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The State of the Markets: Four Issues - Speech by Paul Tucker

In panel remarks to the Association of British Insurers' Biennial conference in London today, Paul Tucker, Deputy Governor for Financial Stability and a member of the Bank's Monetary Policy Committee, comments on four broad issues.

On the macroeconomic outlook, he says that while near-term indicators have improved a bit, the medium-term outlook remains "highly uncertain". He says, "For the moment it is unclear - as, I must say, it is bound to be at this stage - whether the financial system can generate the expansion of credit that will most likely be necessary to support recovery". He warns against the risks from banks simultaneously deleveraging by cutting back on the availability of credit, pointing out that "not lending would be a counterproductive business and financial strategy."

On the Bank's policy response to the crisis, Paul Tucker discusses quantitative easing and notes the "mildly upward sloping money market curve, which signals that the market is confident - as it should be - that the MPC will retighten monetary conditions when in due course that is warranted by the medium term outlook for inflation." On trade and working capital finance, he welcomes the recent initiative by the insurance industry to release a code of conduct for trade-credit insurance, alongside the Bank's own consultation on a new liquidity-insurance scheme under the umbrella of the Asset Purchase Facility.

He also stresses the need for more resilient capital markets. He notes that while "entrepreneurial innovation is the life blood of economic growth.sometimes it outstrips the supporting infrastructure". Paul Tucker says "In particular, the Bank of England agrees that more of the vanilla OTC markets should be cleared via central counterparty clearing houses." He goes on to say that the financial community must also be open to more trading in core, vanilla markets going via exchanges or other well-designed platforms, to help preserve liquidity when times are tough. "We would, for example, like to see serious consideration of whether the corporate bond markets could benefit through something along those lines."

Finally, on bank capital instruments, Paul Tucker argues the case for only equity counting as regulatory capital for banks in the medium term; and he calls for investors to consider exchanges of subordinated debt for equity or senior unsecured debt, as has already occurred in some cases.

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech391.pdf