



**BANK OF ENGLAND**

**Ben Broadbent**  
Deputy Governor, Monetary Policy

The Rt Hon. Lord Forsyth of Drumlean  
Chair of the Economics Affairs Committee  
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London  
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4 June 2021

Dear Lord Forsyth

Many thanks for your letter dated 27 May 2021.

You asked whether I had any further points to make. I have two.

The first concerns the point Lord Chandos made about the market value of the assets in the Asset Purchase Facility (APF), and their effect on any transfers between the APF and the Treasury. The second point is about the impact of QE on the overall cost of government debt, net of any transfers within the boundary of the public sector.

*1. The impact of the APF on flows within the public sector*

As you know, the APF finances long-term assets (predominantly gilts) with a short-term liability (a loan from the Bank of England, charged at Bank Rate).

This “maturity transformation” is central to the way QE works. But it also means the coupon income and interest cost can differ. When Bank Rate falls below the average yield on the assets, at the time they were purchased, receipts will tend to exceed interest costs and the fund generates a cashflow surplus. This has generally been the case since the facility was created 12 years ago. During that time, the APF has generated positive net cashflow of £112.5bn, all of which has been transferred to H M Treasury. Conversely, were Bank Rate to rise above that average yield, and the fund’s interest costs therefore to exceed its coupon receipts, the cashflow would turn negative. The Treasury would then reimburse the APF. The nature and the determinants of these flows has been highlighted by the Bank of England on several occasions and over several years.<sup>1</sup> In response to the review of QE by the Independent Evaluation Office, the Bank will publish further analysis on this later this year.

As Lord Chandos pointed out, the differing nature of its assets and liabilities also means the mark-to-market value of the APF can vary over time. While the value of the liabilities is fixed, rising bond yields depress the price of the assets (the one is the counterpart to the other), falling yields do the opposite. However, these revaluations have no direct bearing on flows between the APF and the Treasury unless there are actual transactions at the new prices.

That’s certainly possible. For example, reinvesting the proceeds of maturing debt will result in a small loss if the bonds were originally bought at above their par value (to which the price tends to converge at maturity). This has tended to be the case through much of the QE period, but the effect is small and, thus far, it has been

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<sup>1</sup> See for example, the exchange of letters between Mervyn King and George Osborne in 2012, published [here](#); [Mclaren and Smith \(2013\)](#), “The profile of cash transfers between the Asset Purchase Facility and Her majesty’s Treasury”, Quarterly Bulletin, Vol. 53, No.1, pages 29-37; [Weale \(2016\)](#), “Unconventional monetary policy”; [IEO Review \(2021\)](#) “IEO evaluation of the Bank of England’s approach to quantitative easing” and the Bank of England’s [response](#).

significantly outweighed by positive net coupon receipts (the figure of £112.5bn is net of this reinvestment effect). Similarly, if the MPC decided at some future date actively to sell the assets in the APF, before they mature, any intervening change in value would then be realised, with a corresponding effect on net cashflow. But in the absence of such transactions mark-to-market gains or losses on gilts have no impact on these flows.

From an accounting perspective I think this makes sense. If every change in bond yields necessitated transfers between the APF and Treasury, one way or the other, those flows would become very volatile. More significantly, perhaps, it would have wider implications for the government balance sheet that many people would, I suspect, find a bit counter-intuitive. It would imply in particular that the government – for which government debt is obviously a liability not an asset – should be considered better off when bond yields rise (because the market value of its liabilities would decline).

At any rate, the approach means that swings in the value of its assets, whether up or down, have no direct bearing on flows in or out of the fund. For much of the past few years bond prices have generally risen (yields have on average declined). That has resulted in a small capital gain on the assets of the APF, contributing to what is scored in its accounts as “the value of the indemnity”. But that sum has not been transferred to the Treasury.

## *2. The impact of the APF on flows between the public and private sectors (the overall cost of government debt)*

It is often said that the APF has made the cost of government’s debt costs “more sensitive” to interest rates. I wanted to try and explain more precisely the sense in which this is true – and the sense in which it’s not.

It’s helpful for this purpose to think of the government and APF balance sheets not separately but as a consolidated whole. The effect of QE is to lower the maturity of the liabilities of that consolidated balance sheet. It replaces some of the private sector’s longer-term, interest-bearing claims on the public sector (gilts) with short-term versions of the same (reserves at the Bank of England). If there had been no APF but the DMO had instead, over the years, issued more short-term than long-term debt, the fiscal implications would be similar. Those fiscal implications do not include the long-run impact of permanent changes in interest rates and bond yields. That long-run impact is unaffected by the maturity of the debt (or, therefore, the presence of the APF). If the whole yield curve were to shift up by one percentage point, for example, the annual cost to the government would eventually be an extra 1% of its outstanding liabilities – currently around £20bn – regardless of their maturity.

What a shorter maturity does mean is that (i) the government’s overall debt costs (including any payments to the APF) are at the margin more sensitive to shorter-term rates, relative to longer-term yields, and (ii) the impact of any lasting change in short and long rates tends to come through more quickly. The surplus generated by the APF over the past few years, in an environment of falling interest rates and bond yields, illustrates precisely that effect.

Even then, however, these effects should not be seen in isolation because, in the background, the maturity of the gilt stock has actually risen quite a bit since QE was first conducted back in 2009. Based on face values, the weighted average maturity of gilts has gone from 13½ to 15 years in that time. Taking into account the effect of the APF, the overall maturity of the state’s consolidated liabilities (the Bank and government balance sheets together) is lower than this – 10½ years as opposed to 15 - but it’s not much lower than it was in the mid-2000s. And it remains materially higher than in other developed economies. Adjusted for QE, the weighted average maturity in both the Euro area and US is several years less than in the UK – the equivalent figure in the Euro area is 5½ years. In the United States it’s 4.

So it’s true that, were there a lasting rise in global interest rates, across the curve, QE would hasten the resulting increase in the cost of government debt (all else equal). But it has no bearing on the eventual cost of such a rise. In the UK, this effect has been offset to a degree by a lengthening in the average maturity of the stock of gilts (all else has not been equal). It remains the case, as it was before QE began, that the extra cost would come through more slowly than in other jurisdictions.

Yours sincerely

A handwritten signature in black ink, appearing to read "Ben Broadbent". The signature is written in a cursive, flowing style.

Ben Broadbent  
Deputy Governor, Monetary Policy