Prior to 2007 - 2009 => belief in ZERO %

↳ lowering int rates ↓-- 0% => result

? about effectiveness of conventional monetary policy when economy is weak

INSTEAD of int rates ↓---0% => QUANTITATIVE EASING (QE)

⇓

Central bank commiting to large-scale, continuous buying of high quality domestic bonds (from banks)

⇓ effects

Bank reserves (banks' deposits at central bank)

+ sovereign yields

Desired outcomes: => should stimulate banks

=> should stimulate businesses + individuals

⇓

should stimulate

⇓

should stimulate

+ should drive asset prices

Reality: business borrowing ↗ BUT often used to fund

Results of QE are

Eventually, central banks opted for zero / negative int. rates

↓

did NOT trigger shift to physical cash

Reason: convenience yield / value of deposits explicit cost of holding deposits (- int. rates)

⇓

Negative int. rates may prove

Theoretical action chain => businesses/individuals encouraged to hold less deposits, seek higher returns on riskier assets, save less, borrow more, invest in profitable projects

=> STIMULATE GROWTH

For this to work => businesses, consumers, investors must feel they are adequately compensated for higher risk

Implementation of MONETARY POLICY at low int. rate levels is DIFFICULT

IMPLICATIONS of (-) int. rates for capital market expectations

if S-T int. rate is negative => baseline risk-free int. rate for long-term capital market expectations

?

instead of using observed negative rate

may substitute with → neutral (Taylor rule)

Expected interest rate path: long-run convergence to equilibrium level

Asset return expectations under (-) int. rates: similar to those typical of phases of business cycle.

Additional considerations when int. rates are (-):

Historical data

→ may not include periods with (-) int. rates

→ models may not work under conditions different to those for which they were calibrated

Other monetary policy measures may be occurring at the same time