Bank of England shocks markets with 50bp rate cut

Markets will focus on the 50 basis point move, but arguably the more important measures are the ones policymakers unveiled to keep credit flowing to businesses affected by the virus. As the full extent of the economic shock becomes clear, a further partial rate cut, coupled with fresh quantitative easing, is possible in coming months

Source: Shutterstock

What has been announced?

With hours to go until the UK budget, the Bank of England has announced a string of measures to help combat the Coronavirus economic shock. The key headlines are:

- A punchy 50bp rate cut, taking Bank Rate to 0.25%
- A new Term-Funding Scheme, designed to offer cheap funding to banks based on the amount they lend to the “real economy”. Extra incentives will be offered to encourage lending to SMEs.
- Reducing the counter-cyclical buffer, releasing capital that banks were previously required to hold through the 'good times'.

What will the effect be?

This is undoubtedly a big move from the Bank of England. We had wondered whether concerns surrounding the Bank's independence could have got in the way of easing at the same time as the budget. But given that a primary aim of this package will be to improve confidence, acting in coordination with the Treasury arguably makes sense.

Markets will undoubtedly focus on the 50bp rate cut, which will send a strong signal to investors, although the impact on the wider economy is more uncertain. For consumers, it's worth remembering that the majority of mortgage holders are increasingly on fixed rate products, which means the immediate impact will feed-through to that part of the lending market with a delay.

But the real focus here is on businesses, which are being increasingly hit by lower demand (concentrated in areas like travel, leisure, hospitality at this stage), as well as staffing disruption. In that context, a rate cut may not do a large amount to offset the cashflow damage.

That means that the other measures announced by the Bank of England could ultimately prove to be more relevant. These are targeted measures to support banks keep credit flowing to the affected companies.

All eyes on the budget

Markets will now be looking towards the Budget later today to see if the Chancellor can complement these measures with fiscal moves.

The Treasury is currently constrained by a fiscal rule that requires the government to balance day-to-day spending by 2022-23, leaving it very little room to boost spending without raising taxes. But in the current circumstances, particularly with borrowing costs so low, we're likely to see either an explicit announcement, or implicit hint, that the rules may be subject to change.

The exact virus-tackling measures are still unclear, but one interesting thing to look out for would be any programmes designed to guarantee loans to small businesses. Such schemes have similar precedents, for example the Enterprise Finance Guarantee Scheme.

There will also be a lot of focus on raising public investment, although at this stage headlines suggest this is likely to be more of a statement of intent at this point, rather than an unveiling of a range of initiatives.

What next from the Bank of England?

Today's move effectively brings forward any measures the Bank might have been minded to announce at its March meeting, so we are unlikely to see many fresh fireworks at the formal gathering on 26 March. However the Bank has been at pains to highlight that it has plenty of policy space left, which it may well use depending on the extent of the shock.

So what could policymakers do? Well, the lower bound is generally perceived to be a little above zero, perhaps 0.05%, which would leave another 20bp rate cut available. However the Bank would then quickly turn to quantitative easing (QE) – probably both in the form of government and corporate bond purchases.

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

 ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit http://www.ing.com.