

[Rate race](#) [1]

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As the coalition government slogs through the quagmire of implementing its goal of deficit reduction, a timely [report from McKinsey Global Institute](#) [3] underscores the urgency of the mission.

In short, McKinsey argues that the past three decades featured a decline in the investment rate of mature economies, leading to the decline in real interest rates that fed the global credit bubble. They're now forecasting a "potentially enormous wave of capital investment" driven by emerging markets and putting "sustained upward pressure" on interest rates.

It's that prospect of generally higher rates that makes cutting the UK's budget deficit so critical. At the risk of some over-simplification, it can be argued that the nation's current government and personal debt load has been largely due to funding pre-mature consumption rather than long-term investment. Feel-good government programs, unfunded pension obligations, over-priced houses, glitzy kitchens, flash cars and exotic holidays were all bought on tick.

The McKinsey study doesn't make specific forecasts of precisely when and by how much rates will start to rise. It does suggest, though, that, if real interest rates return to their average since the early 1970s, then a rise of 150 basis points would be in order. And they reckon that the rise in long-term rates may start within five years as investors start to price in this long-term structural shift.

Broadly, that timetable is in line with the UK government's schedule of deficit reduction. To avoid spiralling debt service costs from the forecast rise in interest rates, it must not be deflected from its strategy, even as its impact turns ugly on the streets. And it would be smart to borrow long now while rates are still low.

Paying off the bill soon for past consumption excesses, whether government or personal, would leave the UK well-positioned to benefit from McKinsey's anticipated "wave of capital investment." It's a tough world out there but the UK has formidable business expertise in engineering, architecture, infrastructure, communications, legal and financial services, food processing, agriculture, biotechnology, education, retailing, mining and oil & gas.

A mature and ageing economy like Britain's has little alternative than to reduce domestic over-consumption and to increase under-investment in foreign growth opportunities.

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