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?

Most important problem faced by SMEs

- Finding customers: 25%
- Availability of skilled labor: 20%
- Competition: 15%
- Cost of production: 15%
- Regulation: 10%
- Access to finance: 10%

Solutions:
- Fiscal and structural policy
- Monetary policy

Source: ECB (Survey on Access to Finance, March 2016), DB Global Markets Research
Reform momentum has slowed in several European countries in recent years.
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

**Direct & indirect contribution of negative deposit rate on lending volume**

- Somewhat or considerably lower
- Basically unchanged
- Somewhat or considerably higher

Past six months
Next six months
Past six months
Next six months

Deutshe 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

Share of banks for which increased liquidity due to QE had "basically no" impact on lending

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

Source: ECB Bank Lending Survey Apr 2016, David Lock, DB Global Markets Research
Impact of negative interest rates on global financial markets
US yield levels continue to look attractive for foreigners

**Government bond yields**

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<th>% trading below 0% yield (May 2016)</th>
<th>Market value trading below 0% (US$bn)</th>
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<td>Switzerland</td>
<td>75.6%</td>
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<td>Japan</td>
<td>69.5%</td>
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<td>Germany</td>
<td>65.4%</td>
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<td>Austria</td>
<td>57.7%</td>
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<td>Belgium</td>
<td>43.8%</td>
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<td>Netherlands</td>
<td>60.8%</td>
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<td>France</td>
<td>50.3%</td>
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<td>Sweden</td>
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<td>Finland</td>
<td>58.8%</td>
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<td>Denmark</td>
<td>43.1%</td>
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<td>Italy</td>
<td>19.1%</td>
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<td>Spain</td>
<td>20.1%</td>
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<td>Norway</td>
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<td>UK</td>
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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

Source: ECB, Haver Analytics, DB Research
Foreign private sector big buyer of US Treasuries since March 2015

Net foreign purchases: US Treasury bonds & notes

Source: Treasury, Haver Analytics, DB Global Markets Research
We are getting to full employment anyway in the euro area

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<th>United States</th>
<th>Euro area</th>
<th>Japan</th>
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<td>2005 level (i.e. full employment)</td>
<td>6%</td>
<td>8%</td>
<td>6%</td>
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Source: BLS, EUDATA, ECB SPF, Ministry of Internal Affairs and Communications, Japan, Haver Analytics, DB Global Markets Research
Torsten Slok, Ph.D.

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- Deutsche Bank Securities, Inc.

- 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.
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