



BANK OF ENGLAND

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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:

"During the past six months there have been widespread downward revisions to forecasts for short-term economic growth. Even so, credit spreads have declined markedly and the heightened concerns about corporate credit risk evident in Autumn 2002 appear to have abated. This seems partly to reflect firms' efforts to restructure their balance sheets, and also the low level of interest rates, which has reduced cash debt service requirements for corporate, household and sovereign borrowers.

But low interest rates, and plentiful liquidity, may also have encouraged a 'search for yield' - with some investors as a result shifting their portfolios towards riskier assets. The decline in credit spreads may in part reflect such shifts rather than a genuine reduction in credit risk. The implications of this 'search for yield' for the overall distribution of risks in the financial system would seem to merit further investigation and additional vigilance.

Household sector debt-to-income ratios have continued to increase, notably in the USA and the UK. There may have been over-borrowing in some cases, but there are few signs of a general weakening in household credit quality. Losses on lending to households have generally remained small.

Banking systems, with one or two exceptions, have continued to show considerable resilience. For the most part capital ratios remain comfortable; and in the UK, as in several other developed countries, profitability has been maintained. Looking ahead, the health of financial intermediaries will clearly depend critically on how far the projected modest pick up in global economic activity actually materialises."

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 'Conjuncture and outlook overview'):

- balance sheet adjustment in the corporate sector (pages 8-9);
- financial stability risks from household borrowers (pages 9-11);
- the 'search for yield' (page 11);
- the resilience of financial markets and institutions (pages 12-13).

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.