

The ESRB risk dashboard: an overview

Issue 5

The macroeconomic outlook

The macroeconomic indicators show some first signs of recovery. The euro area's positive real GDP growth in the second quarter of 2013 follows six consecutive quarters of negative growth. Forecasts for 2014 (indicator 2.1) and the economic sentiment indicator (indicator 2.10) show a significant improvement. Similarly, indicators for Greece, Spain, Portugal and Italy now exceed or are approaching their three year average, suggesting a recent renewed confidence in the economic environment, although from a very low level. On the downside, unemployment rates, which are expected to remain at their current high levels in 2014, are likely to weigh down on the recovery for some time to come (indicator 2.4).

Interconnectedness and systemic risk indicators

The composite indicator of systemic stress (indicator 1.1) **confirms that market perception of systemic risk remains low at around pre-crisis levels.** 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 been contained between 5% and 10% since the end of last year. Also contagion among sovereigns, as measured by the co-movements of CDS spreads, is heading down (see indicator 1.4)

Financial markets

Overall, financial market conditions remain buoyant. As indicated by the global risk aversion indicator, risk sentiment has remained low since mid-2012 (indicator 5.1). Price-to-earnings ratios have returned to their long-term average of around 15 for the banking and non-financial sectors, and around 10 for the insurance sector (indicator 5.3). Money markets spreads (indicator 4.1) and financial market liquidity indicators (indicator 4.2) have been stable at low levels over the last three quarters. After a period of high volatility, uncertainty regarding euro-area short-term interest rates has recently fallen to levels similar to those in the UK and the US (indicator 5.4). Following several quarters of increases, the equity index for the insurance sector reached its highest point since the start of the financial crisis (indicator 5.2.b), albeit still below pre-crisis levels and with less buoyancy than other sectors of the economy. Despite a recent jump, corporate bond yields, particularly for triple-A bonds, are historically still very low (indicator 3.3)



Debt levels

Countries' levels of indebtedness remain high. While the projections for the 2013 deficit-to-GDP ratio for the EU are edging closer to the 3% benchmark (indicator 2.6), public debt levels continue their ascent (indicator 2.5). Projections for 2013 debt levels continue to be revised upward for virtually all EU countries (indicator 2.5). In addition, as shown by the household's debt-to-gross disposable income ratio (indicator 2.9) and the non-financial corporations' debt-to-GDP ratio (indicator 2.13), indebtedness of the real economy is likely to continue to weigh down the recovery.

Banks

Banks' deleveraging continued during the second quarter of 2013 (indicator 4.5). Most EU countries' banking systems contributed to a one-year cumulated outflow of total liabilities (excluding capital) of roughly €1.2 trillion by the end of the quarter. This development was most visible in the progressive reduction in central bank refinancing since February 2013, which mainly reflected the repayments of the European Central Bank's three-year longer-term refinancing operations (indicator 4.6). Similarly, banks' deposits with the Eurosystem are falling (indicator 4.7). It remains unclear to which extent this bank deleveraging reflects a structural trend towards smaller (and sounder) bank balance sheets, a cyclical response in the face of a sluggish economy or a desire to reduce bank reliance on central bank refinancing.

Low profitability weighs down banks' ability to clean their balance sheets. Over the past two years, banks' income-generating ability has been subdued largely due to weak macro-financial conditions (indicator 6.2.a), particularly in the face of continuously rising impaired and past due loans (indicator 6.3.b).

Credit supply

Banks' credit conditions continue to tighten. According to bank lending surveys for the second 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 moderate pace. The domestic bank credit-to-GDP gap, which measures the gap between the credit-to-GDP ratio and its long-term trend, has narrowed further compared with 2012 and 2011 (indicator 2.2). The gap has been significantly narrowing for more than a year in the United Kingdom and in Ireland.



Real estate

Developments in residential property prices remain heterogeneous across the EU and have tended to move towards values more 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 (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 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.

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). Overall, the equity index for the insurance sector is at the highest of the last two years (indicator 5.2.b).