

Asset Purchase Facility

Quarterly Report 2009 Q1



BANK OF ENGLAND



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Asset Purchase Facility

The Bank of England Asset Purchase Facility Fund was established as a subsidiary of the Bank of England on 30 January 2009, in order to fulfil the remit of the Chancellor of the Exchequer given to the Bank on 19 January⁽¹⁾ and detailed in an exchange of letters with the Governor on 29 January.⁽²⁾ This remit was subsequently expanded to enable the Fund to be used as a monetary policy tool, at the request of the Monetary Policy Committee, as detailed in the exchange of letters on 17 February and 3 March.⁽³⁾

The Governor noted in his letter of 29 January, 'it is important that the Asset Purchase Facility is operated in an open and transparent manner. The Bank will publish a quarterly report on the transactions as part of the facility, shortly after the end of each quarter'. This is the first of those regular reports. More information on the Committee's monetary policy decisions can be found in the *Inflation Report*.⁽⁴⁾

The Bank's Executive Directors for Markets and for Monetary Analysis and Statistics have been appointed as directors of the Fund. The Directors make recommendations on the assets to be purchased to the Governor, who decides after consulting with the two Deputy Governors. The Fund and the Bank are indemnified by the Treasury from any losses arising out of or in connection with the Facility.

The initial objective of the Facility was to improve the liquidity in, and increase the flow of, corporate credit by making purchases of high-quality private sector assets including commercial paper and corporate bonds. Those purchases would be financed by the issuance of Treasury bills.

The Facility was initially authorised by the Treasury to purchase up to a total of £50 billion of private sector assets financed by Treasury bills. The first purchases of commercial paper began on 13 February.⁽⁵⁾

The scope of the Asset Purchase Facility was designed to enable the Facility to be used by the Monetary Policy Committee in order to meet the 2% target for CPI inflation, should it wish to do so. The Committee was given the option to finance purchases under the Facility by issuing central bank reserves. The range of assets eligible for purchase by the Facility on behalf of the Committee included UK government debt in the secondary market.

For this purpose, the Facility was authorised to purchase up to £150 billion of assets, of which up to £50 billion should be used to purchase private sector assets.

The Committee voted at its March policy meeting for the Facility to purchase £75 billion of assets financed by the issuance of central bank reserves. This would include continued purchases of private sector assets but, in order to reach that total, the majority of purchases would be of UK government debt. The aim of this action is to boost the supply of money and credit in order to raise the rate of growth of nominal spending to a level consistent with meeting the inflation target in the medium term. A more detailed explanation of the reasons for the Committee's decision can be found in the minutes published on 18 March.⁽⁶⁾

The first purchases of gilts by the Facility began on 11 March.⁽⁷⁾ The Facility continued to purchase commercial paper but, from 6 March onwards, this was financed by reserves balances held at the Bank. And the Facility began to purchase corporate bonds financed in the same way from 25 March.⁽⁸⁾ The Facility stands ready to purchase bank debt issued under the Credit Guarantee Scheme (CGS) should conditions in that market deteriorate.⁽⁹⁾

(1) The Chancellor's statement is available at www.hm-treasury.gov.uk/press_05_09.htm.

(2) The exchange of letters are available at www.bankofengland.co.uk/markets/apfgovletter090129.pdf and www.hm-treasury.gov.uk/d/ck_letter_boe290109.pdf.

(3) The exchange of letters are available at www.bankofengland.co.uk/monetarypolicy/pdf/govletter090305.pdf and www.hm-treasury.gov.uk/d/chxletter_boe050309.pdf.

(4) The February 2009 *Inflation Report* is available at www.bankofengland.co.uk/publications/inflationreport/ir09feb.pdf.

(5) The Facility offers to buy high-quality commercial paper through a daily window from either the primary or secondary markets, subject to approval by the Bank. For more details see www.bankofengland.co.uk/markets/marketnotice090403.pdf.

(6) The March MPC minutes are available at www.bankofengland.co.uk/publications/minutes/mpc/pdf/2009/mpc0903.pdf.

(7) The Facility purchases gilts in twice-weekly operations. In each operation a particular maturity range of gilts is purchased: either those with a residual maturity of between five and ten years; or those with a residual maturity of between ten and 25 years. Purchases are made in reverse auctions with both a non-competitive and a competitive element. For more details see www.bankofengland.co.uk/markets/marketnotice090305.pdf.

(8) The Facility offers to purchase high-quality corporate bonds through a number of daily operations each week. Each eligible bond is offered to be purchased at least once a week through reverse auctions on a uniform price basis. For more details see www.bankofengland.co.uk/markets/marketnotice090319.pdf.

(9) For more details see www.bankofengland.co.uk/markets/marketnotice090319.pdf.

Report for the quarter ended 31 March 2009

Operations

Chart 1 and Table A below summarise the amount that the Fund has purchased each week in each facility.

Purchases of assets by the Facility are financed via a deposit from the Bank. Initially, this deposit was financed in turn through the issuance of Treasury bills by the Debt Management Office. Following the decision by the Monetary Policy Committee (MPC) on 5 March to use the Asset Purchase Facility as a monetary policy tool, the deposit for all purchases of assets by the Facility since 6 March, totalling £14 billion up to 26 March, has been financed by the issuance of central bank reserves.

Chart 1 Cumulative asset purchases by type

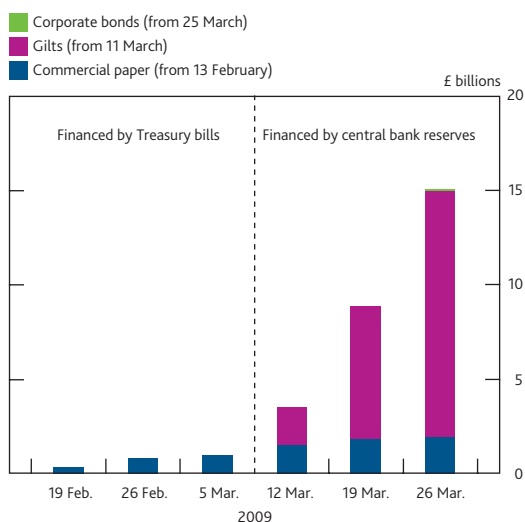


Table A Asset purchases by type (£ millions)^{(a)(b)}

Week ending	Commercial paper	Gilts	Corporate bonds	Total
19 February 2009	340	–	–	340
26 February 2009	480	–	–	480
5 March 2009	164	–	–	164
Total financed by Treasury bills	985	–	–	985
12 March 2009	561	2,000	–	2,561
19 March 2009	345	4,993	–	5,338
26 March 2009	76	6,000	128	6,204
Total financed by central bank reserves	982	12,993	128	14,103
Total asset purchases	1,966	12,993	128	15,087

(a) Amounts are in terms of the proceeds paid to counterparties, less redemptions valued at initial purchase price, rounded to the nearest million. Data are aggregated for purchases from the Friday to the following Thursday.

(b) Weekly values may not sum to totals due to rounding.

Conditions in UK government and corporate debt markets

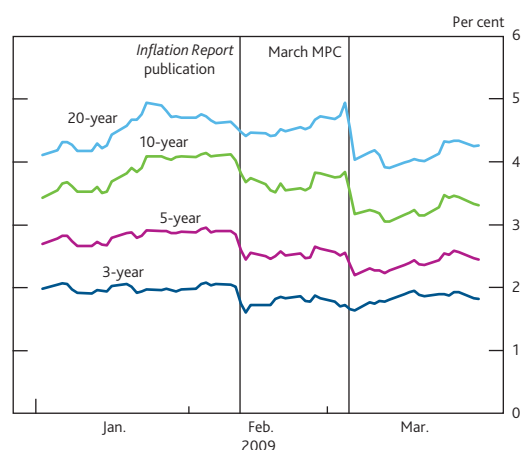
The announcements and subsequent purchases of assets by the Facility during the first quarter of 2009 were followed by falls in yields on medium to long-term UK government bonds. Spreads on sterling investment-grade non-financial commercial paper and corporate bonds also fell somewhat over the quarter leaving yields on those assets lower. Issuance of corporate bonds remained high relative to long-term averages. But it may take some time for the full effect of purchases by the Facility to be observed.

More information on market conditions up to the end of February 2009 can be found in the *Quarterly Bulletin*.⁽¹⁾

UK government bond market

Yields on nominal gilts fell following the publication of the February *Inflation Report* (Chart 2). And there was a further substantial fall in yields following the MPC's March policy announcement that the Facility would buy nominal gilts at maturities of between five and 25 years. But later in the quarter yields rose back slightly. That left the curve of government forward rates at the end of 2009 Q1 much flatter at short to medium-term horizons but higher at longer horizons (Chart 3).

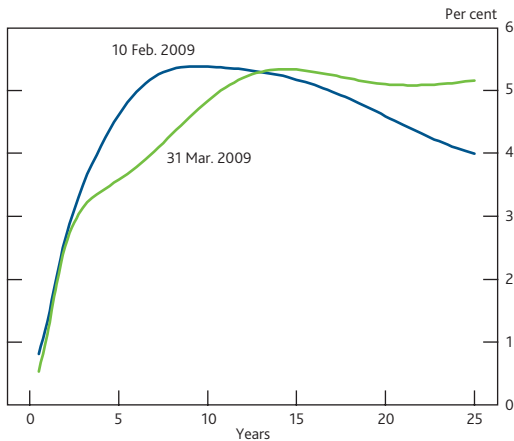
Chart 2 UK nominal spot rates



Sources: Bloomberg and Bank calculations.

(1) The 2009 Q1 *Quarterly Bulletin* can be found on the Bank's website at www.bankofengland.co.uk/publications/quarterlybulletin/qb0901.pdf.

Chart 3 UK nominal forward rates

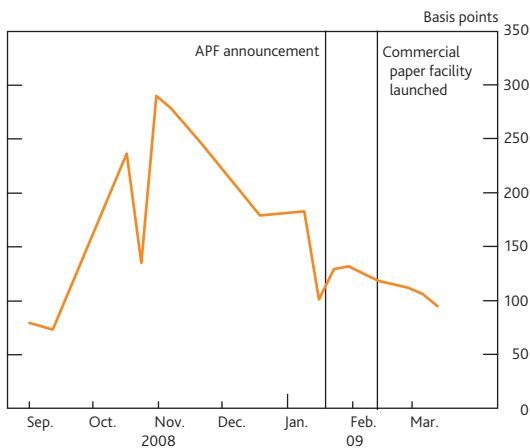


Sources: Bloomberg and Bank calculations.

UK corporate debt markets

Secondary market activity for sterling non-financial commercial paper is limited but data available on primary market transactions suggest spreads for A1-rated issuers had narrowed over 2009 Q1, although they were quite volatile (Chart 4). Net issuance of sterling non-bank commercial paper increased slightly over the quarter for lower-rated firms (Chart 5). Market contacts reacted positively to the Facility buying commercial paper and expected the level of issuance to increase further.

Chart 4 Primary market spreads on sterling three-month A1/P1-rated non-financial commercial paper^(a)

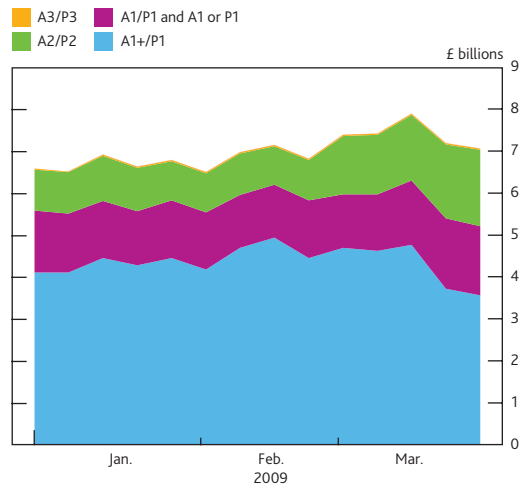


Source: Euroclear.

(a) Spreads to OIS rates.

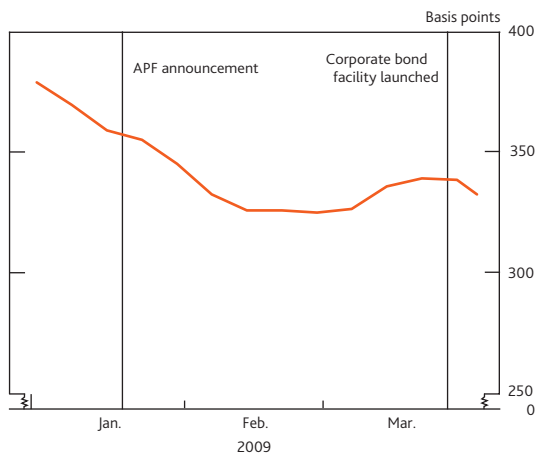
Secondary market spreads on sterling investment-grade non-financial corporate bonds also narrowed slightly during 2009 Q1 (Chart 6) and primary issuance continued to be robust (Chart 7). This, combined with falling UK government bond yields, resulted in significantly lower investment-grade corporate bond yields (Chart 8). Market contacts suggested that many companies were planning to issue corporate bonds in the near future and expected levels of gross issuance to remain fairly high.

Chart 5 Amount outstanding of sterling non-bank commercial paper by rating



Source: Dealogic.

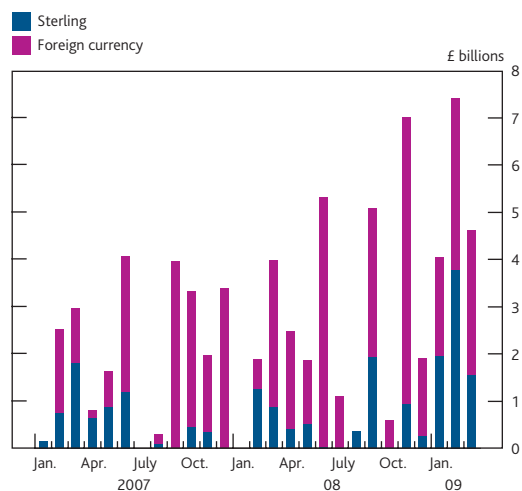
Chart 6 Sterling investment-grade non-financial corporate bond spreads^{(a)(b)}



Sources: Merrill Lynch and Bank calculations.

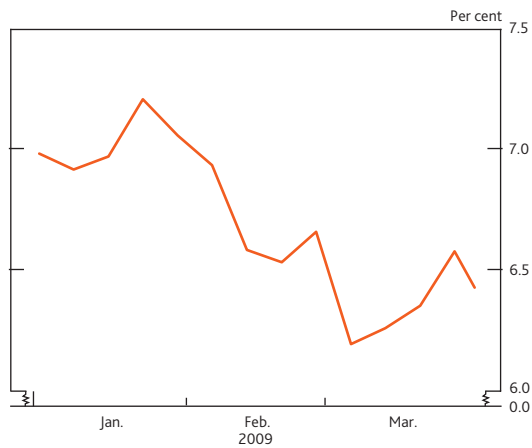
(a) Option-adjusted spreads.
 (b) This weekly index has been constructed using Merrill Lynch corporate bond index data such that the constituents of the index are equal to those constituents of the Merrill Lynch Industrials and Utilities sterling investment-grade corporate bond indices as at 31 March 2009.

Chart 7 Issuance of bonds by UK PNFCs



Source: Dealogic.

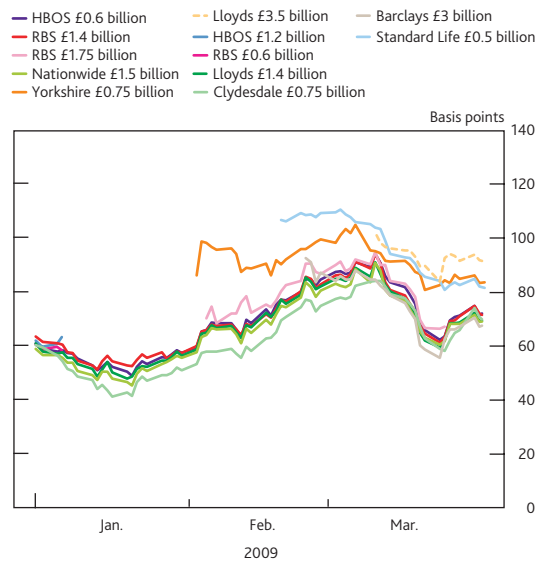
Chart 8 Sterling investment-grade non-financial corporate bond yields^(a)



Sources: Merrill Lynch and Bank calculations.

(a) This weekly index has been constructed using Merrill Lynch corporate bond index data such that the constituents of the index are equal to those constituents of the Merrill Lynch Industrials and Utilities sterling investment-grade corporate bond indices as at 31 March 2009.

Chart 10 Secondary market maturity-matched sterling spreads on paper covered by the CGS^(a)



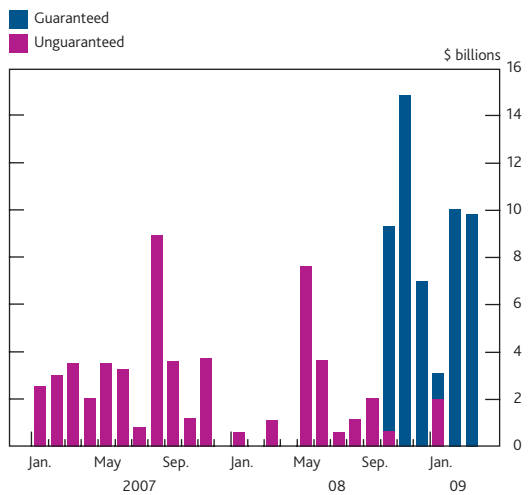
Sources: Bloomberg and Bank calculations.

(a) Spreads to gilts.

CGS bond market

UK banks continued to issue sizable amounts of paper under the CGS (Chart 9). Spreads on those assets remained broadly stable (Chart 10). And were comparable with those on sterling bonds issued under foreign government guarantees. The Facility stands ready to make purchases of CGS bonds from the secondary market should conditions in that market deteriorate.

Chart 9 UK bank fixed-rate senior debt issuance^{(a)(b)}



Source: Dealogic.

(a) Issuance with a value greater than \$500 million equivalent and original maturity greater than one year.
 (b) Senior debt issued under HM Treasury's Credit Guarantee Scheme.