



**BANK OF ENGLAND**

# News release

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## **Bank of England Publishes Financial Stability Review**

The Bank of England is today publishing its latest Financial Stability Review. It contains the Bank's regular half-yearly review of risks to financial stability and measures taken to strengthen the financial infrastructure, together with a number of articles (summarised in the 'Themes and issues' editorial).

Sir Andrew Large, the Bank's Deputy Governor for Financial Stability, commented:

"Over the past six months, the outlook for the global economy has improved. Indicators of credit risk have continued to subside and concerns over the creditworthiness of some highly geared industries, highlighted in autumn 2002, appear to have eased.

Household sector borrowing around the world has in general been growing more rapidly than corporate borrowing. Debt-to-income ratios are high by historical standards. However, in many countries, including the United Kingdom, lower interest rates have so far broadly offset the rise in debt, so income gearing has not risen significantly. The biggest increases in debt in the UK have been amongst higher-income households, and the share of households reporting debt to be a burden has changed little since the mid-1990s. However, there is a possibility, in countries where debt-to-income ratios have increased particularly rapidly, such as the United Kingdom, that households' expectations of future income growth and ability to service debt payments will turn out to have been optimistic. And there are some households who are much more vulnerable than average to any rises in debt service payments.

It is noteworthy that, possibly in a search for yield, a significant build-up in hedge fund activity has taken place, without identifiable problems at this stage. Separately, the importance of credit risk transfer markets is continuing to grow. In both these areas, financial stability authorities need to monitor potential vulnerabilities closely.

Internationally, the periods of heightened interest rate volatility in the summer and exchange rate volatility in early autumn appear to have been weathered successfully. But they highlighted the continuing need for financial institutions to manage their market risk exposures carefully.

Banking systems, for the most part, remained resilient during the global slowdown and have emerged with their reported capital ratios sound. The large UK-owned banks have continued to be well capitalised and relatively profitable. And pressures on UK life insurers have eased somewhat.

Looking ahead, the prospects for financial institutions here and abroad will depend partly on the durability of the global economic recovery and partly on how borrowers cope with any future increases in their debt servicing payments."

### **Notes to Editors**

(1) The Bank's assessment deliberately focuses on potential threats to financial stability rather than the most likely prospect. It identifies a number of themes over the past six months (page references are to the 'Financial stability conjuncture and outlook overview'):

- exposures to corporate and household sectors (pages 9-11);
- risks from changes in global capital flows (pages 12 and 13);
- the 'search for yield' (page 13);
- interest rates and financial institutions (pages 13 and 14);
- the robustness of financial systems (pages 14-16).

Analysis of each of these issues is developed in the main text of the 'conjuncture and outlook' article as well as being summarised in the overview.

(2) The Bank of England's financial stability mandate is related to the stability of the system as a whole rather than the regulation of individual firms.