Zero rates preferable to negative rates for investors' risk-taking

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Ben-Gurion University of the Negev (BGU) researchers have determined that zero interest rates are more efficient than negative interest rates in terms of motivating individual investors to borrow money and take risks.

"President Trump tweeted in September 2019, 'The Federal Reserve should get our interest rates down to ZERO, or less.' The goal of this paper is to evaluate the impact of zero and negative interest rates on individuals' investment decisions," says Prof. Mosi Rosenboim, of the BGU Guilford Glazer Faculty of Business and Management.

"The suggestion to implement a negative monetary policy has divided economists and politicians and is relevant given the financial fallout from the pandemic shutdown," adds Prof. Rosenboim.

The study, published in the *Journal of Behavioral and Experimental Economics*, proved that that there is no statistical difference between the effect that positive and negative interest rates have on the change in the allocation of risky assets in investment portfolios.

In several lab experiments, the researchers demonstrated that a zero-interest rate policy has the strongest impact on individuals' investment decisions driving their decisions to borrow money and the percentage of risky assets in their portfolios. Specifically, dropping the interest rate below zero, a negative interest rate policy, is less effective in terms of increasing leverage and shifting individuals' allocations to risky assets.

"Indeed, where investors are concerned, moving from a zero-interest rate policy to a negative interest rate policy might even have the opposite effect," says Prof. Lior David-Pur of BGU's Department of Economics and head of the Government Debt Management Unit in the Israeli Ministry of Finance. "Specifically, when interest rates decline from zero to a negative interest rate, the average leverage decreases instead of increases. The results clearly indicate that individuals react strongly to zero interest rates."

"Finally, the counterintuitive effect of negative interest rates on saving accounts implies that savers should pay interest rather than receive it," says BGU economics researcher Dr. Koresh Galil.

"Hence, one can argue that there is no reason for savers to accept negative rates and would prefer to hold cash. However, in practice, the answer to this question is less clear because there are risks associated with holding cash such as losing it or being robbed. This argument is reinforced because worldwide negative interest rates are low, below 1%."

The researchers say that further work is needed to understand how far below zero interest rates can go before they will prompt people to hoard cash.

"There is a good alternative to zero-interest savings accounts and CDs for individuals 65 and over," says Doug Seserman, chief executive officer of American Associates, Ben-Gurion University of the Negev. "There's never been a better time to get high-interest rates on charitable gift annuities, which provide guaranteed fixed-rate lifetime income and charitable tax deductions." For more information visit http://www.aabgu.org/cga-rate-request.

More information: Lior David-Pur et al, To Decrease or Not to Decrease: The Impact of Zero and Negative Interest Rates on Investment Decisions, *Journal of Behavioral and Experimental Economics* (2020). DOI: 10.1016/j.socec.2020.101571

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