European goodbye to negative rates – or is it just 'au revoir'?

By Mark John And Dhara Ranasinghe/ London

Europe's decade-long experiment with negative interest rates, which ended on Thursday with the Swiss National Bank's return to positive territory, showed one thing: they can exist beyond the realms of economic science fiction.
Launched to revive economies after the 2007/08 financial crisis, the policy flipped standard money wisdom on its head: banks had to pay a fee to park cash with their central banks; some home-owners found mortgages that paid them interest; and rewards for the act of saving all but vanished.
With the exercise now abandoned in the face of galloping inflation brought on by pandemic and the Ukraine war, doubts linger over its effectiveness and under what circumstances it will ever be used again.
"I think that probably the bar is going to be higher in the future," said Claudio Borio, head of the Monetary and Economic

Department of the Basel-based Bank of International Settlements which acts as bank to the world’s central banks.

Rarely does monetary policy generate as much sound and fury as did the recourse in the early 2010s to negative rates by four European central banks and the Bank of Japan – now the only monetary authority still sticking with them.

With interest rates back then already close to zero, they had run out of conventional ammunition to ward off the threat of outright deflation they feared would choke off the economic recovery. The only way out, they decided, was to go below zero.

Bank chiefs fumed as the European Central Bank, Swedish Riksbank, Swiss National Bank (SNB) and Denmark’s Nationalbank went negative in moves they said undermined the whole banking business model of being able to make a profit out of lending.

Local media joined in the criticism, with Swiss newspapers in 2015 calling the moment “Frankenshock” and Germany’s Bild labelling the then ECB chief Mario Draghi “Count Draghila” for “sucking our accounts dry”.

For sure, those who relied on the return from cash savings clearly suffered during Europe’s period of ultra-low to negative rates – even if they could at least take solace from the fact that low inflation was protecting their initial savings.

Other side-effects are harder to pick apart.

Fears of negative rates leading to money-hoarding proved largely unfounded: in Switzerland, for example, the number of 1,000-franc notes in circulation remained the same, suggesting customers were not withdrawing cash to store in a safe at home.

As one Danish bank vaunted the world’s first negative rate mortgage, it is likely that cheap borrowing added steam to house price spikes across the region. But prices were often being squeezed higher by local factors including tight supply.

While many other elements have been at play, euro area bank stocks have fallen some 45% since 2014 – despite ECB moves to shield them with exemptions from charges on some deposits and

access to ultra-cheap borrowing.
Yet a report to European Parliament by the Bruegel think tank last year concluded that overall bank sector profits had not been significantly harmed by negative rates, noting that the downside was being offset by gains in asset investments.
“In the end, they worked the same as normal rate cuts,” said report co-author Gregory Claeys, while acknowledging the impact may have been greater had the experiment gone on for longer.

No future?

The question of whether negative rates actually achieve their goals is harder to answer given the modest extent of the trial – no-one ever went lower than minus 0.75% – and the fact that they have been swept aside by the turmoil of the last two years.
ECB policy-makers point to data showing that lending in the euro zone was shrinking year after year in the 2010s until negative rates helped turn that into growth by 2016 – even though that growth has never attained its pre-2009 heights.
Others point to the fact that the negative rate period coincided with the vast quantitive easing with which the ECB and other central banks around the world also boosted demand with trillions of dollars of asset purchases.
“That was a much bigger deal – much more impactful,” said Brian Coulton, chief economist at Fitch Ratings. “Using your balance sheet aggressively – that is a powerful weapon.”
Some economists argue negative rates create perverse incentives that ultimately do a disservice to the economy – for example by keeping alive “zombie companies” that by rights should fold, or by removing the impetus for governments to push tough reforms.
“What is lacking, in Europe, is the focus on structural reforms. Why didn’t they happen in the last 10 years, why didn’t we strengthen productivity growth?” said Societe Generale senior European economist Anatoli Annenkov.
Burkhard Varnholt, Chief Investment Officer Switzerland,

Credit Suisse Switzerland, goes further, saying the message they send about investing in the future was even akin to the nihilism of the No Future refrain of the 1977 Sex Pistols' punk rock track God Save the Queen.

"It's the central bankers who have taken interest rates to a level where we attach no value to the future," he said. "Today's punks wear white shirts, grey suits and a blue tie."

As the negative rate era closes, the global pool of assets with negative yield has shrunk to less than $2tn from a 2020 peak of some $18tn.

Despite the misgivings, others say the experiment has at least shown policy-makers that rates can go below zero and so is an option for them: witness the fact the Bank of England for a while considered that path as Covid-19 was ravaging the economy.

Even if the current inflationary bout means it could be a while before Europe's central bankers need to use negative rates again, it is unlikely they will want to rule them out.

"They will always be spoken of as something that remains in the toolkit," said Rohan Khanna, strategist at UBS in London. "I am very doubtful anyone here is ready to say never again for negative rates." – Reuters