Bank of England

The Rt Hon Rachel Reeves
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
SW1A 2HQ

Andrew Bailey
Governor

12 November 2024

Dear Rachel

Asset Purchase Facility

Stock of holdings in the Asset Purchase Facility

As you are aware, the Bank currently holds a stock of high quality assets within the Asset Purchase Facility (APF), arising from activities in support of its statutory objectives. The APF's portfolio comprises UK government bonds (gilts) and is being reduced in line with the instructions of the Monetary Policy Committee (MPC).

As agreed when it was established in 2009, the activities of the APF are indemnified by HM Treasury (HMT). As the size of APF holdings changes, the authorised maximum size of the APF should be periodically adjusted to reflect the size of the portfolio. On 3 February 2022 it was agreed that the maximum authorised size of the APF should be updated every six months in line with the reduction in the stock of assets and that this be detailed by an exchange of letters between us.[1]

I can confirm that the stock of APF gilt holdings, as of 6 November 2024, was £654.5 billion.

The maximum size of the APF can therefore now be adjusted downwards from £704.2 billion as agreed in an exchange of letters with your predecessor on 30 April 2024 to a total of £654.5 billion. This will be reviewed and confirmed between us again in six months, alongside the relevant APF Quarterly Report.

[1] **Letter from the Governor to the Chancellor on the Asset Purchase Facility - February 2022**

I would be grateful if you could confirm these changes.

The Bank's approach to unwinding the APF

In September 2024 the MPC voted to reduce the stock of UK government bond purchases held for monetary policy purposes, and financed by the issuance of central bank reserves, by £100 billion over the 12-month period from October 2024 to September 2025, comprising both maturing gilts and sales.[2] Due to the high amount of gilt holdings that are maturing throughout the year, a lower number of auctions is required in each quarter to meet the MPC's target reduction of the APF, compared to previous years.

The appropriate pace of gilt stock reduction continues to be guided by a set of key principles. First, the MPC intends to use Bank Rate as its active policy tool when adjusting the stance of monetary policy. Second, sales are to be conducted so as not to disrupt the functioning of financial markets. Third, to help achieve that, sales will be conducted in a gradual and predictable manner over a period of time.

The MPC judged that quantitative tightening had continued to proceed smoothly in the past year. There was no evidence of a negative impact of gilt sales on market functioning across a range of financial market measures. In particular, measures of gilt market liquidity had further improved. APF reduction was likely to have had some tightening effect on yields, which, while difficult to measure precisely, was judged to have been modest. That was in line with the MPC's previous expectations, and was broadly consistent with findings from other empirical studies and central banks.

Whilst different unwind strategies might affect the timing of cash flows between HMT and the APF, they are expected to have little effect on total cost in present value terms.[3] For example, active sales incur upfront costs, but they also reduce lifetime net interest costs from carrying gilts on the APF's portfolio when Bank Rate is higher than coupon payments.

The Bank's operations, as carried out by the Bank Executive, should maximise value for money by minimising cost and risk over the lifetime of the APF, subject to achieving the MPC's chosen unwind target and in line with the MPC's key principles. That is achieved, amongst other things, through:

[2] **Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 18 September 2024**

[3] **Asset Purchase Facility Quarterly Report - 2024 Q3**

- The use of auction mechanisms that are carefully designed to maximise demand and competition.
- Close liaison with the Debt Management Office (DMO).
- The application of comprehensive risk management techniques.
- Detailed public information on activity on the APF, and the design and control of auctions, available in the Bank's **Markets Operations Guide**.
- Comprehensive governance, reporting and transparency arrangements consistent with the indemnity provided by HM Treasury and the HM Treasury Accounting Officer's requirement to protect the rights and assets of the taxpayer including value for money.

The Bank and HMT have reviewed the APF's operational cash management arrangements. Over time, the size, timing and nature of cash inflows and outflows for the APF have evolved, changing how the APF's cash buffer is needed to meet expected outflows. As a result, the Bank and HMT have agreed an operational change to how the level of cash held in the APF is determined. This change impacts the quarterly profile of cash transfers between the APF and HMT, rather than representing a change to the net lifetime position of the APF.

The Bank's future balance sheet

The unwind of the APF is an important aspect of the future design of the Bank of England's balance sheet. While quantitative easing had the effect of increasing the supply of central bank reserves, quantitative tightening has the reverse effect with reserves being withdrawn over time. This reduction in the supply of reserves has implications for the operation of the financial system, notably when the stock of reserves will eventually approach the level demanded by banks.[4]

The Bank's approach to this transition is guided by our mission to maintain monetary and financial stability. The facilities within the Sterling Monetary Framework (SMF) are designed to ensure that interest rates are controlled in line with the MPC's aims and the financial system has access to a sufficient supply of central bank reserves. As the APF continues to unwind and the Bank's balance sheet continues to normalise, we expect usage of SMF facilities to increase. The Bank will continue to engage with HMT on its strategy for, and implications of, managing the transition towards its future balance sheet.

[4] **The importance of central bank reserves by Andrew Bailey | Bank of England**

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Yours sincerely,

Andrew Bailey