

Kwarteng has created a mess. It will take many years to...

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I have [just posted this thread](#) on Twitter:

The Bank of England has a supposed duty to control inflation in the UK, being required to ensure it runs at about 2% a year. The crash in the value of the pound this weekend makes that even more unlikely. What will the Bank do now? A short thread.....

The Bank of England has only three weapons to tackle inflation. One is that it can raise interest rates. It can do this to either take excess money that's fuelling demand in the UK economy out of circulation. But, bankers apart, no one has excess money in the UK right now.

Or it can also raise interest rates to protect the value of the pound because if that value falls the cost of imports goes up and that fuels inflation. We have the pound collapsing on financial markets right now.

The second thing the Bank can do is quantitative easing (QE). QE sounds complicated but in reality it is just a ruse to hide the fact that the Bank is lending the money to a government that needs to run a deficit without it having to borrow from the financial markets to do so.

In effect, QE disguises the fact that the government is really running an overdraft with the Bank of England.

The third thing the Bank can do is quantitative tightening (QT). This is the reverse of QE.

Instead of the government not borrowing from the financial markets when running a deficit, under QT the government does, via the Bank of England, in effect issue new bonds but not to fund a deficit but to, instead, control inflation.

QT controls inflation by taking private sector money out of circulation in the hope that this will reduce demand for goods and services and so reduce inflationary pressure.

This is all the Bank of England can do. It has no other powers. The question is in that case what it will do now?

My suspicion is that if Kwasi Kwarteng does nothing today to address the crisis we are facing the Bank will be having an emergency meeting of its monetary policy committee very soon.

The only purpose for that meeting would be to increase interest rates. They could go up dramatically: something well over 1% might be likely. Even 2% would be possible, I think. Nothing like this has happened since 1992.

The result would be a disaster. Millions of UK households will not be able to pay their mortgages if this happens. Rents will skyrocket too. Renters will feel the impact very quickly. We will face an unprecedented housing crisis if rates go up like that.

That could also lead to a banking crisis bigger than 2008. Only this time we would be the only country facing it.

I hope Kwarteng has the sense to stop this happening. Instead he could authorise the Bank of England to do more QE. The Treasury has to approve this before it can happen.

Even if it did there is no guarantee the Bank would do it. Only last week the Bank decided, quite bizarrely, to do £80 billion of QT instead. I have no idea if they could be persuaded to change their minds.

If they will not change tack then Kwarteng could suspend the Bank's powers. He can do so, in effect, using a 1998 Act of Parliament. This would spook markets, again, but it may be he would have to take that risk.

Then Kwarteng could demand the Bank do £250 billion of QE (which is less than it did for Covid) to provide him with the money he needs in the next year. That would work, just as it did in the 2008 crash and in 2020 and 2021.

In that case the markets would not be asked for new money. They would not need to be spooked to the extent that they are now. The pound could stabilise, and even rise a bit. Time would have been bought. That is vital when everyone is panicking.

However, the crisis would not be over. Kwarteng's budget still makes absolutely no sense, at all. Markets will know that, and will wonder how long QE could last. The answer is we don't know. But, I stress again, time would be available.

In that time Kwarteng would have to change policy. It would either be that, or the Tories would have to be rid of him and Truss and their madness.

That would still leave us in a horrible mess, with austerity very likely from the Tories (and Labour too, I am afraid). But the moment of madness we are now in could be deferred and some sanity could be restored.

My suspicion is that the Bank are going to force the issue on all this: they are going to either up rates, or want to do QE, or both and Kwarteng will crumble. But that does not mean the crisis is ended.

Kwarteng has revealed the weaknesses in economic management and politics that exist across the UK political spectrum right now. We are going to pay a price for that, and it is going to be massively uncomfortable. Kwarteng has created a mess. It will take many years to clear it up.