Sharp slowdown could leave lenders with losses of £80bn, says Bank of England

Katherine Griffiths, Banking Editor
Thursday May 07 2020, 9.00am, The Times

The Bank of England said that the losses facing banks would be below the £120 billion of losses they demonstrated that they could withstand under the Bank's 2019 stress tests

Banks would lose £80 billion if the economy shrank by almost a third in the three months to June but could cope because of their high levels of capital, according to the Bank of England.

Banks must, however, draw down their capital and lend to businesses and individuals struggling with the coronavirus crisis, otherwise they would suffer a substantial hit to their own capital as well as hurting the overall economy, the Bank said.

The Bank's financial policy committee, which assesses risks to the financial system, carried out analysis of what would happen to banks and building societies if GDP fell by 30 per cent in the second quarter compared to the final three months of 2019 and by 14 per cent this year. Lenders would suffer from about £80 billion in losses, but that would be well below the £120 billion of losses they demonstrated that they could withstand under the Bank's 2019 stress test of the sector.

The difference between the annual stress test and the forecast of what may happen now as a result of damage caused by the coronavirus crisis is that this time officials believe that the economy will dive more sharply but then recover more quickly, owing to the government's job retention scheme and other interventions and prolonged very low interest rates.

Andrew Bailey, governor of the Bank of England, said: "Major banks have the capital buffers to draw on to withstand the losses that would be expected in this scenario, while continuing to provide credit to the real economy."

If they do not more businesses will go under and individuals will be unable to repay loans, which in turn would hurt banks. Sir Jon Cunliffe, the Bank's deputy governor responsible for financial stability, said: "The economic impact of banks failing to provide support to the economy could worsen their own capital positions by around a full percentage point."

UK banks entered the crisis with more than three times the quality capital that they had before the financial crisis and have about £1 trillion of liquid assets, the Bank said.

Lenders can now "draw on the substantial capital and liquidity buffers that have been built up", the Bank said.

The Bank has already cut the countercyclical buffer banks must hold from 1 per cent to zero, freeing up £23 billion of banks' capital that they could use to lend £190 billion to businesses, according to the central bank's calculations.

Banks will be able to eat into their other capital and liquidity buffers, regulators have said, and will be given time to build them up again after the crisis.