



BANK OF ENGLAND

News release

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1 May 2008

Confidence is Key for Financial Markets

The Bank of England is today publishing its *Financial Stability Report*. Rising US sub-prime defaults have triggered a broad-based repricing of risk and deleveraging in credit markets. An adjustment was needed after the credit boom and was bound to have costs, but it is proving even more prolonged and difficult than anticipated. Prices in some credit markets are now likely to overstate the losses that will ultimately be felt by the financial system and the economy as a whole, as they appear to include large discounts for illiquidity and uncertainty. Conditions should improve as market participants recognise that some assets look cheap relative to credit fundamentals. But with sentiment still weak, the Bank has announced a special scheme to improve the liquidity position of the banking system and to increase confidence in financial markets.

This Report sets out:

- The reasons for the repricing of credit risk and deleveraging being so protracted.
- Why market-based estimates of the costs of the crisis are likely to overstate ultimate losses.
- Prospects for financial stability.
- Measures to help contain the length and costs of the turmoil and to prevent its recurrence.

Introducing the report, John Gieve, Deputy Governor for Financial Stability, said:

"The unavoidable correction after the credit boom is proving protracted and difficult. However the pricing of risk in credit markets seems to have swung from being unsustainably low last summer to being temporarily too high relative to fundamentals. So, while there remain downside risks, the most likely path ahead is that confidence and risk appetite will return gradually in the coming months."

"To reinforce those prospects of recovery, we need to restore confidence in the banking system. That is why we have launched the Special Liquidity Scheme and why I welcome the steps taken by some banks to strengthen their capital positions."

Notes to Editors

The *Report* is produced half-yearly by Bank staff under the guidance of the Bank's Financial Stability Board, whose best collective judgement it represents.

Under the Memorandum of Understanding with HM Treasury and the FSA, the Bank contributes to the maintenance of the stability of the financial system as a whole. The Report is one vehicle for helping meet those responsibilities.

A visual summary of the FSR, which highlights the key risks identified by the Bank, and actions necessary to address those risks, is attached as an annex (see link below) to this News Release.

Visual Summary of the Financial Stability Report

<http://www.bankofengland.co.uk/publications/Documents/fsr/2008/fsrsum0804.pdf>

Financial Stability Report, Issue 23

<http://www.bankofengland.co.uk/publications/Documents/fsr/2008/fsrfull0804.pdf>