

# THE STATE OF PLAY OF THE GLOBAL FINANCIAL STABILITY

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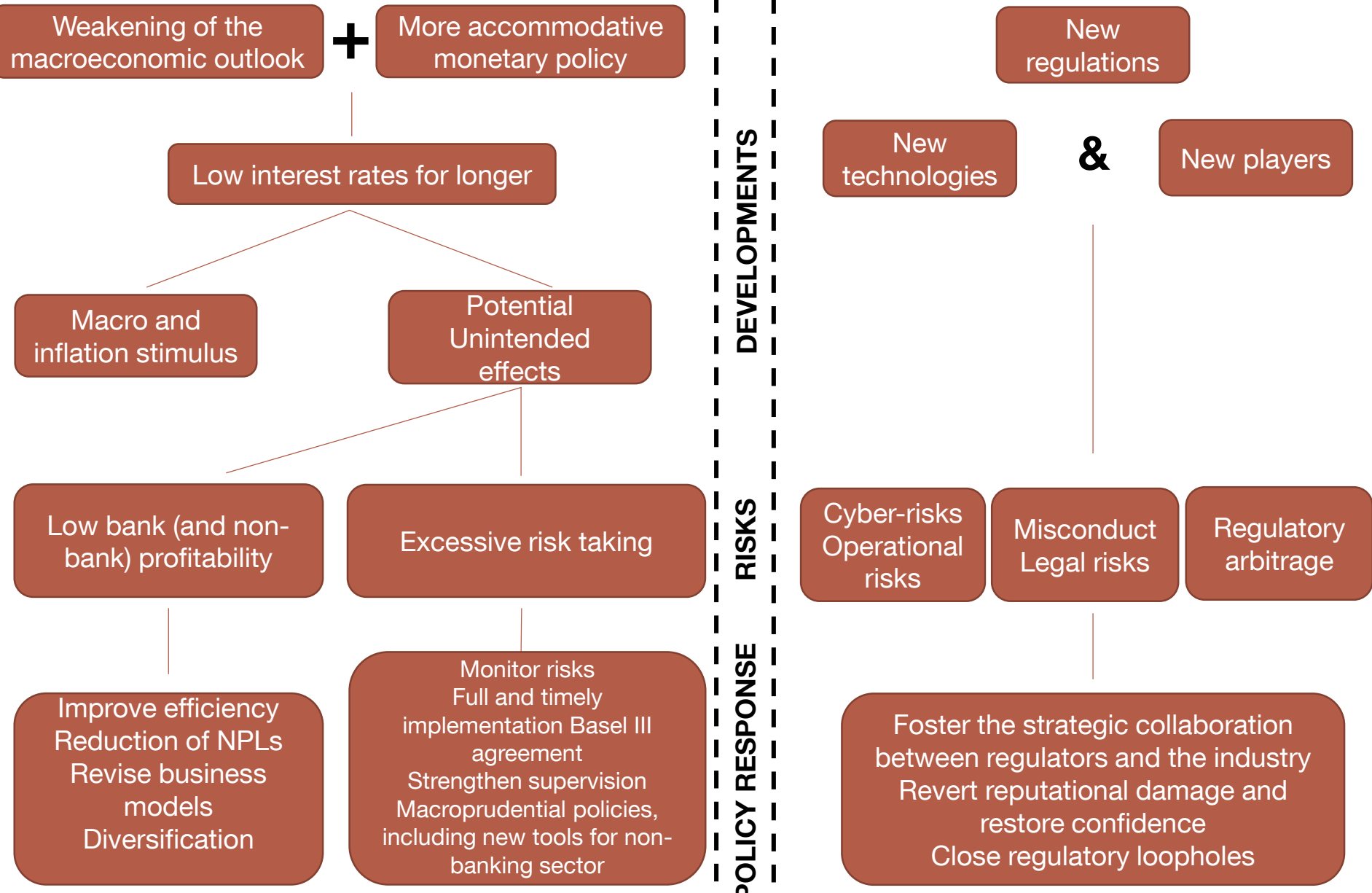
Eighth High-Level Policy Dialogue  
of the Eurosystem and Latin American Central Banks

Cartagena de Indias

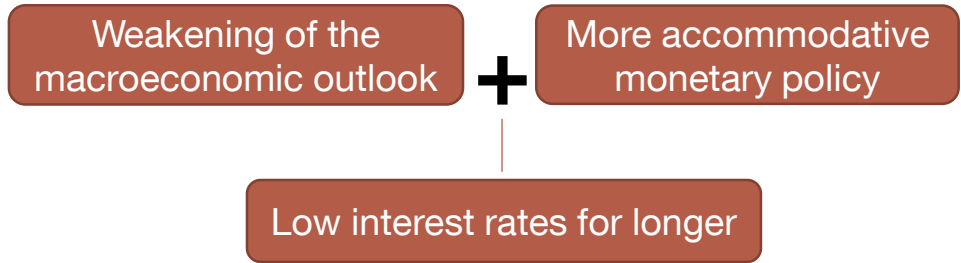
29 November 2019



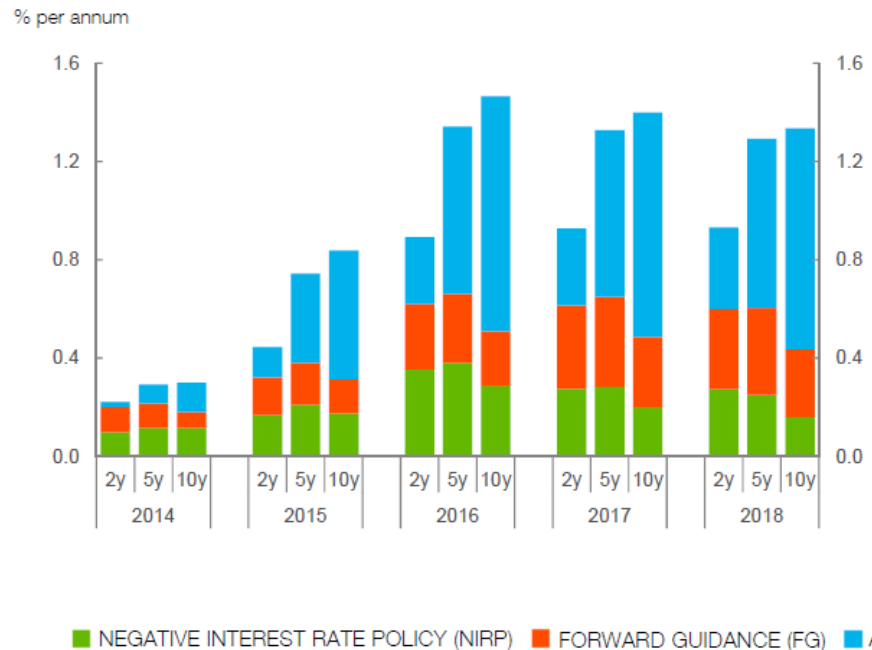
# A TREE OF MACROFINANCIAL DEVELOPMENTS, RISKS AND POTENTIAL POLICY RESPONSES



# MESSAGE #1: UNCONVENTIONAL MONETARY POLICY HAS BEEN EFFECTIVE AT EASING FINANCIAL CONDITIONS, SUCH AS YIELD CURVES ...



**UPWARD PRESSURES ON EURO AREA SOVEREIGN BOND YIELDS IN ABSENCE OF ECB'S NON-STANDARD MEASURES 2014-2018**



SOURCE: *Rostagno, Altavilla, Carboni, Lemke, Motto, Saint-Guilhem, Yiangou (2019), forthcoming.*

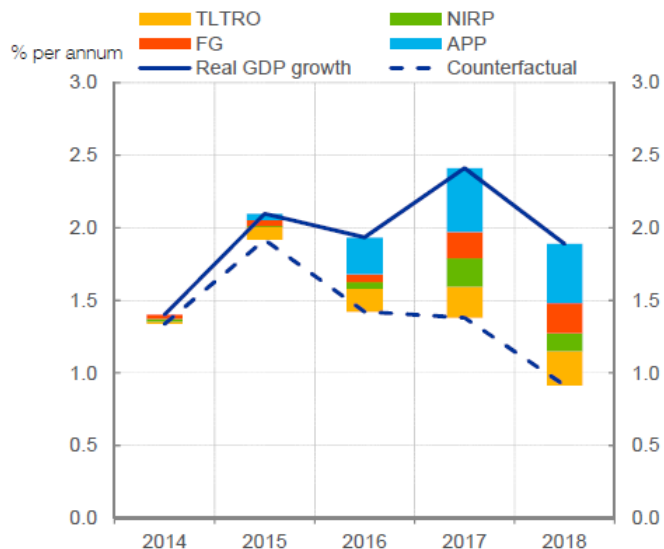
Notes: The chart shows the impact of ECB non-standard measures on the GDP-weighted aggregate of euro area sovereign bond yields.

# ... WHICH, IN TURN, HAVE STIMULATED GROWTH AND INFLATION

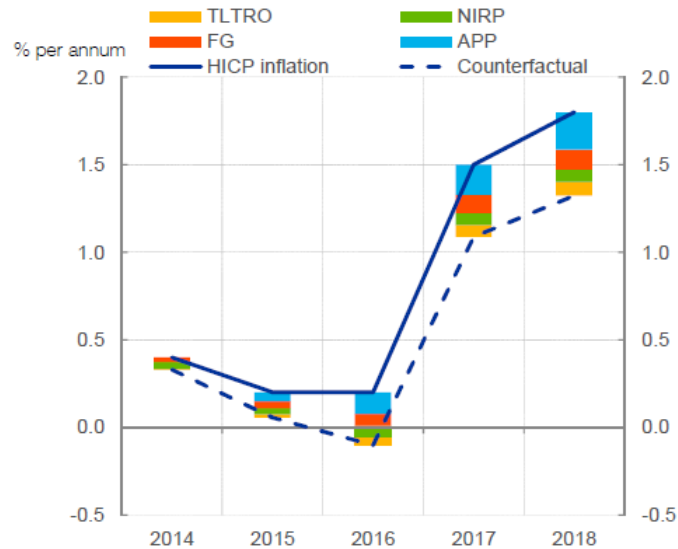
Low interest rates for longer

Macro and inflation stimulus

### CONTRIBUTION OF ECB NON-STANDARD MEASURES TO REAL GDP GROWTH 2014-2018



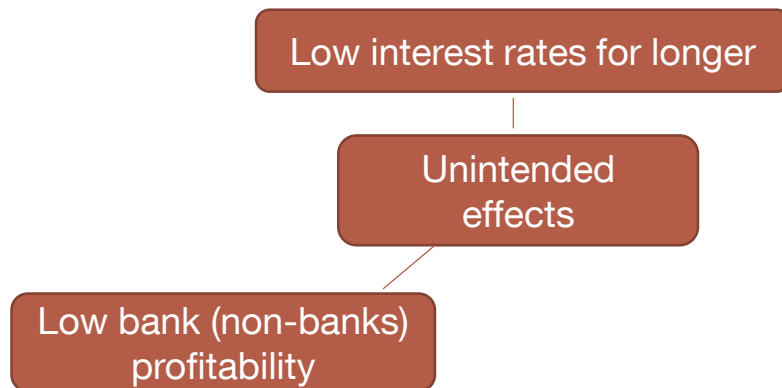
### CONTRIBUTION OF ECB NON-STANDARD MEASURES TO HICP INFLATION 2014-2018



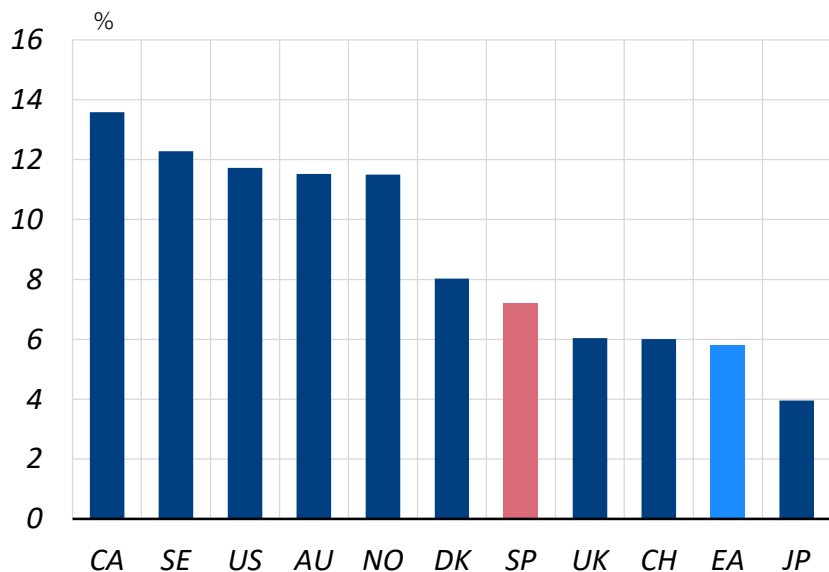
Source: Rostagno, Altavilla, Carboni, Lemke, Motto, Saint-Guilhem, Yiangou (2019), forthcoming.

Notes: The chart shows the impact of ECB non-standard measures on macro variables based on a macroeconomic model with financial variables conditioning on their estimated impact on the yield curve.

# MESSAGE #2: THE LOW FOR LONGER SCENARIO MIGHT LEAD TO SOME UNINTENDED EFFECTS SUCH AS LOW BANK (AND NON-BANKS) PROFITABILITY ...

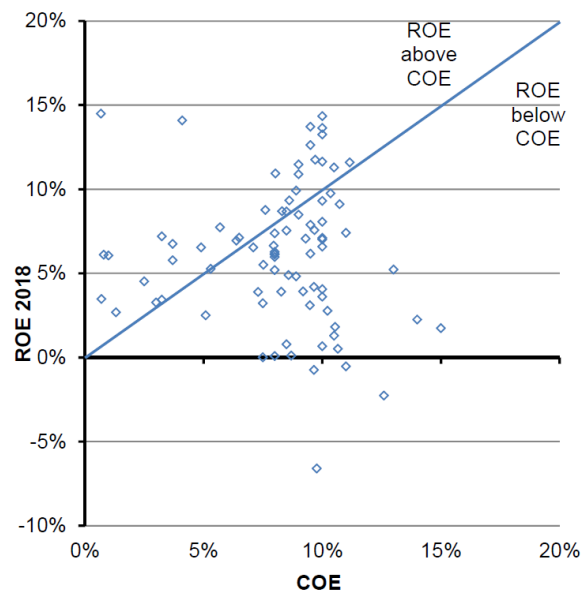


### ROE 2018 (consolidated figures)



Source: Banco de España, ECB, Federal Reserve, SNL and Finanstilsynet.

### EU banking sector profitability and cost of equity



Source: Enria (September 2019), "Post-crisis repair and the profitability malady".

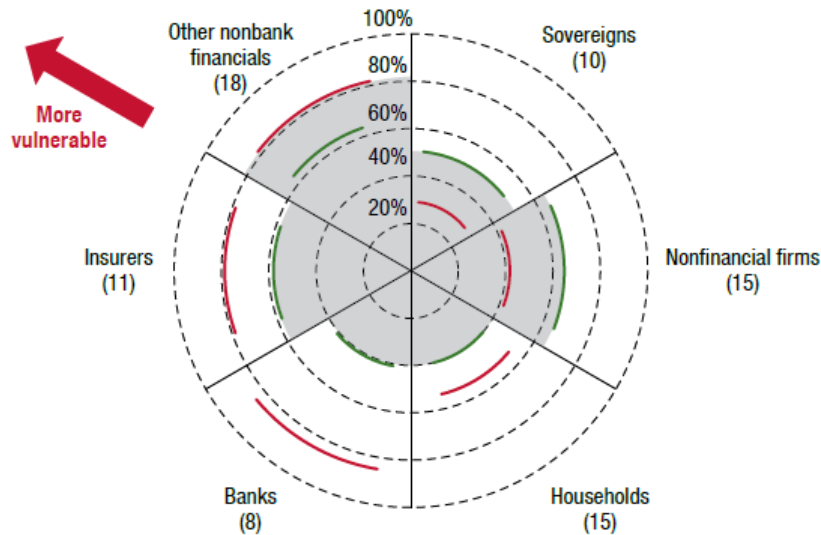
Low interest rates for longer

Unintended effects

Excessive risk taking

**Proportion of systemically important economies with elevated vulnerabilities, by sector**

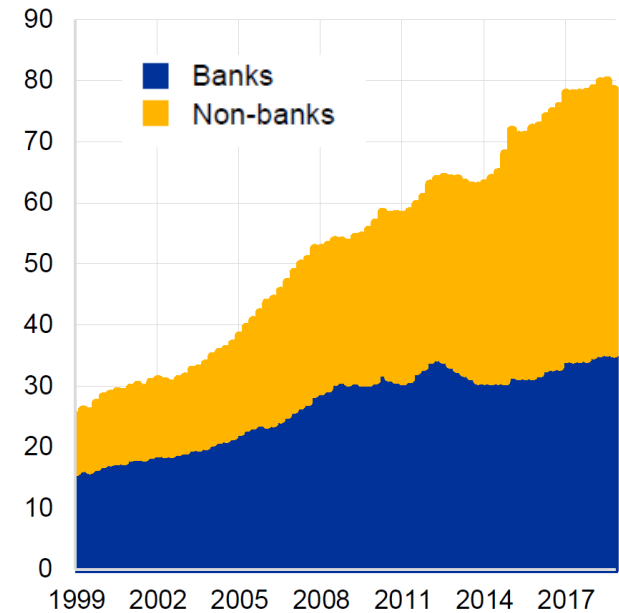
(% of countries with high and medium-high vulnerabilities, by GDP; number of countries in parentheses)



Source: IMF Global Financial Stability Report (October 2019).

**Growth of non-banks' financial assets in the euro area**

(€ trillions)

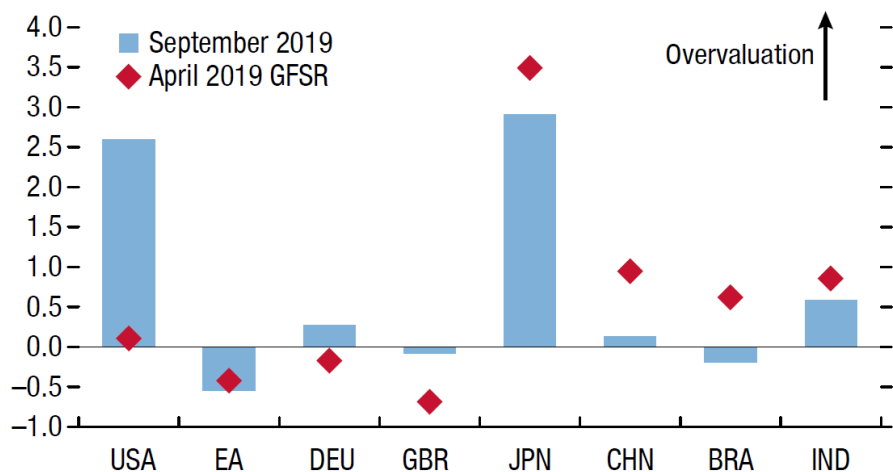


Source: ECB Financial Stability Review (May 2019).

# ... SUCH AS STRETCHED ASSET MARKET VALUATIONS ...

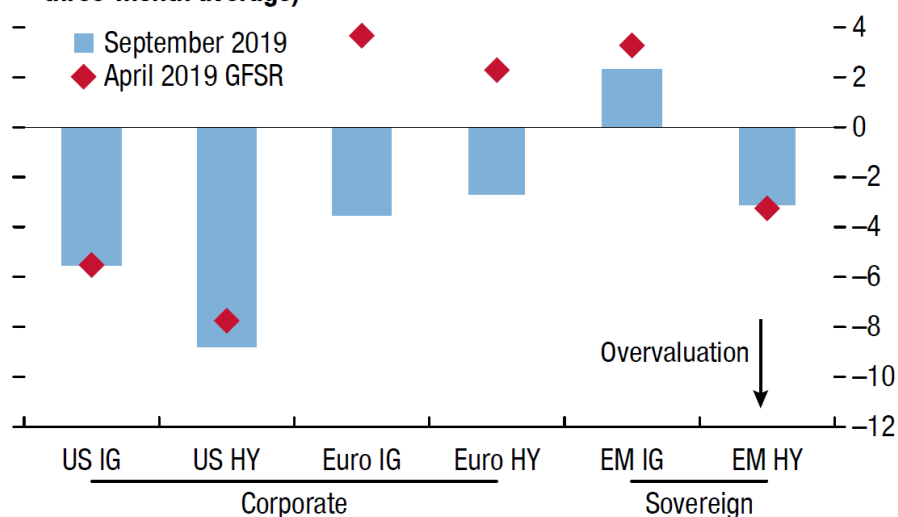
Equity valuations appear stretched in some countries ...

**3. Global Equity Markets: Price Relative to Fair Value**  
(Percent, scaled by standard deviation of returns, three-month average)



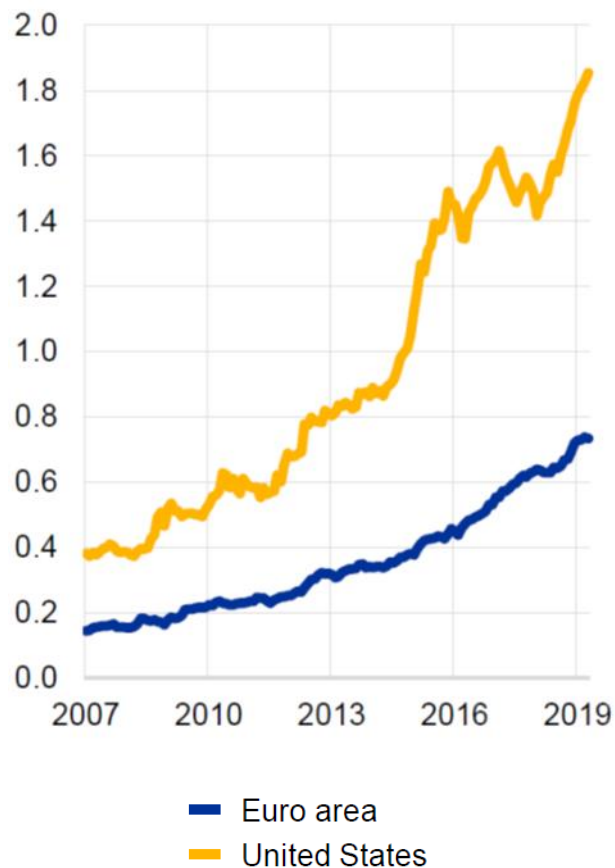
... and bond spreads are too compressed relative to fundamentals.

**4. Global Bonds: Spread Relative to Fair Value**  
(Basis points, scaled by standard deviation of spread changes, three-month average)

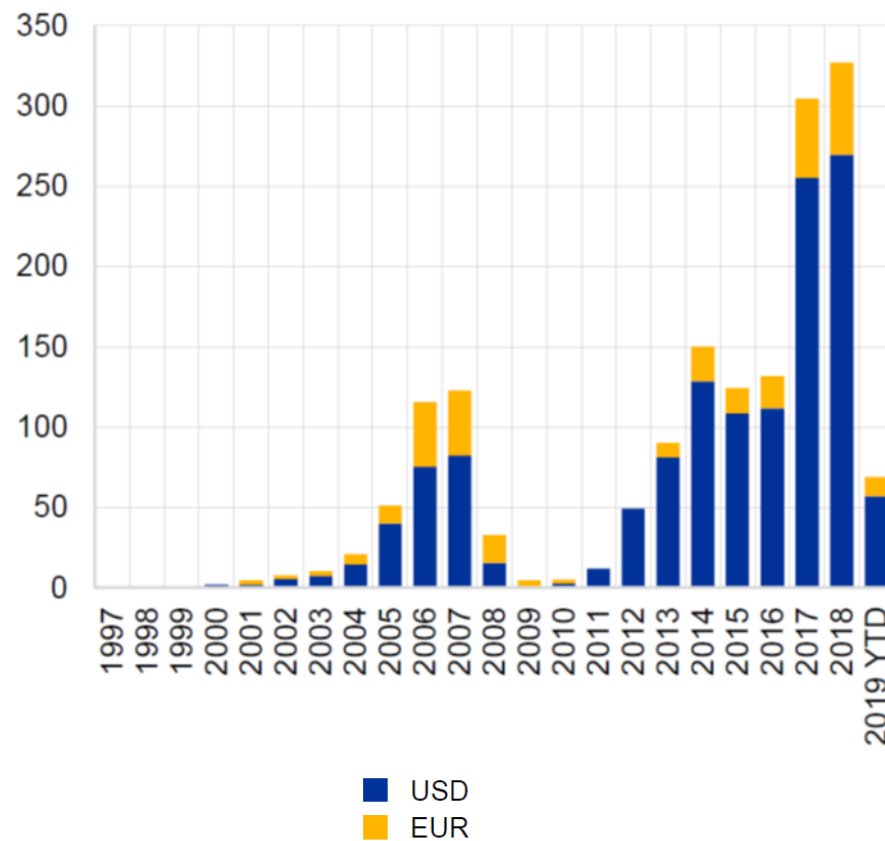


Source: IMF Global Financial Stability Report (October 2019).

**Euro area and US non-financial  
BBB-rated corporate debt**  
(€ trillions)



**CLO issuance**  
(USD billions)



Source: ECB Financial Stability Review (May 2019).



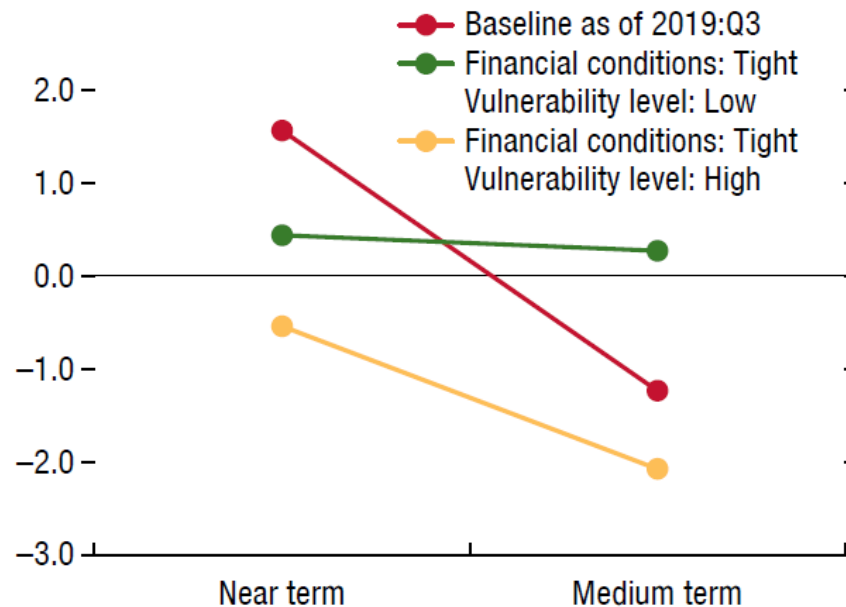
## MESSAGE #3: THE WAY TO ADDRESS THESE INCREASED FINANCIAL VULNERABILITIES IS NOT TIGHTENING FINANCIAL CONDITIONS IN THE CURRENT CONTEXT...

- *A tightening in financial conditions when private nonfinancial vulnerabilities are low results in increased risk in the near term, but helps mitigate medium-term risks.*
- *In contrast, when vulnerabilities are high, a tightening in financial conditions increases risks at both time horizons relative to the baseline.*

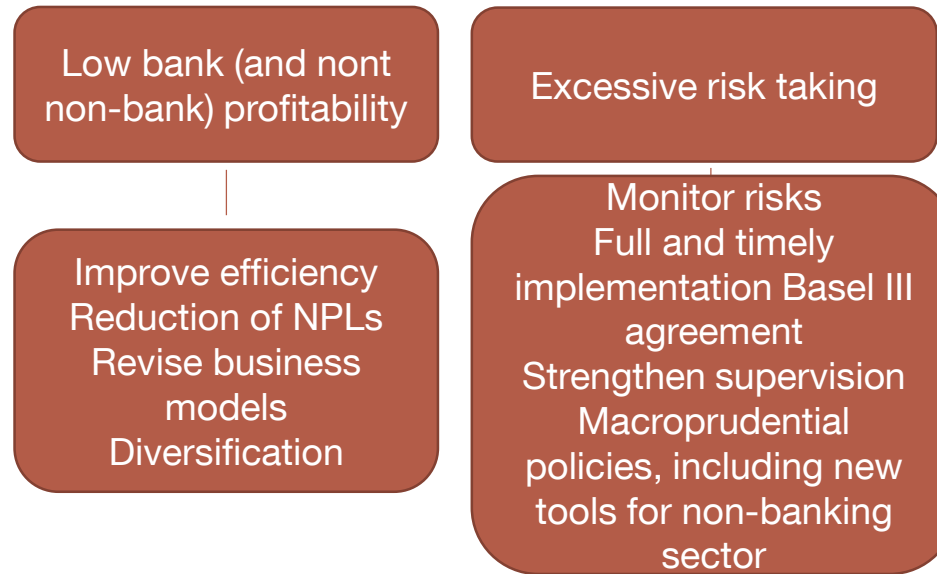
*(IMF Global Financial Stability Report, October 2019)*

### Impact of Tightening Financial Conditions

(one-std increase in the Financial Condition Index;  
one-std change in the Financial Vulnerability Index  
of the Private Non-Financial sector)



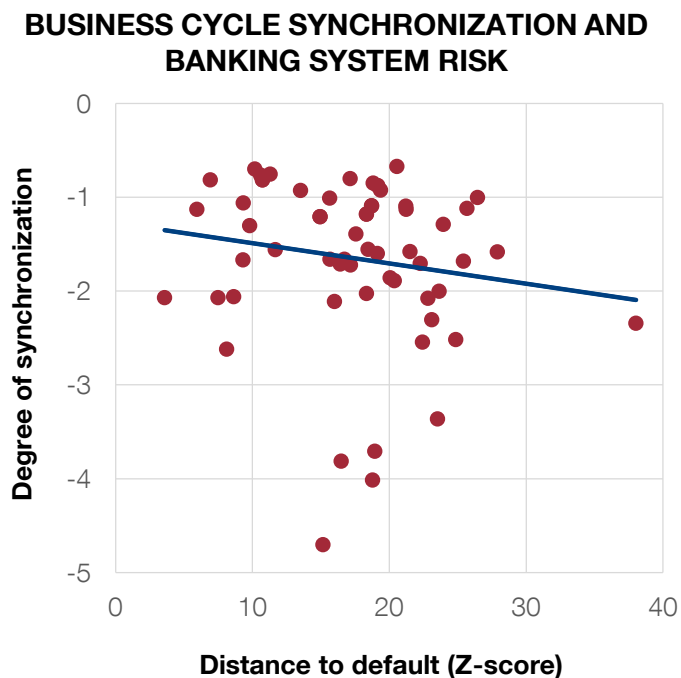
## ... BUT TO IMPROVE/DEPLOY OTHER POLICIES



- Full and timely implementation of Basel III agreement
- Increase regulation and supervision in the **non-bank** financial sector
  - Not enough information regarding non-banks financial intermediaries.
  - Not enough understanding regarding their interconnectedness (also with banks).
  - Not enough *consistently tested* tools to address the already visible risks.
- Deploy macroprudential tools in the banking sector and pursue a wide range of measures to mitigate the effects of a “low for longer” interest rate scenario
  - Foster efficiency gains, possible through additional consolidation/restructuring
  - Speed up reduction in NPLs
  - Search for more income diversification

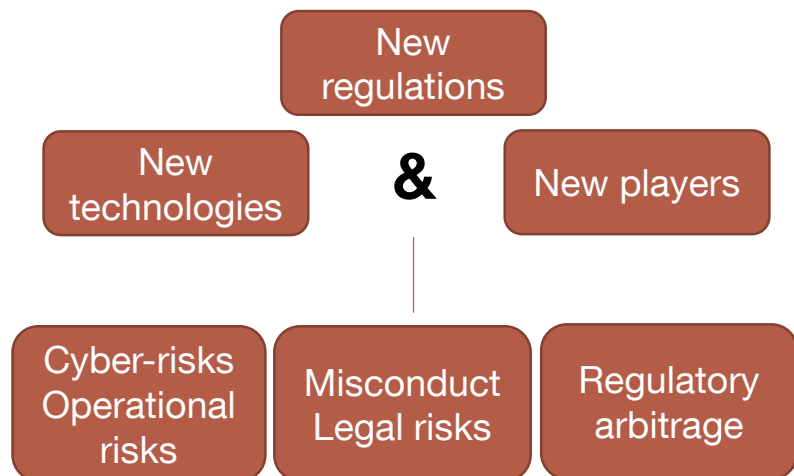
# THE SPANISH EXAMPLE OF GEOGRAPHICAL DIVERSIFICATION

- International diversification helped the Spanish banking sector to cope with the crisis ...  
... and it still means an increasing source of revenues
- Of course, international diversification is not without risks, ...  
... but the evidence suggests that when the economic cycles of the home and host countries are less synchronized, the reduction achieved in bank risk is larger



Source: I. Argimón (2017), “Decentralized multinational banks and risk taking: the Spanish experience in the crisis”, Working Paper 1749, Banco de España.

# MESSAGE #4: DO NOT GET DISTRACTED WITH THE MOST TRADITIONAL RISKS. IN AN ALWAYS EVOLVING FINANCIAL SECTOR, NEW RISKS MAY BE EVEN MORE DANGEROUS

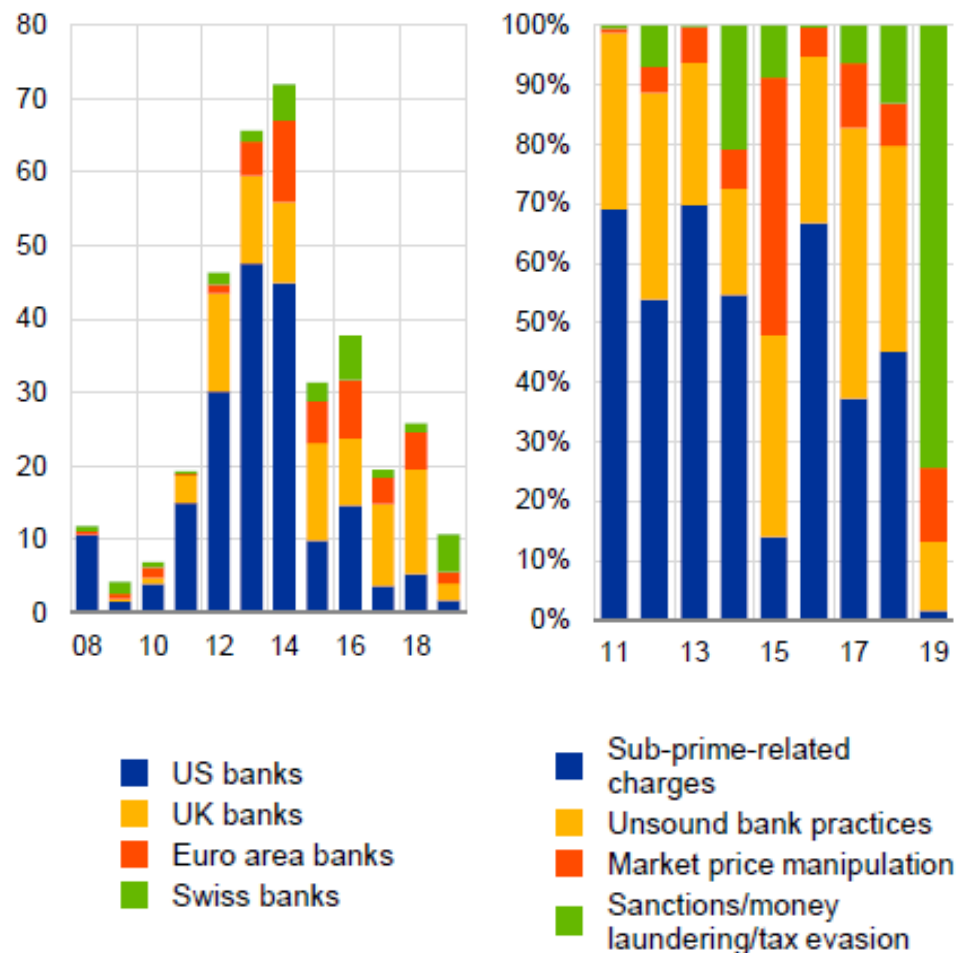


## Survey of risks to financial stability (% of respondents)



Source: IMF Working Paper WP/18/143.

## Global banks' misconduct costs (USD billions) and type of misconduct



Source: ECB Financial Stability Review (November 2019).

THANK YOU FOR YOUR ATTENTION

