ESRB
European Systemic Risk Board
European System of Financial Supervision

Press release

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Lower for longer – macroprudential policy issues arising from the low interest rate environment

The European Systemic Risk Board (ESRB) has today published a second report on macroprudential policy issues arising from the low interest rate environment in the financial system of the European Union (EU). The work behind the report, which was conducted by a joint task force of the ESRB's Advisory Technical Committee, the ESRB's Advisory Scientific Committee and the ECB's Financial Stability Committee, began in late 2019 and built on an earlier report that the ESRB published in 2016.

The latest analysis has a forward-looking medium-term time horizon of five to ten years. While the report acknowledges cross-country heterogeneity, its focus is predominantly on the EU financial system as a whole and on interest rates in the EU. The report begins with an extensive analysis of how the low interest rate environment has been driven mainly by structural factors, including demographics, productivity, excess savings and low investment. Looking beyond recent cyclical developments, the coronavirus (COVID-19) shock may have increased the likelihood and persistence of a "low for long" scenario, making it "even lower for even longer".

The risk analysis of the report identifies four areas of concern owing to the low interest rate environment:

- profitability and resilience of banks, as the negative effects of existing structural problems in the EU banking sector, including overcapacity and cost inefficiencies, are being compounded;
- indebtedness and viability of borrowers, who are taking on more debt as a result of their search for yield;
- systemic liquidity risk, as the financial system has become more sensitive to market shocks, also as a result of structural changes;
- sustainability of the business models of insurers and pension funds offering longer-term return guarantees, as they are coming under increasing pressure.

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The report notes that addressing those risks requires wide-ranging macroprudential policy responses. These would need to go beyond the scope of existing instruments, which are currently limited to the banking sector and to borrower-based measures for households, based on national legislation. The report sets out a range of policy options for mitigating systemic risks and improving systemic risk analysis, and the ESRB will continue to develop appropriate policy responses. For example, the current macroprudential toolkit does not provide instruments that can be used to deal directly with risks related to structural changes in the financial system. A move from traditional banking activities and the associated risks to non-bank financial intermediation requires developments in macroprudential policy beyond banking and in activity-based regulation.

Furthermore, the report identifies key actions to complete the policy framework outlined in 2016, in the following areas: (i) sustainability of the business models of insurance companies and pension funds offering longer-term return guarantees; (ii) implementation and monitoring of lending standards across the financial system; (iii) monitoring of leverage in the financial system; (iv) analysis of interconnectedness; (v) identification of regulatory arbitrage; and (vi) subsequent analysis of the need for activity-based regulation.

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