Lucas Papademos: Opening remarks at the press briefing on the occasion of the publication of the December 2008 ECB Financial Stability Review

Speech by Mr Lucas Papademos, Vice President of the European Central Bank, at the press briefing on the occasion of the publication of the December 2008 ECB Financial Stability Review, Frankfurt am Main, 15 December 2008.

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I. Introduction

My colleagues and I would like to welcome you to today's press briefing on the occasion of the publication of the December 2008 edition of the ECB Financial Stability Review. The financial stability assessment contained in the Review has been prepared with the close involvement of the ESCB Banking Supervision Committee. It is for the most part based on information that was available up until the "cut-off" date of 28 November. The Review examines in some detail the main trends and events that characterised the euro area financial system over the past six months and it contains 14 boxes and five special feature articles that address topical financial stability issues in a more focused and analytical manner. The central objective of the ECB Financial Stability Review is to identify the main sources of risk and vulnerability to financial system stability and to provide a comprehensive assessment of the capacity of the euro area financial system to absorb adverse disturbances.

For this edition of the Review, we made an additional effort to provide a summary that makes the key messages of our analysis more accessible. In my presentation, I will broadly follow this summary, but also provide additional explanations on some of the most topical issues. I will start with a brief review of the overall impact of the financial market turmoil on the global banking system and the current macroeconomic outlook. I will then examine the risks and vulnerabilities in: *(1)* the global macro-financial environment; *(2)* the euro area corporate and household sectors and; *(3)* the euro area financial system. Finally, I will conclude with our overall assessment of risks to euro area financial stability in the period ahead.

II. The financial market turmoil: overview

Since the publication of the previous Financial Stability Review in June 2008, the financial crisis has intensified. Banks had to absorb further asset valuation write-downs in an environment where wholesale funding costs remained elevated. At the same time, the global economic outlook deteriorated and became more uncertain, risk aversion among financial market participants surged, and the prices of most financial assets fell.

The persistent liquidity stresses in the early phases of the turmoil eventually gave way to deeper concerns about creditworthiness and the adequacy of capital buffers. Following the bankruptcy of Lehman Brothers, investors and creditors lost confidence in the ability of some financial firms to meet their obligations. As a result, many key financial firms faced mounting challenges in accessing short-term funding and capital markets, which triggered sharp drops in their stock prices. Some of the world's largest financial institutions were affected by this adverse dynamic and a number of them were ultimately declared bankrupt, purchased by other financial institutions, or provided with government support.

Central banks and governments have taken extraordinary remedial actions, which aim at addressing liquidity stresses and strengthening capital positions, thus contributing to restoring confidence in and improving the resilience of financial systems. These measures have succeeded in stabilising the euro area banking system. Over time, as some

government measures are being fully implemented, they should contribute to lowering funding costs of banks and facilitate the provision of credit to the broader economy.

After these introductory remarks, let me first present the latest available figures regarding the total turmoil-related income losses and the new capital raised by major global banks since the beginning of the second quarter of 2007 up to and including the third quarter of 2008. Over this period, the total mark-to-market losses amounted to USD 720 billion globally. This figure includes losses related to holdings of structured finance instruments and mortgages which are reflected either in net income or in the value of equity or in other comprehensive income.[1] As shown in Chart 1, the share of European banks in this total was 37% (or USD 239 billion). Euro area banks reported losses of USD 131.3 billion, which represented 18% of the global amount. North American banks bore the bulk (59%) of the global mark-to-market losses.

Within the same period, major global banks raised USD 765 billion in new capital, that is, more than the losses reported (see Chart 2). The capital raised includes common stock, preferred stock, and hybrid securities that are accepted as capital by regulators.[2] The share of European banks in the total new capital raised globally is 39% and that of euro area financial institutions is 18%. These shares are, respectively, somewhat higher or the same as the corresponding figures for the total losses. However, bank losses in the euro area seem to be more widely spread across individual institutions than is the case in the US and other countries. This notwithstanding, the intense stresses that emerged after the failure of Lehman Brothers raised serious doubts among investors about the asset quality and the adequacy of the capital buffers of some euro area institutions and resulted in an abrupt and significant deterioration in money market conditions. Consequently, government and central bank actions were necessary to help stabilise the banking system.

Since September this year, tensions have increasingly spilled over from the financial sector to the real economy. In the euro area, a number of the downside risks to economic activity that had been previously identified materialised. The significant weakening of economic activity could have a negative effect on borrowers' ability to service their debt and thus on the credit risk faced by banks.

According to the December 2008 Eurosystem staff macroeconomic projections for the euro area, global economic weakness will persist in the coming quarters; thereafter we expect a gradual recovery, supported by the fall in commodity prices and assuming that the external environment improves and the financial tensions weaken (see Chart 3).

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1 **Losses related to banks' operating activities are not included, to** the extent that investments in related assets can be segregated from operating losses. If a bank's core business involves mortgage-loan origination, securitisation, or otherwise requires the firm to hold related assets, these losses are included. Losses from investments in all other banks or firms are included only if the firms or banks in question are not included in the data used to compute these figures, or if the loss affects cash flows, as in the case of fixed income securities. **Figures are pre-tax and net of any relevant financial hedges and off-setting gains,** unless a bank does not report these factors. Most recorded losses are the quarterly or accumulated losses that were reported at quarter-end. One important exception is when the company reports provisions for credit losses and charge-offs. In this case, the year-over-year increase in provisions or charge-offs are used instead, in order to minimise the impact of normal operations on the figures. Unless it is certain that loan charge-offs are not included in new provisions for losses, these charge-offs are only recorded for 2007. The underlying assumption is that charge-offs after the end of 2007 are already included in previously recorded provisions. **Some banks do not expect to fully realise these write-downs**, especially in the case of unrealised losses, mark-to-market losses, and loss provisions. Inclusion in the figures is not meant to imply that the firm has already incurred such losses, and any reversals or realised gains are included to mitigate the effects on write-down figures.

2 **Gains and losses from asset sales (gains/losses from assets sold) and divestitures (value of quantity sold) are also included.** The after-tax gain on asset sales is reported so as to provide a more accurate picture of its effect on equity, if this data is provided by the firm. Otherwise, pre-tax gains or total proceeds from sales are used. A capital infusion may also be excluded if sufficient information is not available. **Information on write-downs and capital raised is limited by the individual bank's willingness and ability to report it.** In general, data is included from the first quarter in which the bank reported related losses on, and the first observations are for Q2/2007.

III. Sources of risk and vulnerability

This leads me to the second part of my presentation that focuses on the main sources of risk and vulnerability that may affect the euro area financial stability outlook over the next six to twelve months.

III.1 The global macro-financial environment

Let me start with the risks and vulnerabilities we have identified in the global macro-financial environment. Global imbalances, notably the persistently large *US current account deficits* and the recycling of surpluses from emerging Asia and oil-exporting countries continue to pose substantial risks to global financial stability. The cumulated net capital inflows to the United States remained relatively stable (as shown in Chart 4), because the lower capital inflows from private investors were counterbalanced by important official inflows stemming from the continued accumulation of foreign exchange reserves by major oil exporters and other surplus economies.

Another important source of risk stems from the *US housing market* which has been the epicentre of the financial market stresses. The outlook for US house prices is shown on Chart 5 using the Case-Shiller futures price indices. The market expects that house prices will bottom out in 2010, about six months later than had been expected at the beginning of 2008. The narrow index which measures developments in the largest US cities, also indicates that house prices are expected to drop to a level that is more than 30% below the peak recorded in mid-2006, before they start to stabilise. Estimates of the existing excess supply in the housing markets put the housing overhang at around 1 million houses. At the current rate of housing starts, it would take up to two years to eliminate the excess supply. Box I of the Review provides a more in-depth assessment of the current and expected future valuations in the US housing markets.

At the same time, the outlook for the *US corporate sector* has, on balance, also weakened substantially. By mid-September, corporate profits growth and default rates had already deteriorated rapidly. As financing conditions have tightened significantly, even some of the largest corporations have reported shortages of cash. As shown in Chart 6, the rest of the world has remained the only positive contributor sustaining corporate profit growth in the US. It is likely, however, that the slowdown of the global economy will also curb this contribution in the period ahead, while declining domestic demand will continue to depress corporate profits.

A further source of risks to financial stability has been the continued worsening of the average *hedge fund* investment performance amid prolonged and heightened financial market volatility. During times of stress, many hedge funds reduced risk-taking and instead concentrated on capital preservation, either voluntarily, or due to the reduced availability of bank funding and investor withdrawals. The deleveraging in the hedge fund sector has been widespread and rapid as illustrated in Chart 7. Looking forward, if hedge funds fail to retain their investors and cases of hedge fund closure become more frequent, the possibility of further sizeable position unwinds by the sector may pose a challenge to financial markets.

In a context of global de-leveraging and mounting risk aversion, foreign investors also markedly reduced their exposures to *emerging market financial assets*. Persistent turbulence in financial markets weighed on those emerging economies that rely on external financing to fund their current account deficits, particularly in Central and Eastern Europe. This is of relevance for financial stability also in the euro area because of the sizeable cross-border exposures of European banks *vis-à-vis* new EU Member States. The pertinent facts and potential risks are presented in Box 2 of the Review. The share of assets in new EU Member States was the highest for banks in Austria, Greece, Sweden, Belgium and Italy, while other euro area countries were less exposed (as shown in Chart 8). In 2007, the growth of euro area banks' assets in this region was, on average, 35 percentage points higher than their total asset growth. Furthermore, given the higher profit margins that can be realised in the

banking markets of new EU Member States the contribution of some euro area banks' subsidiaries in the new EU Member States to group profits have been substantial. Some large banks that are active in the region could, therefore, be negatively affected if macroeconomic conditions in new EU members were to deteriorate.

III.2 The euro area corporate and household sectors

In the *euro area household sector*, pockets of vulnerability may have grown in the mortgage markets, mostly stemming from developments in income and house prices. Regarding the latter, Chart 9 indicates that house prices in the euro area – with the exception of Germany – increased more strongly than housing rents over the last decade. The 45-degree line depicts equal growths rates of house prices and rents. Box 5 of the Review analyses developments in selected euro area housing markets using a dynamic asset pricing model. The main findings are, first, that while the bulk of the variability of house price movements can be attributed to changes in rental yields, a generalised decline in expected returns on housing investments may permeate the housing markets of all euro area countries, irrespective of the evolution of fundamentals. A further interesting finding of this analysis is that house prices tend to overreact to news, especially when fundamentals are deteriorating. While the ongoing slowdown in the annual growth rate of euro area residential property prices has remained gradual so far, the possibility of a market overreaction to negative news might well apply to house price dynamics in some regions at the present juncture.

Euro area non-financial corporations tend to exhibit, at present, stronger balance sheets than just before the last credit cycle downturn. However, their operating environment has become more challenging and less favourable than six months ago. In the near term, balance sheets are likely to deteriorate due to the expected slowdown of earnings growth, in an environment of weak economic activity, persisting high leverage, and difficult funding conditions for the corporate sector. Reflecting this outlook, Chart 10 depicts forecasts of private entities which suggest that the default rates for European firms are likely to rise from the current low level over the next 12 months.

Many euro area financial institutions have large lending and investment exposures to *euro area commercial property markets*. In most euro area countries, commercial property inflation continued to decline in the first three quarters of 2008, and prices were even falling in seven out of the 12 countries for which data are available. Prices were affected by reduced commercial property investment activity in the latter part of 2007 and in 2008. Chart 11 shows that investment volumes declined by 63% in the third quarter of 2008 compared to the same quarter of the previous year although wide variations were observed across euro area countries. As a result of these developments, income risks for many commercial property investors have increased. Funding costs and risks have also grown, raising costs for leveraged property investors and, in turn, contributing to the observed negative price dynamics in some markets.

III.3 The euro area financial system

Turning to the euro area financial system, conditions in the *euro area and other major money markets* deteriorated significantly in mid-September, as the default of Lehman Brothers fuelled concerns about counterparty credit risk and challenged the widely-held view that any large bank, which was considered too big or too interconnected to fail, would be supported by public authorities. This event triggered a sharp increase in the spreads between Euribor and EONIA swap rates across all maturities (as shown in Chart 12). Banks hoarded liquidity (or lent only for the shortest maturities) in view of growing concerns about the creditworthiness of counterparties and heightened uncertainty about their own liquidity positions. Conditions in money markets in other advanced economies exhibited similar developments.

Since mid-September, central banks have stepped up the already remarkable levels of cooperation and provided liquidity in coordinated actions. Moreover, the ECB and also other central banks have made extensive efforts to provide refinancing at longer maturities and to expand the lists of assets that are eligible as collateral in credit operations. Not least thanks to these actions, the recent weeks have seen a noticeable improvement in the euro money market. For example, in the past week, the spreads between term deposit and overnight index swap rates declined considerably, by 15 to 20 basis points along all maturities, reflecting the continued fall in the Euribor rates. The spreads fell to 80 basis points for the one-month maturity and 160 basis points for the 12-month maturity.

An interesting analysis related to the current problems in the money markets is presented in Box 7 of the Review which highlights the link between market liquidity and funding liquidity risk, on the basis of evidence from recent data. The results show that a negative relationship between high funding liquidity risk and low market liquidity was established only after the financial turmoil had erupted, while in "normal" times, there is no obvious relationship between the two measures. This supports the theoretical proposition (advanced by recent academic research) that interactions between the two measures emerge only when banks face funding constraints, that is, when shocks to banks' funding liquidity can lead to forced asset sales and may depress asset prices, with dire consequences for market liquidity.

The tensions in the money market, and more generally the fallout from the financial crisis, have had a significant negative impact on *large and complex banking groups in the euro area*. In the first three quarters of 2008, their profitability suffered further due to the unfavourable financial market conditions and, increasingly, by rising credit costs (i.e. gradually increasing provisions and loan losses). Chart 13 shows that the wide dispersion in the rate of return on equity across euro area LCBGs observed in the second half of 2007 persisted also in the first three quarters of 2008. Institutions in the lowest quartile of the profitability distribution of these major banks continued to see significantly lower profitability. Moreover, those LCBGs that suffered substantial losses in the second half of 2007 remained among the weakest ones in the first three quarters of 2008.

At the same time, however, the regulatory capital buffers of euro area LCBGs improved moderately as a consequence of additional capital raised and slower growth in risk-weighted assets (as shown in Chart 14). While this was largely due to the actions of individual banks aimed at reducing risks in their balance sheets, it also reflected, to a certain degree, the impact of the implementation of Basel II. In addition, some of the newly attracted capital came in the form of hybrid financing which is reaching prudential limits. Nevertheless, the actions that have been taken by governments and central banks since October 2008 to support the banking systems in euro area countries, despite comfortable solvency ratios, highlight the perceived fragility of the global financial markets.

Box 9 of the Review analyses alternative ways in which LCBGs can reduce leverage in the process of restoring their balance sheets. It shows that by cutting their dividend pay-out ratios, LCBGs could generate rather substantial additional capital buffers. On the other hand, if the banks decided to de-leverage mainly by shedding assets, this could imply a sharp contraction of credit to the private sector. It is therefore essential that banks use available opportunities to raise new capital, either from private sources or from the public funds provided by governments in the euro area.

The outlook for *euro area insurers* also deteriorated, as financial performance has weakened and some pre-existing risks facing the sector increased and some started to materialise. Investment income was reduced by the falling values of structured credit products, corporate bonds and equities. In addition, some insurers suffered losses on investments in commercial property. All in all, the information available for the first nine months of 2008 suggests that the shock-absorption capacity of euro area insurers in terms of their solvency positions has not been significantly affected, which should help them to cope with the possible materialisation of the risks they face.

The size of euro area insurers' exposures to structured credit products differ considerable across institutions, as shown in Chart 15. In some cases, exposures to non-sub-prime structured credit products are rather large. This is a source of vulnerability in the event that the credit market problems were to affect also the valuations of prime or near-prime asset-backed securities. Since insurers can hold investments until maturity (to back liabilities), the key risks from insurers' credit exposures are not temporary losses in value but defaults. Nevertheless, sharp downgrades of the ratings of structured credit products could force insurers to reduce their holdings or recognise impairments, which would affect their results and capital positions.

A summary measure of the risks faced by the euro area banking sector is provided by a market-based *systemic risk indicator* which is depicted in Chart 16. In September 2008, systemic risk increased sharply, driven by a further widening of banks' credit default swap (CDS) spreads. However, it is important to emphasise that, since July 2008, participants in the CDS market have started to increasingly discriminate across institutions. This could be seen as first sign that the market is on its way to a gradual recovery, because the market no longer "penalises" all banks across the board with similarly high spreads. That said, CDS spreads are likely to remain high for some time to come. Following a series of defaults or near defaults of several global financial institutions after September 2008, the systemic risk indicator decreased substantially, as central banks took coordinated actions, guarantee schemes were approved and some euro area LCBGs were recapitalised. Nevertheless, the indicator has remained above the levels of summer of 2008, which suggests that market participants continued to assign a relatively high probability to systemic defaults by both euro area and global LCBGs.

The *extraordinary measures that have been taken by central banks and governments* since October 2008 are summarised in the table on this slide and are described in detail in the Review. In the euro area, the actions taken and the commitments made have helped to stabilise the banking system and should further mitigate counterparty credit risks from trading in the unsecured interbank money markets. Over time, and once they have been fully implemented, these measures should improve the functioning of the term money markets and the access of banks to wholesale funding markets. This should lower the cost of bank funding and facilitate the provision of credit to the economy. That said, in order to revive the process of efficient financial intermediation, financial institutions will need to play their part in the adjustment process by taking advantage of these measures to effectively recapitalise and repair their balance sheets.

IV. Overall assessment

Let me conclude with our *overall assessment of financial stability* at the current juncture: the euro area financial system has undergone a further significant test of its shock-absorbing capacity since the finalisation of the June 2008 Financial Stability Review. At the same time, there are a number of risks and vulnerabilities lying ahead with which the financial system may have to cope, notably the possibility of:

- a further deterioration in the US and the euro area housing markets and the impact this may have on banks' loan quality and the value of securities backed by mortgage-related assets;
- a deeper and more prolonged slowdown in both the global and the euro area economy than currently expected that could cause a sharper and broader deterioration in borrowers' ability to service their debt;
- a more pronounced de-leveraging by banks, due to persistently high funding costs and concerns about the adequacy of capital buffers, which could negatively affect the flow of credit extended to the broader economy; and

- an increase in financial market volatility caused by a further unwinding of positions by hedge funds.

All in all, given the risks that lie ahead, banks will need to be especially watchful in ensuring that they have adequate capital and liquidity buffers in place to cushion the challenges ahead.

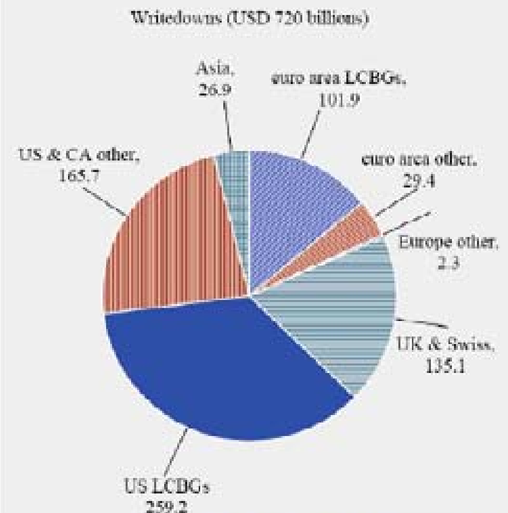
Thank you very much for your attention. I am now at your disposal for questions.

I Overview

Between the beginning of the second quarter of 2007 and early December 2008, the total write-downs due to mark-to-market losses for the global banking system amounted to USD 720 billion…

… with euro area banks accounting for USD 131 billion, or 18% of the global amount

Chart 1 Turmoil-related bank writedowns by region



EUROPEAN CENTRAL BANK 3

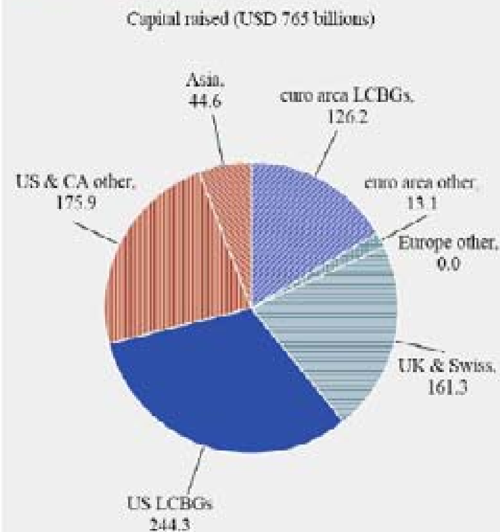
I Overview

Over the same period, banks raised USD 765 billion worth of new capital throughout the world, USD 139 billion, or 18%, of which was accounted for by euro area banks ...

... on aggregate, banking systems have consequently more than covered the losses they have reported thus far with fresh capital

Chart 2 Capital injections into banks by region

(Q2 2007 – 10 Dec. 2008)



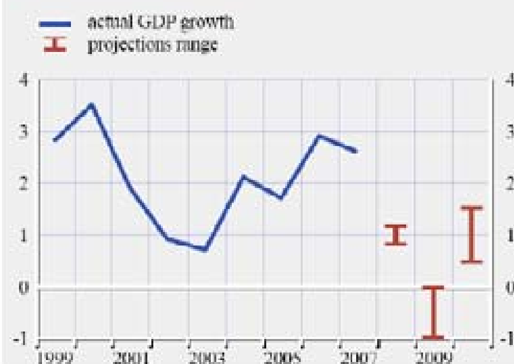
I Overview

Credit losses of euro area banks generally remained low in 2008 ...

... in the period ahead, a key risk for euro area financial system stability is the outlook for borrowers' credit quality and the possible adverse feedback of financial system stresses on the broader economy

Chart 3 Real GDP growth in the euro area and the Eurosystem staff macroeconomic projections for the euro area

(percent change per annum)



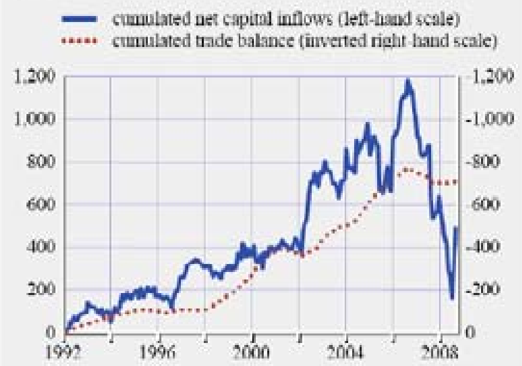
II Risks in the global macro-financial environment

The risk of a disorderly correction of global imbalances persists …

… the US trade deficit remains large and inflows of private capital from abroad have not been matching the trade balance

Chart 4 US trade balance and net capital inflows to the United States

(USD billions; 12-month moving sums)



II Risks in the global macro-financial environment

Since June 2008, US household sector balance sheet conditions have deteriorated somewhat further …

… and futures markets are pricing in another year of declines in house prices, suggesting that further credit losses could yet crystallise

Chart 5 US house prices and outlook

(index: Q2 2006 = 100; nominal prices)

II Risks in the global macro-financial environment

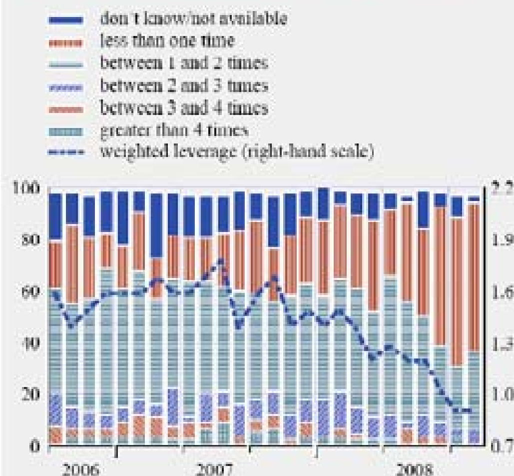
The outlook for the US corporate sector has weakened substantially amid slowing economic growth ...

... with profits from the rest of the world the only positive contributor to profit growth in 2007 and 2008

II Risks in the global macro-financial environment

Hedge funds have been deleveraging sharply in order to preserve capital ...

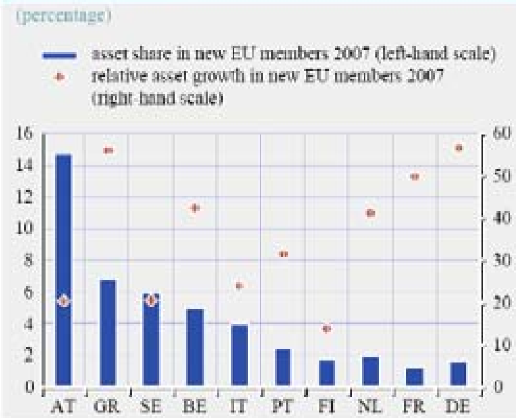
... the process has been partly voluntary, but forced liquidations have also increased in response to investor withdrawals



II Risks in the global macro-financial environment

The presence of euro area financial institutions in Central and Eastern European countries has continued to grow rapidly …

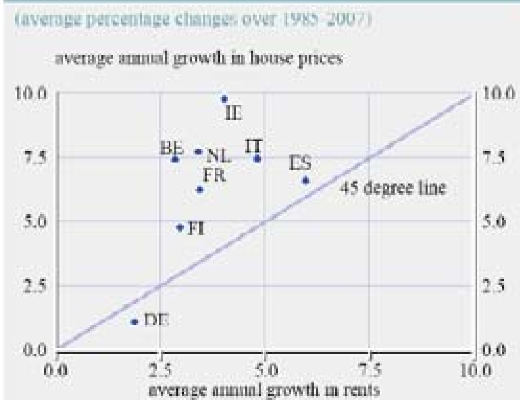
… but the economic slowdown in these countries implies that risks originating from EU banks' exposures to the new EU Member States have grown



III Risks in the euro area non-financial sectors

Euro area households' income and employment expectations have deteriorated further …

… while risks of house price declines remain in some parts of the euro area, thus contributing to growing credit risks for banks



III Risks in the euro area non-financial sectors

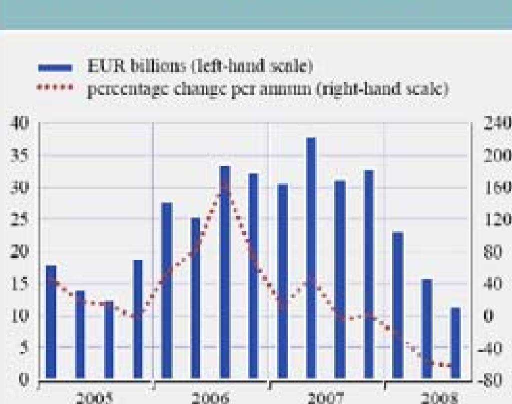
Euro area non-financial corporate sector balance sheets are relatively sound …

… but the slowdown in demand has contributed to an increase in expected distress among lower-rated firms

III Risks in the euro area non-financial sectors

The decline in direct investment volumes contributed to stabilising or even falling prices in the commercial real estate sector…

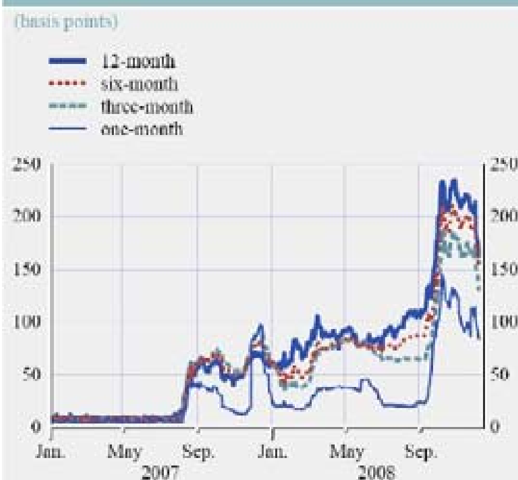
… to which many euro area banks have large financing and/or investment exposures



IV Risks in the euro area financial system

The failure of Lehman Brothers triggered a further increase in counterparty risk in global money markets …

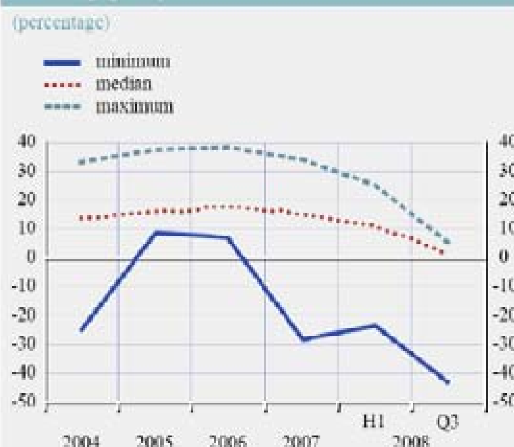
… with the widening of term spreads driven by uncertainty about the creditworthiness of counterparties and banks' own liquidity needs



IV Risks in the euro area financial system

For euro area large and complex banking groups (LCBGs), persistent funding problems, as well as sizeable write-downs on securities, contributed to falling profits …

… although performance measures have shown a rather wide dispersion across institutions since the beginning of the turmoil



IV Risks in the euro area financial system

Declining growth of risk-weighted assets and new capital raised contributed to improving solvency ratios …

… but further risks ahead imply that banks should use all means at their disposal to bolster their capital buffers in order to minimise the risk of a slowdown in lending to the broader economy

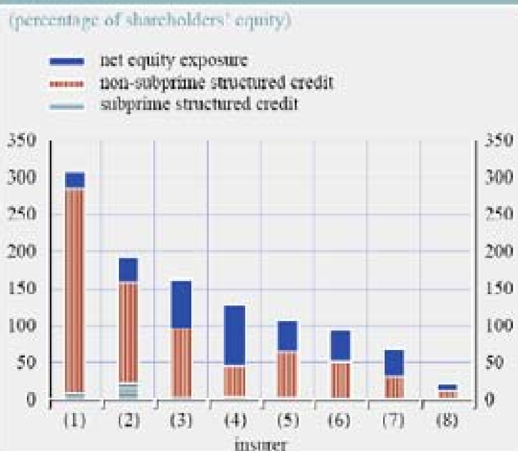
Chart 14 Overall solvency ratios for euro area large and complex banking groups

IV Risks in the euro area financial system

Investment losses have also contributed to a deterioration in the profit outlook of the euro area insurance sector …

… but the magnitude of the exposures to structured credit products and equities differs across institutions

Chart 15 Credit and equity exposures of selected euro area primary insurers and reinsurers



IV Risks in the euro area financial system

The financial sector turmoil intensified sharply after September 2008 …

… coordinated actions by central banks and governments contributed to a decline in systemic risk …

… but indicators remain at elevated levels, suggesting that further stress cannot be ruled out

Chart 16 Systemic risk indicator for large and complex banking groups

1. Turmoil begins
2. Bear Stearns rescue take-over
3. Rescue plan of US Fannie Mae and Freddie Mac announced
4. Lehman Brothers defaults
5. US Senate approves Paulson plan
6. Coordinated central bank and government actions

IV Risks in the euro area financial system

The extraordinary measures taken by the public sector to support financial institutions include liquidity and capital support, debt guarantees and asset purchases … but it is important that the financial sector plays its part in the adjustment process by taking advantage of these measures

Measures taken globally to support financial system stability

	Euro area	Other Europe	US
Liquidity	Extensive longer term refinancing, expanded collateral frameworks, joint efforts to provide USD liquidity		
	Joint efforts to provide liquidity outside the euro area between the ECB and the central banks of Denmark, Hungary, Switzerland		
Capital injections	EUR 92 billion injected out of EUR 201 billion of explicit commitments	EUR 64 billion injected out of EUR 68 billion of explicit commitments	USD 242 billion of the USD 700 billion TARP injected + USD 200 billion into 2 GSEs
Guarantees	Temporary rise of deposit insurance limits. Guarantees on new bank debt established		
	Wider – even blanket – guarantees of bank liabilities set up in some countries		
Asset purchases	EUR 30-50 billion fund in Spain. Swapping bank assets against government bonds in Greece (EUR 8 billion) and Italy (EUR 40 billion)	EUR 42 billion fund in Switzerland to purchase illiquid assets.	Not included in the TARP anymore. Several other programs to purchase whole loans, MBSs, ABCP
Regulation changes	Temporary bans for short-selling of financial stocks		
	Allowing for reclassifying financial assets out of trading portfolio in the IFRS (IASB)		Clarification of the application of fair value accounting under US GAAP in a market that is not active (FASB)

V Overall assessment (I)

The euro area financial system has undergone a further significant test of its shock-absorbing capacity since the finalisation of the June 2008 Financial Stability Review.

At the same time, there are a number of risks and vulnerabilities lying ahead which the financial system may have to cope with, notably the possibility of:

EUROPEAN CENTRAL BANK 20

V Overall assessment (II)

- a further deterioration in the US and the euro area housing markets and the impact this may have on banks' loan quality and the value of securities backed by mortgage-related assets;
- a deeper and more prolonged slowdown in both the global and the euro area economies than currently expected that could cause a sharper and broader deterioration in borrowers' ability to service their debt;
- a more pronounced de-leveraging by banks, due to persistently high funding costs and concerns about the adequacy of capital buffers, which could negatively affect the flow of credit extended to the broader economy; and
- an increase in financial market volatility caused by a further unwinding of positions by hedge funds.

EUROPEAN CENTRAL BANK 21