Mike West

President, Moody's Investors Service

The post pandemic financial landscape

Hello, I'm Michael West, President of Moody's Investors Service and it's my pleasure to join you today.

The pandemic provides a stark reminder that we face a wider range of complicated and inter-connected risks than ever before.

I'd like to start with observations on three key features of the post-pandemic financial landscape: the banking system, corporate debt markets, and sovereign balance sheets.

So let me take the European Banking Sector.

The European banking sector has come through the pandemic in good health. Capital has increased, and after a brief spike in bad debts, non-performing loans have continued their long-term decline. Liquidity is abundant and earnings exceed pre-Covid levels. This leaves the banking sector well-positioned to support an ongoing economic recovery.

It's a different story with respect to non-financial corporations, where debt has increased significantly in the public and private credit markets, and particularly within the leveraged finance segment, where credit profiles are weaker, and where covenant packages have loosened. Nonetheless, due to abundant liquidity and policy support, the global corporate default cycle was shorter and milder during the pandemic compared to previous cycles.

And lastly let's turn to the sovereign balance sheet. In the past two years, we have seen that as governments stepped in to support healthcare, economies and societies, sovereign debt increased significantly. However, the low interest rate environment has meant that for advanced economy sovereigns, the cost of carrying this additional debt is relatively low, whereas emerging market sovereigns face somewhat greater debt servicing costs.

Let's turn our attention here to future financial stability.

As supply chain disruptions persist and inflation remains elevated, the interest rate outlook is evolving. While some central banks have started raising monetary policy rates, we expect a more gradual pace of eventual monetary tightening from the ECB. However, financial markets have already tightened, with long-dated yields rising.

Looking ahead, as financial conditions tighten we may witness occasional bouts of market volatility. These would pose risks to financial stability in the event that liquidity tightened significantly for a sustained period, causing financial asset price declines and spillovers into the real economy. However, a gradual increase in interest rates accompanied by continued growth would not cause financial disruption.

Another important trend relates to disintermediated finance.

Globally, we are seeing a shift towards disintermediated finance, which gives businesses access to more funding sources. Still, Europe remains heavily reliant on the banking system.

Disintermediated finance presents significant opportunities for Europe. The EU is a net exporter of capital, and further deepening of capital markets could provide a stronger incentive for the private sector to keep funds in Europe.

Steps to boost disintermediated finance in Europe, and - more broadly - to drive the Capital Markets Union agenda would complement the planned Next Generation EU initiative and amplify its benefits.

We have to mention another priority for us all, and that is climate change and the transition to net zero.

Banks' and capital markets will play an important role in financing climate resilience, mitigating the impact of climate change and the transition to a low carbon economy. Financing will be required to retrofit factories, decommission assets, improve energy efficiency and build climate resilience in infrastructure

Over the coming years, financial institutions will need to increase climate risk assessments and set clear goals for reaching net zero in their financed emissions.

Better disclosures will allow for better data analysis which will ultimately drive better decisions. Proper accounting and disclosure of greenhouse gas emissions is foundational, with regular

reporting to track changes in emissions for every borrower.

However, let's not forget cyber risk.

Along with climate, cyber risk is another issue that threatens the reputation and financial profile of every corporation and government.

The financial services sector, in particular, is a prime target for cyberattacks.

Even for non-financial companies the risk of cyberattacks, particularly ransomware attacks, is growing, while a cybersecurity talent gap makes it harder to build defenses. Finally, cyber insurance is poised for change as premiums continue to climb, while the scope of coverage narrows.

A key challenge is that financial markets have a limited ability to quantify the threat. Organizations need more help in identifying, measuring and managing the financial impact of cyber risk.

And with new risks emerging all the time, resilience can be just as important as preparedness. Building resilience will help organizations that come under attack to maintain operations, limit the damage and recover more quickly.

So let me wrap this all up.

It is clear that we are facing more risks than ever before.

In our inter-connected world, failing to manage risks effectively can cause significant financial and reputational damage.

After the last two years of disruption in Europe and around the world, Eurofi gives us a valuable opportunity to discuss risks – and the opportunities – that lie ahead on the road to recovery.

I'd like to thank Eurofi for the opportunity to speak to you today. I wish you all the best for a successful event.