EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Press release

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Euro area banking sector resilient to stress caused by coronavirus, ECB analysis shows

- Exercise to identify banking sector's potential vulnerabilities at early stage in wake of coronavirus shock
- Results show euro area banking sector can withstand pandemic-induced stress, but if the situation worsens, depletion of bank capital would be material
- Central scenario depletes banks' aggregate capital (CET1) ratio by approximately 1.9 percentage points to 12.6%, and severe scenario by 5.7 percentage points to 8.8% by end 2022
- Impaired credit exposures and market risk losses key drivers of capital depletion
- Central and severe scenarios reflect ECB's June 2020 staff macroeconomic projections

The European Central Bank (ECB) today published the aggregate results of its vulnerability analysis of banks directly supervised within the Single Supervisory Mechanism. The exercise assessed how the economic shock caused by the coronavirus (COVID-19) outbreak would impact 86 euro area banks and aimed to identify potential vulnerabilities within the banking sector over a three-year horizon. Overall, the results show that the euro area banking sector can withstand the pandemic-induced stress.

The vulnerability analysis focused on two scenarios set out in the June 2020 ECB staff macroeconomic projections. The central scenario, the most likely to materialise according to ECB staff, foresees real gross domestic product (GDP) in the euro area decline by 8.7% in 2020, and GDP growth at 5.2% and 3.3% in 2021 and 2022, respectively. The severe scenario, which represents a more adverse, but still plausible development of the crisis, foresees real GDP decline by 12.6% in 2020, and GDP growth at 3.3% and 3.8% in 2021 and 2022, respectively. The analysis also reports the results under the baseline scenario published by the European Banking Authority for the EU-wide 2020 stress test. As this scenario was defined before the coronavirus outbreak it provides a benchmark to assess the impact of the pandemic on banks.

The central and the severe scenarios include, to a large extent, the impact of the monetary, supervisory and fiscal relief measures taken in response to the coronavirus crisis. These include, among others,

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national job protection schemes, other fiscal support measures, credit guarantees, capital and operational relief measures by ECB Banking Supervision as well as the recent European-wide measures to provide relief under some of the provisions of the Capital Requirements Regulation.

In the **central scenario,** which already foresees a harsh recession, banks' average Common Equity Tier 1 (CET1) ratio, a key indicator of financial soundness, deteriorated only by 1.9 percentage points to 12.6% from 14.5%. As a result, banks could continue fulfilling their role of lending to the economy.

In the **severe scenario**, banks' average CET1 is depleted by 5.7 percentage points to 8.8% from 14.5%. In this scenario, several banks would need to take action to maintain compliance with their minimum capital requirements, but the overall shortfall would remain contained.

"The results show just how important it was that banks strengthened their capital position in recent years as a result of the post financial crisis regulatory reforms. The extraordinary and coordinated policy support measures have already helped mitigate the pandemic's impact on the economy," says Andrea Enria, Chair of the Supervisory Board. "However, if the situation worsens along the lines of the severe scenario, authorities must stand ready to implement further measures to prevent a simultaneous deleveraging by banks, which could deepen the recession and severely hit their asset quality and capital positions."

The key drivers of capital depletion are impaired credit exposures, market risk losses and lower profitability. As expected, the most profitable banks saw smaller declines in their CET1 ratios. This shows that banks that have strengthened their profitability through efficiency-enhancing measures can also benefit from greater resilience in times of stress.

Considering the extraordinary current circumstances and in order to avoid subjecting banks to additional operational burden, the ECB used already available data for this exercise, including regular supervisory reporting.

The vulnerability analysis represents a useful tool to gauge the overall resilience of the euro area banking sector. Individual banks' results have not been discussed with credit institutions and will be used in the supervisory review and evaluation process (SREP) in a qualitative manner. In particular, they will help supervisors to challenge banks' capital projections, foster consistency in the assessment of risks and promote prudent provisioning policies.

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