Bank of England

Looking through a glass onion: lessons from the 2022 LDI intervention

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Four lessons from the LDI intervention

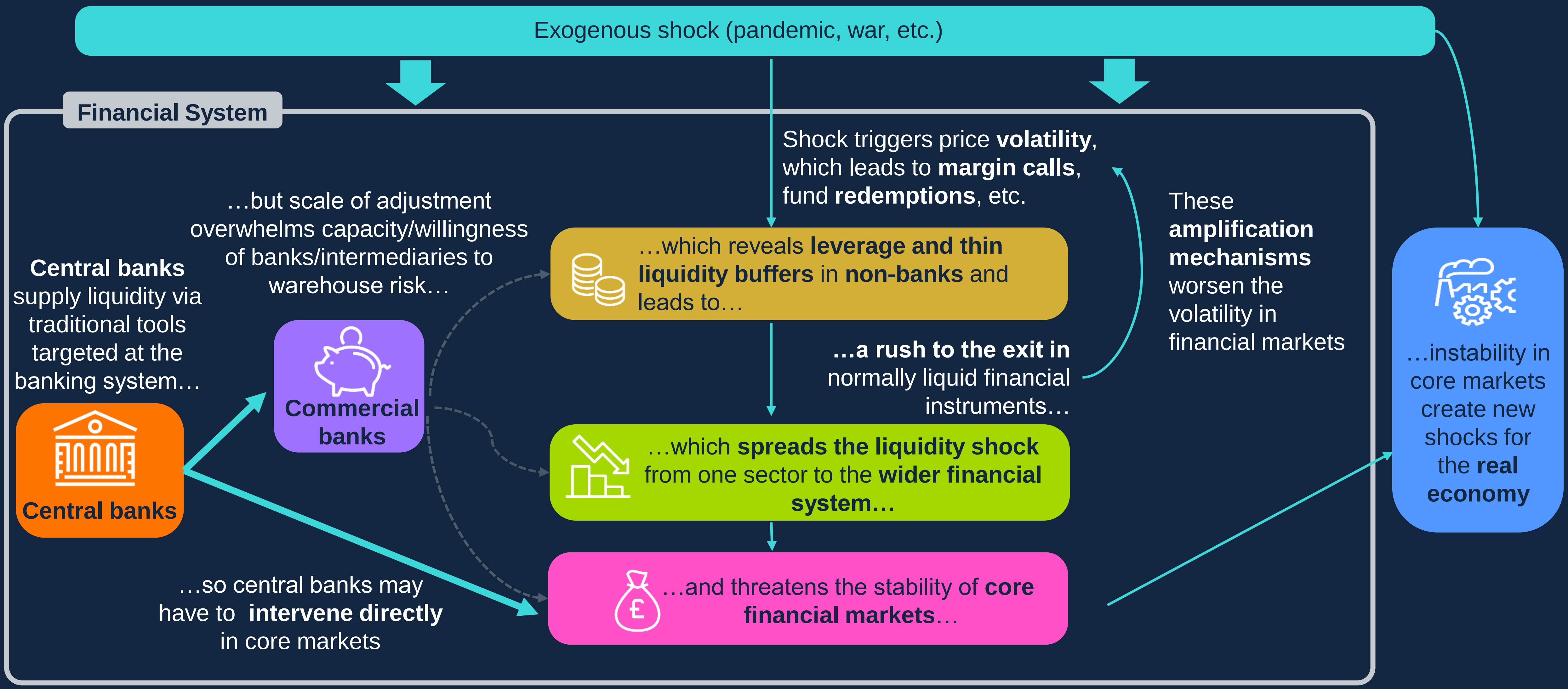
1. LDI and the dash for cash were not isolated symptoms of a polycrisis world: we are entering a new era of systemic liquidity risk, originating in non-banks and capital markets

2. Bagehot still applies. Central banks have to be the backstop, not the frontstop. But the divide between public and private insurance is a key social choice. Must it keep happening by trial and error?

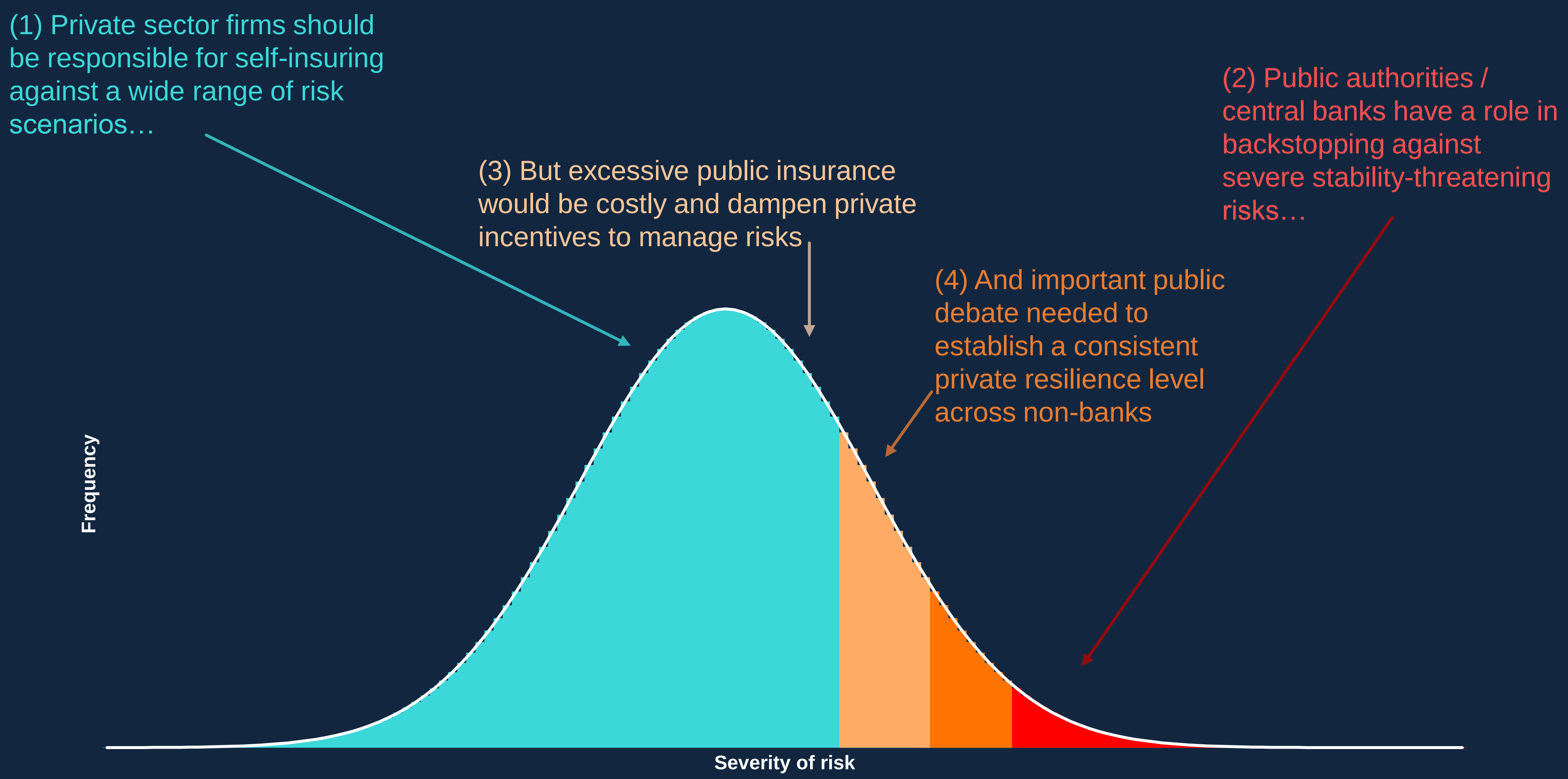
3. Central banks need new tools for a new era – capable of getting liquidity to new places, through new channels, in a stress. One size will not fit all.

4. Careful design is needed to maximise effectiveness while minimising risks: to the stance of monetary policy; to public funds; and to market incentives.

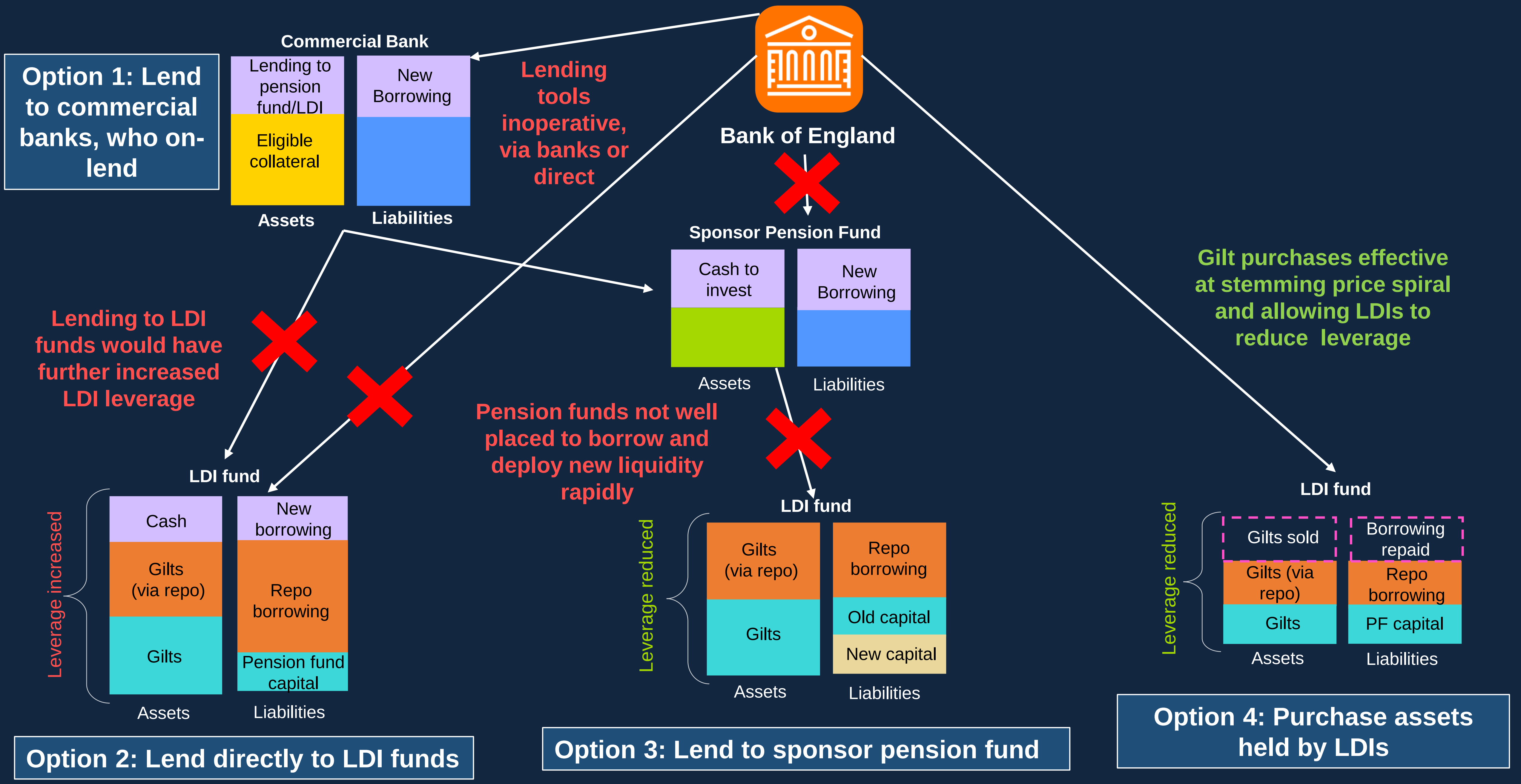
Dysfunction in core markets causes systemic liquidity risk



Public vs private insurance against non-bank liquidity risk



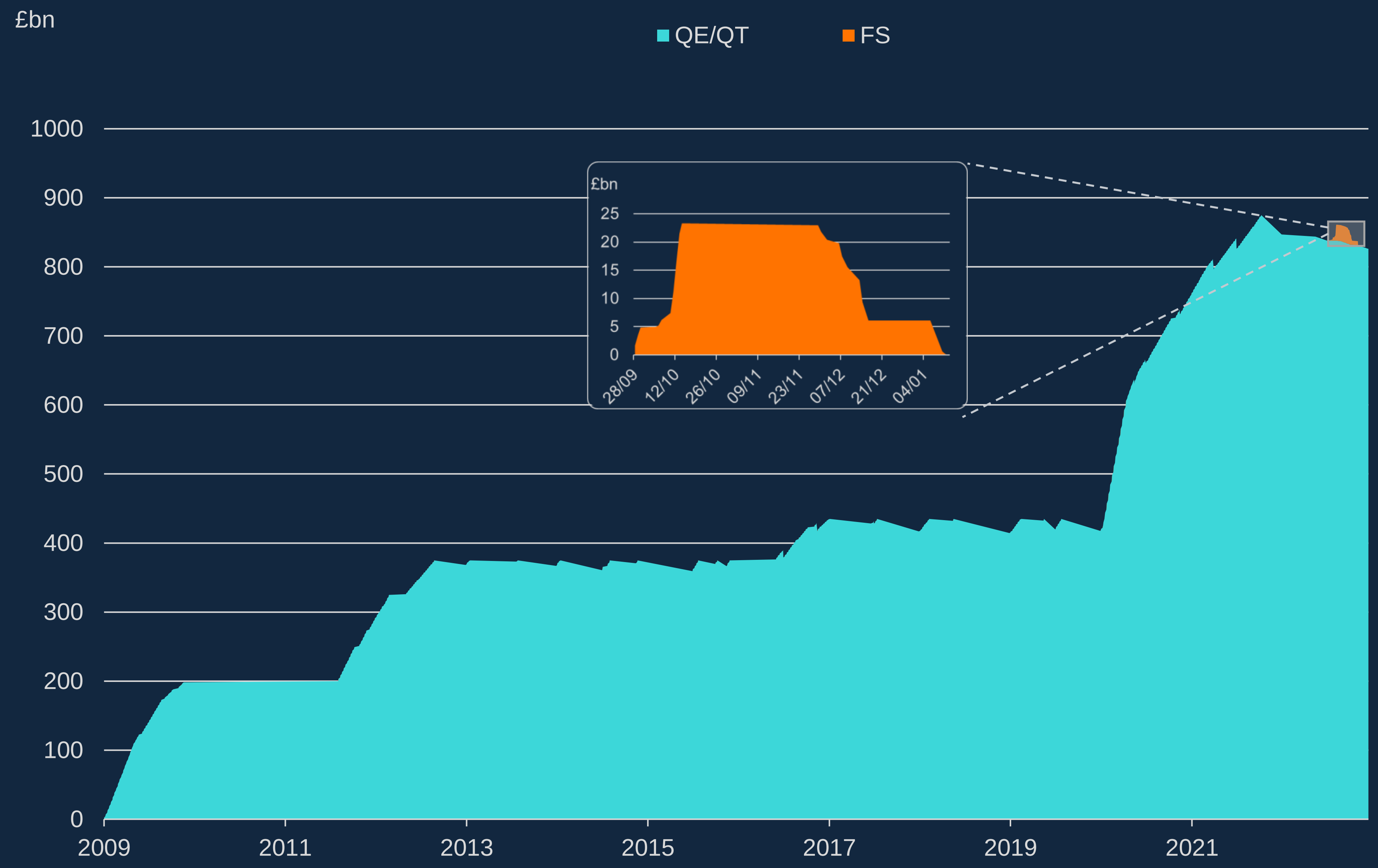
Central bank liquidity options to stop the LDI doom loop



Comparing gilt purchases for financial and monetary stability purposes

	Financial stability purchases (Oct 22 – Jan 23)	Monetary stability purchases (QE)
Purpose and governance	Aimed at reducing the risk of a self-reinforcing price spiral triggered by LDI vulnerabilities. FPC recommended action to tackle financial stability risk; MPC informed, in line with the Concordat regarding balance sheet operations; Bank executive implemented.	QE aimed at easing monetary conditions in pursuit of the inflation target. MPC voted on quantity targets; Bank executive implemented.
Duration of purchases and exit plan	**Temporary**: purchases undertaken for only as long as required by financial stability issue; and unwound through sales back to market in timely and orderly way once dysfunction resolved.	High level targets for purchase, unwind and sales programmes voted on by MPC as part of its monetary policy process.
Asset selection	**Targeted**: at assets most affected by financial stability issue.	Appropriately broad based to achieve monetary policy goals.
Pricing	**Backstop pricing**: to ensure the facility did not unduly interfere with price discovery or substitute for the need for market participants to manage their own risks over the medium term.	Priced to deliver MPC-determined quantity targets.

Comparing QE/QT and FS purchase portfolios



Differential reserve pricing for conventional and index linked gilts