Asset Purchase Facility

Quarterly Report 2011 Q3

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 2009[(1)] and detailed in an exchange of letters with the Governor on 29 January 2009.[(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 2009.[(3)]

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 report covers the three months to 30 September 2011. 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 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.[(5)]

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's) 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.[(6)] 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[(7)] and to £200 billion in November 2009.[(8)] On 4 February 2010,[(9)] and in each subsequent month to 30 September 2011,[(10)] 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.[(11)] 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.[(12)] Since 4 February 2010 all purchases have been financed by the issuance of Treasury bills and the DMO's cash management operations.

(1) The Chancellor's statement is available at 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 and www.bankofengland.co.uk/markets/apfgovletter090129.pdf.
(3) The exchange of letters is 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/ir11aug.pdf.
(5) For more details see www.bankofengland.co.uk/publications/other/markets/apf/boeapfannualreport1007.pdf.
(6) For more details see 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 and 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 and 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.
(10) The September 2011 minutes are available at www.bankofengland.co.uk/publications/minutes/mpc/pdf/2011/mpc1109.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.
(12) The rationale for corporate asset purchases is set out in a speech by Paul Fisher available at www.bankofengland.co.uk/publications/speeches/2010/speech423.pdf.

The Facility first purchased commercial paper on 13 February 2009,[1] gilts on 11 March 2009[2] and corporate bonds on 25 March 2009.[3] 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.[4] This measure was aimed at supporting price transparency and improving two-way liquidity through the establishment of pricing points.[5] The proposed changes took effect from the week beginning 4 January 2010, with the first sales operation taking place on 8 January 2010. Since then, the Bank has regularly acted on both sides of the market, buying and selling small amounts of eligible bonds.

On 3 August 2009, the Bank launched a Secured Commercial Paper (SCP) Facility, in which the APF stands ready to buy qualifying securities to support the flow of credit to a broad range of corporates.[6] The Bank announced on 15 November 2010 that it had recognised the eligibility of a programme for the SCP Facility. The APF first purchased secured commercial paper on 30 November 2010.

On 15 November 2010, the Bank announced a number of changes to the Facility.[7] The Bank provided twelve months' notice of its intention to withdraw the Commercial Paper Facility, reflecting improvements in the market. The CGS Bond Secondary Market Scheme[8] was withdrawn as it was judged no longer necessary given the improvements in financial market functioning seen over the previous year. Finally, the Bank announced that it would adapt its reserve prices in the Corporate Bond Secondary Market Scheme to permit relatively more sales of corporate bonds. This change reflected the improved conditions in the corporate bond market since the Scheme was introduced.

(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.
(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.
(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.
(4) For more details see www.bankofengland.co.uk/markets/marketnotice091222.pdf.
(5) 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.
(6) For more details see www.bankofengland.co.uk/markets/apf/securedcpf/index.htm.
(7) For more details see www.bankofengland.co.uk/publications/news/2010/088.htm.
(8) For more details see www.bankofengland.co.uk/markets/apf/cgs/index.htm.

Report for the quarter ended 30 September 2011.

Operations

Table A below summarises the amount of assets that the Fund has purchased and sold each week of 2011 Q3, ending Thursday, in each facility and the total amounts outstanding as at week ending 29 September 2011. **Chart 1** shows the cumulative asset purchases by type since the establishment of the Fund. As at 29 September 2011, cumulative assets purchased totalled £200 billion.

Table A APF transactions by type (£ millions)

Week ending[a]	Commercial paper	Secured commercial paper	Gilts	Corporate bond Purchases	Corporate bond Sales	Total[b]
2011 Q2[c][d]	0	30	198,275	1,124		199,429
7 July 2011	0	0	0	2	14	-12
14 July 2011	0	0	0	0	0	0
21 July 2011	0	30	0	0	0	30
28 July 2011	0	0	0	0	2	-2
4 August 2011	0	0	0	0	10	-10
11 August 2011	0	0	0	16	0	16
18 August 2011	0	0	0	0	0	0
25 August 2011	0	30	0	8	0	38
1 September 2011	0	0	0	0	0	0
8 September 2011	0	0	0	15	18	-3
15 September 2011	0	0	0	9	0	9
22 September 2011	0	25	0	9	51	-17
29 September 2011	0	0	0	3	0	3
Total financed by a deposit from the DMO[d][e]	0	25	–	287		312
Total financed by central bank reserves[d][e]	0	0	198,275	801		199,076
Total asset purchases net of sales[d][e]	**0**	**25**	**198,275**	**1,088**		**199,388**

(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) 2011 Q2 measured as amount outstanding as at 30 June 2011.
(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.

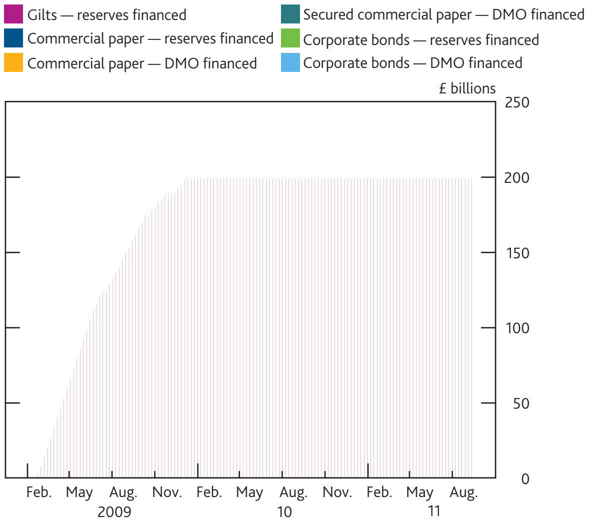
Conditions in UK government and corporate debt markets[1]

UK government bond market

Nominal gilt yields fell sharply during 2011 Q3, with rates on average around 90 basis points lower than at the end of 2011 Q2, with a larger decrease in medium maturities (**Chart 2**). Overnight index swap (OIS) rates also decreased during 2011 Q3, and by more than gilt yields at both short and long maturities, with the result that gilt-OIS spreads increased (**Chart 3**).

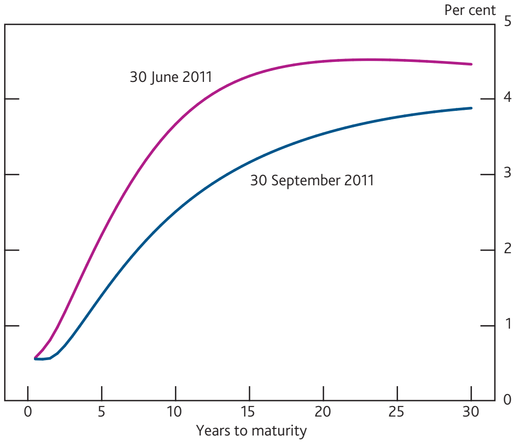
A significant amount of the gilts purchased via the Facility continue to be made available for on-lending to the market through the gilt lending arrangement with the DMO.[2] The

Chart 1 Cumulative asset purchases by type: amounts outstanding[a]



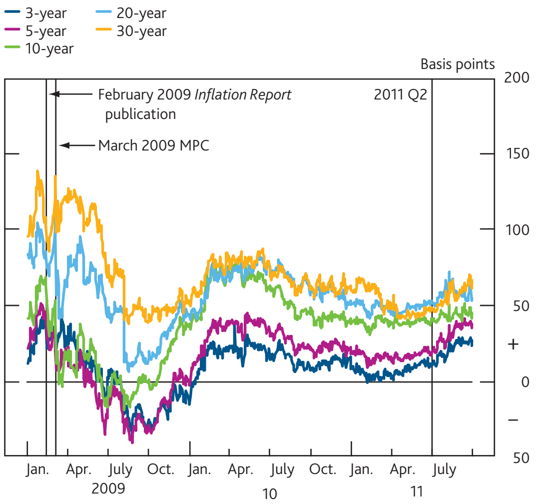
(a) Data based on settled transactions. Note that bars for categories other than gilts are very small.

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.

This chart has been amended since publication on 24 October 2011.

(1) More information on market conditions up to 26 August 2011 can be found in the *Quarterly Bulletin* at www.bankofengland.co.uk/publications/quarterlybulletin/qb1103.pdf.
(2) For more details see www.dmo.gov.uk/docs/gilts/press/sa060809b.pdf.

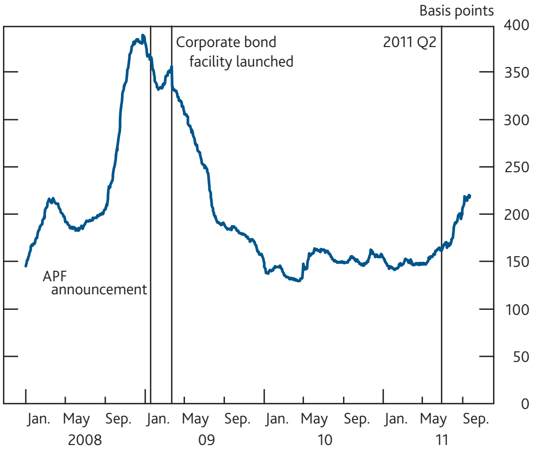
average daily aggregate value of gilts lent by the Asset Purchase Facility to the Debt Management Office during the three months to 30 September 2011 was £2.6 billion, slightly more than the £2.4 billion lent on average during the previous quarter.

UK corporate debt markets

Activity in the Bank's APF was increasingly driven primarily by the deteriorating liquidity conditions in corporate debt markets, with both material purchases and sales of corporate bonds towards the end of 2011 Q3 (**Table A**) as the scheme acted as both a source of supply and backstop to the sterling UK corporate bond secondary market.

As gilt yields decreased, spreads on UK non-financial investment-grade corporate bonds increased markedly over the period (**Chart 4**), with levels in line with those seen in March 2008 but still well short of the peak reached at the end of 2008. However, UK non-financial investment-grade corporate bond yields remained stable over the quarter (**Chart 5**). Bid-ask spreads for corporate bonds, as quoted by market makers, increased over the past quarter reflecting lower liquidity in this market. However, these measures remain below the levels observed during the intensification of the financial crisis in 2008 Q3 and Q4 (**Chart 6**). Gross bond issuance by UK private non-financial corporations (PNFCs) increased in September 2011 after the seasonal summer lull in July and August (**Chart 7**).

Chart 4 Sterling investment-grade non-financial corporate bond spreads[a]

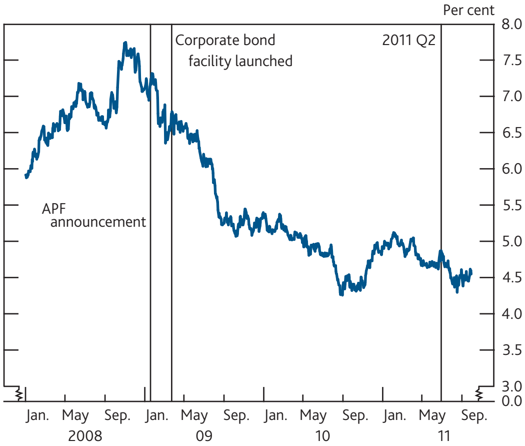


Sources: Merrill Lynch and Bank calculations.

(a) Option-adjusted spread over government rates.

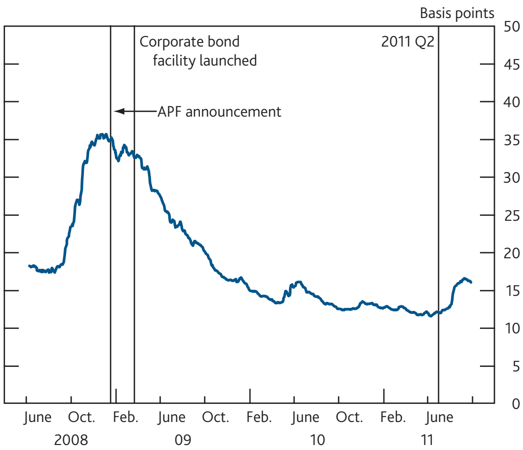
The difference between corporate bond spreads and corresponding credit default swap (CDS) premia, one indicator of market liquidity, was broadly unchanged for APF eligible bonds in 2011 Q3, as CDS premia widened in line with bond spreads (**Chart 8**). CDS premia for APF ineligible bonds widened by more than bond spreads, reflecting increased volatility in the CDS market, rather than an improvement in bond market liquidity.

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



Sources: Merrill Lynch and Bank calculations.

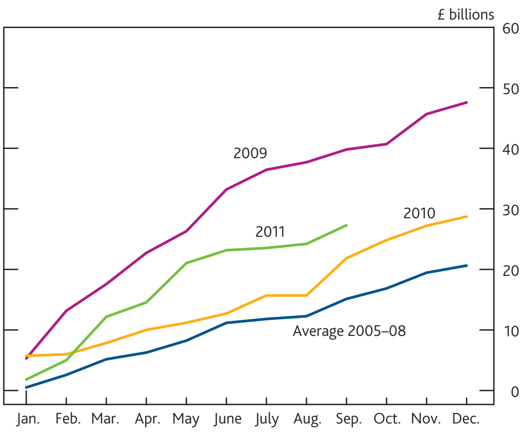
Chart 6 Median sterling investment-grade non-bank corporate bond bid-ask spreads[a]



Sources: UBS Delta and Bank calculations.

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

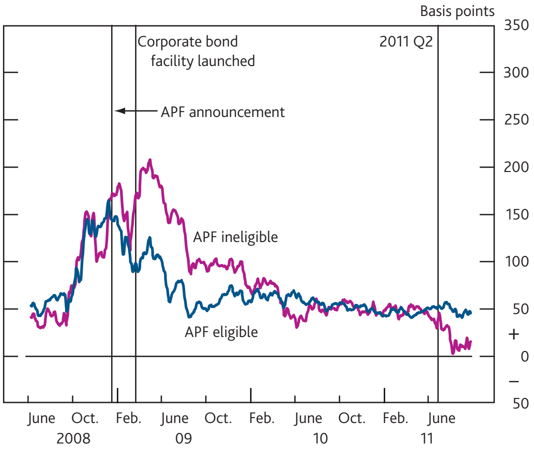
Chart 7 Cumulative gross issuance of bonds by UK PNFCs[a]



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[(a)]

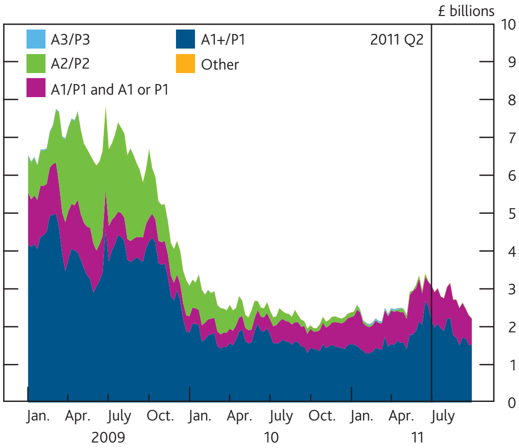


Sources: UBS Delta and Bank calculations.

(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 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 decreased in 2011 Q3 (**Chart 9**) but remains broadly in line with the average outstanding in 2011. Average quoted sterling primary market spreads were stable and remain well below the levels seen in early 2009. Consistent with these developments there was no 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.

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 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. The Bank announced on 15 November 2010 that it had recognised the eligibility of a programme for this facility. This programme has drawn on the facility since 2010 Q4.

ISSN: 2041-1936 (online)