





MACROPRUDENTIAL POLICIES AND FINANCIAL STABILITY CONTACT GROUP

FRANKFURT AM MAIN, THURSDAY 15 MARCH 2018

MEETING SUMMARY

1) **Introductory presentation by the ECB**

Key risks to euro area financial stability

	Current level (colour) and recent change (arrow)*
<div style="display: flex; align-items: center;"> <div style="width: 15px; height: 10px; background-color: red; margin-right: 5px;"></div> <div style="font-size: 8px;">pronounced systemic risk</div> </div>	
<div style="display: flex; align-items: center;"> <div style="width: 15px; height: 10px; background-color: orange; margin-right: 5px;"></div> <div style="font-size: 8px;">medium-level systemic risk</div> </div>	
<div style="display: flex; align-items: center;"> <div style="width: 15px; height: 10px; background-color: yellow; margin-right: 5px;"></div> <div style="font-size: 8px;">potential systemic risk</div> </div>	
1. Abrupt and sizeable repricing of risk premia in global financial markets – triggered e.g. by a policy expectation shock – leading to a tightening of financial conditions	
2. Adverse feedback loop between weak bank profitability and low nominal growth, amid structural challenges in the euro area banking sector	
3. Public and private sector debt sustainability concerns amid a potential repricing of risk premia and increased political fragmentation	
4. Liquidity risks in the non-bank financial sector with potential spillovers to the broader financial system	

* The colour indicates the cumulated level of risk, which is a combination of the probability of materialisation and an estimate of the likely systemic impact of the identified risk over the next 24 months, based on the judgement of the ECB's staff. The arrows indicate whether the risk has increased since the previous FSR.

ECB staff presented the ECB's views on the risks and vulnerabilities for euro area financial stability as published in the ECB's November 2017 Financial Stability Review.

Regarding these risks, MFCG members were concerned most about the risk of repricing in global financial markets and least about bank profitability.

2) **Market developments since the September 2017 MFCG meeting**

Members discussed the financial stability outlook, including the return of volatility in February. They agreed that the episode was mainly technical in nature and had not had a discernible impact on other asset classes. It might, however, reflect the beginning of a period of higher volatility, which could push asset prices lower. In addition, market participants might have become overly optimistic during the prolonged low volatility environment, contributing to a higher risk appetite and greater risk taking. The search for yield had led to distortions in some market segments, with lower-rated debt securities' and US equity valuations appearing stretched by historical standards.

3) Developments in the corporate sector

Members discussed risks to financial stability related to developments in the euro area (non-financial) corporate sector. They highlighted (i) the migration of exposure to corporates from the banking sector to non-banks with the response of non-bank credit providers in times of market stress being less known than for banks; and (ii) potentially greater credit losses in the future owing to weaker creditor protection, which is likely to translate into lower recovery rates. Members noted that in Europe and in the United States, investment grade and high yield corporate leverage had increased in recent years, leaving corporates with less flexibility and at risk of rating downgrades should macroeconomic conditions worsen. Members agreed that risk taking in the corporate sector reflected the wider reach for yield across various markets and instruments.

4) Technology in the financial system

Members discussed opportunities and risks related to technology in the financial system. As for opportunities, members highlighted efficiency gains from digitalisation for the banking sector. However, the investment costs necessary to reap the full benefits might be out of reach for smaller institutions. Regarding risks, members argued that cyber-attacks, particularly those aimed at systemic institutions and infrastructures, were a significant threat. Such risks could become systemic, especially where interconnectedness was high and when industry participants were relying on the same technology. Moreover, there were concerns over many institutions' preparedness to face such threats.