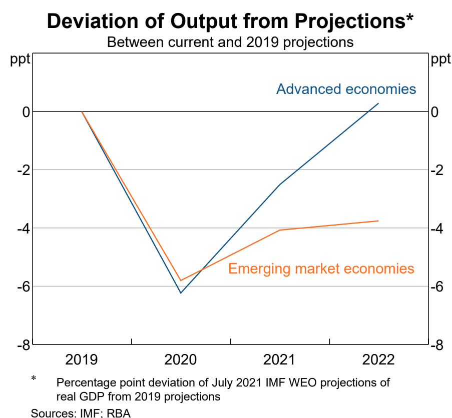
1. The Global Financial Environment

The global financial system has remained resilient through the ongoing economic disruption caused by further waves of the COVID-19 pandemic. In general, banks are well capitalised and liquid, financial markets are functioning, and financial distress among households and corporations has not been as widespread as initially feared. These positive factors reflect the substantial support provided to household and business incomes by governments, central banks and regulators. The reforms following the 2008 financial crisis also enhanced the resilience of financial systems.

The economic impact of the pandemic is still a major risk to global financial stability. Cases of the highly transmissible Delta variant of COVID-19 increased sharply and remain elevated in some economies. With COVID-19 widespread globally there is a risk of vaccine-resistant or more virulent and transmissible mutations developing. Periodic pandemic-induced disruptions to economic activity could see incomes decline, which would result in financial distress building among households and corporations and an increase in loan arrears. In emerging market economies (EMEs), where vaccine rollouts have been slower, the outlook for economic growth has been revised lower since the start of the year. Output in EMEs in 2021 is expected to be well below where it was projected to be before the pandemic, while in advanced economies it is expected to recover to around what was projected before the pandemic (Graph 1.1). EMEs are also vulnerable to capital outflows and inflationary pressures if interest rates in advanced economies increase faster than currently expected, which would tighten financial conditions and slow the economic recovery. Some EMEs are already facing high inflation and have tightened monetary policy in response.

Vulnerabilities in China's financial system remain elevated and authorities face a difficult balancing act. If they act too quickly in addressing these vulnerabilities, confidence in the implicit guarantees that underpin much of China's financial system could collapse, which would lead to financial distress. In contrast, if they act too slowly, the probability of more severe financial stress in the future will increase. Continued bailouts also risk further entrenching perceptions of implicit guarantees. One recent example of this trade-off is Evergrande, a large real estate developer that is facing a liquidity crisis, and whose collapse could trigger wider stress in China's financial and real estate sectors.



In many advanced economies, housing credit growth has picked up alongside strong growth in housing prices. Faster credit growth – particularly in excess of income growth – raises the risk of households becoming excessively leveraged (including because of unrealistic expectations of ongoing capital gains) and/or the quality of housing loans on banks' balance sheets deteriorating. Corporate indebtedness is also elevated in many countries, with debt-at-risk still high in industries most affected by the pandemic, such as hospitality and travel. Financial asset prices remain elevated, and regulators in some economies have expressed concerns about the risks associated with a possible sharp correction in these prices. Sharp declines in financial asset prices could be exacerbated by leverage and liquidity mismatches in some non-bank financial institutions (NBFIs), such as money market funds (MMFs), as occurred in March 2020.

The pandemic continues to be a key focus of analysis and discussion within global bodies such as the G20 and the Financial Stability Board (FSB). Recent work has included the lessons learnt from the COVID-19 shock, which found that core parts of the financial system were resilient, though key funding markets experienced acute stress and needed significant policy support. In response, the FSB and other bodies have intensified efforts to enhance the resilience of money market and other investment funds, as part of broader work on NBFIs. Addressing the financial risks arising from climate change remains a major area of interest – the FSB has released a roadmap of its own and other bodies' upcoming work in areas such as enhancing disclosures of climate-related risks by financial institutions.

Work has also continued on ensuring financial institutions manage cyber and operational risks effectively, with the cessation of most LIBOR tenors at the end of December a key focus in this area. Global bodies and national regulators have emphasised the importance of a timely transition to robust alternative benchmarks to mitigate the risks arising from the cessation of LIBOR. Significant progress has been made, but with the end of LIBOR imminent, it is critical that this transition work is now completed. Regulators, including in Australia, are monitoring progress closely as a disorderly transition would create significant risks for the financial system and non-financial firms.[1]

Financial systems in EMEs remain vulnerable to COVID-19-related stress, although conditions have been stable in recent months

EMEs face several challenges as a result of COVID-19. The spread of the Delta variant amid a slower rollout of vaccinations led to the re-imposition of containment measures in some countries and has constrained economic activity. Less than one-third of the population is fully vaccinated in most EMEs, compared with more than half in most advanced economies. The disruption to economic activity is placing pressure on the balance sheets of households, businesses and governments. Authorities have reintroduced or extended some support measures, such as loan guarantees and delayed recognition of non-performing loans (NPLs).

EMEs are vulnerable to capital outflows as a result of the quicker recovery in advanced economies, especially if interest rates in advanced economies were to increase at an even faster pace than expected.[2] Capital outflows could lead to funding stress as debt would become more expensive and more difficult to roll over. Capital outflows are also likely to contribute to exchange rate depreciations, which would raise the cost of foreign-currency denominated debt and contribute to higher inflation. Central banks – particularly those in countries with a large share of external financing and/or poorly anchored inflation expectations – may therefore be forced

to tighten monetary policy by more than is warranted by their domestic economic conditions, which would slow the recovery.

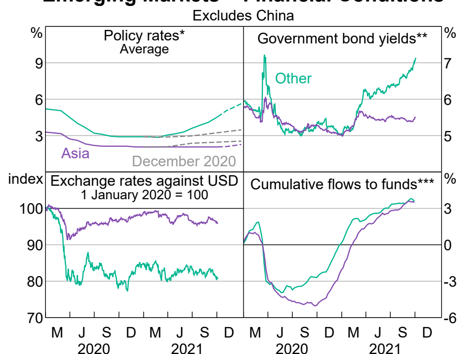
These pressures are most acute in several major EMEs – including Brazil, South Africa and Turkey – where the pandemic has exacerbated existing macroeconomic and financial imbalances. These imbalances include large fiscal deficits, high levels of debt and a large share of external financing. Exchange rates in non-Asian EMEs have depreciated by around 20 per cent on average against the US dollar compared with pre-pandemic levels, compared with 5 per cent in Asia (Graph 1.2). Some EME central banks – notably in Brazil, Chile, Mexico and Russia – have responded to higher inflation by tightening monetary policy. Markets have revised higher their expectations for the path of EME policy rates in Latin America, with policy rates projected to increase by around 175 to 375 basis points over the coming year.

Financial conditions in Asian EMEs have generally been more stable in recent months after tightening at the start of the year. Since June 2021, government bond yields have been little changed, exchange rates have depreciated slightly, and portfolio investment flows into bond and equity funds have picked up after slowing earlier in the year. As a share of GDP, foreign exchange reserves in Asia are also around one-third higher on average relative to other EMEs. Asian economies tend to have less foreign-currency denominated debt, providing greater capacity to manage the volatility associated with capital outflows.

Graph 1.2

Emerging Markets – Financial Conditions

Excludes China



* Solid lines indicate actual policy rates; dashed lines show current implied rates and implied rates as at December 2020

** Local currency bonds, weighted by market value

*** Per cent of assets under management; includes flows to bond and equity funds

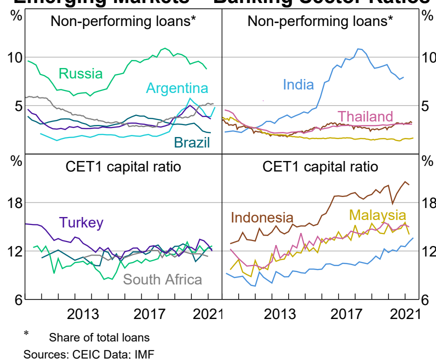
Sources: Bloomberg; EPFR Global; IMF; JP Morgan; RBA; Refinitiv

Asian EME banks are generally well capitalised and liquid, with an average Common Equity Tier 1 (CET1) capital ratio of 16 per cent (Graph 1.3). In contrast, vulnerabilities in the Indian banking system remain elevated, with higher NPL ratios and lower capital levels than other Asian banking systems. Indian bank NPLs are likely to rise further in the period ahead as temporary measures that allowed banks to delay recognition of NPLs during the pandemic have expired and other pandemic support measures are due to be withdrawn in coming months.

EME sovereigns and corporations have continued to issue significant amounts of local currency and US dollar-denominated debt. Much of this new debt has been bought by domestic banks, resulting in intertwined financial stability risks between corporations, banks and governments. The Reserve Bank of India recently stated that the increased share of government debt held by domestic banks may limit their ability to extend private credit during

Graph 1.3

Emerging Markets – Banking Sector Ratios



* Share of total loans

Sources: CEIC Data; IMF

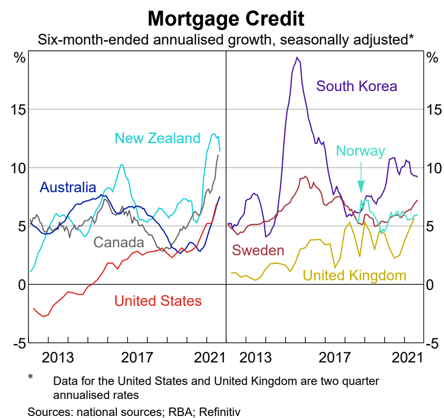
the recovery. The composition of debt issuance has also increased vulnerabilities in some EMEs. The share of debt denominated in foreign currency has increased in several South American countries and remains at a high level in Turkey. This increases currency risk where the debt is unhedged. Some EMEs have also issued local currency debt at shorter maturities, increasing rollover risk.

Housing credit and price growth are high in many advanced economies

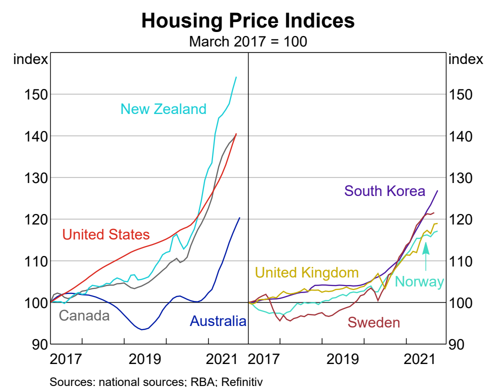
Housing credit growth has continued to increase and exceed income growth in a range of advanced economies (Graph 1.4). This pick-up in credit has followed strong growth in housing prices. Mortgage credit growth has been particularly strong in New Zealand, where six-month-ended annualised growth reached 13 per cent, the highest rate since 2007. Mortgage credit growth is also at post-2008 highs in Canada, the United Kingdom and the United States. This strong growth in credit has led to increasing household debt-to-income (DTI) ratios since the start of the pandemic in several countries, including New Zealand, Norway and Sweden. Regulators in Canada, New Zealand and Switzerland have raised concerns about both the risks associated with high household indebtedness and the sustainability of housing market valuations relative to fundamentals.

Housing price growth across advanced economies has been underpinned by low interest rates and a large build-up in savings by many households during the pandemic as a result of reduced consumption opportunities and government fiscal transfers. Constraints on new housing supply have been exacerbated by lockdowns and supply chain disruptions in some economies. Housing price growth has picked up sharply since mid 2020, and six-month-ended annualised growth is currently around: 10 per cent in Sweden; 15 per cent in both South Korea and the United Kingdom; 20 per cent in each of Canada, New Zealand and the United States; and 25 per cent in Australia (Graph 1.5). Rapid price growth increases the risk of price corrections at some point. However, there are some signs that growth in housing prices may have peaked in many advanced economies, with the slowing most pronounced in Norway and Sweden. Moreover, some regulators are expecting growth in housing prices to slow further as pandemic-induced drivers begin to subside and housing supply increases. Sustained low interest rates will, however, continue to provide an incentive to borrow for housing.

Graph 1.4



Graph 1.5



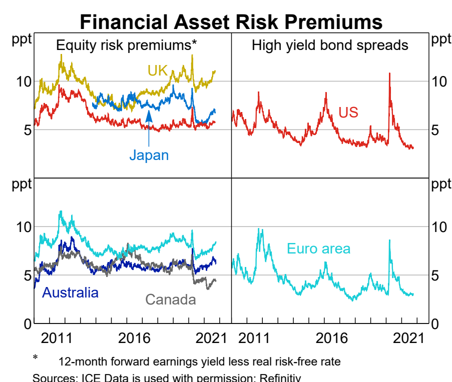
High-risk lending has increased in New Zealand and Canada, prompting regulators to tighten macroprudential measures. The Reserve Bank of New Zealand (RBNZ) and the New Zealand Government implemented measures in March in response to an increase in high-risk lending and strong housing price growth. Despite these measures, the RBNZ has recently stated that there has not been a sufficient reduction in high-risk lending, and that it is particularly concerned about those who have borrowed at both a high loan-to-valuation ratio (LVR) and a high DTI ratio. For example, the share of new lending to owner occupiers at a DTI ratio above six rose sharply to 25 per cent over the year to June 2021. To address these risks, the RBNZ announced a further tightening of LVR restrictions for owner-occupiers from 1 November – the share of banks' new loans to owner occupiers that can have an LVR over 80 per cent has been cut from 20 per cent to 10 per cent. The RBNZ will also start a consultation shortly on implementing DTI restrictions and interest rate floors.

In Canada, authorities tightened serviceability assessments in June, by increasing the interest rate floor at which new borrowers are assessed. This followed an increase in high loan-to-income (LTI) borrowing, including from some borrowers with high LVRs. The Bank of Canada noted in May that the share of new mortgage lending with an LTI ratio above 4.5 had increased to above the 2016/17 peaks when serviceability assessments were first tightened. In South Korea, the financial regulator has begun to tighten a range of macroprudential policies and other regulations as part of a two-year plan to stabilise growth in household debt and improve lending standards. These changes include a new sectoral counter-cyclical capital buffer linked to banks' household debt exposures and the introduction of borrower-level debt serviceability restrictions.

Financial market optimism contrasts with pandemic-induced economic uncertainty

Equity prices have increased further over the past six months, although the rate of increase has slowed. Major equity indices in advanced economies are on average about 20 per cent higher than their pre-pandemic levels, and corporate bond spreads are around 10 basis points narrower. Various measures of compensation for risk indicate an elevated risk appetite among investors, despite metrics such as forecast dispersions showing persistent uncertainty about the ongoing impact of the pandemic on economic prospects (Graph 1.6). Equity risk premiums (measured as the forward earnings yield less the real risk-free rate) are low relative to history in a range of countries including Canada, Japan and the United States.

Some measures of leverage in equity markets are elevated. Margin lending in the United States has increased by more than 50 per cent since the start of 2020, and in the euro area outstanding contracts for difference and equity swaps have increased substantially.[3] Elevated levels of leverage can increase the probability of disorderly price adjustments, as leveraged investors may need to sell assets to meet margin calls if prices fall. The events surrounding the Archegos fund in March 2021 highlighted this



risk and demonstrated that some leverage in financial markets remains hidden. A disruptive correction in financial markets could be caused by higher-than-expected inflation (and therefore interest rates), especially if this is not accompanied by an increase in expected corporate earnings. A correction could also be caused by lower-than-expected growth (e.g. due to additional COVID-19 outbreaks). This would lead to a reassessment of earnings forecasts and the ability of companies to repay their debts.

Issuance of risky debt has increased

Investor demand for risky debt has been strong. Issuance of high-yield debt has increased during 2021, as corporations have taken advantage of low borrowing costs. The stock of high-yield corporate bonds outstanding in the United States and the euro area has increased by 35 per cent since the beginning of the pandemic and the stock of leveraged loans has increased by 20 per cent (Graph 1.7). Demand for risky assets has been supported by a steady decline in default rate forecasts since mid 2020 alongside the global economic recovery. Search for yield dynamics have also been a factor as investors seek more profitable investments in the low interest rate environment. An increase in merger and acquisition activity is also driving the issuance of risky debt, particularly in the leveraged loans market.

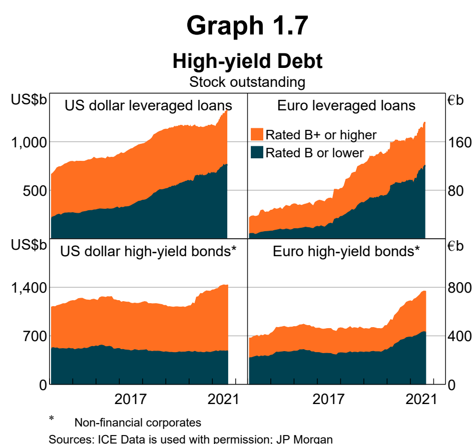
Recently issued leveraged loans have generally had riskier characteristics than the outstanding stock. European regulators have reiterated their concerns over risks in leveraged lending, particularly for some large banks. While originating banks sell many leveraged loans to other investors, such as investment funds and insurance companies, they typically retain around half of leveraged loans on their balance sheets, and so continue to be exposed to losses.

Global short-term funding markets have generally functioned well following the dislocations in March 2020, supported by ample liquidity. The growing popularity of 'stablecoins' such as Tether, which are privately issued crypto-currencies that aim to maintain a stable value against fiat currencies (particularly the US dollar) or other assets, has generated new investors in money markets. For stablecoins pegged to the US dollar, issuers generally seek to match the amount of stablecoins on issue with an equivalent amount of US dollar assets (mostly short-term securities and cash), making them broadly similar to MMFs. However, stablecoins are not subject to the same disclosure and liquidity requirements as MMFs, making them potentially vulnerable to runs (disrupting short-term funding markets) if investors lose confidence in the value of their holdings.

Earnings are recovering in most industries, but corporate indebtedness is high

Corporate borrowing increased sharply at the onset of the pandemic as firms sought to build precautionary liquidity buffers. While much of this debt has been repaid, overall corporate indebtedness remains well above pre-pandemic levels in many advanced economies – corporate debt-to-GDP ratios are a little above 100 per cent in Canada and Japan, around 80 per cent in the United States and around

Graph 1.7



* Non-financial corporates
Sources: ICE Data is used with permission; JP Morgan

70 per cent in the euro area (Graph 1.8). High corporate debt has been identified as a risk by regulators in a number of jurisdictions.

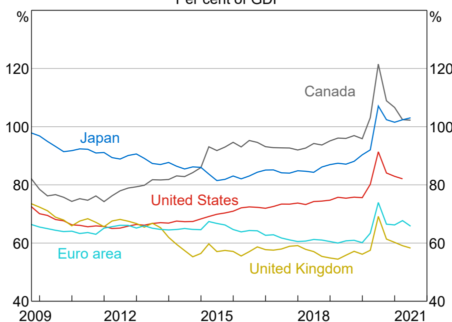
The ability of many businesses to service their debts has improved since earlier in the pandemic, as corporate earnings have continued to recover and interest rates have remained low. After declining sharply in 2020, earnings of listed companies are forecast to be around 20 per cent higher in 2021 relative to 2019 in the United States and 10 per cent higher in the euro area. However, earnings are forecast to remain weak for firms in sectors that are more exposed to the impact of COVID-19, including parts of the consumer discretionary sector (e.g. hotels and leisure firms) and some industrial firms (e.g. airlines and airport services). These sectors also have a higher share of firms with debt-at-risk (an interest coverage ratio less than one, indicating that a firm has interest expenses in excess of earnings).

After tightening in 2020, lending standards for corporate and industrial loans have generally eased in 2021. However, credit conditions remain tight for sectors that are still heavily affected by the pandemic, and for small and medium-sized enterprises (which are typically over-represented in affected service industries).

Graph 1.8

Non-financial Corporate Debt*

Per cent of GDP



* Debt is net of loan assets to help adjust for inter-company loans on a consistent basis

Sources: RBA; Refinitiv

Conditions in commercial real estate (CRE) markets vary markedly by type of property, reflecting the effects of the pandemic. Property values are below pre-pandemic levels in many countries for the pandemic-exposed hotel, retail and office sectors, despite some bounce back from their 2020 trough. In contrast, industrial CRE price growth remains strong, reflecting warehouse demand from online retailers that have benefited from shoppers' inability or reluctance to visit physical shopping centres. Delinquency rates on US commercial mortgage-backed securities have continued to decline, but remain elevated for hotel and retail properties.

A downturn in the CRE sector is a risk to financial stability in many advanced economies. The CRE sector has been a significant source of bank losses in previous financial crises due to the high volatility of CRE markets, banks' sizeable exposures to the sector and high loss rates following such crises. Debt is used to fund over half of all assets owned by real estate investment trusts that are primarily exposed to CRE. CRE loan defaults pose a greater risk in Norway, Sweden and some euro area countries where banks have a larger exposure to the sector – CRE accounts for around 40 per cent of all bank lending to non-financial corporations in Norway and Sweden. In addition, NBFIs have substantial exposure to the sector in the United States, Norway and the euro area (especially the Netherlands).

Banks' profitability has increased, but uncertainties related to the pandemic are a key risk

Advanced economy banks continue to be well capitalised with ample liquidity. CET1 capital ratios have increased by around 60 to 140 basis points compared with a year ago, partly as a result of restrictions on capital distributions (Graph 1.9). With the economic recovery more firmly under way, regulators are looking to further wind back the regulatory relief extended

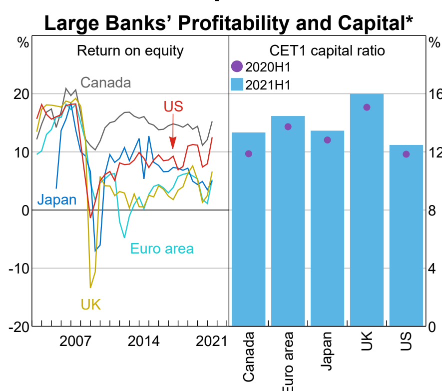
during the height of the pandemic. Some countries have announced an increase in regulatory capital buffers, including Canada, Denmark, Norway and Sweden. In addition, other regulatory capital relief has expired or will expire soon in major jurisdictions: banks in the United States no longer receive supplementary leverage ratio (SLR) relief for their holdings of government bonds and central bank deposits; banks in Canada will also not receive SLR relief for government bonds from the end of 2021 (but will continue to receive relief for central bank deposits); in the euro area, leverage ratio relief for central bank exposures will expire after March 2022; and for UK banks the favourable treatment on intangible software assets will expire by the end of 2021. Transitional arrangements for the capital impact of new credit loss accounting standards will also start to phase out in 2022.

The unwinding of regulatory relief will see banks' capital buffers decrease in coming quarters, but these will mostly remain high. Recent stress test results also confirmed the resilience of major banking systems to potential shocks. As a result, regulators have removed capital distribution restrictions and many large banks have announced share buyback plans and increased dividends.

Large banks' profitability has increased during 2021, with new provisions for loan losses falling sharply and some banks decreasing the stock of loan-loss provisions (Graph 1.10). In the euro area, the stock of large banks' provisions as a share of gross loans is below pre-pandemic levels, reflecting a longer-run trend of disposing of impaired loans in countries with elevated NPLs. Banks have also reported signs of recovery in consumer and commercial lending. Nevertheless, the pandemic continues to pose downside risks to banks' profitability, asset quality and credit demand. Banks' profitability is being constrained by narrowing net interest margins (NIMs) due to the prolonged low interest rate environment. Average NIMs for large US banks have fallen by over 70 basis points since the end of 2019, and NIMs for large UK banks have fallen by around 40 basis points. In contrast, average NIMs have fallen by less than 10 basis points for Australia's major banks in this period.

NPLs are at historically low levels in many countries, but are expected to rise as government support ends. Risks remain elevated in sectors most significantly affected by the pandemic, particularly given the recent spread

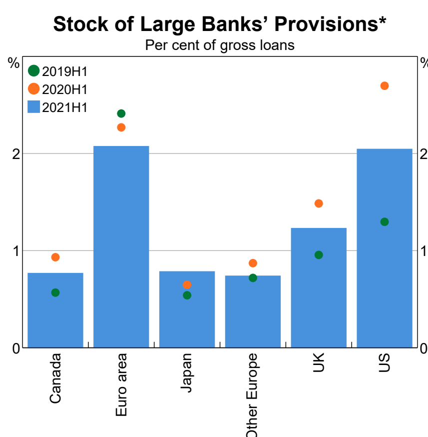
Graph 1.9



* Number of banks: Canada (6), euro area (36), Japan (4), United Kingdom (4) and United States (12)

Sources: RBA; S&P Global Market Intelligence

Graph 1.10



* Number of banks: Canada (6), euro area (37), Japan (4), other Europe (10), United Kingdom (4) and United States (12)

Sources: RBA; S&P Global Market Intelligence

of the Delta variant. For example, delinquency rates for CRE loans in the United States remain high (relative to low levels before the pandemic).

The events around the Archegos fund in March indicate that management at some banks do not have complete information on risks in their brokerage units. Several banks lent to Archegos to invest in stocks, and reports suggest banks did not know the full extent to which other banks had made similar loans (such that they did not know how concentrated Archegos' investments had become). Several banks faced large losses, although these losses were not severe enough to see their capital levels fall below their regulatory minimum. Regulators in several jurisdictions are investigating these events.

There are some persistent challenges facing banking systems in Japan and the euro area:

- In Japan and the euro area, low bank profitability and equity valuations impede the financial resilience of banks and their ability to raise capital to support lending. Some euro area banks also entered the pandemic with high levels of NPLs and provisioned less for potential losses.
- Large Japanese banks have increased overseas lending and invested in leveraged loans and collateralised loan obligations, largely due to the banks' excess deposits and search for higher returns – however, in doing so they have increased their risk exposure.
- In the euro area, banks are holding a large share of the pandemic-related increase in sovereign debt, which, combined with government loan guarantees to corporations, has intensified the credit relationship between governments, corporations and banks.

Vulnerabilities in China's financial system remain elevated

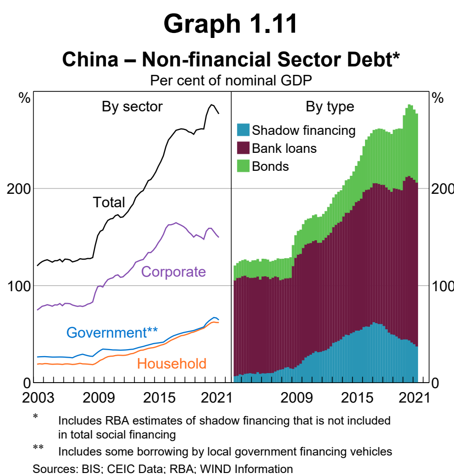
There are several vulnerabilities in China's financial system that authorities have been working to address over the past few years. These include: a high level of corporate debt; undercapitalisation among many smaller banks; an opaque and undercapitalised shadow banking system that engages in extensive maturity mismatch and has strong links to the banking system; weaknesses in some local government balance sheets; and widespread perceptions of implicit guarantees. This broader environment has become more challenging in the context of slowing medium-term growth prospects and increased policy and regulatory uncertainty as China sets new medium- and long-term policy goals.

Corporate debt as a share of GDP decreased by around 6 percentage points during the first half of 2021 (Graph 1.11), while government debt relative to GDP decreased by 2½ percentage points. Authorities have increased their scrutiny of projects to be funded with local government bonds, and introduced further restrictions on local government funding through off-balance sheet entities. Chinese banks' non-performing assets (NPAs) are currently less than 2 per cent of total assets; however, this number could rise due to a slower recovery for small firms, the scheduled expiration of loan forbearance at the end of 2021, and banks bringing off-balance sheet assets (including NPAs) onto their balance sheets to comply with new rules on asset management products.

Chinese authorities face a difficult balancing act in addressing the vulnerabilities in China's financial system. If they act too aggressively, confidence in the implicit guarantees that underpin much of the financial system could collapse, which would lead to widespread stress. In part reflecting these concerns, in August Chinese regulators announced a bailout of China Huarong Asset Management, a large

state-owned financial institution, after months of concerns about its financial health and ability to repay its obligations. Increased support from local governments is one reason why corporate bond defaults by state-owned enterprises (SOEs) have declined since early 2021. At least four local governments have established 'credit stabilisation funds' to provide temporary financing for SOEs as they restructure their businesses. Some local government officials have also assured investors that debts will be repaid.

At the same time, bailouts risk entrenching perceptions of implicit guarantees. More broadly, if authorities act too slowly in addressing vulnerabilities in China's financial system, the probability that an economic or financial disruption triggers broader financial stress in the future would increase. However, lowering vulnerabilities means regulators will have to make more decisions on whether to let firms fail. The widespread nature of vulnerabilities means authorities may also have to make multiple difficult decisions simultaneously, which could interact and raise the probability of a policy misstep.



Graph 1.11

China – Non-financial Sector Debt*

Per cent of nominal GDP

* Includes RBA estimates of shadow financing that is not included in total social financing

** Includes some borrowing by local government financing vehicles

Sources: BIS; CEIC Data; RBA; WIND Information

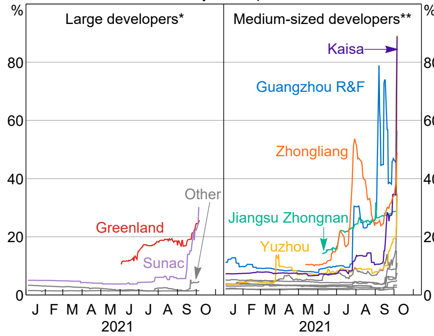
Financial stress has risen in China's property sector

Financial stress has risen in the property sector, alongside tighter regulatory restrictions. In mid 2020, Chinese authorities introduced a 'three red lines' policy, which limits the debt growth of real estate developers depending on their leverage as measured by three financial ratios. This policy (alongside other restrictions on property) has heavily affected Evergrande, one of China's largest and most leveraged real estate developers. Evergrande's leverage has expanded rapidly over the past few years, and its profitability has not kept pace with the increase in debt. It is also facing a liquidity crisis because of its declining profitability, the shorter maturity of its liabilities relative to its assets, and an inability to raise additional debt to meet interest payments and pay suppliers and contractors. To increase its cash holdings, Evergrande has: sold properties at steep discounts; sold other assets; delayed payments to suppliers, holders of its wealth management products and on some of its other liabilities; and sought to offer debt holders discounts on properties in lieu of payments. These steps appear insufficient and Evergrande is widely expected to collapse without some type of government support.

At this stage, authorities are reluctant to support Evergrande directly. This is consistent with a desire to reduce both implicit guarantees and the economic importance of the property sector. However, if Evergrande was to collapse, it could be a source of systemic stress if it shifts perceptions about overall risk in the property sector, noting that there are other developers that are over some or all of the 'three red lines'. Consistent with this, local and US dollar bond yields for highly-leveraged developers have risen sharply (Graph 1.12).

Investors in opaque shadow finance investment products, such as trusts and wealth management products, may also become concerned about their potential exposure to

developers and withdraw funds. A run on shadow banking products would create further stress in the property sector and would be damaging for the financial system more broadly. In addition, many banks could face large losses as they are significant creditors to developers both directly and indirectly (via shadow financing). Another concern is the extent to which Chinese developers use pre-sales as a source of funding. If buyers question the safety of pre-sales, they could stop purchasing properties, forcing developers to stop construction, leading to a sharp decrease in economic activity. The health of local governments could also be affected by a sharp fall in real estate prices, as many rely on land sales for revenue, including to repay debts of local government financing vehicles. Land is used as collateral for loans to such vehicles, and so a sharp fall in land prices will lead to losses for creditors if these vehicles were to default.



Endnotes

[1] For more information on the transition away from LIBOR, see RBA (2021), 'Box A: The Transition Away from LIBOR', *Financial Stability Review*, April, pp 16–21.

[2] For more information on financial vulnerabilities in emerging market economies, see RBA (2021), 'Box A: Emerging Market Vulnerabilities and Financial Conditions in Advanced Economies', *Statement on Monetary Policy*, May, pp 21–23.

[3] Contracts for difference and equity swaps enable greater leverage because buyers do not generally need to hold the underlying asset the contract is referencing (other than for hedging purposes).