

Modelling Net Interest Income in a Low Rate Environment



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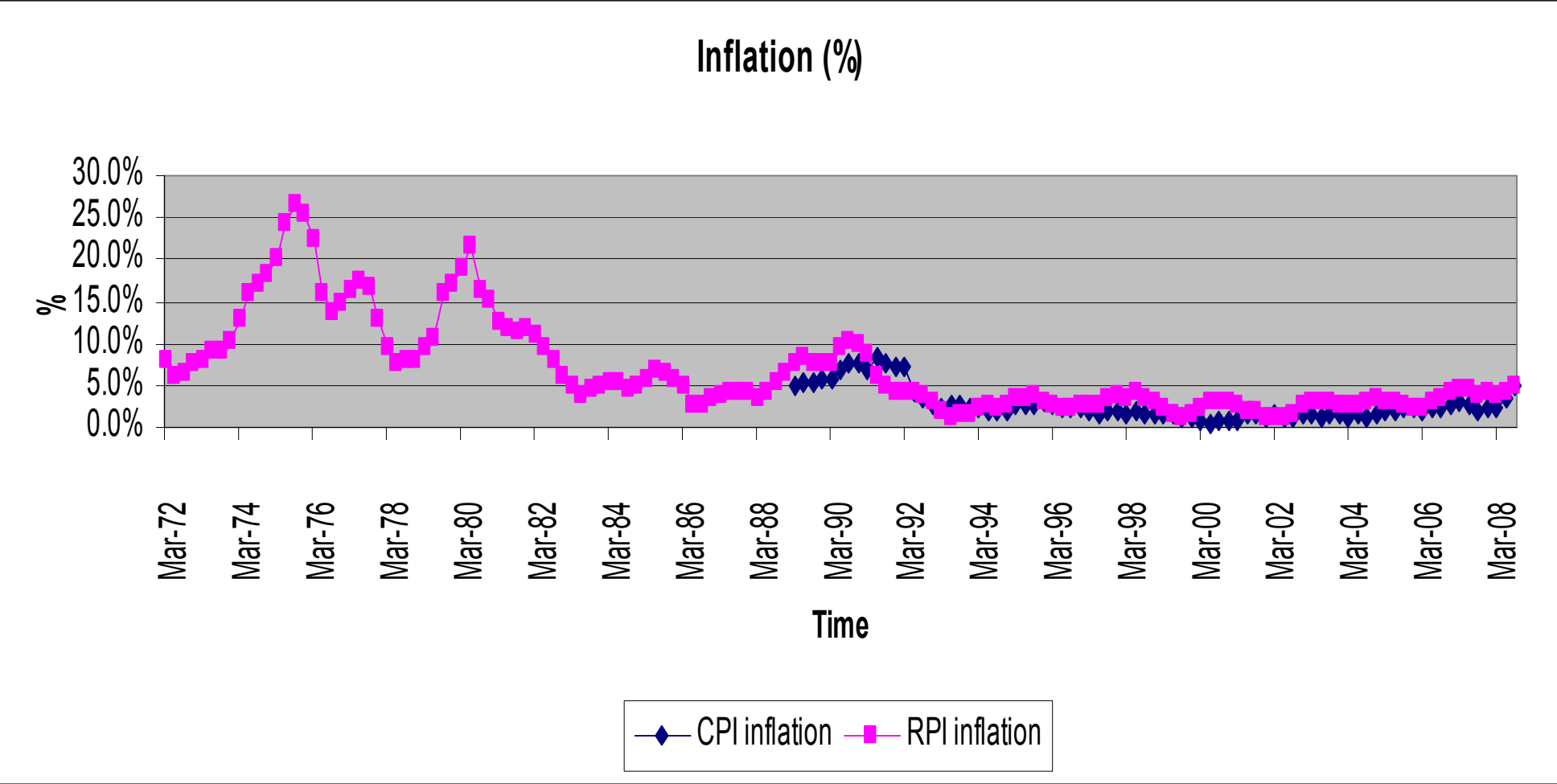


- **Backdrop**
- **Regulatory Objectives**
- **Potential Net Interest Income Effects**

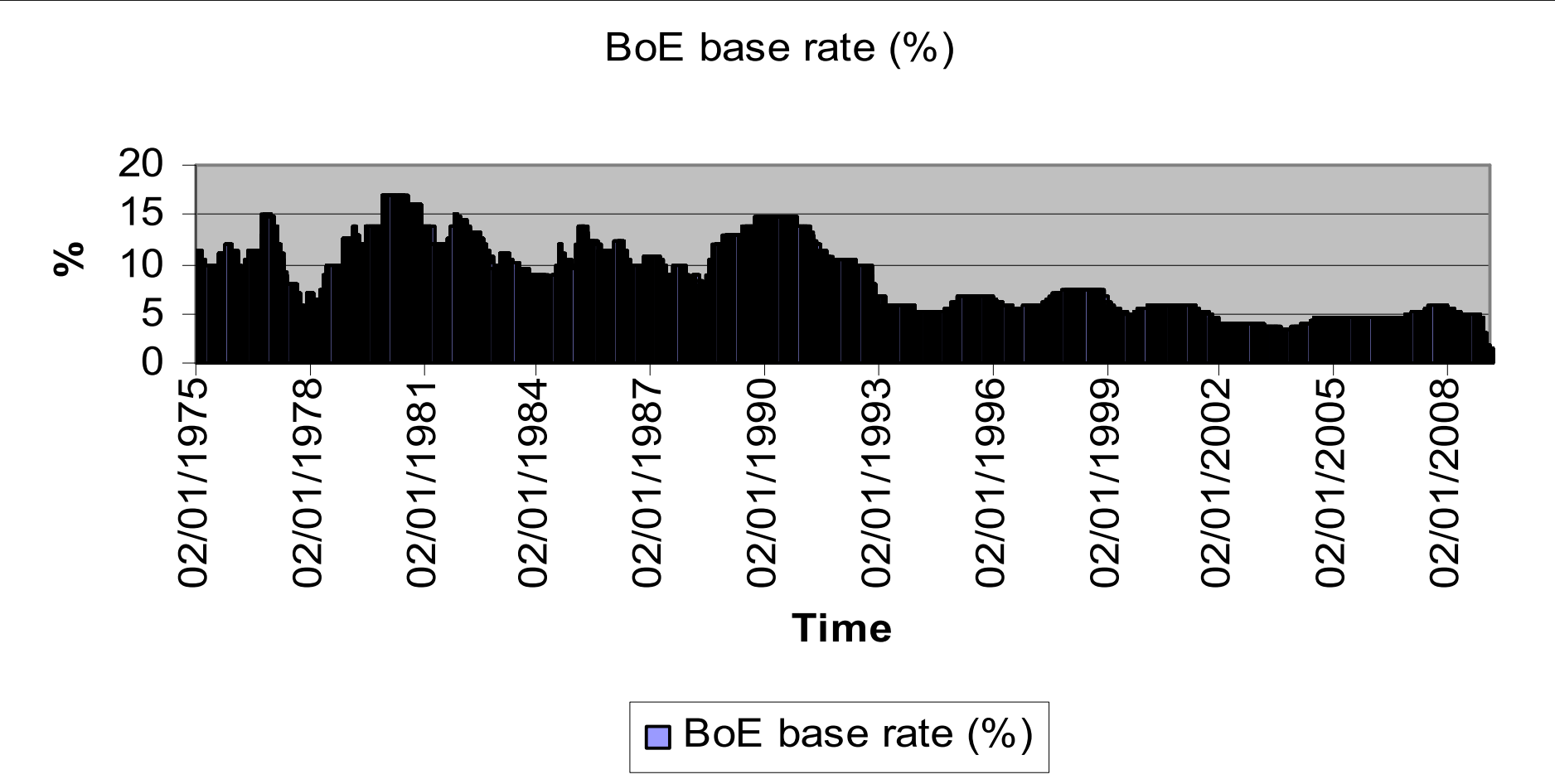
Backdrop

- **Adjustment – deleveraging**
- **ZIRP**
- **Inflation** ↓
- **Unemployment** ↑
- **Consumer sentiment** ↓

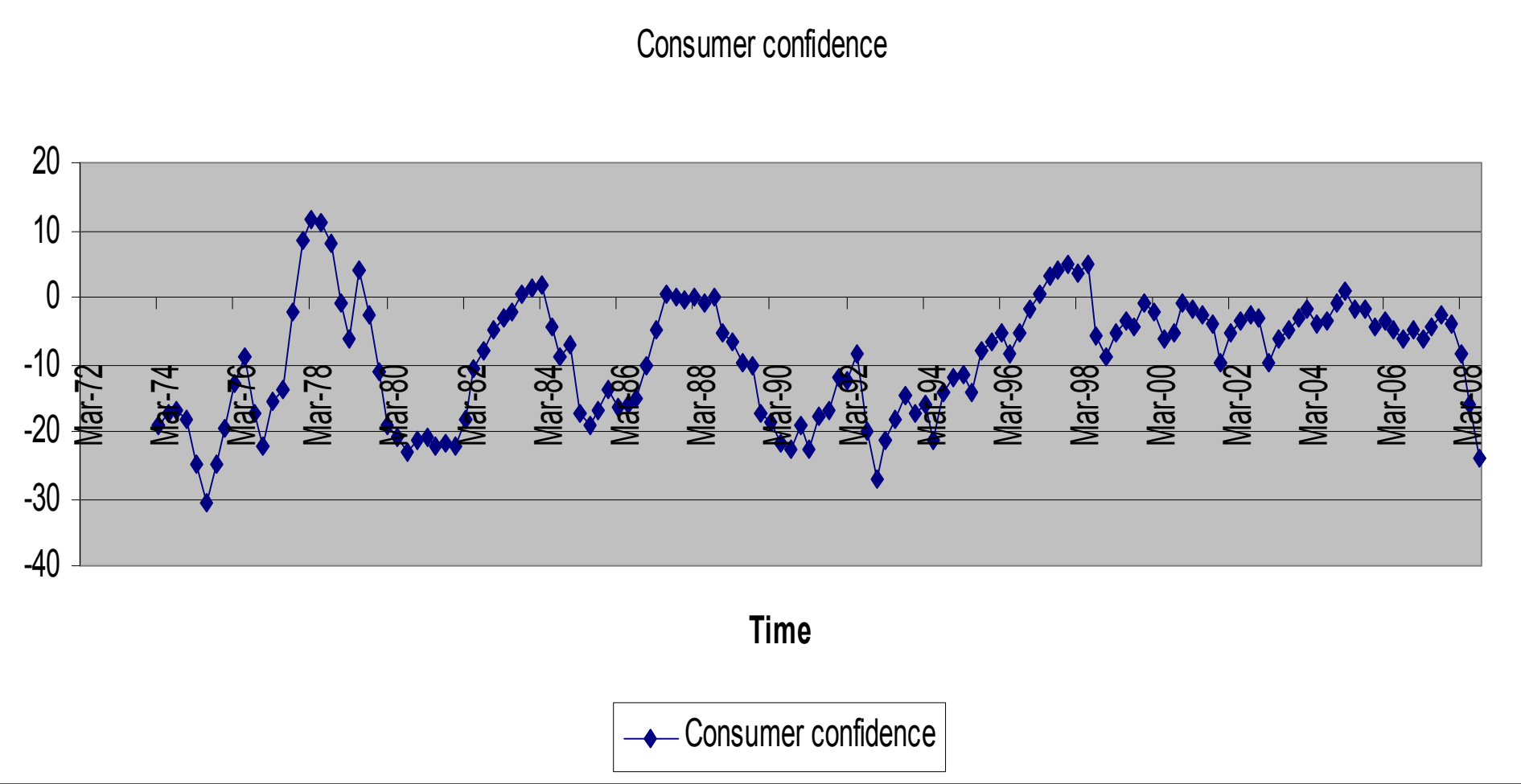
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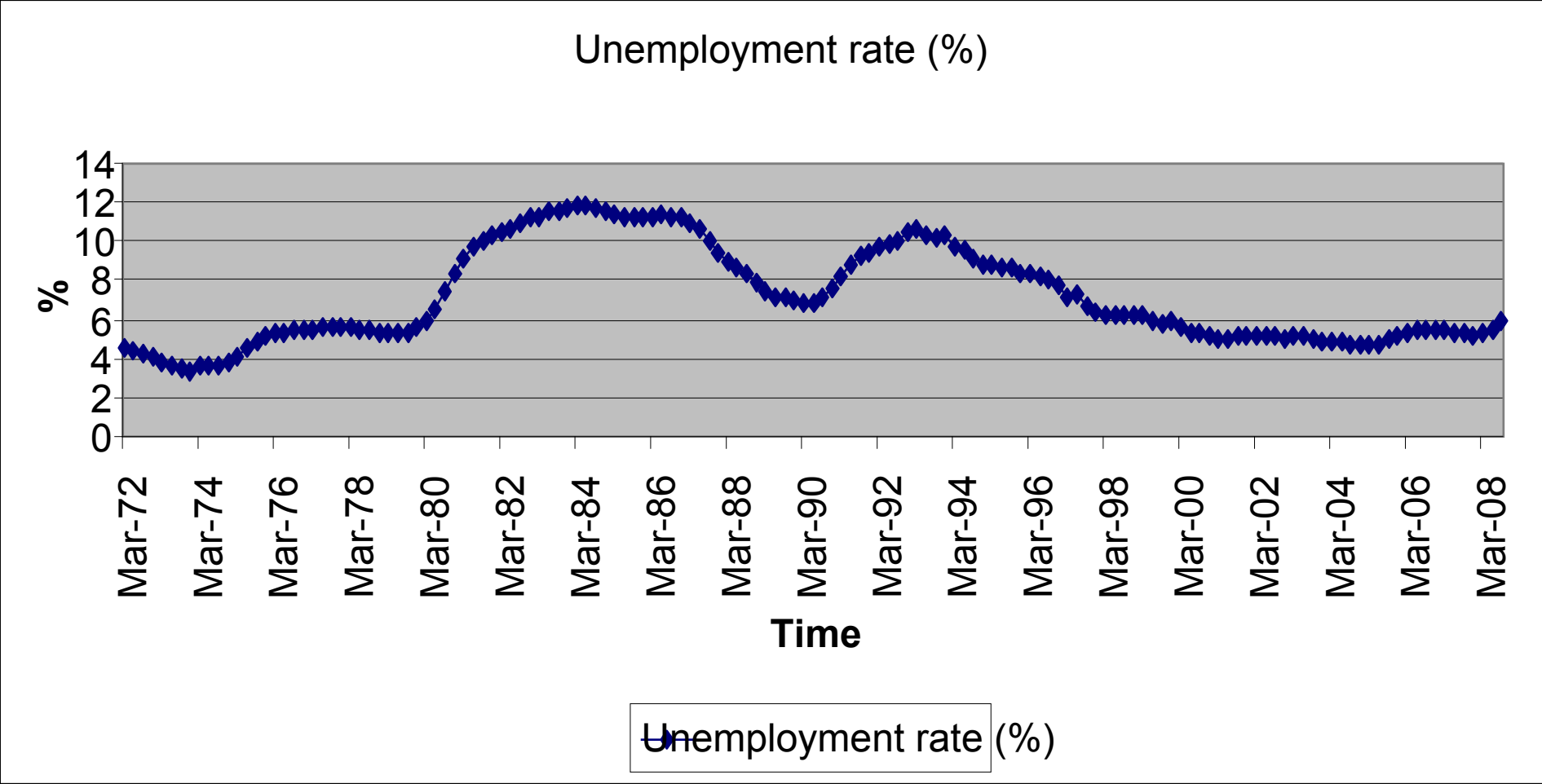
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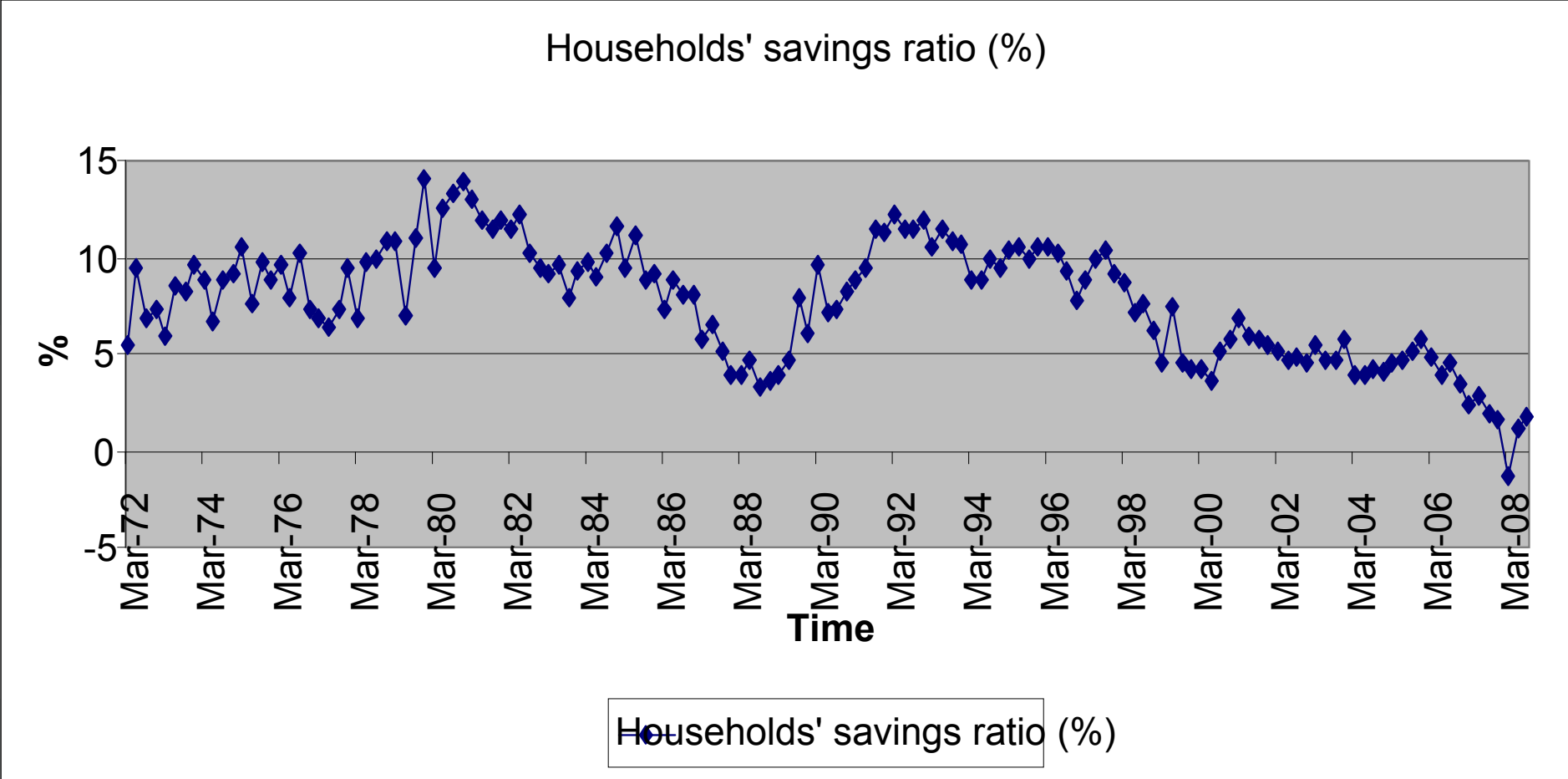
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Backdrop



Regulatory Objectives

- **FSMA 2000:**
 - Maintain market confidence
 - Promote public understanding
 - Consumer protection
 - Combat financial crime

Potential Net Interest Income Effects



- **Banking institutions' lending margins** ↓
 - Profitability
 - Capitalisation
 - Conflict in government policy; bank health vs macro economic health
 - Risk vs reward
 - Extent of interest rate pass through product in firms' asset mix
 - Firms' tariff structures

Potential Net Interest Income Effects



- **Fixed income investment returns ↓**
 - Annuity rates ↓
 - Pension pot buys less
 - Guaranteed return products
 - Impact on business model

Potential Net Interest Income Effects



- **Nominal rewards to savers ↓**
 - Behaviour influenced by
 - Inflation backdrop
 - Threat of unemployment
 - Consumer Sentiment
 - Options available to savers
 - Stop saving, increase consumption
 - Seek yield by going out the curve
 - Use savings to repay debt, deleverage

Potential Net Interest Income Effects



- **Impact on firms**
 - Attracting savings
 - Lending margins
 - Deleveraging
 - Modelling behaviour

Potential Net Interest Income Effects



- **Nominal incentives to borrowers** ↑
 - Behaviour influenced by
 - Inflation backdrop
 - Threat of unemployment
 - Consumer Sentiment
 - Options available to borrowers
 - Increase borrowing
 - Term out borrowing
 - Accelerate debt repayment, deleverage

Potential Net Interest Income Effects



- **Impact on firms**
 - Delinquency rates
 - Loan extension
 - Increased loan repayment rate
 - Modelling behaviour

Potential Net Interest Income Effects



- **Impact on FX rates**
 - Impact on existing hedges
 - Ongoing access to foreign capital markets

Potential Net Interest Income Effects



- **Impact on monetary policy**
 - Conventional money market operations
 - Unconventional mechanisms
 - Basis risk

Summing up...behaviour, behaviour, behaviour



- **Low rates affects actions of all market participants**
- **Lack of historical data**
- **Factor into business model and product offering**
- **Factor into risk management framework, including systems and stress and scenario modelling**