Deutsche Bank

Negative interest rates: Confidence costs outweigh small economic benefits

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Interesting and comprehensive paper

A: Why NIRP? Inflation low, something needs to be done

B: Model exercise: Shows impact on longer rates

C: Transmission and macro impact: Shows small impact on market rates and small impact on loan growth.

D: Financial stability: Less convincing, what about the ongoing hunt for yield in markets? Have ECB policies pushed stock market and credit market valuations so high that asset price valuations are inconsistent with expected future cash flows?

Bottom line: Small impact of negative interest rates, but at what cost? Confidence costs, behavioural changes = banks, consumers, corporates turning more cautious.

Key question: Should the ECB just accept passive structural and fiscal policy? Given there is no crisis at the moment why not say "We have done what we can, now the politicians need to do their job"

Are negative interest rates the answer to Europe's problems?

Problem: Low headline inflation because of oil.

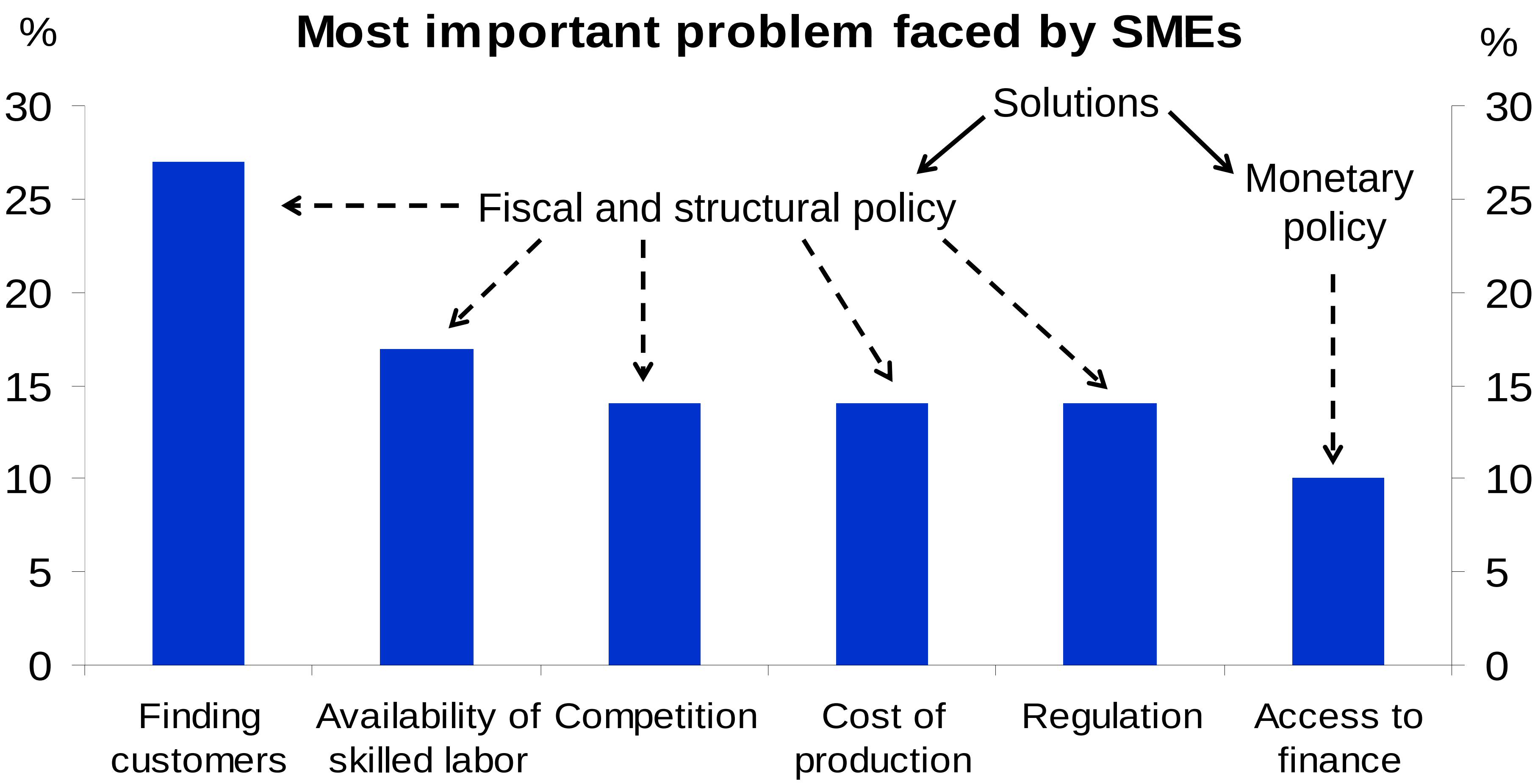
Solution: Change target to core inflation?

Problem: High youth unemployment

Solution: Lower interest rates? More QE? Credit easing?

No. Much better solution: Tax subsidies to firms hiring young people. Or higher transfers to incentivize more education

Are negative interest rates the answer to Europe's problems?



Source: ECB (Survey on Access to Finance, March 2016), DB Global Markets Research

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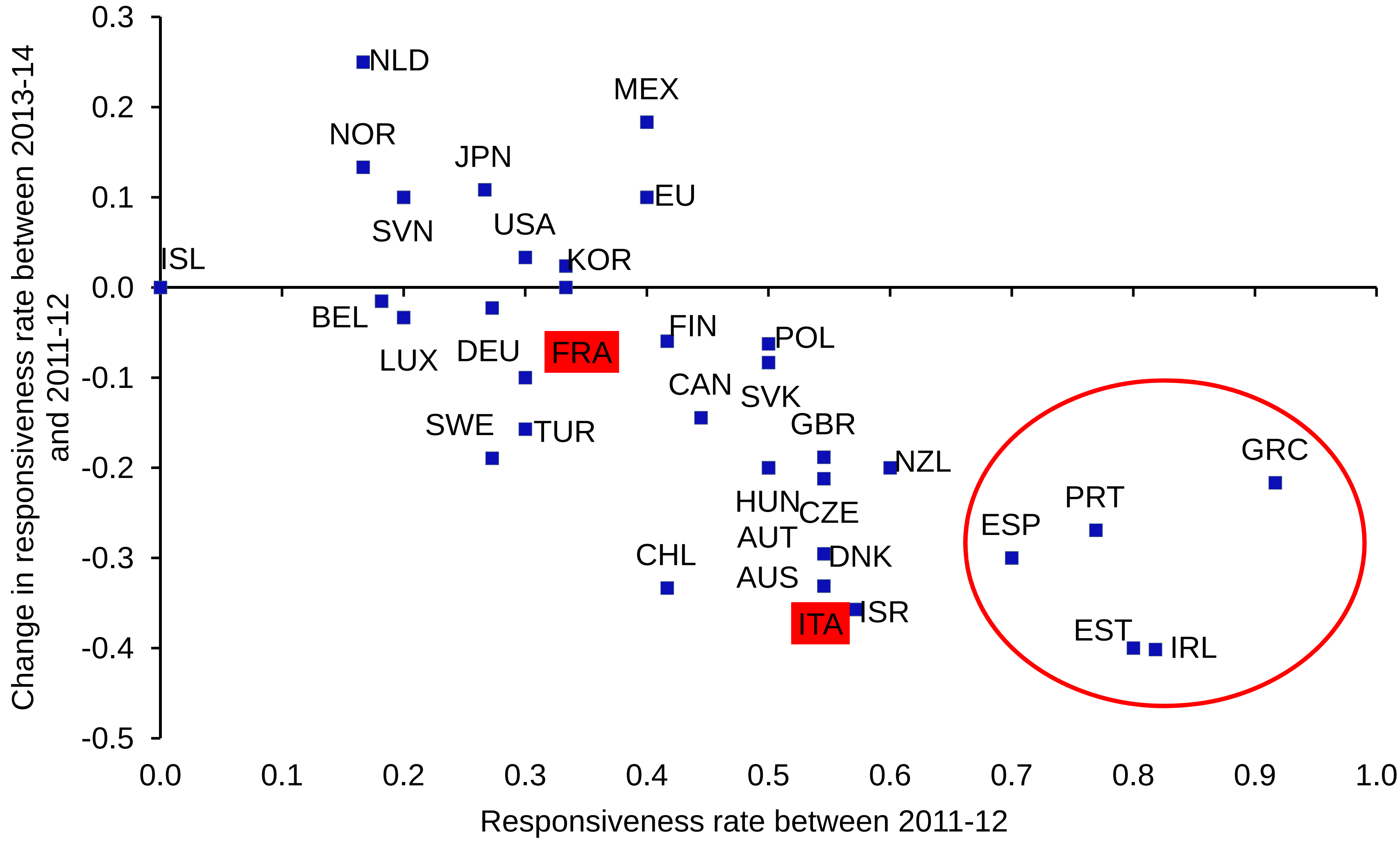
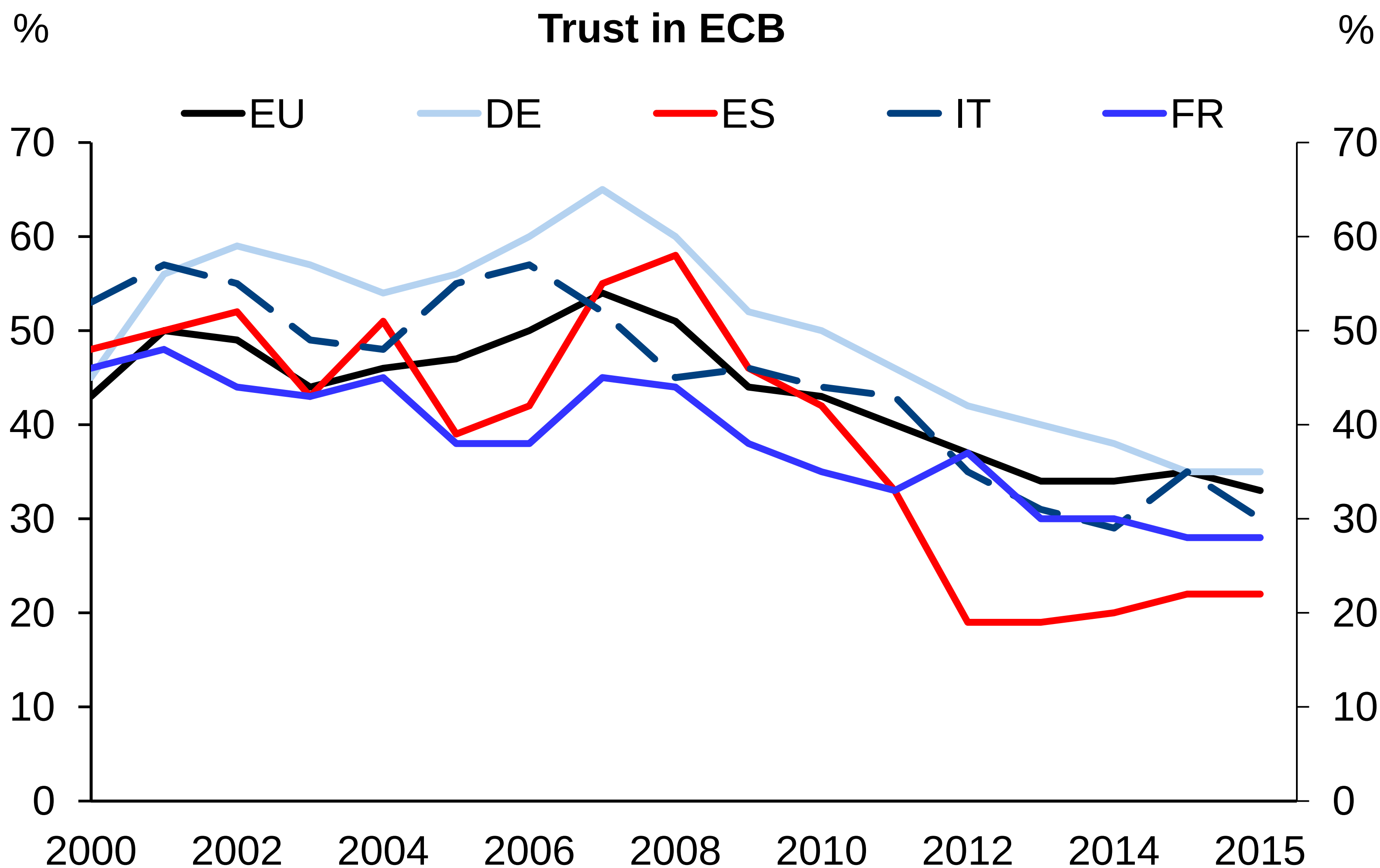
Reform momentum has slowed in several European countries in recent years



Source: OECD, DB Global Markets Research

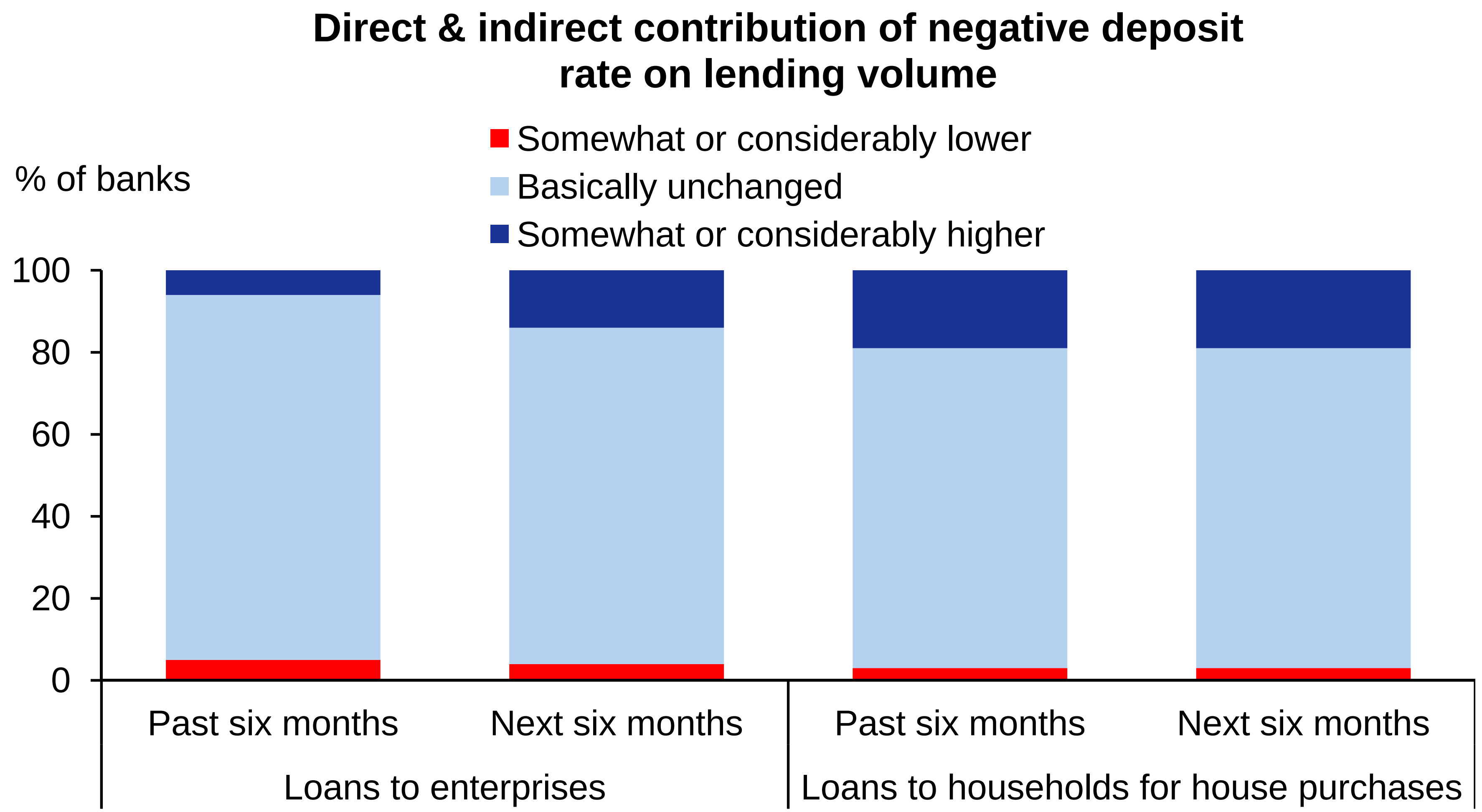
Trust in the ECB trending down



Source: Eurobarometer, DB Global Markets Research

Negative interest rates: Is it working?

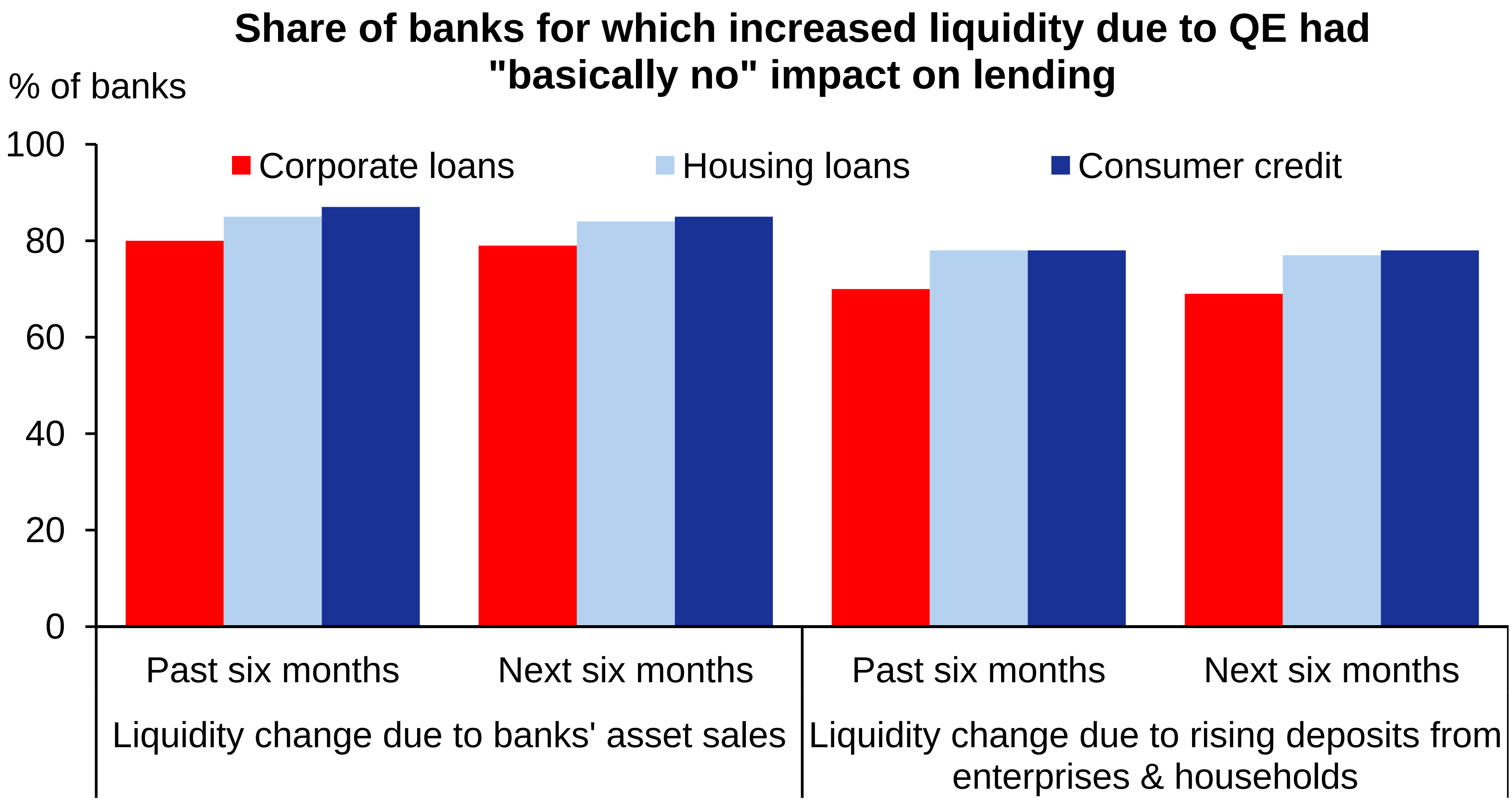
Vast majority of banks see no impact on lending of negative interest rates



Deutsche Bank estimates & analysis, ECB data. HH = mortgages only

Source: ECB Bank Lending Survey Apr 2016, DB Global Markets Research

Vast majority of banks see no impact of QE on lending

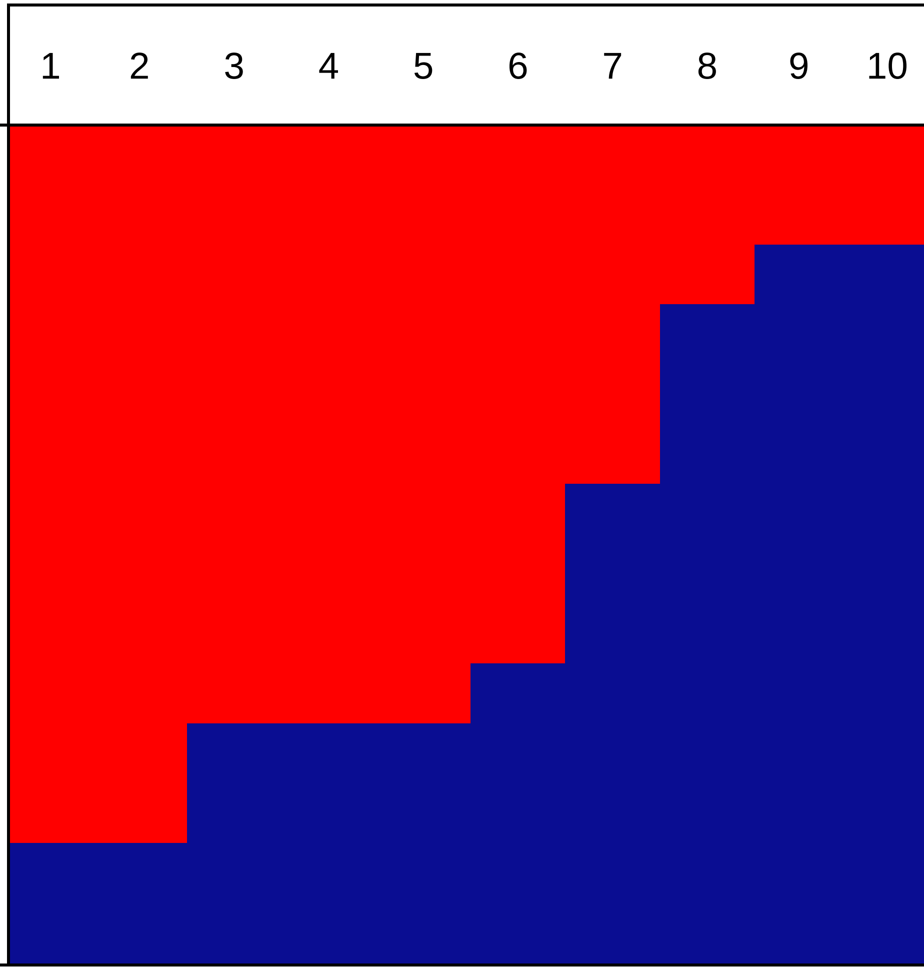


Deutsche Bank estimates & analysis, ECB data. HH = mortgages only

Source: ECB Bank Lending Survey Apr 2016, David Lock , DB Global Markets Research

US yield levels continue to look attractive for foreigners

Government bond yields



	% trading below 0% yield (May 2016)	Market value trading below 0% (US$bn)
Switzerland	75.6%	61
Japan	69.5%	4768
Germany	65.4%	772
Austria	57.7%	141
Belgium	43.8%	176
Netherlands	60.8%	240
France	50.3%	787
Sweden	44.4%	34
Finland	58.8%	61
Denmark	43.1%	46
Italy	19.1%	299
Spain	20.1%	162
Norway	0.0%	0
UK	0.0%	0

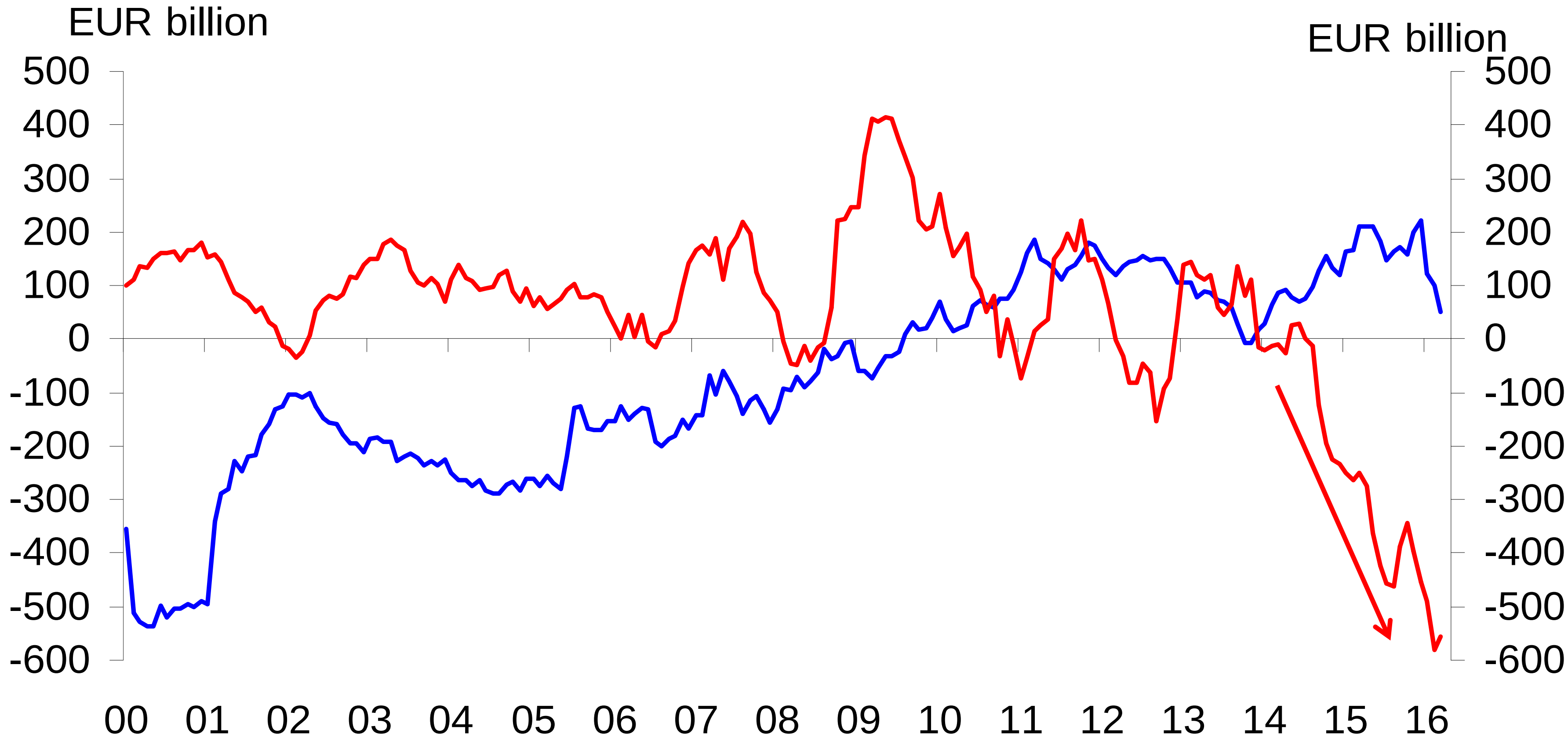
Negative yield
Positive yield

Source: Bloomberg Finance LP, DB Global Markets Research

Bond investors fleeing European negative interest rates at a record pace. This will continue to put downward pressure on US interest rates

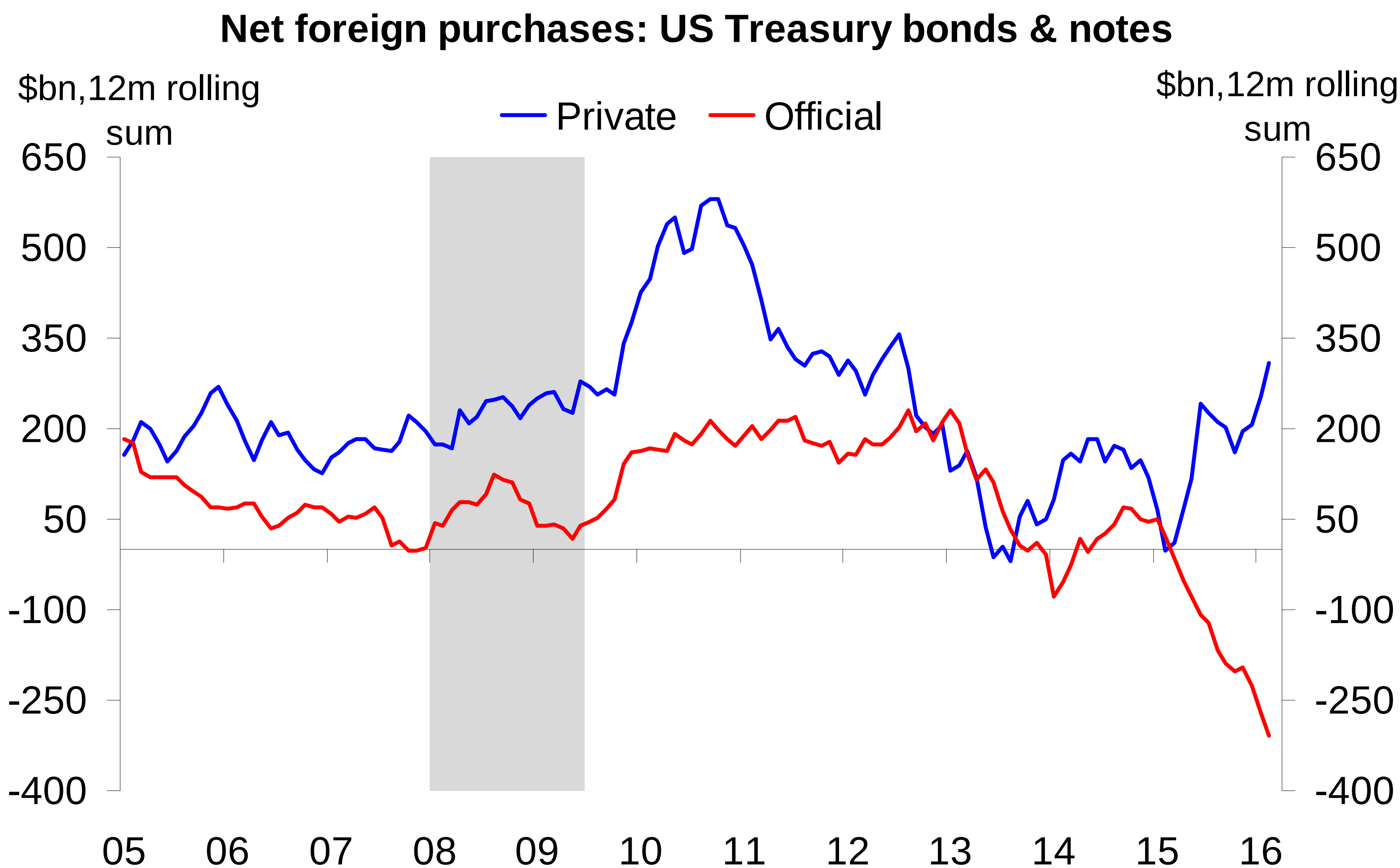
Euro area: BOP: financial account: Net portfolio investment
12 month rolling sum

Equities and investment funds shares — Fixed income



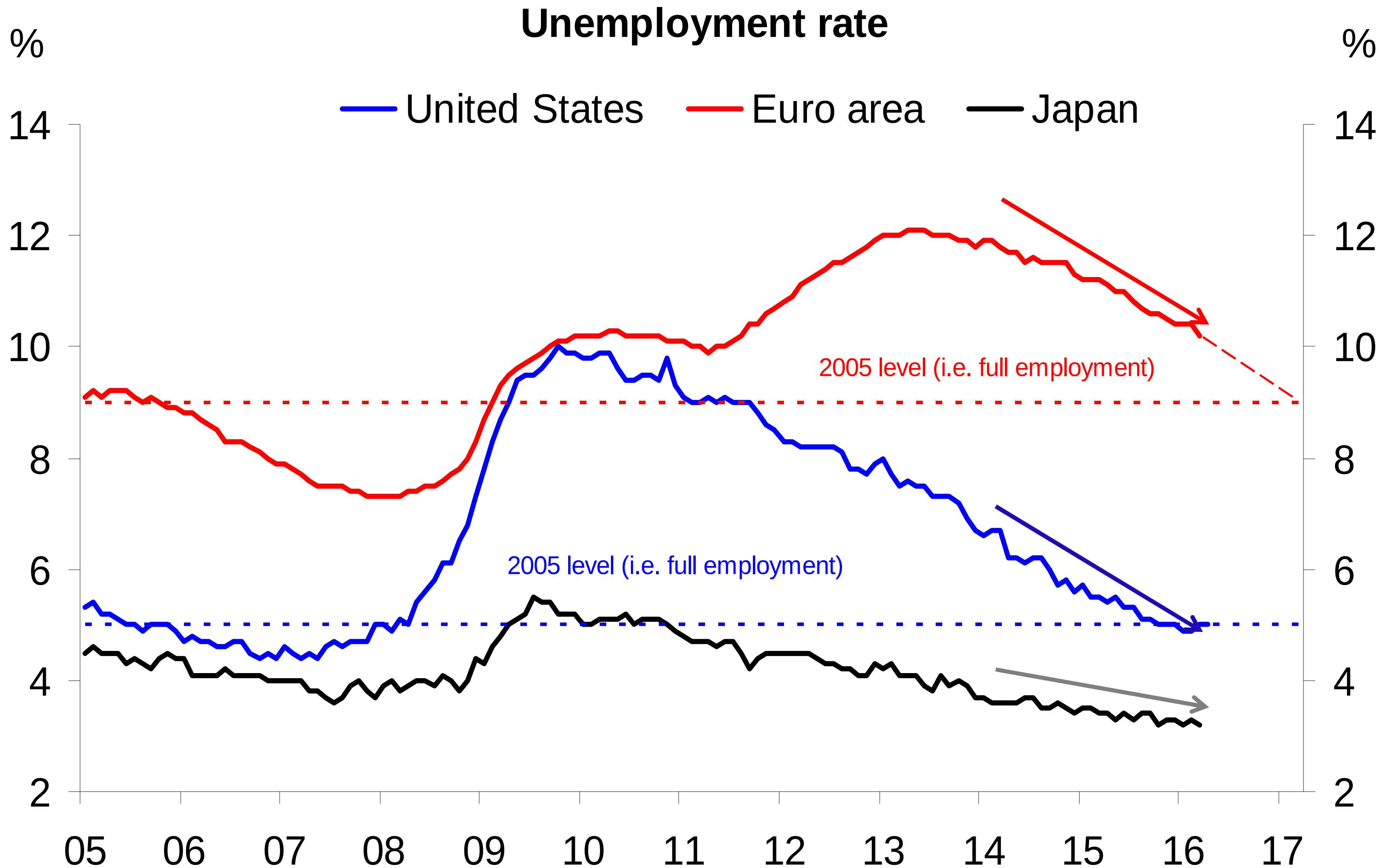
Source: ECB, Haver Analytics, DB Research

Foreign private sector big buyer of US Treasuries since March 2015



Source: Treasury, Haver Analytics, DB Global Markets Research

We are getting to full employment anyway in the euro area



Source: BLS, EUDATA, ECB SPF, Ministry of Internal Affairs and Communications, Japan, Haver Analytics, DB Global Markets Research

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- Torsten Slok joined Deutsche Bank Securities in the fall of 2005.
- Mr. Slok's Economics team has been top-ranked by Institutional Investor in fixed income and equities for the past five years. Slok currently serves as a member of the Economic Club of New York
- Prior to joining the firm, Mr. Slok worked at the OECD in Paris in the Money and Finance Division and the Structural Policy Analysis Division. Before joining the OECD he worked for four years at the IMF in the Division responsible for writing the World Economic Outlook and the Division responsible for China, Hong Kong, and Mongolia.
- Mr. Slok studied at University of Copenhagen and Princeton University. He has published numerous journal articles and reviews on economics and policy analysis, including in Journal of International Economics, Journal of International Money and Finance, and The Econometric Journal.

Appendix 1
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