BANK OF ENGLAND

May 2020

Monetary Policy Report & interim Financial Stability Report

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Tuesday 12 May 2020

Plan for the session

Fergal will be giving you an overview of the *Monetary Policy Report*

Sarah and Matt will give you an overview of the analysis in the *interim Financial Stability Report*

Ben and Andy will be on hand to answer your questions

Please submit those as we go and we'll put some to them – anonymously

We're also running a couple of polls to get your input on the economic outlook – please do take part if you feel comfortable

Monetary Policy Report

May 2020

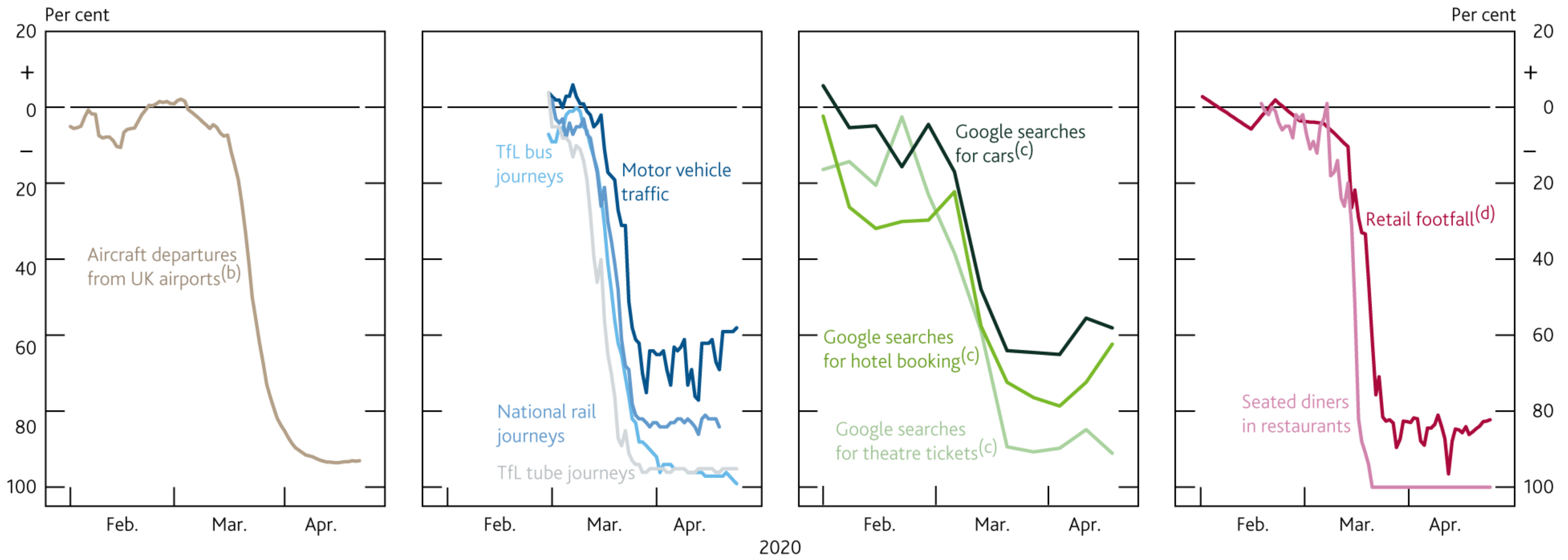
MPC actions since the onset of the Covid-19 shock

- In the current circumstances and, consistent with its remit, monetary policy is aimed at supporting businesses and households, and limiting any lasting damage to the economy
- Alongside measures taken by the rest of the BoE and by HMG, MPC has:
  - Reduced Bank Rate to 0.1%
  - Introduced Term Funding Scheme with additional incentives for lending to Small and Medium-sized Enterprises (TFSME)
  - Increased purchases of UK government and investment-grade corporate bonds by £200 billion – reaching £645 billion in total (by early July at current pace)
- MPC will continue to monitor the situation closely and stands ready to take further action as necessary

Why MPC has published an illustrative scenario, not a forecast

- Unprecedented situation means the outlook is unusually uncertain…
- …will depend on the evolution of the pandemic and how governments, households, businesses and financial markets respond.
- Recognising these uncertainties, the MPC has constructed a plausible illustrative economic scenario based on a set of stylised assumptions.
- While the scenario is highly conditional, it helps to illustrate the potential impact of Covid-19 on the economy.
- Alongside a number of estimates of the sensitivity of the economy to some key variables, it also illustrates the important drivers of the outlook.

High frequency indicators consistent with dramatic fall in economic activity



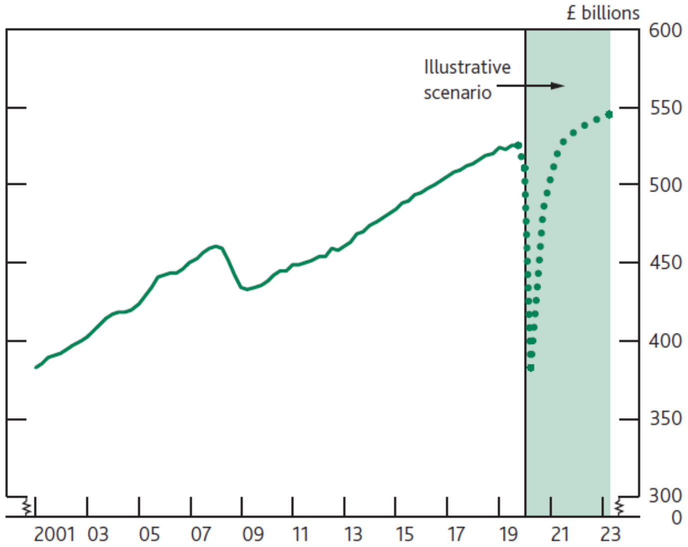
- A range of sources consistent with a 3% fall in GDP in 2020Q1 and around a 25% fall in GDP in 2020Q2

Main building blocks of the scenario

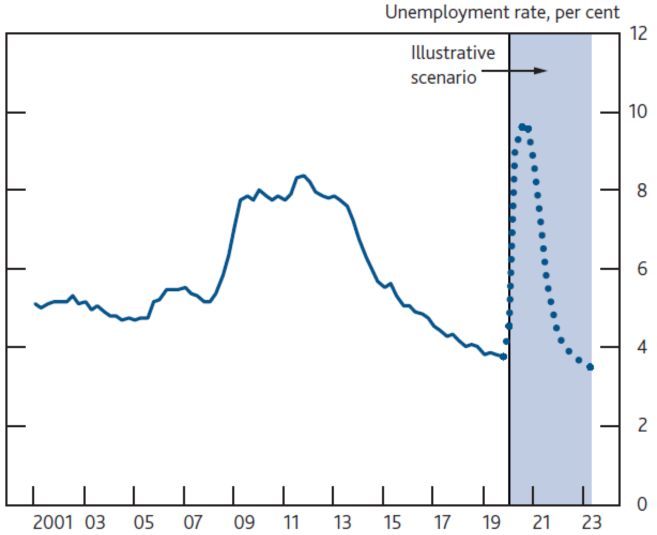
- Social distancing measures and government support schemes remain until early June, before being phased out over Q3 – in UK and rest of the world.
- These support schemes limit adverse economic effects – in particular, the Job Retention scheme (CJRS) materially lowers the number of job losses.
- Most spending that would have been happening is lost permanently, though some is made up.
- But that boost is outweighed by reduced confidence and higher uncertainty…
- …and some voluntary social distancing continues for up to a year after the Government restrictions are lifted.

GDP, unemployment and CPI inflation in the scenario

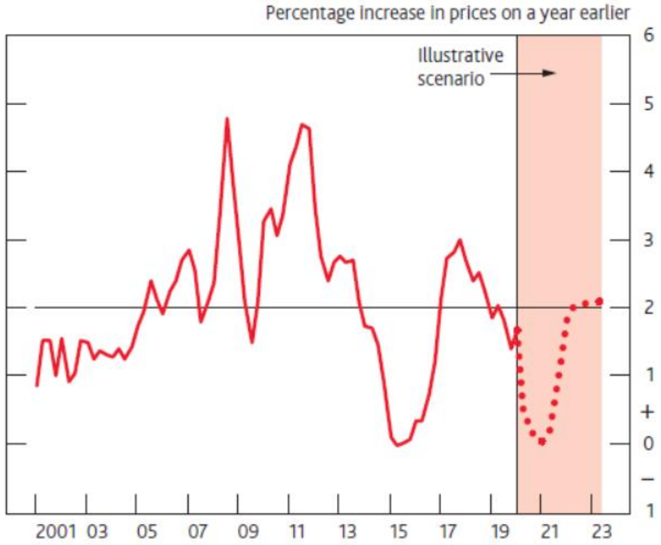
GDP



Unemployment



CPI inflation



Key sensitivities

- The global outlook – policy actions around the world will affect the outlook for the UK
- The persistence of the fall in UK activity – the timing of the recovery will depend in large part on how long social distancing and support measures are in place
- The speed of the recovery will also be affected by how households and businesses respond once measures are lifted
- The degree of long-lasting scarring in the economy – the eventual recovery in GDP will be affected by developments in the economy's supply capacity
- The impact of changes in economic activity on prices – CPI inflation will be affected by how companies respond to changes in demand.

BANK OF ENGLAND

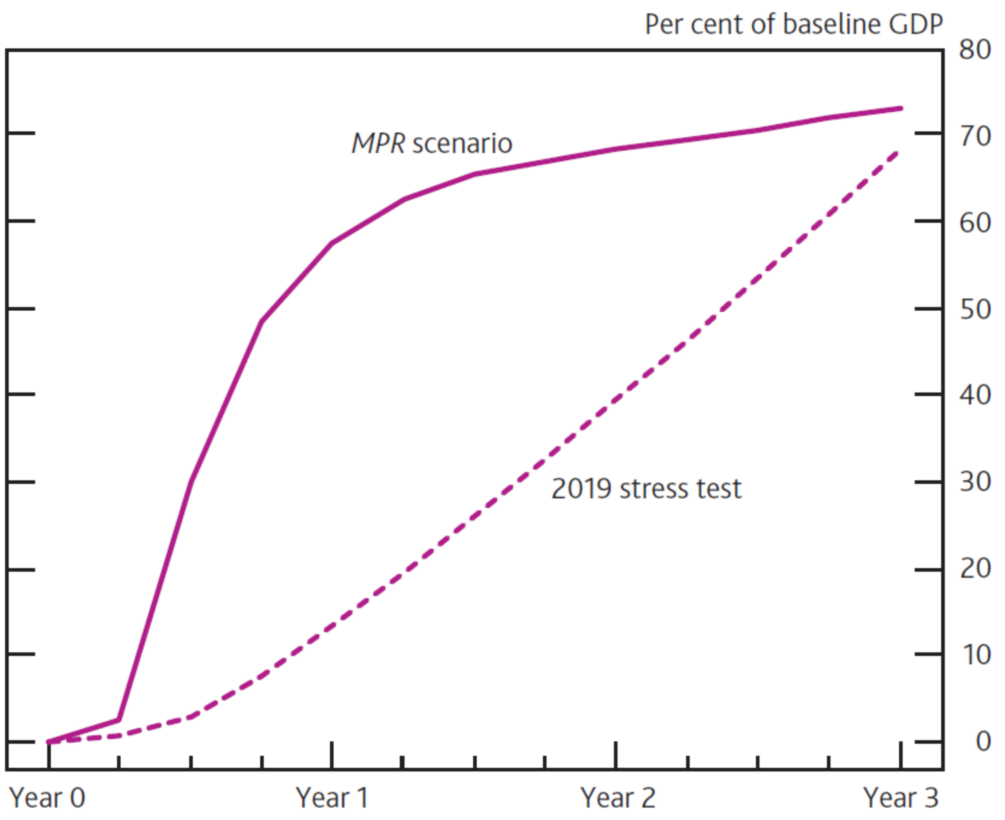
May 2020 Interim FSR

Sarah Breeden
Matt Waldron

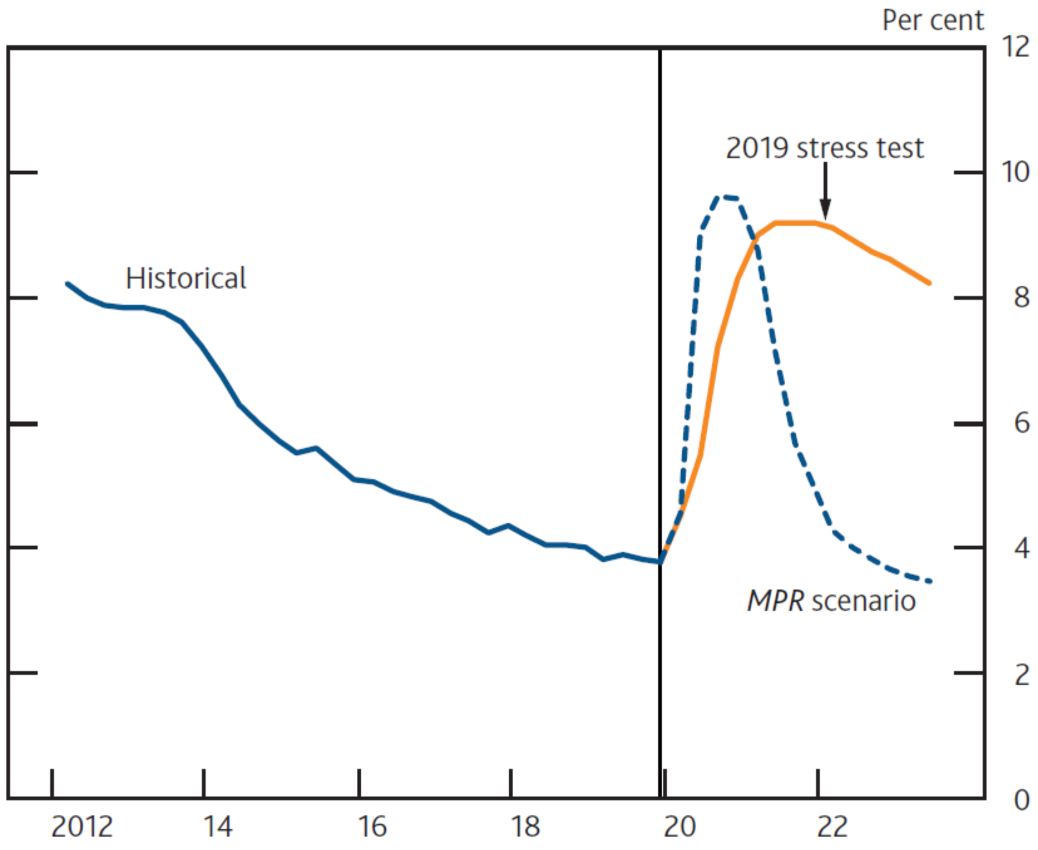
The decline in economic activity illustrated in the MPR scenario would be expected to result in significant credit losses for major UK banks on their domestic and overseas loans.

The MPR scenario incorporates a very sharp fall in UK and global GDP and a substantial increase in unemployment.

Cumulative UK GDP losses in the MPR and 2019 stress-test scenarios

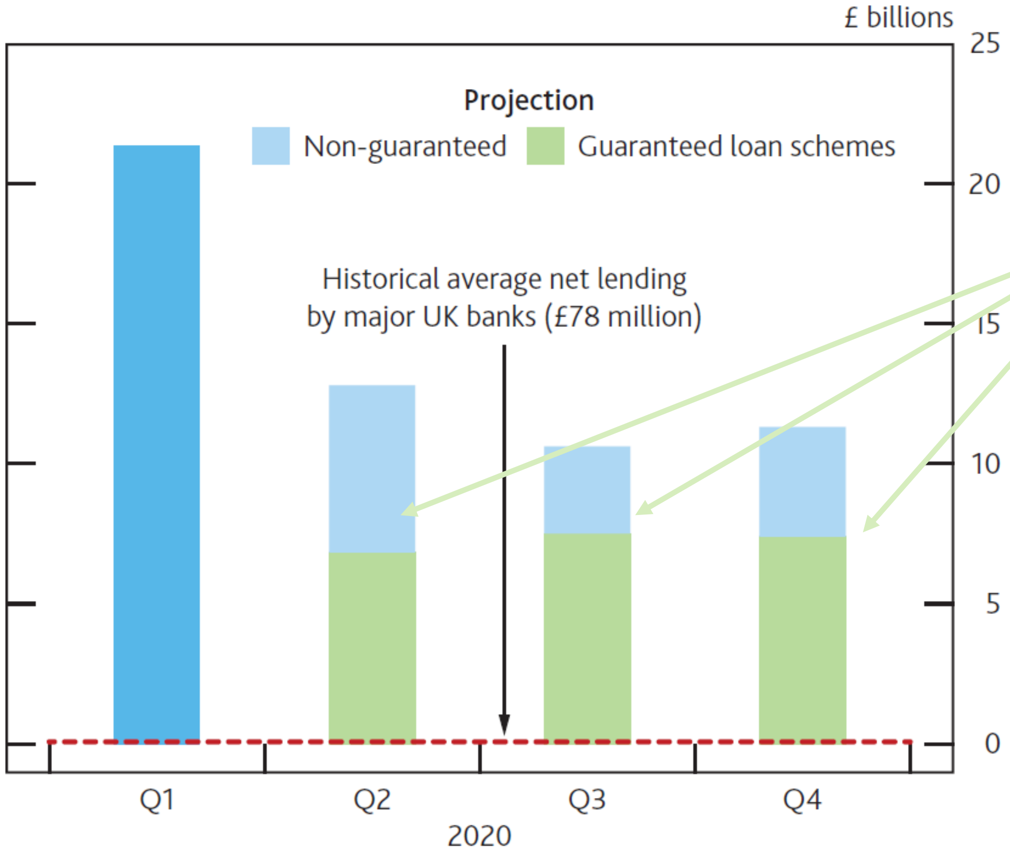


UK unemployment in the MPR and 2019 stress-test scenarios



Supported by our actions, and by Government and Bank of England lending schemes, the UK financial system can help businesses deal with financial difficulties.

Projected net lending to UK corporates over the course of 2020



Guaranteed loan schemes:

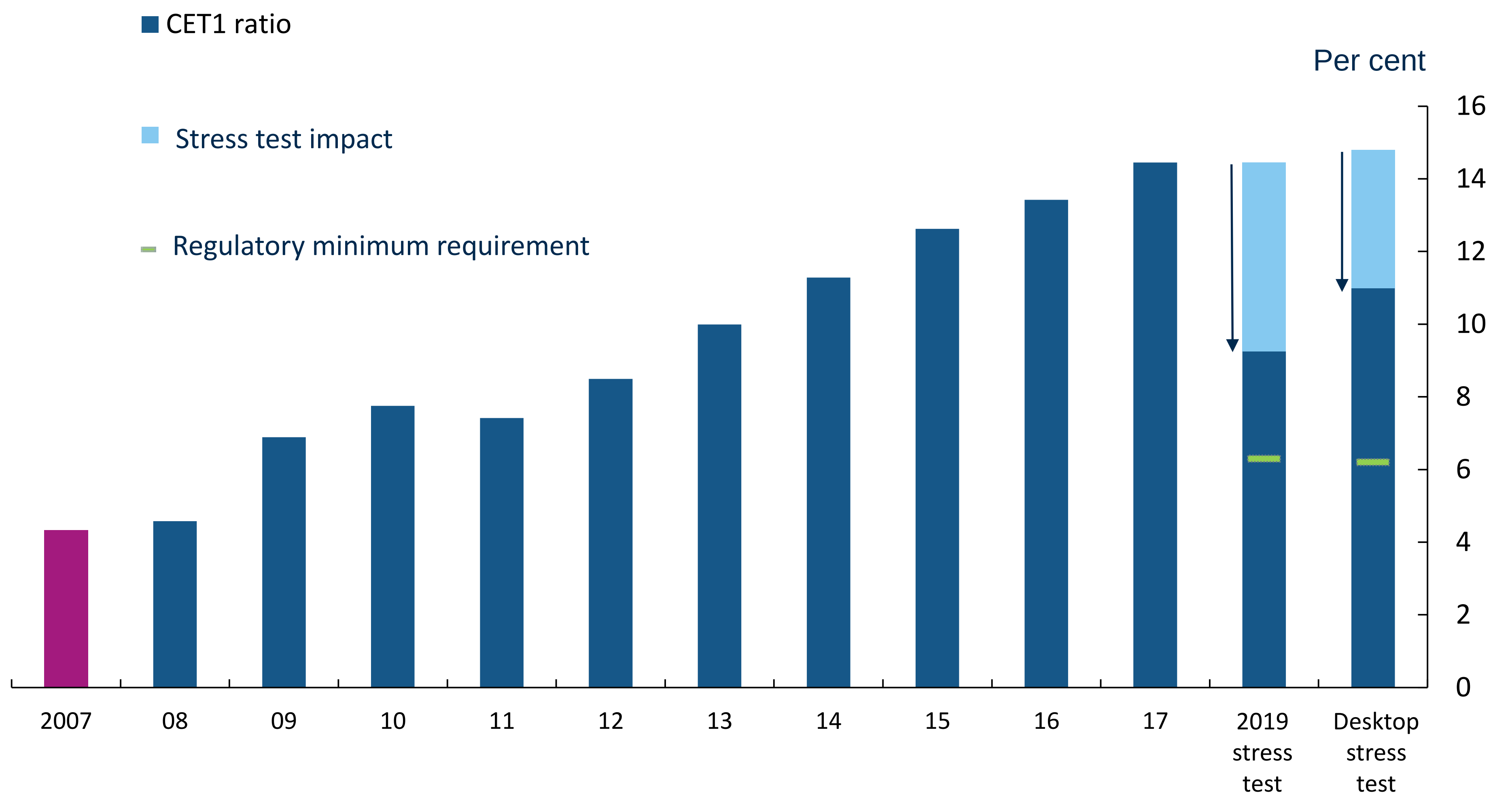
- Coronavirus Business Interruption Loan Scheme (CBILS)
- Coronavirus Large Business Interruption Scheme (CLBILS)
- Bounce Back Loan Scheme (BBLS)
  Note: No additional credit risk for banks

Also available to help businesses:

- Covid Corporate Financing Facility (CCFF)
- Term Funding Scheme for SMEs (TFSME)

The desktop stress test, using prudent assumptions and based on the MPR scenario, generates materially smaller losses for banks than did the Bank's 2019 stress test.

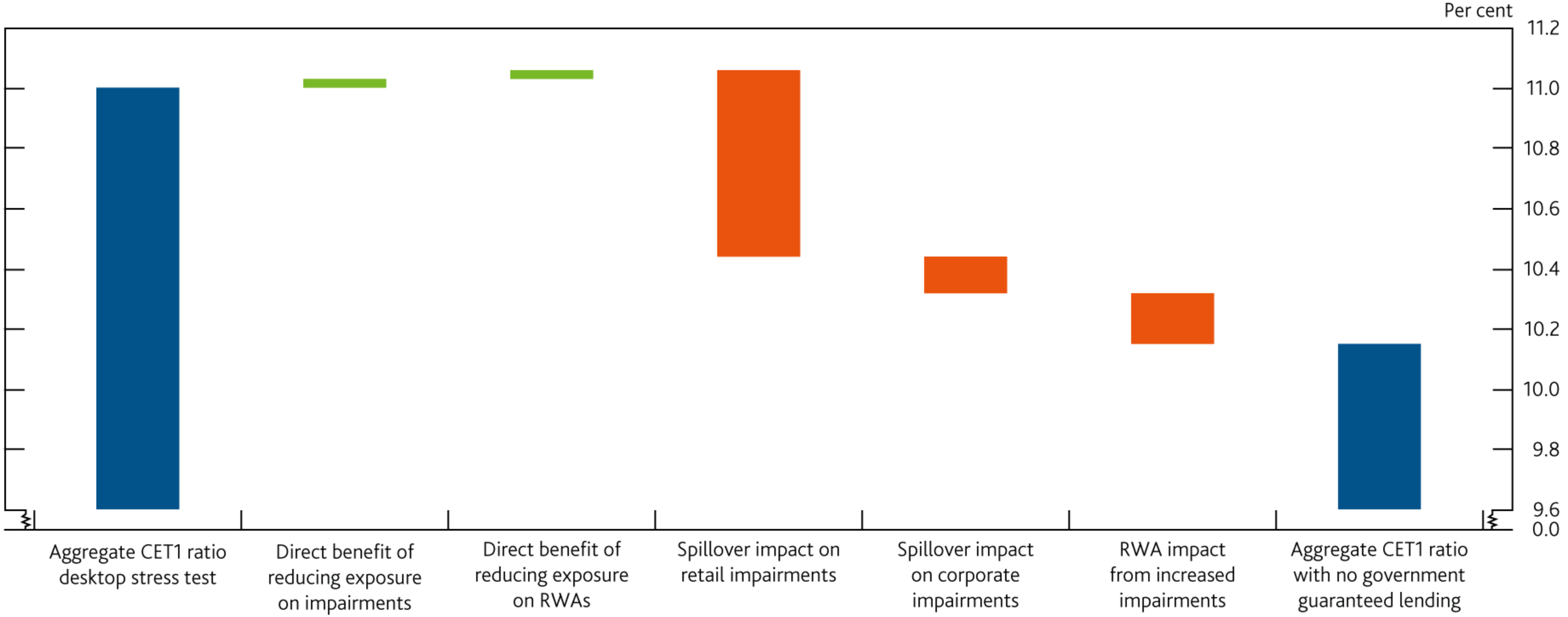
Aggregate CET1 capital ratio of major UK banks since the financial crisis



We have tested the major UK banks. This has shown that they are strong enough to continue lending during this period of severe economic disruption.

Continued expansion of bank credit is essential if deeper and longer lasting damage to the economy is to be mitigated.

Illustrative CET 1 ratio impact of cutting lending by banks assumed via government guaranteed schemes



Major UK banks are strong enough to expand lending. Doing so will support the economy and is in their own interest.

Revenues of many UK companies have declined and cash flows have come under pressure. Some businesses will need to access external finance in order to avoid cost cutting measures which, if widespread, would risk longer-term economic damage.

A large-scale accounting exercise using a dataset of c. 85,000 UK companies

What is the size of UK companies' cash-flow deficits under the Covid-19 scenario?

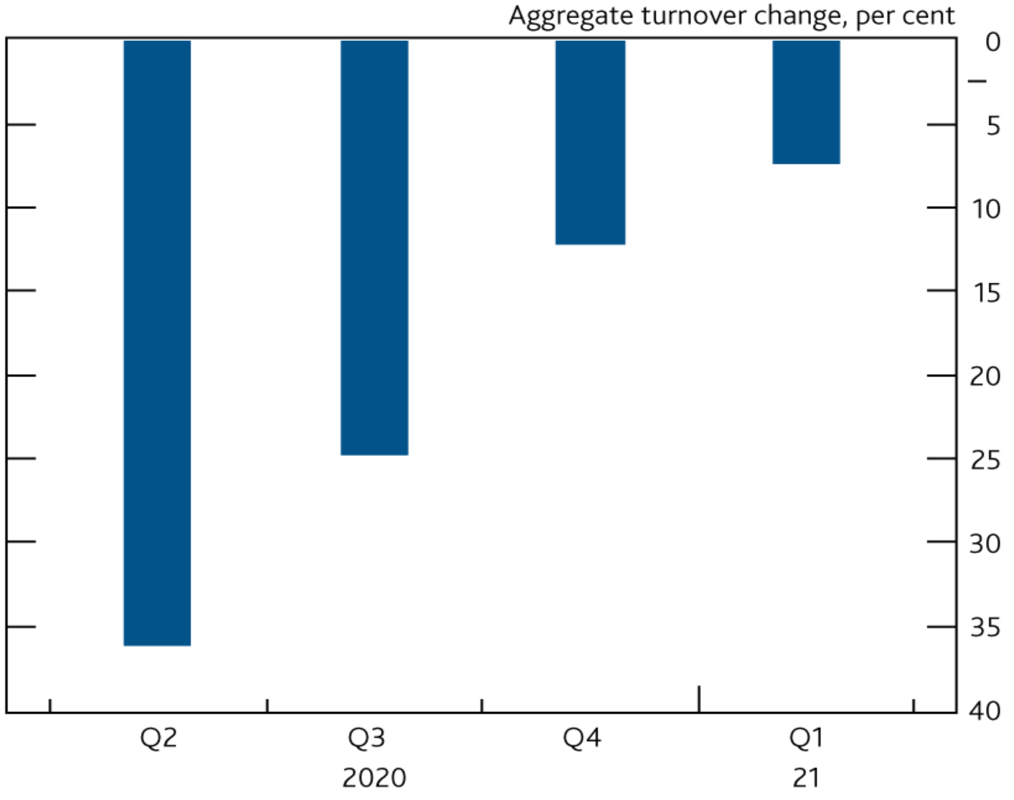
How might those deficits be financed?

Key ingredients

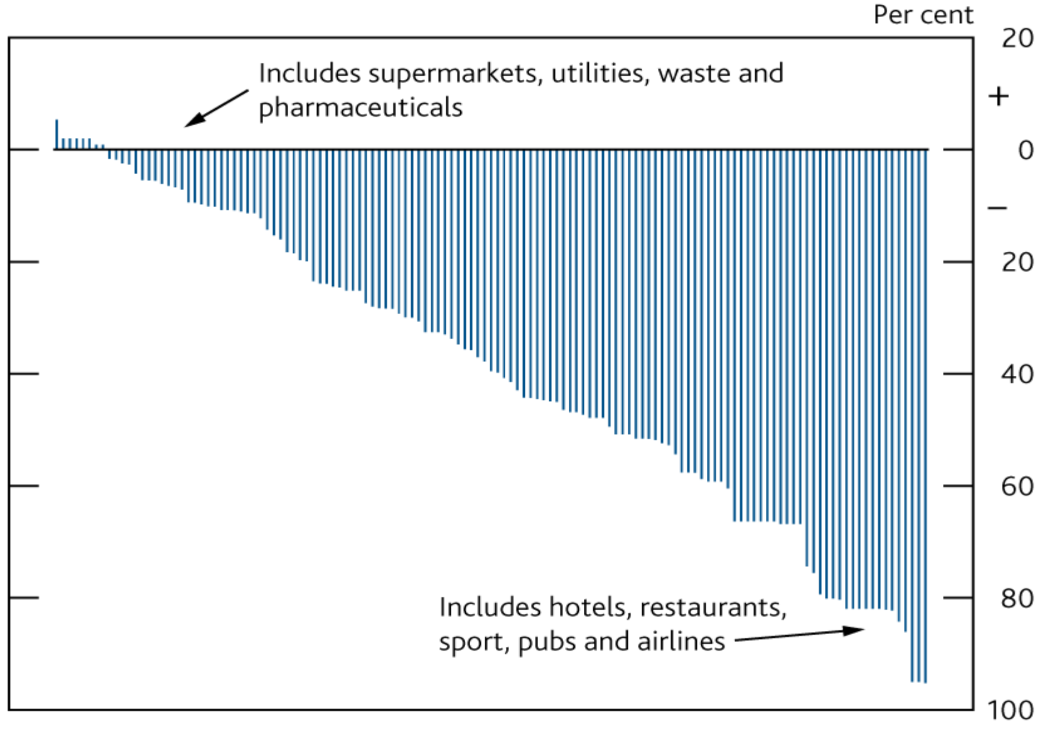
- Scenario for companies' turnover that is broadly consistent with the Covid-19 scenario in the MPR

A Covid-19 scenario for UK companies' turnover

Aggregate turnover in scenario in 2020-21



Turnover by sector in scenario 2020Q2



A large-scale accounting exercise using a dataset of c. 85,000 UK companies

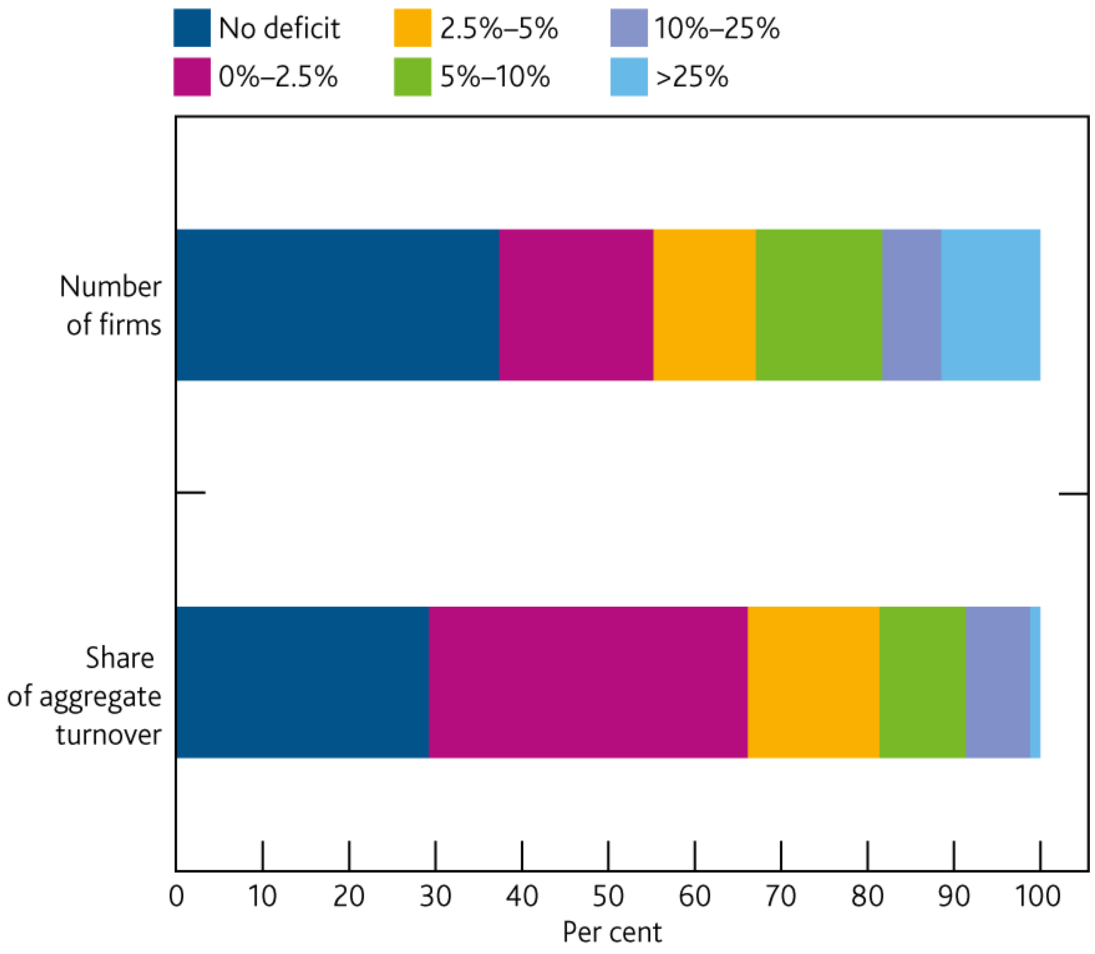
What is the size of UK companies’ cash-flow deficits under the Covid-19 scenario?

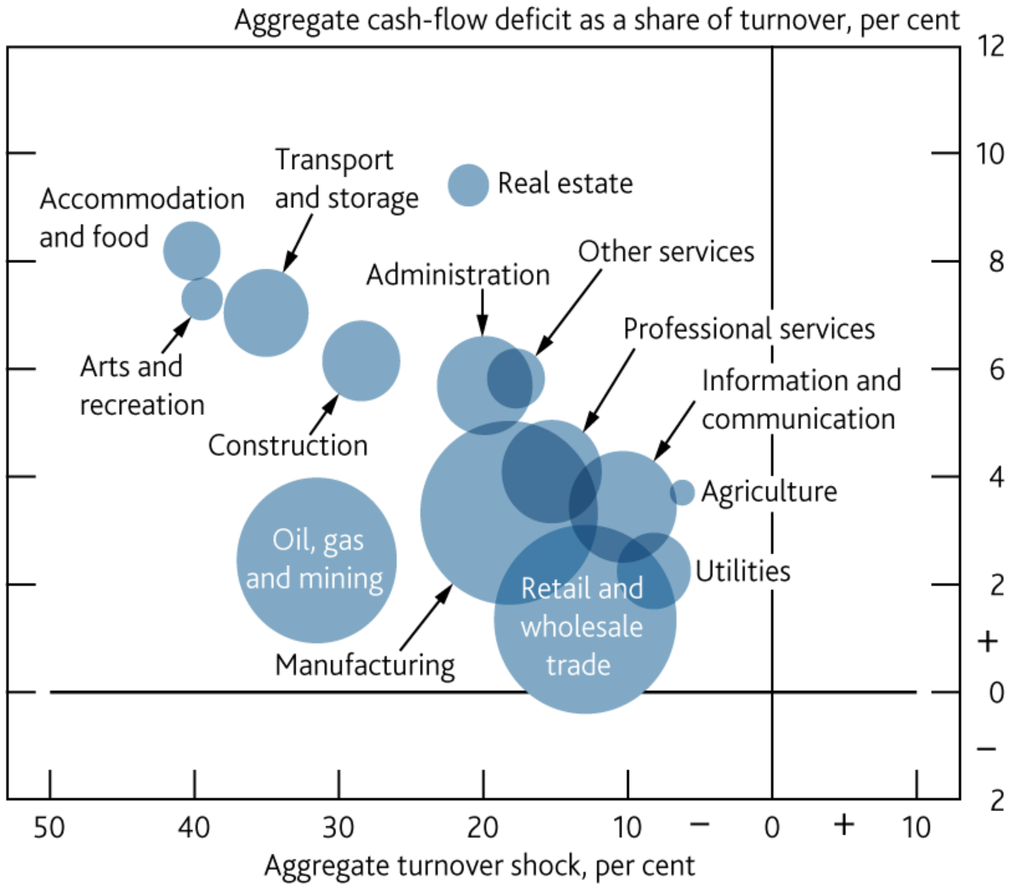
How might those deficits be financed?

<u>Key ingredients</u>

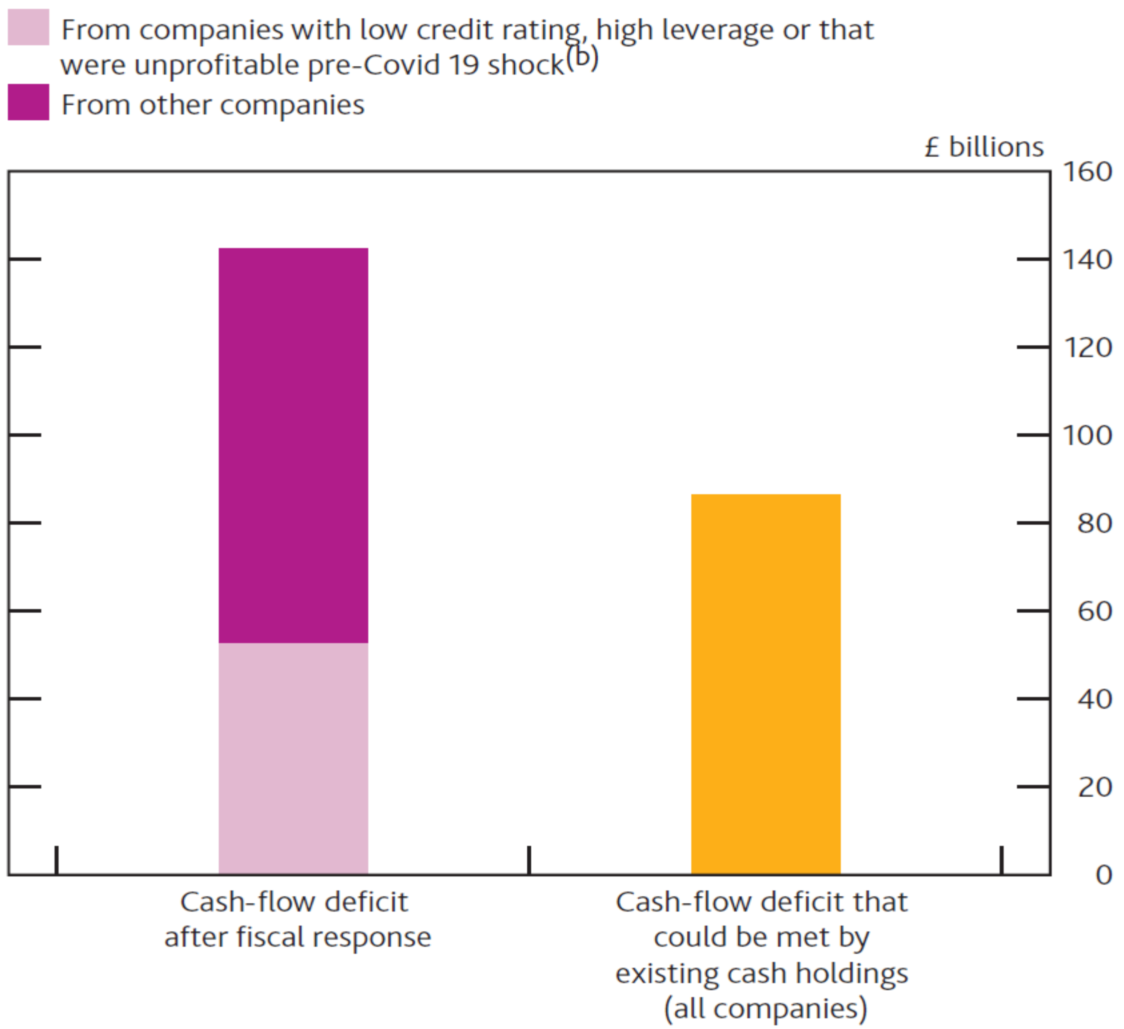
- Scenario for companies’ turnover that is broadly consistent with the Covid-19 scenario in the MPR
- Assumptions about costs, trade credit and fiscal support measures

Size of estimated cash-flow deficit varies a lot across companies and sectors





Aggregate cash-flow deficit of £140bn … some of which could be readily financed



Questions