

Interest rates can't fix inflation now

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Inflation is likely to rise again, but governments are reaching for the wrong solution.

When policymakers see inflation, they instinctively raise interest rates and try to slow the economy. But that only works if inflation is caused by excessive demand.

Right now it is not.

The inflation risk facing the UK comes from supply shocks driven by war, energy disruption and broken supply chains. Higher interest rates cannot produce more oil, reopen trade routes or repair supply chains.

What they can do is damage the rest of the economy.

In this short video, I explain why governments repeatedly make this mistake and what their real job should be during a crisis: protecting people, preventing profiteering and stabilising the economy while the shock passes.

https://www.youtube.com/watch?v=vOxBR_LIKno?si=bdeevO3YcqxnNb6R

This is the transcript:

In the face of crises, governments keep making mistakes, and that's profoundly annoying.

At the moment, we face a risk of inflation, and when inflation rises, governments nearly always reach for the same solutions. They raise interest rates. They say the economy must slow down. They say spending must be reduced, but that only makes sense if

inflation is being caused by too much demand, and that is not the case at present at all.

Right now, the risks we're facing within the economy are coming from supply shocks. They're the result of war, energy disruptions and broken supply chains.

Raising interest rates does nothing to fix any of those things. High interest rates do not produce more oil. They do not reopen trade routes, and they do not repair supply chains.

What they do instead is damage the rest of the economy. Businesses will delay investment. Households will cut their spending. Mortgage costs will rise. And a temporary shock will turn into a recession if the government increases interest rates.

We have seen this mistake time and time again in the past. Instead of stabilising the economy, policymakers panic.

But the real job of a government during a crisis is different; their job is to protect people, to prevent profiteering, and to keep the economy stable while the shock passes.

If governments use the wrong tools, they do not solve the crisis. They make it worse, and that is what we're heading for.