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Banknotes in Circulation - Still Rising: What Does This Mean for the Future of Cash? Speech by Andrew Bailey

In a speech to the Banknote Conference 2009 in Washington DC, Andrew Bailey - Executive Director for Banking Services and Chief Cashier - discusses recent trends in the demand for banknotes and the implications for the future of cash use, and some of the key challenges the Bank of England faces in managing the circulation of its banknotes.

He describes the apparent 'paradox of banknotes' - the increasing value of notes in circulation alongside their gradually declining use as a means of payment.

As a share of nominal GDP, the value of notes in circulation declined from 6% in 1970 to a low point of 2.4% in the mid-1990s but has since stabilised and then increased, noticeably over the past two years. He explains that from a macroeconomic perspective, sustained low inflation has increased confidence in the real value of the currency since the mid-1990s, while more recently demand for banknotes has risen during the recession, particularly for £50 notes. This recent trend contrasts with the pattern in previous recessions. Rising demand for notes might reflect some loss of confidence in banks and very low interest rates, which reduce the opportunity cost of holding banknotes as a non-interest bearing asset. Andrew Bailey says that is "pretty good prima facie evidence that there has been an increase in demand for banknotes as a store of value". This pattern has been seen in other major currencies.

But as a share of all transactions, the use of cash has been gradually declining, to around 60% in volume terms and 4% in value terms in the UK presently. Commenting on the future demand for cash, Andrew Bailey says, ". we should recognise that the paradox of banknotes. indicates that there may well be a limit to the growth of the value of notes in circulation insofar as the use of banknotes as a means of payment is not increasing". But he stresses that there is considerable uncertainty about when demand might peak given its dependence on the state of the economy and the financial system, as recent experience indicates. He says: "This is a challenge for central banks because we have to manage our own contingency stocks based on a view of likely future demand".

Meeting the public's demand for banknotes has traditionally involved ensuring the value of notes demanded was available. But the Bank of England is also trying to meet two other objectives: maintaining a satisfactory

physical quality of our notes in circulation, and meeting the public's demand for different denominations. The ongoing difficulty in the UK of getting more £5 notes into circulation connects the physical quality of notes and the denominational mix demanded by the public. Andrew Bailey notes that few ATMs dispense £5 notes and this relative scarcity means they tend to stay in circulation longer, and change hands more times before they return into the wholesale cash distribution system for fitness sorting. He says: "We need to see more [£5 notes] dispensed so that they are less scarce and therefore they return to cash centres for sorting more often."

Over the past few years the total number of £5 notes in circulation has increased but there is more to be done. Two recent pilot schemes run by the Bank suggest progress can be made. One major bank has stocked some of its ATMs with £5s to test the effect on its cash business; and a major retailer has supplied more £5s to many of its stores to be used as change. Both pilots have been positive. Andrew Bailey says: "In the New Year I hope and expect that we will take these examples to other financial institutions and major retailers to make the case for a change of policy towards issuing £5s. .we need to see more £5s dispensed from ATMs and by retailers in change".

Concluding, Andrew Bailey explains why banknotes matter to the Bank of England. He says: "The answer is simple. We should not forget that our job is to ensure that confidence in our currency is maintained - and crucial to that is satisfying the public's demand for our notes".

Key Resources

Banknotes in Circulation – Still Rising: What Does This Mean for the Future of Cash? - Full speech
<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech417.pdf>