Financial Stability Report Press Conference

Tuesday 5th July 2016

Opening Remarks by the Governor

Today, I want to outline how the Financial Policy Committee (FPC) is ensuring that the financial system can dampen shocks and help firms and households to seize opportunities associated with the UK's new relationships with Europe and the world.

The FPC's efforts are part of a four part Bank of England plan:

- First, to identify clearly the risks to financial stability and be straight with the British people about them;
- Second, to build on series of measures taken over recent years that have increased the resilience of the financial system;
- Third, to supplement this core strength with contingency measures implemented in the past few months to address immediate risks to financial stability; and
- Fourth, to take action to support jobs and growth during a period of heightened uncertainty.

First, clearly identifying risks to financial stability

At its March meeting, the FPC judged that "the risks around the referendum [were] the most significant near-term domestic risks to financial stability."

Some of those risks have begun to crystallise. In particular,

- The concerns that the historically large current account deficit could be vulnerable to sudden shifts in foreign capital and sharp adjustments in sterling appear to have been borne out. Portfolio flows into UK equities and corporate debt appear to have slowed, and sterling experienced its largest two-day fall against the dollar since floating exchange rates were re-introduced almost half a century ago.

- It is now more likely that adjustments in commercial real estate could tighten credit conditions for UK businesses. Foreign flows of capital into commercial real estate fell 50% in the first quarter of 2016, transaction volumes have fallen further during the second quarter, and share prices of property REITs dropped sharply following the referendum.
- In addition, the number of vulnerable households could increase due to a tougher economic outlook and a potential tightening of credit conditions. In particular, there is growing evidence that uncertainty about the referendum has delayed major economic decisions, such as business investment, construction and housing market activity.

More positively, sterling's sharp depreciation should, for given foreign demand, provide support to UK exporters, and the sharp fall in gilt yields has meant that all-in corporate borrowing costs actually fell modestly over the course of last week. In addition, financial markets have managed the volatility around the referendum well and have not added to stress.

The second part of our plan relies on a series of measures taken over years to build financial resilience

The Bank of England has consistently strengthened the resilience of the UK financial system over the past seven years. Major UK banks have raised more than £130 billion of capital since the crisis and their aggregate Tier 1 capital now amounts to 13.5% of risk-weighted assets.

In recent years, the FPC and PRA have tested bank balance sheets against scenarios far more severe than the country currently faces. For example, all our major banks and building societies passed last year's stress test which included losses twice those incurred during the global financial crisis.

Recent moves in financial markets have borne out this progress. Although lower bank equity prices are consistent with investor concerns over an uncertain economic outlook and lower bank profitability, overall bank funding costs have not increased. Markets are focused on returns not concerned with resilience.

The third part of our plan has been to implement a range of contingency measures to address immediate risks to financial stability

Responding to more intensive supervision by the PRA and their own risk assessments, major UK banks now hold more than £600 billion of high quality liquid assets, or around four times the amount before the financial crisis.

In addition, eligible counterparties have pre-positioned collateral with the Bank of England that creates the capacity to access more than £250 billion of funds through our normal facilities. In March we pre-announced a series of auctions around the referendum date and last week we announced that we will continue weekly auctions until the end of September.

The Bank of England is also able to provide substantial liquidity in foreign currency, if required.

We expect institutions to draw on this funding if and when appropriate, just as we expect them to draw on their own resources as needed in order to support markets and provide credit to the real economy.

The fourth part of our plan is to take action to support jobs and growth during a period of heightened uncertainty

This begins with using the flexibility embedded in the UK's regulatory framework to the greatest extent possible.

This framework is explicitly designed to allow up to half of the capital and all of the liquidity buffers held by banks to be used to absorb shocks in times of stress.

This ability to draw on buffers will encourage banks to continue to lend to UK households and businesses, even if times prove challenging.

To reinforce these incentives, the FPC is today reducing the countercyclical capital buffer on banks' UK exposures from 0.5% to 0% with immediate effect.

This is a major change. It means that three quarters of UK banks, accounting for 90% of the stock of UK lending, will immediately have greater flexibility to supply credit to UK households and firms.

Specifically, the FPC's action immediately reduces regulatory capital buffers by £5.7 billion and therefore raises banks' capacity to lend to UK businesses and households by up to £150 billion. For comparison, last year with a fully functioning banking system and one of the fastest growing economies in the G7, total net lending in the UK was £60 billion.

To be clear, this measure only supports domestic banking activities. Moreover, PRA supervisors will ensure that no bank increases dividends or distributions to shareholders as a result of this action.

When combined with the already strong balance sheets of UK banks, today's action means that UK households and business who want to seize viable opportunities in a post referendum world can be confident they will be supported by the financial system.

Financial institutions, like the rest of us, desire certainty in order to plan for the future.

In this regard it is important to note that:

- The Bank's liquidity framework is now well established;
- The FPC finalised the overall bank capital framework last year; and
- The Bank is steadily implementing measures to develop ring-fenced banks and end the scourge of too-big-to-fail.

Moreover, nothing in financial regulation will change until the process of the UK's withdrawal from the European Union is complete, and EU law ceases to have effect in the UK. The law is the law. Rules are rules.

Conclusion

The UK has entered a period of uncertainty and significant economic adjustment. The efforts of the Bank of England will not be able fully and immediately to offset the market and economic volatility that can be expected while this adjustment proceeds. More fundamentally, the future potential of this economy and its implications for jobs, real wages and wealth are not the gifts of the Bank of England, but will be driven by major decisions made by others in the public and private sectors.

However, by promoting monetary and financial stability, the Bank of England can help facilitate these decisions, smooth the necessary economic adjustments and help UK households and businesses seize new opportunities.

The Bank has a clear plan. We are rapidly putting its main elements in place. And it is working.

The FPC's past efforts have created resilient financial institutions which can draw on their substantial capital and liquidity reserves to support the real economy, even during challenging times.

The contingency measures we have put in place are addressing the immediate risks from the vote and ensuring that the financial system dampens shocks rather than amplifies them.

And the FPC is supporting the real economy, by ensuring that banks can use the substantial capital and liquidity buffers they have in place. Our actions today alone have released up to £150 billion in new lending capacity to UK businesses and households.

Going forward the Bank will continue to consult and cooperate with all relevant domestic and international authorities to ensure that the UK financial system can concentrate on doing its job so that the British people can do theirs.

And our various policy committees will work closely together to ensure that, during this time of heightened uncertainty, the measures we take will be as effective as possible.

In this spirit, the Bank can be expected to take whatever action is needed to promote monetary and financial stability, and as a consequence, support the real economy.

These efforts mean we can all look ahead not over our shoulders.

With that, Andrew, Jon and I look forward to your questions.