

QE: a tale of bankers bickering about the deckchairs wh...

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An exchange of tweets created economic headlines yesterday. [This is it:](#)

Let's put this in context: Rupert Harrison was George Osborne's Chief of Staff for most of the time he was Chancellor whilst Nick Macpherson was Permanent Secretary to the Treasury during that period. These two know each other, well. And they are disagreeing over the unwinding of QE, [which I discussed yesterday](#).

Harrison responded to an FT tweet that in turn referred to the fact that the European Central Bank may have to stop QE soon: but that's because there just aren't enough bonds left for them to buy. Harrison clearly sees that as creating a crisis in its own right: without QE it's not clear what happens in the eurozone. Mcpherson on the other hand wants out of QE, which he says has not worked.

This is a real issue. It needs to be discussed intelligently. So let me work through this.

What was QE for?

The Bank of England [summarises the whole process like this](#):

To be a little more technical, what this means is that the Bank bought safe assets (government bonds) off those who held them. In the process they bid their price up (gilts are at record price levels as a result) with the intention of forcing their rate of return down. Around the world that's so successful that [US\\$9 trillion of bonds](#) trade with negative yields i.e. people pay governments to deposit money with them.

What did QE achieve?

Except, that was not what was meant to happen. Savers were meant to go to look instead for higher yielding assets to hold. But let's not ignore the fact that they did;

they just bought the wrong ones. As a result Wall Street and the FTSE 100 have seen record prices. Commercial property is doing nicely. And banks in the UK, awash with QE money, lent money as fast as they could to fuel (yet another) property price boom. And when that looked like running out they just pumped money into new car leases like oil was going out of fashion instead.

The cost of borrowing was lowered as the Bank wanted, and it's stayed at record lows.

And asset prices have risen, enormously, and that has boosted very particular spending. So far so good

But it has not boosted investment in the real economy. As the Office for Budget Responsibility [showed in March 2017](#), low interest rates did not persuade the business community as a whole to borrow to invest:

At this level QE simply failed. It boosted bank balance sheets. It boosted asset prices and so increased inequality whilst taking private housing out of the reach of millions more than need be the case. But because it did not boost investment, it did not increase productivity and so it did not boost wages, and as a result it did allow the personal debt crisis for those on lower pay to grow. In other words, it exaggerated but did not tackle any of the issues that so plague the UK economy.

Was QE's failure foreseeable?

I would argue that QE's failure to deliver anything much of benefit to the UK economy was entirely foreseeable, because I foresaw it. [Writing with Colin Hines in 2010 I argued](#) :

The [2009] quantitative easing programme might be considered a short term success, but as we note, the benefit has been captured almost entirely by the financial services sector whilst further asset boom and bust cycles are, at least potentially being recreated with resultant risk to the economy. These are undesirable long run outcomes when the real aim is to get the UK economy working again. For that reason we cannot support a further round of quantitative easing in the form used in 2009.

When we wrote £200 billion had been spent. Since then another £235 billion has been spent. I would argue that this was wasted money. What was needed in 2010, we argued, was green QE (and it still is). How this might work [is explained here](#): it is very different from QE as run by the Bank of England.

I would argue in that case that Mcpherson was right; QE was a drug, and it was not helpful when better options (which it seems he did not back but of which I suspect he should have been aware) were available. In that case Mcpherson was part of the problem.

Does that mean QE should be unwound?

So far the discussion is over spilt milk: the likes of Harrison and McPherson let QE happen since Treasury consent for QE was required, and given. It may not have worked as desired, and McPherson may regret that, but that is not the same thing as saying it should now be reversed. I very strongly suspect that QE does not unwind as readily as it was created. Before checking that let's, however, check the reasons for unwinding.

Reasons to unwind

As the Bank of England note in their our purple chart, the reason to unwind QE is that if inflation is too high the bonds held can be sold to reduce the inflationary trend in the economy.

First, let's note that there is only very limited inflation in the economy at present.

Second, let's also note that this is not because of the creation of excessive new money by the QE programme. As Charles Adams has shown at [Progressive Pulse](#), the M4 measure of broad money in the UK (which is generally used for appraisal of monetary risk) has flatlined since 2010, contrary to all previous experience:

Far from QE creating excessive new money supplies it has, at best, managed to maintain the money supply. There is then no risk of general inflation from excessive money creation as a result of QE. But this is, according to the BoE, the only reason to unwind it. To unwind it to tackle inflation caused by other factors, such as leaving the EU with its consequent impact on the exchange rate, makes no sense at all. That would be to use the wrong tool for the wrong job.

That leaves only one other reason to unwind QE, and that is normalisation; or, to put it another way, to put things back the way they were before 2007. I [have already dealt with this issue](#). It is primarily motivated by a desire to put bankers back in charge of the bond markets, which is a power QE has destroyed. I can say that with confidence because no other coherent explanation for it has been offered.

I have heard it said that normalisation, meaning an increase in interest rates, will give the BoE the tool it needs (the potential for an interest rate cut) to tackle the next recession. It will, however, also create that recession, which makes the prescription somewhat self-fulfilling.

And it has certainly been said that this will favour savers who have suffered for too long. Except savers are, of course, the better off in society, and respectfully, the world is already tilted rather too far in their favour.

And third....actually, I am struggling for a third reason for normalisation except that it 'puts things right' and 'the way they always were'. And we should remember that the Treasury is deeply conservative (small c) and likes things to be in good order, which

means that they're the way they always were, so hardly surprisingly Nick Mcpherson wants to be rid of this new fangled economic method so that old order can be restored, and nanny tucks everyone up for a snooze after lunch. You might think I am being facetious, but so lacking in innovation have central bankers and the Treasury been since the financial crisis (QE apart) and so little has their role been redefined despite the disaster they oversaw I do not think it wrong to say that nostalgia for an old order is the main intellectual driving force in the Treasury and BoE alike.

To put it another way, there is then no reason to unwind QE now apart from a desire to do so on the part of a few central bankers.

Will unwinding QE work?

On this I can be emphatic: no it won't.

Unwinding QE cannot stop an inflation it did not cause: only abandoning Brexit can do that.

Will unwinding QE cause harm?

I can be equally emphatic: yes it will.

The harm comes in a number of ways. First, QE may not have increased the amount of money in the economy but in that case it certainly stopped it declining, which was an initial objective for the policy, with the aim of preventing deflation. That worked. But with there still being no new money around reverse the policy and the money spent buying second hand QE debt will reduce liquidity: that is certain. Deflation is a real risk, and with it stagnation.

Second, as I [noted yesterday](#), there is a shortage of government debt in the economy but that can also be met by ending austerity and running deficits or by creating bonds to [fund worthwhile investment](#). Both have real social benefit and create jobs. Unwinding QE, on the other hand, sells secondhand paper to the financial markets and achieves no social or economic goal whatsoever, other than restoring bankers' pride and power. It is the worst possible choice.

Third, let's assume the downside of QE - asset price inflation - reverses. That would mean gilt prices would fall. As would stock markets. And house prices. All are at least possible. And note that the last two tend not to decline in orderly fashion: rout is their normal method for price adjustment. That is then followed by economic uncertainty and recession, households in negative equity and insolvency and business failure as the collateral used for lending (rightly or wrongly) disappears from the market. You can wish for all those things if you want, but please be explicit about it. I won't be joining any appeal for them. But I think that's exactly what QE reversal will create.

The risk of QE is then deflation, a negative impact on investment, asset price crashes,

recession, major insolvency and, as a result, likely bank failures to be followed by a bail out, using QE. It would be ironic that those proposing this exercise cannot see that, except for the fact that it is so tragic.

Can we leave QE in place?

The short answer is, yes, of course we can. QE can just be allowed to roll. Or it could, as bonds are redeemed, be gradually allowed to unwind as reinvestment of the proceeds of redemption did not take place.

What would letting QE roll mean? Essentially it would mean that the debt was cancelled and money had been permanently created, but as noted above, that's had no inflationary effect at all and overall must then have helped the economy keep going.

The only price to doing this is it would mean admitting that the government can create money, which is anathema to bankers and hard core neoclassical economists alike, and yet is, of course, a fact. But don't expect them to concede control on this issue any time soon.

Unwinding QE is about dogma

The argument for unwinding QE will continue despite its disastrous potential because it is pursued by those with financial wealth and power who are also in possession of an anti-government dogma that refuses to believe that, in the first instance, the government can do something and, secondly, that benefit might on occasion arise from it. They let QE happen because it suited banking. But their real fear, and why they want it rolled back, come what may, is that a government that knows it can create money for social gain, using [People's QE](#), will actually make money for that purpose and directly intervene in the economy as a result.

This is what the fight over QE is now about: it's about who has the power to control money. The bankers and their friends in the Treasury want it to be the money markets, as in times of old. And some want government to use money to advantage the people of this country. 'Normalisation' I think really means 'putting the elite back in charge'. And that's precisely why the policy is wrong, in addition to all the harm it will cause, to which those proposing it are indifferent.