New Bank boss must act to put out a fire that nobody foresaw ‘even a month and a half ago’

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Sunday March 08 2020, 12.01am, The Sunday Times

The race is on to stop a health crisis becoming a financial one. Jill Treanor asks whether authorities have enough firepower

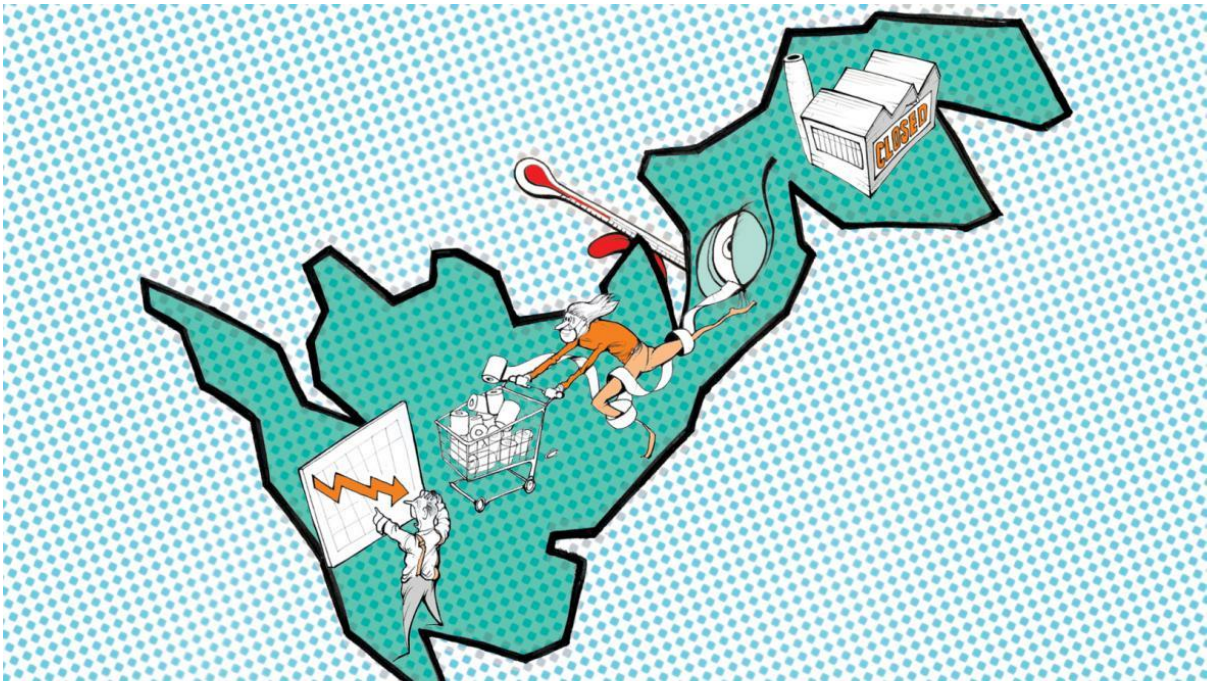

ILLUSTRATION: RUSSEL HERNEMAN

Andrew Bailey will walk out of the Financial Conduct Authority on Friday with criticism of his four-year tenure ringing in his ears — and straight into a new crisis. As the 121st governor of the Bank of England, Bailey will have to use the firefighting skills he honed during the financial crisis to hose down the economic impact of the coronavirus.

The 60-year-old will also face an early test of his relationship with another man new to his job: Rishi Sunak, the 39-year-old chancellor who made his fortune as a hedge fund manager during the banking crisis and who is scheduled to deliver his first budget on Wednesday.

Bailey — who until taking the helm of the FCA had been a Bank “lifer” — told MPs as much in an often-heated session of the Treasury select committee last week.

“There is no question in my mind that [the coronavirus] is going to be the first most pressing issue that we face,” he said on Wednesday. “It’s evolving very quickly and it’s evolving in many ways in unprecedented and unexpected fashion.” He had already discussed with the chancellor “how you get the most effective co-ordination of the authorities” in a situation where a health crisis has the potential to turn into an economic and financial one.

A virus first traced to a market in the Chinese city of Wuhan in December has spread around the world. There have been more than 100,000 confirmed cases globally and more than 3,000 deaths. The figures for the UK, at the time of going to press, were 206 confirmed cases and two deaths.

The markets are rattled, crashing the week before last as hard as they did during the financial crisis a decade ago. So are policymakers, who are turning to the armoury used during the 2008-9 downturn. Last week began with G7 finance ministers and central bankers making a joint statement in an attempt to soothe markets, an emergency 0.5 percentage point cut in US interest rates and more turmoil on Wall Street. Not only were US stocks falling but bond prices were hitting record highs — signalling expectations of more rate cuts and a flight to safety.


No honeymoon: Andrew Bailey

In a rollercoaster week, the Dow Jones index rocketed up 1,000 points on two separate days before tumbling and then rallying again, eventually ending higher on the week. Asian markets were in turmoil, with Japan’s Nikkei index falling to six-month lows by the end of the week. Oil prices were down amid expectations of lower global demand and after Opec failed to agree production cuts with Russia. On Friday, Brent crude was off by 9% at about $45 a barrel.

In London, the FTSE 100 blue-chip index was down 1.8% on the week, despite a midweek rally, taking its losses to more than 12% in a fortnight. Yields on UK government bonds also fell to record lows.

The chaos means that Leicester-born Bailey — who first joined the Bank in 1985 after a history degree at Cambridge — has no hope of a honeymoon when he returns to Threadneedle Street.

His time at the FCA ended in controversy. Conservative MP Steve Baker remarked in last week's select committee grilling that "real people" had "suffered enormously" on Bailey's watch. Baker recited a laundry list of scandals — from mini-bond selling by the collapsed London Capital & Finance and the closure of Neil Woodford's fund management empire, to the handling of compensation for victims of fraud at HBOS Reading.

Dubbed "the big sexy turtle" by Mark Carney, the Canadian who officially hands over a week tomorrow after a tumultuous period as governor, Bailey had not been expecting this turmoil when he took the £495,000-a-year job. The chancellor who appointed him three months ago after a protracted recruitment process — Sajid Javid — is no longer in post as the coronavirus tests his mettle from the outset.

"It is a very different backdrop from what we were expecting even a month and a half ago," said George Buckley, chief UK economist at Nomura.

Back then, analysts were hoping for a rebound in the British economy after Boris Johnson's decisive election victory and his pledge to "get Brexit done" had raised hopes of an end to inertia.

Now the coronavirus is forcing economists to take a red pen to their forecasts and leading to speculation that there could be a rate cut in Britain this month — possibly ahead of the scheduled meeting of the Bank's rate-setting monetary policy committee on March 26, the first to be chaired by Bailey.

The US Federal Reserve's rate reduction, the first outside a regular cycle since the banking crisis, appeared to add to the anxiety of the markets rather than soothe it. But in Britain, the market is convinced a rate cut is coming.

Traders at one point priced in a 90% chance of a 0.5 percentage point cut this month, according to Ruth Gregory, senior UK economist at the consultancy Capital Economics. She reckons a quarter-point cut is likelier. While she said it might come on March 26, "We are braced for it sooner than that."

There are those who think the Bank should resist the temptation to move outside the cycle. David Marsh, chairman of the Official Monetary and Financial Institutions Forum think-tank, said premature action by central banks often allowed governments to take a back seat.

With UK rates already at a low level — 0.75% — the impact of a cut on the economy might, in any case, be minimal. Anna Titareva, European economist at UBS, who last week brought forward her forecast for a quarter-point cut from May to the monetary policy committee's March meeting, said a cut in rates was "more of a sentiment tool" than a hard measure to drive economic activity.

Practical steps to keep funds flowing around the financial system are seen as more important, given the nature of the shock to the system. Buckley noted that what started as a supply worry in the form of stock failing to arrive from China was starting to have effects on demand.

"Liquidity shortages, coupled with high levels of uncertainty about the spreading of the virus, could lead to staff lay-offs and bankruptcies," said Titareva. This "would imply that a temporary, albeit significant, supply shock would turn into a longer-lasting demand shock."

The banks have started to take their own action. Ian Rand, chief executive of business banking at Barclays, said his managers had been speaking to small companies to “see if they require additional support during this time”.

Such measures seem unlikely to be enough. Tools similar to those that Bailey helped roll out during the 2008-9 crisis, as the Bank’s chief cashier, could be revived. He told MPs of the likely need to “provide some form of supply-chain finance” in the not very distant future, particularly for small businesses.

Among the ideas that City analysts think could be adopted are versions of the Funding for Lending Scheme launched in July 2012 — offering banks cheaper finance to encourage them to channel loans to households and business — or the Term Funding Scheme announced in the wake of the Brexit vote, which had resulted in £127bn of loans by the time it ended in February 2018.

One senior financier said he expected the Bank to hold off on any policy initiatives until after Wednesday’s budget, which takes place 48 hours before another of the Bank’s key committees is scheduled to meet: the Financial Policy Committee, set up in the wake of the financial crisis to look for risks in the system. This is the committee that decides on seemingly esoteric but crucial policy levers, including so-called counter- cyclical buffers — an extra cushion of capital for banks — which are due to rise to 2% by the end of the year. That measure could be unwound to encourage banks to provide loans and breathing space to businesses.

However, economists warn that modelling the impact of the coronavirus is not straightforward. “From the economic perspective, it’s not really the virus that is of concern — it’s about how much disruption is caused by containment efforts,” said Guy Foster, head of research at the wealth manager Brewin Dolphin.

James Knightley, UK economist at ING, said: “The issue for the Bank is this isn’t really a problem of cost-of-debt servicing. The real risk here is firms’ revenues are falling, staff can’t get to work . . . There’s only so much the Bank of England can do [through interest rates alone].”

He added: “The real emphasis will be on what the budget has to say.”

And here again, measures rolled out during other crises may provide an indication as to what could be on offer.

The government’s action plan already mentions HM Revenue & Customs’ “time to pay scheme” — a tax payment deferral system offered on a case-by-case basis to companies suffering cashflow issues.

Titareva said other measures might include “temporary tax cuts, tax credits and debt guarantees” if the situation deteriorates.

It is shaping up to be quite a week for two men changing jobs and one preparing to carry the red budget box for the first time. Market chaos in the time of coronavirus shows no sign of abating.