



EUROPEAN CENTRAL BANK

EUROSYSTEM

Financial Stability Review May 2026

Press briefing

27 May 2026

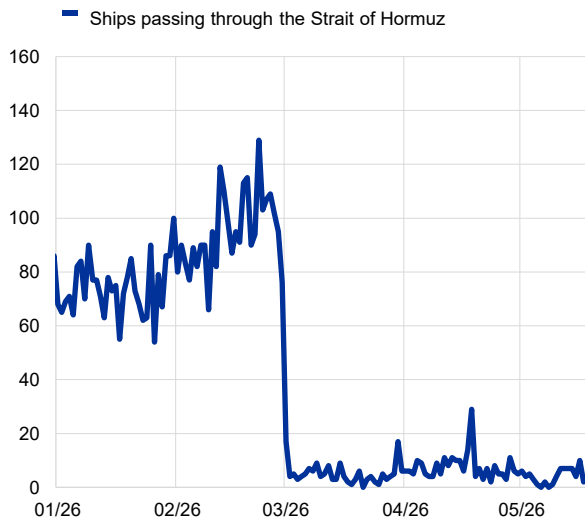


What's new: An adverse geoeconomic shock is unfolding

- Closure of Strait of Hormuz and attacks on energy infrastructure have disrupted global energy supply.
- Implications for growth, inflation and financial stability depend on duration and severity of the war.
- Lingering risks of further disruption in international trade and cooperation, with ever-present cyber threats.

Number of ships passing through the Strait of Hormuz

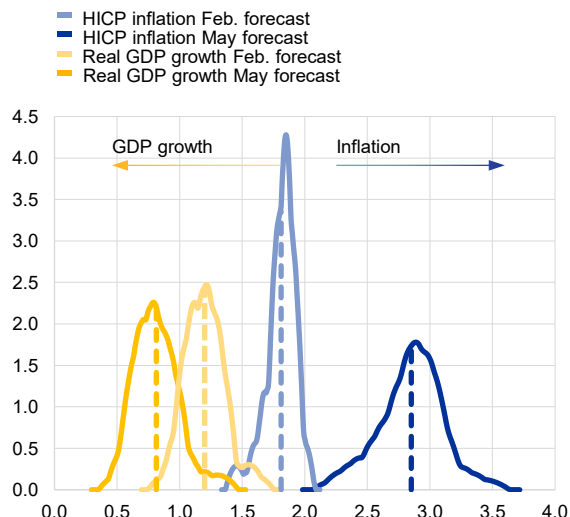
(1 Jan.-17 May 2026, total)



Sources: UN Global Platform and PortWatch.

Distribution of 2026 HICP inflation and real GDP growth forecasts for the euro area

(Feb. 2026, May 2026; probability densities)

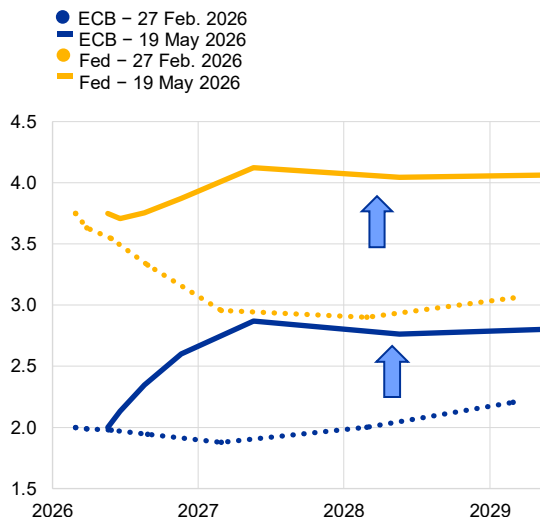


Source: Consensus Economics Inc.

Notes: The dashed lines represent values for average HICP and the real GDP growth forecast. HICP stands for Harmonised Index of Consumer Prices.

Market-implied interest rate expectations

(Jan. 2026-May 2029, percentages)



Source: Bloomberg Finance L.P.

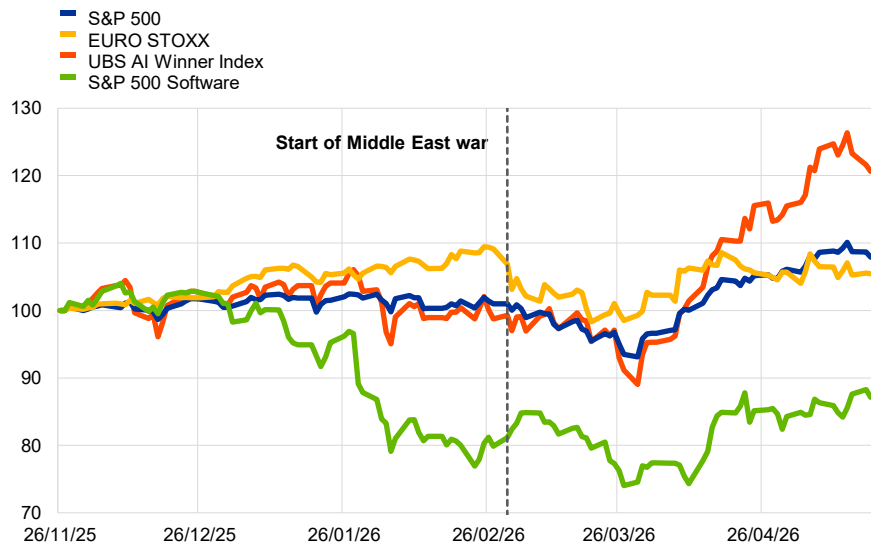
Euro area financial stability vulnerabilities remain elevated as geoeconomic shock unfolds

- 1 | Prolonged geopolitical tensions and lingering fiscal challenges could test financial market sentiment and expose sovereign vulnerabilities
- 2 | Vulnerabilities among non-banks, including those active in private markets, could amplify stress in financial markets and increase the risk of cross-sector spillovers
- 3 | Banking sector resilience has strengthened overall, but credit, liquidity and funding vulnerabilities might unravel given exposure to non-banks and energy and trade-sensitive corporates

1 Prolonged war could test financial market sentiment and expose sovereign vulnerabilities

Price movements for selected equity indices

(26 Nov. 2025-19 May 2026, index = 100 on 26 Nov. 2025)



Sources: Bloomberg Finance L.P. and ECB calculations.

Note: The UBS US AI Winner Index comprises 45 US companies positioned to benefit from the artificial intelligence value chain.

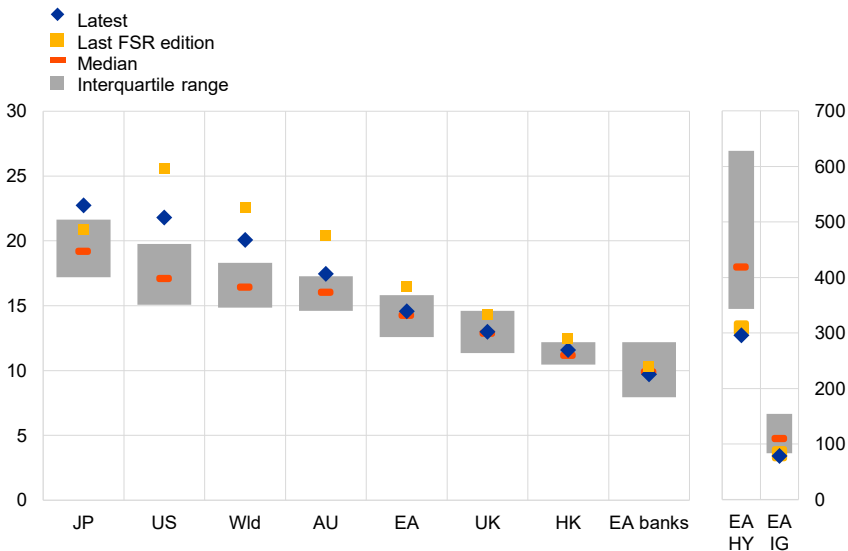
- *Financial market sentiment has waxed and waned, shifting from ...*
- *... emerging concerns around the disruptive potential of AI ...*
- *...to worries about energy supply, visible in broad-based equity market declines after eruption of the war ...*
- *...and recent sell-offs in sovereign bond markets.*

1 Prolonged war could test financial market sentiment and expose sovereign vulnerabilities

- *Despite market adjustments, valuations still appear stretched in most markets.*
- *Sovereign bond market functioning remains orderly, but a shifting investor base and external fiscal imbalances could yet cause strains.*

Equity and bond valuations

(1 Jan. 2005-19 May 2026, left chart: p/e ratios, right chart: basis points)

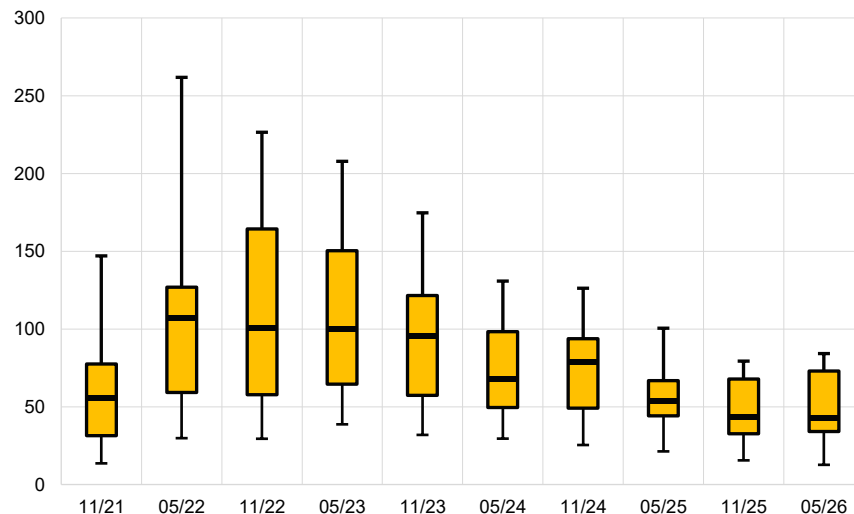


Source: Bloomberg Finance L.P.

Notes: For equities, the boxplot shows interquartile range of one-year forward price/earnings ratios relative to the distribution since 2005. The latest edition of the ECB's Financial Stability Review was published on 26 November 2025. Wld = MSCI World Index, HK = Hong Kong, AU = Australia. For bonds, the boxplot shows interquartile range of latest z-spread compared with the distribution since 2000.

Distribution of euro area sovereign spreads vs Germany

(Nov. 2021-May 2026, basis points)



Source: LSEG.

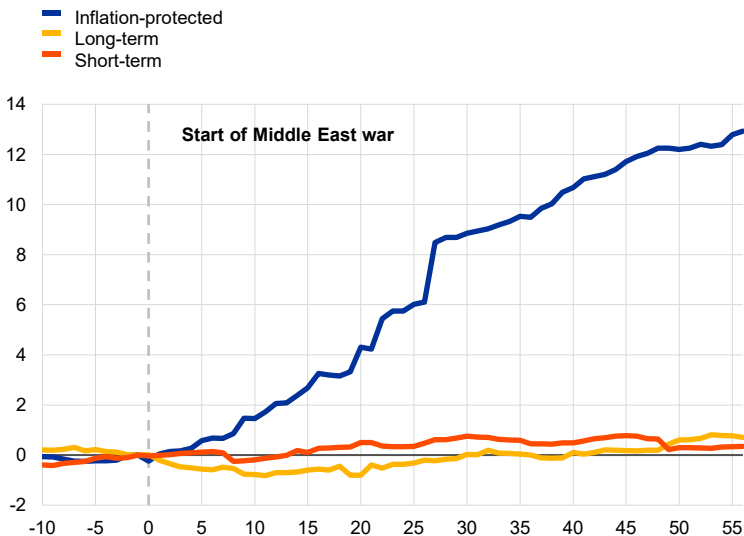
Notes: Spreads are based on daily data corresponding to Financial Stability Review publication dates. The latest observation is for 19 May 2026.

2 Vulnerabilities among non-banks could amplify market stress and cause spillovers across sectors

- *Flight-to-safety flows accompany shifts towards inflation-protected debt amid high uncertainty and rising inflation fears.*
- *For now, non-banks have remained resilient, but renewed financial market volatility could result in margin calls and additional outflows from riskier funds.*

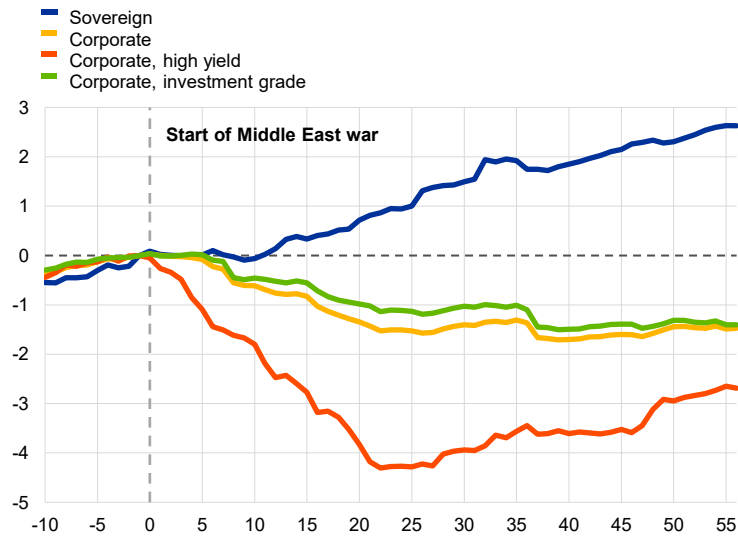
Cumulative investment fund flows into European bonds

(16 Feb.-19 May 2026; days before/after start of Middle East war, percentage shares of total net assets)



Source: EPFR Global.

Notes: "Start of Middle East war" refers to the first trading day after 28 February 2026, which is 2 March 2026, with 0 on the x-axis marking the event date and other values indicating the business days before and after the event. The sample is based on globally domiciled funds investing primarily in Western European bonds.

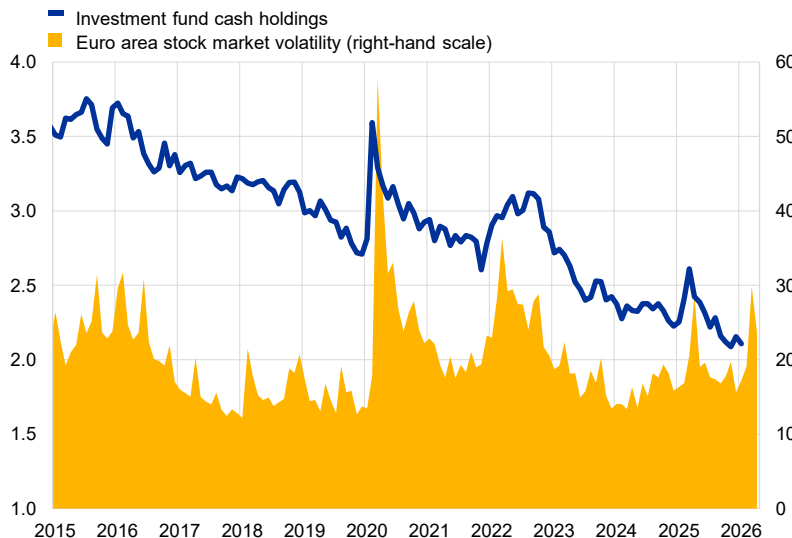


2 Vulnerabilities among non-banks could amplify market stress and cause spillovers across sectors

- *Concentrated holdings of US assets at elevated valuations expose non-banks to the risk of both valuation losses and exchange rate fluctuations.*
- *Potential for amplification into disorderly market dynamics remains, given structural NBF1 liquidity and leverage vulnerabilities.*

Euro area investment funds' cash holdings and market volatility

(Jan. 2015-Apr. 2026; percentage of total assets, index)

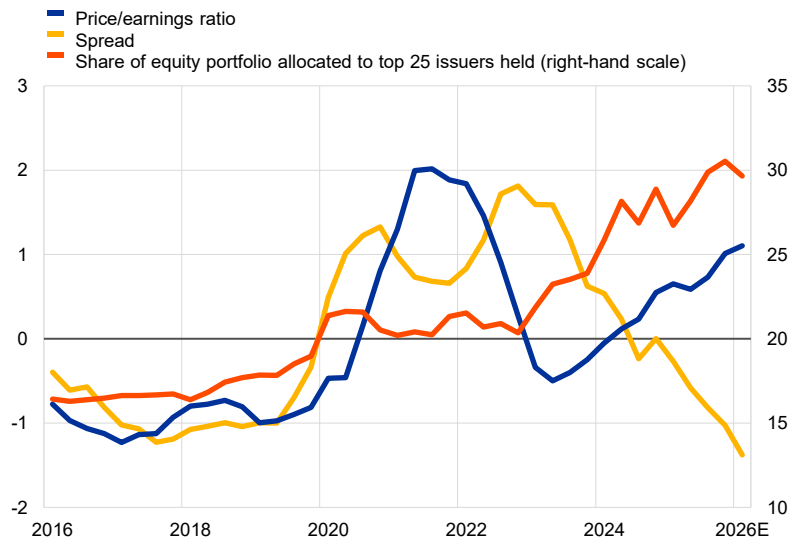


Source: ECB (BSI, IVF).

Notes: "Euro area stock market volatility" refers to the EURO STOXX 50 Volatility Index (VSTOXX). The investment funds cash holdings series is available up to February 2026.

Valuations of non-banks' equity and bond portfolios, and concentration of equity exposures

(Q1 2016-Q1 2026E; z-scores, percentages)

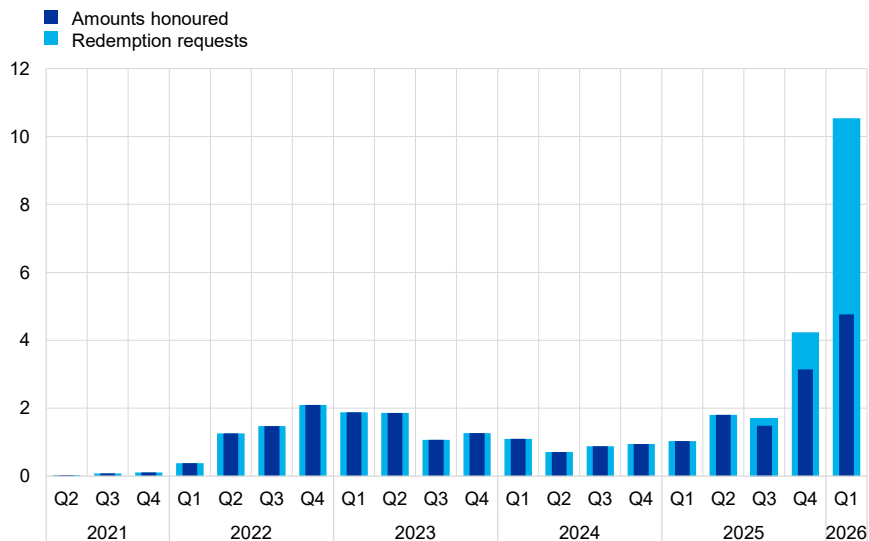


Sources: Bloomberg Finance L.P., ECB (CSDB, SHS, EXR) and ECB calculations.

Notes: Q1 2026 values are estimates. Holdings are projected by repricing the Q4 2025 portfolio composition using the latest available 2026 prices. Changes in estimated Q1 concentration therefore reflect only relative asset price movements, not active portfolio management.

Redemption requests from business development companies in the United States

(Q2 2021-Q1 2026, percentages of net asset value)



Source: Company SEC filings and ECB calculations.

Note: Data for a total of 26 non-traded business development companies that reported redemption requests in the periods shown. Business development companies (BDCs) are investment vehicles that lend primarily to small and medium-sized US firms. They come in two forms. Listed BDCs trade on public exchanges, providing investors with liquidity through the secondary market despite the fund's closed-end structure. Non-listed BDCs function more like semi-open-ended funds, offering quarterly redemptions at net asset value, but are typically subject to redemption gates that can limit or suspend withdrawals during stress periods.

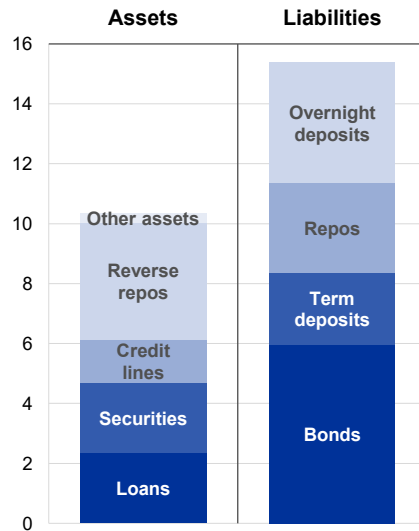
- *While not a systemic concern per se within the euro area, private markets warrant close monitoring.*
- *Unusually large redemption requests tested redemption gates of US private credit funds in Q1 2026.*
- *Although direct exposures to US private credit funds are limited, ...*
- *... if sentiment shifts were to affect high-yield bonds, leveraged loans and equity markets, spillover risks for euro area pension funds and insurers could be material.*

3 Bank resilience has strengthened, but credit, funding and liquidity vulnerabilities might unravel

- *Euro area banks navigated recent bouts of volatility well, supported by strong capital, liquidity and profits.*
- *Direct exposure to the Middle East is limited, but asset quality could deteriorate if the war were to trigger a worsening of macro-financial conditions, while funding sourced from non-banks might prove flighty.*

Euro area banks' assets and liabilities with non-banks

(Q4 2025, percentages of total assets)



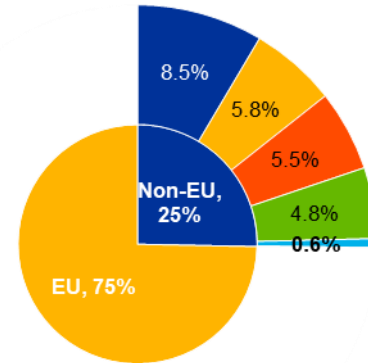
Source: ECB (supervisory data).

Note: Banks' asset exposures to and funding from non-banks are ordered by their liquidity profile.

Total non-EU exposure of euro area banks, by region

(Q4 2025, percentages of total assets)

- United States
- United Kingdom
- Other advanced economies
- Middle East
- Other emerging market economies



Source: ECB (supervisory data)

Note: Regional classification based on [IMF world economic outlook groups](#), excluding all EU Member States.

Preserving resilience of banks and non-banks essential as geoeconomic shocks unfold

For banks



Maintain macroprudential buffers while remaining agile

Complete the banking union and make the single market more efficient

Simplify the supervisory and regulatory framework *without* compromising resilience

For non-banks



Implement internationally agreed reforms to address leverage and liquidity risks

Enhance supervisory and macroprudential frameworks to develop EU capital markets

Address data gaps to support risk monitoring efforts, including in private credit

Euro area financial stability vulnerabilities remain elevated as geoeconomic shock unfolds

1

Prolonged geopolitical tensions and lingering fiscal challenges could test financial market sentiment and expose sovereign vulnerabilities



- Further escalating and/or prolonged geopolitical tensions could stress global energy markets, with marked implications for growth, inflation and interest rates.
- Equity and corporate bond market valuations fell after the outbreak of the Middle East war but remain high by historical standards and at risk of sharp repricing.
- Fiscal capacity to cushion the impact of the war on households' and firms' expenses might be limited by stretched public finances in some countries.
- Fiscal slippage or adverse spillovers from fiscal shocks in other major advanced economies could lead to a global repricing of sovereign risk.
- Investor concerns about AI disruption or disappointment could further strain market segments with exposures to AI-related assets, notably private markets.

2

Vulnerabilities among non-banks, including those active in private markets, could amplify stress in financial markets and increase the risk of cross-sector spillovers



- Investment funds have weathered market turmoil relatively well but may face outflows in a context of heightened geoeconomic uncertainty.
- Further stress in opaque and interconnected private markets may trigger adverse confidence effects and spillovers to public markets.
- High valuations and concentration in financial markets continue to represent vulnerabilities for non-bank portfolios.
- Declining cash holdings and significant liquidity mismatch in some types of open-ended investment funds make funds vulnerable to redemption shocks.
- Pockets of elevated financial and synthetic leverage in some entities, notably hedge funds, may exacerbate the risk of financial contagion.

3

Banking sector resilience has strengthened overall, but credit, liquidity and funding vulnerabilities might unravel given exposure to non-banks and energy and trade-sensitive corporates



- The ability of euro area banks to absorb future shocks is supported by robust earnings momentum and ample capital and liquidity buffers.
- Rising financial sector linkages could cause stress in the non-bank financial intermediation sector to spill over to euro area banks, especially via funding.
- While euro area banks' direct Middle East exposure is limited, second-round effects could be material as the shock propagates through the real economy.
- Banks with high exposure to trade, energy and interest rate-sensitive industries could face worsening asset quality in the event of prolonged geoeconomic stress.
- A cost-of-living shock, weaker than expected growth outturns and deteriorating labour market conditions could erode some households' debt servicing capacity.

Special Feature A	–	From dictionaries to AI: a new era in sentiment analysis for financial stability
Special Feature B	–	Rising bankruptcies, resilient loan books: unpacking euro area corporate credit risk
Special Feature C	–	House price booms and policy choices: Insights from a meta-regression analysis
Special Feature D	–	Stress in global private credit markets and its implications for euro area financial stability
Chapter 1 – Box 1	–	Financial stability implications of geopolitical and geoeconomic risks
Chapter 2 – Box 2	–	Along the curve: investor reallocation in euro area government bonds
Chapter 3 – Box 3	–	The drivers of the 2025 surge in euro area banks' market valuations
Chapter 4 – Box 4	–	Drivers of investor behaviour in highly valued equity markets
Chapter 4 – Box 5	–	Assessing the macroprudential impact of liquidity management tools for investment funds: a system-wide analysis