



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

PRESS RELEASE

9 October 2017

ECB finds interest rate risk is well managed in most European banks

- ECB publishes findings of a supervisory exercise in which it assumed various hypothetical interest rate changes
- Higher interest rates would lead to higher net interest income in the next three years for a majority of banks, but lower economic value of equity
- Supervisors will follow up on the results in supervisory dialogues with the individual banks

Higher interest rates would lead to higher net interest income in the next three years for most of the banks directly supervised by the European Central Bank (ECB), but to lower economic value of equity, according to the [results of the 2017 ECB stress test](#). This supervisory exercise allows the supervisor to gather more insight and information on the outcome of various hypothetical scenarios of changing interest rates.

The ECB conducted a sensitivity analysis of interest rate risk in the banking books based on year-end 2016 numbers. The exercise was designed to provide ECB Banking Supervision with additional information on the interest rate sensitivity of the net interest income and the economic value of equity of banks' banking book positions.

The results were used in the yearly assessment of the banks' overall capital demand. While the capital demand for individual banks might be adapted to the identified risks, the overall capital demand will not change as a result of the interest rate sensitivity analysis, all else being equal.

ECB Banking Supervision applied six hypothetical interest rate shocks to determine how the economic value of equity and net interest income projections would change in an evolving interest rate environment. The six shocks drew on the ones set by the Basel Committee on Banking Supervision and captured

European Central Bank Directorate General Communications
Global Media Relations Division, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany
Tel.: +49 69 1344 7455, e-mail: media@ecb.europa.eu, website: www.ecb.europa.eu

Reproduction is permitted provided that the source is acknowledged.

changes in the level and shape of the interest rate curve. The shocks were hypothetical and not modelled as projections for the development of interest rates in the euro area.

According to the findings, a hypothetical increase in interest rates of 200 basis points would lead on aggregate to a rise in net interest income of 4.1% in 2017 and of 10.5% by 2019, while the economic value of equity would decrease on aggregate by 2.7%. Should interest rates stay at their end-2016 level and absent any credit growth, the aggregate net interest income would however decrease by 7.5 %. These projections are strongly influenced by the assumptions banks make about their customers' behaviour. For example, under a rising rates scenario, the stickiness of retail deposits constitutes a crucial assumption for the increase in net interest income to take place.

The ECB also asked banks about the behavioural models they use to measure and manage their interest rate risk and how they assess underlying risks. As the behaviour of customers is a crucial input for banks' interest rate risk - especially for deposits - banks use behavioural models to better measure and manage their interest rate risk. In that respect, the exercise revealed that most deposit models are based solely on a period of decreasing interest rates and hence might entail high model risk. The supervisors gained fresh and substantial insights into how the institutions they supervise manage these risks and will discuss the conclusions individually with the banks during the supervisory dialogue.

The stress test also illustrated how banks use interest rate derivatives for hedging risk exposures and reaching a target interest rate profile and how they adopt quite diverse "positioning" towards future interest rates movement. Where relevant, this will also be part of the supervisory dialogue with individual banks.

For media queries, please contact Uta Harnischfeger, tel.: +49 69 1344 6321.

Notes:

Interest rate changes affect both the interest income that can be earned by holding a financial instrument (e.g. a bond) and the marketable value of the instrument itself. Both dimensions therefore need to be observed in an interest rate sensitivity analysis.