What Horrified Fund Managers, Banks & UK's Pension Minister Said About the Bank of England's Sudden "We Don't Rule Out" Negative Interest Rates

by Nick Corbishley • May 22, 2020 • 71 Comments

"The stimulus the country urgently needs is not experimental and dangerous monetary policy."

By Nick Corbishley, for WOLF STREET:

Andrew Bailey, the recently appointed governor of the Bank of England (BoE), is considering going where no other BoE governor has ever gone in the central bank's 325-year history: into negative interest rate territory. On May 20, Bailey told British MPs that the BoE is refusing to rule out cutting the benchmark interest rate below zero in response to the virus crisis.

"We do not rule things out as a matter of principle. That would be a foolish thing to do," Bailey told MPs. "But that doesn't mean we rule things in either."

That statement came just six days after Bailey had told FT readers that negative interest rates are "not something we are currently planning for or contemplating." Since then, Bailey says he has "changed [his] position a bit."

Bailey, who replaced Mark Carney as BoE governor just two months ago, is not the only senior BoE official who's apparently warming to the idea of foisting negative interest rates on the British economy.

So, too, has the central bank's chief economist Andrew Haldane, who last week said: "The economy is weaker than a year ago and we are now at the effective lower bound, so in that sense it's something we'll need to look at – are looking at – with somewhat greater immediacy. How could we not be?"

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In the wake of the virus crisis, the Bank of England has already slashed interest rates by 0.65 basis points to 0.1%, its lowest level ever. It has also revved up its swap lines with the Federal Reserve and other central banks, offered billions of pounds of fresh liquidity support to banks, and expanded its QE program by £100 billion to £745 billion and extended what it buys to include corporate bonds.

On Wednesday, markets responded to Bailey's ambiguous comments on negative rates by pushing the yields on gilts into negative territory for the first time ever. The UK Debt Management Office was able to sell £3.75 billion worth of three-year gilts at a yield of -0.003%, meaning that investors are now effectively paying to lend to the UK government, which is great news for the UK government as it massively increases its spending.

But not everybody's happy about the BoE's new openness to negative rates. While British bank executives have so far avoided a direct confrontation with Bailey, former UK pensions ministers, bank analysts and fund managers have warned that the move would be devastating for savers and could obliterate banks' interest margins and profits. Here are six of the choicest quotes:

"Trying to fund pension liabilities with guarantees could become ruinous. Negative rates are an unwelcome distortion of capital markets. The policy is designed to boost growth, but its side effects could have damaging consequences that play out badly." Ros Altmann, the former pensions minister (Telegraph).

"The stimulus the country urgently needs is not experimental and dangerous monetary policy, but rather an early end to lockdown before more businesses, jobs and lives are destroyed." Investec analyst Ian Gordon (Telegraph).

"With interest rates already effectively at zero, we don't think it's the cost of capital that is restraining any liquidity, it's really the availability of it and making sure that it's getting to the parts of the economy that need it." Goldman Sachs Asset Management analyst Andrew Wilson (Telegraph).

"If you were thinking it couldn't get worse, negative interest rates would have a much longer lasting impact on UK banks' profitability than current concerns on credit quality." analysts Rohith Chandra Rajan and Alastair Ryan, Merrill Lynch International.

"The big banks will hate negative rates." Paul Lynam, chief executive officer of Secure Trust Bank Plc.

"I can't think of an economy where negative rates are a worse idea than the U.K. How on earth does it make sense to even consider adding negative rates to the mix? The economic benefits are dubious but the power of a cocktail of negative rates and massive QE to weaken the currency seems clear. Kit Juckes, strategist at Societe Generale (Pensions&Investments).

What was supposed to be a short-term emergency experiment has become standard policy at the Swiss National Bank, the European Central Bank, Denmark's National Bank, Sweden's Riksbank, and the Bank of Japan. But in December the Riksbank abandoned the experiment over concerns that negative interest rates were fueling rising asset inflation and rising debt.

Negative rates have also drawn criticism from the Federal Reserve. Fed Chair Jerome Powell said on May 13 that "the evidence on the beneficial effects of negative interest rates abroad was mixed," and "that it was unclear" what effects negative rates have on banks' willingness "to lend and on the spending plans of households and businesses." They also damaged the profitability of banks and are "not something that we're looking at," he said.

Bundesbank president Jens Weidman also criticized negative interest rates, including in a speech to the European Banking Congress last November, citing two reasons: one they hurt the profitability of banks and could cause them to "cut back on lending"; and two, they stimulate the "search of yield" and cause investors "to take on undue risks that could sow the seeds of financial imbalances" and asset price inflation.

The Bank for International Settlements (BIS) also lashed out against them. "There is something vaguely troubling when the unthinkable becomes routine," said the head of the BIS's Monetary and Economic Department, Claudio Borio. Even the ECB, the Bank of Japan and the Swiss National Bank have conceded that negative rates weaken banks, but they still continue to use them. *By Nick Corbishley, for WOLF STREET.*