

# Asset Purchase Facility

Quarterly Report 2010 Q1



**BANK OF ENGLAND**



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# Asset Purchase Facility

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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 2009<sup>(1)</sup> and detailed in an exchange of letters with the Governor on 29 January 2009.<sup>(2)</sup> 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 2009.<sup>(3)</sup>

The Governor noted in his letter of 29 January 2009, '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 fifth of those regular reports. More information on the Committee's monetary policy decisions can be found in the *Inflation Report*.<sup>(4)</sup>

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 Fund was initially authorised to purchase up to a total of £50 billion of private sector assets financed by Treasury bills and the Debt Management Office's (DMO) cash management operations. When its remit was extended to enable the Facility to be used as a monetary policy tool, the Fund was authorised on 3 March 2009<sup>(5)</sup> to purchase for that purpose up to £150 billion of assets, of which up to £50 billion could be used to purchase private sector assets. All purchases of assets between 6 March 2009 and 4 February 2010 were financed by central bank reserves. At the request of the MPC, the limit was increased twice, to £175 billion in August 2009<sup>(6)</sup> and to £200 billion in November 2009.<sup>(7)</sup> The aim of these actions was 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. On 4 February 2010 the MPC voted to maintain the stock of asset purchases at £200 billion.<sup>(8)</sup> The Chancellor authorised the Bank to continue to transact in private sector assets, with further purchases financed by the issuance of Treasury bills, in line with the arrangements set out in the initial exchange of letters in January 2009.<sup>(9)</sup>

On 4 March 2010<sup>(10)</sup> the MPC voted to maintain the stock of asset purchases at £200 billion. The Facility has continued to make small purchases of corporate assets, consistent with the Bank acting as market maker of last resort in order to maintain conditions for the stable provision of financial services to the wider economy.<sup>(11)</sup> Since 4 February 2010 all purchases have been financed by the issuance of Treasury bills and the DMO's cash management operations.<sup>(12)</sup>

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(1) The Chancellor's statement is available at [www.hm-treasury.gov.uk/press\\_05\\_09.htm](http://www.hm-treasury.gov.uk/press_05_09.htm).

(2) The exchange of letters is available at [www.hm-treasury.gov.uk/d/ck\\_letter\\_boe290109.pdf](http://www.hm-treasury.gov.uk/d/ck_letter_boe290109.pdf) and [www.bankofengland.co.uk/markets/apfgovletter090129.pdf](http://www.bankofengland.co.uk/markets/apfgovletter090129.pdf).

(3) The exchange of letters is available at [www.bankofengland.co.uk/monetarypolicy/pdf/govletter090305.pdf](http://www.bankofengland.co.uk/monetarypolicy/pdf/govletter090305.pdf) and [www.hm-treasury.gov.uk/d/chxletter\\_boe050309.pdf](http://www.hm-treasury.gov.uk/d/chxletter_boe050309.pdf).

(4) The February *Inflation Report* is available at [www.bankofengland.co.uk/publications/inflationreport/ir10feb.pdf](http://www.bankofengland.co.uk/publications/inflationreport/ir10feb.pdf).

(5) For more details see [www.hm-treasury.gov.uk/d/chxletter\\_boe050309.pdf](http://www.hm-treasury.gov.uk/d/chxletter_boe050309.pdf).

(6) The exchange of letters is available at [www.bankofengland.co.uk/monetarypolicy/pdf/govletter090806.pdf](http://www.bankofengland.co.uk/monetarypolicy/pdf/govletter090806.pdf) and [www.hm-treasury.gov.uk/d/chx\\_letter\\_060809.pdf](http://www.hm-treasury.gov.uk/d/chx_letter_060809.pdf).

(7) The exchange of letters is available at [www.bankofengland.co.uk/monetarypolicy/pdf/govletter091105.pdf](http://www.bankofengland.co.uk/monetarypolicy/pdf/govletter091105.pdf) and [www.hm-treasury.gov.uk/d/chx\\_letter\\_051109.pdf](http://www.hm-treasury.gov.uk/d/chx_letter_051109.pdf).

(8) For more details see [www.bankofengland.co.uk/publications/minutes/mpc/pdf/2010/mpc1002.pdf](http://www.bankofengland.co.uk/publications/minutes/mpc/pdf/2010/mpc1002.pdf).

(9) See the Chancellor's letter on 4 February to John McFall, Chairman of the Treasury Select Committee on [www.hm-treasury.gov.uk/d/chx\\_letter\\_040210.pdf](http://www.hm-treasury.gov.uk/d/chx_letter_040210.pdf).

(10) For more details see [www.bankofengland.co.uk/publications/minutes/mpc/pdf/2010/mpc1003.pdf](http://www.bankofengland.co.uk/publications/minutes/mpc/pdf/2010/mpc1003.pdf).

(11) The rationale for corporate asset purchases is set out in a recent speech by Paul Fisher available at [www.bankofengland.co.uk/publications/speeches/2010/speech423.pdf](http://www.bankofengland.co.uk/publications/speeches/2010/speech423.pdf).

(12) The Chancellor's letter can be found on [www.hm-treasury.gov.uk/d/chx\\_letter\\_040210.pdf](http://www.hm-treasury.gov.uk/d/chx_letter_040210.pdf).

The Facility first purchased commercial paper on 13 February 2009,<sup>(1)</sup> gilts on 11 March 2009<sup>(2)</sup> and corporate bonds on 25 March 2009.<sup>(3)</sup> The Facility stands ready to purchase bank debt issued under the Credit Guarantee Scheme (CGS) should conditions in that market deteriorate.<sup>(4)</sup> On 3 August 2009, the Bank launched a secured commercial paper facility, in which the Facility stands ready to buy qualifying securities.<sup>(5)</sup> On 22 December 2009, the Bank announced, following a consultation process, that it would act as a seller, as well as a buyer, of corporate bonds in the secondary market. The proposed changes took effect from the week beginning 4 January 2010, with the first sales operation taking place on 8 January.<sup>(6)</sup>

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(1) 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](http://www.bankofengland.co.uk/markets/apf/cp/index.htm).

(2) The Bank announced on 5 November that it would normally conduct auctions to purchase gilts with a maturity of 10–25 years on Mondays; of over 25 years on Tuesdays; and of 3–10 years on Wednesdays, with the auctions spread over a two-week cycle. For more details see [www.bankofengland.co.uk/markets/apf/gilts/index.htm](http://www.bankofengland.co.uk/markets/apf/gilts/index.htm).

(3) The Facility offers to purchase high-quality corporate bonds. 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](http://www.bankofengland.co.uk/markets/apf/corporatebond/index.htm).

(4) For more details see [www.bankofengland.co.uk/markets/apf/cgs/index.htm](http://www.bankofengland.co.uk/markets/apf/cgs/index.htm).

(5) For more details see [www.bankofengland.co.uk/markets/apf/securedcpf/index.htm](http://www.bankofengland.co.uk/markets/apf/securedcpf/index.htm).

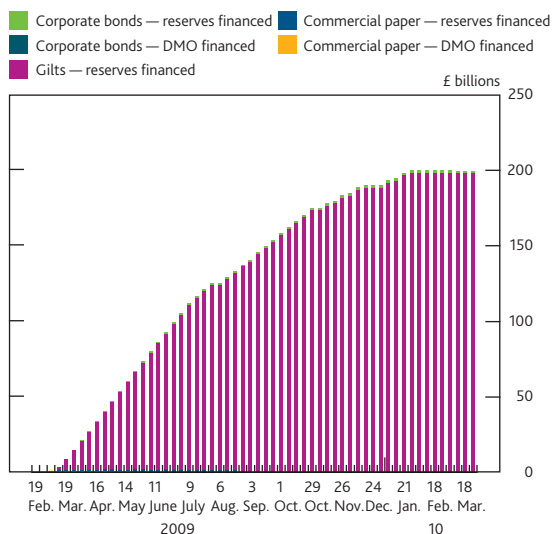
(6) For more details see [www.bankofengland.co.uk/markets/marketnotice091222.pdf](http://www.bankofengland.co.uk/markets/marketnotice091222.pdf).

## Report for the quarter ended 26 March 2010.

### Operations

Chart 1 and Table A below summarise the amount that the Fund has purchased and sold each week in each facility and the total amounts outstanding as at 26 March 2010. As at 26 March 2010, assets outstanding totalled £200 billion.

**Chart 1** Cumulative asset purchases by type: amounts outstanding<sup>(a)</sup>



(a) Data based on settled transactions. Note that bars for categories other than gilts are very small.

**Table A** APF transactions by type (£ millions)

Week ending <sup>(a)</sup>	Commercial paper	Gilts	Corporate bond		Total <sup>(b)</sup>
			Purchases	Sales	
2009 Q4 <sup>(c)</sup>	429	188,076	1,549		190,053
7 January 2010	25	3,400	0	0	3,425
14 January 2010	30	1,700	10	76	1,816
21 January 2010	275	3,400	29	19	3,723
28 January 2010	200	1,700	0	8	1,908
4 February 2010	25	0	3	18	46
11 February 2010	0	0	12	2	14
18 February 2010	0	0	8	12	20
25 February 2010	25	0	3	1	29
4 March 2010	50	0	0	6	56
11 March 2010	25	0	2	67	94
18 March 2010	0	0	5	43	48
25 March 2010	70	0	15	4	89
Total financed by a deposit from the DMO <sup>(d)</sup>	25	–	28		53
Total financed by central bank reserves <sup>(d)</sup>	55	198,275	1,338		199,668
<b>Total asset purchases<sup>(d)</sup></b>	<b>80</b>	<b>198,275</b>	<b>1,366</b>		<b>199,721</b>

(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 Q4 measured as amount outstanding as at 31 December 2009.

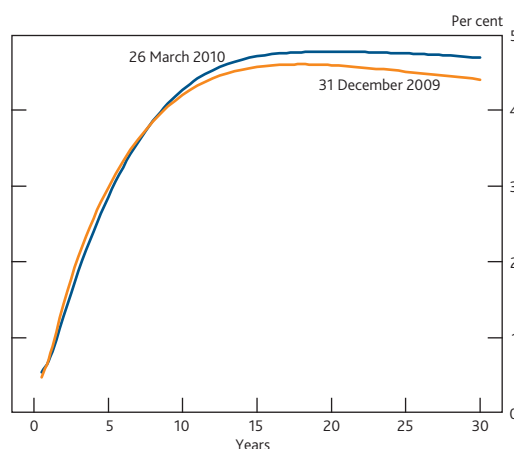
(d) Aggregate proceeds at purchase less redemptions and sales to date, reported on a settled basis (sale and redemption value taken as the value at which the Bank initially purchased the securities). The change in amounts outstanding may be less than the sum of purchases due to redemptions and non-operation based transactions, such as participation in corporate actions.

## Conditions in UK government and corporate debt markets<sup>(1)</sup>

### UK government bond market

The curve of nominal gilt yields steepened somewhat during 2010 Q1, with rates at short maturities around 20 basis points lower and those at long maturities up to 30 basis points higher than at the end of 2009 (Chart 2). Overnight Index Swap (OIS) rates fell at all maturities, and, as a result, gilt-OIS spreads widened by 30 to 40 basis points during January and the first half of February (Chart 3).

**Chart 2** UK nominal spot rates



Sources: Bloomberg and Bank calculations.

**Chart 3** UK nominal spot gilt yields less OIS rates



Sources: Bloomberg and Bank calculations.

A significant amount of the gilts purchased via the Facility continue to be made available for on-lending to the market through the gilt lending arrangement with the DMO.<sup>(2)</sup> The average daily aggregate value of gilts lent by the Asset

(1) More information on market conditions up to the end of February 2010 can be found in the *Quarterly Bulletin* at [www.bankofengland.co.uk/publications/quarterlybulletin/qb1001.pdf](http://www.bankofengland.co.uk/publications/quarterlybulletin/qb1001.pdf).

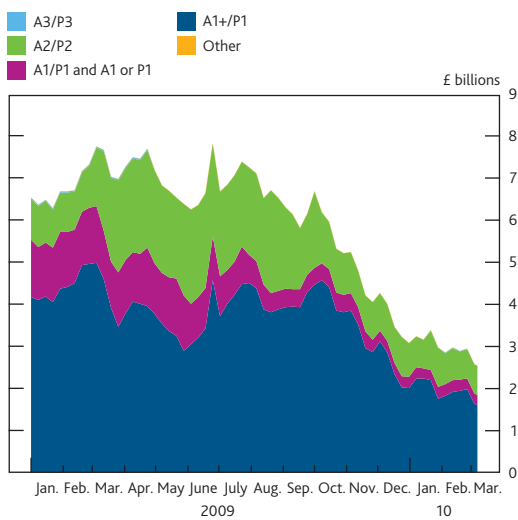
(2) See [www.dmo.gov.uk/docs/gilts/press/sa060809b.pdf](http://www.dmo.gov.uk/docs/gilts/press/sa060809b.pdf).

Purchase Facility to the DMO during the three months to 26 March 2010 was £3.8 billion, slightly above the £3.3 billion lent on average during the previous quarter.

**UK corporate debt markets**

Conditions in corporate debt markets remained broadly similar to those in the last quarter of 2009. The market for sterling non-bank investment-grade commercial paper continued to function relatively well during 2010 Q1. Most quoted sterling primary market spreads remained below those offered by the Facility. Liquidity was reasonably good, with most issuers able to issue in the size and maturity required. The total amount of sterling-denominated commercial paper outstanding for UK corporate and non-bank financial firms continued to decline over the quarter as the demand for sterling short-term funding fell (Chart 4). The Facility's purchases of commercial paper have also decreased over the quarter.

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

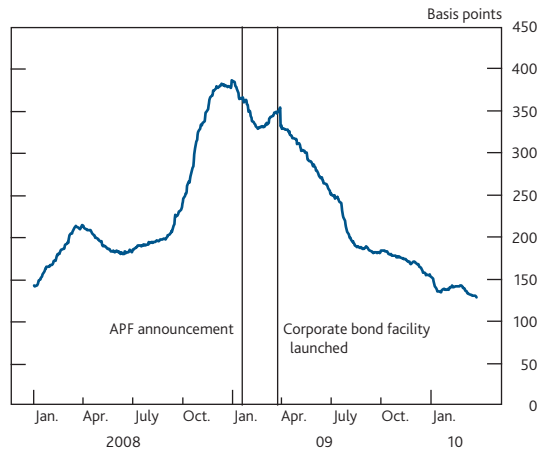


Sources: Bloomberg and Bank calculations.

Conditions in the corporate bond market were broadly similar to the last quarter, with some signs of slight improvement. Secondary market spreads on sterling investment-grade non-financial corporate bonds narrowed further, by around 25 basis points during 2010 Q1 (Chart 5). Yields on such bonds were around 30 basis points lower (Chart 6). Issuance by UK private non-financial corporations (PNFCs) during the quarter was below the comparable period in 2009, but slightly above its historical average (Chart 7). Bid-ask spreads quoted by market makers continued to narrow, albeit at a slower pace than in 2009, suggesting liquidity had improved slightly (Chart 8).

The difference between corporate bond spreads and credit default swap (CDS) premia was broadly flat for bonds that are eligible for purchase by the APF, whereas it decreased markedly for ineligible bonds (Chart 9). The decrease was driven by corporate bond spreads for ineligible bonds falling faster than

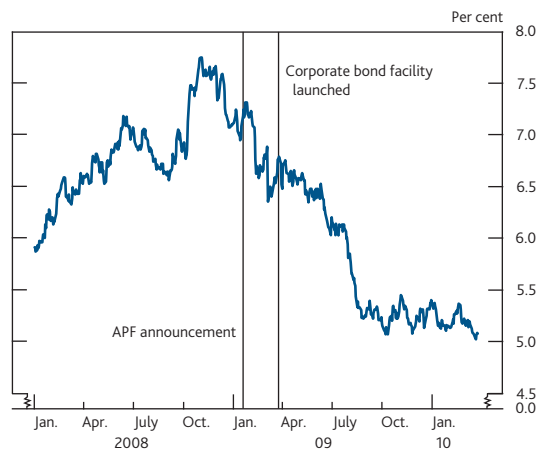
**Chart 5** Sterling investment-grade non-financial corporate bond spreads<sup>(a)</sup>



Sources: Merrill Lynch and Bank calculations.

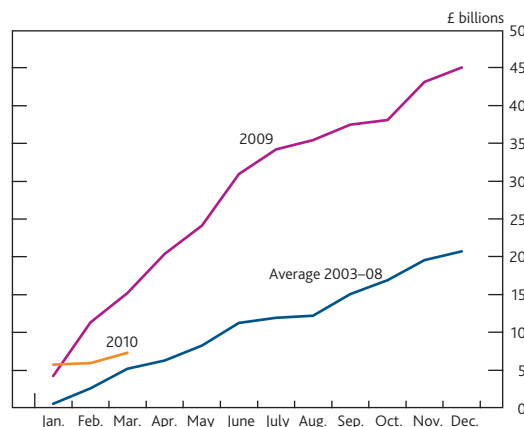
(a) Option-adjusted spread over government rates.

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



Sources: Merrill Lynch and Bank calculations.

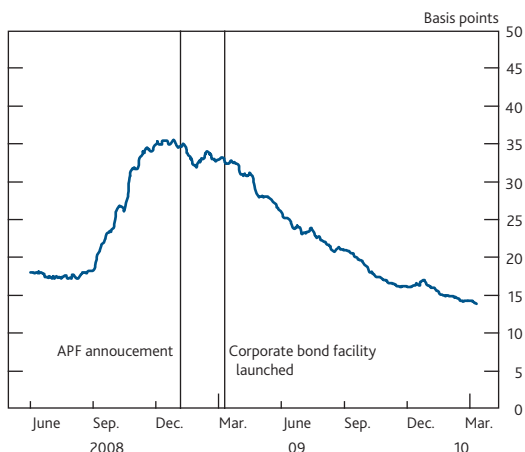
**Chart 7** Cumulative gross issuance of bonds by UK PNFCs<sup>(a)</sup>



Sources: Dealogic and Bank calculations.

(a) Data are subject to periodic revisions.

**Chart 8** Median sterling investment-grade non-bank corporate bid-ask spreads<sup>(a)</sup>



Sources: UBS Delta and Bank calculations.

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

CDS premia, and is further indication of some improvement in liquidity in corporate bond markets over the quarter. The difference between corporate bond spreads and CDS is now at levels last seen before the events of September 2008, both for eligible and ineligible bonds.

**Chart 9** Sterling non-bank investment-grade corporate bond spreads less CDS premia<sup>(a)</sup>

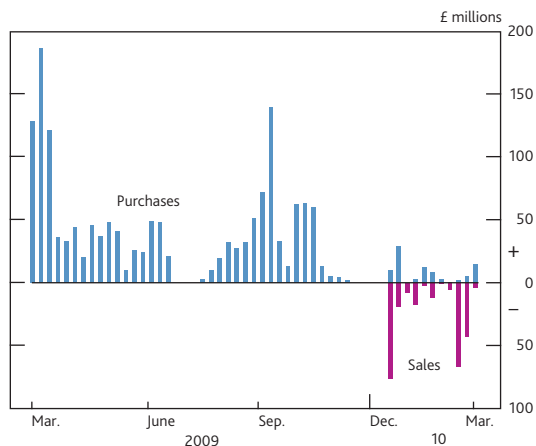


Sources: UBS Delta and Bank calculations.

(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 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.

On 8 January 2010 the Bank started acting as a seller, as well as a buyer, of corporate bonds in the secondary market.<sup>(1)</sup> This measure was aimed at supporting price transparency and improving two-way liquidity through the establishment of pricing points.<sup>(2)</sup> The Bank has regularly acted on both sides of the market, buying and selling small amounts of eligible bonds (Chart 10).

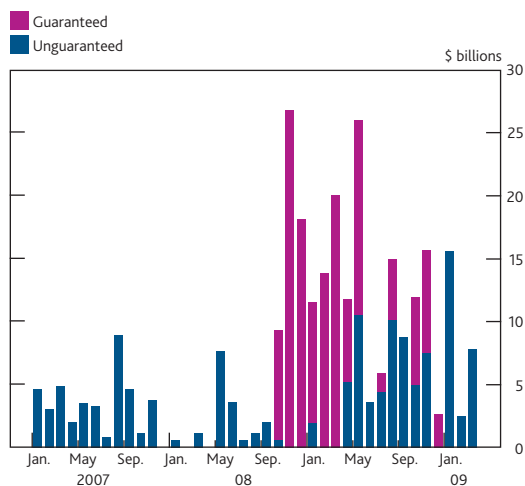
**Chart 10** Corporate bond purchases and sales



**Credit Guarantee Scheme**

UK banks issued a relatively large amount of long-term unguaranteed debt over the quarter, with January a record month (Chart 11). There was no issuance of guaranteed debt. Since 28 February 2010, institutions are able to refinance debt already guaranteed under the Scheme, but they cannot increase the total amount of guaranteed debt.<sup>(3)</sup> The Facility stands ready to make purchases of Credit Guarantee Scheme bonds from the secondary market should conditions in the market deteriorate.

**Chart 11** UK bank senior debt issuance<sup>(a)(b)(c)</sup>



Sources: Dealogic and Bank calculations.

- (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.
- (c) Data are subject to periodic revisions.

(1) For more details see [www.bankofengland.co.uk/markets/marketnotice091222.pdf](http://www.bankofengland.co.uk/markets/marketnotice091222.pdf).  
 (2) For more information see the box 'Asset Purchase Facility Corporate Bond Secondary Market Scheme', 2009 Q4 *Quarterly Bulletin*, page 269.  
 (3) For more details see [www.dmo.gov.uk/documentview.aspx?docname=cgs/press/pr20100329.pdf](http://www.dmo.gov.uk/documentview.aspx?docname=cgs/press/pr20100329.pdf).

### Secured commercial paper facility

On 3 August, the Bank launched a secured commercial paper (SCP) facility to support the provision of working capital to a broad range of corporates, including non-investment grade companies that are not eligible for the Bank's commercial paper facility. The aim 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 has been no use of the Facility to date, and no SCP programmes have so far been deemed eligible. This largely reflects a change in market conditions since the original consultation.