First Trust
Monday Morning OUTLOOK
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Those Crazy Negative Interest Rates

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More than five years ago the European Central Bank adopted negative interest rates as a policy tool to address economic weakness in the Eurozone. Starting at -0.1%, eventually the target short-term rate fell to -0.4%.

In Europe, as in every country or region that has tried Quantitative Easing, banks have not increased loans by the amount that QE suggested. As a result, central banks (like the ECB) have attempted to force banks to lend by "charging" banks (with negative rates) to hold these excess reserves. Negative interest rates are "man-made"," not something that has happened organically. More importantly, they prove QE didn't work. If QE worked, then negative interest rates wouldn't be necessary.

Now policymakers are nearly in a panic because some key Eurozone economies are sputtering. Germany's industrial production was down 5.2% in June versus a year ago, the largest drop since 2009. Meanwhile, many now expect that German real GDP contracted in Q2. Italy's economy hasn't grown in the past year and France's economy is up only 1.3% from a year ago. Some economies in Europe are doing well, particularly Poland and Hungary, but these aren't large enough by themselves to power the whole Eurozone higher.

It's time for Europe to recognize that neither negative interest rates nor quantitative easing have saved their economies. By using negative rates, the ECB has been trying to punish banks into lending, and it hasn't worked. Worse, negative rates are, in effect, a tax on the financial system. As a result, they undermine bank profitability and weaken the financial system.

Instead of looking toward monetary policymakers to rescue their economies, they needed to point their fingers at the real culprits all along, bad fiscal and regulatory policies. Germany, for example, is still running budget surpluses even though investors buying their debt are willing to accept negative rates. This is absurd.

This isn't to say the German government should spend more, spending is already too high. But Germany has room for deep tax cuts oriented toward boosting incentives for investment and economic growth. Increasing the incentive to produce would, in turn, generate the growth in lending that negative interest rates were supposed to encourage.

On top of tax cuts, we'd recommend cutting government transfers to non-workers (yes, that includes limiting the generosity of future government retirement benefits) and regulations that have stifled entrepreneurship.

Hopefully the US learns the right lessons from Europe's crazy negative rate approach, which is an admission of failure by government officials. In the 1980s, the US saw real GDP growth of 4% - not because of low (or negative) interest rates – but because of better fiscal policies. Paul Volcker actually held interest rates high while President Reagan pushed through tax rate and regulatory reductions and spending restraint. Those policies strengthened the dollar and the economy. That's what works.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-13 / 7:30 am	CPI – Jun	+0.3%	**+0.2%**		+0.1%
7:30 am	"Core" CPI – Jun	+0.2%	**+0.2%**		+0.3%
8-14 / 7:30 am	Import Prices – Jul	-0.1%	**-0.2%**		-0.9%
7:30 am	Export Prices – Jul	-0.1%	**0.0%**		-0.7%
8-15 / 7:30 am	Initial Claims Aug 10	212K	**211K**		209K
7:30 am	Retail Sales – Jul	+0.3%	**+0.2%**		+0.4%
7:30 am	Retail Sales Ex-Auto – Jul	+0.5%	**+0.3%**		+0.4%
7:30 am	Q2 Non-Farm Productivity	+1.4%	**+2.1%**		+3.4%
7:30 am	Q2 Unit Labor Costs	+1.8%	**+2.5%**		-1.6%
7:30 am	Empire State Mfg Survey – Aug	1.9	**6.0**		4.3
7:30 am	Philly Fed Survey – Aug	10.0	**16.4**		21.8
8:15 am	Industrial Production – Jul	+0.1%	**+0.2%**		0.0%
8:15 am	Capacity Utilization – Jul	77.8%	**78.0%**		77.9%
9:00 am	Business Inventories – Jun	+0.1%	**0.0%**		+0.3%
8-16 / 7:30 am	Housing Starts – Jul	1.253 Mil	**1.260 Mil**		1.253 Mil
9:00 am	U. Mich Consumer Sentiment- Aug	97.4	**98.9**		98.4