Reserve, Distributional Financial Accounts

Exhibit 8: Estimate of the overall composition of the rise in total deposits since 2019 by household income. Based on Bank of America household savings and checking balances for a fixed group of households (%)

Around a quarter of the rise in deposits relative to 2019 may be held by lower-income households



Source: Bank of America internal data, Bank of America Institute estimates

Increasingly the labor market and labor income will matter most

As we discussed in the August Consumer Checkpoint, based on their current trajectory, deposit buffers should remain elevated relative to 2019 well into 2024. Gradually, over this time, the 'boost' to spending from buffers will likely diminish, with the exact timeline determined in part by how deposits evolve relative to income, inflation and of course how consumers feel about the economic outlook more broadly.

The upcoming resumption of student loan repayments is another 'hurdle,' which could see some impacted people dip into their deposit buffers. But the overall impact across all consumers is likely to be small given that the Bureau of Economic Analysis (BEA) estimates that the forbearance was worth only 0.2% of disposable income. The Administration's announcement of an 'on-ramp' also allows those most pressed to meet the resumption of payments time to prepare.

Overall, as buffers fade and the savings rate rises, the outlook for the consumer will become ever more closely aligned with developments in the broader labor market and households' labor income. BofA Global Research currently forecasts a fairly gradual slowdown in the pace of employment growth over 2023-2024. This should help keep consumer spending on a slower but continued upward trajectory over this period.

Methodology

Selected Bank of America transaction data is used to inform the macroeconomic views expressed in this report and should be considered in the context of other economic indicators and publicly available information. In certain instances, the data may provide directional and/or predictive value. The data used is not comprehensive; it is based on **aggregated and anonymized** selections of Bank of America data and may reflect a degree of selection bias and limitations on the data available.

Any payments data represents aggregated spend from US Retail, Preferred, Small Business and Wealth Management clients with a deposit account or credit card. Aggregated spend include total credit card, debit card, ACH, wires, bill pay, business/peer-to-peer, cash and checks.

Any **Small Business** payments data represents aggregate spend from Small Business clients with a deposit account or a Small Business credit card. Payroll payments data include channels such as ACH (automated clearing house), bill pay, checks and wire. Bank of America per Small Business client data represents activity spending from active Small Business clients with a deposit account or a Small Business credit card and at least one transaction in each month. Small businesses in this report include business clients within Bank of America and generally defined as under $5mm in annual sales revenue.

Unless otherwise stated, data is not adjusted for seasonality, processing days or portfolio changes, and may be subject to periodic revisions.

The differences between the total and per household card spending growth rate can be explained by the following reasons:

1. Overall total card spending growth is partially boosted by the growth in the number of active cardholders in our sample. This could be due to an increasing customer base or inactive customers using their cards more frequently.

2. Per household card spending growth only looks at households that complete at least five transactions with Bank of America cards in the month. Per household spending growth isolates impacts from a changing sample size, which could be unrelated to underlying economic momentum, and potential spending volatility from less active users.

3. Overall total card spending includes small business card spending while per household card spending does not.

4. Differences due to using processing dates (total card spending) versus transaction date (per household card spending).

5. Other differences including household formations due to young adults moving in and out of their parent's houses during COVID.

Any household consumer deposit data based on Bank of America internal data is derived by anonymizing and aggregating data from Bank of America consumer deposit accounts in the US and analyzing that data at a highly aggregated level. Whenever median household savings and checking balances are quoted, the data is based on a fixed cohort of households that had a consumer deposit account (checking and/or savings account) for all months from January 2019 through the most current month of data shown.

Bank of America aggregated credit/debit card spending per household includes spending from active US households only. Only consumer card holders making a minimum of five transactions a month are included in the dataset. Spending from corporate cards are excluded. Data regarding merchants who receive payments are identified and classified by the Merchant Categorization Code (MCC) defined by financial services companies. The data are mapped using proprietary methods from the MCCs to the North American Industry Classification System (NAICS), which is also used by the Census Bureau, in order to classify spending data by subsector. Spending data may also be classified by other proprietary methods not using MCCs.

Generations, if discussed, are defined as follows:

1. Gen Z, born after 1995

2. Younger Millennials: born between 1989-1995

3. Older Millennials: born between 1978-1988

4. Gen Xers: born between 1965-1977

5. Baby Boomer: 1946-1964

6. Traditionalists: pre-1946

Any reference to card spending per household on gasoline include all purchases at gasoline stations and might include purchases of non-gas items.

Bank of America conducts a Proprietary Market Landscape Insights Study in order to provide an ongoing pulse on consumer attitudes, insights, and trends to help understand consumer responses to an ever-changing external landscape. The bank's Culture and Trends team manages quarterly and monthly online quantitative surveys conducted among customers and non-customers that provide a representative view of the U.S. adult population. Insights are based on aggregated and anonymized responses to surveys.

Additional information about the methodology used to aggregate the data is available upon request.

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Disclosures

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