Funding the Future

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Interest rates on UK 10-year gilts and US ten-year Treasuries hit levels last seen before the 2008 global financial crisis yesterday:

The UK rate, as noted above, was 4.727 per cent.

The apparent market betting is that inflation can be beaten and recession can simultaneously be avoided if base and guidance rates are increased again.

There are three assumptions that make that logic work.

The first is that interest rate rises work to bring down inflation.

The second is that interest rates can remain high after inflation falls.

The third is that in a high interest-rate economy where real interest rates are higher than the rate of inflation - which is something unknown since 2008 - we can apparently avoid a recession. That, apparently, is because although interest will still be sucking the lifeblood out of people's capacity to spend whilst increasing inequality, so reducing multiplier effects, there will, supposedly, be enough spare income to keep the economy buoyant.

All three of these assumptions are totally absurd. None is true.

Inflation is not being cut by increasing interest rates: inflation is being cut by the fall in global commodity prices.

In addition, interest rates cannot remain high if inflation falls - and other market makers, like mortgage lenders, are already indicating their awareness of that fact and the reality that current rates are unsustainable by beginning to reduce the mortgage interest rates they are demanding.

Third, there is no way that the fragile economies in which we now live can sustain positive real interest rates and grow, whatever money market makers might like to think. Positive real interest rates will simultaneously cut consumption, government spending and investment, which are three of the four components of GDP growth (the other being net exports).

Markets are living in a fantasy world right now. The risk of a lot of things falling apart very rapidly if this fantasy worldview is not shattered remains high.