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INTERNATIONAL

Japan and Switzerland see rise in cash use, suggesting a limit to negative interest rates

Negative interest rates are now part of the European and Japanese financial landscape. There are, however, constraints on using such a monetary policy, including the possibility of resorting to cash.

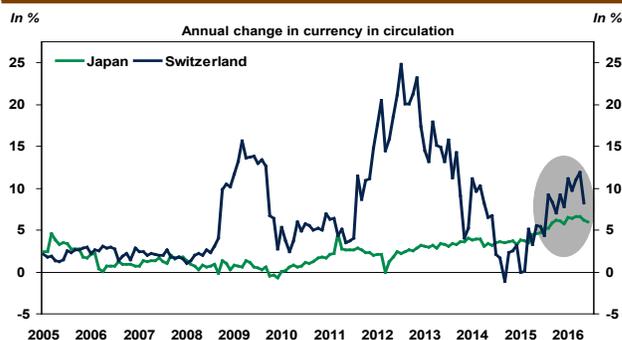
Faced with the option of paying interest on a deposit or an investment in the bond market, it can become more advantageous to hold currency. So if a large number of individuals opted for this strategy, the financial system would lack funds to grant credit and monetary policy as we know it would become ineffective at stimulating the economy. Still, there are inconveniences to holding cash, leaving some room for lowering interest rates into negative territory. These inconveniences include risk of theft, the cost of safes and more intricate transactions.

Until now, fears of a massive displacement to paper money have not materialized. That said, we are possibly seeing the first signs of such displacement in Japan and Switzerland, where the amount of currency in circulation is rising more quickly now.

In the case of Switzerland, we can see in the graph opposite that there have already been periods where the increase in currency was as quick, or even faster, than now. However, these periods coincided with major events such as the 2008–2009 financial crisis and the European sovereign debt crisis. This type of event raises demand for the Swiss franc, which is often used as a safe-haven. As there has been no new major crisis since 2015, it seems more likely that the increase in cash use is related to the negative rates policy. Switzerland is also where the steepest decrease in key rates by a central bank has been observed (to -0.75%), as well as where bond yields dove furthest below zero. Recently, a 50-year Swiss bond traded at a negative yield.

In Japan, the central bank did not need to be very aggressive for the bond market to massively convert to negative yields.

Cash in circulation is rising faster in Japan and Switzerland



Sources: Datastream and Desjardins, Economic Studies

The Bank of Japan's main policy rate stands at -0.1% , but it still must be assumed that a 10-year bond yields around -0.30% .

Implications: If the trend toward cash sharpens, it could discourage central banks from resorting to negative rates. Other tools should then be employed to stimulate the economy and inflation. This could be particularly problematic for Japan, which must already grapple with a yen that is 20% stronger than last year. In the short term, foreign exchange interventions could be an alternative solution for the Japanese monetary authorities. This also suggests that we are possibly approaching the use of helicopter money. Monetary expansion would then no longer be supported by credit, but rather by newly minted money that would be transferred directly to the government or consumers.

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