



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

4 August 2016

Mark Carney
Governor
The Bank of England
Threadneedle Street
London
EC2R 8HA

Dear Mark,

EXTENSION OF ASSET PURCHASE FACILITY

Thank you for your letter of 4 August, setting out the MPC's case for its decision to raise the limit on purchases that may be undertaken by the Asset Purchase Facility (APF), which will include a new scheme to purchase private sector assets and a new funding scheme that will lend central bank reserves to banks and building societies for an extended period at rates close to Bank Rate (the Term Funding Scheme).

In recent weeks we have discussed the state of the economy following the referendum. You make clear that in its August Inflation Report the MPC expects the vote to leave the European Union (EU) will lead to a materially lower path for growth and a somewhat higher path for inflation than set out in May. The UK economy is fundamentally strong – employment is at a record high, there are almost a million new businesses since 2010 and the budget deficit has been reduced by almost two-thirds as a share of GDP. This is a new chapter for Britain, but we are well-placed to deal with the volatility caused by the vote to leave the EU.

As set out in the MPC's remit, active monetary policy has a critical role to play in supporting the economy. I note that it is the MPC's view that in the absence of monetary policy stimulus there would be undesirable volatility in output and employment, and it would be less likely to achieve a sustainable return of inflation to the target in the medium term.

Your letter explains that the MPC judges that the level of Bank Rate needed to support growth and ensure inflation returns to target over an appropriate horizon has fallen, and it voted to reduce Bank Rate to 0.25%. The MPC has taken the additional step of announcing a Term Funding Scheme and judged that it would be appropriate to impart further stimulus through additional asset purchases.

As you explain in your letter, the Term Funding Scheme should ensure that the very low level of Bank Rate is passed through to lending rates faced by households and businesses. The MPC also expects that purchases of corporate bonds will improve the availability of credit to UK companies and that further purchases of gilts will reduce borrowing costs,

raise asset prices, affect expectations and confidence, and thereby support demand in the economy.

Alongside the actions the Bank is taking, I am prepared to take any necessary steps to support the economy and promote confidence. The UK starts from a position of economic strength as we address the challenges and take advantage of the opportunities that will arise as we forge a new relationship with the EU. The government will set out its fiscal plans at Autumn Statement in the normal way, once the Office for Budget Responsibility has produced a new forecast.

The decision to leave the European Union marks the beginning of a new phase for our economy, and while there may be some volatility in the months ahead, we have the tools we need and are well-placed to face these challenges. This government will continue to provide strong leadership as we forge a new role for ourselves as we leave the European Union.

I note that, in line with the requirements in the MPC remit, the amendments to the APF that could affect the allocation of credit and pose risks to the Exchequer have been discussed with Treasury officials. The risk control framework previously agreed with the Treasury will remain in place, updated to reflect the inclusion of secured lending in the APF. I welcome the strengthened oversight arrangements for the expanded APF, including enhanced information sharing between the Bank and Treasury officials to monitor the operation and performance of the facility, and regular risk oversight meetings of Treasury and Bank senior officials. I also welcome that there will be an opportunity for the Treasury to provide views to the MPC on the design of the schemes within the APF, as they affect the government's broader economic objectives and may pose risks to the Exchequer.

I am therefore writing to authorise an increase of £70 billion in the amount of assets that the APF is authorised to purchase financed through the issuance of central bank reserves, of which £10 billion can be eligible private sector assets. I agree to authorise an extension of the definition of assets eligible to be held in the APF to include secured lending of central bank reserves, backed by the full range of collateral eligible in the Bank's Sterling Monetary Framework. I note your expectation that the value of this lending would increase in line with the amount outstanding in the Term Funding Scheme, which will in turn be determined by usage of the scheme, and could reach around £100 billion. I therefore authorise an increase in the total size of the APF of £170 billion. This will bring the maximum total size of the APF to £545 billion.

In light of this, and the fact that markets are currently functioning normally, I confirm that I am content with the closure of the Secured Commercial Paper Facility and the Corporate Bond Secondary Market Scheme.

I confirm that the government will continue to indemnify the Bank and the APF from any losses arising out of or in connection with the facility.

I am copying this letter to the Chairman of the Treasury Committee and depositing a copy in the libraries of both Houses of Parliament.

A handwritten signature in blue ink, appearing to read "Philip Hammond". The signature is fluid and cursive, with a prominent initial "P" and a long, sweeping underline.

PHILIP HAMMOND