



## Attractive Term Deposit Rates for The Taking

**By Mark Story | 17.04.2011**

What a difference a few weeks can make to capital markets: As recently as January, economists and analysts alike were expecting two, possibly three hikes to the Reserve Bank of Australia's (RBA) current interest rate of 4.75 percent later this year. Fast forward to early April and there was no one holding their breath for a rate increase any time soon.

A few brave souls have even speculated that the RBA could be in rate-cutting mode by mid-year, especially if sluggish economic data outside the mining sector continues. But the consensus view is for the RBA to resume rate hikes – albeit later than expected – with the next increase due around August.

Victor Rodriguez head of Aberdeen's Australian Asset Management Fixed Income team expects another two RBA rates hikes to take the official rate to 5.25 percent by year's end. So if he's right, where does that leave cash/fixed interest as an asset class, compared with bonds and equities.

With the market pricing in another two rate hikes, Rodriguez expects cash to marginally outperform bonds by around 1 percent. But he reminds investors that while cash won't rally if share markets fall – bonds will. Yet this looks unlikely with analysts expecting the ASX 200 to put on another 10 percent to 5500 points by year end.

Given the strong outlook for corporate earnings, coupled with an increase in dividend growth by an average 6.4 percent over the last six months, shares – which still look undervalued – are looking increasingly more favourable against cash. The average [term deposit](#) currently yields 6.1 percent while the 90 day bill rate is 4.9 percent.

By comparison, the average dividend yield across the ASX is currently 5.8 percent grossed up for franking credits – with the index yielding 7.3 percent grossed up for franking credits. Adding to the attractiveness of shares is the prospect of an additional premium from capital growth, expected to average around 5 percent this year.

The only drivers of an unlikely kicker for bonds, says Steven Wright director of fixed-interest with RBS Morgans would be either a changing inflationary outlook or the direct impacts of global shocks on domestic growth. "Given that the RBA has proactively kept underlying [inflation](#) within its mandated 3 percent range, any

short-term kicker for bonds looks unlikely," says Wright. While bonds currently appear 'out of the money', Wright also expects 2011 to be a relatively bearish, yet stable year for interest rates. He expects the current 1 percent margin of cash over bonds to contract to around 75 basis points (BPS) as banks fail to fully reflect two 25 bps rate adjustments in term deposit rates. Wright says this partly reflects the fact that banks aren't as desperate for retail term deposits as they were last year. He says it also reflects their limited success in 2010 locking in longer-term funding from the retail sector. While interest rates will remain attractive, he doubts they'll again nudge the 8 percent level offered on some five year term deposits last year.

"So there's an argument for investors locking in some of their money on longer term deposit – over one to three years – with rates of 6 percent or better," advises Wright. "And if you can get a floating rate of mid to high 6 percent, even better – this doesn't look bad when underlying inflation is at 3 percent."

Wright expects to see more companies follow the lead of Tabcorp, CBA, Bendigo Bank - and Primary Health Care which offered an 11 percent yield - that recently entered the retail listed bond market. Market whispers suggest one major is about to launch a new retail listed bond.

Last November CBA raised \$570 million through a five-year bond - with a margin of 100 to 115 basis points over 90-day bank bill swap – with a coupon of 6.85 percent. Bendigo Bank also raised \$90 million through a three year bond paying a coupon of 6.8 percent.

Rodriguez also expects to see the re-emergence of residential mortgage backed securities (RMBS) which typically form part of a bank's funding base. Included among the myriad 'Prime' RMBS deals - with subordinated issues offering an effective return of around 9 percent - is the \$1 billion RMBS deal recently issued by Members Equity Bank. He urges investors to keep a close eye on greater liquidity of RMBS deals returning to the market, possibly later this year. "Representing 'pockets of value', RMBS are structured such that investors are protected from falling house prices," says Rodriguez.

Admittedly, shares are expected to outperform cash by up to 6 percent this year. Nevertheless, investors still love banks - so much so that \$153 billion dollars of their cash remains in low or no-interest transaction accounts. They also prefer the name recognition associated with major banks, especially the local 'bigfour'. With fixed interest investments being easy to understand, offering relatively attractive rates - while offering a risk-free haven from the volatility of shares - Rodriguez doesn't expect investor appetite for term deposits to fade any time soon. Adding to investor comfort with term deposits is the government's undertaking to guarantee up to

\$1 million per 'authorised deposit-taking institution' (ADI).

While this guarantee may be reduced subject to a review in October, Andrew Murray director with Curve Securities says it's unlikely to disappear altogether.

However, given investor appetite for name recognition, he says it could trigger potential outflow from unrated organisations into banks. As a result, he says unrated credit unions and similar may have to offer higher yields to continue attracting investors.

"There's a wide range of compelling options for investors to choose from, and nothing comes close to term deposits for risk/reward" says Murray. "It's time for investors to capitalise on the ongoing battle for domestic deposits, and lock in good returns."

Regarded as the market's best five-year term deposit is RaboDirect's rate of 7.15 percent, with the bank also offering a one-year term deposit paying 6.6 percent. Even though Rabobank is a AAA credit-rated bank, Murray suspects they're having to offer higher rates in order to attract investors unfamiliar with the brand. Other organisations offering attractive rates on five years include: BankWest and SGE Credit Union with 7.10 percent and 7.25 percent respectively, while the best rates on three years are SGE Credit Union's 7 percent, and Victoria Teachers Credit Union's 6.75 percent.

"Investors can find good specials in the one to two year part of the curve, where a rate of 6.6 percent still offers 135 bps over the cash rate," says Murray.

He reminds investors that while the majors don't always have the best headline rates, they will 'pay up' when push comes to shove.

"So shop around at the branch level for the best deal, especially on larger amounts," advises Murray. "Some banks will pay more for \$500,000 to \$1 million than says \$5 million on the pretext that 'institutional money' is less sticky than the retail variety."

By comparison, government bonds are only being viewed as offering protection against another GFC style downturn. Inflation linked bonds, like those offered by Rabobank or CBA - that are paying around 4 percent over inflation - take their current returns close to 7 percent.

Then there's long dated senior bank paper that's paying more attractive returns, with Barclays having released a four year senior note paying around 7 percent, while Morgan Stanley has a 2017 floating rate note (FRN) yielding over 8 percent.

By extending the maturity, solid returns can also be found in the corporate and infrastructure space with a 2020 fixed rate bond issued by Stockland, and the long dated Southbank TAFE publicprivate-partnership (PPP) bond both yielding between 8 and 9 percent.

Meantime, further along the risk curve, returns approaching 9 to 10 percent can be achieved from some solid banking and insurance

company debt securities. As a case in point, Swiss Re the world's second largest reinsurer has a Tier 1 security - with expected maturity at first call in May 2017 - with a yield just over 10 percent. Local tier 1 securities from NAB Capital Securities or dated subordinated debt for Suncorp-Metway Insurance/Vero Insurance are expected to offer returns of 8 percent-plus. Relative to the underlying risk, Wright says a yield of 8 percent for ASX-listed hybrids offered by major banks is also worth a look. "The risk of major banks not being able to pay these returns is low, so a 250 bps margin over the swap, makes hybrids look attractive compared with cash," says Wright. Colin Campbell client adviser with Wilson HTM urges investors to do their homework to ensure term deposits aren't rolled over at lower rates once they've matured. He says investors who rely on financial institutions to advise them on options, may risk their funds being rolled-over by default into significantly lower-yielding investment. "Remember, that if the rate you're being offered isn't competitive, there's likely to be a more attractive one on offer for a different term, and if not - check out the opposition."

### Fixed term Deposits – snap shot of rates

Issuer	60 days	90 days	180 days	1 Year	2 years	3 Years	4 years	5 Years
LaikiBank	4.40%	5.80%	6.20%	6.70%				
Victoria Teachers Credit Union	4.75%	5.45%	5.90%	6.40%	6.50%	6.75%	6.75%	6.75%
RaboDirect		5.50%	6.30%	6.60%	6.80%	6.90%	7.0%	7.15%
BankWest	3.0%	5.0%	5.01%	6.30%	5.75%	5.90%	6.30%	7.10%
NAB	3.15%	4.0%	5.90%	6.10%	6.10%	6.20%	6.50%	6.80%
Westpac	2.55%	3.0%	5.90%	6.00%	6.00%	6.10%	6.50%	6.80%
SGE Credit Union		5.75%	6.00%	6.50%	6.75%	7.00%	7.15%	7.25%
ING Direct		5.40%	6.00%	6.50%	6.70%			
Rural Bank	2.75%	5.60%	6.25%	6.30%	5.80%	6.0%	6.0%	6.25%
Investec	5.41%	5.55%		6.36%				
CUA	6.35%	5.40%	6.0%	6.20%	6.15%	6.50%		
Suncorp		6.0%	6.10%	6.30%				

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