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Financial Focus

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Negative Interest Rates

By Clinton Orr

For many reasons, we are in the mix of a historic moment. In the financial world there are several unique items, one of which is negative interest rates. The talk of negative rates has increased recently. The Bank of Canada has lowered its deposit rate to 0.25%, in the US the Federal Reserve has dropped its deposit rate to 0%, while in Europe the European Central Bank has a deposit rate of -0.5%. While rates have been falling, on multiple occasions, the President of the US has publicly said he wants to see negative rates in the US. Could Canada and the US get negative rates? What would happen if we did?

Monetary policy can get complicated, for our discussion it is important to understand that the deposit rate at the central bank influences the rates you and I see at the banks and credit unions. The central bank adjusts rates to stimulate or slow the economy. In bad economic conditions people and business tend to hold on to their cash and wait for things to improve. However, this behaviour can make things worse, a drop in spending can impact businesses leading to job losses, which can lead to even less spending. It can be a vicious cycle. To stop the cycle and to incentivize individuals and businesses to spend, the central bank will lower interest rates. In drastic times they might even lower rates into negative territory.

Negative rates are a recent monetary policy tool. In July 2009, Sweden's central bank became the first to use negative interest rates. The European Central Bank followed in June of 2014. Today a handful of European and Asian central banks have imposed negative rates.

In theory when negative interest rates are implemented people would be charged to leave their money in a savings account at the bank. As well, banks would lend money to borrowers who would not repay the full value of the loan. Essentially, banks would be paying folks to borrow money.

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An exception to what was mentioned above is Denmark. Jyske Bank, one of Denmark's largest banks, in the summer of 2019, introduced the first negative rate mortgage. It was a 10-year-fixed-rate mortgage at -0.5%. Time will tell if other banks follow their lead.

It is too early to say whether or not negative interest rates are an effective monetary policy tool. Interest rates impact many aspects of an economy. They impact our currency, they influence the prices of bonds, stocks, real estate and many other assets. Negative rates are new monetary policy tool, right now there simply is not enough data to determine their impact.
So, will Canada or the US have negative interest rates? We are in an unusual environment; I won't rule anything out. However, while it is possible, I do not believe it is probable. For now, the Bank of Canada and the Federal Reserve are using quantative easing and other policy measures to stimulate the economy. It is unlikely we will get negative rates.

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