DEUTSCHE
BUNDESBANK
EUROSYSTEM

How can stress testing support policy making in unprecedented times?

Valerie Herzberg, Deputy Director General, DG Financial Stability, Deutsche Bundesbank

Not intended for distribution.

Stress test simulations of the impact of an energy embargo in a stressed macrofinancial environment

- Very useful decomposition of effects:
  - how shocks transmit,
  - how usable buffers dampen the impact on lending
  - How reduced lending amplifies the effect on GDP

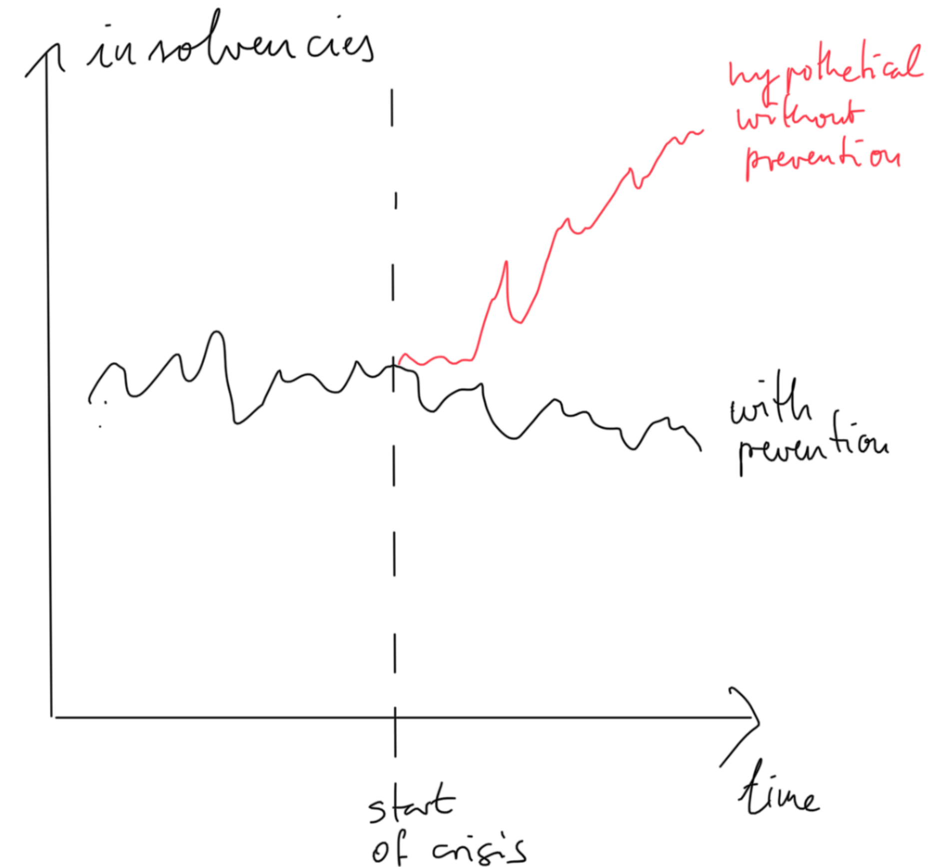
- Important question: Do we trust these findings?
- Two problems

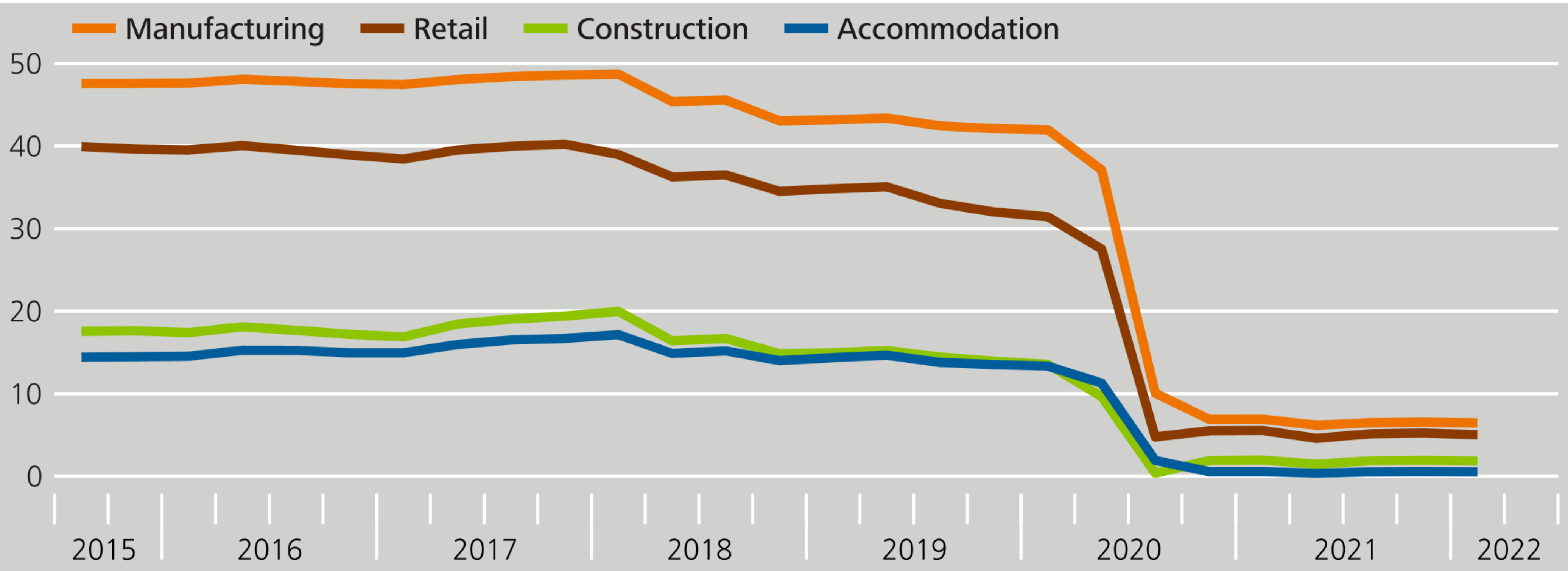
Problem 1: In the past, scenarios were not very stressful…

- Did we consider the wrong shocks?
- Is the “prevention paradox” working against us?

The prevention paradox

- Prevention may break the link between macrovariables and risk materialization
- If this prevention is not controlled for, empirically calibrated stress tests are likely to underestimate the elasticity of risk metrics to macroeconomic risk factors.
- Put differently: successful prevention undermines the tools for future prevention




Correlation between GDP growth and credit default rates
squared, % based on rolling regressions with sample periods starting in Q2 2008
Manufacturing
Retail
Construction
Accommodation
50
40
30
20
10
0
2015
2016
2017
2018
2019
2020
2021
2022
Deutsche Bundesbank

Problem 2: The shocks we now consider produce considerable stress…

- Is it the state of the financial system that has changed?
- Methodological changes in our toolkit?
- Is it the shocks we consider?