

## **FINANCIAL STABILITY REPORT PRESS CONFERENCE**

**Thursday 28 November 2013**

### **Opening Remarks by the Governor**

In the six months since the June *Financial Stability Report* an economic recovery has taken hold in the UK. Confidence has returned and credit conditions have eased further. UK banks have bolstered their capital positions by more than £20bn to meet the shortfalls identified by the Financial Policy Committee (FPC) and Prudential Regulation Authority (PRA). Liquidity conditions remain robust.

To promote financial stability, the FPC's job is not to rest on these laurels but to focus on underlying and emerging vulnerabilities. Despite the return to solid growth, financial stability risks remain, including those arising from high levels of indebtedness both here and abroad. Sharp rises in global interest rates could test financial system resilience, particularly if not associated with strengthening incomes.

In its risk assessment, the Committee paid particular attention to recent developments in the UK housing market. That reflects the importance of housing and mortgage debt on households' and banks' balance sheets. Any housing downturn could affect financial stability both through its direct impact on banks and from the exposure of borrowers more broadly to an economic downturn.

Housing activity has picked up from a low level and prices are 7% higher than a year ago. Price increases are gaining momentum and broadening out around the country. Valuations, while below levels reached in 2007, are high by historic standards and are likely to rise in the near term.

The immediate threat to financial stability from these developments is mitigated by the higher quality and levels of capital at banks and building societies as well as by material improvements in underwriting standards since the crisis.

Risks to financial stability may grow if there are further substantial and rapid increases in house prices and a further build-up of household indebtedness. These risks would be

amplified if underwriting standards on mortgage lending were to weaken as has been the case in previous house price cycles.

As part of a graduated response, the FPC is acting in concert with other authorities to implement a package of measures to guard against these risks. Some of these measures are already in train; others are new. Collectively, they are significant. But they are not exhaustive: in today's FSR, the FPC outlines a wide range of additional steps that it could take in future, should they be necessary to meet its statutory objective to ensure financial stability.

Let me start with those measures that are already in train but that haven't yet taken full effect.

First, over the course of the next year the capital adequacy of major UK banks and building societies will be assessed as part of new FPC-PRA stress tests which will include a close examination of the risks arising from housing-related portfolios.

Second, the Financial Conduct Authority (FCA) is putting in place measures to help maintain strong mortgage underwriting standards as part of its Mortgage Market Review (MMR). Some banks are already applying these higher standards; all banks and building societies will be required to do so by April of next year.

Authorities are announcing today two new measures.

First, the PRA has decided to end its temporary capital relief on new household lending from the beginning of next year.

Second, the Bank and HM Treasury have announced that the Funding for Lending Scheme (FLS) will be refocused towards supporting business lending starting next year. Since the FLS was launched, it has contributed to a substantial fall in bank funding costs. This has fed through to a significant improvement in household credit conditions. Given this success, there is no longer a need for the FLS to provide further broad support to household lending. Instead, the FLS extension will only generate additional allowances from new business lending, with incentives heavily skewed towards lending to SMEs.

The FPC welcomed these changes to the FLS. The MPC has judged that they will have no material impact on the stance of monetary policy and noted that they do not affect the MPC's policy guidance.

The package of measures I have described today will contribute to a constructive evolution of the housing market. By reinforcing financial stability, they further reinforce the MPC's ability to provide exceptional monetary stimulus to the entire UK economy for as long as it deems appropriate.

In today's FSR, the FPC has identified a range of tools that it could deploy in future, should that be necessary. These tools include recommendations on underwriting standards, the Help to Buy scheme and the availability of higher-risk loans, as well as recommendations or directions on bank capital requirements.

Finally, the FPC is also acting today to create a new macroprudential tool – the ability to vary the affordability criteria that mortgage borrowers must meet. This will help ensure that underwriting standards don't slip and that borrowers can afford to service their mortgages if conditions change more than they expect.

The package of measures that I have described is a coherent, proportionate response to the evolving risks in the housing market. Those risks are manageable and they are being managed. This will help keep the housing market on a sustainable path and ensure the broader economy continues to receive the stimulus it needs, for as long as it needs, to sustain the recovery. By acting now in a graduated fashion, authorities are reducing the likelihood that larger interventions will be needed later.

Securing financial stability requires much more than a resilient housing market. That is why the FPC has today set out in detail its three other strategic priorities for 2014. Those are: first, helping set the medium-term bank capital framework, including by conducting a review of the role of the leverage ratio within that framework; second, working to end 'too big to fail'; and third, identifying and addressing risks in shadow banking, while supporting diverse and resilient sources of market-based finance. All of these structural measures are essential to developing a more resilient and diverse financial system.

As it pursues these strategic objectives, the FPC will continue to monitor carefully risks to financial stability and work in close coordination with other authorities to achieve its objectives.