



Annual Conference

Wednesday 17 November 2010

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TISA

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Why have a crisis if we don't
learn the lessons?

Richard Northedge
Journalist



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Richard Northedge:

Why have a crash if we don't learn the lessons?

Why, you may be asking, are you being addressed this afternoon by a journalist – someone with all the popularity of an MP but without the expenses to compensate. If we're so clever, you may wonder, why didn't we predict the crash of 2007?

Well the simple answer is that we did. And the crash of 2006. And the 2005 crash. We had to be right sometime. The Press is so bearish we have forecast five out of the last three recessions. Short-selling could have been invented for the media – if only we knew how to do it.

Actually, journalists might be better informed if they were active investors. Relying for advice on wealth from financial writers who have no wealth of their own is like asking people to read a motoring column written by someone who cannot drive - or a wine page penned by a tee-totaller.

But yes, the press is naturally gloomy. Having witnessed one crash, the lesson we learned was to keep warning our readers to expect another – a double dip, a bear market, a fall in house prices or simply higher borrowings costs.

Show us a silver lining, we'll find a black cloud to go round it.

However, on the positive side, the press does have an important role in imparting independent information on finance and, if we are doing our job properly, in assessing the public perception of the investment environment.

And how do I see that perception? Confused.

On the one hand, Mr Bean – not Rowan Atkinson's comic character, or Vince Cable's caustic description of the last prime minister, but Mr Charles Bean, chief economist at the Bank of England – told us last month that it is our patriotic duty to stop saving and start spending. One reason interest rates are so low, he said, is to encourage us to spend – even if that means eating into our capital.

However his boss, Mervyn King, now says we are in the "Sober" decade where the letter 'S' of Sober stands for Savings. "Savings, Orderly Budgets and Equitable Rebalancing". Which mnemonics committee dreamt up that one? Mr King likes acronyms. The Sober decade follows the Nice decade – Non-Inflationary, Consistently Expansionary. Same committee I think.

You might have thought his Nice decade would be followed by a Nasty decade – "Non-stop Austerity Stretching Two Years", perhaps - or that the Sober decade should have been preceded by the Drunk years – D for Debt, R for Remortgaging, U for Unsecured-loans, N for Northern Rock and K for well you choose: something Icelandic, maybe, like Kaupthing or Krona? But obviously not K for King.

So there are mixed messages on saving from those people who are now referred to grandly as "policymakers" – but who used to be just politicians and bankers. I thus listened to George Osborne's recent Commons statement on the Comprehensive Spending Review. The good news is the chancellor used the word "saving" 41 times. However Mr Osborne's definition is not the same as Mr King's. When the chancellor says "Saving" he means cost cuts, not money put away for a rainy day. He had nothing at all to say about saving in the sense we are here this afternoon – tax-incentivised or otherwise.

Indeed, you might be interested to know the Treasury website has a section called "A to Z of Treasury terms". Actually there is no Z: maybe that's another government cut, or simply a civil servant who went home at 5pm. But the word "saving" - nevermind a definition or an endorsement of them - never appears.

However, if policymakers are muddled, so too is the press. We still write "Good news, interest rates down", "Bad news, mortgage rates rise" - even though it traditionally takes seven savers to finance every home loan. That means seven readers who want higher rates for each one wanting a cut.

Yet now, interest rates have been manipulated downward on an international scale to save the global economy. The answer to the Nice decade of cheap borrowing seems, somehow, to be a Sober decade of even cheaper debt. That, surely, makes us even less likely to save.

I am old enough to have witnessed enough economic crises to need a second hand to count them, but what makes this latest one unique is that slashing of rates. In every other crisis I know, high interest rates either caused the crash or were the supposed solution for it. This time, prudent savers are being penalised while the profligate borrowers are rewarded. What sort of lesson is that to take away from a financial crisis?

If people did not save when rates were higher, why will they save now? The savings ratio was already negative when the crunch came, forcing Britain to rely on emerging economies to finance our borrowing binge. What we used to call the Third World now has a first mortgage on Britain. The money we spend on their exports has returned to buy UK gilts, shares, property – even our football clubs. Other countries are doing our investing because we aren't saving.

But it was not just the public's false confidence in the future, or our appetite for must-have consumer goods, that turned us against saving before the crash. The returns were so poor. Even tax-breaks could not make unattractive investments look appealing.

Pre-2007 interest rates may look astronomical now, but by the standards of previous decades they were already low. Remember how immediately after 9/11, those global policymakers held emergency meetings to cut rates and then kept on cutting. That fuelled the subsequent borrowing boom – and hence the savings slump.

I'm not sure even Osama Bin Laden realises his role in the collapse of western capitalism.

But equity markets provided no obvious alternative. There have been very few times in history when share indices have failed to rise over a five-year period; that has been one of the main attractions of equities. Yet despite the recent rally, the FTSE is not only lower than it was five years ago, it is well down on a decade ago. Performance like that does nothing to encourage the public to invest.

Nor can investors even rely on a steady income from shares. Directors now cut dividends at the first whiff of trouble. So investors who see their capital wiped out by falling share prices now find their income slashed too. Banks, builders, BP – they've all

delivered this double whammy. What sort of lesson in loyalty does that give to long-term investors?

What's the point of putting shares into a tax-incentivised vehicle when the decisions of directors undo any fiscal advantages? And if the vehicle offering that tax-break is a pension or life policy, it may well be worth less now than it was in the 1990s - even without an MVA being imposed. And the annuity it buys will be at a depressed and depressing rate – thanks to interest rates being manipulated down. Savers must wonder whose side these policymakers are on.

The lesson they've learned is, frankly, why bother with financial products? Especially ones that lock up savings.

It is not surprising that those who do still believe in saving have chased yield, even if they failed to appreciate the associated risk. A bank with an unspellable name in a country you cannot find on the map thus suddenly looks quite attractive if it offers an extra quarter-point interest that offsets some of the fall in market rates.

In their pre-crash chase for profits, people pored into the one investment that looked attractive when others were unappealing: property - its prices inflated by banks overeager to overlend. I mean, why save to invest when you could borrow to invest?

Housing is the tax-incentivised investment that people understand best of all. For owner-occupiers the dividend comes in kind – you pay no tax for living there. And the capital gain is tax-free too.

Mr King's Nice Decade thus became a period when Britain traded-up, remortgaged, extended and purchased second homes – and when we could occupy no more space ourselves, we bought-to-let and helped our offspring onto a housing ladder that had become a high-speed one-way housing escalator.

Thus was founded the Bank of Mum & Dad. Branches everywhere, but not regulated by the FSA or shackled by Basel capital rules. Indeed, the role of the Bank of Mum & Dad was to top-up loans when even the most reckless of high-street banks imposed limits; and to provide finance for children who had failed to save.

This nationwide chain would have been better named the Bank of Dumb and Mad - but parents saw buying property in their children's names as a way to put more cash into real estate, taking

advantage of cheap gearing, while – no questions asked - avoiding gains tax, avoiding inheritance tax and usually avoiding stamp duty too.

That was their definition of a tax-incentivised investment.

If those parents have learnt any lesson from the financial crisis, it is probably because their equity has been wiped out and their offspring are lumbered with a liability.

The lesson learned by the traditional banks was to stop giving mortgages of 90 per cent – nevermind 110 per cent - of value and to demand a deposit that cushions any further price falls. But that requires buyers to save and buyers seem to think that that is an unfair request!

And the lesson learned by the press? To blame the banks for that belated prudence and tell them to give more mortgages to first-time buyers and at lower rates.

So it seems the newsrooms have learned little.

What has government learned from this experience? That we need more banks and more competition. Even though it was competition that made Northern Rock offer mortgages higher than the house value, and made Abbey lend five-times borrowers' incomes – or invented incomes.

But just as the answer to the problems caused by low interest rates is even lower rates, the answer to the reckless competition among banks is even more competition.

The government view is that Britain has four large banks – which are too big to fail but too few to compete. Is the number the problem? Just four major supermarkets account for the vast bulk of Britain's grocery sales but their rivalry is cut-throat.

They have probably done more to suppress inflation than the Bank of England has.

So more banks is not necessarily an answer. Remember, in those "good old days of old-fashioned banking values" that people want to recreate, we had 200 building societies – and they operated as a cartel.

People grumble about their banks – they may blame them for the financial crisis (even blame them for the government budget deficit) - but how many people moved their account because of the crisis? Perhaps they regard all banks as bad as each other?

Nevertheless in the name of competition, Royal Bank of Scotland has been made to hive off 318 branches to Santander – hardly a tiddler in UK banking – and Lloyds TSB must sell 600 branches, complete with staff, clients and accounts.

Quite why it constitutes consumer choice for customers to be forcibly moved from the bank they want, to a start-up operation they've never heard of, only government knows.

But in another or the ironies resulting from the crisis, Tesco – condemned so often as the evil monopolist and ruthless predator – is now heralded as a champion of consumer competition, congratulated for breaking up the cosy banking cabal. What a funny world we live in. And adding to that fun are new banks like Metro, whose slogan is "Dogs Rule at Metro" and which provides bowls and biscuits for customers' canines – and Magic Coin Counters and lollipops for the humans.

Metro, by the way, is modelled on an American bank. If you look at the US Metro's website, it carries a disclaimer stating it is "not affiliated with Metro Bank GB plc".

If you look at the website of the British bank it too carries a disclaimer – stating it is "not affiliated with Metro newspaper".

It says something about the standing of the press when even banks want to distance themselves from us. I've not looked to see if Lloyds bank's website says if it not affiliated with Lloyd's List. Or if Standard Chartered dissociates itself from the Evening Standard. Or if Barclays' website says it has nothing to do with the twins who own the Daily Telegraph. Or.....

But while dog bowls and lollipops may be good fun, should banking be frivolous?

We did that in the dotcom boom when banks were so keen to shed their boring image they gave their operations names like Egg, Cahoot, Marbles, Goldfish, IF, Smile.

You couldn't make it up. Oh, sorry, you did. Spelling the name without a capital letter or adding an exclamation mark made it look even more 'cool'.

Well, it may have worked a decade ago, but surely one lesson to learn from the recent crisis is that banking is a serious business. Did the public learn nothing by chasing after banks from Iceland and beyond?

My mother once asked me what HSBC stood for. She was probably a Midland customer from before the takeover. "Hongkong & Shanghai Banking Corporation," I replied. Her face whitened and her jaw dropped. To her, Hong Kong and Shanghai were not the thrusting emerging-market powerhouses of the new global economy. She came from a generation for which Hong Kong was synonymous with shoddy goods - and Shanghai was a verb. Before she could be abducted into white slavery she had moved her savings to somewhere with safe names such as "Bradford" and "Bingley".

But of course, Bradford & Bingley was safe. No saver lost their deposit, anymore than customers at Northern Rock or Halifax or RBS did. Not even the savers with Icelandic banks lost. So what lesson did the financial crisis teach those customers? Not a lesson to be careful, or that high reward involves high risk.

So what of the future? Well, austerity, higher taxes and job losses may leave us with less money, but it gives us even more reason to accumulate a nest egg. That is the paradox of saving: when we most need to do it we can least afford it.

We may all be in this together, but financially, we're all on our own. Youngsters need savings to pay off student loans. We need savings to buy a home. Savings to provide an income in old age and savings to pay for care in our dotage.

But, the banks need us to save too. The new banks insist they will rely only on retail funds. So we're back to the days when if seven of us don't save, the eighth one can't have a mortgage. And that can't be seven Chinese savers. We can't expect foreign countries with trade surpluses to keep bailing us out via the money markets. In future, Mum & Dad must put cash in the high-street bank so that someone else's kids can borrow it - and the bank must therefore pay those parents a rate sufficient to persuade them to save.

Now here's another anomaly of manipulating the markets. Before the crash, banks and building societies paid their depositors slightly less than the Bank of England base rate and charged their borrowers slightly more. A spread. Now, even though Britain's bank rate is just half a per cent, in the real market, the price of persuading the public to save is 3 per cent or more. So both saving rates and borrowing rates are far above that nominal half per cent. We have a black market in money, where the price on

the street bears no relationship to official interest rates. What lesson does that teach anyone wanting to understand finance?

And while the government seeks more tax from us, and while Mr Bean would like us to spend more, the politicians also need us to save if they are going to exit the banking crisis. When the Treasury sells its shares in the nationalised banks it will need to recover more than the total proceeds of the whole privatisation programme of the 1980s and 1990s. So you'd better tell Sid he needs to come out of retirement.

However, BT, British Gas and the other privatisations were sold into a bull market: subscribing looked like a one-way bet. If equity markets are still below their 1990s level, why should a generation disillusioned by stockmarkets buy these bank shares?

It will need some sort of incentive. Maybe they should be pre-packaged in ISAs or the like: certainly a tax-break is better than selling the shares too cheaply.

But more generally, the government – for its own sake – needs to instil a culture of savings on the country. That will not be easy now there is a generation used to buying a home on a 100 per cent mortgage, a car with no deposit, and putting the holiday on a credit card for repayment after the suntan has faded.

But how do you tell someone in their 20s to save when they are still repaying their student loan? Why should someone put money in a pension fund they cannot tap into when they have shorter-term needs? How do people whose lifestyle exceeds their income save anyway? And why save if we are penalised when we try to claim for benefits such as long-term care? Or penalised for having too much in a pension pot – or for dying before we turn it into an annuity. Indeed, why spend a lifetime making National Insurance contributions if everyone will now receive an enhanced state pension even if they didn't collect stamps? What lesson does that teach?

The 2007 credit crunch should have been the greatest lesson the public ever receives in personal finances. But I think very few lessons have been learned. Has perception of risk improved? Has prudence been rewarded? Do low interest rates encourage saving? Have they curbed inflation? Do investors trust equity markets?

What's the point of having a good crisis if we don't learn the lessons?

We need a clearer message as to whether we are supposed to be spending or saving.

Child funds go; Junior ISAs come in. Pension contributions are curbed; Nest is launched. Vat goes down; Vat goes up. And up again.

Rationalising the array of tax-incentivised vehicles might reduce the consumers' confusion. But, Mr Chairman, for fear of insulting our host here today, I would like to see the Tax-Incentivised Savings Association made redundant. I would be happy to speak next year at Risa – the Reward-Incentivised Savings Association.

If there is a better prospect of a profit, if there is more likelihood of a decent return, then people will have a reason to save. And save they must.

Thank you