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Financial Markets

3.32 pm

The Chancellor of the Exchequer (Mr. Alistair Darling): With permission, Mr. Speaker, I should like to make a statement on today's announcements on bank lending. The House will, I hope, understand that it was necessary to issue a market notice this morning in the usual way.

In the last few months our priorities have been: first, to prevent the collapse of the banking system; secondly, to support the economy; and, thirdly, to ensure that we get lending going again. That problem is also faced by Governments across the world and it is therefore necessary to achieve the maximum degree of international co-operation.

We are taking steps not just to support the banking sector but, importantly, to safeguard the millions of jobs that could be put at risk by the continuing difficulties in the international financial system. Extending the banks' ability to lend is an essential part of the economic recovery, so today I am proposing further measures to meet two objectives. The first is to begin to replace the lending capacity lost by the withdrawal of foreign banks and other institutions, and the second is to remove the barriers that are preventing UK banks from expanding their lending.

I want to set out the new measures in the context of the strategy we have put in place to steer the country though the worst global economic crisis for generations. Over recent months, banks have faced increasingly difficult conditions, as we have seen everywhere around the world, with the Bank of America rescued last week, with Citigroup—one of the largest banks—broken up, with Anglo Irish nationalised, with Commerzbank rescued in Germany and with RBS today reporting substantial write-offs.

Last October, faced with the potential collapse of the banking system, we recapitalised the banks, strengthening their position. As a result, the Government took temporary stakes in two British banks, but, as I said then, we have a clear view that British banks are best managed and owned commercially and not by the Government. That remains our position. As a result of the action we took, no savers in UK banks have lost money.

In the pre-Budget report, I announced substantial extra help for people and for businesses. Lower income tax, more capital investment now and lower VAT, hand in hand with interest rate cuts and lower inflation, will support the economy and jobs. There is clear international consensus that putting money into the economy now, to counter the recession and to help people, is the right thing to do.

The cost of doing nothing would be substantially greater. In almost every country, fiscal expansion policies have now been agreed—including Germany only last week. In the United States, President-elect Obama has already signalled the scale of the fiscal expansion there, but as the President-elect said only yesterday,

> "restoring the economy requires that we maintain the flow of credit to families and businesses."

In the UK, the total amount of lending available still falls short of meeting the needs of the economy. Over the last 10 years, lending by foreign banks and non-bank institutions accounted for over half of new corporate

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loans and 45 per cent. of new mortgages here. A significant amount of lending capacity—by those foreign-owned banks and specialist lenders, for example—has been withdrawn or has been returned to their home markets, demonstrating again the need for co-ordinated international action. On top of that, in the last few weeks the world economic downturn has intensified everywhere: the US, the euro area, and now spreading to Asia, including China, which are all seeing weaker production, companies in trouble and fewer jobs.

As we go into what will be a difficult year, dealing with this global financial crisis will need continuous effort. There is no single remedy. There is no instant solution. We will need a range of measures designed to support lending, help businesses and protect jobs. Together, my measures today remove uncertainty and accelerate a resumption of lending—a necessary precondition for recovery both here and around the world.

There are three measures to address the capacity reduction in the banking sector. First, because of current conditions, companies are finding it harder to get loans, so the Government have today authorised the Bank of England to create, for the first time, a new £50 billion fund that will help increase the amount of funding available to companies—by purchasing corporate assets from the banks—enabling them to invest. That will help large companies and complement the substantial measures announced last week by my right hon. and noble Friend the Secretary of State for Business, Enterprise and Regulatory Reform to support small and medium businesses. The fund will buy assets from banks, financial institutions and financial markets, with finance provided by the Treasury. The Treasury is also supporting the fund with an indemnity. It will initially purchase high-quality private sector assets, such as corporate bonds, commercial paper and syndicated loans, which companies use to finance their business.

The assets purchased by the Bank of England will be good-quality investments, which will eventually be sold, so the taxpayers' interests are protected, and will enable larger companies to get the funding they need at a lower cost. The operating remit of the scheme will be set by the Government, but it will be run on an independent basis by the Bank of England. When purchasing those assets, the Bank of England will ensure that the total amount of money in the economy does not increase. In future, the Monetary Policy Committee will keep under review whether the facility could be used as an additional way of meeting the inflation target, in line with similar operations at the US Federal Reserve. In such circumstances, I will decide the overall scale of the scheme, and I will keep the House informed.

Secondly, to maintain some of the capacity being lost in the mortgage market, I have decided that Northern Rock will no longer pursue a policy of rapidly reducing its mortgage book. In addition, looking at when the housing market recovers, I am considering whether, and if so how, Northern Rock or other UK lenders can best support prudent lending to creditworthy customers who need mortgages but can only afford deposits of less than 25 per cent.

Thirdly, to ensure that RBS, which owns NatWest and a number of other banks, can continue to support lending, I am taking action to strengthen its position. When the Government purchased their stake in the bank in December, a new management team was put in

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place. The company has announced further losses today, many of which are associated with its investments in the US following its takeover of a Dutch bank, ABN, in 2007, so I have agreed to its request to convert the Government's stake of preference shares into ordinary shares. The Government could now own up to 70 per cent. of RBS. In return, we have agreed with RBS an extension of lending commitments to large companies, and an increase in lending of £6 billion in the next 12 months.

As well as taking action to maintain lending capacity, I want to remove some of the barriers and uncertainty preventing the existing banks from lending further, but in return for that we intend to negotiate with each bank a lending agreement. Those agreements will be specific, covering both the quantity and type of lending made available to people and businesses across the country, just as we have done with RBS today. These commitments will be binding and externally audited.

In return, the banks will get access to support measures: first, a new scheme under which the Treasury will insure certain bank assets, for a commercial fee, against losses on banks' existing loans. The purpose of the protection is to allow the expansion of lending, so the pricing has to be fair and reflect all our objectives. The banks' problems stem from uncertainty about the value of their assets, and faced with that uncertainty, individual banks are reluctant to lend to businesses and companies. This reduces the banks' exposure to risks and will give them the room that they need to lend more. We will insist on the highest international standards of public disclosure and transparency in the operation of the scheme. Countries all over the world are considering similar proposals, and we will work with them to take action together.

The second step towards removing barriers to lending is an expansion of the funding capacity in the financial markets. The credit guarantee scheme that I announced in October will be extended beyond its current end date of April this year, so that it will run until the end of 2009, subject to state aid approval. That scheme guarantees new unsecured borrowing, and so far over £100 billion of the guarantees have been taken up. These guarantees have been successful in helping to bring down the inter-bank lending rate from 6 to 2.25 per cent. To complement that, the Bank of England will continue to provide similar types of liquidity support when the special liquidity scheme expires at the end of this month.

Until recently, up to half of UK mortgages were funded from the wholesale markets. At the time of the pre-Budget report, I accepted the recommendations in the Crosby report on mortgage finance markets. I have announced that the Government will provide up to £50 billion of guarantees, initially on new mortgage lending and eventually on other assets. Overall, the liabilities taken on will be backed by financial assets, and fees will be charged for guarantees and insurance, which will safeguard the taxpayer's interest.

Thirdly, the Financial Services Authority has set out today its policy on capital requirements. It has set out the level of capital that individual banks need to keep on their books to allow them to withstand the slow-down and maintain lending. It will be a key signal that banks

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should allow their capital to be used to absorb the losses from investments, while not unnecessarily restricting their lending. And because the regulation of capital is fundamentally an international matter, tomorrow I will present our plans to European Finance Ministers in Brussels, and I hope that we can agree similar capital policy changes there.

This financial crisis is affecting every country in the world, so it is crucial that other countries, too, take steps to support their banking sectors. We cannot risk a damaging worldwide spiral of weakened confidence and national-only policy solutions. Stronger international collaboration will be strengthened with the arrival of the new US Administration, and we must not give way to financial protectionism, which could be every bit as damaging now as it was to trade in the 1930s. Instead, we must look to the causes of this international financial crisis; we must strengthen the supervisory and regulatory regime both here and internationally. I shall publish proposals on the regulatory framework for the banks in the spring, together with the FSA's own review.

Internationally, we will be actively pursuing that, as part of our presidency of the G20 throughout 2009. Our objectives in the G20 will be to continue to take action jointly to support the world economy, to act together to restore the flow of credit and to improve the international regulatory regime. This is a continuing effort. Countries all over the world are united in supporting their economies, maintaining lending and protecting jobs. We are ready to do whatever it takes, and I commend this statement to the House.

Mr. George Osborne (Tatton) (Con): I begin by thanking the Chancellor for his statement, but he should have been straighter with the British people about the announcements that he is making today. This is not some long-planned, carefully thought-through second phase of Government policy; it is instead the clearest possible admission that the first bail-out of the banks has failed, and now the Government have no option but to attempt a second bail-out—a bail-out whose size we still do not know, whose details remain a mystery and whose ultimate cost to the people of Britain will be known only when this Government have long gone.

Of course we cannot allow the banking system to fail—but for two months now, the Opposition have warned the Government that bank recapitalisation was not working, that the cost of the preference shares was too high, that the liquidity operations had to be extended, that the promised lending to businesses was not taking place, and that Government guarantees to get lending flowing to the real economy were needed.

For almost a year we have argued for countercyclical rules that control bank lending in a boom and encourage it in a bust. Each one of those arguments was dismissed by the Government, and each one is today accepted by them. The Prime Minister has finally been forced to confront the truth: he has not saved the world, he certainly has not saved the economy, and he has not even saved the British banks yet. Let us remember what he promised last autumn. He said at the Dispatch Box that

> "the aim of the recapitalisation...is to ensure the flow of money to small businesses and families in our economy."—[*Official Report*, 20 October 2008; Vol. 481, c. 30.]

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Yet he did nothing to make that happen, and the result has been dozens of companies going bust through lack of credit, and thousands of jobs being lost, while the Prime Minister and the Chancellor wasted their time on a temporary VAT cut that the country could not afford.

The Prime Minister also said at the time of the first bail-out in October:

> "We believe that these shares"—

bought by the taxpayer—

> "will grow in value over the next period of time".

Well, perhaps the Chancellor could confirm today that on current market valuations the taxpayer has lost almost £17 billion on those shares. We now discover that the Government really did not have a clue about what they were buying, and they did not bother to find out. They did not appear to know that the Royal Bank of Scotland was preparing to post the largest loss in British corporate history. Indeed, on today's share price, the entire bank is now worth less than the £5 billion of preference shares that the Chancellor is swapping.

The Prime Minister says in interviews that he is angry with the banks. What about the anger of the taxpayers who trusted him with their money? So when the banks come to the Government and say, "Please can we have some more?" we expect the Prime Minister and the Chancellor to answer the following questions before they say yes. First, will the Government conduct their own full, independent audit, not just of the agreements signed, which the Chancellor mentioned in his statement, but of the balance sheets of the banks, so that we know exactly what we, the taxpayers, are now underwriting?

The Prime Minister called this weekend for the banks to come clean about their losses. Instead of pleading with them, why does he not insist? That is what the Swedish Government did when they pursued the bad bank model in the early 1990s. That is the minimum required if we are to price correctly the insurance that the Government are offering and protect the taxpayer from catastrophic loss. That is the minimum if we are to reassure the public that there is some control over their losses, and that they are not writing a blank cheque.

That brings me to the second question that the Chancellor must answer. How much is the taxpayer in for? What is the potential loss this time? He could not tell us this morning on the radio, even as the Treasury appeared to be briefing people that the amount was £200 billion. What is the correct figure? What is his estimate? Surely that is the very least that Parliament and the public have a right to know. We need to be absolutely sure that the threat of insolvent banks does not turn into the threat of an insolvent country. We need to be clear that our country's reputation in global markets, and its credit rating, is not put at risk.

Finally, will the Chancellor be straight with people about the announcement today of an asset purchase facility? He mentioned it in his statement, but he did not spell out that it could have implications for the whole country for years to come. That asset purchase facility gives the Bank of England the power to use asset purchases for monetary policy purposes. That amounts to a programme of "quantitative easing"—the modern equivalent of printing money. While no one rules it out, it is the last resort for Governments who have run out of other options. Two weeks ago the Chancellor said in Liverpool that it was "an entirely

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hypothetical debate"; that was the phrase that he used. Two weeks later, it has become a real option for which the Government are clearly preparing. What has changed in the space of a fortnight?

The first bail-out has failed. The VAT cut has failed. None of the endless summits and initiatives has worked. Unemployment continues to rise. New figures out this morning show that Britain is set to have the deepest recession of any major economy in the world. The Government have achieved nothing. As the Prime Minister and the Chancellor ask the British people to put more of their money on the line, surely the time has come for the Prime Minister and Chancellor to stop blaming everyone else and start accepting their responsibility for the boom that turned to bust. When will they accept that, ultimately, the buck stops with them?

Mr. Darling: Let me deal with the various points that the hon. Gentleman made. First, let me deal with his point about the bank rescue scheme that we put in place last October. His criticism would have much more strength if, in fact, he had not at the time supported what we were doing. There was cross-party consensus that what we did to recapitalise British banks was the right thing to do, because we faced a situation in which the system, not just here but in different parts of the world, faced collapse. That is why we took action, and why it was followed in just about every other developed country, and the hon. Gentleman supported it at the time—although he subsequently found it convenient to move away from that and take up a different position, as the truce the Opposition promised, with cross-party co-operation, appeared to break down.

Secondly, in relation to the support we have announced today, we have done so, because it is quite obvious not just in this country—and it is happening here—but in other countries across the world that economic conditions have deteriorated over the past few months. That is blindingly obvious to everyone, and it is affecting every country in the world. We are seeing it in America and in the euro area. In Germany we have recently seen the effect in industrial production and growing job losses. Growth in China has dropped quite dramatically in the past few months, which in turn has had an impact on confidence in banks and on their reluctance to lend. That is why I have introduced a range of measures to try to unblock some of the problems that we face, as well as providing greater security.

The hon. Gentleman asked about costs, and in October and again today, I have set out the costs that we anticipate. He should remember that many of the up-front costs are offset to a large extent by the fact that the Bank of England or the Government will take securities, or fees will be charged to protect the taxpayer's interest. However, the cost of doing nothing would be far, far greater and far, far more damaging for the country as a whole. He rightly said that if the Government are to insure, acting as backstop, some assets, there must be a thorough audit so that we understand exactly the risks to which we are exposed. The reason why I announced today that we would offer that scheme is that it is now necessary for us to enter into discussions with individual banks, to see what we are prepared to insure. At that point, I will be able to come back to the House and explain exactly what the Government are taking on.