



BANK OF ENGLAND

News release

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The Debt Hangover - Speech by Andrew Haldane

In a speech in Liverpool this evening, Andrew Haldane - Executive Director for Financial Stability - discusses implications of the stocks of debt held by agents across the economy - the debt hangover as he calls it - and the current opportunities available to pay them down, before describing two reforms that might curb the accumulation of debt in the future.

Andrew Haldane begins by emphasising that the financial system has been significantly more stable over the past six months, but some of the root causes of the crisis remain. One of those is an accumulation of debt. He says that to different degrees a debt hangover is affecting households, financial and non-financial companies and sovereign states around the world, but is perhaps greatest in the financial system. He notes that to date the servicing costs of these debts have been cushioned by policymakers' actions, but public sector support can only ever offer temporary relief - they are not a long-run cure.

Turning to remedial actions, Andrew Haldane considers two options. First, he says that banks should take advantage of the profits they have achieved this year to bolster their balance sheets. "There is a strong case for banks, in the UK and internationally, pocketing this windfall rather than distributing it to either staff or shareholders. This would allow banks' balance sheets to be repaired while supporting lending to the real economy." But he worries there has been little evidence of such prudential opportunism thus far. Second, he says there is a case for restructuring debt claims into equity to benefit both lenders and borrowers. He notes that a number of global banks have, in effect, already initiated such strategies and they could help improve balance sheets across all sectors.

Andrew Haldane concludes by saying that debt crises cannot be eliminated, but their frequency and scale might be moderated. He suggests two policy reforms. First, he argues that macro-prudential policies should be designed to curb the credit cycle, and lean against the collective tendency for banks to make significant distributions even when profits are low. Second, he advocates a redesign of debt contracts, such that they become state contingent. He says: "If contingent capital became more widespread, banks' capital ratios would be automatically stabilised over the cycle, lowering the chances of future banking crises." He also believes there is merit in considering how state-contingent debt might be adopted in other sectors.

Key Resources

The Debt handover – Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech422.pdf>