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EBA launches 2020 EU-wide stress test exercise

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The European Banking Authority (EBA) launched today the 2020 EU-wide stress test, the fifth exercise since its establishment, and released the macroeconomic scenarios. The adverse scenario follows for the first time a 'lower for longer' narrative, a recession coupled with low or negative interest rates for a prolonged period. The EU real GDP would decline by 4.3% cumulatively by 2022, resulting in the most severe scenario to date. The EBA expects to publish the results of the exercise by 31 July 2020.

Key features of the exercise

The stress test is designed to provide supervisors, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of EU banks to economic shocks. In line with the previous two exercises, no pass-fail threshold has been included as the results of the exercise are designed to serve as an input to the Supervisory Review and Evaluation Process (SREP).

The EBA's 2020 stress test methodology was published in November 2019 [1] and is to be applied to the scenarios released today.

Key elements of the scenarios

The baseline scenario for EU countries is based on the projections from the national central banks of December 2019 [2], while the adverse scenario assumes the materialisation of the main financial stability risks that have been identified by the European Systemic Risk Board (ESRB) and which the EU banking sector is exposed to. The adverse scenario also reflects recent risk assessments by the EBA.

The narrative depicts an adverse scenario related to a prolonged period of historically low interest rates coupled with a strong drop in confidence leading to a significant weakening of economic growth in EU countries. This is amplified by trade tensions at the global level. Slowing growth momentum and/or rising risk premia could further challenge debt sustainability in the public and private sectors across the EU.

The possible prolongation of negative growth and the low interest rate environment could further exacerbate the search for yield behaviour by investors, leading to under-pricing of risks and asset price misalignments, which could reverse as market sentiment changes and/or risks materialise.

The adverse scenario is designed to ensure an adequate level of severity across all EU countries. By 2022, the EU real GDP would decline by 4.3% cumulatively, the unemployment rate would rise by 3.5 percentage points, equity prices in global financial markets would fall by 25% in advanced economies and by 40% in emerging economies, residential real estate prices would decline by 16%, and commercial real estate prices would decline by 20%.

Detailed information about the adverse scenario can be found in the note produced by the European Systemic Risk Board (ESRB).

Process

The adverse macroeconomic scenario has been developed by the ESRB and the ECB in close cooperation with the EBA, competent authorities and national central banks.

The EBA, who is responsible for coordinating the whole exercise, developed a common methodology and will act as a data hub for the final dissemination of the results, in line with its commitment to enhancing the transparency of the EU banking sector. Competent authorities will assure the quality of the results and decide on any necessary supervisory reaction measure as part of the SREP process.

Notes for editors

- The EU-wide stress test will be conducted on a sample of 51 EU banks – 35 from countries under the jurisdiction of the Single Supervisory Mechanism (SSM) – covering roughly 70% of total banking sector assets in the EU and Norway, as expressed in terms of total consolidated assets as of end 2018. UK banks will be included in the sample as the 2020 EU-wide stress test takes place during the implementation period following the UK's withdrawal from the EU.

The exercise will be run at the highest level of consolidation. This exercise will involve close cooperation between the EBA and the competent authorities (including the SSM, the ECB and the ESRB).

⁽¹⁾ In the package that was published today, the sample has been revised.

⁽²⁾ For non EU-countries, the projections are mainly based on the projections from the October 2019 IMF World Economic Outlook and on the November 2019 OECD Economic Outlook.

DOCUMENTS

- › 2020 EU-wide stress test - Macroeconomic scenario.pdf
 - › 2020 EU-wide stress test - Macroeconomic scenario.xlsx
 - › ESRB Letter on 2020 EU-wide Stress Test Adverse Macroeconomic Scenario
 - › 2020 EU-wide stress test - Market risk shocks.pdf
 - › 2020 EU-wide stress test - Market risk shocks.xlsx
 - › 2020 EU-wide stress test - Templates
 - › 2020 EU-wide stress test - Template Guidance
 - › 2020 EU-wide stress test - Methodological Note
 - › 2020 EU-wide stress test - FAQs.pdf
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