

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



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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.

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