Asset Purchase Facility

Quarterly Report 2009 Q4

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.[(3)]

The Governor noted in his letter of 29 January, '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 fourth of those regular reports. 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 have been appointed as 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 Facility was authorised to purchase up to £150 billion, of which up to £50 billion could be used to purchase private sector assets. At the request of the MPC, the limit has been increased twice, to £175 billion in August[(5)] and £200 billion in November.[(6)]

At its November 2009 policy meeting, the Committee voted to increase its purchases to £200 billion. The Committee expected the announced programme to take three months to complete. The aim of this action is 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. A more detailed explanation of the reasons for the Committee's decision can be found in the minutes published on 18 November 2009.[(7)]

The first purchases of commercial paper began on 13 February but, from 6 March onwards, these were financed by reserves balances issued by the Bank rather than by the issue of Treasury bills.[(8)] The Facility began to purchase gilts on 11 March[(9)] and corporate bonds on 25 March,[(10)] both financed by reserves balances. The Facility stands ready to purchase bank debt issued under the Credit Guarantee Scheme should conditions in that market deteriorate.[(11)] On 3 August, the Bank launched a secured commercial paper facility, in which the Facility stands ready to buy qualifying securities.[(12)] On 22 December, the Bank announced, following a consultation process, that it would act as a seller, as well as a buyer, of corporate bonds in the secondary market. The changes would take effect from the week beginning 4 January 2010, with the first sales operation taking place on 8 January 2010.[(13)]

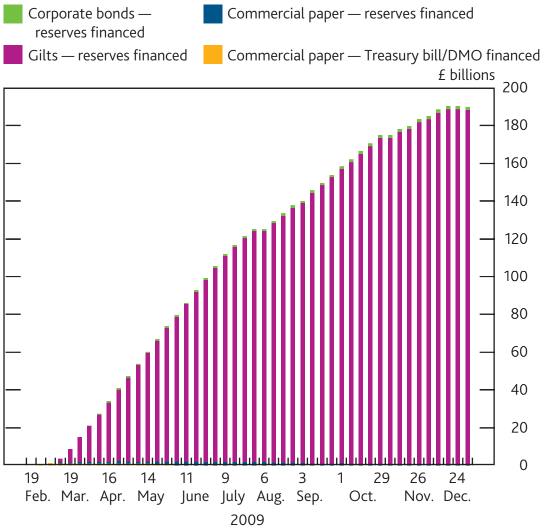
(1) The Chancellor's statement is available at www.hm-treasury.gov.uk/press_05_09.htm.
(2) The exchange of letters are available at www.bankofengland.co.uk/markets/apfgovletter090129.pdf and www.hm-treasury.gov.uk/d/ck_letter_boe290109.pdf.
(3) The exchange of letters are available at www.bankofengland.co.uk/monetarypolicy/pdf/govletter090305.pdf and www.hm-treasury.gov.uk/d/chxletter_boe050309.pdf.
(4) The November *Inflation Report* is available at www.bankofengland.co.uk/publications/inflationreport/ir09nov.pdf.
(5) The exchange of letters are available at www.bankofengland.co.uk/monetarypolicy/pdf/govletter090806.pdf and www.hm-treasury.gov.uk/d/chx_letter_060809.pdf.
(6) The exchange of letters are available at www.bankofengland.co.uk/monetarypolicy/pdf/govletter091105.pdf and www.hm-treasury.gov.uk/d/chx_letter_051109.pdf.
(7) The November MPC minutes are available at www.bankofengland.co.uk/publications/minutes/mpc/pdf/2009/mpc0911.pdf.
(8) 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.
(9) The Bank announced on 5 November 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.
(10) 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.
(11) For more details see www.bankofengland.co.uk/markets/apf/cgs/index.htm.
(12) For more details see www.bankofengland.co.uk/markets/apf/securedcpf/index.htm.
(13) For more details see www.bankofengland.co.uk/markets/marketnotice091222.pdf.

Report for the quarter ended 31 December 2009.

Operations

Chart 1 and **Table A** below summarise the amount that the Fund has purchased each week in each facility and the total amounts outstanding as at 31 December 2009.

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.

Table A Asset purchases by type (£ millions)(a)(b)

Period/Week ending	Commercial paper	Gilts	Corporate bonds	Total
2009 Q3(c)	922	151,775	1,073	153,771
1 October 2009	225	4,200	72	4,497
8 October 2009	80	4,200	139	4,419
15 October 2009	25	4,200	33	4,258
22 October 2009	145	4,201	13	4,359
29 October 2009	0	4,200	62	4,262
5 November 2009	0	0	63	63
12 November 2009	0	3,400	60	3,460
19 November 2009	70	1,700	13	1,783
26 November 2009	224	3,400	5	3,629
3 December 2009	0	1,701	4	1,705
10 December 2009	125	3,400	2	3,527
17 December 2009	190	1,700	0	1,890
24 December 2009	0	0	0	0
31 December 2009	25	0	0	25
Amount outstanding financed by Treasury bills as at 31 December(d)	–	–	–	–
Amount outstanding financed by central bank reserves as at 31 December(d)	429	188,076	1,549	190,053
Total amount outstanding as at 31 December(d)	**429**	**188,076**	**1,549**	**190,053**

(a) Week-ended amounts are in terms of the proceeds paid to counterparties, 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) 2009 Q3 measured as amount outstanding as at 24 September 2009.
(d) Aggregate proceeds at purchase less redemptions 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). The change in amounts outstanding may be less than the sum of purchases due to redemptions and non-operation based transactions, such as participation in corporate actions.

Purchases of assets by the Facility are financed via a deposit from the Bank. Initially, this deposit was financed in turn through the issuance of Treasury bills and the Debt Management Office's (DMO) cash management operations. Following the decision by the Monetary Policy Committee (MPC) on 5 March to use the Asset Purchase Facility (APF) as a monetary policy tool, all purchases of assets by the Facility since 6 March have been financed by the issuance of central bank reserves. As of 31 December, these purchases totalled £190 billion.

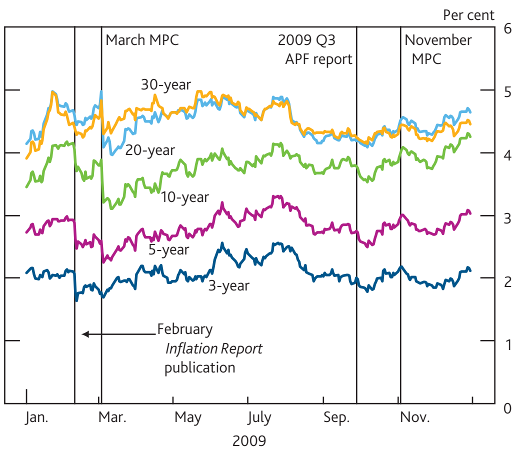
Conditions in UK government and corporate debt markets

Yields on UK government bonds rose during 2009 Q4. These rises were greater than for the corresponding overnight index swap (OIS) rates, leading to an increase in gilt-OIS spreads over the quarter. Despite these recent moves, gilt-OIS spreads remain lower than before the publication of the *Inflation Report* at the start of February 2009. Conditions in the sterling investment-grade commercial paper market continued to be liquid for most issuers, with most quoted sterling primary market spreads below those offered by the Facility. Issuance of non-financial corporate bonds increased, spreads continued to fall and liquidity in that market appeared to have increased further. More information on market conditions up to the end of November 2009 can be found in the *Quarterly Bulletin*.(1)

UK government bond market

As at 31 December, yields on nominal gilts were 15 to 50 basis points higher than at the time of the APF report for the third quarter (**Chart 2**). Rates rose before the MPC's decision on 5 November to increase the asset purchase programme by £25 billion to £200 billion, then fell during the rest of

Chart 2 UK nominal spot rates

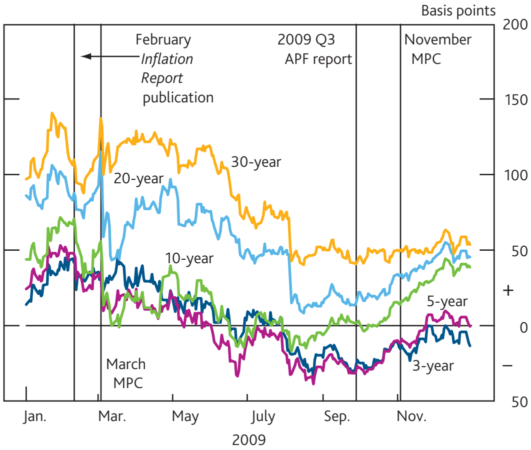


Sources: Bloomberg and Bank calculations.

(1) The 2009 Q4 *Quarterly Bulletin* can be found on the Bank's website at www.bankofengland.co.uk/publications/quarterlybulletin/qb0904.pdf.

November and rose again in December. OIS rates increased by less than gilt rates over the quarter, and, as a result, gilt-OIS spreads increased by 10 to 35 basis points across maturities (**Chart 3**). Despite these recent moves, gilt-OIS spreads remain 35 to 55 basis points narrower than before the publication of the February *Inflation Report*.

Chart 3 UK nominal spot gilt yields less OIS rates



Sources: Bloomberg and Bank calculations.

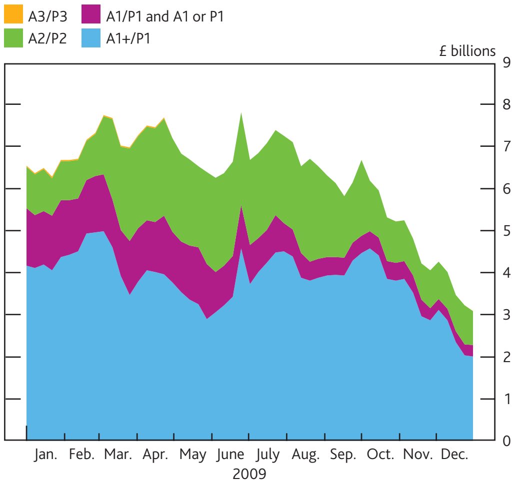
By the end of 2009 Q3, the Bank had acquired a sizable proportion (around 70%) of the free float (the total issue size of a gilt minus government holdings) in four gilts, which were subsequently suspended from auctions until further notice.(1) Following further issuance by the UK DMO, the Bank's holdings as a proportion of the free float fell in three of these gilts during 2009 Q4. As a result, these bonds were made eligible for purchase again.(2) The Bank continues to keep the gilts eligible for purchase by the APF under review, taking into account the size of the Facility's holdings relative to the nominal amount of those stocks in issue and their relative richness to the yield curve.

A significant amount of the gilts purchased via the Facility are made available for on-lending to the market via the DMO through its normal repo market activity.(3) The average daily aggregate value of gilts lent by the Asset Purchase Facility to the DMO during the three months to 31 December was £3.3 billion, lower than the £4.8 billion lent on average during the previous quarter.

UK corporate debt markets

The functioning of the market for sterling non-bank investment-grade commercial paper was generally good during 2009 Q4. Most quoted sterling primary market spreads remained below those offered by the Facility. The Facility acted as a backstop, for example following temporary reductions in market liquidity. The total amount of sterling-denominated commercial paper outstanding for UK corporate and non-bank financial firms continued to decline over the quarter (**Chart 4**). Liquidity remained reasonable during December and was not seriously affected by the year end approaching.

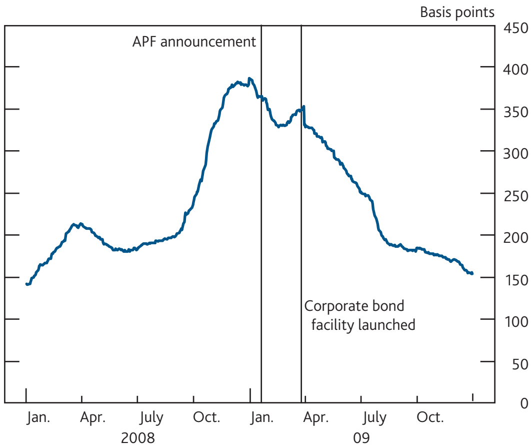
Chart 4 Amount outstanding of sterling non-bank commercial paper by rating



Source: CPWare.

Secondary market spreads on sterling investment-grade non-financial corporate bonds narrowed by around a further 30 basis points during 2009 Q4 (**Chart 5**). This was more than offset by a rise in corresponding gilt rates, leaving yields on those corporate bonds 15–20 basis points higher (**Chart 6**). The last two months of 2009 saw strong gross bond issuance by UK private non-financial corporations (PNFCs) (**Chart 7**). Total gross issuance for 2009 was twice the average of

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

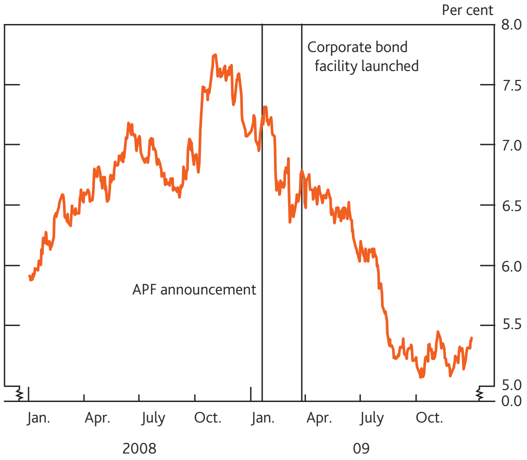


Sources: Merrill Lynch and Bank calculations.

(a) Option-adjusted spread over government rates.

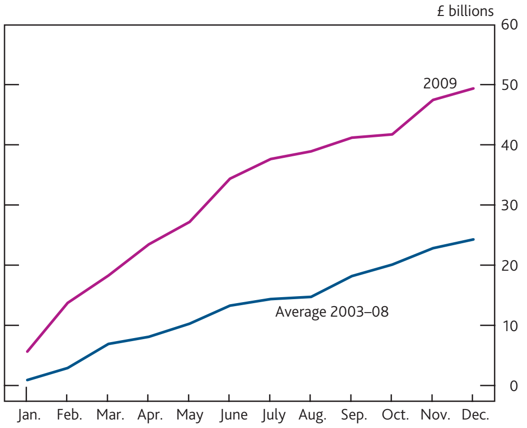
(1) The 5% 2014, 4.75% 2020, 8% 2021 and 4% 2022 gilts. The 8% 2021 is now the only remaining ineligible bond.
(2) 4% 2022 on 12 October, 4.75% 2020 on 26 October, 5% 2014 on 11 November.
(3) See www.dmo.gov.uk/docs/gilts/press/sa060809b.pdf.

Chart 6 Sterling investment-grade non-financial corporate bond yields



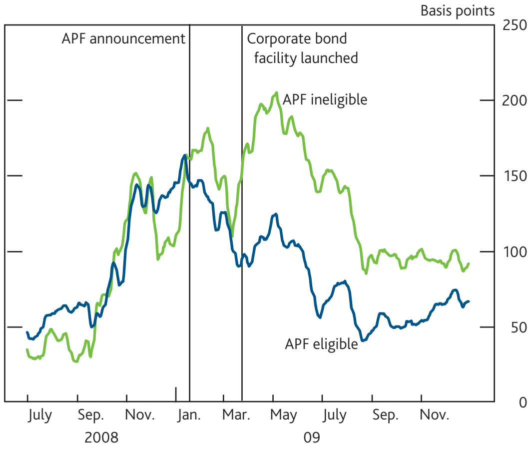
Sources: Merrill Lynch and Bank calculations.

Chart 7 Cumulative gross issuance of bonds by UK PNFCs



Sources: Dealogic and Bank calculations.

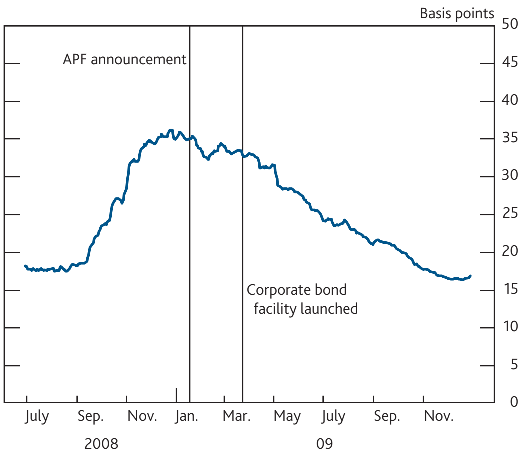
Chart 8 Sterling non-bank investment-grade corporate bond spreads less CDS premia(a)



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.

Chart 9 Median sterling investment-grade non-bank corporate bond bid-ask spreads(a)



Sources: UBS Delta and Bank calculations.

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

2003–08, although net issuance of corporate bonds and commercial paper was broadly in line with the average. The difference between corporate bond spreads and credit default swap (CDS) premia was broadly flat over the quarter for bonds that are ineligible for purchase by the APF (**Chart 8**). It increased somewhat for eligible bonds, but remained around the level observed in the summer of 2008. Bid-ask spreads quoted by market makers narrowed further and are now similar to the levels observed before the events of September 2008 (**Chart 9**).

On 3 December, the Bank launched a consultation process on proposals to act as a seller, as well as a buyer, of corporate bonds in the secondary market.(1) The proposals are aimed at improving secondary market liquidity further, supporting price transparency and improving two-way liquidity through the establishment of pricing points.(2) On 22 December, the Bank announced that the changes would take effect from the week beginning 4 January 2010, with the first sales operation taking place on 8 January 2010. In addition to these changes, the Bank may sell bonds into tender offers initiated by the issuing firm where such sales are consistent with the overall objectives of the programme, including prudent risk management.

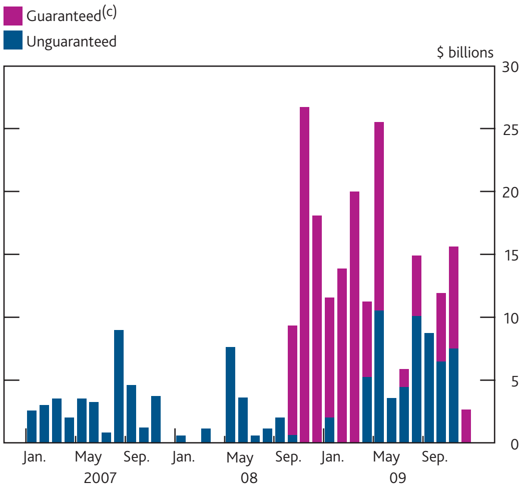
Credit Guarantee Scheme

Conditions in banks' longer-term funding markets remained much improved with respect to the beginning of 2009, although activity decreased in December. Over the final quarter of 2009, the volume of debt issuance was similar to the previous quarter. Issuance of guaranteed debt made up a

(1) For more details see www.bankofengland.co.uk/markets/marketnotice091203.pdf.
(2) For more information see the box 'Asset Purchase Facility Corporate Bond Secondary Market Scheme', 2009 Q4 *Quarterly Bulletin*, page 269.

larger proportion of the total than in the third quarter of 2009, but still a smaller proportion than in the first half of the year (**Chart 10**). 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[a][b]



Source: Dealogic.

(a) Issuance with a value greater than $500 million equivalent and original maturity greater than one year.
(b) Data are subject to periodic revisions.
(c) Senior debt issued under HM Treasury's Credit Guarantee Scheme.

Secured commercial paper facility

On 3 August, 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. It was always envisaged that there would be a few months lead time to the Facility being used, as institutions set up new conduits to meet the Facility's eligibility requirements. There has been no use of the Facility to date, and no SCP programmes have so far been deemed eligible. This largely reflects a change in market conditions since the original consultation. Existing asset-backed commercial paper (ABCP) programmes are now able to fund themselves in the US ABCP market, where pricing has largely normalised. There is also sufficient 'spare capacity' in these programmes to fund further assets if required. That means there has not been demand to set up new conduits to be funded by the SCP facility.

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