How The Credit Crunch Could Be Good News For Savers

As anyone who has a passing interest in financial matters will be well aware of by now, the world economy is entering uncertain times. The so-called 'credit crunch', where banks are finding it harder and harder to finance their operations by taking out cheap credit with each other, is causing no small amount of alarm amongst analysts the world over. While there isn't yet a consensus on what the final outcome will be, almost everyone agrees that we're in for choppy economic waters ahead - we're just not sure exactly how bad things are going to get. However, amongst the doom and gloom, there is one group of people who might actually feel a benefit rather than the pinch: serious savers. To understand why, we first need to take a quick look at what the credit crunch is all about in the first place. The basic operation of a bank is to make a profit by acquiring money cheaply, and lending it out again at a higher interest rate. The traditional way of doing this was to accept deposits from savers and investors, and then use these deposits to fund mortgages and other lending. By charging a higher interest rate on the mortgages than they pay on savings accounts, the whole endeavour becomes profitable. And if savings deposits were insufficient, banks could borrow from each other at cheap rates to make up the difference. This sounds rather simple and straightforward, but in real life the financial markets don't like things so simple - it spoils the fun - and so a whole range of byzantine ways of financing loans and mortgages was devised. One such way was to split up liabilities for mortgages into parcels which were bought and sold between the banks, so theoretically spreading the risks around. This gave banks the confidence to lend to people with poorer credit ratings than would have been countenanced previously - in other words, the sub-prime market. This was fine while times were good, but as the economy faces tougher times, more and more sub-prime borrowers are failing to keep up with their repayments, and defaults are growing. And here lies the problem. Because of the intricate system of parceling up debts and trading them between banks, no one is quite sure how much each bank is going to suffer from a downturn. This means that the credit worthiness of each individual bank is somewhat open to question, and so lending between banks has all but dried up, leaving some banks over extended with no way of funding future lending at a profit. The upshot is that many banks are desperate for money to continue trading in the way they have been doing. The central and reserve banks have done their bit by injecting billions of cheap funds into the industry, but banks are loathe to take up this option for fear of looking weak and under threat. So how else can they raise cash? By encouraging savings deposits with higher interest rates, more flexible features, and rate guarantees into the future. So, even though for many the financial future is at best uncertain and quite possibly bleak, for people with funds to deposit into savings accounts, there are opportunities ahead.

About the Author

Nicholas writes for Your Banking Guide, which features information on high interest savings and a savings account comparison feature.