Trump wants negative rates. Here's how that would work

By Jeanna Smialek
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The world has gone topsy-turvy. President Trump invited, and then disinvited, the Taliban to Camp David. Taylor Swift is in a long-term relationship, and Popeyes put its fried chicken on a bun. Now Mr. Trump wants the Federal Reserve to join everyone else in the upside down that is 2019.

The president said Fed officials should slash interest rates to zero or below in a tweet on Wednesday. In doing so, he urged the central bank to adopt a policy that its counterparts, including the European Central Bank and Bank of Japan, have used as an emergency measure to shore up weak economies.

Given that the Federal Reserve is presiding over a strong economy, it is unlikely to acquiesce. The Fed is expected to make a modest quarter-point cut at its meeting next week as it tries to guard against growing uncertainties, lowering its policy rate to a range of 1.75 to 2 percent. But it is also unclear whether the Fed could practically and successfully use negative rates to stimulate the economy.

What are negative rates?

Commercial banks usually earn interest on the extra reserves they keep at central banks, like the Fed or the European Central Bank. Negative policy interest rates force them to pay to keep money in those accounts, a penalty aimed at pushing them to lend more and goose the economy.

Several of the Fed's counterparts have introduced negative rates, including central banks in Denmark, Switzerland, Japan, Sweden and the eurozone to stabilize either growth or their currencies.

How do they affect consumers?

While central bank interest rate moves are usually passed along to investors and consumers, banks in economies like the eurozone — which first turned to negative rates back in 2014 — generally do not charge everyday savers who keep money in retail bank accounts. But consumers do earn less interest on their savings accounts, and there are rare instances in which they have to pay to keep very large deposits at banks.

On the flip side, consumers benefit from cheaper loans. In Denmark, where rates have been below zero for seven years, banks have introduced negative-rate mortgages. Practically, that means borrowers' outstanding balances are reduced by more than they pay in a given period.

If negative rates became a reality in the United States, consumers could face new charges. Jamie Dimon, chief executive of JPMorgan Chase, said this week that the bank had begun to discuss what fees it could introduce if interest rates fell to zero or below.

And investors definitely feel the aftershock. In the eurozone and Japan, about 70 percent of government bonds now have a negative yield, according to the data provider Tradeweb. Rates on the securities have tumbled this year amid concerns about global growth.

By the end of August, the amount of government and corporate bonds investors are paying to hold had reached a record of about $15 trillion, according to Deutsche Bank.

How are they working out abroad?

The policies have a mixed report card. Critics' fears that they would touch off widespread cash hoarding did not materialize in Europe.

At the same time, it is hard to tell how well they are working, partly because it is impossible to know how the economies that have employed them would have fared in their absence. Recent E.C.B. research has found that negative rates have spurred greater lending; other papers find that they result in fewer loans. Research has suggested that Japan's negative rate policies may have backfired, actually lowering inflation expectations instead of firming them, as hoped.

Are they coming to America?

The United States has always faced unique challenges in adopting negative rates. For one thing, it is not yet clear that the Fed has the legal authority to charge banks interest on their excess reserves — then-Chair Janet L. Yellen said in 2016 that the issue required further research. If lawyers determine that negative rates are allowable, they might still be politically contentious. The Fed cut rates to near zero during the Great Recession, but it has never breached that dividing line.

They also could be practically difficult to enact, said Julia Coronado, founder of MacroPolicy Perspectives in New York. Money market mutual funds are more important to day-to-day market functioning in the United States than in Europe and Japan. The funds' business models would suffer in a negative-rate environment, so a move to negative rates could be destabilizing — hardly the goal of a policy that is meant to soothe markets and the economy.

Another former Fed chair, Ben S. Bernanke, pointed out in a 2016 blog post that some of the concerns around money market funds had been alleviated by recent policy changes, though they had not been eliminated. He concluded that such costs now "ought to be manageable," but that "the potential benefits of negative rates are limited." He added that it would "probably be worthwhile for the Fed to conduct further analysis of this option."

Why are we still talking about them?

For all of their challenges, negative rates are likely to remain in the headlines in America and abroad. That is because central bankers are likely to get stuck at zero interest rates often in the future — Fed economists' best guess is that it could happen as much as a third of the time in the United States.

That is happening because long-running trends, including demographics and savings behavior, have depressed the level of interest rates that central banks can maintain without curbing growth. And it matters because it leaves policymakers with less room to stimulate the economy via their most effective monetary policy tool.

The Fed is still in a better position than many central banks: it can lower borrowing costs, buy securities to stoke growth, and pledge lower-for-longer interest rate policy come the next downturn.

But negative rate policies also have some fans domestically, outside of Mr. Trump. Federal Reserve Bank of San Francisco research this year argued that negative rates could have made the last recession less painful, helping the economy to return to full strength earlier.

Why does Mr. Trump care?

Mr. Trump has been attuned to negative rate policies abroad as the European Central Bank looks poised to slash a key rate further below zero. Mere anticipation of that move has caused the dollar to strengthen against the euro, making American exports less competitive.

"The Euro is dropping against the Dollar 'like crazy,' giving them a big export and manufacturing advantage...and the Fed does NOTHING!" Mr. Trump tweeted on Aug. 30.

Germany is Europe's largest economy, and it looks to be on the brink of sinking into recession. The United States, on the other hand, has maintained solid output gains and strong consumer spending.

That said, there are risks on the horizon in America that are prompting the Fed to lower rates — albeit much more slowly than the White House is urging. Those include a global manufacturing slowdown and Mr. Trump's trade wars, which are rattling business and consumer sentiment.