Funding the Future

Could the Bank of England bring the economy down?

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The Bank of England has held interest rates, but the real story is what happens next. Beneath its decision, pressure is building to raise rates again, and that could prove disastrous.

In this video, I explain why that is the case. The inflation we are facing is not driven by excess domestic demand. It is being driven by war, supply shortages, and speculation in global commodity markets. Interest rate rises cannot produce more oil or resolve supply disruption, but they can suppress demand further in an already weakening economy.

That is the risk we now face. Raising rates in these conditions could accelerate the move toward recession, increasing business costs, reducing investment, and undermining confidence. There is a real danger that central banks could turn a fragile situation into a much deeper economic crisis.

The problem, at its core, is that central banks are applying the wrong theory to the wrong problem. When inflation is supply-driven, higher interest rates do not solve it. They can only make it worse. And unless that is recognised soon, the consequences could be severe.

https://www.youtube.com/watch?v=9prQA-vYCHo?si=fH6kvCb3MU3NAc8-

This is the audio version:

https://www.podbean.com/player-v2/?i=fbn3s-1ab08f6-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

Three major central banks have held their interest rates in the last week, including the Bank of England, but their votes show how these banks could still make the world's economic crisis very much worse. We're on the brink of a precipice, and central banks could easily tip us over it. That is what this video is all about. Unless we rein in central banks now, a recession could very easily become a depression, and that's what we need to avoid.

So what has happened? The Bank of England held its base rate at 3.75% yesterday, as was expected.

The US Federal Reserve did the same thing on Wednesday, holding its base rate at between 3.5% and 3.75%, which is the guidance that it provides.

And earlier this week, the Bank of Japan also held its base rate at 0.75% in their case.

All three of these banks face the same global uncertainty. Holding was the right decision, but the story doesn't end there, because some of the decision-makers wanted to raise rates, and the warning has been given by the Bank of England that if the oil price rises above $130 per barrel, they will take action to increase rates to eliminate inflation, and this week oil has been up to $126 a barrel. In other words, the situation where they say they might take significant action is on the cards, most especially when Trump is now talking about the Strait of Hormuz being closed for months to come.

Let's be clear about what the dissenters and these threats all represent. Every one of the claims that underpins what they have to say is wrong. Saying these things suggests that they believe higher interest rates can resolve a global economic crisis created by a shortage of oil, but that's impossible. That crisis is being driven by a wartime shortage of oil, food, and raw materials, and there is not the slightest evidence that changing interest rates can correct any of that. As a matter of fact, changing interest rates will have no impact whatsoever on traffic flowing through the Strait of Hormuz.

The same mistake was made after Putin's invasion of Ukraine in 2022. At that time, the interest rates were increased significantly, and all that achieved was the making of an economic crisis that was much worse than it need have been.

So let's stand back and look at what is going on here. This inflation that we are facing is imported. There is a real risk of inflation. Nobody is denying that. It could rise by 2% or more very easily over the next year, but it is not homegrown. The inflation we face is caused by two things.

One is the absolute shortage of goods created by war.

The other is financial speculation in commodity markets. That requires a financial transaction tax, something I've already talked about.

The war requires action by governments to prevent Israel and the USA from perpetuating this situation, but nothing about this is to do with the UK domestic economy. It takes a decidedly warped imagination in that case to think that changing interest rates at this moment is the right tool to tackle inflation or the economic problems that we are going to face in the UK as a consequence of that war.

Wartime inflation suppresses demand. That is what is happening right now. It doesn't inflate demand; it reduces demand. Meanwhile, standard interest rate theory assumes excess demand is driving inflation. Wartime shortages do the exact opposite. We have suppressed demand at the moment, and not the inflated demand, which is what they think has created the pressure resulting in inflation.

Higher interest rates in this situation will only make the economic crisis we are facing worse. Raising rates when demand is already falling, as it is, accelerates the risk of recession. Consumer confidence is already low in the UK. Business investment is constrained by the prospects that businesses see all around them of falling demand, and jobs are already at risk.

Higher rates can only increase the probability of business failures and unemployment in this situation, and what we are facing now is the equivalent of banks defending the gold standard in the 1920s. That was wrong then; increasing interest rates now is equally wrong. The consequence of that dogmatism back in the 1920s was catastrophic. We had a deep depression, and we could see the same thing happening here, now. This is what the dissenters and those speaking on behalf of the Bank of England to threaten interest rate increases are suggesting we might get as a consequence of their actions, and they don't appear to care.

Higher interest rates will also probably raise inflation, and when I say probably, I mean almost certainly. Interest rate rises feed directly into rental costs and so into business costs in the UK. Businesses facing higher costs for rent, for interest, and for other raw material supplies will all seek to recover them through higher prices. Many goods and services are now also effectively leased with returns tied to finance costs, and as financial costs rise, so do the prices of those products. Altogether, what this means is that if interest rates rise, the Bank of England could be compounding the inflation it claims to be fighting. This is not an unintended consequence. It is a predictable and an entirely avoidable one.

So why is it that independent central banks are failing us in this moment of crisis? That's because the theory of independent central banking is fundamentally flawed. It removes economic decision-making from democratic and political control. Central bankers are given one task, to control inflation, and one tool to do that, which is the interest rate. They're not required to consider the causes of inflation or the consequences of their actions when trying to control inflation. The result is decision-making that is not in the public or economic interest. This is a structural failure, and it is most obvious now when it matters most.

The fact is, neoliberalism, which drove this policy of independent central banks, does not care about people. The personnel and culture of central banks reflects a neoliberal worldview, and monetary credibility is treated by central banks as the supreme economic priority. The needs of the population of a country are structurally subordinated to that goal, and you could not rise to the ranks of those who make these decisions on interest rates in the Bank of England, or anywhere else, by holding different views. This is not accidental. It is by design. The institution selects for the ideology it was built to serve, and therefore, the people who are deciding upon our interest rates are those who just don't care about you, or about me, or about anybody else in the UK, apart from the very rich, most of whom will benefit from what is going on now.

Meanwhile, governments have abdicated their responsibilities. Governments indoctrinated by neoliberalism lack the courage or capacity to intervene. They permit central banks to harm their populations rather than challenge the intellectual framework being used to put these decisions into place, and the alternative, which is to allow inflation to work through the economy naturally, which is what it would do as a matter of fact without any Bank of England intervention, is ignored.

At the same time, governments are also ignoring the obvious need to redistribute wealth at this moment to protect those least able to bear the burden of the cost of inflation, which will be coming our way whatever the Bank of England does. Either approach will be more effective and less destructive than raising rates right now. Instead, government is standing aside and letting the damage be done.

So, what would raising rates actually mean? If central bankers vote to raise rates now, they are voting for a recession. They are voting for the destruction of employment, income, and business viability. They're voting for increased stress, hardship, and preventable suffering. They are choosing ideology over evidence and doctrine over human welfare. This is the neoliberal endgame made visible. It should be the moment when the case for a different economics becomes undeniable.

The conclusion is obvious. We need to run our economy in a much better way. The decisions of this week are a warning, not a resolution. The pressure to raise rates has not gone; it will return, probably within a month or so. And we need decision-makers who engage with the actual cause of the problems we face, and at the moment, it looks unlikely that we've got them or are going to get them.

What we really require are frameworks that put human welfare at the centre of economic policy, and again, that isn't happening. We need politicians with the intellectual courage to challenge institutions like our central banks that are now so obviously failing us. The question is whether we will act now before the damage becomes irreversible, or will we have to wait until it has happened?

I believe we’re going to be forced to wait, but that’s just my opinion. What do you think? There’s a poll down below. Leave your comments. Tell us what you think. Please share this video if you like it, and like it just down below if you do. Subscribe to the channel, and if you’d like to make a donation to support this work, we would be very grateful.

Poll

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