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News release

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Financial Policy Committee statement from its policy meeting, 19 March 2014

At its meeting on 19 March 2014, the Bank of England's Financial Policy Committee (FPC) reviewed its assessment of risks to financial stability and, in light of that assessment, progress against its existing set of policy recommendations. The Committee did not make any new recommendations.

Since the FPC met in November 2013, the recovery in the UK and other advanced economies had gained momentum, against a stance of stimulative monetary policy. Within the euro area, there were signs of a continued modest recovery, even in some periphery countries, and steps were being taken with the aim of strengthening the oversight of banks. In the UK, the resilience of the banking sector taken as a whole had continued to improve, though uncertainty about the impact of conduct costs on banks' balance sheet strength had increased. Overall, conditions continued to provide support to the stability of the financial system.

The recent period had seen a number of developments in emerging market economies, with heightened geopolitical risks, notably in Ukraine, and strains in Chinese financial markets. To date, the impact of these events, in aggregate and individually, on wider financial markets appeared to have been relatively limited and market volatility remained low. However, there was a risk that this apparent resilience to past developments in advanced economy monetary policy could reinforce risk appetite in a way that did not fully take account of the eventual transition expected by financial markets of monetary policy to more normal settings. Changes to the structure and functioning of markets as banks adapted business models to the aftermath of the financial crisis and the resulting regulatory response made it more difficult to judge the likely impact of unexpected developments from any source. Consistent with the FPC's previous recommendation regarding risks from sharp upward movements in long-term interest rates and credit spreads, these issues were now at the heart of the FPC's risk and vulnerability assessments.

There was continued evidence of increasing momentum in the UK housing market, although a number of indicators remained below their long-run average levels. Mortgage approvals had risen by 40% in the year to January, though they remained 20% below their long-run average. Prices had risen by around 10% at a national level over the year to February 2014, according to the average of the main lenders' indices, and 5.5% over the year to December 2013 using ONS data, with increases seen in all UK regions over the second half of 2013. In a continuation of a longer-term trend, mortgages at loan to income ratios above four times accounted for a higher share of new mortgages in Q3 than at any time since the data series began in 2005. New mortgage lending at high loan to value ratios remained low by historical standards, though the number of mortgage products offering higher loan to value ratios had doubled over the previous six months.

In the November 2013 Financial Stability Report, the FPC announced initiatives to reduce stimulus, reaffirmed measures already in train and outlined further instruments it had available to mitigate potential risks from the housing market. Given the increasing momentum, the FPC will remain vigilant to emerging vulnerabilities, will continue to monitor conditions closely and will take further proportionate and graduated action if warranted. As set out in November, measures were being put in place by the Financial Conduct Authority (FCA) with effect from April as part of the implementation of the Mortgage Market Review to help maintain stronger mortgage underwriting standards. The FPC welcomed the work being done by the FCA to allow the FPC to give guidance on appropriate interest rate stress tests to be used by banks in their affordability tests. Subject to consultation and further consideration by the FCA Board, this instrument could be available to the FPC from its June meeting.

Against this backdrop, the Committee discussed the appropriate scenario for the 2014 bank stress testing exercise, with a focus on the UK component. The scenario was not intended to be the FPC's expectation of what would happen, but a coherent tail risk event against which banks' resilience could be tested. A key part of the scenario would examine the resilience of the banks to a housing market shock and to a snap back in interest rates. The 2014 stress test framework would be finalised in conjunction with the PRA Board in due course, with an intention to publish the scenario by the end of April as an additional macroeconomic sensitivity to the EU-wide scenario being developed by the European Systemic Risk Board and the European Banking Authority.

In the context of the Monetary Policy Committee's (MPC) Forward Guidance framework, the FPC also discussed whether the stance of UK monetary policy posed a significant threat to financial stability which could not be addressed by prudential or other regulatory tools. In line with the process set out in the MPC's Forward Guidance document, the FPC's position on the financial stability 'knockout', together with the MPC's response to it, will be published no later than the minutes of the following MPC meeting.

In November 2013, the Chancellor had asked the FPC to undertake a review of the role of the leverage ratio within the capital framework and to agree the terms of reference for that review following the Basel discussions on leverage in January 2014. The Committee agreed the terms of reference at its meeting; these are being published alongside this Statement.

Following a request in November 2013, the PRA outlined to the FPC the possible costs and benefits of asking firms on the internal ratings based approach regularly in addition to calculate, report and disclose their capital ratios using the standardised approach to credit risk. Weighing the PRA's assessment with its own judgment on the costs and benefits for financial stability, the Committee was minded to recommend that these firms make such disclosures as soon as practicable following the FPC's review in 2015 H1 of the progress made in Basel to improve the standardised approach to credit risk.

The Committee also received from HM Treasury an update on progress in implementing the FPC's previous recommendation on improving resilience to cyber risk. The work done so far had focused on developing robust diagnostic tools for understanding the current level of risk. This would provide a basis for setting concrete and specific action plans for firms at the core of the financial system over the course of this year.

The Record of the Committee's meeting will be published on 1 April.