



BANK OF ENGLAND

News release

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Financial Stability Report - Issue 24 Rebuilding Confidence in the Financial System

The Bank of England is today publishing its bi-annual *Financial Stability Report*. The *Report* analyses the developments that have culminated in the turmoil of recent weeks and the actions taken by the UK authorities and other countries. It sets out the Bank's views on the near-term prospects for the financial system and the reforms necessary to address systemic risks.

After a year of exceptional stress in the banking system, the failure of Lehman Brothers triggered a severe loss of confidence. To reverse that, significant measures were announced on 8 October in the UK – and subsequently in many other countries – to provide banks with new capital and guarantees for borrowing, and further to enhance liquidity. The *Report* notes early signs that these measures have helped to underpin confidence in the banking system. They have increased banks' capacity to withstand future losses and lowered the perceived risk of default significantly.

With a global economic downturn underway and growing signs of distress among some emerging market economies, the *Report* notes that risks remain in the financial system. The *Report* also highlights that, over the medium-term, banks will need to adjust their balance sheets and funding models, weaning themselves off current high levels of official sector support. Capital injections and debt guarantees will help this adjustment.

The *Report* goes on to discuss the need for a fundamental rethink of how to safeguard against systemic risk, for example through the development of new countercyclical tools to dampen the financial cycle and through stronger capital and liquidity requirements.

Commenting on the *Report*, Sir John Gieve – Deputy Governor, Financial Stability – said:

“The instability of the global financial system in recent weeks has been the most severe in living memory. And with a global economic downturn underway, the financial system remains under strain. But it is better placed as a result of the exceptional package of capital, guaranteed funding and liquidity support. That is helping to underpin the banking system both directly and by demonstrating the authorities' determination to do whatever is needed to restore confidence.

Looking further ahead, we need a fundamental re-think of how to manage systemic risk internationally. We need to establish stronger restraints on the build-up of risks in the financial system over the cycle with the dangers they bring to the wider economy. That means not just increasing capital and liquidity requirements for individual institutions but relating them to the cyclical growth of risk in the system more broadly. Counter cyclical policy of that sort should complement regulation of companies and broader macroeconomic policy.”

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 is available below.

Visual Summary of the Financial Stability Report

<http://www.bankofengland.co.uk/publications/Documents/fsr/2008/fsrsum0810.pdf>

Financial Stability Report, Issue 24

<http://www.bankofengland.co.uk/publications/Documents/fsr/2008/fsrfull0810.pdf>