Funding the Future

Article URL

Published: January 12, 2026, 7:52 pm

I noted in a video recently that if the Bank of England was setting interest rates now in accordance with long-term trends, then the real interest rate (i.e. the interest rate less the inflation rate) should be as close to zero as makes no difference.

The suggestion is based on a Bank of England staff working paper by Paul Schmelzing published in 2020. In it, he argued:

With recourse to archival, printed primary, and secondary sources, this paper reconstructs global real interest rates on an annual basis going back to the 14th century, covering 78% of advanced economy GDP over time. I show that across successive monetary and fiscal regimes, and a variety of asset classes, real interest rates have not been 'stable', and that since the major monetary upheavals of the late middle ages, a trend decline between 0.6–1.6 basis points per annum has prevailed. A gradual increase in real negative-yielding rates in advanced economies over the same horizon is identified, despite important temporary reversals such as the 17th Century Crisis. Against their long-term context, currently depressed sovereign real rates are in fact converging 'back to historical trend' — a trend that makes narratives about a 'secular stagnation' environment entirely misleading, and suggests that — irrespective of particular monetary and fiscal responses — real rates could soon enter permanently negative territory.

The most relevant of the charts in the paper is, in my opinion, this one on long-term trends in real interest rates:

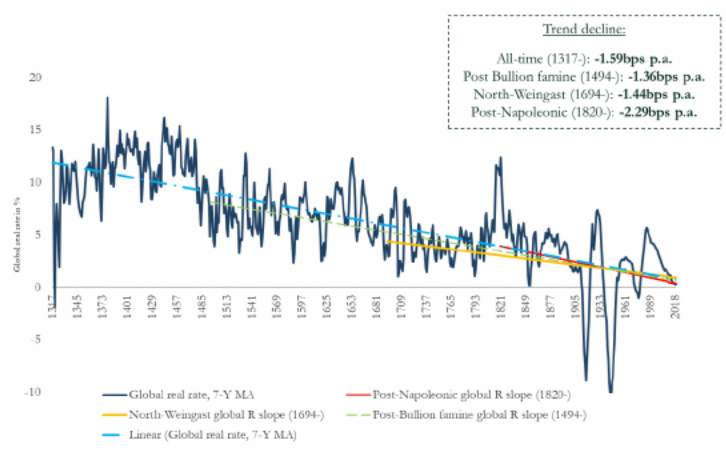

Figure IV: Headline global real rate, GDP-weighted, and trend declines, 1317-2018.

As the trend line in that chart shows, we have now reached the point where net real interest rates should be zero, and there is no excuse for them to be anything else. Essentially, the risk in money lending has gone in a system where the return of funds is guaranteed by the central bank. Nothing more than a return that maintains the value if the money is deposited is required in that case. After all, why else are government guarantees on bank deposits provided if it isn't to eliminate risk and so keep rates as low as possible?

So, why is the Bank of England trying to impose rates that are so out of line with long-term trends at present? I am sure Andrew Bailey might respond to requests for explanation written on the back of a £50 note. If you haven't seen one of them for a very long time, guesswork will have to do. My guess is that the reasons why we have rates so out of line are

* Bankers could not look the gift horse of inflation in the mouth without exploiting it.

* The City thinks the world is made up of bankers. This is good for bankers; ergo, they think it is good for everyone.

* The Monetary Policy Committee are indifferent to growth: long ago, they realised that British capitalism is not about creating value but is instead about extracting it from others, and high interest rates are a perfect example of that. In that case, successfully imposing high rates is a smart move in their book.

* The Bank of England is not accountable for its actions by deliberate neopolitical choice.

* There is no one in politics with the guts to stand and say this is wrong, with reasoning attached.

The system is rotten, in other words.