

2023 Stress Test of Euro Area Banks

Final results



28 July 2023

ECB/SSM performed two supervisory stress test exercises for significant institutions in 2023

Objectives

- Assess the **resilience of financial institutions** to adverse market developments.
- Contribute to the overall Supervisory Review and Evaluation Process (SREP) to ensure institutions' capital and liquidity adequacy, as well as sound risk coverage and internal processes.
- The exercises support also other supervisory initiatives, e.g. risk data aggregation, leveraged finance, and deep dives on sectoral credit risk exposures, commercial real estate, counterparty credit risk

EU-wide EBA stress test

- 57 SSM Significant Institutions
- Publication of bank-specific, granular results
- EU-wide exercise under EBA coordination, in cooperation with ESRB, ECB and NCAs
- 2 macroeconomic scenarios: baseline (provided by EU national central banks) and adverse (provided by ESRB)
- Launch of the exercise: January 2023

SSM stress test

- **41** other SSM Significant Institutions
- Publication of bank-specific, high-level results
- Under ECB/SSM coordination
- Same macroeconomic scenarios
- Launch and methodology broadly aligned with EBA EU-wide stress test

Key takeaways from the 2023 stress test



The recent years' improvements in asset quality and profitability have overall made SSM significant institutions more resilient to shocks

...though stress test results still call for vigilant monitoring of risks and capital headroom



System-level CET1 ratio¹ drops to 10.4% in 2025 under the adverse scenario, corresponding to a depletion of 480 basis points (in fully loaded terms, FL)



CET1 ratio depletion driven by credit risk and market risk combined with a contraction in banks' income generation capacity under the inflationary and rising interest rate scenario

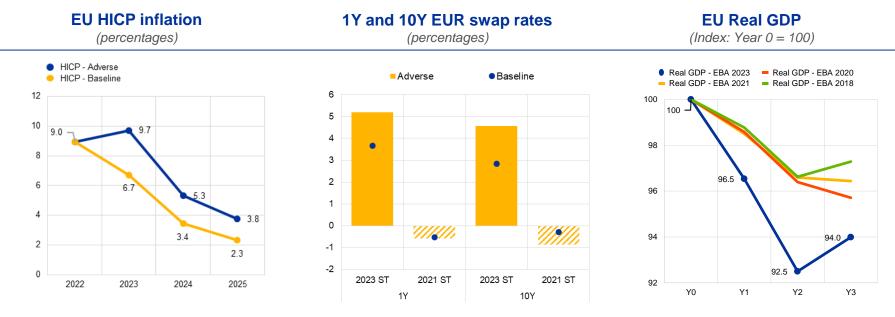


53 banks would breach the MDA trigger under the adverse scenario and 9 banks would fall below their TSCR² or leverage ratio (LR) requirements. Not a 'pass-fail exercise!

Scenario

Aggravation of geopolitical tensions leading to stagflation and higher rates

 Supply and demand factors keep inflation high over the horizon, resulting in higher market rates and a severe cumulative GDP loss accompanied by strong declines in asset prices and real estate prices



Source:2018 EBA ST, 2020 EBA ST, 2021 EBA ST, 2023 EBA ST, ECB and ECB calculations.

Note: Right panel: Figures for the "EBA 2020" series refer to the scenario prepared for the <u>2020 EU-wide Stress Test</u> which was postponed.

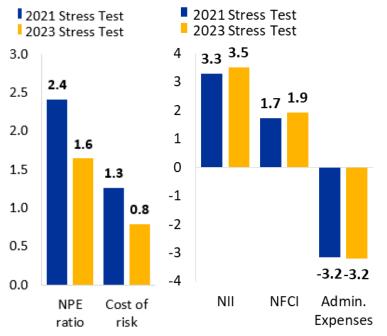
Balance sheet improvements

Banks' resilience bolstered by improvements in asset quality and income generation capacity

- Starting point positions markedly improved compared to the previous stress test:
 - Better quality of the loan portfolios, as banks' nonperforming exposures (NPE) ratios continued their downward trend, driven especially by securitisations and asset disposal strategies
 - Improvement in the system's income generation capacity supported by the recent interest rate increases
- The improvement in the starting points helps to offset the high severity of the adverse scenario

Comparison of starting point key indicators

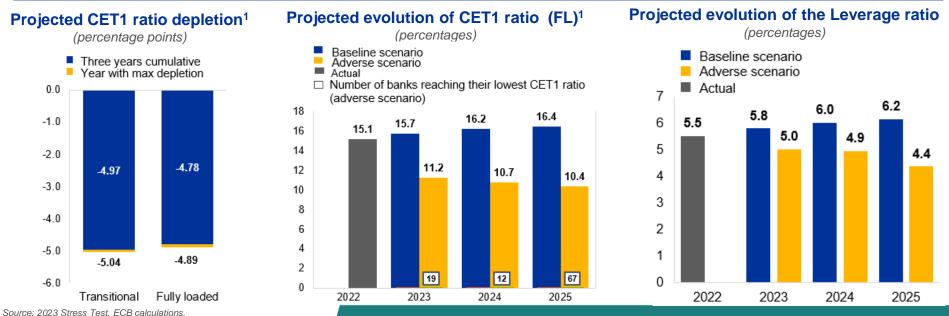
(percentages, percentages of starting point REA)



Capital headroom

At system level capital and leverage ratios remain well above regulatory minima even under the adverse scenario

- Despite a significant CET1 depletion under the adverse scenario, euro area banks are overall resilient
- ...as in previous stress tests, a number of banks breach the MDA threshold (53)...
- ...while only nine banks face difficulties in meeting total SREP capital requirements (TSCR) and/or leverage ratio requirements.



6

Source: 2023 Stress Test, ECB calculations.

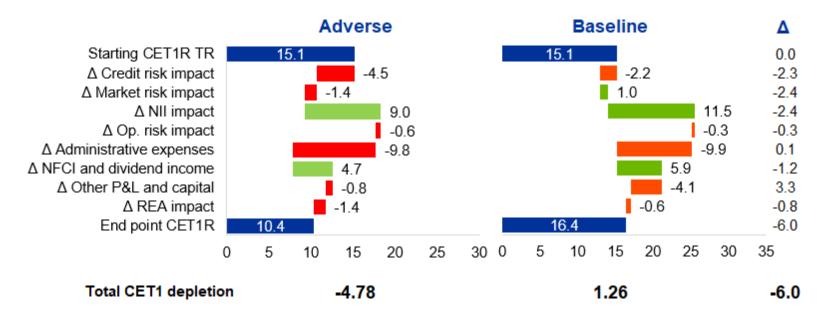
¹The metric shows the maximum level of system level depletion if all banks incurred the maximum depletion in the same year

Capital depletion

Credit and market risk losses and contraction of income generation capacity drive depletion in the adverse relative to the baseline scenario

Depletion waterfall (baseline and adverse scenarios, FL)

(percent, percentage points)



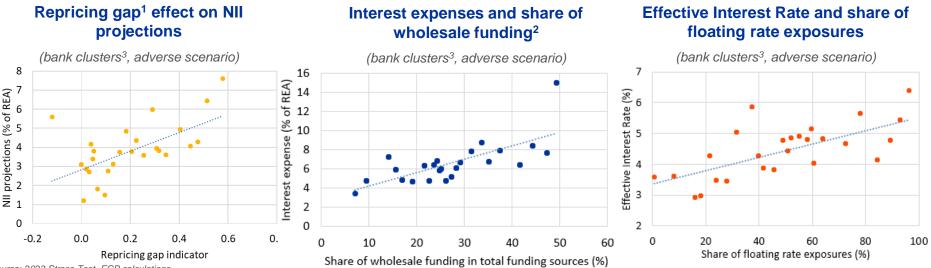
Sources: 2023 Stress Test, ECB calculations.

Note: Other P&L and capital impact covers a variety of items, among which MDA, net tax and dividends paid.

Net interest income

Asset-liability structure a key driver of banks' ability to generate net interest income under the rising interest rates scenario

- Banks that have a larger share of assets repricing within the stress test horizon benefit more from rising interest rate
- ...with banks relying more on wholesale funding experiencing a stronger increase in funding costs
- ...while banks with predominantly floating interest rate exposures are able to pass-on rate increases at a faster pace



8

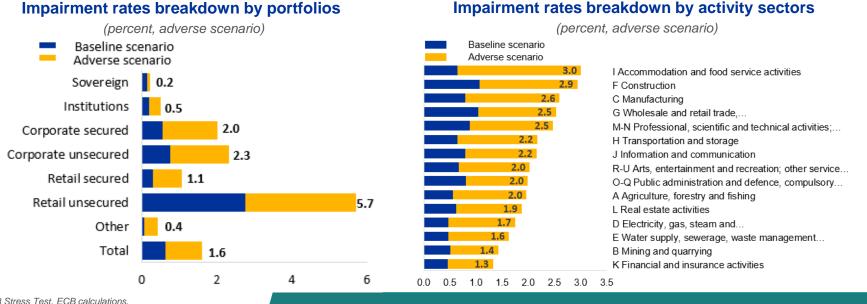
Source: 2023 Stress Test, ECB calculations.

1. The repricing gap indicator shows the weighted average repricing timing of assets compared with liabilities (a higher positive value of the indicator indicates that the time between the repricing of assets and liabilities is lower, thereby supporting NII production); NII projections are annualized figures. 2. Wholesale funding covers all funding sources in excess of the households and non-financial corporations' deposits; derivatives are excluded; interest expense figures are annualized. 3. Observations refer to the average across each cluster of individual banks; the clustering was performed based on the statistical distribution of the variable on the x-axis.

Credit risk

...higher returns are accompanied by higher loan losses, especially in certain segments

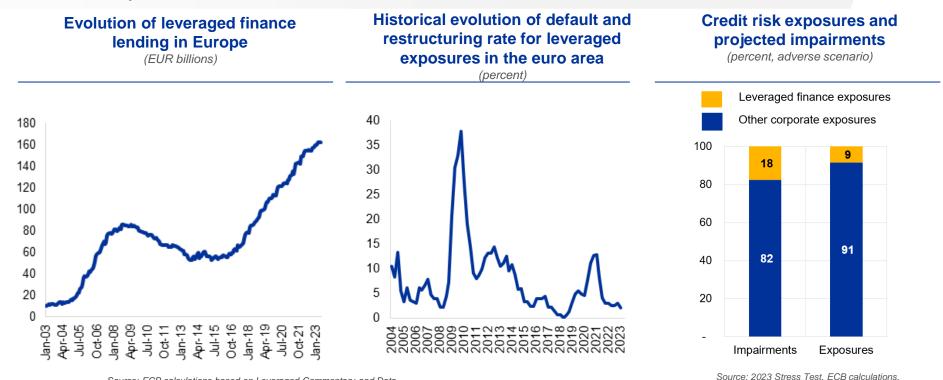
- Retail unsecured exposures and corporate exposures (incl. commercial real estate and leveraged finance) are most vulnerable to an economic downturn coupled with rising interest rates
- At the sectoral level, adverse loan losses are particularly pronounced in sectors I Accommodation and food service activities, F – Construction, C – Manufacturing and G – Wholesale and retail trade.



9

Source: 2023 Stress Test, ECB calculations.

Leveraged finance deep dive Stress test findings confirm that leveraged finance exposures are more risky in a downturn



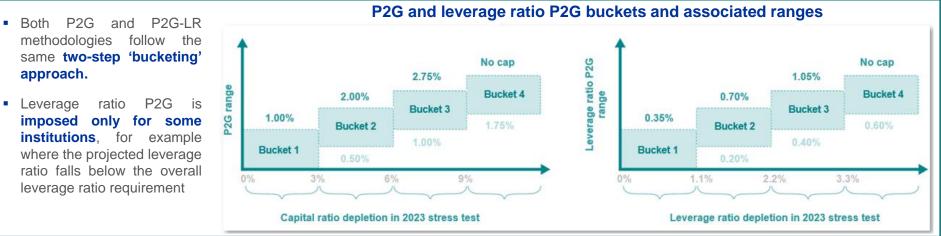
Source: ECB calculations based on Leveraged Commentary and Data.

Integration into SREP

Stress Test results will support the SREP process, both for P2R and P2G calibration

Stress Test is used as an input into the Supervisory Review and Evaluation Process (SREP):

- P2R: Qualitative outcome of the Stress Test is included in the determination of the **P2R**, especially in the element of internal governance and risk management
- **P2G:** Quantitative impact of the adverse Stress Test is a starting point for determining the level of P2G and newly introduced leverage ratio P2G.



Unrealised losses in amortised cost portfolio

Ad hoc data collection confirms that euro area banks' net unrealised losses from bonds held to maturity are overall moderate

Additional losses on amortised cost Change in Unrealised gains and losses in the amortised cost (AC) portfolios portfolios under the adverse scenario (EUR billions) (EUR billions) Sovereign credit spread AC Gross Unrealised G/L (left-hand scale) Other credit spread AC Net Unrealised G/L (left-hand scale) Interest rate 20 The ad hoc data 100 0 collection on banks' 50 amortised cost bond -20 portfolios is not 0 methodologically -40 compatible with the -50 stress test. -60 Results of the two -100 -80 exercises are not additive. -150-100 -200 -120 -250 -140 Bond Hedging instrument Net impact

Source: 2023 Stress Test, ECB calculations.

06/22

12/22

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Thank you!