

Hike interest rates and return real working capitalism back to Britain



by Jonathan Davis
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AFTER the First World War, US industry took out far too much credit. The country experienced a nasty credit bubble and prices, including share prices, soared. Does this remind you of economic conditions anywhere else? The past has direct lessons for Britain, and they suggest that, at its meeting today, the Bank of England's Monetary Policy Committee should hike interest rates from their historic lows.

From the beginning of 1920 to the middle of 1921, the US faced a truly ugly deflationary collapse, as overheated credit markets blew up and manufacturers produced far more goods than consumers could buy. Stockmarket prices plummeted by about a half, and the collapse in producers' prices came at the fastest rate in US history -- surpassing even that of subsequent Great Depression.

Did the then US President Warren G Harding increase spending to "stimulate the economy", as commerce secretary Herbert Hoover demanded (the same Hoover who was President during the Great Depression of the 1930s). Did the Federal Reserve slash interest rates? No. They both did exactly the opposite.

The Fed increased rates and the US government balanced its budget. The over-borrowed went bankrupt, the markets cleared, and 18 months later the US economy was back to full employment. They now call the following decade the Roaring Twenties. But you never hear the preceding deflationary recession talked about by politicians and central bankers. The only reason it was not called a depression is that it didn't last long enough to qualify.

There are lessons from history. One of the most important is that lowering interest rates and maintaining record government deficits is not sustainable. There is not one credible historical example of the current combination of extreme monetary easing and persistent fiscal deficits succeeding in stimulating growth. At best, these policies will only substitute false government-fed demand for a short time, while fostering conditions for an even bigger depression in the future. Just look at the last two decades in Japan. The UK's real GDP is lower now than five years ago, and it will not grow sustainably for another 25 years with the current mix of monetary and fiscal policies.

On the other hand, if governments and central banks were to stop deficit spending and hike interest rates (and thus stop the debasement of people's capital), and if they refuse to feed an over-borrowed economy with ever-cheaper credit, history says the market will clear and the economy will recover.

Due to the Bank of England's excessively low interest rates policy for the decade before the 2008 collapse, borrowing and lending spun entirely out of control. Eventually the banks collapsed. Households and businesses were left with gigantic debts that some will never be able to repay.

The government bailed out the bankers with our children's money. Remember too that the Bank of England didn't spot the biggest economic and financial collapse in history. Since then, it has slashed rates further and has kept them at 300 year lows for the last four years to help the economy. Have you seen any real economic growth during the last four years?

What is the problem? Keynesian socialists have been in power for decades (with a brief respite in the 1980s). We do not have capitalism. If we did, there is no way we would have bailed out banks in 2009. Capitalism without bankruptcies is like Christianity without Hell.

So would higher interest rates help restore capitalism? Yes. The prudent saver would no longer be bailing out the imprudent borrower. Those with savings, who currently receive practically no interest on their capital (despite higher and higher costs of living), would spend in the economy rather than on eating and heating their homes. We would stop handing billions of pounds to banks every year. The cost of living and running businesses would plummet.

This would be a major step in bringing back real capitalism. By keeping zombie companies and households alive, we sap strength from strong businesses and families. Why should a family from Walthamstow, which earns £30,000 per annum, with three children and a mortgage, pay to keep reckless lenders in a princely lifestyle?

Capitalism is the only model that works. Ask the Singaporeans or the Scandinavians, or the UK car workers of the 1980s and 1990s. It's time to bring it back to Britain.

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