Asset Purchase Facility

Quarterly Report 2011 Q4

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[(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 31 December 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. On 3 March 2009, the Chancellor extended the remit to enable the Facility to be used as a monetary policy tool.[(6)] 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. At the request of the MPC, the limit was increased on three occasions: to £175 billion in August 2009,[(7)] to £200 billion in November 2009,[(8)] and to £275 billion in October 2011.[(9)] On 4 February 2010, the Chancellor authorised the Bank to continue to transact in private sector assets even when the Facility was not being used for monetary policy.[(10)] The £50 billion limit for purchases of private sector assets was applied to the total of existing purchases funded by central bank reserves and future purchases financed by the issuance of Treasury bills. On 29 November 2011, the Chancellor announced that this limit for total private sector purchases would be reduced from £50 billion to £10 billion. The limit for total purchases funded by central bank reserves remained at £275 billion.[(11)]

The Facility first purchased gilts on 11 March 2009.[(12)] All purchases of gilts have been 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.

(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 November *Inflation Report* is available at www.bankofengland.co.uk/publications/inflationreport/ir11nov.pdf.
(5) For more details see www.bankofengland.co.uk/publications/other/markets/apf/boeapfannualreport1107.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) The exchange of letters is available at www.bankofengland.co.uk/monetarypolicy/pdf/govletter111006.pdf and www.hm-treasury.gov.uk/d/chx_letter_061011.pdf.
(10) 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.
(11) This reduction coincided with the announcement by the Government of a package of interventions to improve the supply of credit to businesses which do not have access to capital markets. The Chancellor and Governor agreed that the corporate APF programmes could fulfil their purpose, of ensuring that the corporate bond and commercial paper markets function normally, with a substantially lower ceiling than the initial £50 billion. The exchange of letters is available at www.bankofengland.co.uk/monetarypolicy/pdf/govletter111129.pdf and www.hm-treasury.gov.uk/d/chx_letter_291111.pdf.
(12) 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.

The Facility first purchased corporate bonds on 25 March 2009.(1) The Facility has continued to make small purchases of corporate assets throughout the period since then, 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.(2) Between 6 March 2009 and 4 February 2010 all purchases of private assets were financed by central bank reserves. Outside this period, purchases have been financed by the issuance of Treasury bills and the DMO's cash management operations. 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.(3) This measure was aimed at supporting price transparency and improving two-way liquidity through the establishment of pricing points.(4) 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 Fund has regularly acted on both sides of the market, buying and selling small amounts of eligible bonds. On 15 November 2010 the Bank announced that it would adapt its reserve prices in the Corporate Bond Secondary Market Scheme to permit more sales of corporate bonds.(5) This change reflected the improved conditions in the corporate bond market since the Scheme was introduced.

The Commercial Paper Facility(6) closed on 15 November 2011. The Bank had provided twelve months' notice of its intention to withdraw this Facility,(7) reflecting improvements in the market since the Facility first purchased commercial paper on 13 February 2009.

On 3 August 2009, the Bank launched the Secured Commercial Paper (SCP) Facility(8) 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 the SCP Facility. The APF first purchased secured commercial paper on 30 November 2010. This programme has drawn on the facility since 2010 Q4.

(1) 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.
(2) 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.
(3) For more details see www.bankofengland.co.uk/markets/marketnotice091222.pdf.
(4) 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.
(5) For more details see www.bankofengland.co.uk/publications/news/2010/088.htm.
(6) 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.
(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/securedcpf/index.htm.

Report for the quarter ended 31 December 2011.

Operations

Table A below summarises the amount of assets that the Fund has purchased and sold each week of 2011 Q4, ending Thursday, in each facility and the total amounts outstanding as at week ending 29 December 2011. **Chart 1** shows the cumulative asset purchases by type since the establishment of the Fund. As at 29 December 2011 cumulative assets purchased net of sales totalled £250 billion.

Table A APF transactions by type (£ millions)

Week ending[(a)]	Commercial paper[(b)]	Secured commercial paper	Gilts	Corporate bond Purchases	Corporate bond Sales	Total[(c)]
2011 Q3[(d)(e)]	0	25	198,275	1,088		199,388
6 October 2011	0	0	0	9	3	6
13 October 2011	0	0	5,100	22	11	5,111
20 October 2011	0	0	5,100	0	28	5,072
27 October 2011	0	20	5,100	0	42	5,078
3 November 2011	0	0	5,100	0	131	4,969
10 November 2011	0	0	5,100	2	54	5,048
17 November 2011	0	0	5,100	16	0	5,116
24 November 2011	–	0	5,100	9	7	5,102
1 December 2011	–	0	5,100	4	0	5,104
8 December 2011	–	0	5,100	6	12	5,094
15 December 2011	–	0	5,100	7	1	5,106
22 December 2011	–	0	0	0	15	-15
29 December 2011	–	0	0	0	78	-78
Total financed by a deposit from the DMO[(e)(f)]	0	0	–	211		211
Total financed by central bank reserves[(e)(f)]	0	0	249,272	648		249,920
Total asset purchases net of sales[(e)(f)]	**0**	**0**	**249,272**	**859**		**250,131**

(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) The Commercial Paper Facility closed on 15 November 2011.
(c) Weekly values may not sum to totals due to rounding.
(d) 2011 Q3 measured as amount outstanding as at 29 September 2011.
(e) In terms of proceeds paid to counterparties less redemptions at initial purchase price on a settled basis.
(f) Data may not sum due to assets maturing over the period.

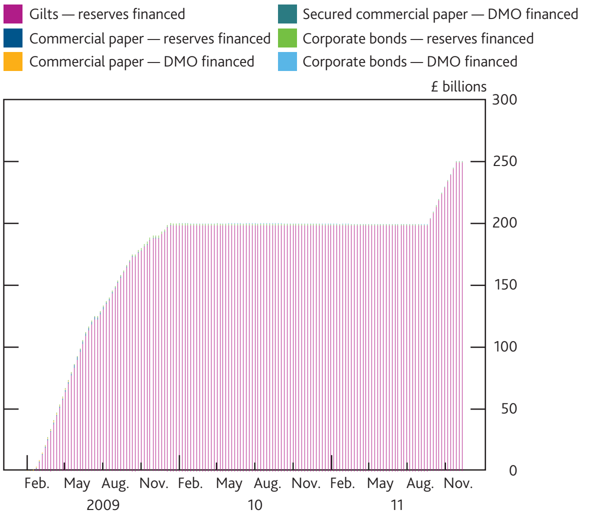
Conditions in UK government and corporate debt markets[(1)]

UK government bond market

Nominal gilt yields fell further during 2011 Q4, with rates on average around 45 basis points lower than at the end of 2011 Q3, with a larger decrease for longer maturities (**Chart 2**). Overnight index swap (OIS) rates also decreased during 2011 Q4, but by less than gilt yields at all maturities, with the result that gilt-OIS spreads decreased (**Chart 3**).

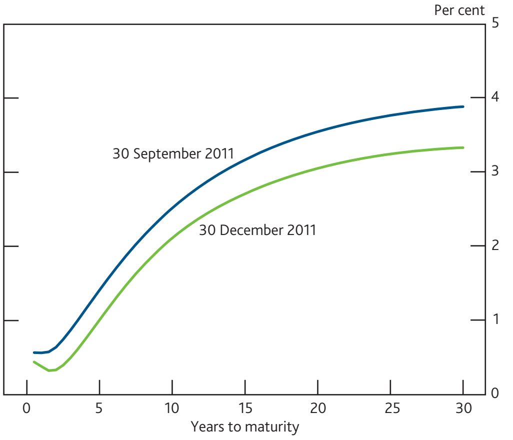
A significant amount of the gilts purchased via the Facility continue to be made available for on-lending to the market

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



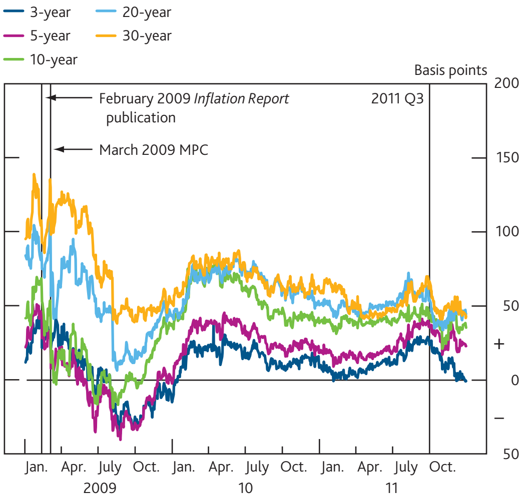
(a) Data based on settled transactions. Note that bars for categories other than gilts are very small.

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.

(1) More information on market conditions up to 25 November 2011 can be found in the *Quarterly Bulletin* at www.bankofengland.co.uk/publications/quarterlybulletin/qb1104.pdf.

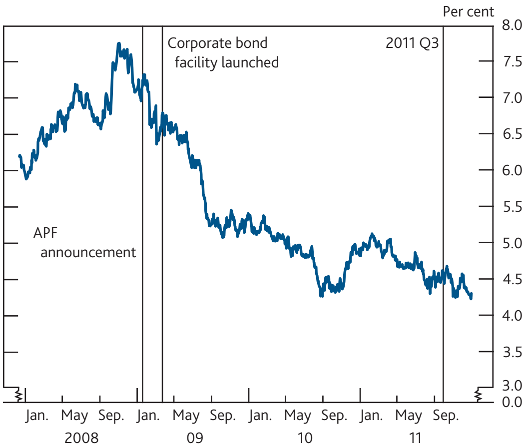
through the gilt lending arrangement with the DMO.[1] The average daily aggregate value of gilts lent by the Asset Purchase Facility to the Debt Management Office during the three months to 31 December 2011 was £1.6 billion, somewhat lower than the £2.6 billion lent on average during the previous quarter.

UK corporate debt markets

Activity in the Bank's APF was increasingly driven by the deteriorating liquidity conditions in corporate debt markets, with an increase in both purchases and sales of corporate bonds in 2011 Q4 compared with the previous quarter (**Table A**). Market contacts suggested that dealers had run down their stock of bonds to reduce their risk positions as conditions became more stressed. This meant that the scheme acted as a backstop, with increased purchases of bonds. But there were also periods of stronger investor demand. Dealers with reduced stocks were unable to satisfy this demand and so they used the scheme as a source of supply.

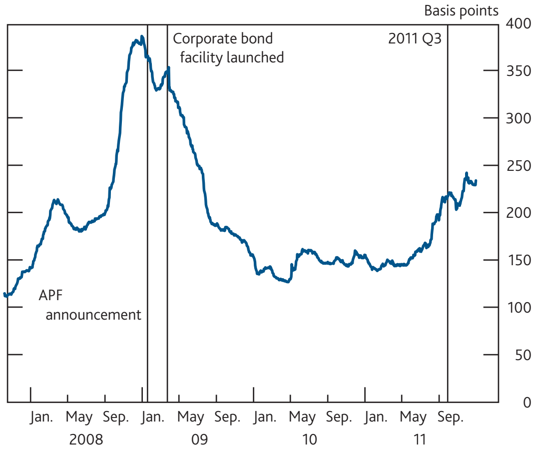
UK non-financial investment-grade corporate bond yields decreased a little over the quarter (**Chart 4**), but by less than gilt yields. As a result, spreads on UK non-financial investment-grade corporate bonds increased over the period (**Chart 5**). The level of spreads is high by historical standards, but still well short of the peak reached at the end of 2008. Bid-ask spreads for sterling investment-grade non-bank corporate bonds, as quoted by market makers, remained elevated over the past quarter reflecting the continued lower level of 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**). Despite poor secondary market conditions, gross bond issuance by UK private non-financial corporations (PNFCs) continued throughout 2011 Q4 after the seasonal summer lull in July and August (**Chart 7**). In part this reflects the low level of yields making new issuance attractive.

Chart 4 Sterling investment-grade non-financial corporate bond yields



Sources: Merrill Lynch and Bank calculations.

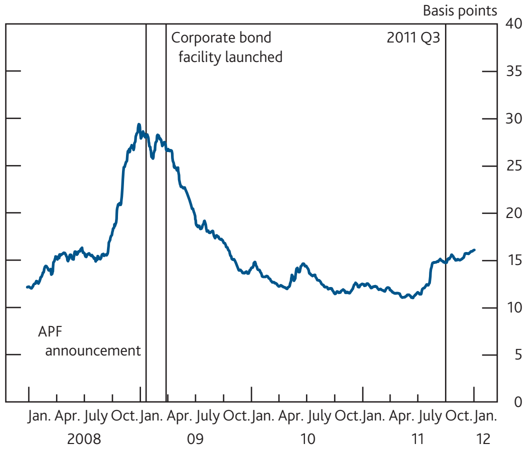
Chart 5 Sterling investment-grade non-financial corporate bond spreads[(a)]



Sources: Merrill Lynch and Bank calculations.

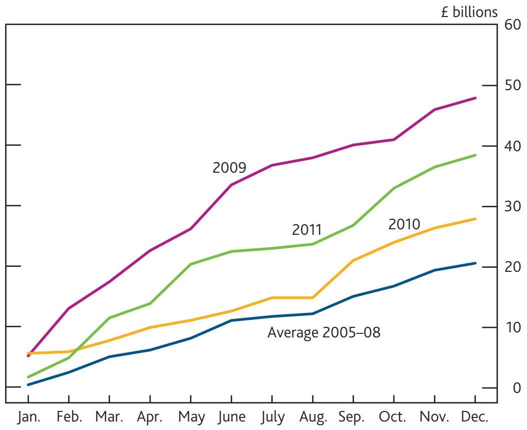
(a) Option-adjusted spread over government rates.

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



Sources: Bloomberg, iboxx and Bank calculations.

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

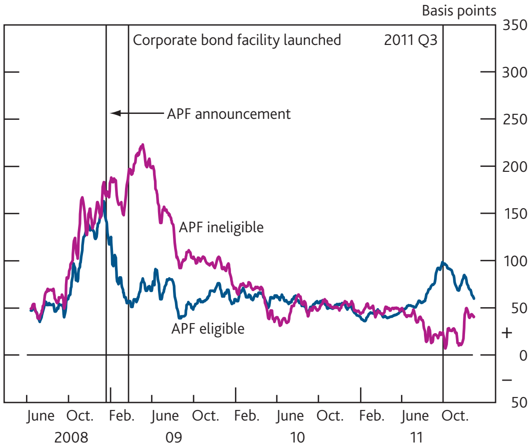


Sources: Dealogic and Bank calculations.

(a) Data are subject to periodic revisions.

(1) For more details see www.dmo.gov.uk/docs/gilts/press/sa060809b.pdf.

Chart 8 Sterling non-bank investment-grade corporate bond spreads less CDS premia(a)



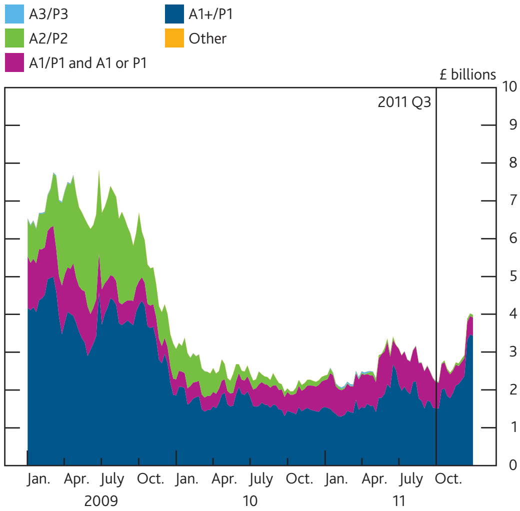
Sources: UBS Delta and Bank calculations.

(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 difference between corporate bond spreads and corresponding credit default swap (CDS) premia, one indicator of market liquidity, decreased for APF eligible bonds in 2011 Q4, as CDS premia widened by more than corporate bond spreads (**Chart 8**).

The market for sterling non-bank investment-grade commercial paper continued to function well. The total

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



Sources: CP Ware and Bank calculations.

amount of sterling-denominated commercial paper outstanding increased in 2011 Q4 to its highest level since December 2009 (**Chart 9**) although this was mainly the result of a large increase by one issuer. Average quoted sterling primary market spreads edged a little wider, but remain well below the levels seen in early 2009. Consistent with these developments there was no use of the APF Commercial Paper Facility ahead of its closure in November (**Table A**).

ISSN: 2041-1936 (online)