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UK: POLICYMAKERS SENDING A BIG MESSAGE WITH COORDINATED STIMULUS

Berenberg Macro Flash

Not taking any chances: Reacting to the stock market rout and developing economic shock from COVID-19, which has tipped major parts of the global economy into recession, UK policymakers are taking the necessary steps today to deliver a coordinated monetary and fiscal stimulus. While the BoE's timing has been a slight surprise, the policy action is in line with our earlier analysis. That the BoE chose to announce its stimulus on the same day as the budget is telling. Policymakers are clearly concerned about the risks ahead. The joint action reflects the intention to send a big message that policymakers are prepared to take aggressive and pre-emptive steps to support the economy.

At 12:30 today Chancellor Rishi Sunak will announce his budget plans for the next five years. We expect a significant debt-financed near-term stimulus along with an extra £100bn in public investment over the next five years.

BoE takes aggressive action: All three policy arms of the BoE held emergency meetings yesterday. Together, they have taken major steps to support the UK economy through the difficult months ahead. 1) The MPC (Monetary Policy Committee) voted to cut the bank rate by 50bps to 0.25% and to re-introduced the Term-Funding-Scheme for 12 months. The scheme, which was first trialled after the Brexit vote in 2016, allows participating banks and building societies to borrow from the BoE at, or very close to, the bank rate for up to four years. It is designed to reinforce the transmission of the rate cut to the real economy when rates are already low. 2) The Financial Policy Committee (FPC) decided to reduce the countercyclical capital buffer for UK banks from 1% to 0% with immediate effect. It expects to keep that rate at zero for at least 12 months. The BoE estimates that the release of the buffer will support bank lending of up to £190 billion. 3) Finally, the Prudential Regulation Authority (PRA) set out new supervisory expectations for banks along with measures to help insurance companies smooth the impact of the large moves in government bond yields in recent days – see here.

More monetary stimulus ahead: We had highlighted the chance that the BoE could cut rates sooner than the next scheduled meeting on 26 March in our previous analysis. The BoE clearly views the risks ahead as serious and is looking to send a signal to markets and economic participants that it is prepared to take big steps to support the UK economy. In light of this pre-emptive and unscheduled policy response, the chance of additional action at the 26 March MPC meeting – the first for new governor Andrew Bailey – is high, in our view. We see a good chance that the MPC decides to cut rates to zero and announces a new round of asset purchases (quantitative easing).

Govenor Mark Carney and soon-to-be governor Andrew Bailey are scheduled to hold a joint press conference to discuss the policy steps taken at 9am.

While monetary and fiscal policy cannot fully offset the impact of any virus related disruptions, intercepting the shock early and supporting confidence is the best way to ensure that an acutely disruptive large – but temporary – shock does not lead to a more protracted downturn. Overall, the decision is positive for the UK markets, firms and households.

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