ESAs see recovery stalling amid existing and new risks

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Russia's invasion of Ukraine and its economic consequences have aggravated the outlook for growth and inflation and brought heightened market volatility. Market resilience will critically depend on the ability of markets and financial institutions to deal with the economic consequences of the Russian invasion of Ukraine, and to withstand changes in public policy support on the monetary or fiscal side without material disruptions.

Some of the risks emerging during 2021 and highlighted in the report were amplified by Russia's invasion of Ukraine. The EU economy was on track for a strong recovery from the crisis caused by the Covid-19 pandemic and the financial sector largely proved resilient. However, the recovery appears to have been hindered by new waves and variants of the virus, concerns regarding inflation risk, rising commodity prices and heightened geopolitical risks.

Additional vulnerabilities and risks for the financial system have built up over time. Financial markets remain vulnerable to changes in market sentiment, particularly if financial conditions tighten unexpectedly due to inflation pressures. In the real estate sector, persistent price increases and higher borrowing by households have increased risks. At the same time, the financial sector is increasingly exposed to environmental risks and risks stemming from digitalisation.

In light of the risks and uncertainties, the ESAs advise national competent authorities, financial institutions and market participants to take the following policy actions:

Financial institutions should be prepared for further potential negative implications stemming from geopolitical tensions and ensure compliance with the sanctions regimes put in place both at the EU and at global levels;

Financial institutions and supervisors should prepare for a possible deterioration of asset quality in the financial sector;

The impact of further increases in yields and sudden reversals in risk premia on financial institutions and investors should be closely monitored;

Retail investors are of particular concern, and supervisors should monitor risks to retail investors seeing that their participation in financial markets has increased substantially in recent years;

Financial institutions should further incorporate ESG considerations into their business strategies and governance structures; and

Considering the elevated level and frequency of cyber incidents, financial institutions should strengthen their cyber resilience and prepare for a potential increase in cyberattacks.

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