



EUROPEAN CENTRAL BANK

Financial Stability Review

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Outline

I Financial Stability Review: Introduction

II Main areas of vulnerability

- Global macro-finance
- Financial markets
- Euro area economic balances
- Financial institutions

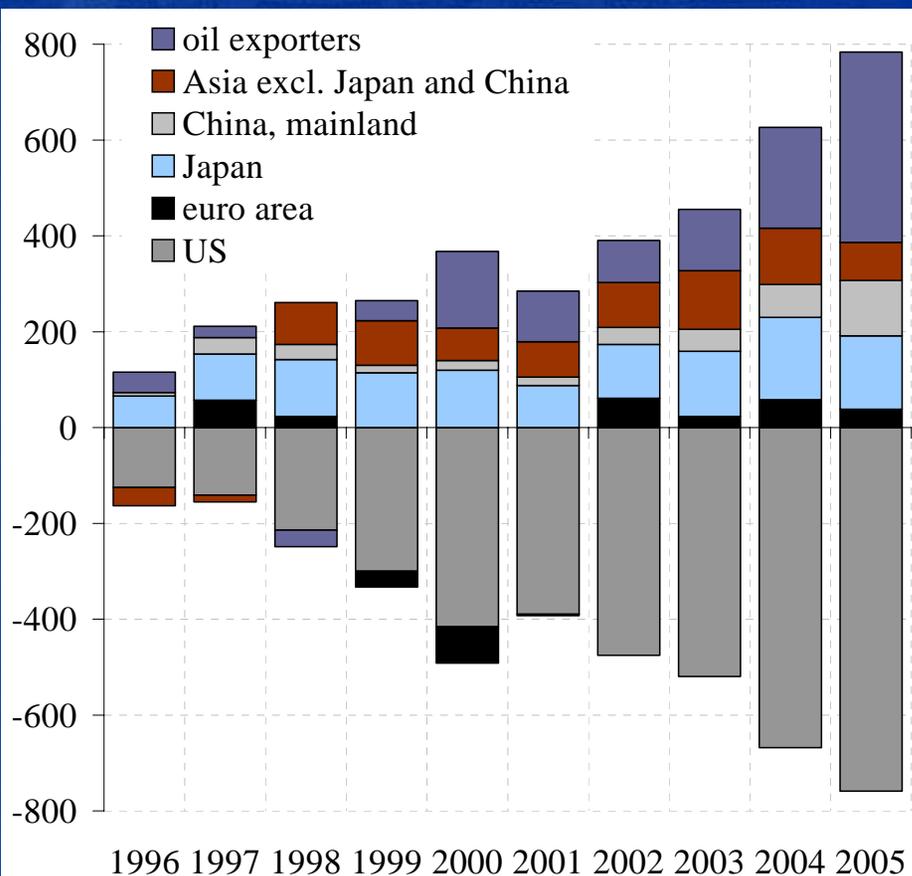
III Overall assessment

Financial Stability Review: Introduction

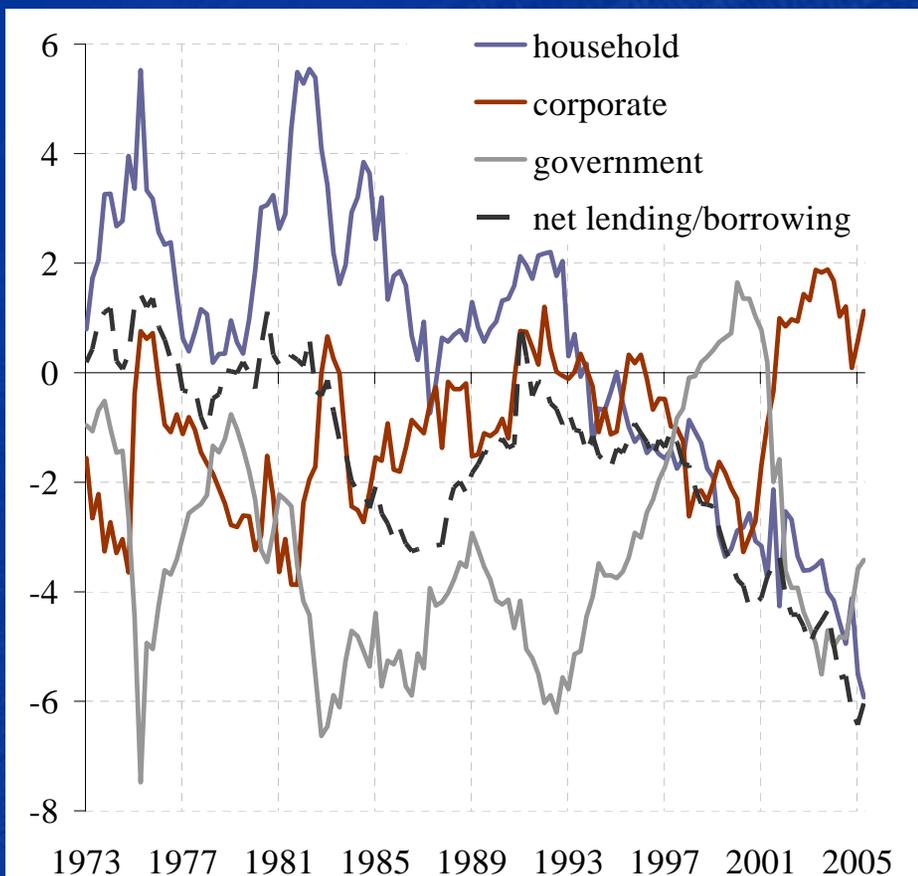
- **Purpose and scope**
- **Framework for financial stability assessment**
- **Co-operative production process**
- **Structure of the Review**

Global current account imbalances keep widening

Global current account positions (USD billions)

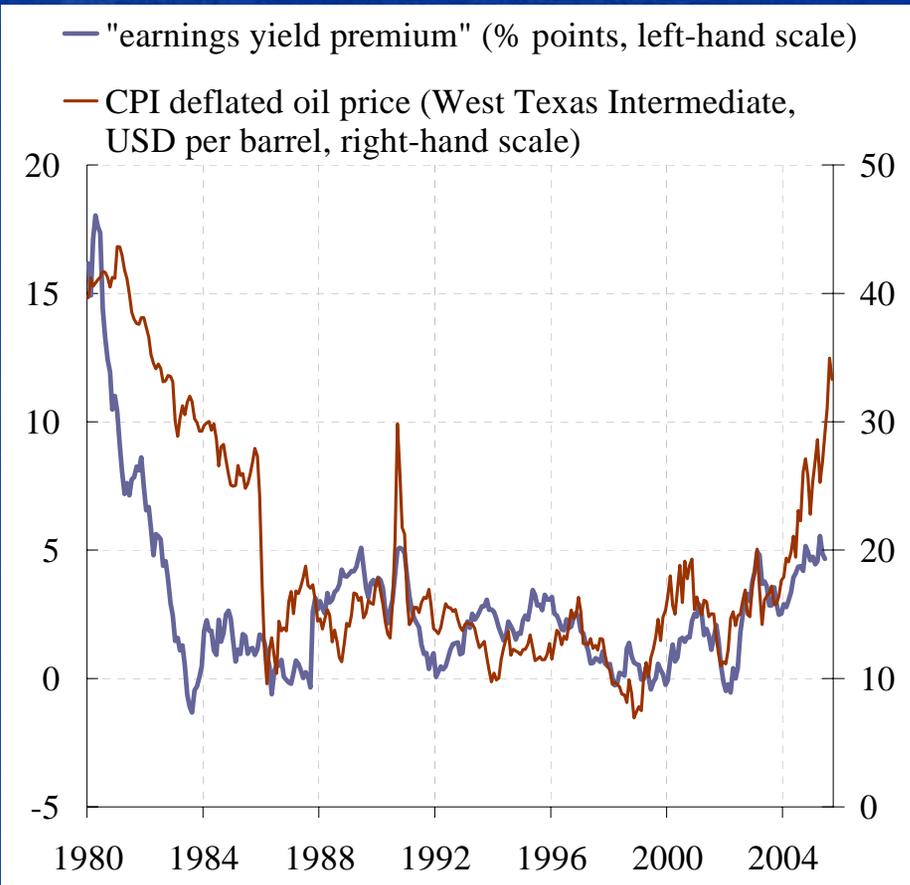


Net lending/borrowing of the US economy (% of GDP)

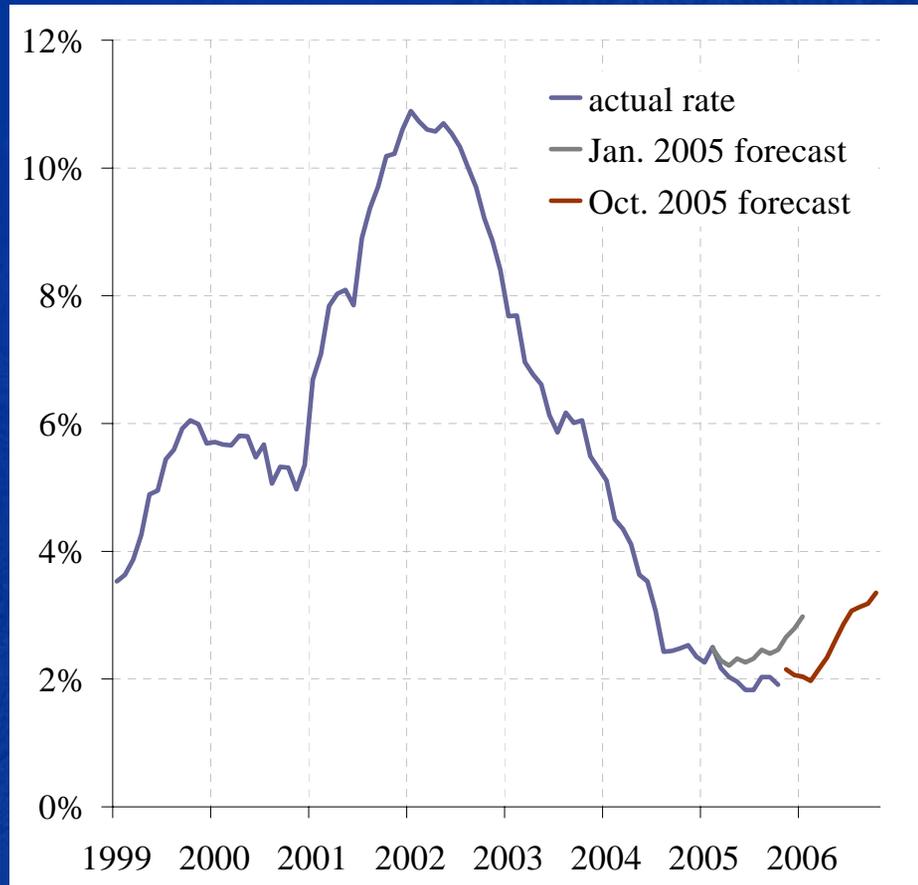


High oil prices pose additional risks for the global corporate sector outlook

US “earnings yield premium” and real oil price

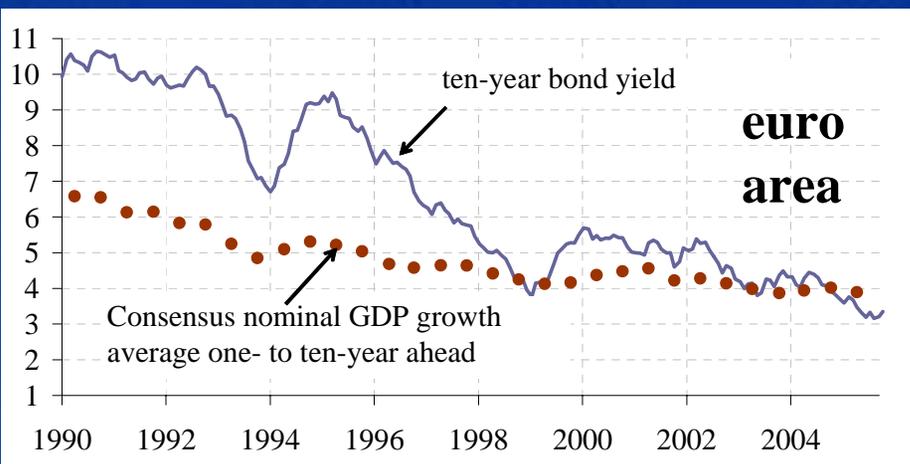
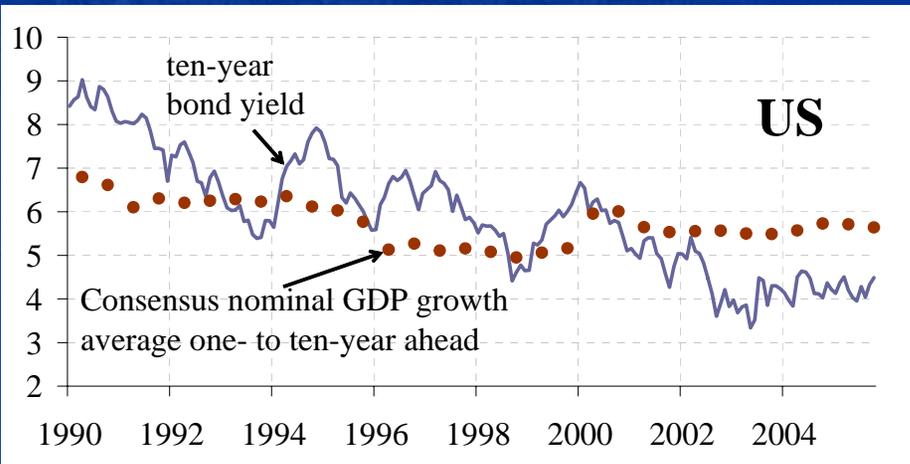


Global speculative grade default rates forecast (% of all speculative grade companies)

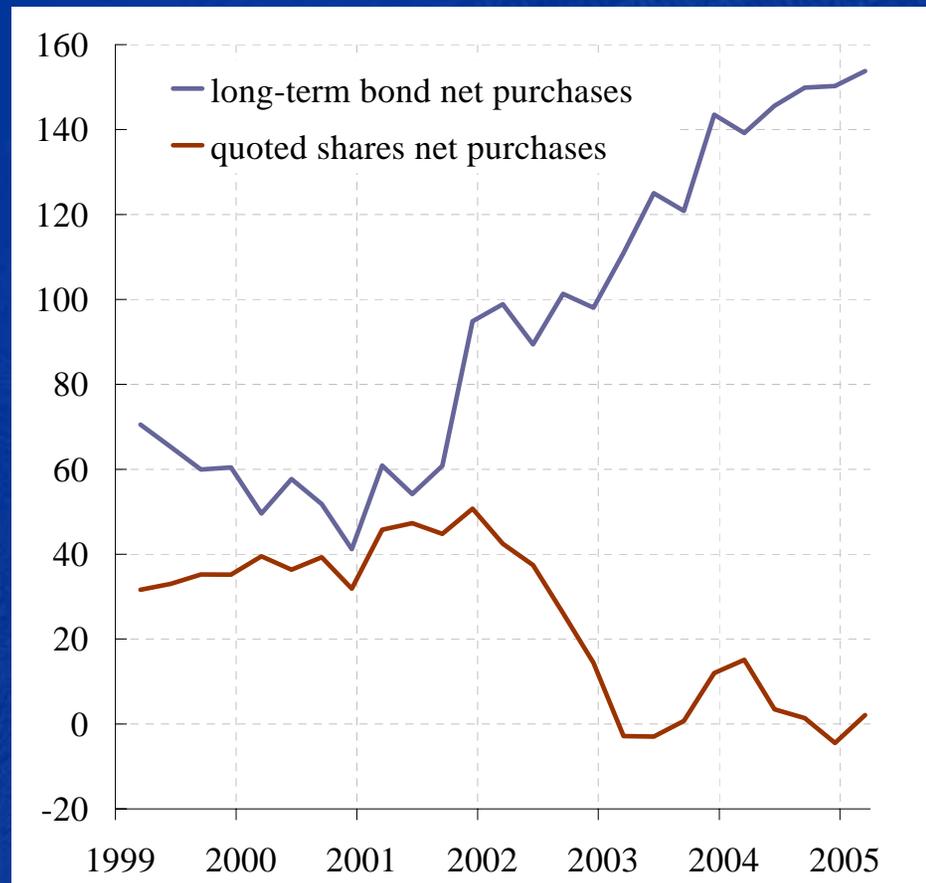


Long-term bond yields remain low, partly reflecting high demand for long-maturity assets

US and euro area 10-year bond yields and growth expectations (%)

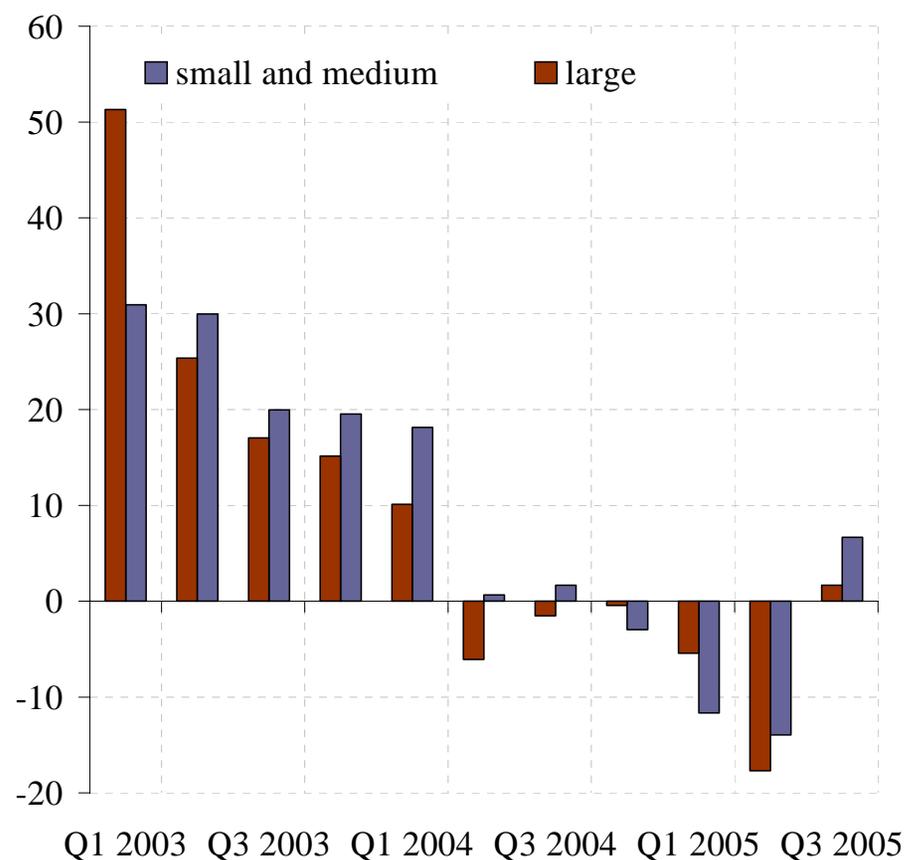


Net purchases of bonds and equities by euro area insurance corporations and pension funds (EUR billions, one-year moving cumulative purchases)

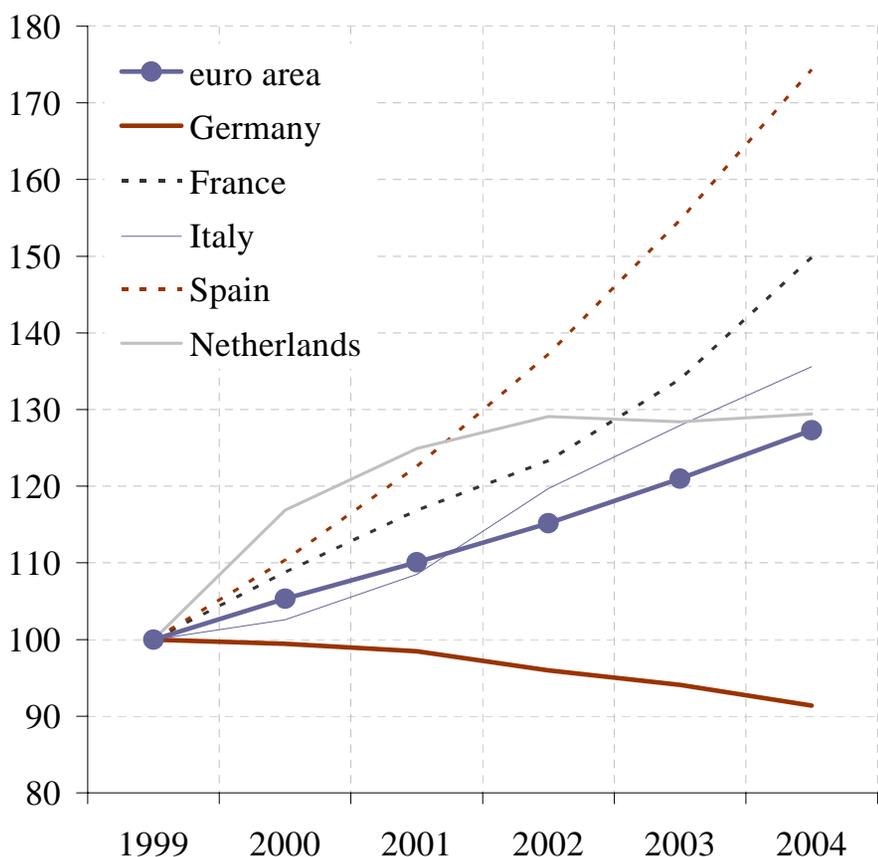


Corporate sector credit quality improves in the euro area, while house prices continue to rise in many countries

Credit standards applied to the approval of loans to non-financial corporations (net percentage changes)

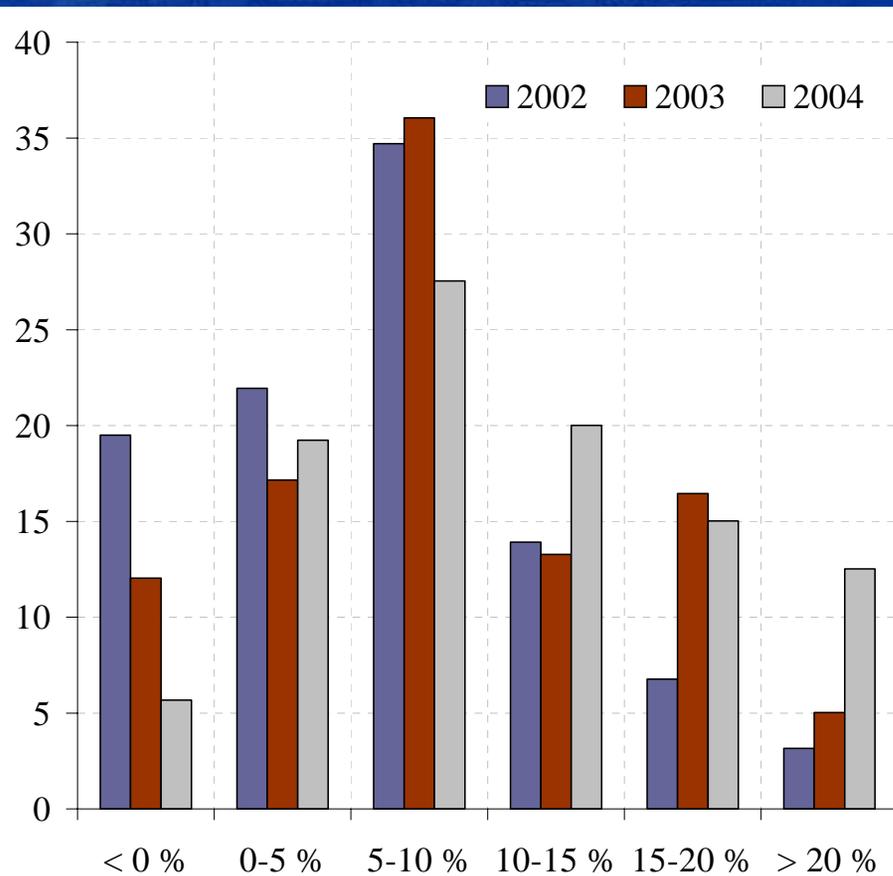


House price-to-rent ratio for the euro area (index: 1999 = 100)

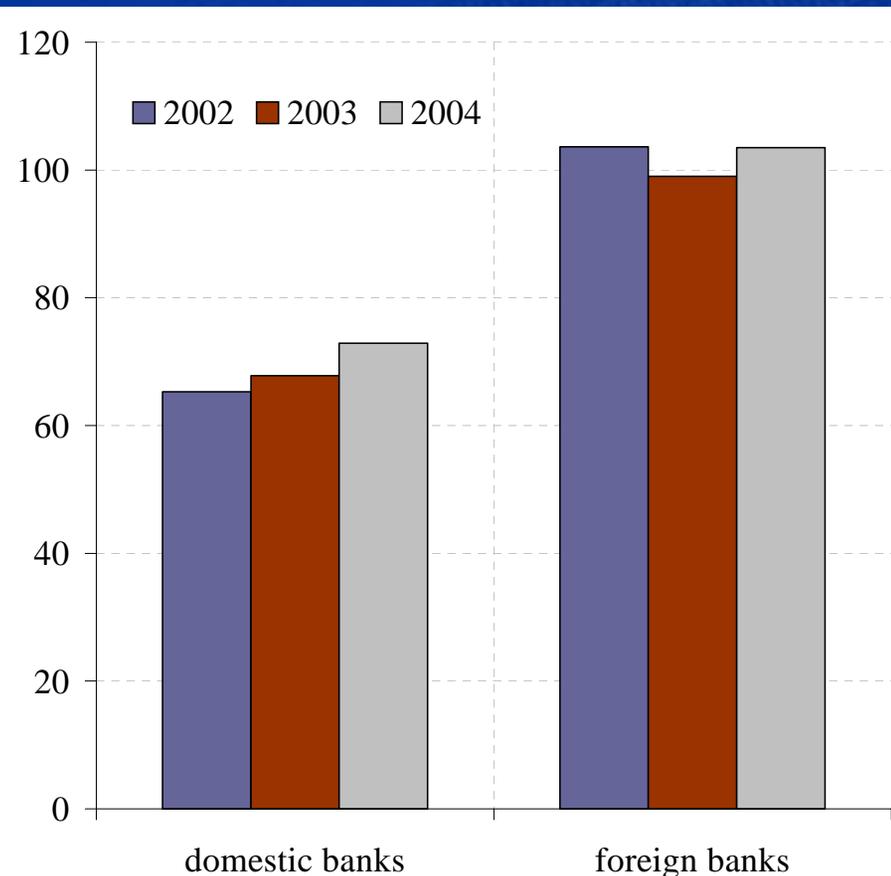


Euro area banks' profits improve significantly despite sluggish economic growth

Frequency distribution of return on equity for euro area banks (%)

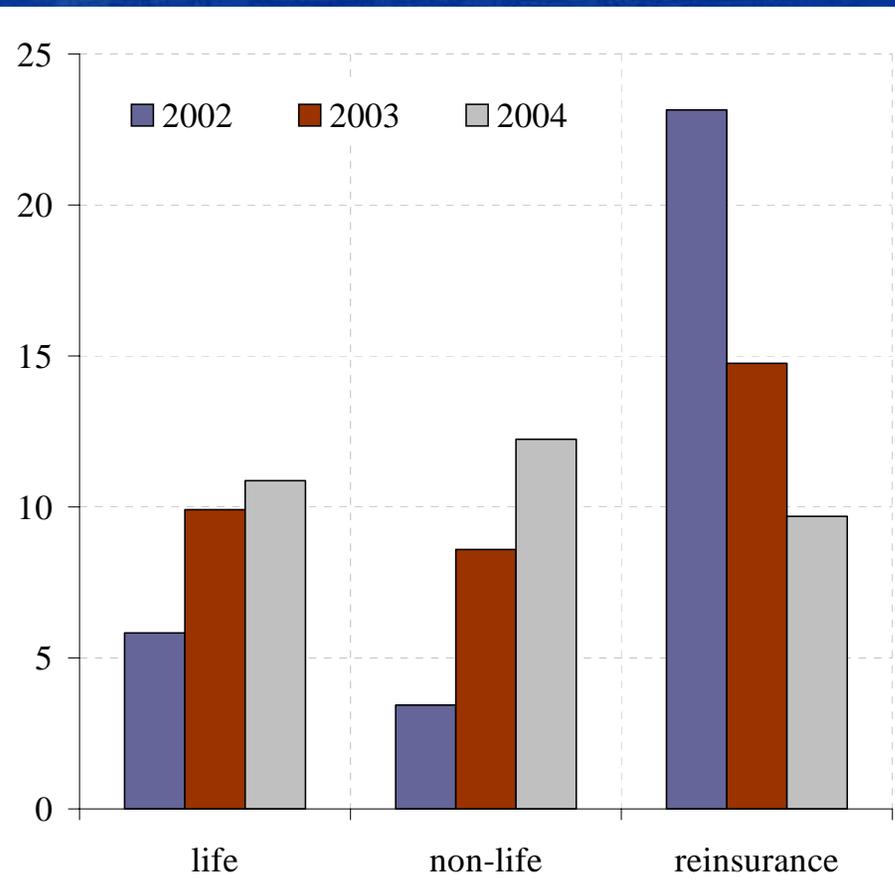


Euro area banks' total provisions (% of non-performing and doubtful assets)

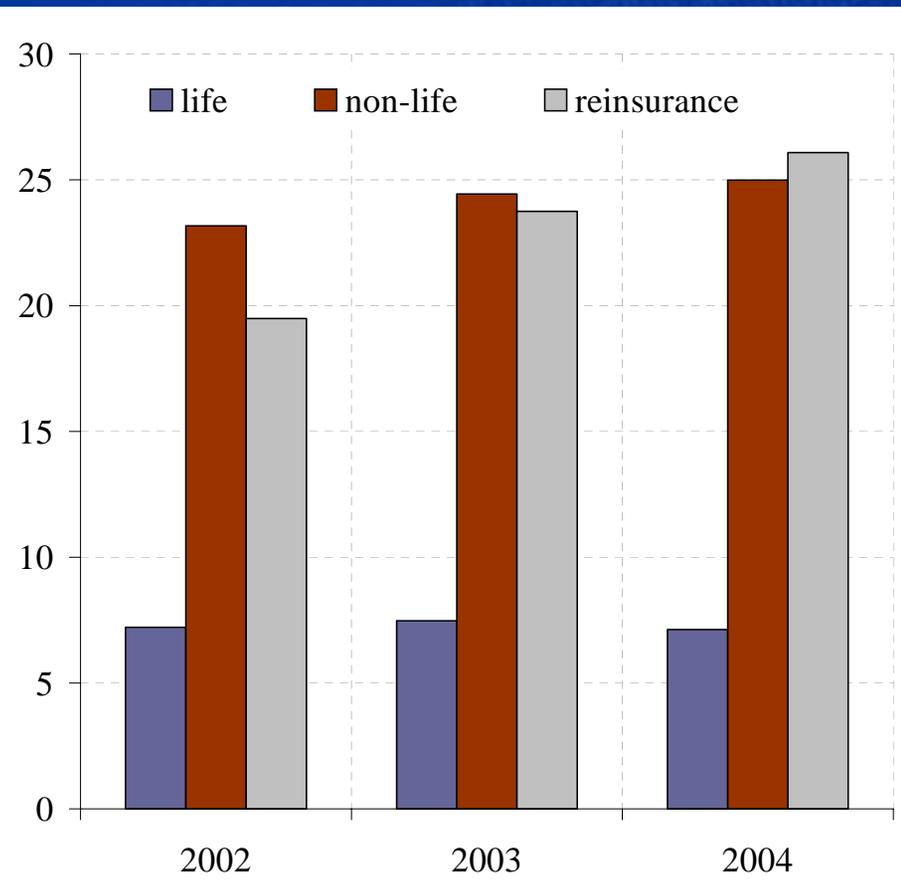


Profits increase in life and non-life insurance sectors, and solvency ratios show further improvement

Return on equity in the euro area life, non-life and reinsurance sectors (%)

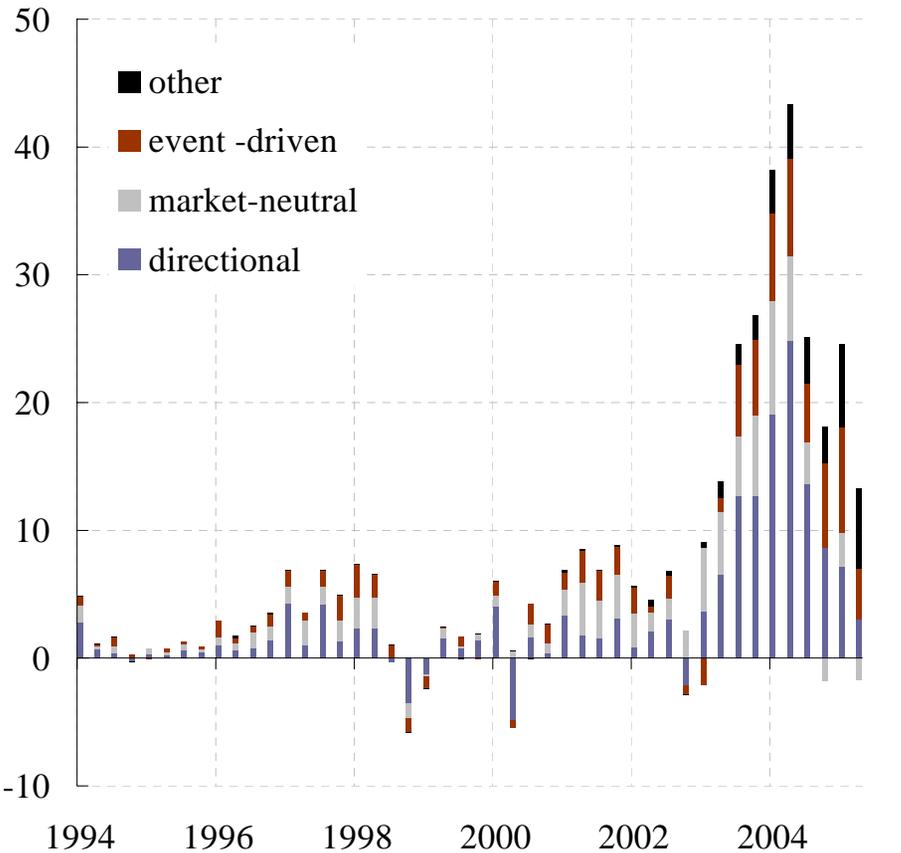


Solvency ratios in the euro area life, non-life and reinsurance sectors (%)

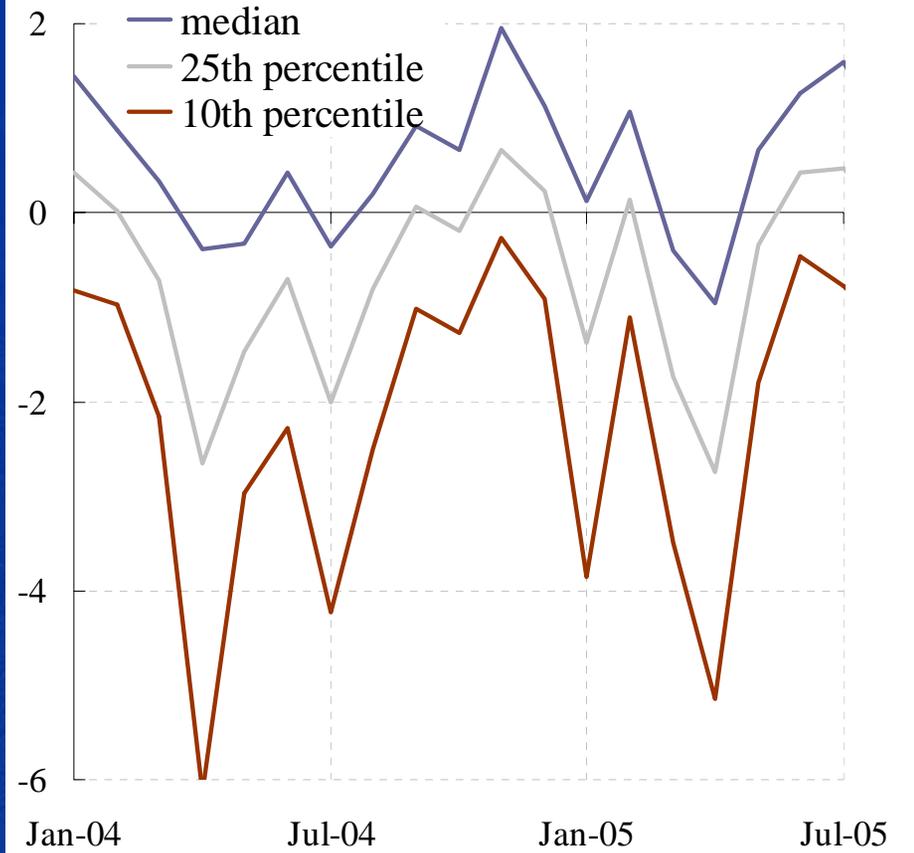


Hedge fund returns and inflows have declined but risks remain

Hedge fund inflows (USD billions)



Distribution of hedge fund returns (% net of all fees)



Overall assessment: the main scenario is expected to be one of continuing financial stability...

There are some positive developments:

- **The pace of global economic activity has remained quite strong**
- **Balance sheets of large corporations have improved further**
- **Balance sheets of financial institutions have been strengthened further**

... but the outlook is clouded by growing risks and appears more mixed than six months ago

Potential risks and vulnerabilities are also growing:

- **Further widening of global imbalances raises medium-term risks of abrupt unwinding**
- **Possibility of disorderly market correction of hunt for yield has increased**
- **High oil prices and sluggish domestic demand raise corporate credit risks**
- **Further gains in house prices in several euro area countries increase risks of house price correction**
- **The current level of banks' provisioning may turn out to be insufficient if credit conditions were to prove worse than expected**