EUROPEAN CENTRAL BANK

EUROSYSTEM

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FINANCIAL STABILITY REVIEW
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Stress in the euro area financial sector has fallen from previous peaks. Several indicators suggest that euro area systemic stress is at its lowest point in two years. ECB policies have been a key factor underpinning this decline in stress. To consolidate this recent progress, further fundamental adjustment must continue at the national level alongside ongoing initiatives at the EU level to strengthen the institutional framework of Monetary Union.

Financial stability conditions in the euro area remain fragile. Several vulnerabilities in the interaction between sovereigns, banks and the macroeconomy persist. Further concrete action by the public and private sector is needed to durably sever negative feedback loops between distressed sovereigns, increasingly diverging economic growth prospects at the country level and concerns about the financial soundness of banks. A roadmap has been drawn up for completing Economic and Monetary Union (EMU). Its completion, including notably the part related to the banking union, is essential.

The analysis in this Review highlights four key risks to euro area financial stability:

1. **A further decline in bank profitability, linked to credit losses and a weak macroeconomic environment.** Continued and prompt progress in proactively tackling bank balance sheet problems is needed.

2. **Renewed tensions in sovereign debt markets due to low growth and slow reform implementation.** Progress in adjusting public finance vulnerabilities should not unravel. Beyond this, continued momentum is needed towards completing a genuine EMU, notably including a full banking union and a strengthening of fiscal frameworks.
3. **Bank funding challenges in stressed countries.** Continued steps at both the national and European level are needed to tackle remaining fragmentation in bank funding. Furthermore, bank funding markets will benefit from a predictable and consistent approach to bank supervision and resolution across Europe; the launch of the single supervisory mechanism will be a key milestone in this respect.
4. **Reassessment of risk premia in global markets, following a prolonged period of safe-haven flows and search for yield.** Stable and predictable policies are key to the prevention of such a risk reversal. To reduce the losses of such a possible risk reversal, banks and supervisors should ensure that bank capital buffers are sufficient.

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