BIS

The November 2024 ECB's FSR: Discussion

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SUERF/Bocconi Webinar: "*Key takeaways from the ECB's new Financial Stability Review*"

22 November 2024

**Views expressed are those of the presenter and not necessarily those of the BIS.*

Main risks and vulnerabilities identified in the ECB Financial Stability Review (FSR)

- Balance of **macro risks** in the euro area has shifted
  - from concerns about high inflation
  - to fears over growth

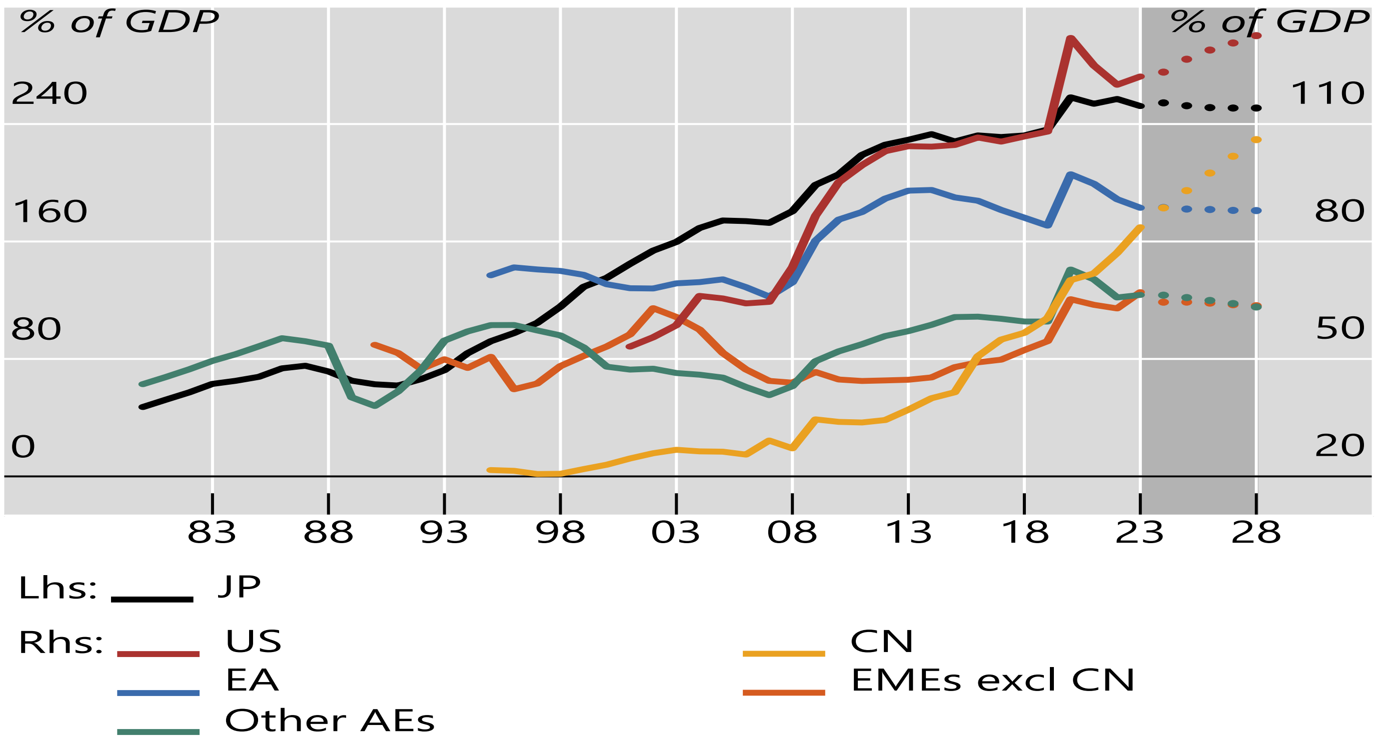
- Key **financial stability risk and vulnerabilities** in the euro area
  - **Financial markets are fragile** due to a combination of:
    - stretched valuations in equity and corporate bond markets,
    - non-bank liquidity and leverage vulnerabilities.
  - **Sovereign debt sustainability** challenged by:
    - heightened policy and geopolitical uncertainty,
    - weak fiscal fundamentals,
    - sluggish trend growth
  - **Credit risk concerns in corporate and household sectors**

Overall assessment and comments

- The **main risks and vulnerabilities** highlighted by the ECB FSR are largely **in line with** those identified by the **BIS** as a part of its Global Risk Surveillance (GRS).
  - High (public and private sector) indebtedness
    - Fiscal trajectories pose a very significant risk
    - Elevated debt levels in the private non-financial sector
  - Significant fragilities in financial markets
  - Cyclical and structural headwinds for the real estate sector
  - Shrinking financial buffers in the private sector

- **Additional issues that warrant attention**
  - Peaking financial cycles
  - Risk migration from regulated financial intermediaries into opaque corners of the financial system
  - Less visible forms of leverage and broader carry trades

Fiscal trajectories pose a significant risk to macroeconomic and financial stability



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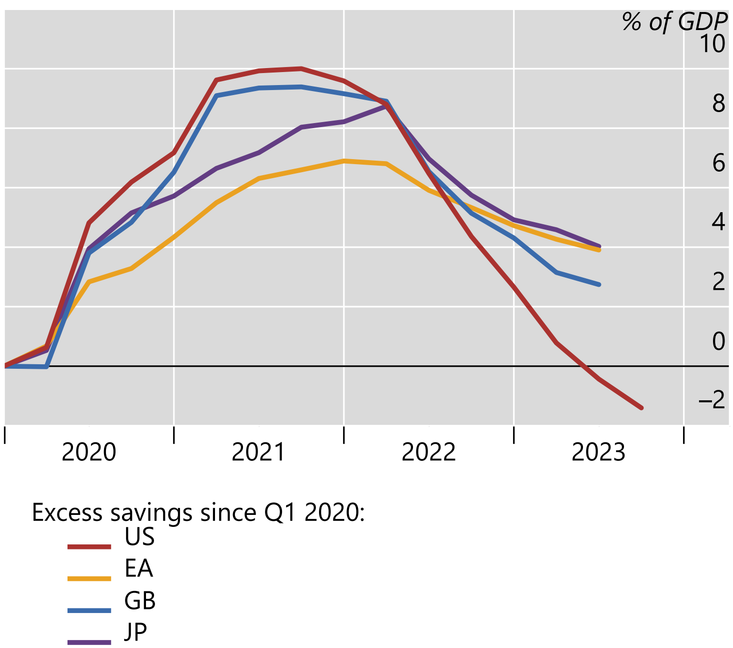
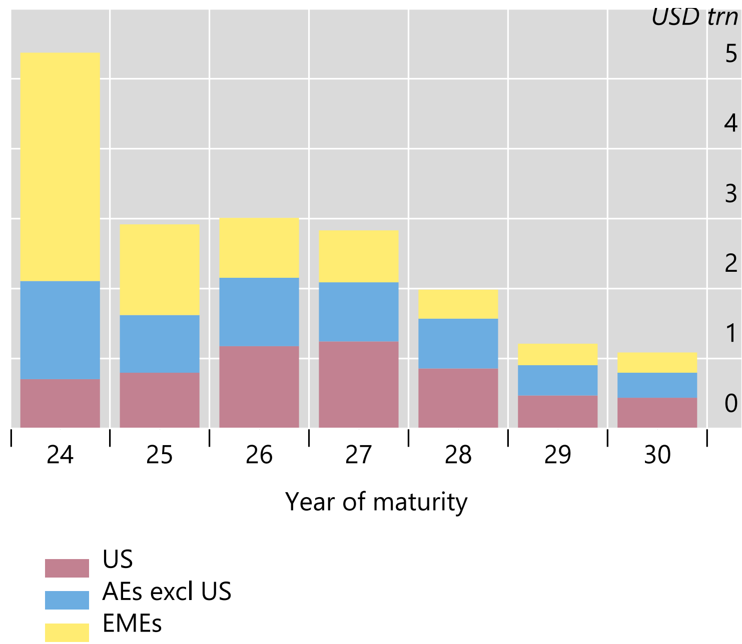
Private sector's financial buffers are shrinking

Excess savings are already or close to depleted



Non-financial companies face maturity walls in the near future



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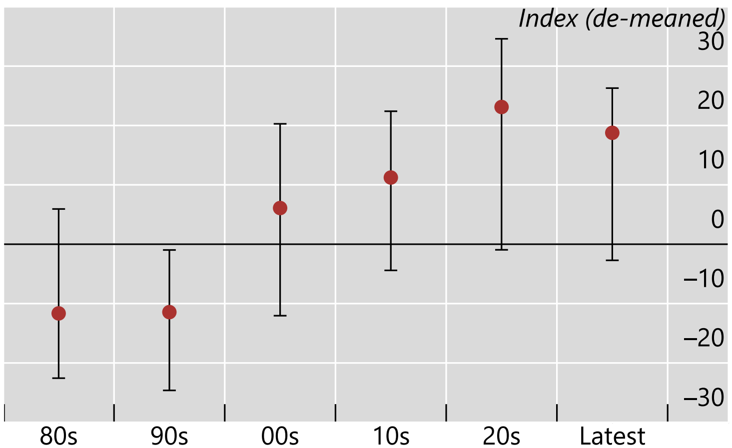
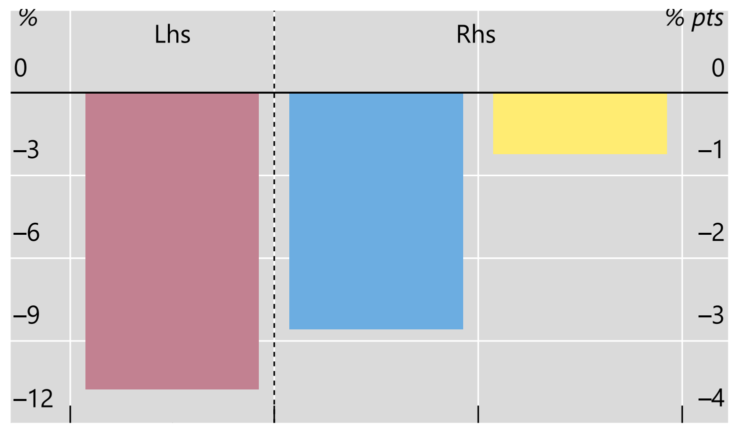
Real estate is facing cyclical and structural headwinds

House price valuations continue to be very stretched



House price-to-income ratio deviation from historical average:
● Median —— Interquartile range

A sharp fall in CRE prices could have a material impact on credit and GDP growth



Effects of adverse commercial real estate shock:
Commercial property prices
Credit growth
GDP growth

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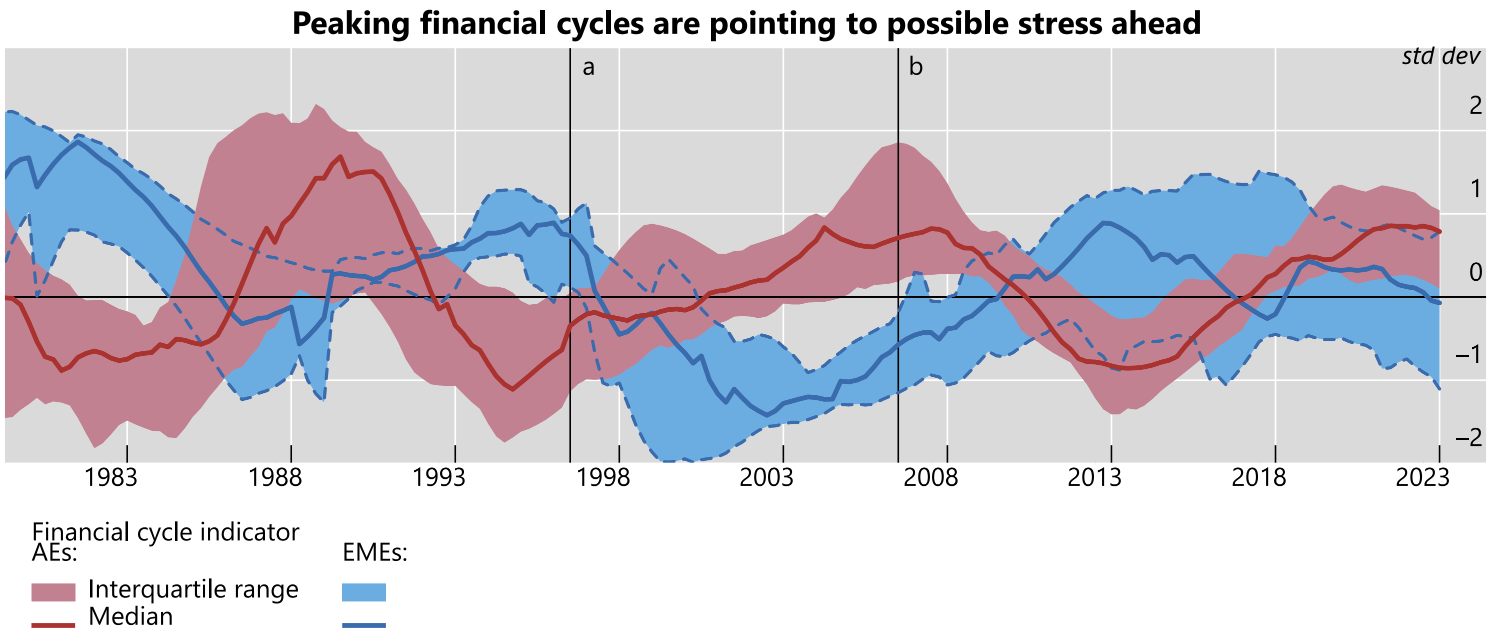
Financial cycles are peaking in many countries



a Start of the Asian Financial Crisis (Q3 1997). b Start of the Great Financial Crisis (Q3 2007).

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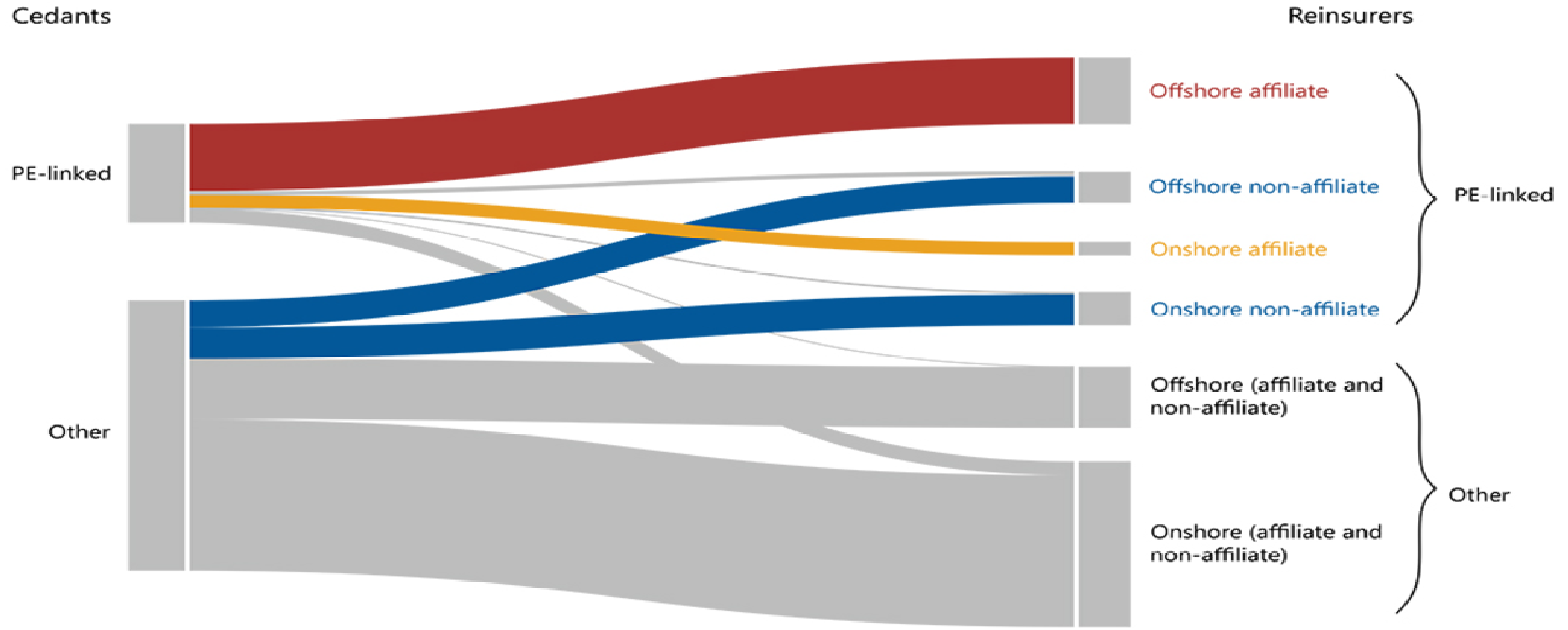
Risks migrating from regulated financial intermediaries into opaque corners of the financial system

Risks moving to offshore reinsurers with links to private equity[1] Graph 5



PE = private equity.

[1] The graph illustrates the flow of ceded reserves ("technical provisions") from cedants in the United States (left-hand side) to reinsurers (right-hand side). See technical annex for details.

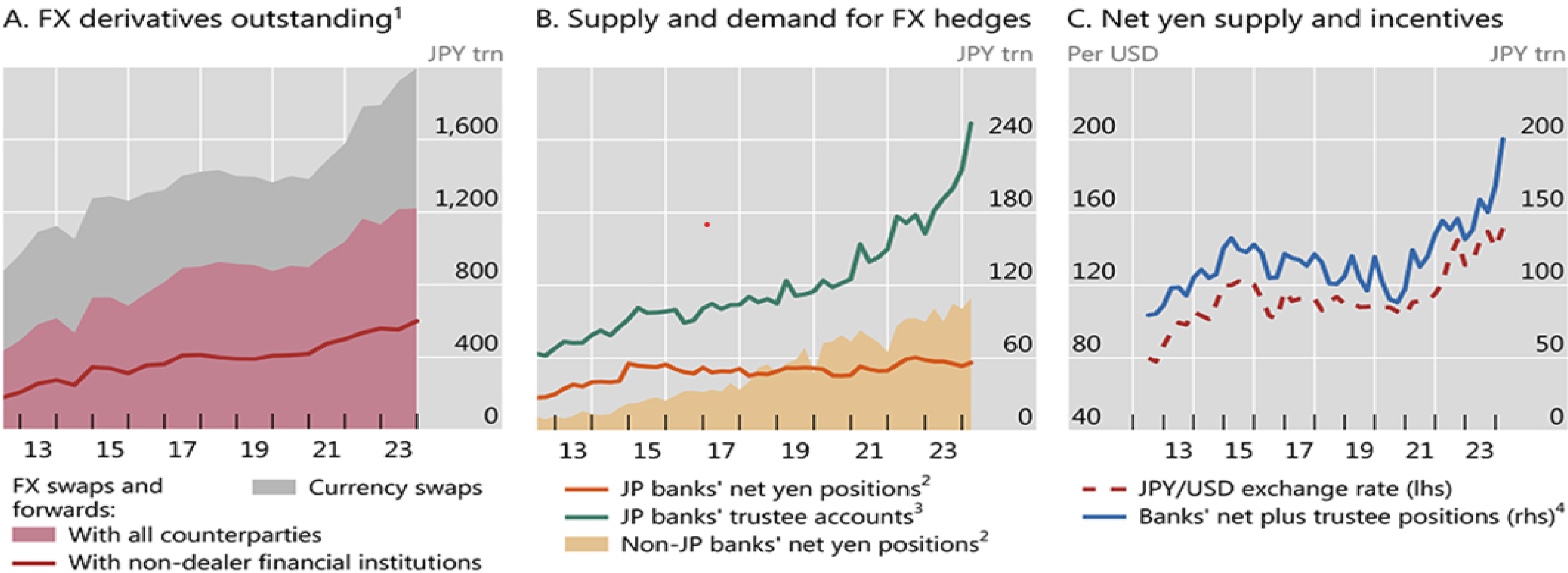
Sources: S&P Capital IQ; company filings; authors' calculations.

"Shifting landscapes: life insurance and financial stability", BIS Quarterly Review, September 2024

FX swap market can be used by the leveraged fund community to bypass funding currency constraints

Off-balance sheet positions in Japanese yen

Graph D1



[1] Outstanding FX swaps, outright forwards and currency swaps with the yen on one side (notional value), corrected for inter-dealer double-counting. Non-dealer financial institutions include non-reporting banks and non-bank financial institutions. [2] See Kloks et al (2023) for derivation. [3] Foreign currency holdings in trustee accounts managed by Japanese banks on behalf of third parties, assuming that 80% of the total is hedged for currency risk. [4] The difference between the estimated supply of yen (green line plus orange line in Graph D1.B) and the observed bank demand for yen (tan shaded area).

Sources: Bank of Japan; Bloomberg; JPMorgan Chase; LSEG Datastream; BIS international banking statistics; BIS OTC derivatives statistics; BIS Triennial Central Bank Survey; authors' calculations.

"Sizing up carry trades in BIS statistics", BIS Quarterly Review, September 2024

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