

# Funding the Future

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I published the second video in the Economic Truths series this morning. In it, I note that most people think banks take in deposits from people and then lend that money to those who want to borrow from them. Nothing could be further from the truth. Banks take deposits and make loans, but they don't lend out depositors' funds. Nothing could be further from the economic truth.

<https://youtu.be/JwcZKEpO9v8?si=C7Vrbm-amrVGjzEh>

The audio version of this video is here:

[https://www.podbean.com/player-v2/?i=4tebv-167ffd9-pb&from=pb6admin&share=1&download=1&rtl=0&font=Arial&skin=8bbb4e&font-color=&logo\\_link=episode\\_page&btn-skin=ff6d00](https://www.podbean.com/player-v2/?i=4tebv-167ffd9-pb&from=pb6admin&share=1&download=1&rtl=0&font=Arial&skin=8bbb4e&font-color=&logo_link=episode_page&btn-skin=ff6d00)

The transcript is:

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It's an economic truth that banks do not lend out the money that people deposit with them.

Most people think that the role of a bank is to take money in from savers and to then lend that money on to people who want to borrow. And that, I've got to tell you, is complete and utter nonsense.

And it's not just me who says so. Almost every central bank in the world has now agreed with this, including our own, the Bank of England, which published a paper on this subject in 2014.

Banks are not intermediaries between savers and borrowers. That is not their role in the modern economy. And yet most people cannot get their heads around the fact that this

is not the case, including almost everybody in government who somehow think that savers fund lending, which fuels investment. And the answer is no, it doesn't but let me explain why.

I've already done a video on why you haven't got money in the bank if you are a saver and in that video I explained that actually all money is debt and that if you are a saver with a bank then the bank owes you your money back. Now, how can they in that case, transfer your debt to somebody else you don't know, who can then use it to fund whatever they want to spend?

You don't know who that person is. You haven't agreed to lend them money. The bank hasn't got the right to transfer your debt to that person, not least because they still owe you the debt that they've acknowledged by printing a balance on your bank statement. It is technically impossible in accounting terms for the money that you are owed to be transferred to them without your consent.

But that's also impossible for another reason. And that's because there is a completely separate loan agreement between the bank and the person to whom they lend money. Just as the bank has a loan agreement with you because they have borrowed your money if you are a saver, they have a loan agreement with the person to whom they lend money because that person now owes them money.

And each of these loan agreements stands independent of all other loan agreements that the bank does and are actually represented by new promises to pay.

You and the bank have a promise to pay if you're a saver. They promise to repay to you whatever sum you deposited with them. And it's that relationship of mutual trust that is represented by the bank statement and, well, not by a lot else. The only thing that guarantees you will get your money back is, first of all, that the bank is good to make a payment, and most banks are, and secondly, that you can prove the balance you're owed because they've recorded it in their books.

Well, the relationship between the bank and the person who borrows money from them is actually not that dissimilar. Of course, there's a contract. That contract between the bank and the person who borrows money is an exchange of promises, just as is the relationship between you as a saver and the bank.

The bank promises to the lender that in exchange for the lender's promise that they will repay the loan, the bank will make a payment of the value of the loan to whomsoever the borrower wants the payment made.

So suppose somebody goes into a bank and says I want to borrow £10,000 pounds, the bank agrees, and they do two things. They put £10,000 in that person's bank current account so that they can spend the money that is represented by the loan. And they put £10,000 in that person's loan account, which represents the money that the

borrower has got to repay.

These two new bank balances, which add up to zero because one is a positive and one is a negative, and which can therefore be created simply by typing numbers into a computer keyboard, therefore represent the creation of money out of thin air.

Those two balances represent the promises made. One, from the bank to the borrower, that they can make a payment to whoever they like. And two, from the borrower to the bank, that they will make a repayment of the loan balance. And that's it. That's how a bank creates a loan, and it's got nothing to do with the money that you deposit with the bank at all.

So, the two sides of banking are entirely unrelated. And if you now want to know why banks are particularly reluctant to pay interest on money deposited with them, well, it's obvious, isn't it? Because they don't really need too many of your deposits in reality, because all the money that they lend is created by those promises that are exchanged when the balances on people's loan accounts that represent the loan are typed into the keyboard. They're not represented by anything that had anything to do with you as a saver.

Therefore, why do they want to pay you for your money? Well, only because regulation requires that they have a certain value of balances available to them to make sure that they can settle any obligations they have to other banks in respect of those payments that either you or the person who's borrowed money from them might have to pay.

But that's a bit technical at this moment. The important point is this one. Your saving and the loan that a bank makes are entirely unrelated to each other. So, when someone tells you, we've got to save more if we're going to invest by making new loans from banks because that's the basis on which our future prosperity depends, they're talking nonsense. There is no reason for savings to fund investment. All that is required is a bank willing to lend money to someone.

I'm not saying savings aren't useful, they are, but they're not related to the funds available for investment and that's the key point to understand. These things are independent. Don't get confused by politicians who claim otherwise. They're talking nonsense. You tell them what the truth is. Your money as a saver does not fund bank lending.