History of Interest Rates-What Can They Tell Us About Today

By Wes McComb

March 8, 2021

There is evidence that the Sumerians in 3000 BC were charging interest on loans of grain and metals. So apparently, wherever pools of wealth accumulate, lending occurs. However, the greatest writers in the past took more notes on what the God(s) were doing, how the latest wars were going, and generally looking at the current human condition than being concerned with what prevailing interest rates were sitting at.

But interest rates are currently getting some buzz in the media so let's take a brief look at the past to see if there is anything to help us make sense of them today.

The ancient Greeks had wealth build up in their temples. Supposedly, donations from supplicants happy with the outcome of the reading of some unlucky goat's entrails, allowed the Oracle of Delphi to own rental properties, loan out slaves and money. This money was lent out to states and individuals. Until the time of democracy in Athens, after financial reforms had occurred, an individual had to put some serious thought into taking a loan. Defaulting could mean being sold into slavery. Which does seem a bit harsh considering you had likely just lost your house and/or farm.

The Romans didn't advance the sophistication of lending. Borrowing money was generally a back-alley deal between individuals. However, their successor states in the Renaissance developed the basis for today's banking system. Florence's Medici family became the lenders to much of European royalty. Genoa did the equivalent for the Spanish Empire. This was fine until continuous war and mismanagement caused a series of state bankruptcies. The Italian city states lost much of their influence after this.

Banking then shifts to the Dutch and British Empires. Better records were kept and we know that they both began issuing perpetual bonds. Perpetual bonds have no maturity date and pay a fixed amount of income per year. The Dutch still have a bond issued in 1624 that is paying interest today. 497 years isn't perpetual, but that kind of financial stability has only been seen in modern times.

Canada issued a perpetual 3% bond in the 1925 but it was redeemed in the late 60's demonstrating that our idea of perpetual is not the same as the Dutch. Perhaps because we are a much younger country.

The interest rates these perpetual bonds from the Dutch and English paid were between 6% and 2.2%, up until the last 50 years. Though the coupon was fixed, prices would fluctuate depending on the economic outlook of the time.

The next innovation (sort of, since the Genoese had fixed term bonds as well) was in the late 1800s in the United States when 5, 10- and 30-year maturity bonds began to be issued. These three maturity dates are what we still see today.

Interest rates were relatively stable for hundreds of years, even with all the turmoil seen in Europe during that period. Then came the interest rate shock of the 1970s and 1980s. Interest rates spiked up to the high teens. There have been many culprits blamed for this rise, from oil shocks, going off the gold standard, demographics etc. but the end result is it taught many investors to be wary of rising interest rates.

Central banks around the world have 'fighting inflation' as one of their core mandates.

Then, once everyone had bought into inflation as the bogie man that we must keep always be vigilant of, it disappeared. There have been many theories offered for this disappearance, including from global trade, technology, demographics (see the common factor with the rise in rates), government manipulation etc. No one knows for sure, but today's headlines are once again suggesting that the bogie man is about to reappear and cause economic strife.

The answer to where interest rates are going is uncertain, but they likely will go up a bit as we come out of the pandemic and return to a sense of normalcy.

How about hyperinflation? Unlikely, if only because much of our central banking infrastructure has been designed around fighting inflation for the last 50 years. It is usually the unexpected that derails our plans, not something that has been a focus for so long.

Lending and borrowing have evolved in fits and starts since the beginning of human history. It is one of the first developments that occurs once we have surpluses and deficits in agricultural societies. Today, we can lend governments, corporations, and individuals’ money. We can borrow from all of them as well. And surprisingly, even without the threat of being sold into slavery, most people meet their financial obligations.