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I have been asked to focus my remarks on two questions in particular. First, what macroeconomic and financial market indicators should guide the unwinding of liquidity support and funding guarantees? Second, are recent developments supportive of current plans for withdrawal? Before addressing these two questions, I would like to make three generic points about the withdrawal process.

First, the unwinding process will be easier—and indeed can be entirely automatic—if the policies have been well designed in the first place. Thus the demand for central bank liquidity support should drop off as markets recover, if that support is provided at penal rates. Christine Cumming's comments this morning about declining use of the Federal Reserve's programs illustrate this point. Similarly, if funding guarantees are priced expensively, then the demand for them will drop off as risk appetite returns to unguaranteed funding markets. For instance, the insurance provided on newly issued bank debt under the United Kingdom's Credit Guarantee Scheme is priced off credit default swap (CDS) spreads during the crisis period. Consequently demand for the guarantees has evaporated as risk appetite has returned to the market for banks' debt.

It will, however, be more difficult to withdraw liquidity support that has been provided at nonpenal rates or against illiquid collateral that a central bank would not normally take in its operations, as the demand for support will remain even as markets return to normal. Similarly, it will be more difficult to judge when it is safe to remove nonpriced guarantees—the most obvious example being enhanced guarantees on retail deposits.

Second, support policies should be a bridge to a new, sustainable equilibrium. Some business models, such as those very reliant on short-term wholesale funding through securitization vehicles, and some asset structures, for instance for some sorts of mortgage-backed securities and complex structured finance assets, are unlikely to be sustainable without ongoing public support. Policy should not support these businesses or markets unless there is an identifiable market failure present. As the recovery proceeds, we will gradually get a better appreciation of which business models and which asset structures can survive (possibly in altered form) and which should be allowed to perish. But there is a danger that political economy considerations may delay, or even prevent altogether, the withdrawal of support for these unviable businesses and assets.

Third, and allied to this, it is important that governments and central banks as far as possible stick to commitments they have already made regarding withdrawal of support. The looming withdrawal of support should encourage banks to take preemptive action to strengthen their balance sheets by retaining profits or raising new capital. For instance, funding costs are generally lower for well-capitalized banks, so the imminent withdrawal of funding support should encourage banks to improve their capital base. I recognize, though, that this may have some adverse side effects, as it could also encourage banks to cut back lending in order to improve capital ratios through that route.

So, turning to the first of my two original questions, what indicators should govern the pace of withdrawal? To begin with, in principle one can have a strong economy and a weak

financial sector or vice versa, but in practice a stronger economy leads to lower default losses and, other things equal, a stronger banking system. So the usual clutch of macroeconomic indicators, such as growth, unemployment, and capacity utilization provide a suitable backdrop.

Second, the indicators of the state of funding markets and measures of credit risk are important. In particular, the terms on which banks can issue unguaranteed debt is critical. So banks' CDS premia potentially provide valuable information. It is worth noting, however, that these may give a misleadingly benign impression if they reflect a belief that the public sector will always ride to the rescue of a beleaguered institution. Moreover, it would be inappropriate to delay withdrawal until the CDS premia for all banks have fallen back to low levels, as some lenders surely should be encouraged to merge with stronger brethren or else exit altogether. The state of the securitization market will also be critical, though the problem here is to know what structures deal adequately with the underlying information and incentive problems that were exposed by the crisis and will consequently be viable.

Third, indicators of the solvency of financial institutions, such as expected losses and capital and leverage ratios, should be valuable. In particular, these considerations should be brought together through the implementation of rigorous stress tests against a range of extreme but not implausible scenarios.

Finally, general indicators of risk appetite in financial markets, including a range of asset prices, should also be factored in.

So, regarding the second question, are recent developments generally supportive of current plans for withdrawal? I have to say that progress looks promising. The worst downside risks have largely dissipated as growth has returned to most of the G-20 economies along with a reduction in the likely losses in banks' banking books and some writing up of the value of assets in the trading book. Risk premia on financial assets have fallen back, CDS premia have returned to levels seen prior to the collapse of Lehman Brothers, and LIBOR-OIS spreads are back to precrisis levels. And the issuance of unguaranteed bank debt has picked up. The main problem is the continued closure of the securitization market, which raises the question of how the funding gap will be filled when the copious quantities of public support are withdrawn.