

If banks create money out of thin air - as we know they...

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The [debate on this blog](#) over the last few days on money creation by banks - as a result of which it has been shown that all central bankers now know, even if they do not freely acknowledge - that all money is created out of thin air by the banking process, has powerful policy consequences.

I was going to write about one of these, which is that this means that most savings have no relationship to investment in the economy, but then read a paper by Michael Kumhof and Zoltán Jakab [for the IMF in 2016](#), and note what they have to say on this instead:

Many policy prescriptions aim to encourage physical investment by promoting saving, which is believed to finance investment. The problem with this idea is that saving does not finance investment, financing and money creation do. Bank financing of investment projects does not require prior saving, but the creation of new purchasing power so that investors can buy new plants and equipment. Once purchases have been made and sellers (or those farther down the chain of transactions) deposit the money, they become savers in the national accounts statistics, but this saving is an accounting consequence—not an economic cause—of lending and investment. To argue otherwise is to confuse the respective macroeconomic roles of real resources (saving) and debt-based money (financing). Again, this point is not new; it goes back at least to Keynes (Keynes, 2012). But it seems to have been forgotten by many economists, and as a result is overlooked in many policy debates.-

The implication of these insights is that policy should place priority on an efficient financial system that identifies and finances worthwhile projects, rather than on measures that attempt to encourage saving, in the hope that it will finance desired investment. The “financing through money creation” approach makes it very clear that with financing of physical investment projects, saving will be the natural result.-

The obvious question that follows is why is the UK still spending more than £70 billion a year subsidising savings that deliver almost no economic value in that case?

I would argue that value could be recreated if those savings were genuinely saved as new capital. But in their current form that does not happen.

This is an area where massive rethinking is required, as has been signalled on this blog in recent years. That work will continue.