EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB Financial Stability Review: *Key takeaways*

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Overview

Positive factors

a growing economy

contained credit growth

banks more resilient

Challenges

continued intense risk taking in financial markets

price overvaluation in certain bond and real estate markets

Looking ahead to the next two years, risks remain:

sharp falls in global asset prices

weak bank profitability jeopardising the supply of credit

concerns over public and private indebtedness

liquidity risks in the investment fund sector

1 - Macro, fiscal and overall credit environment

Economic growth

Economic expansion in the euro area has continued at a robust pace, becoming more broad-based across countries and sectors of economic activity.

Euro area growth prospects remain favourable, supported by private consumption and investment as well as the broad-based global recovery that is boosting foreign demand.

While the risks to the overall growth outlook are balanced, **downside risks** primarily relate to global factors, such as overheating in the US, private debt sustainability in EMEs as well as renewed (geo)political stress, including the risk of growing trade protectionism.

Indebtedness

Credit risks in sovereigns, households and firms are being alleviated by robust growth and favourable financing conditions.

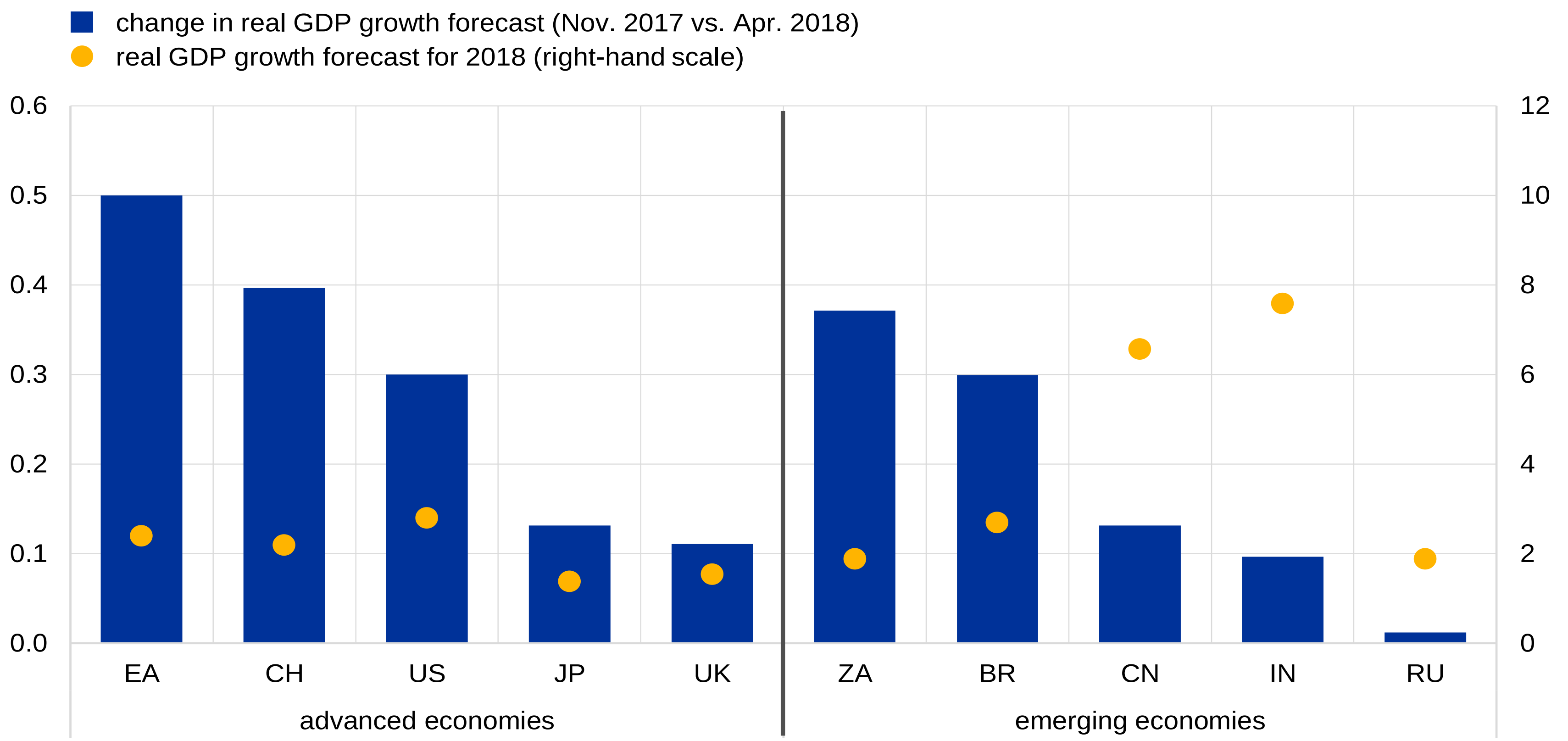
The **sustainability of public finances** may be challenged by a deterioration in economic conditions but also a slowdown of fiscal and structural reform efforts as well as a broader re-widening of risk premia.

Household debt remains elevated in some euro area countries. In countries with mainly variable rate loans, households are vulnerable to the risk of rising interest rates.

Corporate indebtedness remains high by both historical and international standards. Further balance sheet repair should help offset any risks related to a rise in debt servicing costs.

Improved growth prospects across the board

Change in real GDP growth forecasts for 2018 for major advanced and emerging economies
Apr. 2018; changes vs. Nov. 2017; percentages; percentage points



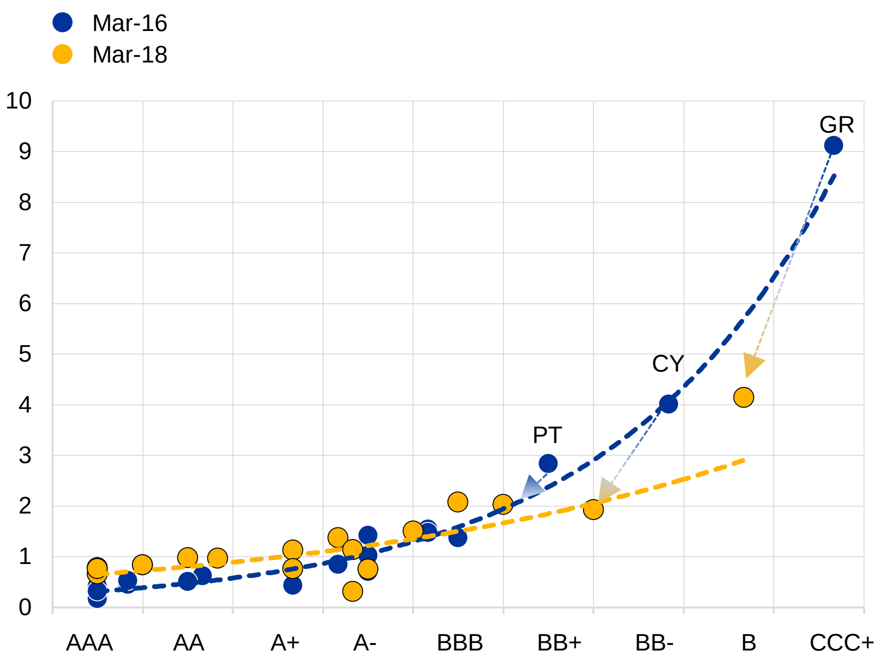
Sources: Consensus Economics and ECB calculations.

Notes: EA: euro area, US: United States, CH: Switzerland, JP: Japan, UK: United Kingdom, BR: Brazil, CN: China, ZA: South Africa, RU: Russia and IN: India.

Sovereign debt overhang subsiding only slowly

10-year government bond yields and credit ratings of euro area sovereigns

Ratings, percentages per annum

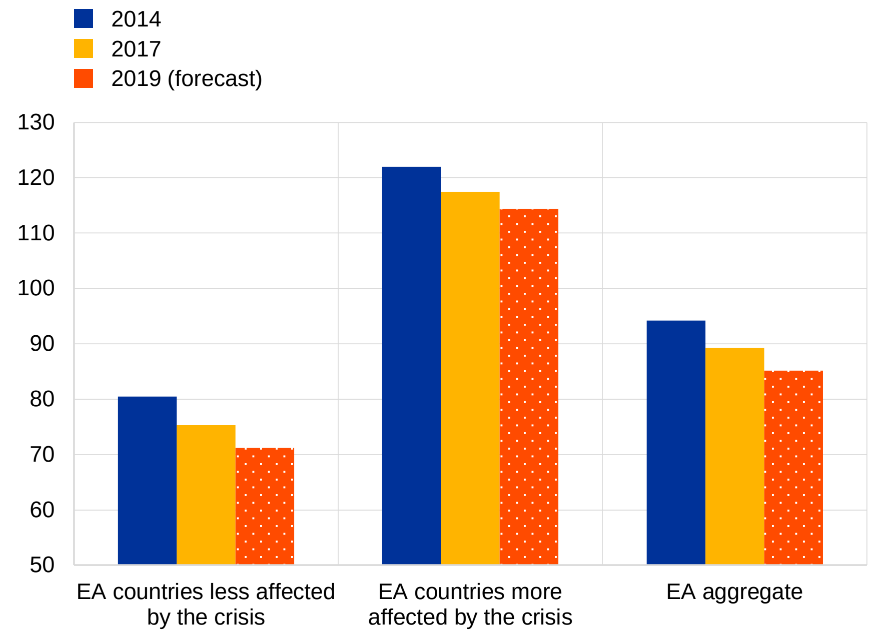


Sources: Standard & Poors, Moody's, Fitch, ECB and ECB calculations.

Notes: The rating score represents the average rating by the three major rating agencies, Moody's, Standard & Poor's and Fitch. The bond yields indicate the long-term interest rate for convergence purposes (secondary market yields of government bonds with maturities of ten, or close to ten, years).

General government debt-to-GDP ratios across the euro area

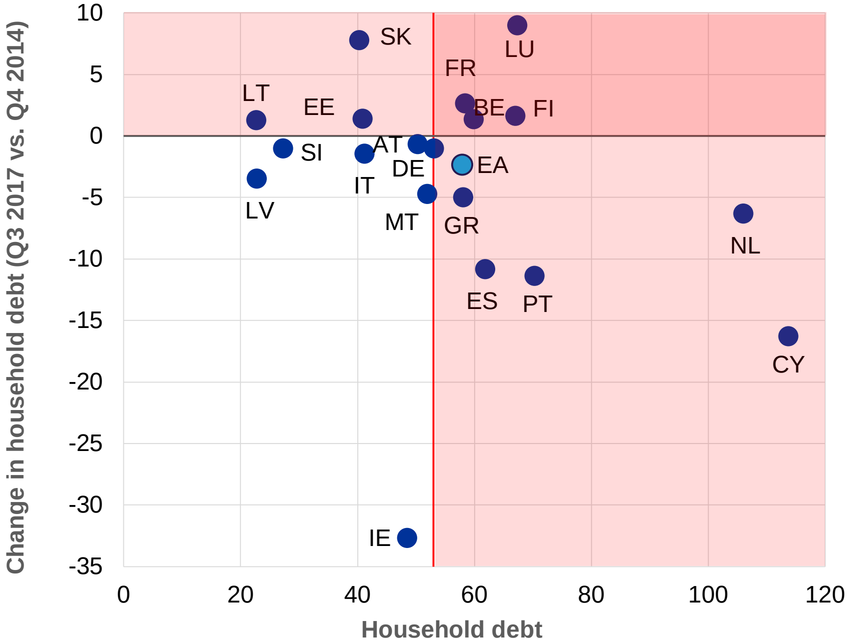
percentages of GDP



Sources: European Commission (AMECO Database) and ECB calculations.

Household debt low and rising, corporate debt high

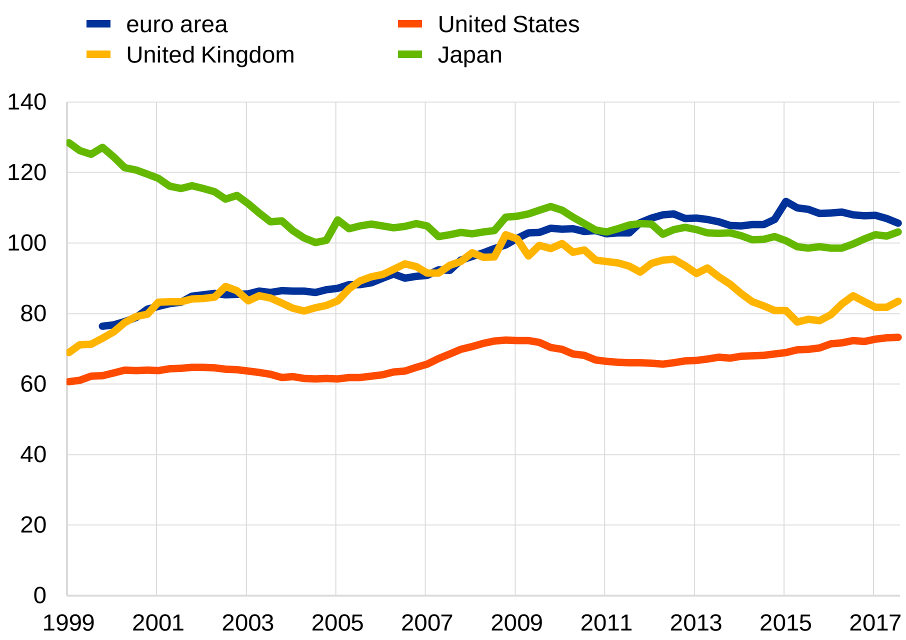
Household indebtedness across the euro area
Q3 2017; percentages of GDP; percentage point changes



Sources: ECB and ECB calculations.

Notes: The vertical red line represents the estimated macroeconomic imbalance procedure (MIP) benchmark of 53% of GDP for household debt.

Non-financial corporate indebtedness in a global comparison
Q1 1999 – Q3 2017; percentages of GDP

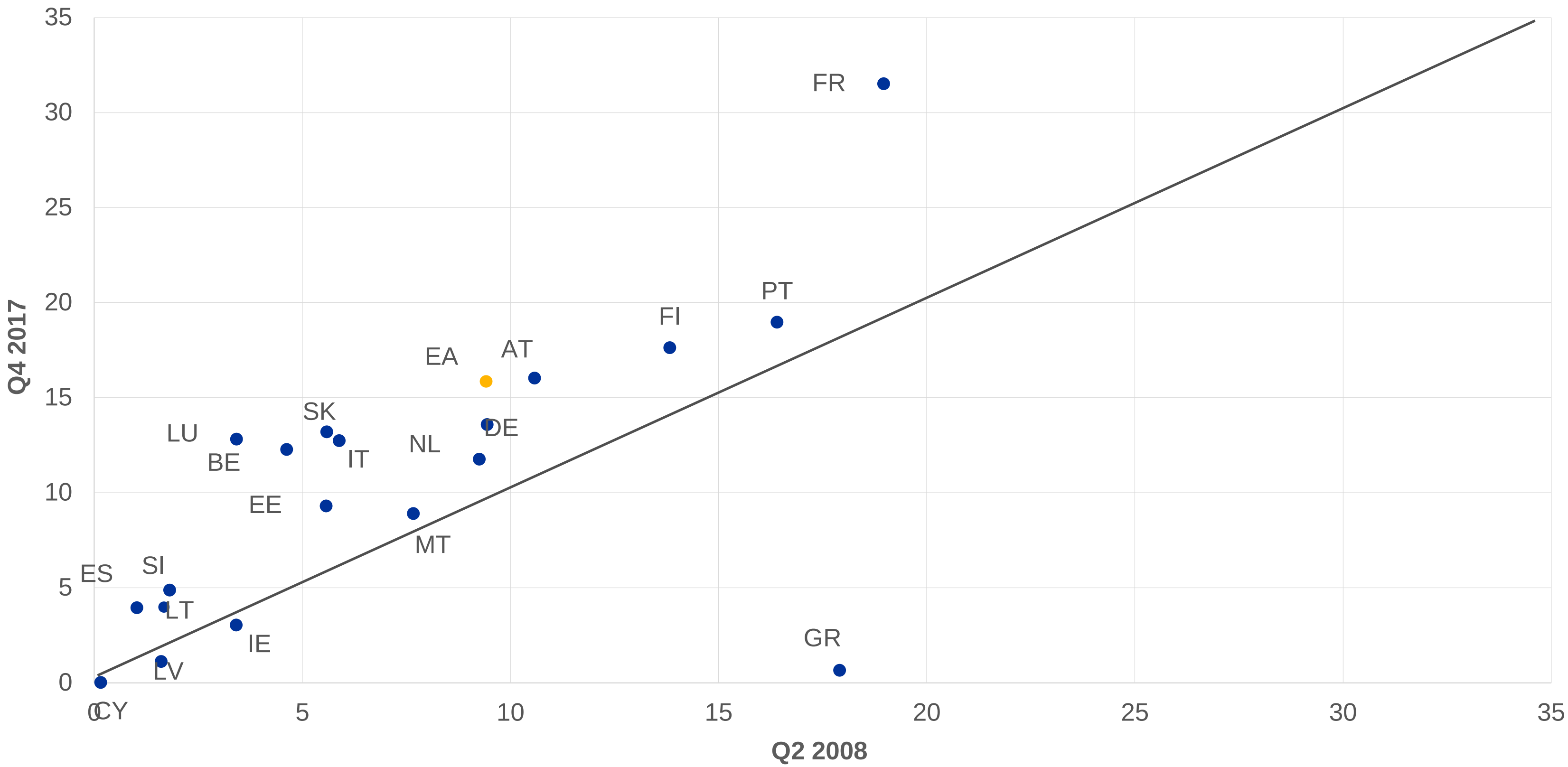


Sources: BIS and ECB.

Notes: Indebtedness of the non-financial corporate sector in unconsolidated terms.

Marked shift towards market-based financing since GFC

Share of debt securities issued in total market-based (debt securities issued) and bank (MFI loans) financing
(Q2 2008, Q4 2017; percentages based on outstanding stocks)



Sources: ECB euro area accounts and ECB calculations. Note: Figures for Spain do not include debt issuance through financial subsidiaries which account for a significant part of the debt securities funding of large corporates.

2 - Financial markets and valuations

Financial markets

The generalised **reach for yield** has intensified over the review period, supported by strong and globally synchronised economic growth.

A **surge in volatility** in US stock markets occurred in early February which underscored the fragility of current market sentiment.

The episode illustrated how abruptly **market sentiment can change** in the current environment of generally compressed risk premia.

Asset valuations and vulnerabilities

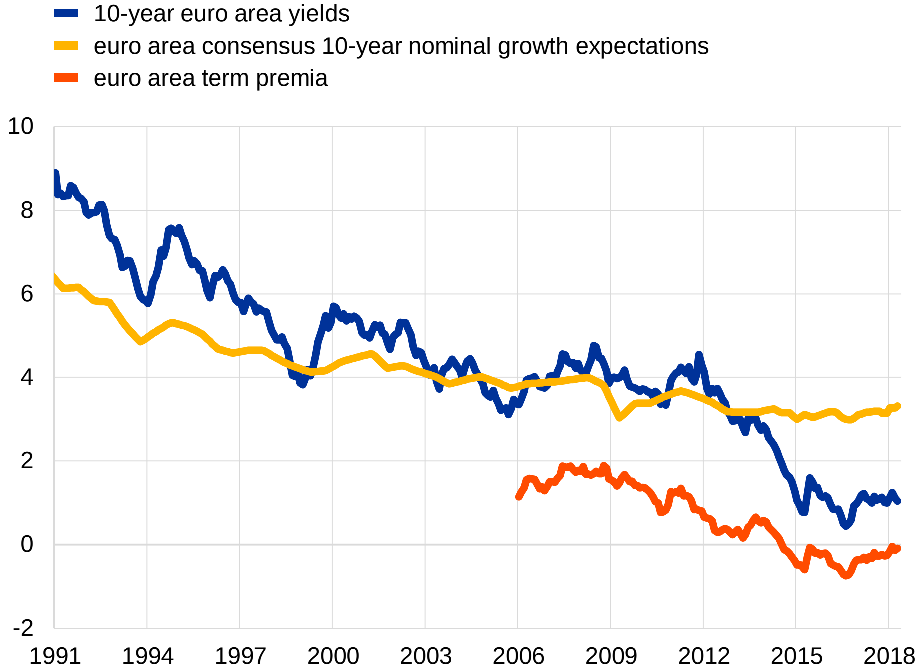
While there are **no general misalignments across asset classes** in the euro area, valuations continue to be stretched in several markets such as high yield bonds, leveraged loans, prime commercial real estate and US equities.

The potential **impact of a significant repricing has increased** due to euro area entities' rising exposure to lower-rated corporate debt.

Financial market participants should **lower their exposure to vulnerable sectors** and prepare for a situation in which the favourable market environment may no longer persist.

Government and corporate bond yields compressed …

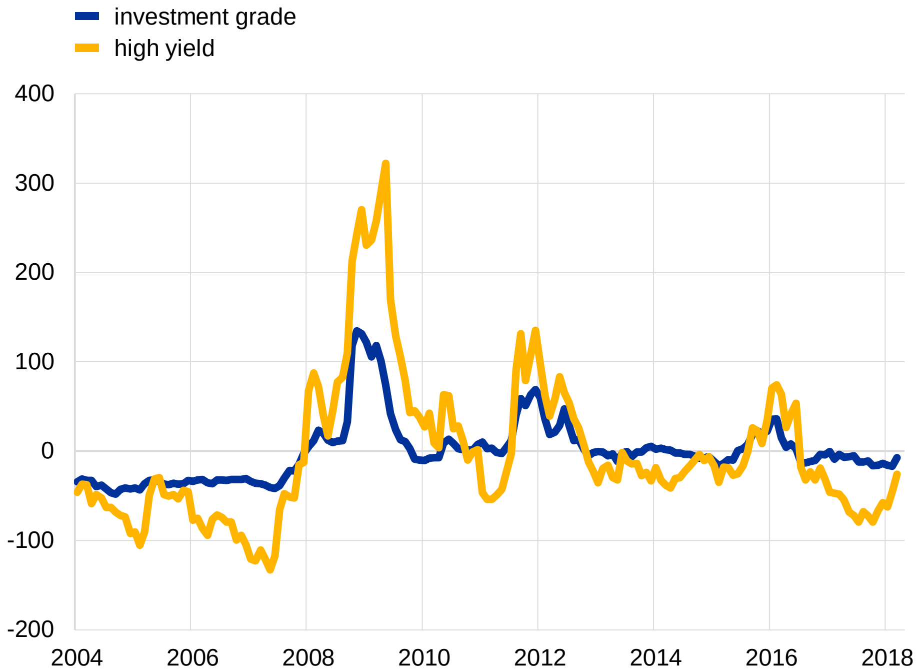
Long-term government bond yields, nominal GDP growth expectations and term premia in the euro area Jan. 1991 – Apr. 2018; monthly data, percentages per annum, annual percentage changes



Sources: Thomson Reuters Datastream, Consensus Economics and ECB calculations

Notes: Before 1999, the euro area bond yields are approximated by ten-year bond yields in Germany. The euro area term premia estimates (based on ten-year OIS rates) use an affine term structure model following the methodology used by Joslin, S., Singleton, K.T. and Zhu, H., “A New Perspective on Gaussian Dynamic Term Structure Models”, Review of Financial Studies, Vol. 24(3), March 2011, pp. 926-970.

Excess bond risk premia on euro area investment grade and high yield bonds
Jan. 2004 – Apr. 2018; basis points

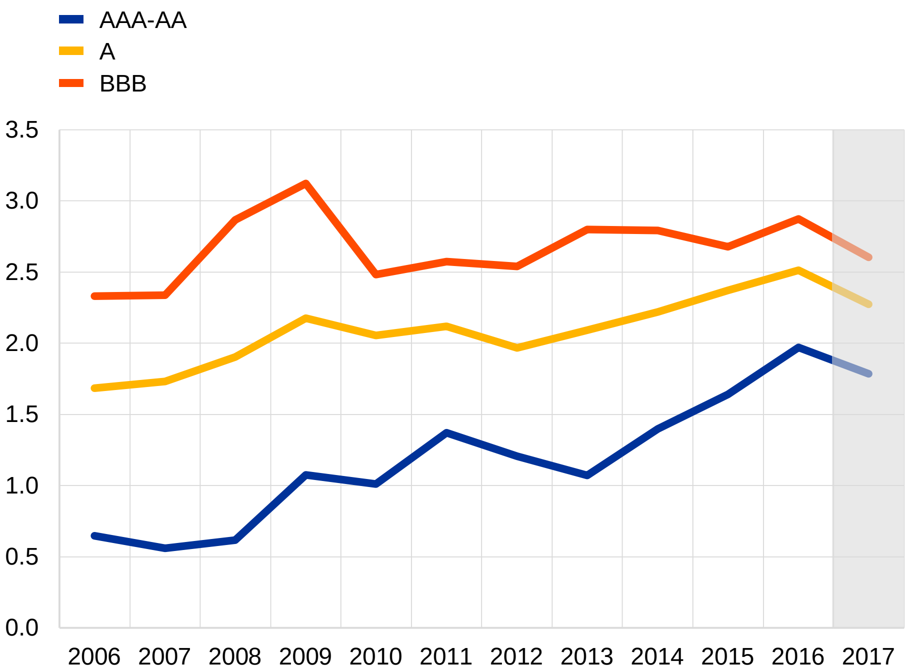


Sources: iBoxx and Moody’s

Notes: The excess bond premium (EBP) is defined as the deviation of credit spreads from measures of credit risk and liquidity risk at individual bond level. The series represent averages from two ECB models.

… amid high corporate leverage, particularly for riskier segments

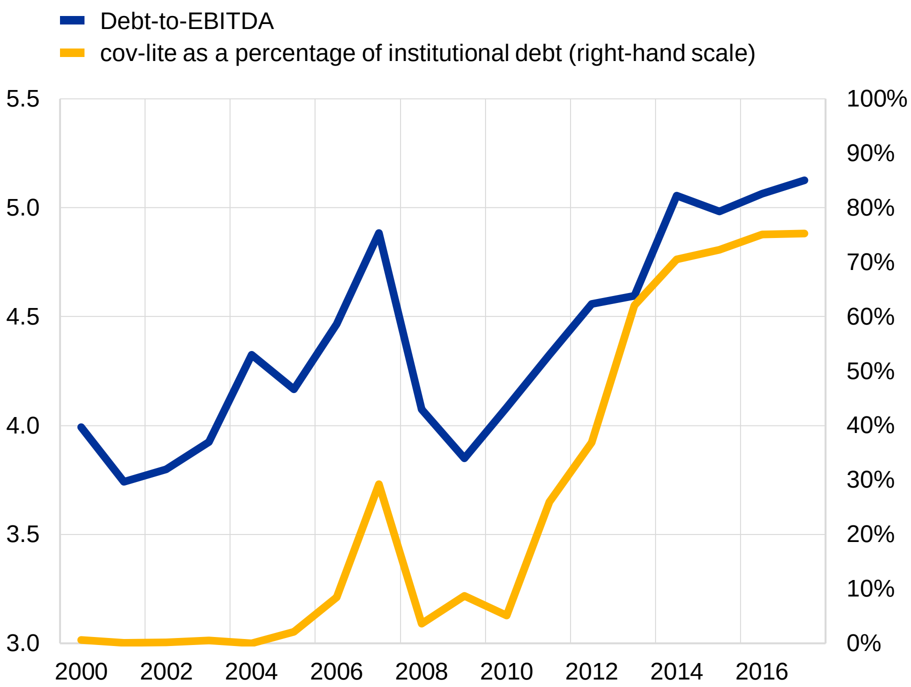
Gross leverage ratios for non-financial European corporates
2006-17, percentages of EBITDA



Sources: Bloomberg, Thomson Reuters and ECB calculations

Notes: Leverage is computed as gross debt to annual EBITDA using median values of a constant sample of 232 European corporates: nine AAA-AA, 71 A and 123 BBB. For 2017 (shaded grey), leverage was computed on the basis of a limited reporting sub-sample.

Leverage levels and the share of cov-lite loans in primary US leveraged loan markets
2000-2018; ratios and percentages

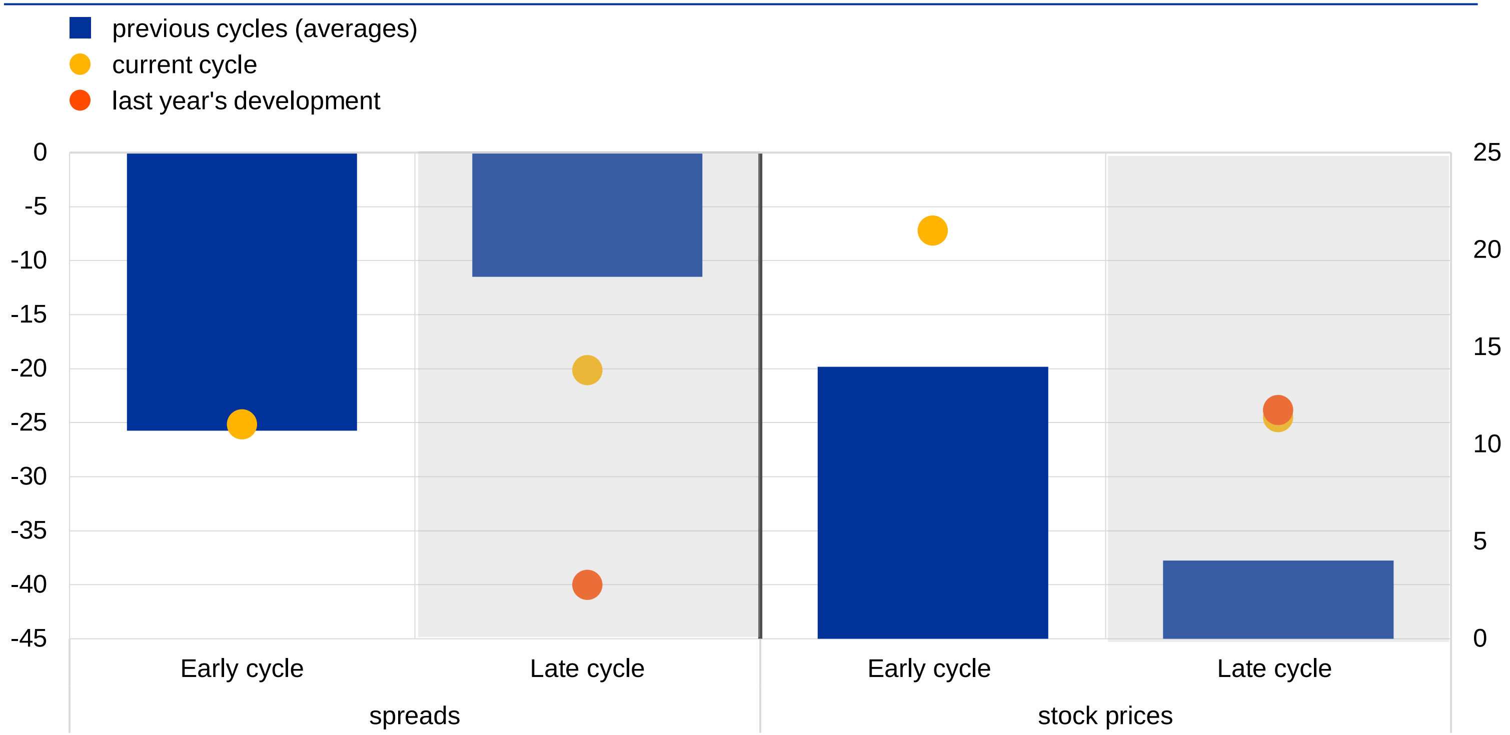


Sources: S&P Ratings Direct and ECB calculations.

Note: Leverage is computed as gross debt divided by pro-forma EBITDA.

Atypical asset price developments for this point in cycle

Changes in US Baa corporate bond spreads and stock price returns for the S&P 500 index during the current and previous expansions
basis points (bond spreads), annual percentages (stock prices), left-hand axis for spreads and right-hand axis for stock prices

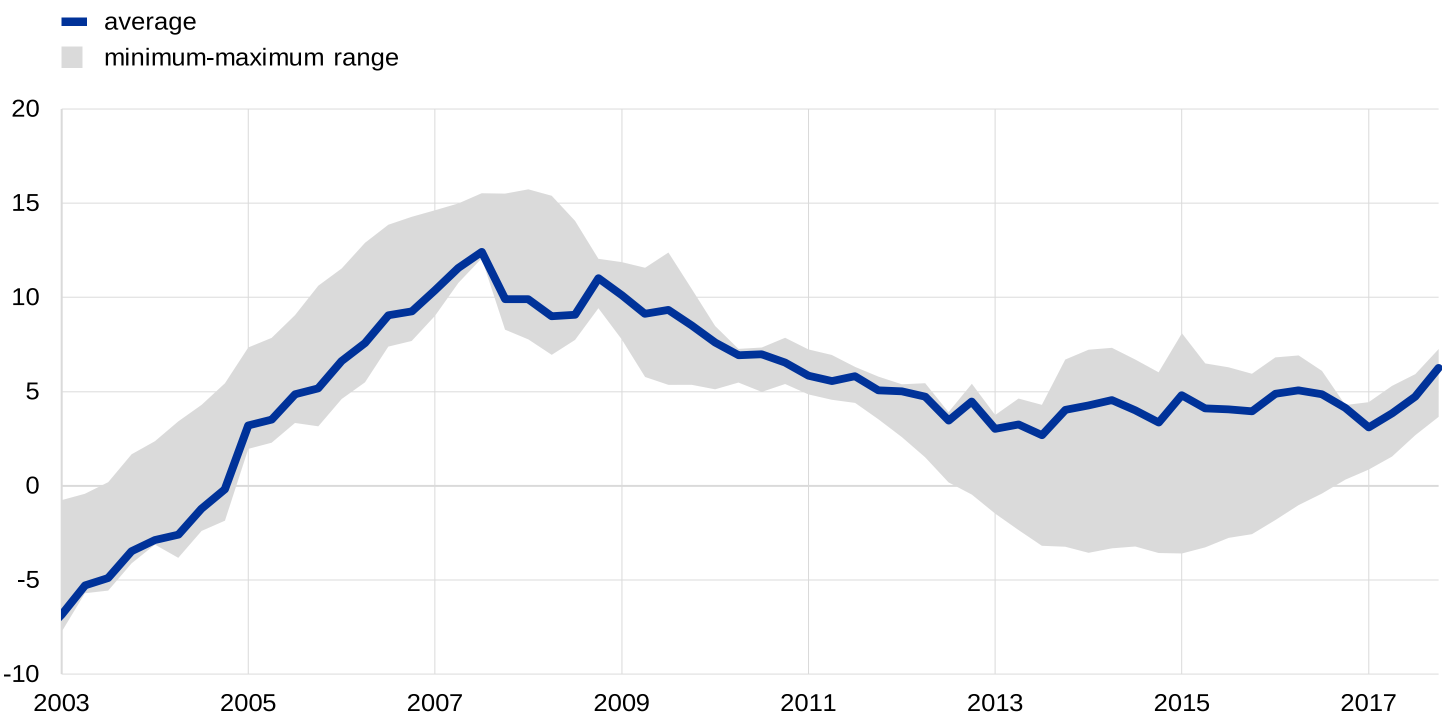


Sources: Bloomberg, National Bureau of Economic Research (NBER), Federal Reserve Economic Data St. Luis Fed and ECB calculations

Notes: Spreads computed as Baa Corporate Bond Yield relative to yield on 10-Year treasury constant maturity. The cycles are defined according to the expansionary periods defined by NBER since 1960. Early and late cycles are defined as the first and second half, respectively, of the expansionary periods. Changes in credit spreads and stock price returns are annualised. Current cycle is defined as the period June 2009 – March 2018.

Real estate valuation metrics also creeping up

Residential property prices at the euro area level: deviations from estimated fair value
Q1 2003 – Q4 2017, percentages, average valuations, minimum-maximum range across valuation estimates

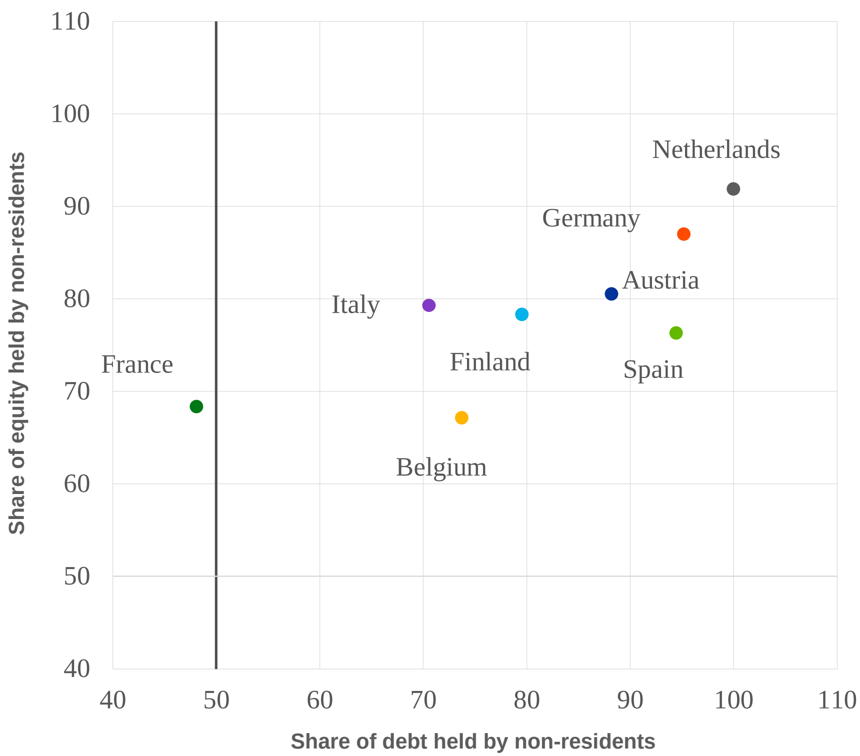


Sources: ECB and ECB calculations.

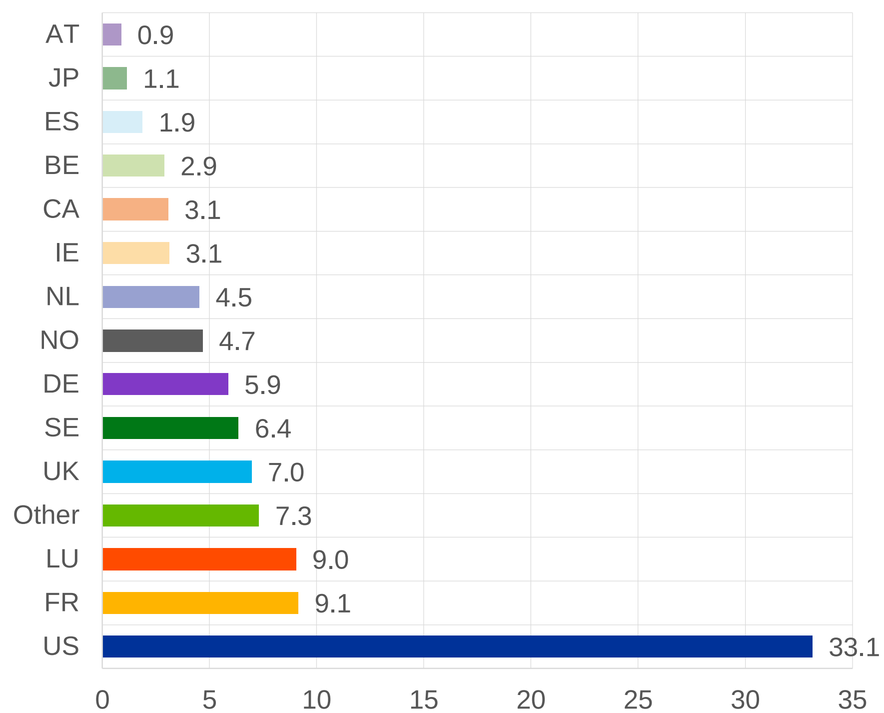
Notes: The fair value estimations are based on four different methods: the price-to-rent ratio, the price-to-income ratio and two model-based methods, i.e. an asset pricing model and a new model-based estimate (BVAR).The average is based on the price-to-income ratio and the new model-based method. For details of the methodology, see Box 3 in Financial Stability Review, ECB, June 2011, as well as Box 3 in Financial Stability Review, ECB, November 2015.

Foreign investors exposure to listed euro area CRE companies

Share of debt and equity in listed euro area CRE companies held by non-domestic investors
2016; percentages



Foreign holdings of equity in listed euro area CRE companies by country of holder
2016; percentages



Sources: Bloomberg, SHS, FTSE Russell and ECB calculations Notes: Left panel: "Non-domestic" refers to investors from both inside and outside the euro area. Foreign holdings as a percentage of debt and equity issued by companies listed in the FTSE – EPRA NAREIT Europe Index and included in Securities Holdings Statistics (SHS). Right panel: Calculations are based on the weighted average of aggregate total assets in the euro area. Domestic holdings represent total holdings held by investors from the same country and foreign holdings represent total holdings held by investors from foreign countries (including in the euro area).

Banks

Bank profitability picked up amid improving cyclical conditions and **solvency positions** strengthened further.

Banks need, however, to make further progress in **business model adjustment** in order to achieve sustainable profitability.

There is **no broad-based evidence of excessive risk-taking** by banks in response to profitability pressures.

Increasing exposures towards some **riskier segments** (e.g. consumer lending, leveraged loans) warrant closer monitoring.

NPL reductions accelerated in 2017 but banks should take advantage of current favourable macroeconomic conditions to increase their efforts to reduce NPL stocks.

Non-bank financial sector

Increased risk-taking and common asset exposures have rendered a larger part of the euro area non-bank financial sector vulnerable to a potential shock in global financial markets.

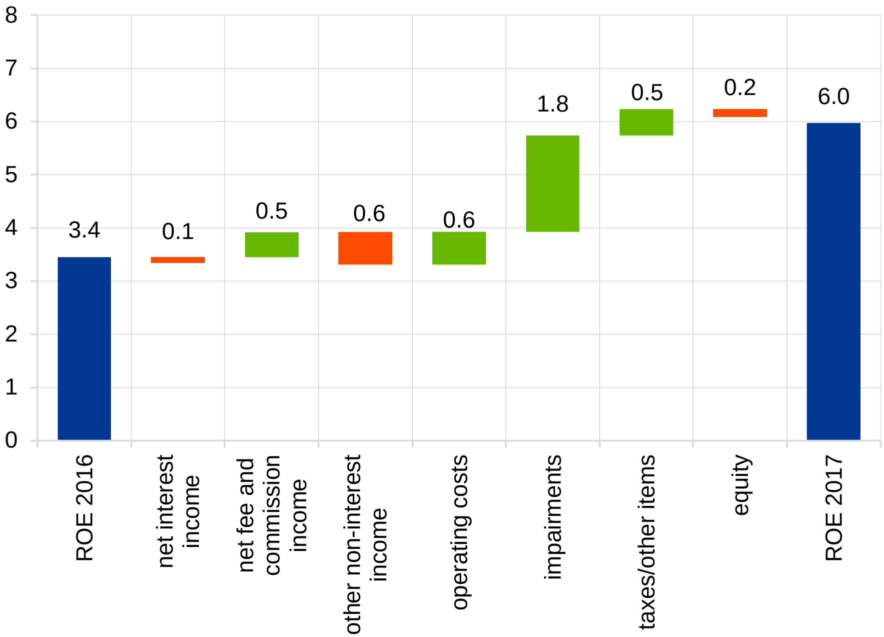
Rising yields are bolstering the profitability outlook for **life insurers**, while **reinsurers** sustained exceptionally costly catastrophes in 2017.

Some **bond and equity funds** have suffered outflows since the end of 2017 due to rising yields and an increase in equity volatility.

Over the past years, **liquidity and maturity transformation among bond funds** has grown, increasing the funds' sensitivity to changes in interest rates and larger outflows.

Near doubling in bank profitability, as solvency strengthens further

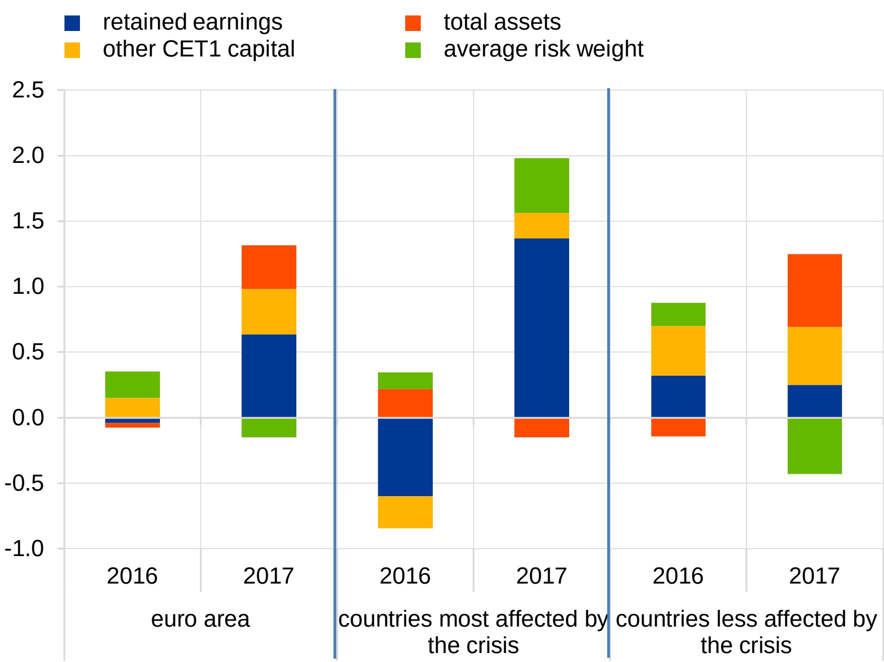
Decomposition of the change in euro area significant banks' aggregate return on equity
(2016-17; percentage points)



Sources: ECB supervisory data and ECB calculations.

Notes: Based on a balanced sample of 112 SIs (adjusted for mergers and acquisitions). Green and red bars denote positive and negative contributions respectively.

Decomposition of changes in euro area significant institutions' aggregate fully loaded CET1 ratios in 2016 and 2017
(2016-2017; percentage points)

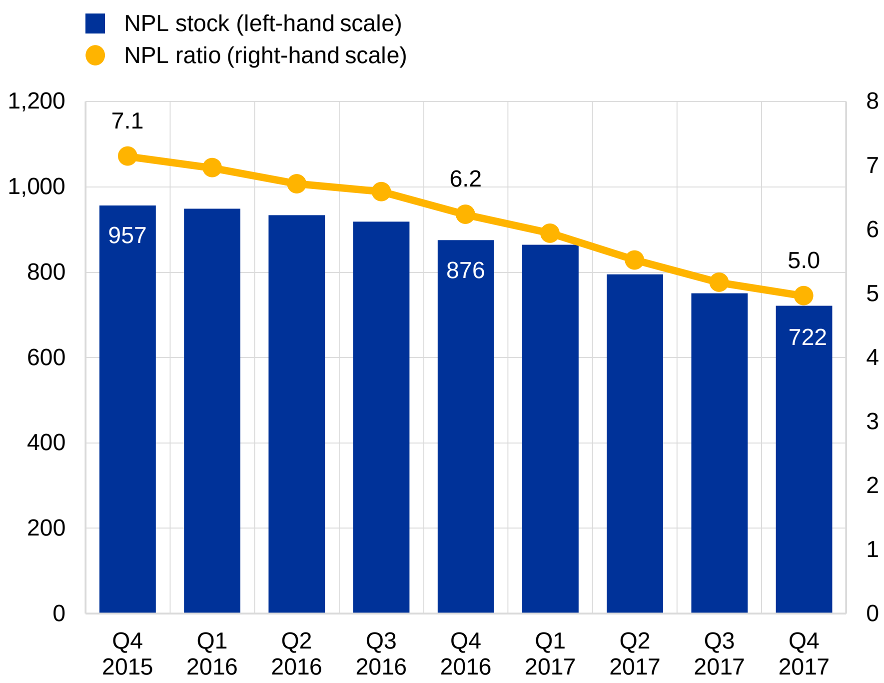


Sources: ECB and ECB calculations.

Notes: Changes in average risk weight and total assets are shown with the opposite sign as their decline (increase) indicates a positive (negative) contribution to the capital ratios. Based on a balanced sample of 89 SIs. Countries most affected by the crisis include Cyprus, Greece, Ireland, Italy, Portugal, Slovenia and Spain.

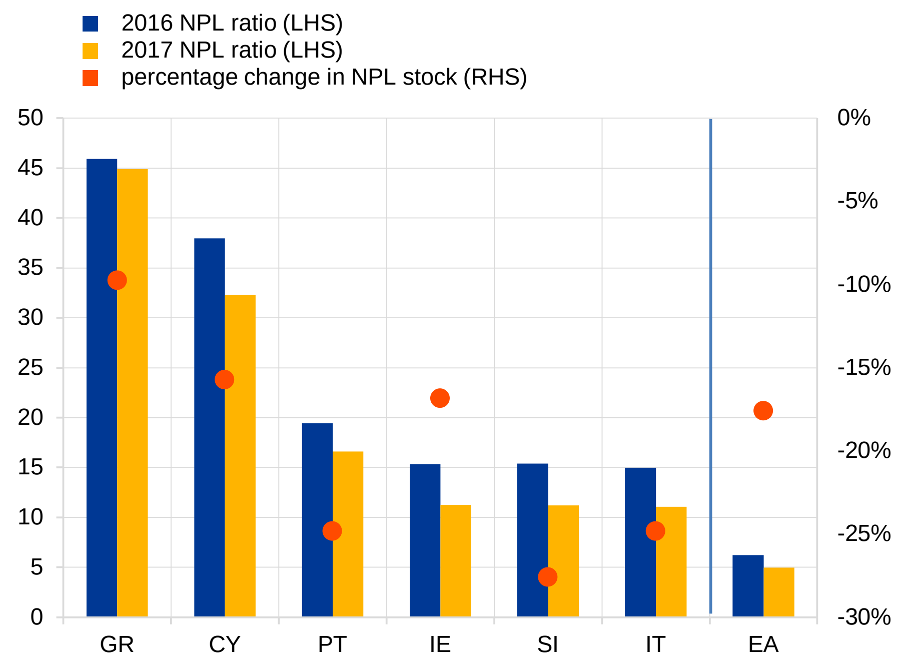
NPL reduction gaining considerable momentum

Euro area significant institutions' NPL stock and aggregate NPL ratio
(Q4 2015-Q4 2017; EUR bn, percentage)



Source: ECB.

Change in NPL ratios and stocks in high NPL countries between 2016 and 2017
(2016-2017; ratios, percentage changes)

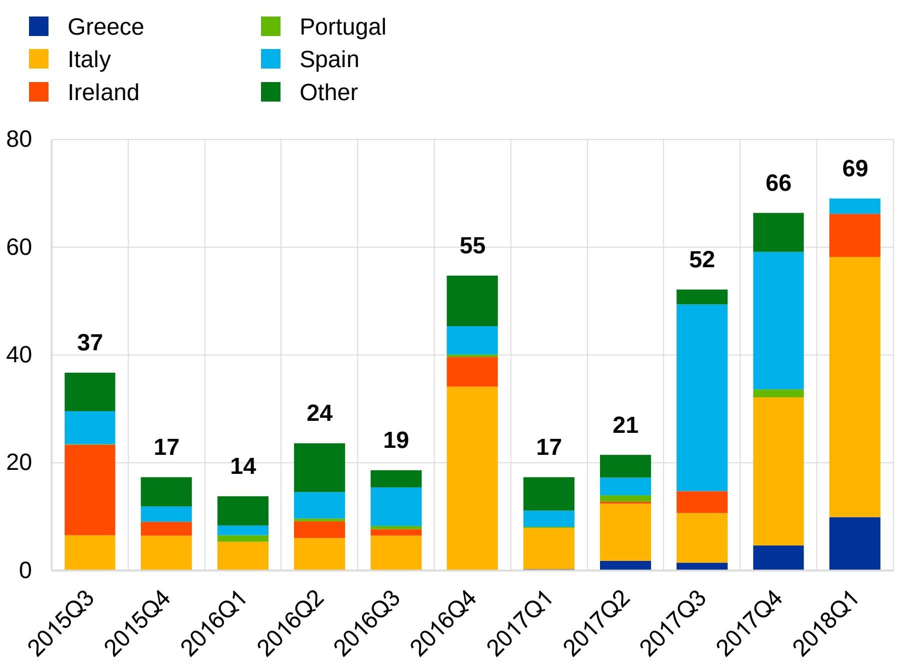


Source: ECB.
Note: Based on country-level aggregates for SIs.

NPL sales suggest stable pricing as secondary market volumes rise

Total gross book value of traded NPL portfolios in the euro area

(Q3 2015 – Q1 2018, EUR billion)

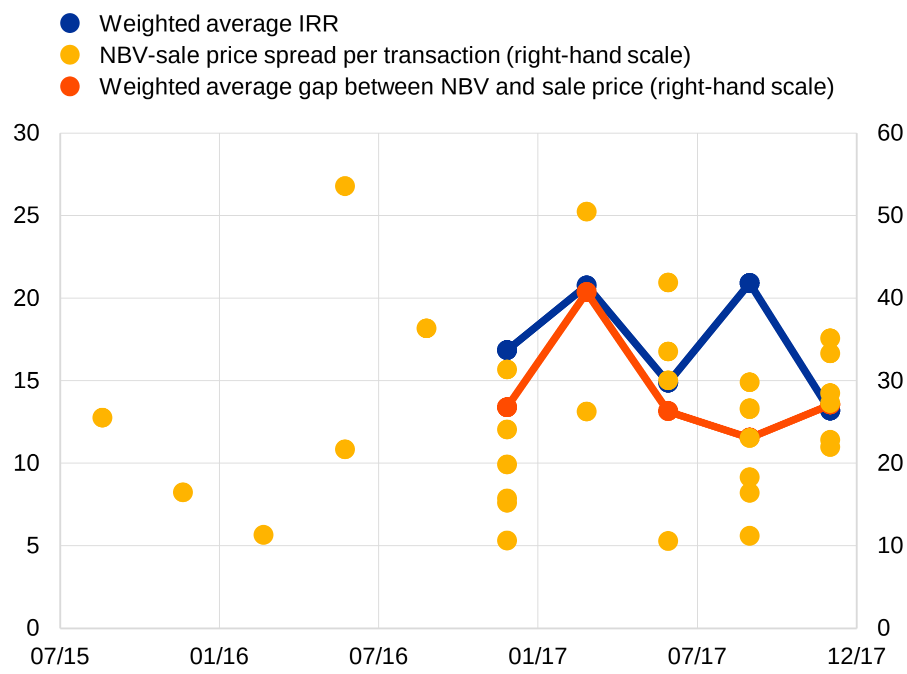


Sources: KPMG Debt Sales Monitor, ECB calculations.

Notes: Q1 2018 data include EUR 33.9 billion of transactions that were ongoing as of 27 March 2018. Numbers above bars indicate total European transaction volumes per quarter.

Estimated IRRs earned by NPL buyers and spreads between net book value and sale price

(Q3 2015 – Q4 2017; percentages, spread in percentages of gross book value)

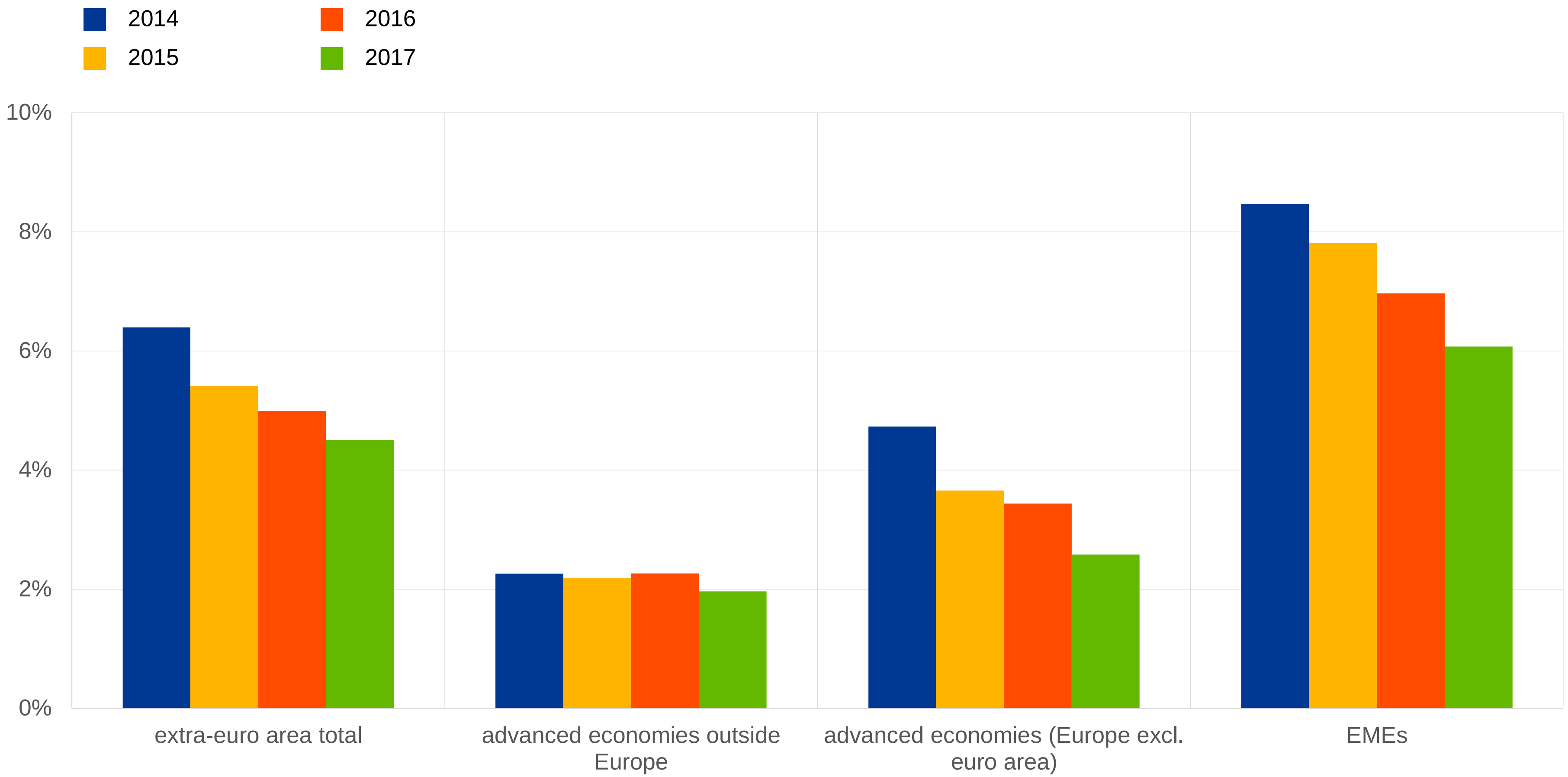


Sources: KPMG, Banca IFIS Market Watch, bank announcements and ECB calculations.

Notes: NBV – net book value. Averages are not calculated prior to the fourth quarter of 2016 owing to the very limited number of observations.

Improved asset quality of euro area banks across all regions

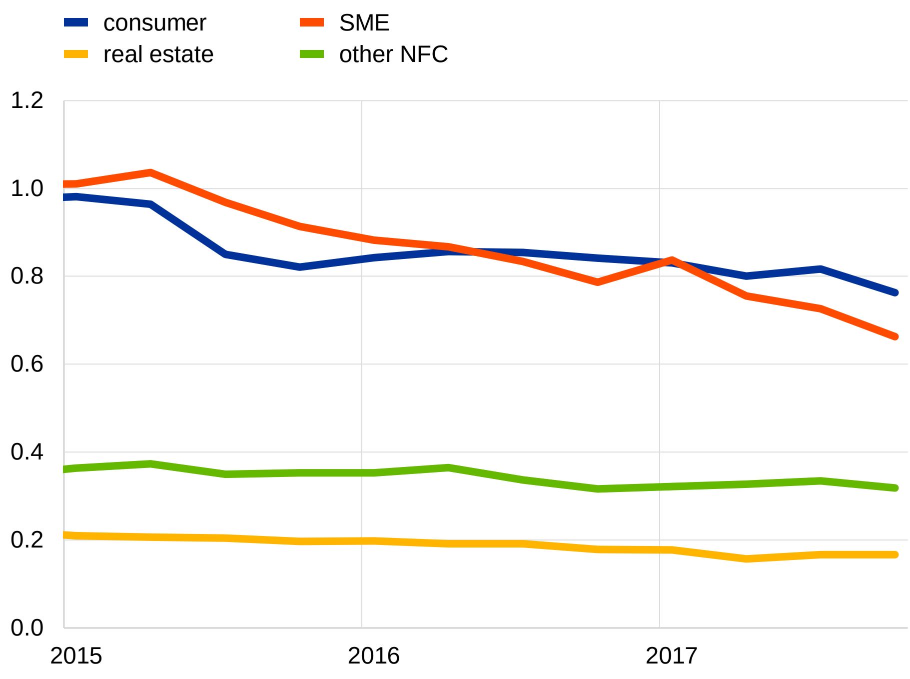
Euro area significant institutions' NPL ratios in regions outside the euro area
(2014-17, percentages)



Sources: ECB

Bank risk taking limited on aggregate (some pockets of vulnerability)

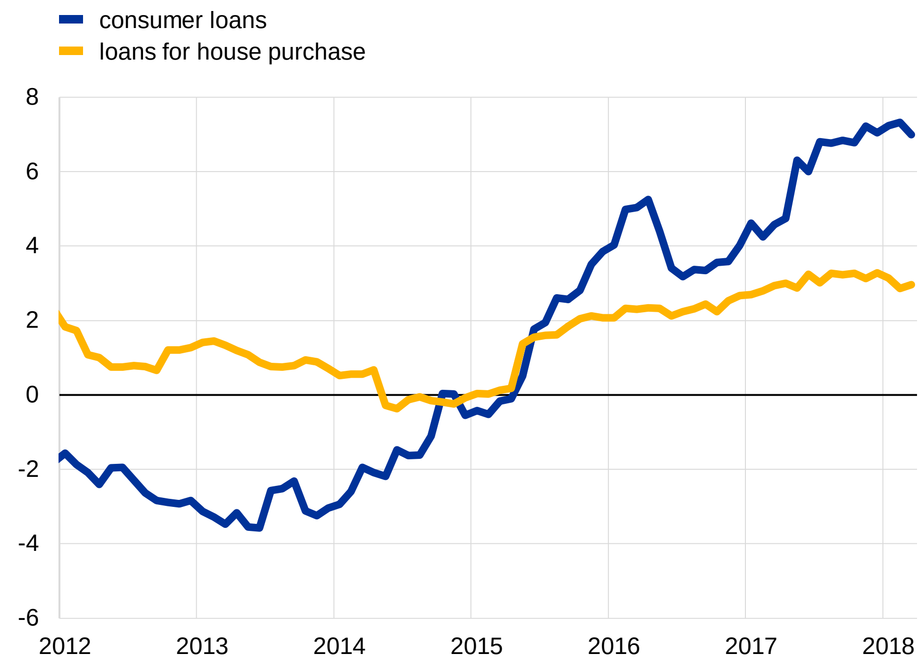
Expected loss relative to exposure at default (EAD)
Q1 2015 - Q4 2017; medians, percentages



Source: ECB supervisory data and ECB calculations.

Notes: Based on measures reported by banks on their IRB portfolios. Excludes exposures in default. Cross-sectional median of a balanced sample of 52 significant institutions with IRB exposures. "Real estate" includes retail loans secured by immovable properties; "consumer" loans includes qualified revolving loans and other, non-secured, retail credits.

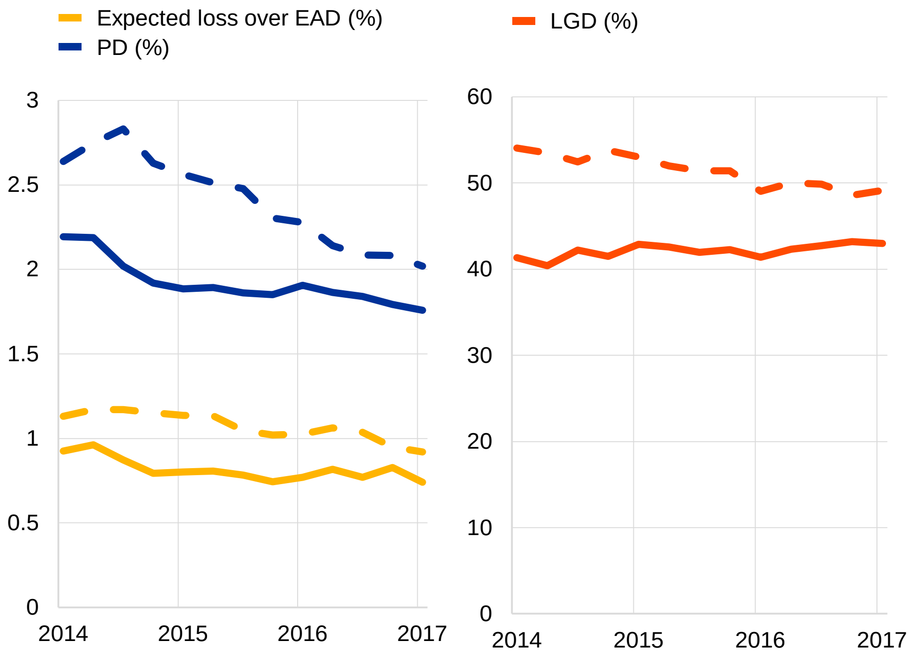
Lending to euro area households by type of lending
Jan. 2012 – Mar. 2018, annual growth rates based on respective indices of notional stocks



Source: ECB and ECB calculations.

Bank credit risk and consumer loan growth

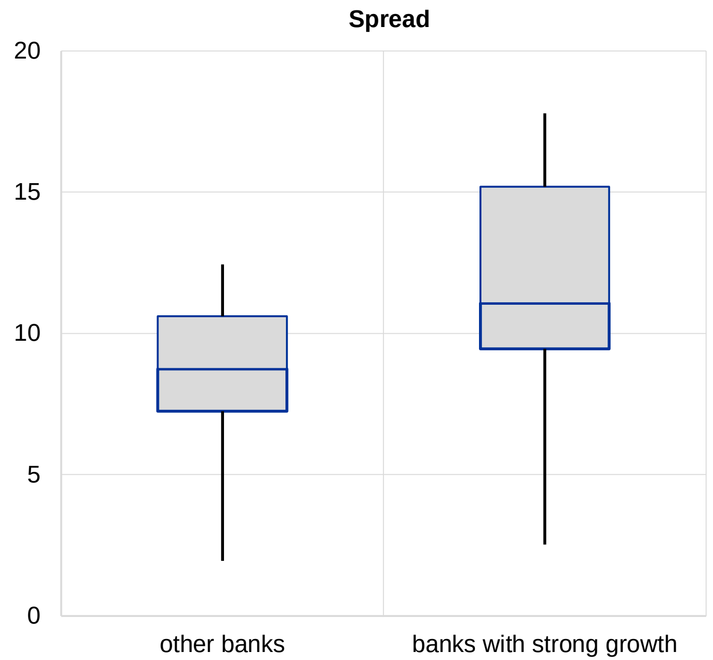
Expected losses (as a percentage of exposure at default), PDs and LGDs on consumer loans by group of banks
Q4 2014-Q4 2017; percentages



Sources: ECB supervisory data and ECB calculations.

Notes: Based on 45 SIs with consumer loans in IRB portfolios. Banks represented by the dashed line represent the top quartile of banks by consumer loan growth.

Loan-deposit spread for banks with stronger consumer lending versus other banks
2017; percentages; median, interquartile and 10th-90th percentile ranges

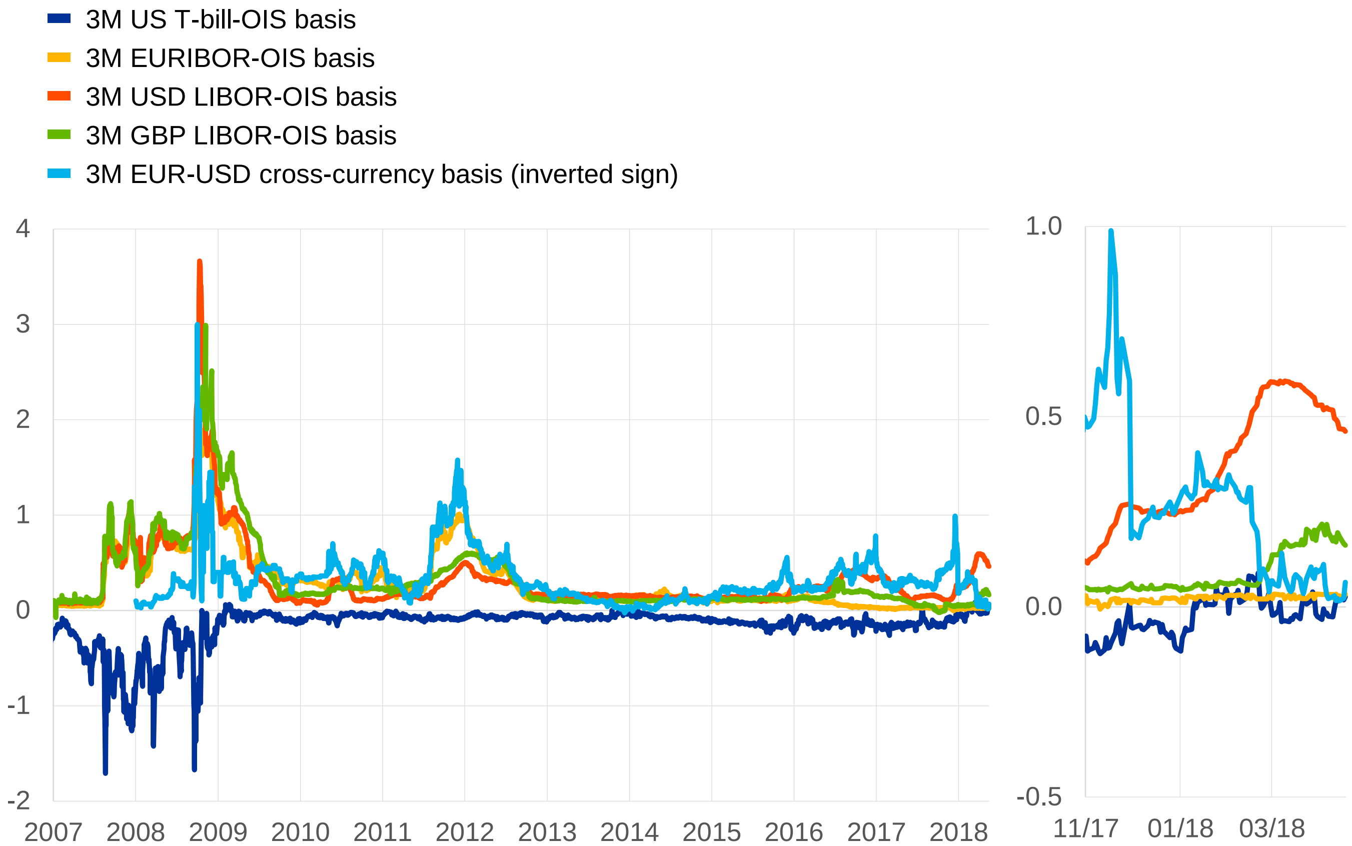


Sources: ECB and ECB calculations.

Note: Banks with strong growth represent the top quartile of banks by loan growth for consumption and other purposes.

Short-term USD funding costs decoupled other currencies

Spreads of selected three-month interbank funding rates and the three-month T-bill rate to the three-month OIS rate and the three-month EUR/USD FX basis
(Jan. 2007 to May 2018; percentages per annum)

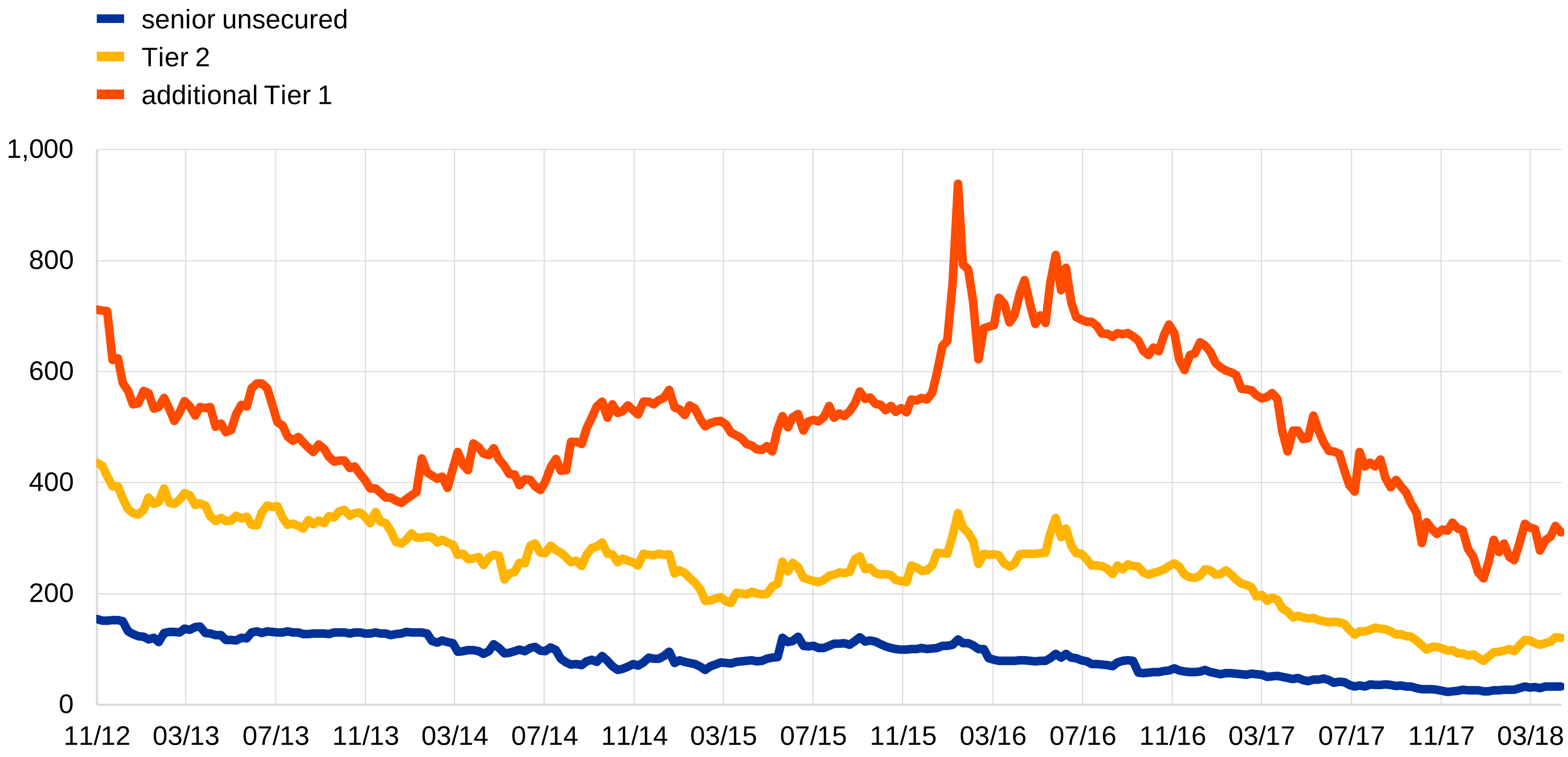


Sources: Bloomberg, Bank of America Merrill Lynch and ECB calculations.

Notes: The vertical lines refer to the publication of the previous FSR on 29 November 2017. The right panel shows averages since January 2002.

Bank bond spreads close to historical lows

Bond spreads of large euro area banks by debt instrument
Nov. 2012 – May 2018; median Z-spreads in basis points

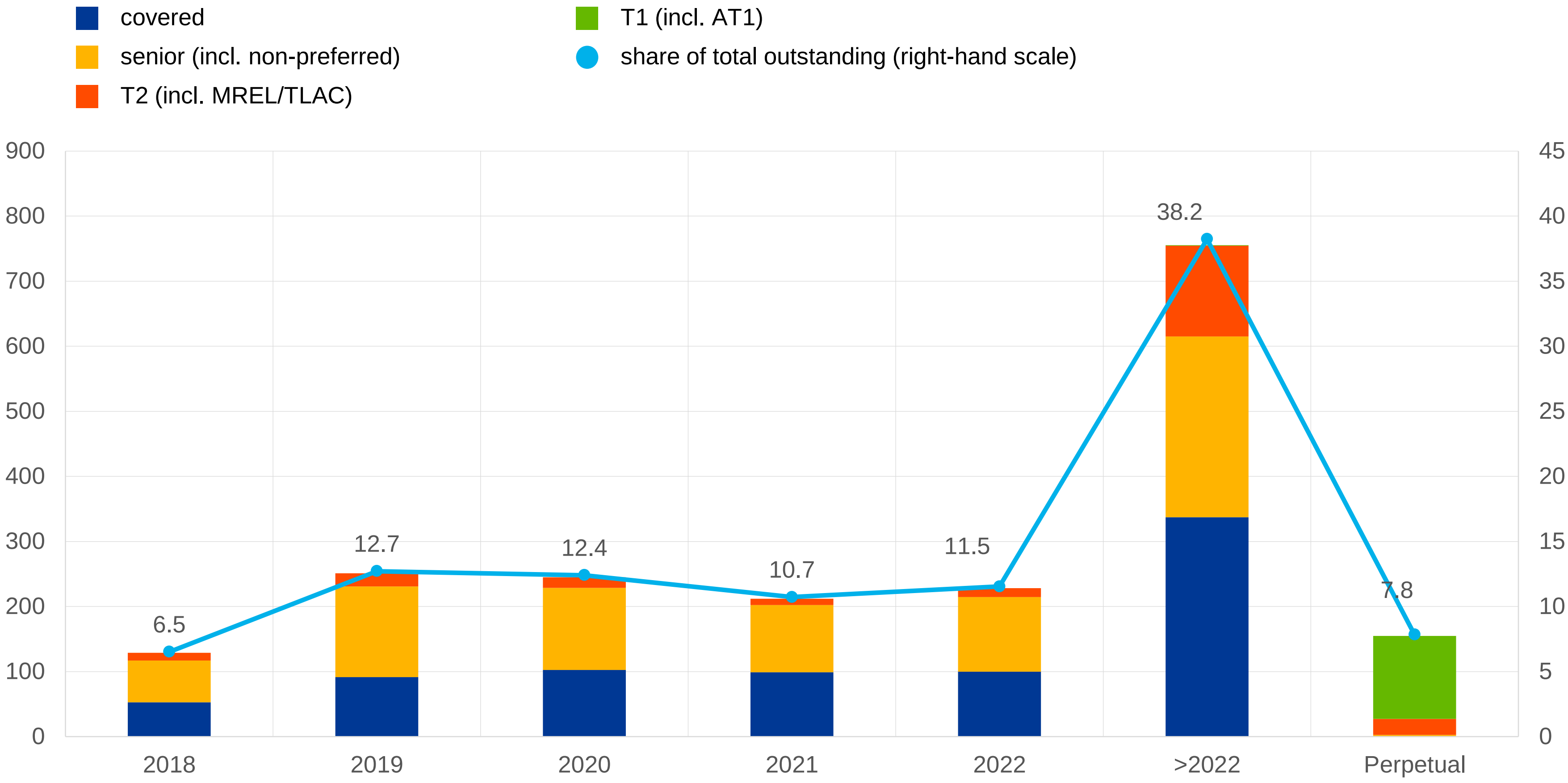


Sources: Bloomberg and ECB calculations.

Notes: Based on a sample of 21 large euro area banks. Z-spreads are defined as the difference (in basis points) between the yield to maturity of a bank's bond and the yield of a maturity-matched euro swap.

Maturity profile of outstanding euro area bank debt

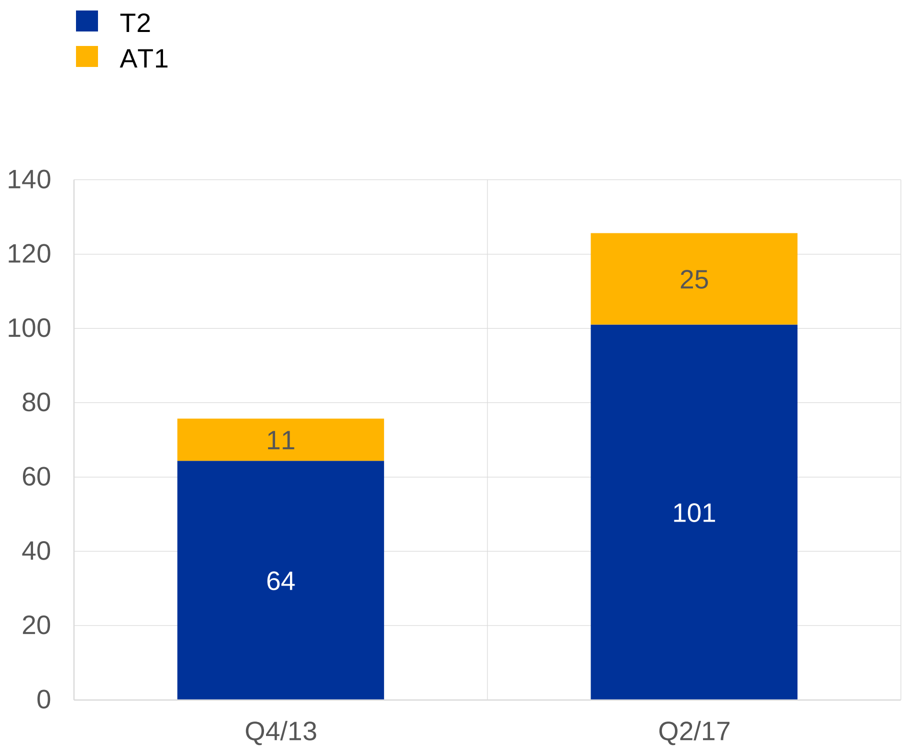
Outstanding bank debt by year of maturity and debt type
(€ billions and percentages)



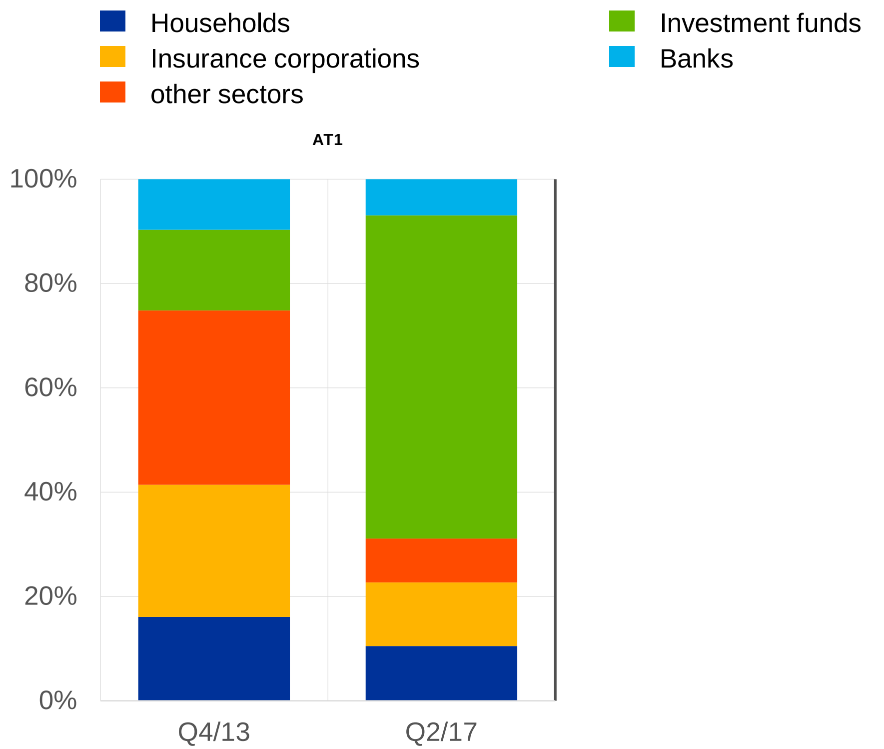
Sources: Dealogic and ECB calculations

Holdings of subordinated bank debt concentrated in investment funds

Euro area holdings of debt securities of significant banks by type of debt
(Q4 2013 and Q2 2017; EUR billions and percentages)



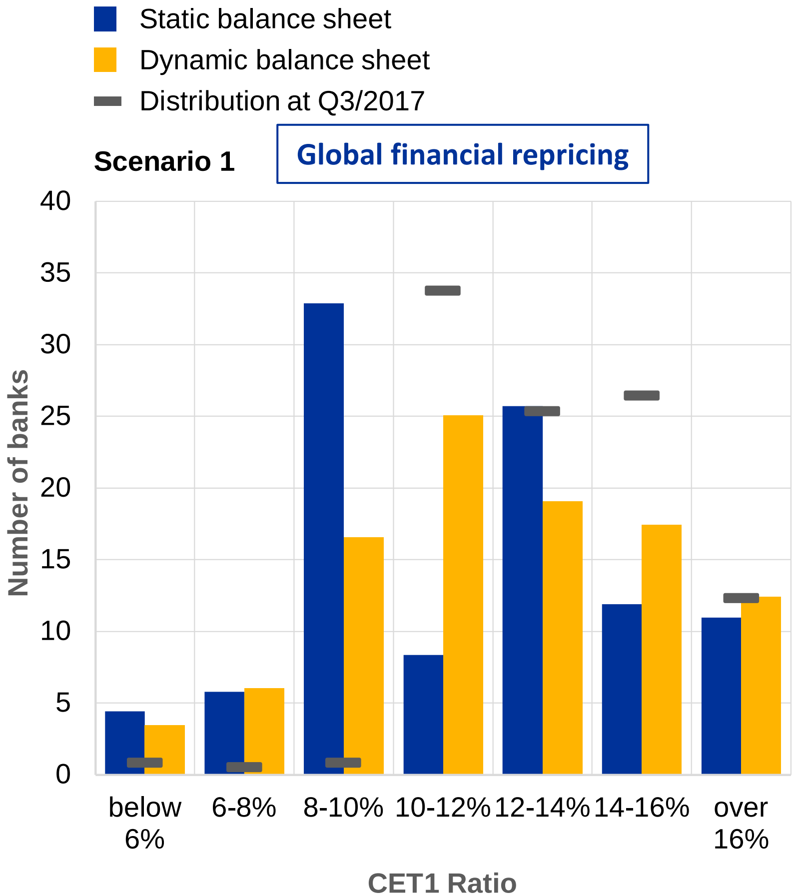
Euro area holdings of debt securities of significant banks by holding sector and type of debt
(Q4 2013 and Q2 2017; EUR billions and percentages)

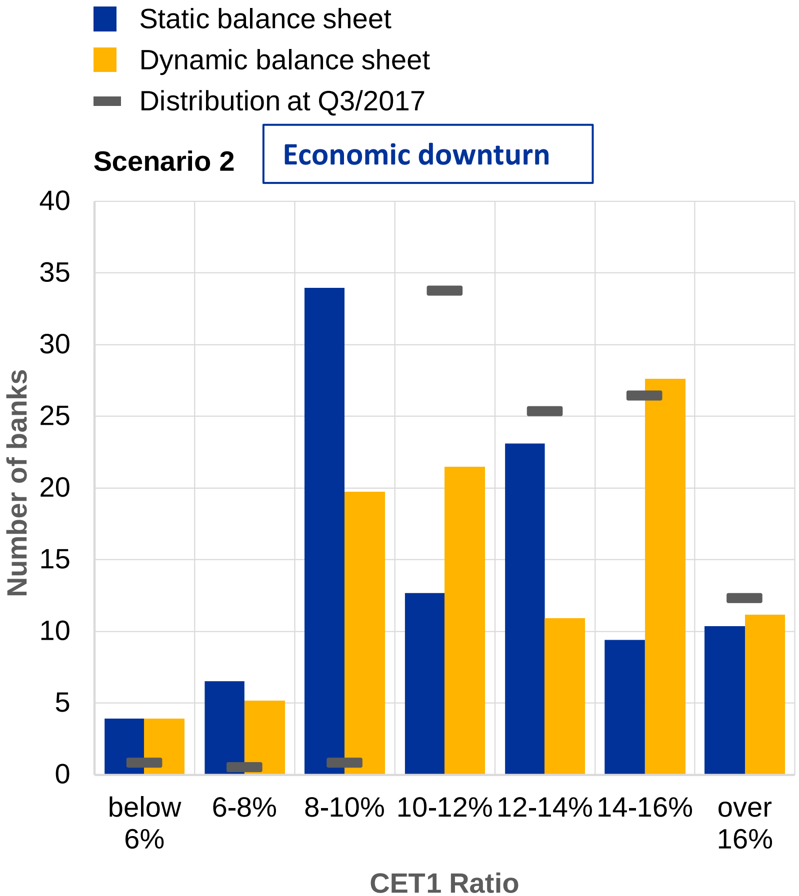


Sources: Bloomberg, ECB and ECB calculations. Notes: The sample consists of around 100 euro area significant banks. The large share of AT1 bonds held by “other sectors” in the fourth quarter of 2013 (right panel) was due to a government intervention in an ailing bank.

Scenario analysis suggests bank resilience

Distribution of banks' assets by CET1 capital ratio
percentages





Source: ECB calculations.

Distribution of interest rate risk: Banks, households, corporates

- Two measures of interest rate risk
  - *net worth sensitivity* (present value of assets minus liabilities)
  - *income sensitivity* (assets minus liabilities with a duration < one year)

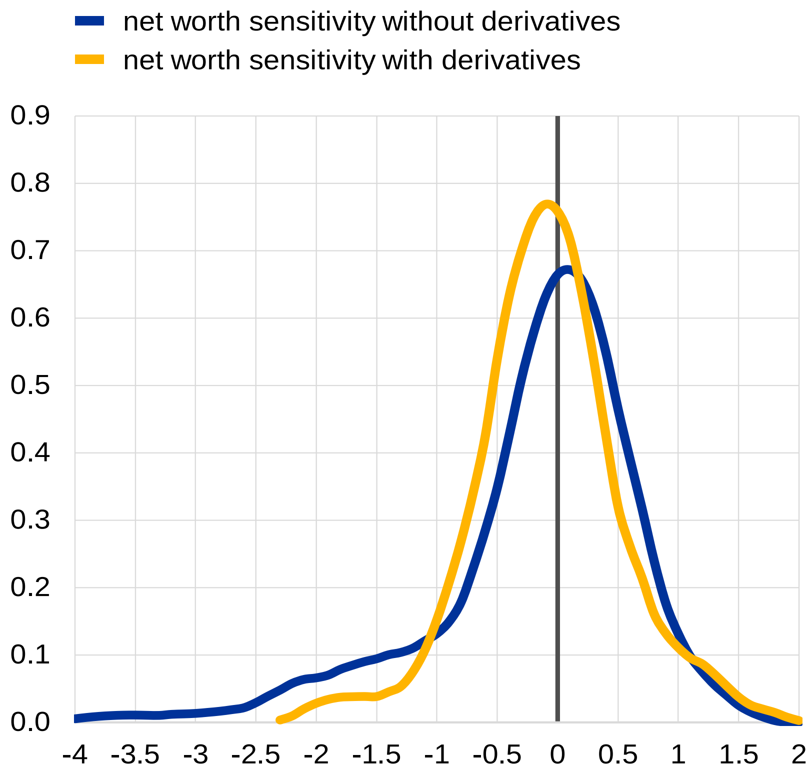
- Calculate *net* banking book exposures
  - On balance sheet using supervisory data
    - *Loans and securities held on the asset side, deposits and securities issued on the liability side.*
    - *Balance sheet items in 14 maturity buckets, on balance sheet duration of each instrument class.*
      - *For fixed-rate instruments, residual maturity. For variable-rate instruments, next repricing date. Use stress test data to model sight deposits.*
    - 104 significant EA banks with total assets of €21.3 trn = 97% of EA significant bank assets
  - Off balance sheet using trade repository data
    - *Transaction-level on banks' outstanding interest rate swaps*
    - *For each contract, identity of the counterparties involved, the residual maturity of the contract, the underlying benchmark rate, and the fixed rate agreed upon at trade execution.*
    - Gross notional value of close to €32.5 trn = 40% of global market for EUR-denominated IRS contracts)

- Also look at interest rate risk for households and non-financial corporates

Mutual risk-sharing in the interest rate swap market

Sensitivity of banks' net worth to higher interest rates

Q4 2015; x-axis: basis points; y-axis: probability density

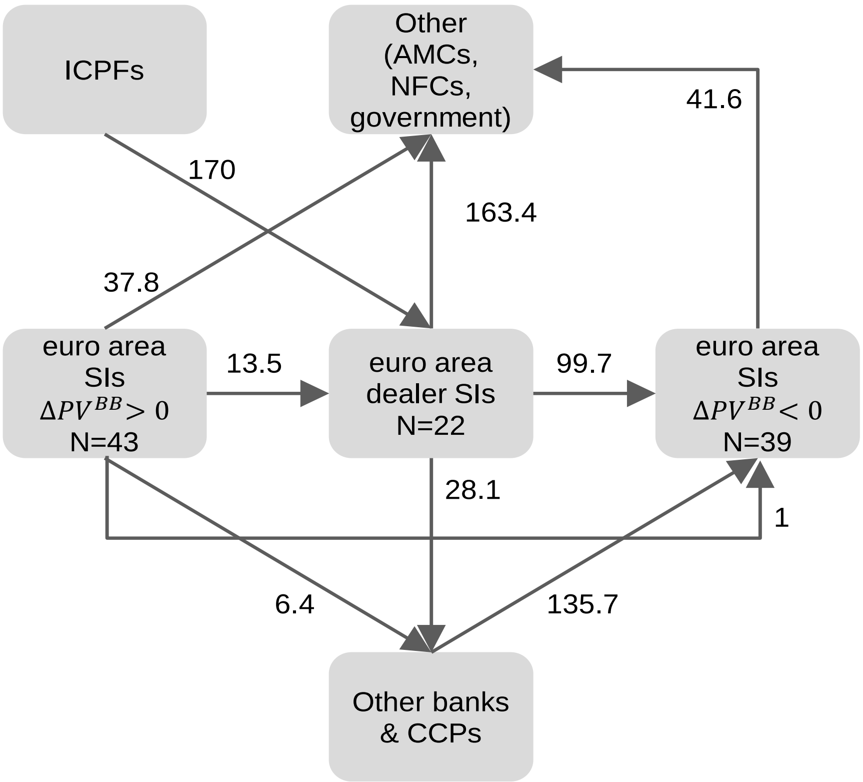


Source: Hoffmann, Langfield, Pierobon and Vuillemey (forthcoming).

Notes: this figure plots a kernel density estimate (with optimal bandwidth) of the cross-sectional distribution of banks' net worth sensitivity before and after accounting for positions in interest rate swaps. The sample comprises 104 euro area significant institutions

Value transfers across sectors following a one basis point increase in interest rates

€ millions

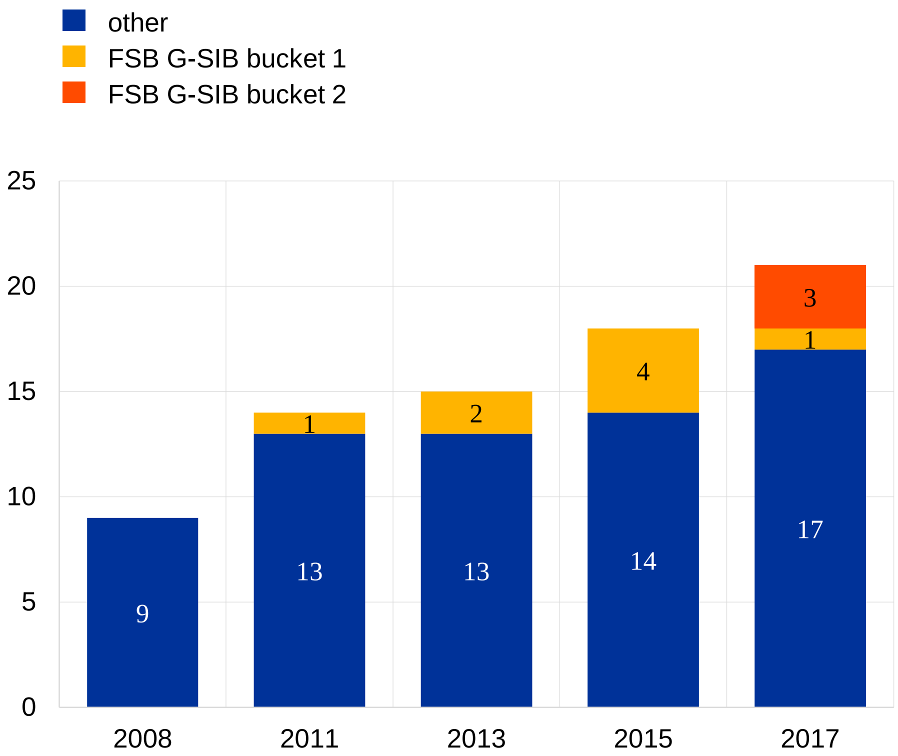


Source: Hoffmann, Langfield, Pierobon and Vuillemey (forthcoming).

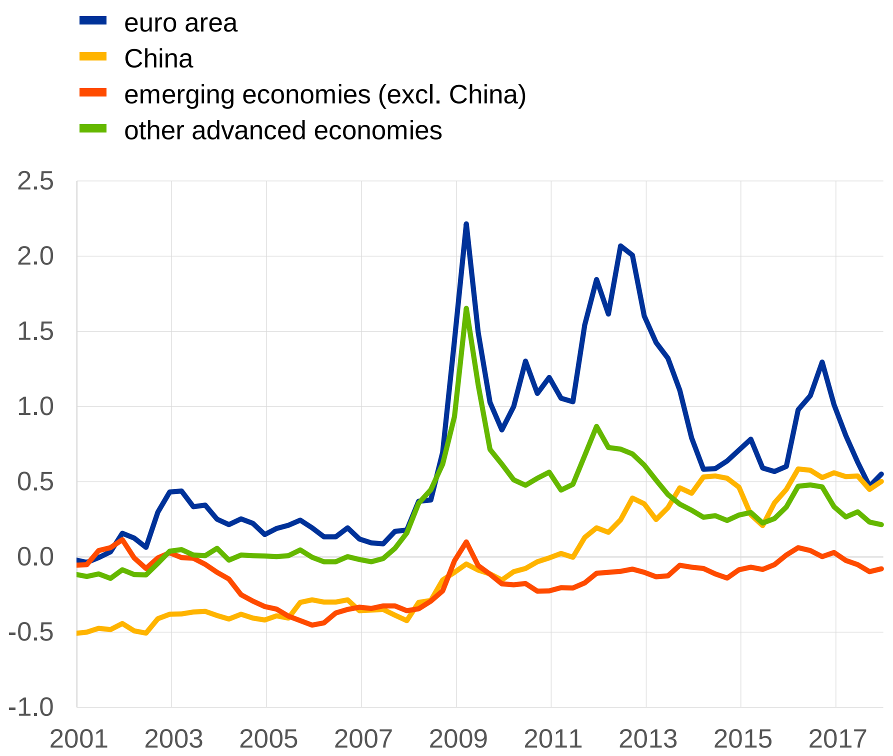
Notes: this figure plots the value transfers across sectors based on outstanding euro-denominated interest rate swap contracts as at the end of 2015. The 104 euro area significant institutions (SIs) are split into three groups: 22 dealer SIs, 43 SIs with a positive on-balance sheet exposure, and 39 SIs with a negative on-balance sheet exposure..

Growing systemic importance of Chinese banks

Number of Chinese banks among the worlds' 100 largest banks based on total assets
2008-17, number



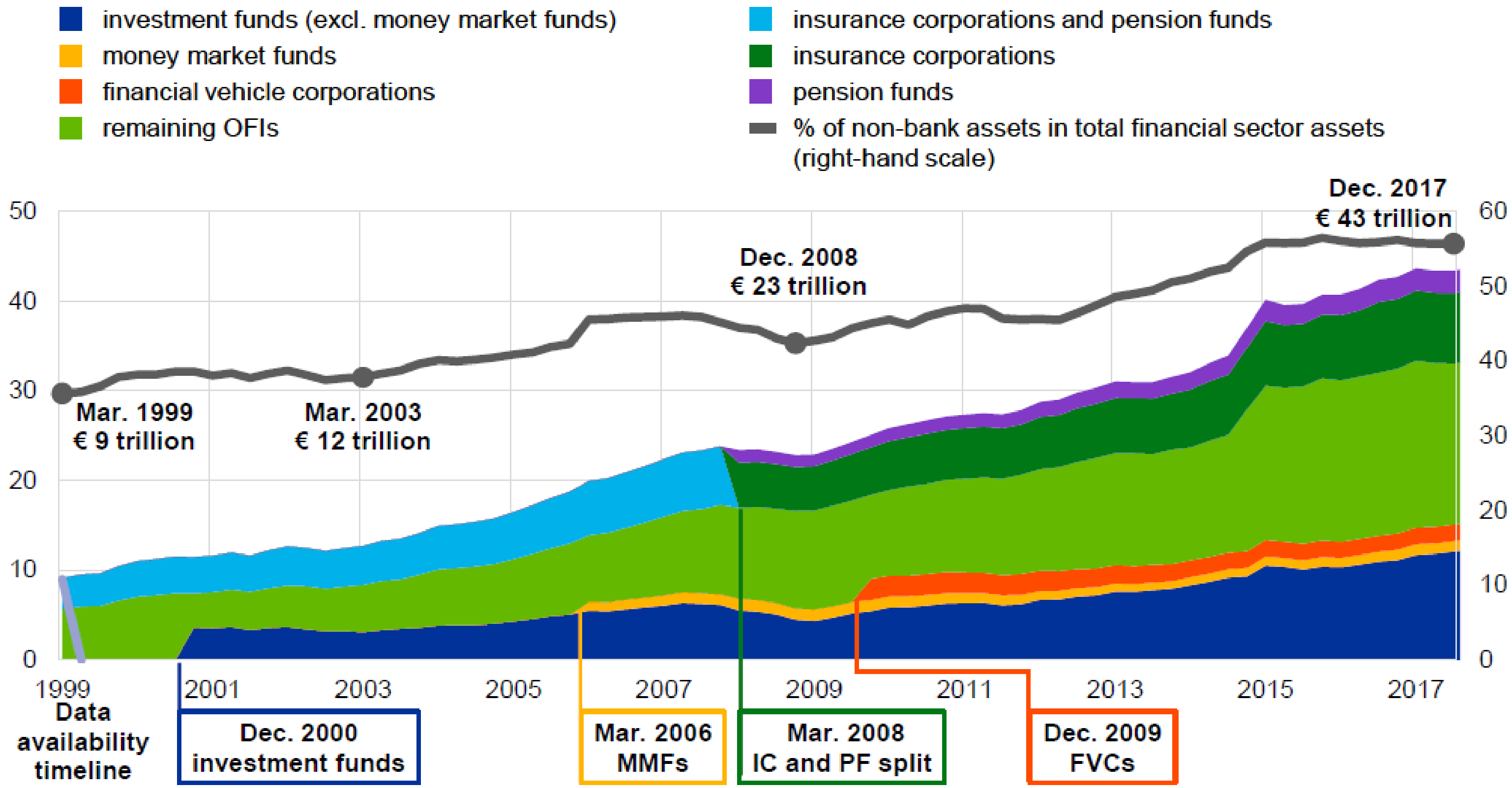
SRISK as a share of global stock market capitalisation
Q1 2001 – Q4 2017, percentages



Sources: FSB, SNL Financial, New York Stern V-Lab and ECB calculations. Notes: The FSB's G-SIB list was introduced in 2011. G-SIBs are allocated to five buckets based on their systemic footprint as measured according to BCBS methodology. SRISK quantifies the capital shortfall conditional on a severe and prolonged stock market decline. A positive (negative) value of SRISK suggests an expected capital shortfall (surplus) of the underlying banks in the case of a systemic event. For further details on the computation of SRISK, see Brownlees, C. and Engle, R., "SRISK: A Conditional Capital Shortfall Measure of Systemic Risk", The Review of Financial Studies, Vol. 30, January 2017, pp. 48-79. Other advanced economies cover Australia, Canada, Norway, Japan, Denmark, Sweden, Switzerland, the United Kingdom and the United States.

Continued expansion of the euro area nonbank sector

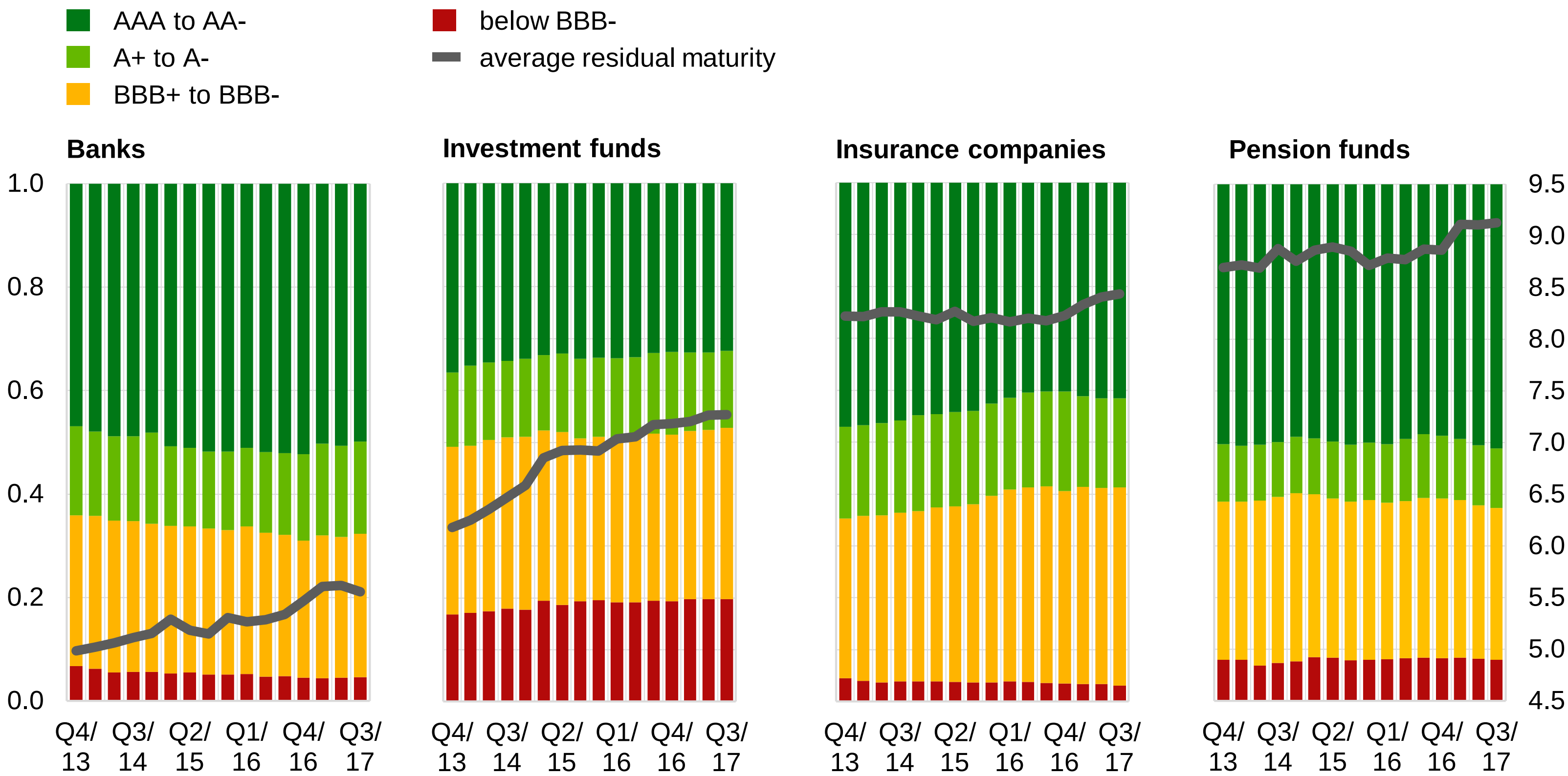
Assets of the non-bank financial sector
(Q1 1999 – Q4 2017, € trillions, percentage of total assets of the financial sector)



Sources: ECB (euro area accounts and balance sheet data of individual sectors) and ECB calculations. Notes: A breakdown of data for investment funds, money market funds, financial vehicle corporations, and insurance corporations and pension funds is available only from the indicated dates onwards. Remaining OFIs (sometimes also referred to as the “OFI residual”) refer to non-monetary financial corporations excluding the sectors depicted in the chart (where data for these sectors are available).

Lower rated securities concentrated in investment fund sector

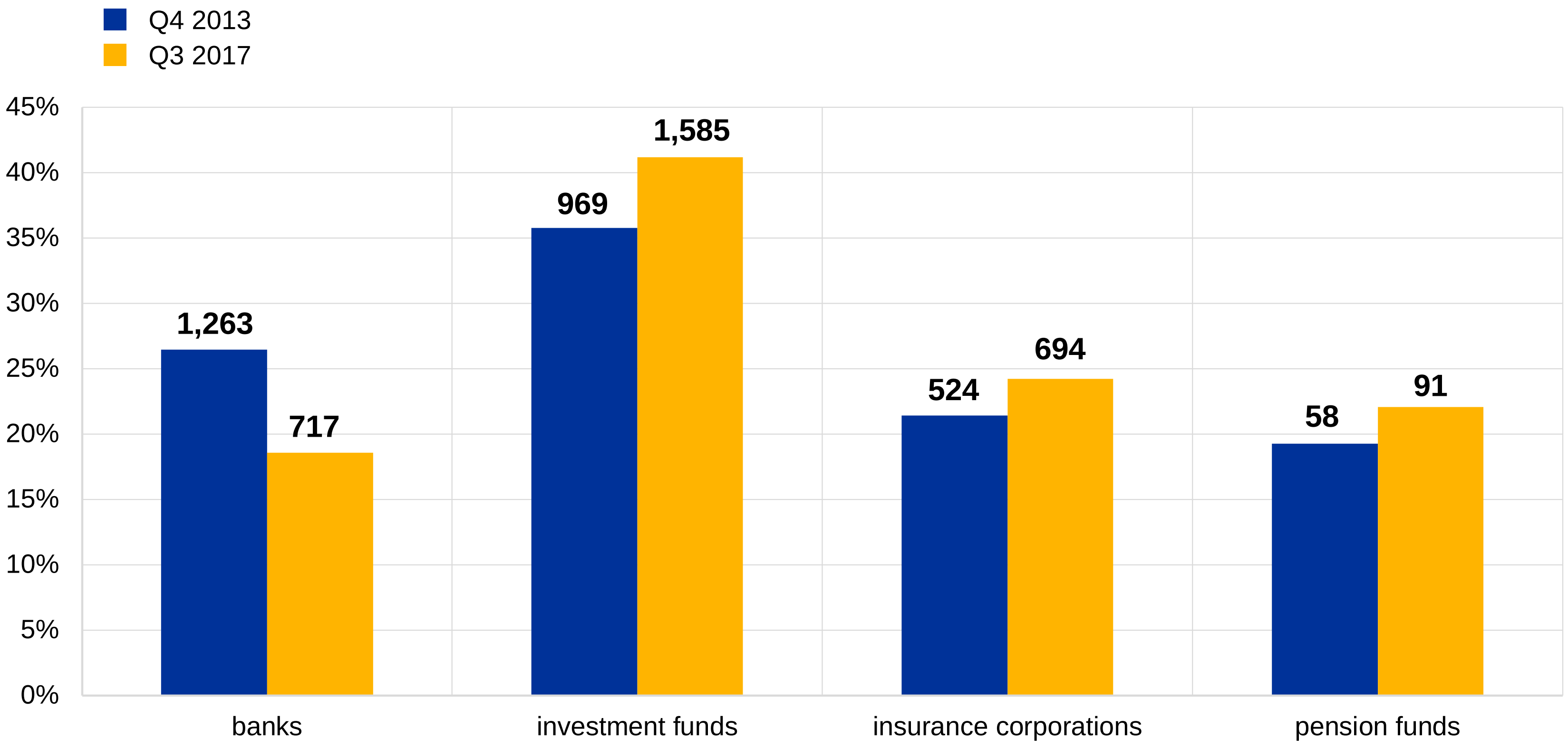
Euro area financial institutions' holdings of debt securities, broken down by rating and sector(Q4 2013 – Q3 2017; percentage points of total assets and average residual maturity in years)



Sources: ECB Securities Holdings Statistics by Sector and ECB calculations. Notes: The first three rating categories correspond to credit quality steps defined in accordance with the Eurosystem credit assessment framework (ECAF). A fourth category is added which includes all rated securities with a rating below credit quality step three (i.e. below BBB-). The analysis is based on the nominal amounts of euro- and foreign currency-denominated securities, including "alive" and "non-alive" securities. The investment fund sector excludes money market funds. Long- and short-term, euro- and foreign currency-denominated debt securities are included in the computation of residual maturity only if they have an ISIN reported, are considered "alive" and have a residual maturity of up to 30 years. Banks hold a particularly large share of securities with a reported maturity exceeding 30 years for which precise information is less reliable (e.g. for securities without a definite date of maturity) and which are therefore excluded. In order to estimate the average, residual maturities are weighted by the nominal amount held of each security by each sector over the total debt holdings of each sector.

Exposure to risky bonds increasing outside banks

Share of lower-rated financial and non-financial corporates in financial sectors' bond portfolios
percentages of total bond portfolio, EUR billions

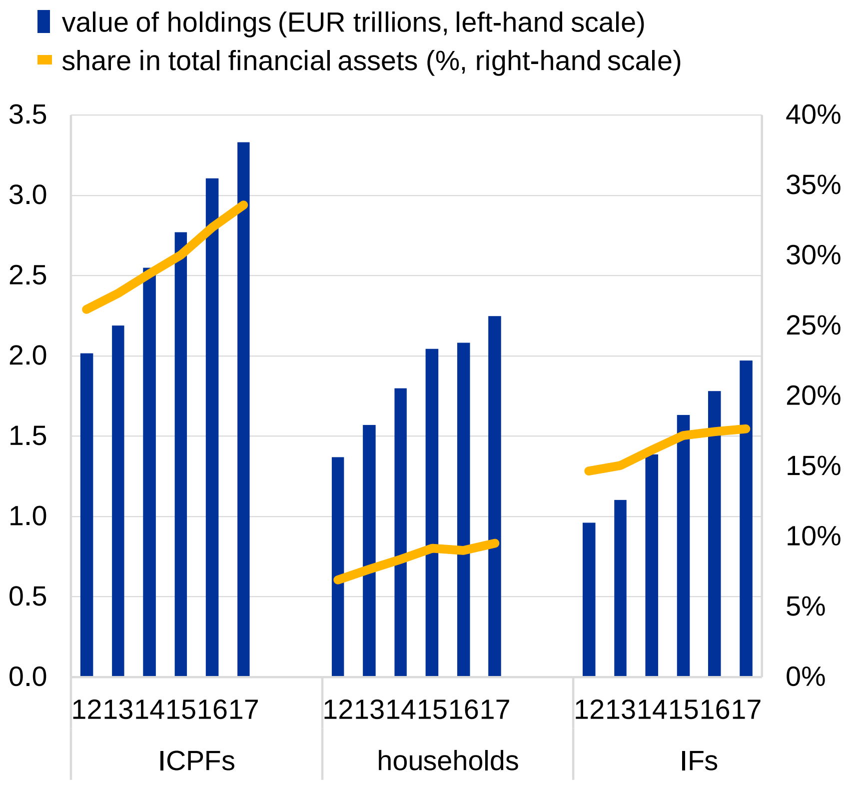


Sources: ECB Securities Holding Statistics (SHS) and ECB calculations.

Notes: Corporate bonds issued globally by both financial and non-financial companies. Lower-rated bonds are BB- and below. The figures above the columns show the market value of lower-rated bond holdings.

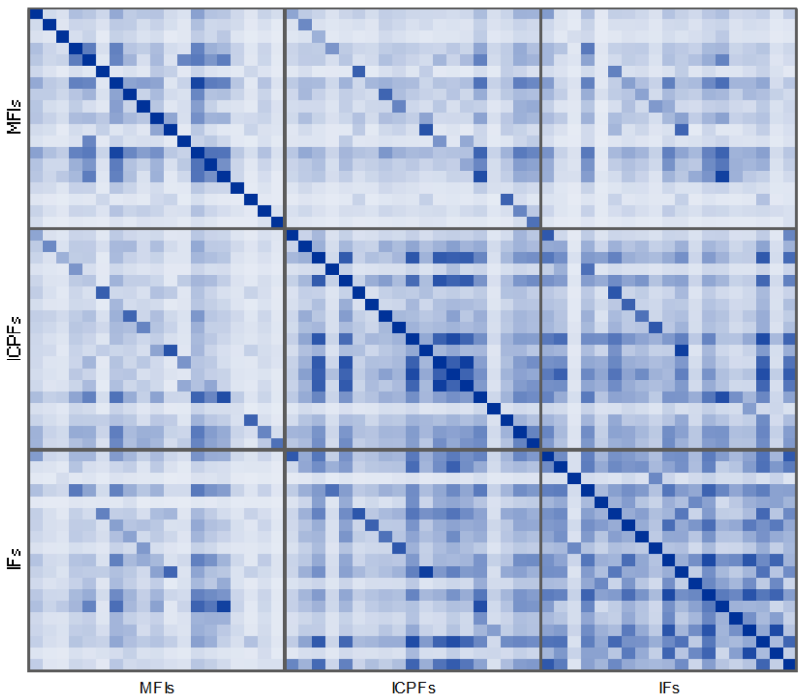
High interconnectedness of nonbanks: Exposures and portfolios

Holdings of investment fund shares by euro area sectors
(Q4 2012 – Q4 2017, € trillions



Sources: ECB euro area accounts and ECB calculations.

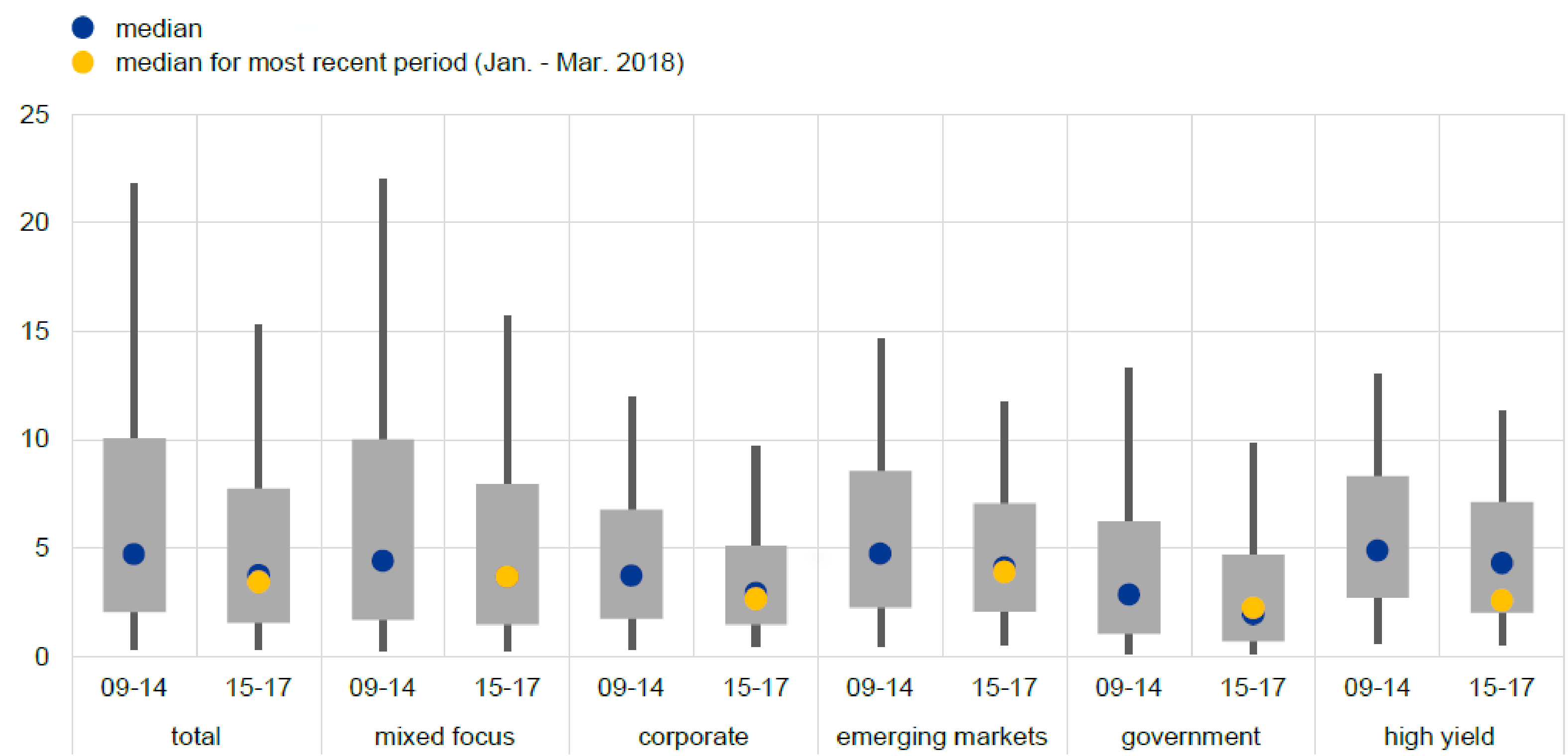
Similarity of portfolios
(white colour = no similarity, dark blue colour = identical portfolios; Q3 2017)



Notes: Based on the cosine similarity indicator, which measures the level of commonality between pairs of portfolios (see Getmansky, M., Girardi, G., Hanley, K.W., Nikolova, S. and Pelizzon, L., 2016, “Portfolio similarity and asset liquidation in the insurance industry”, working paper). The indicator equals zero (white colour) if the portfolio allocations of two country-sectors are uncorrelated and equals one (dark blue colour) if they are the same. Colours within this range quantify the degree of similarity. Assets belong to the same group if they are issued in the same country/region, by the same sector and are of the same instrument type. The chart is symmetric. Euro area countries (not shown) are ordered alphabetically.

Bond funds’ liquidity buffers remain low

Cash holdings for bond funds domiciled in the euro area
(percentage of total assets, median and interquartile range)



Sources: Lipper IM and ECB calculations.

Notes: The sample of the first period (2009-14) consists of end-of-year fund-level holdings from December 2009 to December 2014. The second period (2015-17) contains the end-of-year holdings for December 2015 to December 2017. The median for the most recent period (Jan.-Mar. 2018) is shown as a yellow dot. The boxplots show the 10th, 25th, 50th, 75th and 90th percentiles of the distributions.

A A new Financial Stability Risk Index (FSRI) to predict near term risks of recessions

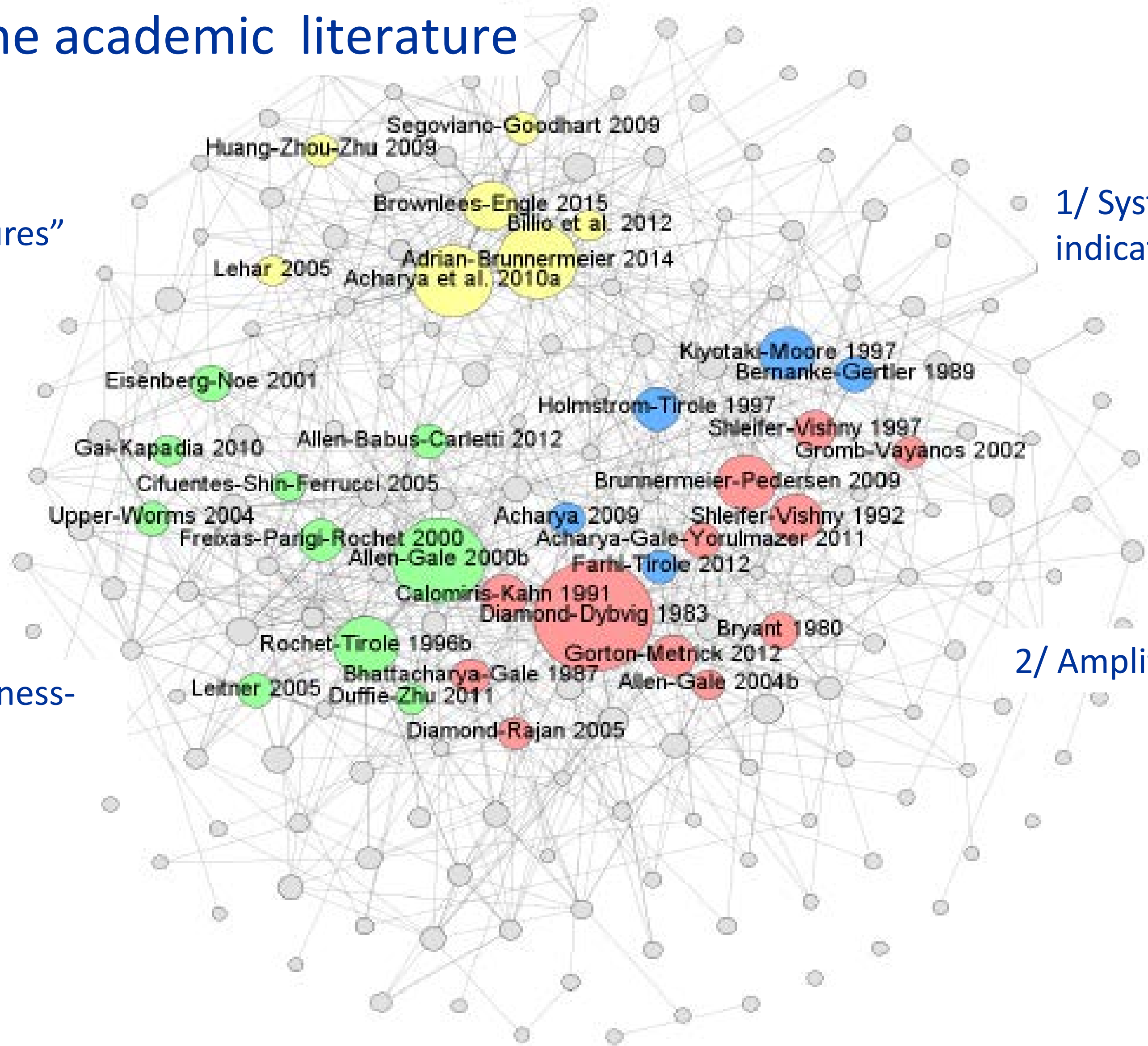
B Predicting the likelihood and severity of financial crises over the medium term with a Cyclical Systemic Risk Indicator (CSRI)

C The distribution of interest rate risk in the euro area

`Mapping the academic literature

4/ "Global measures"

1/ Systemic risk indicators

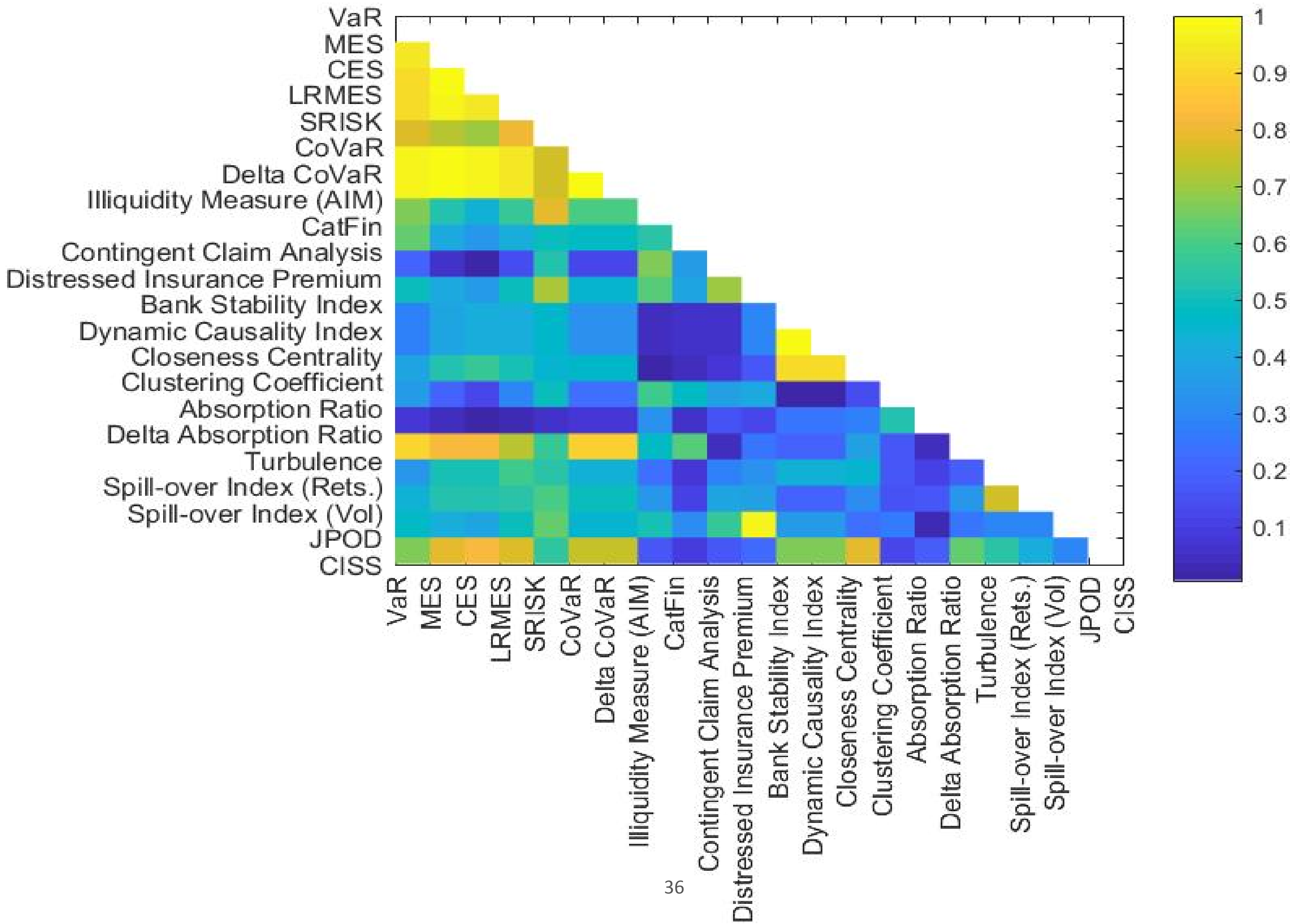


2/ Amplification

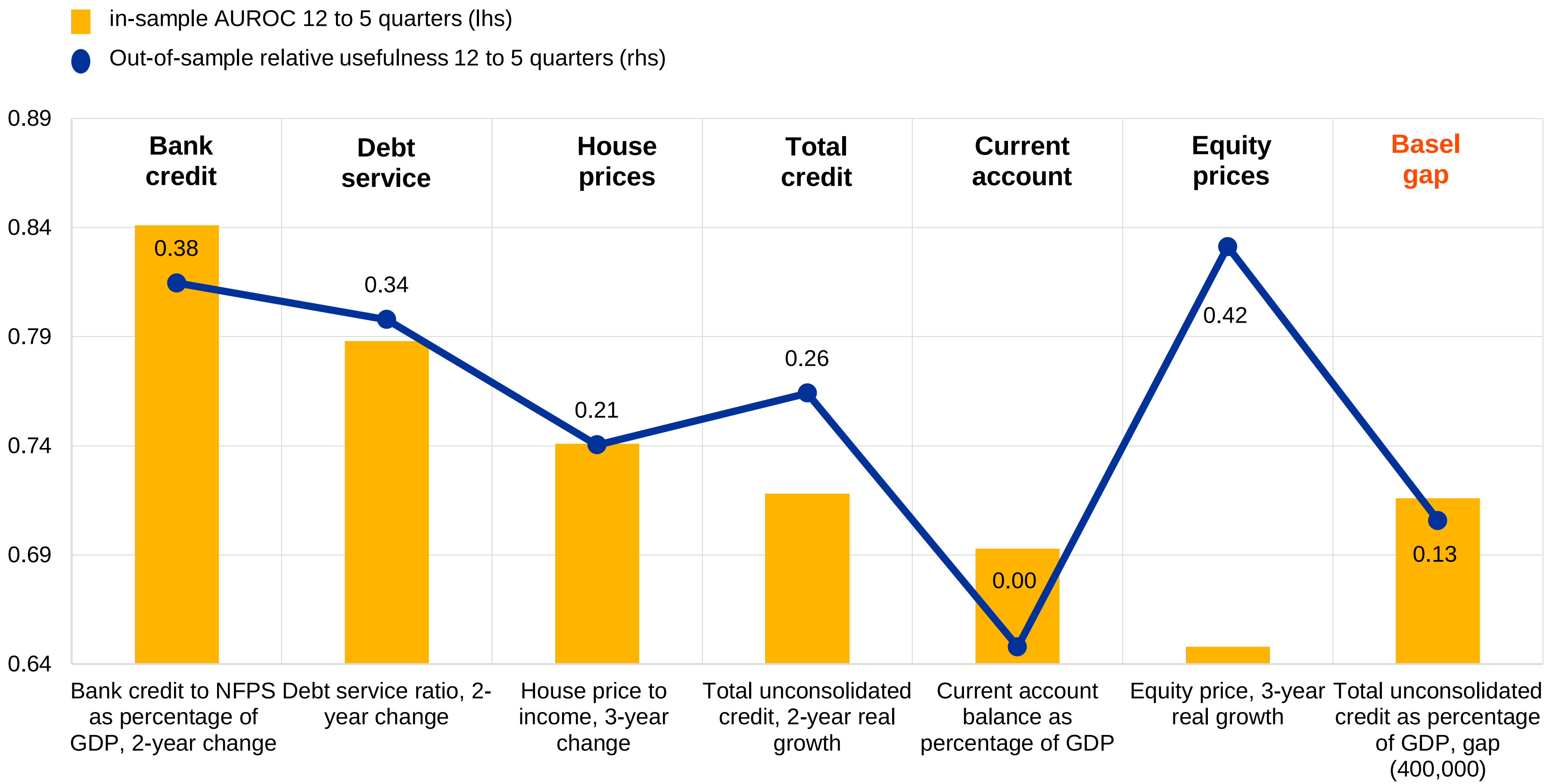
3/ Interconnectedness-contagion

Source: Benoit et al (2017), "Where the Risks Lie: A Survey on Systemic Risk", Review of Finance, 21 (1), March.

Taking stock of a myriad of systemic risk indicators: *Correlations*

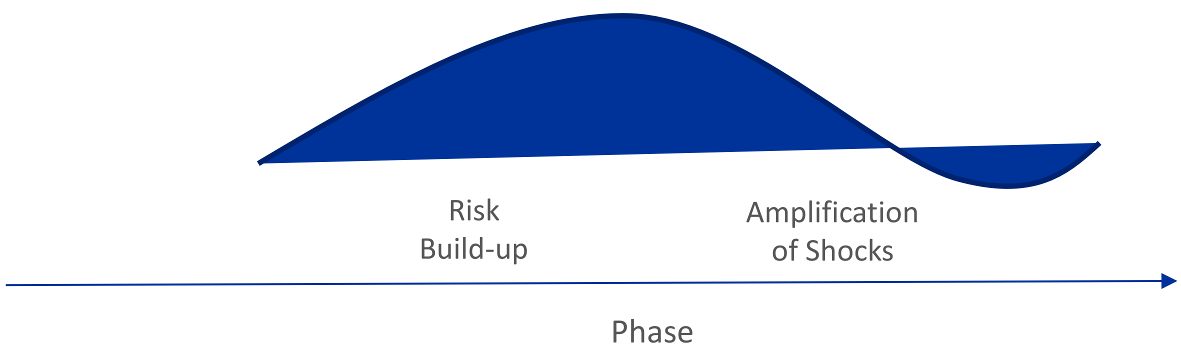


Limitations of the "Basel gap": *Early warning performance*



Where the time series and cross sectional dimensions intersect …

Phase	Type of systemic risks	Measurement focus	Dimension	Examples of vulnerabilities/ externalities	Modelling approach
Risk build-up	Cyclical risks	Probability of default	Time	Asset price misalignment, excessive leverage, maturity mismatch	Time series models, early warning models, market-based indicators
Amplification of shocks	Contagion and spillovers	Loss given default	Cross-sectional, cross-border	Interconnected-ness, commonalities in exposures	Networks, spillover models, conditional loss probabilities, structural



Source: ECB Financial Stability Review (2018), May

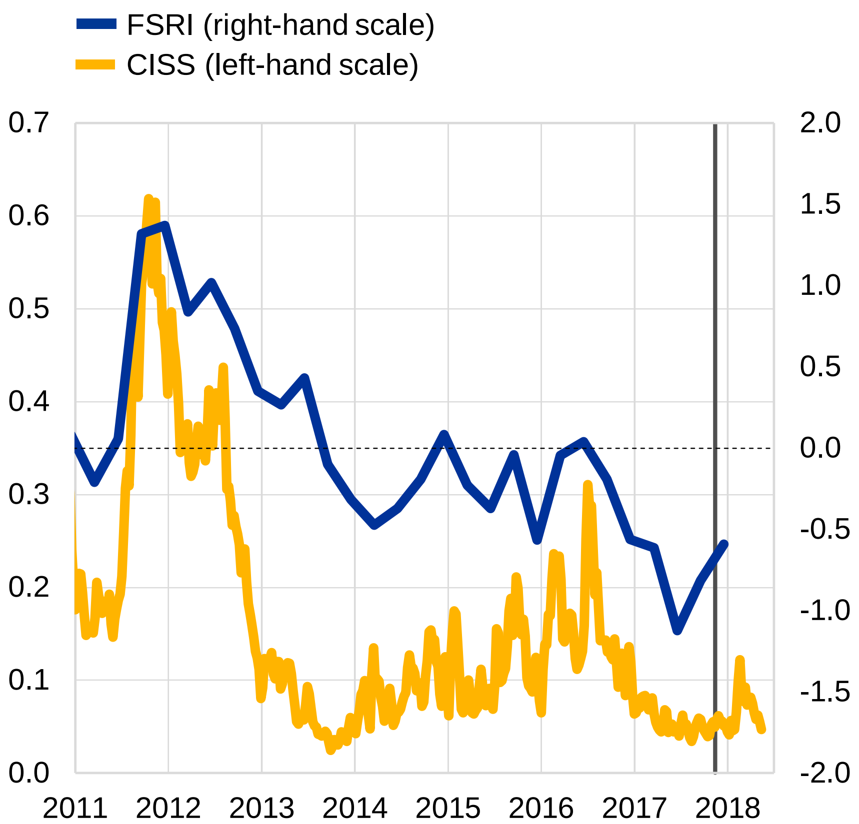
… complementary measures for the term structure of systemic risk

	Financial Stability Risk Index (FSRI)	Cyclical Systemic Risk Indicator (CSRI)
Predictive Horizon	near term (<1Y)	medium-term (>1Y)
Indicators	valuation pressure and risk appetite, non financial imbalances, financial vulnerabilities, spillovers and contagion indicators	bank credit; debt service; house prices; total credit; current account; equity prices
Aggregation Focus	euro area aggregate	country-level
Time Period	from 2000	from 1970
Method	partial quantile regression	weighted average of 6 best-performing univariate early warning indicators

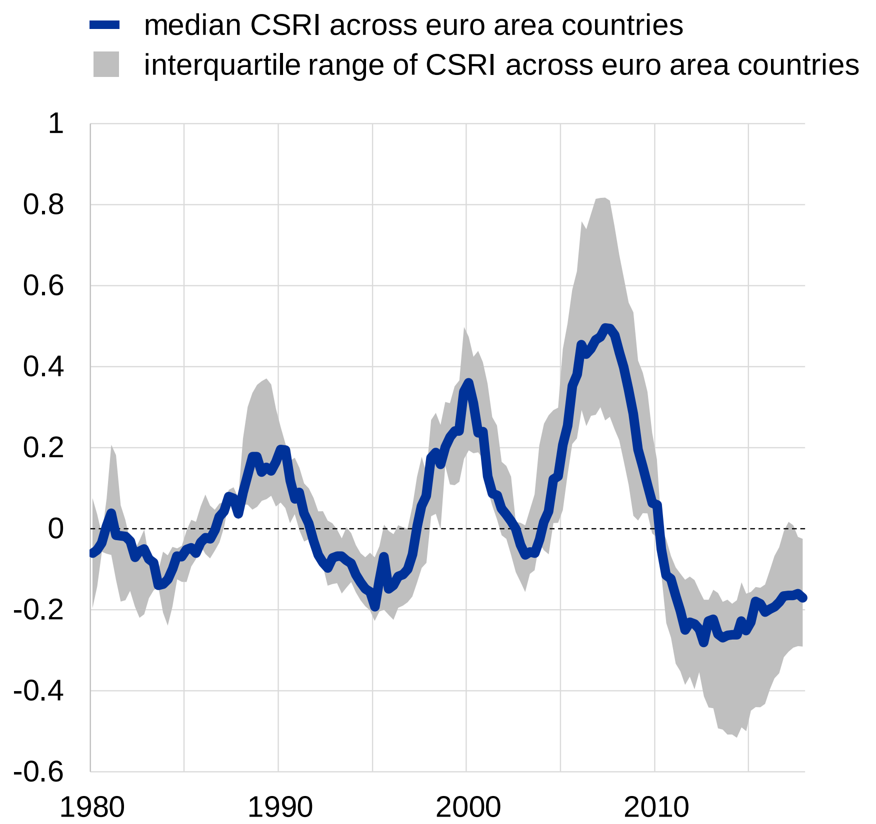
Source: ECB Financial Stability Review (2018), May

Systemic risk contained for both near- and medium-term

Near term financial stability risk index and current stress
Jan. 2011 – May 2018; Q1 2011 – Q4 2017



Cyclical systemic risk buildup for euro area countries
Q1 1980 – Q4 2017, median and interquartile range



Sources: Bloomberg, ECB, Eurostat and ECB calculations.

Positive factors

a growing economy

contained credit growth

banks more resilient

Challenges

continued intense risk taking in financial markets

price overvaluation in certain bond and real estate markets

Looking ahead to the next two years, risks remain:

- sharp falls in global asset prices
- weak bank profitability jeopardising the supply of credit
- concerns over public and private indebtedness
- liquidity risks in the investment fund sector

EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB Financial Stability Review:
Key takeaways

Paul Hiebert
Head, Systemic Risk and Financial Institutions Division
Directorate General Macroprudential Policy and Financial Stability

ERCI Workshop on Financial Stability hosted by ADB
Manila
4 June 2018

Policy considerations

- Cyclical systemic risks
- Property markets
- Banks
- Asset management sector
- Highly indebted sovereigns and corporates

Regulatory issues

Bank regulation

A full and timely **implementation of the Basel III package** across all jurisdictions is key to financial stability. Continued international cooperation also in the implementation phase is crucial.

The ongoing **review of the CRR and CRD IV** should be used to strengthen and harmonise the European regulatory architecture.

An ambitious set of targeted changes in the **EU macroprudential framework** should also be introduced in the context of the CRR/CRD IV review.

Non-bank financial sector regulation

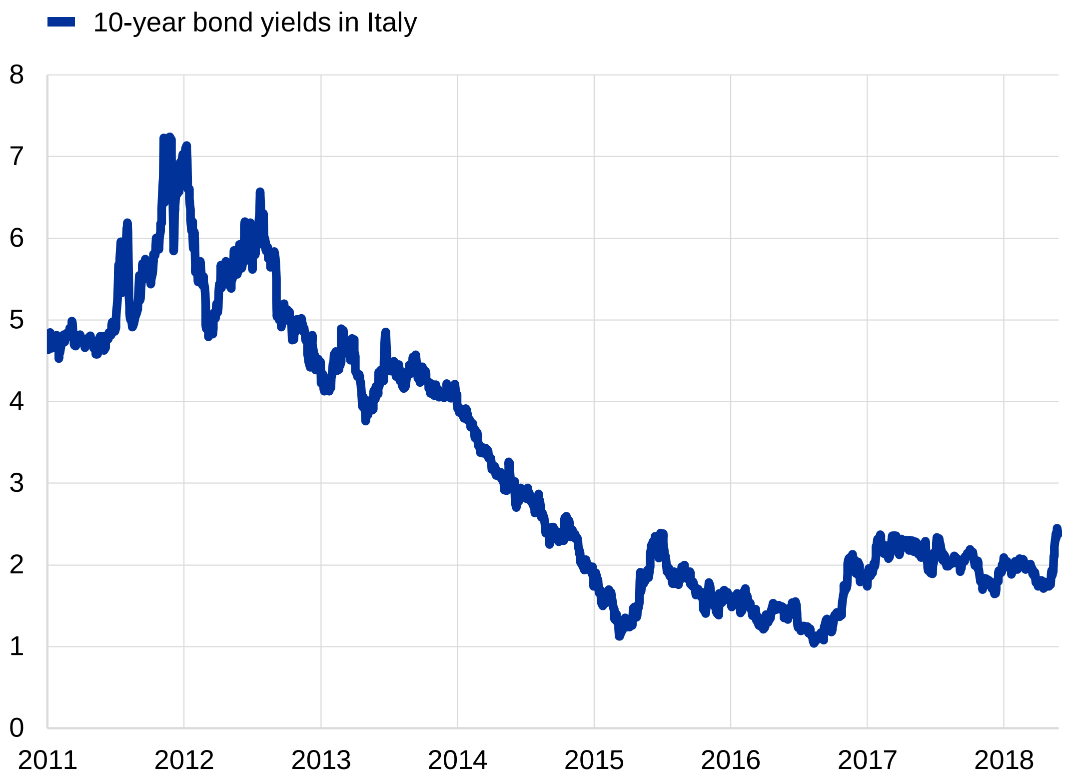
The **regulatory and supervisory framework for non-banks** needs to be strengthened, including by adding macroprudential instruments on leverage and liquidity for investment funds.

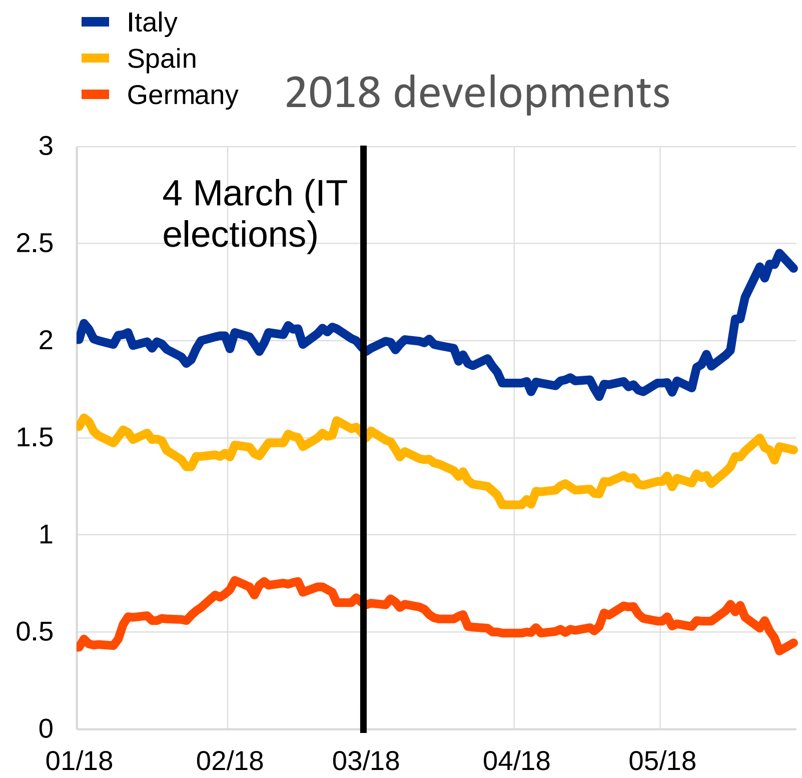
The European Commission's decision to foster innovation and more coordinated approaches to standards for **fintech** is welcome.

Recent developments

- Significant repricing in the Italian bond markets amid higher political uncertainty
- Limited contagion to other jurisdictions so far

10-year bond yields in selected euro area countries
Jan. 2017 – May 2018; annual percentage points





Source: Bloomberg and ECB calculations