# Funding the Future

# Without QE, or simple government money creation, Kwarte..

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This was the FT's UK homepage on its email listing this morning:

FINANCIAL TIMES

Monday, 26 September 2022

UK HOMEPAGE

Kwasi Kwarteng's fiscal shift prompts backlash on Tory backbenches

Most Conservative MPs give chancellor's tax cuts the benefit of doubt but dissent is also rife

Foreign investment grows in north of England but falls in rest of UK

Increase in FDI is only 'notable success' of Northern Powerhouse project, says former Treasury minister O'Neill

Kwarteng has shaken investor confidence in the UK

Market sell-off on 'fiscal event' was as bad a one-day verdict as any chancellor could fear

Sterling falls to record low of $1.035 against the dollar

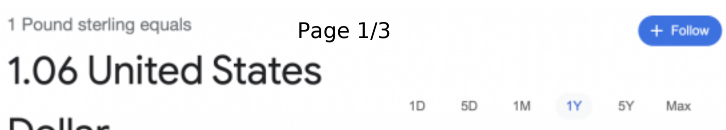
Pound tumbles after Kwasi Kwarteng announced biggest tax cuts in 50 years

Kwasi Kwarteng doubles down on tax cuts as Tories brace for investors' verdict

UK chancellor says 'more to come' despite Friday's historic sell-off after mini-Budget

The FT thinks the UK is in trouble. They also think Truss and Kwarteng are in trouble. And they are right to do so. This was the overnight US dollar / pound exchange rate chart:


That is a record low for the pound. But as interesting is this chart for the last year::



Of course, the dollar is doing well, but the clear indication is that the markets have lost faith in both Brexit and the Tories. And this is not just with regard to the dollar. This is the euro chart for the last year:


This is grim, however it is looked at. So, what does it mean, what is the solution and how likely are we to get out of this without being hurt, very badly?

The answers are all linked. The first thing to say is that there is no sterling crisis for the government. We have no overseas borrowings of consequence in any currency but sterling. As a result, the UK government has no problem settling its debts despite this fall. As a consequence there is not going to be a rush to the IMF or someone else for a bailout: we simply do not need it.

Second, this means that this is a private sector crisis at this moment. These awful exchange rates mean the pound is buying a lot less, but most especially a lot less petrol and gas per £1 spent, and that translates directly into UK inflation. By how much depends on whether this is just a blip or a long-term readjustment to value the pound at this rate, and we do not know that as yet. But that there will be inflationary impacts is beyond doubt.

Third, that also means that the Bank of England will react with interest rate increases. These could now be horrible in their scale - with rates going to in excess of 5 per cent. If so this crisis will turn into a mortgage, rent and housing crisis, to be followed by a banking crisis as house prices fall and banks lose the security in the properties that they have lent against. There is therefore very real threat in all this.

Fourth, contrary to the opinion of the presenter on LBC News who has just interviewed me, more tax cuts will not solve this or calm the markets. They will simply leave the market more panicked as they will increase borrowing still further.

Fifth, nor will the austerity that The Times is forecasting on its front page today help either: cutting real spending on the public sector right now as planned will make public services even worse, leave people without pay to make ends meet and create further downward pressure on the economy when the Chancellor says he wants growth.

Sixth, nothing will solve this until Kwarteng says how he is going to fund the programme he is running, which he has not as yet, which is his major economic crime 0f the moment. Markets think he wants to borrow maybe £250 billion in the next year, just as the Bank of England says it will also be selling £80 billion of gilts it owns. So more than £330 billion of funds is being sought by the government in the next year as a result of this incoherent policy. Nothing like that sum has ever been sought before. In the big years of supposed borrowing, like 2009, 2020 and 2021 quantitative easing covered all borrowing and markets were hardly called upon at all to fund government debt. Net of QE that debt is now about £1,600 billion. You can see why markets being asked to fund nearly a fifth more of that in one year is spooking them.

So, seventh, the answer is in the form of QE. It quite literally cannot be in anything else. However, that will require cooperation from the Bank of England and it is not at all clear that they will play ball. Having a government / Bank fight in the middle of all this would not help, but it may be necessary. Only the cancellation of the Bank's plan to sell bonds and the use of QE to cover government deficits can work right now.

Eighth, even that is not enough. As I have explained on this blog, QE increases what are called central bank reserve accounts. These are funds held by commercial banks on deposit with the Bank of England as a result of QE. Bank base rate is paid on these, and this is going to be far too expensive to manage over years to come, so not only must government money creation via QE be used to pay for the deficits to come but the resulting funds must be injected into the economy via new special bank reserve accounts, which are the same as central bank reserve accounts but with little or no interest paid on them.

I literally cannot see anything else but this working right now. The proposal is radical and in uncharted territory. But that is where we are and what is required. We cannot fund the deficit to come with market borrowing, because that will destroy the economy via a mortgage crisis. We cannot pay the interest on borrowing at the rates that will be demanded if we try to do so because that will crash public services with the resulting austerity. So we have to use money creation without interest being paid to solve this mess.

I have nothing more to offer than that: the right of the government to create money costlessly is the only way out of this. Markets will have to be cut out of the funding equation, in other words. That can be done. It needs to be done, and the government needs to say it is doing it, preferably today.