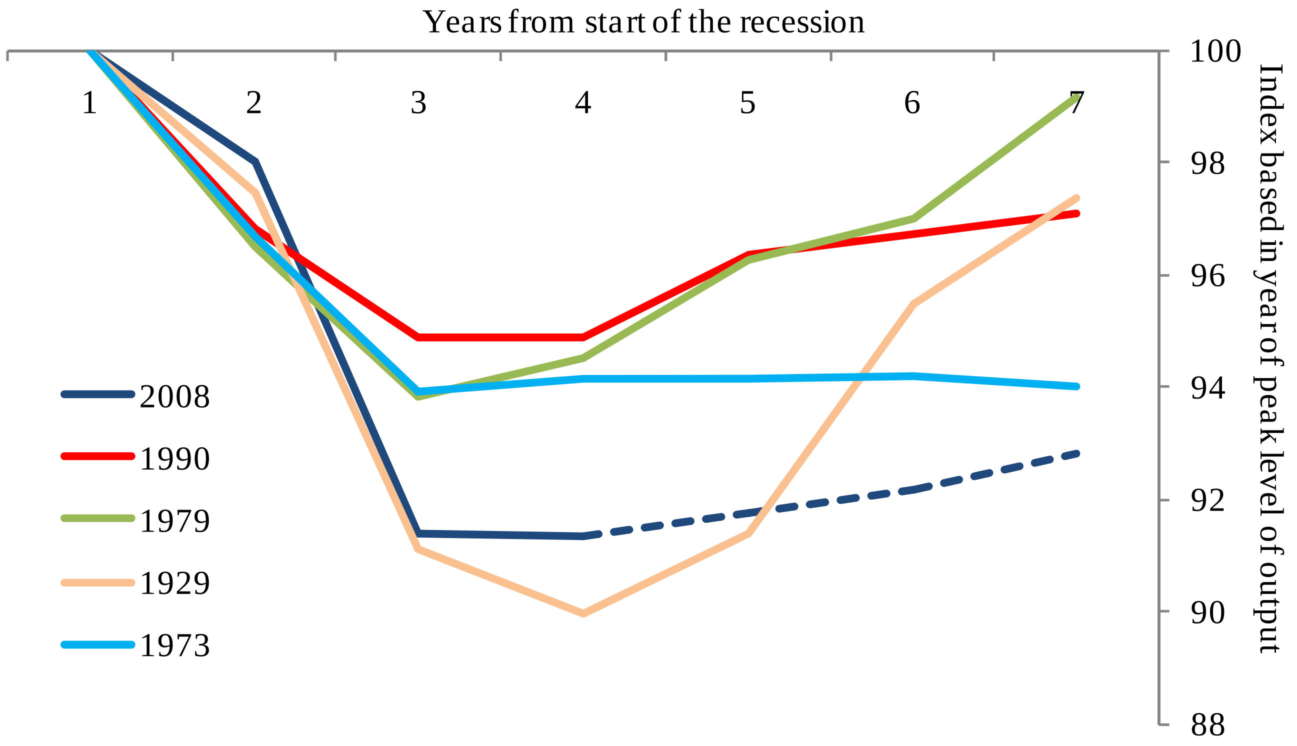
Monetary Policy and Banking Fragility

David Miles
The Monetary Policy Committee
The Bank of England

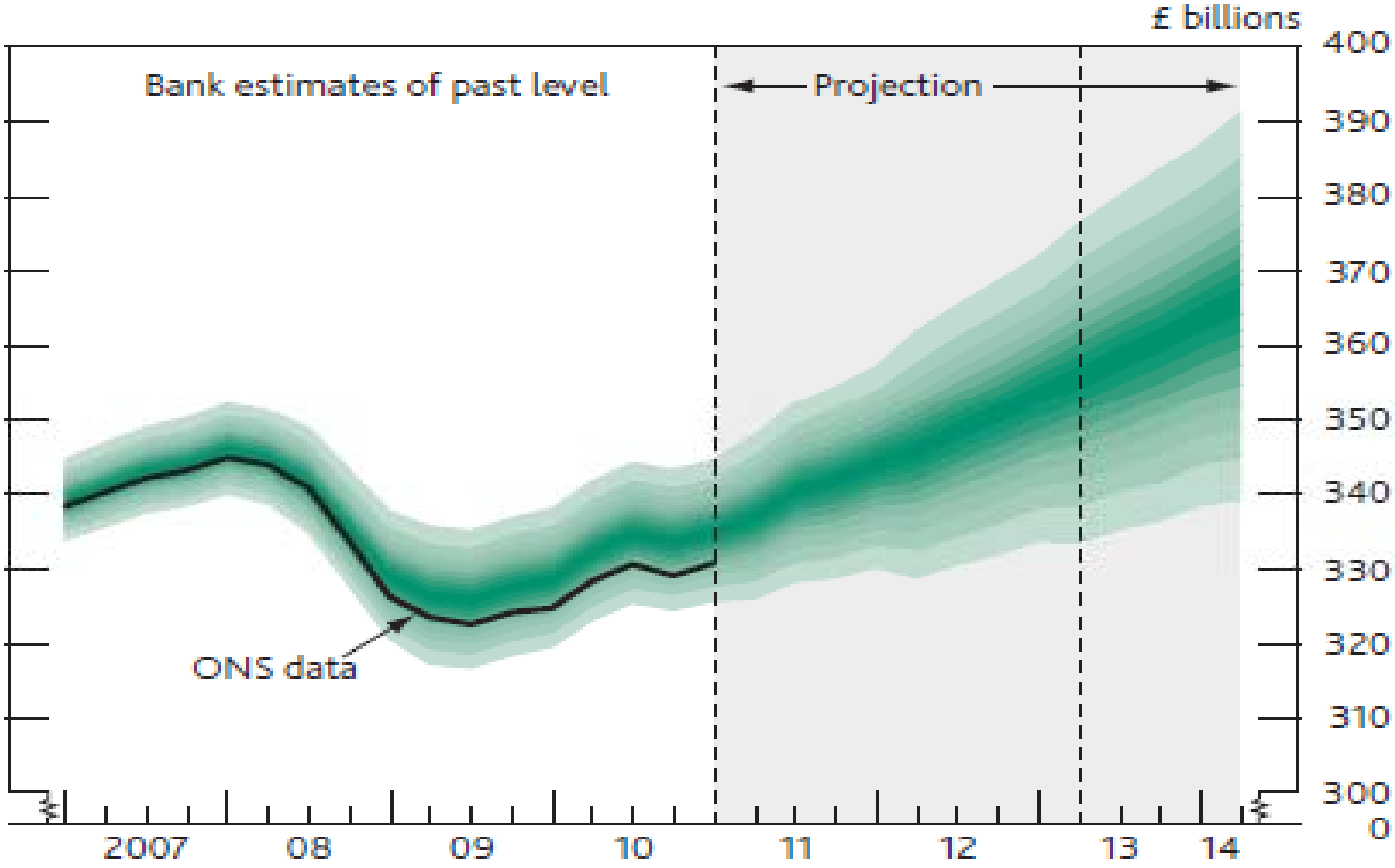
July 2011

Level of output relative to pre-crisis trend during past recessions [(a)]



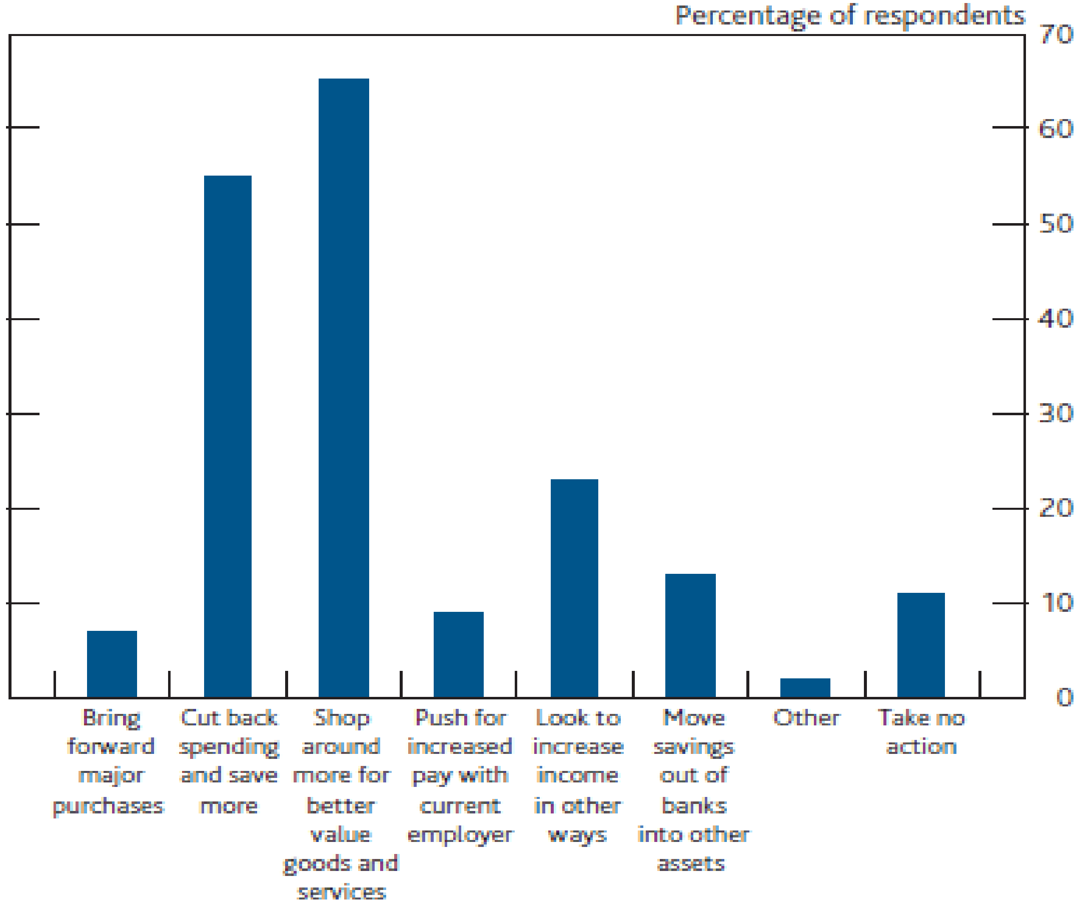
(a) I use GDP and trend growth estimates from Hills, Thomas and Dimsdale (Bank of England Quarterly Bulletin 2010) to create this chart. The authors use a Hodrick-Prescott filter to separate the trend and the cyclical components of real GDP growth. I assume that their trend growth estimate at the start of each recession would have prevailed during the following seven years had the recession not occurred. The chart shows deviations of actual GDP from this projected trend growth. The dotted line for the latest recession uses the MPC's mean projection for output growth over the forecast horizon as reported in the May 2011 Inflation report.

Projection of the level of GDP



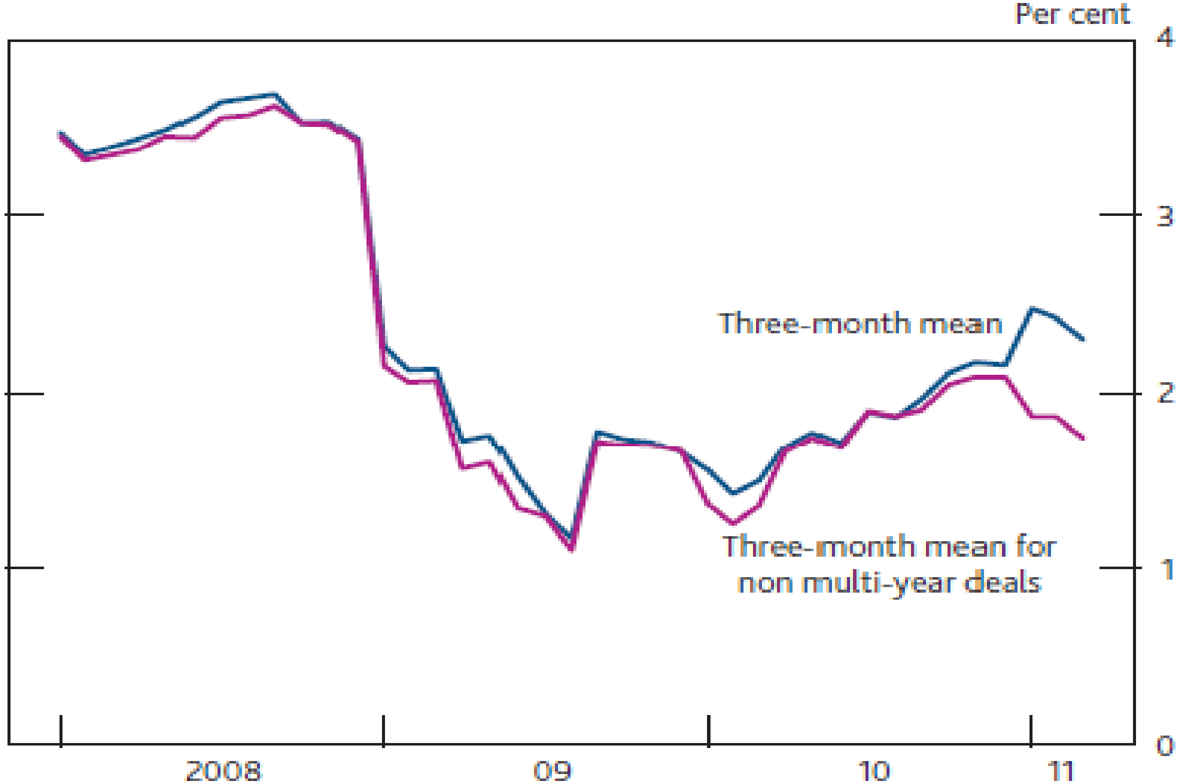
Source: ONS and Bank calculations

Households’ response to higher inflation expectations



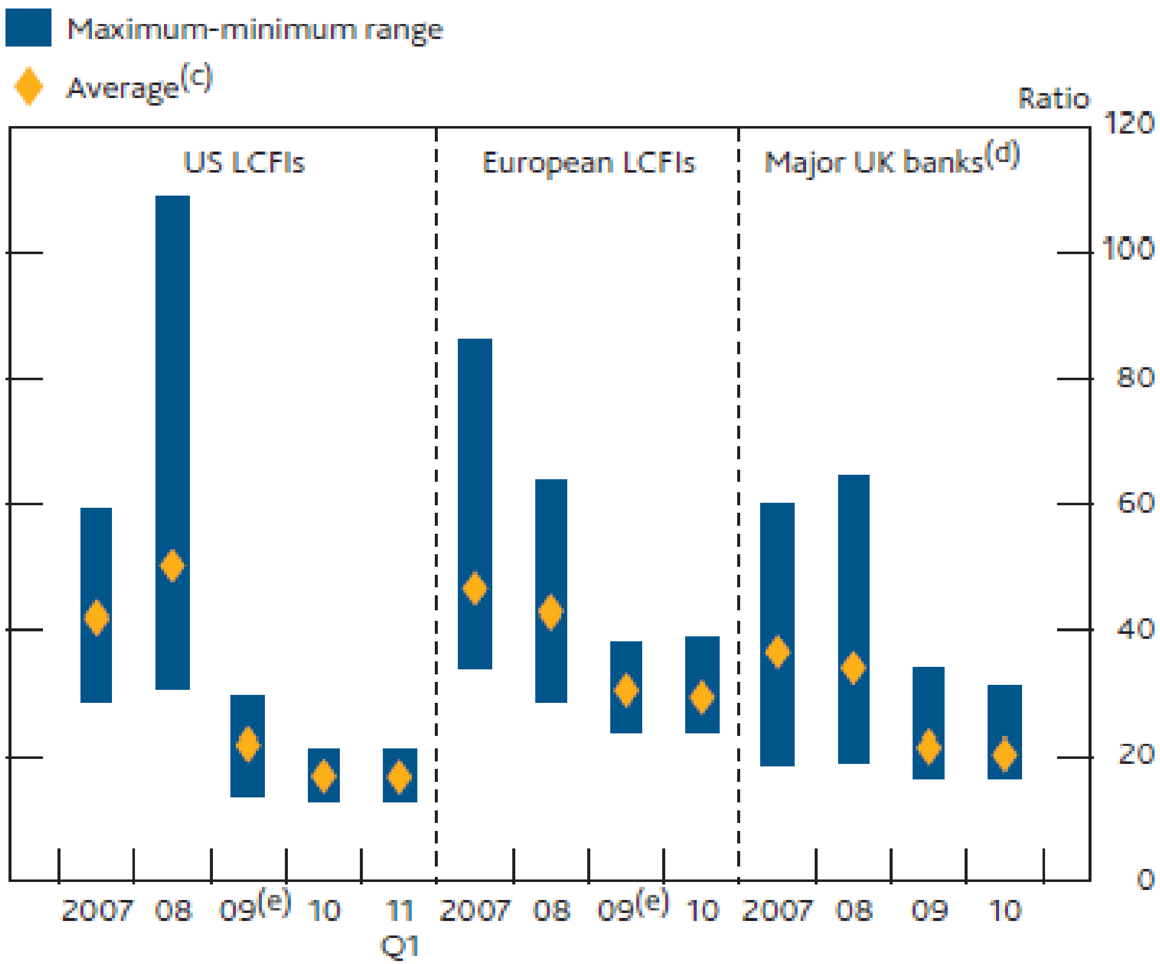
Sources: Bank of England, GfK NOP and Bank calculations.

Private sector pay settlements



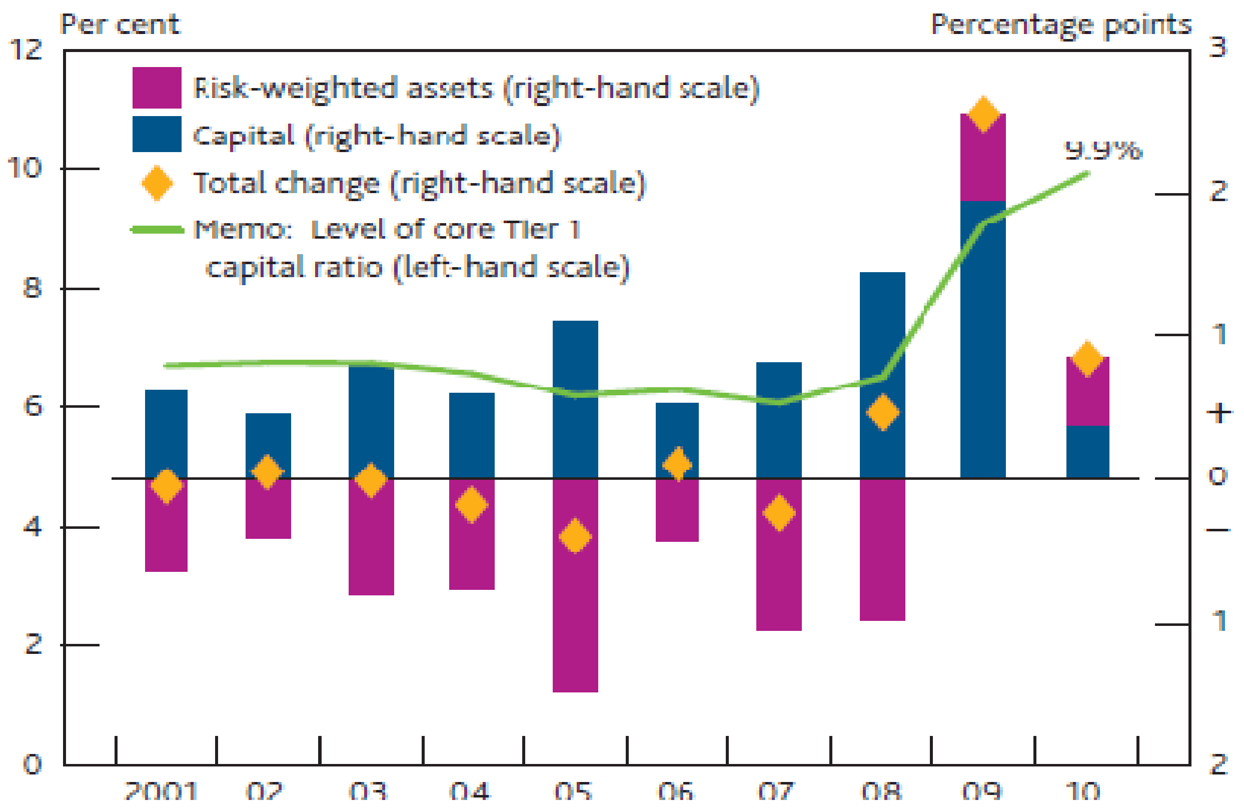
Sources: Bank of England, Incomes Data Services, the Labour Research Department, ONS and XpertHR.

Major UK banks’ and LCFIs’ leverage ratios



Sources: Bank of England, published accounts and Bank calculations.

Contributions to the change in major UK banks' core Tier 1 capital ratios



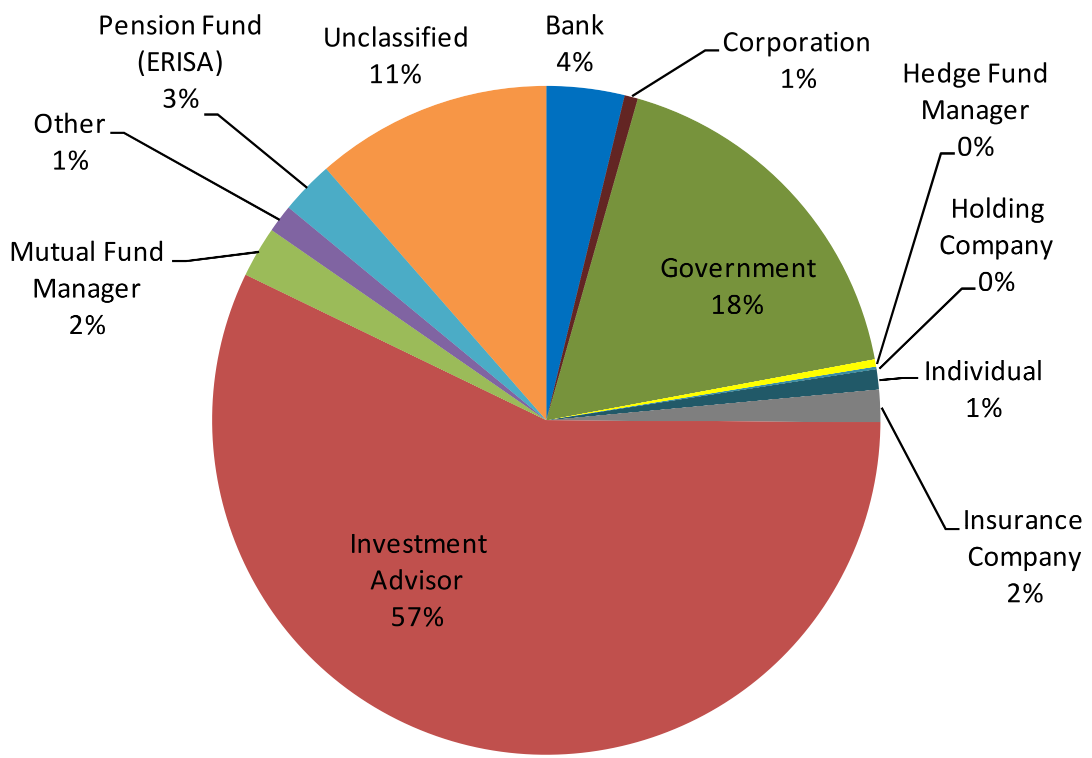
Sources: Published accounts and Bank calculations.

Approximate ownership structure of major UK banks' liabilities

Liability instrument	Counterparty	% of total liabilities
Deposits	Banks	14%
	Private non-financial corporations	5%
	Households	16%
	Other financial corporations (OFCs)	18%
Bonds and medium-term notes in issue	largely banks, OFCs	8%
Other debt securities in issue	likely to be banks, OFCs	6%
Subordinated liabilities	largely OFCs	2%
Other liabilities (includes derivatives)	N/A	26%
Total equity	largely OFCs	5%
...of which Core Tier 1 equity		4%

Source: Bank calculations. Breakdown of liabilities at the end of 2010 for Alliance and Leicester, Barclays, Bank of Ireland, Cooperative Financial Services, HSBC Holdings, Lloyds TSB, National Australia Bank, Nationwide, Northern Rock, RBS, and Santander. An exception are deposit holdings of private non-financial corporations, households, and other financial corporations, where the shares refer to all UK resident banks.

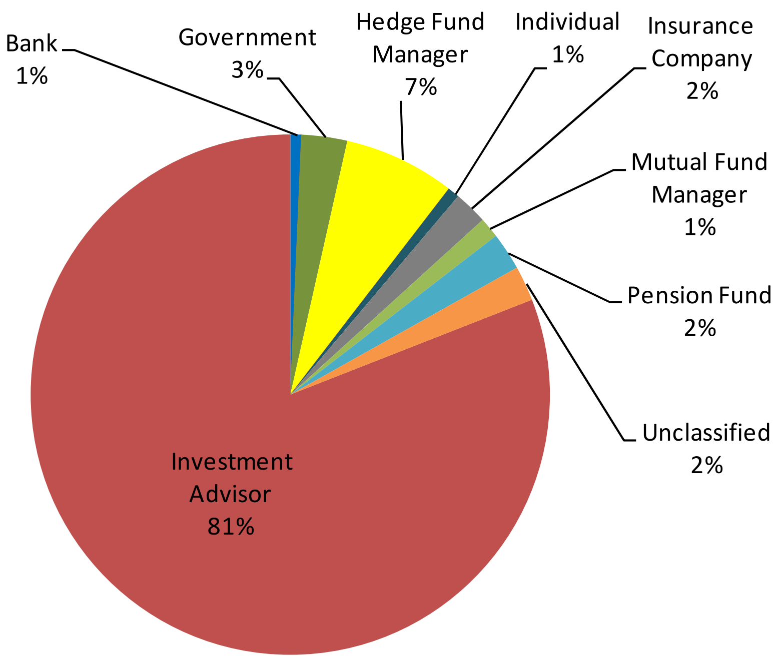
Major UK banks' shares – investor distribution by type



Source: Bloomberg, shareholders' register

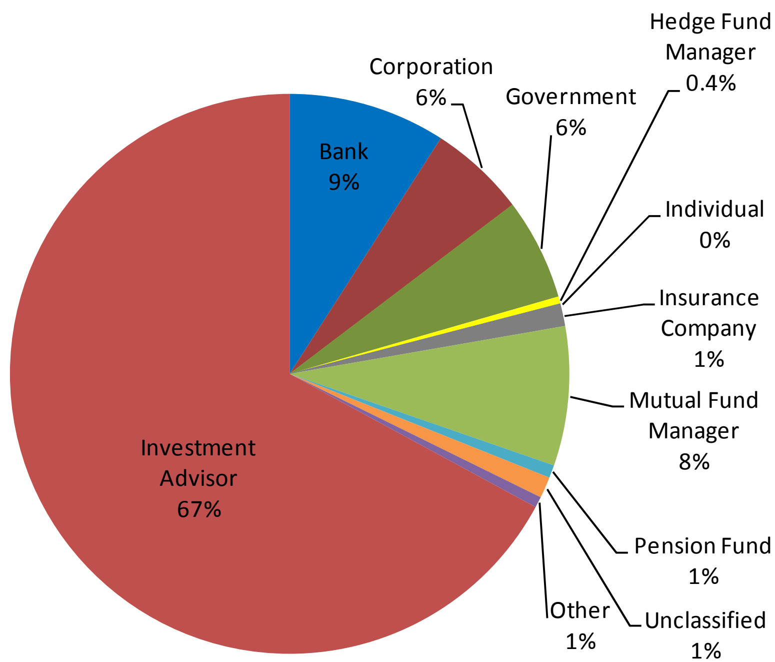
Major US and German banks' shares – investor distribution by type

US bank shares



Source: Bloomberg, shareholders' register

German bank shares



Source: Bloomberg, shareholders' register

Equity-for-debt swap

Original positions

Bank

Assets	Funding
A	D
	E

Portfolio of the equity investor

Value of equity	A - D
Value of bonds	d
Total value	A – D + d

Now swap 5 of debt for equity...

Bank

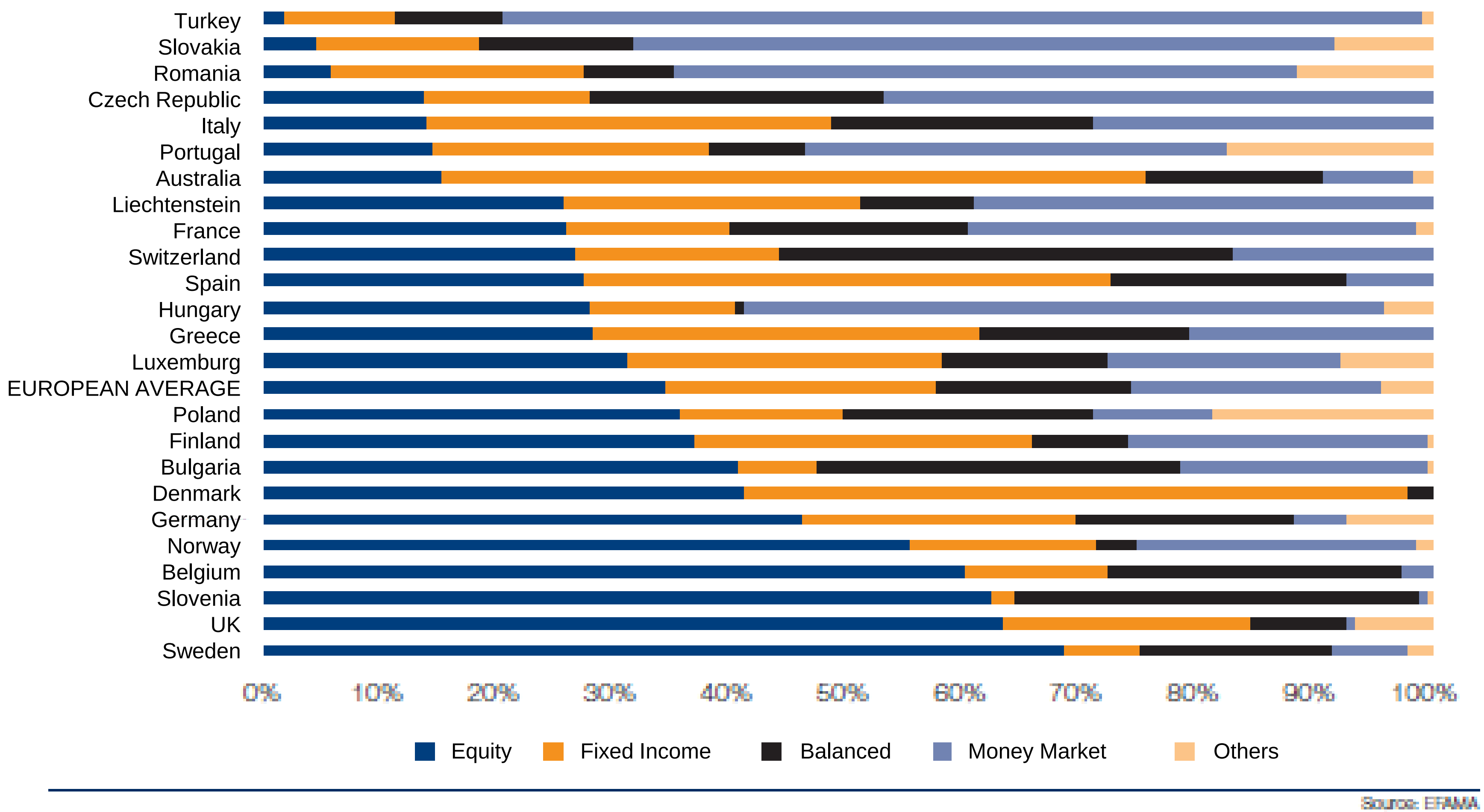
Assets	Funding
A	D – 5
	E + 5

Portfolio of the equity investor

Value of equity	A – (D – 5)
Value of bonds	d – 5
Total value	A – (D – 5) + d – 5 = A – D + d

Note: D is total bank debt; d is the equity investor holding of bank debt.

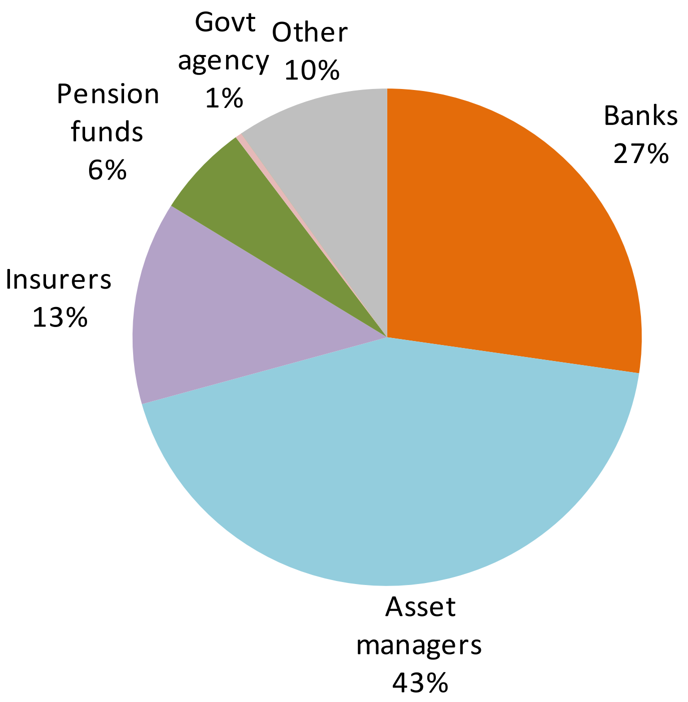
Asset mix in UCITS funds – European countries



Source: EFAMA, '*Asset management in the UK: The IMA Annual Survey 2009/10*'

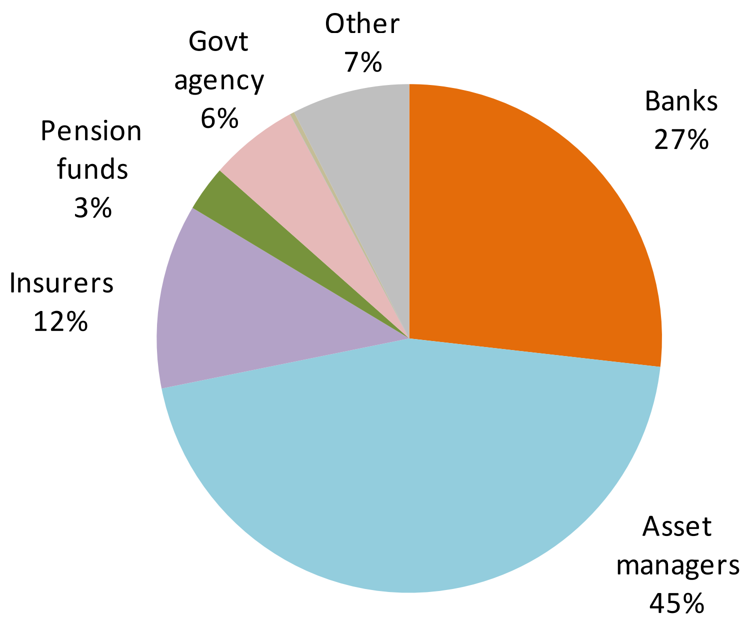
Issuance of debt instruments by major UK banks in 2010 – investor distribution by type

Senior unsecured issuance



Source: Bank calculations based on deal sheets from debt capital market desks and Euroweek. Based on sample of around £17bn deals in 2010.

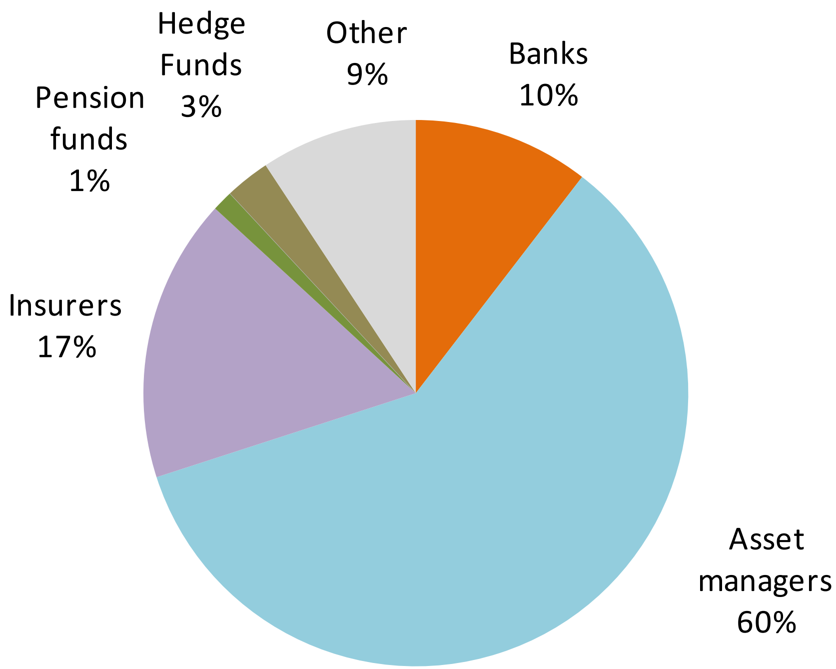
Covered bond issuance



Source: Bank calculations based on deal sheets from debt capital market desks and Euroweek. Based on sample of around £25bn of new issuance in 2010.

Issuance of debt instruments by major UK banks in 2010 – investor distribution by type

Subordinated debt issuance



Source: Bank calculations based on deal sheets from debt capital market desks and Euroweek. Based on sample of around £17bn deals in 2010.