

## The risk from interest rate increases

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As the [FT reports](#) this morning:

*The Bank of England is likely to keep interest rates steady this week even as it confronts the prospect of above-target inflation for the rest of 2026, as policymakers buy time to assess the risks stemming from the energy crunch.*

As [they also report](#), the Bank of Japan did just that yesterday:

*The Bank of Japan has held its benchmark interest rate despite forecasting a sharp rise in inflation as the war in the Middle East clouds the global economic outlook and tests the country given its exposure to rising energy prices.*

That report from Japan does come with a warning, though. Of the nine members of its monetary policy committee, three voted for an increase. We can expect a split of a similar sort in the Bank of England vote this coming Thursday, because the deficit hawks on that committee, who live their lives terrified by inflation, will have noted [claims like this](#) in the Daily Telegraph:

*Retailers have warned consumers to brace for a wave of price rises in supermarkets.*

All those central bankers who might vote for an increase in interest rates at this moment suffer from a very weird malady. I can only presume that it is their honest belief that somehow or other the consequences of war in the Middle East can be addressed by raising interest rates in countries that have, at present, no direct influence on the outcome of that war.

This belief makes no sense at all. It is evidence of economic derangement, and little else. The reason for increasing interest rates when inflation rises is to suppress what is presumed to be heightened domestic demand arising from economic overheating, driven by excess private-sector activity that pushes demand beyond the economy's capacity to supply what consumers wish to buy.

Nothing like that situation exists at present. Demand within our economy is already

depressed. Consumer confidence is low. Business confidence is declining. Levels of the investment looked to be falling. Simultaneously, the government is [looking at austerity](#) once more with the intention of reducing support for those in need in the country.

All the signs are that we have a shortage of demand within the UK at present because of falling confidence created by the fact that households are now, or do expect to be, squeezed in the level of consumption that they might be able to enjoy due to price increases forced upon them by circumstances entirely beyond their and the country's control. We are, then, in the exact opposite position of the one in which a monetary policy committee should decide to increase interest rates to control inflation.

The economic impact of those price increases, for fuel, energy, food, and other essential products, is, in fact, exactly akin to that created by an interest rate increase. What those price increases do is reduce demand within the economy for the supply of other goods and services that people might otherwise acquire. In other words, those price increases might fuel inflation, but what they also do is reduce other demand in exactly the same way that an interest rate increase is supposedly intended to achieve.

The imposition of an interest rate increase in this case is, therefore, a double whammy. Not only is the economy already suffering a reduction in demand because price increases have been imposed upon it for reasons that we cannot control, but an interest rate increase then imposes another price increase (that for money itself), that households cannot control, doubling the impact of the reduction in demand and necessarily increasing the risk of major economic downturn, depression or even recession if the combination of these factors become becomes deeply oppressive, as I think it might.

How and why those tasked with managing monetary policy cannot see or understand this completely baffles me. Their incomprehension of economic reality is staggering. Despite that, and even if the Bank of England does this week decide not to increase rates, as I think is likely, I suspect that this will only be a decision postponed and the Bank of England's continuing war on the well-being of people in this country will be resume shortly thereafter, as a result of which Labiur will insist that it has no choice but to also cut government spending because it will claim that it has had a cost imposed by way of increased interest rates which it too has no ability to control when the exact opposite will be the case.

One day, it is just possible that this country might enjoy coherent economic management. Do not expect that any time soon.