



TOPICS:

Stress Test

SOURCE

European Central Bank

ECB: Stress Tests in Uncertain Times - Assessing Banks' Resilience to External Shocks

- In this ECB blog, **Claudia Buch - Chair of the ECB Supervisory Board** - outlines the importance and methodology of stress testing in evaluating the resilience of euro area banks under adverse economic conditions. The ECB's 2025 stress test, involving **96 significant institutions**, examined the impact of a hypothetical geopolitical shock scenario on bank capital positions over a three-year horizon. The results indicated that the **euro area banking sector remains resilient**, with a system-level Common Equity Tier 1 (CET1) ratio of 12.0% under stress, up from 10.4% in 2023 and 8.5% in 2014.
- **Stress testing serves multiple supervisory functions:** guiding capital adequacy assessments, informing the Pillar 2 Guidance (P2G), identifying emerging vulnerabilities, and promoting transparency. However, the stress test's static balance sheet assumption limits its ability to reflect banks' adaptive behaviour during real crises. Supervisors mitigate this by integrating bank-specific corrective actions and macroprudential tools such as the countercyclical capital buffer (CCyB).
- **The exercise's scope is intentionally narrow, focusing primarily on credit, market, and operational risks.** It does not fully capture emerging risks like cyber threats, sectoral shocks, or feedback loops in the broader economy. To address these gaps, the ECB employs **complementary tools including thematic stress tests and reverse stress testing**. The upcoming 2026 exercise will focus on bank-specific vulnerabilities to geopolitical risk, reversing the typical approach by identifying what shocks would most severely impact solvency.
- **Banks' internal modelling and scenario analysis are crucial for robust risk management.** Yet these models often underestimate risk due to reliance on historical data, especially when recent shocks were softened by fiscal intervention. Overlay adjustments and ECB quality assurance are used to correct such limitations.

FOLLOW US!

