Lucas Papademos: Assessment of identified risks to the euro area financial system and the capacity to absorb disturbances

Opening remarks by Mr Lucas Papademos, Vice President of the European Central Bank, at the press briefing on the occasion of the publication of the June 2010 ECB Financial Stability Review, Frankfurt am Main, 31 May 2010.

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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 June 2010 edition of the ECB Financial Stability Review.[1] The primary objective of the Review is to identify the main sources of risk to the stability of the euro area financial system and provide a comprehensive assessment of the capacity of the financial system to absorb adverse disturbances. The Review integrates the interdepartmental work of the ECB with that of the Banking Supervision Committee (BSC) of the ESCB. It contains 16 boxes and five special feature articles that address topical financial stability issues in a more focused and analytical manner. As in the past, we have prepared a summary note that contains some key messages of our analysis and assessment.

In my presentation, I will highlight the seven main risks and vulnerabilities identified and assessed in the FSR (slide 3) and the associated financial stability challenges. Four of these risks stem from outside the euro area financial system, while the other three originate from within the financial sector.

II. Main risks identified outside the euro area financial system

A main risk to the euro area financial stability is the possibility that concerns about the sustainability of the public finances persist, or even increase, with an associated crowding out of private investment (slide 5). The progressive intensification of market concerns about sovereign credit risks among industrialised economies in the early months of 2010 opened up a number of hazardous contagion channels and adverse feedback loops between financial systems and public finances, in particular in the euro area.

The main reason for the severe deterioration of public finances was the activation of automatic stabilisers as a result of the marked contraction of economic activity which followed the collapse of Lehman Brothers. At the same time, because the structural fiscal deficits of a number of euro area countries were sizeable before the financial crisis erupted, fiscal deficits in those countries rose to very high levels. Added to this were the discretionary fiscal measures taken by many countries to stimulate their economies, following the adoption in December 2008 of the European Economic Recovery Plan.

By early May this year, adverse market dynamics had taken hold across a range of asset markets in an environment of diminishing market liquidity. Ultimately, the functioning of some markets, such as the government bond markets in countries with a very negative fiscal outlook, became impaired, thereby triggering a significant widening of government bond yield spreads in these countries, as shown on Chart 1 on slide 5. This hampered the monetary policy transmission mechanism and the effective conduct of monetary policy. At the same time, fears about the implications of growing fiscal imbalances in some euro area countries and the potentially adverse impact on banks' exposures to higher sovereign credit risk – including their funding costs and portfolio exposures – led to an increase in perceived

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[1] The cut-off date for data included in the June 2010 FSR was 19 May 2010.

systemic risk for large banking groups in the euro area to the highest levels seen since the collapse of Lehman Brothers.

To help improve the market functioning and the transmission of monetary policy, the Governing Council decided on 9 May 2010 on several remedial actions. In parallel, at an extraordinary meeting on 9/10 May, the Ecofin Council agreed to establish a European Financial Stabilisation Mechanism. This back-stop financing arrangement will be subject to strong conditionality. The mechanism will have up to €500 billion of funds to be provided by euro area Member States at its disposal. The IMF will participate in the financing arrangements and is expected to provide at least half as much as the euro area countries' contributions. Following the implementation of these measures, market volatility was significantly contained.

A second main risk is the possibility of adverse feedback between the financial sector and public finances continuing. The review summarises various contagion channels through which persistently large fiscal imbalances could pose risks to financial stability. If government indebtedness reaches a sufficiently high level that it triggers a loss of confidence in fiscal sustainability, investors will require additional risk premia to compensate for having to bear greater sovereign credit risk. The resulting rise in sovereign risk premia can be passed through to private sector funding costs, especially if there is doubt about the ability of the public sector to counter adverse disturbances to non-financial and financial sectors. Chart 2 on slide 6 shows how CDS spreads for large banks have become increasingly correlated over the past seven and half months with the sovereign CDS spreads of the countries where these banks have their headquarters. Two snap-shots are shown in the chart: one for 26 November 2009 and the other for 19 May 2010. As can be seen from the chart, between these two dates, as sovereign CDS spreads have risen, so have bank CDS spreads. It is furthermore interesting to note that, in the cases where concerns about fiscal imbalances have been greater, the co-movement has been substantial.

The third risk we have identified outside the euro area financial system is the possibility of vulnerabilities being revealed in non-financial corporations' balance sheets, because of high leverage, low profitability and tight financing conditions. The balance sheet conditions for the euro area non-financial corporate sector have slightly improved since the last issue of the FSR, which has translated into a moderate lowering of the expected write-downs facing euro area banks on their corporate loan portfolios by end–2010. Against the background of the gradual economic recovery, financial market participants have also become more optimistic concerning corporate earnings prospects. That said, the high leverage of euro area non-financial corporations, coupled with low profitability in 2008 and 2009, has translated into high default rates for non-financial firms. Chart 3 on slide 7 shows patterns of default rates for euro area firms of all size categories, indicating that, in 2009, bankruptcies reached historically high levels. There is a large degree of cross-country heterogeneity within the euro area with some countries having endured annual increases in bankruptcies of more than 70% in 2009.

When considering the outlook, it is instructive to examine past correlation patterns between bankruptcies and real GDP growth. As Chart 3 shows, insolvencies in the euro area remained at very high levels after the last downturn (2002–03), even after GDP already picked up. Hence, notwithstanding a recovery in economic activity, it might still take some time before a normalisation of bankruptcies would be observed.

The fourth risk identified outside the euro area financial system is the possibility of greater-than-expected household sector credit losses if unemployment rises by more than expected. Over the past six months, the condition of euro area household sector balance sheets has changed little with only a slight increase in new ECB estimates for write-downs on residential mortgages and consumer loans up to end–2010. That said, considerable increases in the rate of unemployment in most countries are expected between the fourth quarter of 2009 and the fourth quarter of 2010. This means that downside risks for household income and debtservicing capacity are likely to persist and that banks could face losses for some time, although there are important differences across countries. However, on a more positive note, there are signs that the past sharp falls in house prices, together with low interest rates, have improved housing affordability. This appears to explain, at least in part, the recent turnaround in the extension of new loans to households for house purchases, shown in the Chart 4 on slide 8, although substantial differences in these patterns remain across Member States.

III. Main risks identified within the euro area financial system

Let me now turn to the three main risks that we have identified within the euro area financial system. The first is the possibility of a setback to the recent recovery of bank profitability. After the sizeable net losses, which were endured by around half of the euro area large and complex banking groups (LCBGs) in late 2008, many of them returned to modest profitability during 2009. Moreover, as shown in the left-side of Chart 5 on slide 10, banks' financial performances strengthened further in the first quarter of 2010 and all LCBGs which have reported financial results so far have shown a positive return on equity. The same pattern can be seen as regards the return on assets.

The leverage ratios of LCBGs have remained broadly constant after a sharp decline in the first quarter of 2009. These relatively stable ratios, however, conceal some differences in the ways individual institutions have lowered their leverage ratios. Most of them have increased their Tier 1 capital, while many have also reduced their assets. Overall, the shock-absorbing capacities of euro area LCBGs improved substantially during 2009 and in the first quarter of 2010. Even those institutions with the lowest capital ratios managed to enhance their buffers to levels well in excess of minimum regulatory requirements. At the same time, the capital buffers in some segments of the euro area banking sector may not have improved as quickly as has been the case for the LCBGs and will require further strengthening. Conditions in euro area LCBG funding markets have also tended to improve for much of the past six months, although the recent rise in sovereign credit risks has led to a setback for longer-term debt financing costs.

As shown in the right-side of Chart 5, the most important driver of euro area LCBGs' net income throughout 2009 and in the first quarter of 2010 continued to be net interest income. By the first quarter of this year, around two-thirds of the total net income of the LCBGs was generated from this source, while, before the crisis, around half of the total came from net interest income. The turnaround of the profitability of the LCBGs in 2009 is also attributable to a remarkable recovery of net trading revenue in the second quarter of 2009, which was more or less sustained throughout the year and in early 2010, despite a progressive lowering of market volatility, a tightening of bid-ask spreads and a stalling of the recovery in financial markets. Finally, income from fees and commissions has continued to produce a stable revenue flow for euro area LCBGs, and even increasing somewhat in the late 2009 and early 2010, boosted in particular by revenues from underwriting government and non-financial corporate sector debt securities issuances.

Looking ahead, although their financial performance has much improved, the challenges facing euro area LCBGs remain considerable. The central scenario is one of subdued banking sector profitability in the short to medium term for a variety of reasons. First, the recovery in the financial markets that has taken place in late 2009 has lowered the ECB estimates of banks' cumulative mark-to-market losses on holdings of securities throughout the entire period of the financial turmoil. However, the new estimate in the current FSR indicates that the potential cumulative write-downs on securities and loans for the euro area banking sector for the period 2007 to 2010 is EUR 515 billion, which is lower than the estimate published in the December 2009 FSR. Given the sizeable decline in projected losses on securities, and the large provisions that had already been made against loan losses by the end of 2009, the potential total future write-downs on securities and loans has fallen quite substantially.

Chart 6 on slide 11 shows the profile of write-downs on securities and loans over time, applying the same methodology as in previous assessments published in the FSR. This time the horizon of the estimates for future losses has been lengthened to 2011 and sizeable loan losses are still expected next year. The expected write-downs on loans will constitute a significant and lasting drag on banking sector profitability and will raise the risk that the recent recovery of profits does not prove durable. At the same time, the pressure on banks to keep leverage under tight control, the disengagement from public support of banks' balance sheets and the vulnerability of net interest margins of some banks to the prospect of a flattening of the yield curve are likely to contribute to keeping profitability moderate.

Regarding the year-by-year distribution of losses by type of exposure, write-downs on securities exposures were the main contributor to the substantial losses for, and capital drains on, euro area banks in 2008. Going forward, while the recovery in securities prices makes valuation *write-backs* on securities holdings more likely in 2010, write-downs on loans are expected to remain relatively high. However, in contrast to the uncertainties created by securities valuations in 2008 and 2009, banks should largely be in good positions to forecast the loan losses facing them, using their internal models, and they should thus be in a better position to manage the potential future write-downs without unexpected capital shortages.

The second risk that we have identified within the euro area financial system relates to vulnerabilities of financial institutions associated with concentrations of lending exposures to commercial property and to Central and Eastern European (CEE) countries. You may recall that, in the December issue of the FSR, we drew your attention to these two types of exposures. Since then, in the commercial real estate sector, prices and rents have continued to fall in most euro area countries, although at a moderating pace. Reflecting this deterioration, estimates of losses facing banks on their commercial property loan portfolios had been revised upwards by almost 50% over the past six months, as shown in Chart 7 on slide 12, and concerns remain about concentrations of such exposures among some euro area banks. This increase in estimated losses on commercial property loans is expected to more than offset the recovery in the valuations of commercial mortgage-backed securities held by banks in the euro area.

As regards banks' exposures to the CEE region, since December, the economic outlook in the region has improved. However, new vulnerabilities have emerged, especially a broad-based deterioration in the fiscal positions in a number of non-euro area EU countries, a number of which are currently under excessive deficit procedures. As Chart 8 on slide 13 illustrates, it needs to be kept in mind that the stock of outstanding foreign currency loans in these countries, while no longer increasing, remains sizeable, which makes the quality of exposed banks' assets vulnerable to exchange rate risks. Given that the exposures to the CEE region are rather concentrated among some euro area countries' banking sectors, the risks remain material in these cases.

The third risk that has been identified within the euro area financial system is that of heightened financial market volatility if macroeconomic outcomes fail to live up to expectations. Until the increase in volatility experienced this month, the stock markets in the euro area had broadly stabilised after a strong recovery in 2009, which mainly reflected the impact of improving macroeconomic news and better corporate earnings prospects. Chart 9 on slide 14 shows that most conventional valuation measures, such as the long-term price-earnings ratio do not suggest that valuations are particularly high by historical standards. But there is a risk of heightened financial market volatility, if expectations of macroeconomic outcomes are disappointed.

I would also like to briefly comment on the current state of the euro area securitisation markets. The securitisation markets were rendered dysfunctional by the financial crisis for a variety of micro and macroeconomic reasons. Efforts are being made both by the financial industry and the policy-making community to address the most important micro issues, including the lack of transparency, product complexity and inappropriate incentives in the originate-to-distribute model. However, in recent months there have been some, albeit nascent, signs of improvement in securitisation activity, in part supported by a narrowing of spreads on securitised products (i.e. yield on securitised products over Libor). The narrowing spreads, which reflects the compensation investors are demanding for holding these assets, could bring prices closer to levels where issuance of ABS securities makes economic sense. This has been indicated in the responses to ECB bank lending surveys and in lower retention rates by banks for newly-issued ABS. While it is difficult to disentangle the relative contribution of micro and macro factors to the improvement, it seems clear that the improved economic outlook has played an important role.

IV. Overall assessment

Let me now conclude with the overall assessment of the identified risks to euro area financial system stability (slide 15). Although the main risks to euro area financial stability essentially remain the same as those to which attention was drawn in the last issue of the FSR, their relative importance has changed significantly over the past six months. Ultimately, the significance of risks for financial system stability must be judged by the probability of their materialisation in combination with their likely impact, both on the financial system and on the broader economy, in the event that they do materialise. By this criterion the two most important risks for euro area financial stability at the current juncture are, first, the possibility of concerns about the sustainability of public finances persisting or even increasing with an associated crowding-out of private investment and, second, the possibility that adverse feedback between the financial sector and public finances continues.

Considering other risks, albeit less material, identified outside the euro area financial system include the possibility of vulnerabilities being revealed in non-financial corporations' balance sheets – because of high leverage, low profitability and tight financing conditions – and the possibility of greater-than-expected household sector credit losses, if unemployment rises by more than currently expected.

Within the financial system, the central scenario is for modest banking sector profitability in the short to medium term, given the prospect of continued loan losses, lasting pressure on the sector to reduce leverage and market expectations of higher funding costs (slide 16). Given this outlook, an important risk is the possibility of a set-back to the recent recovery of bank profitability and of adverse feedback with the provision of credit to the economy. Moreover, in view of the considerable near-term funding needs of euro area governments, a particular concern is the risk of bank bond issuance being crowded out, making it challenging to roll-over a sizeable amount of maturing bonds by the end of 2012. In addition, the vulnerabilities of financial institutions associated with concentrations of lending exposures to commercial property markets and to Central and Eastern European countries remain. There are also risks of heightened financial market volatility, if macroeconomic outcomes fail to live up to expectations. A key concern is that many of the vulnerabilities highlighted in my presentation today could be unearthed by a scenario involving weaker-than-expected growth.

I will now conclude with five policy messages stressed in the Review (slide 17).

First, the measures taken by the ECB to stabilise markets and restore their functioning, as well as the establishment of the European Financial Stabilisation Mechanism, have lowered tail and contagion risks.

Second, sizeable fiscal imbalances remain and the responsibility rests on governments to frontload and accelerate fiscal consolidation, so as to ensure the sustainability of public finances, not least to avoid the risk of a crowding out of private investment, while establishing conditions conducive to durable economic growth.

Third, with pressure on governments to consolidate their balance sheets, disengagement from financial sector intervention means that banks will need to be especially mindful of the risks that lie ahead. In particular, they should ensure that they have adequate capital and liquidity buffers in place to cushion the risks, should they materialise.

Fourth, and against this background, the problems of those financial institutions that remained overly-reliant on enhanced credit and government support will have to be tackled decisively. At the same time, fundamental restructuring will be needed when the long-term viability of banks is likely to be threatened by the taking away of state support. This may involve the shrinking of balance sheets through the shedding of unviable businesses, with a view to enhancing profit-generating capacities.

Fifth, for the longer-term, a key objective of the agenda for regulatory reform is to strengthen capital and liquidity buffers so as to ensure a safer financial system that is more robust to adverse disturbances. Swift completion of the process of calibration and implementation of these necessary reforms should remove related uncertainties and allow banks to optimise their capital planning and, where necessary, adjust their business models.

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

I. Summary of main risks and vulnerabilities

The main risks for euro area financial system include the possibility of:

- Concerns about the sustainability of public finances persisting or even increasing with an associated crowding-out of private investment
- Adverse feedback between the financial sector and public finances continuing

Other, albeit less material risks, identified outside the euro area financial system include the possibility of:

- Vulnerabilities being revealed in euro area non-financial corporations' balance sheets, because of high leverage, low profitability and tight financing conditions
- Greater-than-expected euro area household sector credit losses if unemployment rises by more than expected

Within the euro area financial system, important risks include the possibility of:

- A setback to the recent recovery of the profitability of large and complex banking groups and of adverse feedback with the provision of credit to the economy
- Vulnerabilities of financial institutions associated with concentrations of lending exposures to commercial property markets and to central and eastern European countries
- Heightened financial market volatility if macroeconomic outcomes fail to live up to expectations

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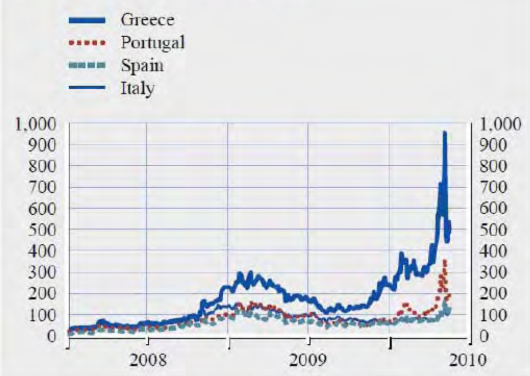
Concerns about the sustainability of public finances persisting or even increasing with an associated crowding-out of private investment

Public finances in the euro area have deteriorated rapidly, primarily on account of the activation of automatic stabilisers and discretionary fiscal measures in many countries …

… by early May, the concerns about sovereign credit risk contributed to adverse market dynamics which, ultimately, hampered the monetary policy transmission mechanism. To help restore the normal transmission of monetary policy, the ECB decided on several remedial measures.

Chart 1 Intra-euro area yield spreads on ten-year government bonds

(Jan. 2008 – May 2010; basis points)



Sources: Thomson Financial Datastream and ECB calculations.
Note: The chart shows ten-year yield spreads relative to Germany.

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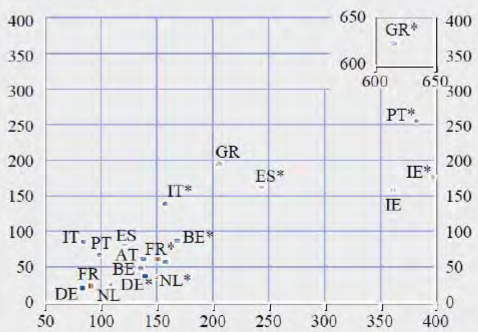
Adverse feedback between the financial sector and public finances continuing

The rise in sovereign credit risk premia was passed through to private sector funding costs ...

... which resulted in increased correlation between credit default swap (CDS) spreads for large banks and sovereign CDS spreads for the governments of the countries where the banks have their headquarters.

Chart 2 Sovereign and bank CDS spreads in selected euro area countries

(first snapshot: 26 Nov. 2009; second snapshot (*): 19 May 2010; basis points)



Sources: Bloomberg and ECB calculations.
Notes: For each country, the CDS spreads of the five largest banks for which CDS quotes were available were used to calculate the average CDS spread of banks in that country. For some countries there were less than five banks with quoted CDSs.

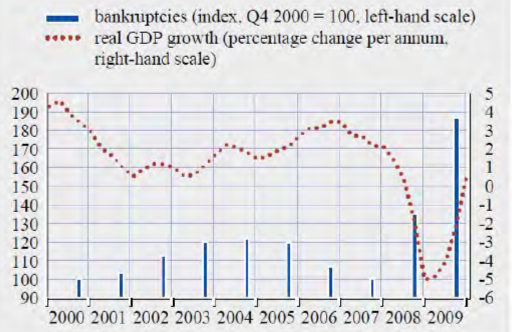
Vulnerabilities being revealed in euro area non-financial corporations' balance sheets, because of high leverage, low profitability and tight financing conditions

For the euro area non-financial corporate sector, balance sheet conditions have improved slightly since the last issue of the FSR ...

... but the high leverage of non-financial corporations, coupled with very low profitability in both 2008 and 2009 and persistently tight lending standards, has translated into high default rates for non-financial firms.

Chart 3 Bankruptcies and real GDP growth in the euro area

(Q1 2000 – Q1 2010)



Sources: National central banks, national statistical offices, Euler Hermes ("Insolvency Outlook", 2/2009) and ECB calculations.
Notes: GDP growth refers to total euro area, while data for bankruptcies only refers to 12 euro area countries (Cyprus, Malta, Slovakia and Slovenia not included). The index is weighted by GDP. Bankruptcies in 2009 are partly estimated.

Greater-than-expected euro area household sector credit losses if unemployment rises by more than expected

The condition of euro area household balance sheets has changed little, but there are downside income risks if unemployment in the euro area were to remain at high levels for longer than expected …

… however, there are signs that the sharp fall in house prices, together with low interest rates, has improved housing affordability, which, in part, helps to explain the recent turnaround in the extension of new loans to households for house purchases.

Chart 4 Loans for house purchase and house prices in the euro area

(Jan. 2000 – Mar. 2010; percentage change per annum)

Source: ECB.

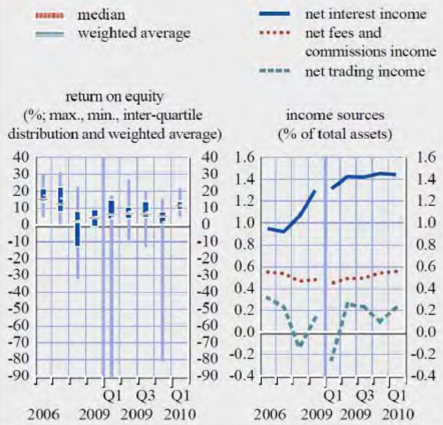
A setback to the recent recovery of the profitability of large and complex banking groups and of adverse feedback with the provision of credit to the economy

Many euro area large and complex banking groups (LCBGs) returned to modest profitability in the course of 2009, and their financial performances strengthened further in the first quarter of 2010 …

… net interest income continued to be the most important profitability driver among this group of banks throughout 2009. Also, the capital ratios of euro area LCBGs improved substantially.

Chart 5 Euro area large and complex banking groups' profitability and breakdown of income sources

(2006 – Q1 2010; maximum, minimum and inter-quartile distribution)



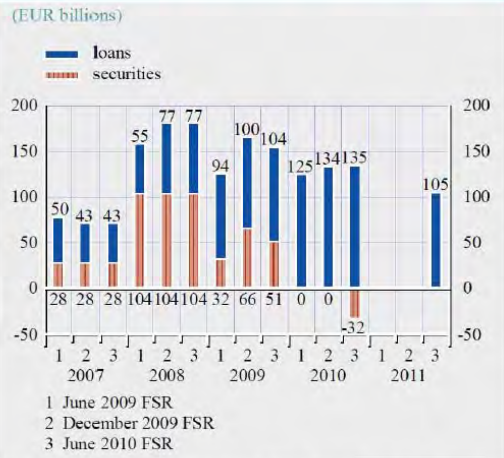
Sources: Individual institutions' financial reports and ECB calculations.
Notes: The left-hand chart is based on the Tier 1 measure of equity. Quarterly returns have been annualised.

A setback to the recent recovery of the profitability of large and complex banking groups and adverse feedback with the provision of credit to the economy

The latest estimate of the potential cumulative write-downs on securities and loans for the euro area banking sector is €515 billion over the period from 2007 to 2010, which is lower than the estimate published in the December 2009 FSR, owing to a recovery in securities prices in 2009 and in early 2010 …

… at the same time, the total estimate of potential write-downs on loans for the period from 2007 to 2010 has increased slightly and further loan write-downs are likely during 2011.

Chart 6 Potential write-downs on securities and loans facing the euro area banking sector



Sources: Association for Financial Markets in Europe, Banking Supervision Committee, national central banks, ECB and ECB calculations.

Vulnerabilities of financial institutions associated with concentrations of lending exposures to commercial property markets and to central and eastern European countries

Commercial property prices and rents have continued to fall in most countries in the euro area, albeit at a more moderate rate …

… estimates of losses facing banks on their commercial property loan portfolios have been revised upwards by almost 50% over the past six months. This more than offset the recovery in the valuations of commercial mortgage backed securities held by banks in the euro area.

Chart 7 Potential write-downs on commercial mortgage-backed securities (CMBSs) and commercial property mortgages facing the euro area banking sector over the period from 2007 to 2010

Sources: Association for Financial Markets in Europe, Banking Supervision Committee, national central banks, ECB and ECB calculations.

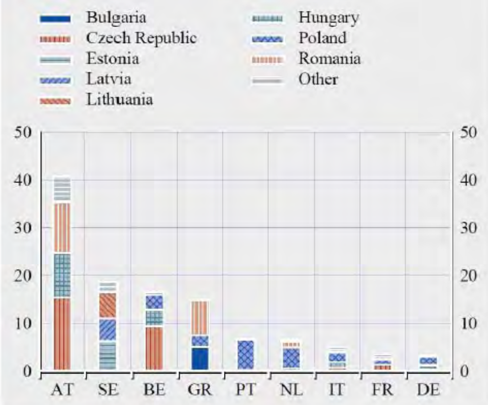
Vulnerabilities of financial institutions associated with concentrations of lending exposures to commercial property markets and to central and eastern European countries

The economic outlook in central and eastern European (CEE) countries has improved, but new vulnerabilities have emerged, especially a broad-based deterioration in the fiscal positions of these countries …

… given that the exposures to the CEE region are rather concentrated among some euro area Member States' banking sectors, the risks remain material in these cases.

Chart 8 Consolidated lending exposures of selected EU banking systems to selected non-euro area EU countries

(2009; percentage of GDP, per lending country)



Sources: BIS and Eurostat.
Notes: BIS statistics on consolidated foreign claims of domestically owned banks in lending countries on individual non-euro area EU countries on an immediate borrower basis. The largest three exposures to each particular country are shown in the chart, while smaller exposures are combined under other countries.

Heightened financial market volatility if macroeconomic outcomes fail to live up to expectations

Long-term (cyclically adjusted) valuation measures suggest that equity prices are not particularly high by historical standards …

… but there is a risk of a heightened financial market volatility, if macroeconomic outcomes fail to live up to expectations.

Chart 9 Implied volatility and price/earnings ratios (based on ten-year trailing earnings) for the euro area stock markets

(Jan. 1999 – May 2010)

Sources: Thomson Reuters Datastream and Bloomberg.
Note: The last observation for the implied volatility is 19 May 2010.

IV. Overall assessment (I)

- Although the main risks to euro area financial stability essentially remain the same as those to which attention was drawn in the last issue of the FSR, their relative importance has changed significantly over the past six months.
- The two most important risks for euro area financial stability at the current juncture are: the possibility of concerns about the sustainability of public finances persisting or even increasing with an associated crowding-out of private investment; and the possibility that adverse feedback between the financial sector and public finances continues.
- Other, albeit less material, risks identified outside the euro area financial system include the possibility of vulnerabilities being revealed in non-financial corporations' balance sheets and of greater-than-expected household sector credit losses, if unemployment rises by more than expected.

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IV. Overall assessment (II)

- Within the financial system, the central scenario is for modest banking sector profitability in the short to medium term, given the prospect of continued loan losses, lasting pressure on the sector to reduce leverage and market expectations of higher funding costs. The possibility of a setback to the recent recovery of bank profitability and of adverse feedback with the provision of credit to the economy are important risks.
- There is also a risk of heightened financial market volatility if macroeconomic outcomes fail to live up to expectations.
- A key concern is that many of the vulnerabilities highlighted in this FSR could be unearthed by a scenario involving weaker-than-expected economic growth.

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IV. Overall assessment (III)

- The measures taken by the ECB to stabilise markets and restore their functioning as well as the establishment of the European Financial Stabilisation Mechanism have considerably lowered tail and contagion risks.
- However, sizeable fiscal imbalances remain, and the responsibility rests on governments to frontload and accelerate fiscal consolidation so as to ensure the sustainability of public finances, not least to avoid the risk of a crowding-out of private investment while establishing conditions conducive to durable economic growth.
- With pressure on governments to consolidate their balance sheets, disengagement from financial sector intervention means that banks will need to be especially mindful of the risks that lie ahead. In particular, they should ensure that they have adequate capital and liquidity buffers in place to cushion the risks should they materialise.
- The problems of those financial institutions that remain overly reliant on enhanced credit measures and government support will have to be tackled decisively.
- Swift completion of the process of calibration and implementation of regulatory reforms should remove related uncertainties and allow banks to optimise their capital planning and, where necessary, adjust their business models.

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