

Funding the Future

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This [incredibly valuable collection of quotes from central banks](#) and bankers on their ability to create money out of thin air was assembled by regular reader Bill Kruse. I share it with his permission because I think many people will find it valuable. I certainly will:

According to **the Bank of England**;

"... Whenever a bank makes a loan, it simultaneously creates a matching deposit in the borrower's bank account, thereby creating new money. The reality of how money is created today differs from the description found in some economics textbooks."

from this PDF file

[Money Creation Modern Economy](#)

The BoE have helpfully made a video on this subject too;

[Money Creation in the Modern Economy](#)

This subject so excited Parliament, they had a [debate](#) about it.

Here we're advised by the Norges Bank, the Bank of Norway, that "When you borrow from a bank, the bank credits your bank account. The deposit - the money - is created by the bank the moment it issues the loan. The bank does not transfer the money from someone else's bank account or from a vault full of money. The money lent to you by the bank has been created by the bank itself - out of nothing: fiat - let it become. The money created by the bank does not disappear when it leaves your account. If you use it to make a payment, it is just transferred to the recipient's account. The money is only removed from circulation

when someone uses their deposits to repay a bank, as when we make a loan repayment... To sum up: banks create money out of nothing and withdraw it when loans are repaid."

<https://www.norges-bank.no/en/news-events/news-publications/Speeches/2017/2017-04-25-dnva/>

What about in the EU? Here it's the ECB's [European Central Bank] turn to describe how money is created as debt by the privately-owned commercial banks, when they explain: "Commercial banks can also create so-called "inside" money, i.e. bank deposits - this happens every time they issue a new loan. The difference between outside and inside money is that the former is an asset for the economy as a whole, but it is nobody's liability. Inside money, on the other hand, is named this way because it is backed by private credit: if all the claims held by banks on private debtors were to be settled, the inside money created would be reversed to zero. So, it is one form of currency that is created - and can be reversed - within the private economy."

https://www.ecb.europa.eu/explainers/tell-me-more/html/what_is_money.en.html

Here's the German Bundesbank explaining where money comes from, and that banks aren't intermediaries as popularly imagined, "In terms of volume, the majority of the money supply is made up of book money, which is created through transactions between banks and domestic customers. Sight deposits are an example of book money: sight deposits are created when a bank settles transactions with a customer, ie it grants a credit, say, or purchases an asset and credits the corresponding amount to the customer's bank account in return. **This means that banks can create book money just by making an accounting entry: according to the Bundesbank's economists, "this refutes a popular misconception that banks act simply as intermediaries at the time of lending - ie that banks can only grant credit using funds placed with them previously as deposits by other customers".** By the same token, excess central bank reserves are not a necessary precondition for a bank to grant credit (and thus create money)"

How money is created

Does this mean they're printing banknotes all night and day then? Non, according to France's BNP Paribas: "Printing banknotes accounts for only a tiny fraction of money creation. There are two different types of money creation. On the one

hand, the central bank creates so-called 'central bank' money (or 'high-powered money', the 'base money' or the M0 monetary aggregate), consisting in all issued bills and coins, plus commercial bank reserves with the central bank. This form of money is only exchanged between banks on the interbank market.

On the other hand, ***banks create scriptural money (non-cash), representing short-term customer deposits included in their liabilities.*** These deposits are an integral part of money since they are extremely liquid and allow for fast payments. Scriptural money accounts for a greater share of all money creation than fiduciary money.

As for the M3 monetary aggregate (also known as the 'money supply' or 'broad money'), 95% of it is composed of the money that you and I use, meaning the bills and coins in our wallets and the amounts of our demand deposits (checking accounts), our holdings requiring a notice of withdrawal of three month or less (savings accounts) and our term-deposits with a maturity of two years or less. More precisely, the M3 aggregate also includes debt securities with a maturity of less than two years issued by banks, which can be traded on the money market, as well as shares in money mutual funds. But these instruments account for only a small share of the money supply (about 5%). So the money supply consists in a portion of central bank money (bills and coins) and scriptural money, which is by far the larger share. In December 2018, fiduciary money amounted to 1,175 billion euros, scriptural money (short-term customer deposits) totaled 10,541 billion euros, while the total money supply in the eurozone reached 12,638 billion euros.

That is why printing money (or producing fiduciary money) is actually part of money creation, but it is only a small fraction of the whole. Moreover, this form of money creation is mostly offset by the monetary destruction caused by the Eurosystem pulling old bills out of circulation. In 2018, these actions represented 94% of the flow of new bills placed in circulation in the same year, and 83% of the total value of all bills in circulation.

Finally, despite the development of new payment methods (debit cards, contactless payment, e-wallets, etc.), fiduciary money remains deeply ingrained in our habits. Indeed, bills and coins made up 7.5% of broad money (M3) in 1997. Remaining stable since 2015, their proportion reached 9.5% in 2018

<https://group.bnpparibas/en/news/money-creation-work>

Here's the Canadian Library of Parliament describing not only how money is created for the Canadian govt to spend into the economy by the Bank of Canada but also how the private banks create money from nowhere, both as 'loans':

"Both the Bank of Canada and private commercial banks create money by making asset purchases or making loans. However, money creation by the Bank of Canada through purchases of Government of Canada securities is essentially an internal government

process; this means that external factors, such as financial market dysfunction, cannot cause the federal government to run out of money."

https://lop.parl.ca/sites/PublicWebsite/default/en_CA/ResearchPublications/201551E

The IMF are getting in on the act too with this relevant paper entitled "Money Creation in Fiat and Digital Currency Systems": "To support the understanding that **banks' debt issuance means money creation**, while centralized nonbank financial institutions' and decentralized bond market intermediary lending does not, the paper aims to convey two related points: First, the notion of money creation as a result of banks' loan creation is compatible with the notion of liquid funding needs in a multi-bank system, in which liquid fund (reserve) transfers across banks happen naturally. Second, interest rate-based monetary policy has a bearing on macroeconomic dynamics precisely due to that multi-bank structure."

<https://www.imf.org/en/Publications/WP/Issues/2019/12/20/Money-Creation-in-Fiat-and-Digital-Currency-Systems-48843>

Here's Professor Richard Werner (known for his definition of quantitative easing, QE) gently schooling City veteran and commentator David Buik (who you'll probably recognise) on the subject of banking, the financial sector and money creation

[Money Creation by Werner](#)

Celebrated (and sadly late) anthropologist David Graeber correctly notes that what we use for money is simply IOUs and importantly that the Bank of England, the central bank, supplies government spending: "When banks make loans, they create money. This is because **money is really just an IOU**. The role of the central bank is to preside over a legal order that effectively grants banks the exclusive right to create IOUs of a certain kind, ones that the government will recognise as legal tender by its willingness to accept them in payment of taxes. There's really no limit on how much banks could create, provided they can find someone willing to borrow it. They will never get caught short, for the simple reason that borrowers do not, generally speaking, take the cash and put it under their mattresses; ultimately, any money a bank loans out will just end up back in some bank again. So for the banking system as a whole, every loan just becomes another deposit. What's more, insofar as banks do need to acquire funds from the central bank, they can borrow as much as they like; all the latter really does is set the rate of interest, the cost of money, not its quantity. Since the beginning of the recession, the US and British central banks have reduced that cost to almost nothing. In fact, with "quantitative easing" they've been effectively pumping as much money as

they can into the banks, without producing any inflationary effects...What this means is that the real limit on the amount of money in circulation is not how much the central bank is willing to lend, but how much government, firms, and ordinary citizens, are willing to borrow. Government spending is the main driver in all this (and the paper does admit, if you read it carefully, that the central bank does fund the government after all). So there's no question of public spending "crowding out" private investment. It's exactly the opposite."

truth-money-you-bank-of-england-austerity

Britain's British Broadcasting Corporation, the BBC, have needed some encouragement into adopting this new, accurate, narrative, which at first they ignored. Complaints eventually led to: a response from the Head of the BBC's Executive Complaints Unit; Fraser Steel who admitted there had been "a serious breach" of BBC editorial standards.

"...we agree the original version of the article misrepresented the way modern banking works. As you have pointed out, it is not correct to imply banks act as financial intermediaries by simply lending out the deposits which savers place with them."

"I share your concern that the BBC should accurately reflect the way modern banking works...a number of senior BBC News managers have been made aware of your complaint and our finding and I hope this will help to ensure journalists and editors are properly briefed and informed on this issue."

battle-with-the-bbc

Oh, by the way... anyone still under the impression the Bank of England has any significant independence from the Government might like to consider the Bank of England Act 1998 where it states in so many words they don't. It's arguably best to consider the BoE and Government as one and the same, with the Treasury higher in the food chain.

Bank of England 1998 Act

While we're on the subject of the Bank of England and it's actual lack of independence, let's go into its operations a little deeper with Neil Wilson: "The Bank of England is just a bank and operates in the same manner as any other bank (to the extent that it requires capital injections from HM Treasury to maintain its loss adjusting buffers). A bank that is and remains, both legally and structurally, subsidiary and subservient to HM Treasury in all

ways. Its primary task is to discount liabilities imposed upon it by HM Treasury into bank liabilities. It does that by order of HM Treasury, has done since at least the 19th century, and continues to do so today. The Bank has no legal authority to refuse those orders."

<https://new-wayland.com/blog/how-uk-government-payments-are-made/>

The study referred to, "An Accounting Model of the UK Exchequer - 2nd edition" can be downloaded in PDF format from the link below. The accompanying notes tell us: "In this timely study, the authors investigate the structure and function of the UK's public financial institutions, in groundbreaking depth and scope. Drawing on historical sources from the birth of the modern sterling economy, testimonies from government departments, official documentation, and parliamentary abstracts, the study forensically disassembles the components of the UK's government finances, debunking ideology and half-truths along the way."

The authors expose the myth of Bank of England "independence", and illustrate the central, driving role of HM Treasury in the UK financial system and the primacy of Parliament in determining spending and resourcing in the UK.

The study describes in detail how the financial operations of the UK Government work, and the accounts and structure of the UK Exchequer, including its relationship with the devolved UK administrations. Supported with references from forgotten or little-known sources and extensive appendices detailing the history of the UK financial system, this important work destroys the myths and obfuscation of governments, economists and the financial services sector that has allowed decades of needless austerity to wreak social and political devastation in the UK and beyond. As such, this is an overdue exposé that has implications beyond the field of economic literature and challenges the basis of UK economic policy since the 1980s."

<https://gimms.org.uk/2021/02/21/an-accounting-model-of-the-uk-exchequer/>

And then there's this: "This paper constitutes a first detailed institutional analysis of the UK Government's expenditure, revenue collection and debt issuance processes. We find, first, that the UK Government creates new money and purchasing power when it undertakes expenditure, rather than spending being financed by taxation from, or debt issuance to, the private sector. The spending process is initiated by the government drawing on a sovereign line of credit from the core legal and accounting structure known as the Consolidated Fund (CF). Under directions from the UK finance ministry, the Bank of England debits the CF's account at the Bank and credits other

accounts at the Bank held by government entities; a practice mandated in law. This creates new public deposits which are used to settle spending by government departments into the economy via the commercial banking sector. Parliament, rather than the Treasury or central bank, is the sole authority under which expenditures from the Consolidated Fund arise. Revenue collection, including taxation, involves the reverse process, crediting the CF's account at the Bank. With regard to debt issuance, under the current conditions of excess reserve liquidity, the function of debt issuance is best understood as a way of providing safe assets and a reliable source of collateral to the non-bank private sector, insofar as these are not withdrawn by the state via quantitative easing by the Bank of England. The findings support neo-chartalist accounts of the workings of sovereign currency-issuing nations and provide additional institutional detail regarding the apex of the monetary hierarchy in the UK case. The findings also suggest recent debates in the UK around monetary financing and central bank independence need to be reconsidered given the central role of the Consolidated Fund."

<https://www.ucl.ac.uk/bartlett/public-purpose/publications/2022/may/self-financing-state-institutional-analysis>
