Department of Economics
University of Toronto
Summer 2017

ECO 209
Macroeconomic Theory and Policy

Case Study No. 8

Case Study No. 8 on ***Negative Interest Rates*** will be discussed in class on August 8. The required short-readings have been posted on the course website. Read these articles and come to class ready for the discussion. The following questions will help you in your preparation:

1) The ECB reduced the interest it pays to banks on their reserves to negative levels, i.e., it now charges the banks for keeping deposits at the ECB. What was the reason for implementing such a policy?
2) Denmark, Switzerland and Sweden also reduced their policy rates to negative values. What was their main reason for doing so? And Japan? What was Japan's main reason for reducing the policy rate below zero?
3) What was the impact of negative policy rates cum quantitative easing on sovereign bonds? What was the banks' reaction to these policies?
4) If negative interest rates were to be charged to retail customers' deposits, what would be their likely reaction?
5) Some economists propose the elimination of cash altogether. What would be the purpose of such a policy? What would be the likely behavioural reaction of the public?
6) Would turning interest rates even more negative help persuade banks to lend more money to their customers? Would it make corporations increase their expenditures on productive investment? Would it make households increase their consumption expenditure and reduce their savings?
7) At one point, Stephen Poloz indicated that the Bank of Canada would be open to reducing the target for the overnight rate to negative values and implementing quantitative easing policies if needed. What do you think might have prompted him to make such an announcement regarding monetary policy?
8) The federal government and the Bank of Canada are about to renew their five-year agreement on the inflation target. How might the Bank of Canada's consideration of a possible negative overnight rate affect their choice of the optimum inflation target?
9) If the main impact of further reducing the rate of interest is the depreciation of the domestic currency, what do you think it will happen if all countries implement similar expansionary monetary policies at the same time?
10) If the implementation of conventional and unconventional expansionary monetary policies proves unsuccessful, what should governments do to avoid deflation and have their economies growing again? Is there still a role for the central banks to play?