**Appendix II – Economic Scenario (guidelines)**

As per the Executive Risk Committee’s (ERC) decision on 17/09/14, the Economic Scenario of Risk Appetite should feature a shock of similar magnitude.

The definition of “similar magnitude” varies depending on the economic variable; these can be classified in two categories:

* Type I: Variables where the scenario is defined in terms of a relative movement:
  + Peak to trough fall in GDP c.3%
  + Peak to trough fall in House prices c.20%
* Type II: Variables where the scenario is defined in absolute terms:
  + Unemployment rate rising to approx. 10%
  + Low rates environment – Bank rate at 0.5%

This document present general guideline for the construction of scenarios which are consistent with the premise that we will continue lending to the real economy. However, these should be scrutinised to ensure the economic scenario is the most relevant at any point in time.

In any case, the scenario will be provided by the Economics team who will create a scenario considering these guidelines but ensuring it is consistent and remains plausible.

Type I variables:

In an expansionary economic environment, for Type I variables, the drop will be measured from the start of the scenario, or after if the peak is modelled to happen after the start of the scenario. The graph below illustrates this case.



In an economic downturn, the peak from which the type I variables fall will be measured may have occur prior to the start of the scenario. The graph below illustrates this case.



Finally, in the unlikely situation where the economic performance is worse than the parameters originally defined, the economic variable will be modelled as the worst of the base case or, a flat economic environment. The graph below illustrates this case.



Type II variables:

In an expansionary economic environment or economic downturn where the unemployment has not reached the level mentioned above, this will be modelled to reach 10% in the economic scenario. The graph below illustrates this case.



In the unlikely situation where the economic performance is worse than the parameters originally defined, the economic variable will be modelled as the worst of the base case or,

a flat economic environment. The graph below illustrates this case.

