EUROPEAN CENTRAL BANK

EUROSYSTEM

DIRECTORATE GENERAL MACROPRUDENTIAL POLICY AND FINANCIAL STABILITY

FINANCIAL STABILITY CONTACT GROUP

FRANKFURT AM MAIN, THURSDAY, 20 APRIL 2023

MEETING SUMMARY

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

Members discussed the financial stability outlook following the eruption of banking sector stresses in the US and Switzerland during March. Most members agreed that financial stability conditions have deteriorated since the last Financial Stability Contact Group meeting (September 2022). However, they distinguished between the vulnerabilities of some US banks and the sound fundamentals of the euro area banking sector, where capitalisation and liquidity coverage are strong. Nonetheless, as banking sector stresses outside the euro area had led to the repricing of some funding instruments, members expected an overall increase in bank funding costs as well as a further tightening of lending standards. Overall, members considered that the macro-financial environment was becoming more uncertain, highlighting the importance of remaining vigilant regarding vulnerabilities, both within and outside the banking sector.

2) Real estate downturn and implications for financial stability

Members also discussed the financial stability challenges posed by the ongoing downturn in real estate markets. While the nature of the vulnerabilities varies across euro area countries, the consensus amongst members was that Commercial Real Estate (CRE) markets will continue contracting as they adjust to higher interest rates. Members thought that stresses could emerge where real estate firms' profits are unable to keep pace with rising financing costs. They also considered lower quality assets in non-prime locations to be particularly vulnerable, with ESG-related costs like to increase significantly over time. Some members argued that some banks may have concentrated exposures and that banks could also be indirectly impacted via exposures to investment funds dealing with real estate. However, members listed mitigants to these risks, including that direct exposures of the euro area banking system to CRE are limited in size while also being substantially less leveraged than before the Global Financial Crisis (GFC).