# Can money alone buy growth?

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We have been facing this question for long.

Now with Bank of Japan (BoJ)'s latest monetary policy action, we now confront the same question again.

A week ago, on January 29, BoJ decided to introduce a negative rate of interest of minus 0.1 percent on excess reserves of commercial banks kept with the central bank.

A negative interest rate is a penalty: it is indeed a fine.

It is now eight years since the Great Recession struck the world. Unusual steps such as buying bad debts of banks in distress under the name of quantitative easing (QE) were initiated by the US Federal Reserve (the Fed). Besides QE which added US$ 4 trillion to money supply, the Fed kept the interest rate as low at zero to 0.25%. That helped the American economy out of recession, though painfully: a jobless recovery in the first five years.

**"All is fair in love and war"**

The objective was to make borrowing cost as low as possible for encouraging private investment. Since savers would realize that their moneys in the banks will bring less income by way of interest, savings will cease to be attractive. Consumers will then step up consumption which is a major component of aggregate demand for speeding the recovery.

The US Fed finally ended the seven year cheap money policy in mid December 2015 by raising the interest rate range to 0.25-0.50 percent, as the rate of unemployment fell below the targeted rate of 5 percent.

As the Fed's QEs brought signs of recovery, they came to be adopted by major central banks of the world, including, Bank of England (BoE), European Central Bank and BoJ. The once shunned "unholy acts" of buying bad debts by central banks were now acceptable.

That was the only way of keeping the failing banks alive to help recovery.

**Negative interest rate**

Japan has been in recession for nearly two decades. The BOJ's inflation goal is 2 percent.

BoJ is unable to reach the elusive goal. The December core inflation rate was just 0.1.

The BoJ Governor Haruhiko, when announcing the new policy: *Quantitative and Qualitative Monetary Easing (QQME) with a Negative interest rate* referred to weakening global growth and falling price level. He wanted "eradication of people's deflationary mindset". Besides continuing government bond purchases for adding to money supply and keeping the low rate of 0.10 percent, under the new *QQME with negative interest rate* policy, a negative rate of interest of minus 0.1 percent would be applied to excess funds kept by banks with BoJ.

Commercial banks if they do not lend or do not find borrowers, park their excess liquidity with central bank. The negative interest rate is expected to act as a disincentive.

The negative 0.1% will be only on any new excess reserves beginning on February 16. The three tier scheme will operative this way: all existing balances kept by banks will earn 0.1 percent. A rate of zero percent will be applied to reserves which are required to be kept with BoJ; and a rate of minus 0.1 interest rate will be applied to any reserves not included in the first two tiers.

BoJ calls it a Policy Rate Balance.

**How will it act?**

It will act gradually. Banks have to pay the fine on excess balances after February 16. In the initial months they will be small. Then after a few months, banks will feel the pinch and will have to meet costs. It will eventually erode profits. So banks will have to look for ways of earnings, including new lending. Fresh lending for investments will speed up recovery and growth.

On the consumption side, banks will pass on the losses due to the fine to savers by way of lower deposit rates. There will be less interest income on savings. It will act as a disincentive to save. Savers turn to consumption. That will add to rise in consumption, the largest component of aggregated demand.

That is the line of thinking.

It is not new.

Already ECB has a negative interest rate on the excess balances kept by banks. Has it worked in Eurozone?

Yet to be seen!

However, no harm trying!

It is worth recalling the memorable words contained in the July 2014 lecture by Reserve Bank of Australia, Governor Glenn Stevens at the Anika Foundation Luncheon.

“The answer is simply subdued ‘animal spirits’ – low levels of confidence. If people think, for whatever reason, that returns for future possible investments will be low, or subject to high risk, then they will be reluctant to invest even if past and current returns are quite satisfactory. Conceivably, this could be a self-reinforcing equilibrium.”