

## Does inflation matter?

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I've written about inflation before, and I'll do so again, without doubt. As long term friends of mine (some who have suffered discussion of this issue for thirty years) know, inflation has always been relatively low on my list of economic concerns. I stress, not absent from my worries, but an issue that has to be placed in context, which very few neoliberals and even fewer politicians influenced by that way of thinking do. Given that the issue is now, undoubtedly on the agenda, that needs more explanation.

Inflation is, of course, a monetary phenomenon. Money (and I grossly simplify, but do so for important reason that no one else seems to be bothering to even think about the issue) has two functions. One is as a flow. This is the money that circulates in the economy to facilitate the ongoing cycle of transactions. The second use is money as a stock: the store of value and, to some degree, the measure of value. It is, almost instantly obvious that inflation is of potentially lower impact on the former than it is on the latter — subject to one massively important caveat and that is that those who are undertaking transactions can, within reason, keep their own cash supply growing so that whilst the absolute amount of cash they spend grows in real terms the value expended is, near enough, neutral. That means wages need to rise in line with inflation, especially for those on low pay — which means minimum wage adjustments are essential — and it means pensions and all benefits must be increased to ensure the least well off in our society do not suffer for inflation.

This identifies the first and most important risk from the current inflation. The government has changed the basis for indexing pensions and other benefits to make sure that although this government has deliberately increased inflation — by completely unnecessarily increasing VAT — they have ensured the poorest will suffer as a consequence. For these people inflation will matter, a great deal. So I am not indifferent to the issue — far from it. There is a matter of social justice to consider here.

There's another issue of social justice too. Increasing interest rates now will, without doubt, remove cash from the UK economy. That will result in reduced demand for goods and services and that in turn will mean a loss of jobs in the UK. We're already going to lose 1.3 million jobs over the next few years — people who do not deserve to lose their

jobs. The VAT rise will increase those job losses. And so too will the impact of the inflation we're going to suffer — inflation that, as I note below, is largely being imported into the UK, but to consciously increase these job losses by increasing interest rates; to reduce demand will increase those job losses again. And that would be another issue of social justice — because those people do not deserve to lose their jobs for this reason.

And they do not need to do so, because the reality is that this inflation is being imported. Russian wheat shortages, imported gas and oil (and we are now a net importer), imported food and increases in the price of raw materials are what are causing this inflation, in addition to the impact of VAT rises. The VAT increase apart none of these will be resolved by any action the Bank of England or the government can take — unless they are willing to regulate speculation in raw material and food prices by hedge funds and others which are no doubt fuelling this crisis. So any action to reduce demand can only make this crisis worse for the working people of this country.

What then about savers? This is the constituency who will yell and shout about inflation. But I'd remind them — this is modest inflation. It is inflation of 3.7%. I accept that this means that many will be earning no real return on their savings. And of course that is going to be hard for some. But let's also be clear; those with capital in the bank have been the winners from this economic crisis. Not one of them lost a penny despite the failure of the banks in which they held their money. In other words — to save the bank deposits of all who have savings in this country we accepted the most extraordinary cost of saving the banks. And the price for that has been enormous. You can add it up any way you like: but on the ground it is 2.5 million people unemployed, students paying fees they never expected, the destruction of our NHS, the loss of services to the most vulnerable in our society, poorer education, the loss of the education maintenance allowance, the increase in tax and falls in real earnings for those in work — which are inevitable. To date savers have lost nothing from this crisis: others have paid an enormous price to ensure that is the case. And remember, whilst many of this who read this might be savers most people aren't. Significant savings are in fact the preserve of a tiny minority in society — and beating inflation is really about preserving their wealth, and not much else.

I'd in fact argue that most savers would be wise to stand back for the time being and accept a bit of inflation — even at cost to their capital. Most of those with modest saving are pensioners — and of course I am concerned for them. That is why I argue that they should have properly index linked increases in their state pensions and other benefits. But pensioners would be wise to remember too that they are dependent on others to look after them in just about every way. People in work make all they consume. People in work supply the health care, social services and other facilities that many pensioners are reliant upon. Those services need to be maintained. They won't be if there is a recession. And those services need people who can work for them on wages that let them meet their own responsibilities — whether to pay their mortgage or

feed their children. And those are pensioners grandchildren, lest they forget.

Yes there is a problem with inflation reducing the stock of value in saver's accounts.

But let us also note inflation — and what we face is very modest inflation — has a benefit too. It reduces the value of people's debt. The saver's loss is the borrowers gain. And the reason why we have an economic crisis is because banks over lent, on property, for consumption, for speculation. The banks made this money- banks make almost the money that exists in the UK. And it was money that fuelled the savings of a few and the debts of many — the many who will be crippled if mortgage rates rise. That many are being crippled by debt — and the young face this more than almost anyone. And in my experience as someone in middle age, with many friends with children in their twenties, this is a cause of massive concern to many who will be pensioners soon. They no longer work to save. They're working to pay off their children's debt. It's an extraordinary situation, and inflation will help these young people. If property prices fall but debt is written off by inflation then there's a chance young people might be able to do something many of their parents took for granted — they might be able to buy a house with the prospect of paying for it before they retire. And that too is pretty vital for most pensioners — because for many of them more of their savings are locked up in housing than anything else — and without buyers for those houses their prospect of realising the value of those properties is low. Inflation might, curiously, help them do that — and at the same time let them know their children might do as well as they have — which is a situation so many parents aspire to.

So who are those who might really lose? Banks will. They borrow short and lend long. That results in real losses to them. And the rich — those with considerable wealth may also lose — but candidly only if they hold their assets in cash, and most in this group do not.

And business? Will it lose? No. Not at all. Business needs inflation. It needs it to be able to give pay rises, which keep people happy, without having to bear the full cost themselves. They need inflation to encourage them to invest now because it will cost more later. And managers need inflation because it is always, always easier to manage a business when numbers are increasing — even when some is from inflation. Of course that breaks down when inflation gets out of control — which may be the case when it hits double digits, but we're far, far away from that with no prospect of it happening because there is no prospect of wage inflation in this country at this time with unemployment at its current rate.

So overall, what's the problem with inflation? Right now there is just one of consequence — which is that the poorest in the UK might suffer most from it and need protection. Thereafter do we have a problem that should be addressed? My answer is no, we don't. But more than that, addressing this issue will make the problem much, much worse, all to protect those who have enormously benefitted from the spending to save our banks. They've already had their social justice. Now it is time for others to get

it. And let's face it, inflation at 3.7% is neither here or there for most people. Once we protect the poorest in our community our priority is to keep everyone else who can be in work. And any action we now take to address inflation will put many more people out of work — and that would be a disaster — including for most of those with savings.

And remember — unless the ConDems raise VAT again next year quite a bit of this inflation falls out of account.¶

So let's keep calm and carry on.

NB I discussed these issues on Radio 2's Jeremy Vine show today