

# How three policy responses impact bank balance sheets

## AUTHORS



**James Macdonald**  
*Partner,  
Senior Portfolio Manager*



**Marc Stacey**  
*Partner,  
Senior Portfolio Manager*



**Peter Goldsworthy**  
*Institutional Portfolio  
Manager*

PUBLISHED  
1 July 2020

READ TIME  
5 minutes

The Covid-19 pandemic triggered a wave of support to keep banks functioning efficiently and economies ticking over through lockdowns. We look at what action has been taken and its impact on the health of the banking sector.



## 1. Central bank monetary policies – low rates

Central banks around the world have been cutting interest rates, with the UK flirting close to zero at +0.1% and a number of banks taking the plunge into negative territory.

This negative rate policy action is designed to lower the overall cost of credit to the global economy. In turn, this helps to maintain the asset quality of banks.

### How?

By lowering the interest cost of loans to the economy, the cost of borrowing charged to companies and individuals also reduces, improving the probability of these loans being repaid. The higher the probability of loan repayment, the higher the quality of a bank's assets.

The European Central Bank is allowing banks to borrow from it at rates lower than its headline negative interest rate policy with very lenient conditions. This means a bank gets paid to borrow money from the central bank and can then lend out that money into the real economy. This improves the profitability of both the individual loans and the overall bank, while encouraging the provision of credit into the economy to help keep things moving through lockdown.

Even if a bank lends money to a company or individual without charging them interest, it can make money by borrowing that same money from the central bank due to the negative borrowing rate.

The European Central Bank asset purchase scheme, which focuses on corporate and government bonds, is helping to lower the cost of funding for banks by maintaining funding spreads at very low levels.

Additionally, banks are typically large holders of government bonds for liquidity purposes. As the central bank is buying these bonds as part of its purchase programme, this inflates the price of these securities, further supporting bank balance sheets.



The obvious risk to this view is that the virus peak and related impacts last much longer than anyone expects, but we are growing in confidence that policymakers are providing all the support required for banks



## 2. Government fiscal policies – loan & income guarantees

### Companies

Governments around the world have introduced guarantee schemes for corporate lending in response to the crisis. The rationale for this is to ensure businesses can continue to trade when the lockdown measures are lifted, aiding a strong economic recovery.

These schemes help to ensure companies can remain operational through this period, which in turn allows them to service their loans and maintains the asset quality of the banks that are providing these loans.

### Individuals

Governments in Europe have provided a variety of schemes that are intended to help individuals, such as the furlough scheme in the UK.

The UK scheme is designed to ensure individuals retain an income during the lockdown that they can use to support their financial position, such as by paying their mortgage. In turn, this protects the balance sheet of the mortgage lender.



## 3. Regulatory policies – building buffers

Bank regulation has increased stringently since the financial crisis of 2008/2009, which has vastly improved the financial strength of banks coming into the coronavirus crisis.

These policies have created vast capital buffers that regulators have been relaxing in response to the current situation, as they recognise that for banks to continue carrying out their role in the monetary transmission mechanism, they must have comfort in their financial strength.

The regulatory action to increase the capital buffers banks hold has given bank management teams more comfort in their relative capital strength, encouraging them to keep lending to the real economy.

## Investment outlook

Multiple steps are being taken by policymakers, central banks and regulators to support banks, underlining our view that banks are an important part of the solution to the current crisis.

The obvious risk to this view is that the virus peak and related impacts last much longer than anyone expects, but we are growing in confidence that policymakers are providing all the support required for banks and that their capital buffers should be robust enough to withstand what we believe will be a sharp contraction and slow recovery over the next two-to-three years. Certainly, owning AT1 securities from national champion banks seems much more appealing to us than extending loans to cruise-ship operators in the current environment.

In the near-term, we feel that investment discipline through robust sector and issuer selection will be paramount in delivering performance over the coming quarters.

This document may be produced and issued by the following entities: In the United Kingdom (UK) by BlueBay Asset Management LLP (BBAM LLP), which is authorised and regulated by the UK Financial Conduct Authority (FCA), registered with the US Securities and Exchange Commission (SEC) and is a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC). In United States, by BlueBay Asset Management USA LLC which is registered with the SEC and the NFA. In Luxembourg, by BlueBay Funds Management Company S.A. (the ManCo), which is regulated by the Commission de Surveillance du Secteur Financier (CSSF). In Germany and Italy, the ManCo is operating under a branch passport pursuant to the Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC) and the Alternative Investment Fund Managers Directive (2011/61/EU). In Switzerland, by BlueBay Asset Management AG where the Representative and Paying Agent is BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, 8002 Zurich, Switzerland. The place of performance is at the registered office of the Representative. The courts of the registered office of the Swiss representative shall have jurisdiction pertaining to claims in connection with the distribution of shares in Switzerland. The Prospectus, the Key Investor Information Documents (KIIDs), the Articles of Incorporation and any other applicable documents required, such as the Annual or Semi-Annual Reports, may be obtained free of charge from the Representative in Switzerland. In Japan, by BlueBay Asset Management International Limited which is registered with the Kanto Local Finance Bureau of Ministry of Finance, Japan. In Australia, BlueBay is exempt from the requirement to hold an Australian financial services license under the Corporations Act in respect of financial services as it is regulated by the FCA under the laws of the UK which differ from Australian laws. In Canada, BBAM LLP is not registered under securities laws and is relying on the international dealer exemption under applicable provincial securities legislation, which permits BBAM LLP to carry out certain specified dealer activities for those Canadian residents that qualify as “a Canadian permitted client”, as such term is defined under applicable securities legislation. The BlueBay group entities noted above are collectively referred to as “BlueBay” within this document. The registrations and memberships noted should not be interpreted as an endorsement or approval of BlueBay by the respective licensing or registering authorities. Unless otherwise stated, all data has been sourced by BlueBay. To the best of BlueBay’s knowledge and belief this document is true and accurate at the date hereof. BlueBay makes no express or implied warranties or representations with respect to the information contained in this document and hereby expressly disclaim all warranties of accuracy, completeness or fitness for a particular purpose. Opinions and estimates constitute our judgment and are subject to change without notice. BlueBay does not provide investment or other advice and nothing in this document constitutes any advice, nor should be interpreted as such. This document does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product in any jurisdiction and is for information purposes only. This document is intended only for “professional clients” and “eligible counterparties” (as defined by the Markets in Financial Instruments Directive (“MiFID”)) or in the US by “accredited investors” (as defined in the Securities Act of 1933) or “qualified purchasers” (as defined in the Investment Company Act of 1940) as applicable and should not be relied upon by any other category of customer. No part of this document may be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, in whole or in part, for any purpose in any manner without the prior written permission of BlueBay. Copyright 2020 © BlueBay, is a wholly-owned subsidiary of RBC and BBAM LLP may be considered to be related and/or connected to RBC and its other affiliates. ® Registered trademark of RBC. RBC GAM is a trademark of RBC. BlueBay Asset Management LLP, registered office 77 Grosvenor Street, London W1K 3JR, partnership registered in England and Wales number OC370085. The term partner refers to a member of the LLP or a BlueBay employee with equivalent standing. Details of members of the BlueBay Group and further important terms which this message is subject to can be obtained at [www.bluebay.com](http://www.bluebay.com). BlueBay Funds Management Company S.A., registered office 4, Boulevard Royal L-2449 Luxembourg, company registered in Luxembourg number B88445. All rights reserved.