Interest rates now higher than at the time of Truss budget

The Bank of England has been up to its old tricks, hiking rates and selling bonds to hike mortgage rates some more. They think taking money away from mortgage holders will squeeze their ability to spend which will cut inflation by reducing demand.

Will it? The extra money mortgage holders pay in interest certainly cannot be spent any longer by them on goods and services. The money however does not disappear. Much of it is passed onto savers who have deposits in the banks that lend the money. They will have more income to spend. Some of the extra interest is extra bank profit, which leads to higher dividends so shareholders will have more money to spend.

Higher mortgage rates therefore will not limit demand for goods and services as much as the Bank seems to think. It is possible the savers will not spend all their extra interest income, whilst it is likely the mortgage holders would have spent more of the money they now have to pass to the lenders. This is however a matter of degree. It is also likely the savers who tend to be older may well pass some of their deposit interest gain onto their children with mortgages to help them out.

The further sell off in bonds underwrites my argument that the high mortgage rates come mainly from Bank of England rate hikes and bond sales.

What is the point of a Central Bank digital currency?

We already have digital money. You and I have money held in a commercial bank which is just an electronic line in their accounts. We can use it to buy something, transferring our digital money to someone else's digital account electronically. We have a digital credit card which we can wave at a machine to pay. If we save money in a deposit account that too is digital. The banks do not keep all our monies in bank notes, just having enough till money to meet usual demands for physical cash with a margin.

Some people have created different digital tokens like Bitcoin. These do not fulfil the normal characteristics of money. You cannot use them to buy things. Most shops and websites decline bitcoin. They are not a store of value as a sound major state currency is, with wildly fluctuating values. They are not a standard of measurement. Few quote prices in bitcoin where many quote them in dollars or pounds.

There are things called stable coins which seek to link their value to a well known currency. Some achieve this, but there could in some cases be failures to do so. If they succeed what advantage do they have over holding the currency itself?

The Bank of England and other leading central banks are thinking of issuing digital versions of their own currencies. Given the way commercial banks already do this I assume it means the Central bank itself offering a current account to regular customers. This would be a big diversion from their current functions and would not offer much that a commercial bank does not already offer.

People worry about the way the state could use a CB digital currency to increase surveillance over people and even control their money. I cannot see them making everyone have a CB account as the Bank of England would not want millions of small accounts. Existing digital money through commercial banks is already under plenty of surveillance to prevent crime and money laundering.

My Business Question to the Leader of the House

John Redwood (Wokingham) (Con):

It would be better to get inflation down by expanding supply, rather than hitting mortgage holders again to get them to spend less. Can we have an urgent statement, before the summer recess, from the Government on measures to expand our domestic output of food, oil and gas, and industrial products with suitable incentives and facilitations?

Penny Mordaunt, Leader of the House:

I thank my right hon. Friend for that very helpful suggestion. He will know that, as Treasury questions are not until after the summer recess, he will have no opportunity to raise it there, so I will make sure that the Chancellor has heard his suggestion. I know that that will be welcomed by many Members across the House.

HS2

I voted against the HS2 project when Parliament made the decision in principle to go ahead. I have always thought it a bad investment. I proposed alternative ways to increase rail capacity for a fraction of the cost with much speedier results.

I am told they are going ahead with one of those ideas. Improved digital on board signalling means a train can see what lies ahead and be warned of blocked lines in real time. Central controllers could slow or stop trains approaching danger if the driver has missed it. It would be safe to run at least 25% more trains on a given line with smaller gaps between trains. As they are all going in the same direction on most tracks and if they see what lies ahead and what speed it is doing we can run more trains. We run far more vehicles with very little separation on busy roads just based on driver eyesight and judgement.

They could also do more to provide many more short sections of bypass track. Non stop express trains need to be able to overtake slow frequent stopper services when timetables get stressed. Again digital signals and intelligence on track positions would facilitate this.

The collapse of five day a week commuting post covid has undermined whatever business case there was for HS 2 . Much rail travel going forwards is going to be leisure and pleasure travel where high speed is less necessary and high cost cannot be repaid by premium business tickets. The government should reconsider the very expensive much delayed Euston and inner London part of the project. Spending a fortune on rail in London was always bizarre for a levelling up project to help the north.

Perhaps given the huge delays in construction and planning this should no longer be called High Speed 2. It is taking years of delay for the first train. HC 2 , High Cost 2, would be a more accurate description.

[Getting inflation down and growth up]

The inflation was brought on as a result of excessive money creation, bond buying and ultra low rates. It was compounded by shortages of energy, food and other basics. The inflation will now come down as money and credit are much tighter. Inflation is however proving obstinate because there remain some difficult supply shortages, price controls have delayed energy falls in the UK and public sector productivity has fallen a lot leading to too high a level of public spending.

The Bank’s policy is to squeeze demand by raising the price of borrowings. This will put off investment, cutting demand for investment goods and construction.   The main impact is on mortgages, narrowly targeting the worst hits on the 2 million or so who will need to renew their mortgage loans before the election, and on potential first time buyers who will be excluded

from the market. It will take time to hit overall demand as the hit to incomes only occurs at the maturity date of the old lower rate mortgage. Meanwhile the millions of savers with money on deposit will enjoy an increase in income facilitating more demand from them. The Bank is hitting mortgages especially hard by selling £80bn of bonds a year, given the way the price and rate on the bonds of the right maturity is directly relevant to fixing commercial mortgage rates.

To get inflation down the government needs to undertake a series of supply side boosting measures. The UK can extract more of its own oil and gas with a big boost to its revenues and reduction in the balance of trade deficit. Grants to farmers not to farm should be replaced with grants and loans to encourage a big increase in domestic outputs, especially of fruit and vegetables where we have lost a lot of market share this century.

Reform of IR 35 allowing more people to work for themselves and to attract contracts from companies could lead to a reversal of the big decline in self employment and greatly add to capacity and flexibility in a range of markets. Raising the VAT threshold from £85,000 to £250,000 would lead to a same year boost to output by many small companies that decline business or have a temporary shut down to avoid going through the threshold.

These two tax measures will be costed as losing revenue, which is debatable. To cover estimated Treasury costs of say £4bn the government could rephase and reduce the £20bn carbon expenditures, suspend the free smart meter programme to save £1bn a year and transfer more of the costs of housing new migrant arrivals to the Overseas Aid budget.

There are many other ways of creating some fiscal space. It would be good to immediately cut inflation by temporarily taking VAT off vehicle and domestic heating fuels. There will be savings on the interest rate programme for a lower inflation rate, given the way the Treasury accounts for the non cash item of indexation costs on Index linked gilts. The government should press on with asset and property sales to release cash and lower spending.

Expanding supply with selective tax cuts paid for by spending controls is the best way to cut inflation whilst allowing some growth. Growth is the best way to get the deficit down.