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# Post-Programme Surveillance Report

Spain, Spring 2019

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European Commission  
Directorate-General for Economic and Financial Affairs

## Post-Programme Surveillance Report

### Spain, Spring 2019

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The report was prepared under the direction of Carlos Martinez Mongay, Deputy Director General, and Manfred Bergmann, Director, Directorate General for Economic and Financial Affairs. The preparation of the report was overseen by Laura Bardone, Head of Unit –Croatia and Spain, Directorate General for Economic and Financial Affairs and Peter Grasmann, Head of Unit - EU/Euro area financial system, Directorate General for Financial Stability, Financial Services, and Capital Markets <sup>(1)</sup>.

Contributors:

Laura Bardone, Gerrit Bethuyne, Peder Christensen, Oskar Grevesmuhl, and Teresa Sastre de Miguel, Directorate General for Economic and Financial Affairs. Peter Grasmann and Miguel Angel Otero Fernández, Directorate General for Financial Stability, Financial Services and Capital Markets Union. Lucas Gonzalez Ojeda, Directorate General for Communication (Representation Madrid). Co-ordination and editing were ensured by Peder Christensen and Teresa Sastre de Miguel. Technical assistance was provided by Michel Gerdøy.

The report was prepared in liaison with the European Central Bank and the European Stability Mechanism.

Comments on the report would be gratefully received and should be sent, by mail or e-mail to:

Laura BARDONE  
European Commission  
Unit ECFIN.DDG1.F.3  
B-1049 Brussels

[Laura.Bardone@ec.europa.eu](mailto:Laura.Bardone@ec.europa.eu)

or

Peter GRASMANN  
European Commission  
Unit FISMA.E.1  
B-1049 Brussels

[Peter.Grasmann@ec.europa.eu](mailto:Peter.Grasmann@ec.europa.eu)

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<sup>(1)</sup> The executive summary of this report was adopted as Commission Communication C(2019)4901 on 24 June 2019. The rest of the report is the Staff Working Document (SWD(2019)284) of 24 June 2019 accompanying this communication.

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## ABBREVIATIONS

AMCESFI	Autoridad Macroprudencial Consejo de Estabilidad Financiera
BdE	Banco de España, Bank of Spain
BMN	Banco Mare Nostrum, S.A.
BRRD	Bank Recovery and Resolution Directive
CCyB	Counter-Cyclical capital Buffer
CDS	Credit Default Swaps
CET 1	Common Equity Tier 1
CNMV	Comisión Nacional del Mercado de Valores, National Securities Market Commission
CSRs	Country-Specific Recommendations
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
ESM	European Stability Mechanism
FAB	Fondos de Activos Bancarios, Bank Asset Fund
FROB	Fondo de Reestructuración Ordenada Bancaria, Fund for Orderly Bank Restructuring
GDP	Gross Domestic Product
HICP	Harmonised Index of Consumer Prices
INE	Instituto Nacional de Estadística, the Spanish National Statistics Institute
MIP	Macroeconomic Imbalance Procedure
MREL	Minimum Requirement for own funds and Eligible Liabilities
NFCs	Non-Financial Corporations
NPLs	Non-Performing Loans
PPS	Post Programme Surveillance
ROA	Return on Assets
ROE	Return on Equity
SAFE	Survey on the Access to Finance of small and medium-sized Enterprises
SAREB	Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria S.A.
SMEs	Small and Medium-sized Enterprise
SRB	Single Resolution Board

## EXECUTIVE SUMMARY

**This eleventh surveillance report provides an assessment of Spain's economic and financial situation following its exit from the financial assistance programme in January 2014.** A team from the European Commission (EC), in liaison with staff from the European Central Bank (ECB), carried out the eleventh post-programme surveillance visit to Spain on 7-8 May 2019<sup>(2)</sup>. The European Stability Mechanism (ESM) participated in the meetings in the context of its own Early Warning System. The report focuses on macroeconomic and financial sector developments over the past months, complementing the surveillance by the Commission under the macroeconomic imbalances procedure, the Stability and Growth Pact and, more broadly, the European Semester of economic policy coordination.

**The Spanish banking sector enjoys overall good profitability, liquidity and capitalisation, even if it ranks low in capital in comparison with its EU peers.** Its profitability has improved mainly thanks to the decline of loan-loss provisions related to the reduction in non-performing loans (NPLs). The NPL ratio for the Spanish banks, including on their international activity, has continued to decline to just above the EU average. Despite the profits recorded by Spanish banks in 2018, their overall capital position slightly deteriorated. Banks have continued to divest, mainly domestic assets. The asset management company SAREB recorded again negative results and is preparing a strategy intended to maximise value in the divestment process, which will have to continue to be closely monitored. Finally, completing the privatisation of Bankia and the further divestment of banking foundations in savings banks will continue to reinforce the Spanish banking sector.

**Strong, though decelerating growth, accompanied by dynamic job creation, supports the correction of Spain's macroeconomic imbalances.** Economic activity is expected to moderate in 2019 and 2020, but remain well above the EU average. Job creation is expected to moderate, but unemployment will continue to decline. Productivity is growing in line with the euro area average, but it remains low in an EU context. In line with the country-specific recommendations issued by the Council of the European Union on 13 July 2018 and the proposals by the Commission adopted on 5 June 2019, policy steps should include further reducing unemployment, addressing labour market segmentation, the fragmentation of product and services markets, and investing in innovation. On 14 June 2019, Spain exited the excessive deficit procedure<sup>(3)</sup>. Under the preventive arm of the Stability and Growth Pact, Spain should pursue fiscal consolidation so as to re-build fiscal buffers, continue reducing its high government debt, and preserve the long-term sustainability of public finances.

**On the basis of the analysis in the report, repayment risks for the ESM loan appear very low.** Overall, a more stable financial sector and the strong economic recovery keep repayment risks low. The average cost of outstanding government debt in May 2019 was about 1.6 pps. lower than in 2011. This, combined with a lengthening average life of debt outstanding, further decreases repayment risks for the ESM. Spain has made nine voluntary early repayments, and the outstanding amount of the ESM loan currently stands at EUR 23.7 billion, or 57% of the total amount drawn by Spain under the programme.

The next post-programme surveillance mission will take place in autumn 2019.

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<sup>(2)</sup> European Central Bank (ECB) Staff participated in this mission, and in the drafting of this report, in accordance with the ECB's competences and thus provided expertise on financial sector policies and macro-critical issues, such as headline fiscal targets and sustainability and financing needs.

<sup>(3)</sup> <https://www.consilium.europa.eu/media/39759/st10336-en19.pdf>

# 1. INTRODUCTION

**1. Spain successfully exited the financial assistance programme for the recapitalisation of financial institutions in January 2014.** The Programme was agreed by the Eurogroup on 9 July 2012 for a period of 18 months<sup>(4)</sup> and provided financing by the euro area Member States of up to EUR 100 billion. Eventually, Spain used EUR 38.8 billion for bank recapitalisation, under restructuring and resolution plans approved by the European Commission under State-aid rules, and around EUR 2.2 billion for capitalising SAREB, the Spanish asset management company. Both the bank-specific conditionality and the horizontal conditionality included in the Memorandum of Understanding were fulfilled as scheduled<sup>(5)</sup>. From July 2014 to October 2018, Spain made nine voluntary early repayments. The outstanding amount of the ESM loan stands at EUR 23.7 billion, which represents 57% of the total amount disbursed to Spain under the programme.

**2. Staff from the European Commission, in liaison with the European Central Bank, undertook the eleventh post-programme review mission to Spain on 7-8 May 2019.** The ESM participated in the meetings on aspects related to its own Early Warning System. Post-programme surveillance (PPS) aims at a broad monitoring of the repayment capacity of a country having received financial assistance<sup>(6)</sup>. There is no policy conditionality under PPS, although the Council can issue recommendations for corrective actions if deemed necessary and appropriate. PPS is biannual in terms of reporting and missions. The previous PPS mission took place in October 2018<sup>(7)</sup>.

**3. The spring 2019 PPS focuses on the Spanish financial sector, complementing the surveillance under the macroeconomic imbalances procedure, the Stability and Growth Pact and more broadly the European Semester of economic policy coordination.** This PPS report complements the 2019 Country Report for Spain<sup>(8)</sup>, published on 27 February 2019 in the context of the European Semester. That report included an In-Depth Review on the prevention and correction of macroeconomic imbalances under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis in the report led it to conclude that Spain is experiencing macroeconomic imbalances which have cross-border relevance<sup>(9)</sup>. On 13 July 2018, the Council of the European Union adopted the 2018 Country-specific Recommendations (CSRs), which called on Spain<sup>(10)</sup> to pursue fiscal adjustment in line with the requirements of the Stability and Growth Pact and address weaknesses in the areas of the labour market, social policy, education, business regulation, and research and innovation. On 5 June 2019 the Commission adopted its proposal for new CSRs, in continuation of the 2018 CSRs. The Council will adopt CSRs in July 2019. On 14 June 2019, Spain exited the excessive deficit procedure<sup>(11)</sup>. Spain therefore became subject to the preventive arm of the Stability and Growth Pact as of 2019.

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<sup>(4)</sup> However, the completion of the restructuring of the banks receiving public support under the State aid rules was due to take place after the exit from the programme.

<sup>(5)</sup> For more details see the report:  
[https://ec.europa.eu/info/publications/economy-finance/evaluation-financial-sector-assistance-programme-spain-2012-2014\\_en](https://ec.europa.eu/info/publications/economy-finance/evaluation-financial-sector-assistance-programme-spain-2012-2014_en).

<sup>(6)</sup> PPS is foreseen by Art. 14 of the two-pack [Regulation \(EU\) N°472/2013](#). It starts automatically after the expiry of the programme and lasts at least until 75% of the financial assistance has been repaid.

<sup>(7)</sup> For more details see the previous PPS report:  
[https://ec.europa.eu/info/publications/economy-finance/post-programme-surveillance-report-spain-autumn-2018\\_en](https://ec.europa.eu/info/publications/economy-finance/post-programme-surveillance-report-spain-autumn-2018_en).

<sup>(8)</sup> <https://ec.europa.eu/info/sites/info/files/2019-european-semester-country-report-spain-en.pdf>

<sup>(9)</sup> [https://ec.europa.eu/info/sites/info/files/2019-european-semester-country-report-communication\\_en.pdf](https://ec.europa.eu/info/sites/info/files/2019-european-semester-country-report-communication_en.pdf)

<sup>(10)</sup> <https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-specific-recommendation-commission-recommendation-spain-en.pdf>

<sup>(11)</sup> <https://www.consilium.europa.eu/media/39759/st10336-en19.pdf>

## 2. MACROECONOMIC DEVELOPMENTS

**4. Spain continued growing above the euro area average.** Despite continued slowdown since the 2015 peak, real GDP grew by 2.6% in 2018, well above the euro area average for the fourth year in a row. Private consumption remained robust, though on a declining path, and investment, especially in equipment, surprised by its strength. However, net exports evolved worse than anticipated, and negatively contributed to growth.

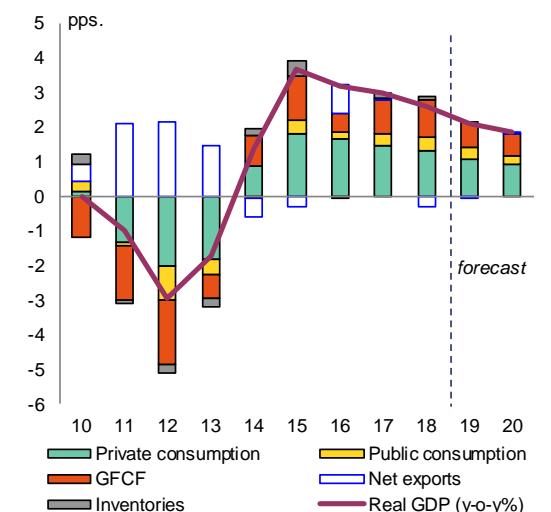
**5. Economic activity is expected to moderate in 2019 and 2020.** In the first quarter of 2019, real GDP growth was 0.7 % q-o-q, higher than expected in the European Commission 2019 spring forecast <sup>(12)</sup>. Still, growth is expected to ease in 2019 and 2020. The deceleration is mainly due to a slowdown in private consumption, as the absorption of pent-up demand wears off and the savings rate, which reached a historic low in 2018, rebounds. However, still robust job expansion and accelerating wage growth – also due to the planned increase in the minimum wage - should continue to support disposable income growth over the forecast horizon. Investment is also expected to moderate in 2019 and 2020 but continue growing above final demand, both in equipment and construction.

**6. The contribution of the external sector to growth is expected to become neutral.** Exports are expected to strengthen in 2019 and 2020, as the transitory factors that impacted export performance in 2018, in particular in the automotive industry, unwind. Imports, which also decelerated in 2018, are set to slow further in 2019 as final demand moderates. As a consequence, after being negative in 2018, the contribution of net exports to growth is expected to become neutral in 2020. The terms of trade worsened in 2018 but are set to stay stable in 2019. These factors should result in the current account surplus remaining in 2019 and 2020 close to 1% of GDP, as in 2018.

**7. Risks to the outlook are on both sides.** Higher than expected real GDP growth and job creation in the first quarter of 2019, and robust confidence among businesses and consumers, may result in higher than projected economic growth in

2019. At the same time, the risk of further protectionist measures in US trade policy and of a more protracted slowdown in world GDP growth than anticipated may also affect Spain's growth outlook. Risks to growth also include oil prices and Brexit developments.

Graph 2.1: Composition of GDP growth



GFCF: gross fixed capital formation

Source: INE, European Commission Economic Forecast, spring 2019.

**8. Core inflation is expected to gradually increase, as wage growth increases in 2019 and 2020.** The European Commission 2019 spring forecast projects HICP inflation to decline from 1.7% in 2018, to 1.1% in 2019 and 1.4% in 2020, as the pickup in core inflation is offset by base effects from oil price developments.

**9. Unemployment is set to continue falling, despite a lower pace of job creation.** Employment growth is expected to slow down over the forecast horizon, as a consequence of the lower growth of final demand, as well as the dampening impact of the increase in the minimum wage in 2019. Still, unemployment is set to continue falling, to 12.2% in 2020, its lowest level since 2008. Wage growth is expected to peak in 2019, also under the impact of the increase of the minimum wage, and moderate but still grow at a rate above inflation in 2020. As labour productivity is forecast to grow moderately over the forecast horizon, this will lead to an acceleration in nominal unit labour costs.

<sup>(12)</sup> The European Commission spring 2019 has a cut-off date of 24 April, and only includes data released until that date.

**10. The housing market and construction sector keep recovering from the sharp adjustment that followed the crisis.** By 2018, the number of transactions on dwellings had increased by about 60% since they bottomed out in 2013, especially those of secondary dwellings that even reached a level similar to that in 2007. However, transactions on new dwellings remain very low, only slightly above the minimum during the crisis. The supply of new housing is at low levels as shown by the share of residential investment in 2018 (5.6% over GDP), fairly below the peak in 2006 (12%). However, the steady growth of new building permits at a high rate over the last three years suggests accelerating housing supply in the near future. Unsubsidised house prices increased by 6.8% year-on-year in the first quarter of 2019<sup>(13)</sup>. Prices of new dwellings went up by 10.4% and those of used dwellings by 6.2%. House price developments vary greatly across regions, with larger increases in the major cities and in the coastal areas. In big cities, the increased propensity to rent after the crisis and improving economic conditions have put pressure on rental prices. Though information on this market is rather scarce, real estate portals point to a fast increase in rental prices that may potentially feed through to house prices.

**11. The general government deficit is expected to continue narrowing, but at a slower pace.** After decreasing by 0.6 pps. to 2.5% of GDP in 2018, the general government deficit is expected to decline further to 2.3% of GDP in 2019, thanks to still robust economic growth. The somewhat slower pace of deficit reduction is the result of measures included in the 2018 budget law also having an impact in 2019, namely the higher revaluation of pensions, the pay hike for public employees and, to a lesser extent, the tax cut for low-income earners. This is partly offset by some revenue increasing measures related to social contributions. The 2019 deficit forecast is also affected by a number of temporary deficit-increasing transactions. In 2020, at unchanged policies, the deficit is expected to narrow to 2.0% of GDP.

**12. The public debt ratio is set to continue decreasing slowly but to remain high over the forecast horizon.** According to the Commission

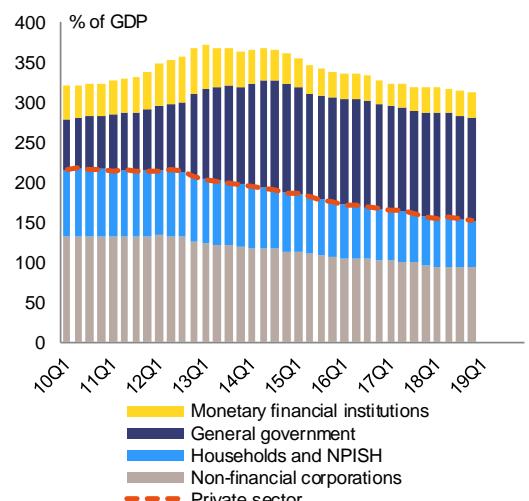
2019 spring forecast, gross general government debt will decrease from 97.1% in 2018 to 95.7% of GDP in 2020. Strong nominal GDP growth and a gradually improving primary balance (which is projected to turn into a small surplus in 2020) would more than offset the impact of interest expenditure. The average life of debt outstanding as of early June 2019 has climbed to around 7.5 years, compared to the low point of 6.2 years in 2013, as the Spanish Treasury benefitted from lower interest rates to extend maturities. While the cost at issuance has reached an all-time low in the first half of 2019 at 0.5%, it remains significantly below the cost of debt outstanding, which stood at 2.4% in the same period. In 2011, both stood at around 4.0%. The average cost of debt will continue falling for as long as the cost of issuance remains below the cost of debt outstanding. Over the last four years, Spanish residents have reduced their holdings of Spanish government debt instruments from just over half of total outstanding debt instruments of the state to around a third. This has been fully offset by a corresponding increase in the holdings of the Bank of Spain, which held around 22% in the first half of 2019, mainly in the context of the implementation of the ECB monetary policy decisions. The share of non-resident investors has been rather stable at around 45%.

**13. The stock of private debt has continued declining, but deleveraging needs persist.** The total stock of debt of the non-financial private sector amounted to 152.1% of GDP in non-consolidated terms in the fourth quarter of 2018 (58.9% of GDP by households and 93.2% of GDP by non-financial corporations (NFCs)) (see Graph 2.2). This is 65.7 pps. lower than its peak in the second quarter of 2010. Consolidated private sector debt decreased by 5.7 pps to 133.4% of GDP in 2018 and is expected to drop slightly below the MIP benchmark of 133% in 2019. However, the stock of private debt has remained above prudential levels and fundamental-based benchmarks for both households and NFCs (2019 Country Report for Spain). In 2018, the stock of debt in nominal terms fell only slightly compared to 2017 for both NFCs and households. GDP growth was thus the main driver of private sector deleveraging in 2018. Most of the debt reduction since 2010 has been made by non-financial

<sup>(13)</sup> Source: INE.

corporations<sup>(14)</sup>, but progress in households' deleveraging was also significant over the period. In recent years, there has been a significant growth in loans to finance durable consumer spending, which has been counterbalanced by a decline in the volume of mortgages. The growth in consumer credits has supported private consumption, but its increase has made agents more vulnerable to adverse shocks. This is the case in particular for some over-indebted households (such as low-income or jobless households) and for companies that are particularly vulnerable to changes in the economic and financial situation<sup>(15)</sup>.

Graph 2.2: Indebtedness by sector



NPISH: Non-profit institutions serving households  
Source: BdE, own calculations.

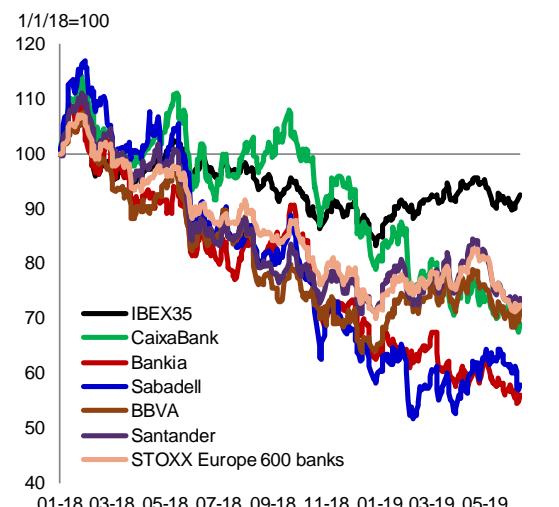
(14) In consolidated terms, the NFC debt decreased from 117.7% in Q2-2010, to 74.5% in 2018-Q4. Financial derivatives are not included in these figures.

(15) Financial Stability Report by Bank of Spain, May 2019  
[https://www.bde.es/bde/en/secciones/informes/boletines/  
 Informe de Estab/](https://www.bde.es/bde/en/secciones/informes/boletines/Informe_de_Estab/)

## 3. FINANCIAL SECTOR TRENDS

**14. Spain's financial sector proved resilient in 2018 and the first half of 2019.** Financial markets and financial stability have remained rather stable, despite some uncertainties in the domestic and international political environment. However, the share prices of Spanish banks have been underperforming in comparison with the national stock index (IBEX 35) and, to a lesser extent, when compared to the European sectoral index STOXX Europe 600 Banks (see Graph 3.1).

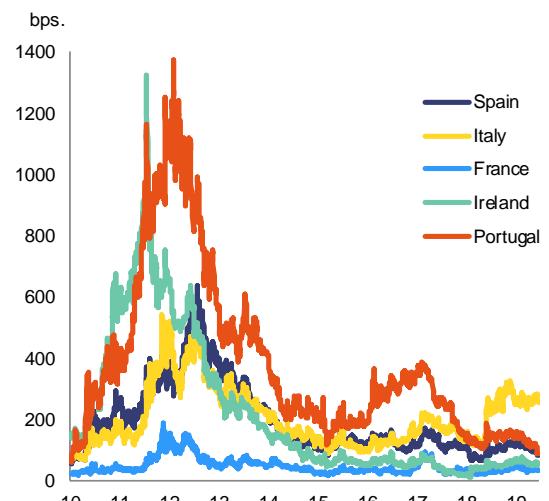
Graph 3.1: IBEX35, STOXX 600 Banks and selected Spanish banks stocks



Source: Madrid Stock Exchange via Macrobond, own calculations.

**15. Spanish government bond yields and spreads have declined since November 2018** (see Graph 3.2). After having risen in the first three quarters of 2018, the sovereign spread to the 10-year German bund stabilised in autumn 2018. Since then, it started to narrow further, decreasing overall by about 30 bps between autumn 2018 and spring 2019, to around 100 bps at the end of May, even though it experienced temporary and limited increases in Spring following tensions on the Italian sovereign market. Likewise, the 5-year Spanish CDS spread has followed a decreasing trend since mid-January 2019 to reach 55 basis points at the end of May.

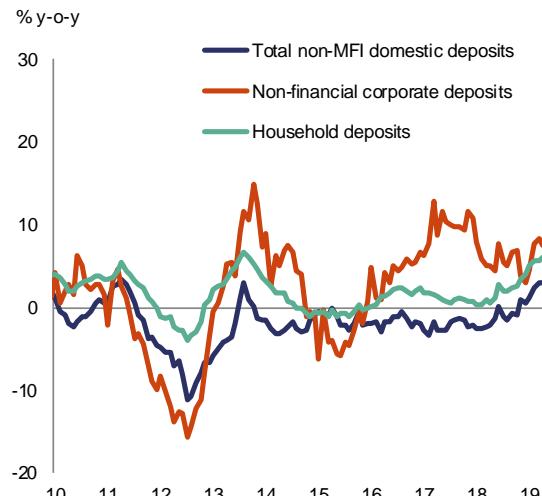
Graph 3.2: Sovereign spreads to the 10-year German bund



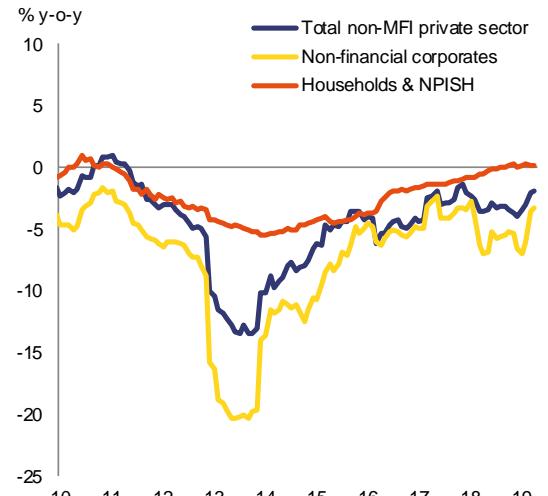
Source: IHS Markit, Macrobond, own calculations.

**16. Spanish banks continued to diversify their funding sources and maintained rather low Eurosystem reliance amidst ample liquidity available.** Total private domestic bank deposits continued to increase at a steady pace of 2.8% y-o-y in April 2019, although with variations across sectors: whilst bank deposits by the private non-financial sector maintained a strong growth pace, with +6.1% for households and +7.6% for non-financial corporations y-o-y (see Graph 3.3), bank deposits of non-monetary financial institutions decreased at a double-digit rate of 10.5%. At the same time, the latest available data on the issuance of securities other than shares by credit institutions shows a similar growth of 2.8% y-o-y in March 2019, reaching 8.3% of total assets in the context of the upcoming MREL requirements <sup>(16)</sup>. Finally, Spanish banks' total net borrowing from the Eurosystem declined by 1.6% y-o-y to EUR 166.9 billion in May 2019, far below its peak of EUR 389 billion in August 2012.

<sup>(16)</sup> MREL: Minimum Requirement for own funds and Eligible Liabilities.

**Graph 3.3: Bank deposits**

Source: BdE.

**Graph 3.4: Bank loans to the private sector**

The decrease in the stock of loans in late 2012 and early 2013 was due to the transfer of assets to SAREB.

Source: BdE, own calculations.

**17. Banks continued to divest, mainly in domestic assets.** Banks' domestic assets stayed below EUR 2 trillion in April 2019, after decreasing further by 4.0% y-o-y, whereas banks' total assets remained above EUR 2.6 trillion in the same period. By asset category, the holdings of securities decreased, while the credit portfolio remained unchanged. In relation to the stock of domestic private credit, it marginally dropped (-1.2% y-o-y in April 2019), mainly driven by the decline in credit to NFCs (-3.3% y-o-y in April 2019) (see Graph 3.4). This decline is explained by the negative new lending to NFCs, led by the strong reduction of credit lines (-14.9% y-o-y in April 2019), whereas other new lending to NFCs increased (+3.8% y-o-y in April 2019) driven by new lending to SMEs (+6.6% in April 2019 y-o-y, proxied by loans under EUR 1 million). Finally, the stock of domestic credit to households remained flat. While the stock of mortgage loans continued to decline by 1.1% y-o-y in April 2019, the stock of consumer credit continued to increase at a double-digit rate (+10.8% y-o-y in April 2019). This trend deserves close monitoring, though the weight of consumer credit over the total credit stock remains low.

**18. In the first quarter of 2019, credit standards for approving loans to enterprises remained unchanged, whereas they were tightened for housing loans<sup>(17)</sup>.** For enterprises, credit standards did not vary overall, as the easing impact of competitive pressures was neutralised by the higher risk perception by banks with respect to the previous quarter, whereas loan demand was dampened by lower reported investment needs and greater use of alternative funding. Concerning households, credit standards for house purchases tightened against the background of changing housing market conditions and prospects, in a context of increased demand favoured by the still low general level of interest rates. Finally, credit standards for consumer credit tightened, led by a higher perception of risk, in a context of declining demand.

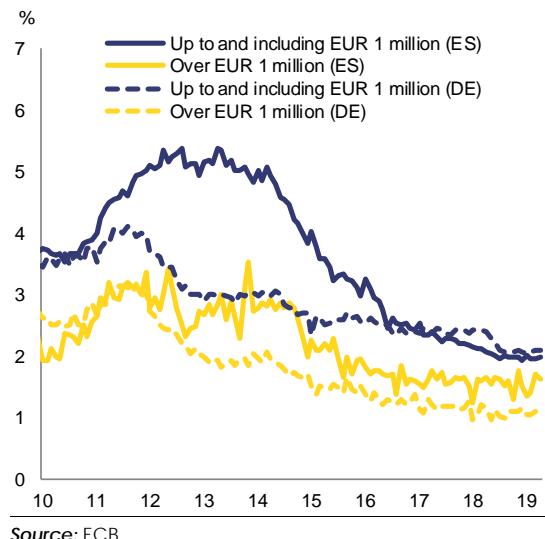
**19. Spanish SMEs continued to indicate further improved access to finance and availability of bank credit.** This is in line with developments elsewhere in the euro area, according to the latest SAFE survey<sup>(18)</sup> (October 2018 to March 2019). Spanish SMEs reported the

<sup>(17)</sup> According to the Eurosystem Bank Lending Survey of April 2019. See the report at: [https://www.ecb.europa.eu/stats/ecb\\_surveys/bank\\_lending\\_survey/html/index.en.html](https://www.ecb.europa.eu/stats/ecb_surveys/bank_lending_survey/html/index.en.html)

<sup>(18)</sup> Survey on the access to finance of small and medium-sized enterprise in the Euro Area at: [www.ecb.europa.eu/stats/ecb\\_surveys/safe/html/index.en.html](https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/index.en.html)

strongest improvement in the availability of bank loans in the euro area (followed by Ireland and Portugal), against the background of continued, though slowing, deleveraging in this segment. At the same time, the demand for bank finance by Spanish SMEs remained unchanged in the last survey, after having registered decreasing needs in the previous three surveys. Overall, the resulting financing gap remains negative (-6%) for Spanish SMEs. In addition, the percentage of vulnerable<sup>(19)</sup> SMEs in Spain declined slightly (3.0% from 3.5% at the previous survey) and is much lower than the peak reached during the sovereign debt crisis. Finally, while the banking system remains the largest source of finance, other sources have emerged.

Graph 3.5: Cost of borrowing for NFCs



**20. On aggregate, Spanish banks continued to reduce their non-performing loans during 2018 and the first quarter of 2019.** Against the background of continued positive economic developments over the past year, the total stock of NPLs in Spain in both the corporate and household segment decreased by EUR 14 billion (-17.3%) y-o-y down to EUR 69 billion in March 2019. The share of NPLs in total loans (NPL ratio) for credit in Spain went down by one percentage point over the same period, to 5.7% in a context of still flat volumes of credit. By sectors, the latest data

<sup>(19)</sup> Vulnerable firms in the context of the SAFE survey, are defined as those firms that have simultaneously reported lower turnover, decreasing profits, higher interest expenses and a higher or unchanged debt-to-assets ratio.

available show that NPLs strongly fell in particular for loans to the construction and real estate sectors, where the NPL ratios were almost halved y-o-y down to 13.7% and 9.6% in December 2018 respectively. For loans to households, the NPL ratio also decreased, but at a lower pace, down to 4.9% in December 2018 compared to 5.4% a year earlier (see Graph 3.6). At consolidated level, data from the European Banking Authority (EBA) show that the NPL ratio for Spanish banks also decreased y-o-y from 4.5% to 3.7% in December 2018, still remains above the EU average (3.2%) although below the euro area average (3.8%). As regards provisioning levels, EBA data show a small improvement of the coverage ratio in Spain (43.0% at the end of December 2018 vs. 41.9% a year earlier) but it remains below the EU average (45.1%).

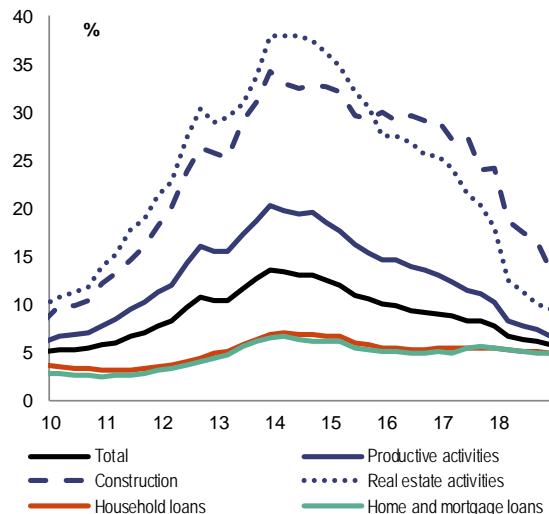
**21. Over 2018, banks continued to reduce their forbearance exposures at a similar pace as the previous year.** Forborne loans went down to EUR 69.5 billion in December 2018 (21% lower than a year earlier) mainly led by the reduction of forborne loans to NFCs<sup>(20)</sup>. Nevertheless, according to EBA data the forbearance ratio for Spanish banks, after experiencing a significant reduction from 10.2% in September 2014 to 3.9% in December 2018, remained almost double the ratio of the EU average (3.9% vs. 2.1%) indicating that there is still room for further reduction. Furthermore, the volume of foreclosed assets decreased from December 2017 to December 2018, by more than EUR 20 billion, representing a year-on-year decline of more than 30%.

**22. Further progress has been made in the restructuring of the banking sector.** The Spanish banking sector continues optimising its business model and lowering its cost base. The merger of the (majority) state-owned Bankia and BMN was finalised in January 2018 and has resulted in the realisation of important synergies. Furthermore, between end-2012 and end-2018, the number of credit institutions declined by one third, and during the same period, the branch network shrank by more than 30%, whilst the number of employees fell by almost 20% between end-2012 and end-2017, and even by 42% and 32%, respectively,

<sup>(20)</sup> Financial Stability Report by Bank of Spain, May 2019 [www.bde.es/bde/en/secciones/informes/boletines/Informe\\_de\\_Estab/](http://www.bde.es/bde/en/secciones/informes/boletines/Informe_de_Estab/)

since end-2008. When comparing with the EU at large, Spanish banks have better levels of cost efficiency, with a cost-to-income ratio of 52.4% in Spain vs. 64.6% at EU level in December 2018 according to EBA data.

**Graph 3.6: Ratio of non-performing loans**



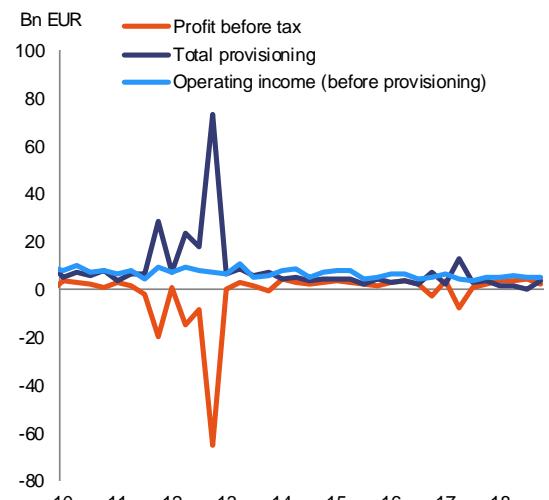
(1) The scope of non-performing loans covered in these figures overlap with BdE's definition of doubtful loans.  
(2) Home loans comprise also loans that are not mortgages

Source: BdE, own calculations.

**23. The profitability of the Spanish banking sector rose in 2018.** Amidst a favourable economic environment and lower impairment losses, Spanish banks returned to positive domestic returns in 2018, after the domestic losses registered in 2017, mostly due to the resolution of Banco Popular, reaching a net profit of EUR 12.4 billion in 2018. The net profits registered at consolidated level in 2018 were EUR 19.4 billion (<sup>(21)</sup>), 25% more than a year earlier, which translated into a return on assets (ROA) of 0.55% (0.44% a year earlier). The return on equity (ROE) also improved (+1.2 pps y-o-y up to 7.2%) for Spanish banks, although it remained below their cost of equity.

(<sup>21</sup>) Financial Stability Report by Bank of Spain, May 2019  
[www.bde.es/bde/en/secciones/informes/boletines/Informe\\_de\\_Estab/](http://www.bde.es/bde/en/secciones/informes/boletines/Informe_de_Estab/)

**Graph 3.7: Bank sector profitability for domestic operations**



Source: BdE, own calculations.

#### **24. Despite Spanish banks' solid profits in 2018, their capital position slightly deteriorated.**

The common equity tier 1 (CET 1) ratio for Spanish banks according to EBA data (<sup>(22)</sup>), decreased from 12.4% at end-2017 to 11.9% at end-2018, below the EU average (14.7%). As regards the fully loaded CET1 ratio, the gap with the EU average remains at around 3 percentage points (11.5% vs 14.4%). The higher CET 1 ratio at system level, 12.2% at end-2018, indicates that, in contrast, smaller Spanish institutions improved their solvency over 2018. Finally, the capital position of Spanish banks shows a better picture on a non-risk weighted base, as their leverage ratio (<sup>(23)</sup>) ranked similarly to the EU average (5.7% vs. 5.5% as of end-2018 according to EBA data).

(<sup>22</sup>) EBA data only takes into consideration the most significant banks in each jurisdiction.

(<sup>23</sup>) The leverage ratio is a non-risk-weighted measure of the capital position of a bank: 'Tier 1 capital / leverage exposure'.

# 4. FINANCIAL SECTOR REFORMS AND POLICY

## 4.1. SAREB – RECENT DEVELOPMENTS AND OUTLOOK

**25. SAREB<sup>(24)</sup> (Sociedad de gestión de Activos procedentes de la Reestructuración Bancaria) significantly increased its net losses in 2018.** The increase of net losses was caused by a drop in revenues (-28%) and increasing financial costs (+22%). 2018 has been characterised by significant volumes of NPL sales performed by the banking sector at significant discounts. Against this market background, SAREB is reluctant to engage in the sale of its NPLs portfolio at possibly even higher discounts and has decided to convert instead a big portion of its real estate loans into real estate assets in order to actively manage, and thereby maximise the value of, these assets. The record number of properties sold by SAREB in 2018 supports the potential of this strategy. It is, however, too early to assess the effectiveness of this strategy and SAREB should consider carefully its viability, mainly the increasing operating costs that the conversion will entail and the execution risk linked to planning the completion of a big portion of the divestments closer to the end of its mandate, by the end of 2027 when SAREB should be liquidated. In this context, it is important that SAREB's operations are based on a detailed business plan with a realistic and complete asset disposal plan in order to timely fulfil its mandate. SAREB plans to increase its efficiency with a new servicing model to contain its operational costs whilst the high financial costs continue to be driven by the high cost of the interest rate swaps signed in 2013 given the current environment of low interest rates.

**26. Overall, since its inception until end-2018, SAREB's total assets under management fell by 33% down to EUR 34.4 billion.** More specifically, its NPL portfolio was reduced by 44%, whilst the property portfolio increased by 9% due to the transformation of loans into real estate assets through foreclosure. Therefore, there is still further work for SAREB to ensure an adequate

<sup>(24)</sup> SAREB is an asset management company which was created to divest the assets transferred from the old savings banks and help the economy recover. The majority of its share capital (54%) is owned by private shareholders, but the main shareholder is the Fund for Orderly Bank Restructuring (FROB), which is publicly owned and holds 46% of SAREB equity.

reduction pace of the current stock during the remaining years of life.

**27. SAREB is exploring alternatives to divest its real estate assets while maximising value in the process.** Therefore, SAREB has engaged in a process of selling parts of its stake in the vehicle that it had created at the end of 2017 to manage its residential rental portfolio of real estate assets. Témpore Properties is listed on the alternative stock exchange market and SAREB owns 98.4% of the new entity. At 31 December 2018, Témpore managed a portfolio of 2,249 residential rental properties across various provinces of Spain, and obtained a revenue of EUR 7 million. It registered losses in 2018, but these were lower than originally foreseen, and the company is expected to turn into profits by 2020. Although modest in size, this operation is part of the more general SAREB's divestment strategy.

**28. Finally, SAREB intends to manage and develop part of its residential development project portfolio.** With this aim, it has recently signed an agreement to create a Bank Asset Fund (FAB – Fondo de Activos Bancarios), as a financial instrument specifically designed for SAREB and operated as a joint venture. This product is aimed exclusively at institutional investors who are able to list on structured markets, and must be managed by a regulated asset management company and be registered with the National Securities Market Commission (CNMV - Comisión Nacional del Mercado de Valores). The plan of SAREB is to place land, unfinished promotions and some of its residential projects that are awaiting development, through the FAB which is valued at over EUR 800 million and will be mainly managed by a private real estate developer specialised in those kinds of assets. The partners in the joint venture will hold a 10% minority stake while SAREB will keep the remaining 90%.

## 4.2. PROGRESS WITH FINANCIAL SECTOR REFORMS AND CHALLENGES AHEAD

**29. Profitability in the banking sector is gradually improving, but emerging risks need to be closely monitored.** Protracted period of low interest rates and sluggish interest margins weigh on banks' profitability. However, the gradual

increase of profitability stems from the significant reduction of provisioning requirements in the context of the still robust economic growth in Spain. Forecast slower growth and global economic uncertainties could weaken profitability drivers in the medium term. The quality of the new production of credit will be monitored in order to avoid higher risks' that could lead to an unwarranted strong increase of provision needs in the medium to long term, thus further undermining profitability. Against this background, credit institutions and supervisors need to ensure sufficiently conservative credit standards.

**30. The impact of legal risk is still of some relevance for some credit institutions.** Litigation costs have been significant for many banks in the aftermath of the financial crisis mainly due to misselling practices. This has led to compensation to consumers following some court rulings. Although costs linked to litigation concerning preferential debt or shares are already paid or provisioned, some potential risks on administrative costs or applied interest rates (i.e. IRPH) could be emerging and, depending on further court decisions, could affect profitability of some affected banks.

**31. The newly created macro-prudential authority met for the first time after its creation.** The Spanish government decided in 2018 to reactivate the creation of a macro-prudential authority. In March 2019 the Royal Decree Law creating the Autoridad Macroprudencial Consejo de Estabilidad Financiera (AMCESFI) was approved. AMCESFI is composed of a Council and a Technical Committee. The Council is chaired by the Minister of Economy and Business and is made up of representatives from the Ministry of Economy and Business and the three sectoral supervisors: Banco de España, Securities Exchange Commission (*Comisión Nacional del Mercado de Valores*) and Directorate-General of Insurance and Pension Funds. On 1 April 2019 AMCESFI held its first meeting, focusing on the impact of recent changes to the regulatory framework and the evolution of credit indicators. The set-up of the national macroprudential authority has been accompanied with the introduction of new macroprudential tools for all three sectoral supervisors, which will remain in charge of the calibration and implementation of their enhanced macro-

prudential toolkit. However, prior notification to AMCESFI is compulsory. Then the new authority will have the capacity to issue opinions on the macroprudential measures notified by the sectoral supervisors as well as warnings and recommendations as a result of identified systemic risks and will have to report to the Spanish Congress annually.

**32. The Banco de España again kept the counter-cyclical capital buffer (CCyB) at 0%.** Under the existing Law 10/2014, on 28 March Banco de España decided to maintain the countercyclical capital macro-prudential buffer unchanged at 0% for the second quarter of 2019, in the light of the evolution and subsequent analysis of credit indicators. The latest available data shows that the credit-to-GDP gap was negative in September 2018 (-48.3 pps.), still far below the level of 2 pps. set by the Banco de España as a reference for the activation of the buffer.

**33. The preliminary MREL targets published under the bank recovery and resolution directive (BRRD) to be achieved during the next years would pose a challenge for some Spanish banks.** Resolution plans have been drafted or approved for all Spanish banks, including significant, less significant and small institutions. MREL planning is ongoing and targets are being sent by the Single Resolution Board (SRB) to significant institutions and will be communicated to less significant institutions by the end of 2019. Depending on the final set of MREL requirements and the length of the transition period, some institutions could face challenges to tap the capital market, if needed.

**34. The implementation of the recently approved mortgage credit Law could have mixed effects on the mortgage credit market.** In February 2019, the Spanish Congress adopted the law transposing Directive 2014/17/EU (so-called Mortgage Credit Directive). The new law introduces standardisation for some contractual clauses leading to an increase of transparency. The extension of the foreclosure periods might result in an indirect increase of the cost of mortgage financing.

**35. The previous Spanish government decided to further extend the period for the reprivatisation of Bankia.** According to the

Royal-Decree law 4/2016, the privatisation deadline for Bankia is further shifted by two years to the end of 2021, therefore reducing short-term market expectations and market pressure on the FROB divestments, in order to maximise the proceeds to be returned to the State. In April 2019, FROB received EUR 219 million in dividends due to its equity holdings in Bankia related to 2018 profits.

## ANNEX A

### Main macroeconomic and financial indicators

Table A.1: Main macroeconomic and financial indicators

	1995 -1999	2000 -2004	2005 -2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 (e)	2020 (f)
<b>Core indicators</b>															
GDP growth rate	3.6	3.7	3.2	-3.6	0.0	-1.0	-2.9	-1.7	1.4	3.6	3.2	3.0	2.6	2.1	1.9
of which domestic demand incl. stocks	4.1	4.3	3.7	-6.4	-0.5	-3.1	-5.1	-3.2	1.9	3.9	2.4	2.9	2.9	2.2	1.8
Private consumption (annual % change)	3.3	3.5	2.6	-3.6	0.3	-2.4	-3.5	-3.1	1.5	3.0	2.9	2.5	2.3	1.9	1.6
Public consumption (annual % change)	2.7	4.7	5.7	4.1	1.5	-0.3	-4.7	-2.1	-0.3	2.0	1.0	1.9	2.1	1.7	1.5
HICP (annual % change)	2.8	3.2	3.5	-0.2	2.0	3.0	2.4	1.5	-0.2	-0.6	-0.3	2.0	1.7	1.1	1.4
Unemployment rate (% of labour force)	17.8	11.3	9.3	17.9	19.9	21.4	24.8	26.1	24.5	22.1	19.6	17.2	15.3	13.5	12.2
Gross fixed capital formation (% of GDP)	22.9	27.0	30.3	24.3	23.0	21.5	19.8	18.8	19.3	19.9	19.9	20.5	21.2	21.6	21.9
Gross national saving (% of GDP)	21.9	23.0	21.7	20.3	19.7	18.6	19.5	20.2	20.4	21.5	22.6	23.0	22.9	23.2	23.5
<b>General Government (% of GDP)</b>															
Balance (g)	-4.1	-0.5	0.2	-11.0	-9.4	-9.6	-10.5	-7.0	-6.0	-5.3	-4.5	-3.1	-2.5	-2.3	-2.0
Gross debt	63.0	51.3	39.1	52.8	60.1	69.5	85.7	95.5	100.4	99.3	99.0	98.1	97.1	96.3	95.7
Interest expenditure	4.4	2.6	1.6	1.7	1.9	2.5	3.0	3.5	3.5	3.1	2.8	2.6	2.5	2.3	2.1
<b>Households</b>															
Households saving rate	12.8	10.8	7.8	13.4	10.1	10.8	8.6	9.6	9.3	8.7	7.8	5.5	4.9	5.5	5.8
<b>Rest of the world (% of GDP)</b>															
Trade balance	-0.7	-2.7	-5.5	-1.2	-1.3	-0.2	1.5	3.3	2.4	2.3	3.2	2.9	2.0	1.9	1.9
Trade balance, goods	-3.6	-5.8	-8.2	-3.8	-4.4	-4.2	-2.8	-1.4	-2.1	-2.0	-1.4	-1.9	-2.6	-2.5	-2.5
Trade balance, services	2.9	3.1	2.7	2.7	3.1	3.9	4.3	4.6	4.6	4.3	4.5	4.8	4.5	4.4	4.4
Current account balance	-1.4	-4.3	-8.9	-4.3	-3.9	-3.3	-0.4	1.5	1.0	1.1	2.2	1.9	0.9	0.9	0.9
Net financial assets	-27.8	-42.2	-69.9	-89.5	-84.7	-89.5	-91.0	-93.8	-96.4	-89.0	-85.2	-82.9	-76.7	n.a.	n.a.
Net international investment position (h)	-28.8	-44.3	-71.6	-93.5	-88.6	-91.9	-89.9	-95.2	-98.0	-89.5	-85.3	-83.5	-77.1	n.a.	n.a.
<b>Competitiveness (index, 2005=100)</b>															
Real effective exchange rate relative to the rest of the euro area	87.2	91.6	100.3	101.1	100.0	98.5	94.1	92.5	91.9	92.2	90.9	90.3	89.3	89.6	89.7
Real effective exchange rate relative to the rest of the European Union	88.4	89.9	98.4	102.4	100.0	98.6	93.7	92.6	91.7	91.0	90.6	90.3	89.3	89.4	89.3
Real effective exchange rate relative to the rest of 37 industrialised countries	87.5	87.9	99.7	104.2	100.0	98.7	92.6	93.1	92.6	89.6	88.8	89.2	89.6	88.9	88.6
<b>Banking sector</b>															
Assets (% of GDP)	170.8	189.9	267.9	319.4	321.1	338.3	344.4	307.3	286.5	261.6	243.8	233.5	218.9	213.0	n.a.
Private domestic credit (y-o-y %)	11.8	14.7	18.9	-1.6	0.8	-3.2	-9.9	-10.2	-6.5	-4.2	-4.1	-2.0	-3.9	-1.9	n.a.
Non-performing loans (NPLs), total (%) (i)	3.3	1.1	1.5	5.1	5.8	7.8	10.4	13.6	12.5	10.1	9.1	7.8	5.8	5.7	n.a.
NPLs, productive activities (%)	n.a.	2.0	2.7	9.3	10.6	14.4	20.2	27.4	25.6	20.9	19.2	16.5	12.8	n.a.	n.a.
* of which, construction, and (%)	n.a.	1.0	1.7	8.5	12.1	18.2	25.8	34.3	32.6	30.0	29.1	24.1	13.7	n.a.	n.a.
* real estate activities (%)	n.a.	0.6	1.8	10.1	14.0	21.4	29.1	38.0	36.2	27.5	25.5	18.1	9.6	n.a.	n.a.
NPLs, residential mortgages (%)	n.a.	0.4	1.0	2.9	2.5	3.0	4.2	6.2	6.1	5.0	4.8	4.9	4.3	n.a.	n.a.
Tier 1 ratio (%)	n.a.	n.a.	n.a.	9.3	9.6	10.2	9.7	11.7	11.7	12.6	12.9	13.2	13.4	n.a.	n.a.
<b>Interest rates</b>															
10 year spread vis-à-vis the Bund (%)	1.6	0.2	0.1	0.8	1.5	2.8	4.3	3.0	1.5	1.2	1.3	1.2	1.0	1.1	n.a.
CDS 5 year (basis points)	n.a.	n.a.	14.6	92.0	204.0	319.6	431.9	235.4	90.5	84.1	82.1	67.4	62.6	65.4	n.a.

Updated on 11 Jun 2019

(e) 2019: forecast or latest available data

(f) Forecast

(g) General government balances include capital transfers related to support of banks

(h) ESA2010 and BPM6

(i) NPLs: ratios, in % of total loans

Source: Ameco, BdE, Bloomberg, Eurostat, Macrobond.



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