



ESRB

European Systemic Risk Board

European System of Financial Supervision

Press release

1 July 2021

The General Board of the European Systemic Risk Board held its 42nd regular meeting on 24 June 2021

At its meeting on 24 June 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 has reduced the probability of severe scenarios and the risk of the COVID-19 crisis spilling over to the financial system. Against this background, the General Board noted that the ESRB Recommendation on restriction of distributions during the COVID-19 pandemic [ESRB/2020/07] could be allowed to lapse at the end of September 2021 if economic and financial sector conditions do not deteriorate materially. It would be for competent authorities to assess at the level of individual financial institutions whether distributions are made in a sufficiently prudent manner, taking into account the specific situations of institutions and the economic environment they operate in. The General Board will consider this matter at its next meeting on 23 September 2021.

The General Board emphasised that the recovery still relies on continued monetary policy and fiscal policy support measures, which have so far helped avoid a surge in insolvencies. The national fiscal support to the economy has been extended and often refocused to address the solvency pressures in the non-financial sector, as expected. The total size and uptake of measures (excluding moratoria) in March 2021 increased, respectively, to 18.7% and 6.9% of ESRB member countries' GDP (compared with 17.5% and 5.7% in December 2020). In parallel, moratoria schemes are being phased out. The ESRB continues to monitor the financial stability implications of national fiscal measures implemented to safeguard the economy against the pandemic.

The General Board noted that potential spillovers from the non-financial private sector to the banking sector, most notably through the channel of deteriorating asset quality, remain a risk that needs to be monitored closely. It also highlighted the importance for banks to appropriately reflect credit risk in their loan classification and provisioning. The General Board also saw a need to proactively address asset quality issues – including by enhancing banks' capacity to manage non-performing loans and by restructuring, on a case-by-case basis, the debt of viable but overindebted

borrowers. The General Board noted that rising credit risk is compounding the challenges for the business models of banks, which are already suffering from low profitability in the prevailing low interest rate environment and elevated cost-to-income ratios.

Furthermore, the General Board noted the increase in asset repricing risk amid rising inflation expectations and long-term bond yields in the United States, which could spill over to European bond markets and affect non-bank financial institutions with high duration, liquidity and credit risk. It recalled that – notwithstanding recent corrections – stock valuations in many market segments perceptibly exceed pre-crisis levels. Similarly, spreads on non-financial corporate bonds remain at risk of a sudden repricing, most notably in the high-yield segment, where spreads are now below their pre-crisis levels despite increased corporate sector vulnerabilities.

The General Board also discussed vulnerabilities related to the EU residential and commercial real estate markets. Residential real estate prices have so far been resilient to the effects of the pandemic, also due to supporting measures like debt moratoria and job protection schemes, as well as the low interest rate environment. In fact, in several EU Member States, rapidly increasing house prices and mortgage lending may aggravate existing vulnerabilities related to household indebtedness and overvalued house prices. Regarding commercial real estate, repricing has already occurred in some segments of the market. From a financial stability perspective this development is important, as in some countries banking systems have sizeable and risky exposures to commercial real estate markets. Moreover, real estate funds show signs of increasing vulnerabilities related to both liquidity and leverage. The General Board continues to monitor the situation in real estate markets closely.

In addition, the General Board considered the financial stability implications of climate change for the EU financial system. The joint ECB/ESRB project team has constructed a unique granular mapping of climate change to the EU financial system, which points to significant vulnerabilities in certain sectors, regions and financial institutions. This exposure analysis was also a starting point for a forward-looking assessment of financial stability risks for EU banks, insurers and investment funds. The results suggest that timely political action to tackle climate risk can yield net benefits for financial stability, notwithstanding any other broader economic, social and welfare benefits. These findings are summarised in the joint ECB/ESRB report, which builds on **previous work** and is being published today.

The ESRB has today published its annual report, which describes the ESRB's risk assessment and contributions to the macroprudential policy framework over the period 1 April 2020 - 31 March 2021. The ESRB is also publishing today its review of macroprudential policy in the EU in 2020 [LINK]. Finally, the ESRB is releasing the **36th 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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