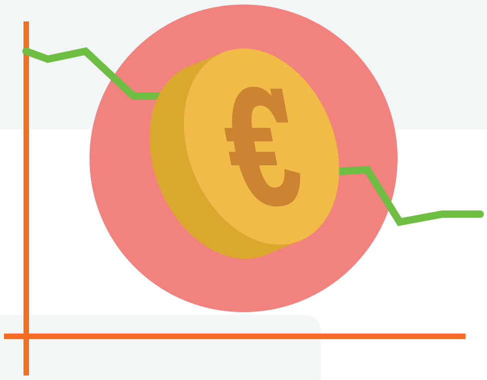
Why are rates so low?

What's causing the current low interest rates?

1. Economic growth is weak and inflation in the eurozone is likely to remain below the "normal" level of 2% over the mid to long term.
2. In line with its role, the European Central Bank (ECB) is trying to boost inflation through very low interest rates. This is to discourage saving and encourage spending. It is also seeking to encourage business investment through low-cost finance. Because consumer spending and business investment boost economic activity and, ultimately, inflation.
3. In 2014, the ECB even decreased most short-term interest rates to below zero to further boost the economy and inflation.



What are the consequences for the financial markets?

1. Interest rates on the financial markets are extremely low. Even most of the so-called "risk-free" rates are negative.
2. Borrowing money has never cost so little, but possessing financial means and keeping them in cash is being penalised by negative interest rates.

What about banks?

The same goes for banks who finance loans to businesses and individuals by borrowing money themselves:

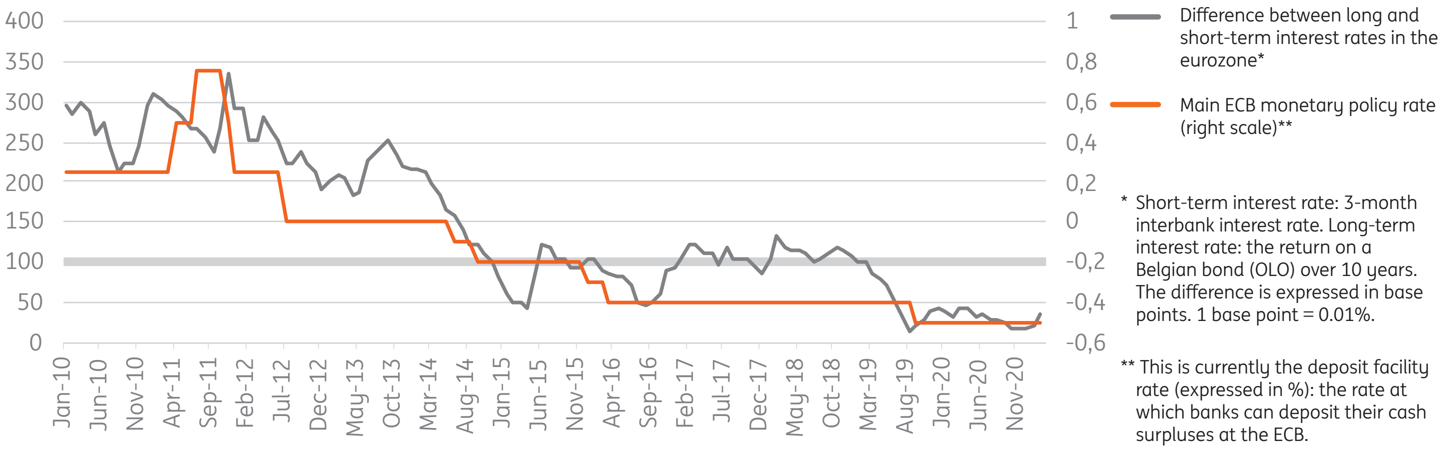
- from the financial markets or directly from the ECB
- from customers who entrust their savings to them in the form of deposits.

Today, the difference between short-term and long-term interest rates is small: the interest rates on loans (usually long-term) granted by banks are not much higher than the ones at which they borrow money (usually short-term) to fund those loans. And yet, this difference has historically been the main source of income for banks.

This is compounded by the fact that banks are not allowed to apply negative interest rates if they use customer deposits as a source of finance. In particular, the law imposes a minimum interest rate of 0.11% on regulated savings accounts (without taking into account the taxes that banks pay for savings accounts).

continued overleaf →

Short and long-term interest rates are low



* Short-term interest rate: 3-month interbank interest rate. Long-term interest rate: the return on a Belgian bond (OLO) over 10 years. The difference is expressed in base points. 1 base point = 0.01%.

** This is currently the deposit facility rate (expressed in %): the rate at which banks can deposit their cash surpluses at the ECB.

Will this change?

Most forecasts were based on a long period of low interest rates. The coronavirus crisis has not helped the situation:

- Economic activity remains well below its pre-corona levels.
- While some factors may increase inflation this year, these are only temporary.
- In response, most central banks have confirmed their intention to keep rates low. This is certainly the case in the eurozone, where the recovery is slow.

What should you do?

Spend? That would keep the economy going which it certainly needs in the contexts of the pandemic. Remember to always keep a cash reserve in case of an emergency.

Save? It is usually recommended to have the equivalent of 3 to 6 months of income in the form of cash.

Even if very low interest rates mean a negative return in real terms depending on inflation.

Invest? Taking risks, according to your investor profile, on the financial or property markets can lead to potentially higher returns in the long run.

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