Funding the Future

Do we need more quantitative easing?

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Over the last day or so, I have seen or heard discussion on whether the government might revive quantitative easing as a way of easing the pressure on the UK economy in response to the crisis that Trump has created. The issue was, in fact, raised with the Prime Minister at yesterday's Liaison Committee hearing in the House of Commons, although he did not, of course, answer the question. I have also heard the same issue being raised in podcasts. It does, therefore, appear to need to be addressed.

The answer to the question is that no, we most definitely do not need another round of quantitative easing, because QE was quite emphatically the wrong thing for the government to have done in 2020, and may also have been wrong in 2008.

On the other hand, if the question is appropriately framed, and it is whether the government should provide direct funding through injection of new money into the UK economy, with such balances being left on account between HM Treasury and the Bank of England, then the answer is almost certainly going to be an emphatic yes.

As I have noted in the glossary to this blog, quantitative easing can be explained as follows:

Quantitative Easing

Quantitative easing (QE) is a form of unconventional monetary policy.

QE is used by a central bank to control the rate of inflation within the jurisdiction for which it is responsible when being at or near the zero bound prevents a central bank using conventional monetary policy and the control of bank base rate to achieve that goal.

When using quantitative easing a central bank buys the debt or bonds of the government of its jurisdiction (and occasionally commercially issued debt as well) in the open market and then holds those bonds under its ownership.

The objective of QE is to increase the price of government debt issued by the jurisdiction undertaking the exercise by reducing the quantity of that debt available for sale in financial markets, which scarcity inflates their value, which in turn reduces the effective rate of interest paid on it.

The theoretical justification for QE is that reducing the rate of return on government debt supposedly forces investors to seek an adequate return on their funds elsewhere. It is presumed that they will as a result invest them in risker assets, so providing money for investment in private markets. It is in turn presumed that this investment will stimulate growth in the GDP of the jurisdiction.

During the Covid crisis this did not, however, appear to be the motive of central banks using QE. Instead, those central banks appeared to be funding the expenditure of the governments that controlled or owned them during this period.

The practical consequence of quantitative easing is to increase the central bank reserve account balances of commercial banks held with the Bank of England, with the increase representing the amount that a central bank has paid to buy back the bonds previously issued by the government that owns or controls it.

Since the central bank reserve accounts held by commercial banks are a significant part of what is termed 'base money' (see separate entry) the consequence is that QE increases that part of the money supply because the sums paid for the bonds purchased by the central bank inflate these balances, meaning that QE results in, or provides cover to, money creation by a central bank although many central banks appear to deny this, as do almost all politicians since this process proves the existence of what they call the magic money tree.

For a critique of quantitative easing see unconventional monetary policy.

As should be apparent from that explanation, QE is a sham.

The bonds that were issued by HM Treasury into the financial markets were acquired by market operators who knew that they would be able to sell them, or equivalent bonds, very shortly thereafter straight back to the Bank of England, having made a small profit in the process.

The Bank of England then owned the government bonds, but the Office for National Statistics has consistently refused to recognise this fact within the national accounts, pretending instead that these are owned by third-party entities.

The effective cancellation of the government debt, which this purchase of it by the Bank of England achieved, did then, however, result in the creation of new central bank reserve account balances between the Bank of England and the UK commercial banks. These were then described as deposits by those banks with the Bank of England, when they were no such thing. They were, in fact, a reflection of the injection of new funds by the Bank of England into the economy via those commercial banks.

The entirety of QE was, then, a gross accounting misrepresentation as to its nature. I would suggest that this was deliberately meant to deceive.

There were also wholly unnecessary costs created, for which we are paying many billions a year in wholly inappropriate interest rewards to UK commercial banks.

Of these rewards, the first was the margin paid to financial institutions that took part in the sham issues of debt by the treasury, immediately prior to the repurchase of debt by the Bank of England.

The second has been facilitated by the Office for National Statistics, who have persistently and deliberately put out totally misleading government accounts that misstate the true extent of government debt so that austerity and high interest rate policies can be maintained by governments intent on imposing these policies without there being economic necessity to do so.

Third, interest has been wholly unnecessarily paid on central bank reserve account balances, most especially since Bank of England base rate increased from 2021 onwards, when there was absolutely no requirement that the government pay commercial banks for gifting them with the liquidity that they needed to operate, whether that be in the aftermath of financial crisis in 2008 or in 2020 2020, during both of which episodes those institutions would most probably have failed but for that support provided to them by the state.

All this does, of course, mean that I am opposed to more quantitative easing. It represents transactions promoted to deceive at considerable cost to the people of the UK. I have, unsurprisingly, never been excited by the government committing fraud of this nature, and yet both our leading political parties have been engaged in those processes.

However, to pretend that the government is going to maintain its fiscal rules, and not raise taxes, and still stand behind the UK economy, as Starmer claimed it would in a facile speech he gave at Jaguar Land Rover this week, is quite obviously absurd. That is a claim that it is obviously impossible for any government to fulfil. In that case, it is inevitable that as this crisis develops - as it surely will - that there will be a need for more government support for the economy than tax alone can sustain.

The result is that the government will be faced with a straightforward choice. It could maintain the fiscal rule, and deliver 1930s-style depression, with all the consequences that we now know flow from that. Let's be clear; in a world as mad as this one, that is what they may decide to do.

Alternatively, they could suspend or replace their fiscal rule and decide that they will provide the means to ensure that the country can do all that is possible. In other words, they could make good the shortfall in demand that the natural lack of confidence that is going to hit the commercial and household sectors will create. This they would need to do by direct money creation, without in any way undertaking quantitative easing, thereby avoiding all the residual problems and costs that the deception implicit in that programme created.

When will Labour realise this? Inevitably, too late is the answer. I cannot be more specific than that. But it will happen, I am sure. I also fear they will use QE instead. That would be a massive mistake.