



**BANK OF ENGLAND**

# News release

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13 December 2004

## **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).

Near-term credit, market and liquidity risks to UK financial stability have remained subdued since the June Review, and the immediate prospects for both the UK and international financial systems appear encouraging. The latest Review acknowledges that the near-term risks are low but also sounds a note of caution about heightened long-term vulnerabilities.

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

"In the present benign environment, there is a possibility that lenders, borrowers and investors may be inclined to under-estimate long-run vulnerabilities and take on too much risk. Nevertheless, the main firms and sectors within the UK financial system - and the internationally active financial institutions to which they are exposed - appear well placed to withstand any unexpected deterioration in economic conditions in the near term. With this in mind we continue to monitor closely developments in a number of areas including the search for yield."

The 'search for yield' has continued in various forms in the international financial markets. Strong inflows into hedge funds have continued, and large complex financial institutions (LCFIs) have expanded in businesses such as energy and commodity trading in response to low margins in more traditional market activities. It is significant that some market contacts have expressed misgiving about the present scale of demand for risky and potentially illiquid assets. The risks accompanying any associated concentration of positions and the potential impact on liquidity of an attempt to unwind these positions abruptly could be exacerbated in the event that the current pattern of global financial imbalances triggered any sharp asset price adjustments.

Nevertheless, the profitability of UK-owned banks has improved further, and their capital and liquidity buffers are well in excess of the regulatory minima. There are also few signs of stress in the non-bank financial sector. A significant step towards ensuring the future resilience of the financial system to potential shocks

has been the agreement on the new 'Basel II' capital framework, which aligns capital requirements more closely with the risks run by banks. But continuing work is necessary, and under way, to ensure that frameworks for prudential regulation and accounting standards keep pace with financial innovation.

### **Notes to Editors**

The Bank's assessment deliberately focuses on potential threats to financial stability, rather than on the most likely prospect. It identifies the potential threats primarily from a UK perspective, and arising from key categories of risk:

- Credit risk and the accumulation of debt (pages 10-11)
- The international financial system and the search for yield (pages 11-12)
- The resilience of the UK financial system (pages 12-13)

(Page references are to summaries in the 'overview of UK financial stability: threats and resilience'. The analysis is developed in the main text of the 'conjuncture and outlook' article.)

The Bank of England's financial stability mandate relates to the stability of the system as a whole rather than to the regulation of individual firms.