Money creation supports the value of pound, rather than…

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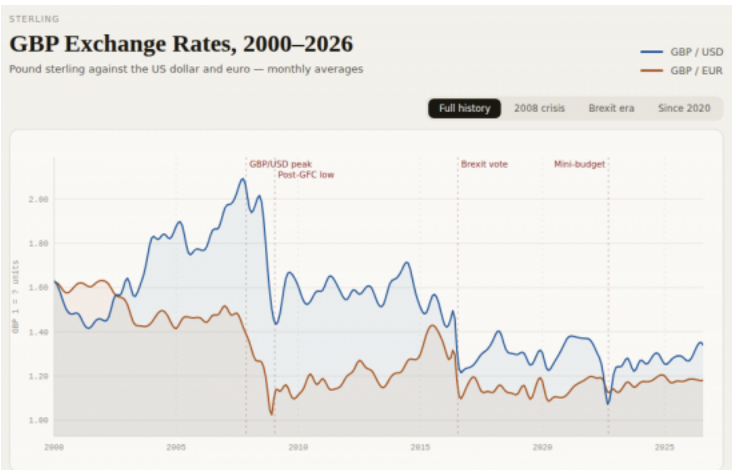
The strongest opposition that I received on LinkedIn, and elsewhere, to my suggestion that we need not worry about the UK's national debt as it approaches £3 trillion, which I noted here yesterday, was that I had ignored the impact of my approach on international exchange rates.

The first thing to say is that my approach is that of modern monetary theory. What MMT describes is the way in which the monetary system of this country, and a great many others, actually works. There is nothing radical about it. It is just a straightforward explanation of what is happening, and is not a speculative suggestion as to what might happen. What is more, it is an explanation of what has been happening since the gold standard was finally abandoned in the 1970s, and so we can say that this system has been in use for a long period of time.

The second thing we can then do is look at why there have been major changes in the UK exchange rate this century to see if they are caused by the creation of additional money, or were instead better explained by other events. To do this, I got Claude AI to plot the sterling exchange rate with both the US dollar and the euro during the course of this century. This is the resulting chart.



It is important to note that the patterns are broadly similar, although not identical, and that is because there is no reason why activity in the UK should necessarily impact the US dollar/euro exchange rate, and we would not, therefore, expect them to follow the same patterns. That said, trends are relatively clear and broadly similar.

Firstly, the value of the pound began to rise against the dollar after 2004, and that was because of the bubbling UK stock markets between 2004 and 2008, which attracted additional funds into the City of London. Gordon Brown created a boom. The exchange rate reflected that fact, without this influencing the rate with the euro, because they had more sense than to follow the hot money.

What then happened was the 2008 crash, and the myth of the City of London was burst, and the exchange rate collapsed against both the dollar and the euro, and for very good reason. This was not, however, because of quantitative easing, which only began in late 2009. It was because the City failed.

QE then stabilised the exchange rate, and even improved it against the euro over the period from 2010 to 2016. In other words, extensive money creation during that period, of more than £400 billion, did not cause the exchange rate to collapse. If anything, it strengthened it.

Then, Nigel Farage knocked the exchange rate to bits because of the fundamental changes in UK international competitiveness caused by Brexit, after which the permanent damage that he created settled matters at a lower level.

However, money creation from 2020 to 2021 boosted the exchange rate against the dollar, until Liz Truss created another sterling crisis from which we have slowly recovered ever since.

What is the point of noting this? There are four.

First, it was politics that created all the major changes in exchange rates.

Second, major money creation and quantitative easing stabilised exchange rates from 2010 to 2016 and again from 2020. It did not cause a crisis.

Thirdly, despite the current and ongoing supposed crises with the balance of payments and fiscal deficits, exchange rates are improving. Markets can easily accommodate them.

Fourthly, nothing I have said about the national debt will change any of this.

In other words, all this hyperbole about modern monetary theory, money creation, and collapse in the value of the pound is complete and utter nonsense. A calm appraisal of the facts suggests that money creation supports the pound, rather than harms it, and that money creation compensates for political errors of judgement, and does not create them.

I suggest that my critics go away and think again.