Funding the Future

Banks do not lend savers' money

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I was asked this question on Twitter this afternoon:

Jay Rayner @jayrayner1 · 48m

@RichardJMurphy A Qs Richard. Banks take money from savers and then invest it. Partly they do this by lending to people who need mortgages. Why does an interest rate rise mean they have to have raise mortgage interest rates? Or are they also borrowing the money they lend?

This was my reply (over six tweets):

Thanks for your question Jay. Your question is based on a common misconception that banks lend savers' money. Actually, they don’t. The Bank of England finally admitted this in 2014. When a bank lends, it creates new money out of thin air. There really is a magic money tree.

That new money then creates deposits in bank accounts. In other words, lending creates savings. But savings are never needed for a bank to make a loan.

All this is because money is nothing more than debt. If I promise to pay the bank £20,000 and they promise to pay £20,000 to the garage I want to buy a car from our mutual promises to pay create that new money. And when the loan is repaid that money is cancelled.

So what do savings do in the macroeconomy? Absolutely nothing at all in most cases. Banks know that. That is why they are so reluctant to pay for them. They are cheap capital for them, maybe, but that’s it. They’re just dead money.

That’s also true of most pension saving by the way - when most is saved in second-hand shares and second-hand buildings and no new value is created by the saving, at all, in mostly cases.

If this was properly understood we could radically change our economy for the better. It isn’t understood because the powers that be (banks and big finance) want us to think they’re really useful. Mostly they’re not, and won’t be until we make them funders of green investment.