

The Bank is forecasting a terrible year to come. They s...

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The Bank of England has very recently issued a press release saying that they have agreed to increase their base interest rate by one-quarter of a percent to 0.5%.

This is madness, in my opinion. Their logic is that they need to reduce demand in the economy to counter inflationary pressure. This morning most heating bills in the UK were increased substantially. An average of £693 is likely. The impact is so serious that the government is having to offer well over half of all households in the country rebates to manage the consequences. And at the same time the Bank is increasing another price - that of money itself - to supposedly counter the inflationary pressure implicit in that energy price increase. You literally cannot make up incoherence of that sort.

Potentially worse, they also announced this:

The Committee voted unanimously for the Bank of England to begin to reduce the stock of UK government bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets. The Committee also voted unanimously for the Bank of England to begin to reduce the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets and by a programme of corporate bond sales to be completed no earlier than towards the end of 2023 that should unwind fully the stock of corporate bond purchases.

Whether or not the government holds corporate bonds is a matter of indifference to me. They were always badly chosen. There are £20 billion of them. I suspect the market can absorb the sale of these without difficulty.

The reversal of QE on gilts is much more serious. Firstly, there will already this year be, in historic terms, exceptional demand made by the government for funding from the financial markets (and I know all the MMT arguments, which will not change the fact that the demand will be made). It is likely that the government will run a deficit of £100 billion in 2022/23. Given the way it plans to operate, this sum will be demanded from the financial markets through new bond issues. This is in real terms (i.e. net of QE)

already exceptional, and on top of that there will be no reinvestment by the Bank of the proceeds of gilt redemption. I am not sure the precise additional sum that this will effectively withdraw from markets. Using an average it will be not less than £30 billion.

Overall then the coming year will see an unprecedented tightening of monetary conditions in financial markets when we have by no means recovered from either Brexit or Covid as yet.

The likelihood that interest rates will need to increase significantly because of this is high.

The risk that this could precipitate a financial crisis as credit is reduced in supply, cash is withdrawn from other markets and pressure on mortgages grows leading to serious risks of default in the housing market is also high.

If you wanted to push the UK economy to its limits, and maybe beyond, this is how to do it. The Bank is forecasting a terrible year to come. They seem to be doing their utmost to make it worse.

I am worried for all the real people who are going to suffer as a result of these callously incompetent decisions.