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INTRODUCTION

Special issue: Implications of ultra-low and negative interest rates

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For a number of years, the central banks of the major advanced economies have implemented quantitative easing (QE) policies and have also pursued unprecedented ultra-low interest rate policies to resolve crises and to support growth. To commit to additional policy easing, many central banks, namely, the European Central Bank, the Swiss National Bank, Sveriges Riksbank, Danmarks Nationalbank, the Bank of Japan and the Hungarian Central Bank, have further implemented a negative interest rate policy (NIRP). It is a negative rate on commercial banks' excess funds held on deposit at the central bank, effectively taxing banks for hoarding cash.

The efficacy of NIRP in lifting growth and inflation remains unknown. However, concerns over a range of possible financial stability risks and unintended consequences of NIRP have been voiced, including financial market distortions, asset price bubbles, deterioration of banks' balance sheets, weakening of banks' willingness to lend, and delayed implementation of necessary macroeconomic and structural policies (Arteta, Kose, Stocker, & Taskin, 2016; Carney, 2016; White, 2014). Like other unconventional monetary policy measures, NIRP could also have spillover effects on the financial markets of emerging market and developing economies through, say, "yield chasing" behaviour. It has long been argued that asset prices in Asian financial markets are affected by monetary policies of advanced economies more than their own policies and fundamentals. Consequently, Asia may be affected disproportionately by volatile swings in currencies, international capital flows, and increasing external debt levels triggered by NIRP deployed by advanced economies.

The theme of the 19th Asian Development Bank Institute (ADBI) Annual Conference, which was held on 1–2 December 2016 in Tokyo, Japan, was the implications of ultra-low and negative interest rates for Asia. The annual conference is part of ADBI's continuous efforts in providing intellectual input and conducting high-level research on issues with strategic implications

for development policy debates and sharing effective development practices and country experiences.

The 2016 annual conference brought together high-level speakers, top policy-makers and renowned researchers to discuss and examine from various perspectives:

1. The implication of an extremely low or negative-yield environment for risk-taking behaviours in Asia and the possibility of financial market dislocations.
2. The side effects of ultra-low or negative interest rates on, for example, financial markets and real economies, banking behaviour, international reserve holdings and the current account balance of Asian economies.
3. The challenge of implementing monetary policies, exchange rate policies and macroprudential policies.

This special issue contains selected papers of the conference. In this introduction, we briefly summarize these papers and put them in perspective.

1 | NEGATIVE INTEREST RATES

The first paper on “Implications of Negative Interest Rate Policies: An Early Assessment” by Carlos Arteta, M. Ayhan Kose, Marc Stocker, Temel Taskin and Naotaka Sugawara provides an overview and framework for analysing short-term domestic and global implications of NIRP. The paper addresses three important questions regarding implications of NIRP, which are:

1. How do transmission channels of monetary policy operate under NIRP?
2. How have key financial variables evolved since the introduction of NIRP?
3. How could NIRP affect financial stability?

Using an event analysis approach to evaluate the experiences of five major countries, the paper finds that NIRP could have a downward effect on money market rates and short-term and long-term bond yields, no effect on inflation expectations, and no conclusive evidence of effect on exchange rate, equity index, change in leverage, asset price valuation and bank profitability. The paper argues that NIRP could provide additional monetary policy stimulus (especially for the euro area), as long as policy interest rates are only modestly negative and do not stay negative for too long, to avoid adverse effects on the financial sector. For global implications, an NIRP announcement associates with currency appreciation, bond spread decline and equity price increase in emerging markets and developing economies.

Allaudeen Hameed and Andrew K. Rose in their article “Exchange Rate Behaviour with Negative Interest Rates: Some Early Negative Observations” tackle the question of “What are the consequences of negative nominal interest rates for exchange rate behaviour?” They examined daily panel data of 61 currencies, on both effective exchange rate and bilateral exchange rates against the Swiss franc, from 2010 to 2016. Specifically, exchange rate volatility, exchange rate changes, deviation from uncovered interest parity and profits from carry trade are analysed. The general result is that there is no strong evidence of NIRP effects on foreign exchange rate behaviour, including on return patterns and volatility, forward premiums and carry trade activities. The authors also suggest that the consequences of NIRP for the financial sector are largely unknown, and may be larger in the long run than in the short run.

2 | SWITZERLAND AND JAPAN

The pressure on the Swiss franc to appreciate led the Swiss National Bank to cut interest rates after abandoning its Swiss franc ceiling in January 2015. The goal was to discourage capital inflows and counter the monetary tightening from the strong franc. Switzerland has traditionally maintained lower interest rates than the rest of Europe, partly because of lower inflation and partly to fend off excessive capital movements. As a result, Switzerland has experienced the largest negative interest rates in absolute value. Jean-Pierre Danthine analyses Swiss NIRP in the paper “Negative Interest Rates in Switzerland: What Have We Learned?”

Jean-Pierre notes that Switzerland adopts an NIRP to fend off excessive capital inflows and currency appreciation pressure. It aims to offer a loose monetary condition, through the exchange rate channel, to the economy, rather than to provide a classical monetary stimulus of guiding saving and investment decisions at zero bound. Jean-Pierre also points out that the Swiss NIRP design could accommodate further negative rates. However, the NIRP has been unpopular with the public. Since the introduction of the NIRP, there have been large exemptions offered to commercial banks, where the average negative rate imposed on the deposits of commercial banks at SNB is much lower than the marginal rate. Deeper rate cuts could be technically feasible by increasing the exemption threshold so that the burden on the banking system remains approximately unchanged; however, it may be subject to resistance by the general public. Hence, it is crucial for the central bank to convince the public of the logic and necessity of the NIRP.

In Asia, the Bank of Japan’s NIRP is to provide additional stimulus to its economy and to fight deflation. Mark M. Spiegel and Andrew A. Tai employ the global factor-augmented vector autoregression (FAVAR) approach in their paper “International Transmission of Japanese Monetary Shocks Under Low and Negative Interest Rates: A Global Factor-augmented Vector Autoregression Approach” to examine implications of the Japanese low and negative interest rates during 1998–2015 for its own economy and three of its major trading partners: Korea, China and the United States. The 2-year government bond yields are used as a proxy of Japan’s policy interest rates. The authors find that positive monetary policy shocks under low interest rates and NIRP significantly and negatively affect the Japanese economy and inflation as predicted by standard transmission channels. However, positive shocks to the Japanese 2-year government bond yields do not influence the global economy as much as a shock to US interest rates (a result in line with some previous studies). That is, Japan’s efforts to stimulate its economy through easy monetary policy tend to have small or insignificant spillover effects on its trading partners.

In “Impacts of Japan’s Negative Interest Rate Policy on Asian Financial Markets”, Shinichi Fukuda explores spillover effects of Japan’s NIRP on financial markets in selected Asian economies; namely, Korea, Singapore, Taipei China and Thailand. The author compares the effects of Japan’s quantitative and qualitative monetary easing (QQE) with and without negative policy rates, and uses generalized autoregressive conditional heteroskedasticity models to capture financial spillover effects on the daily stock price data of these economies. It is found that QQE implemented with NIRP has limited impacts on the yen/dollar exchange rate and stock prices in Japan. However, it has substantial impacts on long-term interest rates and serious concern has been raised about the effects on the profitability of local financial institutions. The author also finds that in an NIRP period, a fall in Japan’s long-term interest rates significantly increases the Asian stock prices, except in Korea, and might have benefited emerging Asian economies. The positive impact can be attributed to the Japanese banks’ yield chasing behaviour that leads capital flows to these markets. One implication is that further QQE will benefit Asian financial markets.

3 | UNCONVENTIONAL MONETARY POLICY

Tamim Bayoumi and Joseph E. Gagnon re-assess the 1997–1998 Asian financial crisis experiences, and assert that some actions of central banks during the crisis are forms of unconventional monetary policy in the category of QE. In their paper “Unconventional Monetary Policy in the Asian Financial Crisis”, the authors use the cases of bank recapitalizations of the Bank of Thailand and the Bank of Indonesia (buying risky assets that the private sector did not want, to increase their value), and massive purchase of equities by the Hong Kong Monetary Authority to illustrate and substantiate their arguments. It is argued that the actions taken by these governments during the Asian financial crisis may have been more effective than the recent QE adopted by advanced economies. Using a theoretical model, the authors analyse how asset purchases by central banks affect the macroeconomy. The model assumes imperfect substitutability of assets, which allows the real economic effects from purchases of assets by the central bank. The results suggest that buying equities is a more effective way of supporting the economy than buying bonds. This is partly because it allows private investors to sell risky equities and buy safe assets (i.e. bonds and money). In contrast, buying bonds would induce investors’ diversification into risky equities as well as safe money. However, lack of financial reform and excessive central bank purchases can go wrong, as seen in case of Indonesia, where QE actions led to inflation rather than economic growth.

In the paper “Divergent Monetary Policies and International Dollar Credit: Evidence from Bank-level Data”, Dong He, Eric Wong, Kelvin Ho and Andrew Tsang examine the impact of divergent monetary policies (normalizing by the US Fed and continued easing by the ECB and the BOJ) on availability of international US dollar loans by global banks. The empirical exercise is motivated by a partial equilibrium model, and is based on a confidential bank-level data set of US dollar loans of foreign bank branches in Hong Kong compiled by the Hong Kong Monetary Authority and using relevant banking data from the BIS. These authors find that continued asset purchases by the ECB and the BOJ are expected to cushion the negative impact of US monetary policy normalization on the supply of international dollar credit. The net effect depends on the stability of global foreign exchange markets and investors’ perceptions of the default risks of global banks.

The monetary policy spillovers from advanced economies to financial markets in Asia is examined in “Bond Yield Spillovers from Major Advanced Economies to Emerging Asia” by Ansgar Belke, Irina Dubova and Ulrich Volz. Specifically, these authors use the vector autoregression framework to evaluate the effects of US, eurozone and Japanese long-term interest rates on nine selected Asian economies during 2003–2016. It is found that these Asian sovereign bond yields significantly responded to, albeit with different magnitudes, the US and eurozone bond yields. Compared with the USA and the eurozone, the Japanese interest rate effects are weaker. The authors also argue that a “decoupling” of these Asian financial markets from the United States or Europe does not exist. One policy implication is that these Asian economies should continue to prepare their economies for monetary policy spillovers from advanced economies and deploy macro-prudential policies if needed to safeguard financial stability.

The papers in this special issue cover a wide array of academic and policy issues. We hope they will prompt further studies and analyses on these issues.

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