FEDERAL RESERVE BANK *of* NEW YORK

Comments on “The Interest Rate Unbound?” by Jean-Pierre Danthine

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For Presentation at the Hutchins Center on Fiscal and Monetary Policy at Brookings
“Negative Interest Rates: Lessons Learned…So Far” June 6, 2016

Swiss experience with negative nominal policy rates

Excellent paper that documents many aspects of the Swiss monetary policy experience with negative policy rates.

- Strong downward movement in the government yield curve.
- Sight deposit rates remain anchored at zero.
- Mortgage mark-up offered by banks rose.
- No large surge of currency use.

How effective has the negative rate policy been?

Small open economy and interest rate differentials

Professor Danthine points to the objective to restore the interest-rate differential with other countries so as to prevent the CHF from appreciating.

There has been a strong transmission into repo rates, while banks have had a large amount of their reserves exempted from the negative rates and have generally refrained from imposing negative deposit rates.

- The effect of negative rates on market rates seems consistent with the policy objective; similar in Denmark.

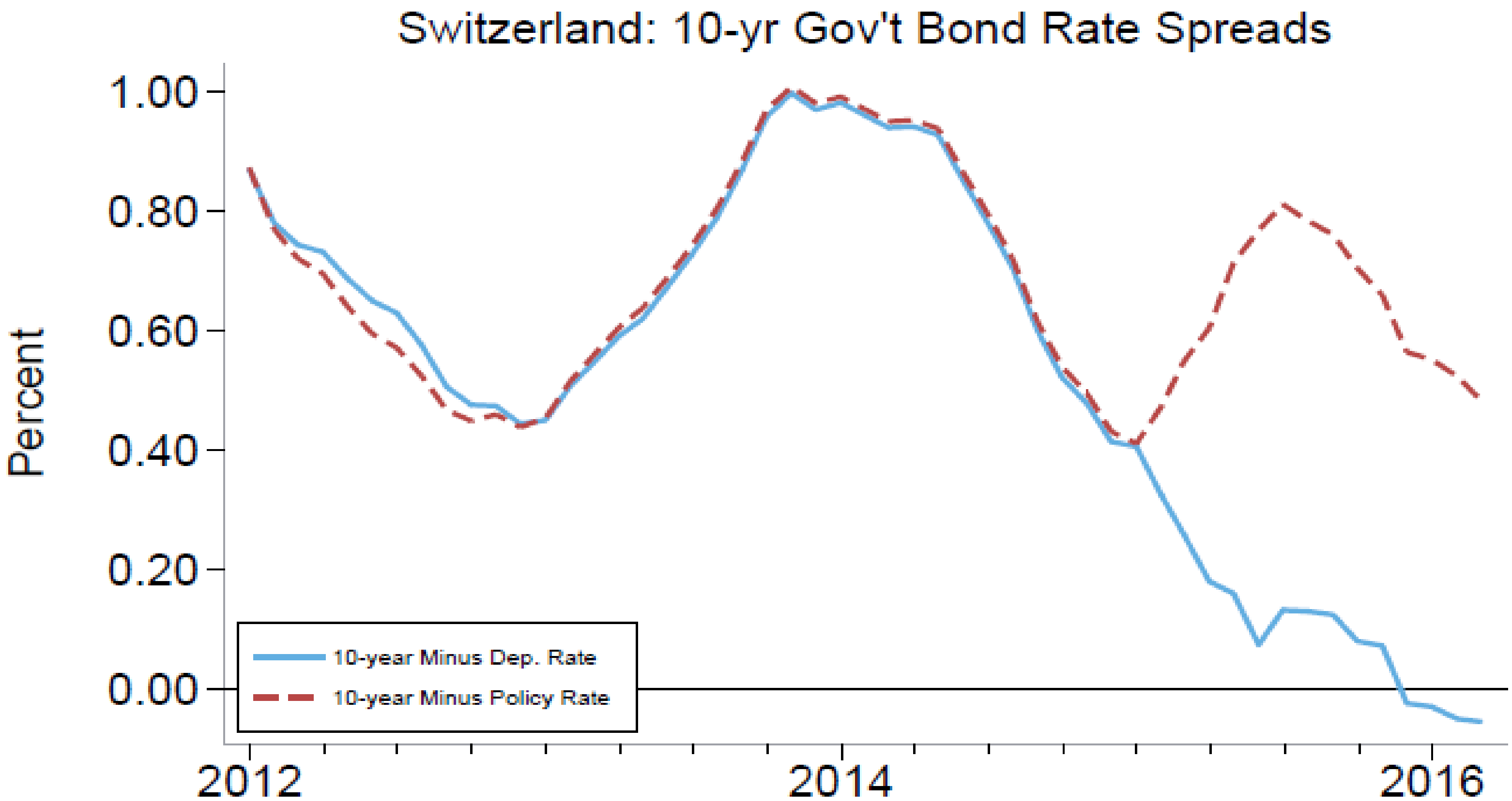
- If the goal is to more broadly affect aggregate demand via the portfolio balance channel, then the exemption of large amounts of reserve balance may not be supportive of the policy objective.

Mortgage rate increases

The increase in longer-term mortgage rates and other spreads is a cautionary sign regarding the effectiveness of negative policy rate in *easing financial conditions*.

While highly rated borrowers do seem to have experienced lower borrowing costs after negative rates were implemented, mortgage rates and other bank rates moved up, and it appears that banks' net interest margins may have expanded. In Denmark too rates rose on longer-term fixed-rate mortgages.

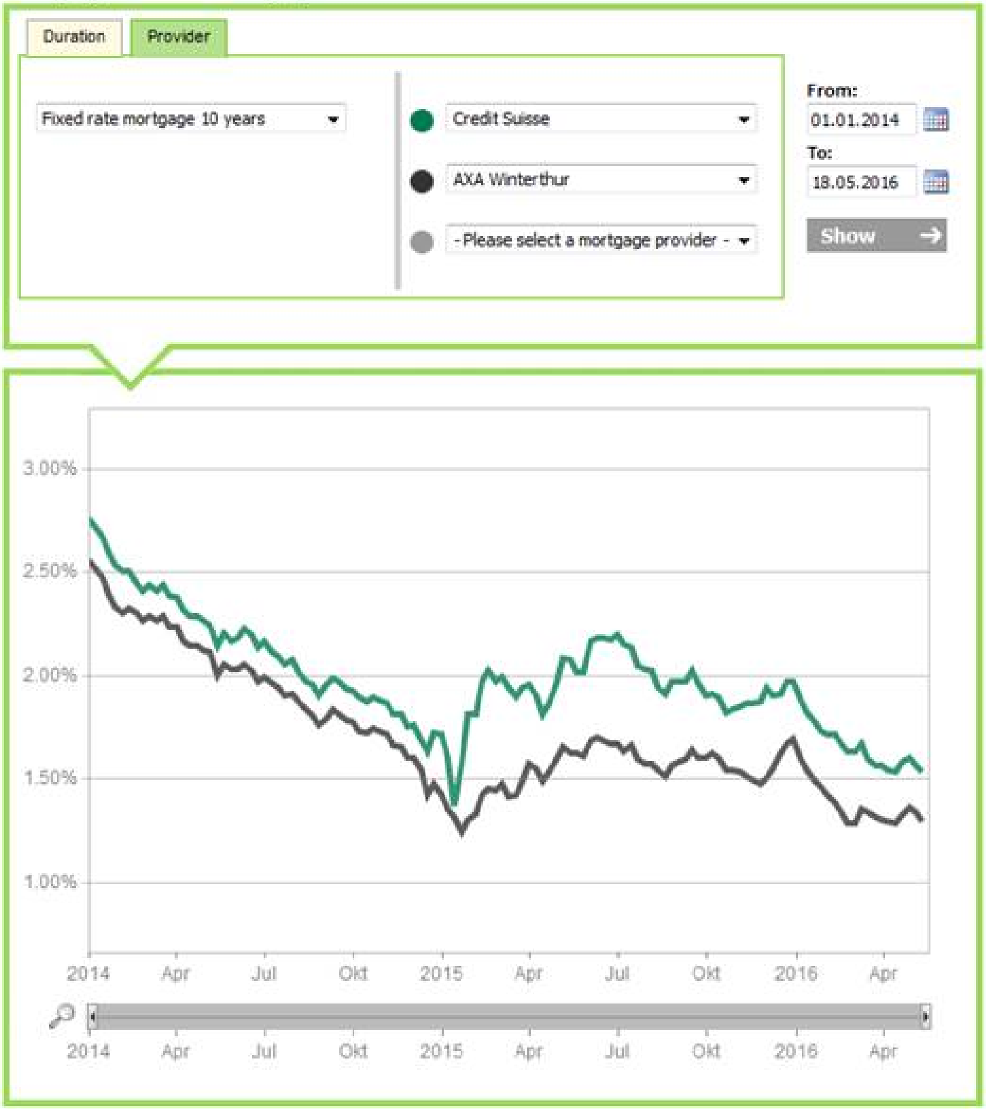
Are deposits or repos the relevant short-term rate?



5-month trailing moving averages
Source: Haver Analytics, Authors' Calculations

Financial innovation in the presence of negative rates

Mortgage rate trends by provider and duration



While these two institutions may not be representative quantitatively, other comparisons go in the same direction, and the topic has been discussed in Swiss newspapers.

Policy effectiveness

There are reasons to question how effective the Swiss experience with negative rates has been.

- Experience of wealth managers offering zero-rate deposits to foreign depositors
- The lack of transmission to bank deposit or lending markets
- The contractual impediments that were put in place to disallow negative rates in variable-rate mortgages
- Have exports been the main channel of transmission?

What alternative policies might be used, after the exchange rate floor was lifted?

- Capital controls—taxing deposits of foreign depositors
  - This can be considered a macroprudential policy
- Changing the target range for inflation from 0 to 2 percent to 1 to 2 percent.
  - Reduce tolerance toward low inflation outcomes in communication and in the policy framework