BANK OF ENGLAND

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

News release

12 June 2012

Property booms, stability and policy – speech by Paul Tucker

In the Alastair Ross Goobey Memorial Lecture given at the Investment Property Forum in London, Paul Tucker – the Bank's Deputy Governor for Financial Stability and member of the Financial Policy Committee – identifies lessons from the commercial property boom and bust for regulation, and outlines some thoughts on the interactions between regulatory, central bank liquidity and monetary policies.

Reviewing developments in commercial property lending in the UK and abroad before and after the crisis, Paul Tucker observes that many economies experienced a lending boom that turned to a bust. He highlights three lessons from this.

First, the distinction sometimes made between safe commercial banks and risky investment banking can be misleading. A highly levered commercial bank lending largely to highly-geared property investors can be risky. Paul Tucker says that in response the rules of the game for finance are being overhauled for all types of banks.

The second lesson is that the effects on the economy of bank failure or distress can be greater when the industry is concentrated. Paul Tucker argues that underpins the case for reducing barriers to entry into banking to encourage diversification. Lowering barriers to exit can contribute to this by ensuring new entrants can be resolved in an orderly manner. He says that the stability authorities "...need to be more alert than in the past to this source of vulnerability, because it affects the economic costs of distress at individual banks."

The third lesson is related to macroeconomic and macroprudential policy. Paul Tucker notes that persistently easy monetary policy can fuel exuberant credit conditions. This is illustrated by credit conditions in certain euro area countries that were far too lax in the run up to the crisis. He says that: "...this makes the case for each country to have a macroprudential authority with the capacity and flexibility to vary capital, liquidity and margining requirements to underpin the resilience of the financial system in the face of heady credit conditions."

Paul Tucker then considers the interactions between the Bank of England's Quantitative Easing (QE) operations, the regulatory regime, and bank lending conditions. In its initial phase, QE was designed to effectively side-step a broken domestic banking system. But banks have since made good progress in repairing their balance sheets. Paul Tucker says that: "It is, therefore, serious that bank lending growth has, in aggregate, remained so weak".

That is partly due to increased funding costs for banks, driven by heightened uncertainty and the risk of a very bad outcome in the euro area. These are gradually being passed on to lending rates for firms and households. Paul Tucker says that the authorities need to consider what more can be done to alleviate these tight credit conditions: "The banks themselves did not bring about the underlying challenges facing the euro area. Given the costs to our economy, the authorities, including the Bank, need to consider what more we could do to alleviate tight credit conditions in the UK."

Policymakers also need to challenge themselves on regulatory policy – on capital and liquidity.

On capital, Paul Tucker believes that banks should take what opportunities they can to build resources, and that: "...when the threat of crisis recedes, the banks' capital planning should return to normal, with Basel 3 not having to be achieved until towards the end of the decade."

But he argues that liquidity is, perhaps, different: "Central banks need to stand ready to provide liquidity to see the banking system through stressed conditions – without strings attached when the source of the stress is beyond banks' control. Accessing such facilities is perfectly normal." As such: "...there is less of a case for regulators to require banks to rebuild their stock of liquid assets in current conditions. At the least, banks need to be free to draw on their liquidity buffers in order to absorb current pressures. And, so far as possible, we should see whether we can liberate this part of their balance sheet in these stressed times." That could, he notes, also be helpful to the operation of monetary policy by freeing up more of the reserves injected through QE for the banks to deploy in expanding their loan books.

Paul Tucker concludes that, when we get through this, Alastair Ross Goobey's warning that the financial markets tend to be affected by collective myopia from time to time must be remembered. Policymakers must be ready to take away the punchbowl when the next period of excess comes. The Bank's new Financial Policy Committee is being created to do just that.

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