

Term Deposit Report

16 September 2020



TD rates keep getting lower

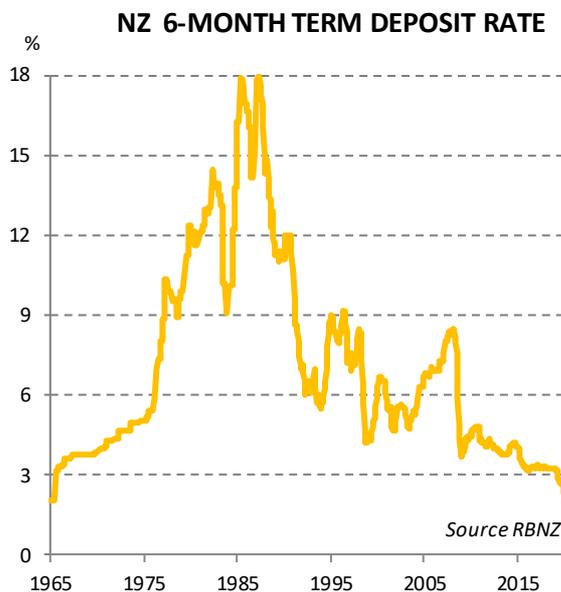
Low interest rates have been helping borrowers and frustrating savers over recent years. Term deposit interest rates have been steadily trimmed over the past year and are significantly below the average levels of the past 10-15 years. In fact, term deposit rates are now at the lowest on records going back to the 1960s. Interest rates are expected to decline even further from today's level and stay low for several years.

ASB's term deposit interest rates are [tabled here](#), and selected rates are shown below.

Term Deposit Rates	90-days	6 months	9 months	1 Year	2 years	3 years	4 years	5 years
10-year ave	2.96	3.61	3.66	3.74	3.97	4.15	4.32	4.47
Sep-20	0.40	1.20	1.20	1.15	1.15	1.20	1.20	1.25

Some important considerations are:

- Term deposit interest rates are incredibly low at present – the lowest on records going back to the 1960s.
- Safety of savings is important – at times like now savers want to know their money is secure.
- Sometimes when term deposit rates were higher, so was inflation and the combination of tax and inflation eroded a large part of the return. At the extreme, inflation eroded all a term deposit's return.
- Consumer price inflation has been low, and generally within the lower half of the Reserve Bank of New Zealand's (RBNZ) 1-3% target range over the past five years. The outlook for inflation is weak and CPI inflation is expected to remain around 1-2% p.a. for the next few years.
- Related to this low inflation outlook, and the economic weakness caused by the COVID-19 pandemic we expect the RBNZ to cut the Official Cash Rate (OCR) even lower than the record low 0.25% set in March. ASB are forecasting a negative 0.5% OCR setting next year.
- Term deposit rates are expected to dip even lower than today's levels, as we see in other countries with similar banking systems and similarly low central bank interest rate settings. Once again, inflation could erode all that return.
- Higher returns are possible through focusing on longer-term investments and diversification into different assets with different risk profiles.
- Making sure you are paying the right tax rate is important.
- It's always important that investors make sure investments suit their personal needs, so talking with an advisor can be a good idea.



Snapshot and Outlook

Our view is that interest rates for most term deposits are going to stay very low for several years, and over the coming months can dip even lower than today's levels.

At the time of writing, term deposit interest rates are largely between 0.4% and 1.25% for terms between 90 days and 5 years for term deposits over \$5K. Over the past 10 years, term deposit interest rates have averaged 2.5% to 3.2% higher than the current rates available for the various terms.

For the popular term deposit rates – short terms up to 1 year – a key influence is what the RBNZ does with the Official Cash Rate (OCR). The RBNZ adjusts the OCR to help it achieve its price stability (inflation) objectives. The RBNZ has a 1-3% target range for inflation and would like it to be around 2% per annum on average. Consumer price inflation (CPI) has averaged just over 1% per annum over the past 5 years. That's too low from the RBNZ's perspective. Furthermore, we expect CPI inflation to remain low, particularly given the consequences of the COVID-19 pandemic which is drastically impacting economic activity and inflation expectations. The RBNZ's latest forecasts and commentary suggest the OCR will likely remain extremely low for several years, and there is a high risk it gets lower. ASB expects the OCR to be cut to -0.5% next year (later in this report we discuss more details on what a negative OCR setting means).

The expectation that the OCR (and other influential interest rates here and abroad) will stay low or get lower over the coming years has major implications for term deposits. The bad news for savers is that term deposit rates are expected to stay low and risk dipping further from today's levels.

Many investors are rightly concerned about the significant income drop caused by the lower interest rates available today compared to earlier years. Inflation is low, but it's still there, eroding some of the real value of investment returns, including term deposit interest. In fact, the current 5-year term deposit rate of 1.25% p.a. is lower than what we expect CPI inflation to average over the next 5 years.

Returns on the longer-term investments (2-5 years) are typically higher than for shorter terms, but that is not the case at present (all rates for terms from nine months out to five years are between 1.15 -1.25% at the time of writing), which adds to the current challenge of generating income from term deposits.

Some risks for consideration

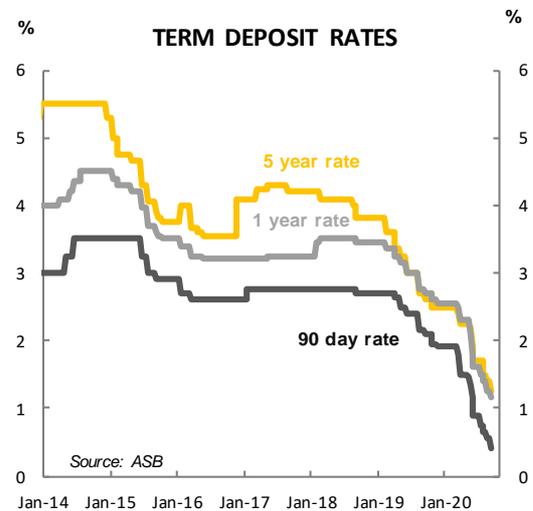
Interest rates are expected to remain low, leaving some investors frustrated for not locking in the higher long-term rates available in earlier months and years. However, with term deposits, funds are locked in, and only accessible in limited circumstances. This is an important consideration for investors, particularly when weighing up longer terms ([more here](#)). In other words, savers need to weigh up their personal circumstances and need for flexibility when considering what term is best for them.

Safety of your money

When financial markets are volatile like they have been this year due to the COVID-19 pandemic, many investors become understandably concerned about the safety of their savings. For term deposit customers, it is important to know that ASB is strongly capitalised and maintains a very conservative (high) level of liquidity. This enables us to safely withstand extended periods of market disruption and uncertainty. ASB's credit ratings reflect the independent opinion of three international rating agencies about the capability and willingness of ASB to repay its debts (which includes term deposits). ASB is rated on an international scale as 'strong to very strong'. The RBNZ's website has information about credit ratings [here](#).

Check you are on the right track

It's worth thinking hard about the timeframe to invest for because the increase in return you can get for making a longer time commitment can make a difference. For example, the current interest rate on a six-month term deposit is 0.80% higher than the three-month rate (1.20% vs. 0.40% for deposits over \$5K).



ASB's term deposit interest rates are [tabled here](#). Higher returns are possible through longer-term investments and diversification into different assets with different risk profiles. But you need to be sure those investments suit your needs. Talking to an [ASB advisor](#) could help.

Check you are paying the correct tax rate

If you are a New Zealand tax resident and have supplied your IRD number but not your tax rate, the default rate is 33%. If you have not supplied your IRD number, then the non-declaration rate is 45%. You can use our [online tool](#) to confirm your Resident Withholding Tax (RWT) rate - it'll only take a few seconds.

The guide then allows you to update your tax rate online using FastNet Classic. If you are a non-New Zealand tax resident the default rate will be the withholding tax rate for your indicated country of tax residence.

Should you be in a term deposit or term fund?

An ASB Term Fund is an alternative to a term deposit, and may provide a better after-tax return than a term deposit offering the same rate, term and fees - if you're on a 30% or 33% income tax rate. [Find out more here](#).

A footnote on negative interest rates

Over recent months many people have asked us "why is the RBNZ talking about negative interest rates and what does this mean for customers?"

When we talk about negative interest rates, we are talking about the Reserve Bank of New Zealand setting a negative Official Cash Rate (OCR). If the OCR was negative, financial institutions would be required to pay interest for depositing excess reserves with the RBNZ. ASB Economics are now forecasting a negative Official Cash Rate setting for early next year. The Record of Meeting from the RBNZ Monetary Policy Committee for the May and August meetings reaffirmed earlier guidance that the OCR will remain at the current 0.25% setting until early-2021. However, the Committee noted that a negative OCR will become an option in the future. New Zealand banks are getting operationally ready for a negative OCR now. We expect the RBNZ will stick with its OCR guidance this year, then cut the OCR to -0.5% at one of its meetings in early 2021 ([read more here](#)). It's important to note that even if the RBNZ cuts the OCR further and sets a negative OCR, we don't expect negative term deposit rates. But we would expect term deposit rates to be significantly lower than they are today – likely between 0-1%.

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