

The Dynamics of Deposit Flightiness

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The Evolving Landscape of Bank Funding Conference
October 2025

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- Deposits are a key source of funding for the banking system
- Sticky deposits allow banks to lend to firms
- Flighty deposits can trigger runs and inefficient asset sales
- Most existing evidence on deposit flightiness is across banks and deposit types
 - E.g., Retail versus wholesale deposits
 - E.g., Insured versus uninsured deposits

1. How does deposit flightiness evolve over time?
2. What determines the evolution of deposit flightiness?
3. What are the implications for conventional monetary policy, unconventional monetary policy?

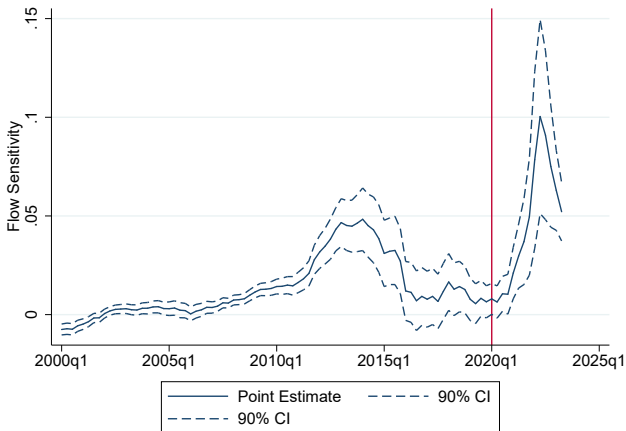
“We knew that the deposits coming in during Covid-19 were different. They have much higher run-off probabilities and we put them into a different bin...”

—CFO of a major European bank

- Run-off probability: how likely depositors are going to leave
- Deposit flightiness: how likely depositors are going to leave in response to a given shock

1. How Does Deposit Flightiness Evolve over Time?

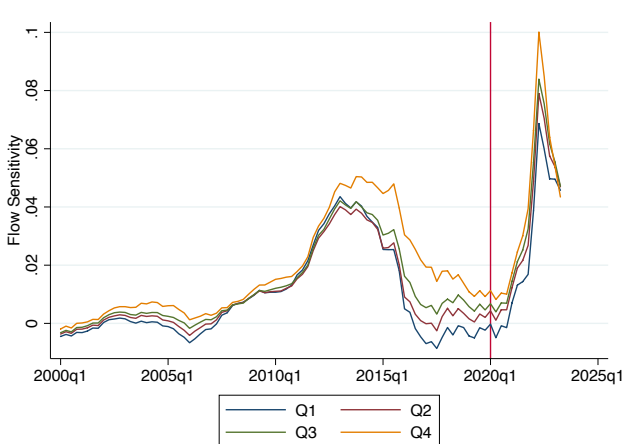
- One proxy for flightiness: when deposit rates of a bank decrease by 1 ppt, how much in deposit flows does it lose to other banks?



1. How Does Deposit Flightiness Evolve over Time?

- Deposit flightiness differs across banks but they all follow a very similar pattern over time

Figure: Deposit Flow Sensitivity (by Asset Size)



2. What Determines the Evolution of Deposit Flightiness?

- $\uparrow$ Deposit flightiness as $\uparrow$ deposit inflow into the banking system

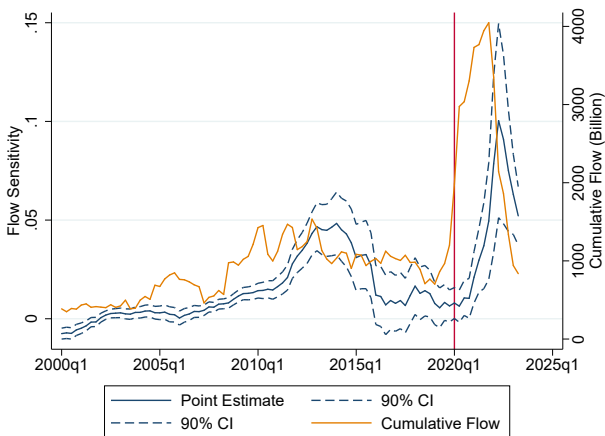


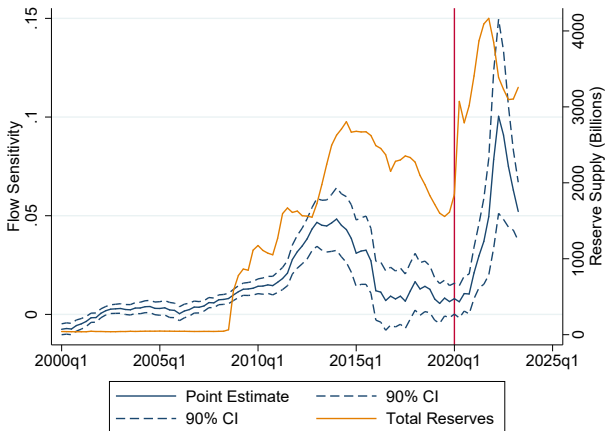
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2. What Determines the Evolution of Deposit Flightiness?

- Bank deposits offer convenience, e.g., payments, but low returns
- Non-banks, e.g., MMFs, offer no convenience but higher returns
- Compared to MMF investors, investors in bank deposits are more attracted to banks' services/less attracted to returns
- After an inflow of deposits from non-banks to banks, the average depositor in the banking system becomes more sensitive to returns
 - → More likely to leave given the same deposit rate = flightier

3. Implication I: Deposit Flightiness and QE

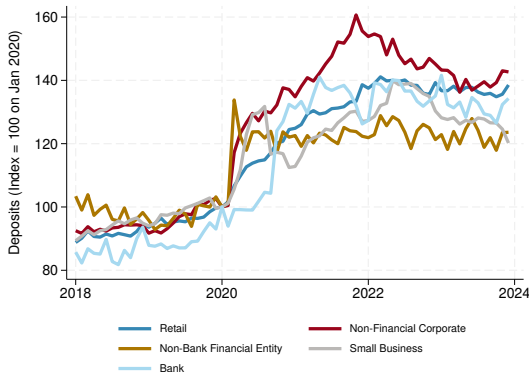
- $\uparrow$ central bank reserve supply $\uparrow$ deposit flightiness



3. Implication I: Deposit Flightiness and QE

- Reserve expansions after March 2020: growth in corporate deposits are most pronounced → disproportionate inflow of flightier deposits

Figure: Volume of Deposits (Indexed to January 2020)



Dollar amount

3. Implication II: Monetary Policy and QE Interaction

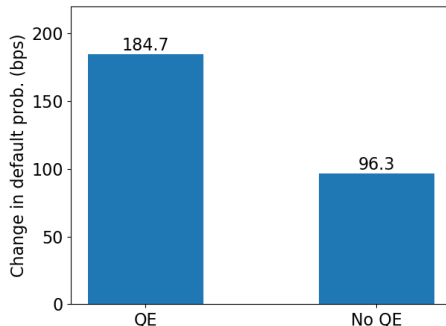
- QE attracts more deposits into the banking system $\Rightarrow$ new deposits flightier than before
- For a given rate hike, deposit outflows are larger following QE
- Rate hike cycle starting in early 2022: steep rate hikes on top of nearly \$4 trillion reserves $\Rightarrow$ amplified outflows
- $\Rightarrow$ Effect of a given rate hike on deposit flows depends on how much QE was done

3. Implication III: Run Risk

- Bank run risk may also increase after large deposit inflows
- Depositors are more likely to run if they think other depositors in the bank are flightier
 - E.g. corporate Treasurers in SVB knew that other depositors were also flighty corporate Treasurers
- $\Rightarrow$ Effect of a given rate hike on run risk depends on how much QE was done

3. Implication III: Run Risk

Figure: Effect of a 2% Rate Hike on Bank Default Probability



- $\Rightarrow$ Interdependence between conventional and unconventional monetary policy through the deposit base

- Deposit flightiness fluctuates significantly over time
- Inflow of deposits = influx of **flightier** deposits
- $\Rightarrow$ Fed: carefully design rate changes with a large balance sheet
- $\Rightarrow$ Banks: set aside liquid assets after large deposit inflows
- Going forward, the expansion of the NBFIs sector may further amplify the variability in the deposit base over time