What is a negative interest rate?

Normally, borrowers pay lenders rate as an annual percentage on the amount borrowed. So for example, when people deposit money in a bank, they anticipate getting back some interest on the account. This was a bedrock hypothesis across many centuries of financial history. However, when interest rates are negative, this relationship is inverted. Lenders have to pay to lend money. (Walker, 2016)

During deflation times, people store money instead of spending and investing. The result is a collapse in aggregate demand, which leads to prices dropping even further, a slowdown or breakdown in real production which leads to escalation in redundancy. If deflation forces are strong enough, simply cutting the central bank's interest rate to zero may not be sufficient to stimulate borrowing and lending. (C.W., 2016)

Theoretically, the central bank, and perhaps private banks, is going to charge negative interest – instead of receiving money on deposit, depositors will pay for the benefit of parking their money into the bank. (Walker, 2016)

Why do we have negative interest rates?

The general idea of imposing negative interest rate policy (NIRP) is to discourage people or organizations from store their money. NIRP try to motivate banks to lend their extra cash, if any, to businesses and customers. The main aim of the Eurozone is to encourage economic growth and to raise inflation. (Steenis, 2016)

In June 2014, the European Central Bank imposed a NIR. It wanted to try to stop banks from depositing money with it, and instead lend to Eurozone businesses. Denmark, Sweden and Switzerland have introduced NIR on commercial banks' excess funds held on deposit at the central bank. In effect, private sector banks have to pay to park their money. (Walker, 2016) The issue which arises here is: Does any bank want to pay another bank to look after their money? European banks are required to hold reserves at the central bank (ECB). Furthermore, negative rate also apply to reserve holdings which are in excess of the minimum reserve requirements and deposits held with the Euro system. Even if banks do not use the ECB's deposit facilities, negative rate will apply to the bank's surplus reserves. (Xing, 2016)

What are the implications of NIRs?

NIRs will push down borrowing costs. In theory, interest rates below zero reduce borrowing costs for companies and households, driving demand for loans. In practice, there is a belief that the policy might do more harm than good. If banks make more customers to pay to hold their money, cash may go beneath the mattress instead. (Walker, 2016)

Theoretically, if a company deposit with a bank that has NIRs, the longer the bank holds the money, the less the company will have in their accounts. The flip side would be: the longer it takes to repay a NIR loan, the less they owe, even if they do not pay anything. (Hamilton, 2016)