

In recent months an improvement has been observed in investors' perception of European credit institutions, which has been reflected in less volatility in bank stocks (see Box 2 of this report), lower risk premia and a recovery in stock market prices.

In fixed-income markets, European banks' credit risk premia, measured through 5-year CDS on senior debt, have decreased notably since the beginning of the year, barely fluctuating, which has contributed to narrowing the gap between these credit risk

Chart 1
RISK PREMIA OF BANKS AND NON-FINANCIAL CORPORATIONS IN THE EURO AREA (5-YEAR CDS) (a)



Chart 2
BANK RISK PREMIA BY COUNTRY (5-YEAR CDS) (b)

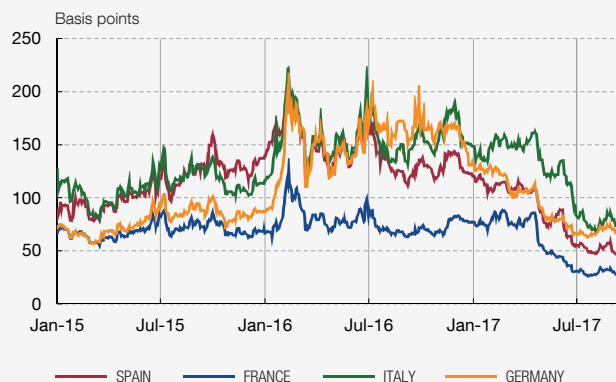


Chart 3
GENERAL AND BANK STOCK MARKET INDICES IN THE EURO AREA (c)



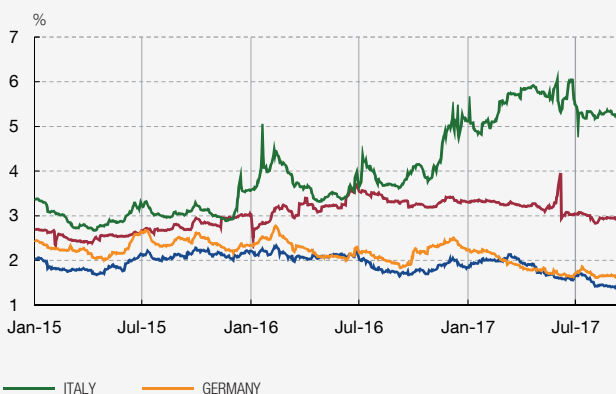
Chart 4
BANK STOCK MARKET INDICES (c)



Chart 5
COST OF FINANCING SENIOR DEBT (d)



Chart 6
COST OF FINANCING SENIOR DEBT (d)



SOURCES: Banco de España and Datastream.

- a Weighted average of GDP of Germany, Austria, Belgium, Spain, France, Greece, the Netherlands, Italy, Ireland and Portugal.
- b The weighted average for each country was calculated using the stock market capitalisation of the 5-year CDS of the major listed banks.
- c The weighted average for each country was calculated using the stock market capitalisation of the share prices of the major listed banks.
- d The weighted average for each country was calculated using the issuance volume of the major listed banks' bond yields.

premia and those of non-financial corporations since 2010 (see Chart 1). As a result of this decline, in the third quarter bank risk premia were averaging less than 80 basis points (bp), reaching levels not seen since mid-2008, although they were still higher than in the run-up to the crisis. These developments spread to most euro area countries (see Chart 2).

Amid general low volatility in the stock markets, bank share prices have grown since early in the year to a greater extent than European indices on the whole, although their performance has been slightly worse in recent months (see Charts 3 and 4).

The more favourable market perception of European banks arose against the backdrop of an improvement in the macroeconomic outlook and in the financial position of banks. Thus, the strengthening of the euro area economy (currently in its fifth consecutive year of growth), higher capital and liquidity levels at banks, together with their better quality assets, have contributed to investors' more positive outlook for European banks.

This course has not been altered by the winding up and restructuring of certain European institutions mid-year and, consequently, there has been no notable contagion to other assets, whether fixed-income securities or equities. The stability shown by financial markets in the face of potentially negative news contrasts with events in the past. Thus, in previous episodes (such as that in February 2016, when uncertainty arose about a certain institution's ability to meet the payment of the interest on its contingent convertible securities (Cocos), turbulence ensued in securities markets which was reflected in higher volatility, rising risk premia and significant declines in stock prices.

Investors' lower risk perception has resulted in a decrease in banks funding costs in the markets in the third quarter. For instance, interest rates on senior debt have fallen during the year to historically low levels (see Chart 5). Subordinated debt yields, which would potentially absorb losses if these were to exceed banks' capital, have also fallen noticeably in the main euro area countries (see Chart 6).