Bank of England

Financial Stability Report

Financial Policy Committee
July 2025

Bank of England

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Presented to Parliament pursuant to Section 9W(10) of the Bank of England Act 1998 as amended by the Financial Services Act 2012.

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The primary responsibility of the Financial Policy Committee (FPC), a committee of the Bank of England, is to contribute to the Bank of England's financial stability objective. It does this primarily by identifying, monitoring and taking action to remove or reduce systemic risks, with a view to protecting and enhancing the resilience of the UK financial system. Subject to that, it supports the economic policy of His Majesty's Government, including its objectives for growth and employment.

This Financial Stability Report sets out the FPC's view of the outlook for UK financial stability, including its assessment of the resilience of the UK financial system and the main risks to UK financial stability, and the action it is taking to remove or reduce those risks. It also reports on the activities of the Committee over the reporting period and on the extent to which the Committee's previous policy actions have succeeded in meeting the Committee's objectives. The Report meets the requirement set out in legislation for the Committee to prepare and publish a Financial Stability Report twice per calendar year.

In addition, the Committee has a number of duties, under the Bank of England Act 1998. In exercising certain powers under this Act, the Committee is required to set out an explanation of its reasons for deciding to use its powers in the way they are being exercised and why it considers that to be compatible with its duties.

The Financial Policy Committee:

Andrew Bailey, Governor
Sarah Breeden, Deputy Governor responsible for financial stability
Clare Lombardelli, Deputy Governor responsible for monetary policy
Dave Ramsden, Deputy Governor responsible for markets and banking
Sam Woods, Deputy Governor responsible for prudential regulation
Nathanaël Benjamin, Executive Director of financial stability strategy and risk
Nikhil Rathi, Chief Executive of the Financial Conduct Authority
Colette Bowe
Jon Hall
Randall Kroszner
Liz Oakes
Carolyn Wilkins
Gwyneth Nurse attends as the Treasury member in a non-voting capacity.

The sections and annex were finalised on 27 June 2025. This document, unless otherwise stated, uses data available as at 26 June 2025.

PowerPoint™ versions of the Report charts and Excel spreadsheets of the data underlying most of them are available at **www.bankofengland.co.uk/financial-stability-report/2025/july-2025**.

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Contents

Financial Stability Report Summary		**6**
1:	**Developments in financial markets**	**14**
2:	**Global vulnerabilities**	**22**
2.1:	The global risk outlook	22
2.2:	Global public sector debt vulnerabilities	25
2.3:	Global household and corporate debt vulnerabilities	27
3:	**UK household and corporate debt vulnerabilities**	**29**
3.1:	Overview of UK economic developments	29
3.2:	UK household debt vulnerabilities	29
3.3:	UK corporate debt vulnerabilities	33
Box A:	UK mortgage market developments and the FPC's LTI flow limit	38
4:	**In focus – Contributing to sustainable growth**	**44**
4.1:	Financial stability and economic growth	44
4.2:	Actions taken by the FPC to support the financial sector's contribution to sustainable economic growth	48
Box B:	The financing needs of high growth potential SMEs	51
5:	**UK banking sector resilience**	**55**
5.1:	Recent developments in UK banks' resilience	55
5.2:	UK banks' provision of credit to households and businesses	59
5.3:	Interlinkages with non-bank financial institutions	61

6:	**The resilience of market-based finance**	**66**
6.1:	Developments in vulnerabilities in market-based finance	66
6.2:	Improving the resilience of market-based finance	70
Box C:	Use of NBFI leverage in UK core markets	75
Box D:	Improving the FPC's capability to assess systemic risk in financial markets	79
Box E:	Implications of the growth in private markets for financial stability and real economy financing	85
Annex:	**Macroprudential policy decisions**	**91**
Glossary		**95**

Financial Stability Report Summary

The Financial Policy Committee (FPC) seeks to ensure the UK financial system is prepared for, and resilient to, the wide range of risks it could face – so that the system is able to absorb rather than amplify shocks, and serve UK households and businesses, thus supporting stability and growth in the UK economy.

The overall risk environment

Risks and uncertainty associated with geopolitical tensions, global fragmentation of trade and financial markets, and pressures on sovereign debt markets are still elevated. Some geopolitical risks have crystalised. Related to this, material uncertainty around the global macroeconomic outlook persists. As an open economy with a large financial sector, these risks are particularly relevant to UK financial stability.

In early April, US announcements on trade policy and subsequent responses from other jurisdictions were followed by sharp falls in valuations across many financial asset classes, including advanced economy government bonds. The US dollar also weakened.

Conditions in core government bond and repo markets were deteriorating but remained orderly and could have worsened absent the US announcement of a tariff pause. Overall, operational resilience was sustained during a period of high volatility and transaction volumes.

In some markets risk sentiment recovered after the pause in the implementation of higher trade tariffs on 9 April. But 30-year government bond prices and the US dollar remain at or near multi-year lows, and correlations with risky asset prices have shifted from historical norms. Overall, term premia globally have increased materially and remain elevated. Risky asset valuations, which had been stretched prior to April, have subsequently returned to previous levels, despite the high level of uncertainty that persists. Therefore, the risk of sharp falls in risky asset prices, abrupt shifts in asset allocation and a more prolonged breakdown in historical correlations remains high. Any vulnerabilities in market-based finance could amplify such moves, potentially affecting the availability and cost of credit in the UK. It is important that in their risk management market participants are prepared for such shocks.

In the UK, household and corporate borrowers remain resilient in aggregate. The UK banking system remains in a strong position to support households and businesses, even if economic, financial and business conditions became substantially worse than expected.

Developments in financial markets

Against a backdrop of fiscal pressures globally, news on trade tariffs have been the primary driver of moves in financial markets since the November FSR. Following the US announcement of plans to implement significantly higher tariffs on 2 April, market measures of uncertainty increased markedly and the value of risky assets fell sharply. Government bond prices also subsequently fell. Increases in US Treasury yields spilled over to government bond yields in the UK, Japan and a number of other advanced economies. Increases in yields were most pronounced for longer-dated bonds, driven by an increase in term premia, which remain higher than at the time of the November FSR, despite declining somewhat since April.

Having weakened somewhat before 2 April, the US dollar depreciated further during the stress and has continued to depreciate since. The rise in US Treasury yields and depreciation of the dollar were notable because during previous periods of market stress, US Treasury yields have tended to fall, and the US dollar has tended to strengthen.

Market participants should consider the implications of further shifts in these historical corelations when managing risk. The recent episode highlights that the interconnectedness of global financial markets can mean stress from one market can move quickly to others. In this environment, significant changes in foreign investor currency hedging may also create extra pressure on funding markets.

Functioning of core government bond and repo markets remained orderly during the period of stress, and there was no net selling of gilts. But conditions might have become more strained had the episode of volatility lasted longer. Only after the US announced a 90-day pause in tariff implementation on 9 April did risk sentiment improve and volatility fall.

Risks to the global outlook remain high, not least as there is uncertainty over the future path of policy when the pause ends. Despite this, risky asset prices have rebounded to historically stretched levels across several asset classes since early April. The FPC therefore continues to judge that risky asset values are vulnerable to a sharp correction, and that this could interact with vulnerabilities in the system of market-based finance, adversely affecting the cost and availability of finance for households and businesses.

For further details see **Section 1** of the FSR.

Global vulnerabilities

Risks to global growth and inflation are higher than they were in November 2024. The US continues to negotiate with many jurisdictions on trade tariffs, although it has agreed to implement a trade deal with the UK. Conflict in the Middle East creates greater risks to energy prices, particularly if the supply of oil and gas were to be disrupted.

The prospect of weaker growth and more uncertainty over interest rates adds to risks, including those associated with sovereign debt pressures globally. These factors impact many types of borrowers but could particularly affect corporates that are highly leveraged. The potential for much higher trade tariffs increases the likelihood of corporate default in the most exposed sectors, and losses for their lenders.

Higher geopolitical tensions have been associated with an increase in the incidence of cyber attacks globally, which could coincide with, and amplify, other stresses. The 2024 Cyber Stress Test assessed participant firms' ability to deliver wholesale payments and settlement services in a severe but plausible data integrity cyber scenario. Recognising that managing cyber-risk is a global challenge, the FPC encourages continued focus from industry, government and the international regulatory community on sharing information and best practices, and on building national and cross-border resilience to these threats.

Alongside the increase in global risks, the appropriateness of financial regulation is being debated actively across a number of jurisdictions. Robust regulatory standards and international co-operation support sustainable economic growth over the long term.

See **Section 2** of the FSR for further details.

UK household and corporate debt vulnerabilities

The outlook for UK growth over the coming year is a little weaker and more uncertain than it was at the time of the November FSR. But the outlook for UK household and corporate resilience remains strong in aggregate, and it would take significant macroeconomic shocks for aggregate debt servicing measures to deteriorate materially.

Although the proportion of high loan to income (LTI) and loan to value mortgage lending has been increasing over recent quarters, and the aggregate household debt-servicing ratio (DSR) is expected to rise modestly in the medium term, the proportion of borrowers with high DSRs is expected to remain low.

Some highly leveraged corporate borrowers relying on market-based finance are particularly exposed to global shocks. But the volume of market-based corporate debt that needs to be refinanced over the coming year has remained low since the November FSR at around 10%. There is less information on the refinancing needs of corporates who borrow in private markets.

For further details see **Section 3** of the FSR.

The FPC's mortgage loan to income flow limit

The FPC discussed the current operation of its LTI flow limit, building on its deliberations in Q1. This included whether there were any impediments to using the LTI flow limit more fully for those lenders that wished to, consistent with lenders' own risk limits and business models. The Committee recommended the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) to amend implementation of its LTI flow limit to allow individual lenders to increase their share of lending at high LTIs while aiming to ensure the aggregate flow remained consistent with the limit of 15%. The share of lending at an LTI ratio of greater than or equal to 4.5 rose to 9.7% in 2025 Q1. This was projected to rise further over the year, in part due to the use of lower stress rates in borrower affordability tests following the **FCA's March statement on its mortgage rules**, but also as a natural consequence of the economic cycle.

For further details see **Box A** in the FSR.

UK banking sector resilience and credit conditions

The UK banking system is well capitalised, maintains robust liquidity and funding positions, and asset quality remains strong. Profitability has also been such that banks have been able to earn their cost of capital and in aggregate now have price to book ratios above 1.

The FPC continues to judge that the UK banking system has the capacity to support households and businesses even if economic, financial and business conditions were to be substantially worse than expected. Aggregate lending has increased since the November FSR, driven by rising mortgage volumes, strong underlying demand from households and a further easing in availability. Corporate credit conditions are broadly unchanged, though corporate demand for credit appears to have weakened slightly.

UK banks provide services and financing that support the functioning of market-based finance, while at the same time non-banks are a source of funding for banks. Banks' exposures to non-bank financial institutions (NBFIs), including to leveraged counterparties such as hedge funds, have grown to over 20% of total assets in recent years. This highlights the importance of appropriate risk management by banks active in these markets, including in respect of counterparty risk and risks around opaque and contingent leverage. The PRA and FCA previously set out their expectations on required risk management enhancements related to prime brokerage, and will continue to monitor this source of risk to banks and to the financial system more widely.

The UK banking system remains well capitalised and has high levels of liquidity, and these positions are broadly unchanged since the November FSR. Considered over a longer time horizon, capital levels in aggregate had been broadly stable since the completion of the phase-in of the post-global financial crisis (GFC) bank capital framework in 2019. While the

FPC judges the level of capital in the banking system to be broadly appropriate, it has been five years since the Committee's last assessment of the overall level of capital requirements. Therefore it will refresh that assessment and provide an update on this work in the next Financial Stability Report.

For further details see **Section 5** of the FSR.

The UK countercyclical capital buffer rate decision

The FPC is maintaining the UK countercyclical capital buffer (CCyB) rate at its neutral setting of 2% based on its assessment of the evolution of domestic economic and financial conditions, and underlying vulnerabilities. The indicators most directly relevant to the risk of banks' UK exposures, to which the UK CCyB rate is applied, such as domestic credit growth and indicators of debt vulnerabilities, were not materially above long-term averages. Although credit conditions in some areas such as mortgages had eased, the Committee judged that they had not significantly added to vulnerabilities that might amplify shocks. The Committee will continue to monitor the evolution of financial conditions closely to ensure the setting of the UK CCyB rate remained appropriate.

The Committee noted that the global risk environment had deteriorated in recent quarters and that vulnerabilities in market-based finance, in particular in core markets, remained. These could spill over to domestic economic and financial conditions via a number of channels, and thereby affect banks' UK exposures to which the CCyB relates. The Bank's stress tests capture these channels. In addition, the FPC is addressing market-based vulnerabilities directly in a range of ways, including by exploring ways to enhance gilt repo market resilience, supporting the Bank in building its toolkit to support the functioning of the repo market in system-wide stress via the contingent NBFI repo facility, and supporting international work to address NBFI leverage (further details can be found below).

The resilience of market-based finance

While UK markets functioned well through the heightened period of volatility in April, this was to some extent a function of the relatively short-lived nature of the market disruption. Vulnerabilities – though not unique to UK core markets – persist, in particular those linked to excessive leverage. These could, under prolonged stress, disrupt market functioning and contribute to broader financial instability.

A wide range of leveraged trading strategies are present in core sterling markets and the number of prime brokers with capacity to support them is limited. While leverage capacity supports the depth of markets in good times, it can increase the risk of a disorderly unwind of positions and a sudden jump to illiquidity. This is particularly the case when leverage is combined with other macrofinancial vulnerabilities such as market concentration, crowded

positions and opacity. Although the nature and scale of risks will vary across strategies, all can be vulnerable to sudden shifts in market sentiment, financing conditions or market correlations. If leveraged market participants with concentrated positions within markets or high interconnectedness across markets hit limits and start to deleverage, this can deepen or broaden an initial shock.

Ensuring the resilience of core markets requires continued monitoring of leverage, data gaps and interconnections – both domestically and across borders. Data published in the FSR are intended to help market participants understand their positions relative to the aggregate to help inform their management of risk. Looking ahead, the FPC intends to expand the data it publishes in this area. For further details see **Box C** in the FSR.

To help improve resilience in gilt repo markets the Bank plans to engage with industry through an upcoming discussion paper, which will seek views on potential options to help mitigate gilt repo market vulnerabilities, including greater central clearing of gilt repo and minimum haircuts on non-centrally cleared gilt repo. The FPC also supports international work, including the implementation of the Financial Stability Board's policy recommendations on NBFI leverage.

For further details see **Section 6** in the FSR.

Contributing to sustainable growth

Maintaining financial stability is the foundation for sustainable growth. Periods of financial instability – such as the GFC – can negatively impact the provision of vital services, weighing on growth. The financial sector makes an important contribution to sustainable economic growth by providing vital services to households and businesses. The FPC is undertaking work in response to the Chancellor's commission in the November 2024 remit letter to identify areas where the financial sector could contribute more to sustainable growth without compromising financial stability.

The Committee is focused on actions which could support the provision of vital services to the real economy by the financial services sector and thereby support activity in the real economy, promoting welfare. The Bank can support the sector's ability to contribute to growth through four main policy levers:

1. **Regulatory efficiency** – such as some of those set out by the **PRA in its June 2025 Secondary Competitiveness and Growth Objective publication**.
2. **Safe innovation** – such as helping the financial system to manage the risks and opportunities posed the by the adoption of innovative technologies like Distributed Ledger Technology (DLT) and the use of artificial intelligence (AI) in the financial system (see the

FPC's **Financial Stability in Focus on AI in the financial system**). In part, the Bank, along with the FCA have done this through their **Digital Securities Sandbox**.

3. **Responsible openness** – including supporting the competitiveness of the UK financial sector, allowing UK firms to compete on a level playing field both domestically and internationally, ensuring the UK is an attractive location for financial services.
4. **Productive finance** – identifying and removing barriers to the efficient allocation of capital to productive investment that increases the capacity of the economy.

The FPC has already taken some steps including to support households (**Box A**) and is assessing the barriers to financing for small and medium-sized enterprises, focusing on firms seeking to scale up (**Box B**). See **Section 4** of the FSR for more details.

Implications of the growth in private markets

The role and size of private equity and private credit has grown significantly over the past 15 years, including in the UK. These markets provide long-term capital that helps businesses scale, innovate, and invest in productivity-enhancing initiatives – and as such they have the potential to support long-term growth in the UK economy. However, the widespread use of leverage across the private finance ecosystem of funds, their portfolio companies, and interactions with banks makes it particularly exposed to macroeconomic uncertainty and tighter financing conditions. And the private market ecosystem remains largely untested in an environment of sustained higher interest rates and weaker growth.

Macroeconomic uncertainty has constrained exit opportunities for investors in private equity-backed corporates. For example, the initial public offering market is currently subdued, as it has been over recent years. In response, some private market funds are employing alternative strategies to provide returns to investors, such as net asset value financing.

As previously set out by the FPC, key vulnerabilities associated with private markets arise from high leverage, opacity and potential conflicts of interest around valuations, and strong interconnections with riskier credit markets such as leveraged loans all of which could amplify economic and financial shocks. The current risk environment increases the risk that those vulnerabilities could crystalise. In addition, differences in insurance regimes between jurisdictions have encouraged the growth in funded reinsurance arrangements between insurers and reinsurers. These arrangements are often complex, opaque, and increase interconnections in the financial system which has the potential to pose systemic risk if unaddressed. Further work is needed to understand how private markets would operate following a shock and the system-wide implications for financial stability and real economy financing. As part of this effort, the Bank intends to undertake structured engagement with

private market participants and key providers of capital to the sector, to explore those channels in collaboration with the industry, as well as continuing with its market intelligence gathering.

For further details see **Box E** in the FSR.

Developments in stablecoin

Since the November FSR, there have been significant global developments in the stablecoin industry. In Q2, the FPC discussed feedback from the FCA and Bank of England's stablecoin discussion paper. There are financial stability benefits of having a regulatory framework that is proportionate to risks, allows for some degree of alignment with other jurisdictions and supports firms setting up in the UK. The FPC supports exploring options for allowing some return on backing assets for stablecoins widely used as money, while continuing to ensure that the regime supported its expectation that such coins be exchangeable into other forms of money at par and at all times. These are global markets, and given that, it is important for the international regulatory community to consider how best to manage the financial stability risks associated with global stablecoins.

For more details see the **2025 Q2 FPC Record**.

The 2024 Cyber Stress Test (CST24)

Cyber and operational resilience stress testing remains a core part of the FPC's toolkit for understanding firms' ability to respond and recover from severe but plausible operational disruption. The FPC welcomes the findings published in the CST24 thematic letter of 9 July, which aims to assist firms in understanding how operational disruption of their services could lead, through financial, operational and confidence channels, to broader potential financial stability impacts. The FPC judges that this important in assisting all firms to improve their understanding and analysis of such financial stability impacts, consistent with expectations for firms' management of their operational resilience.

For more details see the 2025 Q2 FPC Record.

1: Developments in financial markets

Since the November FSR, financial markets have reacted to significant developments in geopolitics, global trade policy, and sovereign debt pressures. These developments caused a deterioration in the risk environment, an intensification of uncertainty, and a weakening of the global outlook (Section 2), which led to significant market volatility in April.

At the start of April, the US announced substantial and broad-based increases in tariffs, to which some jurisdictions responded with changes to their own trade policies. Market measures of uncertainty increased rapidly (Chart 1.1). The value of risky assets fell sharply, particularly in the US.

Conditions in core government bond and repo markets were beginning to deteriorate in early April but remained orderly and could have worsened absent the US announcement of a tariff pause. Overall, operational resilience was sustained during a period of high volatility and transaction volumes.

Unlike in previous periods of market stress where US Treasury yields have typically decreased, reflecting their safe-haven status, long-term US government bond yields rose sharply, after initially falling, accompanied by a notable weakening in the US dollar. Increases in US Treasury yields also spilled over to yields in the UK, Japan, and several other advanced economies. By contrast German bund yields fell, with market contacts suggesting this was primarily due to a rise in demand for alternative safe-haven assets amid the heightened uncertainty.

In some markets, risk sentiment recovered after the pause in the implementation of higher trade tariffs on 9 April, and market-implied uncertainty measures have returned to levels observed earlier this year. But US 30-year government bond prices and the US dollar remain at or near multi-year lows. Correlations, including those with US risky asset prices, have shifted from historical norms.

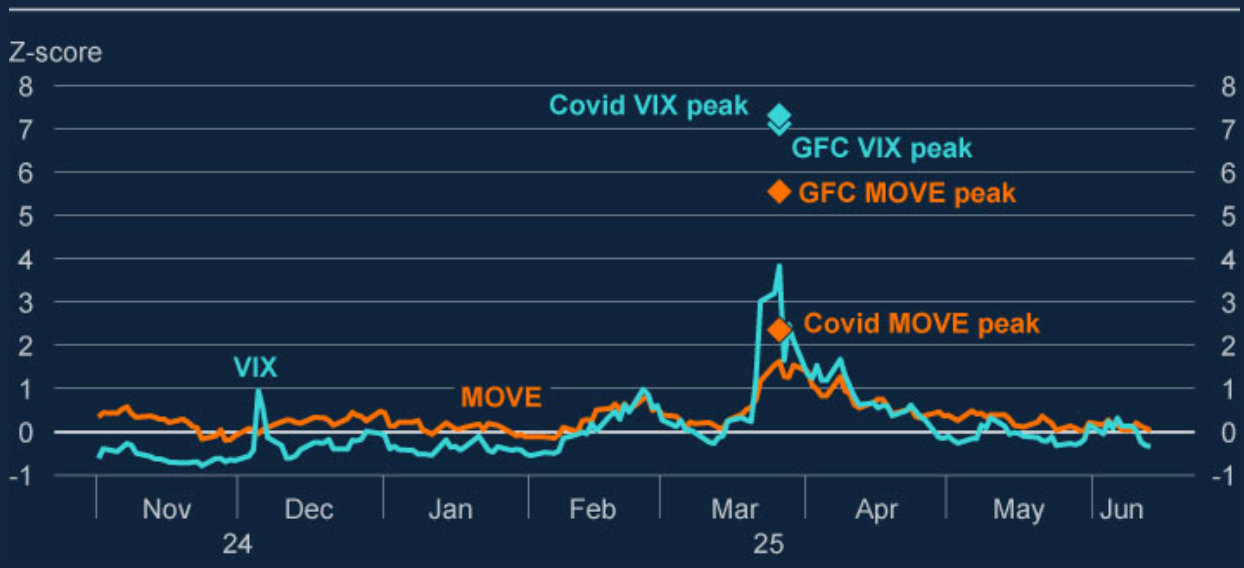
While financial stability risks did not crystallise, conditions would likely have become worse had the volatility continued for longer. The FPC judges that uncertainty around the global risk outlook remains materially elevated compared to the time of the November FSR.

The escalation of conflict in the Middle East did not significantly impact risk sentiment in the oil and gas markets, and having spiked in June, oil and gas prices have since retraced. That said, European natural gas storage levels are lower than usual for the time of year, which

raises the probability of price volatility and sharp increases in margin calls for commodity market participants in the event of further such shocks. The FPC is monitoring developments closely.

Chart 1.1: Market uncertainty spiked in April before declining towards recent averages

Daily Z-scores (number of standard deviations from the mean) of the MOVE and VIX indices (a) (b) (c)



Sources: Bloomberg Finance L.P., Cboe Global Indices, ICE BofAML and Bank calculations.

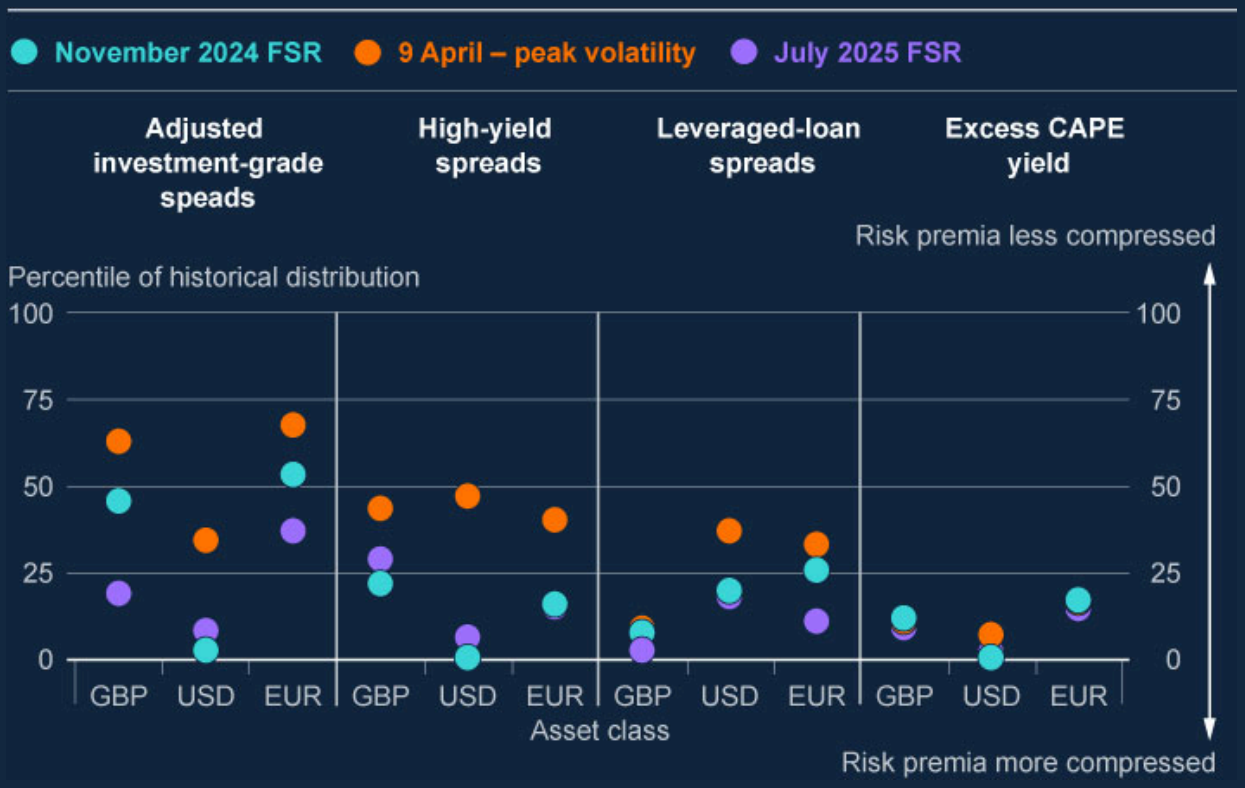
(a) The Merrill Lynch Option Volatility Estimate for interest rates (MOVE Index) is a yield curve weighted index of the normalised implied volatility on one-month US Treasury options of several different tenors.
(b) The Cboe Volatility Index (VIX Index) is an index that measures US equity market volatility, derived from the prices of S&P 500 index options with expirations within the next 30 days.
(c) Mean and standard deviation calculated using data from 2002 to 2024.

Having risen significantly in early April, risk premia across a range of risky asset classes are again compressed relative to their historical distributions.

Risky asset prices across advanced economy corporate bonds and equities fell as risk premia increased through the April volatility – led by the US. The S&P 500 Index fell by 12% between 2 and 8 April, having already fallen by 5% since the November FSR, largely in anticipation of tariff news. Meanwhile, UK and euro-area equity indices fell by less. Since then, risky asset valuations have risen across the board (Chart 1.2). The broad-based tightening in risk premia since 9 April may in part reflect a perception among market participants that the largest trade-related downside risks had been removed following the US announcement of its 90-day tariff pause. However, eventual outcomes on trade policy remain unpredictable.

Chart 1.2: Valuations for a range of risky assets are back near historically stretched levels

Current level of selected risk premia as a percentile of their historical distribution (a), compared to levels at the 2024 Q4 FPC policy meeting



Sources: Bloomberg Finance L.P., Datastream from LSEG, ICE BofAML, PitchBook Data, Inc. and Bank calculations.

(a) Risk premia data are a percentile of a three-day rolling average (except for leveraged-loan (LL) spreads, which are a percentile of a monthly average). Percentiles are calculated from 1998 for investment-grade spreads and high-yield bond spreads, from 2008 for LL spreads and from 2006 for excess cyclically adjusted price-to-earnings (CAPE) yields. Data updated to 26 June 2025 apart from LL which is to 20 June 2025. Investment-grade spreads are adjusted for changes in credit quality and duration. All data are daily except for LL spreads which are weekly.

Following increases since early April, equity valuations again appear stretched in a historical context, at levels similar to those seen at the time of the November 2024 FSR.

Despite the uncertain macroeconomic and financial backdrop, spreads on leveraged loans and corporate bonds in the UK and EU have become more compressed relative to November overall. Several credit spread measures across the UK, Europe, and the US are in the bottom quartile of their historical distributions. Contacts report that in part, this is due to investor perception of generally resilient corporate balance sheets and continued low default rates, but

as discussed in Section 3, pockets of risk remain in the corporate sector. Consistent with this positive investor sentiment, issuance across the credit spectrum has remained robust since the November FSR, with only a limited decline in activity observed through the April volatility.

Given material uncertainty around the macroeconomic outlook, risky asset prices remain vulnerable to a sharp correction, and should it materialise, this could interact with vulnerabilities in the system of market-based finance, adversely affecting the cost and availability of finance for households and businesses (Section 6).

According to market contacts investor appetite for US dollar assets, which had been strong, has reduced somewhat since the November FSR.

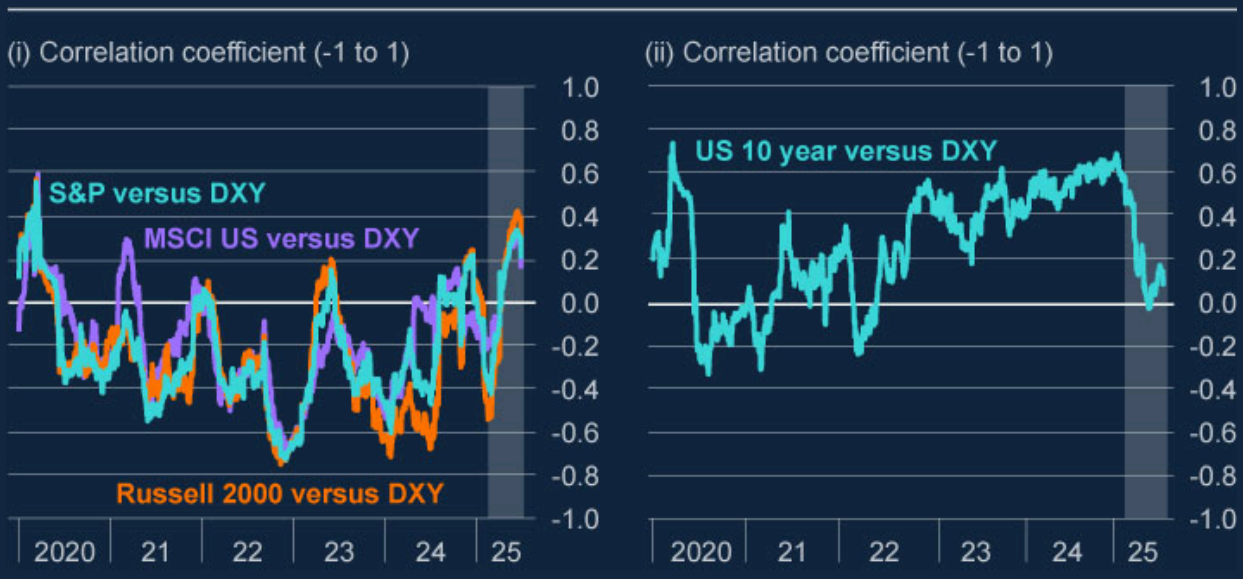
While dollar-denominated US risky asset valuations have mostly recovered since early April, the value of the US dollar remains weaker. At the time of the FPC's June policy meeting, the US dollar exchange rate index was 5% below its early April level and 8% down since the November FSR, at close to a three-year low.

Since late February 2025, there has been a notable change in the usual correlation patterns between the dollar and other US assets, including equities and government bond yields. Historically, when risky asset prices are falling during times of global stress, or when US Treasury yields are rising, the dollar has tended to strengthen. This means non-US investors have often left some of their equity positions unhedged on a currency basis because they expect the dollar to provide portfolio diversification benefits by rising if stocks fall, or if US Treasury yields rise.

But in recent months, these correlations appear to have shifted (Chart 1.3) – increasing the riskiness of unhedged US dollar assets for foreign investors. The trend first emerged in February when weaker macroeconomic data prompted concerns among market participants that activity in the US economy was slowing down at a faster rate than expected. US equities began to decline, and long positions in US dollar futures fell, albeit while remaining at historically stretched levels according to Commodity Futures Trading Commission (CFTC) data. These moves were further accelerated by a deterioration in sentiment toward US assets following the initial US tariff announcement on 2 April.

Chart 1.3: Typical US asset correlations with the dollar have shifted since February

60-day rolling correlation of (i) selected US equity indices, and (ii) the 10-year US Treasury yield, against the US Dollar index (DXY), the value of the dollar against selected G10 peers



Sources: Bloomberg Finance L.P., and Bank calculations.

Market contacts report that foreign investors have been increasing their hedging of currency exposures on US assets in recent weeks by selling dollars and buying home currency to guard against further dollar weakness. This shift in hedging behaviour may contribute to downward pressure on the dollar on a continuing basis. The historic under-hedging and slow-moving nature of some of these investors suggests this could be a gradual process. Market contacts report increased positioning among hedge funds anticipating future dollar weakening due to the expectation that these hedging flows will continue.

> **Market participants should consider the implications of further shifts in these historical corelations when managing risk.**

The recent episode highlights that typical relationships across global financial markets can break down in periods of high volatility and during significant economic shifts. This matters for risk management practices, for example, where participants use portfolio margining based on historical correlations to reflect diversification benefits across different products (Breeden, 2025).[1] The recent episode also highlights how stress from one market can spread quickly to others. In this environment, significant changes in foreign investor currency hedging may also create extra pressure on funding markets, as foreign investors who hedge their US dollar exposure will be left with a short US dollar cash position that they need to roll.

Long-term US government bond yields remain significantly higher than they were at the time of the November FSR.

Having initially seen yields decline across the curve due to growth concerns in early April, long-term US Treasury yields began to rise sharply on 7 April. The intraday moves in the US 30-year yield were the largest since 2020. Other global long-term government bond yields, including UK gilt yields, also moved sharply higher.

According to staff model-based decompositions, the increase in global yields was mainly driven by term premia. This implies investors required even greater compensation to own long-term bonds compared to short-term bonds. While risk premia on equities and corporate bonds have compressed since April, term premia on advanced economy government bonds remain higher. Market contacts cite a range of factors driving these increases in global term premia, including changing supply and demand dynamics in longer-dated government bonds. Weaker than expected demand in government bond auctions in some advanced economies triggered notable increases in yields. Fiscal dynamics are also in focus, including the US federal spending bill – given the potential for debt supply to increase further.

This has left the 30-year US Treasury yield around 20 basis points higher relative to the November FSR, with most of the rise taking place since April. Yields on 30-year UK and European government bonds are also higher than at the time of the November FSR.

Benchmark 10-year yields also rose across some jurisdictions, but by less than 30-year yields, and in the UK and US have since fallen back to levels around or below those observed in November. Meanwhile, short-term market interest rates in the UK and US are lower relative to November, meaning that yield curves in both jurisdictions are steeper than at the time of the November FSR.

Despite some reduction in liquidity through April, core US and UK market functioning remained orderly. Funding stability helped prevent broader deleveraging.

US Treasury repo rates were stable through April, although they had begun to rise slightly in the days immediately before the announced 90-day pause in US tariff implementation. The gilt repo market also continued to function, with repo rates remaining in line with recent averages (Chart 1.4). In both cases, funding stability helped reduce the pressure on leveraged positions in government bond markets including basis trades, thus mitigating the risk of deleveraging and fire-sales, and supporting the liquidity of cash bond markets more broadly (Section 6). Had the deterioration lasted longer, market contacts suggest conditions would have become more strained.

Chart 1.4: Gilt repo rates traded within recent ranges, supporting the functioning of the cash gilt market

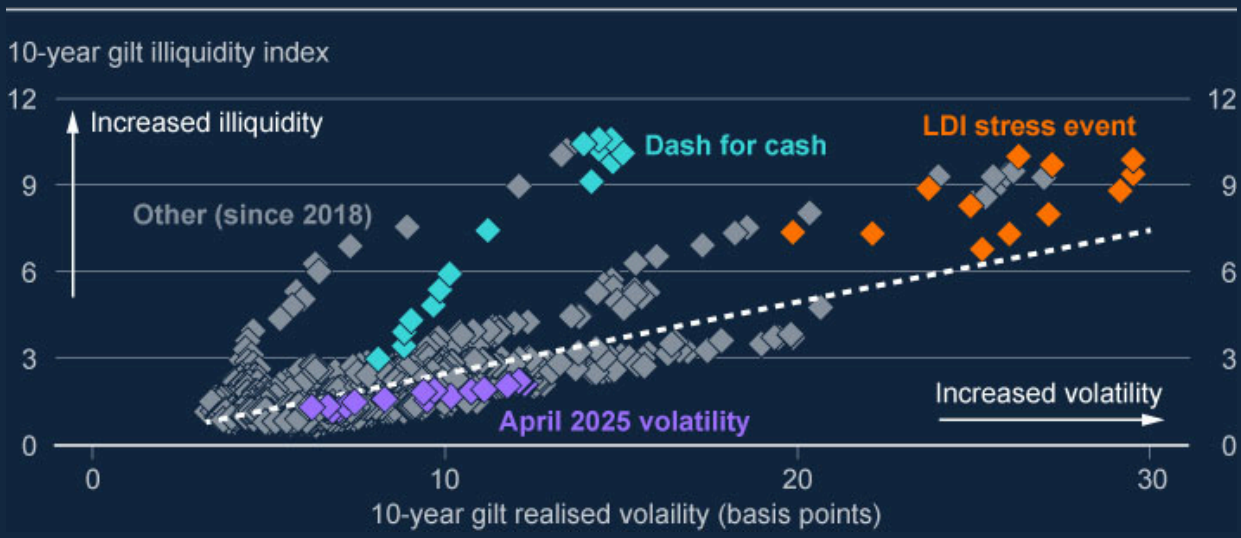
Weighted average overnight centrally cleared general collateral (GC) repo spread to Bank Rate

Sources: Sterling Money Market Data (SMMD), and Bank calculations.

Overall, gilt market functioning has remained orderly since the November FSR, despite displaying some signs of deterioration through early April (Section 6). The level of volatility during that period, while significant, was much lower than in the LDI stress event in 2022 and the Dash for Cash in March 2020 (Chart 1.5). The purple dots, representing the period between 2 April 2025 and present, show the deterioration in liquidity for the benchmark 10-year gilt yield was broadly in proportion to the increased level of market volatility. In common with this episode, gilt market functioning also remained orderly through a short-lived period of gilt market volatility in early January, during which the 10-year gilt yield rose by 21 basis points over seven days before retracing.

Chart 1.5: Gilt market liquidity declined only moderately as volatility in gilt yields rose in early April

10-year gilt illiquidity index (a) relative to 10-year gilt realised volatility (10-day rolling measure)



Sources: Bloomberg Finance L.P., FCA MiFID II, and Bank calculations.

(a) The 10-year gilt illiquidity index is constructed using the first principal component of five liquidity measures, including some based on transaction data. The five measures included are: price impact (Amihud); trading cost estimate (Roll); price dispersion; bid-offer; and yield curve noise. Data is updated to 20 June 2025.

Corporate bond market functioning, which is underpinned by government bond market functioning, was also orderly in April, with bid-ask spreads and trading volumes returning to normal ranges having risen earlier in the month.

Despite the orderly way in which core markets continued to function in April, vulnerabilities in market-based finance remain, and given the risk environment further market volatility is possible. This underlines the importance of continuing work to increase core market resilience (Section 6).

2: Global vulnerabilities

2.1: The global risk outlook

> **Global risks remain elevated. Risks linked to heightened geopolitical tensions, including those related to trade, having intensified.**

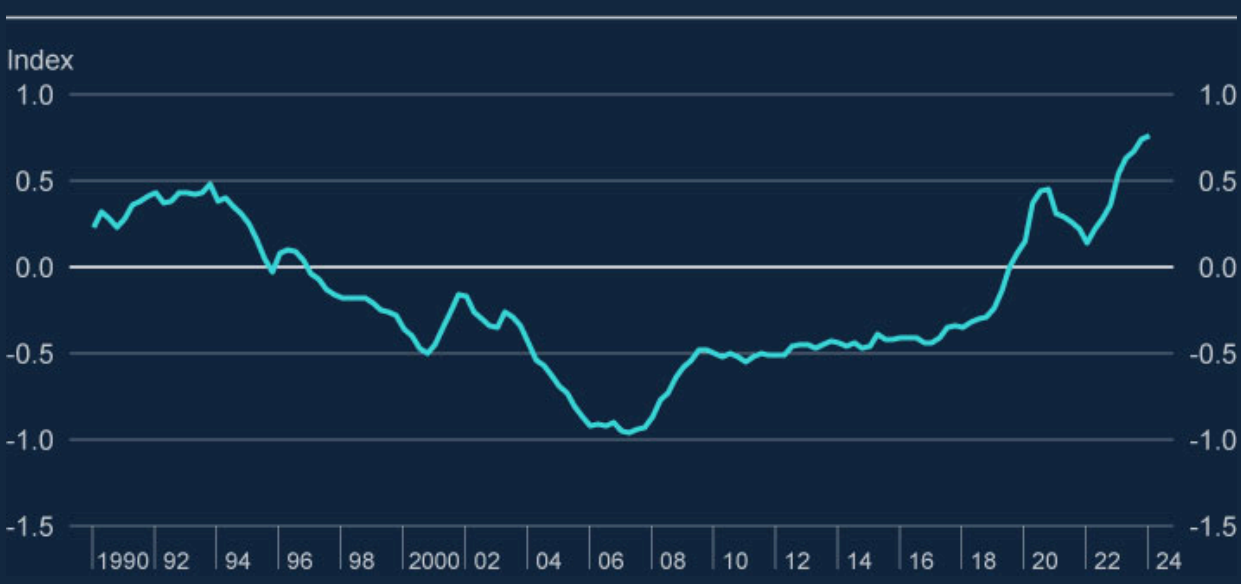
In June, tensions between Israel and Iran escalated into military conflict, and the United States also became involved. In response, oil and gas prices rose, before subsequently falling back. The risk of further escalation remains, with energy prices being particularly sensitive to disruption in the Strait of Hormuz.

Further conflict in the Middle East, Russia's continued war in Ukraine, US-China relations and trade-related tensions globally all continue to represent sources of material geopolitical risk. Respondents to the Bank's Systemic Risk Survey, covering a range of banks and non-bank financial institutions, have continued to cite geopolitical risk as the top systemic threat to the UK financial system.[2]

Geopolitical tensions and other aspects of global fragmentation, such as a reduction in trade and policy cooperation, can interact with – and reinforce – each other. As highlighted by the International Monetary Fund (IMF),[3] indicators of global fragmentation have risen consistently over recent years, with one composite measure at its highest level in several decades (Chart 2.1).

Chart 2.1: Global fragmentation has increased over recent years

Fragmentation index (a) (b)



Source: International Monetary Fund.

(a) Geoeconomic fragmentation index of Fernandez-Villaverde, Mineymama and Song (2024), a composite measure including indicators of geopolitical risk, financial flows and trade openness.
(b) Use of IMF Content and Data is subject to the IMF's **terms** of Copyright and Usage.

In the context of heightened trade policy tension, there is a high degree of uncertainty around the global economic outlook.

Since the November FSR, the US announced increased tariffs, and in response some other jurisdictions announced changes to their own trade policies. Negotiations between the US and China led to a partial reversal of tariff increases in May, with further agreement subsequently reached, and a trade deal has been agreed between the US and the UK. There remains, however, considerable unpredictability about the near-term evolution of global trade policies with negotiations continuing between the US and a number of its trading partners.

These developments are expected to weigh on world growth, driven both by the direct impact of higher tariff barriers and by the dampening effect of trade policy uncertainty on firms' investment decisions. There is a high degree of economic uncertainty around the outlook, and there are downside risks to global growth in the near term, for example in the event of significant global supply chain disruption or further escalation of conflict in the Middle East leading to higher energy prices. These factors also contribute to uncertainty around the future path of inflation. Since the November FSR, several advanced economy central banks have continued to reduce policy rates, and market-implied paths are consistent with further

reductions in central bank policy rates in the coming quarters. This, combined with an increase in term premia, has led to a steepening of advanced economy yield curves (Section 1).

Poorer global macroeconomic performance can affect financial stability by worsening existing global debt vulnerabilities (discussed below), which could increase the potential impact of any further shocks.

Further global shocks could impact financial stability in a number of ways, including via capital outflows and reallocations by non-resident investors…

Geopolitical events can lead to sharp reactions in market pricing, and general uncertainty around the global outlook for growth and inflation can also contribute to more volatile financial markets. Such volatility can interact with vulnerabilities in market-based finance (Section 6).

The sharp market reaction to the 2 April US tariff announcements included a depreciation of the US dollar in conjunction with a fall in the price of US dollar assets such as long-dated Treasury bonds that are commonly perceived as safe havens. This represented a notable break in historical patterns (Section 1). The US dollar (and US dollar-denominated assets) have a unique position in global finance. For example, the US dollar accounts for one side of around 90% of foreign exchange (FX) swaps, with demand for this form of US dollar borrowing in part driven by corporates that operate cross-border and transact in US dollars.[4] Shocks that affect the central role of the US dollar in global finance and trade – or shocks that affect the functioning of short-term US dollar funding markets, including the FX swap market – could have impacts on financial stability globally.

In addition, banks globally can be impacted by sharp market moves, for example as a result of changes in the value of their assets, losses on structural FX exposures, or margin calls on FX swaps. Stresses in overseas banks could affect the UK financial system through macroeconomic spillovers and contagion to funding conditions for UK banks. In the recent market turbulence this potential source of stress did not materialise but more prolonged or extreme bouts of volatility – especially if combined with a shift in historical correlations – could prove more challenging for banks globally to manage. Material adverse impacts on internationally active banks' balance sheets could lead them to pull back from certain markets or types of exposures, potentially amplifying shocks.

…and elevated geopolitical tensions have been associated with an increase in cyberattacks globally. Cyberattacks can coincide with, and amplify, other stresses.

The 2024 Cyber Stress Test assessed participant firms' ability to deliver wholesale payment and settlement services in a severe but plausible data integrity cyber scenario. The **findings** will support firms' understanding of their role in monitoring and managing systemic risk and in

mitigating the financial stability impacts of disruption. Recognising that managing cyber-risk is a global challenge, the FPC encourages continued industry, government and international regulatory community focus on building national and cross-border resilience to these threats.

Meanwhile, any decrease in global regulatory cooperation could reduce the resilience of the global financial system.

The appropriateness of financial regulation is being debated actively across a number of jurisdictions. Robust regulatory standards and international co-operation are needed to limit regulatory arbitrage, improve transparency, and prevent and respond to shocks in order to support sustainable economic growth over the long term. The FPC actively considers the role of regulation in promoting the openness and safety of the UK financial system, in the context of supporting sustainable growth (Section 4).

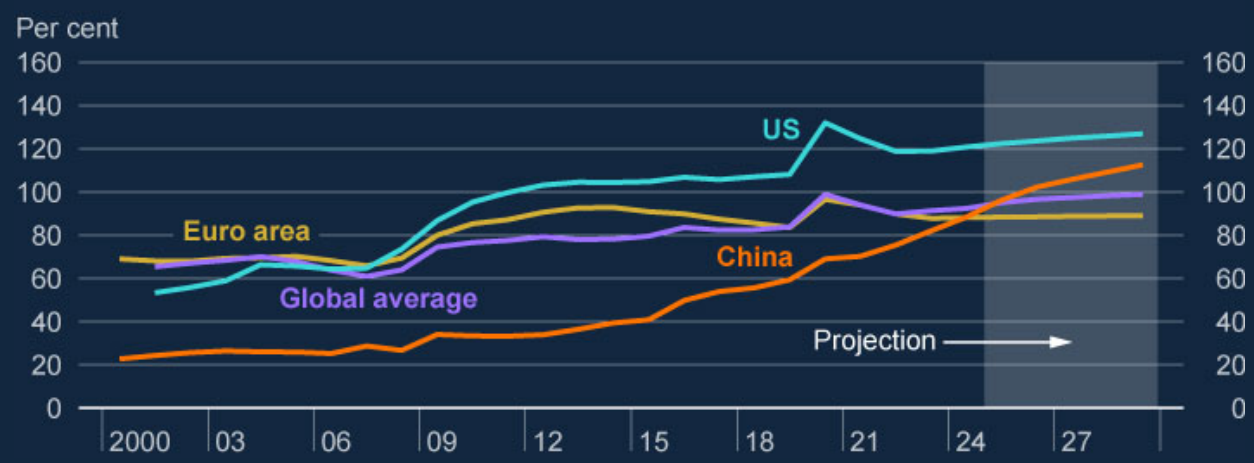
2.2: Global public sector debt vulnerabilities

Public debt-to-GDP ratios are rising globally.

There has been a long-term upward trajectory in public debt-to-GDP ratios across major economies in recent decades and significant further increases are expected in the coming years (Chart 2.2).

Chart 2.2: Average global government debt-to-GDP is expected to continue to rise

Sovereign debt (percentage of GDP) (a)



Sources: International Monetary Fund and Workspace from LSEG.

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Projected increases are in part attributable to the current higher level of growth-adjusted interest rates (that is, the difference between nominal interest rates on government debt and expected GDP growth rates). Downside risks to the economic outlook, for example as a result of trade tensions, could exacerbate this pressure by lowering growth, as could higher market interest rates linked to higher term premia or expectations for higher inflation, for example driven by higher global input costs.

Governments globally are also subject to various spending pressures, including in respect of defence, demographics and climate change. Various recent fiscal policy developments in major jurisdictions illustrate the pressures on governments globally (Table 2.A).

Table 2.A: Recent fiscal policy developments in selected major economies

Jurisdiction	Recent fiscal policy developments
China	In March, Chinese authorities approved a central government fiscal deficit target of around 4% of GDP in 2025, up from 3% in 2024. In addition, special purpose bond issuance quotas equivalent to around 4.4% of GDP were announced for 2025, up from around 3.6% of GDP for 2024.
Euro area	Several euro-area countries plan to boost defence spending, with a likely impact on fiscal deficits. In March, the German Parliament approved an exemption from the 'debt brake' for defence spending above 1% of GDP with France targeting defence spending of 3.5% of GDP, up from around 2% currently. Then in June, NATO states, which include many euro area states, announced a defence spending commitment of 5% of GDP by 2035.
USA	A major fiscal bill has been passed by Congress. The Congressional Budget Office estimated that the version of the bill passed by the House of Representatives on 22 May could add US$2.4 trillion to primary deficits over the next 10 years, equating to around 0.7% of GDP on average per year. The US sovereign credit rating was downgraded by Moody's in May, following a similar move by Fitch in 2023.

As explored in more detail in the November FSR, there are a number of risk channels through which pressures on sovereign debt globally could affect financial stability, including in the UK via cross-border spillovers. These channels include higher interest rates leading to tighter global financial conditions; increased market volatility interacting with vulnerabilities in market-based finance; the reduced ability of governments to respond to future shocks; and the potential for capital outflows from non-resident investors.

It is important that banks and other financial firms factor these risks into their internal risk management and stress testing. The FPC will continue to monitor risks arising from sovereign debt globally, taking into account the potential for them to interact with other financial

vulnerabilities and amplify shocks. Analytical tools, such as system-wide stress testing, can help market participants and authorities globally better understand the channels through which shocks to government bond prices can spill over.

2.3: Global household and corporate debt vulnerabilities

Globally, household and corporate balance sheets remain healthy in aggregate but face headwinds in the context of an uncertain economic outlook.

Shifts in trade policies pose specific challenges for exposed corporate sectors in affected jurisdictions, including through lower earnings and higher production costs (Section 3). In addition, many businesses globally will still need to refinance maturing fixed-term debt at higher interest rates over the coming years. Higher debt-servicing burdens can put pressure on corporate balance sheets, especially for smaller, highly leveraged, capital intensive or less profitable firms. Corporate bankruptcies in major advanced economies have continued to rise, although they remain below pre-Covid levels in the United States.

In the euro area, the steel and automotive industries are particularly export-oriented and therefore tariff-sensitive, and automotive receives a large share of bank lending. The European Central Bank has highlighted how adverse trade developments could impact euro-area banks, including via a deterioration of asset quality, a deterioration of investor perceptions and a decline in share prices.[5] In the US, manufacturing, automotive, consumer goods and construction are among those sectors particularly exposed to trade tensions.

Commercial real estate (CRE) prices globally have broadly stabilised, but some refinancing challenges remain.

Global CRE prices have continued to stabilise. However, year on year declines are still apparent in North American CRE, and uncertainty over the economic outlook globally represents a downside risk to CRE prices. Moreover, there remain significant refinancing challenges, with around half of the outstanding stock of US CRE debt due to be refinanced by 2029. A number of small and mid-sized banks in jurisdictions such as the US, Germany and Japan have significant domestic and cross-border CRE exposures.

In China, the property sector slowdown has continued, albeit with some signs of moderation.

As of May, new and existing home prices in mainland China were, respectively, 8% and 16% below their peaks in 2021 Q3. The pace of decline has shown some signs of moderation, but subdued May data indicate continued weakness in the property sector. The adjustment in the property sector, alongside broader structural trends, is likely to weigh on growth in China for some time. Any further deterioration in US-China trade relations would represent an additional

economic headwind. As of April, in Hong Kong, residential and commercial real estate prices were, respectively, 28% and 47% below their peaks in 2021 Q3 and 2018 Q4. Fundamentals remain weak with cautious overall buyer sentiment.

Financial stability risk transmission channels include the potential for adverse impacts on global economic growth and financial markets (given the size and globally interconnected nature of the Chinese economy) and UK banks' exposures to borrowers in China and Hong Kong.

3: UK household and corporate debt vulnerabilities

3.1: Overview of UK economic developments

The outlook for UK growth over the coming year is a little weaker and more uncertain than it was at the time of the November FSR.

In the May Monetary Policy Report (MPR), UK growth was projected to be slightly weaker in 2025 than expected in November. And near-term prospects for global growth have weakened, in part as a result of uncertainty surrounding global trade policies (Section 2). UK unemployment was projected to increase to around 5% by 2027 Q2, up from the 4.8% projected at the time of the November FSR.

At the time of the May MPR, market pricing implied that Bank Rate was expected to be around 3.6% in two years' time, which is similar to the projection in the November MPR (Section 1). Since November, mortgage market activity has picked up, although the extent of underlying momentum relative to the impact of temporary stamp duty changes is as yet unclear (Section 5). The growth rate of nominal household incomes was unchanged in 2025 Q1, as were corporate earnings, which remained close to 2023 levels.

3.2: UK household debt vulnerabilities

Overall, mortgage borrowers are expected to remain resilient even as they remortgage at higher rates.

The aggregate household debt to income ratio fell by around four percentage points to 126% from 2024 Q2 to 2024 Q4, its lowest level since 2001. Increasing incomes and expected decreases in interest rates mean that, in aggregate, the share of household income spent on mortgage repayments is not expected to rise significantly. The aggregate mortgage debt-servicing ratio (DSR) was flat at 7.1% in December 2024 and is expected to rise modestly to 8.0% by 2026 Q4 – the same as projected in the November FSR – and 8.7% by 2027 Q4.

The share of households in arrears or with high debt-servicing burdens remains low by historical standards. The proportion of all households with high mortgage cost of living adjusted DSRs (defined as COLA-DSRs over 70%) was 1.3% in 2025 Q1. This share is expected to remain well below its pre-GFC peak and slightly below projections at the time of the November FSR. Consistent with this, the rate of mortgage arrears, which was 1.0% in 2025 Q1 is expected to remain well below its early 1990s and post-GFC peaks. Further, NMG household survey evidence suggests households, in aggregate, continued to increase their savings buffers in 2025 Q1, increasing their resilience to potential future shocks. Sensitivity analysis by Bank staff shows that it would take a very severe shock to incomes and mortgage spreads for aggregate household DSRs to reach historic peaks (Chart 3.1).

Chart 3.1: It would take a large decrease in incomes and increase in lending spreads for household DSRs to reach GFC peaks

Aggregate household mortgage DSR and staff projections under a central and stressed scenario (a) (b) (c)

Sources: Bank of England, Bloomberg Finance L.P., FCA Product Sales Data, ONS and Bank calculations.

(a) Calculated as mortgage interest payments plus principal repayments as a proportion of nominal household post-tax income. Household income is defined as disposable (post-tax) income adjusted for changes in pension entitlements, which is adjusted to exclude gross operating surplus and the effects of financial intermediation services indirectly measured, and to add back interest paid. Mortgage interest payments before 2000 are adjusted to remove the effect of mortgage interest relief at source.
(b) The illustrative projections to end-2027 use projections for household post-tax income consistent with the May 2025 MPR. Payment increases are projected using market expectations for Bank Rate based on the overnight index swap (OIS) curve as at 23 June 2025 taking into account the distribution of fixed-deal terms from the FCA Product Sales Data and assuming the aggregate mortgage debt to income ratio remains constant.
(c) The stressed projection is designed to illustrate the sensitivity of aggregate household DSR to severe shocks. It assumes both a cumulative 5% fall in disposable (post-tax) household incomes by the end of 2027 – a little larger than in the GFC – as well a 300 basis points increase in mortgage spreads, which passes through to mortgage borrowers with a lag. The household income measure is adjusted as in the central projection.

> **Since the November FSR, the share of mortgage accounts which have already refixed since rates started to rise has continued to increase, and Bank Rate has fallen. Accordingly, fewer households are expected to refix onto higher rates.**

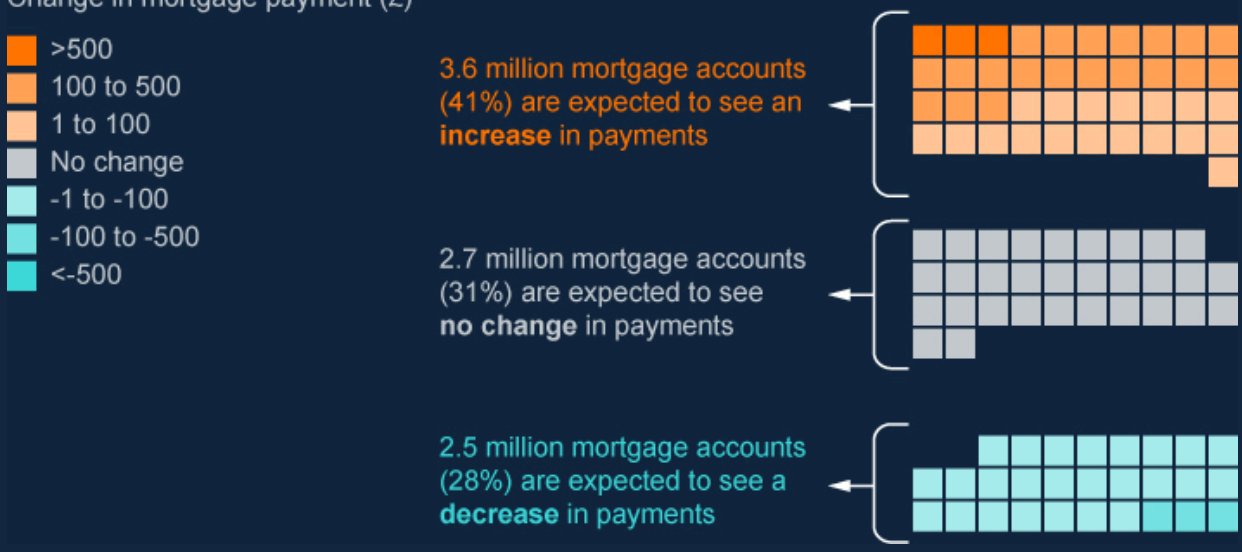
Since interest rates started to rise in 2021 H2, most mortgage accounts have refixed onto higher rates. However, around 30% have not yet refixed, so the full impact of higher interest rates has not yet passed through to all mortgagors. From June 2025 to 2028 Q2, 41% of mortgage accounts (3.6 million) are expected to refinance onto higher rates (orange squares in Chart 3.2). This is less than the 50% expected to refinance onto higher rates over the following three years at the time of November FSR.

For other borrowers, previous and expected falls in Bank Rate will lead to decreasing mortgage payments. 28% of mortgage accounts (2.5 million) are expected to see payments decrease from June 2025 to 2028 Q2 (aqua squares in Chart 3.2). This is slightly more than the 27% at the time of the November FSR. Around 1.5 million of these (16% of all mortgages) are on variable rates, while the remaining 1.0 million are currently fixed above prevailing rates. On balance, for the typical owner-occupier mortgagor rolling off a fixed rate in the next two years, their monthly mortgage repayments are projected to increase by £107 (14%), compared to £146 (22%) at the time of the November FSR.

Previous and expected decreases in interest rates, as well as regulatory changes, mean the share of new lending at high loan to income ratios is likely to increase in coming years (Box A).

Chart 3.2: Around 4 in 10 mortgages are expected to see payment increases by mid-2028

Proportion of owner-occupier mortgages by estimated change in monthly mortgage costs, from June 2025 to 2028 Q2 (a) (b) (c) (d)



Sources: Bloomberg Finance L.P., FCA Product Sales Data and Bank calculations.

(a) There are around 8,889,000 mortgages in the UK. There are 100 squares, each representing 1% of the total current stock of UK mortgages (around 88,890 mortgages), rounded to the nearest 1%.
(b) The projection uses the OIS curve as at 23 June 2025 and the latest available data (2024 H2) on the stock of outstanding mortgages.
(c) Changes in payments on variable-rate mortgages are calculated using the implied change in the OIS curve, and changes in payment on fixed-rate mortgages are calculated by assuming that mortgagors refinance onto a typical fixed rate implied by the OIS curve at the point that their fixed-rate contract ends.
(d) Mortgages with less than £1,000 outstanding are excluded. These data do not include buy-to-let mortgages or mortgages that are off balance sheet of authorised lenders, such as securitised loans or loan books sold to third parties.

Consumer credit growth is close to 2016–19 averages, while pressures on renters and lower-income households continue.

Consumer credit use grew by around 6% between March 2024 and March 2025, close to the 2016–19 average. Aggregate consumer credit DSRs remain low at around half pre-GFC levels and arrears also remain low by historical standards. As set out in the November FSR, direct financial stability risks from consumer credit are likely to remain limited.

Despite some signs of easing, pressures on some renters and lower-income households remain. Higher aggregate income and slightly lower rent increases in 2024 H2 are consistent with more renters reporting an increase in savings in the 2025 Q1 NMG survey. And the share of renters behind on their payments fell slightly in the six months to 2025 Q1, having risen

every quarter since 2021 Q3. The survey also suggested that households' expectations for their own financial situation have not worsened in aggregate. Nevertheless, should unemployment continue to rise as expected, this will adversely affect the finances of some households.

> **The FPC judges that, in aggregate, households are likely to remain broadly resilient. And it would take significant falls in household incomes and rises in interest rates for the aggregate debt servicing burden to rise materially.**

Staff scenario analysis (Chart 3.1) suggests that it would take a substantial shock to both incomes and lending spreads for the aggregate mortgage DSR to reach its GFC peak. Therefore, the FPC expects UK households to remain resilient in aggregate. In the November FSR, the committee noted that the results of the 2024 desk-based stress test indicated that banks would have capacity to continue supporting households in severe macroeconomic scenarios.

3.3: UK corporate debt vulnerabilities

> **Measures of indebtedness suggest the continued resilience of corporates in aggregate.**

Corporate net debt to earnings ticked down in 2024 Q4 as net debt fell and profits picked up. At 122%, the aggregate ratio remained well below Covid (171%) and post-GFC (235%) highs. This reduces the risk that indebted corporates would materially amplify a shock. However, this aggregate picture can mask vulnerabilities within particular firms and sectors.

The share of highly indebted firms that are considered vulnerable also remains low by historical standards. Both the debt-weighted proportion of corporates with low interest coverage ratios (ICRs), and the Bank's broader **corporate debt at risk measure** remain well below GFC and early 2000s peaks. Consistent with the low share of vulnerable corporates, insolvency rates have been broadly flat since the November FSR. Insolvencies were around 50 per 10,000 firms in the 12 months to May 2025, well below their long-term average level of around 100 per 10,000 firms. The current rate of insolvencies is unlikely to pose borrower or lender resilience challenges.

> **But SMEs are generally under more pressure than larger corporates, and arrears rose slightly in 2024.**

Insolvencies continue to be driven by very small firms with limited debt and share of employment. And firms formed since the start of the Covid pandemic make up a significant proportion of recent firm exits. Consistent with that, SME arrears for commercial loans have been rising over the past couple of years, but still remain below 1.5%. And around 10% of SMEs are currently using their overdrafts, similar to pre-Covid averages. SME lending has limited implications for banking system losses in aggregate because bank exposures are

relatively small, and a portion of this lending is government-guaranteed. SMEs with fewer financing options (Box B) might face challenges accessing working capital if credit conditions tightened.

> **Even if the eventual impact on the UK of the shocks to global trade were worse than expected, the aggregate share of vulnerable large corporates would likely remain below past peaks. But some sectors would be particularly impacted.**

In the May MPR, shocks to global trade and associated uncertainty were projected to weigh modestly on UK activity. Notwithstanding the trade deal between the UK and US, if the shock were to worsen, with greater than expected tariffs globally and larger than expected spillovers to world demand, it could impact UK corporates through three main channels:

1. Weaker global demand for goods and costlier supply of inputs to production could reduce corporate earnings, which would particularly impact the UK as an open economy.
2. Heightened uncertainty and material deterioration in risk sentiment could lead to tightening in borrowing conditions, particularly for corporates reliant on riskier forms of market-based finance.
3. Reduced availability of funding could reduce the ability of UK corporates to invest, reinforcing weakness in demand.

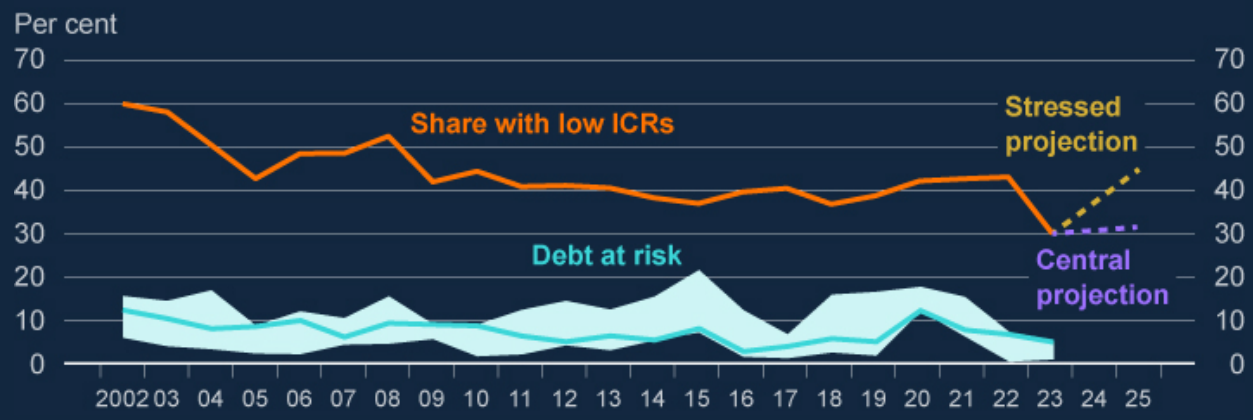
These channels could pose risks to financial stability through the borrower and lender resilience channels set out in the November FSR. Further shocks could particularly impact firms in sectors dependent on demand from the US market, such as manufacturing. These sectors – and others such as retail trade – are also vulnerable to broader reduction in consumer demand globally, as well as often being less able to recover earnings through adjusting prices. Staff analysis suggests that firms in sectors likely to be more impacted by the global trade shock – either directly or indirectly – account for around 60% of UK employment. [6]

These firms account for around 30% of the stock of UK corporate debt, and typically have less debt and stronger ICRs than firms in less vulnerable sectors, mitigating risks to borrower and lender resilience. But increased global fragmentation means that debt issuance could become more challenging for UK corporates in high yield and leveraged lending markets, which are largely reliant on international investors (Section 2).

Staff analysis suggests that, in aggregate, the share of corporates with low ICRs would remain below past peaks, even if corporate earnings fell by 10% in aggregate (around the fall seen in the GFC) and lending spreads increased by 300 basis points (Chart 3.3). This suggests that despite some pockets of vulnerability, UK corporates would, in aggregate, be able to continue to service their debts even in the face of further global shocks such as lower global demand and supply.

Chart 3.3: Measures of corporate vulnerability would remain low even if earnings fell substantially and lending spreads increased

Debt-weighted share of UK corporates with ICRs below 2.5 and share of UK corporates at higher risk of default and staff projections (a) (b) (c) (d) (e)



Sources: Moody's: Bureau van Dijk, S&P Capital IQ and Bank calculations.

(a) These data refer to UK private non-financial corporations only.
(b) The central case ICR projection conservatively assumes full pass-through of the Bank Rate path to the stock of floating and maturing fixed rate corporate debt over 2025. The projection uses the OIS curve as at 23 June 2025. The stressed projection assumes a 10% fall in earnings and a 300 basis points increase in corporate lending spreads.
(c) The aqua line represents the debt-weighted share of UK corporates that simultaneously breach the three thresholds associated with the highest likelihood of firm failure: whether a company's interest coverage ratio, calculated by dividing its earnings before interest and tax, is below 1.5; whether its liquidity ratio (current ratio) is below 1.1; and whether its return on assets is negative.
(d) Alternative projections of debt at risk within the aqua swathe capture firms that breach any three thresholds within six factors (the three set out in (c), as well as turnover growth less than -5%, leverage growth greater than 5% and leverage less than 1) and breach the thresholds with the highest marginal effects. **Stressed or in distress? How best to measure corporate vulnerability**.
(e) The historical timeseries of firms with low ICRs is different to that published in the November FSR due to increases in the sample of companies included. The large decrease in firms with low ICRs from 2022 to 2023 is largely driven by two large firms whose ICRs increased over the 2.5 threshold.

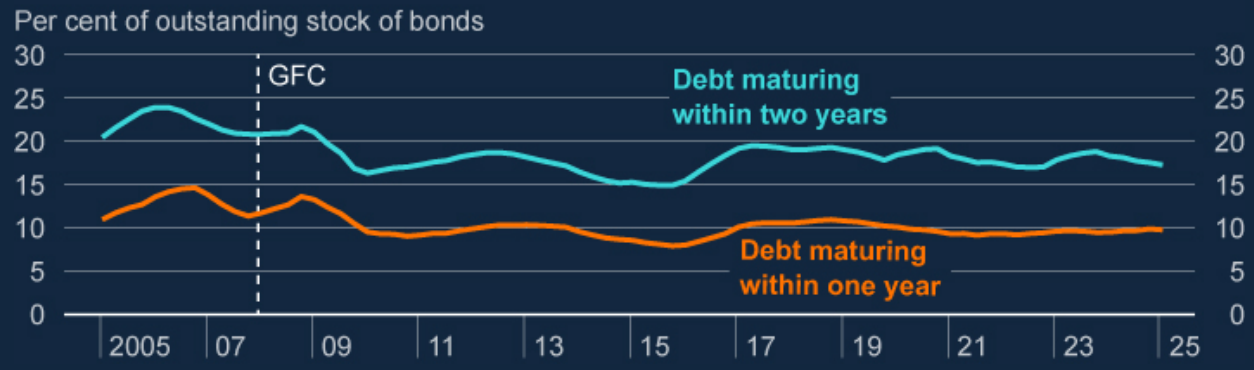
Some highly leveraged corporate borrowers relying on market-based finance are particularly exposed to global shocks.

As set out in the November FSR, UK firms using riskier forms of market-based finance, such as leveraged loans and high-yield bonds, might face refinancing challenges due to higher interest rates, particularly if market conditions tightened. The volume of market-based corporate debt that needs to be refinanced in the coming year has remained around historic averages in recent quarters at around 10% (Chart 3.4). Lower realised and expected interest

rates will have eased some refinancing pressures, but increased uncertainty globally (Section 2) and compressed risk premia (Section 1) mean the likelihood of tightening in market conditions has increased.

Chart 3.4: The share of UK bonds due for refinancing has been broadly flat since the November FSR

Stock of debt maturing within one or two years, as a percentage of the outstanding stock of bonds (a) (b)



Sources: LSEG and Bank calculations.

(a) The total UK private non-financial corporation bonds shown in this chart excludes withdrawn bonds, but includes non-rated bonds.
(b) All UK issued bonds in all currencies converted to sterling.

Recent decreases in interest rates will have benefited the majority of corporates paying floating interest rates on their debt. But a subset of corporates – largely those relying on market-based finance (or with interest rate hedges in place) – have not yet felt the full impact of higher interest rates. Corporate bonds, which comprise 25% of UK corporate debt, have an average maturity at issuance of 10 years, with interest payments generally fixed over that period. That means many UK corporate issuers are still likely to face interest rate increases as they refinance.

Most publicly issued corporate bonds are investment-grade, and their issuers are typically resilient to refinancing risks because of low leverage, strong balance sheets and because they have some choice over sources of finance. But firms issuing high-yield bonds, which comprise 21% of UK corporate bonds, might have to refinance onto even higher rates or turn to alternative sources of finance such as private credit if markets tightened further. And the 10-year reference rate is now around 2 percentage points higher than in 2015 when many of these bonds were issued. This risk is higher given global shocks and the global nature of UK

corporates' investor base. Over a third of the UK high-yield bond and leverage loan issuance by UK corporates is denominated in dollars, making issuance more sensitive to increases in risk premia on US assets, such as those seen during the period of financial market volatility in early April (Section 1).

The FPC continues to monitor vulnerabilities in the private equity and debt sectors (Box E). Recent market intelligence suggests that the provision of private equity and debt, particularly to highly leveraged UK corporates, could decrease if macroeconomic conditions and exit opportunities do not improve in the medium term. However, while the scale and timing of potential refinancing risks in this sector is not as clear as for public markets, market contacts suggest that some firms have been able to 'amend and extend' the terms of their existing debt to reduce these risks in the near term. Firms using riskier forms of market-based finance might be more likely to face refinancing challenges if they are already highly leveraged and/or in sectors vulnerable to external shocks.

Businesses facing higher debt-servicing costs after refinancing, or difficulties in sourcing finance, may take defensive action by cutting back on investment and employment. They may also be more likely to default. Because firms using riskier forms of market-based finance comprise at least 12% of UK employment, stress in these markets could pose borrower and lender resilience challenges.

> **The FPC judges that, in aggregate, the UK corporate sector is likely to remain broadly resilient.**

The unfolding global trade shock and associated increase in uncertainty are unlikely to challenge the resilience of most UK corporates, which have low leverage and strong balance sheets. But the rise in global uncertainty means that risks facing the tail of more vulnerable UK corporates have risen since the time of the November FSR.

Box A: UK mortgage market developments and the FPC's LTI flow limit

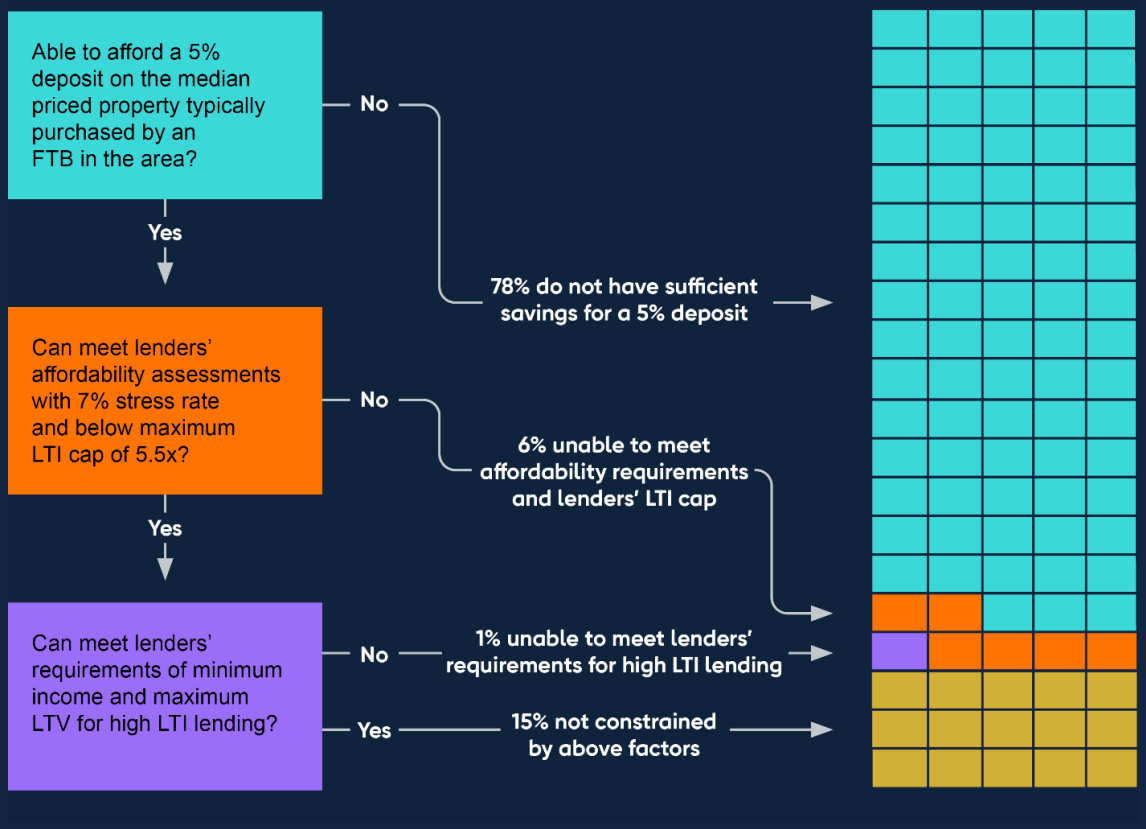
UK house prices are high relative to incomes, and the rate of home ownership has been broadly flat since 2014. Evidence suggests that accumulating a sufficient deposit continues to be the main barrier to owning a home.

From 1997 to 2007, the average house price in England and Wales increased from around 3.5 to around 6.5 times the average annual household income and has remained around this level in most of the years since. These high multiples mean that prospective first-time buyers (FTBs) typically need both a large deposit and a large loan relative to their incomes to be able to access a mortgage. The average deposit paid by FTBs was around 60% of their household income in 2024. That said, the share of new lending to FTBs remains high at 53% in 2025 Q1 – having increased from 33% before the global financial crisis (GFC) – and is near its highest point since the early 1990s.

For many prospective FTBs, these high deposit requirements are a barrier to purchasing a home. Just under 80% of that group do not have sufficient savings to cover a 5% deposit on a median-priced property typically purchased by an FTB in their area, based on the latest available survey evidence (Chart A). Staff analysis suggests a further 6% of prospective FTBs would be able to raise a deposit but would not be able to meet either affordability tests that would apply under the FCA's current Mortgage Conduct of Business (MCOB) framework (assuming a stress rate of 7%), or would be above lenders' own loan to income (LTI) ratio caps (assumed to be set at around 5.5). A further 1% would not meet other requirements lenders set to manage their high-LTI lending (eg around minimum salary). The remaining 15% would not be constrained by any of these factors. The affordability of homes and access to mortgages is also impacted by factors such as housing supply, the tax and regulatory environment, and prevailing credit conditions.

Chart A: Deposit size is the most significant barrier preventing FTBs from buying the median-valued home typically purchased by an FTB in their area

Factors constraining FTBs from being able to afford the median-valued property typically purchased by an FTB in their area (a) (b) (c) (d)



Sources: FCA Product Sales Data, ONS Wealth and Assets Survey and Bank Calculations.

(a) These estimates build on the method described in detail in Section 3.2 of the **December 2021 FSR Technical annex**. Prospective borrowers are identified in Round 8 of the Wealth and Assets survey conducted from April 2020–March 2022. Prospective borrowers are households with one family unit that currently rent, where the head of household is less than 45 years old. More recent granular and complete survey data on household assets and incomes are not available, but the derived share of households that are constrained is not expected to have materially changed since 2020–22.
(b) Constraints are applied sequentially in the given order. Many prospective borrowers who are unable to raise a 5% deposit could also be restricted by other constraints.
(c) It is assumed borrowers cannot benefit from sources other than their own savings to raise deposits. Borrowers are assessed against affordability tests under the FCA's MCOB framework with a 7% interest rate stress test, taking into account the FPC's affordability test that was in place at the time (though is also representative of current stress rates) using a distribution of maximum stressed DSRs described in section 3.2 of the **December 2021 FSR Technical annex**. Lender's LTI cap is set at 5.5. Lender's requirements for high LTI lending are that borrowers with an LTI >= 4.5 must have a household income of at least £31,000, and an LTV ratio of 90% or lower. Given headroom to the FPC's LTI flow limit, it is assumed not to directly constrain any individual prospective FTB.
(d) The accredited official statistics status has been **suspended** from Wealth and Assets Survey statistics from Round 8.

Credit cycles, unless controlled, tend to amplify economic cycles. A central aim of the FPC is to mitigate this risk. Regulatory changes since the GFC have been effective at reducing risks to financial stability.

Previous economic downturns such as the GFC were accompanied by a sharp fall in house prices relative to incomes, leading to lower growth and higher unemployment (Section 4). This was in part due to loose mortgage conditions in advance of the GFC, which were associated with sharp increases in house prices relative to incomes. Relatedly, this pre-GFC period also saw the unsustainable build-up of aggregate household indebtedness and a significant rise in the share of highly indebted households.

Such scenarios pose risks to lenders through higher losses on household lending portfolios, and to borrowers through greater debt-servicing difficulties and potential repossessions. Such debt build-ups can also lead to debt overhangs and make it more likely that households cut spending and consumption sharply during a stress, which could amplify the stress and its impact on households and businesses further.

To provide insurance against a marked and unsustainable loosening in underwriting standards and a further significant increase in the number of very highly indebted households, the FPC introduced mortgage market measures in 2014. These measures included a 15% flow limit on new UK mortgage lending to borrowers with high LTI ratios (at or greater than 4.5).[7] In addition to the FPC's LTI flow limit, the FCA also has Responsible Lending (**Mortgage Conduct of Business 11**, MCOB) rules to protect consumers from unaffordable mortgage debt.

While they have different objectives, FPC measures and FCA rules reduce risks to financial stability that could come from credit-fuelled housing bubbles. The FPC's measure was calibrated to target the point beyond which the aggregate build-up of indebtedness would be unsustainable in the long run. FPC measures and FCA rules have helped keep aggregate DSRs and arrears below the high levels seen in the GFC, even in the recent period of rising interest rates (Section 3).

The FCA recently published a clarification around the stress rate component of its MCOB rules. Lenders report they have, on average, reduced stress rates on lending fixed for less than five years by around 110 basis points in response to the statement and are now stressing new borrowers at rates of 6.5% to 7.5%. This is expected to improve access to mortgages for creditworthy households, as well as allowing existing borrowers to access larger mortgages This change will mean that new borrowers might now have slightly lower resilience to interest rate shocks, and therefore arrears might

be higher than they otherwise would have been as a result. But, taking into account the FCA's recent statement, even if interest rates were to increase, arrears would still be expected to remain low relative to historic peaks.

While looser credit conditions may allow a small share of additional borrowers to enter the market in the near term, **Bank staff analysis** suggests that, unless there is also an increase in housing supply looser mortgage conditions can push up on house prices in the medium term without increasing home ownership rates. The FPC supports initiatives to explore increases in the supply of housing and greater access of creditworthy households to mortgages, including at higher LTVs. And HM Government is introducing a **permanent mortgage guarantee scheme to support FTBs**.

> **While the flow of new lending at high LTIs has increased in recent quarters and is expected to increase further in coming years, the FPC's aggregate LTI flow limit is not expected to be a binding constraint.**

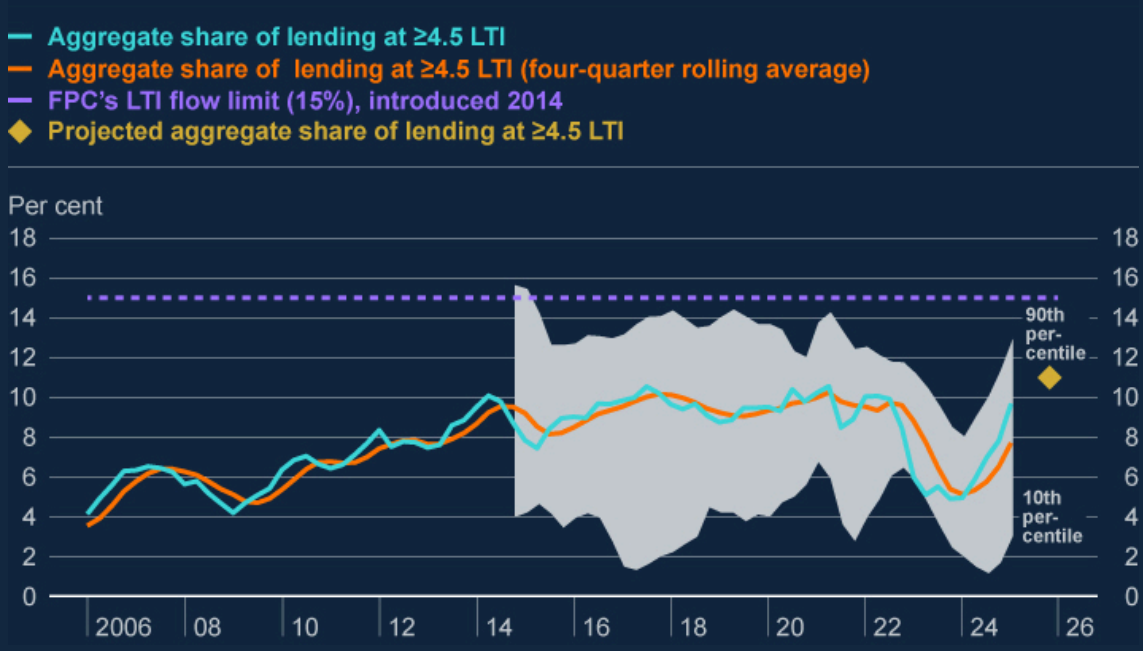
When interest rates are high, fewer households can afford a high LTI mortgage, so there is less pressure on the limit than when interest rates are lower and there is greater demand for larger loans relative to income. On that basis, which is the prevalent constraint will alternate across the interest rate cycle.

The aggregate share of high LTI lending has picked up to 9.7% in 2025 Q1 and remains below the FPC's flow limit of 15% on a four-quarter moving average basis (Chart B). Staff analysis suggests that under the current implementation of the FPC's flow limit, the share of new lending at high LTIs might increase to around 11% of the flow of new lending by end 2025 (Chart B). This is in part due to previous and expected decreases in interest rates, which make high LTI borrowing more affordable for mortgagors, as well as the FCA's recent statement. Staff analysis also suggests that the FPC's aggregate flow limit is unlikely to constrain lending over the next 10 years if the economy evolves in line with the MPC's May Monetary Policy Report (MPR).

Even if the share of new lending at high LTIs increases as expected this year, there will remain aggregate headroom of at least 4 percentage points to the FPC flow limit. Therefore, lenders in aggregate are expected to continue to have capacity for new high LTI lending, although some may be close to 15% on an individual basis. Some lenders report that at present they keep a management buffer to avoid hitting 15%. Others have more limited appetite for such high LTI lending.

Chart B: The share of UK mortgage lending at high LTIs is projected to increase in coming quarters

The share of new lending at ≥4.5 LTI and staff projections (a) (b) (c)



Sources: FCA Product Sales Data and Bank staff calculations.

(a) The projection is estimated using a loan-level model of the UK mortgage market, which builds on Levina et al (2019), is conditional on forecasts consistent with the May 2025 MPR, and takes into account recent developments in the mortgage market, including the reduction in lenders' stress rates following the FCA's clarification.
(b) The FPC's flow limit applies on a four-quarter rolling average basis.
(c) Range of lender's share of lending at ≥4.5 LTI (four-quarter rolling average) constructed using the weighted 10th to 90th percentiles of firm's use of their individual flow limits and shown from the introduction of the FPC's flow limit in 2014 Q4.

> **The FPC judges that the LTI flow limit continues to provide appropriate protection against the household sector becoming overly indebted during periods of rapid house price growth.**

The FPC has considered how household resilience could evolve over the long term and in a scenario of rapidly rising house prices where, absent policy measures, risks would increase sharply. Staff analysis suggests an increase in high LTI lending towards the flow limit would not result in a material increase in the share of mortgage borrowers with high DSRs. Therefore, the FPC judges that in both the central outlook and a house price boom scenario, the share of households with a high DSR would remain sufficiently below pre-GFC highs.

In all, the Committee continues to judge that setting the aggregate limit at 15% strikes the right balance between providing appropriate protection from the increased risk to economic growth of large cuts to consumption associated with an over-indebted household sector, while providing sufficient capacity for otherwise creditworthy households to borrow at higher LTIs.

> **The FPC is taking steps to ensure that the LTI flow limit continues to be implemented efficiently.**

Since the introduction in 2014 of its Mortgage Market Recommendations, the FPC has taken steps to ensure they are implemented proportionately. These include: **supporting** the PRA and FCA's decision to move the flow measure from a fixed quarterly limit to a four-quarter rolling limit to help lenders manage their business pipeline; **withdrawing** their affordability test on the basis that the LTI flow limit alongside the wider assessment of affordability required by the FCA's MCOB responsible lending rules were sufficient; and **recommending** that the PRA and FCA increase the threshold under which lenders are exempt from the LTI flow tool from £100 million to £150 million of residential mortgage lending per year.

The FPC judges that the aggregate 15% limit continues to provide appropriate insurance against the financial stability risks from the household sector becoming overly indebted during periods of rapid house price growth. The FPC has recommended the PRA and the FCA amend implementation of its LTI flow limit to allow individual lenders to increase their share of lending at high LTIs while aiming to ensure the aggregate flow remains consistent with the limit of 15%. The FPC recognises that, in doing so, such high LTI lending by individual lenders could exceed 15% of their total number of new residential mortgages while the aggregate flow remains consistent with the 15% limit. A full explanation of the committee's reasoning and recommendation is given in the **Financial Policy Committee Record – July 2025**.

4: In focus – Contributing to sustainable growth

In November 2024, the Chancellor asked the FPC to undertake work on how the UK financial sector can better contribute to sustainable economic growth via the Committee's **annual remit letter**. This In focus section provides an update on the Committee's work, ahead of publishing its conclusions alongside the December 2025 FSR.

4.1: Financial stability and economic growth

> **The financial sector makes an important contribution to sustainable economic growth by providing vital services to households and businesses.**

Financial institutions provide vital services to households and businesses, which in turn support economic activity, including funding, saving, insurance and payment services.[8] These allow households and businesses to make transactions and manage and take risks, supporting investment, innovation and technological progress.[9] For example, businesses rely on a range of services – including bank lending, market-based finance, and hedging – to make investments and manage risk, which supports productivity and economic growth. Similarly, households rely on financial services such as payments, bank lending, and insurance services to facilitate their consumption, purchase assets and manage their exposure to risk.

In providing vital financial services, banks, insurers and asset managers rely on a range of services from other markets and institutions that do not always interact directly with households and businesses but are nevertheless essential to the efficient provision of services to them. These include liquidity supply, risk management products (such as derivatives), financing (such as interbank loans), asset management, transactions, settlement, and custody.

In all, the financial and insurance activities sector directly accounts for around 9% of UK output. Many factors determine the extent to which the financial services sector contributes to sustainable growth, including financial regulation, tax, investment, and infrastructure – all of which impact the decisions made by financial firms and their real economy customers.

> **Maintaining financial stability is the foundation for sustainable growth. Periods of financial instability – such as the global financial crisis (GFC) –negatively impact the provision of vital services, weighing on output and productivity growth.**

Since the GFC, UK GDP and productivity growth have been relatively weak. Annual UK GDP per capita growth averaged around 3% in the 15 years before 2008, compared to around 1% in the 15 years since. And growth in UK GDP per hour worked – a key measure of economic

productivity – has been below the G7 average since 2008 (Chart 4.1).

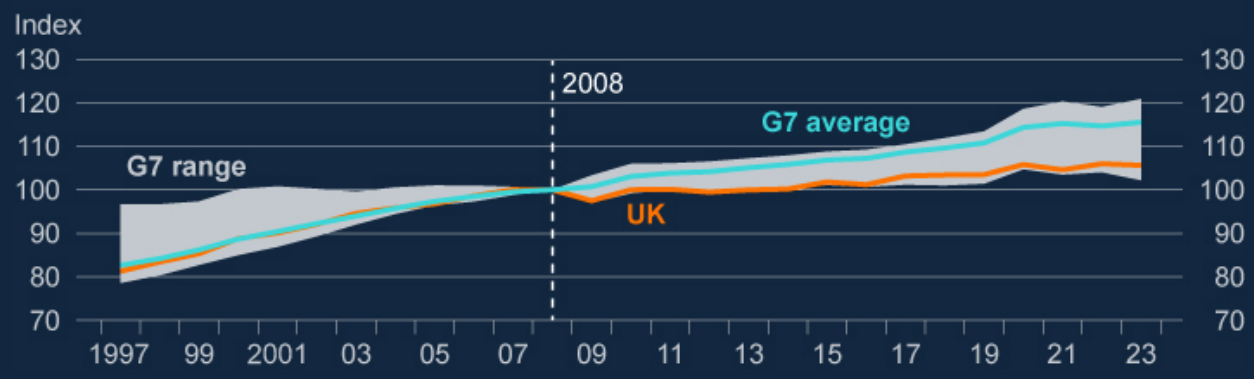
This slowdown was, in part, driven by high levels of borrower indebtedness and insufficient resilience on the part of lenders before the GFC, which created systemic vulnerabilities that amplified economic and financial shocks. The FPC was established to address this. The UK household debt to income ratio averaged 182% in 2007 – well above the 1990s average of 109%. Similarly, the corporate net debt to earnings ratio averaged 202% in 2007, compared to 121% in the 1990s. Banks also held significantly less loss-absorbing capital; major UK banks' average CET1 ratio was around 4% in 2007, over three times less than the 14.4% held in 2025 Q1. These weaknesses exacerbated the crisis and caused economic scarring through four main channels:

- Highly indebted households, impacted by higher unemployment and a fall in house prices from high levels, reduced consumption to service their debts even as Bank Rate was cut. This weighed on the demand for goods and services.[10]
- Highly indebted corporates deleveraged and became more risk averse. This reduced the level of research and development, investment and technology adoption, slowing the rate of economic recovery.[11]
- Weaknesses in bank balance sheets – exacerbated by a loss of confidence and funding – caused lenders to restrict credit to households and businesses. In particular, banks were focused on their own financial health and so were reticent to lend to some credit-worthy borrowers. **Bank of England research** suggests that this could explain around a third of the post-GFC slowdown.
- Government relief packages to support the financial sector and the wider economy, while necessary in the short term, may have reduced public spending on productive investment in the longer term.

Other factors have also impacted UK productivity growth such as a mid-2000s slowdown in US productivity, which also impacted other advanced economies.[12] Since the GFC, weak investment has further weighed on productivity growth.[13] Additional shocks, including the UK's decision to leave the European Union, the Covid pandemic, and the significant rise in energy prices in 2022 following Russia's invasion of Ukraine, have compounded these effects.

Chart 4.1: UK labour productivity growth has been relatively weak since the GFC

GDP per hour worked relative to 2008, UK and G7 weighted average and range (a)



Sources: OECD and Bank calculations.

(a) GDP per hour worked in 2020 US dollars, PPP adjusted. G7 average is weighted by total GDP in 2020 US dollars, PPP adjusted. Indexed to 2008.

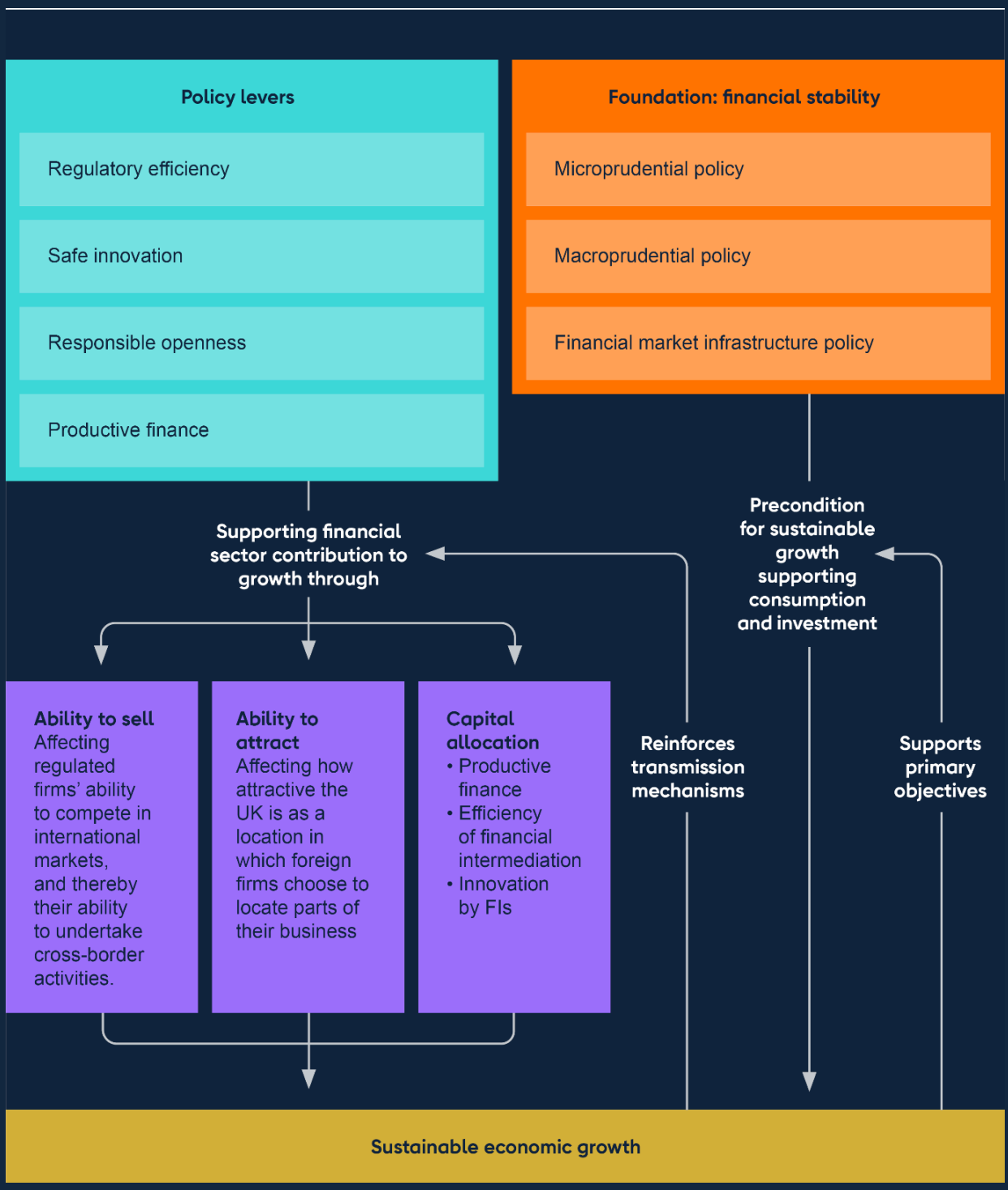
There cannot be sustainable growth over the medium to long term without financial stability (Figure 4.1). Financial stability underpins the continued provision of vital financial services and contributes to a stable and predictable economic environment, including by avoiding the negative consequences of financial crises. These in turn support consumer and business confidence, facilitate investment that drives long-term productivity growth, make the UK an attractive place to do business for international investors, and support UK firms' ability to compete abroad.

Likewise, stable growth supports the FPC's primary objective to maintain financial stability. Strong economic performance supports corporate earnings, employment and investment, and government finances. And low loss rates on banks' books support banks' capacity to lend to households and businesses. Further, some evidence suggests that persistently weak demand – when accompanied by low interest rates – may lead financial firms to take more risks than they otherwise would as they seek to increase returns on investment.

The long-term economic costs of financial instability mean that robust domestic and international prudential standards are vital to support sustainable growth in the UK (orange boxes, Figure 4.1). Robust standards have supported low rates of arrears on mortgage lending relative to before the GFC (Section 3), even as house prices have risen relative to earnings and as interest rates have risen since 2021 H2. They have also supported the

banking system to continue to lend to creditworthy households and businesses during recent shocks such as the Covid pandemic. The positive feedback loops create a virtuous cycle between growth and the Bank's other objectives.

Figure 4.1: Framework showing how the Bank's financial stability functions can contribute to sustainable economic growth



4.2: Actions taken by the FPC to support the financial sector's contribution to sustainable economic growth

> **The FPC is undertaking work in response to the Chancellor's commission in the November 2024 remit letter to identify areas where the financial sector could contribute more to sustainable growth without compromising financial stability.**

As set out in the Committee's **April 2025 Record**, the FPC agrees it should focus on improvements to the long-term productive growth capacity of the economy. This is beneficial for long-run economic welfare – and therefore financial stability – and distinct from short-term increases in output, which risk creating unsustainable and destabilising bubbles that could fuel financial crises with material scarring impacts on the economy.[14]

The Committee is focused on actions which could support the provision of vital services to the real economy by the financial services sector and thereby support economic activity and promote welfare. These include considering potential barriers to access to external finance for SMEs (Box B), sources and allocation of long-term capital, and safe adoption of innovative technology. The Bank can support the sector's ability to contribute to growth through four main policy levers (aqua boxes in Figure 4.1):

1. **Regulatory efficiency** – such as some of those set out by the PRA in its **June 2025 secondary competitiveness and growth objective**.
2. **Safe innovation** – such as helping the financial system to manage the risks and opportunities posed the by the adoption of innovative technologies like Distributed Ledger Technology (for example through the Bank and FCA's **Digital Securities Sandbox**) and the use of artificial intelligence (AI) in the financial system (for example through the FPC's **Financial Stability in Focus: Artificial intelligence in the financial system**).
3. **Responsible openness** – including supporting the competitiveness of the UK financial sector, allowing UK firms to compete on a level playing field both domestically and internationally, ensuring the UK is an attractive location for financial services.
4. **Productive finance** – identifying and removing barriers to the efficient allocation of capital to productive investment that increases the capacity of the economy.

These policy levers contribute to the growth of the overall economy by affecting how attractive the UK is as a location for foreign firms choosing where to locate parts of their business (**ability to attract** channel). They also affect regulated firms' ability to compete in international markets, and thereby their ability to undertake cross-border activities (**ability to sell** channel). These benefit the financial sector's customers by improving the availability and diversity of financial services and products. In addition, they support the financial system in facilitating growth by providing financial services and productive credit to the real economy efficiently

(**capital allocation** channel), reducing frictions between financial sector firms and their end-customers.[15] This includes through enabling the efficient and effective management of risk in the system.

> **The FPC has already taken some steps to support sustainable economic growth, and is considering potential further actions.**

The Committee recognises that financial resilience is not costless, and is committed to seeking every opportunity to make prudential regulation more efficient and effective.[16] Some examples of actions the Committee has already taken to support economic growth include:

- **Reducing the frequency of its main Bank Capital Stress Tests to every other year** to ensure the burden placed on participating banks is proportionate and supports the UK banking sector's competitiveness and growth. In alternate years, these can be supplemented through stress testing in a number of ways that are less burdensome for banks, for example through desk-based exercises.
- Ensuring the efficient implementation of the FPC's housing tools (Box A).
- Supporting access to finance for SMEs (Box B) including through **welcoming** the implementation of Basel 3.1 standards in the UK – which include an 'SME lending adjustment' – and **supporting** the Bank and the Department for Business and Trade's 2024 **survey of UK SMEs identifying barriers to productive finance**.
- **Publishing** recommendations addressing the barriers to investment in less liquid assets such as infrastructure, private equity and venture capital, as part of a diversified portfolio.
- **Exploring** how the benefits of innovation in money and payments, including central bank money alternatives that were compatible with distributed ledger technology, could be harnessed. And **supporting** international efforts to manage risks around cryptoassets and stablecoins.
- **Supporting** the work of UK authorities to tackle the negative effects of climate change on growth.

The FPC is already taking some steps to support households (Box A) and is assessing the barriers to financing for SMEs, focusing on firms seeking to scale-up (Box B). The FPC welcomes the work of other parts of the Bank to support sustainable economic growth. These include actions taken by the PRA, as set out in its **June 2025 secondary competitiveness and growth objective** publication and by the Financial Market Infrastructure Committee in support of its secondary objective to support innovation, as set out in its **2025 annual report**.

> **The FPC will continue to consider ways in which it can support sustainable economic growth as the financial system continues to evolve.**

In particular, the Committee will consider its approach in the context of short and long-term changes to the financial system. It will also act to ensure that macroprudential regulation remains effective and proportionate as the composition of the financial sector continues to change.

When considering the implications for financial stability of emerging technologies, the FPC is also mindful of the significant economic opportunities presented by them. Specifically, the FPC supports innovation in areas such as:

- **Payments** – such as contributing to the **National Payments Vision**; supporting experiments with innovative settlement technologies such as the digital pound and finalising the UK's approach to stablecoins and tokenised bank deposits.
- **Financial market infrastructure and tokenisation** – such as supporting the Bank of England and FCA **Digital Securities Sandbox**; working with HM Treasury and the Debt Management Office on the issuance of digital gilts and working with government and industry to develop a UK strategy to enable the adoption of safe tokenisation in financial markets.
- **AI** – such as the Bank's work to ensure that the AI survey continues to provide relevant insights into potential financial stability risks, and working with the **AI Consortium** to provide a platform for public-private engagement on the capabilities, development, deployment and use of AI in UK financial services.
- **Sustainable finance** – such as considering further opportunities to support the capacity of the financial system to support the transition to net zero.

The Committee intends to publish conclusions of its work on how the financial sector can support sustainable economic growth alongside the December 2025 FSR.

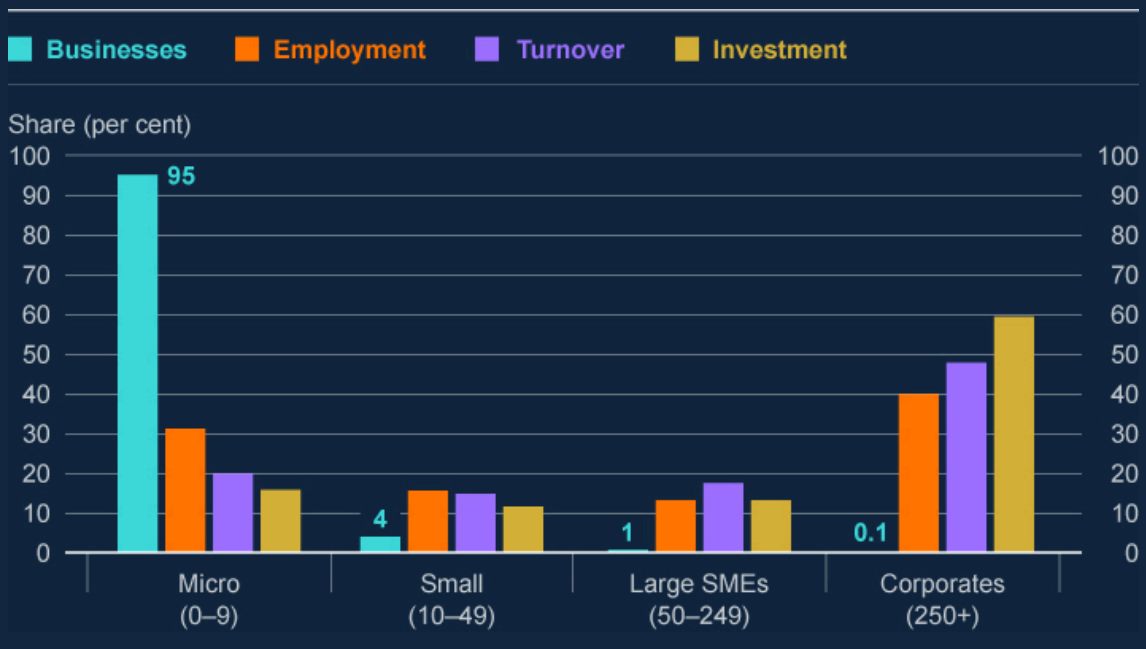
Box B: The financing needs of high growth potential SMEs

Small and medium sized enterprises (SMEs) account for the majority of UK employment. And larger SMEs make a substantial contribution to UK economic growth.

SMEs are businesses with fewer than 250 employees or turnover of less than or equal to £44 million. They represent 99.9% of the UK's 5.5 million private sector firms and are responsible for around 60% of employment and 40% of business investment. Typically, SMEs account for over half of private sector output growth per year, and larger SMEs contribute significantly to productivity growth. Evidence also suggests high-growth and young SMEs make an outsized contribution to employment growth in the UK and globally.[17]

Chart A: SMEs account for a large share of UK businesses, employment, turnover and investment

Share of the UK business population by count, employment, turnover and investment (a)



Sources: Annual Business Survey (ABS) 2023, UK Business Population Estimates 2024 and Bank staff calculations.

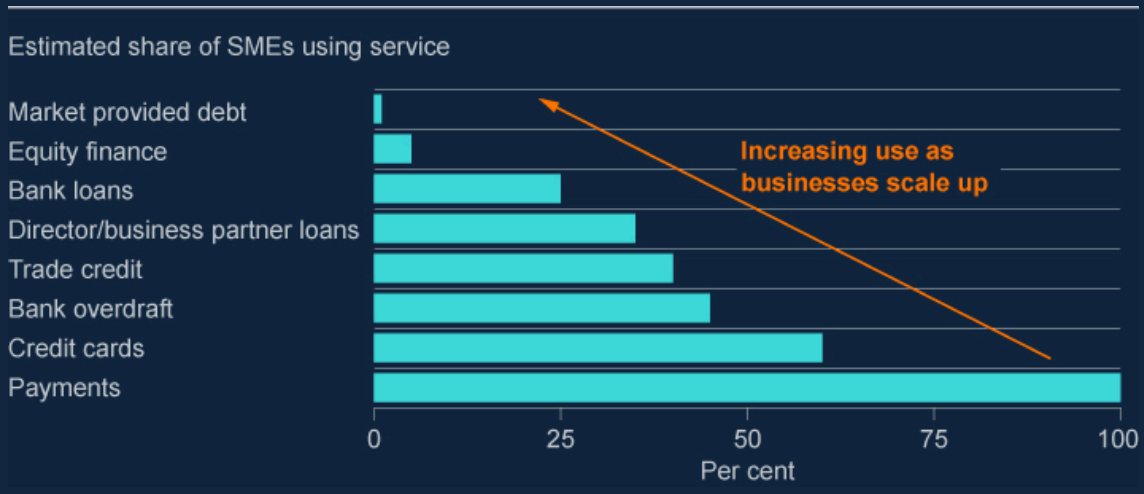
(a) Investment figures are calculated from the ABS by subtracting total capital expenditure disposals from total capital expenditure.

The financial system plays a key role in supporting SMEs through the provision of vital services, in turn supporting their contribution to economic growth.

All SMEs use vital financial services such as payments, and many use short-term overdrafts to manage their day-to-day operations (Chart B). A smaller but significant share also use borrowing products such as short-term trade credit – used to manage cash flow to purchase goods – and bank loans, which are typically used to invest in new premises or technologies. That said, **survey evidence** suggests around 80% of SMEs were not seeking access to external finance in 2024.

Chart B: The fastest growing SMEs typically use more sophisticated sources of finance

Illustrative diagram highlighting UK SMEs' usage of different financial services (a)



Sources: Bank of England Finance and Investment Decisions Survey 2023, BVA BRDC SME Finance Monitor and Bank staff estimates.

(a) This chart, while based on surveys and data as far as possible, is illustrative and aims to give the reader a sense of the importance of different financial services as businesses grow. Where data is drawn from the Bank of England Finance and Investment Decisions Survey, the sum of SMEs reporting that they have currently or previously used a financial service is shown. Covid loans are not included in the bank loan series.

SMEs face greater barriers to accessing credit than larger firms, and some SMEs that seek finance may not be able to access enough or may find it too expensive.

The stock of SME debt as a share of UK GDP has fallen over the past 15 years, from 13% in 2011 Q4 to 8% in 2024 Q4. In 2025 Q1, net lending to SMEs remained negative as Covid guaranteed loans continue to be paid down, in contrast to net

lending to large corporates which was positive. However, the **2025 Q2 Credit Conditions Survey** indicated credit availability for small and medium firms increased slightly in Q2, and intelligence from the Bank's agency network suggests SME financing conditions are close to what they would consider normal.

Lower SME lending as a share of GDP may reflect both small shares of SMEs seeking external finance and longstanding barriers these firms face in accessing external financing.[18] **Previous Bank work** has found that access to finance is a critical factor that hinders SME growth and ability to invest. And **research** suggests that obtaining finance is a particular barrier for small firms, especially following financial crises. Compared to large businesses, SMEs are typically required to publish less financial information, lack long credit histories, and may need to rely on personal assets to act as collateral against borrowing. This means that lenders have often been unable to assess an SME's ability to repay or offer finance at an affordable interest rate. These barriers may in part be addressed by initiatives, including **the Bank's work on the future of finance**, to boost the availability of data and improve relevant technology.

> **SMEs looking to scale-up use more specialised forms of finance, some of which can be challenging to access.**

Bank of England survey evidence suggests that many SMEs do not intend to expand their business, and around 70% would prefer slow growth over taking on debt. But **other survey evidence** also suggests SMEs looking to scale up are much more likely to seek external finance than the micro SME population. The same survey suggests that firms using external finance are more likely to grow quickly – and the **Scale-Up Institute estimates** that while 'scale-ups' comprise only 0.6% of the SME population, they contribute more than half of UK SME turnover.[19]

These 'scale-up' SMEs are likely to demand forms of finance such as seed funding, venture capital and private equity, which are more specialised than bank debt. These businesses often lack physical assets – instead having intangible assets particularly in sectors such as manufacturing and, information and communications technology – and are often loss making in early years. This makes traditional bank debt less suitable for them. **British Business Bank** evidence shows that over recent years, the availability of alternative sources of finance for SMEs – such as venture capital and peer-to-peer lending – has increased. The UK has the third largest venture capital market in the world, although volumes of venture capital financing fell in 2023 and 2024 from 2021–22 highs. **Research** also suggests that the UK's venture debt market has grown in recent years, although its adoption rate is half that of the US.

Scale-up SMEs are also likely to face other particular challenges around financing. For example, as firms grow, they tend to become more dependent on international investment given the less developed UK market for scale-up firms at later stages in their development, potentially making it more challenging to attract investors. Some barriers to scale-up finance have been in part mitigated by British Business Bank initiatives such as the British Growth Partnership and Enterprise Capital Funds Programme, which support the provision of specialised finance to high-growth potential SMEs. And HM Government intend to further **deepen the UK's capital markets** to help fill funding gaps further.

> **The FPC will continue to consider barriers to accessing finance for SMEs, and what actions might improve the flow or type of finance available.**

In April 2025, the Committee asked staff to undertake work to meet the request set out in the Remit letter on sustainable economic growth and to update the Committee over the course of the year as needed (Section 4). Bank staff are working with HM Treasury to engage with the industry and key stakeholders to further understand the key barriers to finance, including through assessing incentives for lenders to provide credit to different market segments. The FPC will focus its future work on high potential SMEs seeking to scale-up, and access to the types of finance that these firms rely on. The Bank intends to publish updates on staff analysis in the coming months.

5: UK banking sector resilience

5.1: Recent developments in UK banks' resilience

UK banks continue to be well capitalised, have high levels of liquidity, and their asset quality remains strong.

The UK banking system remains well capitalised and has high levels of liquidity, and these positions are little changed since the November FSR (Table 5.A). Considered over a longer time horizon, capital levels in aggregate have been broadly stable since the completion of the phase-in of the post-global financial crisis (GFC) bank capital framework in 2019, consistent with no significant increases in regulatory requirements since then. While the FPC judges the level of capital in the banking system to be broadly appropriate, it has been five years since the Committee's last assessment of the overall level of capital requirements. Therefore it will refresh that assessment and provide an update on this work in the next FSR.

Major UK banks' asset quality remained strong in Q1, with little change relative to the November FSR (Table 5.A). Major UK bank CROs reported that they were monitoring the impact of tariff developments on their loan portfolios closely. As would be expected at this stage, losses connected to these developments had not materialised. While the share of new mortgage lending at high loan to value (LTV) ratios has increased in recent months, in aggregate the LTV profile of UK lenders mortgage books remains in line with levels seen since 2015, and 81% of the stock of UK owner occupier mortgages is below 75% LTV. Hong Kong property prices are under continued pressure (Section 2), but UK bank exposures are generally well collateralised, so losses have been limited.

Overall, the UK banking system is resilient to the currently uncertain economic outlook and has the capacity to support households and businesses even if economic and financial conditions were to be substantially worse than expected.

Table 5.A: Selected indicators of banking sector resilience

	Latest	November 2024 FSR
CET 1 capital ratios		
Major UK banks	14.4% (Q1)	14.8%
Small and medium sized UK banks	18.3% (Q1)	18.1%
Liquidity coverage ratios		
Major UK banks (three month moving average)	153% (May)	151%
Small and medium sized UK banks (three month moving average)	285% (May)	269%
Asset quality		
Loans for which there has been a significant increase in credit risk since origination (IFRS 9 'Stage 2') (major UK banks)	9.7% (Q1)	9.7% (a)
Provisions as a share of lending (major UK banks)	0.90% (Q1)	0.91% (a)

Sources: PRA regulatory returns, published accounts and Bank calculations.

(a) Banks subsequently revised figures for 2024 Q3, after the November FSR was published.

The appropriate management of cyber-risks by the banking sector, alongside other sources of operational risk, is important for system-wide operational resilience.

The 2024 Cyber Stress Test assessed participant firms' ability to deliver wholesale payment and settlement services in a severe but plausible data integrity cyber scenario. The operational resilience of such services, including at times of unusually high trading volumes, are important to UK financial stability.

The published **findings** will be useful for a broad range of firms, including UK banks, in understanding their role in monitoring and managing systemic risk and in mitigating the financial stability impacts of disruption. It is important that firms understand the impact of operational disruption on both their clients and the wider financial system, and act to help mitigate impacts on the rest of the financial system, for example through the prioritisation of certain payments. The thematic letter includes the FCA's view of how prioritisation of some

payments to mitigate risks to financial stability can be consistent with rules for Treating Customers Fairly. Greater clarity on this issue helps to increase firms' ability to mitigate financial stability impacts and supports sector operational resilience.

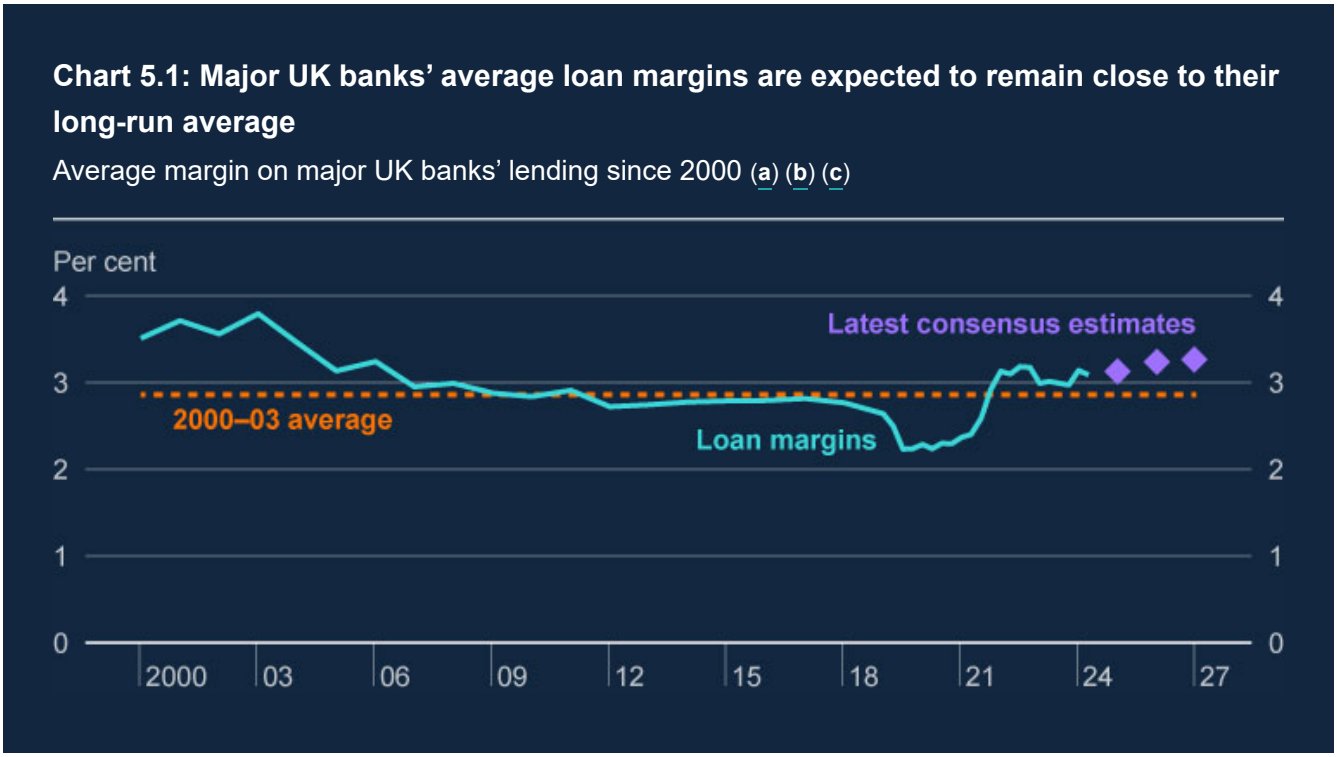
The cyber threat landscape continues to evolve, and firms should continue to develop and improve their approaches to operational resilience, to build the resilience of the sector as a whole. This should include a continued focus on scenario testing and exercising.

UK bank profitability has supported increased valuations.

Major UK banks reported returns on tangible equity (RoTE) of 13.5% for 2024. Consensus expectations are for earnings to remain around their current levels in aggregate over the next three years. The margins that banks earn on their lending are expected to rise a little above current levels but to remain close to long-term averages (Chart 5.1).

Chart 5.1: Major UK banks' average loan margins are expected to remain close to their long-run average

Average margin on major UK banks' lending since 2000 (a) (b) (c)



Sources: Refinitiv Eikon from LSEG, published accounts and Bank calculations.

(a) Loan margin is calculated as net interest income divided by total lending. Loan margins in this chart are calculated across all currencies. Net interest income is interest income minus interest expense.
(b) Figures before 2019 and after 2024 Q3 exclude Virgin Money UK. Figures before 2006 exclude Standard Chartered.
(c) Consensus estimates are scaled based on analysts' expectations of loan margins for Barclays, HSBC, Lloyds Banking Group, NatWest Group and Standard Chartered. Purple diamonds are the forecasts for 2025, 2026 and 2027.

Banks' valuations have risen, with the FTSE 350 bank index up by 27% since the November FSR to around post-Covid highs, having recovered from a drop after the 2 April US tariff announcements. Reflecting that, UK banks' average price to tangible book (PtTB) ratio has

increased since the November FSR to around 1.2, up from Covid-era lows of around 0.5. In general, a PtTB ratio of one indicates that investors expect RoTE to be at or around the level needed to compensate them for the perceived riskiness of those returns (referred to as the 'cost of equity').[20]

Some lenders continue to face uncertainty over the potential for redress payments in respect of past motor finance commission arrangements. A Court of Appeal ruling in October 2024 – that it was unlawful for car dealers to receive commission from motor finance lenders unless it had been appropriately disclosed to the customer and they had given informed consent – is currently subject to an appeal to the Supreme Court. In March, the FCA **stated** that it will confirm within six weeks of the Supreme Court's decision if it is proposing a redress scheme, and in June it set out **key considerations** around a possible redress scheme. The Bank's 2024 desk-based stress test incorporated a stressed level of misconduct costs in both of the scenarios tested, and the UK banking system's aggregate capital ratio remained well above its hurdle rate under both of them.

> **UK banks have continued to adjust to the normalisation of central bank balance sheets, increasing their use of Bank of England standing lending facilities.**

Central banks globally continue to unwind the extraordinary measures put in place in response to the Global Financial Crisis and the Covid pandemic. The Bank of England is continuing to unwind its Asset Purchase Facility holdings and the Term Funding Scheme with additional incentives for SMEs is also winding down. As a result, the level of aggregate Bank reserves has been declining.[21]

UK banks' liquidity coverage ratios have remained broadly unchanged throughout this period of adjustment, remaining well above minimum levels (Table 5.A). As part of this adjustment, the share of major UK banks' high quality liquid assets (HQLA) held as central bank reserves has declined (from 52% in May 2024 to 48% in May 2025) while the share of HQLA held as government bonds has increased (from 28% to 35% in the same period).

Meanwhile, the use of Bank of England facilities, including the Indexed Long-Term Repo (ILTR) and Short-Term Repo (STR), has continued to increase as intended. The STR allows participants to borrow central bank reserves for a one-week period in exchange for high quality, highly-liquid assets. The ILTR allows participants to borrow central bank reserves for a six-month period against the full range of Sterling Monetary Framework (SMF) eligible collateral (including less liquid assets). It is intended to complement the STR, providing participants with a longer-term facility to supply the potentially large stock of reserves the system may demand in steady state. In June, the Bank published a **Market Notice** confirming the recalibrated parameters of the ILTR to ensure it is appropriate for the transition to the new framework.

ILTR drawings have risen to around £25 billion, up from an average of around £2 billion in 2024 Q3 and they can be expected to increase further. Meanwhile, STR drawings have also risen, to around £70 billion, up from an average of around £34 billion in 2024 Q3. As recently outlined by **Victoria Saporta** (2025), the Bank continues to encourage SMF participants to use the ILTR and STR as part of routine liquidity management, consistent with the ongoing transition to a 'repo-led, demand driven' framework.

Banks should continue to factor system-wide trends likely to affect bank funding and liquidity, including the normalisation of central bank balance sheets, into their liquidity management and planning. The FPC will continue to monitor the implications of these trends for financial stability.

Long-term wholesale funding markets were volatile during the April market turbulence, but UK banks had limited funding needs at that time.

Spreads on bank debt – along with those on various other sectors – rose in the immediate aftermath of the 2 April US tariff announcements. However, they retraced quickly, and UK banks had limited issuance activity planned during this period, meaning they were largely insulated from the volatility. Some UK banks rely on short-term US dollar funding markets for a significant portion of their funding, but no sustained stress was evident in these markets during this episode.

5.2: UK banks' provision of credit to households and businesses

Aggregate lending has increased since the November FSR, driven by rising mortgage volumes.

There was an increase in UK banks' gross lending in Q1, driven by a notable rise of 38% in gross mortgage lending since 2024 Q4 (Chart 5.2). Mortgage demand increased as buyers sought to complete house purchases before changes to stamp duty took effect on 1 April, and lenders responded to this with increased supply. The mortgage market has continued to be competitive, with spreads compressing further in Q1 and product availability continuing to increase. There has been an increase in lending at high LTV and loan to income ratios. Major UK banks' CROs and industry bodies reported that underlying mortgage demand remains strong, although in the **Q2 Credit Conditions Survey** (CCS) some moderation of demand was expected in Q3.

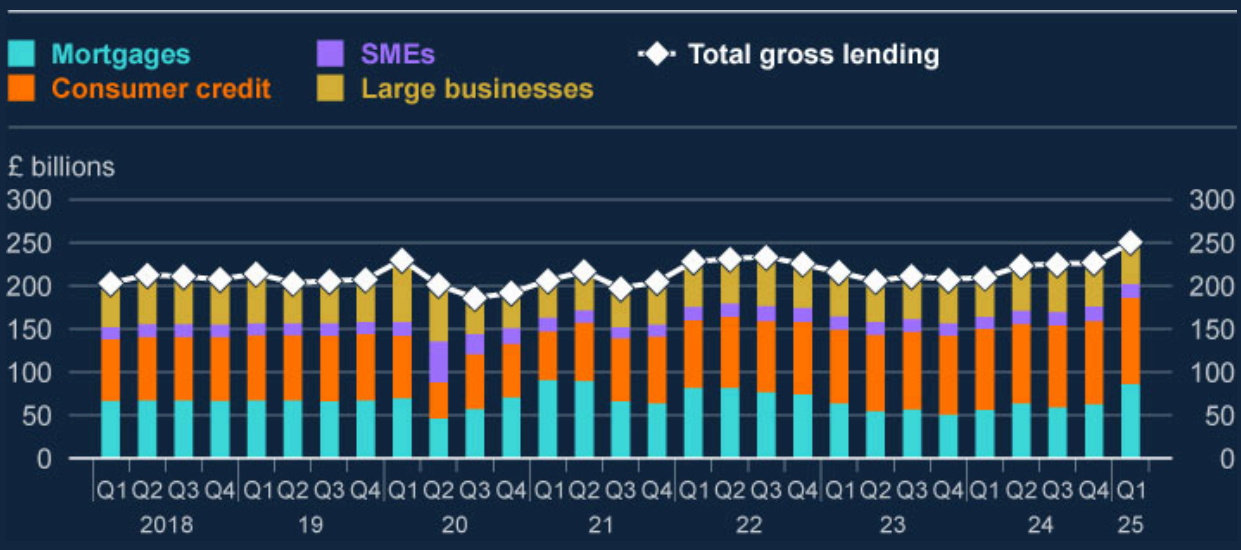
Gross lending to large corporates declined by around 3%. This slight decline appears to be demand-led, with intelligence from the Bank's agency network indicating that some businesses have scaled back investment, pushing down on demand for credit. There is no current evidence of a tightening in credit supply following the 2 April US tariff announcements, with lenders reporting in the Q2 CCS that the overall availability of credit to the corporate sector slightly increased. Agents report that uncertainty around trade policy globally following

the 2 April US tariff announcements might have further contributed to a reduction in demand by causing businesses to delay or change their investment plans. Nonetheless, according to the Q2 CCS, corporate credit demand was expected to increase slightly in Q3.

Gross SME borrowing from banks also declined slightly in Q1 (-5%). As was the case for corporates overall, the Q2 CCS reported a continued improvement in credit availability for SMEs, consistent with Agents' reports (Box B).

Chart 5.2: Total lending volumes increased in the first quarter of 2025

UK monetary financial institutions' gross lending to UK households and businesses, seasonally adjusted (a)



Sources: Bank of England and Bank calculations.

(a) SMEs are defined as businesses with annual debit account turnover on the main business account up to £25 million. Large businesses are those with annual debit account turnover on the main business account of over £25 million.

Credit conditions continue to reflect the macroeconomic outlook.

In its assessment of what has driven changes in credit conditions, the FPC considers a range of factors. These include the quantity, quality and price of credit available; indicators of the macroeconomic environment; and indicators of demand including from the CCS. The FPC also considers the resilience of the UK banking system, which remains well capitalised with headroom over regulatory requirements and buffers. Taking these factors into consideration, the FPC judges that overall developments in credit conditions continue to reflect the macroeconomic outlook.

The FPC has maintained the UK countercyclical capital buffer (CCyB) rate at its neutral setting of 2%.

The FPC sets the UK CCyB rate to help ensure that the UK banking system is better able to absorb shocks without an unwarranted restriction in essential services, such as the supply of credit, to the UK real economy. In making this decision it takes into account a number of principles, as set out in **FPC's approach to setting the countercyclical capital buffer – Policy Statement**. The indicators most directly relevant to the risk of banks' UK exposures to which the UK CCyB rate is applied, such as domestic credit growth and indicators of debt vulnerabilities, are not materially above long-term averages. While credit conditions in some areas such as mortgages have eased, the FPC judges that they have not significantly added to vulnerabilities that might amplify shocks.

The FPC has decided this quarter to maintain the UK CCyB rate at its neutral setting of 2%. Maintaining a neutral setting of the UK CCyB in the region of 2% should help to ensure that banks continue to have capacity to absorb unexpected future shocks without restricting lending in a counterproductive way.

The FPC will continue to monitor developments closely and stands ready to vary the UK CCyB rate, in either direction, in line with the evolution of economic and financial conditions, underlying vulnerabilities, and the overall risk environment.

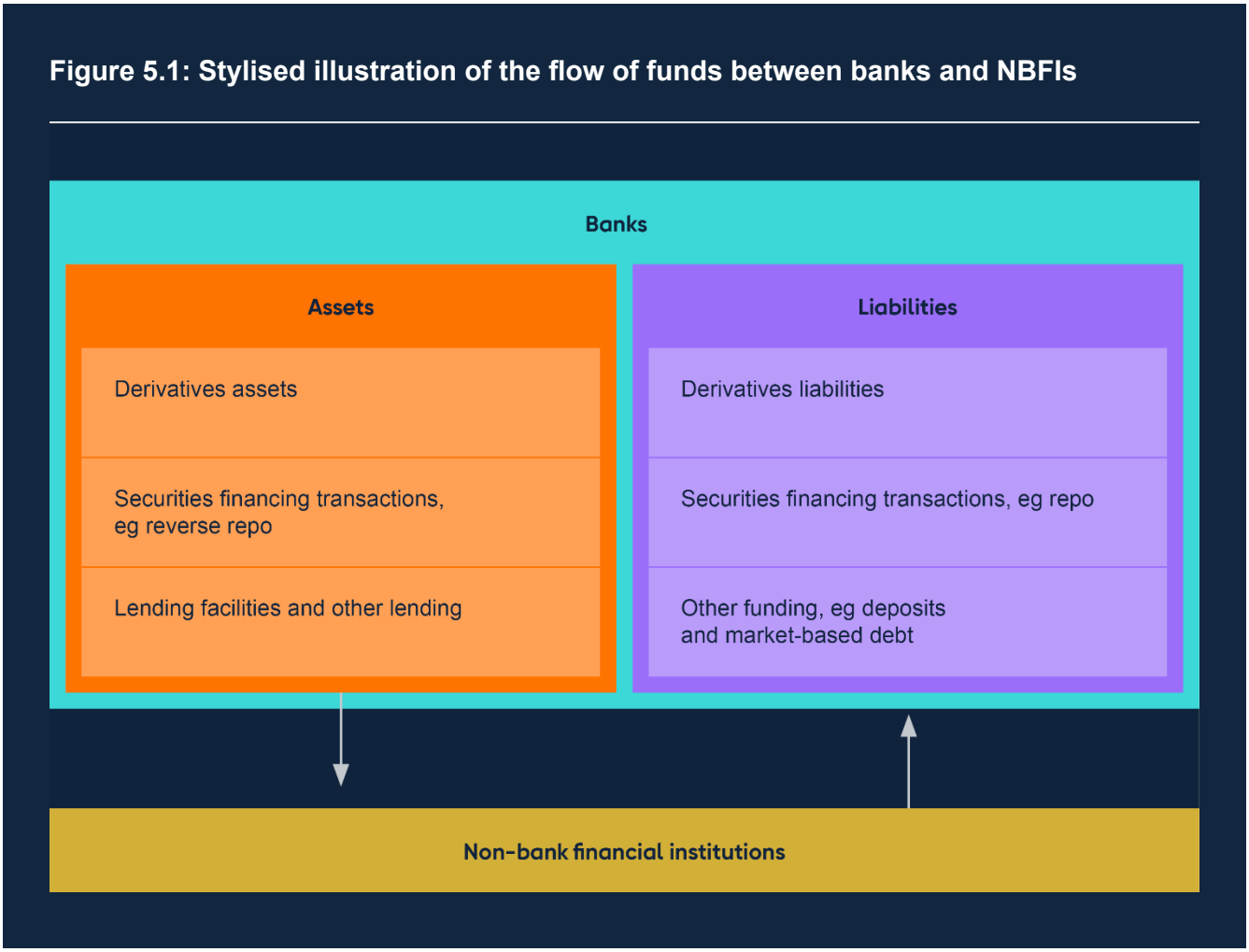
5.3: Interlinkages with non-bank financial institutions

Banks provide services that support the functioning of the system of market-based finance (MBF), while in the other direction NBFIs are a source of funding for banks.

The UK banking system supports MBF through the provision of finance and other services, such as operational support, to various types of NBFIs. Banks facilitate a large proportion of the leverage used by many NBFIs as the counterparty to derivatives transactions (such as interest rate swaps) and securities financing transactions (including repo agreements and margin lending transactions) (Figure 5.1). A small number of large UK and US headquartered banks provide the majority of these services to NBFIs that operate in the UK.

The continued provision of such liquidity by banks to NBFIs, particularly through times of market stress, is important to support market functioning including in core UK markets (Box C). In the other direction, NBFIs are a material source of funding for banks, including by placing cash with banks via deposits or reverse repos, and by holding banks' market-based debt such as bonds.

Figure 5.1: Stylised illustration of the flow of funds between banks and NBFIs



Source: Bank of England.

UK banks' exposures to NBFIs, including to sectors that use leverage such as hedge funds, have grown in recent years.

The financing provided to NBFIs creates exposures in banks' trading books. The extent of these exposures varies significantly among individual banks according to their business model, and they tend to be greater at banks with large investment banking franchises. Measured as a share of balance sheets, major UK banks' exposures to NBFIs (excluding derivatives) have risen over recent years, increasing from 17% of total assets in 2018 to 21% in 2024, and this trend appears likely to continue.

Banks' trading book exposures tend to be highly collateralised. For example, when a bank provides an NBFI with finance to purchase a stock, it holds that security as collateral against the loan. The Potential Future Exposure (PFE) measure nets exposures against collateral received, and is a risk metric commonly used by banks to gauge losses if counterparties were to default. Drawing on an ad hoc PRA data collection and external data sources, Bank staff analysis indicates that as at January 2024, participating major UK banks' total trading book

exposures to all NBFIs stood at around £120bn on a PFE basis, equating to 52% of aggregate CET1 capital. Collateralisation assumptions and differences in PFE methodologies, including netting practices, can affect the accuracy of PFE as a measurement of risk.

Banks mitigate the rapid increase in exposures in times of market stress by demanding additional collateral from their counterparties. But in stress counterparties can default on these margin calls. And the value of the collateral held by banks can quickly fall in value, especially if historical correlations between market risk factors break down. As such, counterparty credit risk exposes banks to losses in the event that they needed to liquidate under-collateralised positions of defaulting counterparties.

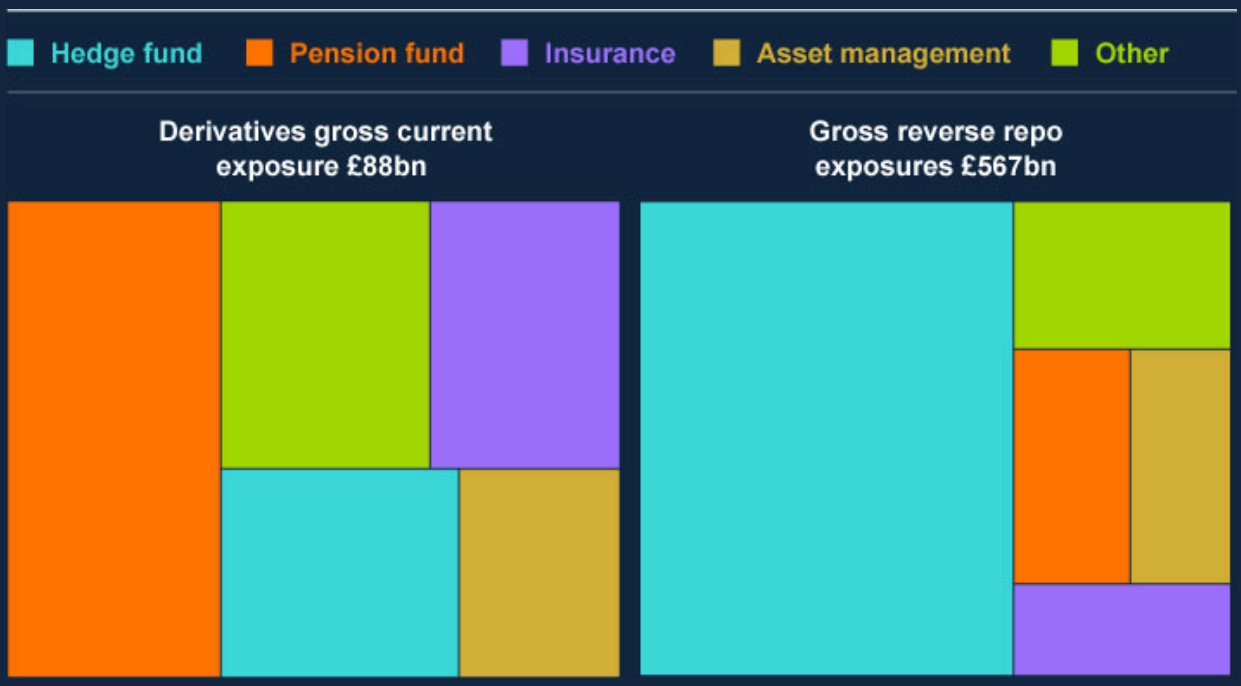
The risks faced by banks can be higher if NBFI positioning is particularly concentrated or opaque. This was illustrated by the 2021 default of Archegos – a firm that had a highly leveraged position concentrated among a few stocks. Its default resulted in significant losses for number of its bank counterparties. While there were other specific factors in this firm's failure, the episode illustrates the more general risk around leveraged counterparties and assumptions about the value of collateral.

If leveraged positions are unwound in a disorderly way during a stress this can further add to market stress and so amplify NBFI – and potential bank – losses on those positions (Box C). The September 2022 gilt market volatility highlighted the vulnerability to large market moves of leveraged counterparties (in this case LDI funds) with similar positions, and the feedback loop caused by resulting firesales.

While bank exposures to NBFIs are generally highly collateralised, given the complexities of understanding and managing these types of exposures under stressed conditions, it is important to assess them using a variety of metrics, including on a gross exposure basis. The gross exposures of major UK banks' participating in the 2024 data collection to the three sectors known to employ high degrees of leverage – hedge funds, pension funds and insurers – are estimated as at January 2024 to have stood at around £60 billion for derivatives (27% of CET1 capital) and around £450bn for reverse repos (198% of CET1 capital) (Chart 5.3). The majority of this was comprised of reverse repos with hedge funds. While relatively small in comparison to other business lines, such as mortgage lending (473% of CET1 capital), these exposures represent a material share of aggregate risk within the UK banking system. Such exposures are captured within the capital requirements framework, although they are generally not capital intensive, due to netting and collateralisation of trades.

Chart 5.3: Major UK banks have material exposures to NBFI sectors that employ leverage

Banks' derivatives gross current exposure and gross reverse repo, by counterparty sector (a)



Sources: PRA data collection in January 2024, PRA regulatory data, and Bank calculations.

(a) CET1 data as of December 2023 and exposure data as of January 2024. Data relate to those banks that participated in the 2024 data collection exercise.

The hedge fund sector is a key user of leverage in the financial system. As set out by **Rebecca Jackson (2025)**, this sector has seen significant growth in recent years. This has been driven by a combination of rising equity values, the rise of quantitative hedge funds relying on significant volumes and leverage to generate returns, and a reallocation of investor capital to alternative investments, including hedge funds. Reflecting this growth, banks' exposures to hedge funds have also increased.

This highlights the importance of appropriate risk management by banks.

UK banks must ensure appropriate risk management of their growing exposures to hedge funds, trading houses, private equity firms and other leveraged NBFIs.

In December 2024, the Basel Committee on Banking Supervision published **updated guidelines** to strengthen banks' management of counterparty credit risks, including from NBFIs. The guidance emphasised the importance of continued monitoring, robust credit risk mitigation strategies, and the use of diverse exposure metrics and stress testing. The PRA

and FCA previously set out their expectations on required risk management enhancements related to prime brokerage in a **joint letter** to banks operating in the UK following a supervisory review of global equity finance businesses and in a second **joint letter** following a supervisory review of fixed-income financing. Supervisors continue to monitor firms' progress in meeting these expectations.

Another important aspect of risk management in this area is consideration of risks from opaque and 'contingent' leverage. Contingent leverage refers to the potential for a firm's leverage exposure measure (LEM) to rise in a stress event.[22] Supervisory Statement **SS31/15** sets out how firms should assess these risks.

The PRA and the FPC will continue to monitor this source of risk to banks and to the financial system more widely.

6: The resilience of market-based finance

6.1: Developments in vulnerabilities in market-based finance

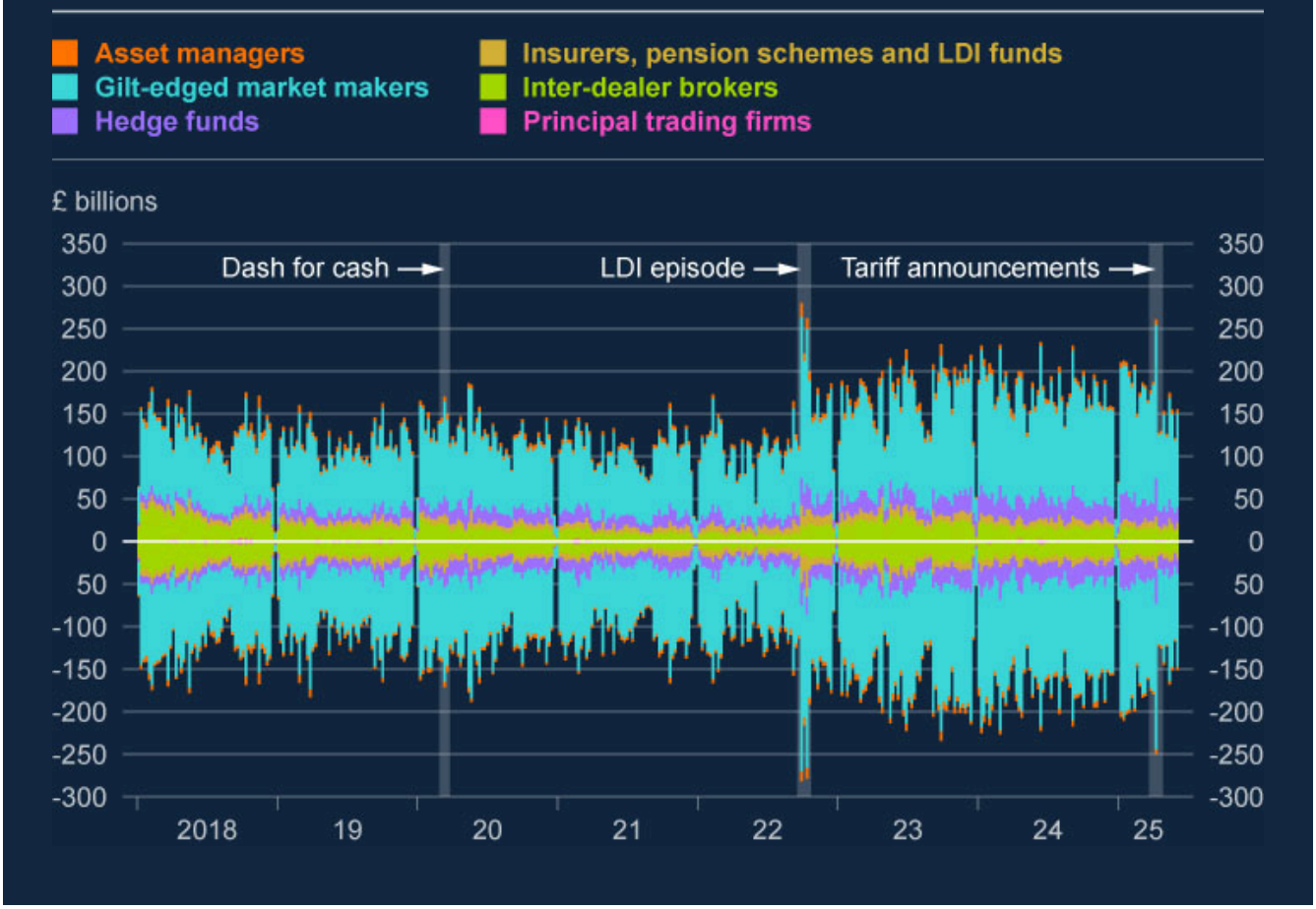
Market-based finance (MBF) is an interconnected system of markets, market infrastructure (such as central counterparties (CCPs)) and non-bank financial institutions (NBFIs) such as insurers, hedge funds and private finance firms. Well-functioning UK core markets are central to that system because they act as a benchmark for the pricing of other financial instruments, and as a source of funding supporting the ability of the financial system to absorb rather than amplify fluctuations in liquidity demand and supply.[23]

> **Despite periods of significant price movement and high volumes since November, UK core markets have continued to function in an orderly way.**

During the period of market volatility in early April, gilt trading volumes reached their highest levels since the September 2022 liability-driven investment (LDI) episode.[24] Sales of gilts over the seven-day period following US tariff announcements on 2 April were comparable to activity during past periods of high volatility (Chart 6.1), while changes in net gilt holdings were smaller than in the March 2020 ‘dash for cash’ and the LDI episode. Funding markets also remained stable throughout this period, with gilt repo rates staying near recent average spreads to Bank Rate (Chart 1.4). Similarly robust functioning in these markets was observed during a short-lived period of rapid increases in gilt yields in early January. Box D provides more detail on the toolkit the Bank is developing to analyse the potential systemic impact of such market moves.

Chart 6.1: UK core markets continued to function in an orderly way, with gilt trading volumes reaching their highest levels since the LDI episode

Weekly gilt volumes across sectors



Source: Financial Conduct Authority MiFID II data.

LDI and pension funds were most affected by variation margin calls. But they managed increased liquidity demands without taking actions that might have amplified market volatility. Liquidity buffers remained stable and recapitalisations proceeded smoothly. This was consistent with funds having increased their levels of resilience following the FPC's LDI fund recommendations.[25] Market intelligence also suggests some leveraged market participants had de-risked prior to the US tariff announcement, limiting the impact of the rise in volatility.

Trading activity across other asset classes remained orderly. Although there were net sales of sterling corporate bonds by pension funds, LDI funds and asset managers, these were within normal ranges of activity for the market. Likewise, money market fund (MMF) redemptions remained limited, showing no significant deviation from usual patterns.

In contrast, there was greater evidence of amplification in US financial markets. Deleveraging by market participants – particularly through the unwinding of crowded 'swap spread' strategies that take advantage of the spread between US Treasury and interest rate swap yields – intensified the sell-off in US government bonds. Although conditions were beginning to deteriorate, the US Treasury repo market continued to function in an orderly manner, providing stable funding which helped contain pressures on leveraged strategies such as the cash-futures basis trade. Market pressures eased following the announcement of a pause in the proposed tariffs. However, had the disruption persisted, the resulting pressures on market participants may have been more severe.

While market functioning remained resilient during the period of high volatility in April, the relatively short-lived nature of the market disruption helped limit its impact. Vulnerabilities in MBF persist – particularly those linked to leverage – which, under prolonged stress, could result in risks to financial stability.

Vulnerabilities in MBF remain, and in some sectors have increased since the November FSR. These vulnerabilities can amplify asset price corrections and limit market participants' ability to absorb losses during adverse shocks. In turn, this can disrupt credit provision to households and businesses, further weighing on economic activity.

Leverage through net gilt repo borrowing by hedge funds has continued to rise, outpacing the growth in other sectors. Data suggest that a proportion of this growth is driven by cash-futures basis trading.

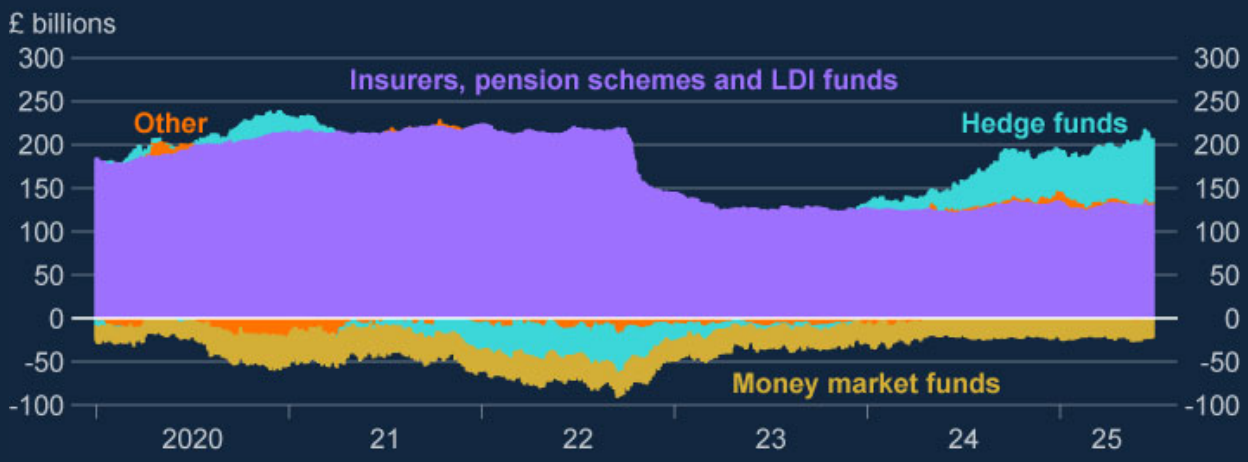
As noted in the November FSR, leveraged market participants, such as hedge funds, have an increasingly important role in gilt market activity – including cash, repo and related derivative markets. In normal times, they serve a useful function by intermediating between different types of market participants, thereby improving market liquidity and price discovery. While this diversification enhances liquidity and efficiency, it also introduces new risks. Leveraged market participants often employ strategies which can be vulnerable to triggers such as shifts in financing conditions or sudden, sharp increases in margin, potentially amplifying volatility during periods of stress (Box C).

Historically, pension schemes and LDI funds had been the largest buyers of gilts, particularly at longer maturities. However, this demand has begun to reduce and could fall further over time. The improved funding ratios of pension schemes may change behaviour, including by increasing insurance buy-out activity of defined benefit schemes.

Since the November FSR, hedge fund net repo borrowing has risen to £77 billion (as of early June 2025), its highest level since data collection began in 2016. This represents the largest increase in borrowing across all NBFI sectors over that period (Chart 6.2). Bilateral repo activity is most often conducted at zero or near-zero haircuts, reflecting both competitive pressures and the ability of dealers to net counterparty credit exposures.

Chart 6.2: Hedge fund net gilt repo borrowing continues to rise, outpacing other sectors and highlighting the growing role of leverage in core markets

Net repo positioning across non-bank sectors (a)



Sources: Sterling money market data (SMMD) and Bank calculations.

(a) Latest data are as of 26 June 2025. SMMD data and the sector classification are reviewed on an ongoing basis in order to continuously improve the quality and coverage of the data set.

Increasing gilt supply has pushed gilt valuations lower relative to other assets classes such as swaps and credit instruments. This, in addition to higher interest rates more generally, has made gilts more attractive to global asset managers seeking higher returns, with a preference for investing in futures over cash gilts. Futures offer greater liquidity allowing for positions to be adjusted more efficiently. UK EMIR data[26] show that asset managers have increased their positions in gilt futures, with hedge funds taking the other side of these positions and intermediating between cash gilt supply and rising futures demand.

> **Excessive leverage, particularly when combined with other macrofinancial vulnerabilities such as market concentration, crowded positions and opacity, increases the risk of a disorderly unwind of positions and a sudden jump to illiquidity.** [27]

Concentration in UK core markets is pronounced; for example, a small number of hedge funds accounts for 90% of net gilt repo borrowing. This concentration means that a rapid unwind of leveraged positions by a few key players could amplify shocks during periods of high volatility.

Crowded positioning could also amplify stress. Past episodes, including the LDI episode and the dash for cash, demonstrated how simultaneous deleveraging by large numbers of similarly positioned funds could trigger forced selling and feedback loops.

Finally, opacity can impede effective monitoring and risk assessment of leveraged strategies. For example, UK authorities lack visibility of some derivatives market activity where trades do not involve a UK-domiciled clearing member. Similarly, prime brokers who provide leverage do not have a full view of their clients' portfolios across counterparties. This lack of transparency was one contributing factor in the Archegos episode, where concentrated leveraged exposures went undetected until losses crystallised.[28] [29]

> **Events in April underline the importance of resilience in MBF as well as the importance of monitoring and transparency to support financial stability.**

While UK core markets continued to function through the volatility, in a more prolonged disruption, the existence of highly leveraged trades combined with other vulnerabilities such as opacity, concentration and correlation, could have intensified market corrections and led to tighter financial conditions across the UK economy.

Private markets

The FPC has previously judged that vulnerabilities in private markets – especially those related to interconnectedness, concentration and opacity around valuation and high leverage – could create risks to financial stability.[30] Box E explores how the current risk environment could interact with these vulnerabilities, and the potential implications of that for UK financial stability.

6.2: Improving the resilience of market-based finance

> **Market surveillance plays a key role in identifying financial stability risks, including those from leveraged participants.**

The Bank monitors leverage, interconnectedness and concentration in core markets using transaction-level data, market intelligence, and system-wide exercises like the system-wide exploratory scenario (SWES). Data published in this Report (eg net gilt repo borrowing across sectors) are intended to contribute to market participants' understanding of their exposures relative to the aggregate market and help inform their risk management accordingly. The FPC intends to expand the data it publishes in this area.

However, opacity, data lags and data gaps – particularly cross-border – remain a challenge. To adapt to the evolving market structure and the increasing role of NBFI leverage, the Bank is enhancing its system-wide monitoring capabilities and stress testing toolkit, building on

lessons from the SWES. The SWES exercise demonstrated how a system-wide approach provides a more comprehensive view of market dynamics under stress.

> **The FPC seeks to strengthen the resilience of MBF to mitigate risks to UK financial stability. Where effective and practical, it works to address vulnerabilities domestically while recognising that for many risks, mitigations require international co-ordination.**

In the November FSR, the FPC welcomed further work to consider how to improve resilience in gilt repo markets. To support this, the Bank plans to engage with industry later this year through a discussion paper (DP), which will explore possible reforms to market structure to enhance gilt repo market resilience (Table 6.A).

Given the interconnected nature of MBF, reforms to improve resilience are most effective when co-ordinated internationally. The FPC supports international work, including the implementation of the FSB's recently published policy recommendations on leverage in NBFI which span measures to improve risk identification, mitigate risks to financial stability and enhance cross-border co-operation.

Work to address risks from margin procyclicality has also continued to progress, including proposals to: 1. improve understanding of potential future margin requirements in centrally cleared markets, through more transparent CCP margin models and governance arrangements that seek to incorporate participants' input; and 2. enhance the liquidity preparedness of non-bank market participants for margin and collateral calls, in centrally and non-centrally cleared derivatives and securities markets. The FPC welcomed the FSB's final policy recommendations on liquidity preparedness for margin and collateral calls, published in December 2024. Domestic authorities are currently working on their implementation.

Table 6.A: Overview of progress on building resilience against key vulnerabilities in MBF domestically and internationally (a)

Vulnerability	Financial stability implications	Policy recommendations and next steps
Liquidity mismatch in money market funds (MMFs)	MMFs are used by UK corporates, investment funds, and other NBFIs as a way of managing cash balances. Investors hold around £290 billion in sterling-denominated MMFs. Liquidity mismatch between the redemption terms and the liquidity of some of their assets makes MMFs vulnerable to sharp redemptions from investors in stress and so risk of both runs and contagion across the sector. This could amplify shocks, impact financial stability if investors cannot access cash, and lead to tighter financial conditions for the economy.	The Financial Conduct Authority launched a consultation paper on enhancing MMF resilience measures, in December 2023. This work is part of broader international efforts to address vulnerabilities and increase the resilience of MMFs, in line with the principles set out by the FSB. In February 2024, the FSB published a **Thematic review on money market fund reforms** in national authorities, taking stock of measures adopted or planed by FSB members. Follow-up work is planned by the FSB in 2026 to assess the effectiveness of those measures. **The FSB has also published a report** (May 2024) enhancing the resilience of commercial paper and commercial deposit markets.
Liquidity mismatch in open-ended funds (OEFs)	Globally, the assets under management of OEFs primarily investing in UK equities, sterling government bonds, sterling corporate bonds, and UK property totalled around £226 billion, £49 billion, £87 billion, and £14 billion respectively as of May 2024. Some OEFs offer daily redemptions while holding less liquid assets. This means in stress, there is an incentive for investors to redeem ahead of others. Funds may struggle to meet **redemption demands without rapid sales of assets, which could lead to contagion across markets.**	In December 2023, the FSB published a set of revised policy recommendations to address structural vulnerabilities from liquidity mismatch in OEFs, complemented by new International Organization of Securities Commissions (IOSCO) guidance on anti-dilution liquidity management tools. The FSB and IOSCO will undertake a stock take, to be completed in 2026, of the measures that have been adopted and planned, with a further effectiveness review by 2028 to see whether financial stability risks have been sufficiently addressed.

Vulnerability	Financial stability implications	Policy recommendations and next steps
Non-bank leverage	Leverage creates counterparty risks and can lead to sudden spikes in demand for liquidity – either to support the financing of leveraged positions, or as deleveraging leads to forced sales, which in turn could amplify shocks and lead to market dysfunction and a potential tightening in financial conditions for households and businesses. The notional amount of non-bank investors' over-the-counter derivatives in 2022 has been estimated at almost $90 trillion. Global NBFI financial debt in 2022 has been estimated at approximately $48 trillion, or 50% of global GDP.	The FSB has published policy recommendations to enhance authorities' ability to identify, monitor and mitigate the risks associated with non-bank leverage. The FPC supports the implementation of these recommendations. **The Bank plans to engage with industry later this year via an exploratory discussion paper (DP) on potential reforms to strengthen gilt repo market resilience and liquidity supply in periods of stress. This DP will seek views on measures such as expanding central clearing and introducing minimum haircuts for non-centrally cleared repo.**
Liquidity demands from margin calls in stress	Margin can increase rapidly in stress to match the increase in expected potential losses and risks. Increases in margin that are unpredictable or unexpectedly large can cause liquidity strains on market participants and the financial system. For example, during the March 2020 dash for cash, initial margin requirements at UK CCPs increased by around 31% to £58 billion, and average daily variation margin calls were five times higher than in January and February 2020.	The Bank has continued to co-chair the Basel Committee on Banking Supervision, the Bank for International Settlements' Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions Margin Group responsible for work to improve the transparency and evaluate the responsiveness of initial margin practices in centrally cleared markets. **The FSB published its final set of policy recommendations in December 2024**, which are expected to culminate in updates to international standards and guidance in 2025. The Bank will look to enhance its domestic CCPs margin framework in line with these proposals. **These policy recommendations aim to enhance the liquidity preparedness of NBFIs for margin and collateral calls in centrally and non-centrally cleared derivatives and securities markets. Recommendations cover liquidity risk management and governance, stress testing and scenario design, and collateral management practices.** (b)

Vulnerability	Financial stability implications	Policy recommendations and next steps
Capacity of markets to intermediate in stress without compromising on the resilience of dealers	Past episodes of market turbulence, such as the 2020 dash for cash and the 2022 LDI episode have shown that vulnerabilities in NBFIs can propagate liquidity stresses in the gilt market, via investor deleveraging, liquidity mismatches in funds, liquidity demands from margin calls and insufficient market participant preparedness to meet rising margins. Exacerbated by limited dealer intermediation capacity, these events have led to periods of forced selling of gilts by NBFIs and self-reinforcing price spirals, threatening UK financial stability.	The FPC had previously noted that there would be value in exploring ways to enhance market intermediation capacity in a stress, without compromising dealer resilience, including through potential changes to market structure. The FPC also welcomed the progress the Bank had made in developing a new lending facility, the Contingent NBFI Repo Facility (CNRF), to address severe market dysfunction in the gilt market that threatens UK financial stability arising from shocks that temporarily increase NBFIs' demand for liquidity. **The CNRF opened for applications in January 2025. As a contingent facility, the CNRF will be activated at the Bank's discretion and will lend cash to participating insurance companies, pension funds and LDI funds against UK sovereign debt (gilts) for a short lending term. To support market participants, the Bank has published an updated Market Notice (28 January 2025) to provide details about the CNRF, including how firms can start the process of applying and as such it is not an activation of the CNRF.**

(a) New policy developments are in **bold**.
(b) **Liquidity Preparedness for Margin and Collateral Calls: Final report**, FSB (2024).

Box C: Use of NBFI leverage in UK core markets

> **Leverage in UK core markets has risen in recent years, reflecting the growth and evolution of trading strategies involving gilt repo, cash gilts and derivatives.**

This box explores some of the strategies underpinning this rise in leverage and the key triggers that could result in forced or widespread deleveraging.

These trading strategies can be grouped into three broad categories:

- **Strategies with large, one-way exposures to yield movements** – such as those employed by liability-driven investment (LDI) funds to hedge long-term liabilities, or by hedge funds to express macroeconomic views – can often be financed through repo borrowing. During the LDI episode a sharp rise in yields led to concentrated collateral calls (in long-dated, inflation-linked gilts) and one-way selling flows. As previously noted, in the case of LDI strategies, the FPC's March 2023 resilience standard for the sector has reduced the risk of a disorderly unwind by requiring them to hold significantly higher levels of unencumbered collateral to meet margin and collateral calls in a stress.
- **Relative value (RV) strategies that use net repo borrowing** to take advantage of differences between the prices of gilts and related interest rate instruments. While these strategies are less sensitive to changes in the overall direction of yields, they are still vulnerable to heightened periods of volatility and changes in pricing relationships or correlation breaks. They also rely on continued access to repo financing, which can become constrained if dealer capacity or willingness to intermediate declines.

  The **cash-futures basis trade** has been a significant driver in the growth of RV strategies in UK core markets. As previously noted, hedge fund borrowing has significantly increased, particularly since early January 2024 (Chart 6.2). Over a similar period, UK EMIR trade repository data indicates that hedge funds have significantly increased their short positioning in gilt futures. This suggests that part of the growth in repo borrowing can be attributed to increased cash-futures basis trading, where funds purchase gilts (financed via repo) and sell gilt futures contracts, anticipating that gilt yields will decline relative to the futures equivalent yield. Since early 2024, the rise in hedge fund net gilt repo borrowing has coincided with a notable rise in gilt futures open interest, pointing to a broader expansion in positions exposed to the cash-futures basis (Chart A).[31]

Other examples of relative value strategies using net repo borrowing include some curve trades (eg steepeners) and swap spread trades.[32] A **steepener** involves a fund buying shorter-dated gilts and selling longer-dated gilts expecting that the yield spread between the two widens (ie yield curve steepens). This involves net financing of gilts because to be duration neutral, the notional of a long position in shorter-dated gilts needs to be larger than the short position in long-dated gilts. In a **swap spread** position, a fund holds a gilt outright (financed by repo borrowing) and takes the opposite position in a same maturity swap on the expectation that gilt yields will fall relative to swap rates.

- Other **RV strategies use offsetting repo and reverse repo positions**. These are typically used to arbitrage between bonds of similar maturities. While a sudden repo funding withdrawal could trigger a disorderly unwind, the presence of two-way repo flows can help limit disruption to overall market functioning.

Chart A: Hedge fund net gilt repo borrowing has grown alongside an increase in futures open interest over the same period. This parallel movement suggests an expansion in cash-futures basis trades

Growth in hedge fund net gilt repo borrowing and gilt futures open interest since January 2024

Sources: Sterling money markets data, ICE Data Indices, LLC and Bank calculations (spikes in gilt futures open interest refer to contract roll periods).

UK markets are therefore not unique in this regard.[33] Similar strategies have emerged in other markets, where increased sovereign bond issuance has led to greater hedge fund activity. Many hedge funds operate across multiple jurisdictions and asset classes, underscoring their global footprint. This increases the risk that stress in one market could spill over into others through shared exposures or correlated deleveraging.

> **Although the nature and scale of risks will vary across different leveraged strategies, all can be vulnerable to sudden shifts in financing conditions or sudden spikes in margin.**

Bank staff analysis highlights four common triggers that could lead to forced or widespread deleveraging of these strategies:

- A **sudden withdrawal of repo funding**, which can prompt rapid asset liquidations and lead to fire-sale dynamics. In the Bank's system-wide exploratory scenario, many banks tightened terms on repo lending and/or became reluctant to extend financing during periods of stress, to a greater extent than expected by borrowers.
- Liquidity stress from **sharp increases in margin or collateral calls**, which could drain liquidity buffers and prompt asset sales for market participants with lower liquidity buffers, as observed in the dash for cash and the LDI episode.
- **Stop loss or risk limit breaches** during periods of high volatility, which could force abrupt deleveraging and position unwinds. This is particularly relevant to leveraged strategies as, without active risk management, losses can exceed capital.
- **Cross-market or cross-border contagion** due the interconnected nature of financial markets and the presence of common participants. Stress in other markets, for example in overseas equity or rates markets, could lead to the unwinding of leveraged strategies within core sterling markets.

> **Visibility of trading strategies varies, particularly for gilt futures and swaps, due to the offshore domicile of some market participants.**

Overall, there is a tendency towards increased concentration and interconnectedness given that the largest non-bank financial institutions (NBFIs) operate across multiple financial markets and represent a significant share of banks' prime brokerage balance sheets (Section 5).

Taken together, the growing use of NBFI leverage across a diverse set of leveraged strategies – combined with concentrated and often correlated participation and reliance on short-term funding – increases the risk that stresses or jumps to illiquidity are amplified.

> **While the increased participation of NBFIs in core UK markets reflects a structural shift, the specific leveraged trading strategies employed at any one time, and the associated risks, can change rapidly – highlighting the need for continued monitoring of evolving risk dynamics.**

Ensuring the resilience of core markets requires continued monitoring of leverage channels, data gaps and interconnections – both domestically and across borders.

Box D: Improving the FPC's capability to assess systemic risk in financial markets

The Bank is investing in its ability to monitor and assess systemic risks in UK financial markets.

Building on the **system-wide exploratory scenario (SWES)** exercise, Bank staff are developing a desktop-based system-wide stress testing capability, as well as other related tools. This will allow for periodic updates to the SWES findings, more quickly and at lower cost than the full SWES exercise, as the financial system and risk-taking behaviours evolve. Key areas for current work and future development include simulating liability-driven investment (LDI) funds' response to sudden changes in interest rates, understanding how investors in open-ended funds respond to price shocks, and how hedge funds behave in periods of heightened volatility. Alongside engagement with financial market participants, this will allow the FPC to improve its assessment of risks in financial markets by taking a system-wide perspective.

Pension funds invest in LDI funds to hedge their long-dated liabilities. LDI remains the largest leveraged strategy in the gilt market by size (Chart 6.2), making it a logical starting point for desk-based scenario analysis tools. Targeted work on this sector led to the development of a model to assess the impact of interest rate shocks on LDI funds, which the FPC used to help understand the impact of recent increases in gilt yields.

Following the autumn 2022 shock to gilt yields and the FPC's subsequent recommendations on LDI funds, regulators took steps to enhance fund resilience. This includes requirements to hold a resilience buffer, which should considerably reduce the risk that funds need to sell gilts in response to market shocks. The FPC also recommended that LDI funds improve the processes in place that enable them to replenish these buffers once a shock has taken place.

The Bank of England has used the SWES scenario to explore the response of LDI funds to shocks and the impacts of the FPC's LDI recommendations.

The **SWES scenario** comprised a rapid and significant shock to interest rates and credit spreads. In the exercise, LDI funds experienced losses on leveraged gilt and derivative positions, which depleted their interest rate buffers. As a result, they sought capital from investors. In many cases, fund managers implemented this by following pre-agreed instructions to sell specific assets, often involving redemptions from money market funds and credit-focused open-ended funds, as well as sales of direct holdings of securities such as corporate bonds and equities. The SWES exercise provided

valuable insights into a key transmission channel whereby a sharp increase in interest rates led to asset sales across the financial system and, in that exercise, contributed to the sterling corporate bond spreads widening and the market 'jumping to illiquidity'.

Sterling LDI funds report monthly to their regulators, providing information such as their net asset value (NAV), repo usage, interest rate sensitivity, and target buffer levels. Using these data, Bank staff have been working with The Pensions Regulator (TPR) to develop a tool to estimate the losses LDI funds would incur under different interest rate scenarios, and to estimate the size of any resulting capital calls to investors. This monitoring tool enhances the FPC's ability to track whether the LDI sector is becoming more, or less, sensitive to rate shocks over time, and to assess the potential knock-on effects on other parts of the financial system. Crucially, it can help identify inflection points or thresholds beyond which recapitalisation activity could become large enough to amplify a market stress. It may also suggest further actions that could be taken by regulators, for instance exploring whether pension schemes could use or find alternative ways of raising liquidity, such as selling different assets or putting in place repo agreements.

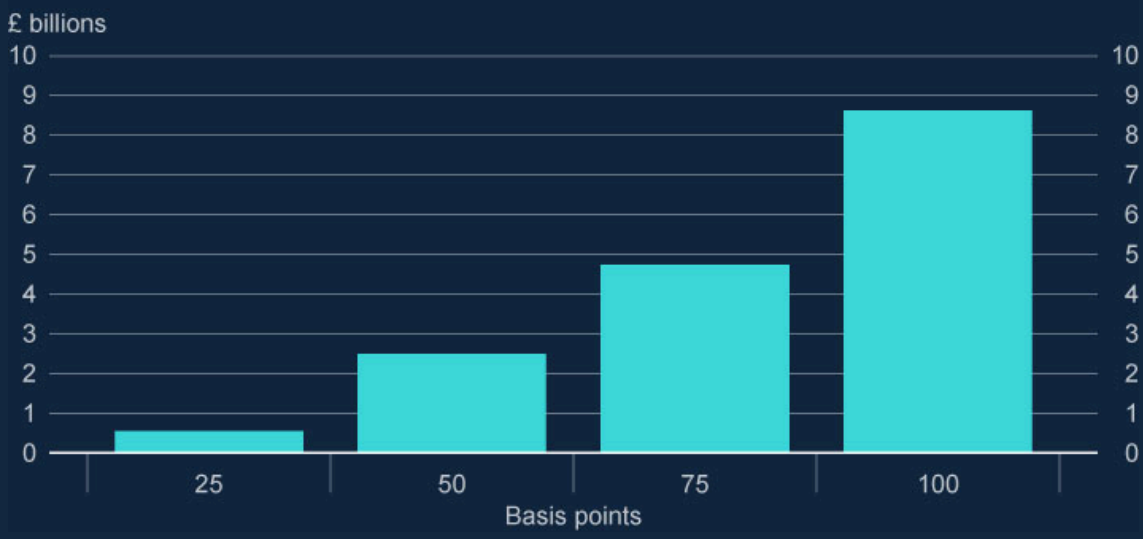
> **During the episode of market volatility in April (Section 1), Bank staff used the tool to assess the potential scale of LDI-related activity in real time.**

Based on the observed market moves, the underlying model flagged that a small number of funds were likely to have hit recapitalisation triggers and called on investors for additional capital. This assessment was consistent with market intelligence gathered by Bank staff, and with subsequent data on transactions in bond markets and redemptions from open-ended funds.

Chart A displays the estimated aggregate recapitalisation needs of LDI funds for different parallel shocks to the yield curve as of end-April 2025. It shows, for example, that a hypothetical 50 basis point parallel rise in yields could result in LDI funds requesting around £2.5 billion in additional capital from investors. To give a sense of the scale, the SWES exercise estimated that a larger 140 basis point shock could have led pension fund investors to receive recapitalisation requests of around £16.5 billion from their LDI managers.

Chart A: Recapitalisation needs for LDI funds increase with larger shocks to the yield curve

Based on illustrative stress testing using parallel yield curve shocks (a)



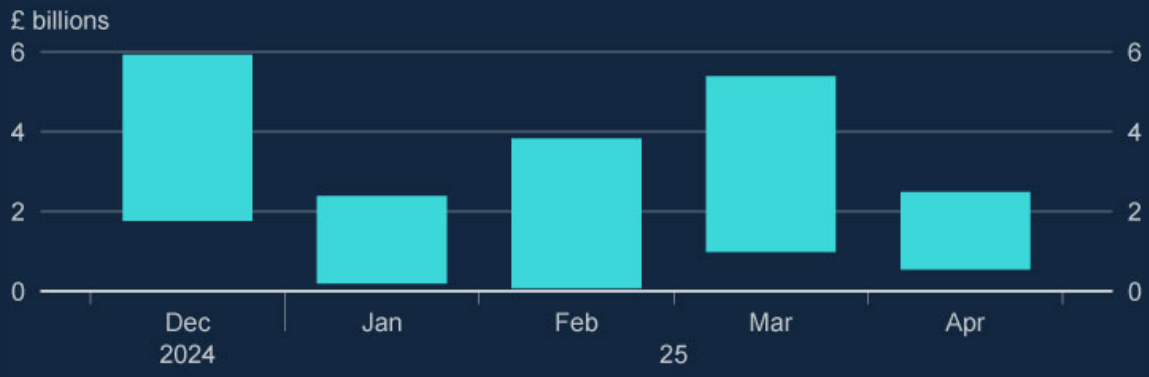
Sources: Bank of England and Bank calculations.

(a) Values in £ billions as reported for 30 April 2025.

Recent yield curve moves have not been parallel. Instead, long rates have tended to move more than short rates. So Chart B illustrates how the sensitivity to a range of possible yield curve moves has changed over time. At the end of 2024, moves in yields of 25–50 basis points would have triggered capital calls of between £2 billion and £6 billion. Then, in January 2025, yields rose prompting some LDI funds to call for additional capital, before yields subsequently fell (Chart C). As a result of this recapitalisation activity, the estimated range for the size of a capital call for a similar move in yields had declined to between £0 and around £2 billion by the end of January.

Chart B: Recapitalisation needs for LDI funds for a fixed shock to yields reveal the size of their buffers

Following a 25–50 basis point parallel shock to yield curve (a)



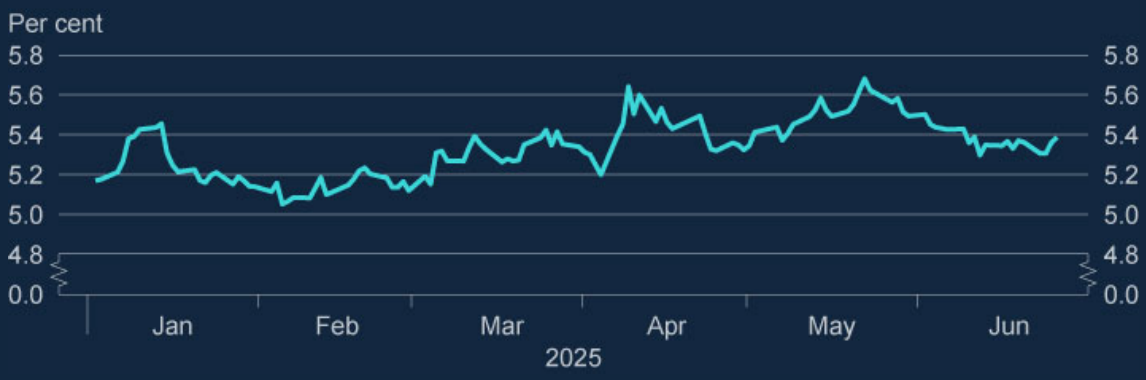
Sources: Bank of England and Bank calculations.

(a) Based on a 25–50 basis point parallel yield curve shock; values in £ billions reflect reported recapitalisation needs across LDI fund types between December 2024–April 2025.

Yields rose again between end-January and end-March, depleting buffers within LDI funds and increasing the size of potential capital calls. In April, another sharp rise in yields triggered further recapitalisation activity. However, by the end of the month, the combination of additional capital raised and a fall in yields brought the estimated recapitalisation need back down to £1 billion–£2 billion for a similar range of yield curve moves.

Chart C: Changes in interest rates (30-year gilt yields) is one driver of the size of LDI buffers

30-year gilt yields over time



Sources: Bloomberg Finance L.P., Tradeweb and Bank calculations.

Despite the severity of the April volatility, LDI funds remained resilient. Their recapitalisation activity did not disrupt market functioning, reflecting the effectiveness of the FPC's recommendations to strengthen the sector's resilience.[34]

> **The Bank is continuing to use lessons from the SWES to enhance its suite of surveillance tools.**

The desktop modelling tool developed for LDI funds marks a significant step forward in the Bank's ability to monitor systemic risk in near real time. It provides a practical and scalable way to assess the potential impact of interest rate shocks on the LDI sector and their possible transmission to other parts of the financial system. While the model currently focuses on parallel shifts in the yield curve, Bank staff are working to extend its functionality to better account for a wider range of market dynamics, including different patterns of yield curve movement. This will help ensure the tool remains relevant across a broader set of scenarios.

More broadly, leveraging the lessons learned from SWES, the Bank is continuing to invest in a suite of tools to support its market surveillance objectives. This includes work to better understand the behaviour of other key market participants such as open-ended funds and hedge funds in times of stress. It will be possible to use that analysis and those sector-specific models in combination to understand interactions between sectors. This will improve the FPC's understanding of how the collective actions of firms could impact core UK financial markets and the implications for financial stability. As part of this broader toolkit, Bank staff have also built a dashboard

that flags large and fast-growing derivative positions as a potential indicator of emerging risk, and built tools to simulate margin calls on derivatives in a range of market scenarios.[35] [36] Staff are steadily expanding this margin calls toolkit to cover more instruments for more classes of derivatives. Further work to expand the Bank's toolkit includes a framework for tracking systemic vulnerabilities in leveraged non-bank financial institutions, and a fund monitoring tool that applies a unified risk framework across key fund types. As with LDI funds, Bank staff expect to complement these tools with structured industry engagement to improve understanding of behavioural dynamics that may not be captured by models.

These efforts are closely aligned with the FPC's approach to assessing and mitigating risks in market-based finance, as set out in the **October 2023 Financial Stability in Focus**. That approach emphasises the importance of improving data, modelling, and surveillance capabilities. These objectives also align with international efforts led by the Financial Stability Board to improve the surveillance of non-bank financial intermediation globally.

Box E: Implications of the growth in private markets for financial stability and real economy financing

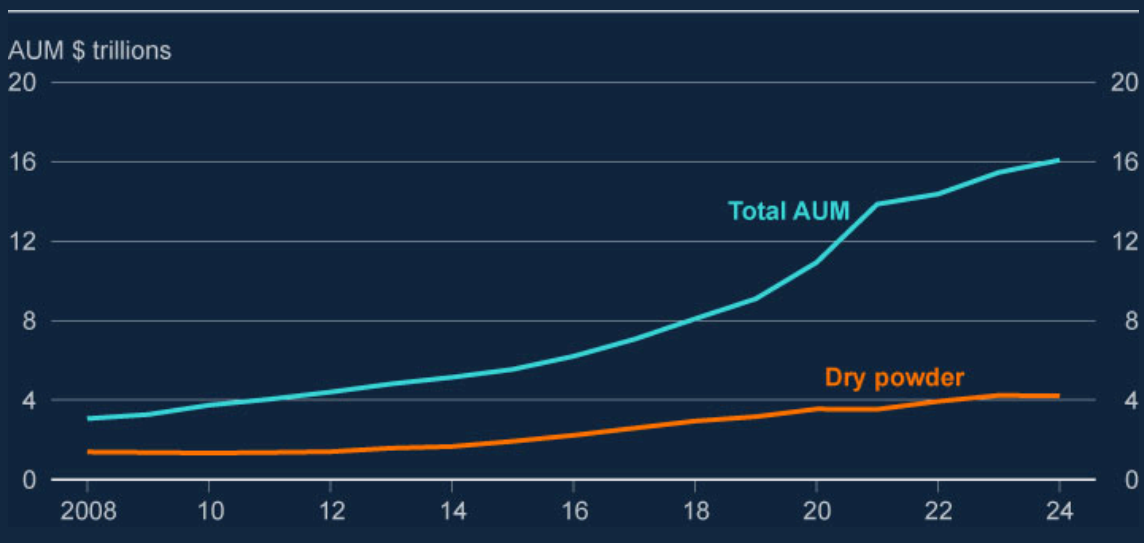
The FPC has previously described vulnerabilities relating to private markets from high levels of leverage, opacity around valuations and interconnectedness with other parts of the financial system. This box explores how challenges associated with the current macroeconomic environment could interact with these vulnerabilities to impact the cost and availability of finance for UK corporates, as well as describing further work the Bank intends to do on this topic.

The role and size of private markets worldwide have grown significantly since the global financial crisis.

Over the past 15–20 years – a period of predominantly low interest rates – private markets have grown globally, reaching around $16 trillion by total assets under management (AUM). Of this, around $4 trillion is committed capital from limited partners that has not yet been drawn down (known as ‘dry powder’) (Chart A). Private markets encompass different types of finance, including private equity and credit, covering infrastructure, real assets, real estate and venture capital.

Chart A: Private markets AUM has increased significantly since the global financial crisis

Global private markets dry powder and total AUM



Sources: PitchBook Inc. and Bank calculations.

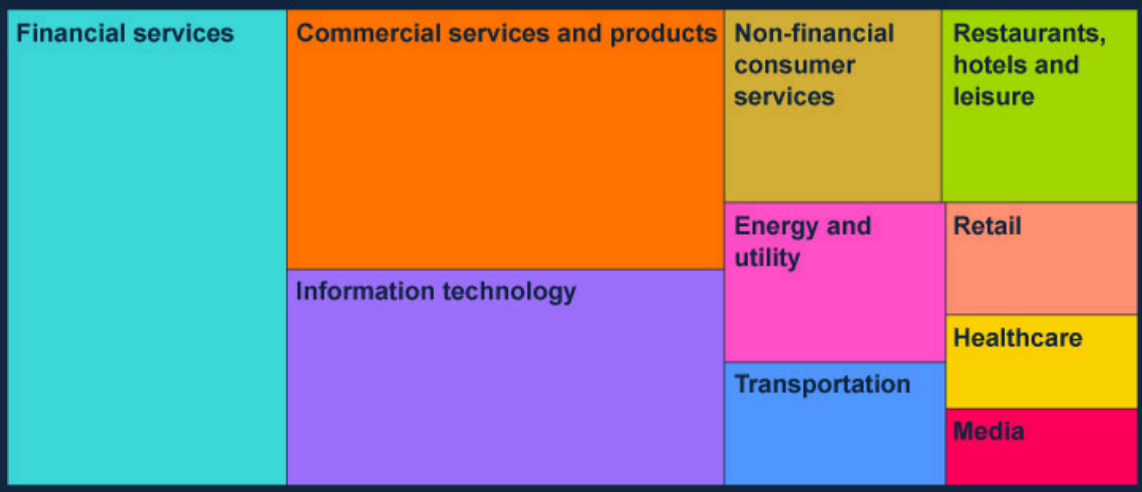
In the UK, private markets have become an increasingly important source of funding for corporates.

Private equity (PE) backed corporates account for around 15% of total UK corporate debt and 10% of UK private sector employment (over two million jobs). UK PE-backed corporates have secured financing through private capital across a diverse range of sectors (Chart B).

PE provides long-term capital that helps businesses scale, innovate, and invest in productivity-enhancing initiatives. Venture capital in particular funds small and medium-sized enterprises (SMEs) that may struggle to access traditional financing (Box B). And as set out in the **June 2024 FSR**, from a macroprudential perspective, the long-term nature of private capital allows and incentivises fund managers to act less cyclically, which can reduce the volatility of financing flows in macroeconomic downturns. Some economic literature also indicates that PE buyouts can increase firm-level productivity through greater capital expenditures.[37]

A large proportion of PE-backed corporates have high levels of debt and are financed from riskier credit markets like private credit and leveraged loans, making PE-backed corporates relatively more exposed to higher interest rates and deteriorations in investor risk sentiment. The Bank has also **previously highlighted** credit risk from the weakening in underwriting standards in these markets in the years following the GFC. Examples include the increasing share of leveraged loan deals with weaker covenants, a rise in the use of earning add-backs to reduce headline leverage multiples, and looser documentation standards.

Chart B: UK PE-backed companies, private capital raised by sector



Sources: PitchBook Inc. and Bank calculations.

> **The private finance sector has been resilient so far. But having grown rapidly in a low interest rate environment, it is now facing challenges from higher interest rates and a weaker and more uncertain growth outlook, in part related global fragmentation around trade. These challenges have the potential to interact with existing private market vulnerabilities from high leverage, opacity around valuations, and interconnectedness.**

A key way that private funds have delivered returns to investors in the past has been by selling their portfolio companies as the funds reach maturity. But according to market contacts, the higher interest rate environment and macroeconomic uncertainty have constrained funds' ability to make such sales, which is consistent with the subdued level of activity in initial public offering markets.

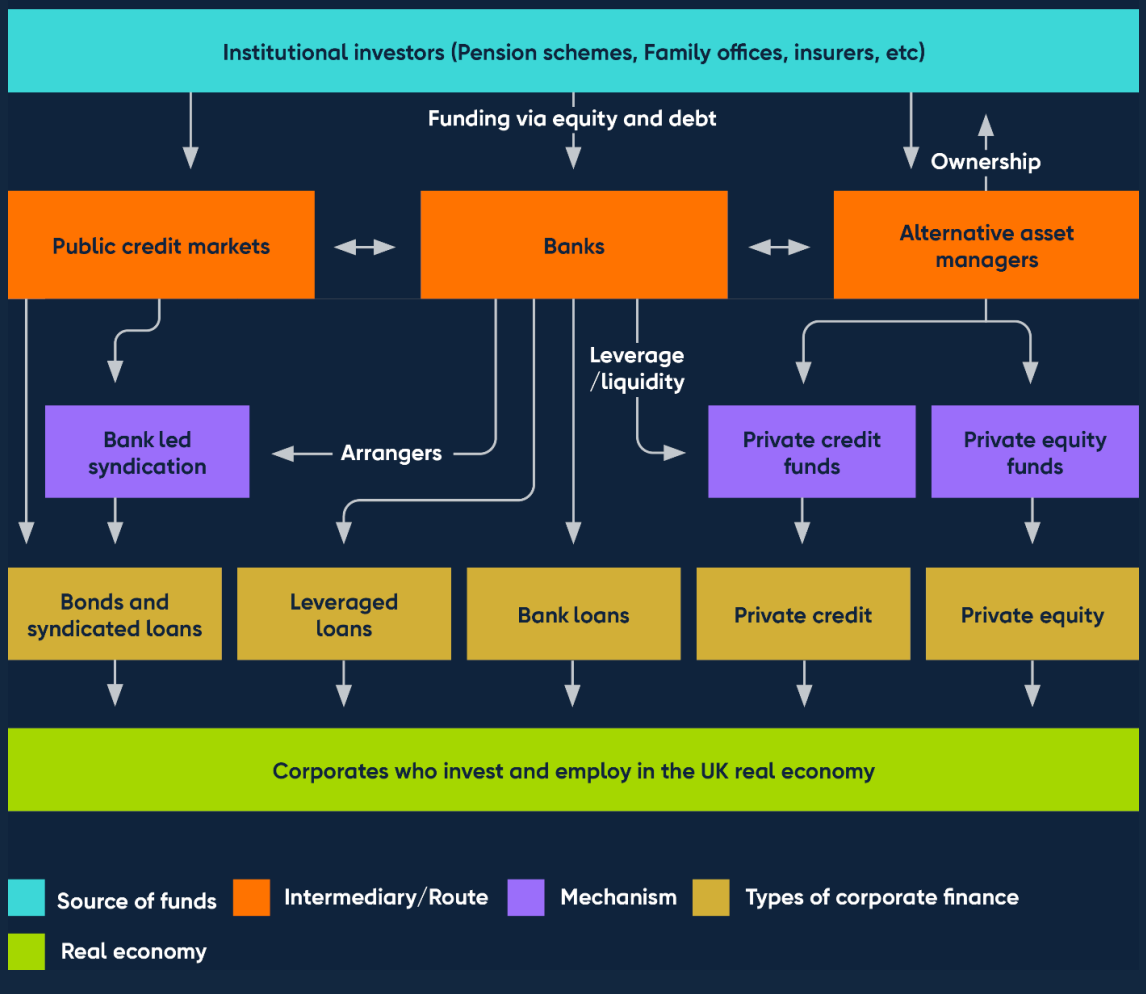
Private market funds are therefore increasingly employing other strategies to provide returns to investors such as continuation vehicles. These vehicles are typically used to transfer ownership of selected portfolio companies to a new fund. Should exit opportunities remain limited, private asset managers may face challenges in attracting new capital and older funds could ultimately be compelled to sell corporate assets at the maturity of their funds. Widespread sales could affect the value of corporate assets more widely, particularly given relative opacity over valuations and some credit ratings in private markets (**see findings from the FCA's review of private market valuation**

practices). This in turn could affect investor risk appetite for corporate debt across private and public markets, reducing the supply and increasing the cost of finance for corporates.

> **Interconnections across financial markets may heighten systemic vulnerabilities, particularly under stress conditions, by reinforcing correlations and amplifying shocks.**

Globally, large institutional investors are the primary participants in private market funds, with insurance companies and pension funds collectively accounting for approximately 75%–80% of capital invested. Banks provide financing to private market funds (Figure A shows a simplified stylistic map). A shock to highly indebted corporates could be amplified by these interconnections, with losses and the impact on risk appetite potentially spilling across several markets and sectors.

Figure A: A stylistic map of economic linkages between private markets and the broader financial system



Banks directly and indirectly finance private market funds and PE-backed corporates through a number of channels. They arrange and syndicate loans, offer various forms of NAV based financing and also typically provide revolving credit facilities to these PE-backed corporates.

Banks offer direct loans and revolving credit facilities to PE-backed corporates. Banks arrange syndicated loans to PE-backed corporates. These loans can become further interconnected with the financial system when securitised via collateralised loan obligations (CLOs). CLOs and other parts of the financial system place a degree of reliance on credit ratings creating an important role for credit rating agencies in this system of finance. As discussed in a speech by an FPC member – **Not-so-private questions**, PE funds are making greater use of secured borrowing against the net asset value (NAV) of their portfolios, commonly referred to as NAV financing. This form of leverage enables funds to monetise existing assets and access liquidity. While this strategy can support short-term returns, it also introduces potential risks. If funds respond to return pressures by significantly increasing leverage through instruments such as NAV financing, this could increase their overall risk profile.

Private market firms are increasingly interconnected with the global insurance sector.

Private asset manager ownership of insurers has grown significantly in the US over the past decade, as highlighted in the **November FSR**. This business model is associated with higher target returns via greater risk-taking, as shown by the growth of PE-backed insurers and reinsurers investments in private assets, which tend to be riskier, less liquid and harder to value. In addition, differences in insurance regimes between jurisdictions have encouraged the growth in funded reinsurance arrangements between insurers and reinsurers. UK insurers have increased their use of funded reinsurance (FundedRe), although currently, the use of FundedRe in the UK is small relative to the industry's annuity liabilities. A sharp deterioration in PE-backed corporate asset performance, or reassessment of their credit risk could impact insurers via the collateral channel. The **November FSR** also highlighted risks from cross-border reinsurance. The growing interconnection of private market firms to the global insurance sector via complex arrangements makes it difficult for regulators and market participants alike to assess risks holistically, including to insurers.

The Bank is enhancing its analytical capabilities to develop a more holistic view of system-wide vulnerabilities.

As noted in a recent speech by the Governor, (**Are we underestimating changes in financial markets?**) it is important to understand the behaviour of different parts of the financial system under stress, and the market dynamics and financial stability risks driven by interactions of market participants. Further work is needed to address

significant data gaps that hinder the ability of financial stability authorities to understand how private markets might operate after a shock, and how stress within private markets might interact with the wider financial system and potentially disrupt to the UK real economy financing.

As part of this effort, the Bank intends to continue to undertake structured engagement with private market participants and key providers of capital to the sector. The objectives of this will be to: a) deepen understanding of how private markets finance the real economy and support growth b) understand how the private markets ecosystem may operate during a downturn, including behavioural responses of investors to losses.

Annex: Macroprudential policy decisions

This annex lists any FPC Recommendations and Directions from previous periods that have been implemented or withdrawn since the **November 2024 Report**, as well as Recommendations and Directions that are currently outstanding. It also includes those FPC policy decisions that have been implemented by rule changes and are therefore still in force.

Each Recommendation or Direction has been given an identifier to ensure consistent referencing over time. For example, the identifier 17/Q2/1 refers to the first Recommendation made at the 2017 Q2 Committee meeting.

Outstanding FPC Recommendations and Directions (as at the date of the FPC's meeting on 27 June 2025)

On 23 March 2023, the FPC made the Recommendation (23/Q1/2) that:

- The Pensions Regulator (TPR) should have the remit to take into account financial stability considerations on a continuing basis. This might be achieved, for example, by including a requirement to have regard to financial stability in its objectives, which should be given equal weight alongside other factors to which TPR is required to have regard. The FPC noted that in order to achieve this, TPR would need appropriate capacity and capability.

On 27 June 2025, the FPC made the Recommendation (25/Q2/1) that:

- The PRA and FCA should together (i) aim to ensure that the aggregate flow of new residential mortgages from mortgage lenders at loan-to-income ratios (LTIs) at or greater than 4.5 does not exceed 15% of total new residential mortgages, and (ii) allow individual lenders to increase their share of lending at such high LTIs while aiming to ensure the aggregate flow remained consistent with the limit of 15%. The FPC recognises that, in doing so, such high LTI lending by individual lenders could exceed 15% of their total number of new residential mortgages while the aggregate flow remains consistent with the 15% limit. The aggregate flow is calculated based on new residential mortgages extended by lenders which extend residential mortgage lending in excess of £150 million per annum.

The explanation of the Recommendation is set out in the **Record of the meeting on 27 June 2025**, and further discussed in Box A of this Report.

FPC Recommendations withdrawn since the 8 April 2025 meeting

On 15 November 2024, the FPC made the Recommendation (24/Q4/1) that the PRA and the FCA should ensure that mortgage lenders do not extend more than 15% of their total number of new residential mortgages at LTIs at or greater than 4.5. This Recommendation applies to all lenders which extend residential mortgage lending in excess of £150 million per annum. The Recommendation should be implemented as soon as is practicable.

Other FPC policy decisions which remain in place

The following text sets out previous FPC decisions, which remain in force, on the setting of its policy tools. The calibration of these tools is kept under review.

Countercyclical capital buffer (CCyB) rate

The FPC agreed to maintain the UK CCyB rate at 2% on 27 June 2025, unchanged from its 8 April 2025 meeting. This rate is reviewed on a quarterly basis. The UK has also reciprocated a number of foreign CCyB rate decisions – for more details see **The countercyclical capital buffer** (CCyB). Under PRA rules, foreign CCyB rates applying from 2016 onwards will be automatically reciprocated up to 2.5%.

Leverage ratio

In September 2021, the FPC finalised its review of the UK leverage ratio framework, and issued a Direction and Recommendation to implement the outcome of the review as set out in its **October 2021 Record**.

In October 2022, in line with its statutory obligations, the FPC completed its annual review of its Direction to the PRA. The FPC revoked its existing Direction to the PRA in relation to the leverage ratio regime, and issued a new Direction on the same terms as in September 2021 with the addition of discretion for the PRA to set additional conditions to the central bank reserves exclusion.

The full text of the FPC's Direction to the PRA on the leverage ratio is set out in the Annex of the **October 2022 Record**, together with the original Recommendation (now implemented).

The PRA has **published its approach** to implementing this Direction and Recommendation.

Other FPC activities since the November 2024 Report

Other FPC activities since the November 2024 Report not included elsewhere in this Report are set out in full in the **Financial Policy Committee Record – April 2025**, and **Financial Policy Committee Record – July 2025**. These include:

- Discussing risks from non-bank financial institution (NBFI) leverage to financial stability via core financial markets and systemically important institutions as well as ongoing policy initiatives to address these; welcoming progress in developing monitoring tools, including more comprehensive data on systemic institutions' exposures to NBFIs and for sterling derivatives; and agreeing to publish aggregated information on leverage and positioning to support market participants in understanding their positioning relative to the market, thereby informing their internal risk management.
- Discussing the significant developments in stablecoins, globally, since the November 2024 Report and discussing Bank and FCA policy proposals for the regulatory regime for systemic and non-systemic stablecoins.
- Considering the findings of the 2024 Cyber Stress Test (CST24) and noting that cyber and operational resilience stress testing remain a core part of the Committee's toolkit for understanding firms' ability to respond and recover from severe but plausible operational disruption. It welcomed the findings published in the **CST24 thematic letter** of 9 July 2024, which aim to assist firms in understanding how operational disruption of their services could lead, through financial, operational and confidence channels, to broader potential financial stability impacts. And it judged this important in assisting all firms to improve their understanding and analysis of such financial stability impacts, consistent with expectations for firms' management of their operational resilience.
- Updating on 3 July 2024 its O-SII buffer framework policy document in line with the restated Capital Buffer Regulations to ensure that its scope continued to include firms that were currently systemically important, or would become so in future, for example, through mergers and acquisitions, or expansion in their balance sheets. It also updated the policy document to reflect the increased length of the review cycle of the O-SII buffer framework from at least every two to at least every three years.
- Welcoming the work of the FCA and PRA in relation to private market valuation practices and private equity related financing.
- Publishing a Financial Stability in Focus to provide detail on its systemic risk assessment and approach to monitoring risks from AI.
- Discussing its approach to responding to the request from the Chancellor to assess and identify areas where there is potential to increase the ability of the financial system to contribute to sustainable economic growth without undermining financial stability.
- Welcoming that the Contingent Non-Bank Financial Institution Repo Facility (CNRF) had opened for applications on 28 January 2025.
- Welcoming plans by HM Treasury, the FCA and the Bank of England to support an industry recommendation to move to T+1 settlement in UK markets by 11 October 2027.
- Welcoming the FCA's policy statement, published on 5 February 2025, on reforming the commodity derivatives regulatory framework that aims to mitigate the risk from concentrated positions in commodity markets.

- Welcoming the launch of the PRA's biennial Life Insurance Stress Test on 16 January 2025.
- Welcoming the launch of the **2025 Bank Capital Stress Test** on 24 March 2025.

Glossary

Abbreviations

ABS – Annual Business Survey.

AI – artificial intelligence.

AUM – assets under management.

CAPE – cyclically-adjusted price-to-earnings.

CCPs – central counterparties.

CCS – Credit Conditions Survey.

CCyB – countercyclical capital buffer.

CET1 – Common Equity Tier 1.

CFTC – Commodity Futures Trading Commission.

CLOs – collateralised loan obligations.

CNRF – Contingent NBFI Repo Facility.

COLA-DSRs – cost of living adjusted mortgage debt-servicing ratios.

CRE – commercial real estate.

CST24 – Cyber Stress Test 2024.

DLT – Distributed Ledger Technology.

DP – discussion paper.

DSR – debt-servicing ratio.

DXY – US Dollar index.

EMIR – European Market Infrastructure Regulation.

EU – European Union.

FCA – Financial Conduct Authority.

FPC – Financial Policy Committee.

FSB – Financial Stability Board.

FSR – Financial Stability Report.

FTBs – first-time buyers.

FX – foreign exchange.

G7 – Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

GC – general collateral.

GDP – gross domestic product.

GFC – global financial crisis

HM Treasury – His Majesty's Treasury.

HQLA – high-quality liquid asset.

ICE – Intercontinental Exchange.

ICR – interest coverage ratio.

IFRS – International Financial Reporting Standard.

ILTR – Indexed Long-Term Repo.

IMF – International Monetary Fund.

IOSCO – International Organization of Securities Commissions.

LDI – liability-driven investment.

LEM – leverage exposure measure.

LL – leveraged loan.

LTI – loan to income.

LTV – loan to value.

MBF – market-based finance.

MCOB – Mortgage Conduct of Business.

MiFID – Markets in Financial Instruments Directive.

MMF – money market fund.

MOVE – Merrill Lynch Option Volatility Estimate.

MPR – Monetary Policy Report.

NAV – net asset value.

NBFI – non-bank financial institution.

OECD – Organisation for Economic Co-operation and Development.

OEF – open-ended fund.

OIS – overnight index swap.

ONS – Office for National Statistics.

O-SII – other systemically important institution.

PE – private equity.

PFE – Potential Future Exposure.

PPP – purchasing power parity.

PRA – Prudential Regulation Authority.

PtTB – price to tangible book.

RoTE – return on tangible equity.

RV – relative value.

SME – small and medium-sized enterprise.

SMF – Sterling Monetary Framework.

SMMD – sterling money market data.

STR – Short-Term Repo.

SWES – system-wide exploratory scenario.

TPR – The Pensions Regulator.

VIX Index – Cboe Volatility Index.

1. See **A system-wide approach to system-wide resilience: CCPs and their users − speech by Sarah Breeden | Bank of England**
2. **Systemic Risk Survey Results – 2025 H1.**
3. IMF, **Global Financial Stability Report** (April 2025), Chapter 2.
4. BIS, **Dollar debt in FX swaps and forwards: huge, missing and growing** (2022).
5. ECB, **Financial Stability Review, May 2025**; **Risks to euro area financial stability from trade tensions**, May 2025.
6. The sectoral definition used here combines sectors more likely to report an expected decrease in sales from the recent US tariffs, with sectors vulnerable to decreases in consumer demand. These sectors are: agriculture, manufacturing, construction, wholesale and retail trade, real estate activities, and hospitality and leisure. This is a broader definition than the vulnerable corporate sectors discussed in Section 2.
7. The FPC also introduced an affordability test recommendation, which was **subsequently withdrawn** to simplify the overall regulatory regime.
8. **Financial stability at your service – speech by Sarah Breeden** and **Picking what matters – speech by Nathanaël Benjamin**.
9. There is substantial evidence that well-functioning debt and equity markets support economic growth. For example, **Rajan and Zingales (1998)**, **Brown et al (2013)**, and **Beck and Levine (2002)**.
10. **Mian and Sufi (2014).**
11. **Anzoategui et al (2019)**.
12. **Fernald and Inklaar (2022)**.
13. **Goldin et al (2024)**.
14. Many papers find credit booms exacerbate the severity of financial crises and reduce the pace of economic recovery. For example, **Braun et al (2024)**; **Ivashina et al (2024)** and **Mian and Sufi (2010)**. **Cecchetti and Kharroubi (2015)** also find bubbles may be harmful because fast growth of the financial sector can crowd out other industries by reducing availability of labour and funding.
15. **Wurgler (2000)** shows that countries with deeper financial markets allocate investment more efficiently across firms, improving productivity growth.
16. **Boissay et al (2019)** find that an increase in bank capital requirements only has a small impact on economic activity, and **Akinci and Olmstead-Rumsey (2018)** find mixed evidence on the relationship between macroprudential policies and growth. However, **Rancière et al (2008)** find that actions to improve financial stability may adversely impact the long-run economic growth rate.
17. **Enterprise Research Centre (2015) – Contribution to Job Creation by High Growth SMEs**, **Nesta (2013) – The Vital 6%**, **OECD (2014) – The Dynamics of Employment Growth** and **Haltiwanger et al (2013)**.
18. **There once was an ugly duckling – speech by Andy Haldane**.
19. Scale-ups are defined as firms growing their employment numbers and/or turnover by more than 20% a year over a period of three years, with at least 10 employees at the start of the period.

20. See **Financial Stability Report – June 2024** (Box A) for detail on the significance of PtTB ratios as an indicator of forward-looking performance.
21. See **Bailey (2024)** and **Financial Stability Report – December 2023** (Box D) for further discussion of the implications for UK banks of the normalisation of the Bank of England's balance sheet.
22. This could occur, for example if a counterparty in a multilateral arrangement were to default, meaning the firm could no longer rely on certain trades that receive lower LEM values than other economically similar transactions. More generally, the extent to which firms can use these more capital efficient transaction may be limited in tighter market conditions where it would be more challenging to form such transactions.
23. Markets such as the gilt market, gilt repo market and associated derivative markets.
24. Although in the most recent case, gilt trading volumes increased from a higher base given the rise in trading activity since the interest rate hiking cycle began in mid-2022.
25. **Financial Policy Summary and Record - March 2023** provides more detail.
26. Data collected under the UK European Market Infrastructure Regulation.
27. These vulnerabilities are described in greater detail in Section 2.1.1. of the **FPC's market-based finance Financial Stability in Focus**.
28. In March 2021, high levels of hidden leverage in equity derivatives were a key factor in the default of Archegos; an episode that highlighted the transmission channels through which the behaviour of leveraged investors can affect both markets and the banking sector.
29. **Shining a light on hidden leverage: using transaction level data to monitor leveraged positions in the non-bank financial system**.
30. **Financial Policy Summary and Record - June 2024**.
31. UK EMIR only covers trades involving counterparties that are established in the UK, refer to **Trade Repository (TR) Data Collections**.
32. Flatteners involve the opposite dynamics to steepeners (including net repo lending) and are likely to be used when investors expect a tighter yield spread between long-term and short-term bonds.
33. Epp and Gao (2025), **Are Hedge Funds a Hedge for Increasing Government Debt Issuance?**.
34. **Financial Policy Summary and Record – March 2023**.
35. For more details please refer to the Bank Overground, **Shining a light on hidden leverage: using transaction level data to monitor leveraged positions in the non-bank financial system**.
36. For more details please refer to the Bank Overground, **Monitoring collateral calls**.
37. See **Private equity financing and firm productivity**, The productivity institute, Lavery et al (2024a) and **Do private equity owned firms have better management practices?**, American Economic Review, Bloom et al (2015).