Funding the Future

The government might be paying up to £40 billion a yea...

Published: January 14, 2026, 2:26 am

Adam Posen, a former and still influential member of the Bank of England monetary policy committee has been arguing this week that the Bank's base rate might need to reach 4%. Others are arguing for even more.

I think their analysis is completely wrong. But let's for a moment consider one consequence of this. That is on the cost of what are called the central bank reserve accounts (CBRAs).

These are the bank accounts maintained by the commercial banks and some other financial institutions in the UK with the Bank of England that have two functions.

One use is to let banks pay each other - which they do through these accounts, meaning that we can in turn pay people who have money in other banks. This makes them essential to the operation of the banking system.

The other use is to assist the flow of money to and from the government. Over the last 13 years that flow has been very much from the government to the economy. Quantitative easing created almost £900 billion of new money. That money is transmitted to the banking system through these accounts. As a result, the balance on them is near enough that figure right now. The banks hold this money that the government created on deposit with the Bank of England. That is because all money is debt, and when the Bank of England created this money it created a liability owed to the commercial banks which they consider to be bank deposit accounts.

By convention, the Bank pays interest on these deposits. Until very recently this was paid at the base rate of 0.1%. The cost was less than £1 billion a year at that time: it was of no consequence.

If, however, the bank base rate increases to 4% or even 5% this cost will skyrocket. The cost might approach or even exceed £40 billion a year.

Let me put this in context. The government has announced today that it wants to cut 91,000 civil service jobs to say £3.5 billion at a rate of about £38,000 per job, including on costs. This is how disproportionate this interest cost is. It would quite literally suck the government of funds to provide welfare to banks to reward them for holding funds on deposit with the government when those funds were created by the government in the first instance and handed to those banks free of any charge for nothing being done in return. The idea that interest should be paid on this that will be used as an argument to prevent people working and the payment of benefits is hideous.

What can be done about this? The answer is easy. The rate paid in these accounts should be set independently of the bank base rate. I suggest 0.1% would still do just fine. And then the government will save up to £40 billion a year. There is literally no reason why it cannot do this. It would be entirely legal to do so, and we're all used to banks having different interest rates depending on circumstances.

Will this be announced as a way of constraining this cost? I doubt it. After all, why would a banker want to stop the flow of unearned funds to banks? So the Opposition should be shouting about this instead. Will they? Only when they break their own fixation with the Bank of England being the epicentre of virtue within the economy. Given that does not seem likely I fear that p[people will suffer as unearned money floods towards banks over the next few years.