The Bank of England wriggles again over its bonds

We are due a reconsideration of the Bank's policy of running down its bond holdings by £100bn a year. It looks as if they will reconfirm they will carry on with it, and update or change the reasons.

The US Federal reserve Board faced with the same problem of a large portfolio of bonds bought at very high prices when interest rates were low has refused to sell bonds in the market at a loss as the Bank of England does. It has allowed its portfolio to reduce as bonds come due for repayment. It has recently reduced the pace of doing this, reinvesting some of the maturing bonds to avoid a bigger lurch in the size of the portfolio. It does not receive a cent of taxpayer money to cover its losses. It just places the losses onto its balance sheet with a matching asset for "future profits" as it can do as a Central bank which can create money it wants as it needs it. The Fed cut the rate of decline in its bond assets as it was worried it was squeezing commercial banks too much who have deposits at the Central Bank to finance the bonds. If their deposits fall too low they will lend less and there will be less money and credit around.

The Bank of England aware that it may well be over squeezing with its aggressive reduction in bonds and commercial bank reserves has launched a new facility for commercial banks. Those that have been squeezed too much by the bond policy can borrow money from the Bank to lend on to customers. The Bank of England is at least honest enough to admit it has no idea what is the correct level of commercial bank reserves and of bond holdings to have, so it lets banks get out of a hole of its making by lending them more if necessary. Why get into the hole in the first place?

The Bank loses money for UK taxpayers in two ways. It needlessly takes big losses on selling long bonds instead of holding them to repayment at a higher price. It has a running loss on the difference between the money it pays commercial banks on their reserves and the low rate of interest it gets on bonds which it bought at very high prices. The ECB has cut its losses on holding bonds by requiring EU banks to deposit a minimum level of money as reserves with no interest payable.It pays a lower rate of interest on the additional deposits than its fixed base rate. The Bank of England used to pay no interest on commercial bank reserves at all until 2006.

The Bank always needed government permission for the bonds and insisted on a full guarantee to pay the obvious losses they would make. As a result the Bank has made a big hole in fiscal policy, not its territory. Why do we allow this to carry on?