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House of Lords
London
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My Lords,

BANK OF ENGLAND, ECONOMIC AFFAIRS COMMITTEE REPORT DEBATE

Thank you for your contributions to the debate on making an independent Bank of England work better. I committed to write in response to the questions that I was unable to address during the debate itself.

Viscount Chandos and Lord Turnbull asked about the losses arising from the Bank of England's quantitative tightening (QT) programme. Firstly, I must stress that monetary policy is the responsibility of the independent Monetary Policy Committee (MPC) of the Bank of England, and this includes decisions on the assets held in the Asset Purchase Facility (APF). The separation of fiscal and monetary policy is a key feature of the UK's economic framework, and essential for the effective delivery of monetary policy. As part of our support for the principle of the Bank's independence, the government does not comment on the conduct or effectiveness of monetary policy.

HM Treasury's indemnity of the APF is in line with Treasury's financial relationship with the Bank and supports the Bank's operational independence by allowing the MPC to make monetary policy decisions on the assets held in the APF. Between 2012 and October 2022, £124bn in profits were transferred from the APF to the Treasury, primarily from net interest income, as the Bank Rate on the APF loan was below the average coupon rate on the assets in the APF portfolio. These cashflows were always expected to reverse as Bank Rate increased and QE was unwound.

The first payment from the Treasury to the APF was made in October 2022 and cash transfers continue quarterly. Between October 2022 and March 2024, the Treasury has transferred £49.4bn to the APF and therefore, the current net realised value of the APF is positive £74.4bn since the start of the Bank of England's quantitative easing (QE) programme in 2009.

Unrealised mark-to-market losses in the APF stood at £153.6bn at the Spring Budget 2024. The independent Office for Budget Responsibility (OBR) regularly forecasts the net lifetime cost of the APF, and in its Economic and Fiscal Outlook (EFO) accompanying the Spring Budget 2024, the net lifetime cost was forecast to be £104bn. The overall gains or losses arising from the APF are highly uncertain and will be determined in the first instance by the future path for Bank Rate and gilt prices. For example, the OBR's Spring Budget estimate for lifetime cost is c.£20bn lower than it was at the Autumn Statement 2023, due to market movements.

There is a high level of transparency on projections of APF losses, as highlighted by a recent IMF working paper. Projections of cashflows and total lifetime costs of the APF are published by the OBR and by the Bank of England in its quarterly APF reports.

While it is true that QE increases the sensitivity of the consolidated public finances to changes in interest rates in the UK and elsewhere, the average maturity of the total stock of gilts is significantly higher than other G7 countries. The average maturity of the UK's debt stock remains consistently longer than G7 peers at c.14 years, and this is true for the UK even after adjusting for the impacts of QE (where our average maturity falls to c. 11 years). The closest G7 peer is France (at c.8 years), and this too falls when taking QE into account. As shown by the OBR in its March 2024 EFO, QT is reversing this debt effect of QE, increasing the UK's effective debt maturity and reinsulating the public finances against changes in borrowing costs.

Lord Burns asked what account was taken of the potential fiscal costs when decisions on QE were made. Unconventional monetary policies, including QE and QT, have direct fiscal consequences, including through cashflows arising from the indemnity of the APF. The presumption is that the financial risks of unconventional monetary policy operations will be borne by the Treasury where exposures exceed the Bank's capital, with assessments for the financial backing done on a case-by-case basis as set out in the Memorandum of Understanding. Consistent with this arrangement, Treasury indemnify the APF, meaning all gains and losses accrue to HM Treasury. Notwithstanding these risks, the Treasury's underlying principle remains the same: independent monetary policy is essential for macroeconomic credibility, and therefore beneficial for the economy and public finances.

The question of governance surrounding QE and QT was also raised by the Treasury Select Committee in their inquiry into QT, to which HM Treasury responded. It was set out in the response to the Committee that the Chancellor may authorise increases to the maximum size of the APF under the indemnity, being ultimately responsible to parliament for the spending implications. Each increase during successive rounds of QE was accompanied by Accounting Officer advice assessing the change against the Managing Public Money framework given the potential direct implications for public

funds through the contingent liability created by the indemnity. This includes assessments for regularity and propriety, and assessments of the expected fiscal and macro-economic impact. This rightly reflects the responsibility on HM Treasury to properly assess the case for committing new public expenditure through expanding the APF indemnity and the associated contingent liability.

Throughout the implementation of QT, the Bank has made it clear that operations, as carried out by the Bank's Executive Directors, 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.

With regards to Lord MacPherson's comment that QE enabled inflation to take root, the Governor of the Bank of England set out a response to this issue in a recent letter to the Treasury Select Committee (TSC).

As the Governor set out, the MPC's decisions are taken for monetary policy purposes and are taken independently, solely to meet the MPC's policy objectives in line with its statutory mandate to achieve the 2% inflation target. The Governor noted that in line with these key objectives, when judging the effectiveness of policy decisions, the MPC considered every round of QE appropriate and necessary to meet its mandate and the remit given to it by the government.

The Governor also emphasised in his response that QE has formed an important part of the monetary policy toolkit since the Global Financial Crisis. The Governor noted that with Bank Rate constrained by a lower bound, the MPC turned to asset purchases as a means for providing additional monetary stimulus to support the economy. The Governor said that asset purchases should be judged on the basis of how successful they have been in supporting the MPC's pursuit of the inflation target. The Governor also noted that in the Bank's Quarterly Bulletin, article 18, there is evidence that on balance suggests that QE pushed down on longer-term borrowing costs for households and corporates, which stimulated demand and helped the MPC reach its inflation target.

Finally, Lord Northbrook noted during the debate his endorsement of the recommendation in the Economic Affair Committee's report, which states that there should be clarification of the interaction between monetary policy and debt management.

As I mentioned in my speech, the Chancellor wrote to the Chair of the Economic Affairs Committee in January this year in response to the report. In that response, the Chancellor noted that monetary policy and debt management are distinct areas with separate mandates and decision-making processes. Given the institutional separation of

monetary and debt management policy, in addition to existing public documents clarifying the relevant governance structure, the government does not consider that an additional Memorandum of Understanding between the two organisations is required to clarify their relationship further.

The longstanding framework for debt management policy has not changed due to developments in monetary policy in recent years, and nor did the Debt Management Office's mandate fundamentally change when QE was introduced. In carrying out QT, the Bank is liaising operationally with the Debt Management Office to ensure that its gilt sales limit interference with the Debt Management Office's issuance programme and avoids disrupting market functioning. This is in line with the Governor's public commitment. As I noted above, decisions on QT remain a matter for the independent MPC.

I would like to thank all noble Lords once again for their contributions to the debate. I am copying this letter to all speakers of the debate, and a copy will be placed in the Library of the House.

Yours,
Charlotte

BARONESS VERE OF NORBITON