ESRB
European Systemic Risk Board
European System of Financial Supervision

Press release

24 September 2021

The General Board of the European Systemic Risk Board held its 43rd regular meeting on 23 September 2021

At its meeting on 23 September 2021, the General Board of the European Systemic Risk Board (ESRB) assessed the key systemic risks in the European Union (EU), as well as public policy priorities to address them. The General Board highlighted that the improved economic outlook had reduced the probability of severe scenarios and the risk of the coronavirus (COVID-19) crisis causing severe instability in the financial system. It took note that in a few EU countries the countercyclical capital buffer and other measures were being activated to mitigate cyclical and real estate risks to financial stability. Furthermore, the results of the EU-wide stress tests by the European Banking Authority and ECB Banking Supervision suggest that the banking sector is, overall, resilient to adverse economic developments. Against this background, and in line with its previous communication, the General Board decided that the ESRB Recommendation on the restriction of distributions during the COVID-19 pandemic should lapse at the end of September 2021. At the same time, the General Board highlighted that this decision reconfirmed the need for financial institutions to remain prudent when deciding on distributions.

Systemic risks to financial stability in the EU somewhat receded but remain elevated. The General Board noted that the improved economic outlook had reduced the risk of widespread defaults in the non-financial private sector, which were now expected to be concentrated in certain sectors and countries. Therefore, the General Board decided to downgrade the level of this risk from “severe” to “elevated”. However, it noted that that there was still significant uncertainty surrounding the recovery due to new virus mutations and the slowdown in vaccinations. Moreover, it emphasised that the recovery continued to rely on public support measures. In line with the decline in the risk of widespread insolvencies, the General Board concluded that the risk of spillovers from the non-financial private sector to the financial system had also decreased. Nonetheless, the General Board was of the view that the COVID-19 crisis continued to exacerbate the challenges for profitability and solvency positions in the banking, insurance and pensions sectors in the low interest rate environment. Better-than-expected financial results in 2021 were largely driven by shrinking credit provisions and higher trading income, but the expected deterioration in asset quality was weighing on the profitability outlook for banks. Most notably, while the non-performing loan ratio for EU banks had declined further in the first half of 2021, inflows into IFRS stage 2 and 3 assets and the share of forborne loans in total loans continued to rise, suggesting that credit risk may increasingly be materialising.

The General Board took note that the risk of future abrupt asset price corrections had further increased since its last meeting in June 2021. It noted that the marked divergence between asset price levels and economic fundamentals in some financial market segments, amid indications of increased leverage in non-bank intermediaries, could give rise to abrupt price corrections and illiquidity. The pronounced and sustained rise in stock prices had led to stretched valuations, albeit more so in the United States than in the EU. The General Board also noted that systemic risks could stem from spillovers to Europe from rising long-term bond yields in the United States, which could also spill over to other asset classes, including corporate bonds and equity prices, lead to a tightening in financing conditions and weigh on economic activity. In addition, the General Board exchanged views on policy options to address risks in money market funds and central counterparties. Furthermore, it noted that vulnerabilities in the residential real estate had increased, as house prices and mortgage lending were adding to the existing valuation stretch.

Finally, the General Board welcomed the two recent reports on the macroprudential policy stance. The General Board noted that operationalising the macroprudential policy stance framework would support policymakers in assessing how appropriate the macroprudential policy instruments are for addressing systemic risk. In the longer run, this would also foster communication of policy decisions to the general public and increase accountability. The reports, which are due to be published over the coming months, provide examples of how to assess the macroprudential policy stance. A testing phase will help refine the specific methods and approaches.

The ESRB is releasing today the **37th issue of its risk dashboard**. The risk dashboard is a set of quantitative and qualitative indicators of systemic risk in the EU financial system.

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