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Negative Interest Rates x Negative Bond Yields = Positive Arbitrage?

Former Federal Reserve Chairman Ben Bernanke recently advised that the Fed should maintain "constructive ambiguity" about the possibility of taking the Federal funds rate below 0% in an effort to simulate the U.S. economy during the next recession. Given that current short-term interest rates in the United States are at near-historic lows, many believe that it is inevitable that U.S. monetary policy will replicate the negative interest rates employed in Japan and Europe when the next recession hits. One economist suggests that negative interest rates and negative bond yields (more on that below) are the inexorable conclusion of a trend that began in the late 1400s. We are on notice.

If the Fed experiments with a Bret Easton Ellis-inspired monetary policy and takes the Federal funds rate to less than zero,[1] what are the potential consequences for issuers of tax-exempt bonds? For some speculation (and to see the text of the first footnote), hit the jump.

Continue reading.

By Michael Cullers on January 20, 2020

The Public Finance Tax Blog

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