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News release

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Developments in financial markets, monetary and macroprudential policy - speech by Paul Fisher

Speaking in London today, Paul Fisher – the Bank's Executive Director for Markets and member of both the Monetary Policy Committee (MPC) and the Financial Policy Committee (FPC) – speaks about the condition of financial markets, as well as aspects of monetary and macroprudential policies. He also gives some background to the Funding for Lending Scheme (FLS), coincident with the release by the Bank of the list of participating groups that have signed up to the Scheme so far.

Paul Fisher notes that financial market conditions over the past year have been buffeted by global events, including an escalation in concerns over the eurozone crisis, a generalised slowdown in global growth, a stream of policy actions undertaken in response to the deteriorating outlook, and, finally, a series of "home-made disasters" which have helped to "suck confidence from the sector just when it might otherwise have been recovering". He underlines the extent and significance of central bank actions over the period, and says that "in the world of central banking, unconventional policies are the new normal. At least for now."

But despite regular crisis points, and a heightened sense of risk and uncertainty about policy developments, Paul Fisher highlights that the period has seen (implied) volatility and skews fall to post-crisis lows across a range of markets. This could, he postulates, reflect the confidence that central banks are on standby to deal with tail risks. An alternative explanation is that market participants have to some extent "grown accustomed to the perpetual state of crisis and decided that the show – albeit a chaste and less spectacular show – must go on". He describes the phenomenon as "not the old, indiscriminate, invest-in-anything-with-a-high-return-and-ask-no-questions 'search for yield'", but rather "a much more calculated hunt. Not so much for return on capital but return of capital". Summarising his assessment, he says that, rather than healing, markets appear to be "scarring over – adapting and evolving to the new environment".

With reference to the sweep of current financial market regulation initiatives in train, Paul Fisher contends it should be understood that their "main collective purpose is to avoid public money being needed in future to bail out the financial sector". He underlines his view that "safe and sound credit institutions are a necessary part of generating sustainable economic growth". Rather than being "in a world where, as a matter of policy, we want to eliminate financial risk", he says that the key is for risks to be "properly appraised, priced, managed and provisioned". And although many of the new regulations are far from being settled, he says that "within, say, a year or so ... I would expect a lot of progress to have been made such that the outlook for the financial sector is much brighter – at least in this regard".

Paul Fisher also suggests that new liquidity regulations should be designed as far as possible to be counter-cyclical so that they are less demanding during a crisis, such as now, than at other times. In this context, he notes the recent recommendation of the Financial Policy Committee to the FSA to make it clear that the new liquidity buffers introduced by the FSA in 2010 may be used in the event of a liquidity stress.

Turning to the Funding for Lending Scheme (or FLS), Paul Fisher describes the decision to "do something innovative" as necessary given that many of the underlying problems in the Euro area and in the financial sector are outside of the UK's direct control. He emphasises that the scheme was designed to support the UK economy, not the banks. He underlines the strong incentives created for banks to boost lending, since every pound of additional lending increases the amount that a bank can borrow in the Scheme by a pound. Meanwhile, if a bank's lending contracts, the price of the Scheme will be higher.

Paul Fisher refers to the publication this morning of the reference stock of lending for the banks and building societies signed up to the FLS to date. Noting that five of the six largest lenders are in that list, he stresses that each bank is in a different starting position. "We cannot expect every bank in the FLS to increase its stock of lending to the real economy over the 18-month [drawdown] period ... the crucial impact will be whether the FLS enables them to lend more than they would have done in its absence". The announcements of reductions in interest rates and the loosening of terms and conditions are indicative of an early impact.

Paul Fisher underlines that the FLS does not seek to allocate credit to particular parts of the economy directly: "we are relying on the pressures of demand and supply, and competition, to ensure that credit flows to where there is demand". He also stresses that it is up to the banks whom they lend to: "it is not our intention that banks put themselves at risk by making imprudent loans". But, he says, by putting pressure on banks to lend profitably where they can, "that may "turn the conversation around" as banks do more to seek out lending opportunities rather than businesses or home buyers struggling to find accommodating banks".

Paul Fisher highlights that he expects some banks' borrowing in the scheme to exceed their lending growth, partly because some banks are acting against a base case of contraction, partly because they may refinance some existing debt at lower rates, and also because the scheme is set up so that the funding can be drawn down in advance or as it is needed, not with a delay. "That is just one of the features designed with the macroeconomic benefits in mind. At every stage we asked ourselves how the design choice would best support lending growth. I believe we have made the right choices."

In conclusion, Paul Fisher underlines as a lesson from the crisis the importance of a properly functioning financial sector. “Financial markets are not there to line the pockets of the participants. They exist because there are social and economic benefits from the services they provide. I believe most of the industry understands and accepts this. We need to focus on policies which encourage those benefits.”

Key Resources

Developments in financial markets, monetary and macroprudential policy (250KB)

Full speech by Paul Fisher