BANCO DE ESPAÑA
Eurosistema

Communication Department

PRESS RELEASE

Madrid, 10 December 2019

Financial Stability Review. Autumn 2019

The autumn edition of the *Financial Stability Review*, published today on the Banco de España website (https://www.bde.es/bde/en/secciones/informes/boletines/Revista_de_Estab/), contains the following articles:

"Energy transition and financial stability. Implications for the Spanish deposit-taking institutions", by Margarita Delgado

Most countries are adopting strategies to reduce greenhouse gas emissions to mitigate the associated risks. The financial sector, in particular, is also exposed to these risks, which may be divided into two types: physical and transition risks. The article focuses on the energy transition risks, since these may affect the credit quality of the potentially most affected sectors. In the case of Spain, the banking system's exposures to risks affected by energy transition make up around 25 % of the portfolio of loans for productive activities. A retrospective analysis shows that, following the global financial crisis, the non-performing loan ratio for activities affected by energy transition has been lower than for other productive activities. But this may be a consequence of specific factors that could disappear in an energy transition scenario, when pollution costs are fully internalised and the environment is more competitive. Lastly, the author considers whether financial regulation should play some role in this transition process

"The energy transition and the financial system", by Jaime Terceiro Lomba

The article first presents an overview of the climate change dilemma, in general terms and from an economic standpoint. It then summarises the international endeavours to reach agreements on carbon pricing that take into account the social cost and facilitate the transition to an alternative, decarbonised economic system, with scant results so far. Against this backdrop, the article presents the risks and opportunities that the energy transition poses for the financial system and the potential problems that delayed decision-making can cause for financial stability. The author concludes that little progress has been made in this respect and that the issue has not been addressed with sufficient determination and rigour. In consequence, it seems unlikely that the financial system will play a significant part in channelling the considerable economic resources needed to finance a new energy infrastructure.

“Building a sustainable financial system: the state of practice and future priorities”, by Simon Dikau, Nick Robins and Matthias Täger

Efforts to align the global financial system with safe and sustainable climate development are entering a new phase. Five years ago, only a handful of central banks paid any attention to the environmental crisis. Today, around 40 central banks and financial system supervisors are taking steps to gain recognition of the role they can play in building a sustainable financial system and implement the most appropriate measures. The article briefly explains the new functions to be assumed by central banks to achieve a sustainable financial system, describing the main characteristics that these functions would require. Lastly, the authors underline the priority issues both for policy-making and research in coming years.

“Non-bank financial intermediation”, by Ana María Martínez Pina

Non-bank financial intermediation covers a range of heterogeneous institutions which, in certain circumstances, engage in business activities that are similar in many aspects to regular banking business. In Spain, the assets of non-bank financial intermediaries at end-2018 amounted to around 6 % of total financial system assets. And this figure is rising, mainly as a result of the growth in investment funds. As a general rule, non-bank financial intermediaries are appropriately regulated and supervised, although not by banking regulations. The author concludes that the Spanish National Securities Market Commission correctly monitors these intermediaries and that the current risks are limited. But they warrant constant monitoring. She also stresses that macroprudential policy should be holistic and should include tools capable of mitigating and reducing the risks associated with the non-bank sector.

“The shadow banking system and regulatory arbitrage: the eternal return?”, by José María Roldán Alegre

The shadow financial system played a predominant, and perhaps even a determining, role in the gestation of the 2007/2008 global financial crisis. Financial intermediation by non-bank institutions – commonly referred to as the “shadow banking” sector – has three essential characteristics: credit risk, leverage (scant own funds and predominance of external funding), and maturity mismatch (long-term assets funded by short-term liabilities). The author takes a critical look at the efforts made to control the risk emanating from the shadow banking sector. He concludes that, despite the efforts made, there is no guarantee that this risk is under control. The reasons for this include problems relating to financial regulation architecture, the asymmetric regulatory measures in place between the banking sector and shadow banking, and the transformation produced by the fourth industrial revolution.

“Capturing macroprudential regulation effectiveness: a DSGE approach with shadow intermediaries”, by Federico Lubello and Abdelaziz Rouabah

This article develops a New Keynesian dynamic stochastic general equilibrium (DSGE) model with heterogeneous agents to investigate how the shadow financial system affects macroeconomic activity and financial stability. It also shows how shadow intermediaries entail a trade-off: they make for greater efficiency, as they permit redistribution of capital in the securitisation market, but they also drive up underlying externalities in the financial intermediation process. The authors conclude that a macroprudential authority may successfully mitigate these externalities by capping both the leverage ratio and the securitisation ratio in the traditional banking sector, and may be effective in safeguarding financial stability, dampening aggregate volatility and enhancing welfare.

"Financial system interconnectedness", by José Alonso and Patricia Stupariu

Interconnectedness between financial institutions – banks and other financial agents – adds flexibility to the financing of the economy and, in particular, to investment, and is an intrinsic characteristic of developed financial systems. However, despite these benefits, at times of crisis non-bank agents can also facilitate or contribute to the propagation of stress through the system. The article presents an overview of interconnectedness in the Spanish financial system, describing the direct linkages between the different resident financial sectors and with non-resident financial sectors, and also the indirect interconnectedness between resident sectors. The authors conclude that there is significant cross-border interconnectedness, a growing presence of the non-bank sector in the Spanish financial system overall and significant portfolio overlap in some financial sectors.

"Brexit: Uncertainties and challenges in the financial sector", by Paloma Marín Bona, Susana Moreno Sánchez and María García Lecuona

Brexit has transformed the financial services map of the European Union (EU), as financial institutions have relocated in light of the uncertainty surrounding the withdrawal process. Moreover, the negotiations have barely touched on financial services, with the consequent lack of definition of the framework for the future relationship. As no other solution for future relations with the United Kingdom has emerged, the article focuses on third-country regimes and equivalence. But these regulatory frameworks were not designed to handle relations with a country that decides to leave the EU and with which there is extensive cross-border activity. In this setting, the possibility of financial services being largely provided by a third country raises concerns regarding appropriate supervision and potential financial stability risks. Lastly, the authors highlight the importance of restarting the capital markets union initiative on more ambitious terms. This will facilitate deeper financial market integration and will tend to dilute the fragmentation of the EU markets post-Brexit.

"Second Financial Stability Conference of the Banco de España and of the CEMFI, 3 and 4 June 2019, Madrid", by Rafael Repullo and Jesús Saurina

The Banco de España, in cooperation with the CEMFI, organises a biennial conference on financial stability. The papers presented are selected by a scientific committee from those received in response to a call for papers. At the second conference the topics presented and discussed included the macroeconomic effects of capital requirements, the effects of capital buffers on credit, the effectiveness of borrower-specific macroprudential measures, the financial determinants of macroeconomic risk and the relationship between monetary policy and systemic risk. The sessions were preceded by addresses by Pablo Hernández de Cos, Governor of the Banco de España, Agustín Carstens, General Manager of the Bank for International Settlements (BIS), and Nobel Prize winner Lars Peter Hansen of the University of Chicago. In her closing remarks, Margarita Delgado, Deputy Governor of the Banco de España, affirmed that this biennial conference has become a key event on the Banco de España's calendar, in keeping with the traditional importance it attaches to financial stability issues, as shown by the articles published since 2001 in the *Financial Stability Review* and, of course, by the dynamic provisions set in place to address credit cycles, in force in Spain from 2000 to 2016.

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