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

12 March 2010

QE One Year On - Speech by Spencer Dale

In a speech today at an academic conference in Cambridge, Spencer Dale - member of the Monetary Policy Committee and Chief Economist - examines the policy of buying assets using the Asset Purchase Facility, known as quantitative easing (QE). He reviews the theoretical foundations for QE, the key channels of transmission, and its impact to date.

Spencer Dale highlights that we have come a long way over the past year. Since the Bank made its first gilt purchases almost exactly one year ago, "...the economy has stabilised, household and business confidence have recovered and financial market conditions have improved."

He discusses the academic literature on unconventional monetary policy and channels through which monetary policy is likely to be able to influence the economy at the zero interest rate bound. The MPC placed weight on three key channels: first, imperfect substitutability between assets and resultant portfolio rebalancing as investors switch out of gilts into alternative assets, such as corporate bonds and equities; second, improvements to financial market liquidity, aided by purchases of commercial paper and corporate bonds; and, third, expectations as asset purchases demonstrated the MPC's commitment to act, boosted confidence in the economic environment and so reduced the likelihood of further large falls in asset prices. Given the challenges facing the UK banking system, an increase in bank lending was not expected to be a key part of the transmission process.

On judging the impact of QE to date, he says it is hard to provide a definitive answer to the £200bn question, not least because a policy of this form and scale has never been implemented in the UK but also because we do not know what would have happened in its absence. He believes that while broad money is still weak, it "...would have almost certainly been far weaker" absent the asset purchases. In addition, event studies that consider the impact of QE announcements on movements in the spread of gilt yields to Overnight Indexed Swap rates suggest "...that the portfolio balance effect may have reduced gilt yields by around 100 basis points." It is also important to consider other asset prices as gilts make up a relatively small proportion of total wealth. In that respect, since the start of QE "equity prices have increased by more than 50%, and corporate bond yields have fallen by over 400 basis points. These movements have been very beneficial for the economy...", he says. Even though it is difficult to identify the incremental role of QE in driving these improvements, Spencer Dale stresses that he has "...little doubt that our asset purchases contributed substantially to these movements...".

He goes on to highlight two important considerations underlying the MPC's recent decisions to maintain Bank Rate at 0.5% and the stock of QE at £200 billion. First, the stock of asset purchases, together with the low level of Bank Rate, should continue to provide a substantial stimulus to the economy for some time to come. Second, the Committee stands ready to make further asset purchases should the outlook warrant them.

Looking further ahead to the MPC's exit strategy, Spencer Dale confirms that policy decisions will remain guided by the outlook for inflation. The Bank's two instruments - Bank Rate and asset purchases - "...can be used at any time, in any order", he says. The most difficult decision will be to decide the timing of the withdrawal, but that difficulty is not specific to QE.

Summing up he says: "One year on, there is a range of evidence - some relatively hard; some more circumstantial - to suggest that quantitative easing is having its desired effect. Asset prices have increased substantially, companies have made record recourse to debt and equity markets, confidence has recovered and inflation expectations remain firmly anchored. But there is still a long way to go. ...The ultimate success of QE will depend on whether the monetary injection and increased asset prices stimulate nominal spending and so help achieve the 2% inflation target in the medium term. Much of the impact of our asset purchases to date is to still to come through and so it is too early to judge their final impact."

Key Resources

QE One Year On – Full speech
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech428.pdf