Negative Interest Rate Policy

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- Under a negative rate policy, financial institutions are required to pay interest for parking excess reserves with the central bank. That way, central banks penalize financial institutions for holding on to cash in hope of prompting them to boost lending. Hence, Banks may charge its depositors if they are depositing the money in the bank.
- The Bank of Japan (BOJ) adopted negative rates in January 2016, mostly to fend off an unwelcome yen spike from hurting an export-reliant economy. It charges 0.1% interest on a portion of excess reserves financial institutions park with the BOJ.

PROS

- lowering of borrowing costs
- They help weaken a country’s currency rate by making it a less attractive investment than that of other currencies.
- A weaker currency gives a country’s export a competitive advantage and boosts inflation by pushing up import costs.

CONS

- Negative rates put downward pressure on the entire yield curve and narrow the margin financial institutions earn from lending.
- If prolonged ultra-low rates hurt the health of financial institutions too much, they could hold off on lending and damage the economy.
- Depositors can avoid being charged negative rates on their bank deposits by choosing to hold physical cash instead.