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

3 March 2009

Mervyn King
Governor
Bank of England
Threadneedle Street
LONDON EC2R 8AH

Dear Mervyn.

ASSET PURCHASE FACILITY

Thank you for your letter of 17 February. I also refer to our meeting of 5 February, where you raised these issues following the meeting of the Monetary Policy Committee.

Operational independence for the Monetary Policy Committee has been a central feature of the Monetary Policy Framework since May 1997. Up until now, the committee has been able to use Bank Rate to influence monetary conditions in the economy. With Bank Rate now at 1 per cent, I agree it is appropriate to consider additional instruments for ensuring that the Monetary Policy Framework can continue to deliver its objective of ensuring price stability.

The objectives of the Framework do not need to be changed. In particular, the committee should continue to maintain price stability and subject to that, support the Government's economic policy, including its objectives for growth and employment. The symmetrical inflation target is 2 per cent on the CPI measure, as specified in my letter to you of 11 March 2008.

As I announced on 19 January, the Asset Purchase Facility provides a framework that the committee can use for monetary policy purposes. In our subsequent exchange of letters on 29 January, we agreed that you would write to me should the committee wish to finance purchases under the Bank of England's Asset Purchase Facility Fund through Central Bank Money. This provision preserves the transparency that has been an important element of the Monetary Policy Framework over the past decade.

Your letter to me of 17 February sets out the committee's case for using the Asset Purchase Facility to help it meet its Remit. I believe that in current circumstances the MPC should be given the option to finance purchases under the Facility using Central Bank Money. I also agree that the range of assets eligible for purchase should be expanded.

I am therefore writing to authorise the MPC to use the Asset Purchase Facility to purchase UK Government debt on the secondary market as well as the full range of private sector assets specified in my letter of 29 January, including syndicated loans and asset-backed securities created in viable securitisation structures.

I am also authorising an increase in the scale of purchases to up to £150 billion, but that, in line with the current arrangements and in recognition of the importance of supporting the flow of corporate credit, up to £50 billion of that should be used to purchase private sector assets.

These are maximum limits within which the MPC will determine the scale of its purchases each month; the overall limit and the balance of purchases between government debt and private sector assets will be kept under review.

I welcome your commitment that the potential purchase of UK Government debt will not affect your plans to purchase private sector assets, which you and I agree is a critical element of our strategy to ease the flow of corporate credit. As I said in my letter of 29 January, asset transactions by the Bank could increase liquidity and trading activity in some UK financial markets, and could stimulate issuance by corporate borrowers and the resumption of capital market flows.

To the extent that the committee chooses to purchase private sector assets, the choice of assets should be delegated to the Bank executive. In making that judgement, the Bank executive should be guided by an assessment of which transactions would be most likely to restore the flow of finance to corporate borrowers, as well as contributing to the committee's wider monetary policy objectives.

I recognise the importance of ensuring that debt management policy is consistent with the aims of monetary policy. I am today confirming that the Government's debt management objective remains to minimise, over the long term, the costs of meeting the Government's financing needs, taking into account risk, whilst ensuring that debt management policy is consistent with the aims of monetary policy.

There will be no change to the financing remit for 2008-09. In 2009-10, the Government will continue its policy of meeting its net cash requirement (plus maturing debt and any net finance required for the foreign exchange reserves) through the issuance of debt, which includes gilts sales, National Savings products, Treasury bills and other short-term cash management instruments.

A provisional Debt Management Report setting out the financing remit for 2009-10 will be published shortly, as required by the Code for Fiscal Stability. An updated financing remit will be published in the Debt and reserves management report 2009-10 alongside the Budget.

In the medium term, consistent with the debt management policy objective of minimising long-term costs taking into account risk, our annual decisions about gilt issuance will continue to be informed by a number of factors including: the size of the annual financing requirement; supply-side considerations including the Government's risk preferences; investors' demand for gilts; the shape of the yield curve; and other financing market conditions.

However, the Government will not alter its issuance strategy as a result of the asset transactions undertaken by the Bank of England for monetary policy purposes.

I will deposit a copy of this letter in the libraries of both Houses.

Yours sincerely

ALISTAIR DARLING