Deloitte Consulting SRL
The Mark Tower, 84-98 Grivitei Road,
10th Floor
Bucharest, District 1, Romania, 010735
Tel: +40 21 222 16 61
Fax: +40 21 222 16 60
www.deloitte.ro

Deloitte Banking Alert

July 2023

EBA EU-wide stress test results

The EU-wide stress test assesses the resilience of 70 banks from 16 EU and EEA countries representing about 75% of EU banks' total assets. This is done by analyzing the impact on the banks of a hypothetical adverse macroeconomic scenario over the three-year horizon 2023-25. The results of the stress test show that European banks remain resilient under the adverse scenario, when they absorb more than 496bn EUR of losses.

The results of the stress test indicate that on average banks finish the exercise in the adverse scenario with a Common Equity Tier 1 (CET1) ratio above 10% and shows that banks can continue to support the economy also in times of severe stress. The current uncertainty in the macroeconomic environment shows the importance of remaining vigilant and the need of supervisors and banks to be prepared for any potential worsening of the current economic conditions.

Scenarios

The scenario includes variables for the evolution of real GDP, inflation, unemployment rates, real estate prices, stock prices, exchange rates and interest rates. The baseline scenario envisages that the GDP in the EU will increase in the three-year horizon (0.4%, 1.8% and 1.9% as of 2023, 2024 and 2025 respectively). The adverse scenario envisages a cumulative decline of EU real GDP by -6.0% from 2022 over the adverse scenario (-3.5%, -4.2% and 1.6% as of 2023, 2024 and 2025 respectively).

The stress test also includes a market risk scenario which is consistent with the macro-financial scenario. The market risks scenario provides instantaneous shocks for risk factors covering interest rates, FX, equities, commodities, sovereign and corporate credit spreads, volatilities, liquidity reserves and global inflation expectations.

The adverse scenario is hypothetical and is not intended or designed to capture every possible confluence of events. The adverse scenario sets out paths for key economic and financial variables in a hypothetical adverse situation triggered by the materialization of risks to which the EU banking sector is exposed. However, the adverse scenario can help provide an understanding of the impact on the EU banking sector if a severe economic downturn materializes. It is also designed to ensure a significant level of severity across all EU countries. The common baseline scenario is based on the December 2022 projections from the EU national central banks.

Deloitte.

New features compared to 2021 EU-wide stress test

The methodology has however undergone some important enhancements. These enhancements include increased sample coverage, the introduction of top-down elements for net fees and commissions income (NFCI) and a more detailed sectoral analysis. Unlike bottom-up projections which are produced by banks, top-down projections are produced by supervisors with own models and data and are then prescribed to each bank for use in the stress test. Adjustments have also been made to incorporate lessons learnt from the previous stress test.

Main findings

Banks included in the 2023 EU-wide stress test reported a 15% weighted average Common Equity Tier 1 (CET1) ratio as of December 2022 (15.2% on a transitional basis) in line with the starting point of the 2021 EU-wide stress test. The aggregate CET1 capital at the starting point was 1,282bn EUR on a fully loaded basis and 1,301bn on a transitional basis. Banks have substantially increased their earnings as well as their profitability since 2021. The average Bank RoE was 7.8% as of December 2022 compared to 1.7% as of December 2020. As of end 2022 the sample banks had aggregated profits of 128bn EUR. Asset quality also improved since 2021, with the average non-performing exposure (NPE) ratio having decreased to 1.6% in December 2022 compared to 2.1% in December 2020. This shows that banks started the exercise with solid and better fundamentals compared to previous stress tests.

	CET1 capital ratio					Leverage ratio	
	End 2022	Baseline 2025	Adverse 2025	Delta baseline 2025-2022	Delta adverse 2025-2022	End 2022	Adverse 2025
Fully loaded	15.0%	16.3%	10.4%	+136 bps	-459 bps	5.4%	4.3%

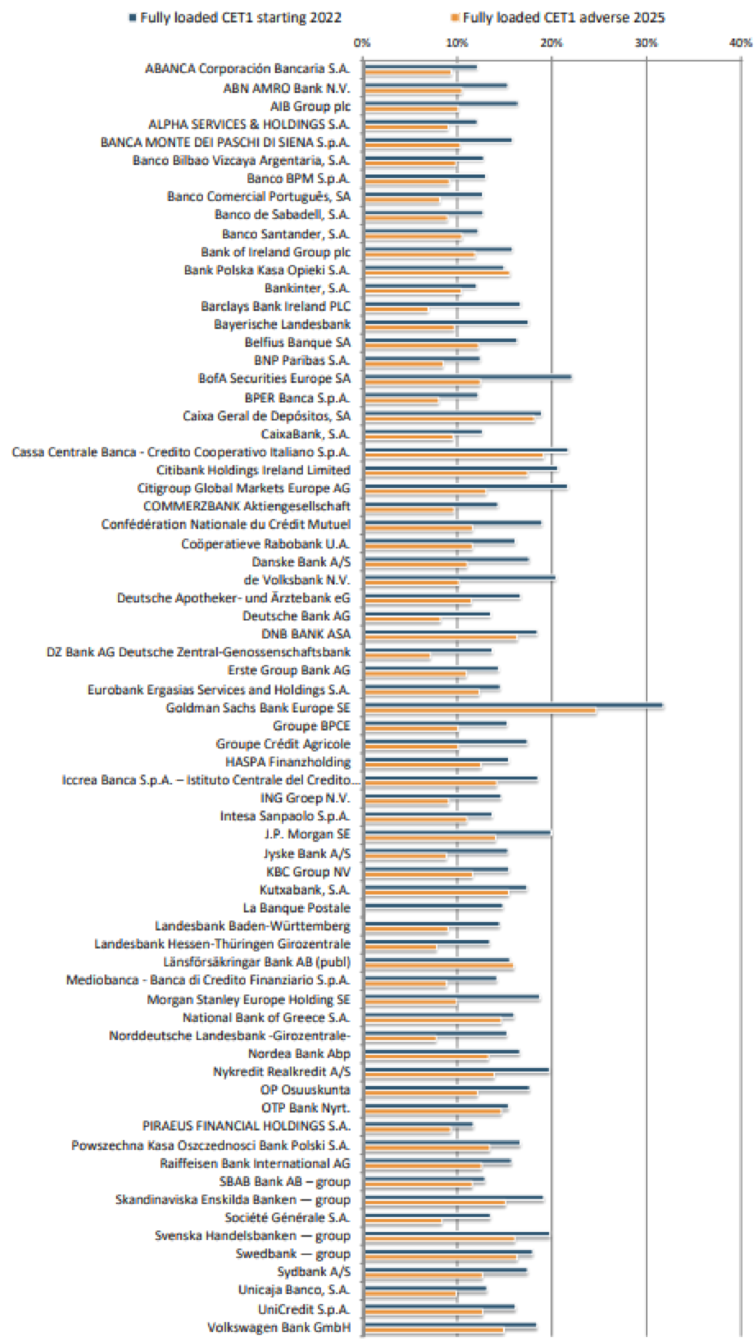
1. Under the baseline scenario the weighted average CET1 capital ratio increases from 15% fully loaded (15.2% transitional) at the end of 2022, to 16.3% fully loaded (same for transitional) at the end of 2025. Therefore, the capital ratios increase by 136 bps (116 bps on a transitional basis). Under the baseline scenario, the median fully loaded CET1 capital ratio as of end 2025 is 17.6% and the inter-quartile ranges between 15% and 20.1%.

2. Under the adverse scenario the weighted average CET1 capital ratio declines from 15% fully loaded (15.2% transitional) as the end of 2022, to 10.4% fully loaded (same for transitional) at the end of 2025. This means a decline of 459 bps (479 bps on a transitional basis). Under the adverse scenario the median is 10.9% at the end of 2025 and the inter-quartile ranges between 9.1% and 13.2%. The depletion is lower compared to the 2021 EU-wide stress test (485 bps on a fully loaded basis 497 bps on transitional basis).

3. The weighted average fully loaded leverage ratio drops by 104 bps (112 bps transitional), from 5.4% (5.5% transitional) at the end of 2022 to 4.3% (4.4% transitional) at the end of 2025 under the

adverse scenario. The drop is solely explained by the decrease in Tier 1 capital as the leverage exposure (i.e., the denominator of the ratio) remains constant according to the methodological static balance sheet assumption.

Figure 3: Fully loaded CET1 capital ratio by bank in alphabetical order at the starting point and at the end of 2025 under the adverse scenario (%)



For further questions regarding the aspects mentioned in this alert, please don't hesitate to contact us:

Dimitrios Goranitis
Deloitte Global leader FSI Risk and Regulatory
Central Europe FSI leader
Tel: +40 751 250 884
Email: digoranitis@deloittece.com