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focus

The End of High Cash Rates is Nigh

After several years of relatively high interest rates, we seem to have reached a turning point. Recently, the Reserve Bank of New Zealand (RBNZ) signalled that the Official Cash Rate (OCR) is likely to move lower sooner rather than later. Over the past few years, favourable interest rates have been available for term deposits and savings accounts, leading many people to park their money in the bank. However, as interest rates are set to decline, keeping funds in the bank will soon become less appealing. This might be the right time to consider whether cash investments still hold value, given their historically lower long-term inflation-adjusted returns compared to other assets.

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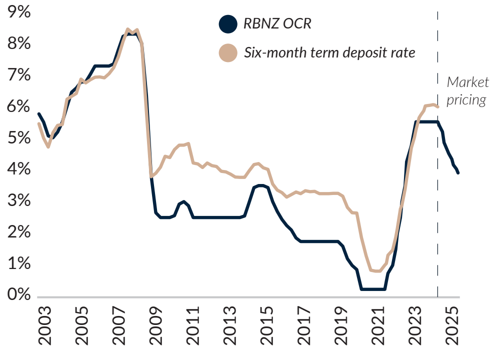
Turning point in interest rates ahead

It looks like the recent regime of relatively high interest rates is coming to a close. The July policy announcement from the RBNZ clearly signalled that the OCR is likely to start moving lower in the future. Quite a change from in May, when the RBNZ entertained the possibility of needing to hike interest rates further. An OCR cut from the RBNZ is likely to see both borrowing and savings rates on offer from banks shift down in tandem.

This change in the RBNZ's stance is driven by considerable weakness in the New Zealand economy, which has flatlined for over a year. Recent data predicts worsening conditions in the coming months, leading to increased spare capacity, rising unemployment, and businesses resorting to pricing discounts to maintain sales. In this environment, headline inflation is expected to fall back within the RBNZ's target band of 1% to 3% in the second half of 2024. The RBNZ is now anticipated to start cutting interest rates by Christmas. This trend of declining interest rates is part of a broader global theme, with central banks in the Eurozone and Canada already cutting rates, and the US and UK expected to follow suit.

The interest rates that banks offer for terms deposits and savings accounts are closely related to the OCR. A falling OCR typically lowers the cost to consumers and businesses to borrow from retail banks, but it also lowers the interest rates on savings and terms deposits. For those with money parked in the bank, the favourable days of 6%+ term deposit rates are likely coming to an end. We have already seen retail banks start to lower deposit and mortgage rates in the wake of the RBNZ's recent statement. While this provides relief to mortgage holders as fixed and variable interest rates decrease, it will also reduce incomes for those with term deposits.

RBNZ OFFICIAL CASH RATE (OCR) AND SIX-MONTH TERM DEPOSIT RATE (%)



Source: Bloomberg, Forsyth Barr analysis

...With interest rates expected to decline, parking money in the bank may become less attractive...

Time to consider the options

It's important to remember that investing is a long-term endeavour, and history has tended to favour equity markets as the way to grow wealth despite a few more ups and downs along the way. With interest rates expected to decline, parking money in the bank may become less attractive. Now could be the time to consider whether cash investments still hold the same appeal, given their historically lower long-term returns relative to other assets. With rates likely to decline, investors face some choices:

Continue to park cash in the bank, but earn a lower return: For those who continue to hold cash, it's important to shop around and secure the best possible rate of return. (Forsyth Barr has a number of cash management solutions that aim to provide more attractive returns than what's on offer from most retail bank deposits.)

Invest in bonds to lock in longer-term rates: Despite a slight pullback due to imminent interest rate easing, bond rates still offer the chance to lock in competitive medium- to long-term rates.

Put money into the share market: For those thinking about investing in the share market, lower rates could be the catalyst to invest. Is now a good time? Timing markets in the short-term is (at best) extremely difficult, but over the long-term investing in equity markets significantly outperforms other asset classes. Lower rates should provide tailwinds for those companies that have struggled against the tough economic backdrop.

With a drop in interest rates on the near-term horizon, now is a good time to consider the best strategies to meet your investment objectives. If at any time you would like to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide advice and assistance.

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