ESRB
European Systemic Risk Board
European System of Financial Supervision

The ESRB risk dashboard: an overview

26 March 2019

Issue 27

1. Systemic risk indicators and financial market conditions

Risks to EU financial stability remain a concern, although market-based indicators of systemic stress in the European Union (EU) slightly declined over the past quarter. The indicators of systemic stress (indicator 1.1) recovered somewhat during the first quarter of 2019, after having increased at the end of 2018, at the back of tensions in some market segments and political uncertainties internationally and within Europe. The indicators for probability of simultaneous default by large and complex banking groups and EU sovereigns (indicator 1.2) followed a similar pattern. Over the past quarter, EU equity indices remained broadly stable, slightly recovering from the declines observed in the course of 2018 (indicator 5.1a). Correspondingly, price/earnings ratios increased somewhat (indicator 5.2), except for the EU banking sector, where some declines have been observed in the past months. At the same time, financial market uncertainty, as measured by implied volatility, has stabilized (indicator 5.1b), showing a lower fluctuation over the past quarter compared to 2018.

2. Macro risk

Economic growth in the EU moderated further. EU GDP rose by 1.5% year on year in the fourth quarter of 2018 (indicator 2.1). In its winter forecast from February 2019, the European Commission cut the 2019 GDP growth forecast for EU28 to 1.5% (from 1.9% forecast published in autumn 2018).[1] The downside risks stem mainly from the threat of increased global protectionism and its impact on international trade, as well as the possibility of re-pricing in financial markets and increasing volatility.

Debt levels remain elevated across countries and sectors in the EU, although most countries deleveraged somewhat in the recent years (indicators 2.5a and 2.5b). The debt reductions in recent years have generally been smaller in scope than the debt increases in the run-up to the global financial crisis. For most countries, the three years average of general government deficit-to-GDP ratio is not higher than the aggregate level of the same indicator observed in Q3-2018, suggesting that the deleveraging process in the European Union continued in the recent years. Generally, high debt levels mean that economies are vulnerable to shocks, such as changes in the growth outlook or interest rate hikes. Regarding sovereign debt, the level in half of the EU Member States, as well as at the aggregate euro area and EU levels, exceeded the 60% debt-to-GDP ratio established under the Maastricht Treaty (indicator 2.6), while the government deficit-to-GDP ratio was below 3% for almost all Member States in Q2 2018 (indicator 2.7).

[1] See European Commission Economic Forecast, Winter 2019, Feb 2019, available at https://ec.europa.eu/info/sites/info/files/economy-finance/ip096_en.pdf.

3. Credit risk

Credit to the private sector continued to grow robustly in many EU Member States. In January 2019, most Member States registered positive annual growth rates of loans granted by monetary financial institutions (MFI) to households and NFCs (indicators 3.1 and 3.2). In many countries, growth rates of both loans to households and loans to NFCs continued to grow significantly. In several countries, lending to NFCs increased significantly compared to the year before. At the same time, in a few Member States very low lending activity is still observed, in the aftermath of the financial crisis.

The cost of borrowing for the private sector remains low, reflecting the low interest rate environment. In most Member States, the cost of borrowing recorded in January 2019 did not change significantly for households and NFCs in year-on-year comparison. In some countries however, the cost of borrowing recorded more sizeable decreases, especially for NFCs (indicators 3.3 and 3.4). The same applies to the dynamics of the lending margins of MFIs (indicators 3.5 and 3.6).

Credit standards continued to ease over the last quarter in the majority of the countries. This was the case for both loans to households (for house purchase) and loans to NFCs (indicators 3.7 and 3.8).

Residential real estate prices continue to rise considerably in most EU Member States. In the third quarter of 2018 year-on-year growth of residential real estate prices continued to exceed 5% in most EU Member States, following also significant price increases over the past three years (indicator 3.13). Reflecting this dynamics, the residential real estate prices appear to be overvalued in several EU Member States, as based on various valuation methods (indicator 3.12).

4. Banks

Bank profitability in the EU showed a slight improvement in the fourth quarter of 2018. Median return on equity increased by 16 basis points to 6.6% on a year-on-year basis, while return on assets remained at 0.43% (indicators 6.1a and 6.1b). At the same time, the cost-to-income ratio remained relatively high, denoting some improvement during 2018, as compared to previous years (indicator 6.1c). On the income side, banks seem to have further increased their dependence on the net interest income (indicator 6.1d).

Banking sector resilience continued to strengthen in the second half of 2018. The median CET1 to risk-weighted assets ratio increased to 16% in the fourth quarter of 2018, up from 15.8% in the fourth quarter of 2017 (indicator 6.2a). Moreover, the median ratio of non-performing loans to total gross loans and advances continued to improve, reaching 3.1% at the end of 2018, down from 3.3% at the end of 2017 (indicator 6.2b). Overall, ongoing supervisory and regulatory work, as well as the improved economic environment, continues to support the reduction of vulnerabilities in the European banking sector.

5. Insurance

Despite a lower profitability due to reduced investment returns, the median solvency ratio of the EU insurance sector is stable above 200%. The lowest quartile of solvency ratios was slightly above 170% in the third quarter of 2018 (indicator 6.4a). The median return on equity has only slightly decreased since the first half of 2017, remaining at around 2.5% (indicator 6.3a). For non-life insurers, the median combined ratio is relatively stable over the past 5 quarters, below 100%. One can still notice combined ratio over 100%, showing that for a quartile of the insurance sector, the written premiums are not sufficient to cover the insurance claims and costs of the period (indicator 6.3b). The annual growth rates of gross premiums written have been mostly positive for both life and non-life insurance, both with a median at around 4% (indicators 7.7a and 7.7b).

The EU insurers' asset allocation is stable. In terms of credit quality characteristics, the EU insurers' bond portfolio remains largely at investment-grade quality, while the liquidity available varies importantly from one insurer to another. Around 50% of the EU insurers' investments are in government or corporate bonds (indicator 1.10), credit quality of almost 80% of which is below or equal to credit quality step 3 (indicator 3.14). The liquid asset ratio indicator shows a quartile of the insurance sector holding more than 70% of liquid assets, while another quartile holds less than 55% liquid assets (indicator 4.9).

6. Investment funds and other financial institutions

After no significant growth in 2017, total assets of EU investment funds and other financial institutions (OFIs) increased in 2018 at a faster pace than the banking sector (indicator 7.4). The assets under consideration include all financial sector assets except those of banks, insurance corporations, pension funds and central counterparties (CCPs).[2] In terms of total assets, investment funds and OFIs accounted for approximately 40% of the EU financial system. This measure has remained stable over the past few years. Within this measure, investment funds account for around one-third of assets and OFIs, including securitisation vehicles, account for the remainder.

New data sources allowed for a reduction in the OFI residual in 2018. The OFI residual is defined as the difference between the total financial sector according to the financial accounts, and the known sub-sectors for which primary statistics are available. The analysis of the OFI residual has been enhanced by the inclusion of Eurostat data which help to identify total assets related to captive financial institutions. Given the large number of captive firms domiciled in Luxembourg, the inclusion of the Eurostat data helps to describe half of the OFI residual, reducing it from around 47% in 2017 to approximately 24% in 2018 of total assets held in investment funds and OFIs.

7. CCPs

The overall picture drawn by the CCP indicators has remained broadly stable, notwithstanding differences between CCPs. Overcollateralisation appears to be widely practiced, to different degrees (indicator 8.3); liquidity resources available to CCPs, which include a significant percentage of margins posted in the form of cash, seem adequate with no sign of meaningful deterioration (indicators 8.4 and 8.5); investment policies do not seem to suggest meaningful increase in risk taking (8.10). However, central clearing in general and client clearing in particular still appear to be a highly concentrated activity (indicator 8.6 and 8.9). For the five current interoperability arrangements of European CCPs, the initial margins provided vary significantly, but remain relatively stable over time (indicator 8.8).

[2] See ESRB Shadow Banking Monitor 2018, Chart 2.