Why Bank Deposit Rates are So Low and Where to Find Better Rates

by John W. Citti, CPA, CTP, Impacting Nonprofits LLC | November 2, 2022

The Federal Reserve has increased the federal funds rate at a rapid pace this year to contain inflation, but banks have not responded with higher interest rates on certificates of deposit (CDs) or money market accounts. Clients may be asking their CPA to explain the disconnect and, more importantly, where they can earn better returns on cash holdings.

As of this writing, CDs maturing in one month pay as little as .01 percent to .05 percent. According to my research, the highest money market account pays .60 percent, but nothing comes close to the current federal funds rate of 3.75 percent. Why aren't bank deposit rates higher?

The reason is supply and demand. Banks are flush with cash now and are unlikely to increase their deposit rates significantly until they need cash. Banks are holding large cash balances because of the pandemic-induced recession two years ago. Home-bound consumers reduced purchases and many received stimulus checks that they deposited into their bank account. Many small businesses closed, reducing demand for business loans, and the Federal Reserve added money to the banking system to restore growth in the economy. The economy has recovered, but banks are still holding large sums of cash.

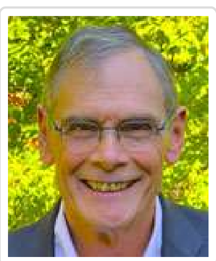
Alternatives

Do your clients have alternatives to near-zero interest rates on bank CDs and money market accounts? Fortunately, the answer is YES! Attractive rates from ultra-safe investments are available. But first, there are a few important considerations to make when choosing where to invest short-term funds. These include:

- **Safety.** When I was a fixed income portfolio manager for a large software services company many years ago, my treasurer was fond of saying, "Return OF investment is far more important than return ON investment!" He meant don't let high interest rates fool you into making risky investments. If the issuer can't repay the principal, you lose money regardless of the promised interest rate. The question becomes, how do you determine if an investment is safe? CPAs should remind clients to thoroughly research investment opportunities. Start with the free bond ratings available from Moody's, Standard & Poor's and other bond rating agencies. The top long-term ratings are Aaa for Moody's and AAA for Standard & Poor's, and the best short-term ratings are P-1 and A-1, respectively. The full range of ratings with explanations is available on each of these websites.

- **Liquidity.** A study conducted in March 2022 by the Association for Financial Professionals found that treasurers managing corporate cash investments consider liquidity as the second most important factor behind safety when making short-term cash investment decisions. Finance managers need access to cash if revenues unexpectedly fall short. For this reason, short-term CDs, money market funds and Treasury Bills are popular among money managers because they provide access to cash in maturities ranging from one day to 12 months.
- **Yield.** Where can your clients find all three features — safety, liquidity and yield? Typically, debt securities of the U.S. government pay lower interest rates than commercial banks and corporate debt because they are considered "risk free." However, in today's environment, Treasury Bills (U.S. federal short-term debt with maturities up to 52 weeks) pay significantly more than most commercial bank deposits. Recent Treasury Bill rates start at 3.6 percent for four-week maturities and increase to 4.5 percent for 52-week maturities. Purchases are simple. Individuals and companies can buy Treasury issues on TreasuryDirect.gov without a broker. The principal is withdrawn directly from the client's bank account on settlement date and returned with interest on the maturity date.

CPAs can make their clients aware that today's economic conditions have created an unusual opportunity to earn attractive yields from ultra-low risk, short-term U.S. Treasury Bills that pay higher rates than many alternative higher risk investments.



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