



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

# Enhanced outlook and emerging risk in the banking union

2 July 2021

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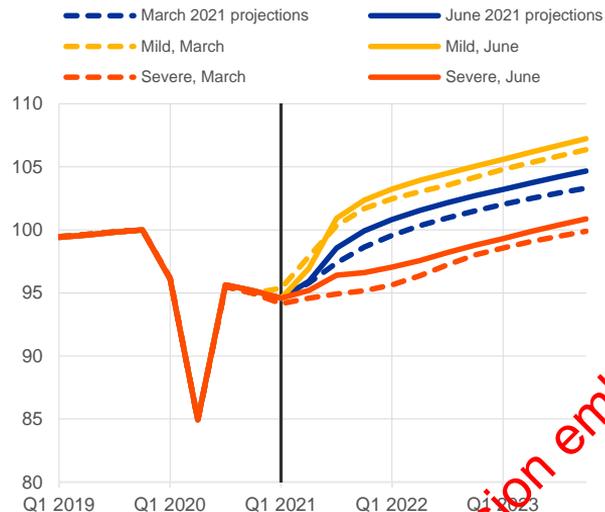
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# Continuously improving macro outlook

## Chart 1 Eurosystem staff GDP projections

(index: Q4 2019 = 100)

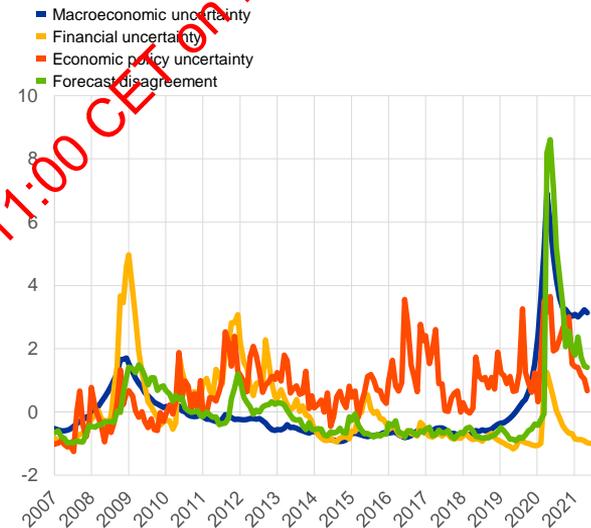


Source: ECB.

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

## Chart 2 Indicators of uncertainty

(standard deviation from mean)



Source: ECB.

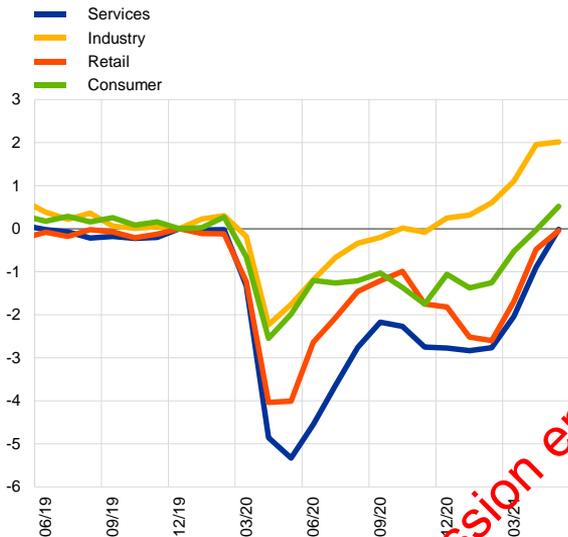
Notes: All measures of uncertainty are standardised to mean zero and unit standard deviation over the full horizon starting in June 1991. A value of 2 should be read as meaning that the uncertainty measure exceeds its historical average level by two standard deviations. The latest observations are for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

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# Increasing confidence and abated stress

## Chart 3 Confidence indicators by sector

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

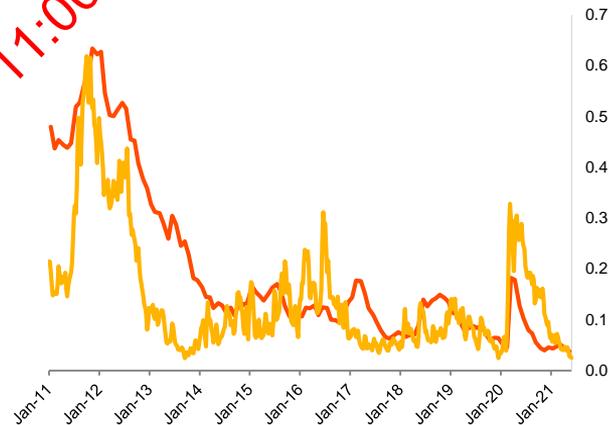


Source: ECB

## Chart 4 Indicators of systemic stress

(January 2011-May 2021; CISS: 10-week moving averages)

Composite indicator of systemic stress in financial markets  
Composite indicator of systemic stress in sovereign bond markets



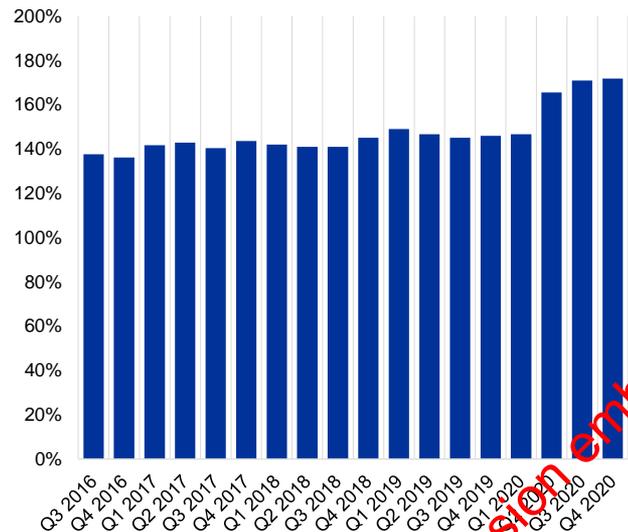
Source: ECB

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# 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)



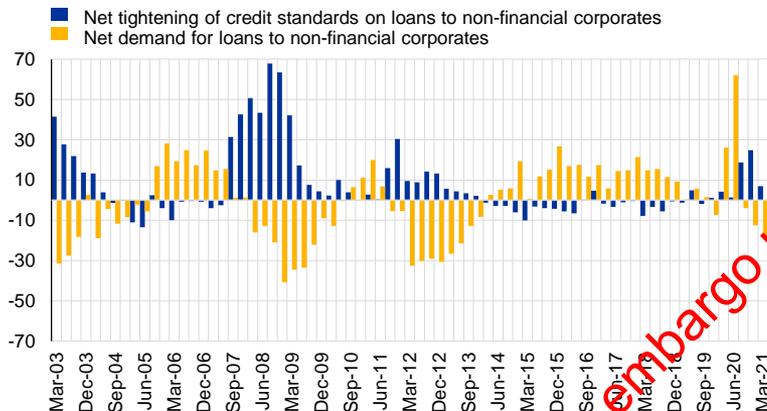
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# Contained tightening in bank lending standards

Chart 7

Lending standards and loan demand: non-financial corporates

(percentages)



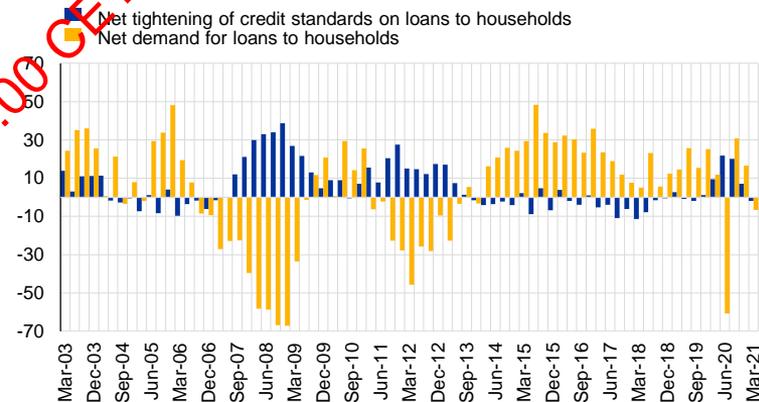
Source: ECB Bank Lending Survey.

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").

Chart 8

Lending standards and loan demand: households

(percentages)



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# Non-performing loans ratio continued to decrease

Chart 9  
Significant institutions' non-performing loans

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



Source: ECB statistics as at the fourth quarter of 2020.

Note: Changing sample.

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# Areas of supervisory concern: vulnerable sectors

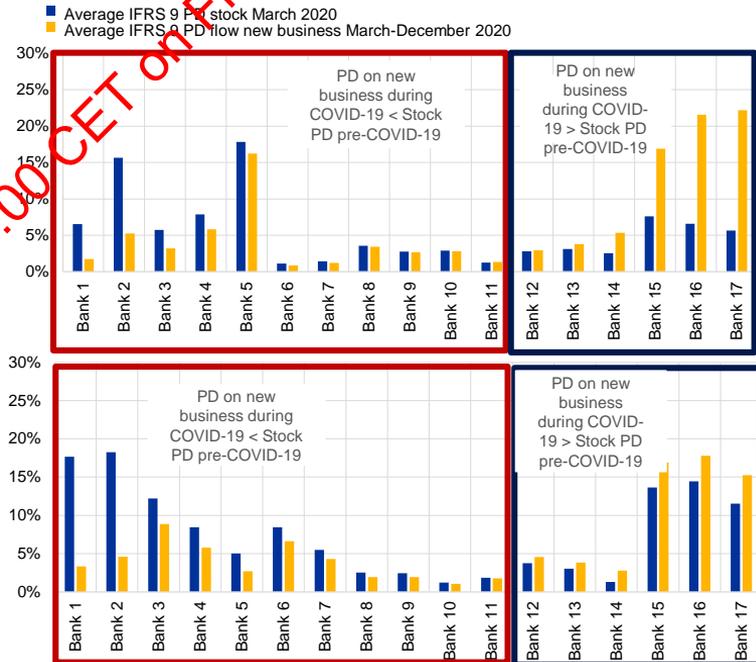
**Chart 10**  
**Significant institutions' exposures to vulnerable sectors**  
 (percentage of total exposures to non-financial corporates)



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)



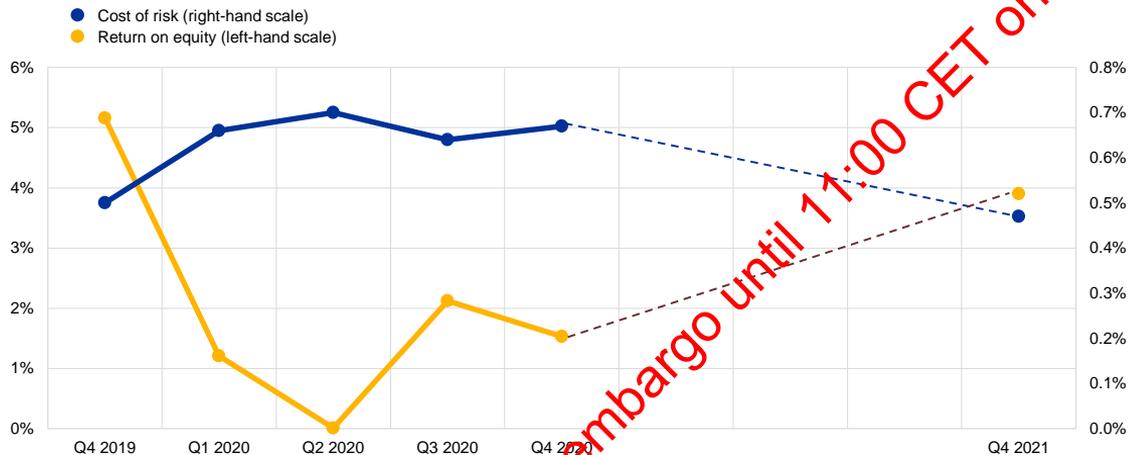
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# Banks' projections: profitability pushed up by lower provisions

Chart 12

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

(percentages)



- 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.

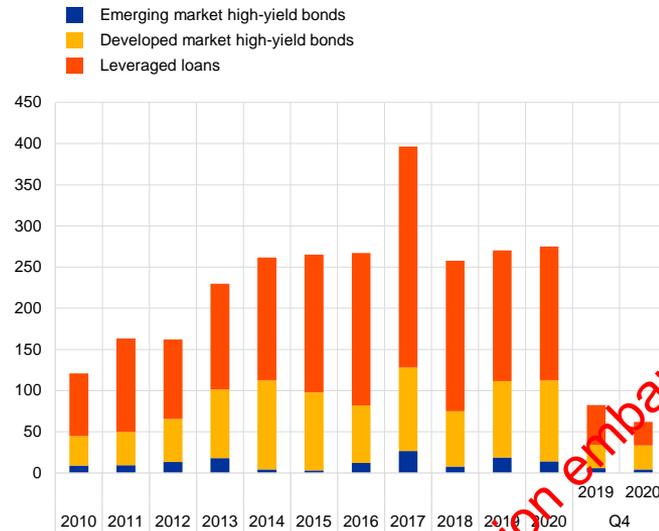
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# EU risky corporate credit market expands as investors search for yields

Chart 13

## European leveraged issuance by type

(EUR billions)

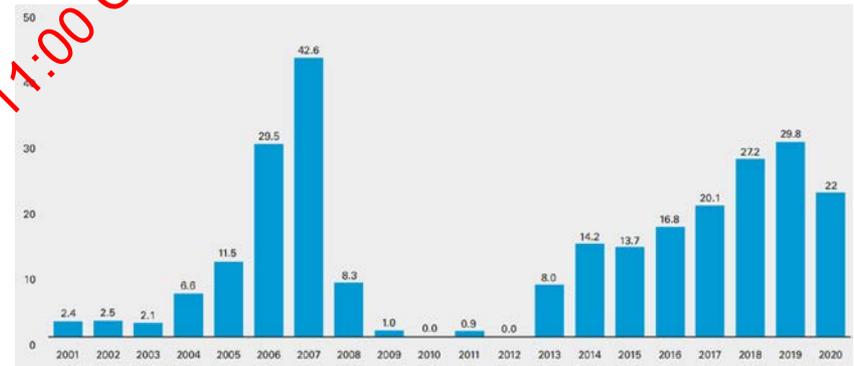


Source: AFME.

Chart 14

## European new-issue CLO volume

(EUR billions)



Source: Creditflux.

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# Broader investor base reduces direct exposures but creates connections and concentrations

Chart 15  
CLO investor base

(Q4 2018, percentages)

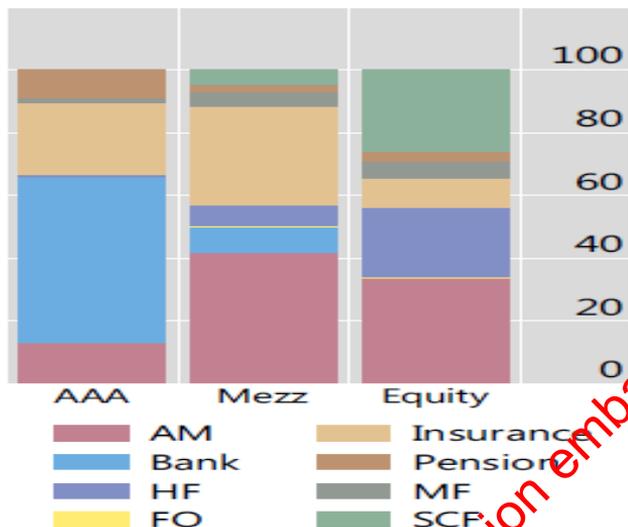
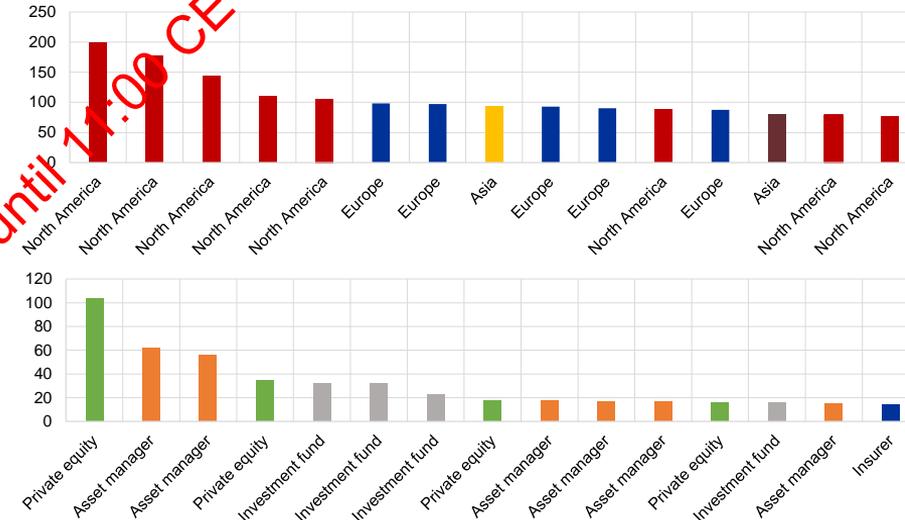


Chart 16

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

(USD billions)



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

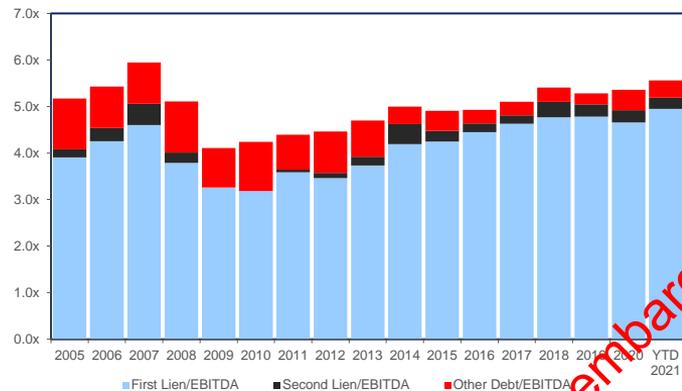
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# Leveraged lending increases corporate leverage, relaxes safeguards

Chart 17

## European leveraged issuance by type

(debt/EBITDA)



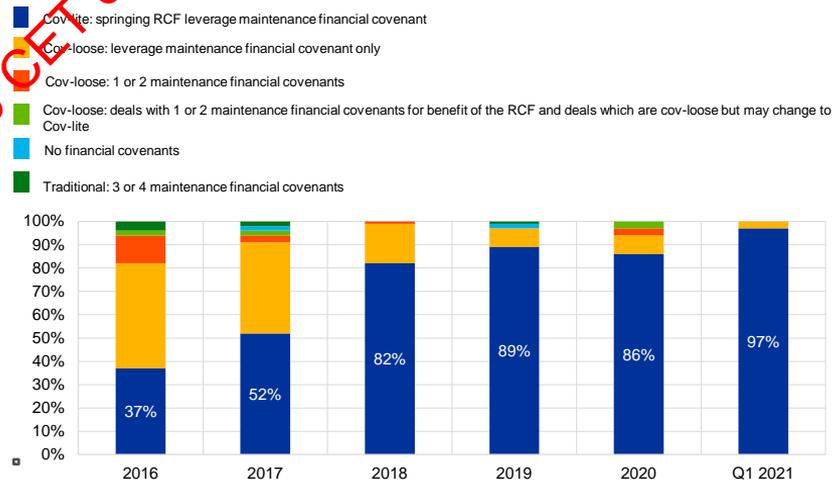
Source: LCD, an offering of S&P Global Market Intelligence

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

Chart 18

## Financial covenant packages in European leveraged loans

(percentages)



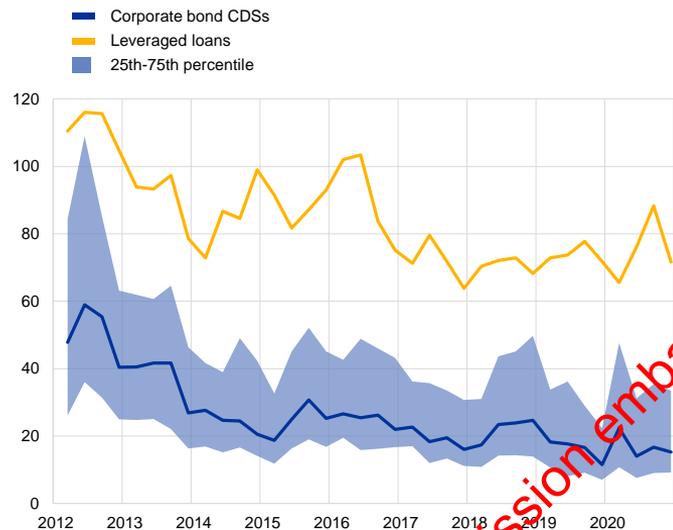
Source: Reorg.

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# 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)

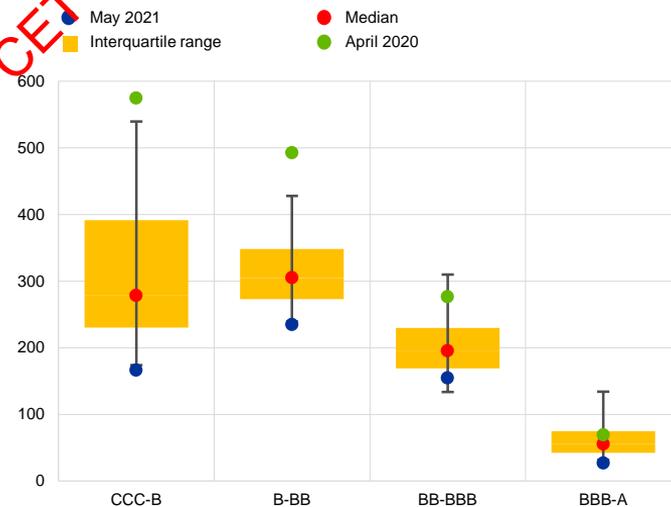


Source: ECB Financial Stability Review (May 2021).

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.

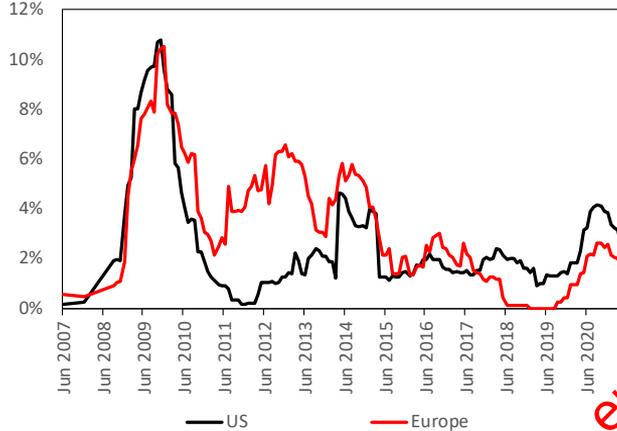
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# Public support contains defaults, but credit quality worsens

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

(percentages)

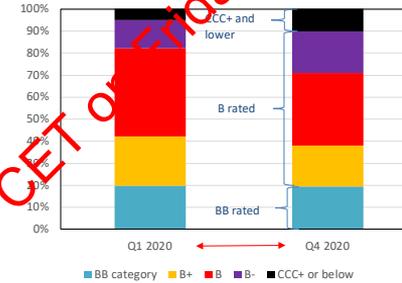
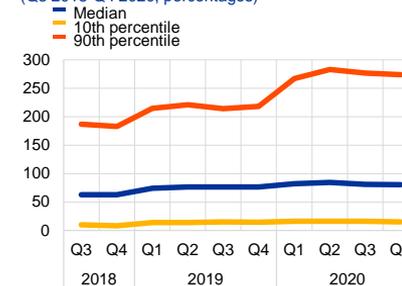


Chart 23

Debt-to-equity ratios of euro area firms

(Q3 2018-Q4 2020, percentages)



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

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

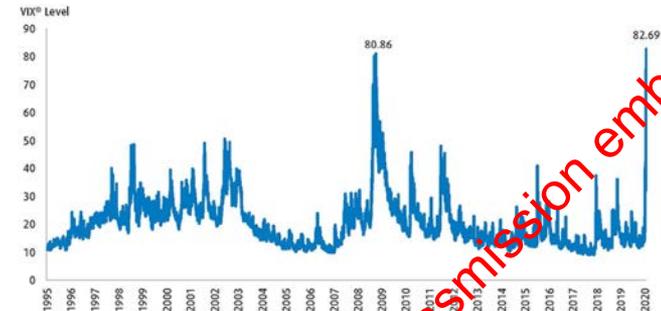
Chart 24 Notional value of contracts for difference and equity swaps

(EUR trillions)



Chart 25 Volatility index on equity markets

(index)



Sources: Chart 24: ECB; Chart 25: VIX.

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## Prime brokerage

Leveraged bets

Concentrated positions

Lack of transparency

Faulty counterparty credit risk management

## Structured products

Inappropriate risk management

Inefficient hedging

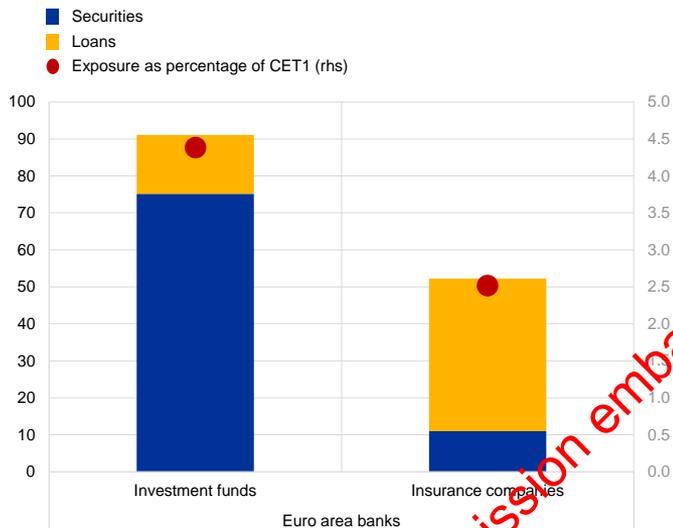
Concentrated business mix

# 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)

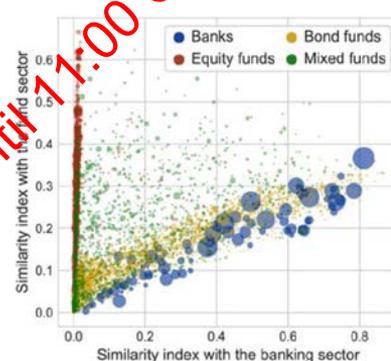


Source: ECB.

Chart 27

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

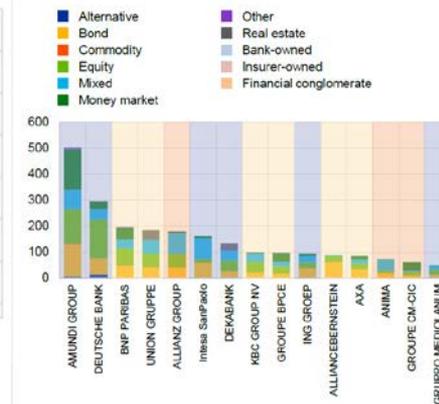
(Q2 2019, similarity index)



Source: ECB.

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

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



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