

# Asset Purchase Facility

Quarterly Report 2010 Q3



**BANK OF ENGLAND**



BANK OF ENGLAND

# 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 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 seventh 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.<sup>(5)</sup>

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>(6)</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>(7)</sup> and to £200 billion in November 2009.<sup>(8)</sup> On 4 February 2010,<sup>(9)</sup> and in each subsequent month,<sup>(10)</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>(11)</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>(12)</sup> Since 4 February 2010 all purchases have been financed by the issuance of Treasury bills and the DMO's cash management operations.<sup>(13)</sup>

---

(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 August *Inflation Report* is available at [www.bankofengland.co.uk/publications/inflationreport/ir10aug.pdf](http://www.bankofengland.co.uk/publications/inflationreport/ir10aug.pdf).

(5) For more details see [www.bankofengland.co.uk/publications/other/markets/apf/boeapannualreport1007.pdf](http://www.bankofengland.co.uk/publications/other/markets/apf/boeapannualreport1007.pdf).

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

(7) 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).

(8) 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).

(9) 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).

(10) The September minutes are available at [www.bankofengland.co.uk/publications/minutes/mpc/pdf/2010/mpc1009.pdf](http://www.bankofengland.co.uk/publications/minutes/mpc/pdf/2010/mpc1009.pdf).

(11) See the Chancellor's letter on 4 February to the 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).

(12) 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).

(13) 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.

---

(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 September 2010.

### Operations

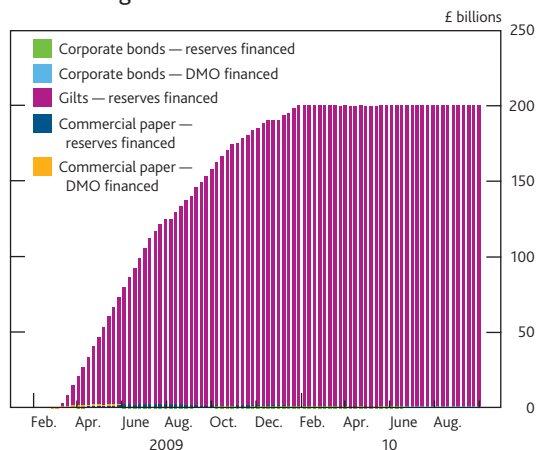
**Table A** below summarises the amount of assets that the Fund has purchased and sold each week of 2010 Q3, ending Thursday, in each facility and the total amounts outstanding as at week ending 30 September 2010. **Chart 1** shows the cumulative asset purchases by type since the establishment of the Fund. As at 30 September 2010, assets outstanding totalled £200 billion.

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

Week ending <sup>(a)</sup>	Commercial paper	Gilts	Corporate bond		Total <sup>(b)</sup>
			Purchases	Sales	
2010 Q2 <sup>(c)(d)</sup>	51	198,275	1,602		199,928
1 July 2010	0	0	4	0	4
8 July 2010	0	0	2	0	2
15 July 2010	0	0	5	2	3
22 July 2010	140	0	9	0	149
29 July 2010	0	0	0	8	-8
5 August 2010	0	0	0	19	-19
12 August 2010	0	0	2	8	-6
19 August 2010	120	0	0	9	111
26 August 2010	0	0	5	4	1
2 September 2010	0	0	5	2	3
9 September 2010	0	0	0	0	0
16 September 2010	0	0	0	4	-4
23 September 2010	0	0	7	0	7
30 September 2010	0	0	4	2	2
<b>Total financed by a deposit from the DMO<sup>(d)(e)</sup></b>	<b>0</b>	<b>-</b>	<b>353</b>		<b>353</b>
<b>Total financed by central bank reserves<sup>(d)(e)</sup></b>	<b>0</b>	<b>198,275</b>	<b>1,225</b>		<b>199,500</b>
<b>Total asset purchases<sup>(d)(e)</sup></b>	<b>0</b>	<b>198,275</b>	<b>1,578</b>		<b>199,853</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 Q2 measured as amount outstanding as at 24 June 2010.  
 (d) In terms of proceeds paid to counterparties less redemptions at initial purchase price on a settled basis.  
 (e) Data may not sum due to assets maturing over the period.

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



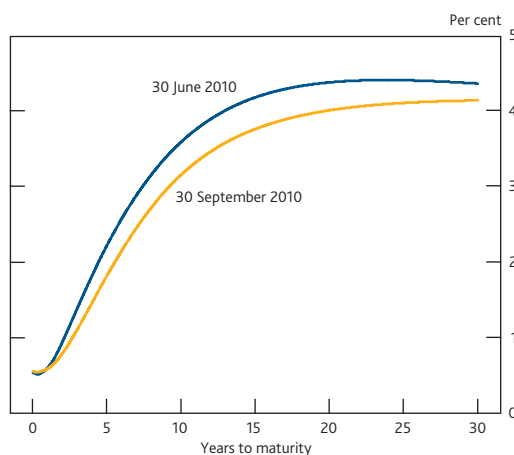
(a) Data based on settled transactions. Note that bars for categories other than gilts are very small.

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

### UK government bond market

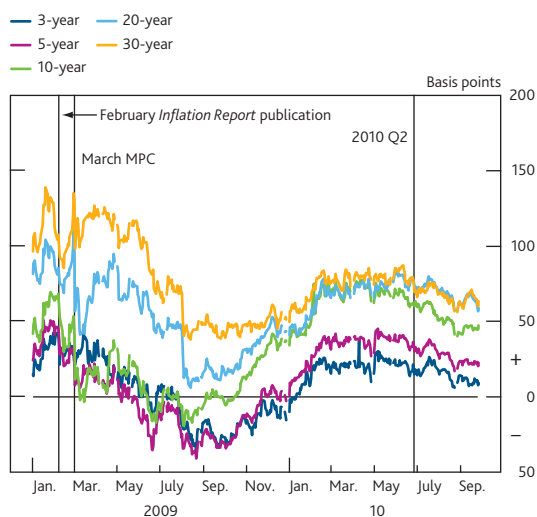
The curve of nominal gilt yields flattened somewhat during 2010 Q3, with rates at medium to long-term maturities around 40 basis points lower than at the end of 2010 Q2 (**Chart 2**). Overnight index swap (OIS) rates fell by slightly less than gilt yields, and, as a result, gilt-OIS spreads narrowed by around 15 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 27 August 2010 can be found in the *Quarterly Bulletin* at [www.bankofengland.co.uk/publications/quarterlybulletin/qb1003.pdf](http://www.bankofengland.co.uk/publications/quarterlybulletin/qb1003.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).

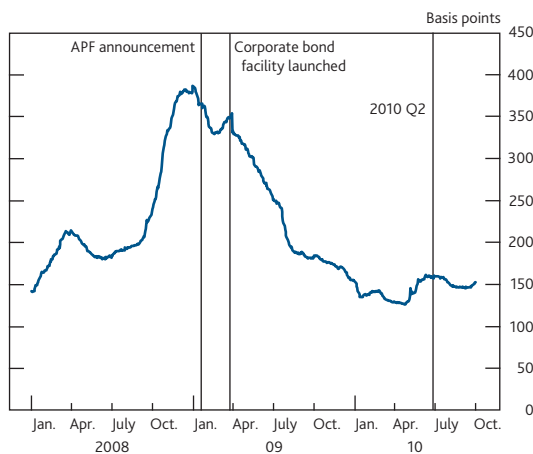
Purchase Facility to the DMO during the three months to 30 September 2010 was £279 million, less than the £2.1 billion lent on average during the previous quarter. The fall in the amount of gilts lent to the DMO is to be expected as continued issuance of gilts by the DMO reduces the proportion of free float held by the Facility.

**UK corporate debt markets**

Conditions in the UK corporate funding markets continued to stabilise during 2010 Q3 and there was reduced usage of the APF purchase facilities, as shown in **Table A**, particularly relative to the late May and early-June period.<sup>(1)</sup>

**Chart 4** shows that spreads on UK non-financial investment-grade corporate bonds narrowed by around 10 basis points over the period. This was reinforced by falling government bond yields leaving yields on corporate bonds around 40 basis points lower at the end of the quarter (**Chart 5**).

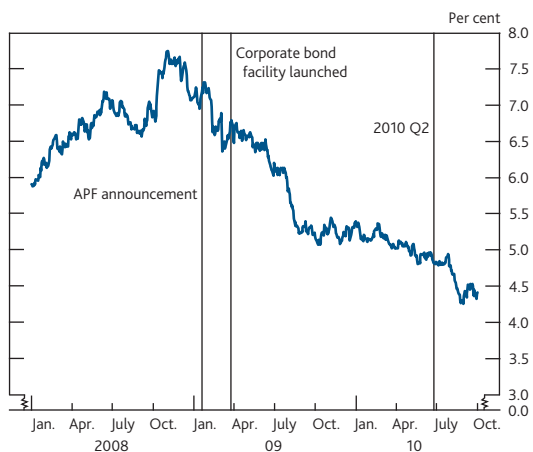
**Chart 4** Sterling investment-grade non-financial corporate bond spreads<sup>(a)</sup>



Sources: Merrill Lynch and Bank calculations.

(a) Option-adjusted spread over government rates.

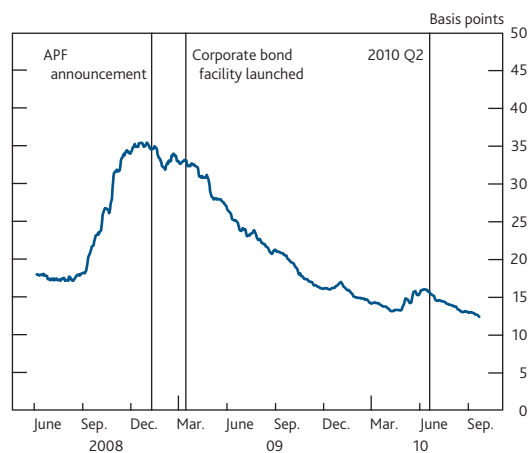
**Chart 5** Sterling investment-grade non-financial corporate bond yields



Sources: Merrill Lynch and Bank calculations.

Though spreads remain around 20 basis points higher than in Q1, yields on corporate bonds are nearly 60 basis points lower as a result of falling government bond yields. Bid-ask spreads for corporate bonds, as quoted by market makers, narrowed steadily over the period reflecting an improvement in liquidity and are now at their lowest since the intensification of the financial crisis in 2008 Q3 (**Chart 6**). **Chart 7** shows that gross bond issuance in Q3 by UK private non-financial corporations (PNFCs) has increased, and, though cumulative issuance in 2010 was lower than in 2009, it remained broadly in line with historical averages.

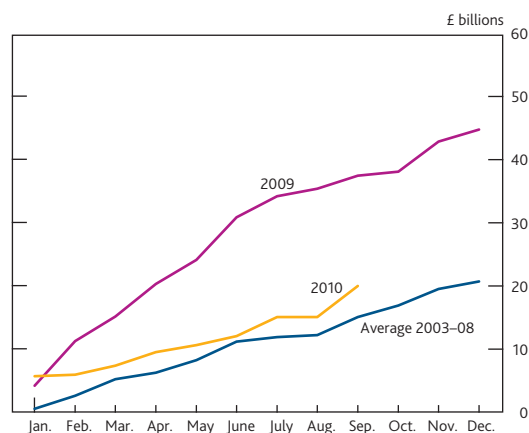
**Chart 6** Median sterling investment-grade non-bank corporate bond bid-ask spreads<sup>(a)</sup>



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>



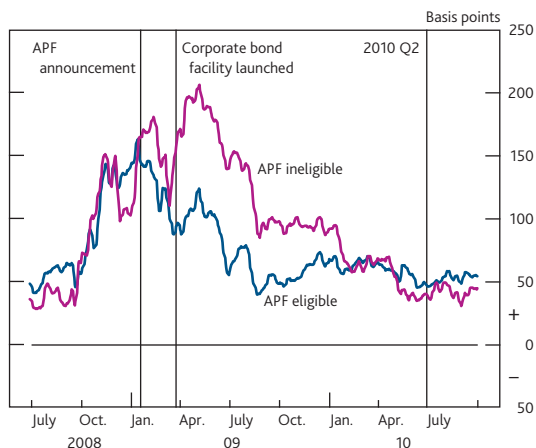
Sources: Dealogic and Bank calculations.

(a) Data are subject to periodic revisions.

(1) See **Table A** of the 2010 Q2 *Asset Purchase Facility Quarterly Report* at [www.bankofengland.co.uk/publications/other/markets/apf/apfquarterlyreport1007.pdf](http://www.bankofengland.co.uk/publications/other/markets/apf/apfquarterlyreport1007.pdf).

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

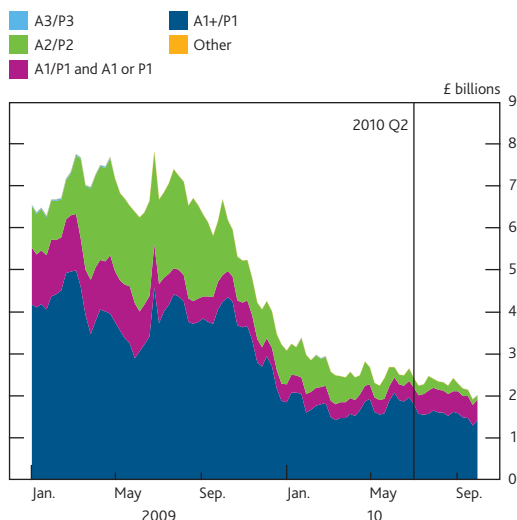


Sources: UBS Delta and Bank calculations.

(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 broadly stable over the period. The total amount of sterling-denominated commercial paper outstanding fell slightly in Q3 (Chart 9), in part reflecting continued substitution into longer-term funding via corporate bonds. Average quoted sterling primary market spreads were broadly stable and remain well below the levels seen in early 2009. Consistent with these developments there was

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



Sources: CP Ware and Bank calculations.

only very limited use of the APF Commercial Paper Facility during the quarter (Table A), with no usage of the facility in the month of September.

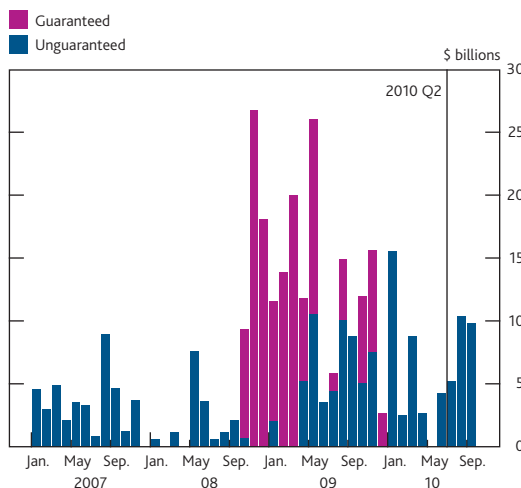
**Secured Commercial Paper Facility**

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.

**Credit Guarantee Scheme**

UK banks continued to issue long-term unguaranteed debt. Issuance in Q3 increased significantly following reduced access to markets during Q2 (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 Asset Purchase 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.

(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).