



BANK OF ENGLAND

News release

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16 December 2005

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 several articles (summarised in the 'themes and issues' editorial).

The major UK banks remain well placed to absorb adverse shocks to their balance sheets – they are profitable, well capitalised and continue to take actions to guard against liquidity risk. Near-term risks to the UK financial sector from default by households, firms and overseas borrowers seem limited, and conditions in international financial markets have been stable.

Nevertheless, in the longer term, some significant risks remain. Previous Reviews have noted the continuing accumulation of debt by many borrowers and an aggressive "search for yield". That has driven a rapid increase in the demand for and supply of highly leveraged financial products – a trend that has intensified since June. The relaxation of lending criteria in some markets and increased demand for illiquid instruments suggests that financial discipline may have weakened. In addition, the factors behind the recent confirmation and assignment backlogs in structured credit markets, while now being addressed, also suggest that some firms are experiencing operational strains in responding to the rapid expansion of some categories of business.

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

"The UK financial system remains healthy and near-term risks appear limited. But there are issues of potential concern for the long run. These include the factors contributing to the backlog in confirmations and assignments, as well as widely reported relaxed lending criteria, and increased reliance by some market participants on potentially illiquid instruments and unpredictability of behaviour from new players.

These points raise questions about whether in some areas, standards of procedure, risk appetite, and financial discipline have weakened. Experience from the past shows that such behaviour in stable times can create problems later. No doubt risk management has improved and risks are more widely dispersed. But I believe that vigilance is still called for. We must remember that the financial environment is now more complex, opaque, interconnected and leveraged, and so a wholly benign outcome may not be a foregone

conclusion. That is why we have highlighted in this Review areas where strengthening of the infrastructure would be of value to financial stability.”

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 as they relate to the UK, and arising from key categories of risk both international and domestic.

- Credit risk (page 13)
- Risks in the international financial system (page 27)
- UK financial sector resilience (page 41)

(Page references are to summaries within the main text of the ‘conjuncture and outlook’ article. An overview of the analysis is on pages 9-12)

The Bank of England's financial stability mandate relates to the stability of the system as a whole and not the regulation of individual firms.

Key Resources

Financial Stability Review Issue 19, December 2005

<http://webarchive.nationalarchives.gov.uk/20100114080129/http://www.bankofengland.co.uk/publications/fsr/2005/fsrfull0512.pdf>