Life Below Zero: Bank Lending Under Negative Policy Rates*

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Abstract

This paper studies the transmission of negative monetary-policy rates via the lending behavior of banks. Unlike for positive rates, the transmission of negative rates depends on banks' funding structure. High-deposit banks take on more risk and lend less than low-deposit banks. The risk taking is concentrated in poorly-capitalized banks. Part of the risk taking comes in the form of new syndicated loans to risky firms without such loans previously. Safe borrowers switch from high-deposit to low-deposit banks. The new risky borrowers appear financially constrained, and use the new funding to invest. For identification, we employ a difference-in-differences approach. Banks with different reliance on deposit funding experience a different pass-through of negative policy rates. To isolate borrowers from interest-rate changes, we use lenders located in a different currency zone. A placebo at the time when policy rates fall – but are still positive – shows no effect. The results point to distributional consequences of negative policy rates with potential risks to financial stability.

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