

Easy money but not in the UK

On Wednesday the Fed chairman Jerome Powell signalled that US interest rates are likely to fall at the next Fed meeting. Whilst he was able to report continuing good growth in jobs and wages, he pointed to trade uncertainties and a slowdown in the rest of the world as a reason the Fed might want to ease a bit more.

Meanwhile the Germans have just issued a government bond with no coupon, to the delight of their fans in the market who dutifully bought it. You might have thought the only reason you would want to own a government bond is to enjoy a secure income on it, yet here we have one which guarantees you no income whatsoever. Presumably the people who bought it expect a further fall in interest rates and more buyers willing to pay more for it in due course. They will need to sell it again before maturity. If you think buying a bond with a guarantee of no income return is foolish, then the only justification is to find someone more foolish to sell it on to at a profit before the reality of the no return bond is confirmed by repayment at par. There is speculation in markets that the arrival of Christine Lagarde as President of the European Central Bank will herald looser money and rates going negative.

Why have interest rates stayed so low for so long? How much longer will this apparent madness continue? The great banking crash on both sides of the Atlantic impaired the ability of commercial banks to generate cash and provide enough loans to propel good rates of economic growth. Intense global competition, large reserves of unemployed and underemployed labour and the advent of digital commerce all reinforced the trend to keep prices down. Many people responded to the ultra low rates by saving more. Japan shows this situation can persist for several decades, where a worse banking crash ushered in a long period of zero rates and no inflation. The position in the west should not last as long, given the less intense crash and the higher propensity to price rises in some places. Indeed, the USA did get its interest rates up to 2.25-2.5%, high levels for an advanced country in current conditions.

The Bank of England looks increasingly isolated and cut off from central banking trends elsewhere. The tight UK money squeeze has slowed the UK economic markedly, yet still the Bank presses on with it. If the Fed thinks the US needs more stimulus after a first quarter growing at 3.1%, surely the UK economy now scarcely growing at all needs a boost?