

# Asset Purchase Facility

Quarterly Report 2010 Q2



**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 sixth 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 are 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 on 3 March 2009, the Fund was authorised 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.<sup>(5)</sup> All purchases of assets between 6 March 2009 and 4 February 2010 were financed by central bank reserves. 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. 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> On 4 February 2010,<sup>(8)</sup> and in each subsequent month,<sup>(9)</sup> the MPC voted to maintain the stock of asset purchases at £200 billion. 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>(10)</sup> 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 May *Inflation Report* is available at [www.bankofengland.co.uk/publications/inflationreport/ir10may.pdf](http://www.bankofengland.co.uk/publications/inflationreport/ir10may.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) The June minutes are available at [www.bankofengland.co.uk/publications/minutes/mpc/pdf/2010/mpc1006.pdf](http://www.bankofengland.co.uk/publications/minutes/mpc/pdf/2010/mpc1006.pdf).

(10) See the Chancellor's letter on 4 February to John McFall, Chairman of the Treasury Select Committee at [www.hm-treasury.gov.uk/d/chx\\_letter\\_040210.pdf](http://www.hm-treasury.gov.uk/d/chx_letter_040210.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 is available at [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 via the Corporate Bond Secondary Market Scheme.<sup>(6)</sup> This measure was aimed at supporting price transparency and improving two-way liquidity through the establishment of pricing points.<sup>(7)</sup> The proposed changes took effect from the week beginning 4 January 2010, with the first sales operation taking place on 8 January. Since then, the Bank has regularly acted on both sides of the market, buying and selling small amounts of eligible bonds.

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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 2009 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).

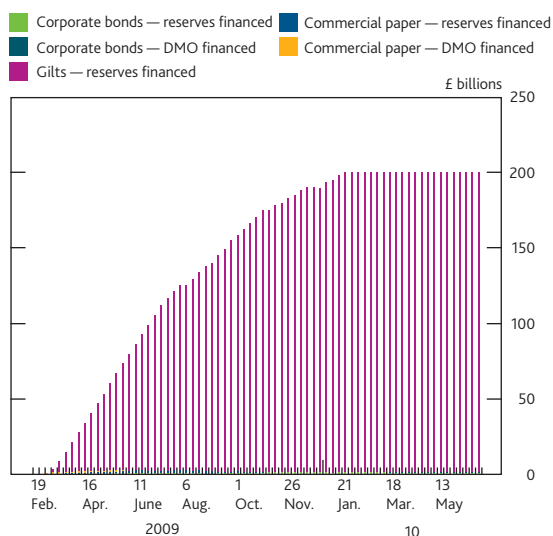
(7) For more information see the box 'Asset Purchase Facility Corporate Bond Secondary Market Scheme', *Bank of England Quarterly Bulletin*, Vol. 49, No. 4, page 269, available at [www.bankofengland.co.uk/publications/quarterlybulletin/qb0904.pdf](http://www.bankofengland.co.uk/publications/quarterlybulletin/qb0904.pdf).

## Report for the quarter ended 30 June 2010.

### Operations

**Chart 1** and **Table A** below summarise the amount that the Fund has purchased and sold each week, ending Thursday, in each facility and the total amounts outstanding as at week ending 24 June 2010. As at 24 June 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	
2010 Q1 <sup>(c)(d)</sup>	80	198,275	1,366		199,721
1 April 2010	0	0	14	2	12
8 April 2010	0	0	20	0	20
15 April 2010	1	0	0	2	-1
22 April 2010	150	0	0	17	133
29 April 2010	0	0	0	1	-1
6 May 2010	100	0	27	1	126
13 May 2010	0	0	5	0	5
20 May 2010	250	0	12	4	258
27 May 2010	200	0	91	1	290
3 June 2010	0	0	25	14	11
10 June 2010	0	0	107	11	96
17 June 2010	50	0	6	3	53
24 June 2010	0	0	4	11	-7
Total financed by a deposit from the DMO <sup>(d)(e)</sup>	51	-	351		402
Total financed by central bank reserves <sup>(d)(e)</sup>	0	198,275	1,251		199,526
<b>Total asset purchases<sup>(d)(e)</sup></b>	<b>51</b>	<b>198,275</b>	<b>1,602</b>		<b>199,928</b>

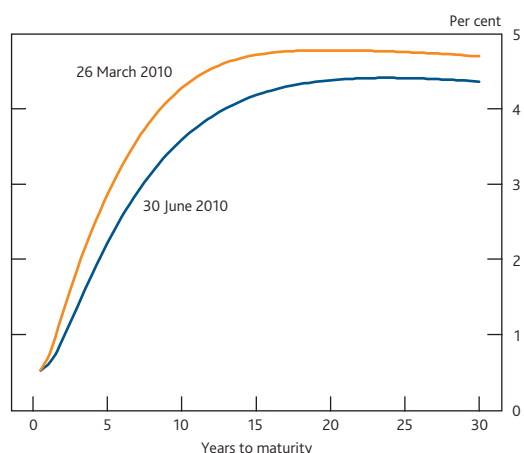
- (a) Week-ended amounts are for purchases in terms of the proceeds paid to counterparties, and for sales in terms of the value at which the Bank initially purchased the securities. All amounts are on a trade-day basis, rounded to the nearest million. Data are aggregated for purchases from the Friday to the following Thursday.  
 (b) Weekly values may not sum to totals due to rounding.  
 (c) 2010 Q1 measured as amount outstanding as at 25 March 2010.  
 (d) Aggregate proceeds at purchase 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).  
 (e) Data may not sum 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

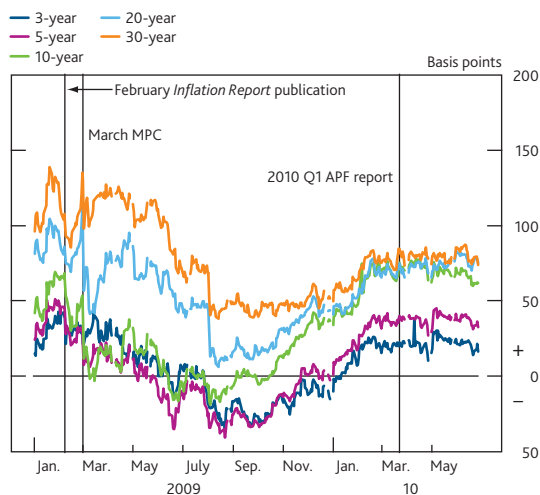
The curve of nominal gilt yields fell and flattened somewhat during 2010 Q2, with rates at short maturities around 50 basis points lower and those at long maturities up to 70 basis points lower than at the end of 2010 Q1 (**Chart 2**). Overnight index swap (OIS) rates fell by slightly less than gilt yields, and, as a result, gilt-OIS spreads narrowed by around 10 basis points (**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 21 May 2010 can be found in the *Quarterly Bulletin* at [www.bankofengland.co.uk/publications/quarterlybulletin/qb1002.pdf](http://www.bankofengland.co.uk/publications/quarterlybulletin/qb1002.pdf).

(2) For more details 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 24 June 2010 was £2.3 billion, less than the £3.8 billion lent on average during the previous quarter.

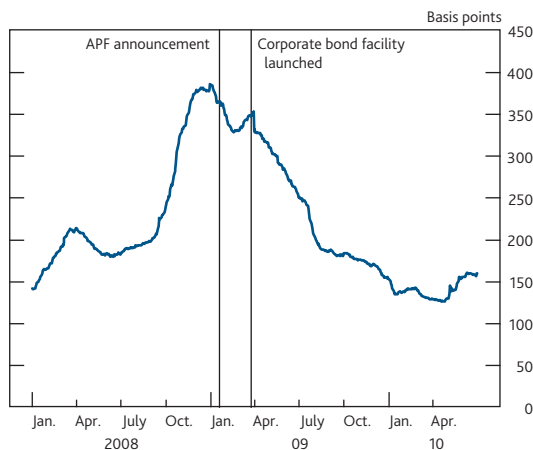
**UK corporate debt markets**

During 2010 Q2, increased concerns about the fiscal adjustment of some euro-area Member States and banks' exposure to sovereign debt fed through into other risky asset prices, such as corporate bonds. The resulting increase in uncertainty and volatility saw conditions in UK corporate debt markets deteriorate marginally during May and early June. This was reflected in increased usage of the APF purchase facilities as shown in **Table A**. Conditions recovered somewhat towards the end of the period but remained slightly worse than those in 2010 Q1.

**Chart 4** shows that spreads on UK non-financial investment-grade corporate bonds widened by around 30 basis points over the period. But this was more than offset by falling government bond yields leaving yields on corporate bonds around 20 basis points lower at the end of the quarter (**Chart 5**). Bid-ask spreads for corporate bonds, as quoted by market makers, widened slightly over the period reflecting a deterioration in liquidity but remained well below the levels of early 2009 (**Chart 6**). **Chart 7** shows that gross bond issuance by UK private non-financial corporations (PNFCs) was lower than in 2009 but broadly in line with historical averages. Market contacts suggested that some firms had delayed issuance as a result of market conditions.

The difference between corporate bond spreads and corresponding credit default swap (CDS) premia was broadly unchanged, both for those bonds eligible for the Facility and those not, and remains at levels last seen prior to the events of September 2008 (**Chart 8**).

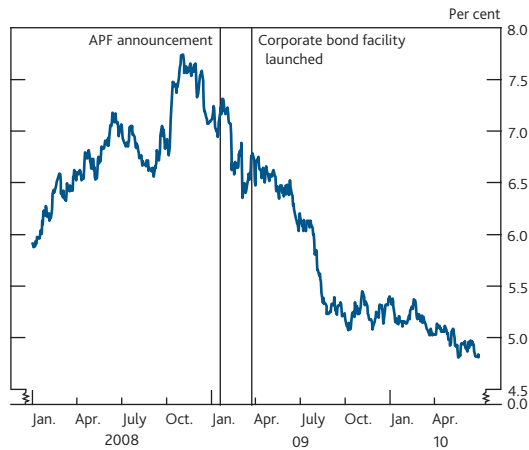
**Chart 4** Sterling investment-grade non-financial corporate bond spreads<sup>(a)</sup>



Sources: Merrill Lynch and Bank calculations.

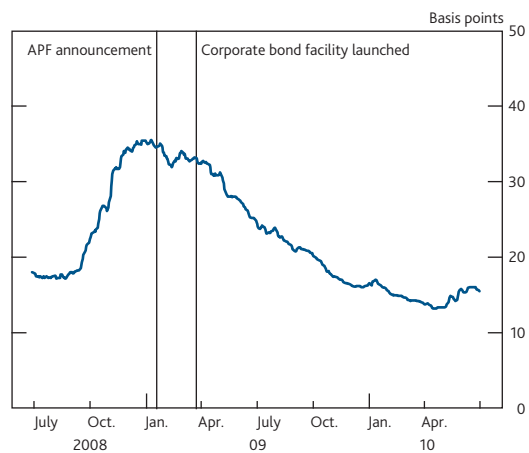
(a) Option-adjusted spread over government rates.

**Chart 5** Sterling investment-grade non-financial corporate bond yields



Sources: Merrill Lynch and Bank calculations.

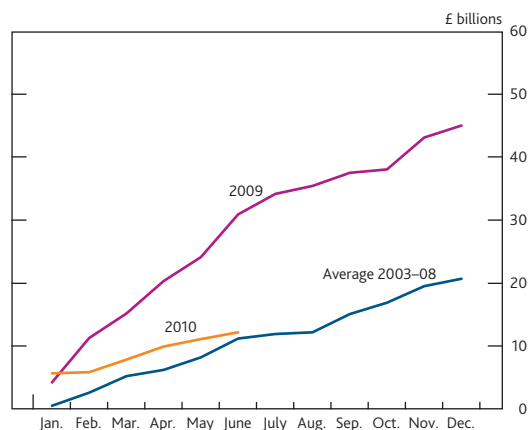
**Chart 6** Median sterling investment-grade non-bank corporate bond bid-ask spreads<sup>(a)</sup>



Sources: UBS Delta and Bank calculations.

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

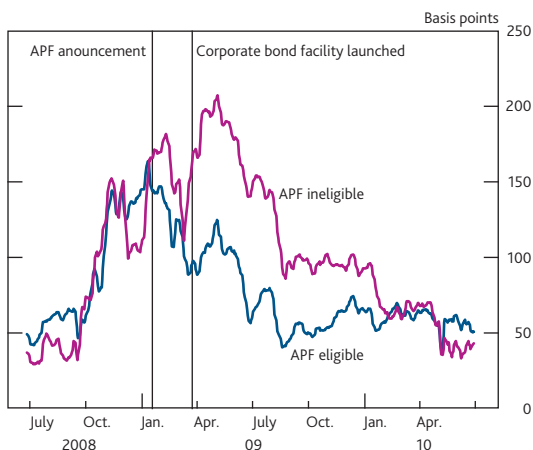
**Chart 7** Cumulative gross issuance of bonds by UK PNFCs<sup>(a)</sup>



Sources: Dealogic and Bank calculations.

(a) Data are subject to periodic revisions.

**Chart 8 Sterling non-bank investment-grade corporate bond spreads less CDS premia<sup>(a)</sup>**

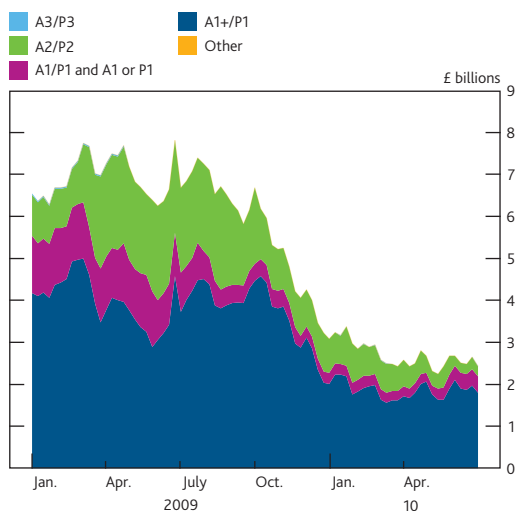


Sources: UBS Delta and Bank calculations.

(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.

The market for sterling non-bank investment-grade commercial paper was somewhat less affected over the period. The total amount of sterling-denominated commercial paper outstanding remained broadly stable (Chart 9). Average quoted sterling primary market spreads widened by around 10 basis points but remain well below the levels seen in early 2009. Consistent with these developments, there was only limited use of the APF Commercial Paper Facility during the quarter (Table A).

**Chart 9 Amount outstanding of sterling non-bank commercial paper by rating**

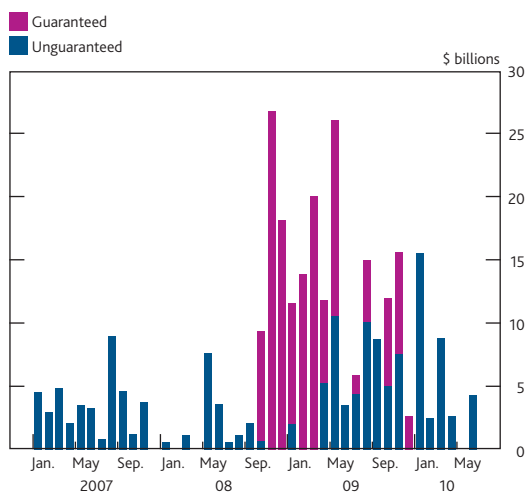


Sources: CP Ware and Bank calculations.

**Credit Guarantee Scheme**

UK banks continued to issue long-term unguaranteed debt though their access to markets had been interrupted by developments during the quarter (Chart 10). There was no issuance of guaranteed debt. Since 28 February 2010, institutions have been able to refinance debt already guaranteed by the Government under the Scheme, but they cannot increase the total amount of guaranteed debt.<sup>(1)</sup> The Facility stands ready to make purchases of Credit Guarantee Scheme bonds from the secondary market should conditions in the market deteriorate.

**Chart 10 UK bank senior debt issuance<sup>(a)(b)(c)</sup>**



Sources: Dealogic and Bank calculations.

(a) Issuance with a value greater than US\$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.

**Secured Commercial Paper Facility**

On 3 August 2009, 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.

(1) 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).