

Enhanced outlook and emerging risk in the banking union

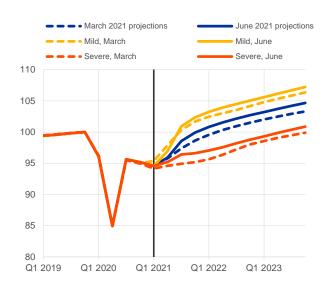


2 July 2021 Andrea Enria

Continuously improving macro outlook

Chart 1 Eurosystem staff GDP projections

(index: Q4 2019 =100)



Source: ECB.

Note: The vertical line marks the start of the projection horizon.

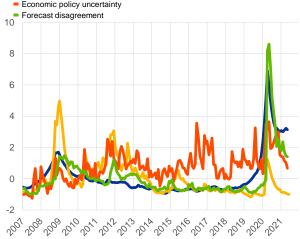
Chart 2 Indicators of uncertainty

(standard deviation from mean)



Financial uncertainty

Economic policy uncertainty



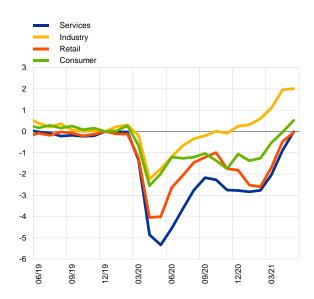
Source: ECB.

Notes: All measures of uncertainty are standardised to mean zero and unit standard deviation over the full horizon starting in June 1991. A value of 2 should be read as meaning that the uncertainty measure exceeds its historical average level by two standard deviations. The latest observations are for May 2021.

Increasing confidence and abated stress

Chart 3
Confidence indicators by sector

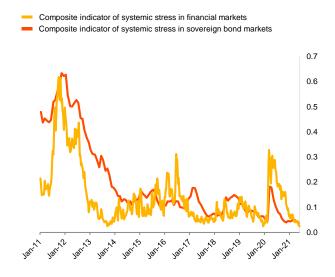
(October 2019-May 2021, percentage deviation from December 2019 levels)



Source: ECB

Chart 4 Indicators of systemic stress

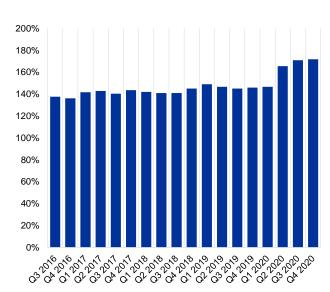
(January 2011-May 2021; CISS: two-week moving averages)



Improving liquidity and capital positions

Chart 5 Liquidity coverage ratio

(percentages)

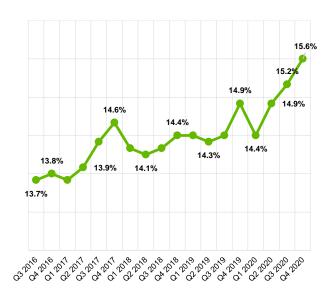


Source: Supervisory reporting.

Note: Sample comprises of 112 SIs as at the fourth quarter of 2020.

Chart 6 CET1 ratio

(percentages)



Contained tightening in bank lending standards

Chart 7 Lending standards and loan demand: non-financial corporates

(percentages)

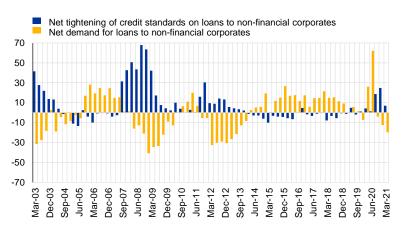
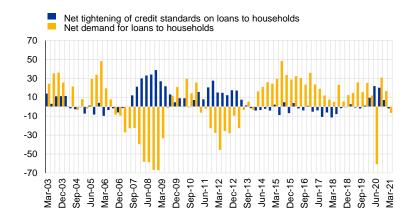


Chart 8 Lending standards and loan demand: households (percentages)



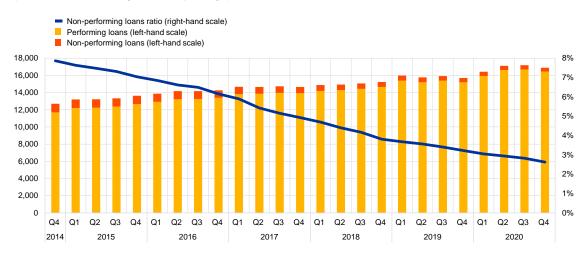
Source: ECB Bank Lending Survey.

Note: A positive net percentage indicates that a larger proportion of banks have tightened credit standards ("net tightening"), whereas a negative net percentage indicates that a larger proportion of banks have eased credit standards ("net easing").

Non-performing loans ratio continued to decrease

Chart 9 Significant institutions' non-performing loans

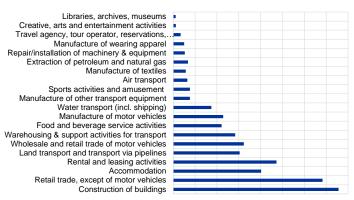
(left-hand scale: EUR billions, right-hand scale: percentages)



Areas of supervisory concern: vulnerable sectors

Chart 10 Significant institutions' exposures to vulnerable sectors

(percentage of total exposures to non-financial corporates)



0.0% 0.5% 1.0% 1.5% 2.0% 2.5% 3.0% 3.5% 4.0%

Sources: Chart 10: AnaCredit data as at the fourth quarter of 2020; Chart 11: ECB ad hoc data collection.

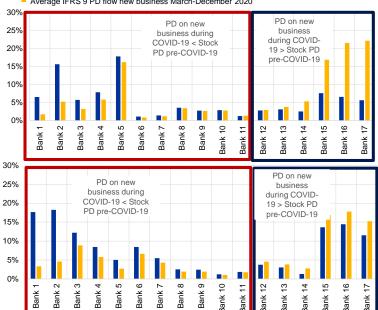
Notes: Chart 10: sample comprises 106 significant institutions. Exposures granted by subsidiaries outside the euro area are not included in AnaCredit. Chart 11: preliminary evidence.

Chart 11

Probabilities of default used for provisioning on new lending within the accommodation and food sectors

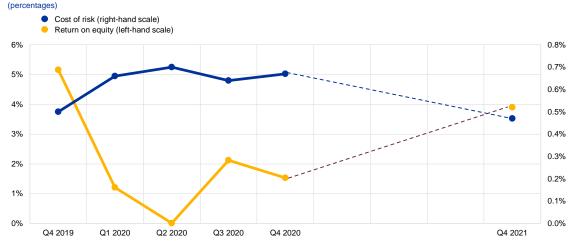
(top chart; accommodation sector, bottom chart; food sector)

Average IFRS 9 PD stock March 2020
 Average IFRS 9 PD flow new business March-December 2020



Banks' projections: profitability pushed up by lower provisions

Chart 12 Significant institutions' loan loss provisions and profitability (observed and Q4 2021 forecast values)



- Increasing revenues: fee income to offset contraction in interest income
- Falling loan loss provisions
- Increasing administrative expenses following reduction in 2020

Sources: FINREP for actual values, COVID-19 reporting for the projections.

Notes: Sample sizes and ratio definitions differ between actual values and projections owing to data availability. Cost of risk is the ratio of the adjustments in allowances for estimated loan losses during the relevant period (annualised) divided by the total amount of loans and advances subject to impairment.

EU risky corporate credit market expands as investors search for yields

Chart 13 European leveraged issuance by type

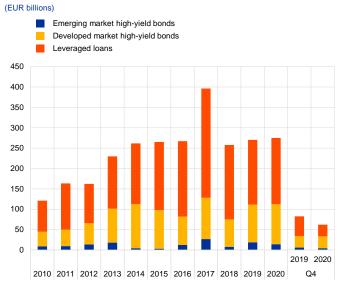
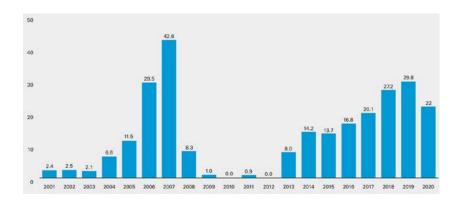


Chart 14 European new-issue CLO volume

(EUR billions)



Source: AFME. Source: Creditflux.

Broader investor base reduces direct exposures but creates connections and concentrations

Chart 15 CLO investor base

(Q4 2018, percentages)

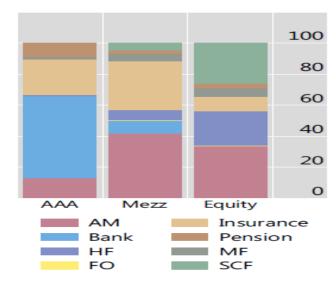
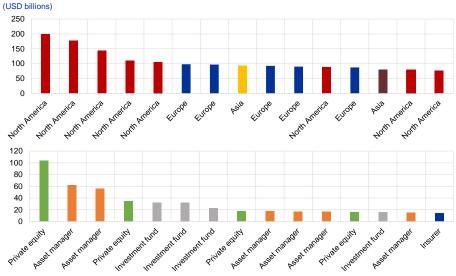


Chart 16

Amounts outstanding of leveraged loans provided by banks on the primary global market, by region (upper chart) and by type (lower chart)



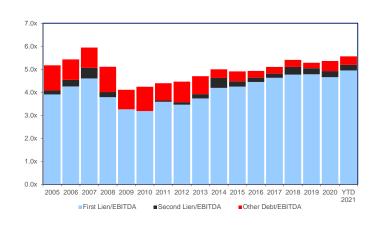
Sources: IMF Global Financial Stability Report, April 2020, based on Dealogic data and IMF calculations.

Source: BIS.

Notes: AM: asset managers; HF: hedge funds; FO: family offices; MF: mutual funds; SCF: structured credit funds.

Leveraged lending increases corporate leverage, relaxes safeguards

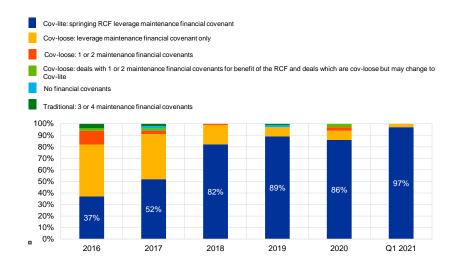
Chart 17
European leveraged issuance by type



Source: LCD, an offering of S&P Global Market Intelligence.

Note: EBITDA stands for earnings before interest, depreciation, taxes and amortisation.

Chart 18 Financial covenant packages in European leveraged loans (percentages)

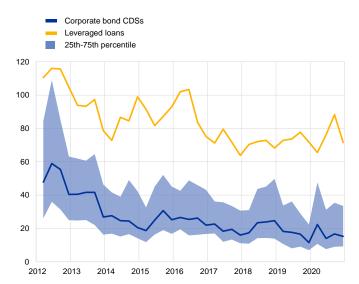


Source: Reorg.

Market complacency and spread compression development: COVID-19 contraction

Chart 19 Spreads per unit of leverage

(Q1 2012-Q 2020, basis points over debt/EBITDA)

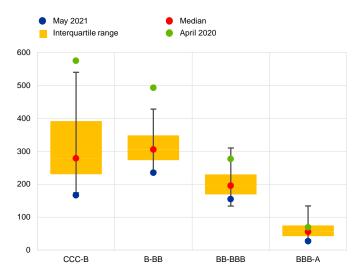


Source: ECB Financial Stability Review (May 2021).

Notes: Turns of leverage are based on annualised quarterly earnings before interest, taxes, depreciation and amortisation (EBITDA). "CDSs" stands for credit default swaps.

Chart 20 Difference in bond spreads of adjacent rating classes

(February 2020, percentages)

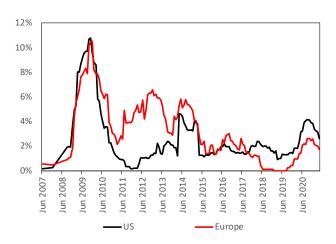


Source: ECB Financial Stability Review (May 2021).

Note: Differences in non-financial corporate spreads between pairs of adjacent rating classes, May 2021 and April 2020 versus historical range.

Public support contains defaults, but credit quality worsens

Chart 21
Leveraged loan default rates, Europe and US
(percentages)



Source: LCD, an offering of S&P Global Market Intelligence.

Chart 22 Leveraged loans, composition by rating

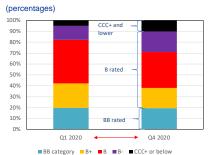


Chart 23

Debt-to-equity ratios of euro area firms



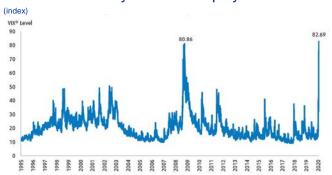
Sources: Chart 22: LCD, an offering of S&P Global Market Intelligence; Chart 23: ECB Financial Stability Review (2021), May.

Leverage also grows in the equity market and complex products remain exposed to market dislocations

Chart 24 Notional value of contracts for difference and equity swaps



Chart 25 Volatility index on equity markets



Prime brokerage

Leveraged bets

Concentrated positions

Lack of transparency

Faulty counterparty credit risk management

Structured products

Inappropriate risk management

Inefficient hedging

Concentrated business mix

Asset price correction or recession may hit banks through visible and less visible channels

Chart 26 Exposures of euro area banks to global funds and insurers

(Q4 2019, left-hand scale: EUR billions; right-hand scale: percentage of CET1 capital)

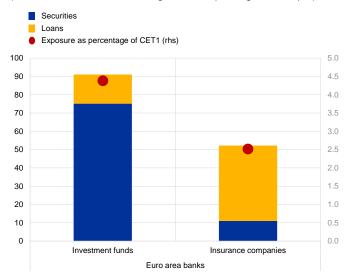


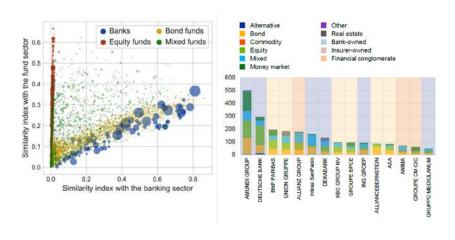
Chart 27

(a) Common holdings of euro area banks and investment funds

(b) Aggregate net assets of top 15 asset managers owned by euro area banks

(Q2 2019, similarity index)

(Q1 2020, funds domiciled in the euro area, EUR billions)



Source: ECB. Source: ECB.