

The Bank of England admits monetary policy does not wor..

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Readers will recall [my post that published correspondence](#) between Glynn Worthington, who reads this blog, and the Bank of England.

Based on my reply Glynn went back to the Bank of England, saying:

Dear Brendan,

I referred your email directly to Professor Richard Murphy, who, in his blog this week, says quite bluntly, that you are lying when you say that the Bank of England has not financed government by printing money.

As the Bank of England [says on its own web site](#):

"Quantitative easing (QE) is an unconventional form of monetary policy where a Central Bank creates new money electronically to buy financial assets, like government bonds. This process aims to directly increase private sector spending in the economy and return inflation to target."

So new money is created. And this helps fund the government. Indeed the Bank of England returned the interest payments to the government! What is that unless funding government?

Might I say too that I fear you didn't answer my query concerning the order of things. I say that spending comes before taxation. What is the Bank's view, in simple English?

Kind Regards,

Glynn Worthington.

The questions were direct, appropriate and fair. Glynn has now shared the Bank's response with me:

Dear Mr Worthington

Thank you for your further email of 15 September. Professor Murphy is entitled to his own view, but we at the Bank think differently about QE.

The reason for that, is because at some point in the future, the Bank will sell its government bond holdings back to private investors. And those bonds will then have to be repaid by the government as and when they mature - just as they would for any borrower.

I hope that you can see that this approach is rather different to simply printing money and giving it to the government. That is not a policy which the Bank has undertaken and is not what we think of as QE.

Your question regarding the return of interest payments to the government is a very reasonable one. As the owner of government bonds, the Bank accumulates interest repayments paid by the government. We return those monies to the Treasury.

So, there is a portion of the stock of outstanding government bonds that the government effectively no longer pays interest on. You might think of it as a 0% loan. But it is still a loan. Again, I hope you can see that this is different to printing money and giving it to the government.

Regarding whether taxation is necessarily required to finance government spending, the answer is no, it is not. Along with raising money via taxation, governments can borrow money and they can create money outright.

Regarding money creation, we tend to think that while monetary policy (in general) might boost spending for a time, eventually it will push up on prices, and inflation, which brings 'real' spending power back to where it would have been without that stimulus.

I hope that answers your question.

Kind regards

Nicole

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That seems to require some unpacking.

First there is the quite extraordinary claim that the Bank will sell its bonds back to private investors. This has not happened yet. Mark Carney gave no hint that it might

yesterday but was looking at the long term. And in other places where QE has been used this has not yet happened, although in fairness the US says it might try doing so, which might be useful to prove just why this is such a bad idea when new debt creation for public benefit is so much more useful. And when the only direction of travel so far has been literally trillions of pounds, euros, dollars or yen (it does not matter which currency you use) going into QE purchases and precisely none going the other way, to rely in this argument is, I would suggest, pretty desperate. To imply that all debt will be sold back is worse than that; it is right now an utterly implausible claim.

Adair Turner has argued that in practice it should be recognised that this debt has been monetised. I agree with him. In view of what [Mark Carney said yesterday](#) **I think deep down he would also agree. There is no chance that all this debt will actually be resold to the public. To claim that it will be as if it is a fact in the way the BoE does here is wholly inappropriate. They have a duty to talk about the world as it is, and not about a fantasy that clearly does not exist.**

Second it's curious that the BoE wants to pretend both that this debt exists and that there is no special relationship regarding it with the government when so obviously the interest waiver proves that this is not true. What that waiver proves is not that there is still the same debt as they claim, when that debt was characterised by the interest payment, but that the debt in question no longer exists because its terms have been waived. The original debt obligation has been cancelled in other words, whatever the BoE claim. That is the reality that needs to be faced. The question is what has replaced it. I return to that below.

Third, there's the oddity that it is claimed that these debts will be redeemed in due course. Technically, of course, some redemptions have already happened. And QE debt has been rolled over despite that technical redemption: new gilts were used to replace those redeemed. Again, reality has been suspended and the BoE needs to admit it.

Fourth, there is the curious issue of whether there is a new loan or not at zero interest rate. That's open to question for reasons already noted. What there undoubtedly is is a debt. And on this issue the BoE really should read its own bank notes. Money is a debt paying zero interest. That is one of its major characteristics. So the BoE is in this case party to a zero interest rate loan that it claims is not money because it claims it is a loan, when all money is a loan because all money is in reality debt that is ultimately underpinned by the government on the basis of its ability to raise future taxation revenue, which is what also underpins the value in this relationship. Far from the existence of this loan proving there is no money created in in this relationship I think it precisely proves it does create money, in precisely the usually accepted form that money has. The BoE has, I think really shot itself in the foot here.

But it is the fifth claim which is fascinating. To reiterate, the Bank says:

Regarding whether taxation is necessarily required to finance government spending, the answer is no, it is not. Along with raising money via taxation, governments can borrow money and they can create money outright.

Incredibly importantly, the Bank admit that tax is not necessary for government spending. This is the admission of something I have long argued and proves that we do not have tax and spend in the UK (or elsewhere) but instead have spend and tax. The spend comes first and how to pay for it comes second. Borrowing is an alternative.

But what is most interesting is the admission right at the end of this paragraph, that the government can create money outright. This is, of course, a fact. The so-called 'Bradbury pounds' issued in World War I were Treasury created money that by-passed the Bank of England entirely and were completely accepted as currency (and why not; after all they too were backed by the promise of future tax revenue?). And the Bank is admitting here is that this is possible now. I suspect they had little choice but do so. After all, on their balance sheet they are holding £435 billion of government (or Treasury) promises to pay with no interest due on them. Or you might call it, Treasury created money as the residual balance sheet component of QE, in which the Bank have been an active and knowing participant. This is government created money used to cancel a liability - for the gilts that the BoE nominally holds but on which no interest is paid. Of course the BoE has to agree that the government can create money.

And that is precisely why it then goes into a vigorous defence of why it should not do so, saying:

Regarding money creation, we tend to think that while monetary policy (in general) might boost spending for a time, eventually it will push up on prices, and inflation, which brings 'real' spending power back to where it would have been without that stimulus.

This is farcical. £435 billion has failed to deliver this outcome. Around the world trillions has failed to deliver much inflation. And when Brexit inflation falls out of the system (as it will if negotiations go well) then the need for more stimulus to create inflation in the UK will arise again, and with it demand for more QE. So the bogey of inflation can be ignored.

In that case what's left in the statement? Well, it's a simple admission that monetary policy - the whole raisin d'etre of the BoE - does not work. In other words, the whole farce of Bank of England independence has been a waste of time. What was always needed was, and is, fiscal policy. Or People's QE, I would suggest.

The reality is that the BoE has just made the most extraordinary series of admissions. They will require further thinking and comment. But as I now need to head for Holyrood

I leave others to start that process.