

Bank of England Cuts Rates Again

Sarah Lloyd

The Bank of England cut rates to an historic low of 0.5% and announced that it would be injecting £75 billion pounds into the economy as quantitative easing. The aim is to encourage both lending and spending in order to boost the economy.

Whilst the initial investment is £75bn, the figure could reach £150bn. It will be used by the Bank to purchase government bonds and corporate debt. By increasing the amount of money banks have to lend, the Bank hopes for cheaper loans and increased consumer spending.

Resorting to quantitative easing is a result of the recent interest rate cuts

failing to stimulate the British economy. In the short to mid-term, both borrowers and investors stand to gain as the rates on fixed rate mortgages should fall and the increased demand for gilts will push their price up allowing for gains in the next year. Unfortunately, savers will not benefit as their money will earn virtually nothing, also causing difficulties for mortgage lenders who rely on savings deposits as funding for mortgages.

This is the first time the UK has resorted to quantitative easing. Japan used it in the 1990s as a last resort and the US is currently pursuing a similar strategy of buying back treasury bonds. The con-

cern with the UK is whether the policy has been adopted early enough to reinvigorate the economy effectively. Mervyn King has insisted he will not allow a "great inflationary surge" as a result of the policy. He expects the Bank to start buying assets within the next few months.

There appears to be a general consensus amongst economists that whilst this may be a shot in the dark, it is the only route open to the Bank



The bank rate is now at an all time low. With little room for more cuts the BOE has resorted to quantitative easing

HSBC Announce Profits for 2008

Pearl Boateng

HSBC saw a drop of nearly 20% in its share price on Monday and promptly announced a rights issue. The world's local bank has sent a wave of nervousness through world markets as analysts try to determine whether the bank is sending out signals of higher than expected exposure to the current global crisis or whether the bank is simply trying to ensure that no further losses are incurred.

Despite remaining profitable in the last financial year with pre-tax profits of \$9.3 billion - which included a \$10.5 billion write-off in goodwill on its US consumer finance operations - profits were less than half those achieved in 2007.

There was a marked difference between the profits of HSBC in the first half of the 2008 and the second in

every division of the bank except Europe.

European operations saw an increase of £1.7 billion aided by the sale of their French operations. The bank aims to earn £12.5 billion in new capital from the ensuing rights issue in order to maintain its position as one of the world's most-capitalised banks. HSBC has also made the decision to cut its dividend payment.

In light of the growing economic slowdown, particularly in the developing world, executives are arguing that Europe and Asia continue to make a profit and this rights issue will enable them to comfortably face any further losses. The rights issue may strengthen HSBC's balance sheet position, namely its tier 1 ratio, up by 10%.

Market Weekly Winners, Losers

| Company | Price | Change |
|--|---------|---------|
| Standard and Chartered (banking) | 700.00p | 19.25% |
| Eurasian Natural Resources (resources) | 370.25p | 19.05% |
| Fresnillo (resources) | 390.75p | 18.77% |
| Antofagasta (mining) | 493.25p | 12.81% |
| Lloyds Banking Group (banking) | 38.20p | -22.67% |
| Legal & General (insurance) | 24.60p | -32.23% |
| Barclays (banking) | 58.20p | -33.64% |
| Aviva (insurance) | 172.00p | -35.70% |

Quantitative Easing

The Bank of England has formally begun its quantitative easing programme after the Monetary Policy Committee voted in favour of the plan. The central bank plans to purchase £75bn worth of assets.

Quantitative easing forms part of monetary policy. It is essentially the creation of fresh money which will subsequently be injected into the economy. This will be done by purchasing government and corporate bonds as well as other corporate securities, mainly those issued by financial institutions integral to the UK economy. This in turn will provide banks with more money and thus more lending can be achieved, freeing up credit markets. It could also reduce the cost of lending. The demand for bonds increases as the government decides to buy them, which in turn will reduce yields.

There are several risks associated with quantitative easing. Pumping too much money into the economy could lead to severe inflation. It would come down to too much money chasing too few goods. Another risk would be that lending does not increase and credit markets remain clogged due to a lack of aggression with the policy. The central bank faces a tough task in correctly judging what the right amount of money is.

In the one day the programme has been in effect yields on government bonds have fallen quite sharply. Ten year gilts have fallen by half a percentage point to

Base rate to 0%

Is a world where money is free a real possibility? In theory yes, at which point economic activity should increase dramatically. However, banks are not going to lend when they cannot make a return, plain and simple, simply causing the opposite effect intended. No lending and banks making no money at all! Square one...

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Any queries, comments or requests?
Please contact us at:

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Sources: www.theft.com, www.reuters.com, www.economist.com, www.timesonline.com, www.bbc.co.uk, www.yahoofinance.com, www.bloomberg.com

Further Woe for Merrill

Bradley Wright

Merrill Lynch was thrown into more controversy after a trader was suspended for racking up more than \$400 million in undisclosed losses. Merrill is reviewing the trading books of Alexis Stenfors, a London based currency trader specialising in Norwegian and Swedish currencies. According to people close to the situation "trades had gone wrong".

Merrill, a once proud investment bank, is in talks with UK regulators after uncovering the trading irregularity on Friday. The New York Times reported the issue, with Mr Stenfors earlier reporting a profit of

\$120 million. According to the newspaper, he had stated the issue was a 'misunderstanding' and is referring all media calls directly to Merrill.

The issue is unlikely to dent the company's currencies operations which made at least two billion dollars profit last year according to some estimates.

The loss will come at a time when questions are being asked about Merrill's financial strength, as well as the viability of its parent, Bank of America. Merrill, a once godfather of Wall Street, reported \$27.6bn in total losses last year.

Strictly Bites

Lloyds Banking Group (LBG) is to become a government controlled bank following its ill-fated takeover of HBOS. The tax payer will take an economic stake of around 77 per cent in the bank in return for insuring £260billion of toxic assets.

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Euro-zone interest rates have been slashed by a half percentage point to the lowest level ever as the European Central Bank responds to continental Europe's worst recession since the second world war.

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American Insurance Group (AIG) revealed a net loss of almost \$100 billion for 2008, incurring a massive loss of \$62 billion in the fourth-quarter, the largest in corporate history.

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The US unemployment rose to 8.1 per cent in February, the highest rate since 1983. The number of jobs lost last month reached 651,000, the third consecutive month in which more than 600,000 posts have been shed, a sequence last recorded in 1939.

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In a further plea by General Motors, the American car Manufacturer stated that its European arm could run out of money as early as next month, putting up to 300,000 jobs on the continent at risk. They have urged European states to help rescue it.

The US government agreed to become the biggest single shareholder in Citigroup last week in their latest attempt to save the ailing financial group. The US taxpayer now owns a stake of up to 36 per cent in the troubled lender.

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Northern Rock, the nationalised bank, revealed a 394% increase in the number of its customers falling behind on their mortgage repayments by more than three months, equivalent to 2.92% of its total mortgage book.

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Allied Irish Bank reported that its profits for 2008 had fallen by 68% to €885 million and said that it might have to boost its provisioning for bad debts.

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Sterlite Industries, India's largest non-ferrous metals producer, said that it would acquire the operating assets of bankrupt US copper miner Asarco for \$1.7bn, nearly \$1bn less than the price it had agreed in November last year. Sterlite will now make its way onto the top-10 list of global copper producers.

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Hit by the downturn in the US housing market, Wolseley will quit its loss-making US building materials business within five months and trim its £2.5 billion net debt with a £1 billion cash call.

*the opinions expressed in this newsletter are those of the authors, and not those of Cass Business School or its staff

Sources: www.theft.com, www.reuters.com, www.economist.com, www.timesonline.com, www.bbc.co.uk, www.yahoofinance.com, www.bloomberg.com