

Funding the Future

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A number of people have asked me to comment on [this article in the FT](#) from a few days ago:

UK quantitative easing [+ Add to myFT](#)

UK government faces £150bn bill to cover Bank of England's QE losses

Estimated cost to taxpayers has increased sharply as interest rates have risen



The QE programme was designed so that the central bank is indemnified by the Treasury against losses © FT montage

Delphine Strauss in London JULY 25 2023 362 

The Bank of England has estimated it will require the Treasury to transfer a total of £150bn by 2033 to cover expected losses on the central bank's quantitative easing programme, up from a previous calculation of £100bn.

To do so I have prepared a summary of the accounts of the company called the Bank of England Asset Purchase Facility Fund Limited (or APF) that actually operates the quantitative easing programme on behalf of HM Treasury, because it is a sham to say that it is run by the Bank of England when the Treasury has to approve all major decisions made by this company and bears the profits and losses arising from its actions. That summary looks like this, covering all years from 2010 when it began to trade:

Bank of England Asset Purchase Facility Fund Ltd																
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Real	Total to 2023
Balance sheet																
Interest receivable	8	64	85	132	87	37	18	14	18	38	93	9	12	281	798	473
Coupons reinvested							14,852	14,274	15,099	14,998	14,485	16,062	18,048	37,081	125,118	308,637
Interest paid							12	12	12	12	12	12	12	12	12	12
Loss from financial instruments at fair value	(2)	(31)	(36)	(248)	(86)	(14)	8,852	8,408	21,040	28,807	32,633	36,106	37,480	(18,096)	(24,916)	(8,421)
Interest paid							18,052	11,416	(1,756)	(3,575)	(3,347)	(742)	(1,386)	(27,375)	(31,360)	(14,401)
Administrative costs	(3)	(31)	(2)	(2)	(11)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Profit before tax to HM Treasury							(18,818)	(21,299)	7,058	(8,218)	(8,084)	45,183	30,848	149,130	154,618	(14,480)
Balance sheet																
Capital	3,761	11,704	35,714	24,913	1,040	1,185	1,831	6,217	4,260	4,800	6,652	3,323	2,261	27,890		
Interest receivable	1,752														22,639	131,115
Debt securities																
Other	204,481	197,803	308,467	395,512	374,649	403,182	413,346	487,961	473,768	472,807	505,732	783,405	466,178	697,775		
Debt securities	7	3	5	2	2	2	2	2	2	2	2	2	2	2	2	40
208,803	239,469	329,145	413,372	375,680	404,987	421,609	530,411	405,157	477,814	520,391	788,748	470,248	696,230			
Debt securities	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
208,803	199,699	313,157	410,571	375,589	404,367	414,958	530,453	305,587	477,818	520,397	788,748	470,248	696,230			

My suspicion is that this will be a little hard to read, although clicking on it a couple of times should produce a much bigger version. So, let me offer this summary version instead:

Bank of England Asset Purchase Facility Fund Ltd	2022 £'m	2023 £'m	Total £'m	Total to 2022 £'m
Income statement				
Interest receivable	11	261	734	473
Coupon income received	18,088	17,081	125,118	108,037
TFS income	-	-	1,042	1,042
Loss from financial instruments at fair value	(47,689)	(169,095)	(249,916)	(80,821)
Interest paid	(1,288)	(17,375)	(31,380)	(14,005)
Admin expenses	(2)	(2)	(36)	(34)
Due for the year to HM Treasury	30,880	169,130	154,438	(14,692)
Profit before tax	-	-	-	-
Balance sheet				
Cash	6,261	17,806		
Due from HM Treasury	22,829	191,113		
TFS loans	-	-		
Debt securities	866,176	637,272		
Other	2	44		
	<u>895,268</u>	<u>846,235</u>		
Due to HM Treasury	-	-		
Loans and other borrowings	895,266	846,233		
Other liabilities	2	2		
	<u>895,268</u>	<u>846,235</u>		

What is now on display are the accounts for 2022 and 2023 plus a summary of all year's income and expenditure to both 2022 and 2023.

Several points stand out:

- * £125 billion of interest costs have now been saved as a result of QE
- * Until 2022 the operation of QE was profitable in every year
- * It was only in 2023 that QE turned from having been a very profitable exercise into being a loss-making one.
- * In 2023 a loss of £169 billion was made on QE operations.
- * That loss was almost entirely due to the value of the investments held by the APF being reduced in value on its balance sheet. There was no actual cash loss in the year. So, why did this loss happen? That is explained by this innocuous-looking note on accounting policies included in the accounts:

ii: Initial recognition of financial instruments

Financial instruments are initially recognised at fair value, and transaction costs are immediately recognised in profit or loss. Financial securities are recognised/derecognised on the date the Company commits to purchase/sell the instrument (trade date accounting). The loan from the Bank is recognised on a settlement date basis.

Fair value is deemed to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

iii: Subsequent measurement

Gains and losses arising from changes in the fair value of assets classified at fair value through profit or loss are included in the statement of comprehensive income in the period in which they arise.

The fair values of quoted investments in active markets are based on current bid prices. In other cases, the Company establishes fair value by using appropriate valuation techniques.

What that note, in effect says is that the financial instruments - in this case, all the government bonds that the APF owns - are valued at what is, in effect, their market value at the APF's balance sheet date.

Note 5 to the accounts adds a little information:

5: Debt securities

	2023 (£mn)	2022 (£mn)
Gilts	630,821	848,582
Corporate bonds	6,451	17,594
Total debt securities	637,272	866,176

The decrease in value of debt securities in the year was £228.9 billion as presented in the Statement of cash flows.

The note is as misleading as it is helpful. The reference to the cash flow is actually to a non-cash movement, and so is not very helpful. What was required was a breakdown in the reduction in the value of assets split between the value written off and sales made. In the absence of this data in the accounts, it is very likely that the split was:

	2023
	£'m
Assets brought forward	866,176
Less: Net sales	(59,809)
Written down value	<u>(169,095)</u>
Assets carried forward	<u><u>637,272</u></u>

The diminution in value was then because of asset sales under the quantitative tightening programme, which could have resulted in some real losses arising, and, much more significantly, the accounting write-down of the value of the portfolio.

As is now clear from total trading of the portfolio to date, including these losses, is that overall if the fund were to be sold at current values, then to date, the whole quantitative easing operation would have resulted in losses of around £150 billion.

So the question to ask is whether that is a fair representation of what will actually happen? Will the Bank of England really lose £150 billion on behalf of the Treasury, and why?

The answer is that I cannot say whether that is the case or not, because it depends upon the decisions that the Bank of England makes. There are three that matter:

- * Will it keep rates as high as they are now for the time being, or even increase them

further?

- * Will it let them fall to a natural rate of 2% or less, which is what the economy clearly needs when inflationary pressure is over, which it will be within a couple of years at most?
- * Will it insist on selling large parts of its bond portfolio at a loss as it is now doing even though there is no need for it to do so?

Those three points need unpacking.

First, it would seem that the Bank of England has now got a deathwish with regard to interest-rate policy, and even the Treasury is now becoming worried that the increases in interest rates that they are pursuing will be harmful to the economy. I can only hope that they bring pressure to bear on the Bank to stop this policy of increasing rates, which is now one of pure folly.

Similarly, I hope that whoever is in office as Chancellor of the Exchequer at the end of 2024 will likewise bring pressure to bear on the Bank to reduce interest rates rapidly at that time to ease the pressure on the economy when there will by then be no evidence of any benefit to arising to it as a consequence of maintaining the high-interest rates that the Bank of England does at present indicate that they wish to remain in place.

Third, if I was to get my wish on interest rates, then the current policy of the Bank of England, which is to sell as many of the gilts in its portfolio as it can at present values is a further example of its pure financial folly. That is because when interest rates are higher in the marketplace than when the gilt was issued, then the value of that gilt does, in current terms, fall. The eventual redemption value of the gilt does not, however, change. In other words, if the investor holds the gilt to the end of its life then they will get back exactly what they were promised. So if they don't sell, they will not make these losses.

Let me use a quick example of a ten-year bond issued last year with an interest rate of 3.25%. [The data is here](#):

TREASURY 3.25% 31/01/33 (TR33) GILT

Sell: £91.39 | Buy: £91.69 | No change *

Prices delayed by at least 15 minutes | [Turn on streaming prices](#)

This price doesn't include accrued interest | [More about bond pricing here](#)

Ex-dividend

AT A GLANCE	CHARTS & PERFORMANCE	COSTS	DEAL
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Open: £91.92

Trade high: n/a

Previous close: £91.92

Trade low: n/a

Previous: ↓ £0.13 (0.14%)

Volume: n/a

SHARE CHART

1D | 1W | 1M | 3M | 6M | 1Y | 3Y | 5Y | 10Y



This bond was issued at a discount to its £100 par value, which is common.

The price at which it has traded has varied from £101 to £89 over the time it has been in issue. Right now, it is nearer the bottom end of the scale.

If the Treasury had bought this on issue, it would now be sitting on a loss. If it sold now, that loss would be real: whoever bought it would in effect buy it at an undervalue compared to the issue price. There would be a transfer of value from the Treasury to the private sector.

But there is no reason for the Bank of England to sell now, except for its wholly unnecessary quantitative tightening policy. If it held it until 2033 it would get £100 back. It would lose nothing.

So, in that case, why is the Bank claiming a loss of £150 billion? Four reasons:

- * It is wholly unwisely putting up interest rates.
- * It wants to keep interest rates high.
- * It wants to sell bonds at a big loss to keep interest rates high.
- * It is doing this because it seemingly wants to trash the economy whilst providing assets at an undervalue to financial markets.

It is, in other words, incompetence that is driving this loss. It is not needed. It does not have to happen. It may not happen. It just requires sanity to be restored to our central bank to stop it happening. But will that happen? Who knows?

What I do know is that the Bank is recklessly seeking to make losses to prevent the government from spending money to meet social need. And that is the real banking scandal of this moment.