Imagine That!

Back in the 1950's and early 60's, when I was growing up, parents would take their kids down to the local bank and help them set up a passbook savings account. You'd have this little passbook and they'd update it whenever you presented it to a teller. The deposits and interest were always small, but they hit the plus column in the passbook. Today, at some banks around the world, that interest is now recorded in the negative column.

Hold On

Let me see if I understand this correctly: You go to the Swedish National Bank, make your deposit, and they reduce the amount of your deposit (according to FactSet on 4/29/16) by 1.25% per year. I'd like to be the mouse in the corner in Sweden listening to some parent trying to explain to a child why they should trade the coins in their piggy bank for a diminishing amount in a bank deposit. Even a financially inexperienced child wouldn't like that proposition.

How did we get here?

It's a little hard to condense global monetary policy to a sentence or five, but let's see how we do. In a desire to meet society's needs, governments borrow money. In ideal situations the economy grows, so that the burden of government debt does not overwhelm the economy. The banking authority influences growth by raising rates when the economy grows too fast and too much inflation gets created. It lowers rates when the economic growth slows, to promote more growth. The wildcard is when government takes on too much debt, overspends and/or when too much regulation stifles the needed economic growth, regardless what interest rate changes are made.

Oversimplified

There is a lot more to it than that, as you might imagine. Still, negative interest rates can be considered an extreme measure by a country's banking authority when an economy and the taxes it raises are not growing fast enough to support the cumulative effect of years of government spending and policies. The hope by the central bank is to make money easier to use in the economy by charging less, even negative interest. They hope more people will borrow and use money for economic gain, spurring growth. They are also hoping to stave off a reduction in the economy, a recession.

Robbing Peter to Pay Paul

You would think that growth means more jobs and more prosperity right? Yes, for those who are working and borrowing money there are benefits. But, what about the people saving for retirement, pension funds and retirees living off the interest from their savings? Last month we described the very harsh impact that low interest rates have on savers and retirees. Negative interest rates make that picture even less attractive.

Physical Currency Issue

Let's be clear, the Federal Reserve is making noises that it may wish to raise interest rates when it meets this month, so we are not facing a potential for negative rates today. But, if you were in a country where you would be guaranteed to get less money out of a bank than you put in, what would you do? You might pull all of your money out into hard currency and not ever deposit any in the first place. Some countries are actually discussing how to do away with their physical currency, as a result of their negative interest rates.

Merchant Madness

This is much harder to grasp. With positive interest rates, people want to pay on delayed terms and merchants put penalties on late payments. When interest rates are negative, merchants will actually want to charge more if you pay up front, because they will end up with less money in the bank than if you make payments over time. This mind puzzle is counterintuitive and if you need to talk this through, just give me a call. It also tends to turn the world upside down.

Bottom Line

Everything I'm seeing says that negative interest rates do not seem to a concern in the near-term here in the US. One reason our Federal Reserve is raising rates is so that, if they encounter a downturn in our economy in the future, they will have some room to lower rates. Room so that the use of negative interest rates might not be needed. For those of us who lived through the eighties and the very high interest rates of those days, it's hard to fathom today's rates. Still, it seemed important to mention the possible impact of negative rates to readers. If it happens in other countries, it could certainly happen here too. It is a condition to think through before it happens.

Your Feedback

I would love feedback on this newsletter. Future issues may include a host of good ideas, insights, specific steps to take financially, life insights and of course "Wit and Wisdom". Most importantly, I'd like it to be of value to you and to encourage an exchange of great ideas and insights. Please send your feedback to:

Colin S. Mackenzie, CFP®
Cetera Advisor Networks LLC, Member FINRA/SIPC
301 E. Colorado Blvd, #400
Pasadena, CA 91101
mackenziec@ceteranetworks.com
www.cmackenzie123.com
(626) 795-8896