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inflation

Your money what the Bank does

risks

spending

interest rates



BANK OF ENGLAND

What the Bank does

The Bank of England is the UK's central bank. It's not like a bank in your local high street. It has special functions that help keep the economy and financial system stable. That affects us all.

Low inflation, trust in banknotes and a stable financial system are key ingredients for the economic well-being of our country.

You need to know your money will keep its value. Rising prices – inflation – reduce what your money is worth. The Bank sets the official interest rate – Bank Rate – to keep inflation low. Interest rates influence how much money everyone spends and saves and, in turn, costs and prices.



You need to be able to trust that your money is the real thing.
The Bank issues most of the country's banknotes which have special security features to make them hard to copy.

You need to be confident that the financial system handles your money in a reliable way.
The Bank assesses the health of the financial system as a whole, and works with others to keep it stable.

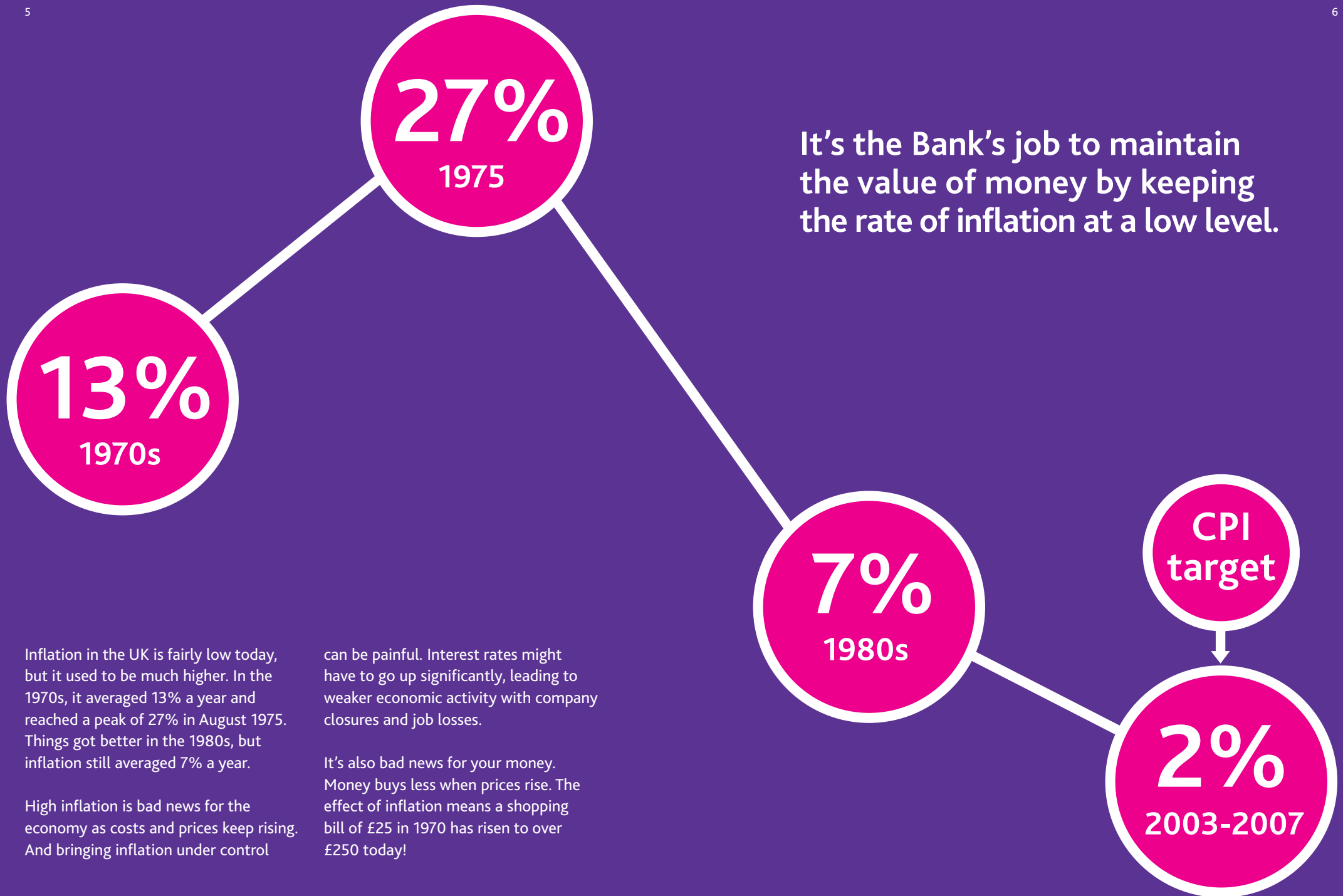
The value of your money – inflation and interest rates

What your money is worth depends on the prices you pay for things. Rising prices reduce the value of money – your money buys less.



It's a fact that lots of spending can push prices up. Inflation is about rising prices. But it's not just about prices for individual products – these rise and fall all the time. Inflation occurs when prices are rising for goods and services generally.

The rate at which prices are rising reflects the amount of spending in the economy compared with what can be produced, and the pressure this demand puts on company costs and prices. If the value of spending increases too quickly, costs and prices tend to rise – that's inflation.



The Government's 2% inflation target

The Bank aims to keep the annual rate of inflation at 2% – the inflation target set by the Government. Some prices will rise by more, others by less. But, on average, the aim is that prices across the economy rise by 2% a year.

Since 2003, the inflation target has been set in terms of the Consumer Prices Index (CPI).



2%

Bank Rate

A committee of nine experts – the Monetary Policy Committee (MPC) – meets each month to set the official Bank interest rate, known as Bank Rate. They each have an independent vote to decide what interest rate to set. There is no Government influence on the MPC’s interest rate decisions.

Looking into the future

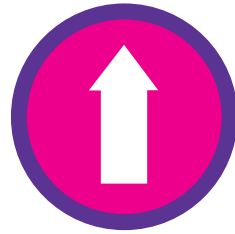
Interest rates can take up to two years to affect inflation. So today’s Bank Rate decision is based on where the MPC thinks inflation is heading over the next few years. That is always uncertain because unexpected things will happen.



So nobody knows what the interest rate will be in the future. Each month the MPC looks at how the economy is faring and whether the outlook for inflation has changed.

How do interest rates affect inflation?

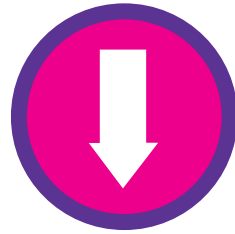
The interest rate set by the MPC affects interest rates on mortgages, loans and savings.



Higher interest rates take money out of the economy by increasing the amount we pay on our loans and the interest we receive from our savings. This influences what people and companies spend and save. Less spending puts downward pressure on price increases.



Lower interest rates are used to increase spending when inflation looks likely to be below the target.



Low inflation helps businesses and people plan ahead without thinking that interest rates and inflation are going to be 10% or 15%.

Our banknotes, your money

Promises, promises

The Bank of England has been issuing banknotes for over 300 years. Early banknotes were receipts for gold deposited at the Bank. The holder of a banknote could bring it to the Bank of England and exchange it for gold.

This is no longer possible, but banknotes still retain the words 'I promise to pay the bearer on demand'. The Bank will always exchange new banknotes for old ones that it has withdrawn from circulation.

Value and trust

A banknote is only a piece of paper which costs a few pence to produce. But banknotes are worth something more because we trust they can be exchanged for things we want to buy – they are a widely accepted way of paying for things. This trust gives banknotes value.

Did you know?

There are around 2 billion of our banknotes in circulation, worth about £38 billion. In 2007 the Bank printed around 500 million new notes, and destroyed around 700 million old notes.

There are four denominations of Bank of England note: £5, £10, £20 and £50. Each has its own design, and larger value notes are bigger in size. The most common note in circulation is the £20 – the rarest is the £50.

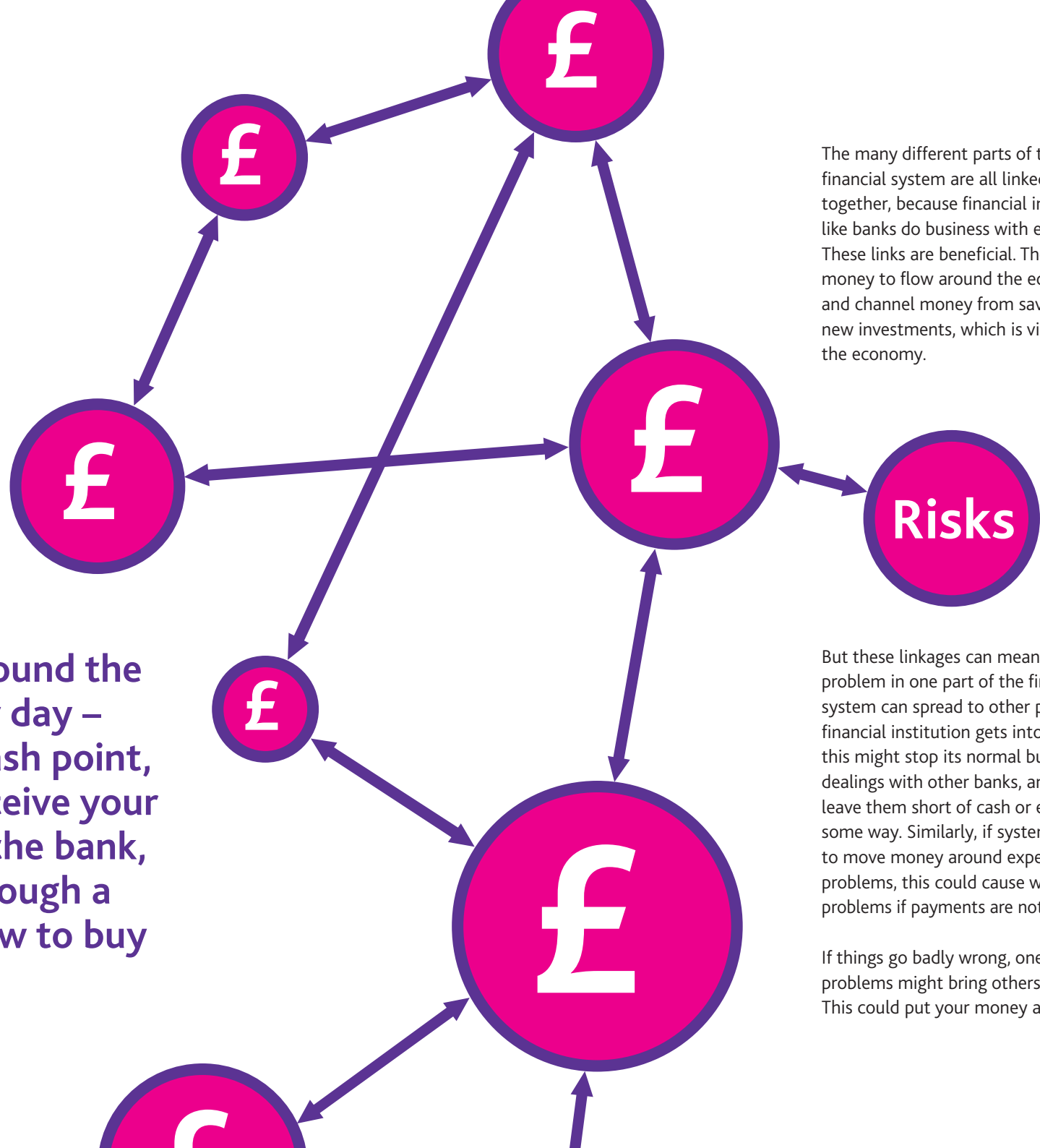
The Queen has featured on the front of Bank of England notes since 1960. The reverse side has images of eminent British people. Currently, these are Elizabeth Fry, Charles Darwin, Adam Smith and Sir John Houblon.

In Scotland and Northern Ireland, some commercial banks also issue banknotes. And it is the Royal Mint, not the Bank, that issues the nation's coins.

The Bank protects trust in banknotes by ensuring that they are hard to copy, so that fake notes don't undermine confidence in the real thing. Counterfeit notes are worthless.



Your money and a stable financial system



Your money moves around the financial system every day – each time you use a cash point, pay for something, receive your wages, put savings in the bank, invest your money through a pension fund, or borrow to buy a home or a car.

The many different parts of the financial system are all linked together, because financial institutions like banks do business with each other. These links are beneficial. They allow money to flow around the economy and channel money from savings into new investments, which is vital for the economy.

But these linkages can mean that a problem in one part of the financial system can spread to other parts. If a financial institution gets into difficulty, this might stop its normal business dealings with other banks, and could leave them short of cash or exposed in some way. Similarly, if systems used to move money around experience problems, this could cause wider problems if payments are not made.

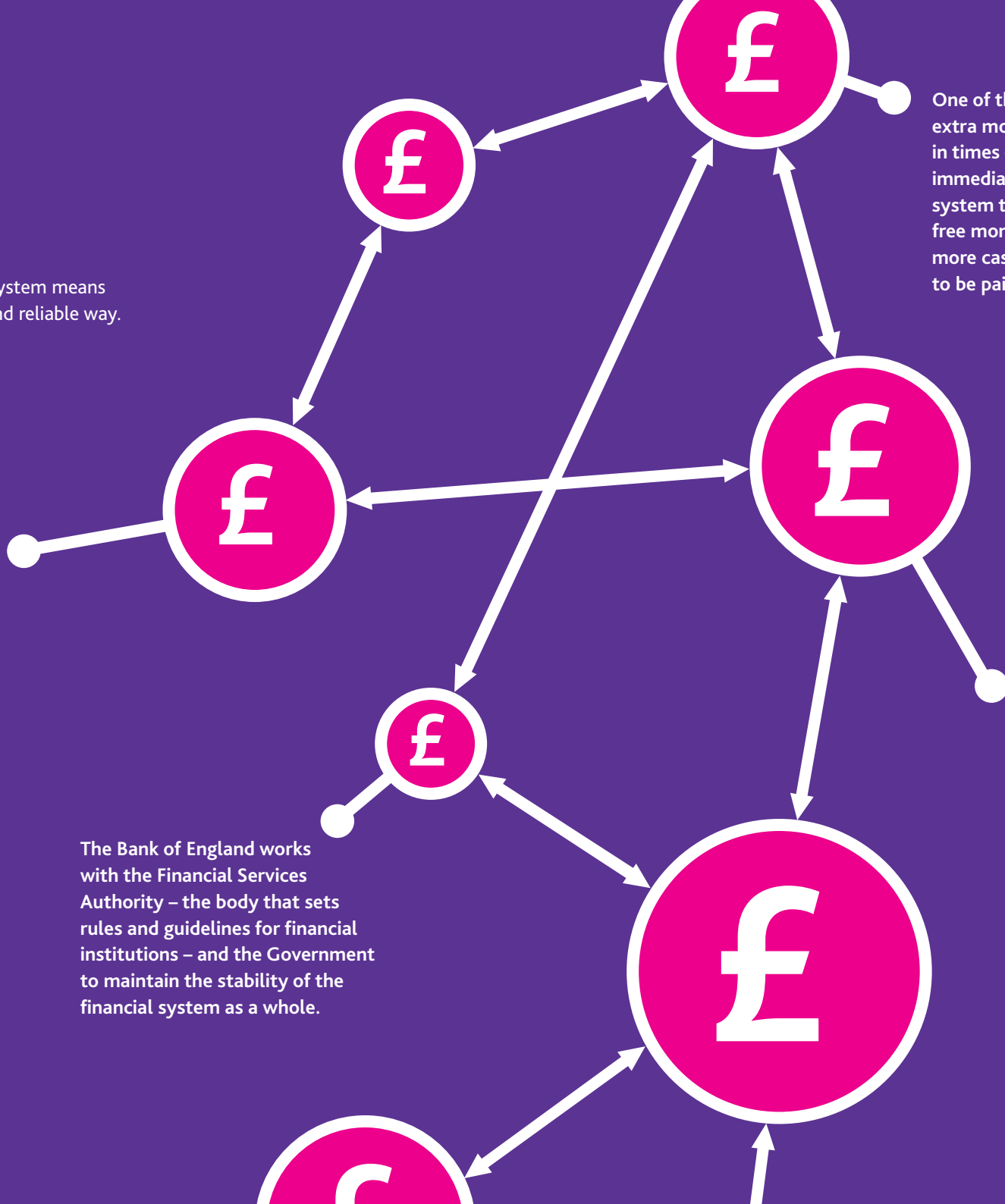
If things go badly wrong, one bank's problems might bring others down. This could put your money at risk.

The Bank and financial stability

Our reliance on the financial system means it needs to operate in a safe and reliable way.

The Bank assesses where potential weak spots might lie in the financial system. We want to reduce the risk that a problem in one part has a damaging impact on the rest of the system.

The Bank of England works with the Financial Services Authority – the body that sets rules and guidelines for financial institutions – and the Government to maintain the stability of the financial system as a whole.



One of the Bank's roles is to provide extra money to the banking system in times of difficulty, so a lack of immediate cash doesn't cause the system to stop operating. This isn't free money. It is lent to banks to get more cash into the system, and has to be paid back.

There will always be risks in the financial system. It's not the Bank's job to eliminate risk-taking by individual institutions. The Bank's job is to work with others to help ensure that problems at one financial institution don't disrupt the way the system as a whole operates.

What the Bank does



More information about the Bank of England can be found on its website at:
www.bankofengland.co.uk

The Bank has produced educational resources for primary and secondary schools, explaining money, prices and the workings of the economy. You can view the material at:
www.bankofengland.co.uk/education

The Bank provides a range of material to help identify genuine banknotes at:
www.bankofengland.co.uk/banknotes

Visit the Bank's free Museum. Details are available at:
www.bankofengland.co.uk/museum

If you have any questions or enquiries about the Bank of England, you can write to:

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