Comment w/c 6th August

Interest Rates in a Digital World

“An investment in knowledge pays the best interest.”

Benjamin Franklin

It was finally all bit of an anti-climax, when interest rates rose to 0.75% last week. After one of the most prolonged ‘shall we, shan’t we’ waiting games, the Bank of England’s Monetary Policy Committee (MPC) was unanimous in its decision - and the £ Sterling promptly fell against other leading currencies.

Perhaps it was because of the accompanying statement, that ‘low interest rates were likely to be the new norm because of an ageing population’ (apparently more likely to save money than spend, although this was somewhat contradicted in the recent **FCA Retirement Outcomes Review** which showed the record rate at which us oldies are using George Osborne’s freedoms to cash in their pensions).

So this commentary looks at this rather lame excuse for low interest rates, we suggest a rather more direct cause, and we look forward to normality returning: as in our view, the decision was correct - even though the Bank’s logic was unconvincing.

Why have inflation and interest rates been so low for so long? It’s a global phenomenon and pre-dates the 2008 financial crisis by a long way. In fact I recall some 12 years ago the strange experience of witnessing a considerably over-heated economy with absolutely no inflation pressure. It was clear that when the bubble burst – as it did a couple of years later – the spectre of deflation would emerge. At The Share Centre, the conviction that interest rates would collapse was so strong that a multi-year interest rate protection policy was taken out in order to protect deposit interest income.

When we look back to the 2008 crisis we think of irresponsible banks who could not reconcile their dual roles of principal and agent, and that was indeed the trigger which set it in motion. But there was an underlying economic hollowing out of the old ‘boom and bust’ mentality, because inflation was no longer there to get us out of the mess, no longer to be a tractor to pull us out of excess borrowing and market panic. All central banks could do was to collapse interest rates, set up quantitative easing – printing money – and wait. It’s been ten long years of waiting during which they could have searched for the real reason, and they’re still not acknowledging it.

And yet that reason is staring them in the face – it is the technological revolution. Indeed on the very day that the rise was announced, the incredible power of one of the tech giants - the Amazon phenomenon - was **declaring its results** .

The tech giants are driving a revolution every bit as big as the Industrial Revolution. It’s not about the taxes they don’t pay, it’s about them injecting huge scalability into supply at the same time as de-monetising so much of the demand. And it is a global phenomenon, because it has unleashed the productive potential of so much of what used to be called ‘the third world’, thus enabling not just digital scalability of supply but also immense physical scalability: and those countries are now showing the growth to prove it.

At home, what companies such as Amazon, Apple and Google are replacing is a crumbling infrastructure of retail stores such as House of Fraser - which used to be the retail economic engines for inflation in the old days: inefficient supply, demanding employees, bricks and mortar issues, transport bottlenecks etc ..

We may live to regret it, but all that is going. Instead anonymous white vans deliver packages to our doorsteps: soon it will be drones. And if something can be delivered electronically such as music, news or instant electronic messaging, it is so done.

As Apple becomes the first US company to be valued at over $1 trillion and Jeff Bezos becomes the world’s richest man with a fortune of $112 billion, the technological revolution is so self-evident that the only surprise must be that the Bank of England doesn’t appear to get it.

Instead what they have come up with is the ageing population argument. It really doesn't hold water: older people do spend money, and generally have disposable wealth built up over their working lives. They spend it not just on themselves but also on the needs of their children and grandchildren, particularly in these times when property prices are so high.

Taking the heat out of the property market is therefore a good reason in itself for raising interest rates. It may not have been acknowledged by the Bank – pushing down house prices is not a popular call for those who own a house already – but **we have to make housing more affordable for young people** .

So over recent years the Bank of Mum and Dad has been one of the most reliable finance houses putting money into the economy: older folk need quite a bit more credit for what they do.

On that subject, it does strike me as somewhat odd that, while we spend £billions educating the young for their 30-40 years of work, we have no formal structure for educating the old for their 30-40 years of 'leisure': and that could have a dramatic impact on their economic turnover and their demands on Government expenditure. If a more coherent structure was established to help older folk prepare for such a different stage in their life, including how to look after themselves physically, mentally and socially, their quality of life and engagement in society could be transformed.

Imagine what could be saved in social care and physical discomfort with courses on how to keep fit and healthy? Imagine if there were training for coping with the digital age, what enjoyment could be had for older folk communicating online - even enjoying company of Alexa? Imagine if the excellent, but rather expensive, courses promoted in the **Oldie magazine** were more widely available, to help older folk enjoy travelling the world and exploring its history?

However I digress from the theme of interest rates. The decision to raise them is right because we can't for ever live on borrowed money at cheap rates with inflated asset prices. Rising rates will encourage business to use equity more in place of debt, with all the benefits that accrue to a society which can participate more directly in business ownership. And, as Capital Economics suggested some months ago, UK productivity will magically rise as interest rates rise, as earnings accrue to the financial sector **(see our commentary on 12th February 2018)** .

A gradual return to normality has to be the right way forward. We will just have to learn to accommodate our electronic consumption appetite at a slightly higher cost. Part of this may be additional tax on digital businesses - levying tax on revenues rather than profits - and that may well become a surrogate for the rise in inflation which the Bank of England will be right to take into account. This thought led me to search for the **Tax & Prices Index** , only to discover that this useful tool, first introduced by Margaret Thatcher's Government, was discontinued by the Office for National Statistics in January 2017. Time to re-introduce it?

Gavin Oldham

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