How the Bank of England and the government can cut UK debt

I agree with the government that UK gross state debt is on the high side. It makes a significant contribution to total UK debt.

There is a simple way to bring it down. The Bank of England should announce that from next month it is going to reduce the stock of government debt it owns by £7bn a month. Over a five year period this would eliminate the £435 bn of government debt the Bank of England owns on our behalf. It would reduce state debt by around one quarter and would reduce our total indebtedness as a nation by a little over one fifth of National Income.

There is a precedent for this. The USA has announced its plan to start to cut the US state debt the Fed owns.

How can this be done? At the moment every time a government bond owned by the Bank is repaid they go out and buy another bond to replace it. Basically they can stop doing this and accept the repayment, which cancels the debt. They would need to switch bonds of varying maturities from time to time to ensure a smooth pattern of debt reduction.

What is the downside? The danger is such action tightens money too much. As an offset the Bank should relax its some of its strictures against new mortgage and car loan borrowing, whilst still policing proper evaluation of individual credit worthiness. It should keep interest rates low whilst reducing the stock of debt in this way. It should be ready to abort the programme of debt reduction if money tightens too much.

If instead money grows too quickly for other reasons then of course it can take other action to avoid any inflationary threat.

What’s stopping them getting on with this? We should be taking strides towards a more normal monetary policy now.

Why does the Bank of England have it in for young people?

Debt is a young person’s game. In most free enterprise societies older people own most of the wealth. Young people borrow to get started as homeowners and business people. This happens naturally, as it takes time to save, to accumulate assets, to buy a home and to benefit from it going up in value. Most of us start out with no assets, receive no inheritance, and have to save for our old age as we work and earn. Even those who can draw on the bank of Mum and Dad usually need to borrow commercially as well to fulfil their ambitions.

It is the job of the banking system to lend the money older people save and deposit to their collective children and grandchildren who need it to buy homes, cars and other expensive assets, and to businesses who need it to increase capacity and to supply new goods and services.

Today the Bank of England is arguing that there is too much mortgage and car loan debt in our country, and this needs to be controlled. They are instructing the commercial banks to lend less. It is difficult to understand why.

The commercial banks now have much more cash and capital by way of reserves than they had during the banking crisis of the last decade. They are also more profitable again. These buffers can take care of any bad debts they do incur. Employment is expanding. As people get jobs so they can afford to borrow to buy a car or a home. The banks should be allowed to meet their aspirations. The invention of the 3 year car loan/lease allowed many more people to have a new car. The banks would be able to foreclose on the vehicle if someone fails to make the payments, so there is reasonable security.

Of course banks need to examine each loan application. The individual has to demonstrate they have the income claimed and show they are likely to keep a job. The bank lending money does need to make a judgement that the person concerned will not behave irresponsibly. Most people do take their debt obligations seriously.

Current levels of mortgage and car loans would only be unsustainable if the Bank decided once again as it has in the past to withdraw liquidity from the markets too quickly and push up interest rates too far too fast. It assures us this time it does not wish to do that. There is already considerable protection against rate rises, as many have chosen to take out fixed rate loans. In that case it should allow more young people to borrow to buy a home or a car. More mortgage and car loan debt when the economy is growing and more people have jobs is not something to worry about. Tomorrow I will describe how the Bank and government could do something that would make a real difference to reduce total UK debt that does not require squeezing the young.

The importance of property to a democracy

Free societies allow individuals to buy and own property. Communist and authoritarian societies claim all property for the state.

Making everyone a tenant of the state gives a state much more control over its citizens. It also usually leads to a crony system, where those who toe the line and are in with those in power, get favourable access to property. Corruption normally follows the concentration of power in the hands of the state, and often is practised surrounding state property or trading assets. The privileged regard state property and nationalised industries as personal fiefdoms, earning rent from them at the expense of everyone else.

Largely free societies do need to impose some restrictions on the freedom to own and use property as individuals and families wish. It is common to discourage anyone seeking on death seek to freeze a property which the dying person liked, to prevent a mausoleum community developing full of empty properties. It is usual to require permits to change the use or develop a site which someone owns, in the interests of protecting the neighbours and creating some order over infrastructure and service provision. It is very common to impose taxes on property ownership. Whilst this is mainly for the state to have more revenue, the taxes may be designed to influence use of the property.

The drift in free societies is to more and more state intervention in the buying, selling, use and enjoyment of property. Taxing property related activities can be easier than taxing income or spending, as the property has a fixed address and a registered owner. What begins as a legitimate interest in orderly development of a neighbourhood can become a large experiment in social engineering, with the state granting huge windfall gains to some who are allowed to build on their land, and denying others any scope for modest self improvement of their property.

In the UK today the argument about rich people owning homes they do not live in for much of the time has become an issue. It is difficult solving the problem without very intrusive regulation and policing. How many nights should a person stay in a given home to qualify as reasonable? What do you do about someone starting up a relationship with a new partner and then spending the nights with them rather than in their own home? How do you capture the complexity of family life with grown up children spending more time in their parents' homes? You could have a law which discriminated against foreign owners, with suitable definitions of who is foreign. This would not be a very welcoming approach, and could have side effects like putting rich individuals off investing in the UK or considering moving more permanently here. It might cut total tax revenue considerably.

I am suspicious of the idea that the state should tell people how much property they need or are allowed. The state can and does affect the pricing of property which will of course influence the decisions of property buyers and users.

[Top people’s pay – the case of Mr Neymar]

The Qatari owners of Paris St Germain think footballer Mr Neymar is worth £775,000 a week, according to media reports. They also think it worth paying a lump sum transfer fee of £198 m to secure his services for six years.

I suppose they might be right. He would need to stay at the top of his game and help his new club to win major trophies. He has already bought PSG a lot of publicity. Maybe more tickets will be sold at higher prices now for their games, and in due course maybe the value of their games to the media will go up. Or maybe this is not about making a profit, but is about making a statement. There is a long tradition of rich people and institutions spending large sums on football clubs and footballers. It can just be a way of recycling some of the money they have made from more successful ventures.

The downside of the spending are obvious. If Mr Neymar was injured, or if his form fell away, it will prove an expensive problem for the club. Top performance requires extraordinary levels of commitment, concentration, practise, fitness. Sustaining these for six years when you are paid so much anyway must require huge self discipline. Being a top sporting performer requires a person to regulate the whole of the rest of their lives. Too little sleep, too much alcohol, wrong diet, too many emotional distractions could throw the peak condition needed to perform well.

I raise all this not because I am concerned about the financial health and sporting performance of PSG but because it is an extreme case in the debate we are having about high pay. Some argue that it is never justified to pay individuals so many times the Minimum wage of those who help sustain their activities. What do the cleaners, caterers and security personnel at football grounds where Mr Neymar plays think of the differentials? Clearly Mr Neymar does not need that much money to live to a very high standard of comfort. He can also earn huge sums in addition to his wages through sponsorship deals and activities based on his fame.

Others argue that sporting or cultural stars are different to senior executives in large companies who negotiate large pay packets. It is true that sporting stars do have to perform to get their large money, whereas some business executives get large salaries or guaranteed bonuses without needing to perform in an exceptional way. In some ways sports people are more like entrepreneurs, who can earn huge sums by selling what the public wants at a price the public can afford and is willing to pay. All the time people pay their sporting tv subscriptions and the ticket prices, the stars can claim they are “worth it”.

Yesterday’s news that FTSE top pay had fallen does reflect the feeling of many that the pay of corporate executives in large quoted companies needs to be more strongly policed by shareholders, taking more interest in ensuring performance is required to justify multi million sums. That is something which shareholders need to do in a free society, on a case by case basis.

Bank of England turns gloomy again and tightens money policy to depress demand

Last year the Bank slashed its forecasts for growth for the year after the Brexit vote and then had to push them up again. Growth accelerated in the six months after the vote against their expectations of a sharp fall. Today the Bank has decided to cut its growth forecasts a little from the upward revisions it made to 2017 at the same time.

The Bank made an important policy statement. What it has decided to do is to tighten monetary conditions despite its own view of sluggish growth. Indeed, it maybe because it is tightening money that it has to cut its forecasts. The tightening occurs in two stated ways. The Financial Policy Committee is reining in both mortgage loans and car loans, whilst issuing general warnings against more consumer debt. This reinforces the contractionary policies being pursued by the Treasury with its big tax hit to Buy to let and dearer properties through higher Stamp Duties made in the April 2016 budget, and its decision to cut back the number of dearer cars sold on the new car market through much higher VED on dearer vehicles. The Bank has also confirmed the end to its Term Lending Facility for commercial banks in February which will soon start to affect their behaviour, reining in credit.

The Bank has confirmed that "much of the weakness in housing market activity over the last eighteen months reflects a fall in the number of buy to let property transactions following introduction of the Stamp Duty change" and confirms that new housing for sale has been growing strongly, with starts up 26% on the year to Q1 2017. Capital investment has disappointed the Bank, though the shortfall is more noticeable in the public sector.

The Bank makes a great deal of the impact of Brexit, blaming Brexit for the fall in the exchange rate. Understanding that it needs to be consistent it has to explain why the Stock market has taken such a positive view since June 24 2016. It decides to say the market has risen because earnings and profits have been good. It then tries to suggest that this is down to sterling, whereas the FTSE 250 Index with more domestic companies and activity has also done well. The FTSE 100 is up 22% since June 24th, whilst the FTSE 250 is up 24%.

The Bank takes the fall in the pound from the pre vote high. The pound reached a 5 year high of $1.71 on 11 July 2014. It fell fairly consistently for 2 years to a low of $1.42 on 16 June, rallied briefly, and then fell away to today's $1.32. Today's level is 10% higher than the post vote low which the Bank does not mention. It is difficult to see why the Bank thinks all the fall since the vote is down to Brexit, but none of the rally is down to Brexit. It also leaves them having to explain what moved the pound down so much prior to the vote and why this influence ceased on the day of the vote. Remember quite a bit of the fall occurred long before we decide to have a vote, and then during a long period when markets were sure Remain would win. Much of the fall was about interest rate differentials at a time of rumoured or actual rate rises in the USA.

The Bank regards the rise in inflation as resulting from sterling, ignoring similar rises in inflation earlier this year in the USA, Germany and others owing to the higher oil price. UK shop prices were 0.3% lower in June 2017 than a year earlier, showing how lower sterling has been absorbed by importers and retailers.

The UK economy generated 324,000 extra jobs over the last year and now has 32 million people in work, with unemployment at 4.5%. the Bank accepts that there will be more good news on employment over the rest of the year. The Bank is being too gloomy again, but this time is tightening money so the economy may well be a bit slower as a result.