

Funding the Future

Will we follow China and suffer deflation - which is ve...

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China is suffering deflation, as has been reported this morning:



FinNews
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#inflation #China #reporting

China - consumer inflation CPI (Jan)

m/m = +0.3% (expected +0.4% / previously +0.1%)

y/y = -0.8% (expected -0.5% / previously -0.3%)

Traditionally, the media write about deflation in China

The fall in consumer prices in January was the strongest since 2009.

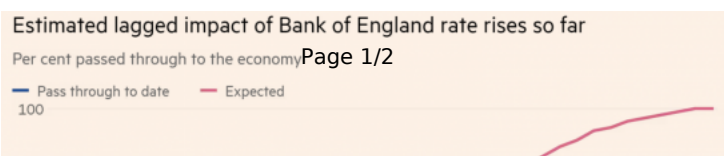
Industrial PPI inflation has been declining for 16 months in a row - CNBC



4:31 AM · Feb 8, 2024 · 37 Views

In Western economies, like the UK, we have an obsession with inflation because deflation is something that we know almost nothing about as a lived experience. However, we should be worried. Deflation is much more dangerous than inflation and is entirely possible in the UK in the next year or two.

Take a look at this chart, [published in the FT](#) this morning that suggests that a significant part of the economic impact of the interest-rate rises put in place by the Bank of England has yet to have an effect, even though we now know that from May this year onwards, inflation in the UK is expected to be less than 3% a year and to remain that way, at best.



High interest rates, which the Bank of England insist must persist, are intended to create a recession by reducing demand, increasing unemployment, and by increasing the cost of capital, which cuts the rate of investment. The result is supposed to be significant downward pressure on prices. However, what we know is that those price changes are already falling in scale, significantly. With much of the Bank's recession-creating effort still to have an impact, the chance that we will have deflation is quite high as a result.

Deflation is dangerous for three reasons.

First, the real cost of repaying loans increases, which penalises all businesses and households that are dependent upon loan finance to make their plans possible. They have to cut their expenditure as a result.

Second, falling prices discourage investment because people defer purchasing decisions in the hope that they can buy things more cheaply in the future.

Thirdly, these two factors do, in combination, put significant pressure on spending capacity, meaning that a steady downward spiral within the economy develops.

As I have long argued, the Bank of England never needed to increase interest rates to tackle inflation because the inflation we had was of a sort that would never have been addressed by interest rate rises and would, in any event, always have passed without any such changes. Now, though, we face the risk of a substantial overshoot by the Bank of England that is very likely to result in a serious recession and potentially in deflation as we follow the path that China is setting.

Economic incompetence of this magnitude takes some effort to deliver.