Grab Higher Rates While You Still Can

The period of bumper deposit rates is well and truly over, and savers should prepare for rates to fall even further, writes JOHN KINSELLA

The past few years have been a good time for people and businesses with cash savings as embattled institutions scrambled to woo depositors. Between 2008 and early 2012, the banks were desperate for cash. With traditional funding avenues closed off to them due to their poor credit ratings, the banks desperately needed deposits. To entice consumers to lodge their savings, the banks hiked interest rates on both long and short-term deposits.

Interest rates applicable to household term deposits increased significantly during 2011 and the first half of 2012, peaking in April 2012 at 3.53%. Since then, the average rate for all deposits has fallen every month and the latest data, for November 2012, shows an average rate of 3.24%. That average takes account of rates offered on term deposits opened three or four years ago. Now it is next to impossible to get that 3.2%.

In relation to shorter-term deposits, which are redeemable at notice, the average rate was 1.51% last November, representing a decline of 82 basis points since the beginning of the year. According to the Central Bank, deposit volumes suggest that depositors are moving out of short-term products, which are redeemable at notice, and into longer-term deposits with agreed maturity.

In terms of new deposit business, interest rates on household term deposits declined to an average of 1.28% last November. For new deposits, the banks' business customers were being offered a weighted average interest rate of 0.83%, a decrease of 25 basis points in just one month. The Central Bank says that 96% of business term deposits were tied up in accounts with agreed maturity of up to two years. The average rate for those deposits in November was 2.57%, so when they come up for renewal the depositors are in for a shock.

Despite the plunging rates, private sector deposits rose at an annual rate of 2.5% in December. People with cash are leaving it on deposit, and cash that had been withdrawn on euro breakup fears is trickling back into the system. With sterling on the slide against the euro, suddenly having a sterling account in Newry doesn't seem so smart any more.

Brendan Synnott, managing director at **Nationwide UK Ireland** says that the drop in interest rates during the second half of 2012 had been well flagged. "The most notable change in the deposits market in recent times has been a fall in interest rate levels across the board. But such a drop had been forecast for the previous 18 months. We went through a period where rates were artificially high and generally unsustainable."

Synnott describes the recent rate trends as a normalisation of market forces. "Around nine months ago,

Brendan Synnott, Nationwide UK (Irl)

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people recognised that rates were on the way down and moved to lock away their funds for one or two years fixed. But it's very much a flat market at the moment regardless of whether you are looking at short-term products or those for one or two years."

Synnott observes that competition between the banks for deposits is now far less intense and notes that the predominant "want" at the moment is security. "Since 2008 we've seen so many Irish investors burned in what were previously regarded as blue chip investments. The average Irish saver is very happy at the moment with a 2% to 3% return on cash. The emphasis is still on keeping money available in ready and liquid form."

The past few years have been characterised by widespread concerns about the long-term future of the euro currency. This prompted a flight to safety as many savers sought to protect themselves against the potential collapse of the euro by opening foreign currency accounts. Though many experts are still convinced that the single currency is doomed, the storm surrounding the euro abated last autumn and Synnott says that the panic has fizzled out.

"At one stage, over 70% of inquiries coming into us were for sterling accounts," he says. "As the demand was there, we decided to satisfy it with sterling accounts and we've seen a large take-up in those products. We also opened an office on Merrion Row in central Dublin, to satisfy personal investor demand for personal interaction."

Richard Kissane, head of savings at **EBS**, is anticipating that deposit rates will continue to fall over the coming year. "This time last year, a rate of 4% wasn't terribly unusual, and now 3% is rare," says Kissane. "But inflation is only around 1% so savings are keeping pace. Some people are surprised when their account matures and they are offered considerably lower rates. The reaction of most savers is to start shopping around, but with the differentials between the rates of the various institutions being so low, there's little point in moving for 0.15%," he adds.

Personal Deposit Rates

	6 Months	12 Months
EBS	2.47	2.60
Nationwide UK (Irl)	2.26	2.75
AIB	N/A	2.60
Investec	2.51	2.60
PTSB	2.43	3.06
KBC	2.75	2.90
Danske Bank	1.71	2.75
Bank of Ireland	2.01	1.90

As of 18 February 2013 (IrishDeposits.ie)

Corporate Deposit Rates

	6 Months	1 Year
AIB	1.20	1.50
Bank of Ireland	0.30	0.45
EBS	1.70	2.00
PTSB	1.60	1.60
KBC	0.50	0.70
Danske Bank	0.37	0.60

As of 18 February 2013 (Dolmen Stockbrokers)

Kissane says that the flight to safety attitude has dissipated. "Since August last year, we have started to see people coming back to us. There's a confidence returning and a belief that the country is getting out of the mess it is in, albeit slowly. It's now quite rare to be asked a question about ELG cover. There was a time when everyone was asking those questions."

Retail deposits of up to €100,000, per depositor and per institution, are covered under the **Deposit Guarantee Scheme** (**DGS**), which is administered by the Central Bank. Accounts with more than €100,000 are covered by the **Eligible Liabilities Guarantee** scheme (**ELG**), which is administered by the National Treasury Management Agency.

The recent liquidation of IBRC, the shell that housed the remnants of Anglo Irish bank and Irish Nationwide Building Society, is a reminder that financial shocks haven't gone away. The government insisted that the sudden and stealthy winding-up of IBRC was necessary to resolve its Promissory Note funding dilemma. But in the process of shuttering the state-owned bank, the government wiped out IBRC's depositors, estimated to be owed between €900m and €1,100m.

The government was sanguine about this overnight manoeuvre, pledging that depositors would be recompensed under the two separate guarantee schemes. But that was cold comfort to depositors who found themselves without access to their cash and with no choice but to go through bureaucratic hoops to get their money back. A number of credit unions expect to have to wait until September to be reimbursed the €17m they had on deposit with IBRC.

Aoibheann Daly, portfolio manager at **Finance One**, observes that many depositors spread their funds across a variety of institutions, so as to avail of the DGS. For business depositors, the chief concerns are value and security. "Over the past year, some of the banks participating in the ELG have introduced non-ELG deposit products paying enhanced rates of interest to business clients willing to forgo the protection of the ELG guarantee," says Daly.

Daly adds that many depositors continue to be highly cautious, and keep large portions of their cash

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End Is Nigh For ELG Scheme

The general expectation is that the government will not seek to extend the Eligible Liabilities Guarantee scheme (ELG) beyond June 2013. The ELG was first introduced in 2009 and is a state guarantee for deposits of more than €100,000. Deposits under that amount are covered by the separate Deposit Guarantee Scheme (DGS).

The initial ELG ran for 12 months and has been extended ever since at six month intervals. The most recent extension covers the period up to the end of June 2013, and the government has stated its intention to phase out the scheme.

Banks who signed up to the ELG scheme included Irish Life and Permanent, Bank of Ireland, ICS Building Society, AIB, Anglo Irish, Irish Nationwide and EBS. In return for the guarantee provided under the scheme, each bank pays hefty fees to the Exchequer.

In 2011, AIB paid €465m for the privilege of the ELG guarantee, while Bank of Ireland said it paid almost €450m. The banks, particularly Bank of Ireland, want to exit the scheme as soon as possible, though they have to be mindful of how depositors will react.

Non-renewal of the ELG would mean that all new deposits made of over €100,000 would not be guaranteed by the state. However, any accounts opened prior to the ending of the scheme will remain covered until maturity, up to a maximum of five years. That means any depositors looking to guarantee their cash should arrange new term deposits quickly.

Those whose deposits are currently covered by the ELG should note that the Department of Finance has stated that banks will not write to customers to inform of any non-renewal of the scheme, though notices will be published in the press.

Richard Kissane, EBS

portfolios in A-rated institutions both abroad and in Ireland. "These depositors place a premium on counterparty credit rating, and as such are willing to accept significantly more modest rates of return," says Daly.

Daly predicts that interest rates will fall over the coming year as banks continue to try and cut the cost of funding. She also expects banks to start exiting the ELG scheme. "As depositors are growing aware of this, many are looking to place their funds on longer periods of up to 12 months, knowing that on maturity the rates available are likely to be significantly lower," she says.

Damian Young, head of deposits and current accounts at **Bank of Ireland**, believes that deposit rates are set to stay low for some time, with further cuts likely. "Customer deposit rates are reflected in what the market is doing. The outlook over the next two to three years is for market rates to be very flat. There's still a dislocation between market rates and deposit rates, indicating that there is still some way for deposit rates to fall."

Young believes the wind-down of the ELG will serve as further evidence of a return to a more normalised banking environment. "Depositors are already opting into products that are not covered by the ELG, and have been doing so for the past year. That is because they now have confidence in the banks and also because the rate they can get on non-ELG covered products is slightly better."

Also top of mind for savers these days is the rate of **Deposit Interest Retention Tax**, which has been hiked twice by finance minister Michael Noonan and currently stands at 33%. Effectively, this means that a deposit rate of 3% is actually 2%, and now the government wants to slap USC tax on the net interest that accrues to individuals.

The DIRT factor brings into focus state savings products marketed by **An Post**, though only if you're prepared to lock away cash for the long term. An Post's three-year Savings Bond pays 7% after three years for a tax-free AER of 2.28%. A five-year lock-in with Savings Certificates raises the tax-free AER to 2.83%. One point worth remembering with state savings is that there is no upper limit on the amount that is guaranteed and no end-date for this guarantee. BP