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Interest Rates Defy Fed's Recent Cuts

Credit-Market Crunch Keeps Yields Relatively High on Savings, While Home-Equity and Some Other Loans Remain Pricey

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Interest-rate cuts by the Federal Reserve are normally bad news for savers and good news for borrowers. But that scenario hasn't been playing out fully since the central bank began cutting rates in September.

The Fed has trimmed a total of three-quarters of a percentage point from short-term rates in recent weeks. However, rates on such popular savings products as money-market funds, savings accounts and certificates of deposit haven't fallen anywhere near that much, and some have even held steady. Meanwhile, rates on certain types of borrowings, including home-equity loans and auto loans, remain stubbornly high.

Behind the discrepancies is continuing tightness in credit markets, where many banks raise much of their capital. Instead, banks remain especially eager to attract consumers' deposits, and are willing to pay savers handsomely to keep the money coming in the door. At the same time, banks' higher cost of raising capital is keeping many of them from lowering rates on some kinds of loans.

"Even though the Fed has eased three-quarters of a percentage point since September, the market has only gotten between 0.25% and 0.50% of that easing," says James Bianco, president of Bianco Research LLC, a market-research firm in Chicago. "If you look at it from a saver's and borrower's side, it shows you that the market is still not functioning properly."

That's fine with savers. Average yields on money-market mutual funds, for example, whose yields typically move in line with changes in the Fed funds rate, are hovering at 4.76%, compared with 5.06% in mid-September -- roughly half the amount they'd be expected to drop, says Peter Crane of Crane Data LLC.

Declines in CD rates also are relatively modest. One-year CDs currently average 3.61%, down from 3.78% in mid-July, and five-year CDs are at 3.92%, down from 4%, according to Greg McBride, a senior financial analyst at Bankrate.com. By contrast, he says, comparable Treasurys have dropped a full percentage point over the same period. "Normally, CD yields would drop like a stone, and now, they've been dropping like a feather," he says.

To be sure, banks may still trim yields on deposits in the wake of this past Wednesday's Fed cut in the federal-funds rate, charged on overnight loans between banks. The move, aimed at bolstering the economy amid plunging home construction and eroding real-estate values, pushed the Fed rate down a quarter point to 4.5%. However, market experts expect consumers will continue to enjoy favorable yields on many savings products in the 4% to 5% range, with the highest yields on savings products still above 5%. "Yields are going to drop a little bit, but won't drop as much as we would expect in normal circumstances," Mr. McBride says.

For borrowers, some lending rates have declined in line with the Fed cuts, and consumers with home-equity lines of credit and variable-rate credit cards should have already seen some rate relief. That's because those products are usually tied to banks' prime rate, which typically moves in lockstep with the Fed funds rate. Average rates on home-equity lines of credit and variable-rate credit cards have dropped to 7.81% and 13.64%, respectively, from 8.25% and 13.97% in early September, according to Bankrate.com.

But other loan rates haven't fallen as quickly as would be expected. Rates on fixed-rate home-equity loans, currently averaging 8.04%, have barely budged from 8.08% in July, according to Bankrate.com. And average rates on five-year new car loans, which are generally tied to the movement in Treasurys, are 7.62%, compared with 7.82% in July.

Homeowners have gotten some rate relief, though average rates on 30-year fixed-rate conforming mortgages, which are typically influenced by rates on 10-year Treasurys, haven't fallen as much as they would under more normal circumstances. While yields on 10-year Treasurys ended last week at 4.39%, down 0.51 percentage point from the first week of June, average yields on 30-year fixed-rate mortgages fell just 0.14 percentage point, to 6.28% on average, in the same period, according to Keith Gumbinger, vice president of mortgage-tracker HSH Associates.

Mr. Gumbinger says mortgage-rate declines have lagged behind those of Treasurys partly because institutional investors are still skittish about mortgage risks and are demanding higher premiums to hold the loans. Also, Treasury yields have been falling more quickly as investors seek the safety of higher quality investments.

Lower rates could benefit some homeowners with adjustable-rate mortgages that are soon to reset. For ARMs whose reset rates are tied to the one-year Treasury, that rate is currently 6.5%. Before the Fed began cutting rates in September, that adjustment might have been 7.5% or more, says Bankrate.com's Mr. McBride.

For savers, some of the best rates are on liquid accounts and short-term CDs. Last month, AmTrust Direct, owned by Ohio Savings Bank's AmTrust Bank division, rolled out an e-Savings account paying an introductory yield of 5.36% for 90 days, while M&T Bank Corp. launched an online money-market account yielding 5.05% in mid-September.

But relatively high short-term rates could begin falling faster, as banks enter a period of the year when loan demand is typically lower, and the institutions are going to have less of a need to raise deposits to fund those loans, says Bradley Smith, executive vice president at UMB Financial Corp.'s UMB Bank.

Savers concerned that short-term rates could head lower might want to consider locking in longer-term rates. J.P. Morgan Chase & Co.'s Chase is offering 4% on its standard CDs with terms of 18 months or longer, a rate that hasn't changed despite the Fed cuts. Countrywide Financial Corp.'s Countrywide Bank -- although it trimmed its rates last week -- is offering 5% on CDs with terms of 18 months or longer. ING Groep NV's ING Direct, which cut rates across its shorter-term CDs and savings account Thursday, maintained the rates of 4.75% on its longer-term CDs with terms ranging from 18 to 48 months and even raised the rates on its 60-month CD to 5% from 4.75%.

Banks are also starting richer checking-account promotions. Chase, for example, is offering $125 to certain customers who sign up for a free checking account -- compared with previous offers of $50, $75 or $100 -- while Bank of America Corp. and its recently acquired LaSalle Bank operations are dangling $100 to customers in Chicago and Michigan who sign up for a checking and savings account. Wachovia Corp., meanwhile, is aiming to lure certain noncustomers who have used the bank's ATMs with a cash offer of $50 to open a free checking account at the bank.