

## Introduction to monetary policy

This is a simple exercise drawn from the Bank of England's website outlining the role of the Bank of England. Students can do it individually, then compare notes with someone else before feeding back into a discussion about why the Bank of England does what it does and which roles are the most important.

The Bank of England has seven 2-3 minute short videos on its role (probably too many to use in class), but number 7 provides an overview and depending on which way discussion goes, some of the others might be worth showing too.

The role of the Bank of England. 7: How the Bank works.

<https://www.youtube.com/watch?v=b75qggHqV98>

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## More about the bank

The Bank's roles and functions have evolved and changed over its three-hundred year history. Since its foundation, it has been the Government's banker and, since the late 18th century, it has been banker to the banking system more generally - the bankers' bank. As well as providing banking services to its customers, the Bank of England manages the UK's foreign exchange and gold reserves.

The Bank has two core purposes - monetary stability and financial stability. The Bank is perhaps most visible to the general public through its banknotes and, more recently, its interest rate decisions. The Bank has had a monopoly on the issue of banknotes in England and Wales since the early 20th century. But it is only since 1997 that the Bank has had statutory responsibility for setting the UK's official interest rate.



[www.bankofengland.co.uk](http://www.bankofengland.co.uk)

### Core Purpose 1: Monetary Stability

The Bank's monetary policy objective is to deliver price stability and, subject to that, to support the Government's economic objectives including those for growth and employment. Monetary stability means stable prices and confidence in the currency.

Interest rates decisions are taken by the Bank's Monetary Policy Committee. The MPC has to judge what interest rate is necessary to meet a target for overall inflation in the economy. The inflation target is set each year by the Chancellor of the Exchequer, and is currently a symmetrical target of 2%+/- 1% (meaning that low inflation is considered just as bad as high inflation). Should the MPC fail to achieve this target, then an open letter must be sent to the Chancellor of the Exchequer explaining why the target has been missed, what is to be done, and when it will return to target.

### Core Purpose 2: Financial Stability

Financial stability requires an efficient flow of funds in the economy and confidence in financial institutions.

This is pursued through:

- The Bank's financial operations, including as lender of last resort;
- Decisions of the Financial Policy Committee;

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## More about the bank (continued)



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The bank implements its interest rate decisions through its financial market operations - it sets the interest rate at which the Bank lends to banks and other financial institutions. The Bank has close links with financial markets and institutions. This contact informs a great deal of its work, including its financial stability role and the collation and publication of monetary and banking statistics.

The Bank of England is committed to increasing awareness and understanding of its activities and responsibilities, across both general and specialist audiences alike.

**Find and list as many functions of the Bank of England as you can.**

**Which functions do you think are the most important?**