Funding the Future

Eventually the Bank of England will have to give in. In...

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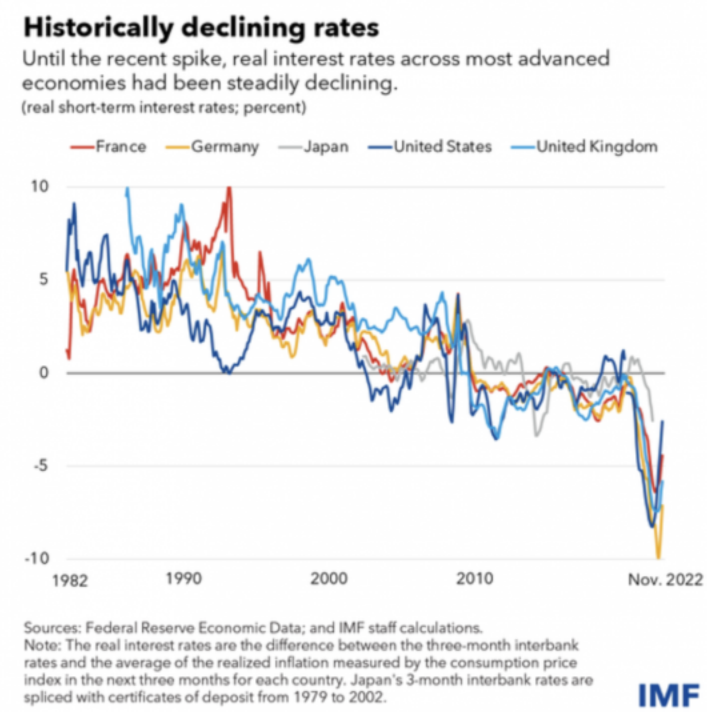
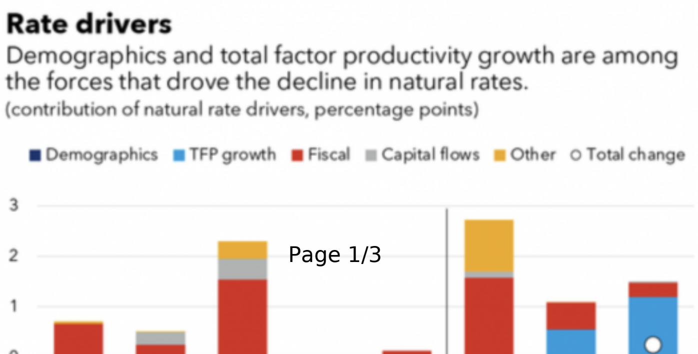
The International Monetary Fund (IMF) blog is usually worth reading. I subscribe to its email feed, as a result of which I saw its [forecast on interest rates](), made over the weekend.

As the authors of the IMF blog note, historic real (net of inflation) interest rates have fallen heavily over the last few decades:



The uptick of late is notable. The authors speculate on whether this can be sustained. They conclude it will not be. They suggested that the overall pressure in rates is downward:

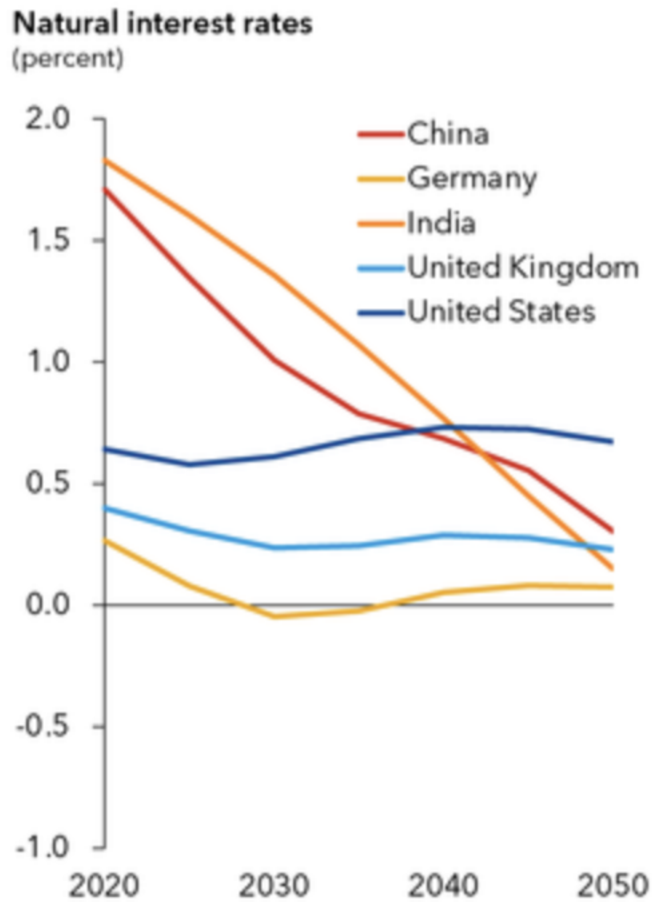


The primary reasons are twofold, in their view. One is the impact of demographics, which I will discuss in a moment. The other is what they define as total factor productivity growth (the total amount of output produced with all factor inputs in the economy), which is declining in most countries surveyed.

I have three thoughts. First, of course total factor productivity is declining. The capitalist economy has run out of ideas as to what to do: innovation is fast disappearing and what there is will require little factor input (including labour in the case of AI). The measure shows an economic system that is not providing answers to meet needs. That is especially true when most needs that are unmet will have to be addressed by the state in future since markets are incapable of delivering what is required.

Second, the term 'demographics' is, I think, likely to be misleading. The required term is 'inequality'. It could be 'intergenerational stress'. The fact is that financial wealth is growing in the world. Most of that growth is going to those who are older. Like almost all those with wealth, the greatest concern of those with that new wealth will be preserving it. They will as a result be intensely risk-averse. The consequence is that they will save in cash, fuelling what is already a glut in worldwide savings. Of course real interest rates will fall as a result, whatever central banks like the Bank of England want to think.

The IMF forecasts are interesting as a result. They suggest this:



In other words, interest rates will track inflation in the UK. Inflation is going to tumble. So too will rates, whatever the Bank of England says.

Unless, of course, they want to create an epic financial crisis.

I don't rule that out.

What I do know is that eventually, the Bank of England will have to give in. Rates are going to fall. We cannot live in a world where there is growing inequality and a glut of savings and have any other outcome.