

**Economics 314**  
**Daily Question #15**

**Spring 2013**  
**March 28**

The “liquidity trap” argument of Keynes says that nominal interest rates cannot be negative—there is a “zero lower bound” on  $i$ . Why would wealth-holders never hold bonds if  $i = 0$ ? We usually assume no such zero lower bound for the real interest rate  $r$ . Why is it possible that bondholders (who care about their real return) would under some circumstances hold bonds when  $r < 0$  (as it likely is right now) but never when  $i \leq 0$ ? Would this still be true if wealth-holders had access to a “perfect inflation hedge”—an asset with a risk-free nominal rate of return equal to the inflation rate?