The ECB’s 2023 macroprudential stress test of the euro area banking system assesses the resilience of around 100 large euro area banks across 19 countries. This exercise differs from the typical EU-wide stress tests by incorporating banks’ endogenous reactions to macroeconomic changes and various amplification mechanisms impacting both solvency and funding costs and the reciprocal effects between the banking sector and the broader economy.

The stress test uses two scenarios: a baseline scenario that anticipates an economic recovery and an adverse scenario that projects a prolonged recession exacerbated by increased geopolitical tensions, leading to stagflation and rising interest rates.

Key findings include:

- a) under the baseline scenario, the system-level Common Equity Tier 1 (CET1) ratio remains stable, indicating robust bank resilience;

b) in the adverse scenario, the CET1 ratio falls by approximately 2.5 percentage points by the end of 2025, driven by heightened credit risk and decreased net interest income, although deleveraging and risk mitigation efforts by banks partially offset these declines.

The stress test also highlights the significant role of banks’ strategic balance sheet adjustments. In response to the economic downturn modeled in the adverse scenario, banks reduce their exposure to riskier assets and adjust their lending practices, which, while stabilizing their financial position, also potentially dampen economic growth due to reduced credit availability.

In summary, the results highlight the resilience of the euro area banking system and the important role banks’ adjustments play in the propagation of shocks to the financial sector and real economy.