

The Czech National Bank is pleased to present its twelfth 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 increased volatility in global financial markets, the environment of very low interest rates and the financing of property purchases. Significant space is devoted to macroprudential capital buffers and other instruments aimed at mitigating systemic risk in the banking sector.

The FSR is based on an advanced analytical and modelling framework and contains stress tests of individual segments of the financial sector. The FSR also contains the results of bottom-up micro stress tests conducted by the CNB in partnership with selected banks, stress tests of households and a public finance stress test, which the CNB uses to assess the management of sovereign exposure concentration risk in individual financial institutions. This year, the FSR does not contain stress tests of insurance companies, as domestic insurance companies are involved in EIOPA tests, whose results will be published in a coordinated manner for the entire EU at a later date.

The financial sector's resilience is tested by means of an adverse macroeconomic stress scenario entitled the *Adverse Scenario*. This scenario, whose probability is very low, describes the risk of a pronounced and long-lasting decline in domestic economic activity caused mainly by low external demand. The adverse economic situation will erode the financial reserves of households and non-financial corporations and cause a significant deterioration in their ability to service their debts. This will lead to sizeable credit losses in the banking sector. The *Adverse Scenario* also assumes a pronounced increase in long-term bond yields, which will result in financial institutions incurring losses due to market risk. This stress 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.

The FSR is divided into four main sections followed by thematic articles that respond to selected topical issues relating to financial stability. The *Real economy and financial markets* section deals with the macroeconomic environment, property markets, corporations and households and analyses overall developments in the financial markets. The section called *The financial sector* discusses developments in the banking and non-banking financial sector and assesses the resilience of sectors on the basis of stress tests. The section *Macroprudential policy* contains an overall risk assessment, information on macroprudential instruments for mitigating risks identified, and an analysis of risks associated with developments in the regulatory environment.

This FSR was approved by the CNB Bank Board at its regular meeting on financial stability issues on 19 May 2016 and was published on 14 June 2016. It is available in electronic form at <http://www.cnb.cz/>.