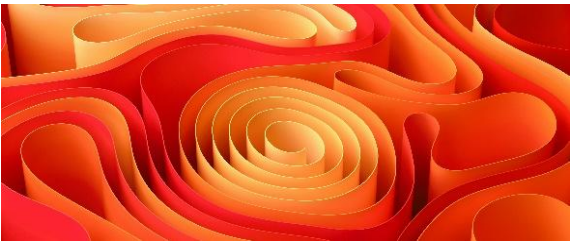
Pills

Regulatory/Supervisory Pills | N.184 December 2025



TOPICS:

Stress test

SOURCE:

European Central Bank

ECB: Stress Testing at the ECB - Mastering Risk Analyses and Impact Assessments with Top-down Models

- The ECB has, recently, published its **2025 Macroprudential Stress Test Extension Report** (MaSTER), complementing the EU-wide bottom-up stress test by integrating top-down models to capture a broader range of financial risks. While the bottom-up stress test confirmed the resilience of banks under adverse economic scenarios, its methodology inherently omits key dynamics - such as banks' potential deleveraging responses, contagion across sectors and structural climate-related impacts.
- **Top-down stress testing**, using ECB's internal models and data from the 2025 EU-wide stress test, addresses these gaps. It assesses the systemic effects of banks reducing lending during stress scenarios, revealing that such deleveraging could improve capital ratios but at the cost of deeper economic contraction - estimated at an additional 2 percentage points of real GDP loss over three years. The release of macroprudential buffers mitigates these effects only marginally, due to their currently limited scale.
- Furthermore, the MaSTER report quantifies **contagion risks** from **non-bank financial institutions** (NBFIs), such as investment funds and insurance companies, under stressed conditions. While banks are generally well-hedged, spillovers can still lead to modest additional depletion of Common Equity Tier 1 (CET1) capital ratios, especially for less sophisticated institutions.
- **Climate risk** is another key extension in the analysis. The inclusion of transition and physical climate risks - specifically those related to energy-intensive sectors and flood exposure - results in additional projected credit losses of approximately 70 basis points. Though overall net capital depletion remains modest and below 2023 stress test levels, certain business models exhibit substantial vulnerabilities when these extended risks are considered.