Business Update – Negative Interest Rates

Information correct as at 11:00am on 30.10.20

- Negative interest rates occur when the Bank of England base rate drops below 0% to incentivise banks to lend. The effectiveness of negative interest rates is being reviewed and if approved, these would not be implemented before 2021 to give banks time to prepare.
- Negative rates would only apply to banks and lenders saving with the BoE and not their customers. It is unlikely that we will see customer interest rates drop much below their current level.
- In practice, negative interest rates would likely make lenders more cautious and risk averse.

What are negative interest rates and what are their benefits?

Negative interest rates are when the Bank of England base rate drops below 0%. During the coronavirus pandemic the base rate dropped to 0.1%, its lowest ever. The London School of Economics are currently investigating the impact of implementing negative interest rates in the UK for the first time. Following discussions between government policymakers, the monetary policy committee, and the BoE and are due to publish their report in December.

Negative interest rates result in commercial banks and lenders having to 'pay' to deposit funds. So instead of their reserves with the Bank of England increasing due to positive interest rates, the total sum will shrink over time. In theory, this incentivises commercial banks to lend more and stimulates business investment and economic growth.

What will the impact be on current borrowings?

Current borrowings on fixed rate interest will be unaffected by any changes whilst variable rate loans may see a slight decrease in interest paid. However, the drop is likely to be limited by original lending terms and conditions. With interest rates already low, any decreases are unlikely to be substantial.

What will the impact be on new borrowings?

If commercial banks have an increased incentive to lend to businesses, the theory is that it may become easier for businesses to have loans approved.

However, with less reserves behind them, it is likely that banks will become more cautious, more risk averse and less willing to lend. This has been observed in other countries that have implemented negative interest rates, where banks do not want to lend due to the overall state of the economy. We are observing this currently in the UK with banks tightening lending criteria and wanting to see lots of sensitivity checks. Any investment or business proposition must be stress tested for different interest rates and be viable in all circumstances.

It is very unlikely that the final lender will offer negative interest rates. In fact, farm businesses already borrow at a lower rate than other businesses and with the base rate already at 0.1%, it is unlikely we will see any further reduction.

What will be the impact on savings?

The negative interest rates will not apply to consumer savings accounts, as banks rely on customers savings for cash. Interest rates on savings will likely drop but not below zero. However, in the case of inflation remaining high and interest rates low, the real value of cash savings may still decrease, again incentivising people to invest.

The impact of negative interest rates is not easy to predict therefore it is unlikely any negatives rates will be implemented before 2021. Banking systems and protocols would also need to be set up and calibrated to deal with negative interest rates should they arise.

For further discussion or to help with any questions that you may have, please contact Consultant Support on consultantsupport@kiteconsulting.com or 01902 851007 / 07542 403225