BANK OF ENGLAND

Andrew Bailey
Governor

Mr Steve Baker MP
Member of the Treasury Select Committee
House of Commons
London
SW1A 0AA

04 December 2020

Dear Steve,

You asked a question at the recent Treasury Select Committee about the size of the QE programme in relation to the measure of broad money M4. I promised to send you and the rest of the Committee a chart showing historically how the size of central bank money and coin has evolved relative to the stock of broad money.

The chart below shows two measures of this on an annual basis back to 1880 when the comprehensive data on bank and building society deposits begins.[1]

The blue line shows the ratio of cash to total deposits held by the public.[2] This shows that cash held by the public is now much lower relative to total bank and building society deposits than it has been historically.

That in part reflects various technological developments in the payments system. It also reflects financial liberalisation and the payment of increasingly competitive rates of interest on deposits and more widespread payment of interest on current accounts.

The red line is a ratio of cash and central bank reserves held by banks, relative to total deposits held by the public. It has the same denominator as the blue line but includes in the numerator the amount of central bank money and coin held by banks and building societies.[3] This ratio, on an end calendar year basis, has increased materially over the past 15 years. Most of the increase reflects the MPC's Quantitative Easing (QE) programme since 2009[4].

The latest data (October 2020) shows the red line has risen above the levels seen in the 1950s, and similar to those observed at the end of both world wars. But we need to be careful about drawing conclusions from this kind of comparison – not least because there have been many structural changes to the banking system and policy regime over this period. For example, changes in banks' liquidity requirements and the introduction of interest payments on reserve accounts will have affected this ratio over time.

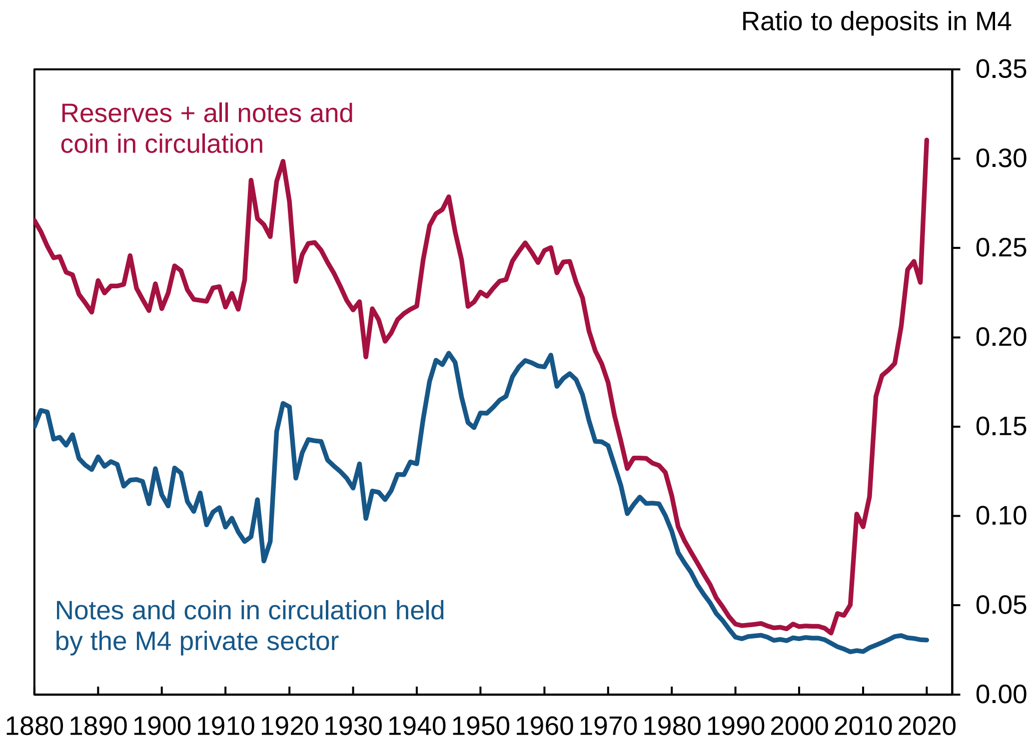
---

[1] It is possible to go back further based on bank deposits only. The 2020 observation is for October.

[2] More specifically, it is the ratio of notes and coin in circulation held outside banks and building societies by the 'M4 private sector' relative to the total amount the M4 private sector holds as deposits with banks and building societies. The M4 private sector includes households, non-profit institutions, private non-financial companies and financial companies other than banks and building societies. We often look at a slightly narrower measure of M4 called "M4ex" that excludes the deposits of certain financial institutions known as IOFCs that either intermediate between banks or are effectively extensions of the banking system. The two lines in the chart would be a little higher after 1997 using that measure.

[3] This measure was formerly known as M0 or the "monetary base" although we do not routinely produce this as an official series any more (although it can easily be constructed from our published statistics).

Chart: The ratio of central bank money[(a)] and coin to bank and building society deposits



Sources: Bank of England, Thomas and Dimsdale (2017) based on Sheppard (1971) and Capie and Webber (1985).

(a) The notes and coin in circulation data include Scottish and Irish notes in circulation excluding backing assets. Prior to 1921 the notes data include some private notes issued by English banks. The notes data also include Treasury Currency notes issued after 1914 which were brought onto the Bank's balance sheet at the end of 1928. See Thomas and Dimsdale (2017) for the breakdown and the following article https://webarchive.nationalarchives.gov.uk/20170823154420/http://www.bankofengland.co.uk/statistics/Documents/ms/articles/art1oct09.pdf.

(b) End calendar year data. The 2020 observation is for October.

Yours sincerely,