EUROPEAN CENTRAL BANK
EUROSYSTEM

DIRECTORATE GENERAL MACROPRUDENTIAL POLICY AND FINANCIAL STABILITY

FINANCIAL STABILITY CONTACT GROUP

FRANKFURT AM MAIN, WEDNESDAY 2 OCTOBER 2019

MEETING SUMMARY

1) Introductory presentation by the ECB

ECB staff presented the ECB's assessment of the risks and vulnerabilities for euro area financial stability as published in the ECB's May 2019 Financial Stability Review. FSCG members were most concerned about the risk of a disorderly increase in risk premia, albeit less so than at their previous meeting in March this year.

2) Recent market developments

Members discussed the implications of negative yields for financial markets. Some members expressed concerns about adverse externalities for financial markets as a result of (i) investors' "hunt for yield" replacing fundamental drivers of asset prices and (ii) the suppression of volatility. They felt that these factors were impeding market discipline, such that firms with weak profitability were enjoying overly easy financing conditions, resulting in increases in credit risk. Members also discussed the implications for the banking sector, pension funds, insurance companies, central counterparty clearing houses and asset managers.

3) Outlook for banks' profitability and resilience

Some members expressed concerns that euro area banks could find themselves in a situation similar to that of their Japanese peers. While participants agreed that the euro area banking sector needed consolidation, they expected only limited M&A activity in the short to medium term, mainly in the form of domestic mergers. Equity investors pointed to the weak earnings outlook in a low interest rate environment, while credit investors highlighted improvements to banks' balance sheets and resilience.

4) Runs on investment funds

A majority of participants felt that liquidity issues in investment funds were a concern from a financial stability perspective. However, not all participants were of the view that the degree of leverage in funds was a concern. Most members agreed that the redemption terms of investment firms should be more closely aligned with the liquidity of their assets, and that such firms should be required to hold a minimum amount of cash and liquid assets. Members also emphasised that the strong growth seen in ETF products had created potential vulnerabilities that had not yet been tested in the presence of a major market dislocation.

Luis de Guindos, Vice-President of the ECB, concluded the meeting by addressing participants (with details of those remarks available here).