The Czech National Bank is pleased to present its tenth Financial Stability Report (FSR) to the public. The aim is to analyse and identify the risks to the financial stability of the Czech Republic. This year’s FSR focuses mainly on the risks that may arise in connection with developments in global bond markets, the financing of property purchases and the banking union project. Significant space is devoted to new macroprudential capital buffers in the banking sector and instruments aimed at mitigating systemic risk.

The FSR is based on an advanced analytical and modelling framework, and stress tests of the key segments of the financial sector (i.e. banks, insurance companies and pension management companies), as well as a stress test of households, are integral parts of the FSR. The testing methodology has gradually been refined and several changes have been made since the previous FSR. In bank stress tests, the parameters of satellite models describing the evolution of some financial variables and risk measures were re-estimated. The FSR also newly contains the results of bottom-up micro stress tests conducted by the CNB in partnership with selected banks and insurance companies. The main refinements of the household stress test consist in enhanced modelling of flows between employment and unemployment and distinction between the short-term and long-term impacts of the interest rate shock.

The financial sector’s resilience is tested by means of an adverse macroeconomic stress scenario entitled *Europe in Deflation*. This scenario assumes a significant decline in economic activity in Europe owing to negative expectations regarding global economic developments, a general increase in investors’ risk aversion and the potential re-emergence of problems in the euro area. This will cause the domestic economy to return to recession and the pessimistic expectations in the private sector to deepen. This adverse scenario is compared with the *Baseline Scenario*, which is based on the CNB’s official May forecast. The impacts of both scenarios are assessed not only from the perspective of the financial sector, but also with regard to the property market and the non-financial corporations and household sectors.

Like last year, the FSR is divided into five main sections followed by thematic articles. The *Real economy* section deals with the external and domestic macroeconomic environment and analyses the financial situation of non-financial corporations and households. The section entitled *Asset markets* analyses risks in the financial markets and the property market. The section called *The financial sector* describes key trends in the financial sector and the main sources of potential risks. The second part of this section includes stress tests of individual segments of the financial sector (banks, insurance companies and pension management companies). The final section *Risks to financial stability and macroprudential policy* focuses mainly on an overall evaluation of the financial stability indicators and risks presented in the previous sections of the FSR and goes on to provide information on how the CNB will respond to those risks using macroprudential policy tools, microprudential regulation and financial market supervision.
The thematic articles react to selected topical financial stability issues. The article *An Indicator of the Financial Cycle in the Czech Economy* proposes the construction of a new aggregate indicator capturing cyclical changes in perceptions of systemic risk and evaluates the current position of the Czech economy in the financial cycle using this indicator. The article *Concurrent Capital Buffers in a Banking Group* focuses on the Basel III capital buffers. It uses simulations to estimate what consequences these buffers would have for a banking group and a subsidiary within that group from the perspective of both the capital held by the parent bank and the probability of failure of the subsidiary or the group as a whole. The study *Collateralization and Financial Stability* looks at collateral use, asset encumbrance and related sources of systemic risk and maps out this phenomenon in the Czech financial system. The article *Office Property in Central European Countries* describes the development of the office property market and analyses its main determinants. Using a simple model, it endeavours to answer the question of whether current office property prices are overvalued or undervalued.

This Financial Stability Report was approved by the CNB Bank Board at its regular meeting on financial stability issues on 22 May 2014 and was published on 17 June 2014. It is available in electronic form at http://www.cnb.cz/.