



EUROPEAN CENTRAL BANK

EUROSYSTEM

# Sources of risk and vulnerabilities for financial stability

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IESE Business School

Alumni Learning Programme

25 February 2021

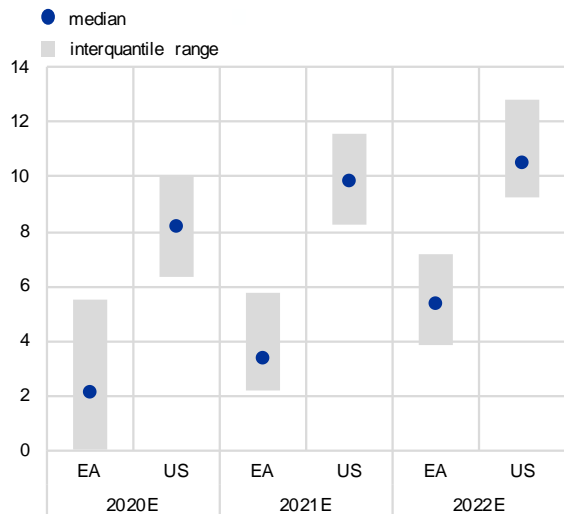
Luis de Guindos



# Bank profitability has improved but the outlook remains very challenging

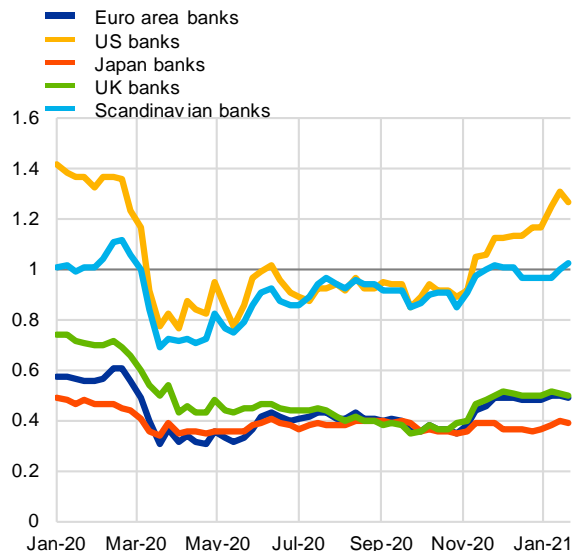
- Euro area bank profitability and valuations remain low
- Model-based estimates point to some risk of under-provisioning. But these do not take into account the impact of extraordinary policy measures in reducing credit risk

## Analyst return on equity expectations for euro area and US banks 2020 – 2022; percentages



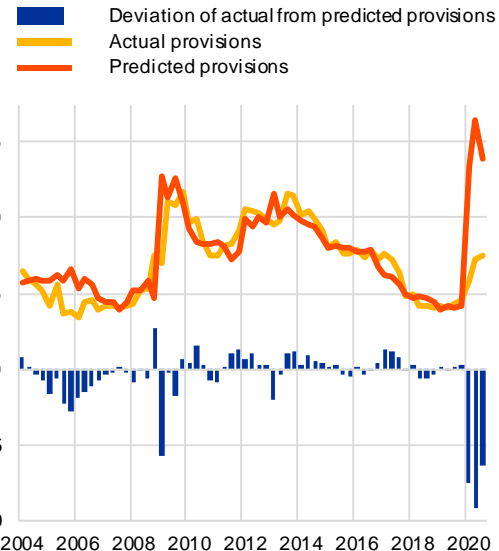
Source: Refinitiv.

## Bank price-to-book ratios Jan. 2020 – Feb. 2021; ratios



Sources: Refinitiv and ECB calculations.

## Model-based estimates of under-provisioning by euro area banks Q1 2004 – Q3 2020; loan loss provisions as a percentage of total loans



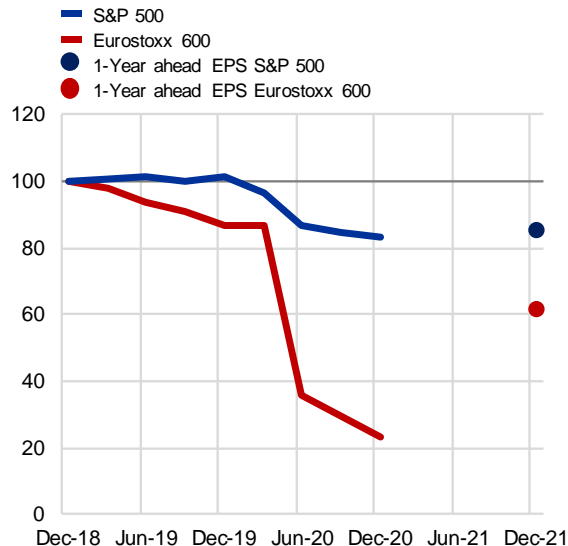
Sources: Bloomberg, ECB supervisory data and ECB calculations.  
Mitigant factors not included: direct support, moratoria, guarantees, quicker recovery, different sectoral crisis impact.

# Corporate sector conditions remain weak, uneven and uncertain

- Corporate earnings stabilised in Q3 2020, albeit at significantly suppressed levels
- Vulnerabilities remain elevated but with large differences across sectors and countries

## Non-financial corporate earnings and earnings expectations

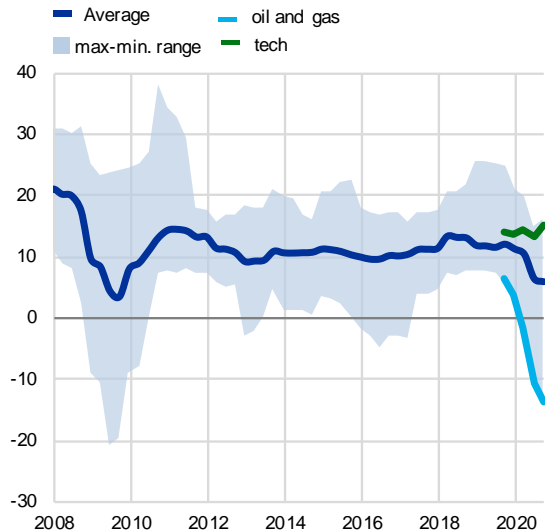
Q4 2018 – Q4 2020; Q4 2018 = 100



Source: Bloomberg.

## Return on equity across corporate sectors in the euro area

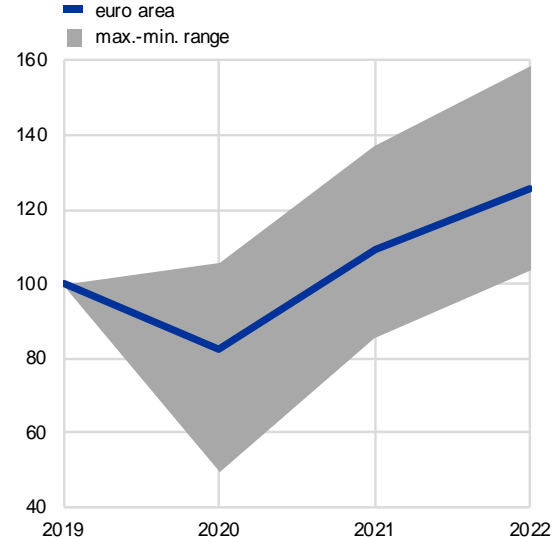
Q1 2008 – Q3 2020; percentages



Source: Bloomberg.

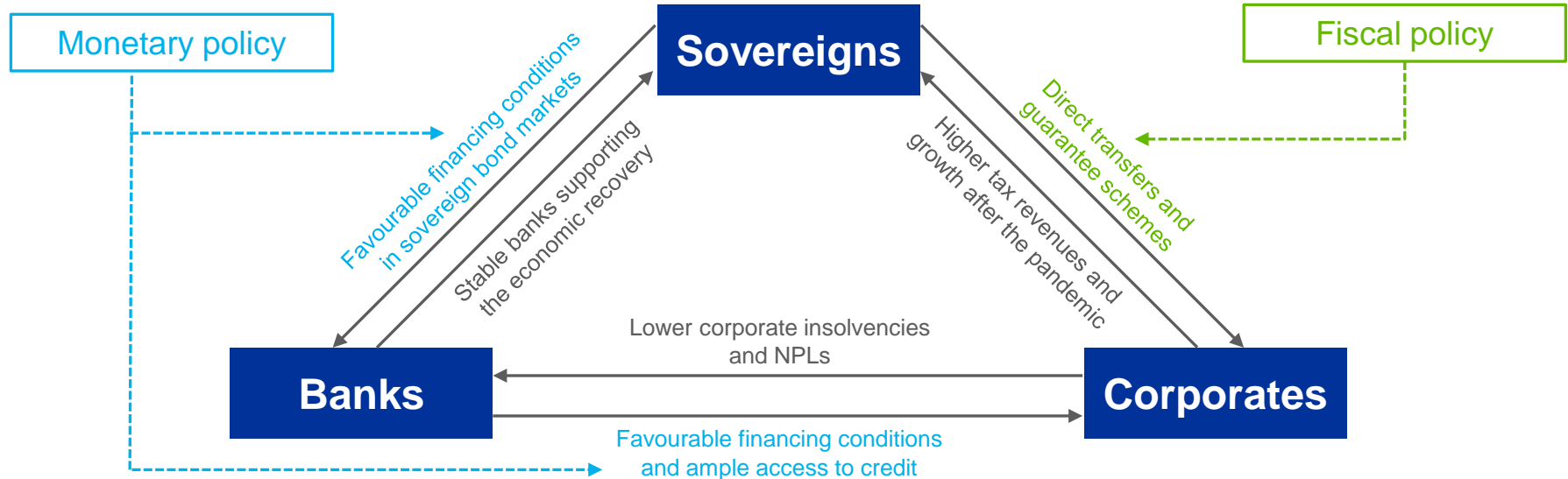
## Expected insolvencies in euro area countries

Index: 2019 = 100



Source: Allianz Euler Hermes.

# A virtuous circle between sovereigns, banks and corporates

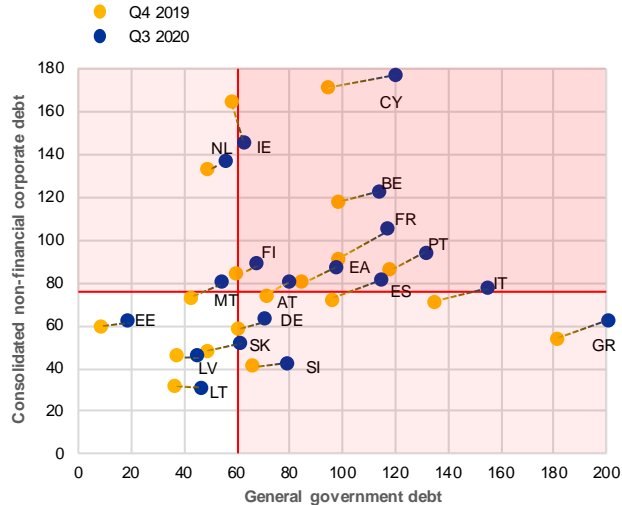


# Potential emergence of a vicious circle between sovereigns, banks and firms

- Corporate and banking sector vulnerabilities are clearly linked, and also closely intertwined with sovereigns, as well as depending on policy support

## Indebtedness of the general government and the non-financial corporate sector across the euro area

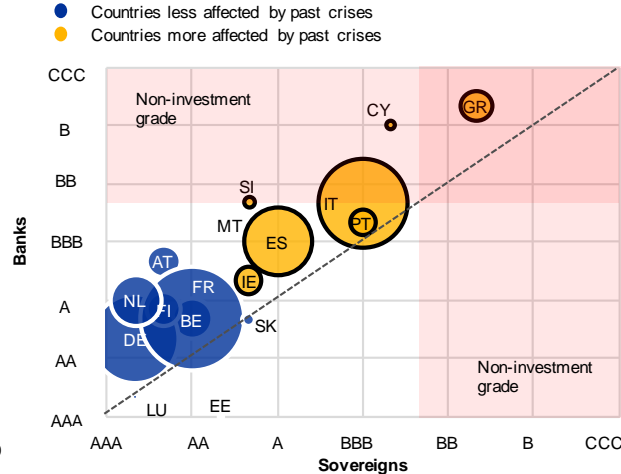
Q4 2019, Q3 2020, percentages of GDP



Sources: ECB and ECB calculations.

## Issuer ratings of sovereigns and banks in the euro area

Rating buckets

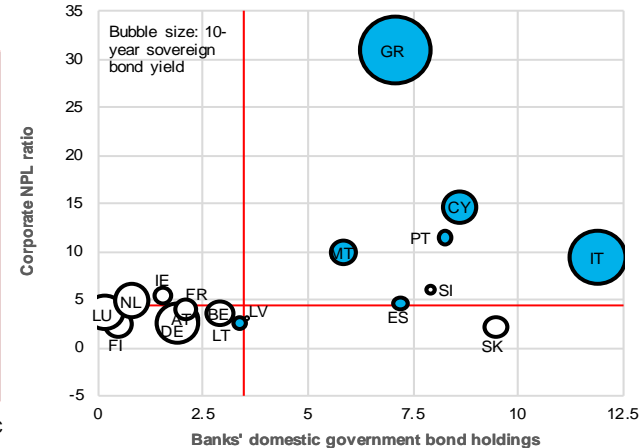


Sources: DBRS, Fitch Ratings, Moody's, Standard & Poor's and ECB calculations.

Note: The bubble size indicates the combined debt of sovereigns and banks (debt securities issued) in a country as a share of the euro area total.

## Banks' domestic government bond holdings and corporate NPL ratios across the euro area

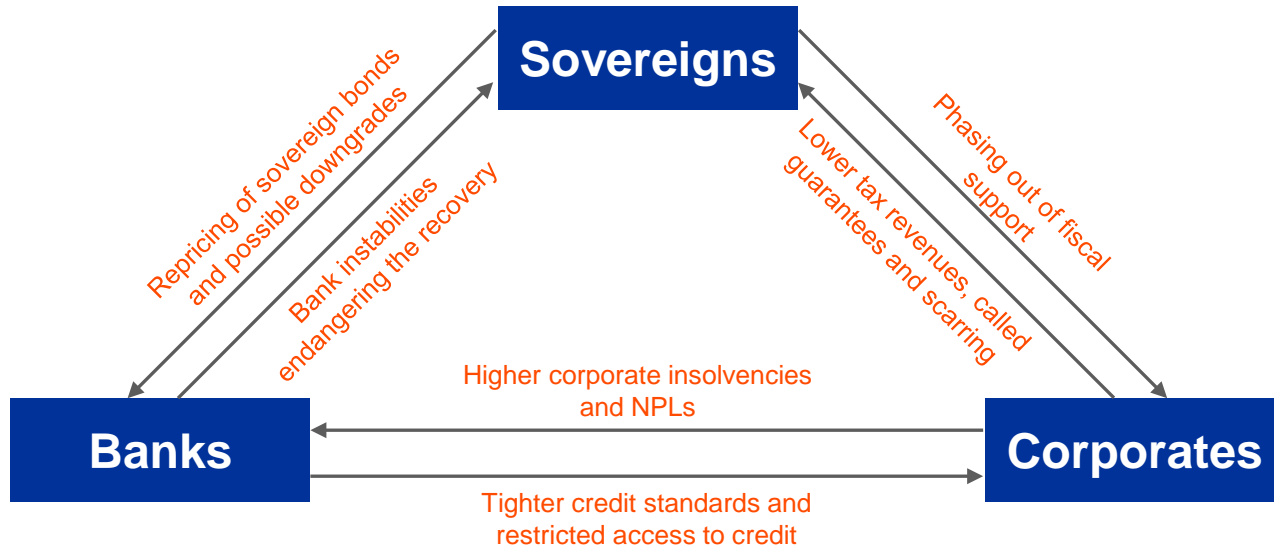
x-axis: % of total assets, y-axis: % of total corporate loans



Sources: Bloomberg and ECB.

Notes: White bubbles indicate negative values. The red horizontal and vertical lines indicate sample medians. [www.ecb.europa.eu](http://www.ecb.europa.eu) ©

# Continued fiscal and monetary support for as long as necessary can avoid a vicious circle between sovereigns, banks and corporates



# Summing up

## Key vulnerabilities to euro area financial system stability:

1. Low bank profitability and challenging outlook
2. Nexus between sovereigns, banks and firms – risk of a vicious circle

A balanced and cautious **phasing-out of fiscal and monetary policy support** is of the essence

**Risks of an early withdrawal are higher** than the risks associated with keeping support measures in place for too long. But care needs to be taken to avoid moral hazard