BANK OF ENGLAND

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

News release

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The Bank of England's Balance Sheet: Monetary Policy and Liquidity Provision During the Financial Crisis - Speech by Paul Fisher

In a speech made today at the Professional Pensions Show in London, Paul Fisher - Executive Director Markets and member of the Monetary Policy Committee - uses the Bank of England's balance sheet as a framework to describe the innovative operations undertaken by the Bank during the financial crisis.

Paul Fisher notes that the Bank of England's support for the economy had been "truly, historically massive - both in terms of liquidity insurance and operations and monetary policy." The balance sheet had expanded to as large a size as at any time in the past two hundred years, and the pace of change had been "unprecedented".

At some point, he says, the Bank's balance sheet will return to something approaching its former composition, and perhaps size, with the temporary operations being time-limited, or have price disincentives for use in normal conditions. But the innovations introduced during the crisis will leave the Bank better prepared to deal with stresses in future. Paul Fisher notes that the Sterling Monetary Framework is used to set monetary policy and to provide liquidity insurance to the banking sector but it ".cannot provide medium-term funding for banks to carry out lending."

In his speech, Paul Fisher describes how the liquidity operations evolved during the crisis. This included the injection of extra liquidity in the Autumn of 2007 and the expansion of 3-month repos against wider collateral, and the introduction of the Special Liquidity Scheme in 2008. That was followed, in the aftermath of Lehman Brothers' collapse, by the Dollar repo operations; the Discount Window Facility; the significant expansion of 3-month repos and further widening of the range of acceptable collateral in the Autumn of 2008.

Paul Fisher describes the establishment of the Discount Window Facility in October 2008, as ".perhaps the most significant development in our operational framework in this period" and emphasises that the terms of the Discount Window Facility ".were designed to be consistent with avoiding creating incentives for commercial banks to take greater risks in future."

The speech also discusses innovation in monetary policy operations. First, the creation of a new instrument, the one-week Bank of England bill, which was designed to drain excess liquidity injected by the three-month

repos. Then, turning to 2009, Paul Fisher focuses on the announcement by the Monetary Policy Committee (MPC) in March that Bank Rate would be reduced to 0.5% - its lowest ever rate - and the start of the Bank's asset purchase programme, financed by the issuance of central bank reserves. As a result, many elements of the Sterling Monetary Framework were suspended and the Bank decided to remunerate all reserve accounts at Bank Rate. He goes on to explain that the purpose of concentrating on purchasing mostly gilts under the Asset Purchase Facility (APF) was to ".expand money spending in the economy and hence help the MPC to meet the inflation target."

Looking ahead to the road to recovery, Paul Fisher says that when the MPC begins to tighten monetary policy, it can do so by either raising Bank Rate, or by selling assets back to the market, or through a combination of the two. If APF assets are sold, reserve balances will fall and the Bank's balance sheet is likely to contract. Paul Fisher notes that the Bank's balance sheet may not return to pre-crisis levels as banks may choose to hold higher reserve balances than before the crisis, perhaps motivated by the Financial Services Authority's more stringent liquidity requirements.

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech413.pdf