

Funding the Future

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The old chestnut of what came first, the savings or the loan, came up on the blog over the weekend.

I have argued for many years that it is, of course, the loan, and that the savings can only exist because a loan brought them into being. I had to work this out from first principles when I was in my twenties because I had always been taught the opposite. It took a long time to find others of similar persuasion. And it was some comfort to find the [Bank of England finally agreed in 2014](#). One of the things they did when doing so was issue this video:

<https://www.youtube.com/watch?v=CvRAqR2pAgw>

What they say is:

- * Loans are made without any need for there to be deposits in a bank;
- * Loans are quite emphatically not the recycling of depositors' money: all loans are made from newly created money;
- * All savings are therefore created by lending, representing the unspent and so deposited part of funds created out of monies borrowed;
- * There is, then, no such thing as fractional reserve banking and those thinking so; those economics text books that say there is; and those who based their economic thinking on this idea, are all wrong.

There are some things I should add I do not agree with in the video: the description of how QE works is just wishful thinking and not what has actually happened. It is also not true that QE has a cost: the interest paid on reserves is in real terms negative at present.

And there are things the video does not say. In particular it does not make clear that because of the argument made, savings do not serve a useful economic function as a source of funding for investment in the modern economy when that role has been supplanted by credit. Nor does it say that as a result the entire saving sector can in that case to some degree be seen as rent seeking and the whole edifice of the financial services industry that is built upon it a largely pointless activity that does not add value. But I won't develop that argument further here: my point at present is to reiterate that savings are not required to permit banks to make loans. This is a myth now known to be

wholly untrue. Those who say otherwise are from the economic dark ages.