‘Addiction’ to cheap money will do ‘tremendous damage’ to the global economy

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People walking along Wall Street in the Financial District of Manhattan on September 03, 2019 in New York City.

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Zero or negative interest rates will do “tremendous damage” to the economy in the long run, analysts warn, adding that the addiction to cheap money has become a problem as central banks around the world go on a path of increasingly lower rates.

The trend of zero interest rates is “perverse” and can “poison” the business environment, said Yuwa Hedrick-Wong, a visiting scholar at the Lee Kuan Yew School of Public Policy.

Low interest rates hurt lenders’ profits as they narrow the margin that banks can earn. In a negative interest rate environment, lowering rates deeper into negative territory essentially means that lenders are paying more to the central bank to keep their excess funds overnight.

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> ***Yuwa Hedrick-Wong***
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> ***visiting scholar at the Lee Kuan Yew School of Public Policy***

Speaking at the Forbes Global CEO Conference in Singapore on Tuesday, Hedrick-Wong said: “I’m a firm believer that zero interest rate, or negative interest rates (is) actually doing tremendous damage to the economy over the long term. To begin with, zero interest rates poison the business corporate environment.”

U.S. President Donald Trump has consistently called for low interest rates, tweeting in September that the Fed should cut interest rates to zero or even set negative interest rates. He also appeared to praise Germany for its negative rates on government bonds.

European banks have struggled for years in a persistently low interest rate environment — first hitting zero in 2012 before turning negative in 2014. The European Central Bank pushed its rate further below zero in September, and other countries such as Denmark, Sweden and Japan have also done so.

“We have to reverse that process. Normalization of interest rates has to be the top priority in managing the economy going forward,” Hedrick-Wong said at a panel discussion. “The addiction to cheap money … that’s the problem, not the solution.”

Still, analysts are expecting the Federal Reserve to continue trimming interest rates amid fears of slowing global growth and uncertainty over Brexit and trade tensions.

Mark Zandi, chief economist at Moody’s Analytics, warned that the U.S. central bank could be cutting rates “a lot more.”

“If the trade war escalates, if Brexit becomes less graceful, then I think the Fed’s going to be cutting rates a lot more. In fact, at some point, talking about the zero lower bound,” he told CNBC on Wednesday, referring to the monetary policy tool of lowering short-term rates to zero in order to stimulate the economy.

In July, the Fed cut rates for the first time since 2008, during the great financial crisis. The central bank cut rates again for the second time in September, lowering the overnight funds rate in a target range of 1.75% to 2%.

“We’re also talking about negative interest rates in the United States too. So if that happens, of course, that’s recession,” Zandi said.

Eventually, monetary policy “could become even less effective” in supporting growth when most major economies are largely using that as a tool, Cornell University professor Eswar Prasad told CNBC in an email. Instead, governments should more balanced in including fiscal stimulus, he said.

“Persistent reliance on ultra-low or negative policy interest rates leaves financial systems ever more vulnerable and has little positive impact on growth,” he wrote in a commentary this week.

— CNBC's Abigail Ng contributed to this report.