The May 2022 ECB’s FSR: Discussion

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SUERF/Bocconi Webinar: “Key takeaways from the ECB’s new Financial Stability Review”
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*Views expressed are those of the presenter and not necessarily those of the BIS.
The ECB Financial Stability Review (FSR)

- **Very comprehensive and thorough assessment** of financial stability vulnerabilities and their implications for:
  - financial markets,
  - debt sustainability,
  - bank resilience,
  - the non-bank financial sector
  - macroprudential policies.

- **Main takeaway:**
  - Financial stability conditions have deteriorated along several key dimensions over the past few months.

- **Key policy messages:**
  - Macroprudential authorities should continue to address building vulnerabilities, adjusting for economic conditions in order to avoid procyclicality.
  - Having macroprudential space and effective buffers will help support medium-term resilience.
  - Risks arising from liquidity mismatches, leverage and margining practices in the non-bank financial sector need to be tackled comprehensively.
Main risks and vulnerabilities identified in the ECB FSR

- **The macro-financial landscape**
  - dominated by **risks to growth, inflation and financial conditions**
    - elevated by energy and commodity price shocks
    - amplified by the war in Ukraine.

- **Stagflationary macroeconomic environment** will put pressure on **vulnerable borrowers**
  - The **debt sustainability** of the more highly indebted euro area sovereigns, corporates and households **could be tested by higher interest rates and cost pressures**.
    - War may challenge fiscal positions
    - Rising input costs will weigh on corporate margins
    - House prices face correction risk

- Despite remaining resilient and able to support the economy, **banks face**:
  - **increased credit risk**
  - **weaker profit outlook**.

- **Risks of sharp corrections in financial markets**
  - **Non-banks are most exposed** to duration, credit and liquidity risks.
  - Some funds exhibit additional vulnerabilities from heavy use of **synthetic leverage**.
Interesting details highlighted in the ECB FSR

- **Corporates**
  - Some pandemic-strained sectors are also highly exposed to elevated energy prices.
  - Corporate vulnerabilities are clustered in countries with:
    - elevated sovereign debt
    - weaker banks.

- **Banks**
  - Euro area banks’ duration gap has widened recently, increasing their interest rate risk.

- **Cyber risks**
  - Rising number of global cyber incidents targeting financial institutions.
  - Euro area banks lag behind their peers in terms of IT investment.

- **Crypto assets**
  - Interconnectedness with the wider financial system has been growing.
  - Demand from institutional investors in Europe has also risen.
  - Retail investors represent a significant part of the crypto-asset investor base.

- **Climate change**
  - Capital markets remain susceptible to greenwashing.
  - Only the most credible green bonds seem to benefit from cheaper funding.
Overall assessment and comments

- The main risks and vulnerabilities highlighted by the ECB FSR are largely in line with those identified by the BIS as a part of its Global Risk Surveillance (GRS).

- Additional issues that may warrant attention
  - Financial stability risks posed by a pandemic resurgence (or by a new pandemic)
  - Snapback risks
  - International spillovers
    - Inward spillovers
      - China macro risk shocks (addressed in the report)
      - US MP shocks
    - Outward spillovers
      - Euro-denominated credit outside the euro area
        - The financial channel of exchange rates
          - Active not only for the USD, but also for the EUR.
Euro-denominated credit to non-banks outside the euro area

Further information on the BIS global liquidity indicators is available at [www.bis.org/statistics/about_gli_stats.htm](http://www.bis.org/statistics/about_gli_stats.htm).

1. Non-banks comprise non-bank financial entities, non-financial corporations, governments, households and international organisations.  
2. Loans by LBS-reporting banks to non-bank borrowers, including non-bank financial entities, comprise cross-border plus local loans.

Sources: Datastream; Dealogic; Euroclear; Thomson Reuters; Xtrakter Ltd; national data; BIS locational banking statistics (LBS); BIS calculations.
Further information on the BIS global liquidity indicators is available at [www.bis.org/statistics/about_gli_stats.htm](http://www.bis.org/statistics/about_gli_stats.htm).

1 Amounts outstanding for the latest available data.

Sources: Datastream; Dealogic; Euroclear; Thomson Reuters; Xtrakter Ltd; national data; BIS locational banking statistics; BIS calculations.
Euro credit outside the euro area\(^1\)

Annual change, in per cent

Graph C.1

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\(^1\) Annual growth of euro-denominated credit to non-banks outside the euro area.  
\(^2\) Annual growth of the euro nominal effective exchange rate (NEER); an increase indicates an appreciation.

Sources: Datastream; Dealogic; Euroclear; Thomson Reuters; Xtrakter Ltd; national data; BIS locational banking statistics; BIS calculations.
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