

March 20, 2009

A look at the Bank of England's balance sheet

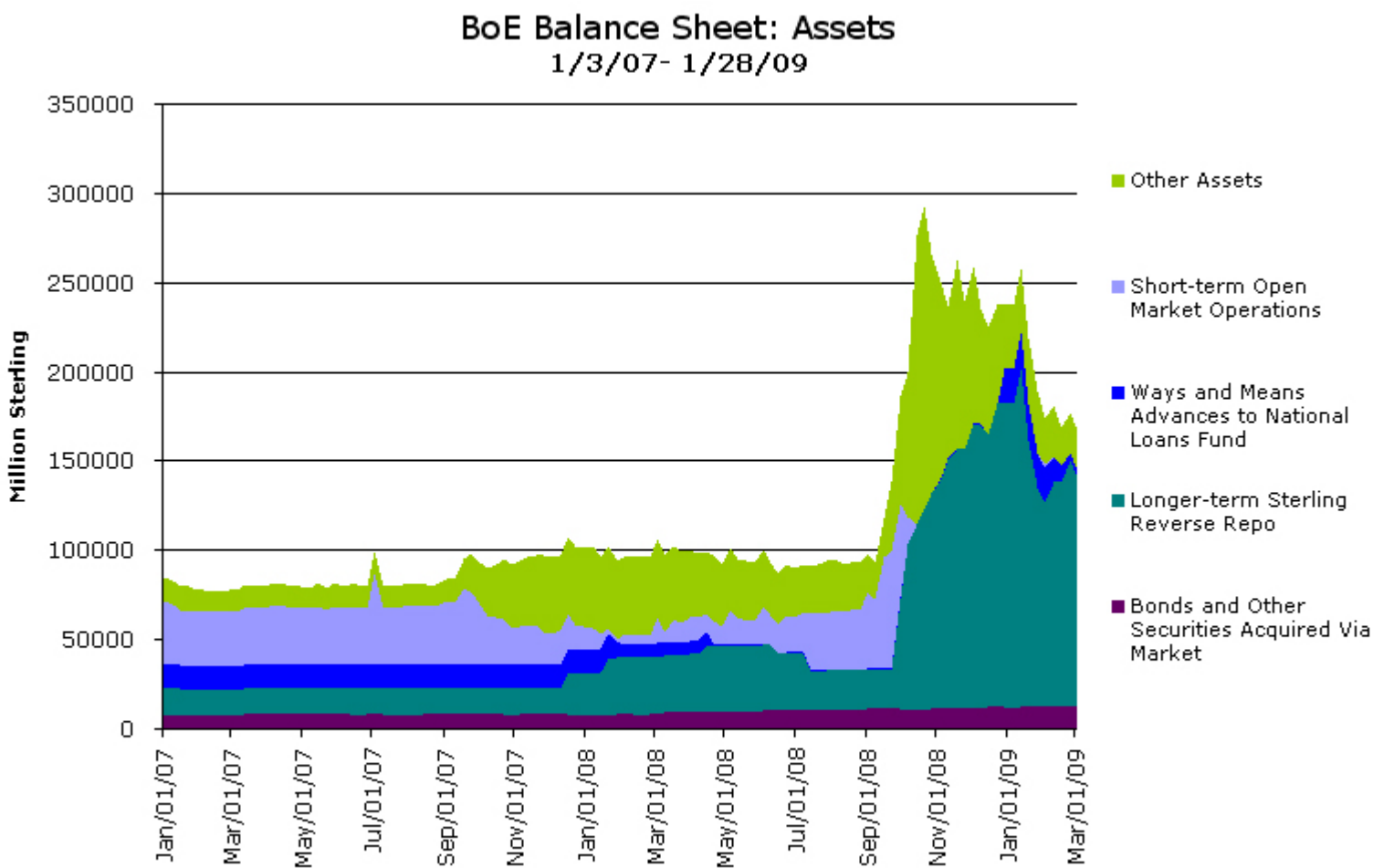
The current financial crisis is global in scope, with central banks responding in various ways to mitigate the strains in their respective countries. The Federal Reserve is not the only central bank that has been aggressive in its response. For instance, the Bank of England's (BoE) Monetary Policy Committee, in its March 5 policy [statement](#), explained the details of its new asset purchase program:

"...the Committee agreed that the Bank should, in the first instance, finance £75 billion of asset purchases by the issuance of central bank reserves. The Committee recognised that it might take up to three months to carry out this programme of purchases. Part of that sum would finance the Bank of England's programme of private sector asset purchases through the Asset Purchase Facility, intended to improve the functioning of corporate credit markets. But in order to meet the Committee's objective of total purchases of £75 billion, the Bank would also buy medium- and long-maturity conventional gilts in the secondary market. It is likely that the majority of the overall purchases by value over the next three months will be of gilts."

Thus, the BoE will purchase £75 billion of assets (approximately U.S. \$108 billion as March 20 and U.S. \$106 billion as of March 5), mostly intermediate-to-longer dated U.K. sovereign debt (or gilts) but also some "investment grade" corporate bonds. Along with this new asset purchase program, to ease strains in credit markets the BoE has previously implemented other efforts, such as purchasing commercial paper, asset-backed securities, and corporate bonds. But these earlier efforts were conducted in such a way that the BoE *sterilized* its purchases—that is, for every £1 of private assets it purchased, the BoE would issue £1 of its own debt (sterling bills), with the effect being that the money base (bank reserves plus currency in circulation) grew much less than the overall size of the balance sheet.

However, with the new asset purchase program, the BoE is targeting a quantity of U.K. sovereign debt to purchase in an *unsterilized* manner, hence the key phrase "by the issuance of central bank reserves." As stated, the BoE will be buying gilts, "with the aim of boosting the supply of money and credit and thus raising the rate of growth of nominal spending to a level consistent with meeting the inflation target [2% CPI inflation] in the medium term."

The impact of the BoE's efforts to support private credit markets can be seen in this chart of [the size and composition of the BoE's assets](#):

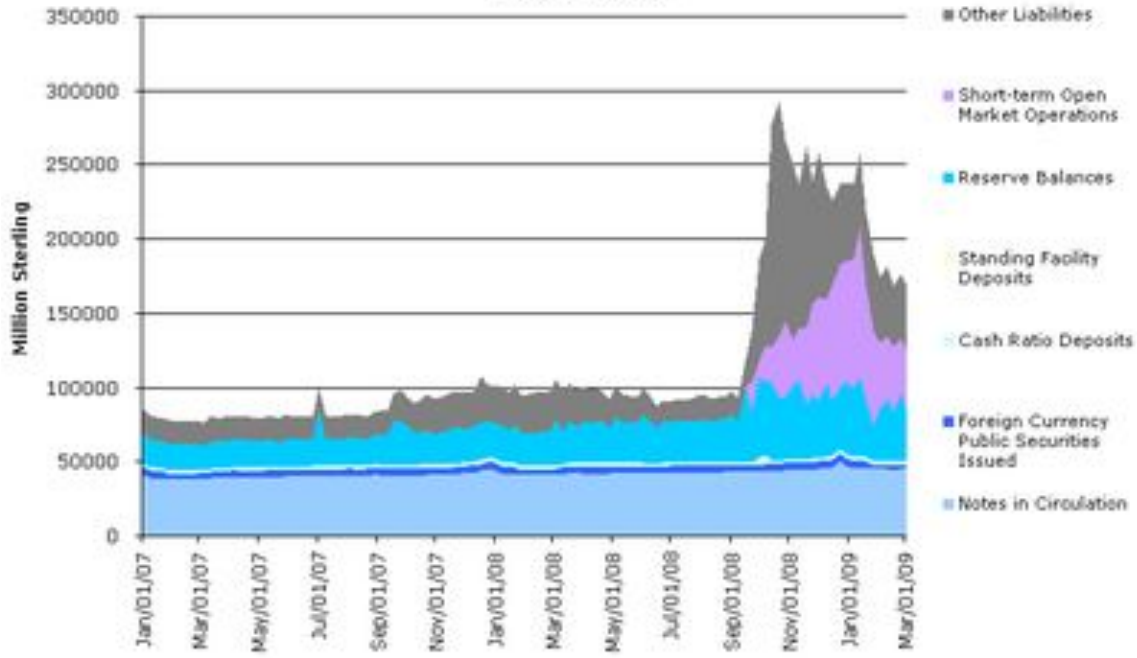


Source: Bank of England

As the size of the asset side of the BoE's balance sheet grew, so did the liability-side:

BoE Balance Sheet: Liabilities

1/3/07- 1/28/09



Source: Bank of England

Notice that much of the increase in the liabilities has come from "other liabilities" and "short-term open market operations" and not "reserve balances." But with the new asset purchase program, reserve balances will become much larger.

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