Asset Purchase Facility

Quarterly Report 2009 Q3

BANK OF ENGLAND

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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 (MPC), 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 third 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 corporate credit markets, 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 MPC 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 initially authorised to purchase up to £150 billion, of which up to £50 billion could be used to purchase private sector assets. At the request of the MPC, the limit has subsequently been increased to £175 billion.[(6)]

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 and at its May and August policy meetings to increase the scale of asset purchases to £125 billion and £175 billion respectively. 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, 20 May and 19 August.[(7)]

The purchases of gilts by the Facility began on 11 March.[(8)] 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.[(9)] The Facility stands ready to purchase bank debt issued under the Credit Guarantee Scheme should conditions in that market deteriorate.[(10)] On 3 August, the Bank launched a secured commercial paper facility, in which the Facility stands ready to buy qualifying securities.[(11)]

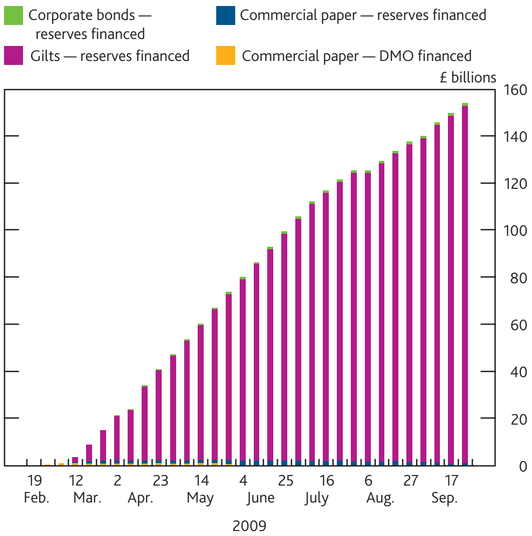
(1) The Chancellor's statement is available at www.hm-treasury.gov.uk/press_05_09.htm.
(2) The exchange of letters are available at www.bankofengland.co.uk/markets/apfgovletter090129.pdf and www.hm-treasury.gov.uk/d/ck_letter_boe290109.pdf.
(3) The exchange of letters are available at www.bankofengland.co.uk/monetarypolicy/pdf/govletter090305.pdf and www.hm-treasury.gov.uk/d/chxletter_boe050309.pdf.
(4) The August *Inflation Report* is available at www.bankofengland.co.uk/publications/inflationreport/ir09aug.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 exchange of letters are available at www.bankofengland.co.uk/monetarypolicy/pdf/govletter090806.pdf and www.hm-treasury.gov.uk/d/chx_letter_060809.pdf.
(7) 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 and the August MPC minutes are available at www.bankofengland.co.uk/publications/minutes/mpc/pdf/2009/mpc0908.pdf.
(8) The Facility purchases gilts in three-weekly operations. In each operation a particular maturity range of gilts is purchased: those with a residual maturity of between 3 and 10 years; between 10 and 25 years, or greater than 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.
(9) 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.
(10) For more details see www.bankofengland.co.uk/markets/apf/cgs/index.htm.
(11) For more details see www.bankofengland.co.uk/markets/marketnotice090730.pdf.

Report for the quarter ended 30 September 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 24 September.

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 Q2[(c)]	1,950	96,368	776	99,094
2 July 2009	80	6,500	49	6,629
9 July 2009	34	6,505	48	6,587
16 July 2009	186	4,500	21	4,707
23 July 2009	25	4,498	0	4,523
30 July 2009	0	4,004	0	4,004
6 August 2009	0	0	0	0
13 August 2009	75	4,197	3	4,275
20 August 2009	166	4,200	10	4,376
27 August 2009	399	4,200	19	4,618
3 September 2009	0	2,800	32	2,832
10 September 2009	5	5,604	27	5,636
17 September 2009	225	4,200	32	4,457
24 September 2009	395	4,201	51	4,647
Amount outstanding financed by Treasury bills as at 24 September[(d)]	–	–	–	–
Amount outstanding financed by central bank reserves as at 24 September[(d)]	922	151,775	1,073	153,771
Total amount outstanding as at 24 September[(d)]	**922**	**151,775**	**1,073**	**153,771**

(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 Q2 measured as amount outstanding as at 25 June 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 has been financed by the issuance of central bank reserves. As of 24 September, these purchases totalled £154 billion.

Conditions in UK government and corporate debt markets

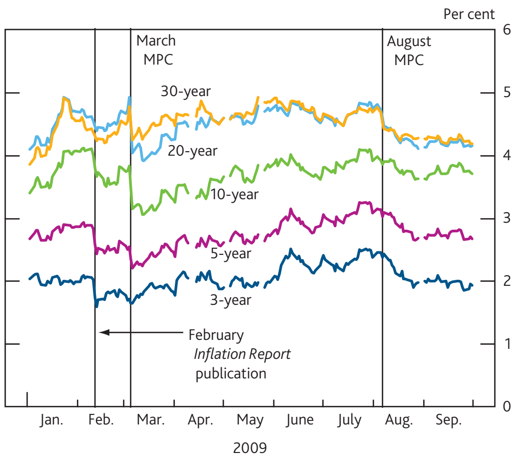
Yields on UK government bonds fell following the MPC's decision in August to increase the size of the asset purchase programme by £50 billion to £175 billion. Over the quarter, conditions in the sterling investment-grade commercial paper market improved with several issuers being able to issue directly into the primary market. Yields and spreads on sterling investment-grade non-financial corporate bonds fell further and liquidity in that market appeared to have increased.

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

UK government bond market

Yields on nominal gilts fell following the MPC's decision in August to increase the scale of the asset purchase programme by £50 billion to £175 billion (**Chart 2**). The Bank announced that the maturity range of government debt eligible for purchase would be extended from five to 25 years, to include all conventional gilts with a maturity of greater than three years. Since the August decision, the curve of government forward rates has fallen at short maturities by up to 75 basis points and long maturities by up to 120 basis points (**Chart 3**). The spread between yields on UK gilts and overnight index swap (OIS) rates narrowed following the August

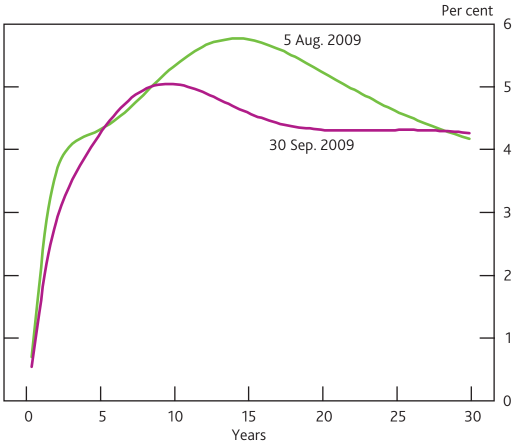
Chart 2 UK nominal spot rates



Sources: Bloomberg and Bank calculations.

(1) The 2009 Q3 *Quarterly Bulletin* can be found on the Bank's website at www.bankofengland.co.uk/publications/quarterlybulletin/qb0903.pdf.

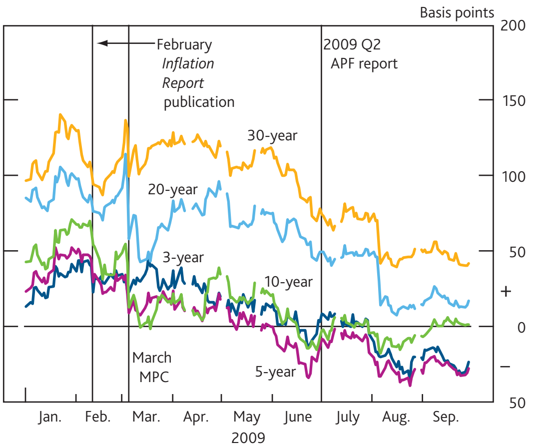
Chart 3 UK nominal forward rates



Sources: Bloomberg and Bank calculations.

announcement.(1) That left the gilt-OIS spread at the end of 2009 Q3 around 30 basis points narrower for short and long maturities and around 10 basis points wider for medium maturities than at the time of the previous APF report (**Chart 4**).

Chart 4 UK nominal spot gilt yields less OIS rates



Sources: Bloomberg and Bank calculations.

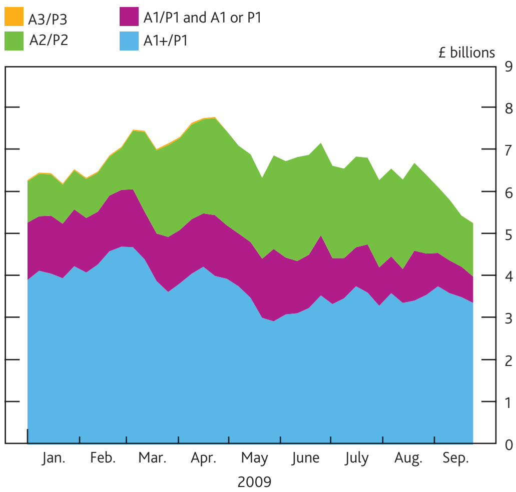
Over the quarter, the Bank excluded two additional gilts from purchase by the Facility. In both cases the Bank's holdings were around 70% of the total nominal amount of those stocks in issue, less government holdings. The Bank continues to keep the identity of gilts eligible for purchase by the APF under 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.

In addition, the Bank announced on 6 August, in a joint statement with the DMO, an arrangement for a significant amount of the gilts purchased via the Facility to be made available for on-lending to the market by the DMO through its normal repo market activity. The Bank will publish the daily average aggregate value of gilts lent by the APF to the DMO during each calendar quarter, on the second Wednesday after the end of the quarter at 10 am.(2)

UK corporate debt markets

The functioning of the market for sterling non-bank investment-grade commercial paper continued to improve during 2009 Q3 with more issuers reportedly able to issue directly into the primary market. Quoted sterling primary market spreads narrowed further and were below those offered by the Facility. The total amount of sterling-denominated commercial paper outstanding for UK corporate and non-bank financial firms declined over the quarter, as issuers reportedly increased foreign currency issuance and continued to raise a proportion of their funding through longer-term markets such as corporate bonds (**Chart 5**).

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

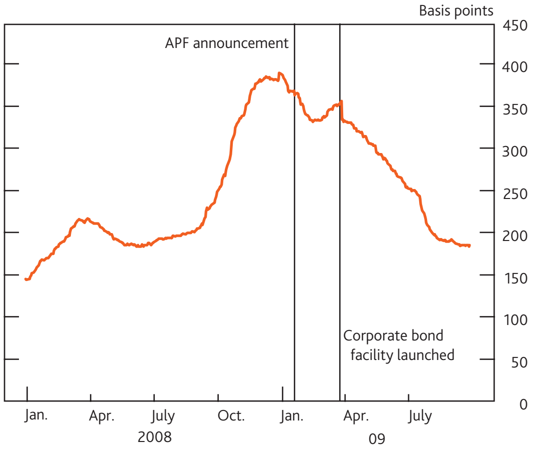


Source: CP Ware.

Secondary market spreads on sterling investment-grade non-financial corporate bonds narrowed further during 2009 Q3 (**Chart 6**). Over the same period corresponding gilt rates also fell, leaving yields on those bonds around 90 basis points lower (**Chart 7**) and at the lowest point since April 2006. Following record gross bond issuance by UK private non-financial corporations (PNFCs) over the first half of the year, issuance slowed during the quiet summer months (**Chart 8**). However, investor demand for corporate bonds has reportedly remained strong. The difference between corporate bond spreads and credit default swap (CDS) premia narrowed further over the quarter, both for those bonds that are eligible for purchase by the APF and for non-eligible sterling bonds (**Chart 9**) possibly indicating that illiquidity premia had further reduced.(3)

(1) For more information see pages 161–62 of the 2009 Q3 *Quarterly Bulletin*.
(2) For more information see the box 'Gilt lending', 2009 Q3 *Quarterly Bulletin*, page 169.
(3) For more information see the box 'Liquidity in corporate bond markets', August 2009 *Inflation Report*, page 16.

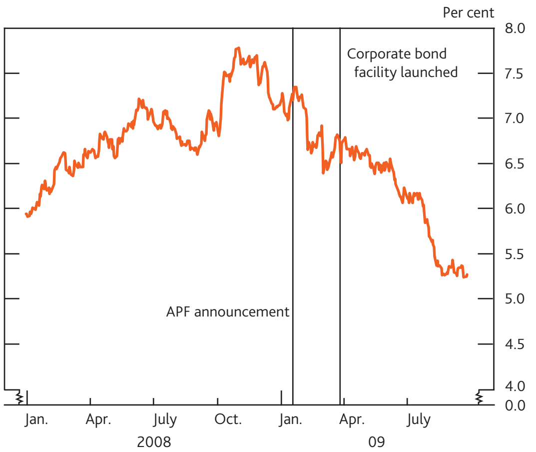
Chart 6 Sterling investment-grade non-financial corporate bond spreads[(a)]



Sources: Merrill Lynch and Bank calculations.

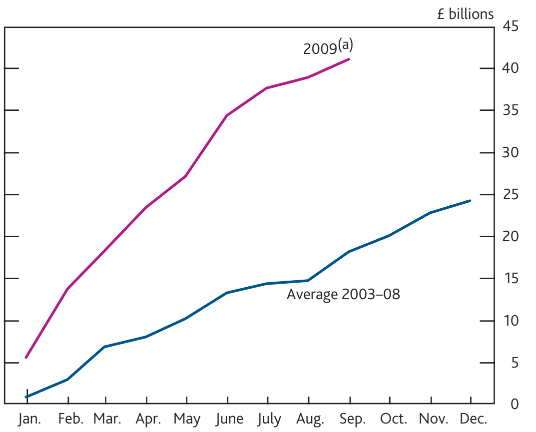
(a) Option-adjusted spread over government rates.

Chart 7 Sterling investment-grade non-financial corporate bond yields



Sources: Merrill Lynch and Bank calculations.

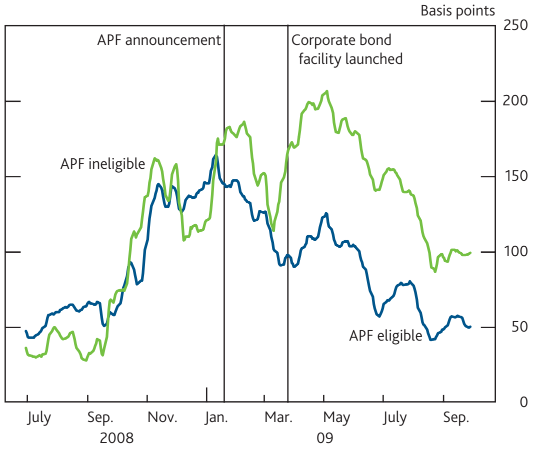
Chart 8 Cumulative gross issuance of bonds by UK PNFCs



Sources: Dealogic and Bank calculations.

(a) The 2009 series is a corrected version to that published initially.

Chart 9 Sterling non-bank investment-grade corporate bond spreads less CDS premia[(a)]

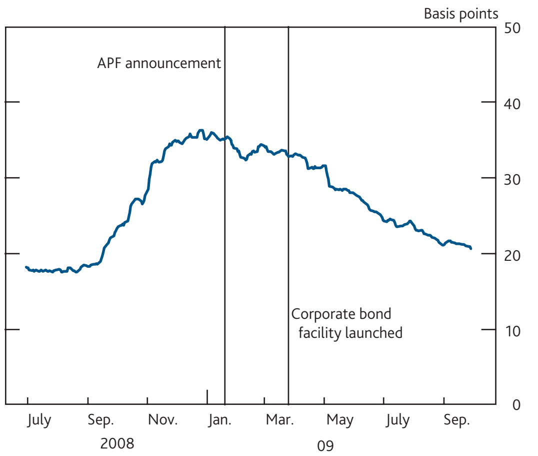


Sources: UBS Delta and Bank calculations.

(a) The data are based on individual corporate bond spreads (relative to asset swaps) less their corresponding CDS premia across the non-bank investment-grade market. The maturity of the bonds used in this calculation may not necessarily match the maturity of the corresponding CDS premia, as data are typically only available for five-year CDS. The chart shows median measures.

Consistent with improved liquidity in corporate bond markets, bid-ask spreads quoted by market makers edged closer to those prior to the events of September 2008 (**Chart 10**).

Chart 10 Median sterling investment-grade non-bank corporate bond bid-ask spreads[(a)]



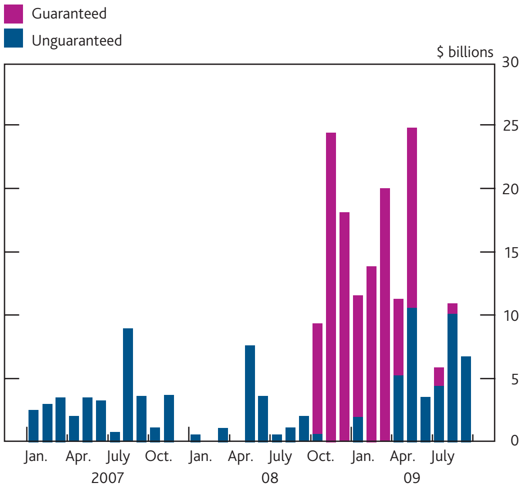
Sources: UBS Delta and Bank calculations.

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

Credit Guarantee Scheme

Conditions in banks' longer-term funding markets continued to improve. Over the quarter the volume of unguaranteed debt issuance increased somewhat, reflecting reports of improved investor demand (**Chart 11**). UK banks issued considerably less paper under the Credit Guarantee Scheme (CGS) during 2009 Q3 compared to the previous quarter. The Facility stands ready to make purchases of CGS bonds from the secondary market should conditions in the market deteriorate.

Chart 11 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.

Secured commercial paper facility

On 3 August, the Bank launched a secured commercial paper (SCP) facility to support the provision of working capital to non-investment grade companies that are ineligible for the Bank's commercial paper facility. The purpose of the SCP facility is to help improve the functioning of the private market by standing ready to make primary market purchases and by acting as a backstop for secondary market investors. There were no programmes that were immediately eligible for the SCP facility and consequently no purchases have been made so far. As part of the consultation process, banks indicated that it would take a number of months to set up programmes that would be eligible for the SCP facility.[(1)]

(1) For more information see page 171 of the 2009 Q3 *Quarterly Bulletin*.

ISSN: 2041-1936 (online)