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Why bank term deposits are falling and what is driving them

By Victor Gugger

Recently, we've observed a trend where major banks are reducing their term deposit rates, as noted in the AFR on 21 August. While much of the focus has been on mortgage wars and increasing margins, I find it more intriguing to consider what the broader markets are signalling and explore the available alternatives.

As of 21 August, the 90-day BBSW rate—an important market indicator reflecting the current and expected cash rate and serving as a guide for most bond and derivative transactions in AUD—stands at approximately 4.38%. However, the Bank Bill futures market is projecting a decline, with the rate expected to drop to 4.14% by December and further to 3.84% by March 2025, which implies two 25 basis point rate cuts. It's important to note that market predictions aren't always accurate.

This brings up a critical question: Are the banks shaping market sentiment, or is market sentiment driving the banks?

For investors, the question then becomes: What are your options? Firstly, it's worth noting that most non-major ADIs (Australian Depository Institutions) have not reduced their term deposit rates as much as the major banks, though finding a rate with a '5' handle is becoming increasingly challenging. Secondly, you could consider the fixed-rate Tier 2 bank corporate bond market, where rates range between 5.50% and 5.90% for terms of 5 to 10 years. The longer the term, the higher the interest rate, and the greater the potential benefit if rate cuts become aggressive.

Personally, I believe the RBA will hold steady for the next six months, which leads me to favour floating rate bonds for the time being. After that, it might be worthwhile to explore bank corporate bonds if rates rise above 6% again.

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