Asset Purchase Facility

Quarterly Report 2009 Q2

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 second 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 government debt on the secondary market.

For this purpose, the Facility was authorised to purchase up to £150 billion, 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. The Committee subsequently voted at its May policy meeting to increase this to a total £125 billion of assets. Purchases of private sector assets would continue to be made 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 decisions can be found in the minutes published on 18 March and 20 May.[(6)]

The 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 issued by 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)] On 8 June, the Bank released a consultative paper setting out proposed extensions to the Asset Purchase Facility, to include a secured commercial paper facility.[(10)]

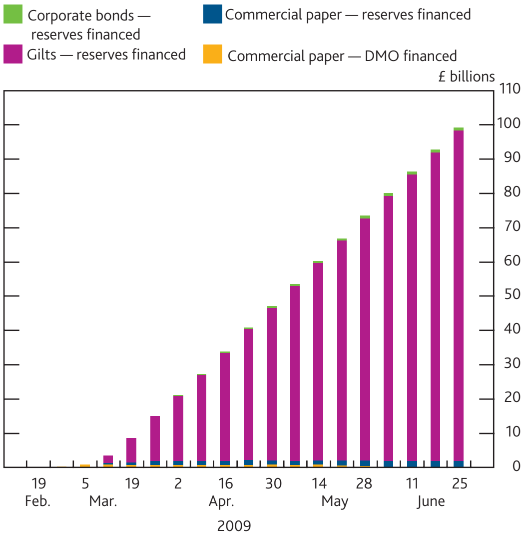
(1) The Chancellor's statement is available at www.hm-treasury.gov.uk/press_05_09.htm.
(2) The exchange of letters are available at www.bankofengland.co.uk/markets/apfgovletter090129.pdf and www.hm-treasury.gov.uk/d/ck_letter_boe290109.pdf.
(3) The exchange of letters are available at www.bankofengland.co.uk/monetarypolicy/pdf/govletter090305.pdf and www.hm-treasury.gov.uk/d/chxletter_boe050309.pdf.
(4) The May 2009 *Inflation Report* is available at www.bankofengland.co.uk/publications/inflationreport/ir09may.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/apf/cp/index.htm.
(6) The March MPC minutes are available at www.bankofengland.co.uk/publications/minutes/mpc/pdf/2009/mpc0903.pdf; the May MPC minutes are available at www.bankofengland.co.uk/publications/minutes/mpc/pdf/2009/mpc0905.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 5 and 10 years; or those with a residual maturity of between 10 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/apf/gilts/index.htm.
(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/apf/corporatebond/index.htm.
(9) For more details see www.bankofengland.co.uk/markets/apf/cgs/index.htm.
(10) The consultation paper on working capital facilities proposals is available at www.bankofengland.co.uk/markets/apf/consultation090608.pdf.

Report for the quarter ended 30 June 2009.

Operations

Chart 1 and **Table A** below summarise the amount that the Fund has purchased each week in each facility and the total amounts outstanding as at 25 June.

Chart 1 Cumulative asset purchases by type[a]



(a) Data based on settled transactions.

Table A Asset purchases by type (£ millions)[a][b]

Period/Week ending	Commercial paper	Gilts	Corporate bonds	Total
2009 Q1[c]	1,964	12,993	128	15,085
2 April 2009	50	6,000	186	6,236
9 April 2009	15	6,000	121	6,136
16 April 2009	345	6,503	36	6,884
23 April 2009	125	6,503	33	6,661
30 April 2009	0	6,508	44	6,552
7 May 2009	50	6,501	20	6,571
14 May 2009	174	6,493	46	6,713
21 May 2009	394	6,494	37	6,925
28 May 2009	701	6,501	48	7,250
4 June 2009	85	6,509	41	6,635
11 June 2009	458	6,338	10	6,856
18 June 2009	263	6,476	26	6,765
25 June 2009	130	6,500	24	6,654
Amount outstanding financed by Treasury bills as at 25 June[d]	–	–	–	–
Amount outstanding financed by central bank reserves as at 25 June[d]	1,950	96,368	776	99,094
Total amount outstanding as at 25 June[d]	**1,950**	**96,368**	**776**	**99,094**

(a) Week-ended amounts are in terms of the proceeds paid to counterparties, on a trade-day basis, 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.
(c) 2009 Q1 measured as amount outstanding as at 26 March 2009.
(d) In terms of proceeds paid to counterparties less redemptions at initial purchase price on a settled basis. Amounts outstanding may be less than total purchases due to assets maturing during the period.

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 (DMO). Following the decision by the Monetary Policy Committee (MPC) on 5 March to use the Asset Purchase Facility (APF) as a monetary policy tool, the deposit for all purchases of assets by the Facility since 6 March, totalling £99 billion up to 25 June, has been financed by the issuance of central bank reserves.

Conditions in UK government and corporate debt markets

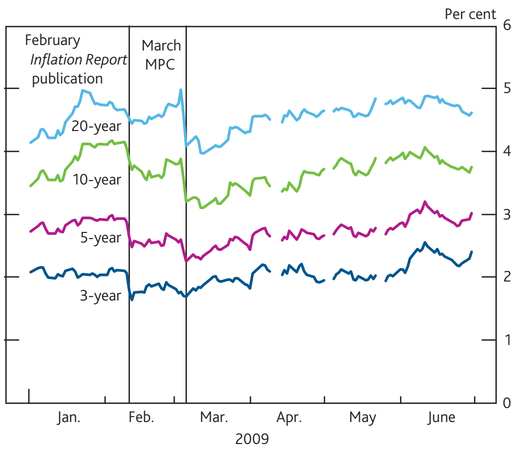
The continued purchases of assets by the Facility during the second quarter of 2009 were accompanied by signs that conditions in corporate credit markets were improving. Yields and spreads on sterling investment-grade non-financial corporate bonds continued to fall and liquidity in that market appeared to have increased. Yields on UK government bonds rose, but this generally reflected higher expectations of the long-run path of Bank Rate as market participants reportedly reassessed the prospects for long-term UK nominal demand.

More information on market conditions up to the end of May 2009 can be found in the *Quarterly Bulletin*.[1]

UK government bond market

Yields on nominal gilts were volatile during 2009 Q2 but generally rose and, for short to medium-term rates, ended the period higher than prior to the March MPC announcement (**Chart 2**). Changes in the rates on sterling overnight index swaps (OIS) suggest that these moves may have been accounted for by increases in the expected path of Bank Rate and changes in the risks around that path in the long term, and did not reflect any increase in specific premia associated with holding gilts such as those for credit and illiquidity risk (**Chart 3**).[2]

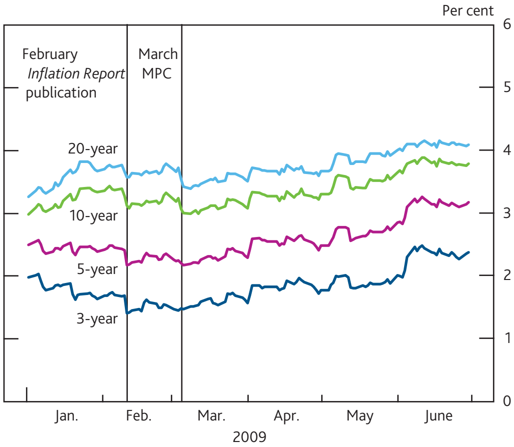
Chart 2 UK nominal spot rates



Sources: Bloomberg and Bank calculations.

(1) The 2009 Q2 *Quarterly Bulletin* can be found on the Bank's website at www.bankofengland.co.uk/publications/quarterlybulletin/qb0902.pdf.
(2) For more information on OIS rates and gilt market liquidity see the box 'Gilt market liquidity' on page 76 of the 2009 Q2 *Quarterly Bulletin*.

Chart 3 Sterling OIS spot rates



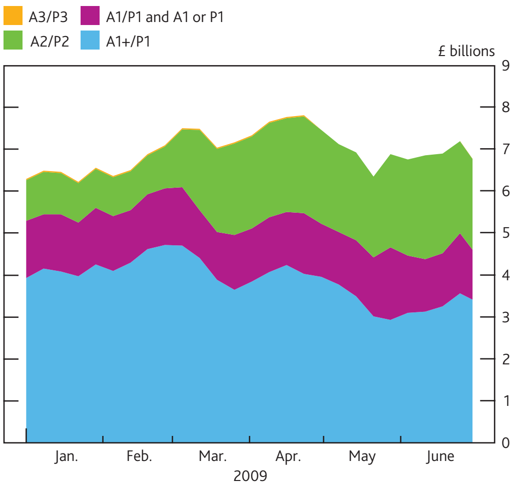
Sources: Bloomberg and Bank calculations.

The Bank excluded some gilts from purchase by the Facility where the Bank's holdings were above 70% of the total nominal amount of those stocks in issue, less government holdings. The Bank continues to keep the identity of gilts eligible for purchase under review, taking into account the size of the Facility's holdings relative to the nominal amount of those stocks in issue and their relative richness to the yield curve.

UK corporate debt markets

The market for sterling investment-grade non-financial commercial paper continued to improve during 2009 Q2. Quoted primary market spreads were close to or below those offered by the Facility and some contacts reported being able to issue directly into the market at those levels. Issuance of commercial paper declined slightly during the period as firms reportedly were able to raise a greater proportion of funding through longer-term markets such as corporate bonds (**Chart 4**).

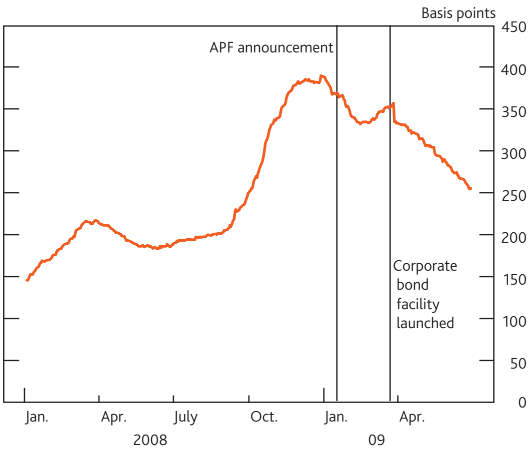
Chart 4 Amount outstanding of sterling non-bank commercial paper by rating



Source: CP Ware.

Secondary market spreads on sterling investment-grade non-financial corporate bonds continued to narrow during 2009 Q2 (**Chart 5**), and by more than the rise in corresponding gilt rates, leaving yields on those bonds around 40 basis points lower (**Chart 6**). Gross bond issuance by UK PNFCs was slightly lower than the previous quarter but remained high relative to past averages (**Chart 7**). The narrowing in spreads was greater than that for corresponding CDS premia (**Chart 8**) possibly indicating that illiquidity premia in corporate bond prices had reduced over the period.[1] Bid-ask spreads quoted by market makers also narrowed, suggesting secondary market liquidity had improved, but remained wider than those prior to the events of September 2008 (**Chart 9**). Market contacts reported that there was some evidence that purchases of corporate bonds by the APF had helped to improve turnover and price transparency for eligible bonds.

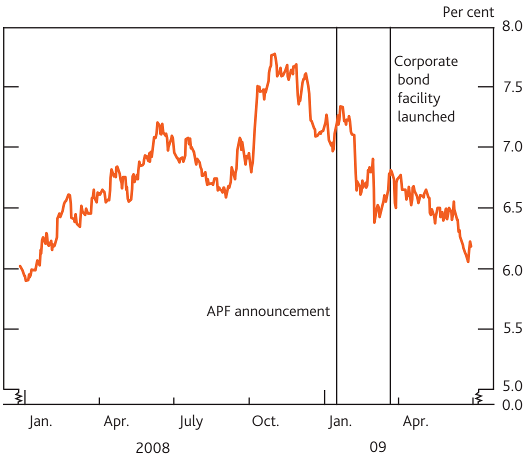
Chart 5 Sterling investment-grade non-financial corporate bond spreads[(a)]



Sources: Merrill Lynch and Bank calculations.

(a) Option-adjusted spreads.

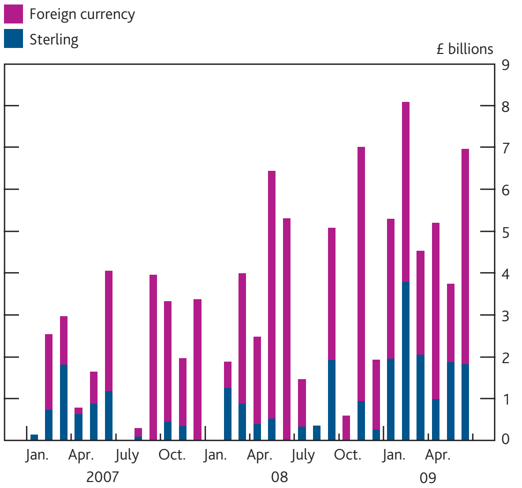
Chart 6 Sterling investment-grade non-financial corporate bond yields



Sources: Merrill Lynch and Bank calculations.

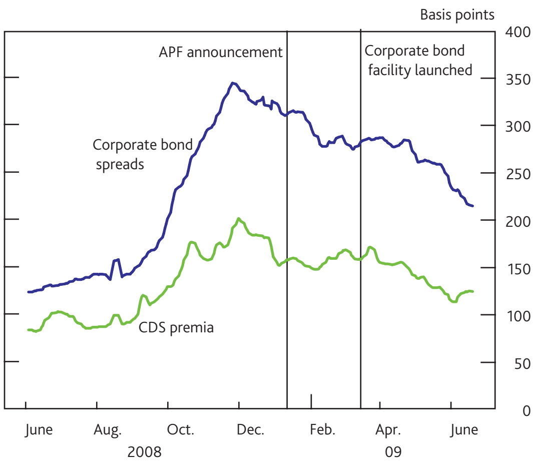
(1) For more information on comparing CDS and corporate bond spreads see page 78 of the 2009 Q2 *Quarterly Bulletin*.

Chart 7 Gross issuance of bonds by UK PNFCs



Source: Dealogic.

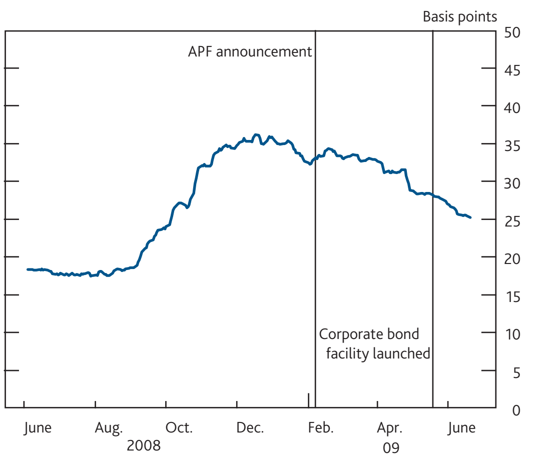
Chart 8 Median sterling investment-grade non-bank corporate bond spreads and CDS premia(a)(b)



Sources: UBS Delta and Bank calculations.

(a) Based on 444 investment-grade sterling bonds issued by non-bank firms.
(b) The maturity of the chosen bond may not match that maturity of the CDS as data are typically only available for five-year CDS.

Chart 9 Median sterling investment-grade non-bank corporate bond bid-ask spreads(a)



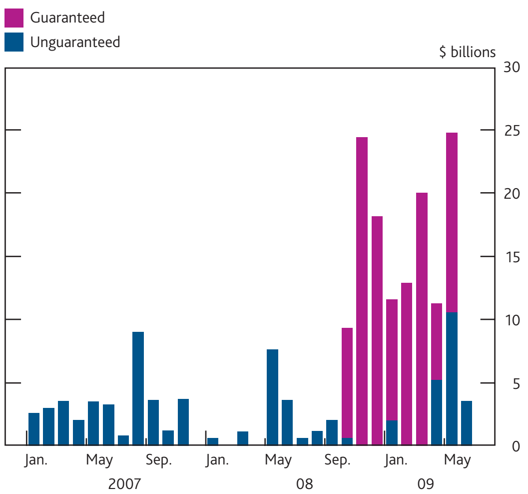
Sources: UBS Delta and Bank calculations.

(a) Based on 444 investment-grade sterling bonds issued by non-bank firms.

CGS bond market

UK banks issued less paper under the CGS during 2009 Q2 than the previous quarter and issued more unguaranteed debt as conditions in the markets for both short-term and longer-term unguaranteed bank funding improved (**Chart 10**). Spreads on CGS paper narrowed over the period (**Chart 11**). The Facility stands ready to make purchases of CGS bonds from the secondary market should conditions in the market deteriorate.

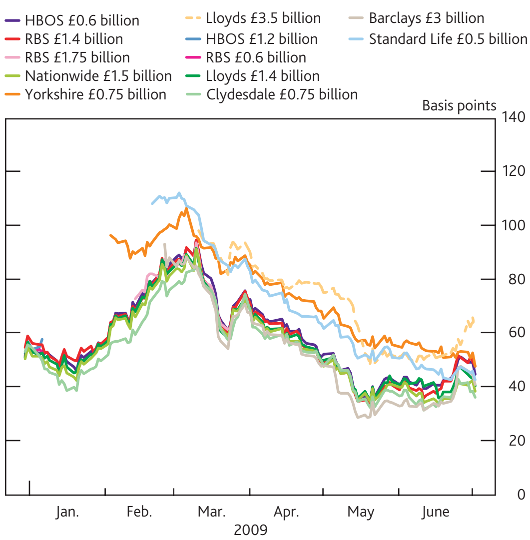
Chart 10 UK bank senior debt issuance(a)(b)



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.

Chart 11 Secondary market maturity-matched sterling spreads on paper covered by the CGS(a)



Sources: Bloomberg and Bank calculations.

(a) Spreads to gilts.

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