Other financial stability publications

This section provides a short summary of other financial stability related publications released by the Bank of England since the April 2007 *Report*.

Regular publications

Markets and operations article, *Bank of England Quarterly Bulletin*, 2007 Q3.

This article reviews developments in sterling financial markets since the 2007 Q2 *Quarterly Bulletin* up to the beginning of September, including a preliminary discussion of the stress in international markets. It also reviews the Bank's official operations during this period.

www.bankofengland.co.uk/publications/quarterlybulletin/qb0703.pdf

Speeches

A perspective on recent monetary and financial system developments.

Paul Tucker, Executive Director for Markets, April 2007.

www.bankofengland.co.uk/publications/speeches/2007/speech308.pdf

In this speech, Paul Tucker considered the risks facing monetary stability and financial stability. After explaining his January vote on Bank Rate, Mr Tucker characterised monetary conditions as 'edging towards restrictive', which provided the platform needed going forward to restrain inflationary pressures. Turning to financial stability, Mr Tucker contrasts the risks presented by global current account imbalances and compressed risk premia. In a world of what he called 'vehicular finance' in which risk is transferred — if only contingently — beyond banks, he called for market practitioners to work to continue to improve *ex-ante* measures to handle periods of stress, including via documentation and insolvency regimes.

The Governor's speech at the Mansion House.

Mervyn King, Governor, June 2007.

www.bankofengland.co.uk/publications/speeches/2007/speech313.pdf

In this speech, the Governor discussed the institutional structures in place for monetary and financial stability. The current institutional arrangements gave the Bank the responsibility for the oversight of payment systems, but gave no powers to discharge this responsibility. He offered a solution where the Bank has narrower responsibilities in this field. Moving to financial stability more generally, the Governor noted that securitisation is transforming banking. New and ever more complex financial instruments create different risks. This suggests that lenders should be cautious, especially when they know little about the activities of the borrower. Assessing the degree of leverage in an ever-changing financial system is far from straightforward and the liquidity of the markets in complex instruments is unpredictable. The Governor noted that excessive leverage is a common theme of many financial crises.

London, money and the UK economy.

John Gieve, Deputy Governor, June 2007.

www.bankofengland.co.uk/publications/speeches/2007/speech314.pdf

In this speech, John Gieve discussed the impact of London's growth as an international financial centre, the effect of financial innovation on the interpretation of economic data and the significance of the growth in money and credit for the economy. He argued that internationalisation, IT and the growing role of capital markets favour the clustering of financial activity. As such, we should expect London to continue to grow in the long term relative to the financial industry worldwide and to the rest of the UK economy. He noted that the growth of the City and new financial markets are making the interpretation of some of the core statistics used to monitor the economy more difficult. Challenges arise from the growing importance of bonuses, the difficulty of measuring the output of financial firms, and the impact of the growth in structured finance on monetary aggregates. After allowing for these effects, he concluded that there have been shifts in the supply of money and credit in recent years and explained that he voted for a further increase in Bank Rate in June partly because he was not convinced that current rates would be sufficient to bring credit growth and nominal demand back to their long-term sustainable path.

Promoting financial system resilience in modern global capital markets: some issues.

Nigel Jenkinson, Executive Director for Financial Stability, and Mark Manning, June 2007.

www.bankofengland.co.uk/publications/speeches/2007/speech315.pdf

In this speech, Nigel Jenkinson and Mark Manning argued that structural change in financial intermediation and the global financial system had exposed new vulnerabilities. Market participants and policymakers alike needed to update their approach to risk assessment and take appropriate steps to identify and contain emerging threats. A well-functioning and resilient operating environment is essential here, with the financial market infrastructure a critical component of this. In an increasingly complex and globally integrated financial system, vigilance, flexibility and international co-ordination among policymakers are likely to become ever more important.

Developing a framework for stress testing of financial stability risks.

Nigel Jenkinson, Executive Director for Financial Stability, July 2007.

www.bankofengland.co.uk/publications/speeches/2007/speech318.pdf

In these comments at the ECB High Level Conference on Simulating Financial Instability, Nigel Jenkinson noted that developing a rigorous, coherent and robust framework to analyse the resilience of the financial system presents many formidable challenges. In particular, the global financial system is evolving at a tremendous pace, fuelled by rapid innovation and cross-border integration, and supported by lower macroeconomic volatility. He described the approach that the Bank of England utilises to assess risks to major UK banks from sources of potential vulnerability. The first stage is to define a coherent stress scenario, then to map the important propagation channels and finally to estimate banks' losses. Nigel Jenkinson then outlined a suite of models being developed in the Bank of England to allow the transmission channels for potential financial system stress to be mapped out more accurately and comprehensively.

Uncertainty, policy and financial markets.

John Gieve, Deputy Governor, July 2007.

www.bankofengland.co.uk/publications/speeches/2007/speech321.pdf

In this speech, John Gieve discussed the range of uncertainty facing monetary policy makers, emerging lessons from the US sub-prime market and the significance of sovereign wealth funds and other influential investors. He argued that the level of uncertainty in the economic environment represented a return to normality. On financial markets, he argued that developments in the US sub-prime market had brought out vulnerabilities in the new structured credit markets. For example: the move to an 'originate and distribute' model of banking; the potential misalignment of incentives; the changing way that exposures impact on bank balance sheets; the way market liquidity can dry up in stressed conditions; and the difficulty of valuing instruments. Finally, he noted that the growth of sovereign wealth funds over time would tend to increase the price of riskier assets, like equities and corporate or emerging market bonds, compared with government bonds, and that the switch of reserve-rich countries from lenders to owners of financial or real assets was also likely to lead to political tensions and pressures for protectionism.

The Governor's speech at the Northern Ireland Chamber of Commerce and Industry.

Mervyn King, Governor, October 2007.

www.bankofengland.co.uk/publications/speeches/2007/speech324.pdf

In this speech, the Governor focused on the incentives facing banks, investors and depositors. In August, problems with the valuation of exposures to US sub-prime mortgage loans produced a sharp reappraisal of risk. Not only did asset prices fall, but the markets in some instruments virtually closed. Banks then faced the possibility that they would have to finance investment vehicles that securitised loans. They hoarded cash and became reluctant to lend to other banks beyond very short maturities. In the United Kingdom, Northern Rock was particularly exposed and it came to the tripartite authorities to seek financial support. It was important that this support was not provided for free to avoid moral hazard — that central bank action encourages the very risk-taking that caused the present problems. In the absence of a well-developed insurance scheme for depositors, once the queues started outside Northern Rock, other depositors faced every incentive to join them. Three lessons were identified. First, liquidity should be central to the regulation of banks. Second, there should be legislation to create powers to intervene pre-emptively in a bank in trouble, to separate the retail deposit book from the rest of the bank's balance sheet. Also, deposit insurance requires some changes. Third, central banks need to be able to lend against good collateral at a penalty rate without destabilising further any bank to which they lend. The Bank will explore ways to restore the use of discretion in central bank operations.

Working papers

Comparing the pre-settlement risk implications of alternative clearing arrangements.

John Jackson and Mark Manning, April 2007.

www.bankofengland.co.uk/publications/workingpapers/wp321.pdf

Inter-industry contagion between UK life insurers and UK banks: an event study.

Marco Stringa and Allan Monks, May 2007.

www.bankofengland.co.uk/publications/workingpapers/wp325.pdf

Cash-in-the-market pricing and optimal resolution of bank failures.
Viral Acharya and Tanju Yorulmazer, June 2007.

www.bankofengland.co.uk/publications/workingpapers/wp328.pdf

The impact of yuan revaluation on the Asian region.
Glenn Hoggarth and Hui Tong, July 2007.

www.bankofengland.co.uk/publications/workingpapers/wp329.pdf