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# European Systemic Risk Board

## ESRB Risk Dashboard

### Overview Note

**Issue 1**

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ESRB
European Systemic Risk Board
European System of Financial Supervision

# The ESRB risk dashboard: an overview
## Issue of September 2012

In preparation for the meeting on 20 September, the General Board of the ESRB approved the regular publication of the risk dashboard.[1] As foreseen by EU Regulation 1092/2010 establishing the ESRB, the risk dashboard is a set of quantitative and qualitative indicators to identify and measure systemic risk in the EU financial system; it is one of the inputs for the Board's discussion on risks and vulnerabilities. The dashboard will be updated and revised on a regular basis, in order to improve its ability to capture systemic risks. This note is intended to provide a broad overview of the current issue of the risk dashboard; it does not summarise the Board's assessment of risks.

Two annexes accompany the risk dashboard: Annex I describes the methodology used to compile the indicators while Annex II provides a description and interpretation of each indicator.[2]

### Interconnectedness and systemic risk indicators

The composite indicator of systemic stress (CISS) showed a steady increase during the first half of 2011; however, from July it reversed its trend and is now well below the peak values it reached at end-2008 and end-2011 (indicator 1). A similar trend is observed in the indicator of the average contribution of individual financial institutions to systemic risk – CoVar (indicator 2) – which is now well below the peaks recorded at end-2011.

As regards cross-border exposures, the most interconnected countries in terms of banks' foreign claims are Germany, France and the Benelux countries: these countries form an important node between the northern and southern parts of Europe (indicator 4). The United Kingdom is a major partner for many countries.

### The macroeconomic outlook

The available macroeconomic indicators suggest that the EU economy is further weakening. In the second quarter of 2012 GDP growth was negative in several countries (indicator 5)

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[1] http://www.esrb.europa.eu/pub/pdf/dashboard/120920_ESRB_risk_dashboard.pdf

[2] Annex 1: http://www.esrb.europa.eu/pub/pdf/dashboard/120920_dashboard_annex1.pdf,
Annex 2: http://www.esrb.europa.eu/pub/pdf/dashboard/120920_dashboard_annex2.pdf

and unemployment was rising, especially compared with the long-term median (indicator 8). As a result of fiscal consolidation, the projected deficit-to-GDP ratio (indicator 10) for the EU has fallen to around 3%, albeit with heterogeneous developments across countries. Economic fundamentals still show weak signals of recovery: the euro area's dependence on external financing is considerable, as current account imbalances remained high for many countries at the beginning of 2012 (indicator 7); furthermore, in August the level of the composite indicator of economic sentiment was below its three-year and long-term averages (indicator 15), revealing a negative outlook for the future performance of most euro area economies.

## Debt levels in the economy

At the end of 2011 government debt levels increased in most countries to level generally high, being above the 60% threshold in most euro area countries (indicator 9). End-2011 data also show that households' debt-to-gross disposable income ratios – which had already been high before the crisis – remained constant or had increased compared with their pre-crisis levels (indicator 14). As for non-financial corporations, the picture is heterogeneous across countries and does not exhibit particular signs of deleveraging (indicator 13).

## Financial markets

In the first half of 2012 financial markets appeared to be stressed, but they became relatively calm in the period from July. CDS premia on sovereign debt were close to their peak values in June 2012 but showed a downward trend subsequently (indicator 11) and their co-movement decreased (indicator 3), indicating that investors were less concerned about contagion compared with June. According to the August 2012 data, the composite indicator of financial market liquidity for the euro area remains in negative territory, although it has gradually improved over the past few months (indicator 25), in particular insofar as its money market component is concerned. Furthermore, interbank rate spreads, while much lower than at their peak, are still higher than their long-term average (indicator 24).

In August risk aversion fell to pre-crisis levels (indicator 32). Equity valuations, as measured by price/earnings ratios, was generally low, especially for banks and insurance companies (indicator 34), and implied volatility was lower than its peaks (around the beginning of 2009) but still high for equity markets and also for fixed income and foreign exchange markets (indicators 33c, 35, 36 and 37).

## Real estate

The evolution of residential property prices has been heterogeneous across EU countries; in some countries, especially those hit by a property bust, prices show a declining trend for the three years prior to the second quarter of 2012 (indicator 23.b) and are slowly converging to values more in line with fundamentals according to data for the first quarter of 2012 (indicator

23.a). Conversely, some other markets show increases in price averages, which are nevertheless still close to their long-term valuations.

## Banks

In June 2012 annual growth rates of total liabilities (excluding capital) for monetary and financial institutions (MFIs) of most EU countries were below their historical averages and in some cases in negative territory (indicator 28.b). Since July 2012 banks' dependence on central bank funding has been heterogeneous, but is generally high compared with the average of the last three years and above 10% for several euro area countries (indicator 29). In addition, loans-to-deposits ratios (indicator 27) were still significantly above 100% for most banks in the sample, according to data for the first quarter of 2012.

Banks' profitability improved in the first quarter of 2012, especially compared with the second half of 2011 (indicator 39.a), also thanks to a generalised reduction of the cost-to-income ratio (indicator 39.b).

## Credit supply

According to bank lending surveys carried out in the second quarter of 2012, credit standards for residential mortgages and for loans to non-financial corporations in the euro area are tightening further, although the picture is quite heterogeneous across countries (indicators 21 and 22). Most recent data show that corporate bond yields, a proxy for the cost of external finance for large non-financial corporations, are decreasing and relatively low by historical standards (indicator 19). A diverse situation is faced by households and firms with scarce access to capital markets: in July 2012 banks' lending margins (indicator 20) varied widely across the euro area, reaching peaks in some of the weakest economies and pointing at fragmented credit markets. The domestic credit-to-GDP gap was negative for most countries in the first quarter of 2012 (indicator 6), a sign that an adjustment is taking place through quantities rather than prices.

## Insurance companies

Insurance companies' balance sheets have also been affected by the adverse environment. Gross premium growth was slow in 2011 although some improvements have been noted in the first half of 2012 both in life and non-life insurance business (indicators 41c and 41d). The median return on equity has been gradually declining in the period from the second half of 2010 to the first half of 2012 (indicator 41a).