



EUROPEAN CENTRAL BANK

EUROSYSTEM

Philipp Hartmann
ECB

Asset Allocation, Financial Integration and Financial Stability in the Euro Area – Selected Issues

Brussels
14 June 2017

1st Meeting of the Center for European Policy Studies Task Force on “Asset Allocation in Europe: What Challenges and Opportunities Lie Ahead?”

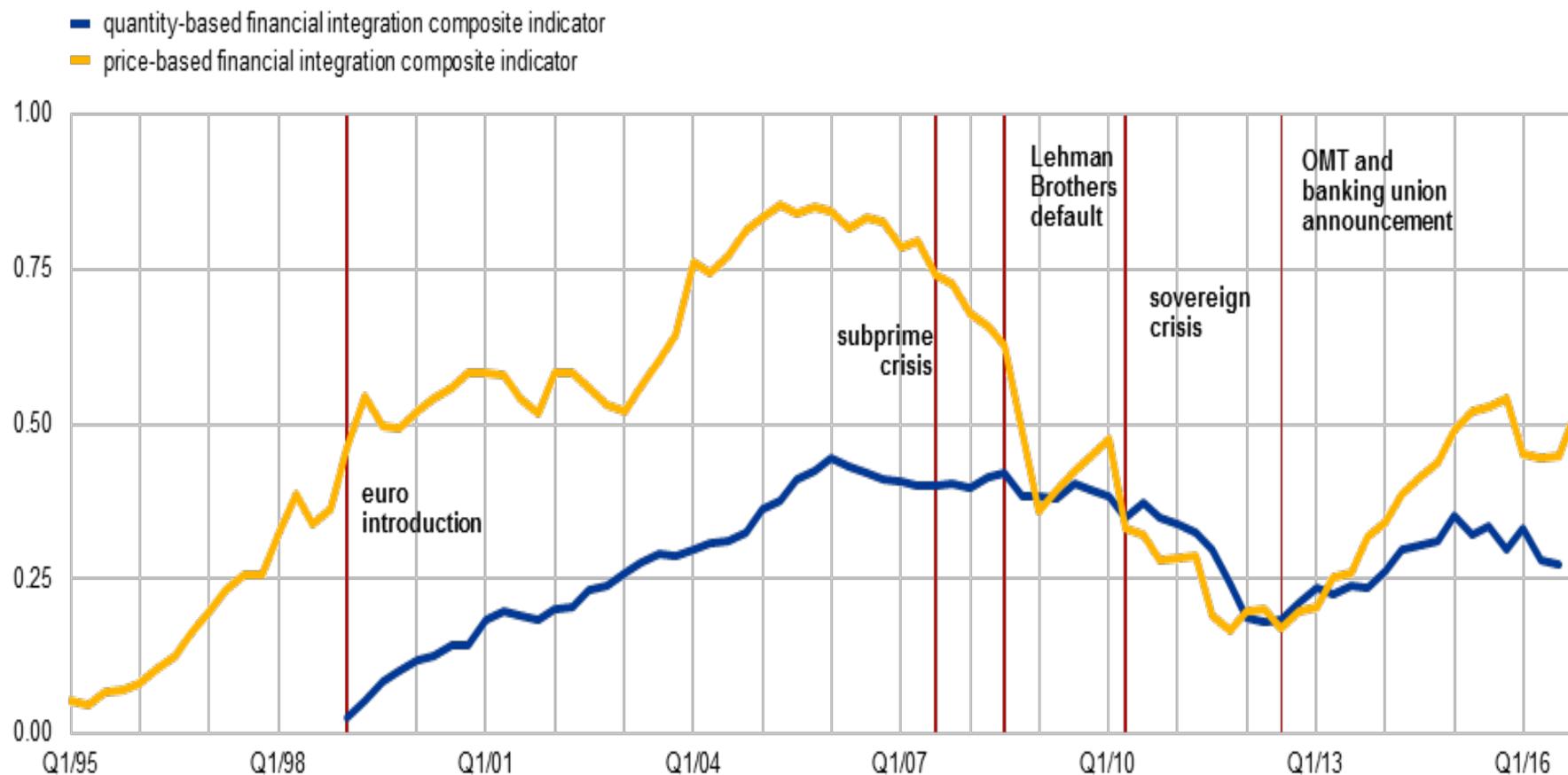
Outline

- **Financial integration perspectives**
 - Overall financial integration developments in the euro area
 - Cross-border asset holdings and home bias
- **Financial stability perspectives**
 - Recent key risks to euro area financial stability
 - Asset allocation and risks of investment funds
 - Asset allocation and risks of insurance companies
- **Annex**
 - Exposure of households to interest rate shocks
 - Debt securities exposures of different financial intermediaries
 - Retail credit market integration

Overall Financial Integration Developments

No further progress in overall financial integration in the euro area during 2016

Aggregate financial integration indicators



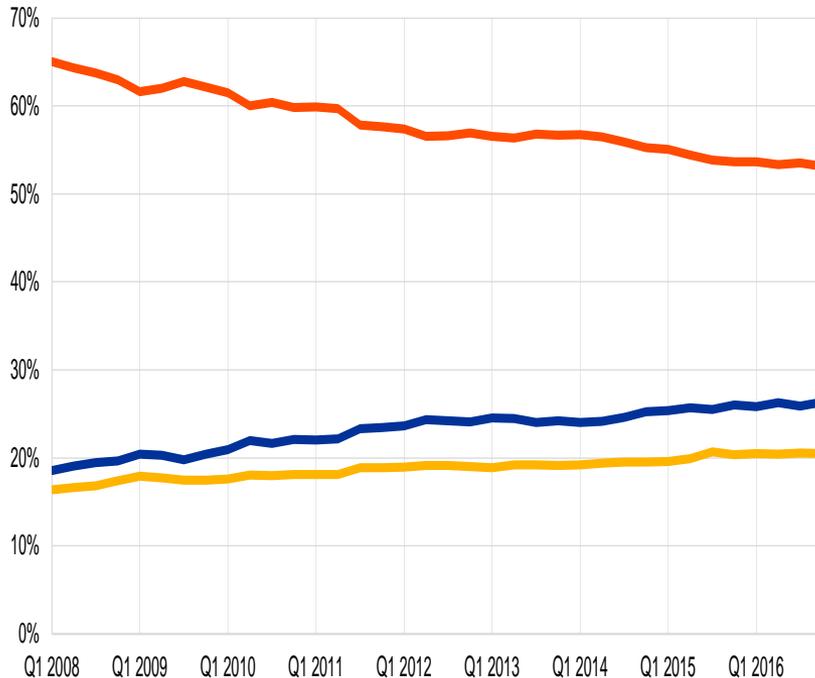
Sources: ECB (2017a), *Financial Integration in Europe*, May, Chart A

Cross-border Asset Holdings and Home Bias 1

Total cross-border **equity** holdings in the euro area increasing but investment funds go extra euro area

All sectors' holdings of equity (incl. investment fund shares and other equity; % of total equity holdings)

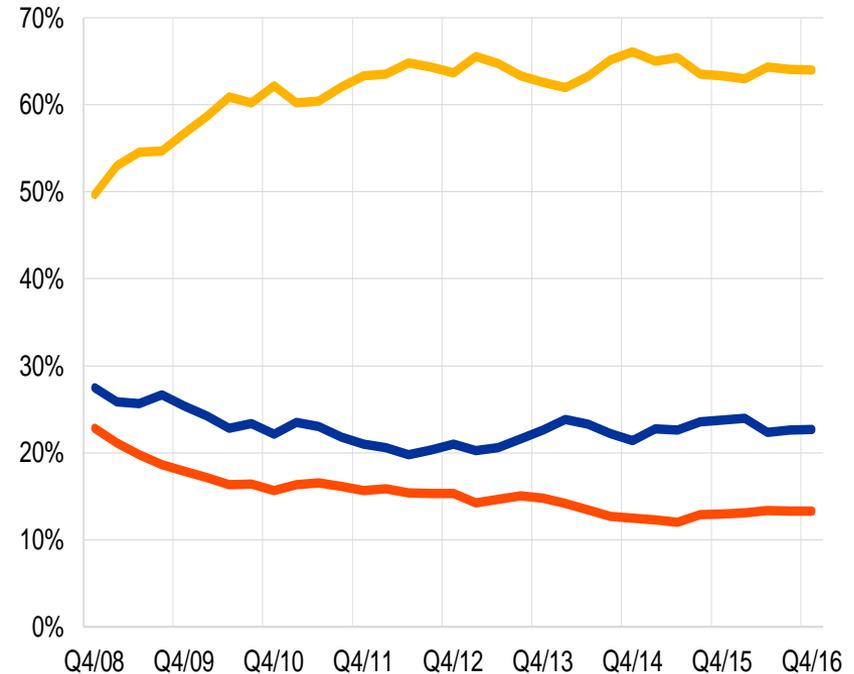
- equity holdings of issuers outside the euro area
- equity holdings of issuers from other euro area countries
- domestic equity holdings



Sources: ECB (2017a), Chart S27

Investment funds' holdings of equity (% of total equity holdings)

- other euro area countries
- extra euro area
- domestic

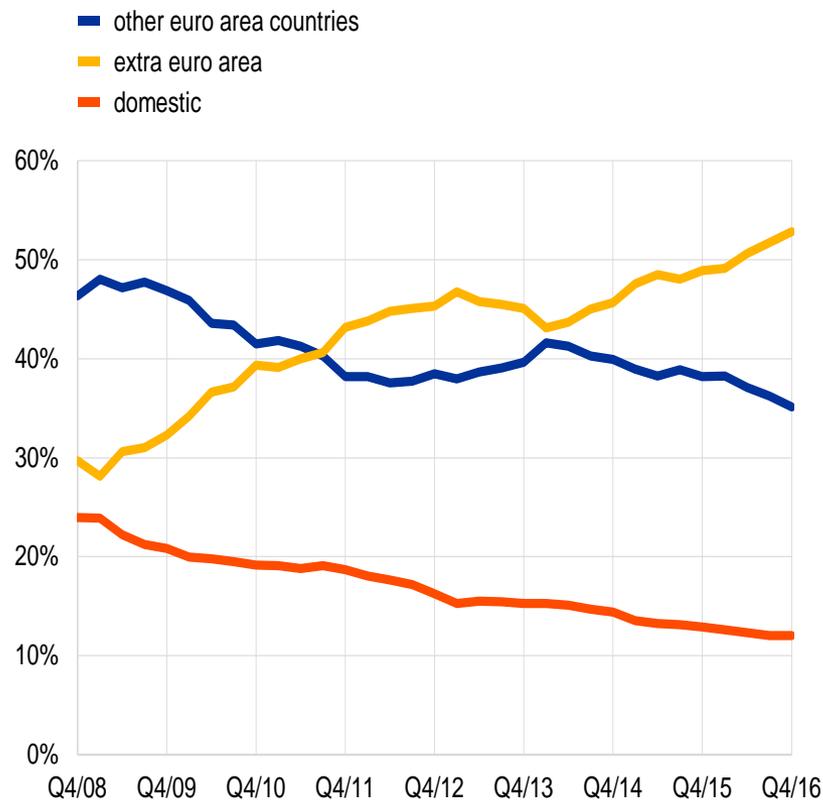


Sources: ECB (2017a), Chart S26

Cross-border Asset Holdings and Home Bias 2

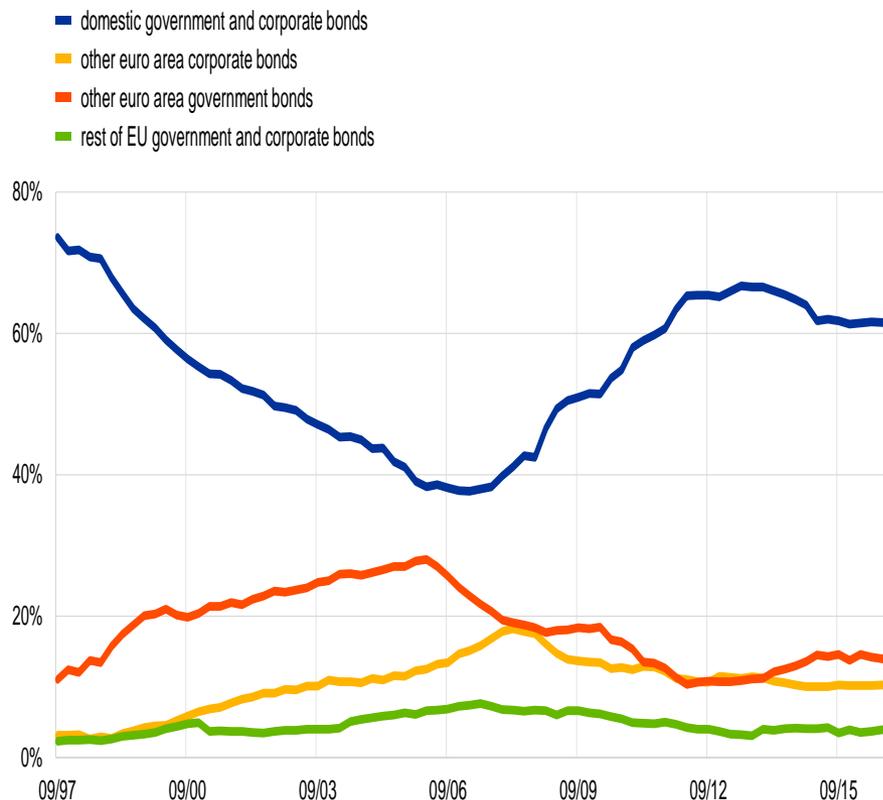
Investment funds diversify **bonds** outside euro area and MFIs recently reversed a renewed home bias

Investment funds' holdings of debt securities (% of total debt securities holdings)



Sources: ECB (2017a), Chart S25

MFIs' holdings of debt securities (% of total debt securities holdings)



Sources: ECB (2017a), Chart S24

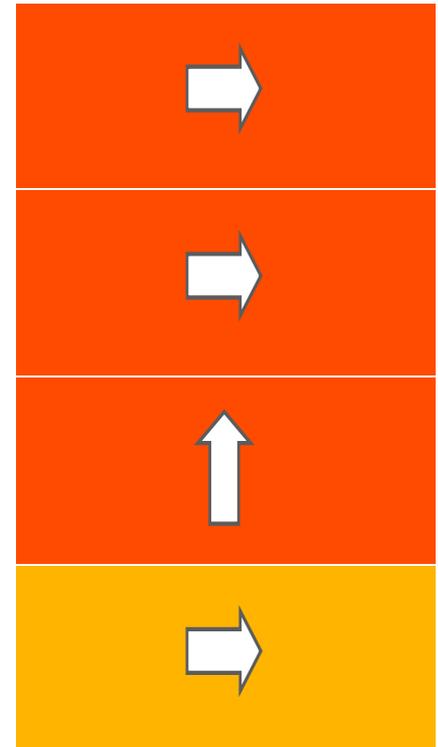
Recent Key Risks to Euro Area Financial Stability

Several of the most important financial stability risks to the euro area relate to fixed income markets

-  pronounced systemic risk
-  medium-level systemic risk
-  potential systemic risk

Current level (colour) and recent change (arrow)

1. Repricing in global fixed income markets – triggered by changing market expectations about economic policies – leading to spillovers to financial conditions
2. Adverse feedback loop between weak bank profitability and low nominal growth, amid structural challenges in the euro area banking sector
3. Public and private debt sustainability concerns amid a potential repricing in bond markets and political uncertainty in some countries
4. Liquidity risks in the non-bank financial sector with potential spillovers to the broader financial system

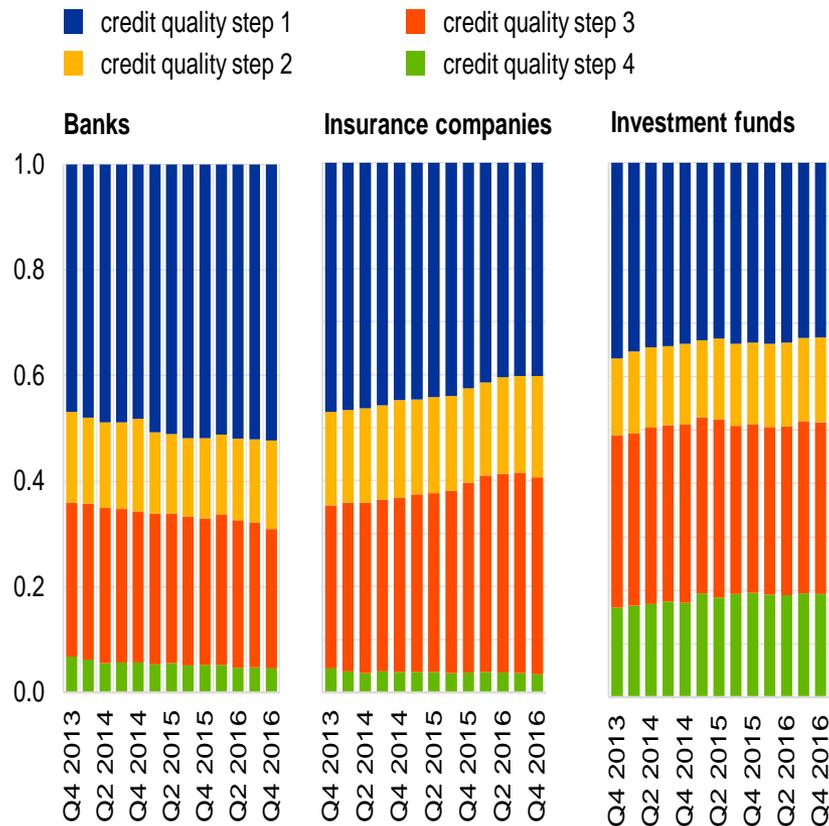


Sources: ECB (2017b), *Financial Stability Review, May, Table 1*

Asset Allocation and Risks of Investment Funds

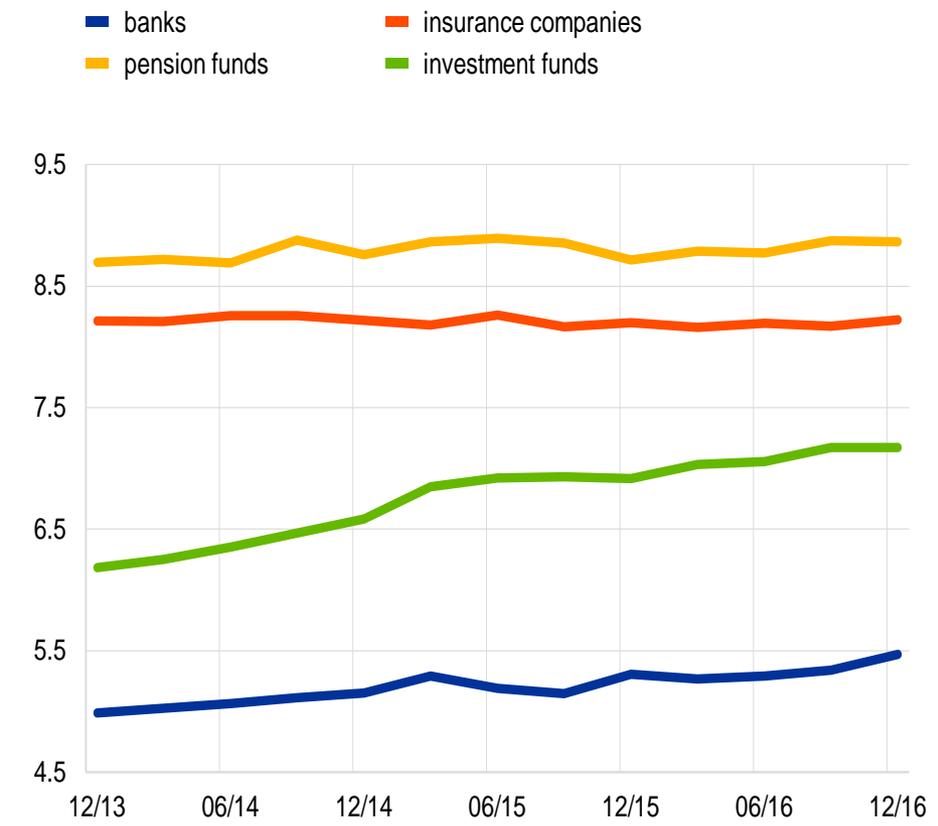
Some types of non-bank financial institutions in euro area increase riskiness of debt securities portfolios

Shares of debt securities by rating (% of total assets)



Sources: ECB (2017b), Chart 3.42

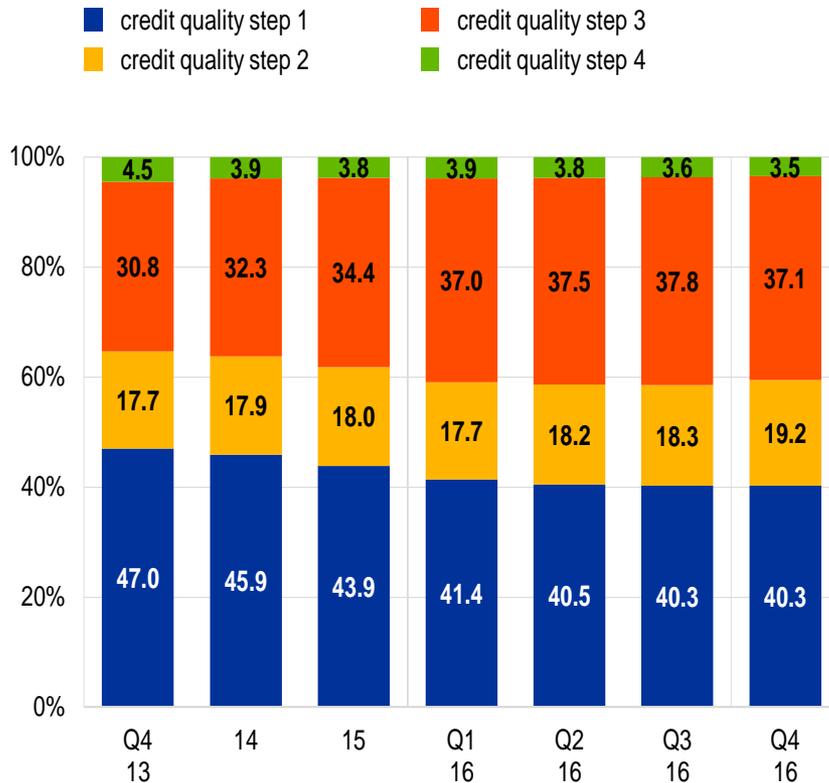
Average residual maturity of debt securities (years)



Sources: ECB (2017b), Chart 3.43

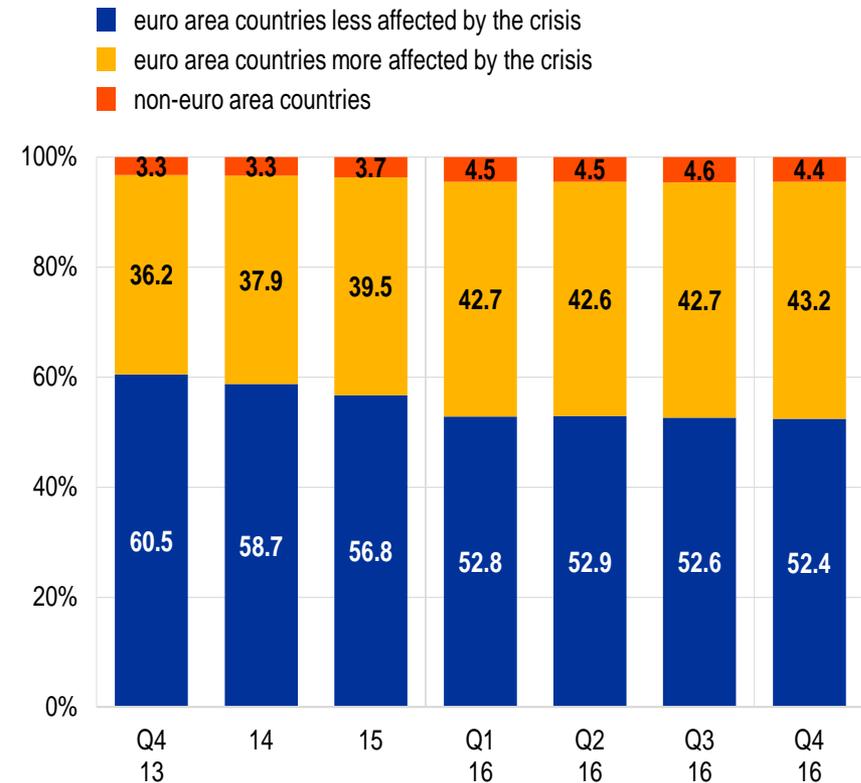
Euro area insurers increased the riskiness of their debt securities portfolios

Shares of debt securities by rating (% of total debt securities holdings)



Sources: ECB (2017a), Chart 3.34

Shares of government debt securities by issuer country (% of total government debt securities holdings)



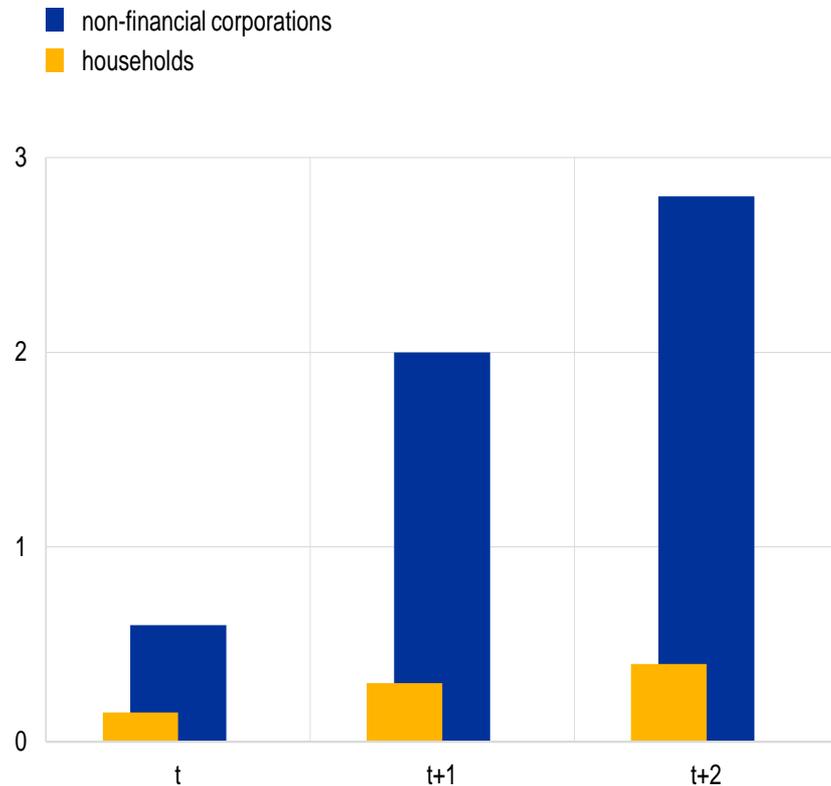
Sources: ECB (2017b), Chart 3.35

Annex

Exposure of Households to Interest Rate Shocks

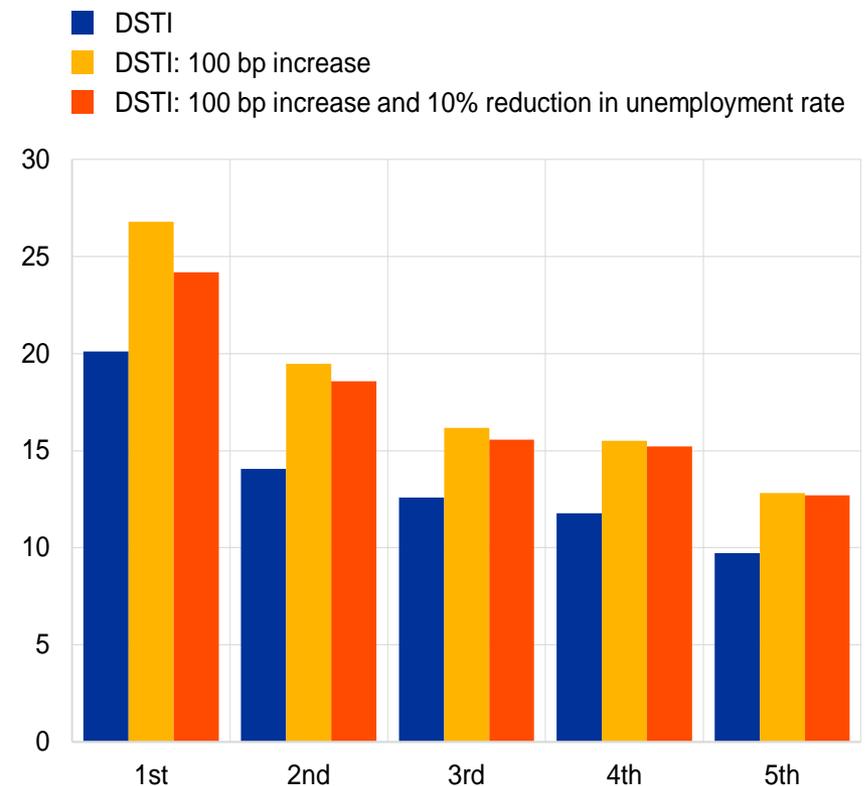
An interest rate increase would have a limited impact on households but affecting low-income most

Impact of 1% interest rate increase on gross interest payments (% of gross operating surplus/disposable income)



Sources: ECB (2017b), Chart 1.25

Actual and simulated median debt service-to-income ratios by income quintile (% , Q4 2016)



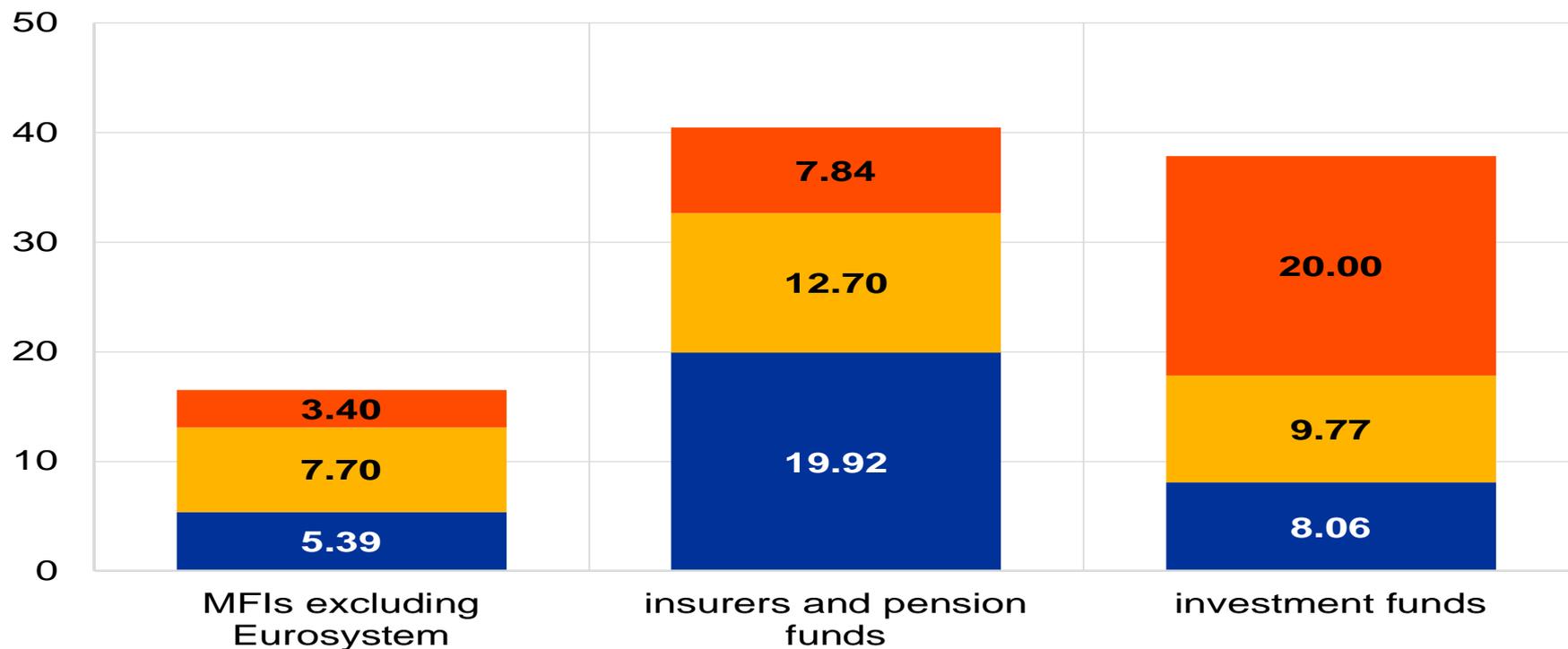
Sources: ECB (2017b), Box 2, Chart B

Debt Securities Exposure of Different Intermediaries

Insurance companies, pension funds and investment funds have sizeable fixed income exposures

Debt securities holdings (% of total assets)

- euro area government debt securities
- euro area corporate debt securities
- non-euro area corporate and government debt securities

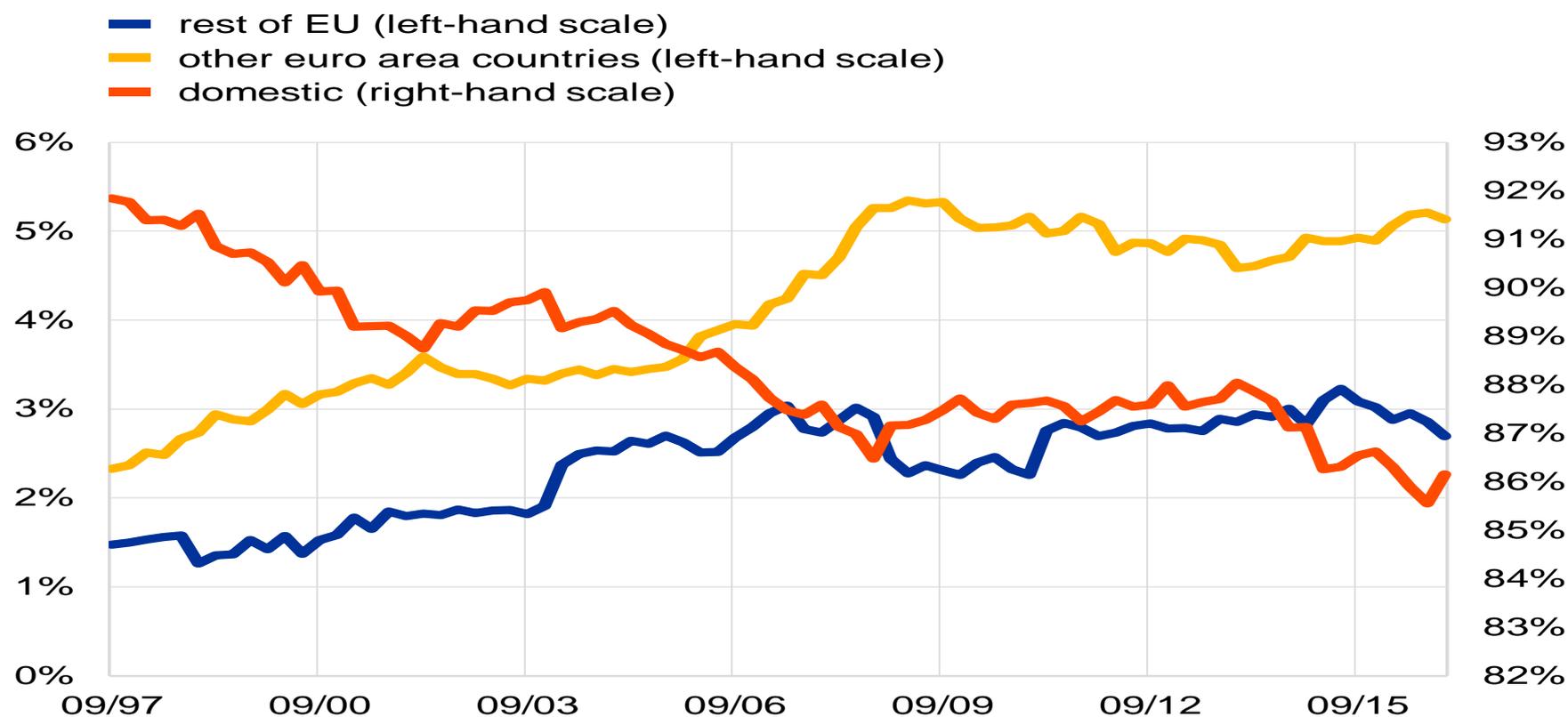


Sources: ECB (2017b), Chart 2.14

Financial Integration Developments

Retail credit market integration remains limited in the euro area

Outstanding amounts of MFI loans to non-MFIs by residency of counterparty (% of total lending excluding Eurosystem)



Sources: ECB (2017a), Chart S28