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HOW NEGATIVE INTEREST RATES WORK?

Negative rates became a reality of the modern financial world several years ago. Dreaming of financial stability, many do not even suggest what amazing (in our opinion today) forms it acquires in wealthy countries. There, in an almost non-inflationary economy, investors sometimes do not receive income from their bank investments, and vice versa - sometimes they themselves pay the bank for the service of storing money in the account. While negative interest rates are a great incentive to borrow, it's hard to understand why anyone would be willing to pay to lend considering the lender is the one taking the risk of a loan default. While seemingly inconceivable, there may be times when central banks run out of policy options to stimulate the economy and turn to the desperate measure of negative interest rates.

Negative interest rates are a drastic measure. In harsh economic times, people and businesses have a tendency to hold on to their cash while they wait for the economy to pick up. But this behavior can serve to weaken the economy further as the lack of spending causes further job losses and lower profits, thus reinforcing people's fears and giving them even more incentive to hoard. As spending slows, prices drop creating another incentive for people to wait as they wait for prices to fall further.

Negative interest rates should help to stimulate economic activity and stave off inflation, but policymakers remain cautious because there are several ways such a policy could backfire. Because banks have certain assets like mortgages that, by contract, are tied to the interest rate, such negative rates could squeeze profit margins to the point where banks are actually willing to lend less.

While negative interest rates may seem paradoxical, this apparent intuition hasn't kept a number of European central banks from giving them a try. Number of

analysts believe negative interest rate policies could have severe unintended consequences.