

IACPM Spring Conference – Regulatory Trends and Priorities

A financial stability perspective

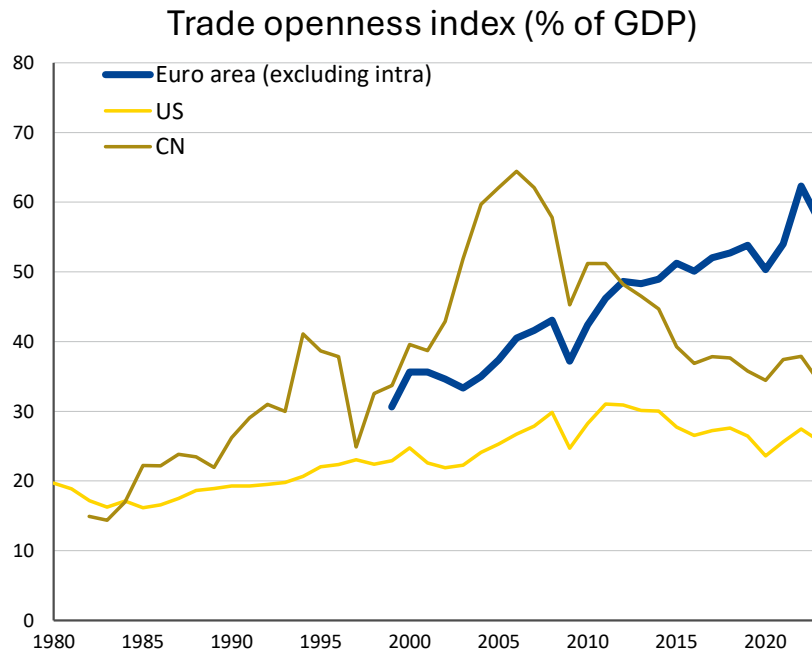
Nicoletta Mascher, Head of Financial Sector and Market Analysis

15 May 2025, Vienna



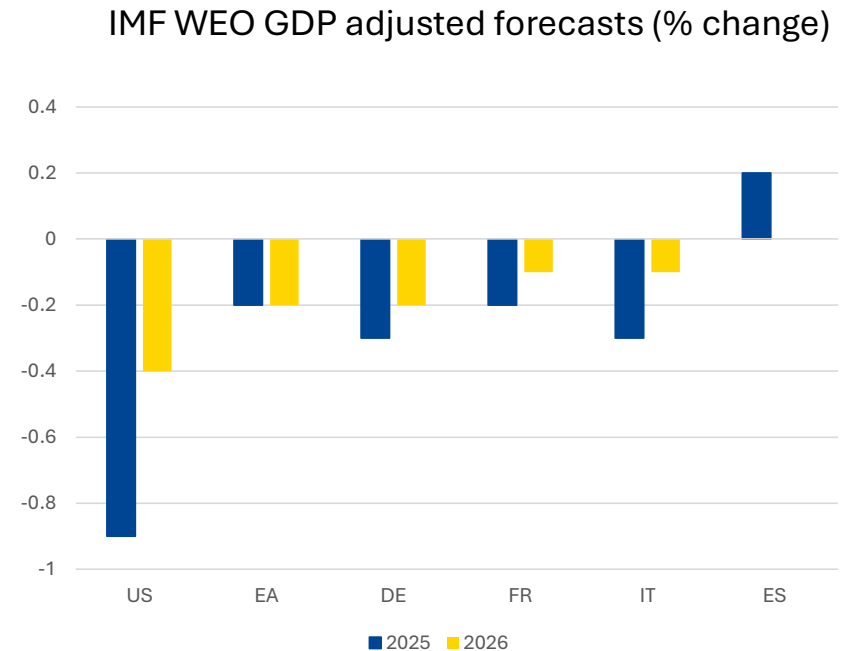
ECONOMIC OUTLOOK DEPENDS ON TRADE DEVELOPMENTS

- Euro area is highly integrated in global trade...



Source: IMF's Balance of Payments (BOP), and ESM's calculations. **Notes:** The global trade openness index is defined as the sum of world imports and exports of goods and services divided by world GDP.

- ...and vulnerable to trade disruptions

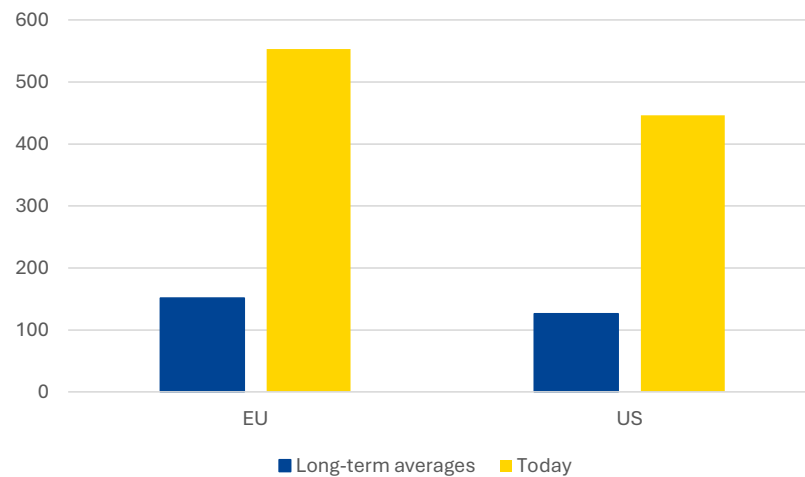


Source: IMF WEO 2025. **Notes:** The % change is computed with respect to the January 2025 WEO update.

UNCERTAINTY IS EXPECTED TO REMAIN HIGH

- Uncertainty has surged to unprecedented levels

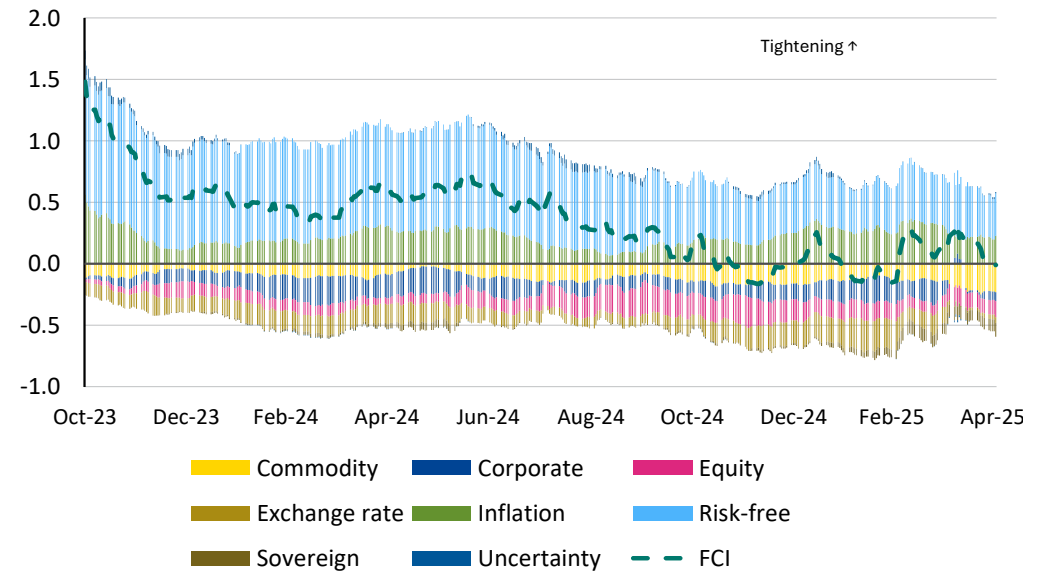
Economic Policy Uncertainty Index



Source: PolicyUncertainty.com **Notes:** The long-term averages are computed from January 1987 at monthly frequencies.

- Financial conditions still relatively benign

Financial Condition Index

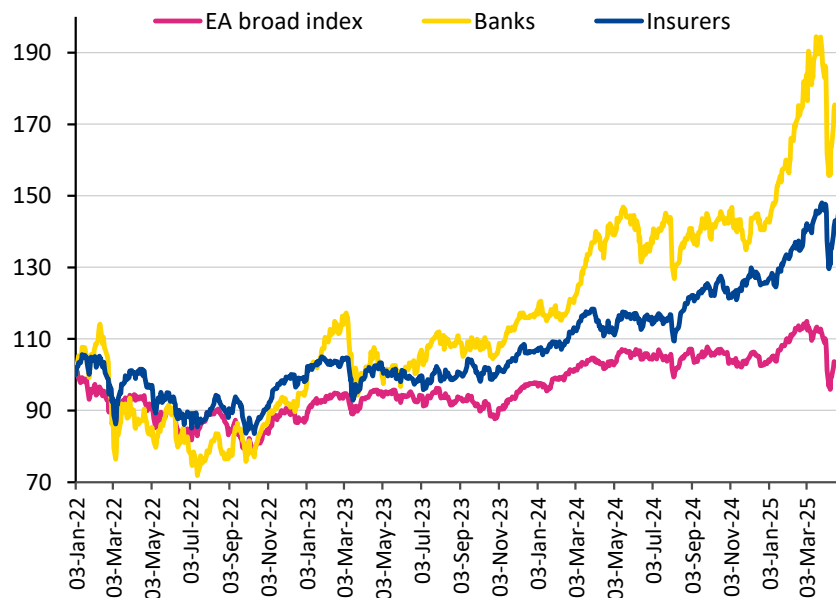


Source: ESM based on BdF and Bloomberg **Notes:** Risk-free rates (EA OIS curve, DE/US 10-year yields, EURIBOR 3m), risk premia (10-year gov. spread), corporate (HY EA index), equity (Euro Stoxx, Euro Stoxx banks), uncertainty (Euro VStoxx, Surprise index), inflation (inflation linked swap 5y, 10y), exchange rate (NEER, Euro/Dollar), commodity (global gas, oil, wheat).

FURTHER PRICE CORRECTIONS ARE POSSIBLE

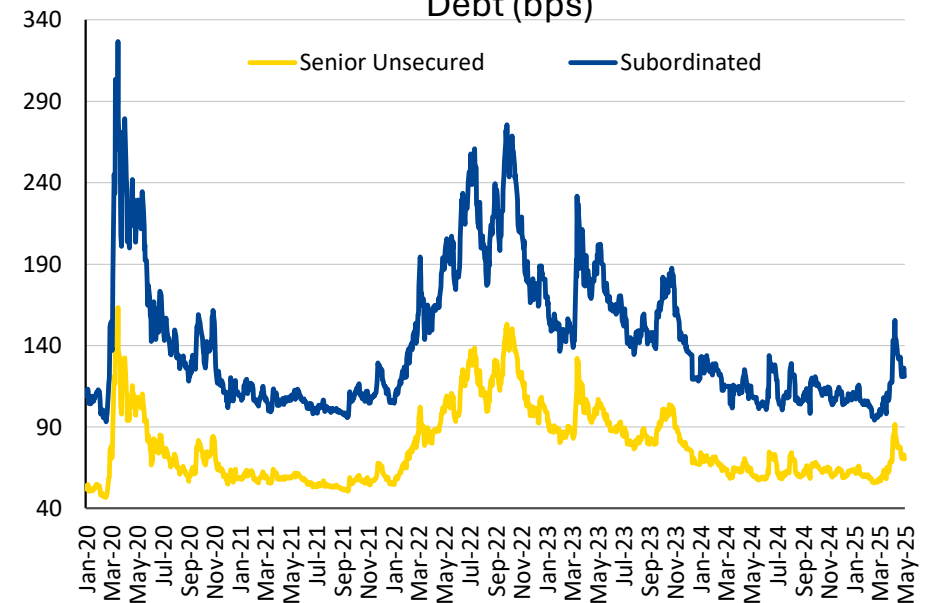
- Valuations remain high...
- ..but may not reflect the higher risk environment

Euro area equity prices (Jan22 = 100)



Source: Refinitiv.

CDS prices for Investment Grade European Financials Debt (bps)

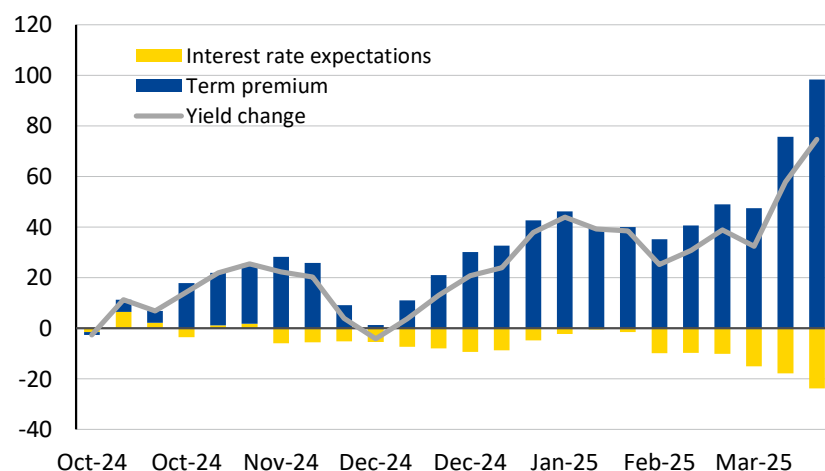


Source: SNL.

SOVEREIGN RISK MAY ADD TO TIGHTENING

- Rise in term/risk premium worsen financing conditions in the euro area.

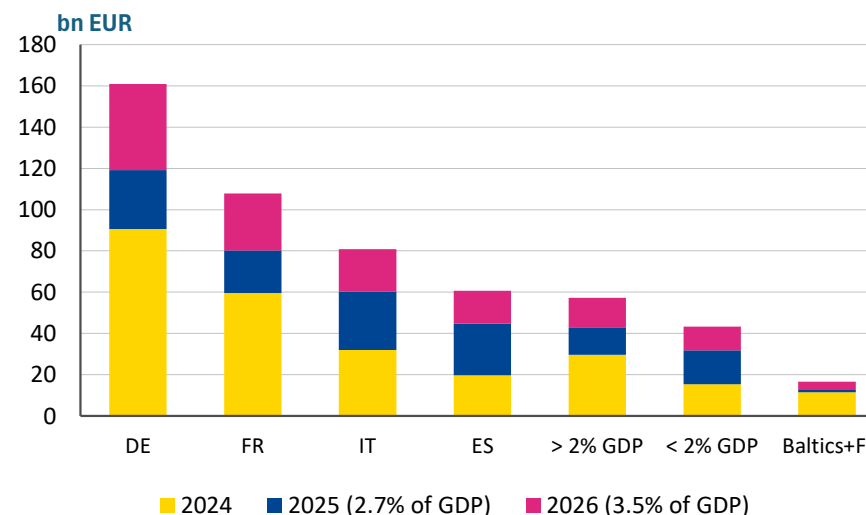
DE yield through the term structure's lens
(relative change since end-September 2024)



Source: ESM estimates based on Bloomberg. **Note:** The chart shows a model-based decomposition of yields of German 10-year Bunds in basis points. The decomposition is based on a Vector Autoregressive Model by Joslin, Singleton & Zhu (2010) that allows for the identification of market's expectations of the future policy rate under risk neutral assumption and the term premium in the euro area. Last datapoint: 13 March 2025.

- Market will need to absorb extra EUR 133 bn in 2025 and EUR 270 bn in 2026 (compared to 2024).

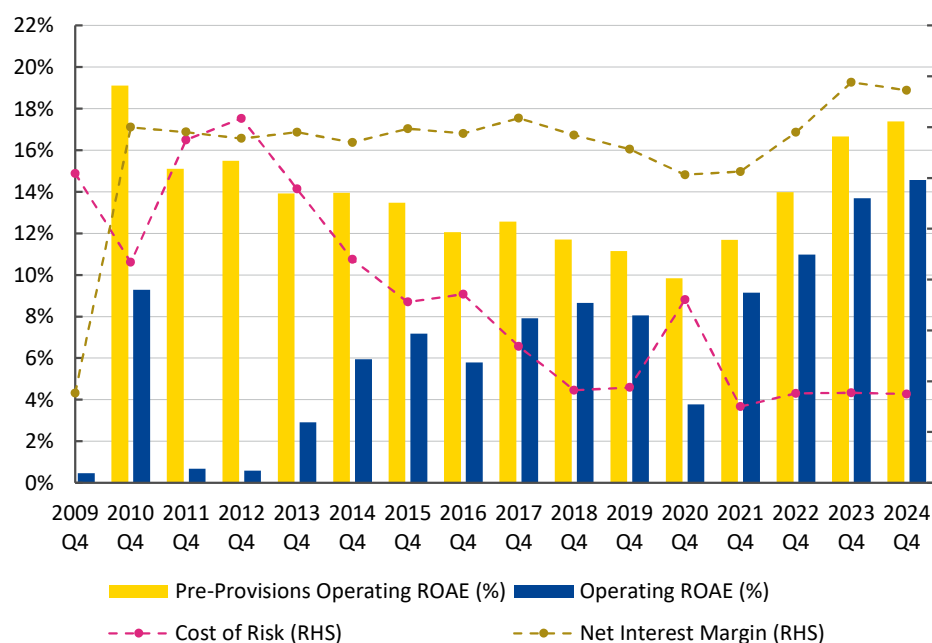
Absorption needs from higher defence spending
(2025/26 relative to 2024 level)



Source: NATO, AMECO, and ESM calculations. **Note:** >2% GDP groups countries estimated to spend more than 2% of GDP in defence by NATO in 2024 (EL, NL, SK). The opposite applies to <2% (HR, PT, BE, LU, SI).

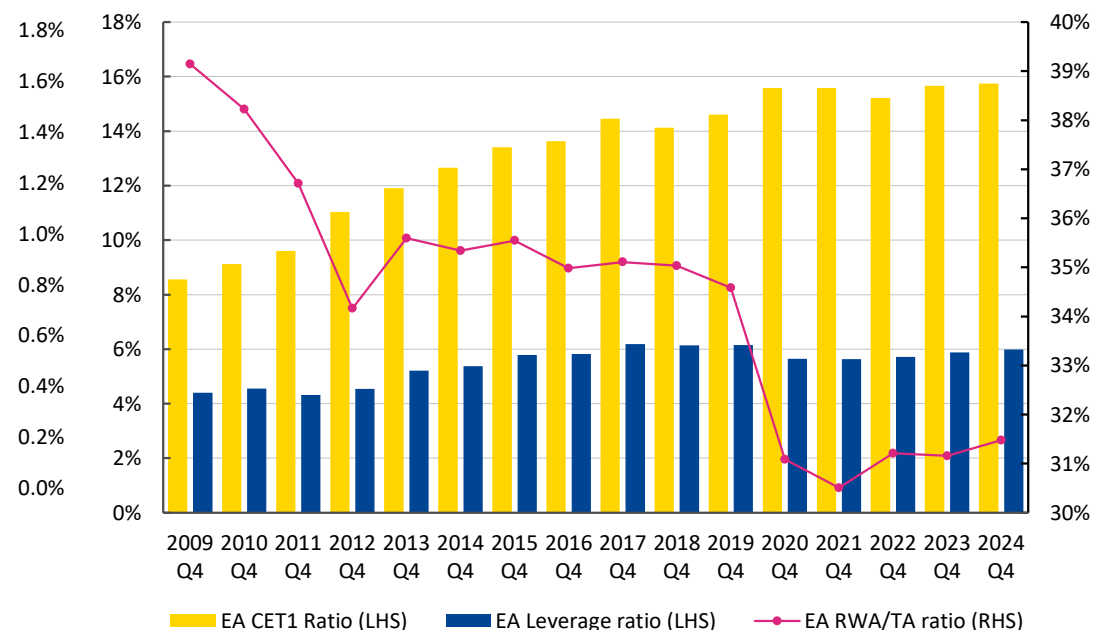
EURO AREA BANKS ARE LESS OF A CONCERN...

- Euro area banks maintained strong profitability



Source: SNL, Fitch.

- Prudential ratios show ample buffers

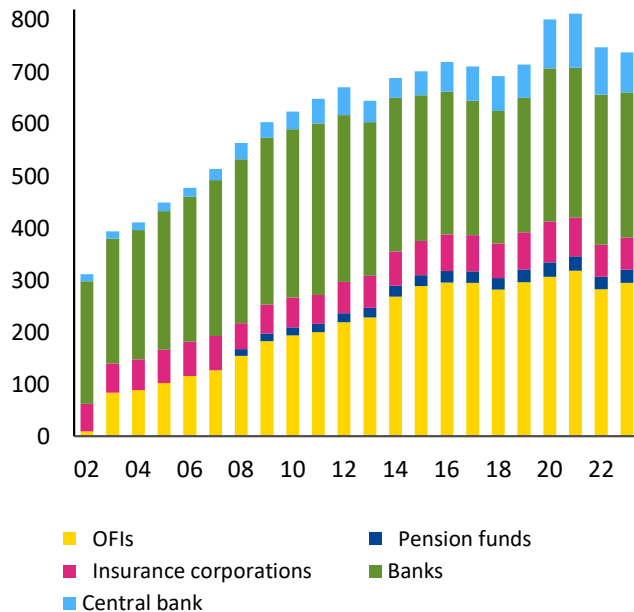


Source: SNL, Fitch.

...NBFI SIZE, LEVERAGE AND INTERCONNECTEDNESS MATTER

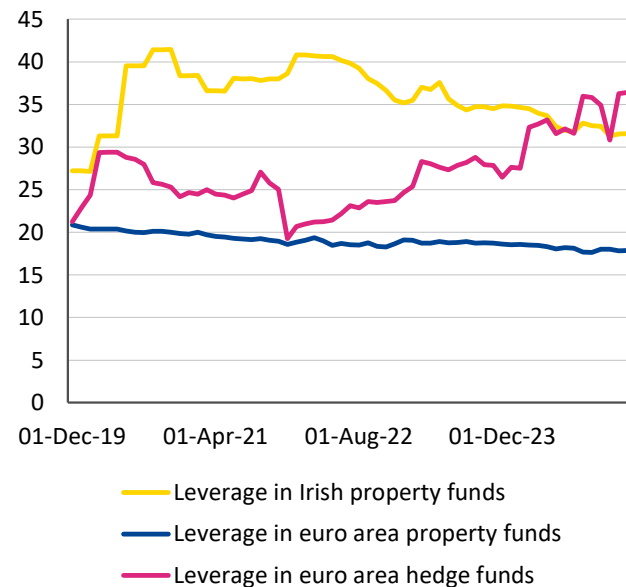
- NBFIs have grown to become dominant financial sector players
- NBFIs in Europe overall less leveraged than in the US, with some exceptions..
- ..and IFs are key players in the market for banks' MREL bonds

Total Assets / GDP (percent)



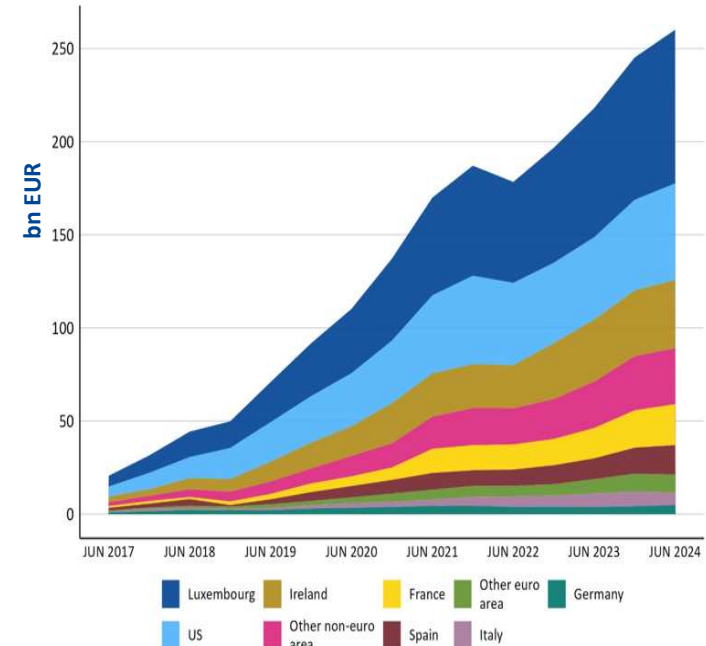
Source: FSB

Debt over AUM (percent)



Source: ECB and ESM calculations.

IFs holdings of banks' MREL bonds



Source: Lipper and ESM calculations. **Notes:** euro billion (market value). Minimum Requirement for Own Funds and Eligible Liabilities (MREL)

WHICH REGULATORY PRIORITIES AGAINST THIS SCENARIO



- The geopolitical outlook strengthens the case for the SIU agenda

- Develop retail engagement via incentives and literacy
- Offer alternative funding channels for sustainable growth and innovation
- Support financial stability with private sector risk sharing



- While measures should address systemic risks arising from non-banks

- NBFIs leverage in some subsectors should be contained
- Interconnectedness via common exposures can amplify external shocks, thus requiring liquidity facilities
- Monitoring on MREL exposure is granting to avoid resolution disruptions

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