THE BANK OF ENGLAND

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Overview – Origins – Formation -The Bank Charter – The Industrial Revolution – Bank of England Notable Dates - Promissory Notes - Lender of Last Resort - Assets and Liabilities

Overview

The Bank of England is the central bank of the United Kingdom and the model on which most modern central banks have been based. Established in 1694 to act as the English Government's banker and still one of the bankers for the Government of the United Kingdom, it is the world's eighth-oldest bank. It was privately owned by stockholders from its foundation in 1694 until it was nationalised in 1946.

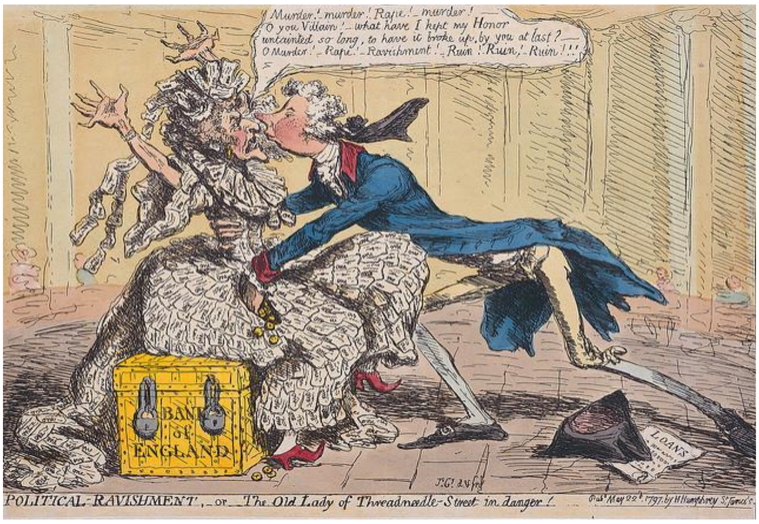
The Bank became an independent public organisation in 1998, wholly owned by the Treasury Solicitor on behalf of the government but with independence in setting monetary policy.

The Bank is one of eight banks authorised to issue banknotes in the United Kingdom, has a monopoly on the issue of banknotes in England and Wales and regulates the issue of banknotes by commercial banks in Scotland and Northern Ireland.

Origins

The establishment of the bank was devised by Charles Montagu, 1st Earl of Halifax in 1694. Previous plans to set up a Bank of England were proposed by William Paterson in 1691 and Philip Burlamachi, Financier to the King in 1636, but they had not been acted upon.

The Bank's original home was in Walbrook, a street in the City of London and moved to its current location in Threadneedle Street in 1734, acquiring neighbouring land to create the site, under the direction of its chief architect Sir John Soane. It is sometimes known as the Old Lady of Threadneedle Street, a name taken from a satirical cartoon by James Gillray in 1797.



The cartoon shows the Prime Minister of the day, William Pitt the Younger. He appears to be wooing an old lady – who represents the Bank of England. But his true intention is to get his hands on the Bank of England's gold reserves: the gold coins in her pocket and the money-chest on which she is firmly seated.

In the cartoon:

1. The Old Lady is dressed in a gown made of the new £1 and £2 notes issued to replace gold coins in circulation. She sits protectively on a chest, which represents the Bank's reserves.
2. The scene is set in the 'Rotunda', at the time a public office in the Bank's Threadneedle Street building. The clerks are seated at their desks in the background.
3. A document entitled 'Loans' – which refers to the Pitt government's continual demands to borrow money from the Bank of England.

Formation

The company then formed undertook to lend to the Government the sum of £1,200,000, at 8% interest, and £4000 per annum to be paid for management expenses. The £1.2 million was raised in 12 days.

To encourage subscription, the subscribers were to be incorporated by the name of the Governor and Company of the Bank of England. The Bank was given exclusive possession of the government's balances and was the only limited-liability corporation allowed to issue bank notes. The lenders would give the government cash (bullion) and issue notes against the government bonds, which could be lent again.

The goldsmiths, who were the private bankers before the formation of the Bank of England, were opposed to the Bank and in 1696 they organised a run on it, buying up its notes and presenting them at a time when the coinage was being re-minted and the bank was short of cash. The run failed and the Bank was subsequently given a monopoly of the right of note-issue among joint-stock banks.

The company was chartered to carry on the business of banking, i.e. to issue notes, to discount bills, to make loans as security and to receive deposits. The bank issued notes to the amount of its loan to the Government. From time to time it assisted in the raising of further loans and in 1696 it co-operated with the Government in the recoinage of silver money.

Half of the money lent to the Government was used to rebuild the navy. England needed to build a powerful navy after the crushing defeat by France culminating in the 1690 Battle of Beachy Head. No public funds were available and the credit of William III's government was so low in London that it was impossible for it to borrow the £1,200,000 that the government wanted.

The huge industrial effort needed, including establishing ironworks to make more nails – and advances in agriculture feeding the quadrupled strength of the navy, started to transform the economy. England and Scotland were formally united in 1707 and this helped the new Kingdom of Great Britain from 1707 to become powerful. The power of the navy made Britain the dominant world power in the late 18th and early 19th centuries.

For nearly a century and a quarter after 1708 the only competitors of the Bank of England were the private bankers – the goldsmiths and their successors. Its strength and reputation increased, and from 1751 it was entrusted with the full management of the National Debt.

The Bank Charter

The original Royal Charter of 1694, granted by King William and Queen Mary, explained that the Bank was founded to 'promote the public Good and Benefit of our People'. The King and Queen were two of the original stockholders.

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1781 it was also the bankers' bank – keeping enough gold to pay its notes on demand.

During the second quarter of the 18^{th} century there was concurrently with the industrial expansion of the period an increase in banking in all parts of the country. After 1815 a strong movement emerged in favour of the legalisation of joint-stock banking. Many private banks had been set up and failed due to bad management.

In 1823 the Government negotiated with the Bank of England on the matter offering to extend its charter until 1843 if the Bank would consent to a limitation of its monopoly to London and the surrounding country within a radius of 65 miles so that other joint-stock banks might be established in provincial towns beyond that limit. No action was taken until 1833 when joint-stock banks were permitted to transact business in London or elsewhere within the 65 miles limit provided they did not issue notes. This led to the formation of banks such as the London and Westminster Bank.

The 1844 Bank Charter Act tied the issue of notes to the gold reserves and gave the Bank sole rights with regard to the issue of banknotes. Private banks that previously had that right retained it, provided that their headquarters were outside London and that they deposited security against the notes that they issued. A few English banks continued to issue their own notes until the last of them was taken over in the 1930s. Scottish and Northern Irish private banks still have that right.

The last private bank in England to issue its own notes was Thomas Fox's Fox, Fowler and Company Bank in Wellington which rapidly expanded until it merged with Lloyds bank in 1927. They were legal tender until 1964.

The Industrial Revolution

The Banking System generally met the needs of the country before the Industrial Revolution. Banking business was mainly confined to London before 1750, though a few country banks had been established.

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The Industrial Revolution, which started in the middle of the 18th century, saw the invention of the steam engine, cotton spinning and railways. Later there was the era of mass industrialisation with rising use of electricity and indoor water supply. The growth of output came from capital investment which had allowed expansion and innovation. England had become a great trading nation with a growth in population, change from agriculture to industry and a move from domestic industry to factory work, a move from water and wind power to steam engines, and a revolution in transport and communications from canals and pack horses to railways and the telegraph. All this progress needed finance and access to banking.

In 1826 an act was passed authorising the establishment of joint-stock banks with the power of issuing notes in any place more than 65 miles from London and the availability of these local banks and the improvement in banking in general played an essential role in organising the finance during the industrial revolution.

Bank of England - Notable Dates

1711

In 1711, the South Sea Company was founded. Threatening the Bank's position as the Government's banker and owner of national debt, the South Sea Company exchanged loans to the Government for trading rights in the Spanish-controlled South Seas (now South America). At this time, Britain was in the midst of war with Spain. Very little trading occurred, but the South Sea Company set its sights on servicing the national debt, which was largely the Bank of England's job at the time. In 1720, the South Sea Company was granted part of the national debt and its stock price rose dramatically. This caused a frenzy of investment in its stock, but prices eventually crashed and thousands of people were ruined.

1725

Before 1725, banknotes were hand written, often for the specific amount deposited by the customer. In 1725 the Bank of England began to issue partially printed notes for amounts of £20 and upwards, in increments of £10. The highest denomination was £90. However, each denomination could be increased in value by a maximum of £9 19 shillings and 11 pence (£9.99 pence) to reflect the actual amount of the deposit. The issuing cashier would increase the value of the note in writing.

1775-1783

During the American War of Independence business for the Bank was so good that George Washington remained a shareholder throughout the period.

1797-1826 Financial Crises

In 1797 fear of a French invasion brought about a run on the Bank of England and the gold reserve was so seriously threatened that the government authorised it to discontinue payment of its notes. For more than twenty years Bank of England notes ceased to be convertible into gold. They continued to circulate freely and for some years they were subject to very little depreciation in value. Towards the end of the Napoleonic War their value fell substantially and at one time a five pound note was worth no more than £3.12s in gold.

The desirability of the bank resuming cash payments was considered in 1810 by a committee of the House of Commons No action was taken at the time but in 1819 another committee presided over by Sir Robert Peel decided that the resumption ought to be delayed no longer. By 1821 the normal honouring of notes in gold was resumed.

As a result of the financial crisis of 1825 to 1826 many country and provincial banks failed and this led to the establishment of Bank of England branches in 1826.

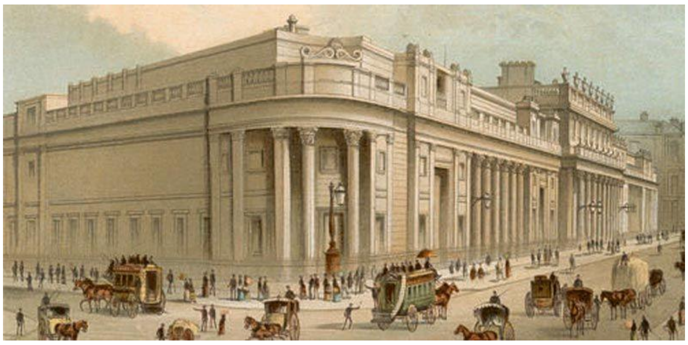
1914-1918

The Bank of England played an important role in helping the Government finance the war, for example by issuing War Stocks in 1914. Although it was reported that these war stocks were oversubscribed, the public did not actually buy enough to help fund the effort. The Bank therefore bought much of the stock out of its own reserves, and hid this fact to maintain public confidence.

1920-1944

Montagu Norman was the longest serving Governor of the Bank of England – 1920-1944. He played a critical role in rebuilding the international monetary system after World War One. He was involved in creating the Bank for International Settlements and the League of Nations. Under Norman, the Bank of England became actively involved in supporting British industry. During the Second World War he made significant contributions to monetary and financial policy.

1925

Between 1925 and 1939, Bank of England architect Sir Herbert Baker demolished Sir John Soane's bank (left above) regarded as an architectural gem and built a new headquarters on the same site (right above). The old Bank of England had mostly been no more than three storeys high. The new building stands seven storeys above ground, with three below to fit in the extra staff needed to tackle the Bank's rapidly increasing amount of work.

Note
The Bank's original home was in Walbrook, a street in the City of London, where during reconstruction of the site in 1954 archaeologists found the remains of a Roman temple of Mithras (Mithras is said to have been worshipped as, amongst other things, the God of Contracts). The Mithraeum ruins are perhaps the most famous of all 20th-century Roman discoveries in the City of London. The Bank moved to its current location in Threadneedle Street in 1734.

1931
The gold standard linked the value of the UK currency directly to gold, and effectively enabled people to exchange Bank of England banknotes for the equivalent value of gold.

In September 1931, the UK suspended the gold standard. Confidence in sterling had collapsed, and the ensuing run on sterling meant that the Bank of England lost much of its reserves.

1939-1945

In an attempt to destabilise the British currency during the war, the Nazis introduced forged £5 notes into Britain. At this point the design and production of the high-value banknotes from £5 to £1000 had not changed for almost a century, with the result that they were copied extremely successfully by the Germans. Almost 9 million notes with a face value of £134 million were printed by the Nazis, representing more than 10% of the total banknotes then in circulation in the UK. Emergency measures were taken to slow this down, including the 1940 special blue £1 note, which is the first time the Bank of England used a metallic thread in a banknote. In 1943 the Bank temporarily stopped issuing denominations greater than £5. to tackle the threat of counterfeiting.

1946

When the Bank was nationalised in 1946, it meant that it was now owned by the Government rather than by private stockholders. This gave the Government the power to appoint the Bank’s governors and directors, and to issue directions to the Bank.

1960

On 17 March 1960, the Bank of England issued the first banknote featuring Queen Elizabeth II. Up until this point, Britannia had been the only character to appear on UK banknotes. Portraits have come to be an important anti-counterfeiting feature. This is because people are more likely to notice slight differences in facial features than they are differences in images of inanimate objects.

1979

The European Exchange Rate Mechanism (ERM) was set up in 1979 to reduce exchange rate variability and achieve monetary stability across Europe. This was seen as preparation for monetary union, which eventually led to the European single currency, the euro. All currencies had to remain within two agreed price points.

1990

The UK joined the ERM in 1990. However, following massive rises in interest rates and intervention in the foreign exchange markets that failed to move sterling from the floor of the ERM, the Government made the decision to pull out, as the cost to try and keep it within the boundaries was deemed too expensive.

The ensuing financial crash was referred to as ‘Black Wednesday’. It was estimated to have cost HM Treasury over £3 billion.

The next day’s interest rate rise to 15% was cancelled, and regular meetings between the Chancellor and the Governor were set up to help the Chancellor with monetary policy.

1992-1993

In October 1992, the Chancellor invited the Bank of England ‘to provide a regular report on the progress being made towards the Government’s inflation objective. Accepting the invitation, the then Governor Robert Leigh-Pemberton said the Bank’s aim would be ‘to produce a wholly objective and comprehensive analysis of inflationary trends and pressures’. The first quarterly Inflation Report was published in February 1993, and to this day it is still one of the Bank of England's major publications. Published quarterly, it is followed by a press conference, held by the Governor and the Deputy Governor for Monetary Policy.

1994

The first governor of the Bank of England was Sir John Houblon, who is depicted in the £50 note issued in 1994.

1997

The Bank of England used to have branches around the country. The branches were first established in 1826 after a financial crisis to control banknote circulation. In 1997 they were replaced with 12 regional agencies, used by the Bank of England to collect information about trends and new developments and help to explain policy decisions to businesses, industry and labour groups.

2011

The Bank's Monetary Policy Committee has a devolved responsibility for managing Monetary Policy. The Treasury has reserve powers to give orders to the committee "if they are required in the public interest and by extreme economic circumstances", but such orders must be endorsed by Parliament within 28 days. The Bank's Financial Policy Committee held its first meeting in June 2011

2016

The first Bank of England banknote printed on polymer – the £5. note featuring Sir Winston Churchill – was issued on 13th September 2016.

Polymer is a thin, flexible plastic material that lasts longer, stays cleaner and is harder to counterfeit than paper banknotes.

June 2020

The UK is now facing another crisis and recession with the bank rate at 0.1%, the current inflation rate at 0.8% (the target being 2%), and quantitative easing at £645 bn.

Financial Definitions

Promissory Notes

A Promissory Note is “an unconditional promise in writing made by one person to another” to pay a sum of money on demand or at some fixed or determinable future time. They do not require acceptance, being drawn by the person who is to pay. Promissory notes as such are not of very great importance today. Strictly speaking banknotes are promissory notes issued by a banker and payable on demand.

Lender of Last Resort

The Bank of England does not lend directly to the joint-stock banks. If the banks are short of cash, they are able to call in short-term loans from the discount houses. Should this leave the discount houses short of funds, they can borrow from the Discount Office at the Bank of England. The rate of interest at which the discount houses can borrow is the Bank rate.

The bank acted as lender of last resort for the first time in the panic of 1866, caused by the demise of a company called Overend Gurney, a large, profitable discount house that had build up large amounts of bad loans and suffered significant losses. The Bank of England had been approached for assistance by Overend Gurney, but the Bank refused on the basis of the broker's insolvency.

Assets and Liabilities

A balance sheet shows the possessions of an organisation (its assets) and the claims (liabilities) that can be made against those assets.

Assets include**:**

Cash in hand and with the Bank of England (Liquid but earning no interest)

Cheques in course of collection (Nearly as liquid but earning no interest)

Money at call and short notice (Money lent out at low rates of interest for very short periods)

Bills discounted (Treasury bills and bills of exchange which are held to maturity and will become liquid in a comparatively short time)

Investments (Government securities which could be sold to provide cash)

Advances (The least liquid asset but the most profitable)

Other items (Premises, equipment, holdings in subsidiary companies, customers' liabilities)

Liabilities include:

Capital and reserve (claims due to shareholders)

Deposits (claims by depositors)

Miscellaneous (mostly liabilities arising from bills accepted by the bank)**.**