

Funding the Future

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I had a conversation yesterday in which the prospect of QE being unwound was discussed.

As regular readers of this blog know, I am firmly of the opinion that very little of the QE programme will ever be unwound, meaning that almost all the gilts that have been bought by the Bank of England on behalf of the Treasury (which did, of course, issue them in the first place) really are, in my opinion, effectively cancelled. The result is that the national debt is some £900 billion less than the government claims it to be.

The discussion very rapidly reached a number of conclusions. The first of these was that my suggestion was right. If there is ever any reversal of QE it will be in modest amount, at most.

Second, anything other than a reversal in very modest amount would run into massive financial market resistance. There is an appetite for UK government debt right now, and that is likely to continue, but there is no appetite in financial markets for £895 billion or so of debt to be returned to private ownership. The possibility of that happening, even over an extended period does not exist.

Third, a real attempt to achieve a reversal of the QE programme would have a massive economic consequence. That should not be hard to work out. Reversing even a small part of the QE programme will remove significant liquidity from the economy. The consequence will be fairly rapid reductions in cash available, most particularly to financial markets. They would need to sell other assets to buy bonds, and the only basis on which they might do that is if the bonds were sold at a significant discount to market price, meaning a loss might be suffered by the government on sale. This would also push up potential real interest rates considerably in the process. Consider all the knock on effects of that and asset prices would fall, rapidly. Even if we can all agree that asset prices are too high, rapid changes in their value will destabilise the finance system. Simultaneously falling share, bond, land and house prices because of an attempt by the government to sell significant numbers of old bonds in the market in an attempt to increase the real volume of public debt without there being government spending to match could trigger a financial collapse on a scale to make 2008 look like a picnic.

So, fourth, this is not going to happen.

In that case, fifth, the threat to unwind QE is in that case nothing more than a threat. Any reversal that does happen will in that case be mere token gestures.

In that case why is there a threat to reverse QE when it cannot happen, and why will token gestures take place when there is no real threat to follow through on the plan to reverse QE in any systematic way? The answer is that this is all politics. The objective is to say that QE could be reversed, and might have to be whilst debt is so high, but there is no real intention to do so because the real consequences are known. However, the messaging is sufficient to make people believe that austerity is essential, and that policy is what the proponents of this supposed plan really want.

QE is being used as a political tool in that case, and not as an economic one. The reality is that the moment that there is any stress in the economy again we all know that QE will be used. Even omicron could trigger its use in 2022. But, the threat to reverse it will always be used as a mechanism to limit desirable government action by those who would rather we have government inaction and suffer for it than have government action and reap the rewards.

QE is now at the core of economic policy in that case. But more than that, it is at the core of political economy. And that is where the real action is. Explaining this is really important in that case.