Funding the Future

What should Rachel Reeves do now?

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War in the Middle East is already pushing oil prices higher, and that means inflation pressure in the UK will rise again.

But this is not normal inflation. It is not caused by excessive demand in the UK economy. It is an external supply shock.

So the real question is simple: will the government protect households, or leave them to absorb the shock?

In this video, I explain why raising interest rates will not solve an oil shock, and why the government should instead:

* Cut VAT
* Cut fuel duty
* Stabilise long-term interest rates
* Protect household incomes

If ministers talk about economic defence in wartime, then protecting society must come first.

https://www.youtube.com/watch?v=mdOFil84XrQ?si=fwpm5Gk7DSEx9AFG

This is the audio version:

https://www.podbean.com/player-v2/?i=jw36p-1a68f20-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-c

olor=auto&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

War inflation is coming to the UK. Rachel Reeves has a duty to protect people now. Oil prices are rising because of war in the Middle East, and that means inflation pressure in the UK is inevitably going to grow. The question at this moment is simple: will the government protect people or leave them to absorb the shock? That's what I'm talking about in this video.

What is actually happening is this: war has disrupted energy supplies, as almost everybody knows now. We're already seeing the consequences at the petrol pump. Energy prices though feed into almost every cost in the economy. Transport, heating, electricity, and food will all rise as a consequence of the increase in fuel costs. The result is imported inflation and not domestic overheating.

This is not normal inflation, is the point I'm trying to make. This inflation is not caused by excessive demand inside the UK economy. It is being caused by an external supply shock. Households did not cause this situation. Workers did not cause this situation. That means that normal policy responses in this situation would be wrong.

The mistakes that the government always makes are threefold.

First of all, they do nothing to protect household incomes.

Secondly, they blame workers for inflation.

And thirdly, they raise bank interest rates to compensate for the inflation that has happened, thinking that this will solve the problem. But bank interest rates do not ever fix oil supply shocks; they simply make people poorer.

The government has a particular duty in wartime, and in my opinion, we are in wartime. If inflation is created by war, the government has a duty to shield society from the shock of that inflation.

It must prevent a collapse in living standards.

It must maintain economic stability.

This is the real meaning of economic defence when it comes to a government in wartime.

There are a number of obvious steps that the government can now take.

One is to cut the general rate of VAT. Why would it do that? Well, VAT, of course, increases prices automatically. It is an addition on top of the basic sale price charged by a company to a customer. So, in reverse cutting VAT automatically reduces the cost of living in this country. It could offset the inflation caused by rising energy prices as a result. In other words, the state could absorb part of the shock of the current inflationary situation instead of households.

The next step is as obvious: the government could reduce fuel duty for domestic consumption. Why? Because many people must travel to work and to get to school and everything else. Life is dependent upon our ability to move. Public transport is not always an option. It's a good one, but is not always available to everyone. Rising fuel prices hit lower-income households the hardest. A temporary reduction in duty would directly protect working households.

And there is another mistake we must avoid as well. The Bank of England must not raise interest rates at this moment. I would've thought that this is obvious, but it isn't to the government. Why? It's because higher interest rates do not reduce oil prices. They do not increase energy supplies. Not a single extra tanker will arrive in the UK because the Bank of England has increased interest rates. All the interest rate increases do is increase mortgage costs, the likelihood of business failures and rent rises. We learned this after the 2022 inflation spike. Rate rises did not fix the problems then; they won't fix the problems now.

There is another tool available, too. The government could control long-term interest rates directly. They can control short-term interest rates using the Bank of England base rate, but the long-term interest rate requires another tool: that is, quantitative easing in all practical terms. They could now undertake a carefully designed bond repurchase scheme. This would stabilise gilt markets, prevent speculative pressure and keep long-term borrowing costs low.

At the same time, the QE problem that we have seen in the past could be tackled. Previous QE programmes failed because bonds were bought and then markets expected them to be sold again. That created speculation. Instead, this time, bonds could be purchased and then be cancelled permanently. This would remove debt from the markets for good and stabilise expectations.

All of this matters. The real issue here is simple: households cannot absorb another shock at this moment. Many UK families already face high mortgages, high rents, and fragile finances. If war inflation hits them again, as looks likely, the damage will be severe. The government can absorb that shock because the government is different from households.

Unlike households, the government issues currency.

The government controls taxation, and the government manages the bond market.

In accounting terms, the government balance sheet is bigger and so can absorb shocks, which households can’t. That’s the key point at this moment, and this is what economic defence looks like right now.

If ministers are talking about defence spending, they must understand this. The first line of defence is society itself. A country that allows its people to become poorer, angrier, and insecure is not defending itself; it is weakening itself.

As a result, Rachel Reeves now faces a choice. She can either protect financial markets or she can protect the public. A government that is serious about stability must choose to protect the public; that is the only option available to it.

My point is this: the government should act, and it should make clear that it is going to do so, now.

It should cut VAT.

It should cut fuel duty.

It should stop interest rate rises.

It should stabilise long-term borrowing costs. These policies would protect households from a shock they did not create, and that is exactly what governments exist to do and what they should do now.

If you agree, there’s a poll down below. Let us know your opinion.

Poll

[poll id="347"]