

# FINANCIAL STABILITY REPORT PRESS CONFERENCE

Tuesday 7 July 2026

## Opening remarks by Andrew Bailey, Governor of the Bank of England

Welcome to the press conference for the July 2026 Financial Stability Report. I should start off by noting that this Financial Stability Report was the last which benefitted from the input of Sam Woods, who left his post as Deputy Governor for Prudential Regulation on 30<sup>th</sup> June. I would like to thank him for his 10 years of service to the PRA and the FPC, and welcome Katharine Braddick back to the Bank. Katharine joined us on 1<sup>st</sup> July, after our FPC discussions had concluded, hence you only have Sarah and me taking your questions today.

I will highlight the key themes from today's publications by the Financial Policy Committee (FPC). I will start with our view on the overall risk environment, before turning to the FPC's work on AI, including the risks emanating from frontier AI, and finally outlining the announcements made today with regards to the FPC's Review of Bank Capital.

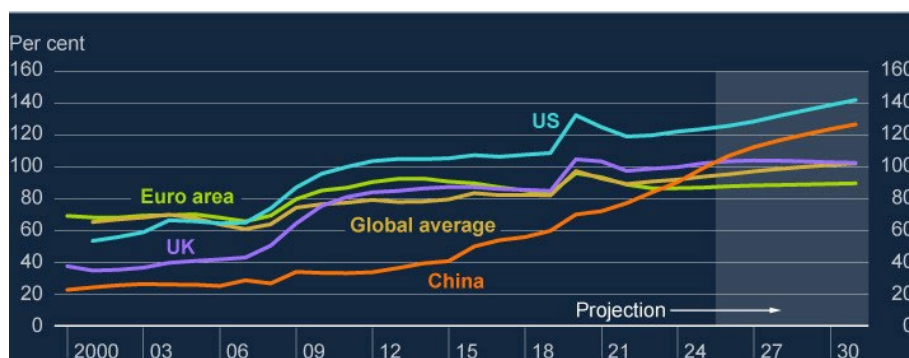
Starting with the overall risk environment, **the conflict in the Middle East has resulted in a substantial negative supply shock to the global economy**. Whilst the signing of the Memorandum of Understanding between the US and Iran has reduced near-term risks, energy prices and sovereign bond yields have been volatile, and market interest rates globally, including in the UK, remain higher, tightening financial conditions.

**Beyond events in the Middle East, vulnerabilities previously highlighted by the FPC persist in sovereign debt markets, risky credit markets, including in private credit, and risky asset valuations**. Since our last FSR, some of these vulnerabilities have become more pronounced, most notably due to a substantial increase in the use of leverage in equity markets. The FPC is particularly concerned that a number of these vulnerabilities could crystallise simultaneously.

Turning first to sovereign debt markets. **Globally we have continued to see historically high issuance, and debt-to-GDP ratios are expected to continue on an upward trajectory in many major economies**, as shown in **Chart 1**. Many of these markets are characterised by a relatively high use of leverage.

## Chart 1: Debt-to-GDP ratios globally continue to trend upwards

Sovereign debt (percentage of GDP)<sup>(a)</sup>

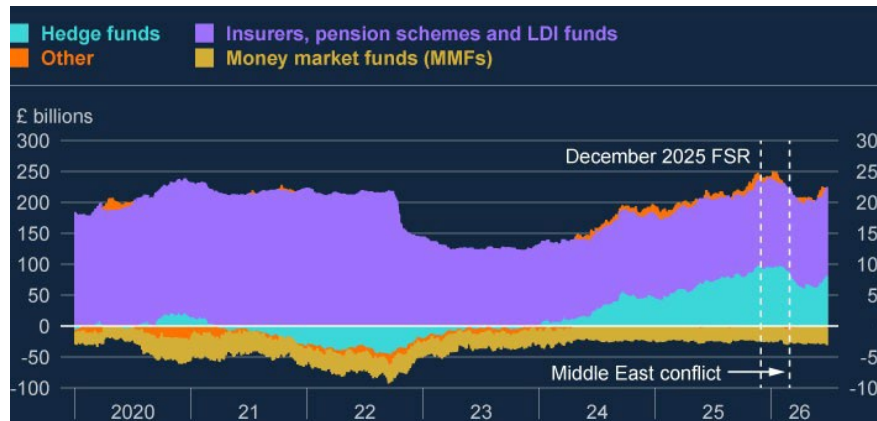


Sources: International Monetary Fund (IMF) and Workspace from LSEG.  
<sup>(a)</sup> Use of IMF Content and Data is subject to the IMF's terms of Copyright and Usage

**High levels of leverage increase the risk of a disorderly unwind of positions in response to shocks, with ensuing impacts on market functioning.** This was visible following the onset of the Middle East conflict, when moves in bond yields in some markets, including the UK, were amplified by hedge fund deleveraging. **Chart 2** shows that these dynamics were reflected in gilt repo markets, where net hedge fund borrowing declined by around 40% between the December FSR publication and mid-April, with most of this decline taking place in the five weeks following the onset of the Middle East conflict. Net hedge fund borrowing has since started increasing again since the end of May. Whilst markets remained functional, this period underscores the importance of continuing to build and maintain resilience in our core markets, to reduce the risks of market volatility leading to dysfunction and threatening financial stability. In particular, the FPC is focused on building resilience in the gilt repo market. The Bank is considering further the benefits and costs of potential market structure reforms, and we are keen to continue to engage with market participants on this important issue.

## Chart 2: Hedge funds have reduced their net gilt repo borrowing, but it remains elevated by historical standards

Net repo positioning across non-bank sectors



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

**Risky credit markets, including private credit, remain vulnerable to a tightening in financial conditions.** Investor sentiment in parts of private credit markets had already weakened ahead of the conflict, reflecting growing concerns around asset quality, valuations, and liquidity. Structural vulnerabilities in these markets, such as high leverage, complexity and opacity persist, emphasising the importance and timeliness of the Bank's second system-wide exploratory scenario (SWES) exercise. Data gaps are being reduced, reflecting continued good engagement from alternative asset managers and other participants in the exercise.

**Despite the challenging global risk environment, equity valuations continue to be high relative to earnings.** Chart 3 shows the cyclically adjusted price to earnings yield for the S&P 500, which has fallen to levels not seen since the dot-com bubble. Even when excluding the top 30 AI-related stocks, the level is around the lowest seen since 2007, suggesting this stretch in valuations is broader than just AI-related optimism. An initial fall in equity prices following the onset of the Middle East conflict quickly reversed, with AI-related companies a particular source of growth, which has led to increased concentration, especially in US equity markets. This is shown in Chart 4 which shows AI-related companies' market capitalisation as a proportion of relevant indices.

### Chart 3: Equity valuations continue to be stretched relative to historical levels

S&P 500, Excess cyclically adjusted price to earnings (CAPE) yield<sup>(a)</sup>



Sources: Bloomberg Finance L.P., S&P Dow Jones Indices, a subsidiary of S&P Global and Bank calculations.

<sup>(a)</sup> 'Top 30 AI' are defined as those stocks which appear in JP Morgan's JPAMAIDE Equity Basket, which is comprised of 30 S&P 500 stocks which are particularly impacted by AI.

### Chart 4: AI-related companies' share of equity indices has grown materially in some jurisdictions since 2022

AI-related companies' market capitalisation as a proportion of the relevant indices<sup>(a)</sup>



Sources: LSEG Workspace and Bank calculations

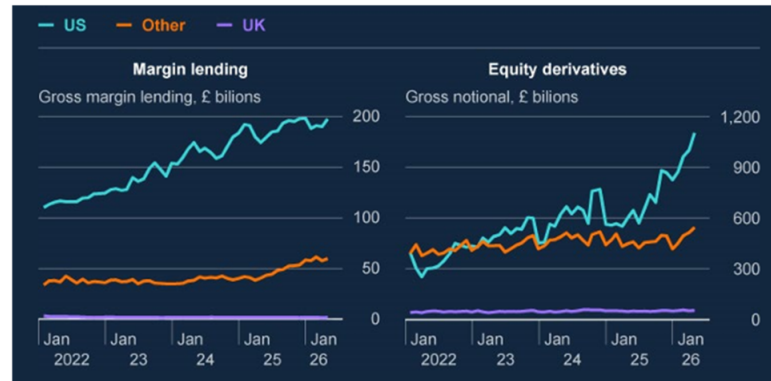
<sup>(a)</sup> The chart shows the share of total index market capitalisation accounted for by AI-related firms across major equity indices: the United States (S&P 500), Taiwan (TAIEX), South Korea (KOSPI), Japan (TOPIX 100) and the United Kingdom (FTSE 100). The numerator captures the combined market capitalisation of firms classified as AI-related, based on a predefined basket constructed from the holdings of AI-focused investment funds. The denominator is the total market capitalisation of each index. Values are reported as at 31 December 2022, 31 December 2025 and 12 June 2026. In all periods, market capitalisation is calculated using index constituents as at 12 June 2026.

In this context, the risk of a sharp correction in equity markets remains high, for example if investor expectations shift as a result of a change in the macroeconomic outlook, or changing expectations about the earnings potential of AI firms. The scope for these sudden movements is increased not only by high concentration and correlated positions, but also by the increased use of leverage in equity markets.

**Chart 5** shows that UK banks' synthetic leverage to hedge funds has risen alongside financial leverage from margin lending, which is collateralised by equities. In addition, we can see this increase in leverage through record levels of prime brokerage balances.

## Chart 5: UK banks' synthetic leverage to hedge funds has risen alongside financial leverage from margin lending

Estimated gross leverage provided by UK banks to hedge funds through gross equity derivatives notional and gross margin lending collateralised by equities



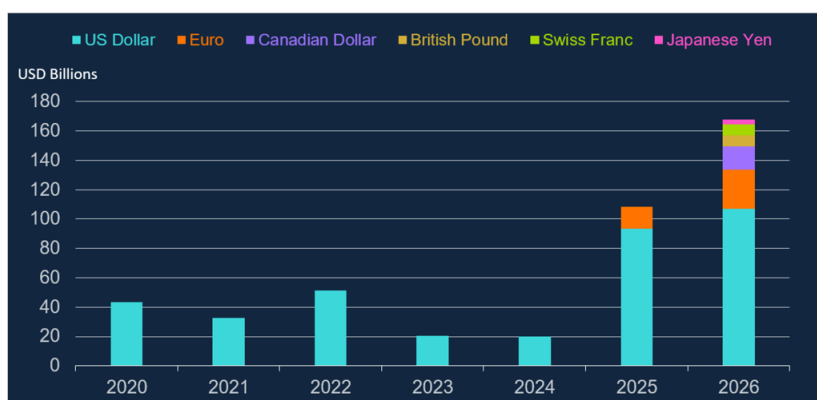
Sources: EMIR and SFTR Data. Bank calculation. Note: For the purposes of the above Figure, we are treating UK banks as banks with a reporting obligation under UK EMIR or UK SFTR, including UK subsidiaries of non-UK banking groups. Some activity may be understated, as it may be provided predominantly by entities that are outside the scope of UK SFTR reporting. Derivatives estimates include all product types and are measured on a gross notional basis. Equity derivatives exposures to hedge funds may be only partially captured as only UK managed or domiciled parties report.

**Meanwhile, there has also been a significant increase in assets under management within levered exchange-traded funds (ETFs)** in recent months, again particularly in those holding AI-related stocks. Market intelligence indicates that retail investors are the main holders of levered ETFs. This increase has occurred in the context of retail investor inflows more broadly, including into unlevered ETFs, which may have added momentum to the rise in equity prices. While total levered equity ETF holdings remain small relative to total unlevered equity ETF holdings, their use of leverage means they can amplify price moves. These dynamics echo those which were prevalent ahead of the summer 2024 equity market sell-off where volatility was substantially amplified.

**AI firms' use of credit markets has accelerated rapidly**, including in public markets, private credit, leveraged and structured finance – and their financing needs are likely to continue to expand. **Chart 6** shows that AI hyperscalers' bond issuance for the first half of this year has already exceeded their issuance for the whole of 2025. And if the scale of AI debt financing grows as expected, consistent with their historically unprecedented pace of investment, an adverse shock to AI companies that impacts their ability to service this debt could more materially affect global financing conditions. **Chart 7** shows that AI hyperscalers' free cash flows are declining, increasing their dependence on accommodative future refinancing conditions in capital markets to sustain their infrastructure investment over time. Increasing complexity and opacity in debt structures could also increase risks to financial stability.

## Chart 6: AI hyperscalers' bond issuance in the first half of 2026 has already exceeded 2025 issuance

AI hyperscalers' bond issuance by year and currency (a)

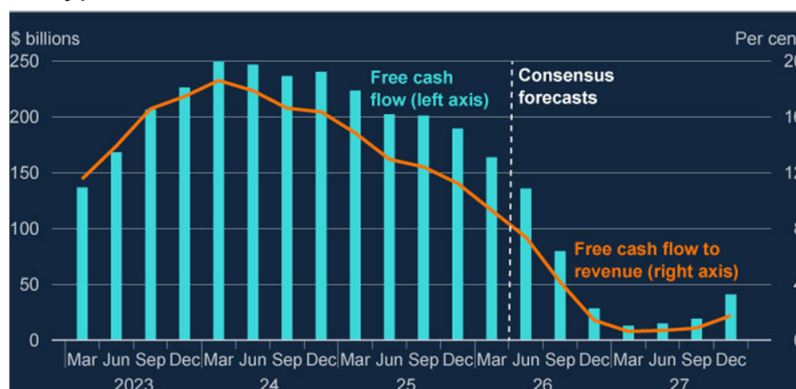


Source: LSEG Workspace

(a) The chart shows investment grade bond issuance by hyperscalers (Meta, Alphabet, Amazon, Microsoft and Oracle), aggregated by year and broken down by currency of issuance. Currency conversions are based on the end-of-day spot rate as at 22 June 2026. All figures are denominated in USD.

## Chart 7: Hyperscalers' free cash flows are declining and are projected to continue

Unlevered free cash flow (bars, left scale) and free cash flow to revenue (line, right scale) for the AI hyperscalers (a)



Sources: LSEG Workspace and Bank calculations

(a) This chart shows aggregate unlevered free cash flow and free cash flow as a share of revenue for the five AI hyperscalers (Meta, Alphabet, Amazon, Microsoft and Oracle). Data are presented on a calendar-quarter basis. Observations are based on reported data where available, with consensus forecasts used for periods where company results had not yet been reported

There is one final point to make on AI which relates to non-financial threats to financial stability. **Rapid progress in frontier AI capabilities presents a significant increase in the risks to financial stability from cyber and operational vulnerabilities.** The latest models are increasingly capable of identifying and exploiting software vulnerabilities both more effectively and more rapidly, increasing the potential for cyber-attacks on financial institutions and market infrastructure. In turn, operational risks are likely to increase as firms accelerate patching and other defensive measures, increasing the risk of operational disruption. In this context it is vital that firms act on the guidance released in May from the Bank, FCA and HM Treasury, and continue to focus on their cyber and operational resilience

frameworks. **The FPC also judges that continued close coordination across authorities internationally will be important to manage the risks to global financial stability from these developments.**

Despite the challenging external environment, **the FPC judges that in aggregate, households and corporates remain resilient**, but we acknowledge that some vulnerable, low income households and smaller, more leveraged corporates, which are financed by riskier credit markets, remain more exposed. **The UK banking system remains appropriately capitalised with high levels of liquidity.** Banks have continued lending to the real economy despite the deterioration in the macroeconomic outlook and heightened uncertainty. Reflecting our assessment of the evolution of domestic economic and financial conditions, the FPC has decided to maintain the UK countercyclical capital buffer (CCyB) rate at 2%, its neutral setting.

Finally, I'll turn to today's announcements on the bank capital framework. Since December, the FPC, working with the PRA, has progressed its analysis of buffer usability and the leverage ratio, informed by the feedback received on our December publications.

First, on capital buffers, the FPC sees a clear macroprudential case for a simpler capital buffer framework. Delivering on this vision will entail working closely with authorities internationally to pursue broad reform of the capital buffer framework. Today, we are announcing concrete domestic steps towards that goal to enhance the usability and releasability of regulatory capital buffers by **making it clear that the other systemically important institution (O-SII) buffer, that applies to certain domestic systemically important firms, will be releasable in a stress.** That will help to ensure that banks can continue lending in a stress, rather than cutting back, ensuring businesses and households are supported when they most need it.

**Second, we intend to consult on a package of measures to improve the way the leverage regime is working.** The FPC reviewed the implementation of the leverage ratio framework in the UK and identified some unintended features, which resulted in domestic lending being more penalised than in other jurisdictions. To address this, and make the framework more effective, the committee agreed a package which includes removing the countercyclical leverage buffer, bringing the additional leverage buffer rate into line with international standards, and making a greater share of the remaining leverage requirements and buffers releasable. We will also adjust our bank capital stress tests to ensure there is no unintended tightening as a result of these changes. The proposed package would reduce leverage ratio requirements for large banks by around 0.2 percentage points in aggregate.

Before finalising these changes to the leverage ratio regime, the FPC wants to be certain that their implications for the resilience of core UK markets are fully understood. As such, the FPC will work with the PRA to identify whether the proposals might leave any financial stability "gaps", for example by leading to an unwanted increase in market-based leverage. This analysis will take into account the FPC's continuing work on gilt repo market resilience, and will be completed by the Q3 FPC meeting, ahead of a consultation on the rest of the proposal.

Together, these proposals make our capital regime more effective, proportionate and better calibrated to the risks in today's financial system, without unduly compromising the safety and soundness of firms.

Let me conclude.

The vulnerabilities previously highlighted by the FPC persist, and, since our last FSR have in some ways become more pronounced, driven by increased leverage, particularly in equity markets. Developments in frontier AI underscore the importance for firms of appropriately managing cyber and operational risk. Making changes to our capital framework is a finely balanced judgement, but the meaningful package we have announced today modernises our framework and makes it better targeted. This leaves the framework better able to support the real economy and functioning of financial markets while remaining consistent with international standards overall.

And now, Sarah and I will be happy to take your questions.