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News release

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The Return of the Credit Cycle: Old Lessons in New Markets - Speech by Sir John Gieve

In a speech at the Euromoney Bond Investors Congress, Sir John Gieve - Deputy Governor of the Bank of England - highlights the return of the credit cycle and how some old lessons have re-emerged in the new credit markets.

He says that: "As in previous banking cycles, a period of strong growth, low interest rates and rapid increases in asset prices lead to over confidence and bad lending at the top of the cycle; defaults, deleveraging and retrenchment follow in the downswing. But the way this old story has unfolded through the new credit markets has sprung some unpleasant surprises, including the speed with which losses in just one market in one country - the housing market in the US - have disrupted wider credit markets in all advanced economies."

He notes that "there is a role for monetary policy in smoothing the cycle but it has to address the whole economy and not just the financial sector. So we need also to consider again how far we can make our regulatory regime for capital and liquidity counter cyclical - that is create a system which raises requirements as the boom gathers pace in order to dampen the upswing and create additional headroom for losses as the cycle turns." "If we cannot do so effectively an alternative may be to require larger capital and liquidity buffers across the whole cycle."

He concludes that: "The structured credit markets and the growth of "originate and distribute" banking have amplified the turmoil in credit markets in recent months. But under the new clothes, the old credit cycle is still recognisable. It is important we learn the lessons about the new credit instruments and markets. But we also need to address again the roots of the credit cycle."

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2008/speech338.pdf>