Pills

Regulatory/Supervisory Pills | N.5 October 2021

TOPICS:
STRESS TEST

SOURCE:
European Central Bank

ECB: Macroprudential Stress Test of the Euro Area Banking System Amid the Coronavirus (COVID-19) Pandemic

Macroprudential Stress Test

The macroprudential stress test for 2021-23 aims to provide insights into the resilience of the European banking sector following the coronavirus (COVID19) crisis. The macroprudential stress test complements the EU-wide stress test run by the European Banking Authority (EBA) and ECB Banking Supervision in three important aspects:

(i) it includes the endogenous reactions of banks to stress inherent in macro-financial scenarios (i.e. it adopts a dynamic balance sheet perspective),

(ii) it considers relevant amplification mechanisms between bank solvency and funding costs and the feedback between the banking sector and the real economy, and

(iii) it incorporates the phasing-out of COVID-19 mitigation policies.

The assessment builds on a macro-micro model and the two scenarios from the 2021 EU wide stress test exercise: the model tracks the evolution of all euro area economies and that of 89 significant banks covering approximately 70% of the euro area banking sector.

Stress Test Main Results

- **In the baseline scenario, the system-wide transitional CET1 ratio goes down from 15.5% in 2020 to its pre-pandemic level of 14.4%.** The evolution of CET1 ratios in the baseline scenario is supported by a stable profitability outlook, and its moderate reduction relates to a marked expansion of banks' assets and the payout of dividends. **In the adverse scenario, the CET1 ratio drops by 5.2 percentage points from 15.5% in 2020 to 10.3% in 2023.**
- Macro-financial amplification in the macroprudential stress test results in higher capital depletion in the adverse scenario compared to the EBA/Single Supervisory Mechanism (SSM) stress test. **Bank lending expands in the baseline scenario and shrinks in the adverse scenario**. The average annual loan growth to the non-financial private sector between 2021 and 2023 stands at around 5% in the baseline scenario and -1% in the adverse scenario. A decline in lending in the adverse scenario is in line with banks' deteriorating asset quality, profitability and capitalization. The outstanding COVID-19 mitigation policies have a pronounced positive lending effect, especially in the adverse scenario. **The banking sector-real economy feedback loop amplifies the severity of the adverse scenario**. The contraction of loan supply in the adverse scenario reduces euro area GDP growth by a further 1.6 percentage points. However, this effect is halved by the positive impact and more intense use of COVID-19 mitigation policies. The adopted assumption on banks' intentions to use capital buffers can affect the outcomes of the macroprudential stress test.