

## MITIGATING THE IMPACTS OF LASTING LOW INTEREST RATES FOR THE FINANCIAL SECTOR

### Whither Eurozone interest rates?

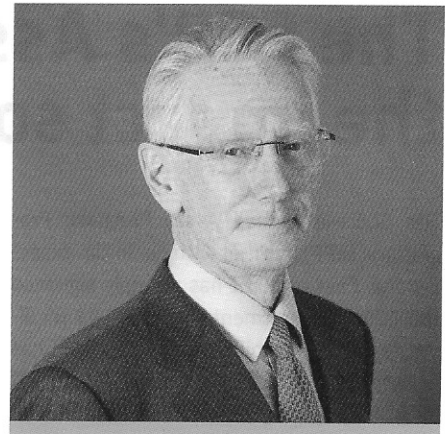
Eurozone interest rates are unusually low, but there might be unusually good reasons for this. After a lengthy economic “boom”, fuelled by easy monetary policies and an imprudent expansion of credit and debt, the advanced market economies entered the inevitable “bust” phase in 2008. Since then, the emerging market economies have repeated similar policy errors leading to the same result. Global debt levels as a percentage of GDP are now significantly higher than in 2008 with half of the increase occurring in the emerging market countries. Thus, every geographical area now faces serious downside risks. Moreover, in a globalized world, problems which emerge anywhere will have implications everywhere. Against this backdrop, low rates everywhere might then be expected to continue.

A further threat to global growth is that much of the increase in debt has been in US dollar denominated instruments. The BIS estimates that non US residents now have 9 trillion dollars of such debt. A rising dollar, particularly due to “safe haven” concerns, will threaten both debt

servicing capacities and commodity prices. As in earlier periods of dollar strength, emerging markets will be most directly affected. Nevertheless, there are likely to be important “knock on” implications for Eurozone (especially German) exporters and potentially Eurozone financial institutions as well.

If these developments clearly threaten aggregate demand in the Eurozone, there is less certainty about possible supply side effects. Demographic developments, very low investment and the “ever greening” of bad loans to “zombie” companies all threaten potential growth in the Eurozone. On the one hand, this could raise inflationary dangers and the need for higher nominal policy rates. On the other hand, lower potential growth implies lower real rates over time.

The European Central Bank has taken unprecedented measures to improve the transmission mechanism to peripheral countries and to encourage stronger demand growth overall. It seems unlikely that such recent



**William R. White**  
Chairman of the Economic and  
Development Review Committee,  
**Organisation for Economic  
Co-operation and Development (OECD)**

measures will be quickly reversed. The danger of course is that such easy monetary conditions will simply add to the imbalances that caused the global crisis in the first place. Similarly to other major central banks, the ECB evidently feels this is a risk worth taking. Let us hope they are right. ■

