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News release

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The state of the financial markets - speech by Paul Fisher

In a speech delivered at the Institutional Investor Institute, MPC and FPC member Paul Fisher reviews the recovery in the financial markets since their seizure at the height of the crisis in 2008. Progress so far is described as a ".gradual healing." but the recovery ".has been neither uniform nor smooth". For example, UK bank funding markets have remained open in 2011, allowing maturing funding to be replaced and support from the authorities to be repaid, despite the sovereign debt crisis in Europe, natural disaster in Japan and civil unrest in North Africa and the Middle East.

Paul Fisher explains that the recovery so far reflects, in part, the actions of central banks, which responded to the precipitous falls in output and the risk of deflation by injecting a significant amount of liquidity into the global financial system. That has not only benefitted the real economy, but also led to a fall in yields on 'safe' securities and a recovery in many asset prices, as investors rebalanced their portfolios towards riskier assets. But he flags the risk that lower yields on 'safe' securities and an apparent shortage of high-quality assets may encourage some investors to reach for additional yield by moving into more illiquid, or more complex, products, or by encouraging financial innovation and growth in some parts of the financial system where the risks may not be so well understood. Although there is little evidence of excessive risk-taking on a generalised basis across the financial system, the Bank's market intelligence function has flagged a number of pockets of increasing risk appetite and a few specific markets which have been showing signs of excess.

Paul Fisher moves on to discuss how, as well as the sovereign debt crisis and the weak macroeconomic outlook in the advanced economies, uncertainty about the regulatory agenda is also weighing on markets. "The financial crisis exposed a need to not just strengthen but to completely re-design aspects of financial regulation, to try to find a solution to 'too big to fail' problem and hence minimise the chances of something similar happening again", he explains. Although it is vital that sufficient time is taken to get these changes right ".many individual regulatory initiatives are not yet parameterised or sufficiently detailed for market participants to anticipate their effects fully". As the many regulatory changes are finalised, Paul Fisher predicts a general improvement in market functioning reflecting both a reduction in regulatory uncertainty and the safer financial system that the regulatory agenda is designed to deliver.

Key Resources

The state of the financial markets – Full speech

Accompanying slides