



Chris Andrew  
and Mustafa Zaidi  
ca@clarmond.co.uk  
+44 20 7060 1400

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Market Comment

CLARMOND

## Lost interest...

**The developed world is not currently in the grip of a major World War, however, the debt burden has increased as if it is. The general population may not be ready to suffer the further sacrifices that this massive deficit increase will lead to, and may unwillingly be becoming the 'lost interest generation'.**

"THE SINEWS OF WAR ARE INFINITE MONEY". Thus observed Cicero on the dual monopolies of the State, money and warfare. But how does the State amass this limitless largesse? It does so in three simple ways: taxation; debt issuance; and currency debasement.

When there is a war, the State issues debt to fund the conflict; citizens purchase this debt and await a future rise in taxation, a currency devaluation and a significant increase in the national debt. The contract between State and citizen is clear; in times of war, sacrifices are required, not only on battlefields but also in bond yields.

This can be seen time and time again, from the Prestiti, issued by Venice in the 1100's, to the National Savings Movement in the British Empire for both world wars of the twentieth century. Indeed the slogans such as 'Lend to Defend' and 'War Savings are Warships' connected the population to the war and the national debt.

### Disconnect

Over the last seven years citizens have lived through a wartime-like increase in national debt, but with no war to explain it. The population has been detached from this peacetime debt explosion, the purpose of which has been to maintain consumption, collateral and capital. These three C's lack the somber seriousness of war. The citizen is justifiably confused, asked as they now are to bear the increased debt

burden, paltry interest rates and possibly currency debasement. Given the rise in global debt burdens, governments now rely upon low interest rates to keep the cost of interest payments to a minimum. Sorry citizens, the State has redefined the contract.

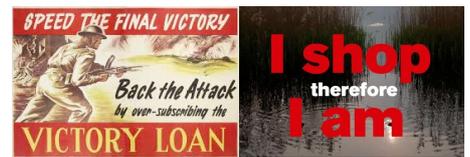
### A tax by any other name

The sovereign debt of the developed world has risen from approximately 80% of GDP to 110%, an additional \$12 trillion of debt, while interest rates have fallen to nothing. A 'normal' short term interest rate is one that is in line with inflation, which has been an average of 2% for the period 2007-2013. Therefore we can roughly calculate that 'citizen-savers' of the world have lost \$1.70 trillion in unreceived interest. This is nothing short of being an undeclared tax levied by the State.

### Modern day example

Has this ever happened before? Yes, in modern day Japan interest rates have been zero for 19 years. However, the important difference is that there has been deflation in Japan during this entire period, so the savers of Japan have kept purchasing power. Rather than trample the savers it was the asset markets that suffered, with the stock market and property prices taking the brunt of zero rates and credit contraction.

As commented on in an earlier piece ('Golden Calf to Raging Bull' -



### Victory at the mall

May 2013) Central Banks have placed the economic world on an 'asset-price' standard. Asset prices have become the collateral upon which credit is issued and therefore must be protected, even if this means sacrificing savers on the altar of zero interest rates. The chances of central banks allowing interest rates to be higher than inflation is remote.

### A Forlorn Hope?

As the quantum of debt has increased, a rise in interest rates would bring hefty costs to the State; currently, interest outlay in the USA alone, at 2.5%, is \$400 billion per annum. Any sustained interest rate rise with the continued level of deficit is not manageable without growth being greater than the yields paid. Simply put, interest rates cannot rise without high growth, therefore a 'lost interest generation' is unfolding.

The only growth lever left for the State is currency devaluation. As Ben Franklin stated "wars are not paid for in wartime, the bill comes later." The State's peacetime but warlike increase in debt awaits its tab. Bill Please. ■