FINANCE UPDATES
DECEMBER 2020

CAMPBELL & McCONNACHIE
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COULD INTEREST RATES TURN NEGATIVE?

And what would it mean for your money?

In a year of firsts for many of us, the Bank of England (BoE) has mooted a first of its own: they have asked the banks if they are operationally ready for negative interest rates. That is, banks, and by extension those that save with them, would be charged for holding onto cash.

It is worth stressing this hasn't happened yet, nor is it imminent. But it does appear to be a monetary tool the BoE is considering in managing the economic response to COVID-19.

It makes an eye-catching headline and, understandably, the first question on many lips is: "what does it mean for my money?"

WHY WOULD RATES TURN NEGATIVE?

With interest rates never fully recovering after the 2008 financial crash, and the subsequent quantitative easing (printing billions of pounds for itself to buy its own government's debt) already done, the central bank does not have much wriggle room.

At the start of the COVID-19 crisis back in March 2020, they cut interest rates to 0.1%. Given how close this is to 0%, you can see the logic in a negative number being a future step.

Their intention would be to make the borrowing market (particularly at a commercial level) more competitive. It would also be deeply uncomfortable for companies, and, to a lesser degree, individuals to sit on cash. So the theory is that a spending spree would ensue to fire up the economy. However, beware the law of unintended consequences.

IS THERE A PRECEDENT FOR THIS?

Negative interest rates have never happened in the UK before, but there are examples from Japan, Switzerland, Denmark and the European Central Bank (ECB) to draw upon.

In Denmark, they've actually seen negative mortgage rates, where borrower's debt goes down more than the value they pay off each month.

But, a little like the twisted fate seen in W.W. Jacobs's classic ghost story *The Monkey's Paw*, mortgage fees went up so much that it still effectively cost people money to borrow, and it made mortgages less affordable at the point of taking one out.

One fear raised for the UK is that cash would merely be shifted into property, driving up house prices yet higher, which comes with its own problems for many in society.

Another is that it would destabilise the banking industry if enough people turn their back on it at the prospect of further cost in the place of decent returns.

For what it's worth, one member of the Monetary Policy Committee, which is responsible for setting the Bank's rates, said the risk of negative interest rates being counterproductive to monetary policy were low. But who really knows?

NEGATIVE INTEREST RATES & SAVINGS

For a retail saver like you (as opposed to a big business or institution), this will not automatically mean that all savings accounts would immediately follow the central bank's rate into negative territory.

In a free market, there will probably be accounts that would offer at least 0%, and possibly a slight positive.

Since the financial crisis of 2008, cash has not been an attractive asset class for good returns, anyway.

However, if you are wedded to cash and are concerned about negative interest rates as you read this, don't forget they are not here yet and it's possible to go out and find a fixed rate which will shield you from any drop for whatever period you sign up for.

As you might have seen or imagined, there have been news articles both raising and quashing the idea of people taking their money out of banks and stuffing it back under the mattress.

Don't forget the FSCS automatically offers protection for the first £85,000 of savers' money held in any banking group, so it's possible to gain more protection by spreading your money with several unconnected banks.

One interesting detail, confirmed by HMRC, is that you personally would not be able to offset losses due to negative interest rates against the tax charged on positive interest rates.

In other words, if you made £500 in interest in the first half of 2021/22 and then lost £500 in negative interest in the second half, you would still have to pay tax on the £500 of interest gained. A business, however, should be able to deduct the interest charge as a cost.

For many, a move or further move to other asset classes might become more desirable and, of course, the driving force behind the BoE's decision would be to stimulate more money being spent in the economy. Albeit, they are thinking more at a commercial level.

OPTIONS FOR SAVERS

For many years, the low interest rates we have experienced have driven people to seek returns elsewhere.

Equities (shares) have appeal in this regard, although they are completely different in terms of the risks involved.

Their value can go up and down so there is the opportunity for capital gain (or loss), and when companies are profitable they normally pay dividends which have tended to be significantly more generous than subdued interest rates of late.

Downward pressure on interest rates lowers the value of sterling, and because most large UK-listed companies earn the majority of their revenue overseas, this actually boosts FTSE 100 returns when converted back into pounds.

Make sure you take professional advice unless you completely understand what you are doing.

There will be winners and losers in the stock market based on a negative rate being set. For example, banks in particular could be squeezed.

You might also want to ensure your international diversification is regularly reviewed and adequate, any BoE decision would relate solely to sterling. So it is important not to be overexposed, while being mindful of currency movement risk.

Gold is seen as a safe haven, and in a time of negative interest rates it would have its attractions. It has 0% yield – not a selling point against positive interest rates, but certainly an advantage when they turn negative.

Gold also tends to be a good defence against inflation, and particularly stagflation (when inflation is high but the economy and demand are low).

You don't have to buy gold bars to get exposure to gold. Many fund managers have the scope to hold it on your behalf and there are specialist funds which track the price of gold.

You can also invest in gold-mining companies, of course.

Another phenomenon associated with a lowering of interest rates is that bond prices go up while their yields go down. Your exposure to these is worth reviewing.

A much more recent development is the option of cryptocurrencies, such as Bitcoin. One of the interesting points about Bitcoin, for example, is that it has no central bank to impose negative interest rates upon it.

Some will be familiar with cryptocurrencies and know the risks and benefits. If you are new to it, do your research first.

Get in touch for a personal review of your finances.

IMPORTANT INFORMATION