Asset Purchase Facility

Quarterly Report 2012 Q1

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 March 2012. 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) cash management operations. On 3 March 2009, the Chancellor extended the remit to enable the Asset Purchase Facility (APF) 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 four occasions: to £175 billion in August 2009,[7] to £200 billion in November 2009,[8] to £275 billion in October 2011,[9] and to £325 billion in February 2012.[10] 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.[11] The £50 billion limit for purchases of private sector assets was applied to the total of purchases funded by central bank reserves and purchases financed by the issuance of Treasury bills. On 29 November 2011, the Chancellor changed the limit for total private sector purchases from £50 billion to £10 billion.[12] The limit for total purchases funded by central bank reserves was not affected and is currently £325 billion.

(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/Documents/pdf/govletter090305.pdf and www.hm-treasury.gov.uk/d/chxletter_boe050309.pdf.
(4) The February *Inflation Report* is available at www.bankofengland.co.uk/publications/Documents/inflationreport/ir12feb.pdf.
(5) For more details see www.bankofengland.co.uk/publications/Documents/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/Documents/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/Documents/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/Documents/pdf/govletter111006.pdf and www.hm-treasury.gov.uk/d/chx_letter_061011.pdf.
(10) The exchange of letters is available at www.bankofengland.co.uk/monetarypolicy/Documents/pdf/govletter120209.pdf and www.hm-treasury.gov.uk/d/chx_letter_090212.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) This reduction coincided with the announcement by the Government of a package of interventions to ease the flow of credit to businesses which do not have ready 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/Documents/pdf/govletter111129.pdf and www.hm-treasury.gov.uk/d/chx_letter_291111.pdf.

The Facility first purchased gilts on 11 March 2009. All purchases of gilts have been financed by central bank reserves. The aim of these actions has been 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.

Following the MPC's decision on 9 February 2012 to increase the scale of the programme of asset purchases from £275 billion to £325 billion, the Bank announced it would continue to purchase conventional gilts with a minimum residual maturity of greater than three years, divided into three maturity sectors, but that the boundaries between those sectors would be adjusted slightly. This operational change was intended to help reduce the risk of undesirable frictions in the functioning of the gilt market arising from the concentration of the Bank's holdings of gilts in certain maturity sectors.(1)

The Facility first purchased corporate bonds on 25 March 2009.(2) 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.(3) 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. There have been a number of changes made to the Corporate Bond Secondary Market Scheme since it was launched, including the Scheme acting as a seller, as well as a buyer, of corporate bonds (from 4 January 2010) and adapting the reserve prices in the Scheme to permit more sales of corporate bonds (from 15 November 2010).(4)

The Commercial Paper Facility(5) closed on 15 November 2011, 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(6) to support the provision of working capital to a broad range of corporates. The APF first purchased SCP on 30 November 2010. In the subsequent year the APF made regular, small purchases of SCP. Since November 2011, there have been no further purchases.

(1) For more details on these changes see www.bankofengland.co.uk/markets/Documents/apf/marketnotice120209.pdf.
(2) 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/Pages/apf/corporatebond/default.aspx.
(3) The rationale for corporate asset purchases is set out in a speech by Paul Fisher available at www.bankofengland.co.uk/publications/Documents/speeches/2010/speech423.pdf.
(4) For more details see www.bankofengland.co.uk/publications/Documents/other/markets/apf/apfquarterlyreport1201.pdf.
(5) The Facility offered 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/Pages/apf/cp/default.aspx.
(6) For more details see www.bankofengland.co.uk/markets/Pages/apf/securedcpf/default.aspx.

Report for the quarter ended 31 March 2012

Operations

Table A below summarises the amount of assets that the Fund has purchased and sold each week of 2012 Q1, ending Thursday, in each facility and the total amounts outstanding as at week ending 30 March 2012. **Chart 1** shows the cumulative asset purchases by type since the establishment of the Fund. As at 29 March 2012 (the last Thursday of the quarter) cumulative assets purchased net of sales totalled £304 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 Q4[d][e]	–	0	249,272		859	250,131
6 January 2012	–	0	3,400	0	0	3,400
13 January 2012	–	0	5,100	0	51	5,049
20 January 2012	–	0	5,100	3	19	5,084
27 January 2012	–	0	5,200	3	19	5,184
5 February 2012	–	0	5,200	0	5	5,195
10 February 2012	–	0	0	3	72	-69
17 February 2012	–	0	4,500	3	32	4,471
24 February 2012	–	0	4,500	3	52	4,451
2 March 2012	–	0	4,500	2	105	4,397
9 March 2012	–	0	4,500	0	43	4,457
16 March 2012	–	0	4,500	0	30	4,470
23 March 2012	–	0	3,000	0	11	2,989
30 March 2012	–	0	4,500	0	10	4,490
Total financed by a deposit from the DMO[e][f]	0	0	–		85	85
Total financed by central bank reserves[e][f]	0	0	303,270		264	303,534
Total asset purchases net of sales[e][f]	**0**	**0**	**303,270**		**349**	**303,619**

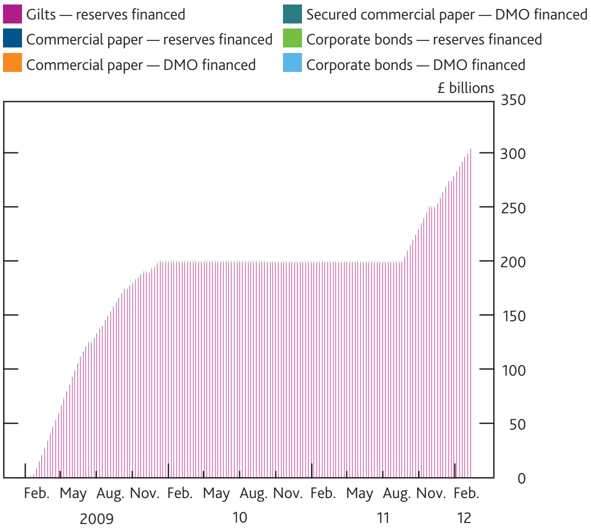
(a) Week-ended amounts are for purchases in terms of the proceeds paid to counterparties, and for sales in terms of the value at which the Bank initially purchased the securities. All amounts are on a trade-day basis, rounded to the nearest million. Data are aggregated for purchases from the Friday to 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 Q4 measured as amount outstanding as at 29 December 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

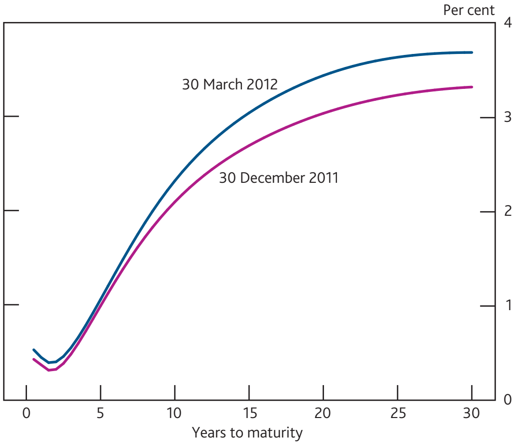
Nominal gilt yields increased in 2012 Q1, with rates on average around 30 basis points higher than at the end of 2011 Q4, particularly for longer maturities (**Chart 2**). Overnight index swap (OIS) rates also rose during 2012 Q1, and by more than gilt yields, with the result that gilt-OIS spreads decreased, particularly for short maturities, to levels last seen in 2009 H2 (**Chart 3**).

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



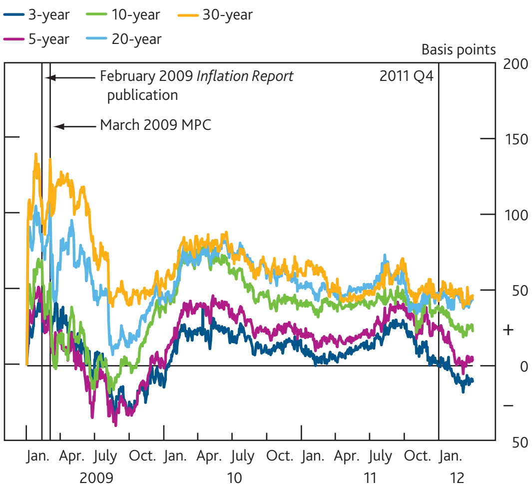
(a) Data based on settled transactions. Note that bars for categories other than gilts are very small.

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 9 March 2012 can be found in the *Quarterly Bulletin* at www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb1201.pdf.

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.[1] The average daily aggregate value of gilts lent by the APF to the DMO during the three months to 31 March 2012 was £0.5 billion, substantially lower than the £1.6 billion lent on average during the previous quarter.

UK corporate debt markets

Activity in the Bank's APF was driven by improving investor sentiment in corporate debt markets, with an increase in net sales of corporate bonds in 2012 Q1 compared with the previous quarter (**Table A**). Market contacts suggested that dealers continued to hold low inventories of bonds to reduce their risk positions following a run down in stocks in 2011. This meant that the scheme acted as a source of supply, particularly in months where primary issuance was not able to satisfy high investor demand. But the pace of APF corporate bond sales slowed towards the end of 2012 Q1, coinciding with strong primary issuance in March 2012 and a reduction in the number of bonds held by the APF.

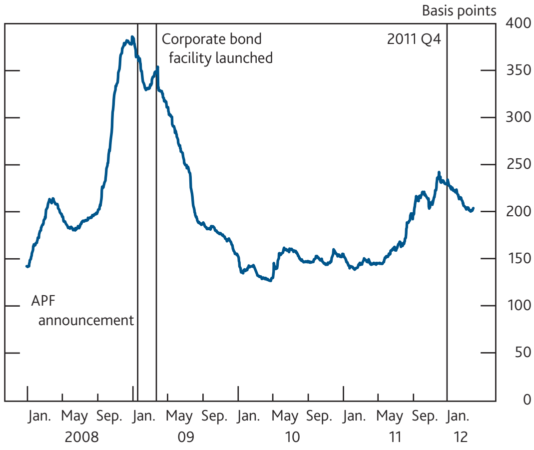
UK non-financial investment-grade corporate bond yields continued to decrease slightly over the quarter (**Chart 4**) as a fall in spreads on UK non-financial investment-grade corporate bonds (**Chart 5**) more than offset the increase in gilt yields. The level of spreads remains high by historical standards, but well below the peak reached at the end of 2008, consistent with an improvement in investor sentiment over the quarter.

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

Sources: Merrill Lynch and Bank calculations.

Bid-ask spreads for sterling investment-grade non-bank corporate bonds, as quoted by market makers, decreased slightly over the quarter but remain elevated, 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**).

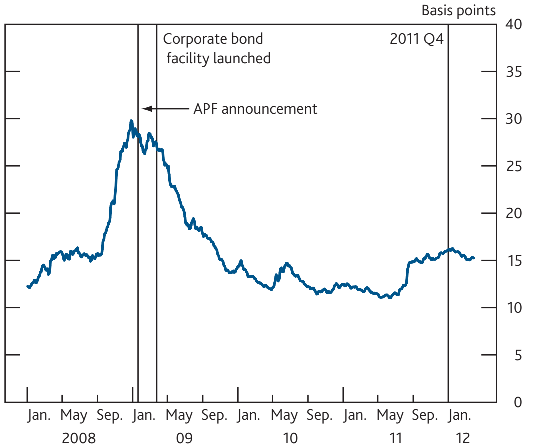
Chart 5 Sterling investment-grade non-financial corporate bond spreads[a]



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



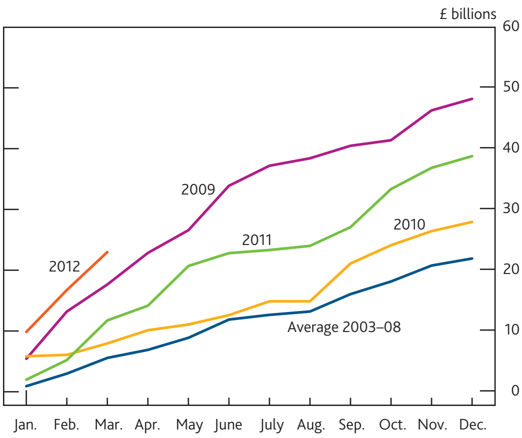
Sources: Bloomberg, iboxx and Bank calculations.

Consistent with improving investor sentiment in the bond market, gross bond issuance by UK private non-financial corporations (PNFCs) increased substantially at the beginning of 2012 and the level of total gross issuance during the quarter was larger than in previous years (**Chart 7**).

The difference between corporate bond spreads and corresponding credit default swap (CDS) premia, one indicator of market liquidity,[2] increased for APF eligible bonds in 2012 Q1, as CDS premia narrowed by more than corporate bond spreads (**Chart 8**).

(1) For more details see www.dmo.gov.uk/docs/gilts/press/sa060809b.pdf.
(2) By subtracting the CDS premia you are able to remove the component of the bond spread which can be thought of as reflecting credit risk and the residual component of the bond spread can be thought of as a premium for liquidity risk. A higher number indicates a greater degree of illiquidity.

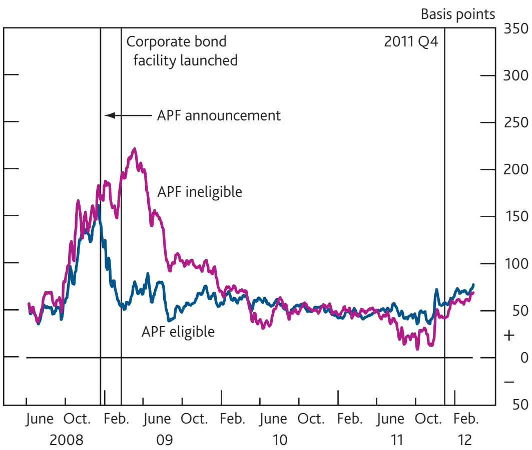
Chart 7 Cumulative gross issuance of bonds by UK PNFCs(a)



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)

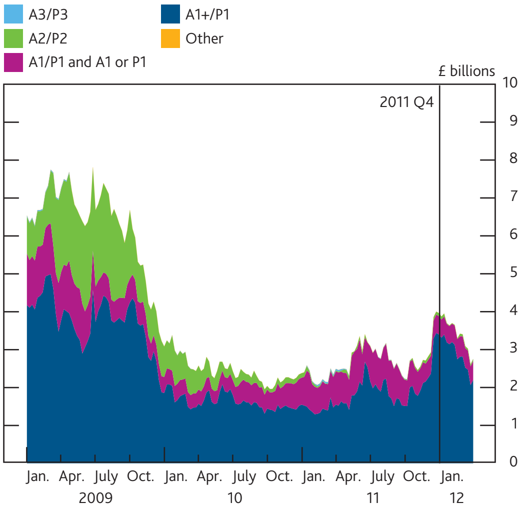


Sources: UBS Delta and Bank calculations.

(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 continued to function well. The total amount of non-bank sterling-denominated commercial paper outstanding decreased in 2012 Q1 (although this was mainly the result of large maturities by one issuer) and is at a level similar to that seen during 2010 and the 2011 H1 (**Chart 9**). Average quoted sterling primary market spreads fell on the quarter and remain well below the levels seen in early 2009.

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



Sources: CP Ware and Bank calculations.

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