



Newsletter – September 2024

It has started! Central banks in the Western economies have started to reduce interest rates. On the 18th Sept the USA reduced rates by 0.5%, the first cut since 2020 after keeping them at a two decade high. The week before the ECB had cut rates and the Bank of England had cut rates in August. This is a complete change in policy after raising them from 2022, at an extremely rapid rate. (See May 2024 newsletter for UK chart: Dec 21 at 0.1% to Aug 23 at 5.25%). The reason they raised them was higher inflation and the belief that raising rates would lower inflation.

Raising rates is the classic central bank response to higher inflation, but it assumes the inflation is caused by monetary expansion. Too much money chasing goods and services and therefore prices rise. But what if the problem was not too much money, but too little supply due to global lockdowns in response to the Covid19 scare? Then higher rates do not help supply and are negative in helping economies recover from that policy. Of course, there was in the wake of Covid19 lockdowns an increase in money supply as governments went into overdrive handing out money they did not have and having to borrow ever more, expanding national debts. The UK was particularly keen to hand out money, remember the "Eat out, to help " 2020 scheme?

The UK finance minister decided it would be a good idea to use taxpayer money to subsidise people who went out to eat. The scheme paid up to ten pounds per order for those going out to eat and cost £849 million for 160 million meals. To put that into context the number of families in the UK is about 20 million, so each family contributed £42 to buy these meals. It was of course racked by fraud and the HMRC issued "nudge letters" to over 4,000 businesses because it was concerned they may have made incorrect claims The finance minister who had this idea was Rishi Sunak who later became Prime Minister.

On that point, about finance ministers in the UK being known for throwing away taxpayer money, Prime Minister Liz Truss fired her finance minister Kwasi Kwarteng after just six weeks when his budget in 2022 nearly destroyed UK pension funds. Before that Gordon Brown, as finance minister from 1999 to 2002, sold half of the UK gold reserve at prices below \$300 and now we have gold at \$2,500. And who can forget the finance minister Norman Lamont, who was in charge when the UK was ejected from the exchange rate mechanism in 1992 at the cost of billions. At the time the Prime Minister was John Major, who was formerly the finance minister and who, it is said, had convinced Mrs Thatcher to join the system. On 30 October 2024 the new UK finance minister Rachel Reeves, will explain her financial ideas!

Reductions in interest rates might suggest better times for companies, employment, profits and share prices but that is not always the case. Central banks are usually far too late and after an initial positive response, the world comes to realise that there are major economic problems ahead if rates are lowered. Plus, as I mentioned in my last newsletter Aug 2024, there are global risks beyond economics at the moment, so interest rates lowered by 0.5% might not be very helpful.

Best wishes

Tim Underwood

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