Transcript

Europe takes key interest rate further below zero

by Amy Scott
December 3, 2015

•

Federal Reserve Chair Janet Yellen told lawmakers Thursday that the central bank is getting close to raising interest rates, as part of a generally upbeat testimony before the Joint Economic Committee in Congress. But as the prospects for a rate hike grow here in the U.S., the European Central Bank is taking the opposite approach.

Thursday, the ECB unveiled its latest measures to stimulate the lagging European economy, partly by cutting its already negative deposit rate to minus 0.3 percent.

If you thought interest rates couldn't go below zero, so did a lot of economists – until central banks in Denmark, Sweden and Switzerland proved otherwise. For more than a year now, instead of paying interest, the ECB has been charging banks to hold their cash overnight.

"What they're trying to do is motivate these institutions to lend more to the private sector," **said Bernie Baumohl, chief global economist with the Economic Outlook Group**. "Certainly one way to do that is sort of to penalize these banks for having their money simply sit idly."

There are some signs that it may be working, said Joseph Gagnon, a former Fed economist now with the Peterson Institute for International Economics. Bank loans are growing in Europe again, he said.

“What people point to more than anything is it’s pushing the Euro down, because international investors have gotten out of euros and they’re putting their money in dollars where they can get at least a small positive interest rate instead of a negative rate,” he said.

That is good for European exports. But so far the tactic has not worked well enough for ECB President Mario Draghi. Many were expecting an even larger rate cut Thursday.

The question is, just how negative can rates go.

So far, banks have been reluctant to pass on their costs to regular depositors, said Francesco Papadia, former director general for Market Operations at the European Central Bank with the Bruegel Institute in Brussels.

“This has not reached bank depositors in any significant way as yet, but at a certain point, if this would go on, they would be forced to do it,” Papadia said.

At that point, the mattress at home starts looking like a better option. If customers start pulling their money out of banks in droves, Gagnon said, we’ll have learned how low rates can go.

###