ESRB
European Systemic Risk Board
European System of Financial Supervision

The ESRB risk dashboard: an overview

20 December 2017

Issue 22

1. Systemic risk indicators and financial market conditions

Market-based measures of systemic stress in the European Union (EU) have remained at low levels. Despite existing uncertainties in the policy area and high geopolitical tensions, both the composite indicator of systemic stress (CISS – indicator 1.1) and the equity market implied volatility (VIX) index (indicator 5.1b) are close to historically low levels. However, these low levels of expected volatility, in particular those of implied volatility, do not necessarily imply an absence of risks in financial markets. Indeed, it has been documented that periods of low implied volatility can coincide with continuous price increases in financial markets.[1] In a situation with high political uncertainty and stretched valuations in several market segments, volatility in the financial markets could rise rapidly and significantly.

2. Macro risk

Economic recovery in the EU has continued in the third quarter of 2017. EU GDP rose by 2.5% compared with the same quarter of 2016 (indicator 2.1). The majority of the EU countries have now experienced faster economic growth than they did, on average, over the last three years. In its autumn forecast, the European Commission expects GDP growth in the EU as a whole to be 2.3% for 2017 and 2.1% for 2018, which is substantially higher than its spring forecast.

Unemployment remains high in some EU countries, but continues on its downward trend. In five countries the unemployment rate still exceeds 10%. However, in all EU countries the current unemployment rate is lower than the three-year average (indicator 2.4).

Although most countries have deleveraged in the years following the global financial crisis, debt levels remain elevated across countries and sectors in the EU (indicators 2.5a and 2.5b). The reductions in debt over the past years have generally been less intense than the increases in indebtedness in the years before the global financial crisis. The high debt levels leave the economies vulnerable to shocks such as changes to the growth outlook or to the effects of a rise in interest rates. Regarding government debt, levels are exceeding the 60% of GDP Maastricht Treaty reference level in the majority of the EU countries (indicator 2.6).

3. Credit risk

[1] For further details of the relationship between implied volatility and market prices, see, among others, Binder, J. and Merges, M., "Stock Market Volatility and Economic Factors", 2001 (link), and Lombardi, M.J. and Schrimpf, A., "Volatility concepts and the risk premium", 2014 (link). For a detailed discussion of the current low volatility levels and the implications for financial stability, please refer to "The volatility paradox: tranquil markets may harbor hidden risks", OFR Markets Monitor Second Quarter 2017, Office of Financial Research (link).

Growth in credit to households and non-financial corporations (NFCs) in the EU rose. The majority of EU countries saw positive annual growth in MFI (monetary financial institution) loans to households and NFCs in September 2017. In addition, the annual growth rates are now higher in the majority of the countries in comparison with the same period last year, and loans are increasing rapidly in some countries. By contrast, some countries are still experiencing a contraction of loans (indicators 3.1 and 3.2).

The cost of borrowing for both households and NFCs remains low, reflecting the low interest rate environment. In most countries, debt servicing costs were lower in September 2017 in comparison with the same period last year. This is particularly true for NFCs (indicators 3.3 and 3.4). The lower debt servicing costs are partly due to banks' lower lending margins (indicators 3.5 and 3.6).

Lending standards have eased slightly over the fourth quarter of 2017. This is the case for loans to both households and NFCs in the euro area as a whole (indicators 3.7 and 3.8).

Residential real estate (RRE) prices continue to grow strongly in the EU. Almost all EU countries saw a rise in RRE prices between the second quarter of 2016 and the second quarter of 2017, as well as between the second quarter of 2014 and the second quarter of 2017 (indicator 3.13). Although some heterogeneity can be observed, RRE prices in several EU countries also appear to be overvalued based on different valuation methods (indicator 3.12).

4. Banks

Bank profitability in the EU improved in the second quarter of 2017, but remains low on average. Median return on equity (8%) and return on assets (0.6%) were higher in the second quarter of 2017 than they have been for the past two years. The situation for banks with the lowest returns has also improved (indicators 6.1a and 6.1b). Other indicators, such as the cost-to-income ratio and the net interest income-to-total operating income ratio, have remained relatively unchanged over the last year (indicators 6.1c and 6.1d).

The median capital ratios of EU banks increased in the second quarter of 2017. The median ratio of common equity Tier 1 (CET1) to risk-weighted assets increased from the first to the second quarter of 2017, as it has done for the past four quarters (indicator 6.2a). During the last year, the median increased by almost 1 percentage point. Moreover, while the median ratio of non-performing loans to total gross loans and advances has decreased for the past three years, it remained almost unchanged from the first to the second quarter of 2017 (indicator 6.2b).

5. Investment funds and other financial institutions

The size of the non-banking part of the EU financial sector has increased over the past years relative to the total assets of credit institutions. While total assets of investment funds and other financial institutions, as well as insurance corporations and pension funds, increased in absolute terms over the second quarter of 2017, total assets of credit institutions were stable (indicator 7.3).