Funding the Future

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The US bombing of Iran could have massive consequences. Oil prices are rising. Stock markets are ignoring risk. And the Bank of England may react in all the wrong ways. This could spiral into inflation, recession, and even a political crisis.

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This is the audio version:

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This is the transcript:

Trump attacked Iran on Saturday, and the consequences are going to be enormous.

On Sunday, the Iranian parliament authorised the closure of the Straits of Hormuz. The Straits of Hormuz are the stretch of water between Iran and the United Arab Emirates. They are only 30 miles wide but 20 % of all the world's oil and gas flows through that narrow passage.

Oil from Iraq, oil from Saudi Arabia, and from Kuwait, and Oman, and the UAE itself, all flows through there, plus some of Iran's oil as well, and they're threatening to shut that passage.

The reality is that if the Straits are shut, then Iran can effectively block all traffic through them. Oil tankers are slow, hard to manoeuvre, and very big, and that makes them incredibly hard to defend. So any Iranian missile could take one out. No one is going to want to take a ship through there.

The consequence is obvious. Alternative routes are going to be necessary, but they are limited and costly, and for the time being, at least, global energy markets are going to react to all of this by increasing prices.

We've already seen on the morning that we're recording this, that oil prices have risen by over $5 a barrel.

They were $75 a barrel, and have been on average for around three years, since things settled down after the Ukraine crisis. But Goldman Sachs is talking about them going above $100 a barrel now, and I think that's very likely as well.

We last saw this level very shortly after Russia invaded Ukraine, and we know what happened then.

There was, in practice, no real oil shortage at that time. There was just a disruption in the flow, and that may well be true now, by the way. There isn't necessarily going to be an oil shortage because of Iran's move, but there will undoubtedly be short-term disruption to markets. That's inevitable because it will take time for the world's oil supplies to find a new way to be delivered, and the result will be quite simple and quite straightforward.

The oil marketeers, those are the people who trade oil, will force the price up. And there will be profiteering on an enormous scale, which will benefit those marketeers to a great degree, most of whom are banks, by the way. And as a result, we are going to get inflation almost invariably. That will be exactly similar to what happened in 2022, when we had the same situation with regards to the oil crisis created by the Ukraine War.

And this will be an inflation of a similar type as well. This will be an imported inflation. This is not domestic demand driven. It's an external supply shock, and the consequence is that UK monetary policy, run by the Bank of England, has no answer to this type of inflation.

In fact, increasing interest rates now would be completely mistaken as a policy adjustment. Rate rises will not fix imported inflation any more than they did in 2022. Instead, they will double the hardship that results from this inflation.

First of all, people will have to deal with the fact that oil prices have gone up, and as a consequence, the price of so many other products will rise as well because oil is embedded in so many things that we buy, from food onwards.

And then on top of that, interest rates will be increased as well, even though there will be no reason to do so. The reason to increase the interest rates is to reduce demand, but the price increase on the products which oil will impact will be sufficient to do that. And yet I am quite sure that the Bank of England will be planning, as it did in 2022, to increase interest rates again.

This is going to be disastrous for the UK economy.

The UK economy is already fragile. Higher energy costs will simply kill demand.

The risk of a downturn now is really serious, and this will have enormous knock-on effects, not only for households with borrowing, and a large number have, but also for employment, and for companies who are marginal as to their profitability, and so much more.

What that means is that Rachel Reeves' current economic plans are now completely obsolete. Almost certainly, we are now talking about living in a wartime economy, and wartime economies are nothing like peacetime economies. And even if we are not at war with Iran, the consequences of that war with Iran will be felt here.

Right now, we don't need the sort of cuts that are already being planned by Labour. Yes, they're talking about increasing defence spending, and yes, I know they're talking about increasing spending on the NHS, but they are cutting almost everything else. And what we need at this moment is not a round of cuts, but we do instead need to have an immediate reaction to make sure that the economy can keep functioning.

How can we do this? We could temporarily cut the rates of tax on oil. That is entirely possible.

We could do as Alistair Darling did in 2009, and cut VAT, precisely to give the economy the sort of stimulus it needs to prevent it going into recession after an external economic shock, which of course happened in the 2008 financial crisis.

We could look at all of those issues, but there's another issue to consider as well, before deciding what to do. Stock markets, including the UK's FTSE 100, are at record highs around the world; literally at the highest levels they have ever been. And it's very interesting to note that Gillian Tett, who is one of the best economists working for the Financial Times, good as an economist because she is, in fact, a social anthropologist of origin, has described what she calls a social silence in financial markets.

She did this last Friday, and what she said is that no one was really talking about the real risks that existed in the world in financial markets, even last week. But behind the scenes, there's been growing fear about what might happen. And what she said was, and I entirely agree with this because I've said it myself on my own blog, geopolitical conflict plus an oil spike could create panic. I believe that's now the case.

I also believe, and it's very obvious to me, that this is the case, that stock markets are seriously overvalued at present.

There could be a tipping point. The sort of tipping point that Gillian Tett was describing, the point where suddenly everyone realises that this overvaluation exists, and what will we get? We'll get a crash.

There will be a stock market crash if this conflict continues for very long. And in particular, if the Iranians do, as they could, block the Straits of Hormuz. So, on top of inflation, we could have a stock market crash. The combination is horribly unattractive.

Just to add to that, there could be a serious backfire against Trump in the USA as a consequence of what he has done. Trump promised his own MAGA - Make America Great Again - supporters that he would not involve the USA in foreign wars, but he's just gone and done that.

He has done it more directly than any of his immediate predecessors as US President, and he's done it against a country that is much stronger than Iraq. It's stronger because it has a much deeper history. It has natural borders. It has a unified population, even if they don't much like their leadership, I suspect. And it's strongly aligned with China, which is giving it an economic strength which other countries in the Middle East really are not enjoying. As a result, some of Trump's supporters in the USA may now turn against him. And they may also do so if markets collapse.

So, Trump isn't guaranteed success as a consequence of what he's done. In fact, some Republicans are already talking about this being an impeachment issue, in other words, seeing whether the time has come to throw him out of office.

We are, therefore, in a state of confusion politically, and we're in a state of confusion economically.

It looks highly likely to me that inflation is inevitable.

We know that the Bank of England will be inclined to increase interest rates if that is the case, and that would be an absolute disaster.

We know that Rachel Reeve's reaction to every economic situation is to lock down and say that the books must balance, but at this moment, that too would be a disaster.

We need to reflate the economy and not close it down, and we need to protect people from profiteers, and the only way to do that is to change tax and reduce VAT or oil tax and to keep interest rates low.

Unless we do that, the UK is facing a full-blown recession. But will Reeves listen, and will the world, and will the lessons of the past be learned?

I don't know, but I seriously doubt it, and that really worries me.

Taking further action

If you want to write a letter to your MP on the issues raised in this blog post, there is a ChatGPT prompt to assist you in doing so, with full instructions, **here**.