

Sure as heck a recession is coming. It is policy, after...

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One of the questions Danny Blanchflower was asked yesterday on the BBC's World at One was whether he thought recession in the UK was likely. The evidence is that at on at least 80% of the occasions when interest rates have risen in a pattern like that seen at present then recession has followed. In the remainder there was flatlining. Upsides are hard to find.

We talked this one through. Danny suggested on air that recession was quite possible. I agree.

Why? Dealing with fundamentals first, increasing interest rates does four things.

First, it cuts disposable incomes available for consumption by increasing spending on debt servicing, whether that is corporate debt, personal mortgages, rents (which are a proxy for mortgages because landlords are usually heavily indebted), car loans or credit card costs. If you cut consumption you reduce growth.

Second, you also cut investment. If debt servicing costs rise you reduce the amount borrowed and so investment spending.

Third, you reduce multiplier effects. Those with high marginal propensities to consume (who, in other words, spend all their income) are forced to pay more of their income as interest to those with wealth, who virtually by definition have lower marginal propensities to consume. The result is you increase the savings ratio and reduce the rate of consumer spending in the economy. Everything slows down as inequality rises.

Fourth, if you have a government that believes it must balance its books in terms of cash and its interest costs increase it will try to cut other government spending, so delivering austerity.

Add all this up and the explicit goal of interest rate rises is to reduce income and investment by forcing savings rates up, matched by leaving available resources (mainly labour) unused within the economy. In other words, the whole point of artificial interest rate rises created by policy and not by market pressure is to create a recessionary

environment.

The assumption is, of course, that the economy has been booming, which is what created the inflation. The slight problem for those still promoting UK interest rate rises now is that there has been no boom. The recessionary environment now being created does not have that backstop. In that case the risk of recession is much higher.

And the reason why there is always a risk of recession when central bankers are set loose with interest rates is that they do not know when to stop. In the current situation I suspect that point was reached by the time rates hit 1%. They are now 4.25% less than a year after that goal was reached. And what we know is that all the effects I describe above take time to happen: the lag is generally reckoned to be two years, but if I am generous might be less given there never was a boom to counter in the current inflation outbreak.

So, the impact of the current rate rises, which many mainstream commentators say must result in rates staying at this level for several years to come (as the Bank of England forecasts they will), is that the recessionary environment will continue for a long time to come, with the downturn getting fiercer over the next year, even as inflation falls considerably.

What will be the signs? Some are obvious. House prices and mortgage data provide powerful indicators. So too do car sales. They will probably decline. Unemployment will rise. It is likely that insolvencies will grow. Growth will be low and may go negative.

But most of all consumer confidence will remain at rock bottom. People now agreeing one off pay deals will at some time realise how badly off they will be as a result henceforth, having effectively given away a big chunk of their income in perpetuity. They will deeply resent this and react to it by seeking to cut all their spending: that is the only rational thing that they can do.

Bizarrely, then, there will be no bounce from falling inflation. That is because although no measures were required from either government or the Bank of England to deliver that fall in inflation because that was always going to happen, those measures they have taken will deeply embed recession in the economy by enforcing cuts in consumer spending, investment and (wholly unnecessarily) government expenditure.

And I stress, this is all by choice. We never needed interest rate rises because there was no consumer boom that caused this inflation, which was all the result of external factors utterly beyond the UK's control and which were never going to be the slightest bit influenced by Bank of England base rate changes. But we got those base rate charges anyway and so of course we have at least an 80% probability of recession, as is normal in such cases. In fact, without there being any contrary influences to prevent recession in the economy the probability looks higher than that.

So, I remind you of the words of former Bank of England Deputy Governor Charlie Bean yesterday on Radio 4 when he said it was the job of the Bank to now impose a 5% pay cut on the UK economy to pay for the impact of war in Ukraine. That is not in their mandate. But it is what they are doing, and excessive interest rate rises are the way that they are achieving it.

So sure as heck we think a recession is coming. It is policy, after all. Charlie Bean gave that away.