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Can interest rate be negative ? Think again...

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Frank Osmany Velunza Martinez · 18 hours ago

By Joshua Zumbrun Jan 31, 2014 10:24 AM ET

...two economists say they've measured how much extra stimulus the bond purchases provide when the main interest rate is already near zero.
The economists, Jing Cynthia Wu and Fan Dora Xia, used a concept known as the "shadow rate" to gauge the impact of quantitative easing and the Fed's forward guidance on the likely path of interest rates.

Their findings: as of December, Fed policy was the equivalent of cutting the benchmark interest rate to minus 1.98 percent, according to Wu at the University of Chicago Booth School of Business and Xia at the University of California at San Diego.

[...]

Unable to cut its short-term rate below zero, the central bank embarked on three rounds of quantitative easing, totaling more than $3 trillion, to continue providing stimulus by pushing down long-term rates. That has made it cheaper for consumers and companies to borrow.

The untested nature of QE has left the Fed guessing at its precise power. Bernanke laid out a range of estimates in a speech in Jackson Hole, Wyoming, in August 2012, less than a month before the Fed started its third round of bond purchases.

Bernanke cited studies that found the Fed's first two rounds of purchases lowered the yield on the 10-year Treasury note by 0.55 to 1.55 percentage points. The yield was at 2.7 percent late yesterday.

With only five years of data in the era of zero interest rates and QE, it's too early for economists to measure the shadow rate with precision, said Drew Matus, senior economist at UBS Securities LLC in Stamford, Connecticut.

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