William R. White, the former chief economist of the Bank for International Settlements, is worried about extreme monetary policies worldwide. The Swiss National Bank, by introducing negative interest rates, is trying to cope with these currents.

In its quest to stop an appreciation of the Franc, the Swiss National Bank (SNB) introduced negative interest rates on Thursday. According to William White, former chief economist of the Bank for International Settlements in Basel, the SNB acts in an international monetary «non-system», where every country only looks out for itself. In his opinion there could be a counterintuitive effect of negative interest rates: To cover their losses, banks could increase the costs of loans.

William «Bill» WhiteBill White, born 1943 in Kenaro (Ontario, Canada), worked for the Bank of England and Bank of Canada before being appointed as Head of the Monetary and Economic Department at the Bank for International Settlements (BIS) in Basel in 1995. He is credited to foresee before 2007 that excessive credit growth would lead to a financial crisis. After retirement from the BIS, he became Chair of the Economic Development and Review Committee at the OECD. The committee regularly evaluates policies of OECD member countries. Mr White, the Swiss National Bank has introduced negative interest rates. What do you think of this measure?

It is one more step along the same path that the SNB has followed for years. There has been an increase of inflows of capital into the Swiss Franc, because of all kinds of trouble around the world. Furthermore, I suspect the SNB expects more trouble along the road, which is the possibility when the European Central Bank introduces a strategy of quantitative easing some time next year. The SNB tries to convince the banks not to channel more capital into the Franc, and to get banks who have long-term positions in Swiss Francs to start reversing them. This is directed to lower the value of the Swiss Franc or at least to take the pressure off the currency.

Will negative interests turn out to be an effective measure to reduce the upward pressure on the Swiss Franc?

Who knows? It did have this kind of impact in the case of the Euro, when the ECB introduced a form of negative interest rates in summer. It might have the impact here as well. But the honest truth is: The particular transmission mechanism is less important than the signal the SNB is sending to the markets: We will do whatever it takes in order to keep the currency at its current level. The SNB has introduced various measures before, and now we are one step further down the road. The hope is that those who say the Swiss Franc will get stronger say: The SNB will do whatever it takes, I leave them alone. This strategy has been successful until now.

But if signaling is so important, does it mean that negative interest rates are merely a symbolic step?

A negative yield has more than a symbolic effect. But we do not know how big that effect will be. In addition, there is the signal to the traders that there are no gains, only losses in holding long positions in the Swiss Franc.

What if the capital inflows into Switzerland continue? What further measures could the SNB use?

If you had gone to –0.25%, you could go to –1%, –2%, and further. The second thing is that currently the charges only apply to reserve holdings above a certain size. This level could be lowered. If inflows just keep coming, the SNB could step up its interventions even more.

Are capital controls a feasible measure?
It is very hard to imagine that for a country like Switzerland. The country has a huge current account surplus and a huge portfolio of assets abroad. But having said that, capital controls are more widely used in emerging market countries today. Even the International Monetary Fund said in 2012 that, if you have done everything else, capital controls are ok. They do not call it capital controls though, but somewhat euphemistically capital flow management.

Will the rate cut of the SNB lower the domestic interest rate level in Switzerland even further?
Maybe yes, maybe no. One argument is, if you lower the rate set by the central bank, then all the other rates will follow. My reaction is: Not so fast, my friend! The Swiss banks are now suffering losses on their reserves at the SNB. Banks could reduce interest rates on deposits to recoup these losses. But this has clear limits: People do not have to hold money at banks, they can ask for their money in notes. The banks could also recoup their losses in a different way, and this is something to be concerned about: They could raise the rates on loans. Far from encouraging lending and spending, negative interest rates at the central bank might work in the opposite direction.

So negative interest rates could actually increase the cost of borrowing?
When interest rates cannot go lower anymore, when they hit the Zero Lower Bound, monetary policy might work like quantum mechanics. Take this simple example from the world of physics: Classical Newtonian mechanics only work when the mass of a body is big enough. When the mass is too small, you are in quantum mechanics. These are completely different ways

of looking at the world. The Zero Lower Bound might be the quantum mechanics of monetary policy. Things just do not operate in the same fashion. If you think things do operate the same way, you might make a very dangerous mistake.

But will Swiss banks really increase loan rates now?
I do not know. The banks might swallow the losses for some time. They may decide, as the SNB likes them to, to put their money in some other currency in which they do get a positive return.

By holding a one-sided peg of the Franc to the Euro, the SNB has in effect linked its monetary policy to the ECB. How will the SNB ever be able to decouple from the ECB?
The hope is that at some time the pressure on the Franc will come off, when interest rates rise elsewhere. Then the SNB could gradually reduce their exposure to the Euro. That may be a while.

Do you have an idea who will win or lose from negative interest rates?
The banks will lose as they have to pay rates on their excess reserves they hold at the central bank. The public sector, the SNB, will gain. If the banks do not push down deposit rates, but increase the loan rates, the borrowers will pay the price. And when interest rates go down, savers will suffer.

The SNB has to follow the ECB in its monetary policy. Is it not dangerous when the monetary policy of one country affects another?
Currently we have an international monetary non-system. Nobody has to follow any rules. Everybody does what they consider is in their own short-term best interest. The real difficulty is: What is in their short-term interest

– for example, following ultra-easy monetary policy – could well backfire somewhere. It might be not in their long-term best interest. And as the easy monetary policy influences the exchange rates, it influences other countries. Almost every country in the world is in easing mode, following the Fed, and we have absolutely no idea how it will end up. We are in absolutely unchartered territory here. This worries me the morst. The SNB has been doing well in what it was forced to do by this international monetary non-system. The Swiss have to do the best they can, because that is what everybody else is doing.

What are the risks of this non-system?

There is no automatic adjustment of current account deficits and surpluses, they can get totally out of hand. There are effects from big countries to little ones, like Switzerland. The system is dangerously unanchored. It is every man for himself. And we do not know what the long-term consequences of this will be. And if countries get in serious trouble, think of the Russians at the moment, there is nobody at the center of the system who has the responsibility of providing liquidity to people who desperately need it. If we have a number of small countries or one big country which run into trouble, the resources of the International Monetary Fund to deal with this are very limited. The idea that all countries act in their own individual interest, that you just let the exchange rate float and the whole system will be fine: This all is a dangerous illusion.