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

30 September 2010

Managing Liquidity in the System: The Bank's Liquidity Insurance Operations - Speech by Paul Fisher

In a speech to the Loan Market Association, Paul Fisher - Executive Director Markets and member of the Monetary Policy Committee - describes how the Bank has developed its liquidity operations over the past three years to support financial stability.

Paul Fisher begins by explaining that central banks are uniquely placed to provide backstop liquidity to both individual firms and the wider financial system in times of stress. But, he notes, ".in meeting that objective, the Bank must ensure that it guards against moral hazard, by setting the incentives in such a way that discourages anything but exceptional use.and that it adequately protects its own balance sheet from risk of loss".

With that in mind, he summarises the various adaptations the Bank has made to its liquidity provision during the crisis: increasing the size of operations, lengthening the term of lending, and widening the pool of collateral eligible in some operations. These changes raised a number of important policy questions for the Bank, and contributed to the introduction of Indexed Long-Term Repos in June 2010.

Turning to the Special Liquidity Scheme (SLS), Paul Fisher reiterates that the Scheme ".will not be extended or replaced. After three years of large-scale liquidity support the Bank expects each institution to be in a position to fund itself through normal market mechanisms." He adds that: ".the Bank has had bilateral discussions with the main users of the Scheme to ensure that there are credible funding plans in place to reduce their use of it in a smooth fashion." He notes that of the £185bn of Treasury bills initially advanced, some £57bn has already been repaid. And he counters assertions that there is a lack of private sector funding to replace SLS funds on maturity by emphasising that the private sector is already ".the ultimate source of funding as the Treasury Bills lent under the Scheme are turned into cash in the market."

Paul Fisher concludes by discussing the supply of credit to the UK economy. He says that: "Despite various forms of support from the Bank of England and from Government, it is clear that the lending capacity of the banking system, in the UK and elsewhere, is impaired and will take some years yet to recover. Some banks need to continue de-risking and de-leveraging. Others, including new banks, are likely to grow. But the supply of bank lending to businesses during the recovery is likely to be more expensive than it was pre-crisis and possibly constrained in quantity." He emphasises that the Bank cannot be considered an alternative source of medium-term funding for banks, but says that ".the Bank has been engaging with market participants over policies or market developments in the loans market which would support lending by non-bank institutions".

Key Resources

Managing Liquidity in the System: The Bank's Liquidity Insurance Operations – Full speech
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech450.pdf