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NEGATIVE FEELINGS OVER NEGATIVE INTEREST RATES

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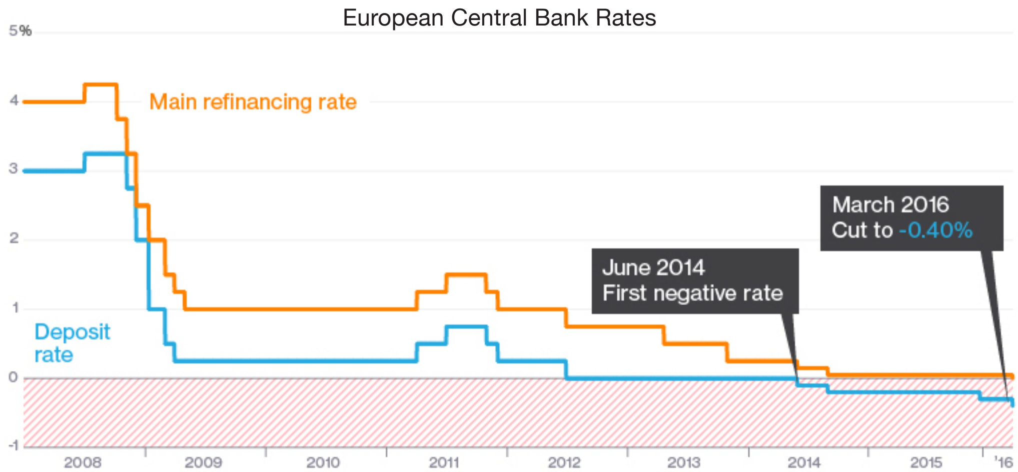
Negative interest rates are back in the news with the very vocal protest by Bank of Tokyo Mitsubishi UFJ (BTMU) over the Bank of Japan's negative interest rate policy. Currently, Japanese Government Bonds are yielding -0.12% and the Bank of Japan has discussed lowering that yield to –0.3%; BTMU has threatened to pull out of the consortium of Japanese banks serving as primary dealers in these bonds. It should be noted that such an action would have a minor-to-nonexistent impact on the market for Japanese Government Bonds and/or the Bank of Japan's ability to market those bonds. Nevertheless, the announcement by BTMU brings to the fore, once again, the question of what can be achieved with negative interest rates and whether the unintended consequences mitigate any possible benefits.

The fundamental idea behind negative interest rates is that, in charging the lender (e.g. the buyer of a government bond with a negative yield) for the benefit of holding cash in "super-safe" government bonds or in an account with a central bank, the lender will be encouraged to lend to more risky endeavors with a positive yield: small business, individual consumers, real estate owners, etc. The borrower, in turn, will increase the use of leverage because of its lower cost and this will then propel economic growth. This simple explanation may seriously overlook or minimize the practical effects of the reduction in bank profits that is the most immediate result, however. There is a reasonable possibility that banks might be less willing to lend if they feel they cannot command an appropriate return for the risk involved or that they might actually raise interest rates on some products, or fees on some services, in order to make up for the revenue lost on their holdings of cash and government bonds.

Europe Dives Below Zero

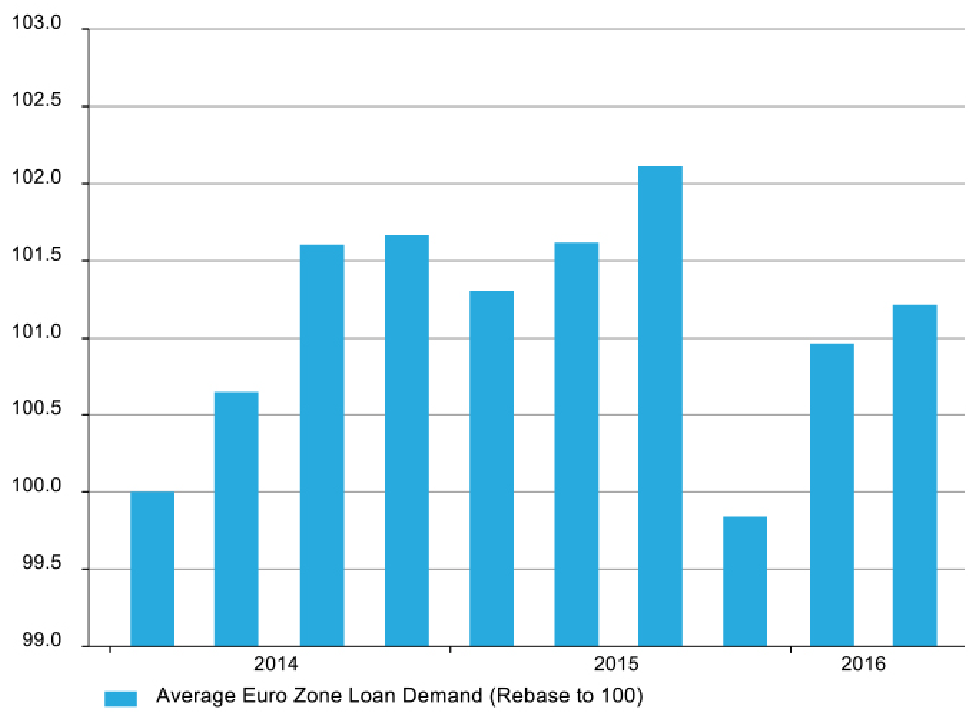


Source: European Central Bank

Negative interest rates also serve the purpose of weakening a domestic currency, providing a competitive boost to exporters and additional fuel for economic growth. Yet this particular benefit can become rapidly diminished the more widespread the use of negative interest rates; a currency war by any other name is still a currency war.

Despite possible, modest, success in Europe where negative rates first materialized in June of 2014 and economic growth and loan demand have risen, it would seem to be depressingly true that negative interest rates are simply another example of unusual monetary policy necessitated by completely ineffectual or nonexistent fiscal policy. Asking monetary policy to do too much is not, in my opinion, the fault of monetarists. In the absence of more traditional economic stimulus from infrastructure spending, investment tax credits, tax cuts, government subsidies, etc. – often in the name of "austerity" or "reduced government" – policy makers have become heavily reliant on one tool: interest rates. Macroeconomic theory provides little support for the use of such a limited toolbox.

European Loan Demand



Source: Thomson Reuters Datastream / Fathom Consulting

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Sources include: European Central Bank, Thomson Reuters Datastream / Fathom Consulting