EUROPEAN CENTRAL BANK

EUROSYSTEM

DIRECTORATE GENERAL MACROPRUDENTIAL POLICY AND FINANCIAL STABILITY

FINANCIAL STABILITY CONTACT GROUP

FRANKFURT AM MAIN, WEDNESDAY, 6 SEPTEMBER 2023

MEETING SUMMARY

1) Recent developments in financial markets and near-term risks for euro area financial stability

Members discussed the macro-financial outlook, with most agreeing that financial stability conditions had improved since the last Financial Stability Contact Group meeting (April 2023), when sentiment had been relatively negative in the immediate aftermath of banking sector stresses which had erupted in the US and Switzerland during March. That said, members also held the view that both macroeconomic and geopolitical uncertainties had increased, rendering financial markets vulnerable to negative news. With valuations remaining stretched in some market segments and jurisdictions while volatility in bond markets also remained high, the potential for disorderly market dynamics was not excluded. Members also expected that credit risks will re-emerge, affecting both banks and non-bank financial intermediaries, with institutions simultaneously facing tighter financial conditions and weaker economic activity. Regarding the euro area commercial real estate sector, members held the view that, while valuations might face further downward pressure in some countries, a significant risk premium is already priced in.

2) Challenges for bank funding and liquidity in the current landscape

Views on the euro area banking sector have become more positive overall as members consider that banks are adequately capitalised for the challenges that lie ahead, while liquidity ratios had only been slightly affected by TLTRO repayments and remained high. In addition, the credit quality of assets continued to perform better than expected and profitability remains solid, boosted by high net interest margins. At the same time, though, the cost of equity remains high overall with bank equity valuations remaining depressed compared to other sectors. Two factors were mentioned to explain the conundrum. First, market-pricing may be signalling doubt about the sustainability of the recent lift to earnings, given a more challenging macroeconomic outlook. Second, it was also partly seen as a legacy of negative market sentiment towards euro area banks since the global financial crisis. Members also noted that funding cost might continue to increase going forward as excess liquidity diminishes and deposit costs increase. Members noted that senior debt issuance by banks had resumed after a virtual halt in March (following the banking sector stresses in US and Switzerland), with year-to-date 2023 cumulative totals substantially above comparable prior periods.