Taking a gamble with negative interest rates

Oliver Hartwich | The New Zealand Initiative | 06 November 2014

If you have never heard of Germany's Skatbank, a direct bank based in the small Thuringian town of Altenburg, you are certainly not alone in your ignorance.

Until last weekend, hardly anyone knew much about the bank, which must be the only financial institution in the world named after a card game (Skat, Germany's most popular card game, was invented in Altenburg two centuries ago).

Skatbank's low profile changed instantly last week when it announced its new interest rates for deposits. It became the first German bank in history to introduce negative interest rates for very high deposits. From 1 November, customers with total holdings exceeding €3 million ($4.3 million) will need to pay the bank 0.25 per cent interest if deposits on their on-call accounts exceed €500,000.

Skatbank is a rather small bank with less than 15,000 clients, the vast majority of whom probably only dream of being millionaires. In all likelihood, the bank's penalty interest rates will only affect very few savers.

However, the bank's new interest rate policy still matters because it sends a strong signal: the European Central Bank's negative interest rates are finally being passed on to private clients, and Skatbank was just the first bank to do so.

Well, actually, not quite. Skatbank was only the first bank to charge private depositors for the privilege of accepting their money. In September, the CFO of a chain of German DIY markets had already complained to the media about the strange new banking world. He found it impossible to park his company's considerable war chest with any commercial bank without having to pay them. The banks, so it was reported back then, are finding new ways of deterring depositors, arguing that they were banks and not asset management companies. Yeah, right. That argument did not stop them from accepting deposits in the past when it was still profitable to do so.

From the banks' perspective, it is nevertheless understandable why they do not want to accept large deposits. Since they now also have to pay the ECB money for taking their deposits, it makes sense for them to recover their costs elsewhere. Except that this was never supposed to happen.

In fact, none of the above was ever supposed to happen. Late last year, ECB President Mario Draghi had all but ruled out the introduction of negative deposit rates. His denial only lasted until early June this year, when the ECB first lowered its deposit rate to -0.1 per cent. It then lowered the rate to -0.2 per cent in September. All the while, Draghi tried to reassure savers that at least inflation rates were almost as low as interest rates and he passed the blame for these low rates to market developments outside his control.

Even Bundesbank President Jens Weidmann, usually not Draghi's closest ally, tried to calm nerves when he said that negative real interest rates had occasionally happened in the past – even when Germany still had its Deutsche Mark. Though that may be technically true, the difference is that in such phases nominal interest rates were always positive whereas today both nominal and real interest rates are below zero.

Germany's commercial banks, meanwhile, did their best to reassure the public that the ECB's policies would never reach ordinary savings accounts. "You can relax, that's not politically feasible," declared the chief executive of a regional savings bank in June this year. In September, Dekabank's chief economist gave an interview in which he boldly declared that "Consumers do not need to fear penalty rates on their deposits; the ECB's negative interest rates are only meant to make the banking system to pump more money into the economy."

As Skatbank's bold decision shows, such assurances were not worth much. The taboo of negative interest rates for bank clients is broken, even though other banks are once again trying to downplay the severity of the situation. Of course Skatbank did not set a precedent, other banks would not follow their example, and negative deposit rates would never ever reach ordinary savers, they were quick to announce. Such assurances sound good, but why would anyone still believe them after all those other assurances in the past?

The opposite development seems likely. With every day that the ECB keeps it deposit rate negative, pressure will mount on banks to pass on their costs of holding deposits to depositors. Skatbank ended the taboo that savers always have to be compensated for handing over their money to a financial institution, and there is no reason why other institutions will not follow. They have little to fear, least of all their customers. German bank customers are probably more faithful to their banks than to their spouses. It is rare for them to change banks, probably because of personal loyalty to bank managers and also out of pure inertia. The hassle of changing bank accounts is considerable. Just withdrawing excess deposits in cash is not an option either, since that would require customers to invest in vaults at home or rent a safe deposit box at their bank. As long as banks do not exaggerate their negative interest rates, they hardly have to fear a bank run. Customers will probably grudgingly swallow that pill.

It is not as if German savers had recently been spoilt anyway. Real interest rates have been negative for quite a while, and that is even before tax. Paying income tax on their measly interest income meant they were not only losing money on their deposits but also paying the taxman for the pleasure. Negative interest rates would at least reduce savers' tax liability. You would need to be a big optimist, however, to see the positive in a policy that reduces the value of your savings year after year. But, hey, at least it saves taxes.

The ECB's big experiment with negative interest rates is finally reaching ordinary people and two things are ironic about it: First, that it was a bank with a hint of gambling in its name which finally drove this message home. And second, that of all weeks in the calendar it had to happen during world savings week: the last week in October when European banks traditionally pretend they like to manage assets and encourage savings. If only.

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