



The May 2022 ECB's FSR: Discussion

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SUERF/Bocconi Webinar: *"Key takeaways from the ECB's new Financial Stability Review"*

25 May 2022

**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**

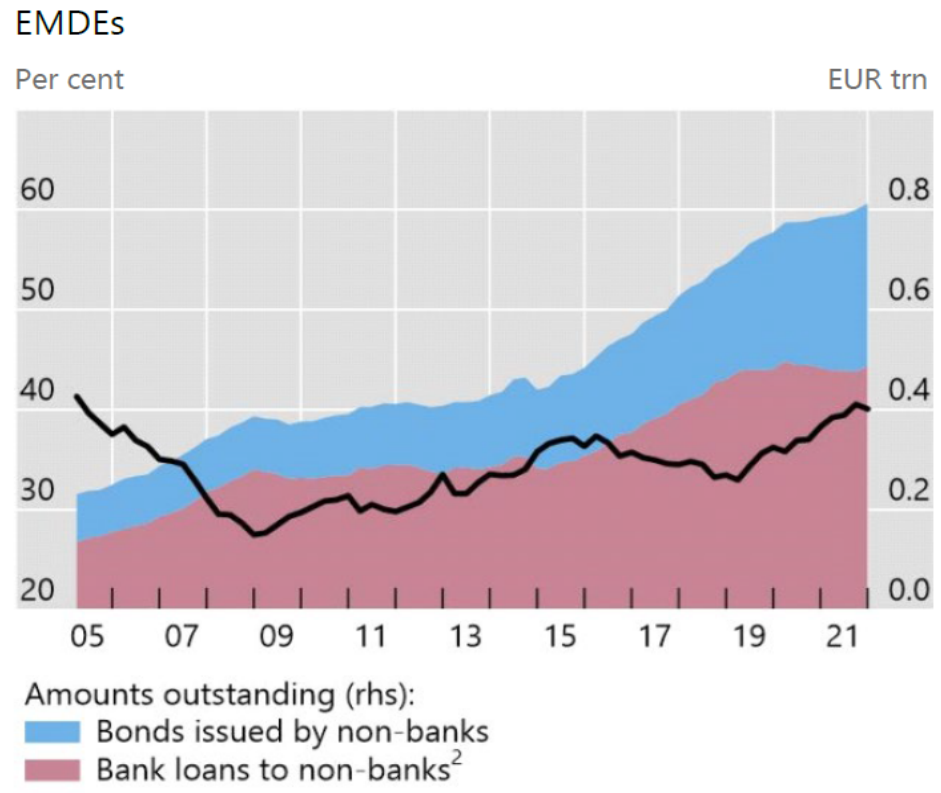
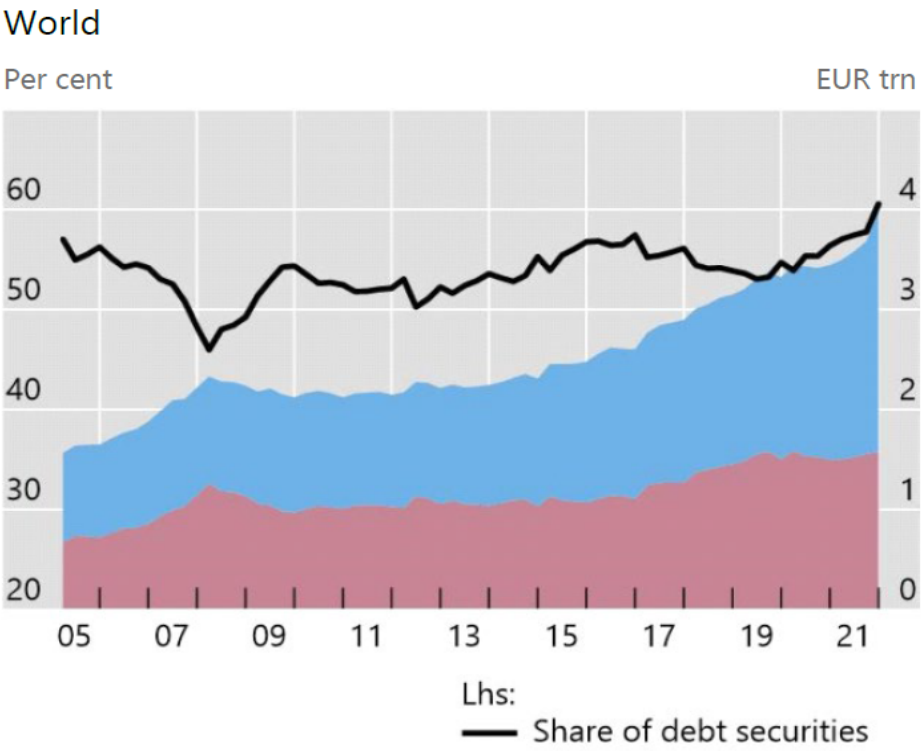
- Capital markets remain susceptible to greenwashing.
- Only the most credible green bonds seem to benefit from cheaper funding.

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 area¹

Graph C.4



Further information on the BIS global liquidity indicators is available at www.bis.org/statistics/about_gli_stats.htm.

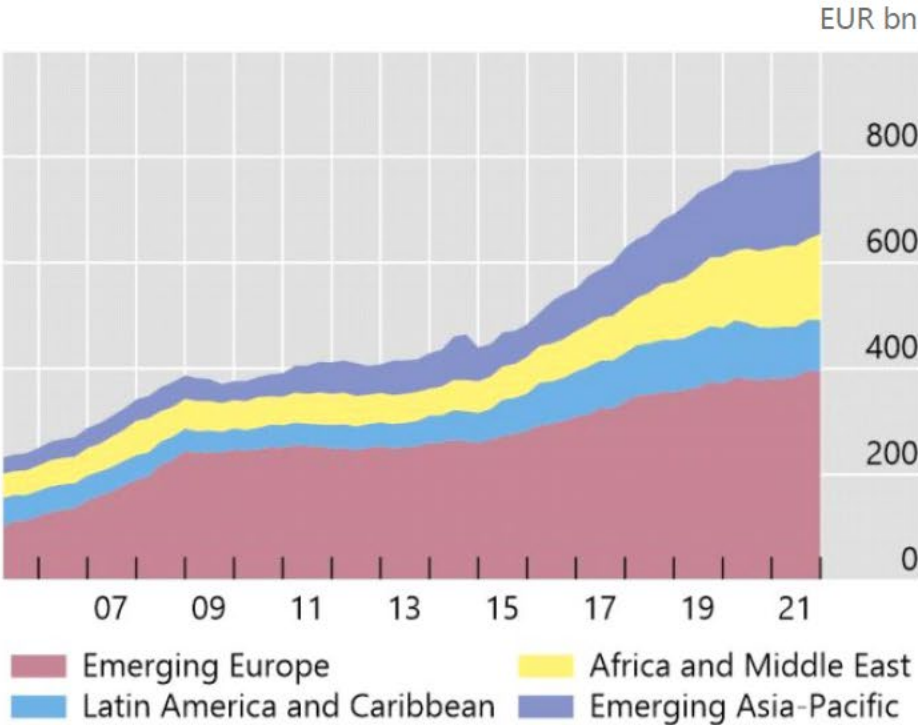
¹ Non-banks comprise non-bank financial entities, non-financial corporations, governments, households and international organisations. ² Loans by LBS-reporting banks to non-bank borrowers, including non-bank financial entities, comprise cross-border plus local loans.

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

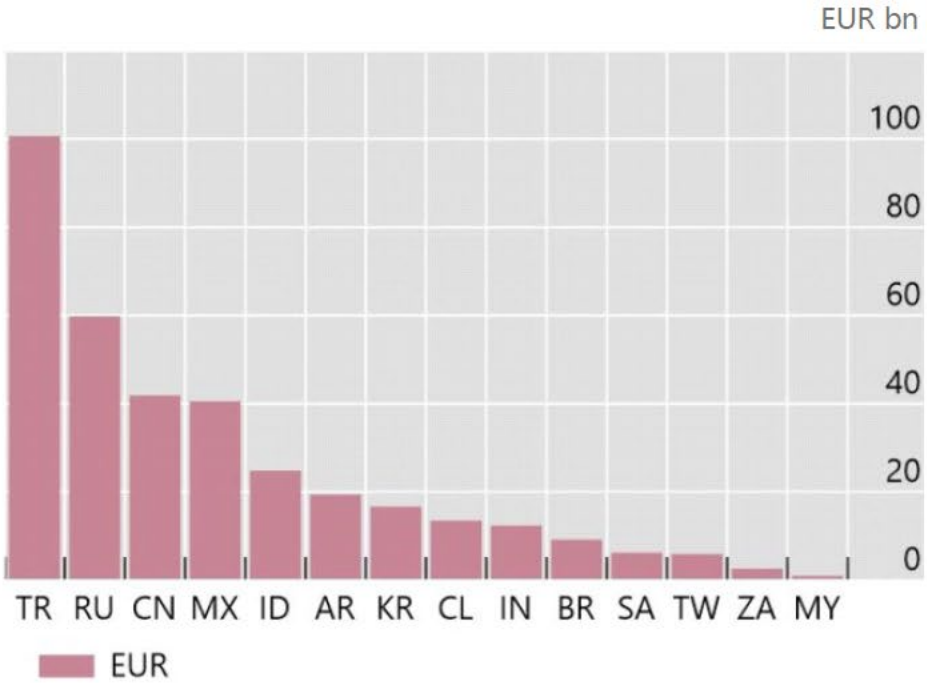
Euro-denominated credit to non-banks in EMDEs

Graph C.5

By region



Selected EMDEs¹



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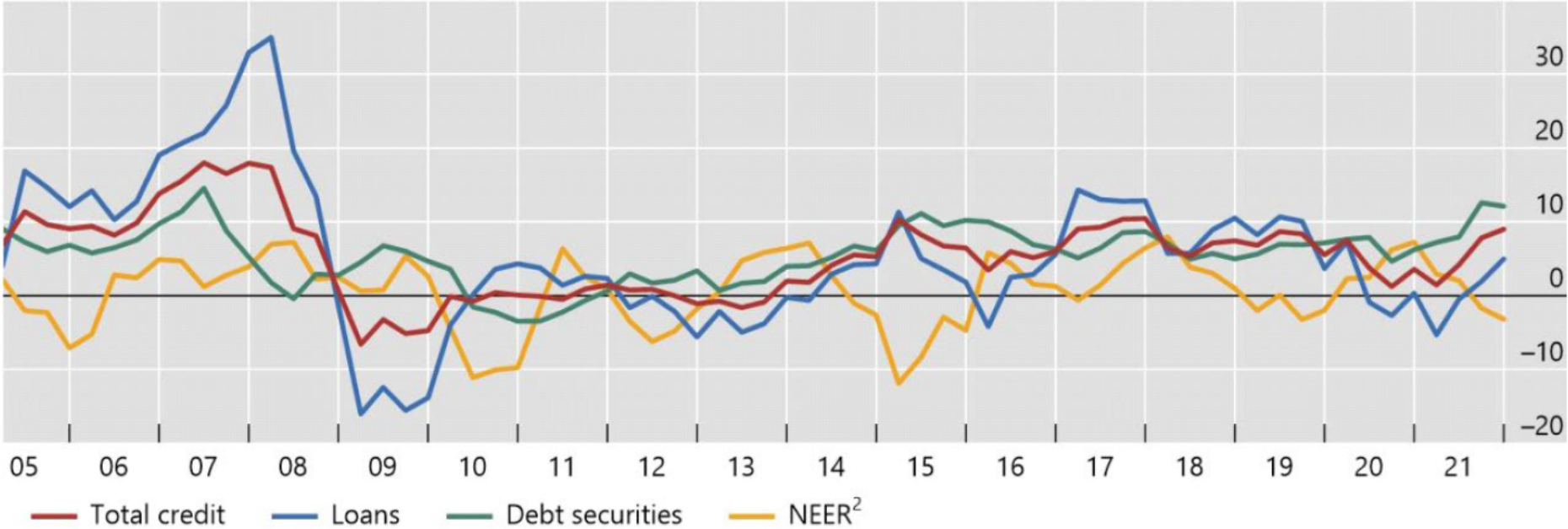
¹ Amounts outstanding for the latest available data.

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

Euro credit outside the euro area¹

Annual change, in per cent

Graph C.1



Further information on the BIS global liquidity indicators is available at www.bis.org/statistics/about_gli_stats.htm.

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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