

## PRESS RELEASE

### FINANCIAL STABILITY REVIEW SHOWS PROGRESS IN STRENGTHENING BANKS AND SOVEREIGNS; HUNT FOR YIELD CONTRIBUTING TO THE BUILD-UP OF NEW RISKS

- Banking system stress has eased further as banking union preparations have gathered pace and banks have strengthened balance sheets
- Growing search for yield has benefited euro area banks and sovereigns, but could also unearth imbalances should risks be reassessed

Euro area financial system stress has remained moderate over the last half-year, according to the new Financial Stability Review of the European Central Bank (ECB) released today. Investor concerns regarding the global financial crisis have continued to diminish, amid on-going action to address “legacy” risks of past crises for both banks and sovereigns. Euro area banks have accelerated the clean-up and strengthening of their balance sheets since the third quarter of 2013, when discussions about the ECB’s comprehensive assessment intensified. Sovereign risk has improved with the implementation of fiscal consolidation and structural reforms, although progress has been uneven.

At the same time, new risks are emerging, particularly a growing search for yield across regions and market segments, driven by increased investor confidence and some rebalancing of portfolios away from emerging markets, among other factors. As the search for yield intensifies, so do concerns regarding the build-up of imbalances and the possibility of a sharp and disorderly unwinding of recent investment flows.

Building on a thorough overview of macro-financial developments, three key risks for euro area financial stability predominate over the next 18 months. These are risks of:

1. **Abrupt reversal of the global search for yield, amid pockets of illiquidity and likely asset price misalignments.** As the potential for disorderly adjustment in financial markets remains, financial institutions need to have sufficient buffers and/or hedges to withstand it.

2. **Continuing weak bank profitability and balance sheet stress in a low inflation and low growth environment.** Continued action is needed to mitigate lingering scepticism regarding euro area bank balance sheets.
3. **Re-emergence of sovereign debt sustainability concerns, stemming from insufficient common backstops, stalling policy reforms, and a prolonged period of low nominal growth.** Despite the continued improvement in sentiment towards euro area sovereigns, public debt sustainability challenges persist and complacency or reform fatigue must therefore be avoided.

This 20th edition, marking a decade of Financial Stability Review publication, also includes several special features: a review of Europe's experiences with macro-prudential tools; how to identify excessive credit growth and leverage; the differences and complementarities between micro- and macro-prudential policies; and euro area banks' emerging market exposures.

The report is available on the ECB website, [www.ecb.europa.eu](http://www.ecb.europa.eu)

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