FIXING THE LEAK

HOW TO END THE £22 BILLION ANNUAL TAXPAYER LOSSES AT THE BANK OF ENGLAND

Carsten Jung

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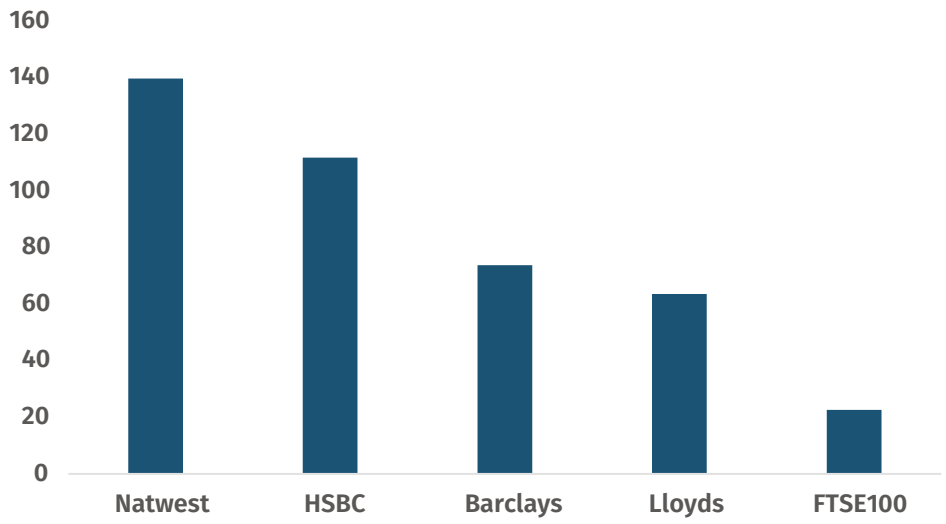
SUMMARY

Since December 2021, the Bank of England has increased its interest rate from close to zero to a peak of 5.25 per cent, although it currently stands at 4 per cent.[1] While high interest rates were aimed at reducing inflation, they also had an unintended effect on the Bank of England's massive government bond buying – 'quantitative easing' (QE) – programme. After a period of making significant profits on this programme, the Bank of England is now making record losses, which is historically very unusual for central banks.[2] And the Treasury is paying for these losses, making the UK an international outlier. The set-up was never meant to work this way (Tucker 2022).

The sums involved are staggering: Bank of England losses will cost the taxpayer £22 billion a year (OBR 2025) in every year of this parliament. This is equivalent to about 1.5 per cent of total tax revenue. And it is about the same as the annual budget of the entire Home Office (including policing and public safety). The net lifetime cost of it is estimated to be £134 billion (OBR 2025). The Treasury pays these funds to the Bank of England, and directly feeds into commercial banks' revenues and, if not passed on to customers, profits. Moreover, under current conditions, the faster the Bank of England unwinds its QE operation, the more it costs the Treasury.

FIGURE S1: UK COMMERCIAL BANK SHARE PRICES HAVE DOUBLED SINCE THE BANK OF ENGLAND STARTED INCREASING INTEREST RATES, WHILE THE FTSE HAS INCREASED BY ONLY 22 PER CENT

Percentage increase in commercial bank share prices between December 2021 and May 2025



Source: IPPR analysis of LSEG

1 Announced on 7 August 2025 (Bank of England 2025a).

2 Other central banks have also made losses (but smaller ones). But their accounting treatment of them was different, meaning it did not fall onto their countries' treasuries to pay for them immediately.

These losses come from two sources: valuation losses from selling government bonds below purchase value; and interest rate losses. The interest rate losses can be described as a government subsidy to commercial banks. QE here was a risk transfer to the public sector, which is now resulting in losses, while crucial public services face severe funding pressures. Given the lack of competition and dynamism in the UK banking sector, this subsidy is largely not passed on to savers. Instead, it mostly accrues to bank shareholders as windfall profits. Profits of the top four banks – HSBC, Barclays, Lloyds and NatWest – are up by £22 billion compared to before the Covid-19 pandemic, having more than doubled. And even the limited pass-through of higher rates to depositors that does take place is not benefitting those hit hardest by the cost of living crisis. The poorest third of households have no savings deposits in commercial banks on which they could earn interest (FCA 2023).

Given these windfall profits, the top four banks' share prices doubled between the end of 2021 and May 2025 (see figure S1). Meanwhile, the number of children in poverty has increased by over half a million (JRF 2024).

The other part of the losses are due to the Bank of England selling the gilts it holds from QE at 'dumping prices'. By doing so, it is realising, on average, **£13 billion of valuation losses in every year of this parliament**. The gains on the other side of these losses do not have a direct private sector counterpart, but are falling on a dispersed web of financial sector participants.

To address this issue, we recommend a two-pronged approach.

INTRODUCE A 'QE RESERVES INCOME LEVY'

First, to recoup interest rate losses for the taxpayer currently occurring at the Bank of England, the government should implement a 'QE reserves income levy' on commercial banks. This could be targeted at the windfall profits directly linked to 'QE-related reserves' and thus the Bank of England's losses. It would only apply to reserves that are 'QE-related', and not those that are held for liquidity and other operational purposes. Moreover, we recommend targeting only the 'windfall profits element' (taxing reserve returns in excess of 2 per cent). We estimate that this could prevent between £35 billion and £40 billion of taxpayer losses over the course of this parliament. This would boost fiscal headroom against the current budget by £5 billion to £7 billion by the end of this parliament (depending on the speed of quantitative tightening). The receipts could be used for supporting households and growth. Tax receipts will fall to zero once all QE-related gilts are off the Bank of England's balance sheet (through sales or redemptions), or when the bank rate reaches 2 per cent. This is thus not a permanent tax.

While this levy would hit commercial banks' bottom lines, **it would still leave them with substantially higher profits** (including from non-QE-related funding) **than before interest rates rose**. The tax would capture only a small share of commercial banks' overall increase in profits compared to before the Covid-19 pandemic. **It would not be a tax on commercial banks' general activity, but only on the element that is related to the Bank of England's QE and windfall profits.** None of the banks' remaining activities would be impacted.[3] Given this targeted nature of the tax, it should have only a small impact, if any, on UK banks' competitiveness. Moreover, given the tax would be aimed at taxing 'pure rent', economic theory suggests that it should not be distortive and thus it will have minimal effects on UK banks' competitiveness. In practice, commercial banks might still pass on some of the reduction in interest receipts (due to the tax) to their customers. However, we

3 However, some might argue that if there is a lack of competition in the UK banking system – and thus excess profits across business lines – a more general profits levy would be optimal.

argue that the significant fiscal savings could be used in a much more targeted way to support households, businesses and growth in the UK.

We propose exempting smaller banks, with assets below £25 billion, from the tax. This would help improve competitive dynamics in the UK retail banking market, which the big four incumbents still dominate. It would also put competitive pressure on larger banks to not merely pass on the levy to their customers.

A number of commentators – including the Bank of England's former deputy governor and Monetary Policy Committee member, Paul Tucker – have suggested that this problem of Bank of England losses could be addressed by so-called 'tiered reserves'. But the Bank of England has said that it would prefer for this to be done via a tax (Bailey 2025). We thus propose a tax that has close to the same effect as tiered reserves, but in some ways is fiscally clearer. In line with Tucker (2022), we argue that monetary transmission should be largely unaffected by this.

We also considered proposals, such as increasing the banking-company corporation-tax surcharge or a levy on banks' net interest income (NII) (Youel and McLaughlin 2025), which would raise the existing tax on banks' overall profits. This would have the advantage of being easier to implement, but we consider it a second best as it is less clearly targeted at the subsidy stemming from the flawed implementation of QE.

There are a number of UK and international parallels to this approach. For example, **Margaret Thatcher's government introduced a 2.5 per cent deposit tax on banks in 1981** after it saw profits surge due to increased interest rates.[4] Thatcher explicitly justified this tax on the grounds that banks "had made their large profits as a result of our policy of high interest rates rather than because of increased efficiency or better service to the customer" (Youel and McLaughlin 2025). And Spain applies a 4.8 per cent charge on net-interest income (NII) – that is, the profits made from customer deposits and similar activities.

Finally, the design of the tax would mean that if the bank rate falls below 2 per cent, tax receipts from it would fall to zero. But this is also approximately the point at which the Bank of England would stop making interest rate losses. In other words, if interest rates fall quicker than the most recent Office for Budget Responsibility (OBR) forecast, this would equally reduce fiscal pressures.

URGE THE BANK OF ENGLAND TO SLOW THE PACE OF QUANTITATIVE TIGHTENING

Second, the government should urge the Bank of England to review and better manage the fiscal implications of its policies, in particular slowing the pace of the unwinding of QE – so-called quantitative tightening (QT) – and any future QE. It could do so by urging the Bank of England to slow QT in its annual remit better. (Another option would be for the government to amend the Bank of England Act 1998 slightly. Giles (2024) proposed to add that the Bank of England should have "regard to public finances".)

If the Bank of England, as result, did actively stop the sales of government bonds – as have the US Federal Reserve and the European Central Bank – it could reduce valuation losses, which the Treasury pays for.[5] We estimate that this could save more than £10 billion a year and the OBR implies that it could save £18 billion a year on average in this parliament. This is because it would slow the speed of the sale of gilts below the value that the OBR had acquired them, or stop the sale

4 It took the form of a 2.5 per cent levy on non-interest-bearing sterling deposits above £10 million.

5 There would still be losses amounting to the difference between purchase value and par value of gilts. But losses would be reduced by about half, by the difference between par value and fair value at sale

completely. Currently, the gilts on the Bank of England's balance sheet are worth about 26 per cent less than when they were acquired (Bank of England 2025b). Slowing sales would also mean that commercial banks would have a relatively larger stock of reserves at the Bank of England, yielding higher tax receipts from the QE reserves levy proposed earlier. This would benefit both the Public Sector Net Financial Liabilities (PSNFL) measure[6] and current budget targets.

This would be a change in monetary policy stance, but likely a small one. It would be up to the Bank of England to set out whether there would be any impacts on its interest policies. Based on the various Bank of England publications on this topic, stopping active QT sales entirely might have a small effect on yields, about 10–20 basis points on longer-dated yields, and it might even make monetary policy implementation more straightforward (Mann 2025). Another former Monetary Policy Committee member said that the Bank of England "has not used QT as an active tightening tool" (Tenreyro 2023), implying that the Bank of England might potentially not have to alter its interest policy at all if it were to stop active sales. In either case, the Bank of England should spell out the trade-offs between QT's monetary policy impact and its significant fiscal implications, as this is currently not the case. Clarifying this would help make monetary policy more independent.

Looking further ahead, the Bank of England should consider how it could improve the future implementation of QE in ways that better limit the fiscal implications and improve monetary independence. Ultimately, this would merely be moving to a set-up similar to that of other advanced economies that are avoiding disastrous unexpected fiscal effects of central bank policies.

To sum up, both of our recommendations could be implemented separately. First, the government could legislate the QE reserves income levy, which would affect commercial banks' profits related to the flawed implementation of QE. This could save the exchequer between £35 and £40 billion over this parliament. Second, active QT sales could result from a slight change to the annual remit letter, but ultimately it would of course be the Bank of England's decision. This could lead to valuation loss savings of £63 billion in this parliament. There would be no immediate 'losers' from this, but it might impact the longer end of the yield curve. The Bank of England might have to take this into account in its monetary policy decisions, although the impact is likely to be small.

None of this would be a meaningful change to the UK's monetary policy regime. Other major economies have introduced similar schemes with negligible effects on monetary policy and credibility. The European Central Bank introduced tiered reserves, both the European Central Bank and the US Federal Reserve stopped active QT sales and there have been various cases of taxes to recoup interest losses – for example in Spain and Margaret Thatcher's tax. In fact, our proposed policies would strengthen monetary policy independence by reducing the entanglement of the Bank of England and the Treasury.

6 It would do so gradually over the gilts' maturity horizon, rather than immediately, everything else being equal. That is because bonds are measured at mark-to-market values, which feed into PSNFL immediately. This mark-to-market PSNFL reverses over time if the bonds are held to maturity (assuming an unchanged bank rate).

1. HOW THE BANK OF ENGLAND ARRIVED AT £22 BILLION ANNUAL LOSSES

To boost the economy in the 12 years after the financial crash in 2008, the Bank of England engaged in quantitative easing (QE). It bought a large amount of government bonds (gilts) in order to lower interest rates across the economy. The policy was important for delivering economic stability and economic stimulus during the financial crisis and the Covid-19 pandemic; albeit the size of its benefits are "uncertain and time-varying" (Bank of England 2022). As a result, as at mid-July 2025, the Bank of England still had £587 billion of gilts on its balance sheet, making it the largest holder of UK government bonds globally.

The Bank of England acquired UK government bonds ('gilts') from commercial banks and in turn created new reserves for commercial banks, on which it pays interest at the Bank of England's bank rate. It created reserves on its balance sheet and used the proceeds to buy gilts.[7] One simplified way of looking at this process is that the Bank of England 'borrowed' from commercial banks (at the bank rate) in order to 'invest' in fixed-interest gilts (see figure 1.1).

FIGURE 1.1: DURING QE, THE BANK OF ENGLAND 'BORROWED' FROM COMMERCIAL BANKS TO BUY GILTS

Source: Author's analysis

While the base rate was low, this was 'a good investment' – the gilts yielded higher returns than it cost to 'borrow' from commercial banks. But as interest rates rose in response to inflation, the Bank of England started making a loss on this investment. The 'investment' turned sour (see figure 1.2).[8] One way to describe this is that QE was a transfer of interest rate risk from the public to the private sector.

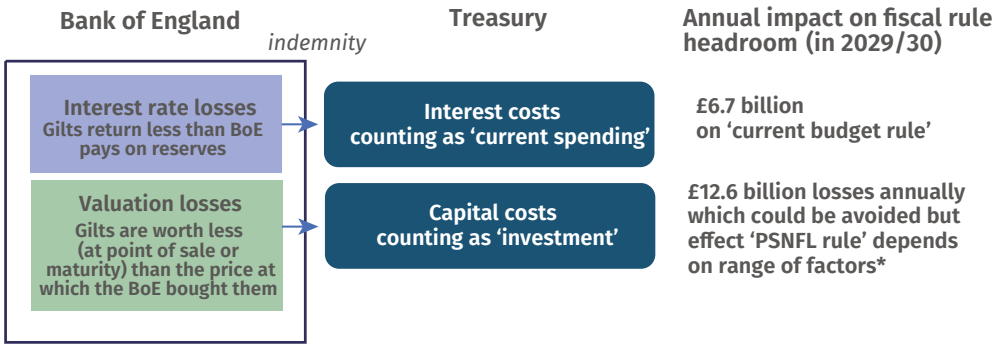
7 As part of money creation in the modern economy, the central bank can create reserves for commercial banks 'out of thin air', which allow it to conduct QE.

8 The resulting Bank of England losses are not necessarily an argument against QE. The primary purpose of QE was not to make money, but rather for large-scale gilt purchases to boost economy-wide lending and growth. This largely worked (see Battarai and Neely 2016). The losses should be seen as an unintended by-product. But, most central banks would argue, it is a price worth paying for the benefits of QE. The UK's arrangement, however, is leading to a total net cost for the exchequer that is projected to be £104 billion over the Asset Purchase Facility's lifetime (OBR 2024b).

There are two sources of these losses:

- **Interest rate losses.** The Bank of England now pays almost double the interest rate on reserves than it receives on the gilts it holds. When the Treasury reimburses the Bank of England for these losses, they count as government interest rate costs and thus directly impact the chancellor's current budget rule.
- **Valuation losses.** The Bank of England is selling gilts at a lower price than it bought them for, as part of its unwinding of QE, or quantitative tightening (QT). Currently, its gilt holdings are worth 26 per cent less than the buying price (Bank of England 2024). These losses are accounted for as capital spending and directly impact the chancellor's Public Sector Net Financial Liabilities (PSNFL) rule.

FIGURE 1.2: THE BANK OF ENGLAND IS MAKING INTEREST RATE AND VALUATION LOSSES, WHICH AFFECT HEADROOM AGAINST CHANCELLOR RACHEL REEVES' FISCAL RULES



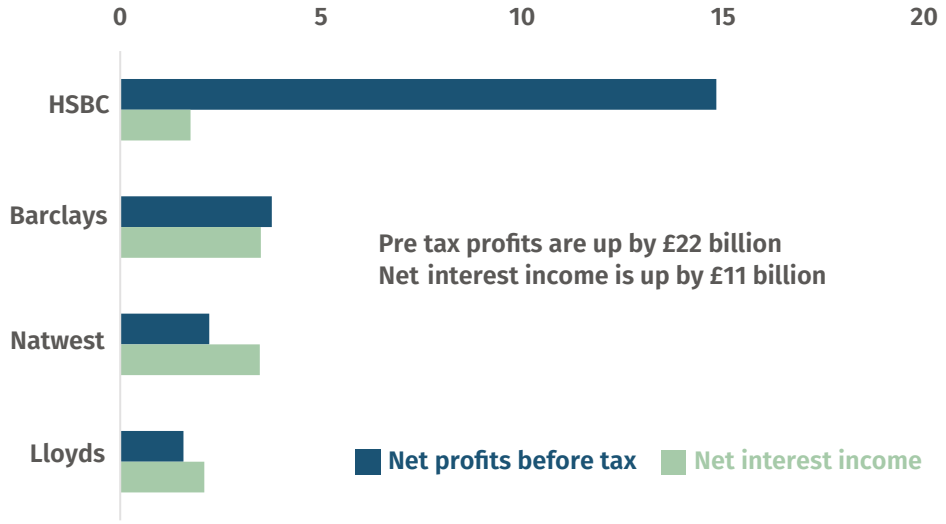
Source: IPPR analysis of OBR, 'The sensitivity of the Asset Purchase Facility to market conditions' (OBR 2024a) and OBR, *Economic and Fiscal Outlook: March 2025* (OBR 2025)
Note: We assume a 2 per cent average yield of outstanding Asset Purchase Facility gilt holdings. Our overall bottom-up estimate for losses is about £1 billion below that of the OBR. The impact on the Public Sector Net Financial Liabilities (PSNFL) rule depends on a range of factors such as the maturity of bonds held in the Asset Purchase Facility. The PSNFL rule captures mark-to-market losses at the Bank of England, but the Treasury only pays these once realised upon sale. If the Bank of the England chose not to sell the assets, it would avoid some losses. Losses would be reduced by about half, by the difference between par value and fair value at sale. But PSNFL would improve gradually over the maturity of the bond – this is called the 'pull to par' effect.

2. THE FLIPSIDE OF THE BANK OF ENGLAND'S INTEREST RATE LOSSES

The mirror image of public losses at the Bank of England are private sector gains. Quantitative easing (QE), which the Bank of England began in 2009, created a huge amount of reserves – at least £600 billion of QE-related reserves is still outstanding – that private banks hold at the Bank of England, and these reserves are now earning high returns. But earnings on the reserves skyrocketed, while the deposit rates did not rise commensurately. Accordingly, net interest income – the profits made on deposits and other related products – for all four top banks increased by more than 20 per cent (about £11 billion) between 2019 and 2024 (see figure 2.1). Valuation losses at the Bank of England have a less clear immediate private sector counterpart. Gains are distributed across past and future private sector gilt holders.

FIGURE 2.1: THE BIG FOUR COMMERCIAL BANKS' PRE-TAX PROFITS INCREASED BY £22 BILLION COMPARED TO BEFORE THE COVID-19 PANDEMIC

£ billion increase in pre-tax profits compared to 2019



Source: IPPR analysis of LSEG

In a perfectly competitive market, a higher bank rate would be largely passed through to depositors, but the lack of competition and dynamism in the UK market meant that this did not take place. The largest banks (including the 'big four') only passed on a fraction of these high interest rates to their deposit holders. The result was sharply rising profits (see figure 2.1). The Financial Conduct Authority noted that "the largest firms generally continue to pay below

the market average for standard easy access products" (FCA 2024). In May 2023, when the base rate was 4.5 per cent, the big nine firms' easy-access accounts averaged 1.25 per cent, representing a 3.25 percentage-point spread below the base rate (FCA 2023). This spread was at the upper bound of historical norms, for example compared to the 2000–07 period. For easy-access deposits, the Financial Conduct Authority found that the pass-through rate of interest rates was only 28 per cent (FCA 2023). **This means that, for these products, banks made up to 70 pence profit for every pound of interest paid to depositors.**

Given this limited pass-through, the risk-free reserves held at the Bank of England yielded what are called 'unearned profits' for commercial banks. They are called unearned because no value-adding financial intermediation took place – banks simply did not pass on the risk-free rate to customers.[9] This is the same mechanism that Margaret Thatcher identified (see the quote in the Summary). In economics, these are called 'pure rents' because they are profits that are not generated by productive activity.

Before the Covid-19 pandemic, there had been some concerns about commercial banks' low profitability. However, their profitability has now returned to healthy levels, including from non-interest business lines (Bank of England 2025c).

Even the modest interest rate pass-through that did take place ('modest' compared to how much the base rate increased) did not benefit those who were hardest hit by the cost of living crisis. In the UK, richer households hold the majority of bank deposits (on which they earn higher returns), while the bottom third of the population have virtually no savings at all (see box 1).

BOX 1: THOSE HIT HARDEST BY THE COST OF LIVING CRISIS ARE NOT BENEFITTING FROM HIGHER RATES ON SAVINGS

Deposit savings vary dramatically across the population. In 2024, up to 34 per cent of adults had either no savings or less than £1,000 in savings accounts, while the average amount held in UK savings accounts was £17,365. This substantial gap between those with minimal savings and the average suggests a significant concentration of savings accounts with higher balances (O'Brien 2024). Furthermore, in 2019, around 40 per cent of working-age individuals (aged 20–59) had less than £2,000 in overall financial wealth (Boileau et al 2023). The persistence of low savings is notable, with 70 per cent of those with low financial wealth in 2018–20 having maintained low savings levels for four consecutive years (Boileau et al 2023).

9 This is why it is wrong to call our proposed tax a tax on financial intermediation. Another way of framing it is that private banks earned the seigniorage that would usually fall onto the Bank of England. The way that QE was implemented affected this.

3. RECOMMENDATIONS

RECOMMENDATION 1: RETURN THE SUBSIDY FOR COMMERCIAL BANKS FROM QUANTITATIVE EASING (QE)

To recoup some of the costs to the taxpayer currently occurring due to the flawed implementation of quantitative easing (QE), the government should put a 'QE reserves income levy' on the subsidy paid to banks related to QE.

We propose the government implements this as a levy on the interest rates above 2 per cent that the Bank of England pays on QE-related reserves.[10] This is a straightforward way to claw back today's liquidity subsidy. It would be the tax that closely mimics some of the 'tiered reserves' proposals that former Bank of England deputy governor Paul Tucker (Tucker 2022) and Chris Giles (Giles 2024), for instance, have advocated for. But it would have the advantage that the government could implement it rather than the Bank of England. This means it could be more explicitly designed to address the unintended fiscal implications of the Bank of England's QE. Our proposed design also complements the Financial Conduct Authority's push for fairer savings rates and competition in the retail market.

It would be relatively straightforward to implement. The tax base is a single number generated mechanically in the Bank of England's payment system. So, the measure is easy to legislate and impossible for commercial banks to relabel or shift offshore. That is because aggregate reserves can only fall if the Bank of England actively reduces their supply. Commercial banks can withdraw their reserves from the Bank of England, but only by 'selling' them to other commercial banks. The corporate banking sector as a whole therefore cannot reduce the central bank reserves it holds. In other words, the amount of QE-related central bank reserves in circulation is a policy decision by the Bank of England. It is this that makes them special and different from 'normal intermediation'.

By being aimed at removing the subsidy leading to excess returns – the pure economic rent that stems from sticky customer deposits rather than banks' marginal funding costs – the levy *in theory* does not raise the cost of additional lending or deposits at the margin. Because it is calibrated precisely to the QE-related reserve stock and preserves a 2 per cent floor, banks' core incentives remain unchanged. That said, it would hit commercial banks' bottom lines but it would still leave them with substantially higher profits (stemming from non-QE-related funding) than before the Covid-19 pandemic: the tax would raise only a small share of commercial banks' overall increase in profits compared to pre-pandemic. It would not be a tax on commercial banks' general activity, but only the element that is related to the Bank of England's QE. Given the tax is aimed at taxing 'pure rent', economic theory suggests that it should not be distortive and

10 A deposit beta tax is, in theory, the first-best policy theory. Deposit beta refers to the wedge between the interest rate paid on reserves and that passed on to customers. It targets the precise rent created when banks pass on less than the full policy-rate rise to savers. In practice, though, it needs granular product-level data, agreement on look-back windows and β definitions, and heavy auditing. The scope for gaming – for example, repackaging deposits as sweep funds or tweaking teaser rates – would be high, and the liability would crystallise only with a long lag, making receipts volatile and backdated. Given those operational headaches and avoidance risks, we have decided against that route for now.

thus it will have minimal effects on UK banks' competitiveness.[11] Moreover, after clawing back the subsidy to banks, it could be spent more wisely in ways that more clearly support growth – in ways that windfall profits for bank shareholders do not.

How the tax could be designed

Tax base

- **Tax the interest paid on reserves in excess of each bank's core-liquidity allowance** – for instance, defined as 1 per cent of its total sterling assets. This is in effect 'the first tier' of reserves, which is not taxed in any way. The interest on marginal reserves – the marginal rate – is the core channel through which the Bank of England's monetary policy would transmit (Tucker 2022). It is important that the ultimate definition encapsulates the needs of wholesale banks in the UK with sterling reserves assets, who use reserves for managing intraday liquidity, clearing and custody. The exact metric should be determined in close consultation with the Bank of England. We therefore describe the tax base as 'QE-related reserve holdings', as they will be largely held as a result of the Bank of England's QE balance sheet expansion.
- The tax should apply to all UK-incorporated banks and UK branches of foreign banks with sterling assets above £25 billion and building societies. The exact asset cut-off should be decided in coordination with the Bank of England and the Financial Conduct Authority. Exempting smaller institutions would help the Bank of England's competition mandate and the Financial Conduct Authority's objective for achieving better results for retail deposit holders.

Tax rate

We recommend setting the tax rate of QE-related reserves, such as taxing the interest revenue on reserves above 2 per cent.

The tax take can be calculated as shown in equation (1).

(1) tax payments on QE-related reserves by bank i
= max(bank rate-2%,0)* QE-related reserves by bank i

Table 3.1 shows what this would yield over the current parliament. The cumulative return of the tax would be £34 billion on the current path of QE and £41 billion if active sales of gilts were stopped over the course of the parliament. Stopping active gilt sales would also avoid about half of the valuation losses, which, according to the Bank of England's most recent Asset Purchase Facility report (Bank of England 2025b), could be 26 per cent. Slower quantitative tightening (QT) and the QE reserves income levy could lead to total fiscal savings of almost £104 billion over the course of this parliament (as shown in table 3.1).

Even though a straightforward tax instrument, a downside of this proposal is that it will still need to be considered in the Bank of England's monetary policy implementation. However, the impact will likely be limited. As former Bank of England deputy governor Paul Tucker argues (Tucker 2022), what matters for monetary policy implementation is the interest rate on the marginal reserve. In particular, whether a commercial bank lends in the interbank market or deposits at the Bank of England depends on the return on that marginal reserve, rather than the return on the bulk of existing reserves.

11 In practice, the reduction in the return on reserves could have some allocative consequences, some of them positive. It might lead individual banks to expand their balance sheet, extending more loans to increase returns.

TABLE 3.1: PROJECTED FISCAL SAVINGS FROM A QE RESERVES INCOME LEVY AND FROM STOPPING ACTIVE QT SALES (£ BILLIONS)

	2025/26	2026/27	2027/28	2028/29	2029/30	Cumulative
Levy revenue (baseline QT)	10.0	7.5	6.2	5.0	3.6	32.3
Public sector net interest savings (baseline QT)	10.0	7.9	6.9	5.9	4.7	35.5
Public sector net interest savings (no active QT sales)	10.0	8.4	7.9	7.4	6.7	40.4
Valuation savings from no active QT sales	12.5	12.5	12.5	12.5	12.8	62.8
Total net fiscal savings (no active QT sales)	**22.5**	**20.9**	**20.4**	**19.9**	**19.5**	**103.3**
Assumed Bank rate (OBR March 2025), per cent*	4.0	3.8	3.8	3.8	3.8	
	APF losses with no policy change					
APF carry losses (baseline QT)	11.2	8.3	6.9	5.5	4.0	35.8
APF carry losses (no active QT sales)	12.1	10.0	9.5	9.0	8.3	48.9
APF valuation losses (OBR estimate)	12.7	17.6	19.5	22.5	19.3	91.6
Change in APF cash	-5.6	-2.1	-2.8	-2.4	-2.0	-14.9
Total APF losses	**18.3**	**23.8**	**23.6**	**25.6**	**21.3**	**112.5**

Source: IPPR analysis of Bank of England, *Bank of England Asset Purchase Facility Fund Limited: Annual report and accounts: 1 March 2024 – 28 February 2025* (Bank of England 2025b) and OBR, *Economic and Fiscal Outlook: March 2025* (OBR 2025)

Notes: APF = Asset Purchase Facility. The APF is the vehicle via which the Bank of England implemented quantitative easing (QE). We approximated the amount of overall QE-related reserves by using the number of outstanding gilts in the APF, valued at purchase value, based on OBR (2025). We excluded reserves held by smaller banks, which is assumed to lower taxable reserves for small banks by 10 per cent. We estimated the losses from selling gilts early at the valuation loss between fair-value and purchase-value APF gilt holdings according to the Bank of England's 2024/25 APF annual report. We assumed an average effective yield of the APF gilt portfolio of 2 per cent. APF carry losses are the same as the 'Bank of England losses' mentioned elsewhere in this report. Public sector net interest savings include the interest savings from the lower public debt stock caused by lower APF losses. It also assumes that the excess reserves from slower QT are skewed towards larger banks. If this is not the case, public sector net valuation saving in this scenario could be £0.3bn lower in 2029/30.

A second-best approach to this would be to lift the banking-company corporation-tax surcharge, which is an existing tax on banks' overall profits. This would have the advantage of being easier to implement (as the surcharge already exists) and it would have slightly less interaction with monetary policy implementation. However, it would be a blunter tool, aimed at overall bank profitability rather than targeted at the flawed implementation of QE. We therefore consider it a cleaner way of reversing the subsidy for commercial banks. Also, the surcharge approach could, to some extent, be avoided by profit shifting abroad. A reserves income levy does not have this problem, because the Bank of England solely determines the overall supply of reserves – there is no room for avoidance.

RECOMMENDATION 2: THE BANK OF ENGLAND SHOULD STOP ACTIVE QT SALES

The Bank of England's primary objectives are ensuring both monetary and financial stability. But subject to achieving these, it should seek to prevent adverse fiscal effects of its policies, which undermine its independence. In the first instance, **the government should urge the Bank of England to stop active QT sales in its annual remit letter**. (Another option would be for the government to amend the Bank of England Act 1998 slightly. Giles (2024) proposed to add that the Bank of England should have "regard to public finances".)

There are four likely considerations in terms of how the Bank of England might better manage the fiscal implications of its policies. Some of them would require changes to Treasury policy too.

1. **The Bank of England could slow quantitative tightening**, or in other words the speed at which gilts are being sold. As argued above, the UK is currently doing this faster than other central banks. In the current context, this would mean fewer valuation losses. As discussed above, this might or might not require a change in the Bank of England's interest rate policy stance. Either way, the Bank of England would have to clearly spell out the trade-offs involved.
2. **The Bank of England could reduce interest losses through tiered reserves**, by changing the amount it pays on a share of the reserves that each commercial bank holds.[12] The European Central Bank and Switzerland are already doing this. This proposal would involve returning to a system similar to the pre-2009 system where only part of the commercial bank reserves at the Bank of England pays an interest – the Bank of England could change this at any time. It could be functionally the same as our proposed levy outlined above.
3. **The Bank of England might change the way in which it implements future QE, in ways that avoid future losses. But the Treasury, in conversation with the Bank of England, could keep the above proposed levy on interest income on QE-related reserves.** The Bank of England might deem this the best way of managing potential future negative fiscal implications of its policies.
4. The Treasury could legislate that the Bank of England follows the European Central Bank and the US Federal Reserve in **simply keeping the losses on its balance sheet, that is, it ends the Asset Purchase Facility indemnity**. In the US and the Eurozone, the profits or losses simply remain on central banks' balance sheets. This does not reduce these losses, but it pushes their accrual into the future. For some parts of the European Central Bank system, that has meant negative equity. But, unlike for commercial banks, this has had no impact on their ability to function normally (Bell et al 2024). This could be done via legislation or changing the nature of the indemnity for the Bank of England. The losses would continue to accrue on the Bank of England's balance sheet, but the Treasury would not immediately pay for them. However, given the Bank of England is part of the public sector, it would still increase the government's debt target.

The outcome of this process would take some time for the Bank of England, and would have to be conducted with utmost emphasis on its independence and the primacy of its monetary and financial stability mandates.

12 Prominent commentators – such as former Bank of England deputy governor, Paul Tucker (2022), former Bank of England deputy governor and *Financial Times* journalist, Chris Giles (2024), and Office for Budget Responsibility Budget Responsibility Committee member, Charles Bean – have called for this to be addressed. The New Economics Foundation has done pioneering work outlining how this could be implemented (Van Lerven and Caddick, 2022).

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