FINANCIAL STABILITY REPORT PRESS CONFERENCE

Friday 11 December 2020

Opening Remarks by Andrew Bailey, Governor

Hello, this is Andrew Bailey.

Welcome to this presentation of the Bank's December *Financial Stability Report*.

Introduction

UK households and businesses have needed support from the financial system to help weather the economic disruption associated with Covid-19. The financial system has so far been able to provide that support, reflecting the resilience that has been built up since the global financial crisis, and the policy responses of the Government and of the Bank of England.

The Financial Policy Committee has played an important role in this, helping to preserve financial stability despite the difficult circumstances we've faced this year. This reflects the actions taken over the past decade, to develop an effective macro-prudential framework, as well as putting our tools to work in response to the risks associated with the Covid-19 pandemic. That has included, for example, releasing the Counter-Cyclical Capital Buffer and running a reverse stress test to assess the resilience of the banking sector. As set out in the Financial Stability Report released today, the FPC is taking further steps to maintain financial stability and support the recovery.

Looking forward, UK companies and households may need further support from the financial system to weather any additional disruption. Although there have been encouraging developments on vaccines, the FPC, consistent with its remit, is focussed on the range of downside risks that remain. These include risks from the evolution of the pandemic, as well as from the transition to new trading arrangements with the European Union.

Banking system resilience

Despite these challenges, the FPC judges that the UK banking system remains resilient to a wide range of possible economic outcomes. It has the capacity to continue to support households and businesses, even if those outcomes are considerably worse than currently expected.

Capital ratios remain strong, but some headwinds to banks' capital ratios are anticipated over coming quarters, reflecting the potential for unemployment and business insolvencies to rise, and risk weights on banks' exposures to increase. Nevertheless, the major UK banks can in aggregate absorb credit losses in the order of £200bn, much more than would be implied if the economy followed a path consistent with the central forecast in the MPC's November Monetary Policy Report.

This is enough to encompass a very wide range of outcomes on both Brexit and Covid. The FPC judges that the UK and global macroeconomic scenarios required to generate losses on this scale would need to be very severe with, for example, UK unemployment rising persistently to more than 15%. And to be very clear, this is a statement of capacity to absorb stress, nothing more.

The FPC's role is to ensure the financial system is resilient to these risks, and indeed that is what we have been preparing for since it was established. Ensuring we are well placed to deal with what could happen, rather than predicting what will.

We therefore expect banks to use their capital as necessary, to continue to support the economy, even in the face of more severe economic outcomes.

Alongside the Prudential Regulation Authority, we are taking action to support the use of capital buffers.

The FPC is updating its guidance on the path for the UK countercyclical capital buffer rate, and extending the period we expect this rate to remain at 0% until at least 2021 Q4.

The FPC also welcomes the PRA's announcement to return towards the standard framework for bank distributions. This reflects some reduction in the uncertainty related to Covid, and the ability of banks to withstand significant losses. The FPC recognises the importance of a stable and predictable capital framework which provides certainty to banks and facilitates the use of capital buffers where necessary.

Cutting support to the economy to avoid the use of capital buffers would be costly for the wider economy and consequently for banks and building societies themselves.

Stability in the provision of financial services at the end of the transition period with the EU

Financial sector preparations for the end of the transition period with the EU are now in their final stages. Most risks to UK financial stability that could arise from disruption to the provision of cross-border financial services at the end of the transition period have been mitigated. This reflects extensive preparations made by authorities and the private sector over a number of years.

However, as we have said many times, financial stability is not the same as market stability and does not mean we can avoid disruption to financial services in all parts of the landscape. We have taken steps to ensure that there is open access to UK financial services, including for clients based in the EU. But we cannot prevent disruption for EU clients caused by measures taken elsewhere, regrettable though that is.

Irrespective of the particular form of the UK's future relationship with the EU, and consistent with its statutory responsibilities, the FPC remains committed to the implementation of robust prudential standards in the UK.

Ensuring the financial system is ready to serve the future economy

The FPC is also taking steps to support the recovery and ensure continued financial stability in the context of innovation in the financial system. There are three particular areas covered in the FSR which I would like to cover briefly.

First, the Covid shock has brought the supply of productive finance into sharper focus, given the need for longer-term financing options to support the corporate sector. In order to help limit the degree of economic scarring caused by Covid-19, work to increase supply of longer-term, equity-like financing is increasingly important. To support this, the Bank, with HM Treasury and the Financial

Conduct Authority, has launched an industry working group to facilitate investment in productive finance.

Second, on the mortgage market, the FPC has announced that it will review the calibration of its Recommendations to limit the proportion of new mortgages with high loan to income ratios.

The FPC's last review of its Recommendations in 2019 found no evidence that they were having a material impact on mortgage availability overall since they were introduced in 2014. That has remained the case since.

However, the FPC judges that changes over time in the risks faced by households mean the measures warrant a further review. That is underway and the FPC will report its conclusions in 2021.

And third, turning to the future payments landscape, the FPC has reiterated its expectation that in order for so called stablecoins to be successful, these need – at all times – to be as safe as existing forms of money.

Having previously set out its expectations of how stablecoins should be treated in the regulatory framework, this round the FPC discussed how the regulatory system should adapt to assure confidence in the value of stablecoins at all times, while supporting effective innovation.

The FPC, along with many authorities internationally, is also considering the potential effects on financial stability if stablecoins were to be adopted widely. A Discussion Paper on these issues will be published in due course by the Bank. That paper will also address issues that may arise in connection to the concept of a Central Bank Digital Currency – an electronic form of central bank money that could be used by households and businesses to make payments.

Conclusion

Let me finish, by reiterating that the FPC aims to ensure the UK financial system is prepared for, and resilient to, the wide range of risks it could face — so that the system can serve UK households and businesses in bad times as well as good. As I have outlined today – and is covered in the Financial Stability Report – during 2020 the FPC has taken a number of actions to maintain financial stability in the face of extremely difficult circumstances. Today we have announced further measures to preserve financial stability, as well as steps to support the recovery and ensure continued financial stability in the context of innovation in the financial system.

Thank you.