



## 1. Systemic risk indicators and financial market conditions

**Market-based indicators of systemic stress in the European Union (EU) showed an increase over the past quarter.** Both the CISS index ([indicator 1.1](#)) and the European equity market implied volatility (VSTOXX) index ([indicator 5.1b](#)) identified rapid rises as a consequence of recent market turbulence, although they remain low from a historical perspective. Similarly, equity prices fell ([indicator 5.1a](#)), leading to a certain correction in price/earnings ratios for equities ([indicator 5.2](#)). These, however, remain high compared to historical averages.

## 2. Macro risk

**Economic recovery in the EU continued in the fourth quarter of 2017.** EU GDP rose by 2.6% year-on-year ([indicator 2.1](#)). Overall, EU GDP is estimated to have expanded by 2.4% last year, its highest rate since 2007 and the start of the global financial crisis. In its winter forecast the European Commission projects EU GDP growth of 2.3% in 2018 and 2.0% in 2019, which is higher than in the autumn forecast.

**Although most countries deleveraged in the years following the global financial crisis, debt levels remain elevated across countries and sectors in the EU** ([indicators 2.5a and 2.5b](#)). The reductions in debt in recent years have generally been smaller in scope than the increases in debt in the years before the global financial crisis. These high debt levels leave the economies vulnerable to shocks such as changes in growth outlooks or to the effects of a rise in interest rates. In terms of government debt, levels in most EU countries exceed the 60% debt-to-GDP ratio established in the Maastricht Treaty ([indicator 2.6](#)).

## 3. Credit risk

**Higher levels of credit to households and non-financial companies in the EU.** Most EU countries saw annual growth in MFI loans to households and non-financial companies in January 2018, and in some countries loans to the private sector are increasing rapidly in a reflection of strong economic growth. In contrast, few countries are still seeing a contraction in lending in the aftermath of earlier financial crises ([indicators 3.1 and 3.2](#)).

**The cost of borrowing for both households and NFCs remains low, reflecting the low interest rate environment.** Debt servicing costs in January 2018 remained generally unchanged from the same period last year, both for households and non-financial companies ([indicators 3.3 and 3.4](#)). Some countries saw more significant changes, partly due to changes in banks' lending margins ([indicators 3.5 and 3.6](#)).

**Lending standards for loans to households eased slightly over the quarter.** This was the case for loans to households in the euro area as a whole, while lending standards for loans to non-financial companies remained relatively unchanged ([indicators 3.7 and 3.8](#)).

**Residential real estate prices continue to see strong growth in EU countries.** The majority of EU countries saw a rise of more than 5% in residential real estate prices between the third quarter of 2016 and the third quarter of 2017. Most countries have also experienced a significant increase in prices over the past three years ([indicator 3.13](#)). Although there is some heterogeneity, residential real estate prices in several EU countries appear to be overvalued even when using different valuation methods ([indicator 3.12](#)).

#### 4. Banks

**Banking sector resilience continued to strengthen in the fourth quarter of 2017.** The median CET1 to risk-weighted assets ratio increased to 15.6% between the third and the fourth quarters of 2017, continuing its trend of the past four quarters ([indicator 6.2a](#)). Moreover, the median ratio of non-performing loans to total gross loans and advances has continued its downward trend, reaching 3.4% in the fourth quarter of 2017 ([indicator 6.2b](#)). Ongoing supervisory and regulatory work as well as the improved economic environment contributed to easing the severity of vulnerabilities in the European banking sector. There has also been an increase in the ratio of liquid assets to short-term liabilities ([indicator 6.2c](#)), which suggests improved resilience to liquidity shocks on the part of the banking sector.

**Bank profitability in the EU continued to improve in the fourth quarter of 2017.** Both median return on equity (6.5%) and return on assets (0.42%) increased compared to the fourth quarter of 2016 (by 1.2% and 0.08%, respectively). The situation for banks with the lowest returns has also improved ([indicators 6.1a and 6.1b](#)). However, due to seasonality profitability was lower in the fourth quarter of 2017 than in the third quarter of 2017. Other indicators, such as cost-to-income and net interest income compared to total operating income, have remained relatively unchanged over the past year ([indicators 6.1c and 6.1d](#)).

#### 5. Insurance

**Solvency and profitability indicators still suggest that the EU insurance sector is performing well.** The average Solvency Capital Requirement ratio rose above 200% in the third quarter of 2017 following a steady increase from around 180% in the third quarter of 2016 ([indicator 6.4a](#)). This slight improvement was partly driven by the moderate increase in the risk-free rates, with the 10-year EIOPA risk-free rate, for example, increasing from 0.187% to 0.828% from the third quarter of 2016 to the third quarter of 2017. As the majority of EEA insurance companies have a combined ratio below 100% ([indicator 6.3b](#)), this would also suggest that underwriting performance for non-life insurance portfolios has, on average, been healthy.

**No big shifts have been observed in insurers' asset allocation over the last four quarters** ([indicator 1.10](#)). In terms of liquidity and credit quality characteristics, the investment exposures of EU insurers are, on average, considered to be highly liquid ([indicator 4.10](#)) and the majority of the bond portfolio is of investment-grade quality ([indicator 6.7](#)).

#### 6. Investment funds and other financial institutions

**In recent years the size of the non-banking segment of the EU financial sector has increased relative to credit institutions' total assets.** The total assets of investment funds, OFIs, insurance corporations and pension funds increased more during the third quarter of 2017 than the total assets held by credit institutions ([indicator 7.3](#)).

#### 7. CCPs

**The CCP sector in the EU is heterogeneous and reflects the different business models and assets cleared by CCPs.** The average concentration of the contributions of the five largest clearing members to the initial margin, default fund and client clearing at a CCP ([indicator 8.6](#)) is substantial, but has remained stable over the last two quarters.