NEGATIVE INTEREST RATES- ARE THEY HEADED TO THE U.S.?

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Both Japan and Europe have been experimenting with negative interest rates since the 2008 recession. With their economies experiencing anemic growth and inflation at subdued or deflationary levels, central banks have turned to a negative interest rate policy. The goal is to reduce rates to a level below zero, enticing individuals and corporations to invest or borrow rather than hold low yielding investments and deposits. With this concept, forcing money back into the economy should increase inflation and growth.

In 2009, Switzerland central bank implemented a negative interest rate policy; Denmark followed in 2012, the European Union in 2014 and Japan in 2016. Though policy is one way to manipulate rates, yet another way that has been used in conjunction is through *negative rate term debt issuance.*

HOW DOES IT WORK?

Central banks generally charge negative interest rates on excess reserves held at the central banks. In practice, deposits that are held above the required levels are charged the negative interest rate, which is paid directly to the central bank. This is usually done through a tiered system where commercial banks pay for holding excess reserves with the central bank. The goal is to discourage commercial banks from maintaining large cash balances and, in turn, incentivize loans.

Each country has its own variation of a tier system. However, for the most part, negative interest will be charged on reserve amounts up to a threshold at which point any balances in excess of the threshold will be charged zero interest. The goal with these tiered systems is to mitigate effects on bank profitability as negative interests in effect become an expense to banks – thus impacting income.

To date, retail customers have been insulated from receiving negative interest rates on their bank balances. There seems to be a general consensus among banks and politicians that negative rates charge on retail deposits would be unfavorable. However, Denmark recently announced they will begin charging negative rates on balances in excess of deposit insurance limits.

THE BIG QUESTION FOR THE U.S.: *ARE WE HEADED FOR NEGATIVE RATES?*

The short answer is, not in the near term. The U.S. has experienced stronger growth than most industrialized economies. Fundamentally, the U.S. economy remains on strong footing with mild inflation, low unemployment and strong wage gains. The U.S. economy is not experiencing deflation, as is the case with Japan and Europe. Also, the U.S. is still the world's reserve currency, and by implementing a negative rate policy has the potential to severely damage this position. All this said, it is important to acknowledge the exogenous factors of negative interest rates from much of the industrialized world. Presumably, the longer other countries hold negative interest rates, the U.S. may be forced in this direction in order to maintain a competitive currency on the global stage. Furthermore, being in the late stages of on economic expansion with historically low interest rates doesn't leave the Fed with a lot of room to work with to combat a slowdown.

IS NEGATIVE INTEREST RATE POLICY WORKING?

What we know – countries that are deploying negative interest rates are seeing households saving at a higher rate and holding more cash instead of spending. The same holds true for business, which is using low-cost cash to buy back stock. Financial institutions are not loaning money as intended and are seeing compression on spreads. This highlights the peril of central bank policy makers. Interest rates are only one means available to stimulate an economy.

About D. James Lutter

D. James (Jim) Lutter is the Senior Vice President of Trading and Operations at PMA Financial Network and PMA Securities, where he oversees PMA Funding., a service of both companies that provides over 1,000 financial institutions with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities and Investment Advisor Representative with Prudent Man Advisors, Inc. Mr. Lutter has the following FINRA licenses with PMA Securities: Series 7, 24, 50, 53, 63, 65 and 99.

About Todd A. Terrazas

Todd joined PMA Financial Network in 2014 as a Financial Analyst for the firm's Credit Risk Management team. He now serves as Business Development & Product Manager for PMA Funding, where he is responsible for developing financial institution partner relationships and managing funding product solutions and association affiliations. Mr. Terrazas also engages in strategic planning and identifying market trends through extensive market research. Prior to joining the firm, he was a Market Research Analyst at Common Goal Systems, Inc. Mr. Terrazas earned his Bachelor of Arts in Finance from Calvin College.