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Credit crunch has savers starting to feel the squeeze

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Now savers are feeling the credit crunch.

Yields on savings accounts, certificates of deposit and money-market accounts are dropping en masse in the wake of the Federal Reserve's latest round of rate cuts.

That's a shift from just last fall, when banks were generally slower to follow the Fed's lead and cut rates as they continued to compete for customer deposits. That gave savers more time to enjoy yields of 4 percent to 5 percent or more. But now, facing their own higher credit costs and weakening loan demand, banks are quicker to pass along the Fed's more-aggressive rate cuts.

In recent weeks, a number of banks that had previously offered high yields on deposit accounts, including Emigrant Savings Bank's EmigrantDirect.com, ING Groep's ING Direct and Washington Mutual, have slashed their rates. At the same time, average yields on CDs dropped below 3 percent in early February from close to 4 percent last fall, and are currently between 1.95 percent and 2.75 percent, according to Bankrate.com.

For now, consumers can still find deals by foraging in some lesser-known corners. One option: limited-offer promotional-rate CDs. In recent weeks, for example, Countrywide Bank began offering a 12-month promotional CD yielding 4.2 percent, even as it cut the yields across the rest of its CDs to 3 percent or 3.25 percent.

Savers can also find attractive yields at smaller banks. Century Bank Direct, the recently launched online banking unit of Century Bank of Kentucky, is offering an online savings account that pays 4.01 percent. "We're new to the online banking world, and we're just basically trying to get a little attention," said Tamara Smith, the bank's marketing manager.

Credit unions and online banks typically offer higher yields than big brick-and-mortar banks. And some firms with big mortgage-lending arms, such as Countrywide and IndyMac Bancorp, that have had trouble raising money in the capital markets have been offering surprisingly high yields on some CDs through their banking units.

Cuts in yield for savers "have certainly picked up speed as the Fed accelerated their pace of rate cuts," says Greg McBride, a senior financial analyst at Bankrate.com, which lists current yields at various financial institutions. Since September, the Fed has cut its federal-funds rate six times, to 2.25 percent from 5.25 percent. Over that time, the top-yielding CDs have dropped from over 5 percent earlier this year, and 5.5 percent last summer to a range of 3.75 percent to 4.55 percent today, according to Bankrate.com.

The credit squeeze is also partly to blame for the lower rates. Last fall, the "crunch wasn't in full swing ... and banks believed they could still lend the money out or buy some other debt obligations," said David Kaytes, managing director of Novantas Llc., a management-consulting firm. Now, amid rising loan losses and tighter underwriting standards, there are fewer places for banks to lend money. And as banks court more creditworthy customers, they are forced to charge lower rates on loans, which is squeezing their profits.

Some savers may be tempted to get a better payoff by seeking out higher-yielding cash alternatives, such as short-term bond mutual funds. But higher yields usually carry more risk.

By contrast, when savers park their cash in bank deposit accounts, their money is typically covered by the Federal Deposit Insurance Corp. for as much as \$100,000 per depositor, per insured institution.

Another alternative for savers are money-market mutual funds. Yields currently average 2.74 percent for the 100 largest funds but are expected to drop to about 2.5 percent by mid-April, according to Peter Crane of Crane Data. Although the securities aren't insured by the FDIC, no retail investor has ever lost money in a money-market fund, he says.

Others are locking in longer-term rates on CDs. In recent weeks, Ken Look of Chicago locked in a 5 percent rate for four years on a CD offered by National City.

"Everything is going negative in stocks, the same thing with mutual funds, so you scratch your head and think, 'What else can I do with my cash?' Even bonds aren't getting great returns," said the 45-year-old computer consultant. "I'd rather take my chances at getting a guaranteed rate of 5 percent."

Seeking higher rates

Consumers can still find decent deals at smaller banks and credit unions and on promotional CDs.

Try personal-finance Web sites such as FatWallet.com. For example, Alliant Credit Union of Chicago was recently offering savings rates over 4 percent.

Go for longer-term CDs to get the best rates, so long as you can tie up the money.