



Treasury Chambers, Parliament Street, London, SW1P 3AG
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6 May 1997

The Governor
Bank of England
LONDON EC1

Dear Governor,

THE NEW MONETARY POLICY FRAMEWORK

Improving the institutional arrangements for economic policy will be accorded a high priority by the Government in order to deliver long term economic stability and rising prosperity. Our Manifesto commitment is to "ensure that decision-making on monetary policy is more effective, open, accountable and free from short-term political manipulation". The reforms I lay out below will put the arrangements for monetary policy-making on a sound and stable footing for the long term.

2. Within its overall responsibility for economic policy, including stability, growth and employment, and for setting the inflation target, the Government intends to give the Bank of England operational responsibility for setting interest rates. The Government plans to provide in the Queen's Speech for legislation to amend the Bank of England Act 1946. The Bank will of course remain in public ownership. The legislation will set up the new monetary policy framework, and provide for greater accountability. It is my intention to ensure the passage of this legislation as soon as possible.



3. This letter sets out how the new arrangements for monetary policy-making will work and how I propose that we manage matters during the transition.

1. The New Framework

i. Objectives of the Bank of England

4. Price stability is a precondition for high and stable levels of growth and employment, which in turn will help to create the conditions for price stability on a sustainable basis. To that end, the monetary policy objective of the Bank of England will be to deliver price stability (as defined by the Government's inflation target) and, without prejudice to this objective, to support the Government's economic policy, including its objectives for growth and employment.

ii. The Inflation Target

5. The Bank will have operational responsibility for setting short-term interest rates to achieve an inflation target which the Government will determine. This target will be confirmed in each Budget Statement. The Bank will be required to publish a quarterly Inflation Report in which it will account for its monetary policy actions, set out and justify its analysis of the economy, and explain how it intends to meet the Government's inflation target and support the Government's economic policy.

6. The legislation will provide that if, in extreme economic circumstances, the national interest demands it, the Government will have the power to give instructions to the Bank on interest rates for a limited period. This power is in line with practice in other countries, and could only be exercised through subordinate legislation approved by Parliament.



iii. Exchange Rate Policy

7. The Government will be responsible for determining the exchange rate regime. The Bank will have its own separate pool of foreign exchange reserves which it may use at its discretion to intervene in support of its monetary policy objective.

8. If the Government so instructs, the Bank, acting as its agent, will intervene in the foreign exchange markets by buying or selling the Government's foreign exchange reserves. All such intervention will be automatically sterilised.

iv. Governor and Deputy Governors

9. The Bank will be managed on a day-to-day basis by the Governor and two Deputy Governors. One Deputy will support the Governor on monetary stability and the other will support the Governor on financial stability. The Governor and Deputy Governors will be appointed according to the existing procedure and for five year terms.

10. I am grateful to know that you are willing to allow the current contracts of yourself and your Deputy Governor to run their course. The second Deputy Governor will be appointed once the legislation has come into force, at which point the division of responsibilities will take effect.

v. Monetary Policy Committee

11. Operational decisions on interest rate policy will be made by a new Monetary Policy Committee comprising the Governor, the Deputy Governors and six members. The decisions will be made by a vote of the Committee, with each member having one vote. If there is no majority, the Governor will have the casting vote. The Treasury will have the right to be represented in a non-voting capacity.



12. Two of the members will take management responsibility for monetary policy and market operations, respectively. They will be appointed by the Governor, after consultation with the Chancellor, for three year terms.

13. The remaining four members will be appointed by the Chancellor, for three year terms. They will be recognised experts. They will be allowed to engage, with the Chancellor's approval, in other activities which do not give rise to a conflict of interest.

14. The intention is to move to a situation where the six members of the Monetary Policy Committee are appointed on a rolling basis (2 per year). There will be no limit to the number of terms a member can serve.

15. The Monetary Policy Committee will meet on a regular monthly basis. Any decisions on interest rates will be taken by the Committee and announced immediately, after the Chancellor has been notified of the decisions and proceedings of the Committee. The meetings will be minuted, and the minutes, including a record of any vote, will be released no later than six weeks after the meeting. The new arrangements for release will be agreed between us and announced this month.

16. The Monetary Policy Committee will report to a monthly meeting of a reformed Court of the Bank, my proposals for which are set out next.

vi. Reform of the Court

17. The legislation will set out the Court's terms of reference. The Bank will be accountable to the Court for its operations and finances.

18. I propose that the Court of the Bank be reconstituted to comprise no more than 19 members consisting of the Governor, his two Deputies, and



16 non-Executive Members. The Court will be representative of the whole of the United Kingdom. The non-Executive Members will be appointed for their expertise and will be drawn widely from industry, commerce and finance.

19. The non-Executive Members will be appointed according to the existing procedure and for three year terms. I do not intend to increase the size of Court beyond its present size, other than the addition of a new Deputy Governor. But, in the first instance, I intend to appoint four new non-Executive Members, as soon as the legislation has come into force. The non-Executive Members will review the performance of the Bank as a whole, including the Monetary Policy Committee. They will have particular regard to whether the Bank is collecting proper regional and sectoral information for the purposes of monetary policy formation. In addition, they will be responsible for ensuring that the internal financial affairs of the Bank are properly conducted.

vii. The Bank's Financial Arrangements

20. The financial arrangements of the Bank will be reviewed, to ensure that they are in line with the Bank's new responsibilities, and appropriate standards of accountability and transparency.

viii. Funding

21. The Bank's role as the Government's agent for debt management, the sale of gilts, oversight of the gilts market and cash management will be transferred to the Treasury.



ix. Accountability

22. The changes I propose will enhance accountability by ensuring that the decision-making process is fully transparent, by the arrangements for appointing the Court and the Monetary Policy Committee, and by the Government's overall accountability to Parliament for economic policy, including the setting of the inflation target. The Bank of England will make reports to and give evidence to the House of Commons, through the Treasury Select Committee, on an enhanced basis, and I will write to the Chairman of the Committee.

2. The Transition

23. It will take some months for this legislation to be enacted. In the meantime, the following arrangements will be put in place.

i. May Monthly Monetary Meeting

24. The May monthly monetary meeting will be brought forward to 8.00 am on Tuesday 6 May. It will be held in the normal way. It will be the last such monthly meeting.

ii. Transitional Arrangements for Monetary Policy

25. I propose to make the following announcements immediately after the May meeting:

- (a) the details of any decision taken at that morning's meeting;
- (b) the Government will provide in the Queen's Speech for legislation to give the Bank of England operational responsibility for setting interest rates, and to give effect to the other reforms outlined in this letter;
- (c) we have agreed to establish immediately an interim Monetary Policy Committee. You, the Deputy Governor and two of the



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existing Executive Directors will be members of this interim Committee. In addition, you have asked me to give you the names of four new members of the Committee as soon as is practicable. You will then ask the Court to appoint them as Bank officials. I will subsequently confirm these appointees as members of the new Monetary Policy Committee once the legislation is in force;

- (d) during the intervening period until the legislation has come into force, all aspects of the new procedure for making and announcing decisions on monetary policy will operate de facto;
- (e) in this interim period, you will set policy to meet the Government's inflation target.

26. I intend to use the Mansion House speech to set out more fully the Government's overall approach to economic policy and how these new monetary arrangements will form part of our wider strategy to improve the performance of the British economy in the long term, and deliver high and stable levels of growth and employment. I am confident that these arrangements will enhance the credibility of UK monetary policy-making.

With best wishes.

Gordon Brown

Gordon Brown MP
Chancellor of the Exchequer