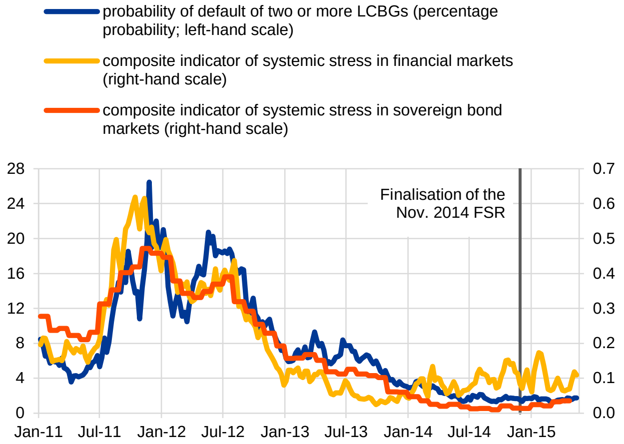
Overview

Chart 1

Low levels of euro area financial market, sovereign and bank stress

Composite indicators of systemic stress in financial markets and sovereign bond markets, and the probability of default of two or more banking groups

(Jan. 2011 – May 2015)



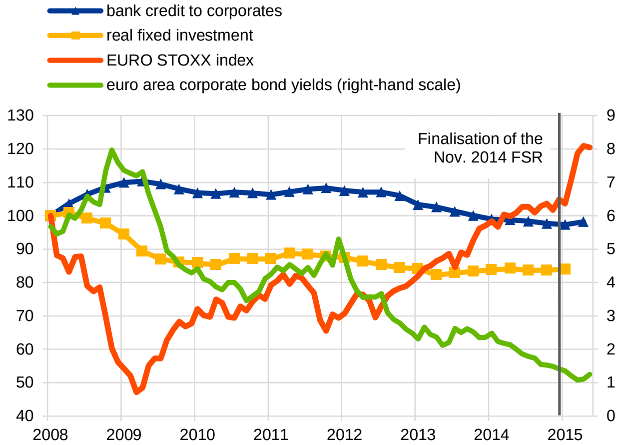
Sources: Bloomberg and ECB calculations.
Notes: "Probability of default of two or more LCBGs" refers to the probability of simultaneous defaults in the sample of 15 large and complex banking groups (LCBGs) over a one-year horizon.

Chart 2

High financial risk-taking, sovereign yields near zero and subdued credit growth coupled with low economic risk-taking

Euro area sovereign and corporate bond yields, real fixed investment and bank lending to non-financial corporations

(Jan. 2008 – Apr. 2015, index: Jan. 2008 = 100, percentages per annum)



Sources: Thomson Reuters Datastream and ECB.
Note: The iBoxx euro corporate bond all maturity index is employed.

Euro area financial system stress has remained low over the past six months, despite a certain increase in global financial market volatility. Broad-based indicators of financial market and banking system risk have generally fluctuated at low levels and stood in mid-May around the marks observed before the outbreak of the sovereign debt crisis (see Chart 1). The low overall level of financial system stress in the euro area reflected an improving real economic outlook supported by ECB action allaying deflation fears that threatened to be harmful to both price and financial stability. Notwithstanding the generally positive financial market sentiment, intermittent bouts of market tension have continued to afflict global financial markets – spanning foreign exchange, commodities and, most recently, bonds. The recurrent incidence and amplitude of such bouts of market tension have suggested a tendency for pronounced sharp asset price sensitivity to investor sentiment.

Euro area financial and economic indicators continue to signal a stark dichotomy in risk-taking (see Chart 2). The prices of financial assets in most segments have continued to rise, not only in the euro area, but also in most advanced economies. The sharp increases in asset prices relative to the fundamentals have pushed valuations up, particularly in the fixed income market, but increasingly also in markets for other financial assets. Nonetheless, a broad-based stretch in euro area asset valuations is not evident. Moreover, the recent increases in asset prices have been accompanied neither by growing leverage in the banking sector nor by rapid private sector credit expansion.

In sharp contrast to the rise in financial risk-taking, economic risk-taking in the euro area is clearly lagging. This is vividly illustrated by the contrast between appreciating financial asset prices and a low level of real investment, which still remains below that of 2008, after a much more marked fall than those seen after previous recessions. Indeed, the prospect of an environment of low nominal growth remains the major factor underlying current challenges for financial stability in the euro area. While monetary policy can support the conditions for economic growth, other macroeconomic policies – such as structural reforms – are needed to underpin sustainable economic growth of the euro area.

Financial system vulnerabilities continue to stem not only from the financial markets, but also from financial institutions, spanning banks, insurers and – increasingly – the shadow banking sector. Following the successful completion of the comprehensive assessment exercise, recent financial disclosures suggest that euro area *banks'* capital positions have continued to improve, profitability has increased marginally and asset quality deterioration has slowed down. Still, profitability remains weak and the return on equity (ROE) continues to remain below the cost of capital for many banks. Looking ahead, a further reduction of problem assets is needed as high non-performing loans dampen banks' potential lending capacity and, by extension, their ability to build up capital buffers. Despite the solid profitability reported so far, euro area *insurers* are facing growing challenges as the low-yield environment has tested their traditional reliance on fixed income assets as a means of generating portfolio returns. Last but not least, the *shadow banking* sector continues to grow robustly – and is in many ways changing into an important provider of funds to the real economy. As this process has accelerated, the systemic importance of this sector has increased concomitantly. Taken together, the rapid growth of this less regulated sector, the large systemic footprints of a number of entities, a more widespread use of synthetic leverage and the increasing prevalence of demandable equity imply that the potential for systemic impacts is increasing.

Table 1

Key risks to euro area financial stability

pronounced systemic risk medium-level systemic risk potential systemic risk		Current level (colour) and recent change (arrow)*
1.	Abrupt reversal of compressed global risk premia amplified by low secondary market liquidity	⇨
2.	Weak profitability prospects for banks and insurers in a low nominal growth environment, amid slow progress in resolving problem assets	⇨
3.	Rise of debt sustainability concerns in the sovereign and corporate sectors amid low nominal growth	⇨
4.	Prospective stress and contagion effects in a rapidly growing shadow banking sector	⇧

* The colour indicates the cumulated level of risk, which is a combination of the probability of materialisation and an estimate of the likely systemic impact of the identified risk over the next year and a half, based on the judgement of the ECB's staff. The arrows indicate whether the risk has increased since the previous FSR.

Financial stability concerns also stem from outside the realm of the financial sector. Despite much needed improvement in both fiscal settings and the institutional framework since the height of the euro area sovereign debt crisis, debt sustainability challenges remain for euro area sovereigns – especially for those that remain highly indebted and therefore vulnerable to economic and financial shocks. On the side of the non-financial private sector, indebtedness of the euro area corporate sector continues to remain elevated, in contrast to household indebtedness which has fallen slightly and remains low compared with many advanced economy peers.

In this environment, four risks emerge as key for euro area financial stability over the next year and a half (see Table 1). While each risk is tied to a specific scenario, the risks are all clearly intertwined and would, if they were to materialise, have the potential to be mutually reinforcing. Each risk is tackled in turn below.

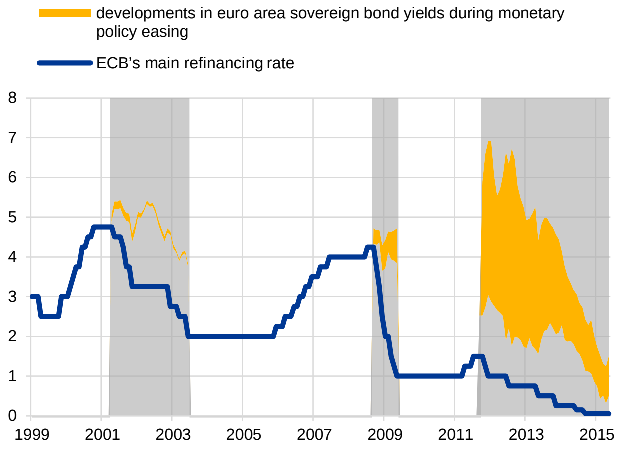
Risk 1: Abrupt reversal of compressed global risk premia amplified by low secondary market liquidity

Chart 3

Marked fall in bond yields during the recent phase of monetary easing

ECB's main refinancing rate and the developments in sovereign bond yields for euro area countries

(Jan. 1999 – Apr. 2015; percentages; yellow area represents the 25th-75th percentile)



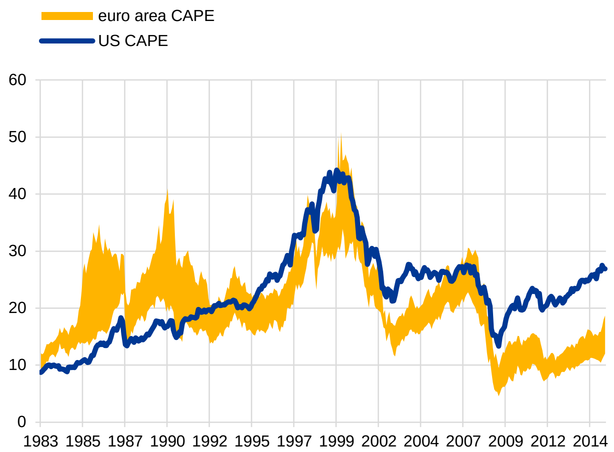
Sources: Thomson Reuters Datastream and ECB calculations.
Note: The grey areas refer to the periods from April 2001 to June 2003, from September 2008 to May 2009 and from October 2011 to April 2015.

Chart 4

Stock prices broadly in line with fundamentals in the euro area, valuations somewhat stretched for US stock prices

Cyclically adjusted price/earnings (CAPE) ratios for the euro area and the United States

(Jan. 1983 – May 2015; yellow area represents the 25th-75th percentile)



Sources: Thomson Reuters Datastream and Robert Shiller's homepage. (http://www.econ.yale.edu/~shiller/data.htm) and ECB calculations.
Notes: The cyclically adjusted price/earnings ratios for the euro area are imputed from Datastream's stock market indices. The US CAPE is taken from Robert Shiller's homepage.

Asset prices in the financial markets of most advanced economies have increased further as global risk-free rates remain low and risk premia have fallen further. In the euro area, sovereign bond yields across the entire maturity spectrum fell to historical lows and, in some cases, even entered into negative territory. Corporate bond markets have also benefited from the buoyant market sentiment. Fragmentation has eased, maturities have lengthened, yields have declined across most rating buckets and credit spreads have narrowed. However, while risk appetite among global investors has clearly increased, discrimination persists with respect to lower credit quality within the high-yield segment. Similarly, euro area stock prices have risen to multi-year highs amid strong portfolio inflows.

The expanded asset purchase programme launched by the ECB in March has helped to diminish risks to price stability. It has also brought benefits for financial stability in the form of higher nominal growth prospects, which are critical for lowering imbalances and reducing the likelihood of risks materialising in the financial system. Notwithstanding these benefits, unintended negative consequences require close monitoring, especially any possibility of financial risk-taking becoming excessive.

Monetary policy actions of the ECB, both conventional and unconventional, have clearly reduced stress and fragmentation in euro area sovereign bond markets throughout the last years (see Chart 3). In many Member States, long-term bond yields stood at historically low levels in mid-May, and intra-euro area spreads narrowed substantially, also resulting in very low term premia. Clearly, any implied deviation from long-term norms might very well prove to be transitory, so that it is important that investors have sufficient buffers and/or hedges to cope with any prospective normalisation of yields over the years ahead, either from global or from euro area-specific changes in financial risk sentiment.

Apart from the direct impact of ECB purchases on sovereign bonds, portfolio rebalancing effects extending to other asset classes have been visible as well. In particular, euro area stock prices have continued to increase rapidly. Standard valuation metrics suggest that deviations with respect to historical norms have been limited, remaining below the somewhat elevated stock market valuations prevailing in the United States (see Chart 4). In the field of tangible assets, the recovery of euro area residential and commercial property markets has continued and is becoming more broad-based across countries. Valuation metrics for the euro area as a whole suggest that residential property prices are broadly in line with fundamentals, but moved further away from their long-term average for prime commercial property given continued strong price increases.

Amid some signs of compressed risk premia, the risk of relatively low market liquidity becoming a potential amplifier of stress remains. Broad market liquidity measures for secondary fixed income markets indicate a deterioration of conditions. While bid-ask spreads have fallen considerably from their crisis peaks, turnover ratios show a steady decline across most market segments and the average deal size traded on the largest inter-dealer trading system for euro area government bonds has fallen sharply. Complementing these data-based signals, market intelligence also indicates reduced confidence among large banks with respect to their ability to make markets during periods of stress.

Two main triggers can be identified that could reverse the current favourable market conditions in the euro area. First, yields on longer-dated bonds remain vulnerable to an increase in global benchmarks for term premia, notably those in the United States. In particular, a faster than expected withdrawal of US monetary policy accommodation harbours some potential to translate into higher risk premia, even in the euro area. Second, global investor sentiment continues to remain sensitive to changes in the economic outlook, geopolitical tensions and emerging market risks, notably related to the BRIC countries (Brazil, Russia, India and China) that had operated as a key driver of global economic growth in the last few years.

Any possible emergence of country, sector and institution-specific challenges would call for the activation of macroprudential policies, as monetary policy retains a necessary focus on price stability.

Risk 2: Weak profitability prospects for banks and insurers in a low nominal growth environment, amid slow progress in resolving problem assets

Euro area banks continue to be challenged by relatively weak profitability. Although profitability improved somewhat, on average, in 2014, thanks to lower funding costs and a moderate decline in loan loss provisions, euro area banks continue to lag behind most US peers and European banks outside the euro area. Subdued profitability prevailing over the past few years has been driven by a confluence of factors, including bank-specific characteristics, banking sector structures and cyclical developments.

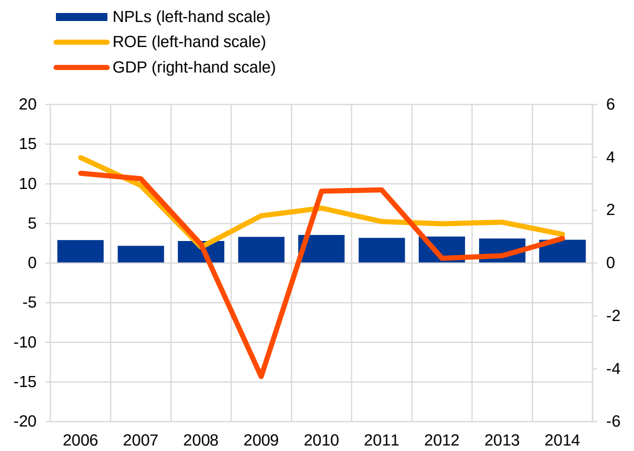
The profitability of euro area banks remains characterised by substantial cross-country heterogeneity. The sharp fall in output and demand in some more vulnerable euro area countries at the height of the sovereign debt crisis and the still fragile recovery continue to weigh on asset quality and dampen profitability – contrasting with the situation in other euro area countries (see Chart 5 and Chart 6). One striking difference between the two groups is the development of non-performing loans (NPLs). In more vulnerable countries, the stock of NPLs remained high during the crisis, and a clear cyclical turning point has not yet been reached. In other euro area countries, the share of NPLs in total loans is significantly lower, and has even declined slightly over the past two years.

Chart 5

Non-performing loans broadly stable in the majority of euro area countries…

Return on equity (ROE), non-performing loans (NPLs) and GDP growth in non-vulnerable countries

(2006-2014; annual percentage changes (GDP); median NPLs as a share of total loans, median ROE)



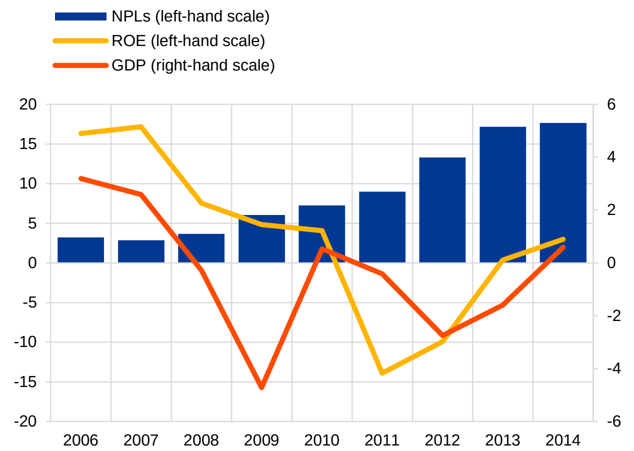
Sources: SNL Financial, Eurostat and ECB calculations.
Note: Euro area countries excluding Spain, Italy, Portugal, Greece, Cyprus and Slovenia.

Chart 6

…while the cyclical downturn in certain countries has contributed to a high outstanding stock of non-performing assets

Return on equity (ROE), non-performing loans (NPLs) and GDP growth for vulnerable countries during the crisis

(2006-2014; annual percentage changes (GDP); median NPLs as a share of total loans, median ROE)



Sources: SNL Financial, Eurostat and ECB calculations.
Note: Vulnerable euro area countries include Spain, Italy, Portugal, Greece, Cyprus and Slovenia.

Euro area banks' profitability will benefit from the ECB's expanded asset purchase programme as it supports nominal growth, improves asset valuations and effectively rules out debt deflation. These benefits notwithstanding, net interest margins are expected to remain under pressure as a result of the low interest rate environment and flattening yield curves. Bank profitability might therefore be squeezed further if banks cannot compensate for this by increasing loan volumes and/or reducing credit risk.

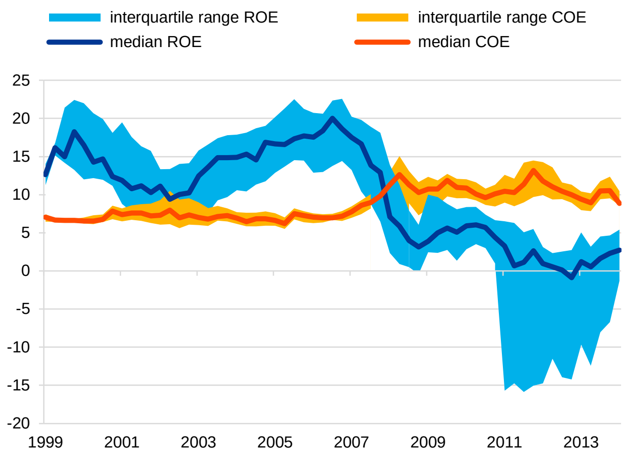
Weak profitability has meant that the return on equity for many euro area banks has remained below the cost of equity. Over the past six months, however, the gap between actual and required returns has narrowed somewhat, driven both by a slightly lower cost of equity and by the modest improvement in profitability (see Chart 7). Somewhat higher confidence with respect to the outlook for euro area banks is also confirmed by the slight increase in overall price-to-book ratios (see Chart 8). This somewhat more optimistic assessment is probably linked to the higher transparency regarding banks' financial conditions provided by the ECB's comprehensive assessment, which revealed only limited capital shortfalls among euro area banks. This notwithstanding, valuation levels are still far from those prevailing prior to the crisis and euro area banks trade at a significant discount relative to their US peers. The still substantial risk premia investors demand for holding euro area bank securities mainly reflect uncertainties regarding banks' expected future cash flows, but also structural factors such as possible litigation costs and some reservations about banks' ability to cope with new, stricter regulatory requirements. Challenges in meeting investors' required returns – as expressed by the cost of equity (COE) – may cause banks to face restraints when attempting to raise new equity, which in turn hampers their ability to extend credit to the real economy.

Chart 7

Still substantial gap between euro area banks' cost of equity and the return on equity

Cost of equity (COE) and return on equity (ROE) for a large sample of listed euro area banks

(Q1 1999 – Q4 2014, percentages)



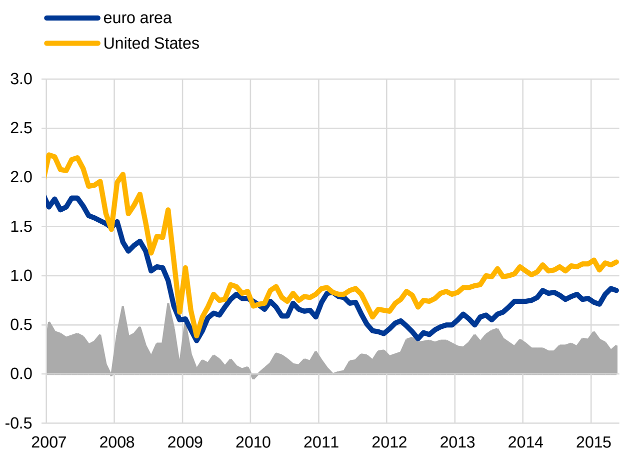
Sources: Bloomberg, Thomson Reuters Datastream, Consensus Economics and ECB calculations.
Note: Based on the sample of 33 euro area banks included in the EURO STOXX index.

Chart 8

Slightly higher valuations of euro area banks in 2015, but they still trade at a discount vis-à-vis their US peers

Price-to-book ratio for euro area and US banks

(Jan. 2007– May 2015, grey area represents the difference between the United States and the euro area)



Source: Thomson Reuters Datastream.

A continuing legacy from the sovereign debt crisis is a large and, in some countries, still increasing stock of non-performing loans. Further progress in removing impediments to the supply of bank credit – including faster NPL resolution – is necessary to improve credit conditions, which should be also supported by the ECB's targeted monetary policy measures. The resolution of systemic NPL problems requires a comprehensive strategy that encompasses necessary improvements in the operational environment and the selection of appropriate resolution strategies. In this respect, it can be concluded that tailored approaches – based on a thorough understanding of the country-specific dimensions of the NPL problem – that are driven as much as possible by the private sector may be most appropriate. The efforts to resolve the stocks of NPLs in parts of the euro area should be carefully designed so as to avoid an undue negative impact on bank capitalisation and to minimise moral hazard.

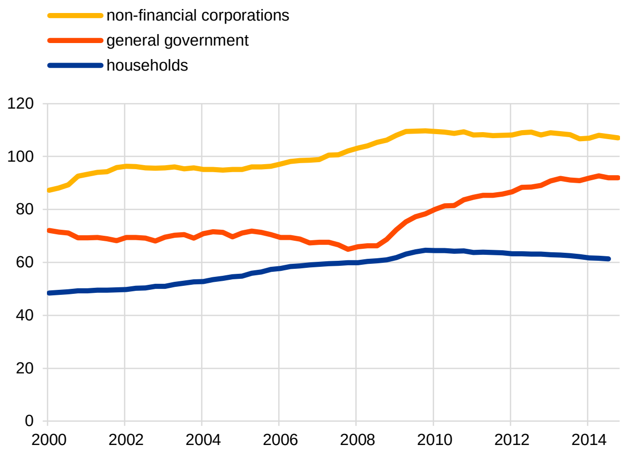
While the comprehensive assessment ensured that significant banks in the euro area have sufficient capital levels, progress needs to continue in parts of the banking system to address remaining fragilities and uncertainties. While efforts to adjust business models continue, further measures need to be taken by banks to restore sustainable profitability. The actions required are likely to differ across banks or national banking sectors depending, for instance, on the size and complexity of institutions or on the structural features of the banking sector in question. With regard to the first aspect, several banks are endeavouring to streamline their business models by refocusing on activities where they have both sufficient economies of scale and better profit margins. In addition, there are signs that overcapacity in, or a high fragmentation of, certain banking markets could hinder the recovery of profitability, suggesting that consolidation could bring some benefits for profitability, at least in some parts of the euro area banking sector.

Chart 9

Euro area debt remains elevated

Euro area debt-to-GDP ratios (households, non-financial corporations and general government)

(Q1 2000 – Q4 2014)



Sources: Eurostat and ECB.
Notes: Based on ESA 2010 standards, except for general government debt from Q1 2000 to Q4 2005, for which the ESA 1995 has been used. Non-financial corporate debt is unconsolidated, comprising loans (incl. intra-sectoral loans), debt securities and pension reserves. For the household sector, the series ends in Q3 2014. For the remaining series, the last data points are for Q4 2014.

The prevailing low-yield environment also poses challenges for the insurance sector. A prolonged period of low interest rates can dampen both investment income and the profitability of new policies sold. This is particularly relevant for those entities seeking sustained portfolio returns to match their liabilities, with limited scope for portfolio diversification (either geographical or across asset classes). In this vein, such market conditions pose a significant challenge for some insurance companies' profitability in the medium term, with the potential to erode capital positions in the long run. The impact of the low interest rate environment is particularly relevant for those life insurers that have locked in high return guarantees and have large asset/liability duration gaps.

Risk 3: Rise of debt sustainability concerns in the sovereign and corporate sectors amid low nominal growth

Debt sustainability in the euro area non-financial sector remains a concern. Although the financial sector has reduced its leverage in the wake of the sovereign debt crisis, the aggregate indebtedness for the remaining sectors of the economy remains high (see Chart 9). Debt sustainability challenges are imminent in the sovereign and non-financial corporate sectors, given a combination of elevated levels of indebtedness, still weak economic growth prospects and the environment of low inflation. At the same time, the cost of issuance and investor appetite on sovereign and non-financial corporate debt markets remain favourable across most euro area countries, while downside risks to economic growth have diminished thanks to recent monetary policy decisions and the lower oil prices.

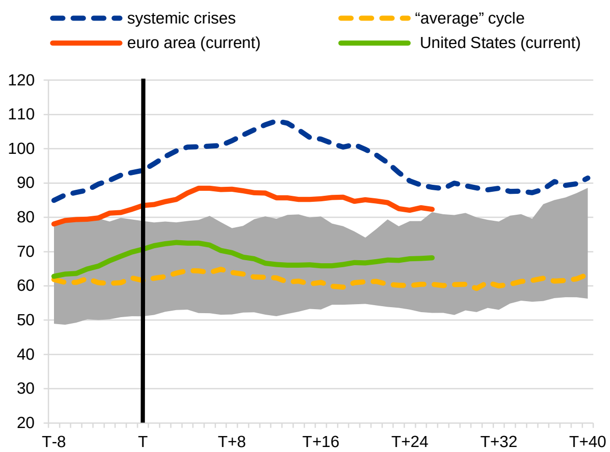
Prevailing financial market conditions clearly provide support for debt servicing capacity. At the same time, fiscal positions remain precarious in some countries. Sovereign risks emanating from Greece, in particular, have increased sharply owing to heightened political uncertainty over the past six months, while the banking sector in Greece has witnessed substantial deposit outflows, a loss of access to the wholesale funding market and deteriorating asset quality. Financial market reactions to the developments in Greece have been muted to date, but in the absence of a quick agreement on structural implementation needs, the risk of an upward adjustment of the risk premia demanded on vulnerable euro area sovereigns could materialise. More broadly, uncertainties relating to sovereign debt sustainability are likely to persist over the medium term as government debt-to-GDP ratios are projected to stay at elevated levels in several countries. At the same time, damaging feedback mechanisms between sovereigns and the banking sector which were at the heart of the euro area strains over the last few years appear less likely to play as destructive a role amid institutional improvements, including notably lowered contingent liabilities from the banking sector through new bail-in tools created by the Bank Recovery and Resolution Directive (BRRD), as well as through the entry into force of the SRM Regulation.

Chart 10

Slow deleveraging in the corporate sector

Paths for corporate debt ratios during banking crises and average cycles in 20 advanced economies

(percentage of nominal GDP)



Sources: Eurostat, European Commission, IMF and ECB.
Notes: In order to ensure cross-country comparability, figures are shown on a fully consolidated basis. Accordingly, corporate debt includes loans net of intra-sectoral loans, debt securities and pension reserves. The dashed dark blue line shows the average profile of corporate debt ratios during five systemic banking crises in advanced economies: Spain in 1977, Norway in 1987, Finland in 1991, Sweden in 1991 and Japan in 1992. In each case, the period T represents the peak in GDP growth. The dashed yellow line shows the mean path for debt ratios across cycles in 20 advanced economies as from the 1970s. The shaded grey area shows the interquartile range of those "normal" cycles. For the euro area and the United States, T represents the peaks in GDP growth in the first quarter of 2008.

The ratio of non-financial corporate debt to GDP also remains high, by both historical and international standards (see Chart 10). The pace of deleveraging has been slow, and indebtedness has been hovering well above the levels of past episodes of recession. The weak nominal growth environment and firms' increased recourse to market-based debt financing in recent years are some of the factors that explain this persistence.

Triggers for the materialisation of risks from high non-financial sector indebtedness are manifold. They could stem from unexpected developments in Greece triggering an adjustment of risk premia, lower than expected domestic nominal growth or a sudden slowdown in global growth prospects. Just as importantly, benign financial market conditions may obscure the urgency of fiscal and structural reforms. If key reforms were to be delayed, a reassessment of sentiment towards euro area sovereigns is possible. Such a reassessment would probably also pose debt sustainability concerns for non-financial firms.

Risk 4: Prospective stress and contagion effects in a rapidly growing shadow banking sector

The investment fund sector has grown rapidly over the past five years. The assets of the sector increased by €4.0 trillion, or more than 70%, between 2009 and 2014 to reach €9.4 trillion. From a financial stability perspective, concerns about the risks posed by investment funds relate to the implications for the wider financial system and the real economy arising from the sector's increasing role in credit intermediation and capital markets (see Chart 11). Possible channels of risk contagion and amplification include correlated asset exposures as well as mutual contractual obligations in securities lending and derivatives markets. Concerns are that shadow banking entities could be part of future systemic events, also on account of their increased size and remaining opaqueness.

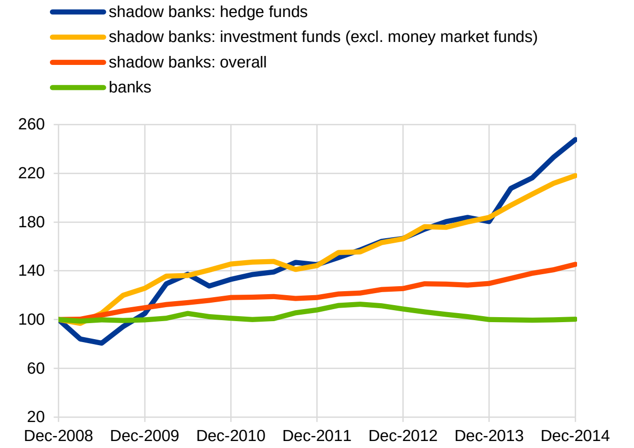
The greater the leverage, liquidity mismatch and size of certain intermediaries, the more likely they are to amplify shocks and impose externalities on other parts of the financial system, such as those resulting from fire sales of demandable equity. Bond funds have the potentially highest market impact owing to their large size, the significant proportion of illiquid assets they hold on their balance sheets and their somewhat higher leverage in comparison with other investment funds (see Chart 12).

Chart 11

Steady increase in the euro area shadow banking sector suggests that vulnerabilities are likely to have been growing more in this segment

Assets of selected euro area financial sectors

(Q4 2008 – Q4 2014; index: Q4 2008 = 100)



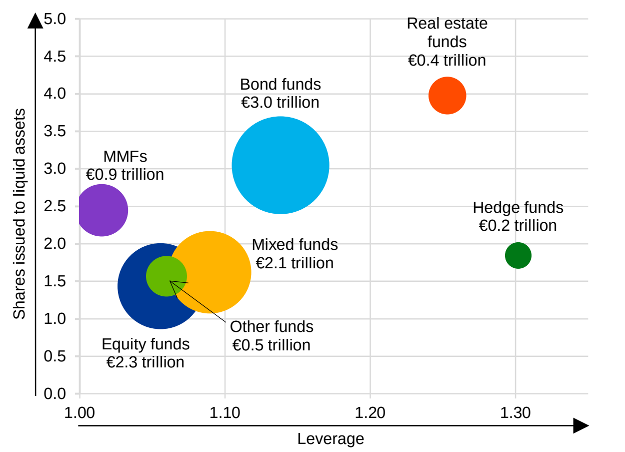
Sources: ECB and ECB calculations.

Chart 12

Bond and real estate funds most likely to amplify shocks and impose externalities on the system

Liquidity mismatch and leverage among euro area money market and investment funds

(data as of Q4 2014; x-axis: leverage (total assets/shares and units issued); y-axis: liquidity mismatch (shares and units issued/liquid assets))



Sources: ECB and ECB calculations.
Note: Bubble size: total assets in EUR trillions.

One of the main vulnerabilities stemming from the investment fund sector is the potential the sector has to amplify liquidity shortages in periods of financial stress. In fact, so-called liquidity spirals could be triggered if funds were to be confronted with high redemptions or increased margin requirements, as these could result in forced selling on markets with low liquidity. With these liquidity conditions, initial asset price adjustments would be amplified, triggering further redemptions and margin calls, thereby fuelling such negative liquidity spirals.

Usage of implicit leverage among investment funds may contribute further to systemic stress. Regardless of the size of underlying cash positions in assets, contingent commitments created by positions in swaps, futures and other derivative positions can augment overall exposures to asset classes, and hence create "synthetic leverage" (see Box 8). Although data gaps make a solid quantitative understanding of prospective financial stability risks difficult, some qualitative indications suggest that synthetic leverage could be a larger concern than balance sheet leverage and cash-equivalent reporting suggest. High levels of synthetic leverage in the sector can be a source of concern since they can create individual or aggregate distress, which can propagate through direct linkages and information contagion, given the opacity of measurement and reporting, while margining and haircut practices in derivatives markets and securities financing transactions used to add synthetic leverage are pro-cyclical and may lead to negative liquidity spirals.

The key trigger for spillovers from the investment fund industry to the rest of the financial system would be significant decreases in asset prices that could cause sector-wide redemptions. Large-scale outflows cannot be ruled out in the event of adverse economic or policy surprises over the medium term. The market impact of large-scale outflows could be aggravated by strategic complementarities among fund investors, in particular as a result of first-mover advantages and of asset managers being forced to adjust portfolios in a timely manner.

Policy considerations

A comprehensive overhaul of the regulation of the financial sector triggered by the financial crisis has continued to make progress, with most key building blocks nearing completion. For *banks*, a few remaining key elements of the new regulatory framework are still subject to finalisation and calibration, including parts of the liquidity regulation, leverage ratio provisions and securitisation rules, as well as measures aimed at increasing loss-absorption capacities, thereby addressing the too-big-to-fail problem of global systemically important banks (G-SIBs). For *insurers*, the implementation of the Solvency II Directive remains the key stream of work for regulators. Several steps have been taken to also strengthen the resilience of *financial infrastructures*, as well as to reflect upon policies needed to complement a growing *shadow banking* sector.

The finalisation of the ongoing initiatives will significantly reduce the regulatory uncertainty regarding capital and liquidity rules for banks and other financial institutions, and will contribute to strengthening the resilience and loss-absorption capacity of the whole financial system. Importantly, the implementation of the measures is subject to thorough impact assessments, thus ensuring that the regulatory framework is designed and calibrated in a way that supports the stable provision of financial services over the whole financial cycle.

Building on these regulatory initiatives, a number of euro area countries have already announced and also implemented targeted macroprudential measures. Based on newly acquired mandates and using the growing set of available instruments, macroprudential policy action has a key role to play in both attenuating financial cycles and enhancing the resilience of the financial system.

More generally, ongoing advances continue in two broad initiatives at the European level to improve the soundness of the financial system – aimed at the banking sector and beyond. First, significant progress has been made in establishing a banking union in Europe, given that the Single Supervisory Mechanism (SSM) became operational on 4 November 2014 and that the Single Resolution Mechanism (SRM) was put in place on 1 January 2015. The Single Resolution Board (SRB) has also been established and will start working on the elaboration of resolution plans and related tasks, as most of the provisions in the SRM Regulation will only apply as from 1 January 2016. Second, as a complementary element to the banking union, the establishment of a capital markets union has been identified as one of the main policy priorities in the years to come. Both initiatives, combined with a variety of targeted regulatory and prudential measures, should contribute to ensuring a more resilient and robust financial system in Europe.