FINANCIAL STABILITY REPORT PRESS CONFERENCE

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Mark Carney: With that, my colleagues and I would be pleased to take your questions, thanks.

Gareth Ramsay: Okay. As always, if you could please give your name and also the organisation you represent. Please stick to just one question the first time around. So, I'll start with Adam and then Simon.

Adam Parsons: Adam Parsons from Sky News. Governor, the bank has today presented a picture of a no deal, disorderly Brexit that would lead to one of the biggest economic slumps in the recent history of this country. So, are you part of 'Project Fear' or do you really think that we are looking at economic catastrophe?

Mark Carney: Thanks for your question, Adam. I will be absolutely clear, our job is not to hope for the best but to prepare for the worst, and, as I think we made clear in the report, as I hope I made clear in my opening statement, we have looked at a potential no deal, no transition Brexit and made a series of worse case assumptions around that. So, for example, that port infrastructure is not ready, for example, that the EU does not recognise, there's no grandfathering of UK product standards and on, they're detailed quite extensively, and also that there's quite a sharp reaction in financial markets. The reason we do that is to be prepared for all eventualities. It's to make sure that our banks have more than enough, and at three times what they had even after that shock, more than three times than what they had going into the financial crisis, they have more than enough capital for a disorderly Brexit to make sure that they have more than enough liquidity. That, as a whole, the way they're managing risk, and the protections that they have from capital liquidity, mean they can continue to serve businesses and households across the United Kingdom.

So, we look at that in order to be prepared for that worst case scenario for a purpose. The thing that I would underscore, and one of the things buried in an avalanche of paper that came out today, both the reports, but also the minutes that will come out, the record which will come out in ten days from now, will unredact a series of discussions that the FPC, and analyses of the FPC, has been doing for the last couple of years, which is exactly looking at exactly these types of scenarios and making sure that we're getting the financial system ready for something which is an unlikely scenario. Even in that unlikely scenario, we've taken it to what we think is the worst case version of that unlikely scenario to make sure that we've done our job, we've got the system ready, and what we're telling you, if there's one thing you take from the avalanche of paper and the numbers and the discussion today, is that the core of the UK financial system is ready for Brexit whatever form it takes.

Gareth Ramsay: Simon at the front.

Simon Jack (BBC): From what comes through in your report, you say that the Bank of England is ready, the financial system is ready for Brexit, but Britain is not ready for Brexit, and there seems to be a lot in your report that's saying part of the severity of some of these outcomes is to do with the unpreparedness of business, of households, whatever, for what's ahead. Could you unpack that a little bit? How much is that to do with the severity of some of these situations?

Mark Carney: Well, again, I'll underscore particularly, because this is all relevant to no deal, no transition, and obviously we've looked at the forms of economic partnership where there is a transition and there is a smooth transition. So, in the case of no transition, and again, with our worst case hat or visor on as you'd expect us to be, there are several drivers of those outcomes. It starts with the frictions of the trading system, because, all of a sudden, there are not just tariffs in place but there are rules of origin checks, a series of customs and checks, for which the system is not yet prepared, and so that adds on top of it additional frictions, and we've laid all of this out very clearly, I think. There are risk premia that come into financial markets at the same time, in part relatedly because of the scale of the economic shock and the degree of unpreparedness and uncertainty effects which hit business. To take it back to the core of your question which is, so what's actually happening on the ground, it is our observation, and it has been for some time, that the number of business, or the proportion of businesses, that have contingency plans, or who have initiated contingency plans, or who have activated contingency plans, remains a fraction of businesses as a whole.

As you dig deeper into that and you have conversations with business indirectly, in several cases, it is very difficult for those businesses to plan for border frictions. They can plan for tariffs, they can plan for a change in the price of selling their goods, but in terms of the logistics of making that happen, it's very difficult. I heard an example on your programme this morning of a very sophisticated business which has that issue, that's a very common phenomenon. So, let's flip it around though, the situation is that the European Union, the United Kingdom, and certainly the United Kingdom government, wants a transition period to whatever form of Brexit we're taking. Certainly, from what we have seen for the economy as a whole, it is advisable to have that transition period, that implementation period, and, if I may, this should be an objective assessment of preparedness and the time it will take to ensure that, not just for businesses, and I go back to the point of, in some cases, the logistical issues, you can't plan for these, you can't plan around them. So, it goes first foremost to making sure that the infrastructure is there and ready, and ready to go, so that we can move as seamlessly as possible to the new relationship, whatever form it takes.

Gareth Ramsay: Okay. Joel, and then Ben in the front.

Joel Hills: Yes, Joel Hills from ITV news. All of your scenarios assume that Britain ends up leaving the European Union in some way, shape or form. What would happen to your growth forecasts if Britain ended up remaining?

Mark Carney: Well, we were asked by the Treasury committee, and I'm sure we'll discuss it with them next week, to compare those scenarios that I just went through, that you referenced, to 'the present position', which is a slightly ambiguous phrase, and, from our perspective, you could interpret it in two ways. The first is, 'the present position', in other words, the current forecast that we have for the economy, which has an element of Brexit in it, obviously, because there has been an effect, as you know, Joel, on business investment because of uncertainty over Brexit, the pound is where it is because of Brexit effects as well. So you can interpret it first as that, but you could also interpret it as a scenario where we remain part of the European Union, and the cleanest, the simplest approach to that, for us, is to take the last forecast we had prior to the referendum, and as you'll see in the documents, there is a straight line called 'May 2016 trend' which is just an extrapolation of the path that the economy is on. It's nothing more, to be absolutely clear, than a mechanical extrapolation of the trend rate of growth that the economy was on, which was around 2% at that time, and it's done throughout the document. You can compare scenarios, and I appreciate you're using the word, 'scenarios', not 'forecast', but these scenarios, whether it's no deal or a partnership, relative to either the forecast we just came out with as the MPC, or that previous trend, and you can make your own assessment from that.

Gareth Ramsay: If we come back to you, Joel, on the second go, if we get time for second goes. Can we go to Ben at the front and then Lucy alongside him?

Ben Chu: Ben Chu from The Independent. Governor, this avalanche of documents mention several times that there's no historical precedent for a disorderly Brexit, there's nothing to guide us from the history books. Given that, what is the scientific basis for saying, as you have several times, that this is the worst case scenario that you've painted here? Dire as it is, doesn't that give us a, sort of, false sense of precision about what we're looking at here?

Mark Carney: Well, I don't know. I'll start and then I'll pass to Ben. Obviously, one could take the most extreme move in credit spreads, the most extreme move in uncertainty, the most extreme moves in border frictions, and add all those up. We're pretty close to that. We're not precisely at that, but we're pretty close to that in terms of what we've done. What is one of the most important things, and I just want to stress this, though, in thinking about the dynamics here, are, how quickly does the economy respond to the sharp decrease in openness, and it's a sharp reduction in openness in the disorderly scenario. Not just because of tariffs and non-tariff barriers, but because of with, you know, logistical problems, other factors. With that sharp reduction, we have made an assumption, and it's grounded in some case studies and some work, but we're very clear about this, this is an uncertainty. We've made an assumption that the adjustment is pulled forward. In other words, the adjustment of the economy is more rapid when you put up barriers than the adjustment of the economy than when you drop barriers in terms of a new trading agreement, and that adds a degree of difficulty, challenge, it makes the scenario worse. So, what I'd suggest, what we would suggest, rather, is that we move to these fairly sharp moves, two standard deviation moves, for example, on uncertainty, plus you have this dynamic that's brought in. It's justified, but we do it in order to have a worst case scenario, but Ben, do you want to?

Ben Broadbent: Yes. We do have a lot of information, and by 'we' I mean the community of economists, on the effect of differing trading relationships, on where volumes of trade end up, and what those do to productivity. You're right that in general, in terms of the changes in those things, they've tended to go in a positive direction, certainly in developed economies more or less continually since the Second World War, and we've not had the reverse experience. So, one important assumption we make is that the magnitude of these effects is the same in reverse as it has been on the way up, as it were. I think that's a reasonable assumption to have made. What is harder to judge, and this is what the government was talking about both in the opening statement and just now, is the speed at which those effects come through.

We think there are several good reasons to imagine that they will come through faster, certainly in the most disruptive cases. There is one case study we've used on the loss of access on the same terms to the UK by New Zealand in the mid 1970s. That's about the only concrete example we can find, but we think there are independently good reasons for that, some of them related to the state of preparedness that we were discussing earlier, why these effects will come through faster, certainly in the worst cases, and I would point you to, there are several pages beginning at page 26 in the report as to why we think that's the case. So, to reiterate, I don't think the scale of the eventual numbers is founded on as little data as you suggest, we've got quite a lot for that. The speed of the adjustment we're less sure about, but we think there are good reasons to imagine it will be slightly faster on the de-integrating side than when you have trade integration.

Gareth Ramsay: Okay, Lucy at the front and then Phil.

Lucy Meakin (Bloomberg): Are you worried that this report that we've seen is the Bank of England effectively endorsing government policy, and does that set a risky precedent, as some of your former colleagues in the Bank of England are already starting to say that it could set a risky precedent for the independence of the central bank?

Mark Carney: Well, let's be clear what's going on here. The Bank of England has tremendous responsibilities, has tremendous powers. It is accountable to parliament. It's accountable to the people of the United Kingdom, it's accountable through parliament. Parliament has demanded this analysis, right. Now, this is the type of analysis, and as I referenced earlier, we have been doing this type of analysis in order to do our jobs, in order to deliver financial stability, monetary stability. Particularly on the former on financial stability, the type of work to think about, exactly what we've just been talking about, is, what could go wrong, what could be really difficult, where could the financial system be caught out, and how can we get it prepared so that the financial system is part of the solution, not part of the problem? The good news is, we're here today to reinforce that, and you have pretty substantial evidence analysis, and in the end, cold, hard capital and liquidity, and if you'd like to hear Sam Woods take up the rest of this press conference by going through the numbers, he'd more than happily do it.

In terms of the assessment of a partnership arrangement, this is something that we also have to do in order to develop, and these are scenarios, not forecasts. This gets to one of the links between the two, which is, we have to have a sense of the potential implications of an arrangement, an arrangement that's different, after all, than the arrangement we have today with the European Union. We have to have a sense of what UK businesses and households think about that arrangement, which isn't necessarily the same thing of what that arrangement could or will be, and, obviously, what financial markets think about it as well, and all of those map into, ultimately, demand, supply and the exchange rate, and therefore the path of monetary policy. So, we have to do it, and we've done it, and if you have to do it and you've done it, and parliament demands it, and you're accountable to the people of the United Kingdom through parliament, you expose it. There's nothing more here than that.

Gareth Ramsay: Okay, just a reminder, could you mention which organisation you represent as well please? So, Phil and then James.

Phil Aldrick: Yes, Phil Aldrick at The Times. In your scenario planning, the worst case scenario, you suggest that interest rates are going to rise to 5.5% as the economy crashes further than it did in the financial crisis. I just wanted to establish, are we looking at theoretical extrapolations or is this realistic that interest rates will do the complete opposite to what happened in the financial crisis, and what's your estimation of the likelihood of the worst case scenario happening?

Mark Carney: Okay. So, the first thing is, in terms of the financial crisis, and I think it's a very well structured question. So, the complete opposite of what happened in the financial crisis, well in many respects, this is the opposite of what happened in the financial crisis, because, as you know, Phil, the financial crisis principally, at least initially, for the first few years, was a demand shock, it was a big demand shock. Actually, when you look back over the course of our professional lifetimes, and stretch further back all the way into the 70s, that is effectively the collective we have been dealing with, which are demand shocks, gradual changes in the supply path of the economy. Some economies doing a little better on productivity, a little more on labour supply, but gradual changes to the supply side of the economy and addressing demand shocks, both positive and negative, and therefore, monetary policy can be calibrated to adjust demand accordingly, bring inflation to target, or not if it's miscalibrated. Obviously, bring inflation to target and support the economy that way.

What's different about this is it first and foremost is a supply shock which then has demand implications. So, it is a totally different situation than people have been living with and experiencing, certainly in advanced economies, for the last 30, 40 years. That's why we've stressed the supply, demand and the exchange rate element. In that situation, we would be faced with a real challenge, and to be absolutely clear, which is, we know the direction of the hit to supply, there will be a negative shock to supply, determining exactly how much of it is coming in at what pace, and how persistent that is, will be difficult. It's part of what Ben was just talking about in terms of, do we think it will come in more rapidly than historic integration, and if it is a scenario, which is unlikely, to be absolutely clear, but we've got to prepare for the unlikely one, and I'll come back to your second part, if it is a scenario where there are logistical issues and other frictions, that are not frictions that are part of the new trading relationship, but are just frictions from adjusting to the new trading relationship, we will have to make a determination about how much of the hit to supply is temporary versus persistent.

That will also have a bearing on the stance of policy. But all things equal in a sharp supply shock with an exchange rate adjustment which is driven by future real incomes with it, inflationary effect from tariffs which, alas, when we largely looked through the first one, not necessarily, it's likely to be inflationary. And in the end, we have a remit which is an inflation targeting remit. We can balance that remit to a certain extent, but we're not going to ignore it. Last point, in terms of likelihood, I think, when one stacks up worst case, worst case, worst case, the joint probability means that it's less likely, but it is a possibility that we will have no deal and no transition. We have always thought that it was a possibility, a tail possibility, maybe the probability has increased with time, you tell me, you're probably closer to it, but probability's increased with time, but even when it was just a small probability, our job was to get the system ready to deal with that, and you can't get it ready overnight. We think the system is ready. Certainly the core of the system is ready now.

Gareth Ramsay: James at the front and then we'll move along.

James Burton: James Burton from the Daily Mail. Governor, if your worst case scenario came through and there was an 8% decrease in the size of the economy, would that make 2019 the worst year for the British economy on record, and given that that is a clear possibility, what would your message be to MPs as they debate Theresa May's deal and consider the possibility of no deal?

Mark Carney: Look, on the first, no, not the worst year on record, certainly not the worst quarter.

Ben Broadbent: When we went back on gold, certainly peak to trough, the drop was almost 20%, I think.

Mark Carney: That was the last time that the bank gave advice to the government, I think, was to go back on the gold. Which answers the second part of your question, which is, no, we're not-, our job is to get the system ready for all possibilities. It's a serious job, a difficult job. We have more than enough to do that. It is absolutely not our job to take one side or another on these issues. That is clearly the responsibility of parliamentarians who will weigh many factors in their determination. We all ultimately serve the same people, you know, your readers, the people of the United Kingdom. Again, what we really want to get across today is, there are lots of issues that people, I'm sure, are thinking about or are concerned about, or have questions about, the one area they shouldn't have questions about is the financial system. The purpose of what we've released today, the part that we've released today, the no deal, no transition, the disorderly scenario, is to provide that reassurance. It's not supposed to make people scared, it's supposed to provide the reassurance that, even if this happened, which is not likely, the system is more than ready for it.

Gareth Ramsay: Okay, if we can come along one to the front, and then Yvonne next to you.

Anna Isaac: Anna Isaac, The Telegraph. These forecasts which are based on given scenarios, to what extent do they reflect the advice you gave to cabinet? I'm thinking particularly the 30% fall in house prices, the 48% fall in commercial property prices, and the unemployment rate, they seem very similar to the figures that emerged from that cabinet meeting. The barriers that you mentioned to financial services, were they also raised at the cabinet meeting, and how does that inform Bank of England independence in terms of its engagement with government in that way?

Mark Carney: First of, there are scenarios, scenarios, scenarios. You dropped the 'F' word in there, they're not, okay? They're scenarios. They're scenarios with transparent assumptions, established economic relationships. Part of the purpose of the scenarios is you can see the sensitivities, if you wanted to changes some of the assumptions, you can see the differences, and that's why you have swathes or paths around them. Secondly, you know, look, discussions at cabinet are confidential, and yes, that's it, that's full stop, so we're not certainly providing a commentary on that. What the responsibility of, again, this institution is to make sure we have the system in place for whatever happens, whatever could happen, in any direction, and that's why these were developed.

I mean, of course we always refresh them, but they were developed a long time ago, right? I mean, we have been thinking about these issues for a long time, and, again, totally transparent, we had used language this time last year, those who came here for this press conference, we talked about the stress test, at the time, encompassing Brexit scenarios. You can see now transparently that our stress test, there's a chart in the executive summary throughout the document which shows the capital draw down in the Brexit scenario much bigger in the stress test, and then, of course, relative to the size of capital, it's very manageable for the banks. That's what encompassing means. So, we had done this before in different ways, we've updated (TC: 00:40:00) it, and, you know, parliament's demanded it and so it's exposed, that's it.

Gareth Ramsay: So, Yvonne and then we'll come to you**.**

Yvonne Esterházy: Yvonne Esterházy, Wirtschaftswoche, German business week. Governor, you said that you need to provide greater clarity when it comes to clearing and, I think, outstanding cross-border contracts. Given that you have this joint working group with the ECB, can you tell us what's happening there? I mean, why can't you resolve these issues, and we're four months away from Brexit, how often does this group meet, how many people are members of this group, and why are things not moving satisfactorily?

Mark Carney: Well, I'll just say at the top level and then I'll hand to one of the members of this group, it's Jon Cunliffe. It did say at the top level that it has been a very constructive working group grappling with the issues, analytically based sharing experiences, and I'll say one other thing on a high level which is that we welcome the progress that has been made, but Jon, I think it's important that you go into it.

Jon Cunliffe: So, first on the group, I think the objective of the group is to make sure that we all share the same analysis, we understand the risks, and where we can compare, if you like, the analysis and the information that we have on the risks and the group has done a lot in that area. On the specific issue of clearing and clear derivatives, it's a big issue. £40 trillion by notional value of pounds of contracts in UK clearing houses will still be there after 29th March next year, and clearly, if the clearing houses can't depend on the European members meeting their obligations, or their boards can't know whether

they're going to be able to provide those services, they would then have to take action, which in itself could be expensive and disruptive.

That's why, as the government have said, the statements by the commission that have come out in the last few weeks are welcome because they say that the commission recognises this risk and it will grant temporary permission, conditional temporary permission, to allow the clearing houses to continue to operate with their European Union clients. I think the point that's made in the checklist, so that's recognised, but for the clearing houses, and this is first and foremost an issue for their boards, they'll need to know the timing, they'll need to know what the conditions are, they'll need to know the scope of products are covered so that they can have assurance they don't need to take the action they can take. That's what we mean when we say that greater clarity is necessary, but I think the European Commission's recognition that temporary equivalence should be granted, and the commitment to do that, is a very welcome step forward.

Gareth Ramsay: Okay, thank you, and then Caroline in the front.

Alanna Petroff: Thank you. I'm Alanna Petroff from Yahoo Finance UK in London. I have a question for Mark Carney. Now, you got your UK passport this month, and I'm wondering if that makes you feel more comfortable talking about the risks surrounding Brexit, as you have faced a lot of criticism for being deeply negative about Brexit? So, now that you're a UK citizen, do you feel more comfortable?

Mark Carney: Thank you, Alanna. I actually don't have my passport yet, I have my citizenship, but I'm sure it's in the mail. The Home Office is a little busy at the moment. No, look, it's an interesting question, I feel as comfortable as I've ever done talking about, whether it's Brexit or any other issue facing the UK economy, facing the UK financial system. Our job is to look at these issues, assess what they could mean for the financial system, for the economic outlook if they're affecting either of our objectives, price stability or financial stability, to take the appropriate action. Look, Alanna, I will say that, during my time as a non-British citizen, it's a great privilege to have this role and, I think, a testament to this country and its openness that, it's not about me, but to bring in somebody from outside into a role like this, and that when I travel around the country, meet businesses, meet people, I've always felt very welcome, very free to speak and represent the bank. Thank you.

Gareth Ramsay: Okay, just Caroline in the front.

Caroline Binham: It's Caroline Binham from the Financial Times. Governor, you say with some certainty that the UK financial system could withstand the worst of all possible Brexits and banks could continue lending to the wider economy. I'm just wondering how you can make such a sure statement given that your stress tests are testing against the GDP fall of 4.75%, and commercial property prices falling at 40%, when under your disorderly assumptions, they fall by 8% and 48% respectively? Thank you.

Mark Carney: Yes. So, that's good, it gets into the mechanics of the thing, and I don't know if Sam can pick up on this, but what we look at is the interaction between the level of rates, the level of unemployment, and the change in unemployment, the change in the underlying asset quality, asset prices. Also, what happens to net income margins as well, and look at that in the round, you get a sense, and I'll pass to Sam, but I'll give you the page reference. I mean, you get a sense in terms of, on page 9 of the EU document, it's also in the FSR, of the scale of losses, including the range of losses, in the disorderly scenario relative to an ACS, and as I hand off to Sam, I'll just mention something else

which is, in the stress test, the stress test has a lot more than a UK recession in it that hits banks, but Sam?

Sam Woods: Yes, I think, Caroline, that really is the key chart, that chart on page 23 of the financial stability report which allows us to do a crosscheck against the normal stress test we do, and I think the simplest way to express it is that in our normal stress test, the draw down on capital for the banks is 5.4% of CT1. That's what we sometimes call the 'triple whammy' because you've got a UK downturn, a global downturn, and a misconduct hit all at the same time. If you come across into our Brexit shocks of the analysis of how that would play out in the disorderly scenario that Mark's been describing, you can see that the UK macro impact is pretty much the same. It comes from a slightly different set of shocks, but I think it's reassuring that it's about the same as the UK macro part of the annual test, and then we've also led in an element of the traded stress, assuming that there was a traded stress around UK assets. So, when I try and get it between those two, I feel pretty confident of the result.

Gareth Ramsay: Okay, Richard at the back there?

Richard Partington: Thank you. Richard Partington from The Guardian. Governor, you've explained why you might need to raise interest rates in a no deal scenario, however, I just wanted to ask, to what degree would the recession in 2019 be as severe if interest rates were cut to 0%? Would they be not as deep as that 8% that you have, not forecast, estimated on your scenario there?

Mark Carney: Yes, I'll let Ben pick it up.

Ben Broadbent: I'll just make a general point, which is that these are scenarios driven predominantly, not to say overwhelmingly, by what happens to the supply capacity of the economy. That explains the difference across all the swathes, mostly. Maybe this is an overstatement that monetary policy is essentially a sideshow, and it acts mechanically to balance any difference between demand and supply and deviations in inflation from the target, but it really is not the main actor here. It has some role because the exchange rate falls so far in the worst case scenario, interest rates do have to go up quite steeply to contain the inflation that results, but really, the fact that that worst case scenario is worse is because all the other things we've been talking about that affect a supply capacity of the economy, and that is really the story throughout this report, and that explains the differences in all the scenarios.

Mark Carney: Yes. So, said another way, and I think our colleague Michael Saunders said this the other day at Treasury committee, lowering interest rates isn't going to open a port, lowering interesting rates is not going to allow a bank in London to continue to operate in the continent if passporting has been taken away. Both of those examples are examples of reduction of the supply capacity, and the economy needs to adjust to that. Now, if demand adjusts much more than supply, then it starts to become more interesting, if you will, or more conventional, maybe, is a better way to put it.

Ben Broadbent: Even then, we can't get economic output above that supply capacity for very long with monetary policy.

Gareth Ramsay: Okay, I think that concludes today's press conference. Thank you very much for coming everybody.