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"Challenges and the way forward: pursuing financial reforms, improving financial stability, ensuring inclusive economic growth"

Konstantinos Kanellopoulos

Head of Financial Risks Monitoring Section,
Financial Stability Department, Bank of Greece

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Financial Stability Risks are more interconnected

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- A sudden repricing of risk premia may carry wider repercussions (the sharp correction in asset prices in February 2018 is attributed to procyclical investor behavior)
  - The realization of the probability of a disorderly repricing may impact banks with large trading portfolios, in case that risk-appetite remains relatively strong and asset valuations relatively high, while servicing costs for the borrowers and the sovereign could increase.
  - The materialization of the rise in risk premia could reactivate the transmission channels between sovereign and the financial sector through (a) valuation losses on bank holdings of sovereign securities and (b) an increase in bank funding costs.
- The widespread adoption of FinTech may spur efficiency gains in the financial sector but also poses risks
  - a larger reliance on automated transactions could potentially increase market volatility due to higher asset price correlations and the increase of vulnerabilities to cyberattack.

Imminent policy actions: authorities responses

- Be supportive on growth policies and the improvement of credit efficiency
- Any tightening in financial sector policies should avoid slowing down credit growth
- Provide incentives for the reduction of corporate leverage, for instance through the strengthening of corporate restructuring mechanisms
- Continued vigilance about household debt ratios and investors' exposure to market and credit risks is warranted
- Rely more on activity-based regulation as financial services are increasingly provided by a diverse group of firms and market platforms

Short term policy actions: Risk Monitoring needs to be enhanced through macro and micro tools

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- Increase the scope for macroprudential monitoring
  - Macroprudential tools for the banking sector need to be calibrated while enhancing macroprudential instruments beyond banking
- A comprehensive system of macroprudential framework for the entire financial sector should be built either
  - by enabling a macroprudential policy in a form of an Act (advantages: holistic, coherent view on what should be done) or
  - by implementing a legislation on item-per-item, but maintaining an overall idea of the overall perspective
- Instruments should be designed proactively
  - The design before even a regulation takes place will enable an assessment of the pros and cons
- There should be a level of harmonisation amongst Member States regarding macroprudential policy

Long-term policy actions: The need for strengthening the institutional framework

As part of a long-term plan for the completion of EMU, the European Commission proposed the creation of a banking union in order to boost confidence in the banking system and the euro (May 2012). The roadmap that provided for three pillars, the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and a deposit guarantee scheme/ central deposit guarantee fund (September 2012).

Progress achieved so far by SSM and SRM:

- Enabling to strengthen confidence in the euro area banking sector
- Prevention of massive deposit withdrawals and their repercussions
- Better functioning of the interbank market
- Eliminating to a large extent the fragmentation of the internal market for financial services
- Curbing the vicious circle of the sovereign-bank nexus

More generally, regulatory reforms on the financial sector have led to a reduction of banks' leverage, the strengthening of their capital base and triggered a gradual change in their mode of operation.

Strengthening efforts on EMU and banking union

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- Efforts to deepen EMU were stepped up with the publication of a roadmap by the European Commission (December 2017)
  - the activation of a backstop for the Single Resolution Fund in the form of a credit line from the European Stability Mechanism (ESM)
  - further transformation of the ESM so that it may evolve to a European Monetary Fund
  - further development of the ECOFIN roadmap of June 2016 for the completion of the Banking Union, including a deposit guarantee scheme
- The Commission has put emphasis on the need for a backstop for SRF by putting forward additional risk-reduction measures – not included in the Roadmap – to reduce non-performing loans, in line with the relevant Council Action Plan (these measures were proposed by the Commission in March 2018)

Moving forward on SRF

- The current economic environment and momentum provides an accommodative backstop for the SRF, enabling the promotion of the Banking Union.
- To this end, a balance between risk reduction measures and risk sharing should be achieved via clear political decisions in the coming months
- but… measurement of risk reduction remains an important open issue and can be achieved either through
  - (a) setting quantitative targets to measure progress in risk reduction that will lead directly to some policy decisions OR
  - (b) shall be used as means to inform political-decision making and that the ultimate decisions are the prerogative of political leaders and cannot be taken in an automatic manner

Financial Sector Reforms in Greece

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- The **banking system has been restructured, consolidated and recapitalized**, following stringent stress tests along with in-depth asset quality reviews. (CET1 ratio at 17% in 2017Q4 compared to 16% for EU-medium-sized banks)
- The **ratio of Non-Performing Exposures to total Exposures remains elevated although improved in Q4 2017** (43.1% of total exposures in 2017Q4 from 44.6% in 2017Q3).
- Institutional reforms have been implemented, i.e. inter alia, the authorization of credit servicing firms, operation of an electronic platform for out-of-court settlement, and electronic auctions of real estate.

Towards a sustainable growth model – policy recommendations for Greece

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- Safeguarding the independence of institutions
- Addressing the public debt overhang
  - The Bank of Greece has put forward a mild debt re-profiling proposal, which extends the weighted average maturity of interest payments on EFSF loans by at least 8.5 years.
- Adopting a growth-friendly fiscal policy mix
- Tackling the problem of non-performing exposures (NPEs)
  - Banks should facilitate the restructuring of viable businesses, the identification of strategic defaulters and the liquidation of non-viable businesses.
- Promoting innovation, education, attracting FDI and supporting the unemployed

Thank you very much for your attention!