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BOE Expands Bond-Purchase Program for First Time Since 2009 (3)
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(Adds details on asset purchases in sixth paragraph, Ed Balls comment in last.)

By Jennifer Ryan

Oct. 6 (Bloomberg) -- The Bank of England pledged to buy the most bonds since the depths of the last financial crisis as officials raced to stop the euro-region debt turmoil from pushing the economy back into recession.

The nine-member Monetary Policy Committee led by Governor Mervyn King raised the ceiling for so-called quantitative easing to 275 billion pounds ($421 billion) from 200 billion pounds.
That’s the biggest expansion since the first round of stimulus in March 2009. Only 11 of 32 economists in a Bloomberg News survey predicted an increase in asset purchases.

The pound dropped and bonds jumped after the decision, which came a day after a report showed Europe’s second-biggest economy grew less than previously estimated in the quarter through June and as Greece’s crisis strained money markets. The central bank said in a statement that slowing global growth and the turmoil in Europe “threaten the U.K. recovery.”

“I think it’s a dramatic intervention and signals the urgency of the situation,” said Brian Hilliard, chief U.K.
economist at Societe Generale SA in London, who predicted a 50 billion-pound expansion. “I expect the size of the program to be increased further.”

The pound fell as much as 1.2 percent against the dollar after the decision to $1.5272. It traded at $1.5310 as of 1:48 p.m. in London. The yield on the 10-year gilt fell 5 basis points to 2.30 percent. U.K. stocks remained higher, with the FTSE 100 Index up 2.1 percent.

‘Under Review’

The MPC’s move marks a victory for Adam Posen a year after he started voting for more bond purchases. The central bank expects the new round of stimulus will take four months to complete and it will keep the program “under review.” It will buy gilts evenly across a range of maturities at three weekly auctions with an initial size of 1.7 billion pounds.

Also today, the bank held its benchmark interest rate at a record low of 0.5 percent, as forecast by all 53 economists in a separate survey.

“The pace of global expansion has slackened, especially in the U.K’s main export markets,” the Bank of England said in a statement accompanying its decision. “Vulnerabilities associated with the indebtedness of some euro-area sovereigns and banks have resulted in severe strains in bank funding markets and financial markets more generally. These tensions in the world economy threaten the U.K. recovery.”

European Central Bank President Jean-Claude Trichet said today the ECB will offer banks additional longer-term liquidity and also restart covered bond purchases. Earlier today, it kept its benchmark rate unchanged at 1.5 percent.

‘Critical Role’

The Bank of England last announced an increase in its bond program in November 2009 and the purchases ended in early 2010. Chancellor of the Exchequer George Osborne said in a statement that monetary policy has a “critical role in supporting the economy” as he authorized the central bank to increase QE.

Today’s expansion shows policy makers are prioritizing the recovery over the threat from inflation, which was 4.5 percent in August, more than double the Bank of England’s target. The central bank said today that the deterioration in the outlook makes it “more likely” that inflation will undershoot its 2 percent goal in the medium term.

Minutes of today’s decision, revealing how officials voted, will be published on Oct. 19 in London. Ben Broadbent and David Miles indicated last month they were moving closer to joining Posen’s call to resume asset purchases.

Fed Steps

The U.S. Federal Reserve responded to the economic slowdown last month by adopting so-called Operation Twist, replacing $400 billion of Treasuries in its portfolio with longer-term securities in a move aimed at further reducing borrowing costs and lowering unemployment.

Two reports this week indicated the U.K. recovery retains some momentum, with gauges of services and manufacturing unexpectedly strengthening in September. Still, gross-domestic- product data showed the economy grew just 0.1 percent in the second quarter, less than previously estimated, as consumer spending plunged the most in more than two years.

Britain has struggled to recover from the recession, with the economy barely growing over the past year. The IMF cut its 2011 and 2012 U.K. growth forecasts last month to 1.1 percent and 1.6 percent from 1.5 percent and 2.3 percent, respectively.

“The downside risks to the economy have materialized from the eurozone crisis and data showing the U.K. economy hardly grew this year,” said Joost Beaumont, an economist at ABN Amro Bank in Amsterdam. “They’re showing they’re ready to act when necessary, and that their focus has clearly shifted to growth from inflation.”

Debt Crisis

U.K. Prime Minister David Cameron said on Oct. 4 that European leaders must resolve the region’s debt crisis without delay, while U.S. Treasury Secretary Timothy F. Geithner warned last month that failure to combat the turmoil could lead to “cascading default, bank runs and catastrophic risk.”

European Union officials are working on plans to boost bank capital to contain the euro-region crisis, the IMF said yesterday. Leaders of the Group of 20 nations will meet in Cannes, France, on Nov. 3-4, which international finance chiefs see as the deadline for resolving the turmoil. The Bank of England publishes new quarterly economic forecasts Nov. 16.

“This is the Bank of England’s contribution to a Plan B,” said Ed Balls, who speaks for the opposition Labour Party on Treasury matters. “While another round of quantitative easing may help, I fear it will do little to create the jobs and growth we desperately need if we are to get the deficit down.”

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