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Who makes these?

Source: Bank of England, Bankstats

Notes and coins = 3% of money supply

Source: Bank of England, Bankstats

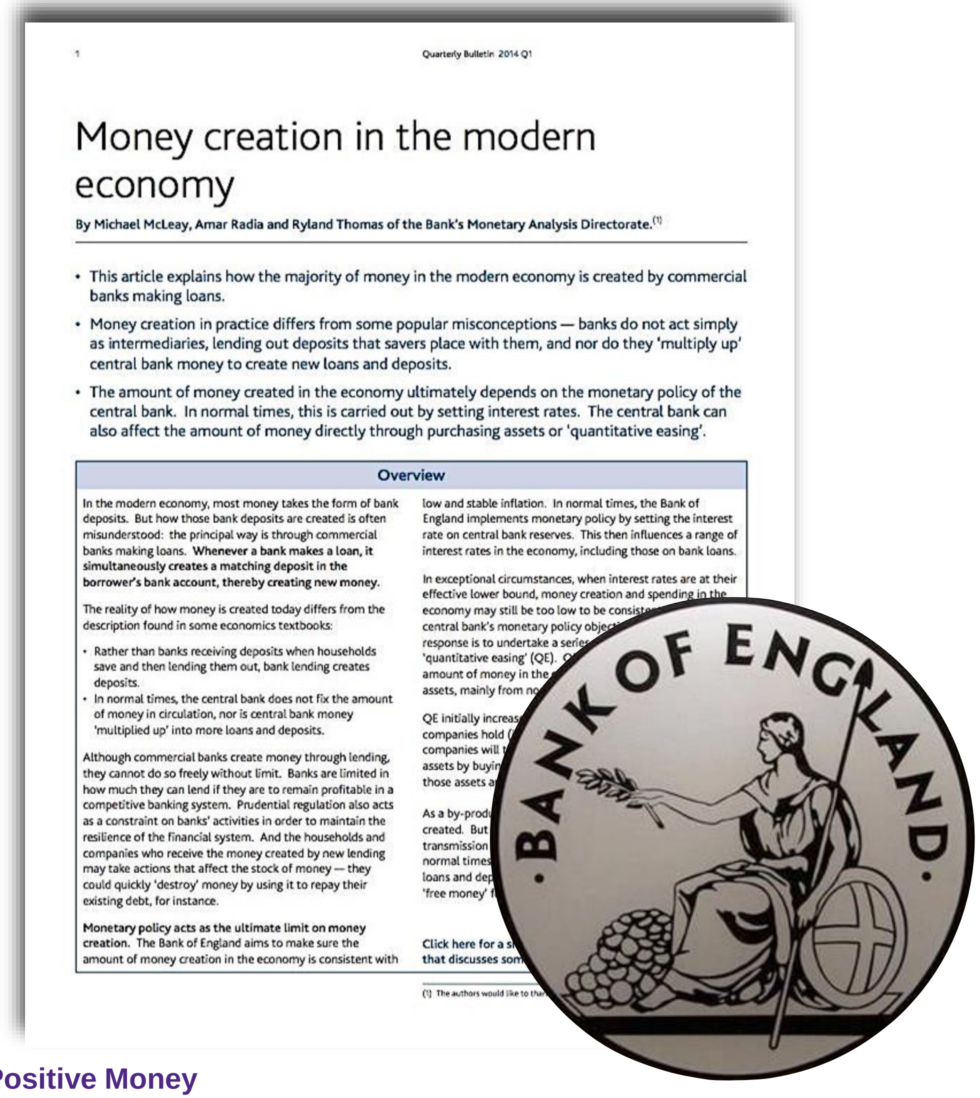
Who makes electronic money?

Your transactions

DD Direct Debit Giro Bank Giro ▭ Card payment Online transfer ATM Cash machine

Date	Description	Money out	Money In	Balance
12 Apr	Start balance			355.32
13 Apr	Giro Received salary Ref: ABCD0000		1,958.52	2,313.84
	DD Direct Debit to Mortgage Co. Ref: 123465789	625.35		1,688.49
	DD Direct Debit to Energy Co. Ref: 123465789	32.50		1,655.99
15 Apr	Card payment to Petrol Station	12.30		1,643.69
16 Apr	Online transfer to Friends bank account Ref: 1111222233334444	4.99		1,638.70

Banks create money by making loans


1 Quarterly Bulletin 2014 Q1

Money creation in the modern economy

By Michael McLeay, Amar Radia and Ryland Thomas of the Bank's Monetary Analysis Directorate.[1]

- This article explains how the majority of money in the modern economy is created by commercial banks making loans.
- Money creation in practice differs from some popular misconceptions — banks do not act simply as intermediaries, lending out deposits that savers place with them, and nor do they 'multiply up' central bank money to create new loans and deposits.
- The amount of money created in the economy ultimately depends on the monetary policy of the central bank. In normal times, this is carried out by setting interest rates. The central bank can also affect the amount of money directly through purchasing assets or 'quantitative easing'.

Overview

In the modern economy, most money takes the form of bank deposits. But how those bank deposits are created is often misunderstood: the principal way is through commercial banks making loans. **Whenever a bank makes a loan, it simultaneously creates a matching deposit in the borrower's bank account, thereby creating new money.**

The reality of how money is created today differs from the description found in some economics textbooks:

- Rather than banks receiving deposits when households save and then lending them out, bank lending creates deposits.
- In normal times, the central bank does not fix the amount of money in circulation, nor is central bank money 'multiplied up' into more loans and deposits.

Although commercial banks create money through lending, they cannot do so freely without limit. Banks are limited in how much they can lend if they are to remain profitable in a competitive banking system. Prudential regulation also acts as a constraint on banks' activities in order to maintain the resilience of the financial system. And the households and companies who receive the money created by new lending may take actions that affect the stock of money — they could quickly 'destroy' money by using it to repay their existing debt, for instance.

Monetary policy acts as the ultimate limit on money creation. The Bank of England aims to make sure the amount of money creation in the economy is consistent with low and stable inflation. In normal times, the Bank of England implements monetary policy by setting the interest rate on central bank reserves. This then influences a range of interest rates in the economy, including those on bank loans.

In exceptional circumstances, when interest rates are at their effective lower bound, money creation and spending in the economy may still be too low to be consist… central bank's monetary policy objec… response is to undertake a series… 'quantitative easing' (QE). … amount of money in the … assets, mainly from no…

QE initially increas… companies hold … companies will … assets by buyin… those assets a…

As a by-produ… created. But … transmission … normal times … loans and dep… 'free money' f…

Click here for a s… that discusses som…

(1) The authors would like to than…

“**Commercial [i.e. high street] banks create money,** in the form of bank deposits, by making new loans.”

Bank of England quarterly bulletin (2014, Q1)

“[Most undergraduate textbooks] say ‘Well what banks do is they take deposits from households and lend money to businesses...’ As a description of what modern advanced economy banking systems do, this is completely mythological.”

ADAIR TURNER

Former FSA Chair

Hear no evil, see no evil…

‘The **loanable funds** and the money-creation approach to banking…

(‘Almost all models of banking—be they micro- or macro-oriented—are based on the so-called “loanable-funds approach to banking.”’)

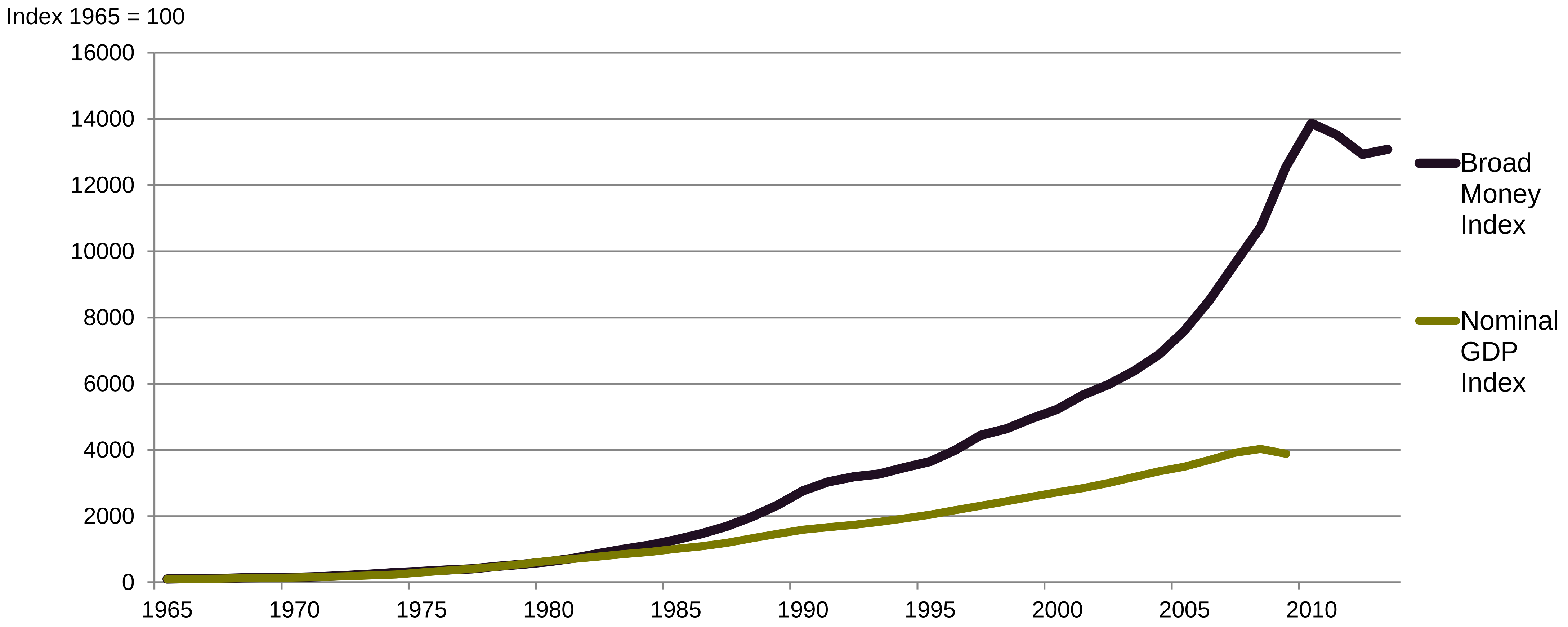
…yield the same allocations when there is no uncertainty and thus no bank default.

In such cases, using the much simpler loanable funds approach as a shortcut does not imply any loss of generality.’

‘Of course, there are various possibilities for extending the benchmark, such as infinite horizon set-ups and growth processes, as long as there is no uncertainty and thus no bank default.’

- Faure, Salomon and Gersbach, Hans (2017). Loanable Funds vs Money Creation in Banking: A Benchmark Result. CFS Working Paper, No. 587, November 15

How much money have banks created?



Sources: Bank of England statistical database (series LPQAUYM)
Hills, S., Thomas, R., & Dimsdale, N. (2010). The UK recession in context — what do three centuries of data tell us? Bank of England Q4 Quarterly Bulletin

WHERE DOES THE MONEY GO?*

Stock of loan debt, Q3 2018
Source: Bank of England

50%

Mortgages

26%

Financial

17%

Non-financial business

5%

Credit cards and personal loans

*government = 2%

Consequences of the banking system

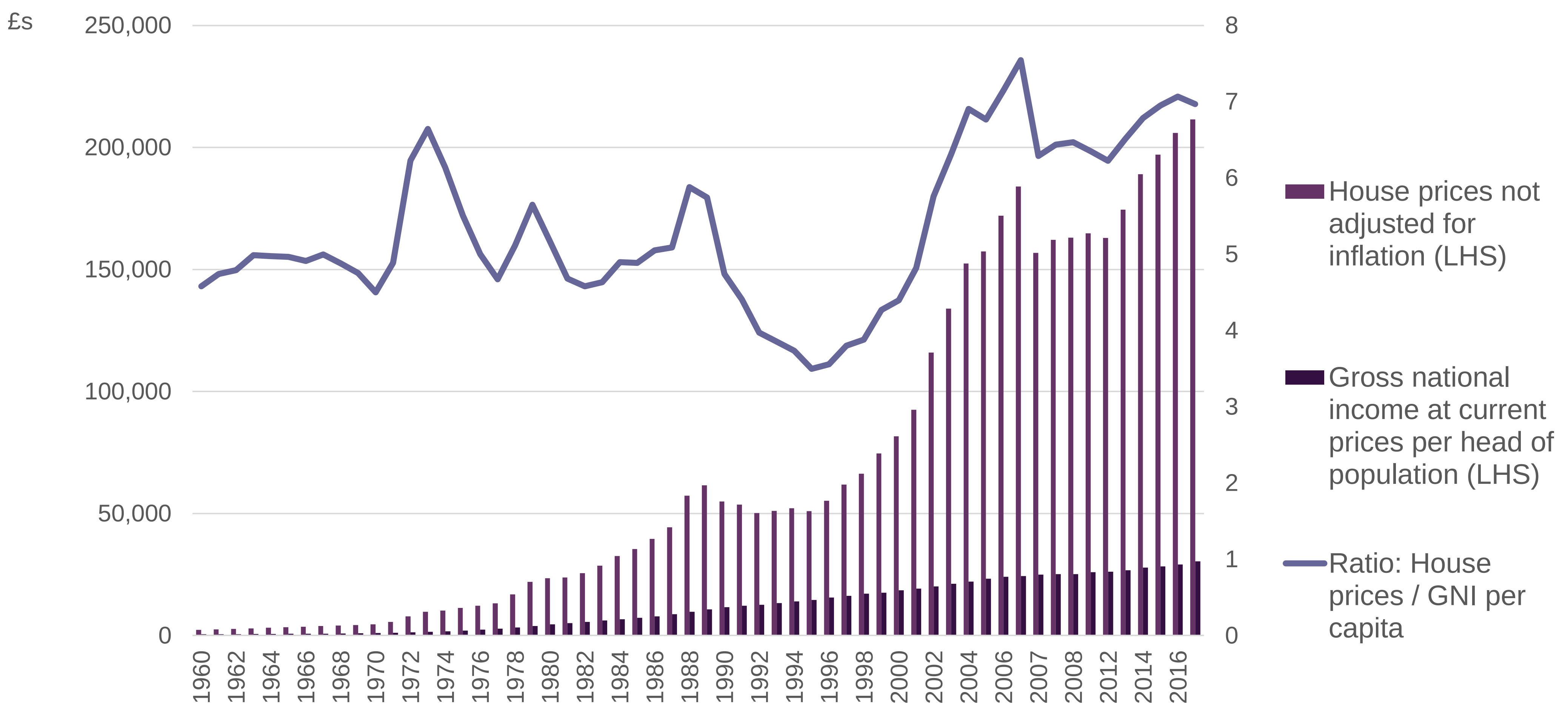
Housing crisis

Over-indebtedness

Inequality

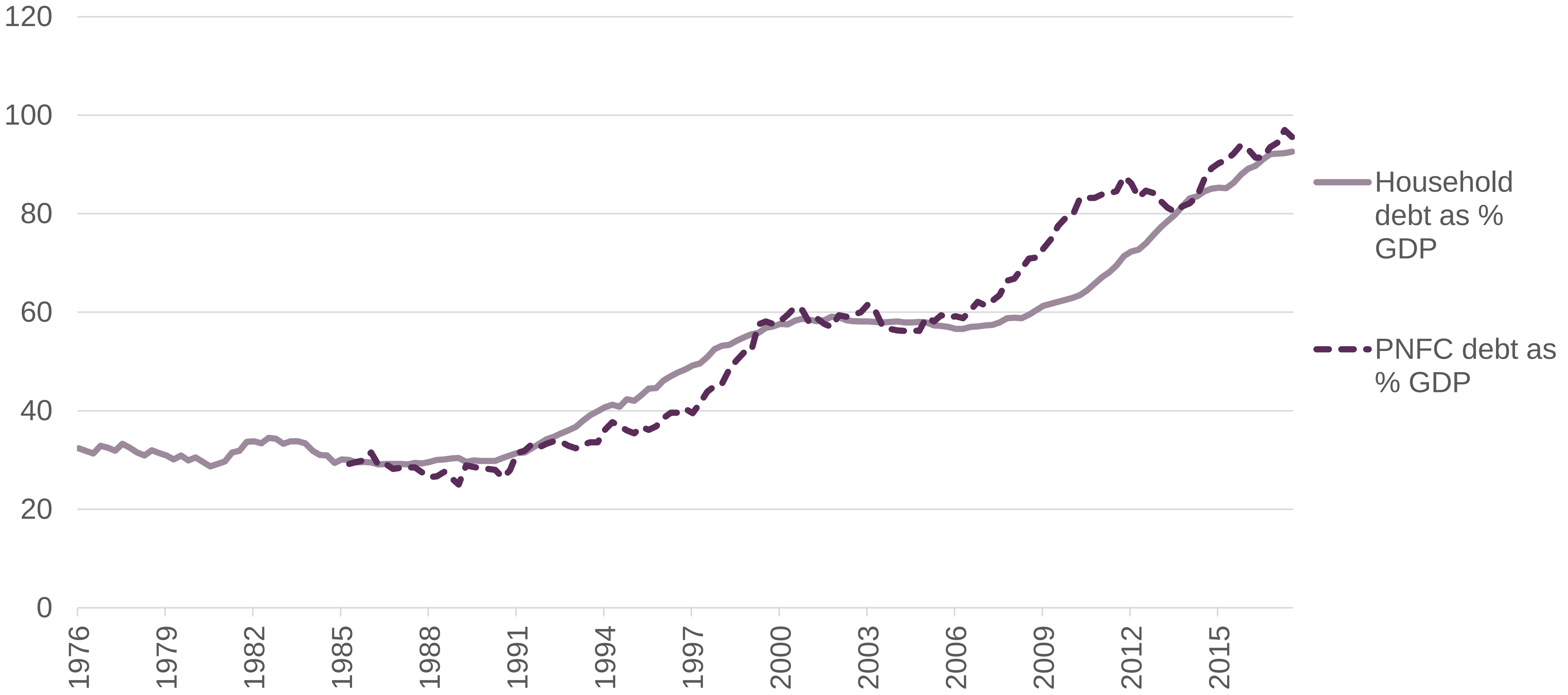
Financial crisis

Housing crisis



Sources: Nationwide UK House Price Index;
European Commission Economic and Financial Affairs, AMECO statistics

Over-indebtedness



Source: Bank for International Settlements statistical warehouse, Tables F2, F3

Inequality

- banking sector makes profits on spread between interest paid to it on loans and interest it pays out on deposits
  - incentives to push out loans => increasing debt burden for poorer households
  - rising debt service costs
- shares in banking sector itself are held in few hands
- growth in money supply enables increased financial intermediation
  - concentrates wealth
  - ‘super-manager’ salaries
- assets mostly held by rich
  - increase in value of houses, companies, other financial assets => increasing investor wealth => greater financial speculation

Inequality

2015-16	Decile of income distribution	1	2	3	4	5	6	7	8	9	10
	Share of total investment income	0%	0%	0%	0%	0%	0%	0%	1%	5%	93%
	Minimum investment income to be in this decile:	-	£4	£9	£13	£17	£34	£110	£242	£809	£5,544
	Average investment income in this decile:	£2	£7	£11	£15	£23	£68	£160	£504	£2,025	£38,642
	Annual investment income (millions)	£6	£17	£28	£40	£61	£179	£422	£1,335	£5,359	£102,264
	of which[4]:										
	income from property[5]:	0%	0%	0%	0%	0%	0%	1%	3%	36%	14%
	interest from banks and building societies[6]:	99%	100%	100%	100%	98%	95%	95%	51%	30%	3%
	dividends from shares in UK companies[7]:	0%	0%	0%	0%	1%	3%	3%	44%	30%	80%
	other investment income[8]:	0%	0%	0%	0%	1%	1%	1%	2%	3%	4%

Source: HMRC Personal Wealth Statistics (2019)

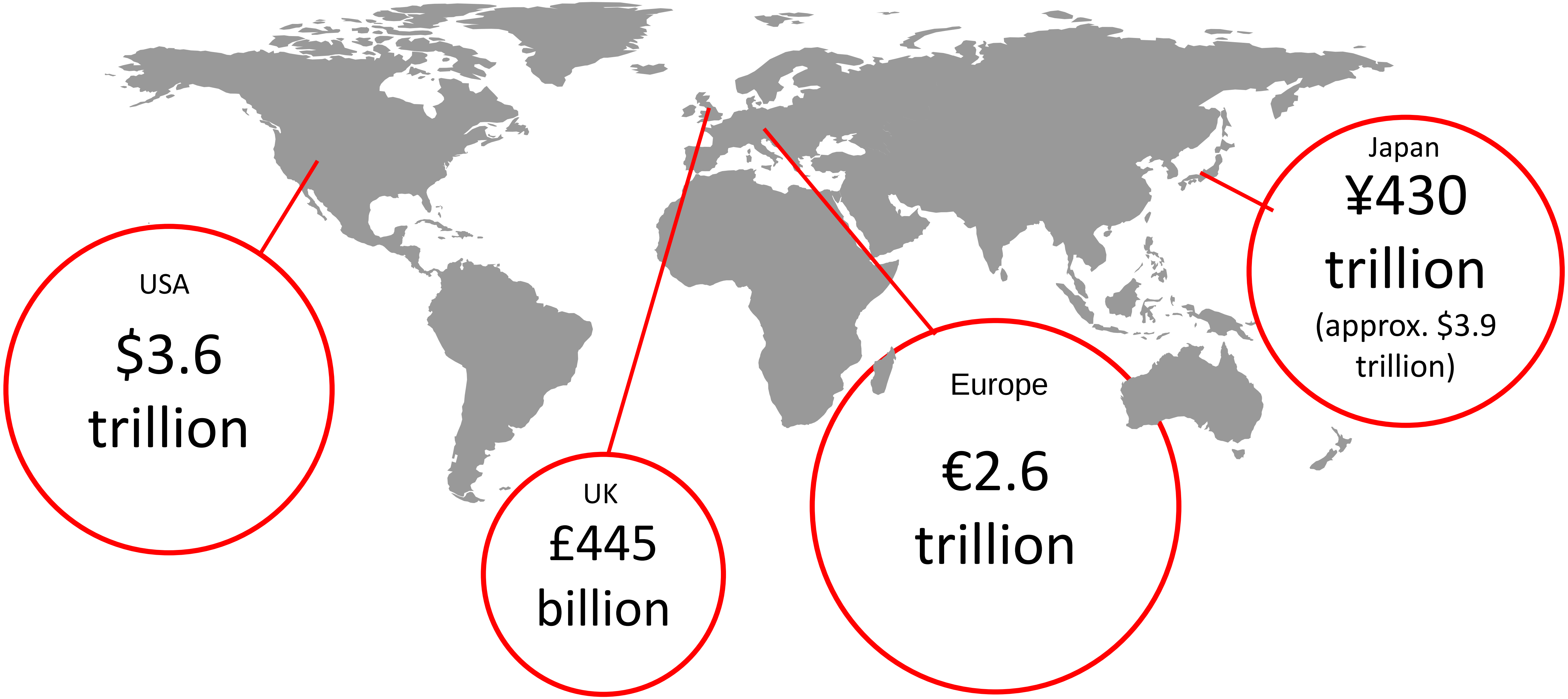
Financial crisis…

“The financial crisis of 2007/08 occurred because we failed to constrain the private financial system’s creation of private credit and money.”

ADAIR
TURNER
Former FSA Chair

From money to monetary policy…

Introducing Quantitative Easing (QE)



QE in a nutshell

- the Bank of England creates new money and uses it to buy financial assets from banks
- aim: ‘to inject money into the economy in order to revive nominal spending’ (Benford *et al.*, 2009)
  - ‘bank lending channel’
  - ‘wealth channel’
  - ‘portfolio rebalancing channel’

- not very effective stimulus: for every £1 of money created via QE, UK GDP increased by just 10p-15p (see Joyce *et al., 2011*)
- much newly created money either stays in banking sector, or inflates asset prices

Benford, J., Berry, S., Nikolov, K., Young, C., and Robson, M. (2009). ‘Quantitative easing’. BoE Quarterly Bulletin, 49(2)

Joyce, M., Tong, M., & Woods, R. (2011). The United Kingdom’s quantitative easing policy: design, operation and impact. BoE Quarterly Bulletin, 51(3)

Boosting inequality

Chart 15: Effects of monetary policy changes since 2007 on net wealth by wealth decile in cash terms

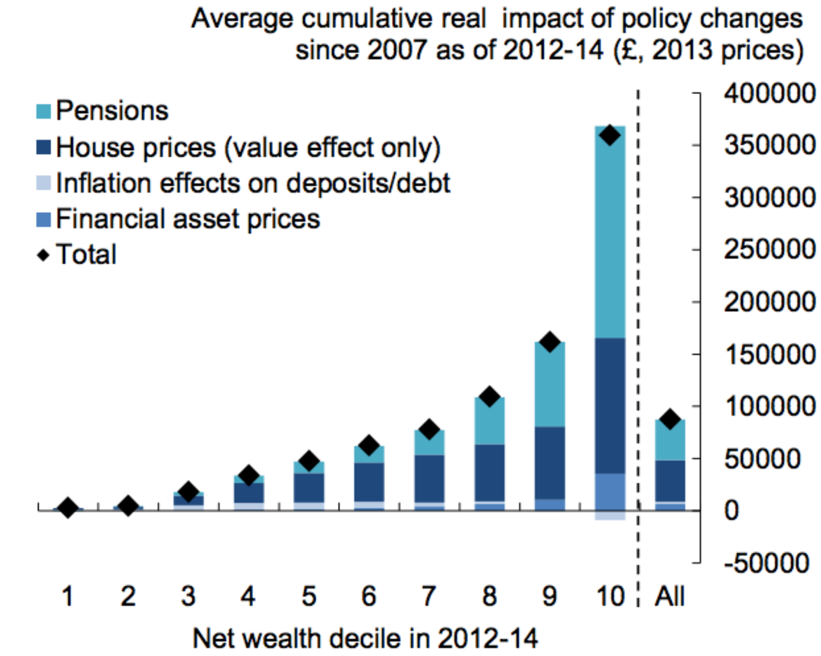


Chart 16: Effects of monetary policy changes since 2007 on net wealth by wealth decile in percentage terms

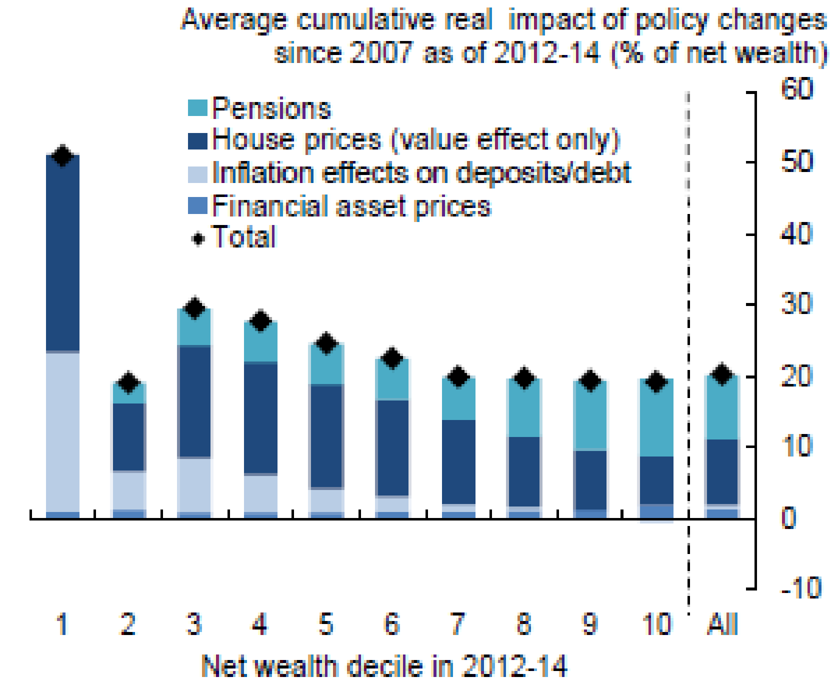
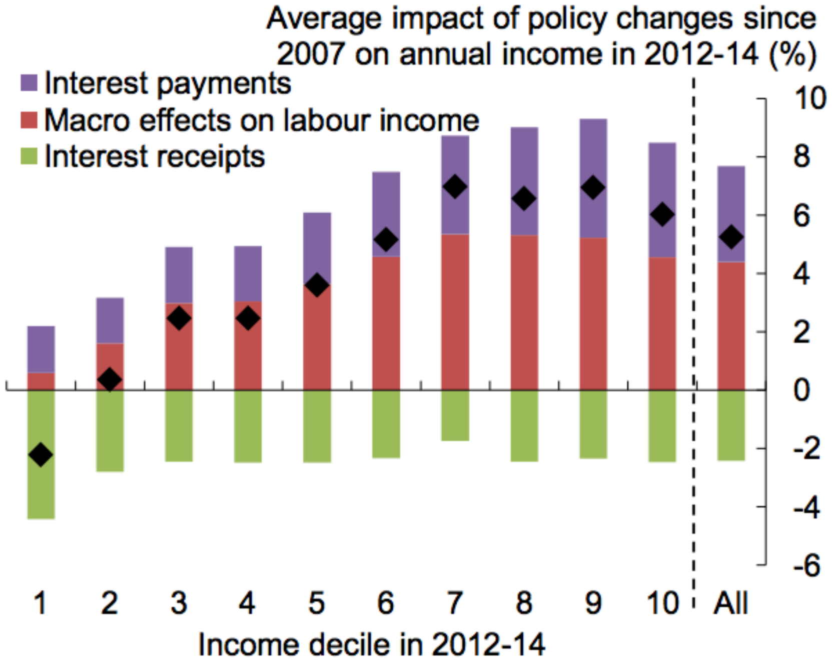


Chart 14: Effects of monetary policy changes since 2007 on income by income decile in percentage terms



Bank of England research – Bunn *et al.* (2018). The distributional impact of monetary policy easing in the UK between 2008 and 2014.

“No magic money tree”?

The Prime Minister just told a nurse who hasn't had a pay rise for eight years:

“There's no magic money tree.”

Lack of understanding among politicians

What’s the alternative?

Positive Money’s vision

Restrain house price growth

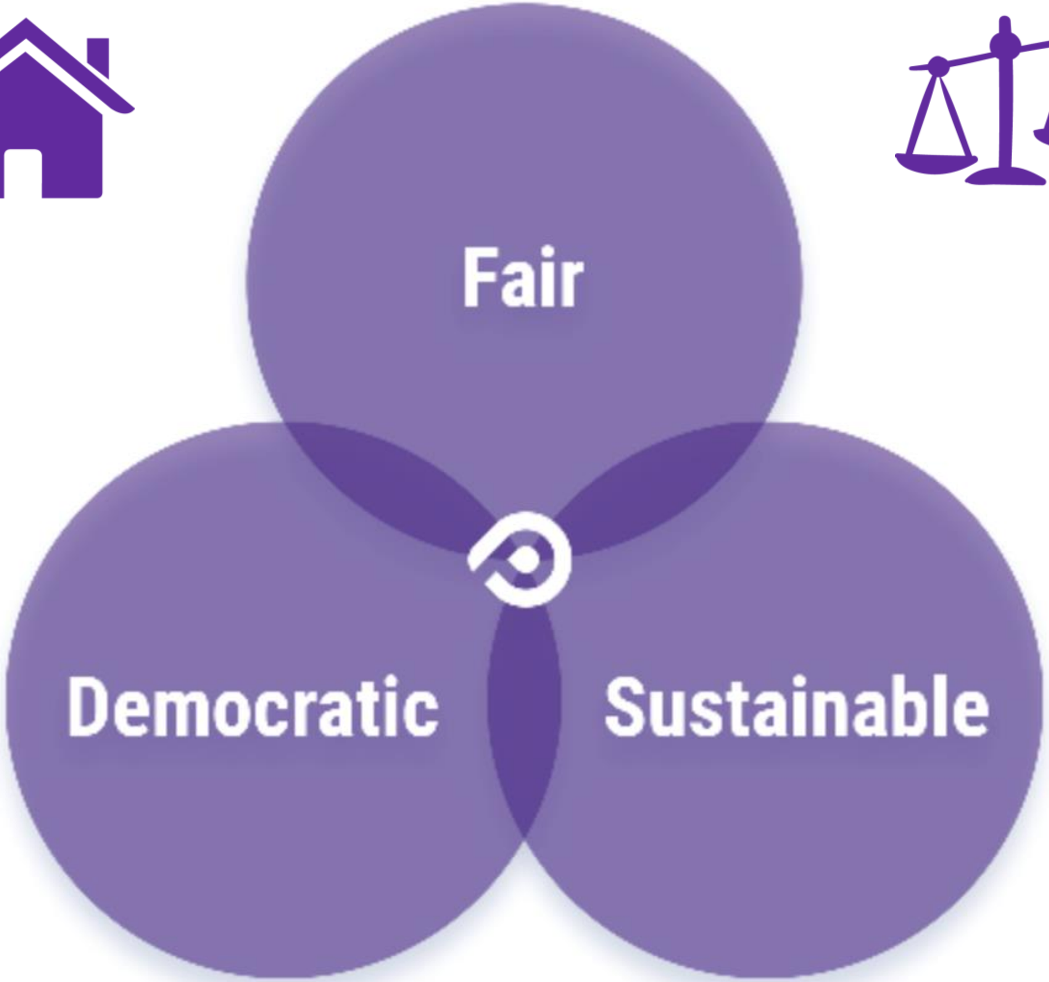
Fight inequality

End austerity

Reduce debt

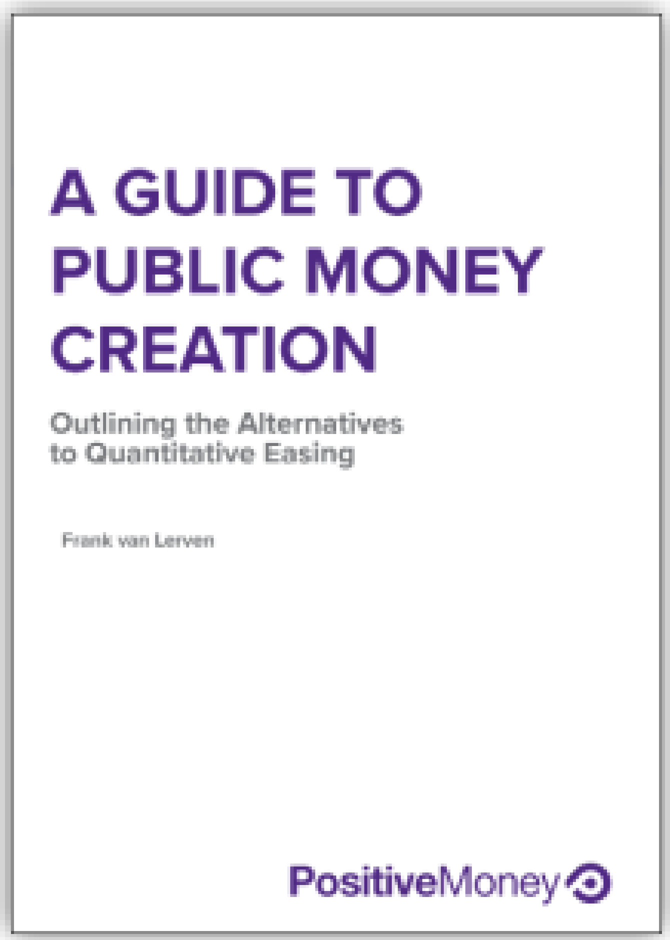
Public control over new money

Protect the planet



1. QE for People, or ‘Monetary Financing’

- instead of going into financial markets, new money could be created to fund society’s needs
- if £445bn of new money distributed evenly amongst the population, every UK citizen would receive £6,834
  - **‘helicopter money’**
- alternatively, new money created by the Bank of England could go to schools, hospitals, construction, clean energy…
  - **‘Green New Deal’**



Wanted: new fiscal-monetary relationship

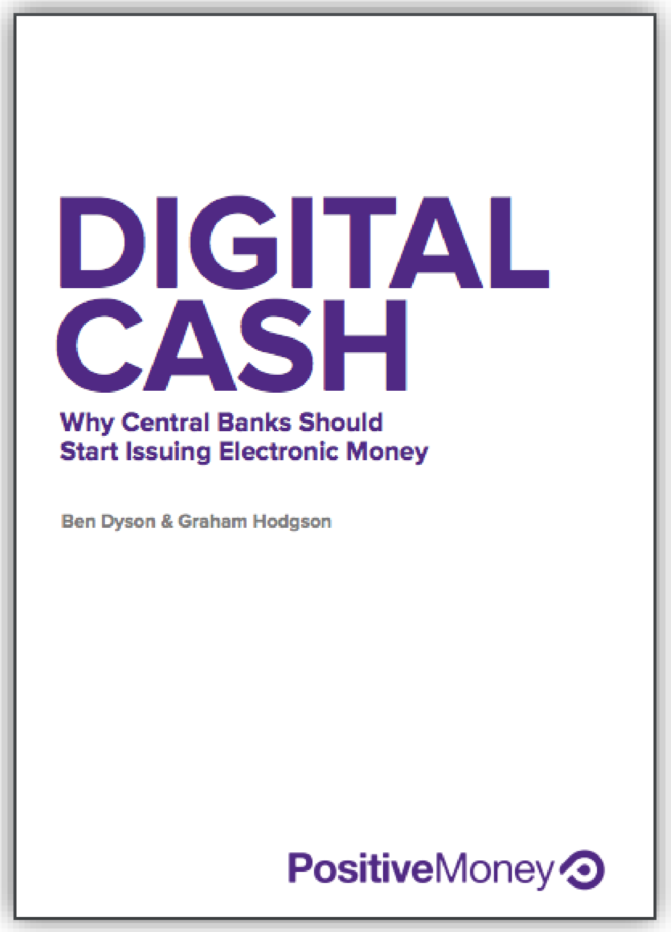
Bank of England

UK
Government

NHS

2. Digital cash…

- electronic version of notes and coins
- design:
  - exists alongside physical cash
  - doesn’t require an account at a high street bank
- advantages
  - promotes competition and innovation in current accounts
  - makes the payment system more resilient
  - removes a reason for “too big to fail”
  - expands the options for monetary policy
  - could promote financial inclusion



…and protecting access to payments

- 2.2 million people reliant on physical cash; majority use regularly
- market failure in payments provision
  - competition from card companies
  - banks' efforts to cut costs
- technological innovation not sufficient to reach excluded groups
- payments should be treated as a utility
  - regulator with specific role to look after cash
  - new powers to stop closures

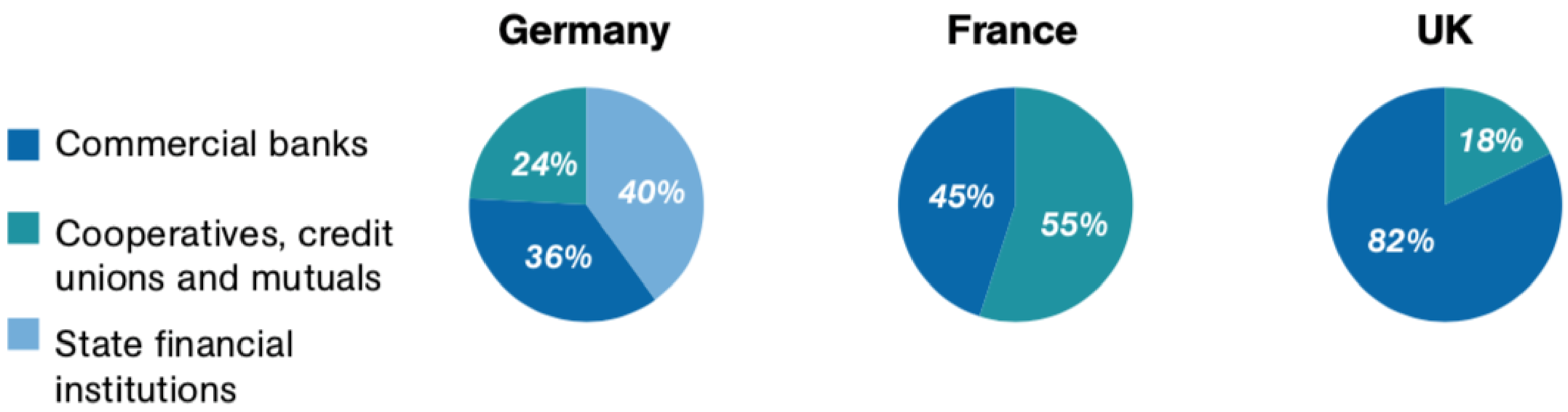

THE FUTURE OF CASH

Protecting access to payments in the digital age

PositiveMoney

3. Diversifying banking

Figure 1 – Market shares of deposits in Germany, France and the UK



- ‘stakeholder banks’ known to be better at:
  - allocating credit to the real economy & SMEs
  - preventing capital drain from local economies => fix regional imbalances
  - better capitalised – less risky
  - enhancing financial inclusion

Prieg, L., and Greenham, T. (2012). Stakeholder Banks: Benefits of Banking Diversity. New Economics Foundation

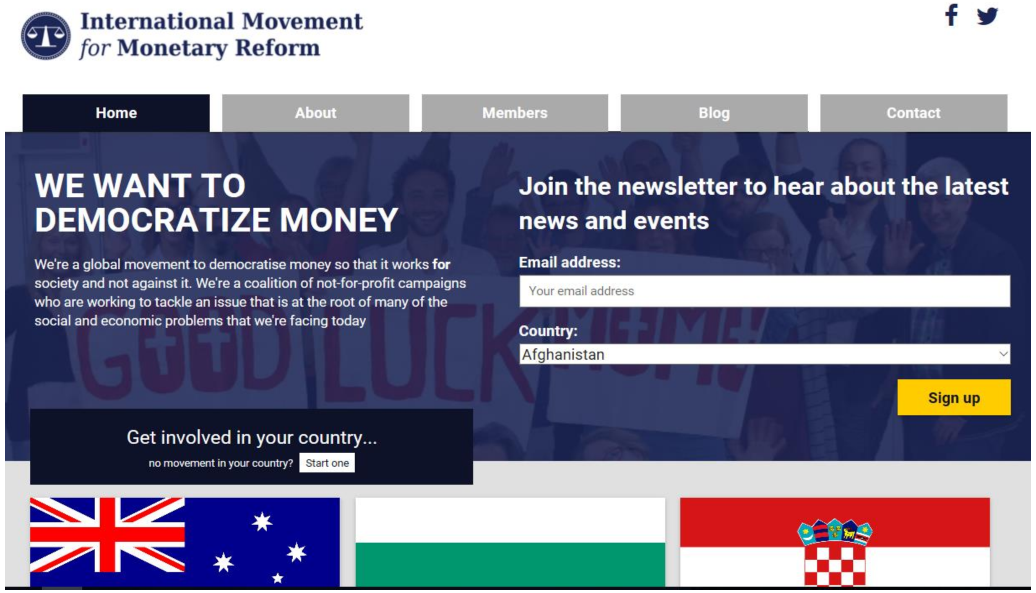
…by breaking with the past

How will we get there?

We have a fantastic supporter network

And support an international movement

PositiveMoney
Europe



So come along to a local group meeting

Or join us at one of our campaign actions

Together, we can make change happen

www.positivemoney.org

@PositiveMoneyUK

Thank you