



1. Systemic risk indicators and financial market conditions

Market-based indicators of systemic risk have stabilised at somewhat elevated levels after sharp increases over the summer months (CISS, [indicator 1.1](#)). Following the outcome of the UK's EU referendum, there was a broad-based increase in market volatility, impacting particularly European financial stocks ([indicator 5.3b](#)) and foreign exchange markets ([indicator 5.6](#)). Following the volatility peak, financial markets have broadly stabilised.

2. Macro risk

GDP growth slowed down slightly in the second quarter of 2016. Seasonally adjusted GDP rose by 0.4% in the EU28 during the second quarter of 2016, compared with the previous quarter, slightly lower than in the first quarter (0.5%). Compared with the same quarter of the previous year, seasonally adjusted GDP rose by 1.8% in the EU28 in the second quarter of 2016, after +1.9% in the first quarter.

Labour markets continued to improve and external imbalances stabilise. The latest observed unemployment rates are lower in almost all EU countries, compared to forecasts or three year averages, pointing towards some improvement in labour markets ([indicator 2.4](#)). The current account balance in relation to GDP has improved in the majority of the economies and it is negative for eight EU countries ([indicator 2.3](#)).

Overall, the aggregate economy wide level of indebtedness improved in the first quarter of 2016 in most EU countries, but remains still elevated. Overall, despite recent improvement, the aggregated sectoral debt levels in the EU economies have remained broadly stable over the past three years ([indicators 2.5a and 2.5b](#)). In most EU countries, the general government debt levels remained elevated in the first quarter of 2016, while in five EU countries, the government fiscal deficits to GDP exceeded the 3 % threshold of the Stability and Growth Pact ([indicators 2.6 and 2.7](#)).

3. Credit risk

Bank lending to both households and the non-financial companies continued its gradual recovery, but remains heterogeneous across countries and sectors. In July 2016, MFI loans to households and non-financial corporations grew faster compared to one year earlier, or three years average for the majority of EU countries ([indicators 3.1 and 3.2](#)). However, the growth rate of bank loans is still negative for a number of countries, but the pace of credit contraction has decreased in most countries. In most EU countries, the cost

of borrowing continued to decline from the levels year ago. The data shows a continuously dispersed picture for change and levels of lending margins for households or NFCs counterparties ([indicators 3.3 to 3.6](#)).

Lending standards for NFC loans continue to show some net easing. For the euro area as a whole, credit standards continued to weaken somewhat for loans for NFCs while remained broadly stable for loans for households ([indicators 3.7 and 3.8](#)).

Residential real estate prices continue to grow rapidly in most of the EU countries ([indicator 3.13](#)). While there is no sign of a broad-based overvaluation in residential real estate prices in the EU as a whole, already in some EU countries the estimated overvaluation are sizeable ([indicator 3.12](#)).

4. Banks

Bank profitability improved slightly in the second quarter of 2016, but was somewhat below the level one year ago. In the second quarter 2016, EU banks' profitability, as measured by return on equity (ROE) and by return on assets (ROA) improved on a quarterly basis due to improved cost-to-income ratios ([indicators 6.1. a-c](#)). However, profitability levels were lower compared to the levels a year ago. Banks were slightly more reliant on other sources of income, since the net interest income as a share of total operating income declined compared to the first quarter of 2016 ([indicator 6.1. d](#)).

Banks' central bank funding continued to decrease in fragile euro area countries ([indicator 4.4](#)). The overall trend, where the average maturity of outstanding debt has increased, continued in the third quarter 2016 ([indicator 4.6](#)). Covered bond issuance, which picked up in the beginning of 2016, somewhat decreased in the third quarter ([indicator 4.7](#)). The CDS spread between senior and subordinated debts have recently declined and are close to the levels last time seen at the end of 2015 ([indicator 4.9](#)).

5. Investment funds and other financial institutions

While the total assets of EU credit institutions continued to decline in the first quarter of 2016, assets of investment funds and OFIs and in particular insurance companies and pension funds continued to grow. In the first quarter of 2016, total assets of insurance corporations and pensions funds continued to grow at an annual rate of over 2 percent. The growth rate of investment funds and OFIs has also been positive, albeit at decelerating pace ([indicator 7.3](#)). In recent quarters, the share of total assets of investment funds and OFIs in relation to total assets of credit institutions has increased more rapidly in euro area compared to the whole EU ([indicator 7.4](#)).