

Worry, because we're heading for deflation

Published: January 13, 2026, 5:24 pm

Over the last few years I have mentioned, every few months, that one of the real economic risks facing the UK has been deflation. I admit my thinking on this issue was influenced by two things. The first is that I have always - since the 1980s - seen some benefit to inflation. The second was the warnings on deflation and debt from my Green New Deal colleague, Ann Pettifor.

Now deflation looks likely. CPI is at 0.5% and Mark Carney says it will drift lower. That, inevitably, means negative territory. Commentators are already trying to say this will be temporary and are using the term disinflation for it. I do not share their optimism. I will call it what it is: deflation.

Deflation is a serious threat to economic well being. Some are saying that because it provides a short term boost to earnings by reducing the cost of living it's useful but this ignores all the potential longer term impacts.

The first is that by default interest rates rise: when there is deflation the capital value of a loan increases in real terms and that increases the debt burden of the person due to make repayment. The real interest rate increases as a result. That reduces the capacity of many to spend on supposedly cheaper goods and services. The realisation will not happen overnight, but happen it will.

Second, in the short term deflation makes it look like real wages have risen and that appears to be good news. And then, before long pay rises disappear as employers have reduced capacity to make them, and the pressure for pay reductions, or changed conditions of employment to achieve the same net effect (because pay itself is downwardly sticky) will become the norm. Given that low pay and the total inability of the UK economy to boost real earnings is one of the major reasons why we have remained stuck with real GDP per capita below 2008 levels this matters, enormously. Wage stickiness also increases the risk of unemployment: that should not be ignored.

Thirdly, those on benefits see them fall. Relative inequality can increase.

Then there's the impact on investment and bigger ticket spending by consumers. Both have a tendency to fall when there is deflation: if people think it will be cheaper to buy an item in the future they defer spending now. And deflation, by producing higher real interest rates creates a second reason for deferring spending. We are already facing a real problem with a shortfall of business investment in the economy, in particular. Deflation exacerbates that and the consequence will be declining GDP.

Next there is the problem that wealth inequality increases in a period of deflation. The owners of debt - who by definition have wealth - see the value of their asset rise. The people who owe that debt - their creditors - see their loans increase in real terms. Inequality is already creating real problems in our society: deflation will increase them.

And the fact that deflation is partly being caused by a decline in oil prices that is bound to cause environmental harm by encouraging over-use of carbon is another negative consequence.

Temperamentally there is also an issue with deflation: we are simply not suited to managing downsides where things appear to get smaller. Like it or not, and even when it is real or not, humans like the perception of positive outcomes that increasing numbers supply. Decreasing ones appear (as they are) to be negative and that depresses the human spirit. This has always been one of my reasons for feeling comfortable with modest inflation. Deflation suppresses the economic mood. We cannot afford that.

There are then no gains to be had from deflation. But there are many costs.

And we do not need deflation. We could print money and stimulate economic activity and boost real earnings at this moment to prevent deflation happening. This, of course, is another reason for using Green Quantitative Easing which would, in the current environment achieve all those goals and deliver real, long term and tangible benefits for society as a whole.

Without such action we face a potentially major economic crisis. With action the current situation provides opportunity for positive change. I fear that politicians will opt for the crisis but hope for something altogether better.