



BANK OF ENGLAND

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28 June 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).

Over the past six months, the near-term risks to UK financial stability from credit losses at financial institutions have eased somewhat as the short-run economic outlook, both in the United Kingdom and elsewhere, has improved. But considerable challenges remain.

Against the current global environment the Review considers the potential credit, market and liquidity risks to financial stability. Current uncertainty about the future paths of interest rates and the fact that asset concentrations have been built up in a 'search for yield', highlighted in previous Reviews, has brought such risks to the fore.

Flows into 'alternative investments' such as hedge funds have remained strong and, until earlier this year, credit spreads on high-yield and emerging market bonds had narrowed considerably, perhaps more in some cases than could be easily explained by fundamentals.

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

"To the extent that these developments reflect higher risk appetite or misperceptions of risk, they raise an issue for financial stability. And if a 'search for yield' has seen market participants adopt similar trading strategies, a change in economic conditions could trigger sharp asset price movements or market liquidity problems if investors simultaneously try to unwind common positions. The Bank continues to monitor these developments closely."

Despite uncertainties, the UK banking system is well-placed in the near term to withstand these risks in the event that they crystallise. It has continued to report robust profits and maintains substantial buffers of capital against any unexpected adverse developments.

Notes to Editors

(1) The Bank's assessment deliberately focuses on potential threats to financial stability rather than the most likely prospect. It identifies potential threats to financial stability, primarily from a UK perspective, arising from key categories of risk (page references are to 'An overview of UK financial stability: threats and resilience'):

- Credit risk (pages 9-11)
- Risks in the international financial system (pages 11-12)
- The robustness of the UK financial system (page 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.