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Bank of England May End Bond Buying

By JULIA WERDIGIER AUG. 5, 2009

LONDON — Five months ago, the Bank of England started a controversial program to purchase financial assets to help put Britain's economy back on its feet.

On Thursday, the central bank's policy committee is expected to decide whether to end the program.

Economists and investors are split. Those who favor an expansion say the plan has only marginally improved the supply of credit and more needs to be done. Those who oppose an extension say that Britain's economy is showing signs of improvement and no further asset purchases are needed.

Recent comments and actions by Bank of England officials point toward a temporary halt of the plan as the central bank awaits clearer signs of whether a recovery is under way.

Back in March, the central bank initially planned to buy government bonds and other assets like commercial paper worth £75 billion ($127 billion) with newly created money. It raised the amount to £125 billion two months later as the economy deteriorated. In July the central bank voted against raising the amount again and that sum has now been spent.

Since the start of the program, concerns about the fragility of Britain's economy have somewhat abated. Yields on government and corporate bonds have fallen, which could bring down some borrowing costs.

Recent economic data have offered some reason for optimism. The service sector expanded the most in more than a year in July, and manufacturing unexpectedly rose as companies produced more cars and computers. Also in July, consumer sentiment improved and house prices increased for a third month.

"If you see the economy improving, you don't want to come in with the same actions as you did when the situation was really dire," said Simon Hayes, an economist at Barclays Capital in London.

Others argued that it was too early to stop the program. The British Chambers of Commerce, a business lobby group, said on Wednesday that the bank must not "be lulled into a false sense of security" by the recent data and should continue the program.

One reason opinions vary so much is that the effectiveness of quantitative easing, or the asset purchases, is extremely difficult to measure. The program coincided with several other government plans to counter a credit squeeze, from guaranteeing some assets to putting political pressure on bank executives to lend more.

History is not much help, either, since economists still cannot agree on the effects of a similar program of quantitative easing in Japan at the beginning of the century.

"It's impossible to know whether it worked, but if you want to expand quantitative easing, then you have to think that it is working and that £125 billion isn't enough," said Amit Kara, an economist at UBS in London and a former Bank of England official.

Mervyn King, governor of the Bank of England, said the main goal of the asset purchase program was to increase the supply of credit to the wider economy: The central bank's debt purchases would free up banks to lend more.

Michael Taylor, a senior economist at Lombard Street Research in London, said this objective had not been reached yet, a reason for the central bank to continue to buy government bonds.

“It’s the right policy,” Mr. Taylor said. “They just need to throw more mud at the wall for more of it to stick.”

Banks remain reluctant to lend as they take larger write-downs from loan losses.

Lending to retail or manufacturing companies and other nonfinancial firms fell by a record £14.7 billion in the second quarter. This, in turn, has reignited criticism that lenders are hoarding the newly created funds.

Some economists also warned that halting the asset-purchase plan might send a signal to the consumer that the Bank of England was moving closer to increasing interest rates again, which could stop any recovery in its tracks.

Others said improving the availability of credit would not be enough to repair Britain’s economy because there was also a lack of demand for loans as companies shrink rather than expand.

A recent comment by Charles R. Bean, the central bank’s deputy governor responsible for monetary policy, hinted that the bank might prefer a wait-and-see approach. Mr. Bean said in July that quantitative easing could take nine or more months to show effects and work itself through the financial system, and indicated that the central bank would prefer to keep an eye on economic data until November before making a decision.

The Federal Reserve, the only other central bank that decided in favor of large-scale quantitative easing, already has started to scale back the measures it set up to help end the recession. It announced in June that it would not extend one of its emergency lending programs and would cut back two others.

The European Central Bank, which is to announce its interest rate decision on Thursday, has resisted pressures to adopt any such measures.

Economists who support a halt in quantitative easing said Britain's economy was in better shape now than it was in May, when the central bank expanded the program. "There have been reasonable indications that the economy is recovering and you'd expect money flow to go along with that," Mr. Hayes said. "When they extended the program there was a lot of concern about deflation. That has eased now."

"There is an argument for extending the program because it's better to err on the side of aggression," Mr. Hayes said. "But for the bank, the £125 billion was already erring on the side of aggression."

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