



EUROPEAN CENTRAL BANK

EUROSYSTEM

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PRESS RELEASE

WEAK ECONOMIC PROSPECTS EXACERBATE FINANCIAL SYSTEM RISKS - FINANCIAL STABILITY REVIEW

- Euro area systemic stress at lowest level since the onset of the financial crisis in 2007 despite intermittent financial market turbulence
- Progress continues in balance sheet repair following the euro area crisis, boosted by the successful completion of the ECB's comprehensive assessment of significant banks
- The economic recovery nonetheless remains weak, fragile and uneven – and could potentially reinforce financial stability risks, against a backdrop of a global search for yield

Systemic stress among euro area banks and sovereigns declined further to levels last seen before the onset of the global financial crisis in 2007, according to the latest Financial Stability Review of the European Central Bank (ECB) released today.

Generally ebullient financial market sentiment contrasts with a weak, fragile and uneven economic recovery – despite progress in addressing banking and sovereign vulnerabilities. In particular, the provision of bank credit remains weak, despite exceptional ECB support, given a combination of weak demand and credit terms in some pockets of the economy that may discourage borrowing and investment.

In the meantime, balance sheet repair in the euro area continues. Banks have strengthened their balance sheets – at least in part as a result of the ECB's comprehensive assessment. However, the work of restoring public finances remains uneven and unfinished.

Combining these legacy issues that require balance sheet repair with emerging risks in the form of continued global search for yield leads to three key risks to financial stability over the next 1½ years that could reinforce each other, if triggered:

- Abrupt reversal of the global search for yield, amplified by pockets of illiquidity, with signs of a growing use of leverage in the non-bank financial sector. This calls for continued efforts to improve the oversight of and the tools to deal with risks from shadow banking activities.
- Persistently sluggish bank profitability in a weak, fragile and uneven macroeconomic recovery
- Re-emergence of debt sustainability concerns, set against low nominal growth and wavering policy determination for fiscal and structural reform

In addition to a thorough review of the main developments relevant for euro area financial stability, this Review also contains three special feature articles. The special feature articles study the effects of spillovers from fire-sales in the euro area financial system, work on characterising the financial cycle in euro area countries and the net stable funding ratio in the context of the new macro-prudential policy toolkit.

The Review is available on the ECB's website (www.ecb.europa.eu).

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