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What's an appropriate period to invest in bank deposits

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What is the appropriate period to invest in a bank term deposit at the moment? Is 12 months too long?

Working out what to do with new and maturing term deposits is going to be one of the biggest issues for retail investors during 2009. A year ago, you could earn about 6.75 per cent on a 12-month term deposit. Six months ago, you could get 8.75 per cent if you shopped around. Now the rate is about 3.6 per cent to 3.8 per cent, although you can earn about 4.8 per cent on a three-month deposit.

The first step in deciding an appropriate term for your bank deposit is to be absolutely clear about your objectives.

For example, is preserving your capital the key aim or are you prepared to look at slightly riskier alternatives that might generate more income? Are you investing for the near term or longer term? Is this bank deposit your main asset or just part of a larger portfolio?

Other aspects of your personal and financial situation could be relevant.

If you are convinced that a term deposit is the best option, then there are three further points you need to consider. The first is that the official inflation rate in Australia is 3.7 per cent. If your term deposit is not at least matching this figure, it's going backwards in real terms.

Secondly, interest rates are almost certainly heading lower.

The consensus in the wholesale money market is that short-term interest rates will dip to about 2.5per cent in mid-2009 before edging up to 3 per cent by the end ofthe year. Term deposit rates are likely to follow a similar path.

Finally, if you invest at 4.8 per cent for three months, you only need to reinvest at about 2.5 per cent during the following nine months to match the current one-year term deposit rate. It might also be worth looking at two-year and three-year deposit rates that are presently as high as 5 per cent at some banks.

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