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Financial World Will Tackle Problems Better than Authorities, says former Bank Governor. UK system is sound though some change needed, says Eddie George in new Politeia pamphlet.

Britain's economic success is closely linked to its financial system. Since last year's failure of Northern Rock and the credit crunch, there have been job losses, home repossessions and predictions of recession. The US government has now moved to bail out its biggest mortgage providers. Is the UK financial system sound or should the Government control British banks and the economy more tightly?

In Politeia's new pamphlet, *Banking on Stability*, Edward George, the Bank of England's highly respected former Governor, explains what has happened and what course is best to restore financial stability.

First, he explains the fundamental changes since the 1960s as the UK economy moved to a more market system. This has benefited our economy, bringing steady growth, stable inflation and rising employment. But the recent turbulence emerged against a background of economic slowdown, with rising household debt and house prices. The industry in 'search of yield' found the high returns of marketable debt assets attractive (and the scale and spread of global debt was becoming less transparent). So when the losses came as two German banks in the US failed, even banks with no shortages were reluctant to lend.

Lord George warns against 'hasty conclusions'. His message is clear: The financial world itself is best equipped to learn the lessons and make the changes: it can do more good than the authorities. The official reaction to Northern Rock was well judged to calm the system without setting a 'dangerous precedent, in terms of moral hazard'; further regulation would merely throttle the system. The buck, he says, must stop with management and shareholders.

Already the central banks have calmed the system in the wholesale money markets: large amounts of liquidity have been made available, for longer periods, against a wider range of collateral and at less penal rates of interests.

Some changes are needed. There should be greater transparency between financial authorities (national or international), a change in managing liquidity risk and a review of the regime for protecting depositors. But the system itself has already adjusted and is fundamentally sound. In particular the author points out that:

- There are grounds for optimism that the central banks are 'on top of the liquidity problem and the financial storm will ... blow itself out'
- The re-pricing of risk is under way
- Many of the banks affected by substantial losses and write-downs have moved aggressively (and very successfully in many cases) to raise new equity.

Lord George warns that times will be difficult. The slowdown in growth has been made worse by the inflation from the world prices for oil and energy, food and commodities. Inflationary expectations may escalate and affect economic behaviour. It will not be easy over the next year or two to maintain stability - in terms of the balance between demand and supply side capacity. But, concludes the author, (known when Governor of the Bank of England as 'Steady Eddie'), '...I'm reasonably optimistic... that it [stability] will be achieved...further ahead' largely because 'the overall approach to macro-economic management... remains... intact'.

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Banking on Stability: A framework for economic success by Edward George is available online from Politeia (www.politeia.co.uk) For an E-version please click <http://www.politeia.co.uk/Portals/0/BankingonStability.pdf> Hard copies are available to journalists on request from secretary@politeia.co.uk