



## The ESRB risk dashboard: an overview

### Issue 4

As foreseen by Regulation (EU) No 1092/2010<sup>1</sup>, which established the ESRB, the risk dashboard is a set of quantitative and qualitative indicators developed to identify and measure systemic risk in the EU financial system; it is one of the input for the General Board's discussion on risks and vulnerabilities. The dashboard is updated and revised on a regular basis. This note is intended to provide a broad overview of the current risks and vulnerabilities reflected in the risk dashboard; it does not summarise the General 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.<sup>2</sup>

#### Interconnectedness and systemic risk indicators

During the first half of 2013, systemic risk measures have stabilised further; the composite indicator of systemic stress (CISS) has remained stable, around its pre-crisis average (indicator 1.1). In addition, the probability of a simultaneous default of two or more large banking groups (indicator 1.2), an indicator of stress in the banking sector, has receded further now that financial tensions linked to the banking crisis in Cyprus have subsided.

#### Financial markets

Overall, financial market conditions have continued their positive trend. As indicated by the global risk aversion indicator, risk sentiment has remained positive since mid-2012 (indicator 5.1). Price-to-earnings ratios have returned to their long-term average of around 15 (indicator 5.3). Money markets have remained liquid, as indicated by interbank interest rate spreads (indicator 4.1) and by the financial market liquidity indicator (indicator 4.2).

However, volatility has recently increased in short-term interest rate markets for the euro (indicator 5.4) and in the foreign currency markets, particularly against the Japanese yen (indicator 5.6). Similarly, buoyant conditions in equity and corporate bond markets, which have been at record high levels since 2012 (indicator 5.2.a and 3.3), may reflect "search for

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<sup>1</sup> Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L 331, 15.12.2010).

<sup>2</sup> See: <http://www.esrb.europa.eu/pub/rd/html/index.en.html>.



yield” behaviour with the possible risk of a snapback. Nonetheless, the growth of equity indices has been more moderate in the EU than in other advanced economies.

## **The macroeconomic outlook**

In contrast to the buoyant financial market conditions, the macroeconomic environment has deteriorated further. Most major EU economies exhibited a negative GDP growth rate for the first quarter of 2013, coupled with a forecast indicating no significant improvement for the rest of the year (indicator 2.1). According to the European Commission forecast, unemployment is expected to remain at the current high levels in 2013, well above long-term benchmarks (indicator 2.4). The EU economic sentiment indicator has worsened further and remains below its long-term average (e.g. below 100 – indicator 2.10).

Some indicators show new signs of economic rebalancing. Thanks to substantial fiscal consolidation efforts, the projections for the 2013 deficit-to-GDP ratio for the EU are edging closer to the 3% benchmark (indicator 2.6). In parallel, current account deficits are shrinking further in most EU countries, particularly in those previously characterised by large deficits, such as Greece, Portugal and Spain. On the other hand, deficits are still growing in France, the United Kingdom and Cyprus (indicator 2.3).

## **Debt levels**

While public debt levels continue their ascent, private sector debt shows signs of receding. Projected 2013 government debt levels continue to rise for virtually all EU countries, hovering around 90% of GDP (indicator 2.5). Compared with end-2011 data, the ratio of household debt to gross disposable income declined in 2012 for many EU countries, most significantly in Ireland and Portugal (indicator 2.9). Based on unconsolidated data, the non-financial corporations’ debt-to-GDP ratio marginally declined during 2012 for several EU countries (indicator 2.13), suggesting signs of deleveraging<sup>3</sup>.

## **Residential real estate**

Developments in residential property prices remain heterogeneous across the EU and have tended to move in the right direction (i.e. towards values in line with underlying fundamentals). In many countries, housing prices have been declining for at least three years (indicator 3.1.b, lower left quadrant), most notably in Greece, Spain and Ireland. For some countries, falling prices are helping to reduce previous misalignments, such as in the Netherlands and the United Kingdom (indicator 3.1.a). For a few other countries, such as Germany and Austria, prices have been increasing steadily (indicator 3.1.b, upper right

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<sup>3</sup> Key exceptions are Belgium and Luxembourg, which are home to international corporations responsible for a large share of intragroup loans. Increases in debt levels for these countries may offset the reductions observed in other EU countries.

quadrant), but have been converging to values broadly in line with underlying economic fundamentals (indicator 3.1.a). Finally, house-price overvaluation persists in some countries, particularly in Belgium.

## **Banks**

The data show some signs of bank deleveraging during the first quarter of 2013. The annual growth rates of monetary and financial institutions' total liabilities (excluding capital) were negative for most EU countries (indicator 4.5.b); at euro area level, in March 2013 this corresponded to a one-year cumulated outflow of roughly €1 trillion (indicator 4.5.a). This development was partly driven by the reduction in central bank refinancing across Europe that started in February 2013, largely reflecting the first repayments of the European Central Bank's three-year longer-term refinancing operations. Key exceptions include banks in Cyprus, Italy and Slovenia (indicator 4.6), which rely broadly on unchanged levels in central bank funding. Similarly, banks' deposits with the Eurosystem are falling rapidly, reaching levels of around one-third of the peak of mid-2012 (indicator 4.7).

In real terms, loan-to-deposit ratios of large EU banks have also fallen further, particularly during the last quarter of 2012 (indicator 4.4). Moreover, the outlook for banks' earnings remains generally weak (indicator 6.2.a), with the median return on equity having fallen for the third consecutive quarter in the last quarter of 2012, despite rising net interest income (indicator 6.2.c).

## **Bank credit supply**

In contrast to positive financial market conditions, banks' credit conditions remain weak. According to bank lending surveys for the first quarter of 2013, banks in the euro area continued to tighten their credit standards for both residential mortgages and loans to large enterprises (indicator 3.5 and 3.6), albeit at a more moderate rate compared with the end of 2012. On the whole, the domestic bank credit-to-GDP gap, which measures the gap between the credit-to-GDP ratio and its long-term trend, remains negative across the EU and is most significant for Ireland, Spain and the United Kingdom. For most EU countries, however, the gap has narrowed compared with 2012, with notable exceptions in Spain and Portugal, where the credit-to-GDP gap now exceeds 10% (indicator 2.2).

The annual growth rate of monetary financial institution (MFI) lending in foreign currency has either remained negative or grown moderately in central and eastern European countries (indicator 3.2.a). Key exceptions include Cyprus and the United Kingdom, where MFI lending is linked predominantly to the activities of the other financial intermediaries and non-financial corporations sectors (indicator 3.2.b).

## **Insurance companies**



Based on data for a sample of large EU insurance groups, profitability indicators for the second half of 2012 show a mixed picture; a robust rebound of the return on equity (indicator 6.4.a) was accompanied by a reduction in gross written premiums for life and non-life insurance business (indicators 6.4.c and 6.4.d). Moreover, despite the increases from mid-2012 onward, the price/earnings ratio for the insurance sector remains largely below those for other sectors (indicator 5.3).