Government Actuary's Department

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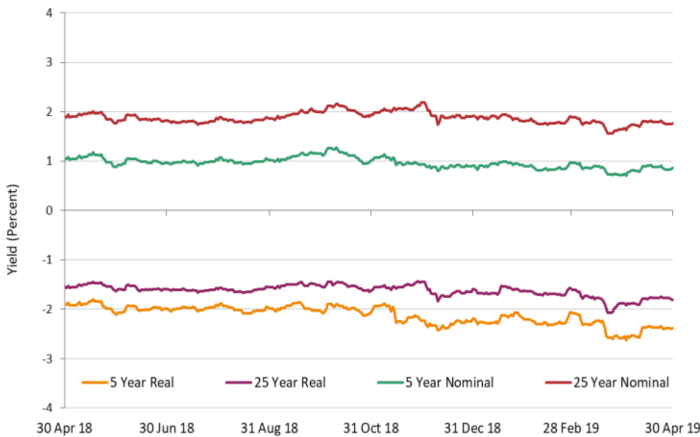
Investment Bulletin

This month in brief

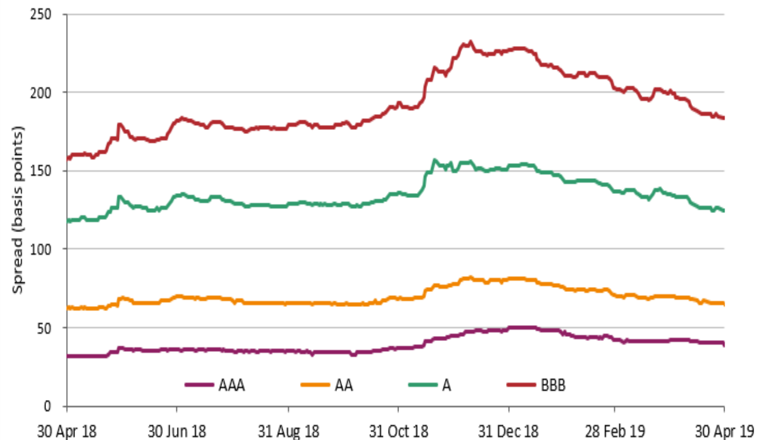
According to preliminary figures published by the Office for National Statistics, the UK Government's borrowing last year has fallen to its lowest annual level in 17 years. For the 2018/19 financial year, the borrowing was £24.7bn, £17.2bn less than in the previous financial year. The reduction to borrowing should give the government freedom to ease austerity measures according to economists.

The ONS has said there has been a slowdown in house price growth over the past two years. During February the UK average house price rose at the slowest rate since September 2012, while London house prices fell. Average house prices in the UK increased by 0.6% in the year to February, but fell in London by 3.8%. CPI Inflation was stable in March at 1.9%, easing pressure on the Bank of England to raise interest rates. The Bank of England target inflation at 2% and in March kept rates unchanged at 0.75%, where they have been since August last year.

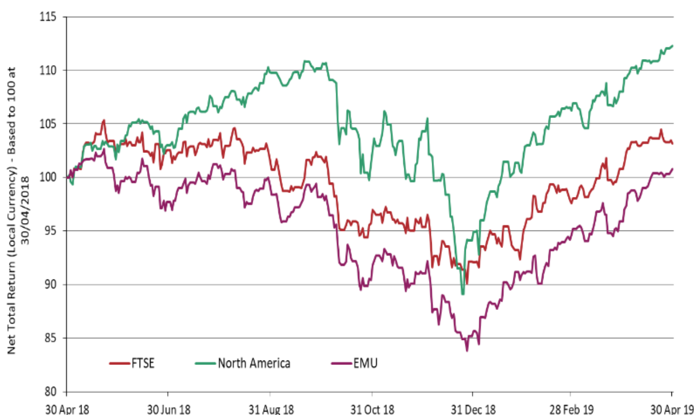
Real yields and nominal yields on short and long term bonds rose slightly over the month.



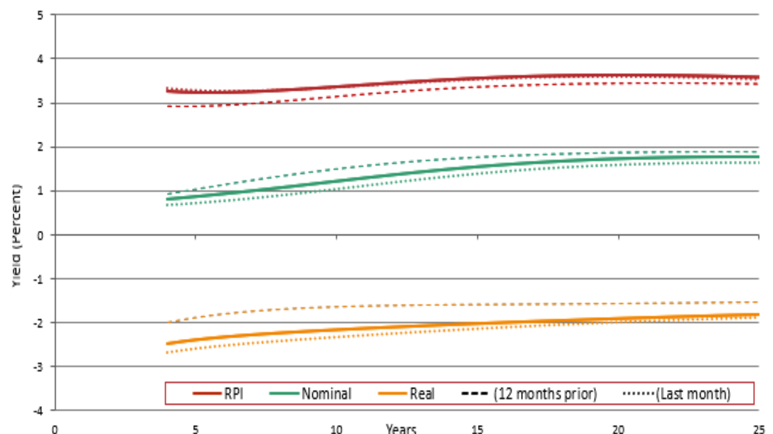
Credit spreads of lower rated bonds continued to drop slightly over the month following the highs seen in November.



North American and EMU equity markets continued to rise slightly over the month whilst FTSE markets remain stable.



Real and nominal yields are slightly higher than last month.



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Investment Bulletin

This month we discuss the persistent low interest rate affecting western countries. This is part of a series in which we will explore the slowdown in global growth, the impacts of this, and the tools which have been used to stimulate economic growth.

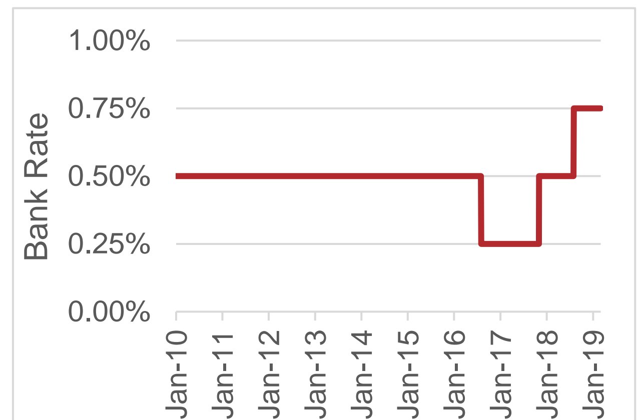
The low interest rate trap

Recent cuts in the global growth forecasts by the Organisation for Economic Co-operation and Development are but one indicator which show demand continues to stall in the western world. The Bank of England has yet to raise the bank rate above 0.75%, compared to 5% before the financial crisis, and it is unlikely interest rates will rise significantly whilst growth remains subdued.

Japan has long faced the challenge of sustained low growth and inflation in a low interest rate environment – with Japanese interest rates hovering around zero since the post-bubble crash in the mid-1990s. Previously, there was a general consensus that the issues Japan experienced could never happen in the Western world and that policymakers would be able to deal with them. However, over a decade since the financial crisis, commentators are asking whether low rates are the new norm?

Policy levers

Broadly speaking, macroeconomic theory outlines that governments can stimulate spending through monetary policies, such as interest rates and quantitative easing, or through fiscal policies, such as tax policy and government spending. Since the financial crisis, governments have used significant monetary stimulus to support economic growth. For example, the Bank of England reduced the bank rate to stimulate spending, by reducing the cost of borrowing, and introduced its quantitative easing programme.



Whilst Japan, the UK, and Europe have all also used fiscal policy since the financial crisis, there are some commentators that argue there is a need for more of a balance between fiscal and monetary responses. Such commentators argue that focus on reducing debt, which soared in response to the crisis, has generally led to lower levels of fiscal response. They argue that a reduced focus on debt reduction may allow tax cuts and government spending that can have a significant impact on economic growth.

Further there are risks that low interest rates are self-fulfilling. Central bankers and other commentators warn of the “debt trap” whereby consumers, businesses and governments can only afford to service their debt because of low interest rates. As such, economic recovery and growth is vulnerable to rate rises.

As a counter example, the US government have implemented tax cuts and increased public spending which has increased US growth and the Fed has increased the interest rate to 2.5% in early 2019. However this comes with the risk of holding more debt including, for example, investors charging a higher interest rate to offset the risk of not being repaid and the dollar deflating, making government bonds less desirable.

Impact for pension schemes and savers

One impact of focusing on monetary policy in a low growth environment is central banks are likely to maintain interest rates around their current low levels. A consequence of these persistent low rates is lower returns on risk-free assets, meaning savers see low growth on their money. As a result, for pension funds to attain the same levels of benefits as during higher growth periods, higher pension contributions and higher risk investments will be required. This may lead to the risk of a population under-saving for retirement, since at the time the incentive is least to save the requirement to make higher contributions for the same benefits is greatest.