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The ESRB risk dashboard: an overview

Issue 10

Interconnectedness and systemic risk indicators

Market perception of systemic risk remains in line with pre-crisis levels despite some renewed bouts of volatility. The composite indicator of systemic risk (CISS) captured well the episodes of market tensions that occurred in August and October ([indicator 1.1](#)) but has since then come back to levels observed earlier in the year, thereby remaining in line with pre-crisis levels. Other measures of financial contagion ([indicators 1.2, 1.3, and 1.4](#)) have stayed at low levels, unaffected by these recent market tensions.

The macroeconomic outlook

Economic recovery in the EU continues to be subdued, with large cross-country differences. In most economies, year-on-year GDP growth was positive in the third quarter of 2014 ([indicator 2.1](#)), but the recovery has been slow and varied across countries. Divergences are particularly high within the euro area. While Ireland outperforms all other EU countries, large euro area economies grew at a slower pace than the EU average, with some close to zero growth (France) or negative growth (Italy).

External balances have been relatively stable over the last quarters, albeit at highly divergent levels across the EU ([indicator 2.3](#)). On the one hand, a group of nine countries (among them the Netherlands and Germany) ran large current account surpluses. On the other hand, a group of three (United Kingdom, Cyprus, and Latvia) ran large and increasing current account deficits. In some vulnerable euro area countries (Greece, Portugal, Italy), the current account balance has improved largely owing to falling imports.

Labour markets have shown continued signs of improvement, but unemployment remains high ([indicator 2.4](#)). The average rate of unemployment has slightly improved to 11.5% and 10.0% for the euro area and the EU, respectively, with significant cross-country variation. In Spain and Greece, unemployment has stayed particularly high but showed sign of improvement over the last 12 months.

Debt levels

Countries' levels of indebtedness raise concerns of sustainability in the medium term, as the growth outlook remains weak. General government debt-to-GDP ratios stay at high levels, well above 100% in several EU countries ([indicator 2.5](#)). Amid these concerns, over the last quarter, CDS spreads increased slightly for lower-rated euro-area countries and in fact significantly for Greece ([indicator 2.7](#)). Meanwhile, private sector indebtedness remains also high: household debt-to-income ratios and non-financial corporate debt-to-GDP ratios stand at 100% or above for most EU countries ([indicators 2.9 and 2.10](#)).



Credit supply

Financing conditions for new loans improved in the third quarter of 2014. Banks continued to marginally ease credit standards on new loans to enterprises ([indicator 3.6](#)) and to households for house purchase ([indicator 3.5](#)). However, there are some countries where a tightening of credit standards can be observed, especially in the United Kingdom for housing loans (see section on Real Estate). Eased credit standards have not translated across the board into narrower lending margins, which show highly heterogeneous patterns across EU countries ([indicators 3.3 and 3.4](#)).

Similarly, funding costs decreased for large firms with direct access to capital, as shown by declining AAA and BBB-rated euro area corporate bond spreads ([indicator 3.7](#)). Spreads of riskier, high-yield euro area corporate bonds, however, increased over the second half of 2014.

Financial conditions

Overall, financial market conditions remain buoyant. Money market spreads ([indicator 4.1](#)) and financial market liquidity indicators ([indicator 4.2](#)) have been stable at low levels over 2014. As indicated by the global risk aversion indicator, risk sentiment has since 2012 remained in line with pre-crisis levels ([indicator 5.1](#)). Similarly to the CISS, the global risk aversion indicator captured the episodes of market tensions in August and October, but has not returned to the extremely low levels observed before the summer. These market tensions also affected equity prices for non-financial companies, which were not able to fully recover their incurred losses ([indicator 5.3a](#)). The recovery in equity prices for financials evidenced since mid-2012 appears to have subsided in 2014. Price-earnings ratios also mainly stayed in the range observed before the crisis with the exception of banks, which have significantly exceeded their pre-crisis level since mid-2014 ([indicator 5.2](#)). However, the sharp increase seems to have come to a halt in the fourth quarter.

However, volatility has increased significantly in some market segments. Uncertainty regarding euro-area interest rates has recently increased again, up to now without any sign of reversal ([indicators 5.4 and 5.5](#)). In particular, implied volatility of euro-area short-term interest rates has reached historically high levels, surpassing levels observed in 2012-2013. In addition, the volatility of the euro exchange rate with other major currencies has risen significantly from its historical low in mid-2014 ([indicator 5.6](#)).

Banks

Despite continued low levels of profitability, banks were able to improve their solvency. Overall, profitability has continued to be subdued ([indicator 6.1a](#)), as revenues, still elevated loan loss provisioning needs and potentially high litigation costs continued to weigh heavily on euro area banks' financial performance ([indicator 6.2b](#)). Nevertheless, in the second quarter of 2014, large EU banking groups were able to increase Tier 1 capital to total assets ([indicator 6.2a](#)), benefitting from favourable equity market conditions (see above).



Funding profiles have generally improved. The share of central bank funding decreased across Europe, except for Hungary ([indicator 4.4](#)). In particular, fragile euro area countries have continued to reduce their reliance on ECB funding although the share of central bank funding is still high. In addition, banks have continued to prolong the maturities of their outstanding debt ([indicator 4.6](#)) and further deleveraged as evidenced by the declining loan-to-deposit ratio ([indicator 4.7](#)).

Real estate

EU housing markets exhibit wide regional divergences. Member States showed very different house price dynamics according to the last available data ([indicator 3.1b](#)). Yet generally, residential property prices have moved towards values more in line with underlying fundamentals ([indicator 3.1a](#)). In the group of countries where house prices still appear most overvalued according to the average indicator (marked by the red dot for the last observation), Sweden experienced rising house prices over the period Q2 2013-2014.¹ House prices kept growing rapidly in some countries in particular in Estonia. In other countries, after a significant drop in the past years, house prices started to stabilise (Spain and the Netherlands) or even rebound (Ireland).

EU Member States took a wide range of macro-prudential policy measures to address issues in their national housing markets. Such measures included higher risk weights for mortgage lending, loan-to-value limits, loan-to-income limits, debt-service-to-income limits, and loan-maturity limits and were adopted in Belgium, Estonia, Hungary, Ireland, Slovakia, Sweden, and the United Kingdom.

¹ It should be noted that valuation estimates are surrounded by a high degree of uncertainty. In addition, the four models underlying the indicator provide, for some countries, a very wide range of valuation.