FINANCIAL STABILITY REPORT PRESS CONFERENCE

Friday 29 November 2024

Opening remarks by Andrew Bailey, Governor of the Bank of England

Welcome to the press conference for the November 2024 Financial Stability Report.

Let me begin by noting that maintaining financial stability is the bedrock for broad-based and resilient growth. And our role is to ensure the UK financial system is resilient so that it can absorb rather than amplify shocks, and in doing so serve UK households and businesses. This in turn supports stability and growth in the UK economy. Put simply, there is not a trade-off between financial stability and growth. This is a fundamental point, but it leaves us naturally with choices about how we fulfil our role through the policies and tools we adopt to maintain financial stability.

I will highlight the key themes from today's assessment of financial stability by the Financial Policy Committee (FPC). I will start with our view on global risks, then turn to the outlook for households and corporates, and the resilience of the banking system including the results of our latest desk-based stress test, before concluding on market-based finance and the outcome of our first-of-its-kind system-wide exploratory scenario, which supports our surveillance of the financial system.

First, **global risks associated with geopolitical tensions, global fragmentation and pressures on sovereign debt levels remain material. And uncertainty around, and risks to, the outlook have increased.**

Geopolitical risk remains elevated. As we are an open economy with a large financial sector, these risks are particularly relevant to UK financial stability. There are several channels through which geopolitical developments can impact our stability. For example, by disrupting global trade and supply chains, worsening existing pressures on sovereign debt levels or exacerbating risks of global fragmentation across trade, financial markets and international policy cooperation. Higher geopolitical tensions also create an environment of heightened risk of cyber-attacks.

Financial markets globally have absorbed recent significant news in an orderly way and core markets have continued to function well, following a short-lived period of volatility in August. As we said in October there was evidence in August of deleveraging amplifying price moves and while it did not spill over to the markets, it might have done so had subsequent economic news not been positive. Government bond yields have increased. But valuations across several risky asset prices have risen further, leaving risk premia even closer to historical lows, despite the challenges facing the global risk environment. We continue to judge that valuations and risk premia are vulnerable to a sharp correction, which could adversely affect the cost and availability of credit to UK households and businesses.

Second, **we continue to judge that the UK household and corporate sectors are expected to remain resilient in aggregate**, although many households and businesses remain under pressure from the higher cost of living and higher interest rates.

The outlook for mortgage borrower resilience has improved in line with the domestic economic outlook. For example, while the aggregate mortgage debt-servicing ratio is expected to rise, it does so modestly. And the share of households in arrears or with high debt-servicing burdens has remained relatively low. In addition, while around half of mortgagors could experience greater borrowing costs over the next three years as they refinance onto higher rates since 2021, a quarter of borrowers are expected to benefit from lower rates.

Turning to corporates, debt market issuance has continued to be strong. However, risks remain among small and medium-sized enterprises and some highly leveraged corporate borrowers. These highly leveraged businesses are likely to face challenges from higher rates as they refinance, which would be greater if investor risk appetite deteriorated or if interest rates remain higher for longer than markets expect.

Third, **the UK banking system is well capitalised, maintains high levels of liquidity and asset quality remains strong**. We judge that – even if economic, financial and business conditions were to materially worsen – the banking system has the capacity to support UK households and businesses.

The results of the 2024 desk-based stress test published today support this judgement. This shows that the UK banking system is resilient in aggregate to two hypothetical severe macroeconomic scenarios: one is a global supply shock that drives higher inflation and interest rates; and the other a global demand shock that results in lower inflation and interest rates. In both, the system can continue to meet the demand for credit from creditworthy households and businesses.

This evidence has supported the FPC's decision today to maintain the UK countercyclical capital buffer (CCyB) rate at 2%, its neutral setting.

We have also today set out our updated approach to stress testing the banking system. We are moving from an annual to biennial frequency for our main bank capital stress test, where in the intervening years, we expect to assess the risks to, and the resilience of, the banking sector through desk-based stress tests and exploratory exercises. This change in approach will ensure the burden on participating banks is proportionate and supportive of the sector's competitiveness and growth, without compromising our assessment of the stability of the banking system. We will undertake our next bank capital stress test in 2025.

Fourth, **long-standing vulnerabilities in market-based finance that we have previously identified remain a concern.** These vulnerabilities – such as increased leveraged positions among hedge funds – if crystallised could amplify market volatility significantly, including by interacting with potential sharp price corrections in financial markets. Several market stress episodes demonstrate the importance of reducing the risks posed by high leverage, under-margining, and margin procyclicality in core markets, including through the Financial Stability Board's international work programme.

In our June Financial Stability Report, we highlighted the vulnerabilities associated with the global private equity sector, which plays a significant role in financing UK businesses. And today, we have published analysis on emerging vulnerabilities at the intersection of the private equity and life insurance sectors, including through private equity-backed reinsurers offering funded reinsurance. We support the regulatory actions by the Prudential Regulation Authority to mitigate risks to UK life insurers, and also support international work to address the build-up of these risks more broadly.

Today, we have also published the conclusions of our system-wide exploratory scenario (SWES) exploring how the UK financial system as a whole would respond to a market shock. It has been the first exercise of its kind, and has been world-leading in its approach. We are grateful to everyone that has participated in this important exercise.

The SWES has improved our understanding of behaviours of banks and non-bank financial institutions during stressed market conditions and revealed several mismatches in expectations among market participants. The results illustrate that actions taken by authorities and market participants following recent stresses, for example on LDI funds, have helped to increase gilt market resilience. They also highlight a number of remaining risks and vulnerabilities that will be important to address, including the importance of the resilience of the gilt repo and the corporate bond markets. All financial market participants should factor system-wide dynamics and the lessons from this exercise into their internal risk management and stress testing.

I would also note that system-wide stress testing has proved to be an effective tool for improving our collective understanding of system-level vulnerabilities. It is very deliberately a flow test, which uses the reactions of participants themselves to get to points of vulnerability. The approach is to lay out the picture so that we can then decide what to do on the basis of a better understanding of the nature of the issue. We will continue to invest in our capabilities in this area for surveillance and risk assessment, and there are potential benefits to the broader international community of exploring such system-wide exercises.

Let me conclude.

While the central outlook is for growth in the UK to remain steady, global risks are high and the outlook has become more uncertain and riskier. And our focus remains on maintaining financial stability by supporting the resilience of the financial system and its ability to support economic growth.

And now, Sarah, Sam and I will be happy to take your questions.