



HM TREASURY

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A Baron,
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Our reference: 10/69579/2010

Dear A Baron,

Thank you for your letter dated 8 March about quantitative easing. As it is not practical for Ministers to respond to all the letters they receive, I have been asked to reply on their behalf.

As you mention in your letter, with the Chancellor's authorisation, the Bank of England has undertaken a programme of asset purchases financed by the creation of central bank reserves totalling £200 billion. It is important to stress that the Monetary Policy Committee (MPC) of the Bank of England has operational independence over monetary policy, and pursues an objective of maintaining price stability – as defined by a 2 per cent annual rise in CPI inflation – and, subject to that, to support the Government's economic policy.

The severity of the global downturn created strong deflationary pressures on the economy, and having cut Bank Rate to 0.5 per cent, the MPC decided that further action was needed to counter the risk of deflation. Asset purchases financed by the issuance of central bank reserves have allowed the MPC to ease monetary conditions further by raising the quantity of money in circulation at a time when it has not been feasible to reduce further the price of money. The stock of past purchases, together with the low level of Bank Rate, will continue to impart a substantial monetary stimulus to the economy for some time to come.

The vast majority of the Bank of England's purchases through the Asset Purchase Facility (APF) have been of government bonds, known in the UK as gilts. Article 104(1) of the Maastricht Treaty forbids EU member states from printing money to finance their deficit. However, the Bank of England has been purchasing gilts in the secondary market. Central banks routinely buy and sell government debt in the secondary market as part of their normal operations in the money markets, and such operations are not deemed to amount to monetary financing under the Maastricht Treaty. Quantitative easing differs from these normal operations only in their scale and the length of time for which the assets are likely to be held. It is important to emphasise that the MPC is undertaking these asset purchases for monetary policy purposes and not for fiscal policy purposes.



INVESTOR IN PEOPLE

Crucially, however, the APF has been designed to enable the MPC to withdraw the additional monetary policy stimulus as the medium-term outlook for inflation picks up. Assuming the economy strengthens in line with the Budget forecast, it will be appropriate and necessary to withdraw some of the monetary stimulus in place. The MPC will determine the appropriate combination of increasing Bank Rate and the sale of assets under the APF. The MPC's flexibility with regard to withdrawing this additional monetary stimulus would be considerably impaired were the newly-created central bank reserves to be used as government spending in the manner in which you suggest.

Thank you for your correspondence, and I hope you find this reply helpful.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Richard Curtis', with a stylized, cursive script.

Richard Curtis
Macroeconomic Coordination and Strategy
HM Treasury