Funding the Future

Unpacking the nonsense being said about interest rates ...

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A massive amount of nonsense is currently being said and written about the 'market' reaction to Rachel Reeves crying in the Commons on Wednesday following the government's defeat on its welfare proposals on Tuesday.

This is the ten-year gilt chart from the FT for the last week. It shows the effective rate of interest that could be generated at any moment if the gilt in question had been bought at a particular moment at the price then prevailing. The rate varies n ot because the actual interest rate does, but because the interest rate payable on the gilt or bond is fixed, but the price paid for it can vary.

What the chart shows is a number of things.

The first is that the prices were fairly stable until 1 July. Then they rose, meaning the interest fell. That happened because Andrew Bailey, in his role as Governor of the Bank of England, suggested that he might cut the rate of utterly unnecessary quantitative tightening bond sales that the Bank might make. These sales only take place to force the rate up, so indicating they might slow down means that the rate fell. This is an issue I have discussed for a long time here, and it indicates how malevolent the impact of the Bank of England on interest rates and the cost of government borrowing is.

Then, on Tuesday night, the government lost in the Commons, and the rate rose a little on Wednesday morning as a result. It did not rise by much. Rachel Reeves' claim that there would be chaos in the markets if disabled people were not sacrificed in their hundreds of thousands to them proved to be totally untrue, as I predicted.

Things only changed when Reeves appeared in the Commons, weeping. She claims this was for a personal reason. Chancellors do not weep in pubic for personal reasons. They hide when that happens. Whatever the cause of her grief, she made a disastrous error of judgement by appearing because it had an impact on the confidence of markets. That is precisely why she should not have appeared in the state she was in.

The reaction was immediate. She sent out a signal that she was out of control. The markets noticed immediately, and the price of gilts fell as a minor sell-off began, with rates rising as a result.

Then Stamer said she was staying.

She delivered a PR appearance matched with lots of faux bonhomie with her colleagues whilst they delivered another nail in the coffin of the NHS, and things stabilised, albeit at a higher level than they were before the defeat.

These issues have to be appraised independently.

Firstly, the fall in rates resulting from Andrew Bailey’s comments proves that I am right that the Bank is acting against the best interests of the country. The means to cut UK interest rates is readily available. Just stop quantitative tightening. It is that straightforward.

Second, the failure of the market to react in any significant way to the events of Tuesday night shows that I was also right: Reeves' claim that markets would react adversely was wrong. They hardly noticed.

But they did notice her crying uncontrollably. It was hard to miss. And they reacted. Risk increased, and so they priced it. Here was a government that was out of control. It need not have been, but a key person within it had obviously lost control, and the reaction was unsurprising, and all Reeves' fault.

Now, three things are being claimed.

The first is that Reeves has to stay, because Starmer saying he supported her calmed markets.

Second, only she, supposedly, has the confidence of markets.

Third, all this proves that the government is utterly dependent on and has to appease markets, and so she has to stay.

You almost wonder if she staged all of this, except that all that is being said is absurdly wrong.

First, the fall in rates on Tuesday proves the government can control rates. All it has to do is tell Bailey and the Bank to stop quantitative tightening. The job is then done, but no one is saying this. Why not, I wonder? Do they all really believe that the Bank is really that independent? If so, they are fools, because it is not. Literally, rates could fall heavily today if the government so wished. It clearly does not.

Second, the drop in rates, but not to where they were before Reeves started crying, is a measure of a slight fall in risk in the short term. It is not an indication that she has to stay.

Third, of course taxes need to rise: but if markets think that means rates must rise then all that means is that the action with quantitative tightening becomes more important still, and both could be done to the overall advantage of the country, most especially if the taxes were very largely on the wealthy - which is what the City really does not like, becasue it is very small-minded and self-interested, which is exactly why Reeves so inappropriately sought to sacrifice disabled people to it in the first place, which they liked, providing some indication of just what sort of mindset is to be found there.

So, are we suddenly in hock to markets? No, of course not.

Is Reeves invulnerable now? No, of course not.

Is Starmer's authority restored? No, of course not.

Shall we move on? Rates are still for the government to set, and it could. Reeves is hopeless at her job, and Starmer should go with her. This is the reality. And sometime this might work out.