



EUROPEAN CENTRAL BANK

EUROSYSTEM

PRESS RELEASE

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Growing financial risk appetite within a gradual economic recovery – Financial Stability Review

- Euro area systemic stress remained low in past six months amid improving, but still subdued, economic growth
- Financial markets show continued asset price rises and bouts of volatility, but without generalised overvaluations
- Challenging operating environment for euro area banks and insurers, while rapid growth of shadow banking sector continues

Euro area systemic stress has remained low over the past six months, according to the latest Financial Stability Review of the European Central Bank (ECB), which was released today. This also reflects ECB action that calmed fears of a too prolonged period of low inflation threatening to harm both price and financial stability.

Despite a generally positive financial market sentiment, there have been repeated moments of tension in global financial markets. Large banks have become less confident about their ability to make markets during periods of stress.

Set against increasing financial risk-taking, economic risk-taking in the euro area is still lagging – something that is particularly visible in the contrast between appreciating financial asset prices and a low level of real investment. While the economic recovery in the euro area has been gaining momentum, it remains weak by international standards. At the same time, credit to the real economy is recovering, benefitting from ECB monetary policy action. Despite these signs of improving economic conditions, the risk of continuing low nominal growth remains a challenge to financial stability in the euro area. Should

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country, sector and institution-specific challenges arise, this would call for macroprudential policy measures, as monetary policy remains focused on price stability.

Financial system vulnerabilities continue to stem not only from the financial markets, but also from financial institutions, ranging from banks to insurers and – increasingly – the shadow banking sector. Bank profitability remains weak and the return on equity remains below the cost of capital for many banks. Despite the solid profitability reported so far, euro area insurers are facing growing challenges as the low-yield environment is testing their traditional reliance on fixed income assets as a means of generating portfolio returns. The shadow banking sector continues to grow robustly, increasing the potential for systemic risks. Finally, highly indebted sovereigns remain vulnerable to both economic and financial shocks.

The ECB has singled out four risks to financial stability over the next year and a half.

- Abrupt reversal of compressed global risk premia amplified by low secondary market liquidity
- Weak profitability prospects for banks and insurers in a low nominal growth environment, amid slow progress in resolving problem assets
- Rise of debt sustainability concerns in the sovereign and corporate sectors amid low nominal growth
- Prospective stress and contagion effects in a rapidly growing shadow banking sector

The review also contains three special feature articles. They assess cross-border spillovers from macroprudential policies, examine the main drivers of euro area bank profitability over the past years as well as non-performing exposures in the banking system and their prospective resolution.

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