{ INTEREST RATES }

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If ageing populations are one of the drivers behind historically low interest rates, then it's hard to see a remedy

Back in 2010, Bill Gross, the so-called "king of the bond markets", proclaimed that UK government bonds were "resting on a bed of nitroglycerine" and predicted some kind of related asset price collapse. With the near-death experience of the financial crisis fresh in everyone's minds and the eurozone sovereign debt meltdown about to kick off, it was easy to see why he said what he did.

Britain had one of the largest budget and current account deficits in Europe and its creditworthiness as a nation was being widely questioned. As it turned out, Gross could scarcely have been more wrong. Since then, gilt yields – which move in inverse proportion to prices – have gone down and down, hitting historic lows just recently. And it is not just Britain. Elsewhere, the decline in yields has been even more extreme. The yield on German 10-year bunds has sunk to virtually zero, while Japanese 15-year money has slumped into negative territory. Worldwide, there are reckoned to be more than $10 trillion worth of government bonds trading on a negative interest rate, with many corporate bonds, too now joining the sub-zero club. Never before in history have governments, or creditworthy corporations, been able to borrow so cheaply.

In part, these ultra-low rates are the result of central bank money printing. Britain and the US ceased their bond-buying programmes (quantitative easing) some time ago, but asset purchases continue apace in the eurozone and in Japan. If bond yields are being driven to zero in these regions, then investors look for higher yielding 'risk-free' assets elsewhere, so UK and US yields fall, too.

Yet unconventional monetary policy is as much a consequence of the low interest-rate environment as a cause; there is a deeper, underlying reason – the so-called 'savings glut'. Central banks are in truth only responding to a broader market-based fall in rates, forcing them to reduce official interest rates to zero and beyond in order to provide stimulus.

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On a global basis, corporations and households are saving their earnings rather than investing and spending them, creating a self-fulfilling climate of low demand and poor growth. Growing risk aversion forces this excess of savings into supposedly risk-free assets such as US Treasuries, German bunds and even UK gilts. None of these securities is at all likely to default, if only because in extremis they can all be serviced through central bank money printing. Investors are all but guaranteed their money back, yet in chasing these assets, investment in productive growth grinds to a halt.

The cautionary effects of the financial crisis provide a partial explanation for risk aversion. In time, this ought to pass. Yet, unfortunately, there is also a rather more pervasive and therefore worrying one: demographics. As societies age, they save more to support themselves in retirement, and they spend and invest less freely. Eventually, there will come a tipping point, when retirees will want to draw down their savings rather than add to them, but that may still be some distance off.

In any case, today's negative interest-rate environment is having some perverse consequences, creating new bubbles in a number of other asset classes such as housing. There is also some evidence to suggest that wafer-thin returns are causing companies and households to save even more, thus further crimping consumption and investment. More worrying still, the further yields erode, the greater the risks of catastrophic loss should prices correct and yields rise sharply again, as one day they inevitably will.

Policymakers seem to have run out of road. It's hard to see how this low interest-rate environment ends, except badly.

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