SUPERVISORY STRESS TESTS OF SELECTED BANKS

Financial Market Supervision Department
Financial Stability Department

2018

ČNB ČESKÁ NÁRODNÍ BANKA

SUMMARY

The aggregate results of the supervisory stress tests of the largest domestic banking groups,[1] accounting for around 76% of the assets of the Czech banking sector, confirmed that those groups are sufficiently resilient to potential hypothetical adverse economic developments. The capitalisation of the part of the banking sector tested would remain well above the regulatory minimum of 8% even in a stress scenario assuming a sizeable decline in economic activity in the Czech Republic and abroad. The sector's resilience is based mainly on its capital ratio, return on assets and return on equity, which amounted to 18.2%, 1.2% and 15.7% respectively at the end of 2017. As usual, credit risk was the most significant of the risks under review.

1. INTRODUCTION

The CNB has been conducting supervisory stress tests in partnership with selected domestic banks and banking groups since 2009. The tests are used to assess the risks[2] they face in the event of hypothetical adverse economic developments as represented by the *Adverse Scenario* defined by the CNB. The results are used by the CNB's Financial Market Supervision Department in the process of supervising and assessing the capitalisation of individual banks.[3] Since 2018, the supervisory stress test methodology has been based on the European Banking Authority's rules for EU-wide stress testing adapted to the specificities of the Czech banking system.

2. MACROECONOMIC SCENARIOS

The ***Baseline Scenario*** is based on the CNB's macroeconomic forecast published in Inflation Report I/2018 and assumes economic growth of 3.6% this year.[4] Annual GDP growth will stay above 3% in the next two years (see Chart 1). Investment and wages increase and general unemployment remains at its current low levels over the entire scenario horizon. Consistent with the forecast is a rise in market interest rates.

The ***Adverse Scenario*** assumes a marked drop in economic activity in Europe. The combination of a downturn in external demand and then also in domestic demand will cause a sizeable and lengthy decline in economic activity in the Czech Republic and result in a V-shaped recession. The recession will last nine quarters and lead to a drop in annual real GDP growth from the current 5% to -5% (see Chart 1). Unemployment increases significantly. The problems in the real economy also affect the financial sector. Monetary policy remains easy, the three-month PRIBOR stays very low over the entire test horizon and the exchange rate weakens sharply. However, long-term bond yields surge as global risk aversion increases and the quality of some assets is re-assessed.

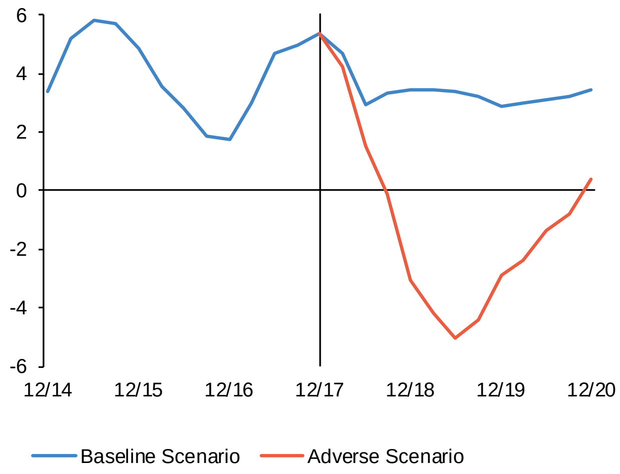
[1] Consolidated groups: Skupina České spořitelny including Stavební spořitelna České spořitelny, Skupina ČSOB including Hypoteční banka and Českomoravská stavební spořitelna, Skupina Komerční banky including Modrá pyramida stavební spořitelna, Skupina Moneta Money Bank, Skupina Raiffeisenbank excluding Raiffeisen stavební spořitelna and Skupina UniCredit Bank.

[2] The supervisory stress tests cover credit risk, market risk, operational risk, interest income and expenditure risk and capital risk.

[3] Article 100 of Directive 2013/36/EU of the European Parliament and of the Council (CRD).

[4] The *Baseline Scenario* and the *Adverse Scenario* were created solely for stress testing purposes. Neither the *Baseline Scenario* beyond the horizon of the forecast published in Inflation Report I/2018 nor the *Adverse Scenario* is an official forecast of the CNB. For details see FSR 2017/2018.

Chart 1
Alternative scenarios: real GDP growth
(year on year in %)



Source: CNB

Table 1
Net profit, capital requirements and the capital ratio

	Actual value 31 Dec. 2017	*Baseline Scenario* 31 Dec. 2020	*Adverse Scenario* 31 Dec. 2020
Net after-tax profit (CZK billions)	63.7	58.2	-15.2
Regulatory capital (CZK billions)	360.9	395.5	307.0
Risk-weighted assets (CZK billions)	1,980.6	2,055.3	2,378.6
CET1 capital ratio (%)	17.3	18.4	12.2
Total capital ratio (%)	18.2	19.2	12.9

Source: CNB

3. RESULTS

Persisting high returns in the *Baseline Scenario* enable growth in the volume of capital (+9.6%). Despite a slight increase in risk-weighted assets (+3.8%), the total capital ratio goes up to 19.2%.

The sharp decrease in profit (123.9%), i.e. the fall into loss, in the *Adverse Scenario*, due mainly to an increase in credit risk, has an adverse effect both on the volume of capital (-14.9%) and on the volume of risk-weighted assets (+20.1%). This is subsequently reflected in a decline in the total capital ratio to 12.9%, which is, however, well above the regulatory threshold of 8%. The results of the supervisory stress tests thus confirm that the part of the banking sector tested is highly resilient to adverse economic developments.