

# Why we now need above inflation rate pay rises - and wh...

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*I posted this thread on Twitter this morning:*

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The government and the Bank of England are again calling today for wage restraint to beat inflation - as if the whole cost of beating inflation must fall on wage-earning households and not the companies and banks that are causing it or the wealthy who are gaining. A thread....

As I have said time and again, wage rises cannot be causing our inflation. Wage rises have been persistently lower than the rate of inflation throughout the period since Covid and so there is no basis whatsoever for saying wage rises are causing inflation.

If the Governor of the Bank of England and the government want to crack down on inflation they need to cut interest rates as they are pushing up prices. They also need to end profiteering. And they need to tax those who have gained - the wealthy and the banks - more.

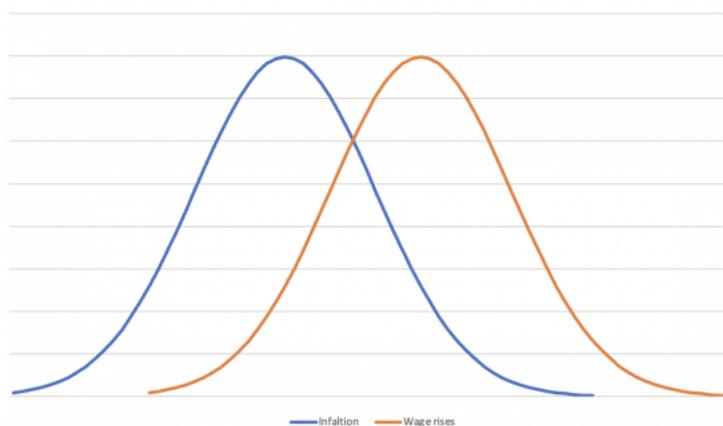
In that one last tweet, I offer a complete strategy for beating inflation, because, given the facts, it's not hard to work out what to do. But the government and the Governor refuse to take account of the facts. That's because they have a dogmatic dislike of working people.

How do I know that? Because the Governor has let his senior staff say that people must get used to this inflation cutting their real incomes and the government is trying to force perpetual pay cuts on public sector workers. That's what anti-working people policy looks like.

But let's instead of engaging with their rhetoric look at what has actually happened. We have had inflation:

The inflation arrived after the Covid reopening. It peaked a few months ago. It is now falling. It will - because throughout history it always has - go back to around one to two per cent a year. No action is needed for that to happen. Inflation just always does go back to normal.

And then we have wage rises. In an ideal world they would go like this:



Wage rises will always follow inflation and continue after that inflation has gone back to normal because that is necessary to make sure that working people do not suffer as a result of that inflation.

It is important to say that if the inflation is even - i.e. all businesses can increase their prices evenly - then they can also all increase their wages because the price increases clearly give them the means to do so. Wage rises are not an issue in that case.

There is an issue if some companies can increase prices excessively and others cannot. Banks, fuel companies, some supermarkets and mobile phone suppliers look like they are profiteering - i.e. increasing prices excessively - right now.

At the same time, many smaller businesses are having problems passing on their cost increases. So inflation is creating real stress between large and small business - and so on their ability to pay wage rises. But overall, if employers want people they have to pay the going wage.

The only question then is by how much the wage rate will rise, and what period of time is required for it to do so. The first chart with wages rates on it (above) assumed wages would follow the same pattern as inflation, with a bit of a lag.

However, that is not what has happened since 2021. There has, instead, been something like this going on:



Wages have fallen compared to inflation to date. This is apparent in this chart: real wages are falling as inflation peaks in this chart. However, there is then a lengthy catch-up period. Long after inflation has fallen away wages keep rising at rates that exceed inflation.

This catch-up period has to happen. If it does not then inflation permanently shifts income in the economy from working people to employers. The result is a recession because people do not have enough to spend.

That is why everyone, employers included, always want wages to catch up with inflation in the end. The pretence that this is not the case from both the government and the Bank of England is particularly worrying: it is as if they want to crash the economy.

Importantly, this catch-up process is not inflationary. That's because employers will have increased their prices long before wages catch up. They will have made excess profits until wages are increased again to match inflation. They can, as a result, afford the pay rises.

So why will they give up those excess profits? First, because they will not get staff unless they do. Second, because they can afford to pay, and third, they will know that unless they do people will not have the means to buy what they have for sale.

In that case, all that the long tail of pay rises at rates above inflation does is redress the imbalance between wages and profits created by inflation in the first instance in a way that hopefully restores working people's incomes and prevents recession.

This is what economic reality looks like. It is enforced by the fact that people are free to change employer and they will if they cannot get the pay rises they need to pay inflated prices and (quite critically) inflated costs of borrowing.

The pressure on people to demand pay rises - which will continue for some time as yet (two or three years, I suggest) - will come from both price and interest cost increases, so much of this upward pressure on wages is in fact wholly created by the Bank of England.

And whatever any politician says, people will demand these rises because they will have to do so in order to stay in their homes, feed their families and meet their essential costs of living, all of which will have risen in price. They're not being greedy. They want to survive.

Apparently the Bank of England does not understand that need to survive, but as I have shown recently that is unsurprising: average pay at the Bank of England is £69,000 a year with an average £20,000 pension contribution on top of that.

Why does all this matter? Three reasons, I suggest. Firstly, because whilst the government persists with its low pay policy our public services will get worse and worse

as people have no choice but cease working in them to make up their income elsewhere.

Second, because very soon we will be hearing politicians saying they cannot meet the pay demands of people that will be for above-inflation pay rises - but they will have to pay them unless public sector workers are going to be made perpetually worse off.

Third, because unless this demand that wages be held down changes we are going to inevitably head for a recession. It is as simple as that.

The result is that unless we get some change of heart in the government - and in Labour, who appears to have no greater understanding of this issue - then we are heading for more, and very prolonged industrial strife, major private financial stress, and recession.

None of that is necessary. If we simply accept that wages have to maintain a fair share of the income of the country or bank loans cannot be repaid and goods and services cannot be bought then none of this stress is needed. A process of managed realignment is required instead.

And if the country is to be worse off - as the Bank of England says it will be because the cost of imports has risen - that does not change any of my argument. Everyone should share that loss - and not just working people. So wages should still increase.

Instead, in that case, the exchange rate should be allowed to fall (something we should be used to since it has already tumbled since Brexit). That then shares the additional cost of imports, if they are really rising.

Not understanding anything of this is simply a recipe for economic stress, economic disruption and destruction of our public services. Since understanding it is really not hard, I am staggered by the intransigence of the government and the Bank of England.

What is their motivation for wreaking havoc? I wish I could offer a benign answer to that question, but I can't. I can offer an explanation of the sort Warren Buffet once provided: "There is a class war going on and its by the wealthy on working people." That is it, I'm afraid.

There is no justification for that class war. I am baffled as to why Labour appears to be signed up for it. But I will keep talking about it until common sense - and economic peace - breaks out. I am just hoping that might be soon.