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 distributional effects of asset purchases

In a paper published today, the Bank of England provides an initial analysis of the distributional effects of its asset purchase programme (QE). The paper forms part of the Bank's response to a request by the Treasury Committee for the Bank to explain the costs and benefits of its policy actions, in particular to groups that are perceived to have been negatively affected.

The Bank's response to the financial crisis has been unprecedented, with Bank Rate cut to a historically low level and asset purchases totalling £375 billion to date. Most people in the United Kingdom would have been worse off without this response, including savers and pensioners. All assessments of the effect of QE must be seen in that light. QE has caused the price of gilts to rise and yields to fall, in turn leading to an increase in demand for, and price of, a wide range of other assets, including corporate bonds and equities. That has lowered borrowing costs for companies and households and increased the net wealth of asset holders, both of which have acted to stimulate spending.

As with all changes in the stance of monetary policy, the recent period of loose monetary policy has had distributional consequences, and its benefits have not been shared equally across all individuals. The paper analyses the direct impact of the cuts in Bank Rate and QE on savers, pensioners and pension providers. It is important to note that the calculations focus on just the direct impacts, and not the wider benefits described above.

Households hold the majority of their savings as easily accessible deposits. As a consequence, the cuts in Bank Rate – not QE – have been the dominant influence on savers. Lower interest rates have depressed the aggregate interest payments received by households on their deposits. But QE has worked in the opposite direction, boosting the value of households' financial wealth by pushing up a range of asset prices. As far as the impact of QE on pensioners goes, the incomes of those already drawing a pension before QE began will have been unaffected. The implications of QE for those approaching retirement and for pension providers depends on the type of pension scheme and how well it is funded.

For those approaching retirement in 'defined contribution' schemes, lower gilt yields as a result of QE have reduced annuity rates. But it is crucial to allow for the fact the QE has raised the value of pension fund assets too. Once allowance is made for that, QE is estimated to have had a broadly neutral impact on the value of the annuity income that can be purchased from a typical personal pension pot invested in a mixture of bonds and equities.

The paper shows that QE also has a broadly neutral impact on a fully funded ‘defined benefit’ scheme. Moreover, the pension incomes of people coming up to retirement in a defined benefit scheme, whether fully funded or not, will have been unaffected by QE. But schemes that were already in substantial deficit before the financial crisis are likely to have seen those deficits increased.

The paper notes that the main factor behind increased pension deficits and falls in annuity incomes has not been the Bank’s asset purchases, but rather the fall in equity prices relative to government bond prices. This fall in the relative price of equities was not caused by QE. It happened in all the major economies, much of it occurred prior to the start of asset purchases and stemmed in large part from the reluctance of investors to hold risky assets, such as equities, given the deterioration in the economic outlook as a result of the financial crisis. Indeed, by boosting the economy, monetary policy actions in the United Kingdom and overseas probably dampened this effect.

Key Resources

http://www.bankofengland.co.uk/publications/Documents/news/2012/nr073.pdf