

FINANCIAL STABILITY PRESS CONFERENCE

Monday 13 December 2021

Opening Remarks by Andrew Bailey, Governor

Hello, this is Andrew Bailey.

While it's disappointing that we cannot host this press conference for the December Financial Stability Report in the Bank today, I am glad that we can still carry on by hosting this virtually.

Before answering questions, I'd like to highlight some key themes from the Report and the FPC's Q4 policy meeting, in particular covering the FPC's decisions on the countercyclical capital buffer and our mortgage market tools.

Recent developments

Starting first with the backdrop to the latest report, the UK and global economies have continued to recover from the effects of the pandemic. But uncertainty over risks to public health and the economic outlook remains.

As you will understand, I will not be saying anything on monetary policy today.

In the UK, corporate debt vulnerabilities have increased only relatively moderately over the pandemic so far, and despite recent strength in the housing market, aggregate mortgage debt relative to income has remained broadly stable and there has been little evidence of a deterioration in household lending standards.

Overall, the FPC judges that domestic debt vulnerabilities have not increased materially over the course of the pandemic. But the FPC remains vigilant to debt vulnerabilities in the economy that could amplify risks to financial stability.

In global financial markets, risk-taking in certain markets remains high relative to historical averages, notwithstanding recent market volatility. Also, risks in leveraged loan markets globally continue to increase. And global debt vulnerabilities remain material.

The UK banking system has weathered the pandemic well. UK banks' capital and liquidity positions remain strong, and they have sufficient resources to continue to support lending to the economy. Today we have also published the final results of the 2021 solvency stress test, which tested the resilience of the UK banking system against a much more severe evolution of the pandemic and consequent economic shock. Factoring in the results, the FPC continues to judge that the UK banking system remains resilient to outcomes that are much more severe than the Monetary Policy Committee's most recent central forecast.

The UK countercyclical capital buffer rate

Looking across all of the recent developments in system-wide risks, the FPC judges that vulnerabilities that could amplify economic shocks, and affect the UK banking system, are now at a standard level overall, as was the case just before the pandemic.

Now is the right time to start rebuilding resilience so that we are well prepared for future possible shocks.

The FPC cut the UK countercyclical capital buffer (CCyB) to 0% in March last year to support banks in continuing to lend during the pandemic. Before the pandemic, a 2% UK CCyB rate was due to come into effect by the end of 2020.

The current risk environment would be consistent with the CCyB rate returning to the region of 2%. However, there continues to be uncertainty about the evolution of the pandemic and the economic outlook. Should downside risks emerge, the economy could require more support from the financial system.

The FPC is therefore increasing the UK CCyB rate from 0% to 1%, to be implemented by 13 December 2022. If the UK economic recovery proceeds broadly in line with the MPC's central projections in the November MPR, and absent a material change in the outlook for UK financial stability, the FPC would expect to increase the rate further to 2% in 2022 Q2, with a usual 12-month implementation period.

Building the resilience of the financial system

The FPC remains focused on building a stronger and safer system for the future.

On market-based finance, the FPC strongly supports international work, led and co-ordinated by the Financial Stability Board, to assess and develop policy responses to address the underlying vulnerabilities that amplified the dash for cash. The FPC endorses the FSB's policy recommendations for money market funds, which now need to be implemented by all jurisdictions.

But there is more to do and 2022 will be an important year for making further progress internationally. Further policy measures are needed to enhance the resilience of market-based finance in other areas including open-ended funds, margin, the liquidity structure and resilience of core markets, and leveraged investors and their prime brokers.

The FPC is also vigilant to the financial stability risks that cryptoassets could pose. Cryptoassets, and their associated markets and activities, continue to grow and develop rapidly. The total market value of cryptoassets has grown ten-fold since early 2020, now representing around 1% of global financial assets. The vast majority of this market is 'unbacked' cryptoassets, which have no underlying assets. Such cryptoassets have no intrinsic value, are vulnerable to major price corrections and so investors may lose all their investment.

Direct risks to the stability of the UK financial system from cryptoassets are currently limited. However, at the current rapid pace of growth, and as these assets become more interconnected with the wider financial system, cryptoassets will present a number of financial stability risks.

Enhanced regulatory and law enforcement frameworks, both domestically and at a global level, are needed to influence developments in these fast-growing markets. Any future regulatory regime should aim to balance risk mitigation with supporting innovation and competition. The FPC considers that financial institutions should take an especially cautious and prudent approach to any adoption of these assets until such a regime is in place.

Review of the FPC's mortgage market Recommendations

The FPC reviews its mortgage market Recommendations regularly and today we have set out the results of our latest review.

An excessive build-up of mortgage debt, often associated with rapid increases in house prices, has historically been an important source of risk to the UK financial system and to the economy, and which in turn could amplify an economic downturn and financial stability risks.

In 2014, the FPC introduced two Recommendations to guard against a loosening in mortgage underwriting standards, which could lead to a material increase in aggregate household debt and the number of highly indebted households. The 'flow limit' limits the number of mortgages that can be extended at loan to income (LTI) ratios higher than 4.5. And the 'affordability test' specifies a stress interest rate for lenders when assessing prospective borrowers' ability to repay a mortgage. The affordability test builds on the FCA's Mortgage Conduct of Business framework, which includes the FCA's own rules on affordability testing.

In its latest review, the FPC has concluded that its mortgage market measures in aggregate continue to play an important role in guarding against a loosening in underwriting standards and an increase in household indebtedness.

Indeed, since the measures have been introduced, mortgage debt to income has been broadly stable. And, in the recent period of high house price growth, there has been little evidence of a deterioration in lending standards, a material increase in aggregate household debt or the number of highly indebted households. The tools have played the role intended.

This latest review looked at whether the structural fall in long-term interest rates, that has continued since the measures were put in place, has reduced the overall level of risk associated with household debt. As outlined in the Report, there is no strong evidence it has reduced the risk. Although interest rates are expected to remain low for longer – which, other things equal, implies a reduction in debt-servicing costs for households – both the causes and consequence of the fall in long-term interest rates imply an offsetting increase in risks. In particular, part of the decline in long-term rates since 2014 reflects weaker growth prospects. And if interest rates remain low for longer, there is less scope for them to fall in response to shocks, making indebted households more vulnerable. The FPC has therefore concluded that the structural decline in interest rates does not, by itself, justify a loosening in the overall calibration of its mortgage market measures.

The FPC's analysis suggests that the measures have relatively little impact on mortgage market access, and that raising a deposit remains the most significant barrier to access, particularly for first-time buyers. In aggregate, there remains a significant degree of headroom below the LTI flow limit.

As part of the review, the FPC also considered whether the framework could deliver similar benefits in a more efficient way. As set out in the Report, the LTI flow limit appears to play a stronger role than the affordability test in guarding against risks when house prices rise rapidly. The FPC judges that, on current evidence, the LTI flow limit, without its affordability test but alongside the FCA's affordability testing, delivers an appropriate level of resilience to the UK financial system, but in a less complex and more proportionate way. A framework without the FPC's affordability test would be simpler and more predictable.

The FPC therefore intends to maintain the LTI flow limit Recommendation, but consult, in the first half of next year, on withdrawing its affordability test.