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Money Market Funds and the Expiration of Unlimited Deposit Insurance

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As stipulated in the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Federal Deposit Insurance Corporation's unlimited insurance coverage on non-interest bearing transaction accounts, also known as the Transaction Account Guarantee (TAG), expired on December 31, 2012. Prior to the program's expiration, analysts predicted a massive shift ("hundreds of billions of dollars") from non-interest bearing transaction accounts to money market mutual funds.

So what do the numbers tell us thus far in 2013? Bank deposits remain significantly higher than a year ago—more than $700 billion higher—while money market fund assets are just $17 billion above their January 2012 level. Money market funds have not received a surge in cash in January related to the TAG expiration. In fact, money market fund assets declined by $9 billion in the first full three weeks of January.

Rising Tide of Cash Lifts All Boats in Late 2012

In the last two months of 2012, both banks and money market funds experienced inflows. On a seasonally adjusted basis, deposits at domestically chartered commercial banks rose by $222 billion in the last two months of 2012. Similarly, assets in all money market funds increased by a non-seasonally adjusted $158 billion in the nine weeks to January 2, 2013. (ICI does not publish seasonally adjusted levels.)

Some of the increase in money market fund assets may be seasonal. To see how much of a seasonal increase in money market fund assets might be expected over the last two months of 2012, we seasonally adjusted money market fund assets using monthly data back to 1990. Historically, money market funds have seen large seasonal inflows during the last two months of the year (i.e., more cash flows into money market funds near the end of the year). We estimate that at least $80 billion of the $158 billion that flowed into money market funds during the nine weeks to January 2 was due to normal seasonal factors. On this basis, banks and money market funds both received a large dollop of cash in late 2012.

Two questions remain, however. Why did so much cash flow to banks (an extra $222 billion) and to money market funds (an extra $78 billion) at the end of 2012—and will it all flow out going forward?

Behind the Inflows: Fiscal Cliff Uncertainty and Looming Tax Changes

There was above-average uncertainty in the air as 2012 came to a close, and not because the Mayan calendar had ended. Individuals and corporations were highly uncertain about what tax rates would be in effect during 2013 and beyond, and it was unclear whether massive automatic government spending cuts (sequestration) would take effect and cause a recession, as many economists predicted.

In such an environment, it is not surprising that individuals and corporations might take defensive actions and build cash balances. In the case of individuals, those actions included selling securities to realize taxable capital gains before 2012 ended. Indicative of this, an estimated $70 billion flowed out of equity mutual funds in the fourth quarter of 2012. On the institutional side, many corporations distributed special dividends because of the risk that dividend tax rates might rise. Corporate cash balances may also have risen as some businesses delayed major business decisions until the uncertainty was fully resolved.

What Goes Up Must Come Down?

Both banks and money market funds both received significant cash inflows in late 2012. To the extent that cash inflows indeed reflected temporary factors, those flows might be expected to reverse once the temporary factors had passed. In the first two full reporting weeks of January, deposits at domestically chartered commercial banks fell by $82 billion on a seasonally adjusted basis, reversing 37 percent of what they received in the last two months of 2012. This decline may well reflect the reversal of some of the cash surge at the end of 2012, so it is unclear whether much, if any, of the decline reflected the expiration of TAG.

Recent money fund data underscore this reversal. In the first three full reporting weeks of January, money market fund assets declined by $9 billion. This data is not seasonally adjusted, and some of this decline is clearly related to quarterly tax payments due on January 15. But it makes it hard to argue that the outflows from banks in the first few weeks of 2013 solely reflect the expiration of TAG, if money market funds are also seeing outflows.

Interestingly, it appears that some mutual fund investors may be moving out of cash (i.e., bank deposits and money market funds) and into equity mutual funds, which received nearly $24 billion in the first two full weeks of January. Equity funds, it seems, may be benefitting from reduced uncertainty out of Washington.

For more on money market funds, please visit ICI's Money Market Funds Resource Center.

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