BANK OF ENGLAND

The Bank of England's unconventional monetary policies: why, what and how

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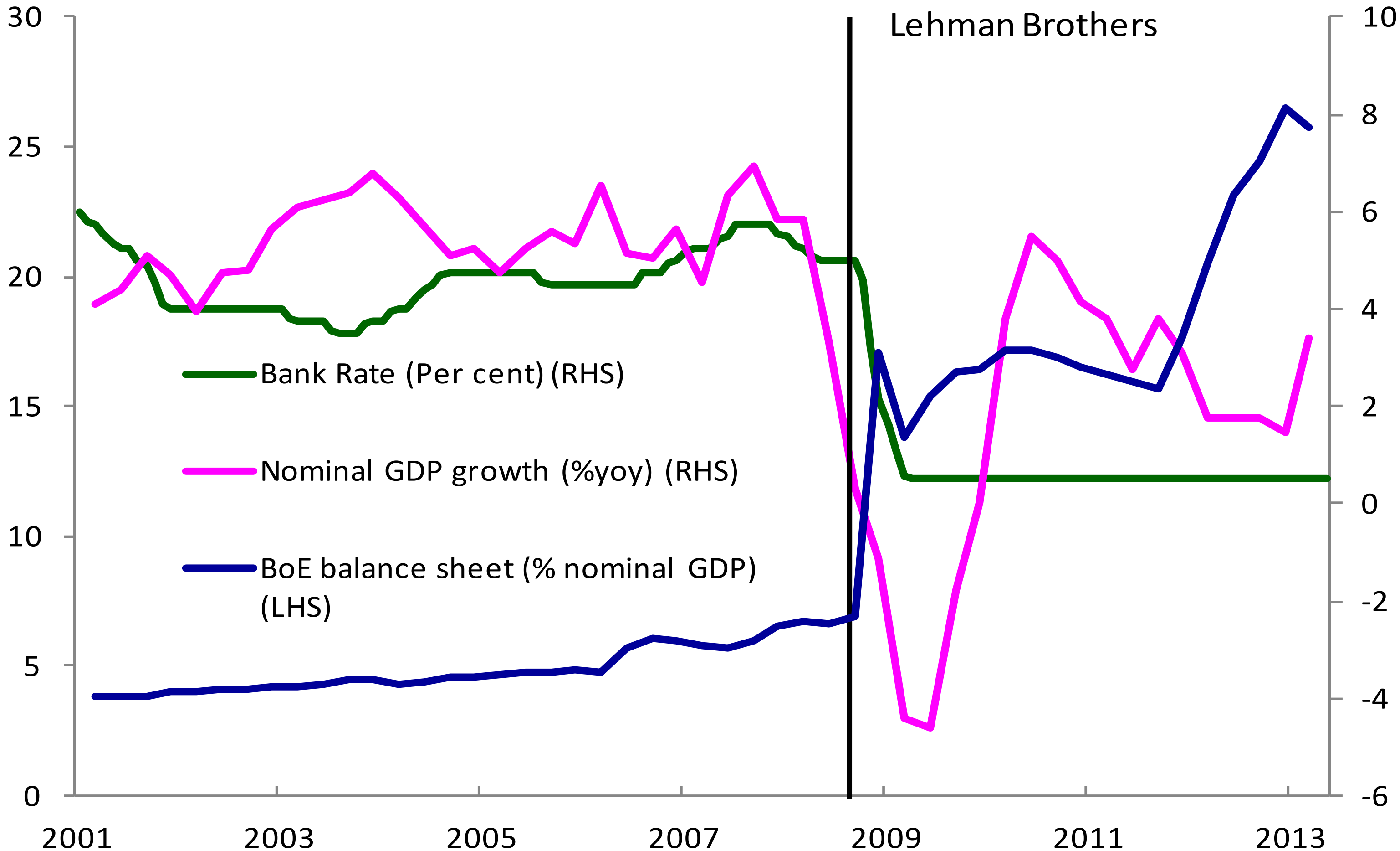
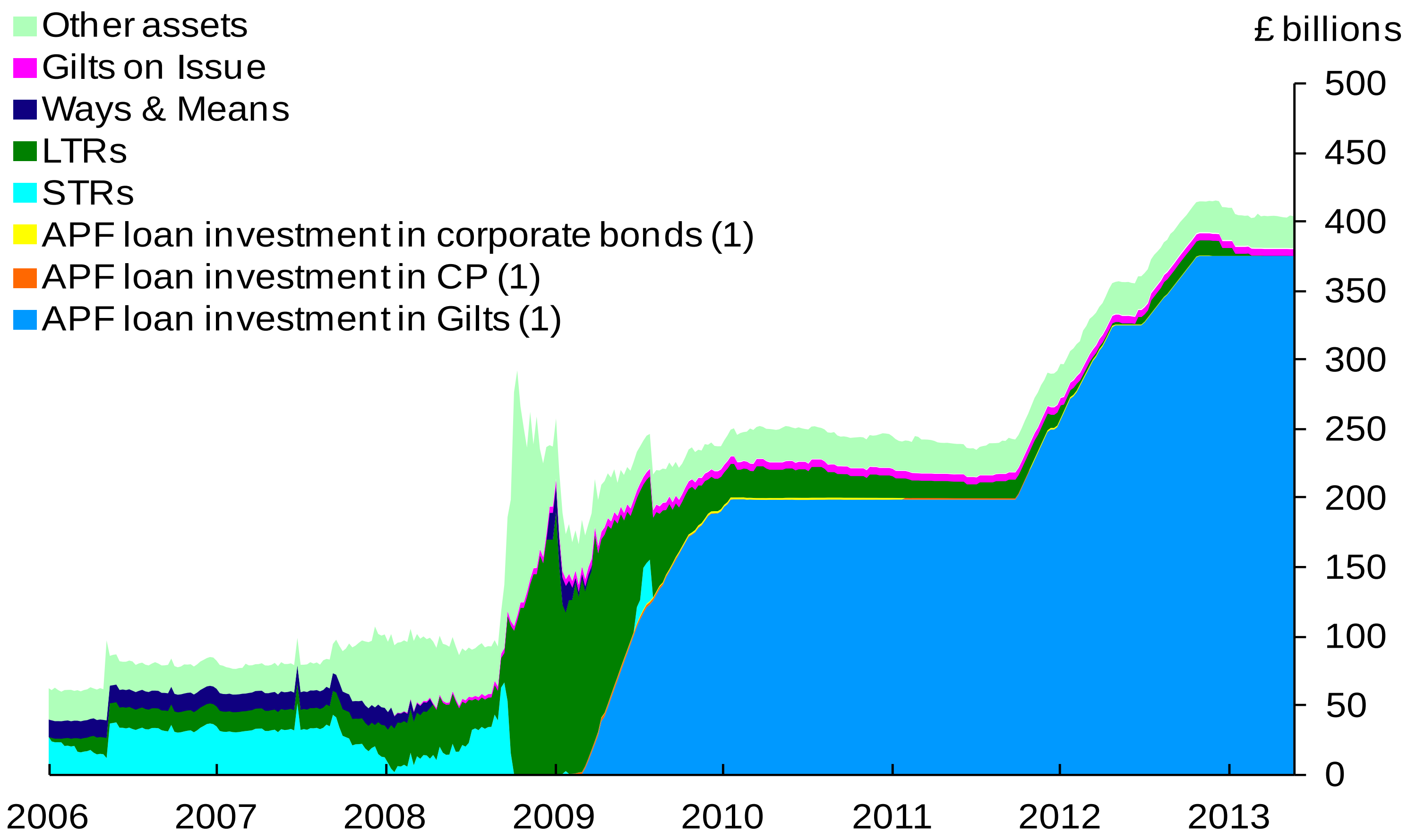
Nominal GDP growth, Bank Rate and the BoE balance sheet



Policy responses to the crisis

- Monetary policy
  - Conventional
    - Bank Rate reduced to 0.5% from March 2009
  - Non-conventional
    - enhanced liquidity support: wider collateral, long-term repos, discount window facility, SLS
    - actions to address dysfunctional markets: corporate asset purchases
    - **QE and FLS**
- Other domestic measures: Direct support for banking sector; Fiscal stimulus
- International measures

Bank of England balance sheet



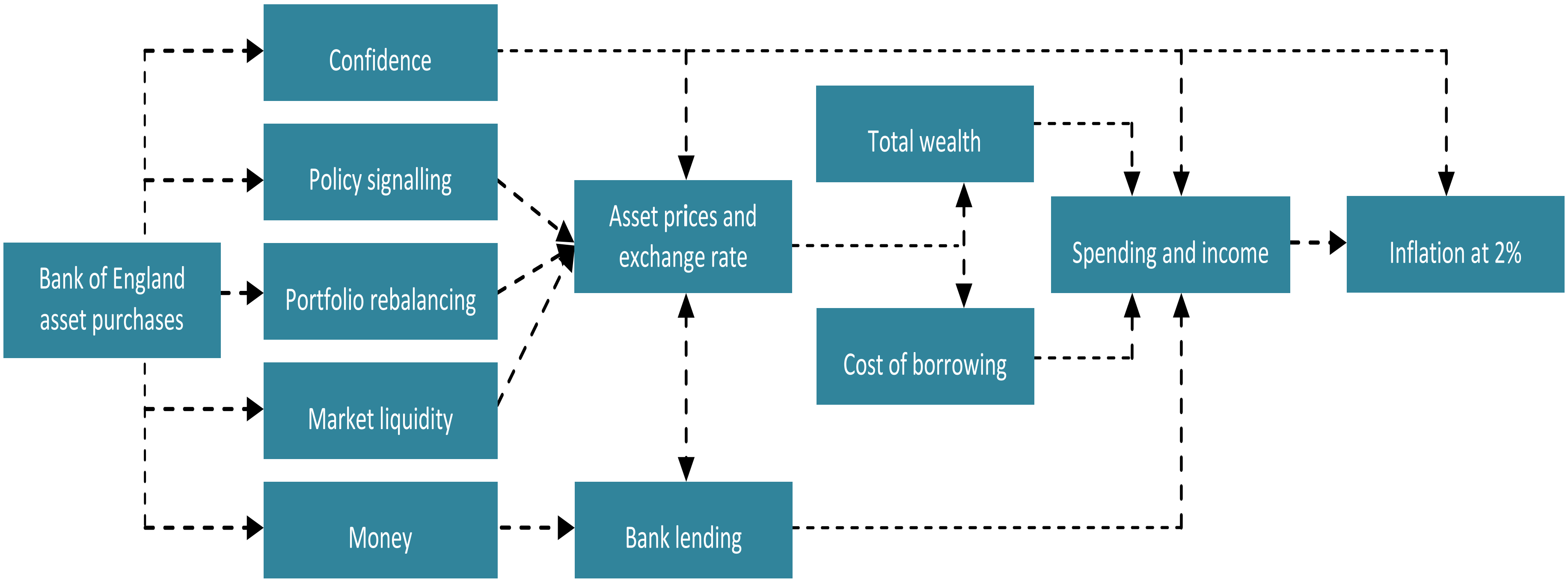
Quantitative easing: timeline

- QE1: Announced on 5 March 2009. Reflected perceived risk of otherwise missing the inflation target in the medium term. Initial decision to purchase £75 billion of assets over 3 months financed by issuance of central bank reserves. Purchases increased over subsequent months to £200 billion, completed in January 2010.
- QE2: Purchases resumed in October 2011, largely in response to the impact of the growing euro crisis. Further £125 billion of purchases completed in May 2012.
- QE3: Additional £50 billion announced in July 2012 and completed in November 2012.

Quantitative easing: design & operation

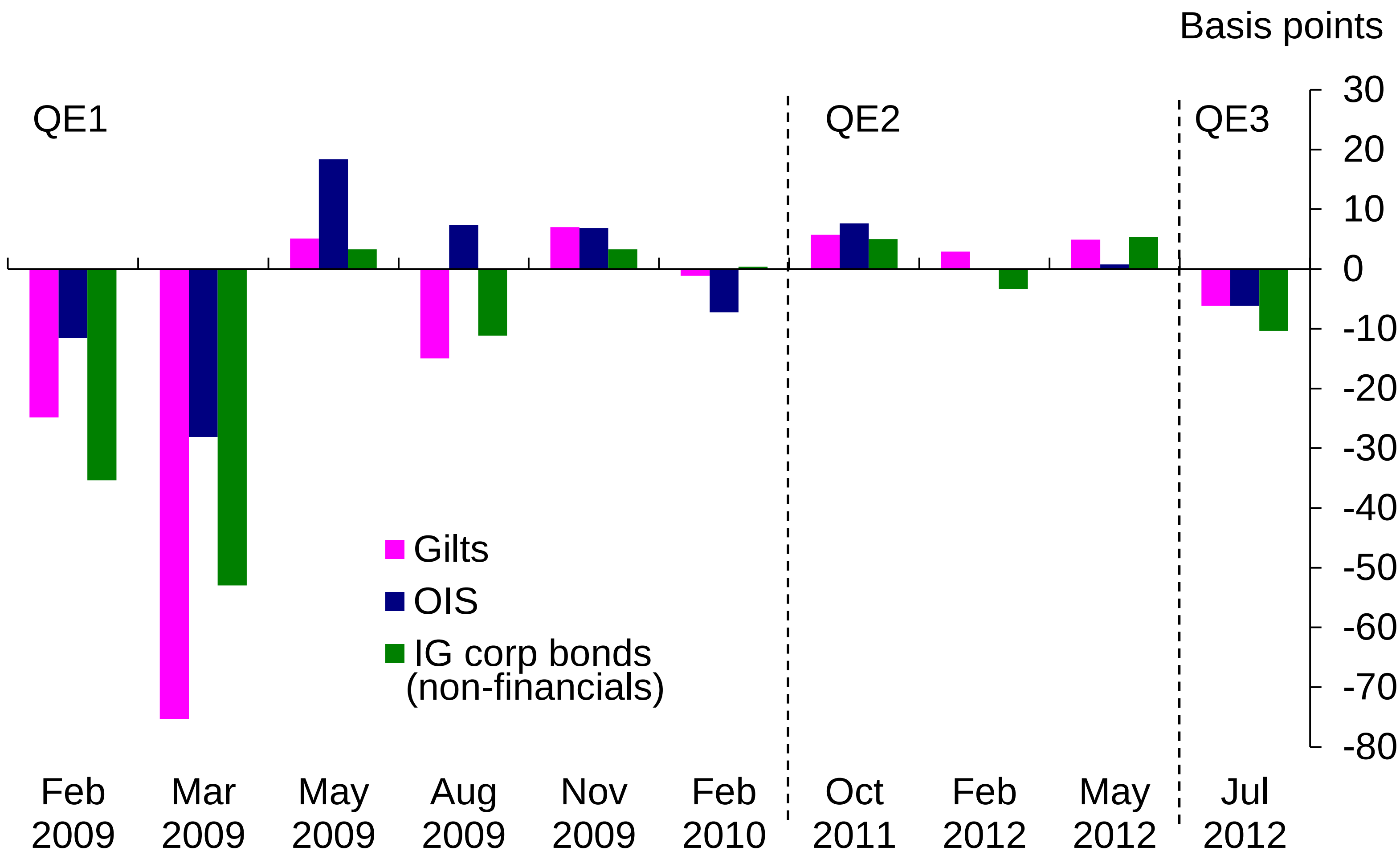
- Bulk of purchases were medium- and long-maturity government securities (gilts) in the secondary market. The small amount of corporate purchases aimed more at improving market functioning.
- Choice of purchase range reflected desire to target non-banks. Any impact on banks thought likely to be small given the desire to deleverage. QE aimed to go round banks. To increase asset prices through ‘portfolio rebalancing’ channel.
- Purchases took place through an indemnified subsidiary, the Bank of England Asset Purchase Facility (APF).
- BoE conducted multiple-price (discriminatory) reverse auctions; accepting cheapest offers relative to market prices.

Key transmission channels of QE

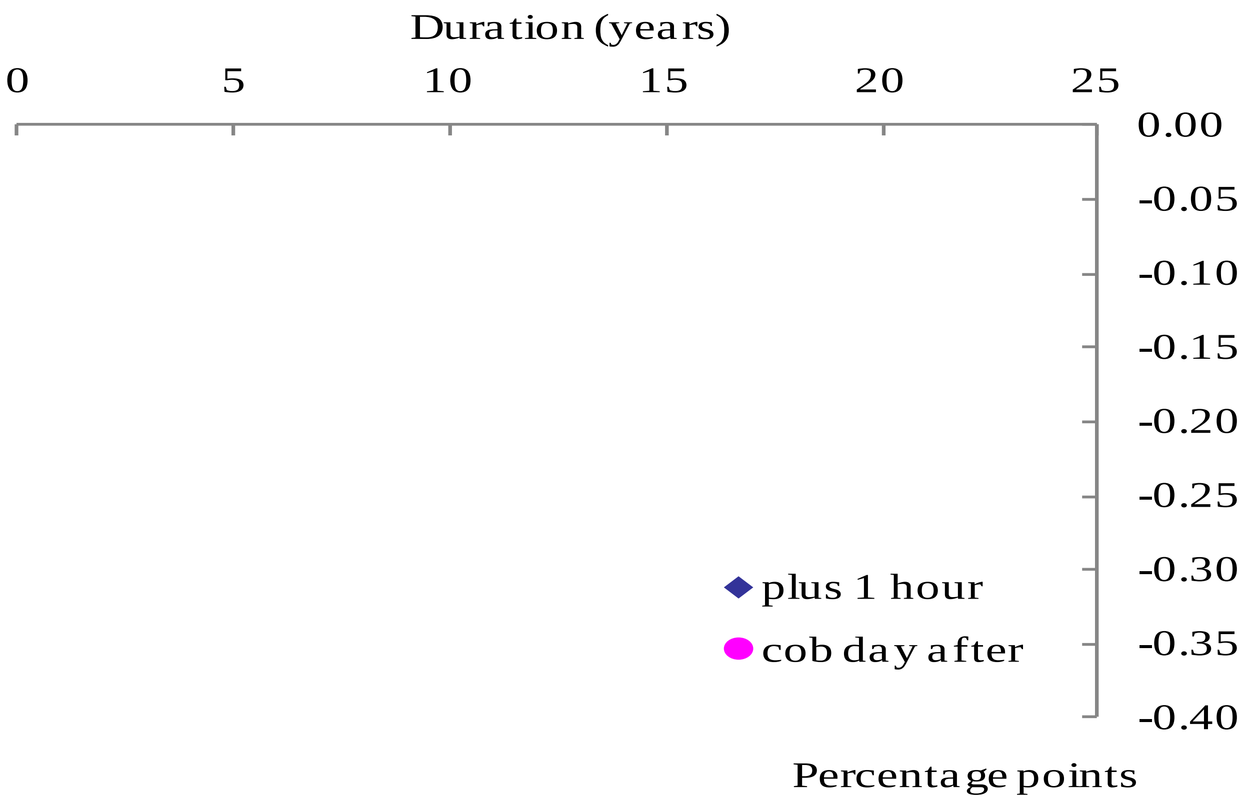


Source: Joyce, Tong and Woods (2011)

Reaction of yields to QE announcements

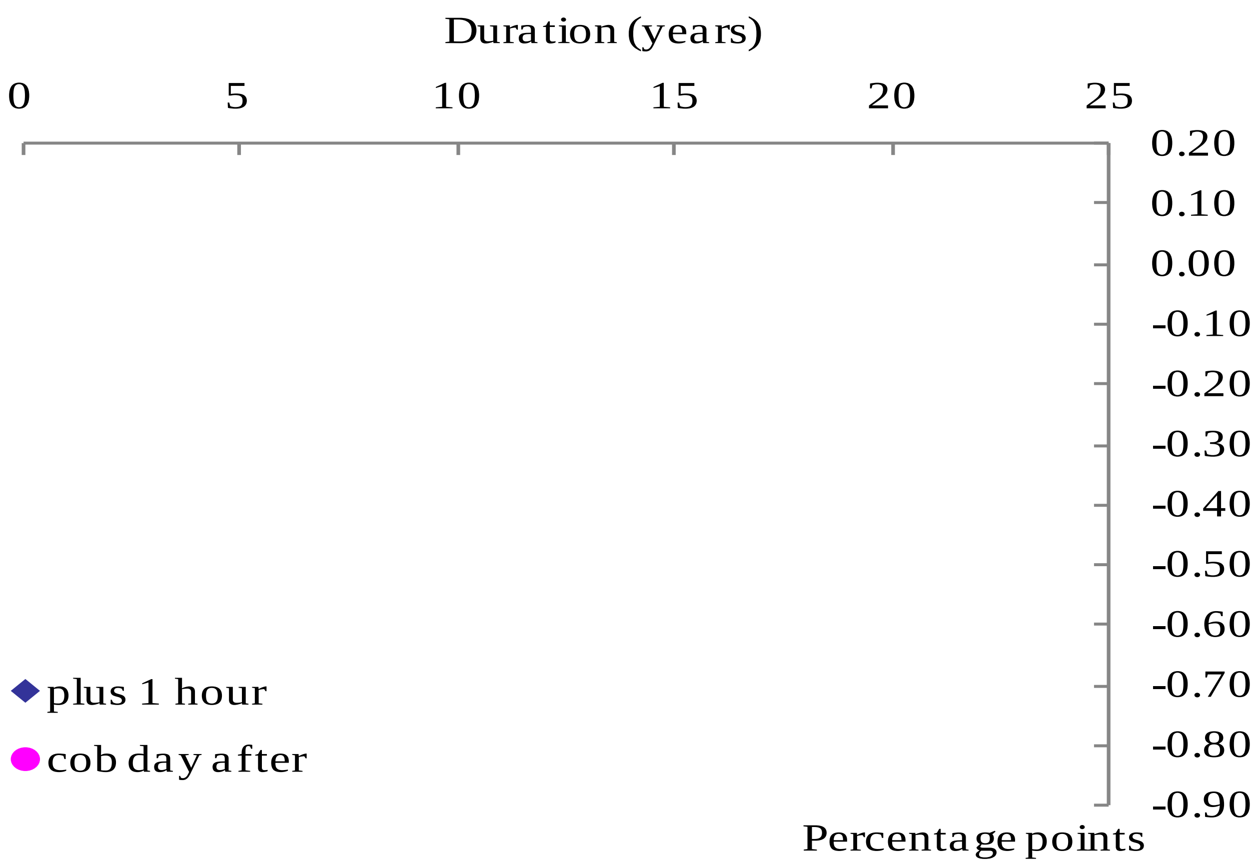


YTM reactions following February 2009 announcement



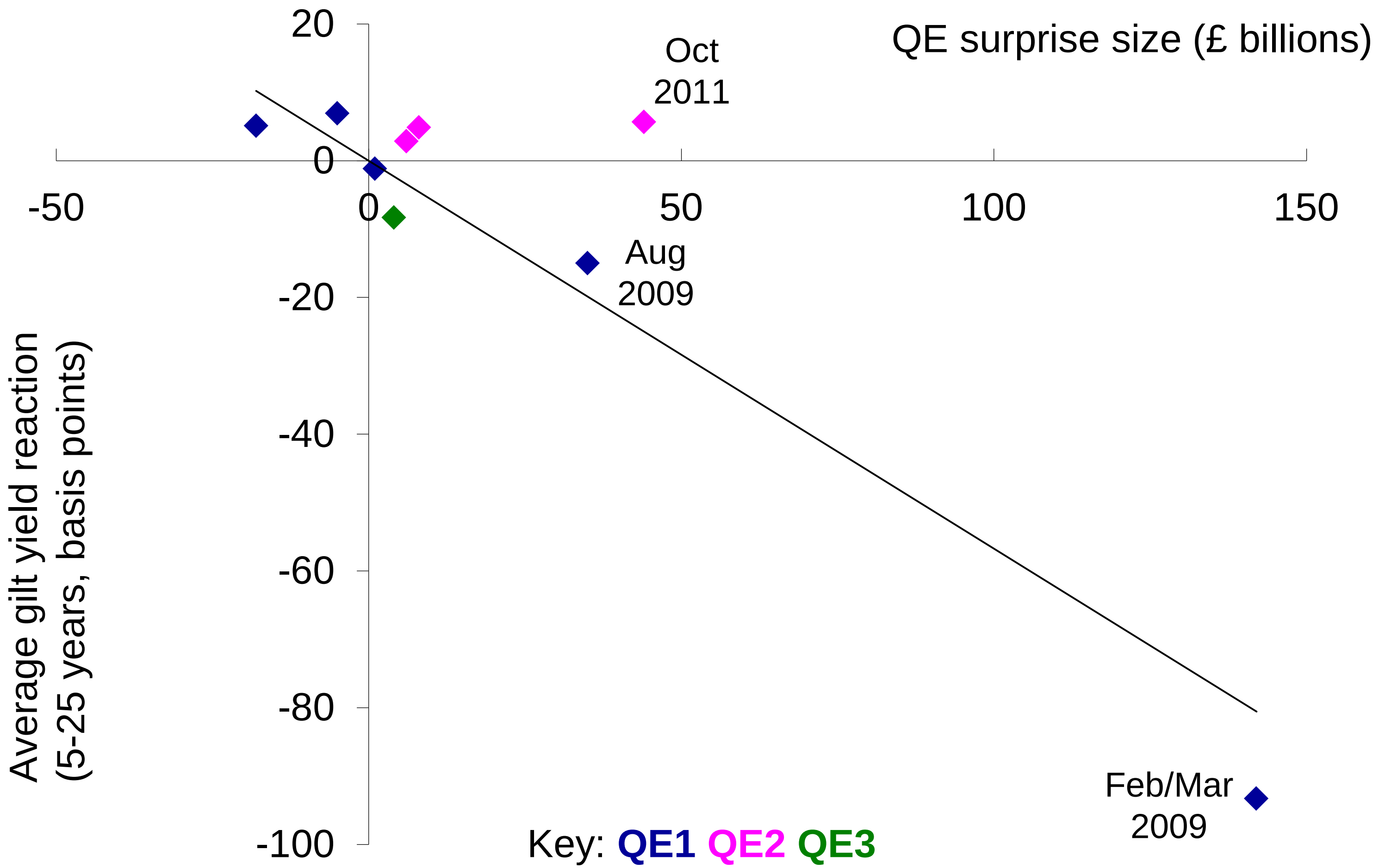
Source: Joyce and Tong (2012)

YTM reactions following March 2009 announcement



Source: Joyce and Tong (2012)

Size of QE "surprise" and reaction of gilt yields



Summary of asset price movements

	QE1: total of £200bn purchases over 6 announcements (Feb 09, Mar 09, May 09, Aug 09, Nov 09, Feb 10).		**QE2/3**: total of £175bn purchases over 5 announcements (Oct 11, Feb 12, May 12, July 12, Nov 12).	
Asset	**Change around QE1 announcements**	**Change 4 March 2009 – 26 January 2010**	**Change around QE2/3 announcements**	**Change 5 October 2011 - 31 October 2012**
Gilts (5-25 year spot rates)	-104bp	-9bp	+2bp	-45bp
Corporate yields (investment grade)	-69bp	-390bp	-7bp	-200bp
Corporate yields (high yield)	-151bp	-1938bp	-11bp	-354bp
FTSE All-Share	-3%	+46%	+4%	+6%
Sterling ERI	-4%	+4%	1%	+6%

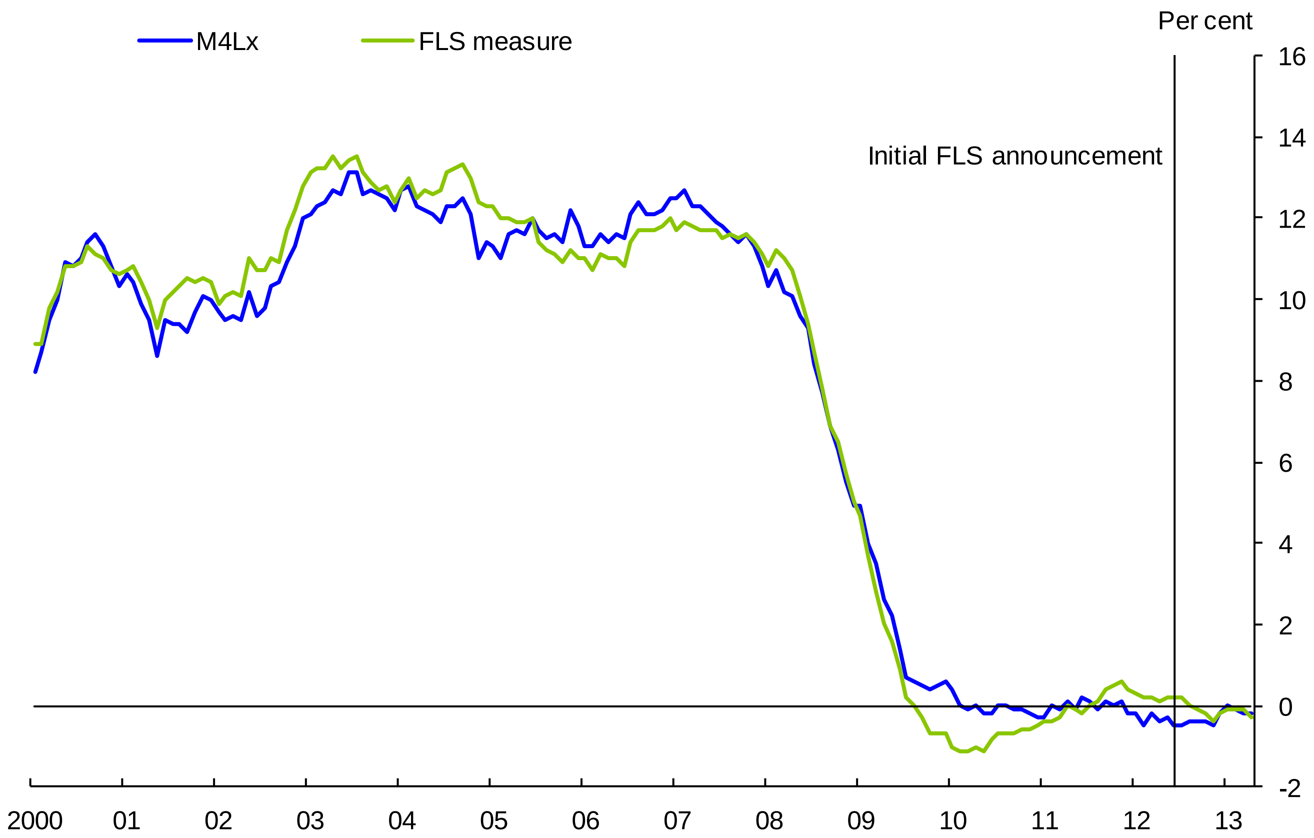
Wider effects

- Recovery in risky asset prices particularly during QE1, although difficult to estimate relative contribution of QE versus other factors, including international spillovers.
- Modest but temporary impact on sterling exchange rate.
- Most studies of the macro effects suggested QE played a significant role in warding off further output losses and deflation (Kapetanios, et al (2012), Bridges and Thomas (2012), Ashworth and Goodhart (2012), Baumester and Benati (2013)).
- Effect of £200 billion equivalent to decline in Bank Rate of 150-300 bp (Joyce, Tong and Woods (2011)).

Some conclusions on QE

- QE1 had clear effects on financial markets: gilt yields fell by around 100 bps and other asset prices rallied. Some evidence of portfolio balance effects (Joyce et al (2011), Joyce and Tong (2012), Breedon, Chadha and Meaning (2012), Christensen and Rudebusch (2012)). Large increase in corporate bond and equity issuance.
- Impact of later purchases more difficult to measure, in part because markets now more familiar with role of asset purchases in BoE's toolkit. In addition, euro area developments may have partly offset the effects, by weighing down on risky asset prices and increasing risk aversion and reducing portfolio rebalancing.
- Analysis based on surprise changes in the distribution of the Bank's gilt purchases suggests that effects through local supply were similar in QE1 and QE2 (Banerjee et al (2012)). Other evidence shows the impact on money supply was similar (Butt et al (2012)). But possible other channels have been weaker.

12m growth in lending to households and PNFCs



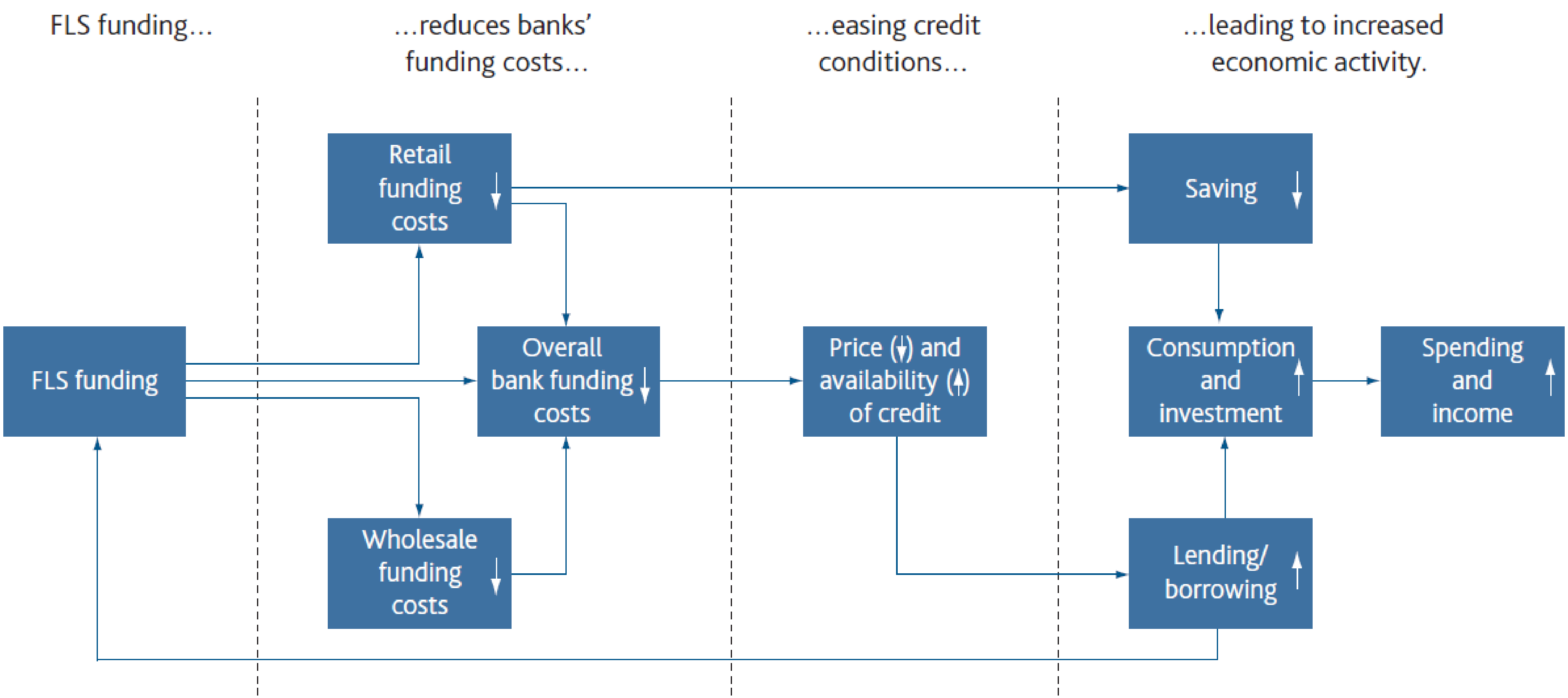
Funding for Lending Scheme (FLS)

- FLS launched by the BoE and HM Treasury on 13 July 2012. Response to the protracted weakness of bank lending and the intensification of the euro crisis which increased the funding costs facing banks.
- Aim to provide funding for an extended period, at below elevated market rates, with a direct link between the quantity and price of funding available from the scheme and participants' performance in lending to the real economy.
- Designed to encourage banks and building societies to boost their lending to UK households and businesses.
- Complementary to QE: goes directly through banks, rather than round them. FLS reduces bank funding costs, QE reduces costs of capital market issuance.

FLS extension

- On 24 April 2013, FLS was extended, in order to:
  - Give banks and building societies confidence that low cost funding for lending to the UK real economy will be available until January 2015.
  - Increase incentive for banks to lend to SMEs.
  - Include lending involving certain non-bank providers of credit, which play an important role in providing finance to the real economy.
- Complements other policies including FPC recommendations on bank capital and various UK Government schemes to encourage lending.
- Provides insurance against further rises in funding costs.

Transmission mechanism of the FLS

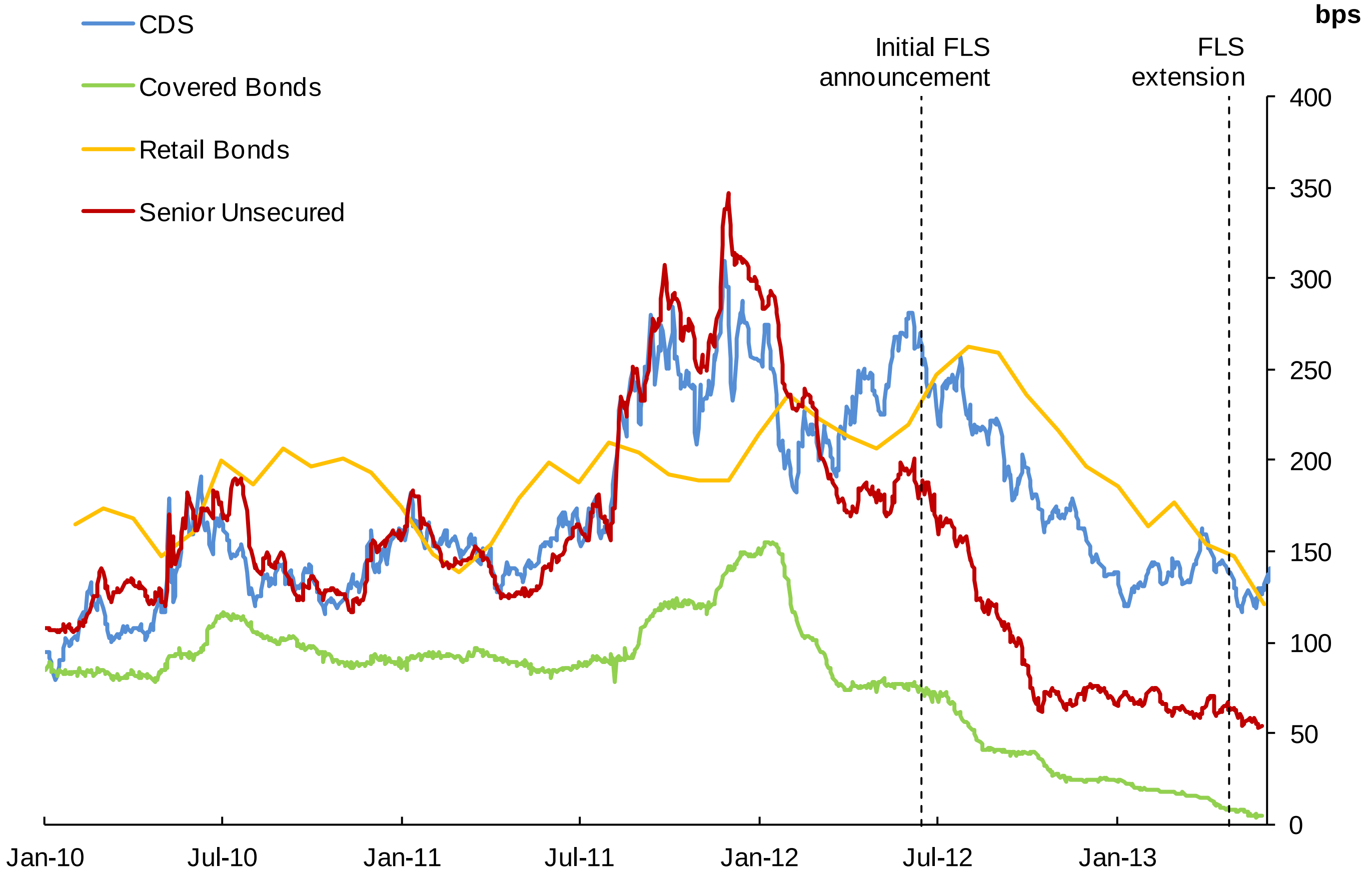


Source: Churm et al (2012)

FLS: evidence

- Widespread participation – 40 banking groups, over 80% of the stock of eligible loans. Outstanding drawings of £16.6 bn.
- Indicative measures of UK banks longer-term funding spreads – both retail and wholesale – fell sharply after the announcement. Also short-term bank unsecured funding and Libor rates. Part of the fall reflected other factors, including ECB's OMT announcement, but seemed to be a FLS-specific effect.
- Reduction in quoted terms and availability of credit for secured household borrowers and large corporates.
- Net lending broadly flat, though this needs to be judged against counterfactual that it was expected to fall. Net lending currently expected to pickup gradually through this year.

Indicative bank funding spreads



Conclusions

- QE worked in preventing further output losses and deflation.
- It remains an important policy instrument at the ZLB. How effective, through which channels it works and whether its effects have diminished remain open issues. Also the costs and risks.
- FLS plays a complementary role in directly addressing weak bank lending. It has helped reduce bank funding costs and may have prevented a further decline in lending. Seen as an insurance policy against future shocks to bank funding costs.
- Scope for further monetary policy action? The Chancellor has requested the MPC provide an assessment of forward guidance including intermediate thresholds for the August Inflation Report.

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