Jean-Claude Trichet: Press briefing on the ECB Financial Stability Review - June 2005

Opening remarks by Mr Jean-Claude Trichet, President of the European Central Bank, at the Press briefing on the ECB Financial Stability Review - June 2005, Frankfurt am Main, 31 May 2005.

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Ladies and Gentlemen, welcome to this press briefing on the publication of the ECB's June 2005 Financial Stability Review.

Let me start by saying that in publishing this Financial Stability Review, the second of its kind, the European Central Bank (ECB) is enhancing the way in which it addresses its financial stability mandate by issuing a public report on a semi-annual basis. Under Article 105 (5), the Treaty establishing the European Union assigned to the Eurosystem the task of contributing *"to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system"*. In this vein, the issuing of this review, which represents the common view of the Governing Council of the ECB, and is now published half-yearly in June and December, is to promote awareness in the financial industry and among the public at large of issues that are relevant for preserving and enhancing the stability of the euro area financial system. By providing an overview of sources of risk and vulnerability to financial stability, the review also seeks to help preventing financial tensions.

Many of the national central banks that make up the Eurosystem are also addressing their own financial stability mandates by periodically issuing public reports on the functioning of, and sources of risk facing, their own financial systems. By providing a unique pan-euro area perspective on financial stability issues, the ECB Review aims at complementing the analyses contained within these reports.

As I have said on the occasion of the publication of the ECB's first Financial Stability Review last December, central banks have a strong and natural interest in the safeguarding of financial stability. This is in particular because financial institutions, notably banks, are issuers of by far the largest component of the money stock. It is equally because a stable financial system is needed for an effective transmission of monetary policy and for the smooth operation of payment systems. A robust financial system is therefore needed to ensure that the single monetary policy can deliver on the primary objective of maintaining price stability in the euro area. Finally, but not least, the health of the financial system is inextricably intertwined with the performance of the economy and its resilience to shocks. These are the reasons why the ECB and the Eurosystem have an important stake in financial stability in the euro area.

Complex to define, financial stability is not only of the essence in avoiding financial crises but also in paving the way for the best financial environment in normal times. It is a condition where the financial system is capable of performing well in normal times all of its normal tasks and where it is expected to do so for the foreseeable future. From this viewpoint, financial system stability requires that the principal components of the system – i.e. financial institutions, markets and infrastructures – are jointly capable of absorbing smoothly a full array of adverse disturbances. It requires that the financial system is facilitating an efficient reallocation of financial resources from savers to investors, that financial risk is being assessed and priced accurately and that risks are being efficiently managed. Financial stability also has an important forward-looking dimension. For instance, inefficiencies in the allocation of capital or shortcomings in the pricing of risk can, by laying the foundations for future vulnerabilities, compromise future financial system stability and therefore economic stability.

Three steps are needed to produce a comprehensive picture of the stability of the financial system. The first entails forming an assessment of the individual and collective robustness of the institutions, markets and infrastructures that make up the financial system. The second involves an identification of the main sources of risk and vulnerability that could pose challenges for financial system stability in the future. The third and final step is an appraisal of the ability of the financial system to cope with crisis, should these risks materialise. The overall assessment will determine whether remedial action is needed.

It is important to bear in mind financial stability analysis is very different from the analysis that underpins our monetary policy assessment. Financial stability analysis has a focus on calling attention to potential sources of risk and vulnerability to the functioning of the financial system and it does not aim at identifying the main – or most likely - future scenario for the euro area economy. It neither aims at identifying the full balance of risks surrounding this main scenario as is the principal focus in the monetary policy assessment and decision-making process. Rather it entails the highlighting of potential and plausible sources of negative events, even if these are remote and very unlikely.

As was the case with the preparation of the December 2004 Financial Stability Review, the analysis contained in this review was prepared with the close involvement of, and contribution by, the Banking Supervision Committee (BSC). The BSC is a forum for cooperation among the national central banks and supervisory authorities of the EU and the ECB. The collaboration with the BSC has meant that the review draws upon a very broad knowledge-base and the analysis contained within it blends together the macro perspectives of central bankers with the micro perspectives of supervisors.

Over the past seven years the driving force behind the development of financial stability analysis at the ECB, both at the conceptual and practical level, has been Tommaso Padoa-Schioppa. As you are aware, today is also Mr. Padoa-Schioppa's last working day at the ECB. I would therefore like to take this opportunity to express in the name of the ECB my deep gratitude for the work he has undertaken as a founding member of the Executive Board and of the Governing Council, as well as for the inspiration he has provided for the work of many of the committees and working groups that together form the flesh and blood of the Eurosystem. In this vein, the financial stability analysis, in particular, is an area that, I am sure, will continue to be shaped by the guidance provided by Mr Padoa-Schioppa.

Let me now give the floor to Mr Padoa-Schioppa, who will present to you the main findings of the analysis in the June Financial Stability Review.