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Fast Facts: UNDERSTANDING THE STRESS TESTS

CRUX OF THE TEST: In November 2011, the Federal Reserve asked 31 U.S. banks (over \$50 billion in assets) [to test their capital levels against an economic scenario](#) even worse than the 2008 recession. The Fed's stress scenario was designed to test the resilience of the financial services industry and give markets peace of mind about how much economic pressure banks could withstand while maintaining adequate capital buffers.

On January 9, 2012, banks were required to submit the results of their stress tests to the Federal Reserve.

FACT: The Federal Reserve's stress test required banks to test their capital levels against the following [adverse scenario](#):

- GDP growth drops to negative 8% in Q1 2012.
- The Dow drops to 5,700 in Q4 2012.
- The unemployment rate jumps to 13% in 2013.
- Commercial real estate drops by 23% by 2013.
- Housing prices fall by 20% by 2014.
- Europe goes into a recession and growth in Asia dramatically slows.

FACT: The scenario is highly unlikely. For example:

- [The unemployment rate has never gone over 11%](#) (let alone reach 13%) since the Great Depression.
- [The lowest monthly Dow close during the most recent recession was 7,062 \(February 2009\).](#)
- [GDP has dropped by 8% or more only two times since 1947:](#) Q4 2008 (-8.9%) and Q1 1958 (-10.4%).

FACT: And the scenario, if it ever occurred, would be catastrophic for nearly everyone. Moody Analytics projects that if it came true:

- By end of 2012, 4.5 million additional jobs would be lost, compared to Moody's baseline forecast;
- By mid-2013, national debt will have increased by an additional \$1 trillion over the baseline;
- By the end of 2012, retail sales would be down 10%. In particular, car sales would drop off by 5 million or 33% lower than projected sales.

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FACT: The Federal Reserve makes it very clear it is **ONLY A TEST**. The stress scenario is: (1) not a forecast or projection for the U.S. economy; (2) nor does it take into account any actions a bank could take to mitigate a crisis.

FACT: The results of the stress test will be **one of the factors** supervisors use to determine companies' capacity to pay dividends and other capital distributions. The Federal Reserve is scheduled to publish the results in April.

Did you know banks are at their highest capitalization levels in history? View last week's Fast Facts: CAPITAL here:

http://www.fsround.org/fsr/publications_and_research/fast_facts.asp

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