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### **The negative interest rate policy in the euro area and the supply of bank loans**

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From the summer of 2014 onwards, the Governing Council of the European Central Bank (ECB) embarked on a series of measures intended to further ease its monetary policy stance in the face of falling inflation. These measures include the lowering into negative territory of the deposit facility rate, the key policy interest rate which has served as a reference rate for euro area markets these last years.

Synonymous with navigating in uncharted waters (as the ECB was the first large-economy central bank to take the plunge), the ECB's "negative interest rate policy" has been constantly targeted by questions and criticism from observers. Some argue, for instance, that the negative interest rate may have an unfavourable impact on banks' profitability and, consequently, curb loan dynamics. This article endeavours to look more deeply into this argument in the euro area's case and reaches the following conclusions:

***The negative interest rate policy is of a very specific nature from the banks' point of view because it is associated with downward rigidity in interest rates on retail deposits.***

Following the cut below zero of the deposit facility rate, interest rates paid on retail customers' deposits have resisted to come down any further after a certain moment. That proves the existence of a "physical lower bound for nominal rates" near 0 %.

***As the downward rigidity of banks' borrowing costs related to the negative interest rate can weigh on their profitability, this could lead to restrictive effects on loan dynamics. The emergence of such effects nevertheless depends on how long the negative interest rate policy lasts and on the composition of banks' balance sheets.***

The downward rigidity of banks' borrowing costs may exert downward pressure on their net interest margin and eventually constrain their capacity to lend more to the real economy. The interest-rate bound at which banks will start slowing their lending is the "effective lower bound for nominal rates". The longer the period of negative rates, the greater the likelihood of restrictive effects on loan dynamics emerging.

But banks can also benefit from capital gains and the improvement in macroeconomic conditions associated with monetary policy easing. Thus, the ultimate effect of the negative interest rate on banks' profitability and on bank lending will depend on the composition of banks' balance sheets. Empirical analyses of data from individual euro area banks show that a large proportion of retail deposits in relation to the balance sheet total accentuates the possible restrictive effects of the negative interest rate policy, while holding a larger proportion of tradable securities could mitigate them.

***The negative interest rate policy in the euro area is by no means an isolated measure: the other monetary policy measures taken by the Eurosysteem since the summer of 2014 may have also helped to support loan dynamics.***

Trying to discern the specific contribution of negative interest rates to the observed trend in bank lending dynamics and bank lending rates is no easy task, given that the ECB has at the same time implemented other measures too, such as forward guidance, the asset purchase programmes and targeted longer-term refinancing operations. The complementarities and interactions between these measures and the negative interest rate policy can offset the potentially unfavourable impact of the latter policy on lending dynamics. In view of the positive development of loan dynamics, the low level of bank lending rates and the continued easing of lending standards, it appears that the combination of measures in the euro area has ensured a smooth transmission of the monetary easing through the banks.