

European banks: 2025 stress tests

Resilient in the face of not-so-remote downside risks

The results of the 2025 European Banking Authority (EBA) and European Central Bank's (ECB) EU-wide biennial stress tests align with our view that European banks have relatively resilient credit profiles, thanks mainly to capital accumulation over the past few years and improved profitability.

The stress test highlights that these strengths would help banks weather the negative impacts of rising economic and operating environment challenges on credit risk. Credit risk has risen since the previous exercise and remains the key driver of total losses in the 2025 one. In our view, the exercise shows that risks are tilted to the downside, since even the adverse scenario does not fully capture the recent heightening of uncertainties in global trade.

At the same time, the higher revenue generation embedded as a key driver of the stress test results could come under pressure, for example if some of the alternative interest rate scenarios provided in the ECB's sensitivity analysis materialise.

This year's results point to the likelihood that capital requirements will remain stable and that any challenges European banks might face in continuing to implement similar capital distribution policies as in the past few years are limited. The dispersion of individual banks around average capital depletion in the adverse scenario will be key in this regard, however.

The results of the tests also provide an insight into the non-negligible impact of fully phasing in transitional CRR3 arrangements under Basel III finalisation, although we believe the 2033 implementation deadline gives banks ample time to undertake mitigating measures

European banks face potential challenges from a position of strength

The stress-test results highlight that a large proportion of European banks can maintain relatively strong and resilient solvency levels, not only in absolute terms but also relative to previous stress tests. This year's stress test covered 64 banks in the sample of the stress test co-ordinated by the EBA, accounting for about 75% of total EU banking assets. Another 45 significant institutions directly supervised by the ECB participated in the parallel ECB stress test.

The 2025 stress test yielded a strong system-level CET1 ratio for both the total and EBA samples that was higher than in 2023. The aggregate CET1 ratio reaches about 12.0% in the adverse scenario by 2027 for the total and the EBA samples, compared with 10.4% and 10.43%, respectively, in 2023. Other comparisons between the two exercises lead to similar conclusions.

Table 1: Comparison of key results of the 2025 and 2023 ECB stress tests

	Initial CET1 ratio (at start of three-year horizon)	CET1 ratio after three years (baseline)	CET1 ratio after three years (adverse scenario)	Lowest CET1 ratio in three years (adverse scenario)	Cumulative losses over three Years (adverse scenario)
2023 Stress test	15.30%	16.40%	10.40%	10.30%	EUR 548bn
2025 Stress test	16.00%	17.10%	12.00%	11.80%	EUR 628bn

Source: ECB, Scope Ratings

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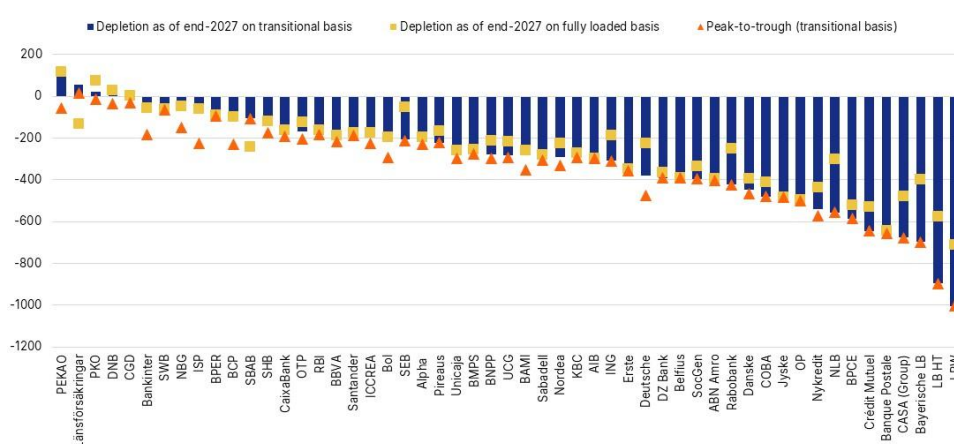
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Strong and comparatively higher capital levels in the 2025 stress test are in part the result of higher capital levels as the starting point for this year's test following the accumulation of stronger organic capital generation over the past few years. The actual 2024 CET1 ratio (on a transitional basis) that was taken as the starting point for this year's test was 15.9% for the whole sample and 15.72% for the EBA sample, compared with 15.3% and 15.2% in 2023.

The 2025 stress test also shows lower capital depletion under the adverse scenario than in 2023. Better sector profitability, supported by stronger earnings generation capacity over the stress test horizon, mitigates the impact of higher credit losses in this year's test than in 2023's exercise. The 400bp decline in CET1 ratios in this year's adverse scenario is almost 100bp less than in 2023. The same observation can be made for banks included in the EBA sample, which showed a 370bp decline in 2025, compared with 479bp two years ago.

Figure 1: Bank-level CET1 ratio depletion under the adverse scenario for selected banks in the 2025 stress test (in bp)



Note: The "peak-to-trough" refers to the maximum depletion (on transitional basis) over the 3 years of the stress test horizon, which does not always occur in 2027 for some banks

Source EBA, Scope

The adverse scenario in this year's test still results in a meaningful compression of total net income (15% and 24% for the total and EBA samples over the three-year horizon), under the weight of higher funding costs and macro-financial shocks. But the benefits of the higher initial profitability in the adverse scenario act as a first line of defense and reduce the pace and extent to which adverse conditions erode capital.

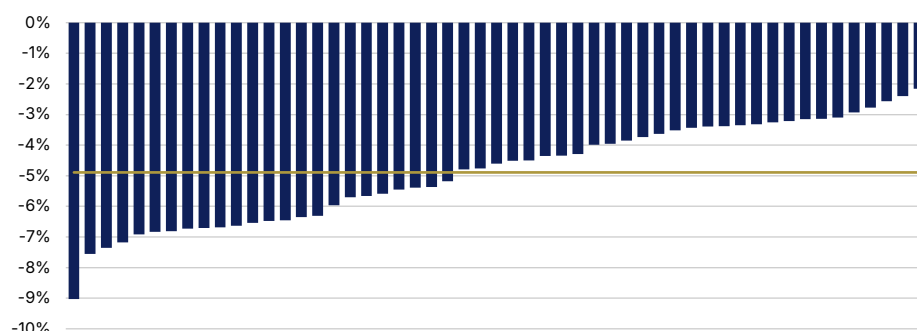
For the EBA sample, net income adds 509bp to CET1 under the adverse scenario in 2025, while credit-risk losses deplete CET1 by 437bp. Credit risk losses account for the bulk of total losses: market and operational risks represent a decline of just 108bp and 61bp respectively.

The outcome of the stress test is consistent with our views about the resilience of European banks' asset quality. However, moderate pressures are already emerging on this front and risks are skewed to the downside. Within the EBA sample, aggregate credit losses in the adverse scenario reach 1.9% of total 2024 exposures, which represent cumulative losses over the stress horizon of EUR 394bn, compared with EUR 347bn in the 2023 stress test, a 15% increase in impairments.

The worse credit-risk performance in this year's stress test is to some extent attributable to higher Stage 2 exposures as a starting point (8.2% in 2025 stress test vs 7.4% in 2023) while the starting point of Stage 3 exposures is the same at 1.7%. This provides some comfort, as we believe banks can manage easier transitions of Stage 2 exposures into Stage 3. Lower Stage 3 coverage at the start of the stress-test horizon (42.5% in 2025 vs 44.9% in 2023) explains the higher impact of credit-risk losses this year, with lower, albeit still meaningful, management overlays available to cushion impacts (EUR 18.4bn in 2025 vs EUR 25bn in 2023).

The stress-test results highlight that there can be significant dispersion among individual banks around the average, depending on their degree of exposure to pockets of risk (e.g. commercial real estate and tariff-exposed economic sectors). In the adverse scenario, the contribution of credit losses to CET1 depletion in the EBA sample ranges from a very material level of almost 900bp to a negligible 10bp. (See Figure 2 below).

Figure 2 – Impact of cumulative credit losses on CET1 under the adverse scenario for a selection of banks included in the stress test



Note: The bars reflect the cumulative credit losses per bank calculated as the ratio between accumulated impairments on financial assets not measured at fair value through profit or loss, and total risk exposure (phased-in) as of year-end 2024. The line reflects the average of the ratio calculated for the sample of banks selected within the EBA sample.

Sources: EBA, Scope Ratings

Our views about the strength of the European banking sector are also supported by the stress-test results related to MDA triggers and breaches of Supervisory Review and Evaluation Process (SREP) capital or leverage requirements. A significantly smaller number of banks in the 2025 exercise than in 2023 had to incorporate distribution restrictions due to breaches of MDA triggers.

The number of banks that would breach their MDA triggers in the adverse scenario fell significantly to 17 in the EBA stress-test sample, plus another seven in the ECB sample, from 53 in the 2023 total stress-test sample. Distribution restrictions contributed to a moderate EUR 4bn (equivalent to a 43bp impact on the end-2027 CET1 ratio).

Also, importantly, only four banks in the total sample fail to meet their legally binding total SREP capital requirement and/or leverage ratio requirement, compared to nine in 2023. In the EBA subset, none of the banks breached the CET1 total SREP requirement in the adverse scenario and only one fell below the T1 total SREP leverage ratio requirement.

Stable regulatory requirements and payout policies; challenges of fully-loaded CRR3 impacts

The positive trajectory of regulatory capital ratios under the baseline scenario in the 2025 stress test supports our expectation of relatively unchanged overall regulatory requirements for the next SREP exercise.

Under the baseline scenario, banks continue to increase capital through retained earnings, reaching an aggregate CET1 capital ratio of 17.1% for the total sample and 16.9% for the EBA sample by end-2027. In this scenario, all banks meet their overall capital requirements with an aggregate EUR 526bn of CET1 capital in excess of end-2027 requirements. Importantly, leverage ratios meaningfully improve in the baseline scenarios, reaching 6.5%, and 6.32% in the total and EBA samples, respectively.

The ECB included an analysis in the 2025 stress exercise that evidences how the baseline scenarios in past exercises have aligned with the actual data reported by banks in subsequent periods. It explicitly highlights that its assumptions for the baseline scenario are derived from its macroeconomic projections. This suggests that supervisors are likely to take the outcome of the baseline scenario in this year's exercise as a reliable guideline of how solvency metrics will evolve in coming years.

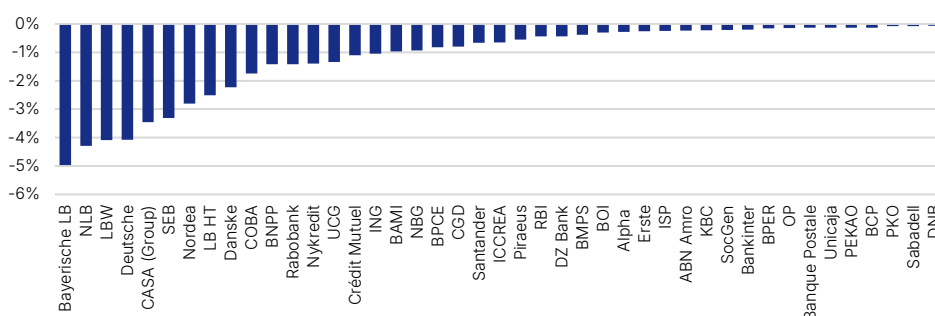
Together with the payout ratios built into the outcome of adverse scenarios, this also suggests there is unlikely to be significant pressure to reduce payouts to shareholders if banks maintain similar capital policies to those of previous years. This takes into account higher median dividend payout ratios in the profitable years of the adverse scenario in the EBA sample (up to 50% in 2025 vs 32% in 2023), as well as the simple average of the payout ratios for banks included in the total sample dropping to about 20% in 2025 but going back up to almost 40% in the two years following the horizon of the 2025 stress test.

But we note that the SREP exercise considers fully-loaded capital ratios. Therefore, the information provided in the stress tests on fully-loaded capital depletion offers insights into the likely evolution of Pillar 2 Guidance and regulatory capital requirements more broadly.

In aggregate, the proforma impact of the introduction of CRR3 elements of Basel III results in an almost 130bp reduction in the system-level CET1 ratio for both the total and EBA sample at year-end 2024. Capital depletion is mainly driven by the removal of output floor transitional arrangements. This proforma exercise has a much higher impact on the system-wide CET1 ratio at the end of the stress test. It would come down to 11.34% in the adverse scenario in 2027. Concerns about these hypothetical impacts are tempered by the banks' ability to take corrective measures and accumulate capital during the long transition period until the 2033 final implementation date, which the proforma exercises disregard.

In this context, given that SREP is a bank-specific exercise, our expectation is that the significant dispersion (which is also meaningful on a transitional basis) created by CRR3 restatement effects has a different bearing on specific banks' requirements. Across the 96 banks participating in the stress test, fully-loaded CRR3 provisions would lead to an increase in the proforma CET1 ratio at year-end 2024 of more than 200bp for six banks, whereas a high 20 banks would see their ratio fall by more than 200bp.

Figure 3 – Delta between phased- in and fully-loaded CET1 ratios as of YE 2027 under the baseline scenario for a selection of banks included in the stress test



Sources: EBA, Scope Ratings

Reality surpasses scenario definition, testimony to downside risks

We believe some of the scenario assumptions could plausibly come under greater stress than the adverse scenario. We do not believe the stress test fully captures the potential impacts of an asymmetric crystallisation of certain risks that start unfolding beyond baseline scenario assumptions since the stress test was designed and launched (e.g. trade tensions).

We believe the scenarios for these variables and their impacts would likely be closer to the adverse scenario. We also take into account that the adverse scenario does not include the impacts of ECB's sensitivity analysis of more negative but still plausible interest-rate scenarios for some European banks' business models

Deteriorating macroeconomic assumptions incorporated into the stress test result in relatively severe aggregate impacts. In the adverse scenario, real EU GDP is projected to fall by 6.3% between 2024 and 2027, with average unemployment rising by 5.8% and peaking at levels above the Global Financial Crisis (GFC). This scenario incorporates a slightly inverted yield curve and a peak of around 4.8% in long-term rates (comparable to GFC levels) driven by heightened sovereign debt sustainability concerns.

Nevertheless, the current level of some of the variables in certain European markets, used as the starting point for the 2025 stress test, is relatively benign. Therefore, the adverse scenario does not reflect a very stressed environment relative to previous crises or to historical averages in some instances. For example, unemployment in Spain peaks at 14.1% in the adverse scenario, which is relatively low by historical standards.

The fact that the sharpest negative impacts occur mainly in the first year of the stress- test horizon offers insights into the impacts of a shock scenario. This strengthens the usefulness of the stress test, given the current heightened geopolitical risks that can lead to adverse event-driven scenarios for which there is little visibility in advance.

Greatest downside risk: elevated geopolitical and trade tensions

We believe the greatest downside risks to the results of the adverse scenario stem from currently elevated geopolitical and global trade tensions. These factors have led to some of the risks considered hypothetical in the adverse scenario materialising since the exercise was launched. This is testimony to the event-risk challenges in the current macro and economic environment. The crystallisation of these risks can lead not only to a weaker picture for European banks than that of the baseline scenario but to even greater negative impacts than those incorporated in the adverse scenario.

We have taken into account the ECB's sensitivity analysis for an alternative tariff scenario provided alongside the stress test. Just by incorporating a higher confidence interval for assessing higher probabilities of default in tariff-sensitive sectors shows an additional 20bp in capital depletion versus the adverse scenario. Similarly, the sensitivity analysis for estimated GDP decline for a level of US tariffs for the EU at 20% (which compares with 10% in the adverse scenario and 15% US finally agreed upon on July 27) results in an additional 32bp.

Given the importance of profitability in absorbing negative impacts, we also see downside risks from the potential materialisation of alternative interest-rate scenarios and/or how banks' clients react to the rate environment, relative to those incorporated in the stress test. EBA analysis shows that net interest income (NII) is one of the key variables supporting resilient profitability. But it also highlights that there is significant dispersion among banks in NII performance in the adverse scenario, with banks' balance-sheet structures and business models being the key drivers of the variability in the context of the inverted yield curve embedded into the stress test.

The ECB's sensitivity analysis of the impact of alternative yield-curve scenarios for different types of banks highlights how a downward slope with a hump either at the short end (e.g. for many smaller banks) or the long end (e.g. for G-SIBs and universal banks) is the most adverse for most banks' business models (except for investment banks) and would amplify in a non-negligible way the negative effects beyond those detailed in the NII adverse scenario.

The EBA sensitivity analysis for the adverse scenario indicates that the impact of higher depositor compensation because of higher short-term rates would increase capital depletion under this scenario by a significant 61.1bp. A similar exercise to explore the impact of banks being unable to pass on interest-rate increases to customers via loan pricing would also lead to a meaningfully higher capital depletion by 71bp.

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