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# Post-Programme Surveillance Report

## Spain, Autumn 2019

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European Commission  
Directorate-General for Economic and Financial Affairs

# Post-Programme Surveillance Report

## Spain, Autumn 2019

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The cut-off date for the data included in this report is 7 November 2019
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<sup>(1)</sup> The executive summary of this report was adopted as Commission Communication C(2019) 8470 on 20 November 2019. The rest of the report is the Staff Working Document SWD(2019) 415 accompanying this Communication.

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## ABBREVIATIONS

BdE	Banco de España, Bank of Spain
BRRD	Bank Recovery and Resolution Directive
CCyB	Counter-Cyclical capital Buffer
CDS	Credit Default Swaps
CET 1	Common Equity Tier 1
CSRs	Country-Specific Recommendations
EC	European Commission
ECB	European Central Bank
ESM	European Stability Mechanism
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
SAREB	Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria S.A.
SMEs	Small and Medium-sized Enterprise

## EXECUTIVE SUMMARY

**This twelfth 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 twelfth post-programme surveillance visit to Spain on 8-9 October 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 has relatively good profitability, strong liquidity and adequate capitalisation, but faces risks.** As in other EU countries, banking sector profitability and hence capital generation will remain under pressure in the prolonged low-interest-rate environment and as Spain's economic activity is slowing down. Spanish banks managed to decrease further their non-performing loan (NPL) ratios to just above the EU average. However, real estate market activity has moderated in 2019 and this could slow down sales of non-performing real estate assets by banks. The banking sector's overall capital position has slightly improved but remained low in comparison to the rest of the EU. The asset management company, SAREB, continues to implement its new strategy of accelerating the pace at which it takes possession of the real state property collateral behind its non-performing loans to real estate companies. This is aimed at improving the overall recovery rates on its non-performing assets through real property sales. Implementing this strategy might entail high operational costs and could pose risks to the materialisation of the planned recoveries within SAREB's lifespan, i.e. by end 2027. Consequently, the implementation of this strategy requires close and regular monitoring, with, if needed, appropriate adjustments.

**Economic growth is set on a moderating though still expansionary path.** Revised national accounts show that GDP growth in recent quarters has been lower than previously estimated. Economic activity is expected to moderate further going forward to 2021, but remain above the EU average. Job creation, which started to lose traction in mid-2019, is also expected to continue weakening. Still, the unemployment rate is set to continue falling, to 13% in 2021. On 14 June 2019, Spain exited the excessive deficit procedure and became subject to the preventive arm of the Stability and Growth Pact as of 2019 <sup>(3)</sup>. The Country-specific Recommendations (CSRs) adopted by the Council of the European Union on 9 July 2019 <sup>(4)</sup>, call on Spain to pursue fiscal adjustment by delivering an adequate fiscal effort towards the medium term objective of a balanced budget in structural terms. The CSRs also recommend Spain to address weaknesses in the labour, product and services markets, improve social policy and educational outcomes and preserve the sustainability of pension system, while fostering innovation and resource and energy efficiency.

**On the basis of the analysis in the report, repayment risks for the ESM loan appear very low.** Overall, a stabilised financial sector and still relatively robust economic growth keep repayment risks low. The average cost of outstanding government debt in September 2019 was about 2 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 spring 2020.

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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>

<sup>(4)</sup> <https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-specific-recommendation-commission-recommendation-spain-en.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>(5)</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 consistently with 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>(6)</sup>. From July 2014 to October 2019, 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 twelfth post-programme review mission to Spain on 8-9 October 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>(7)</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 May 2019 <sup>(8)</sup>.

**3. The autumn 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>(9)</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>(10)</sup>. On 14 June 2019, Spain exited the excessive deficit procedure and thus became subject to the preventive arm of the Stability and Growth Pact as of 2019. The Country-specific Recommendations (CSRs) adopted by the Council of the European Union on 9 July 2019, call on Spain <sup>(11)</sup> to pursue fiscal adjustment in line with the requirements of the Stability and Growth Pact, in particular by delivering an adequate fiscal effort towards the medium term objective of a balanced budget in structural terms. The CSRs also recommend Spain to address weaknesses in the labour, product and services markets, improve social policy and educational outcomes and preserve the sustainability of pension system, while fostering innovation and resource and energy efficiency.

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<sup>(5)</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>(6)</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>(7)</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>(8)</sup> For more details see the previous PPS report: [https://ec.europa.eu/info/sites/info/files/economy-finance/ip106\\_en\\_1.pdf](https://ec.europa.eu/info/sites/info/files/economy-finance/ip106_en_1.pdf)

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<sup>(9)</sup> <https://ec.europa.eu/info/sites/info/files/2019-european-semester-country-report-spain-en.pdf>

<sup>(10)</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>(11)</sup> <https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-specific-recommendation-commission-recommendation-spain-en.pdf>

## 2. MACROECONOMIC DEVELOPMENTS

**4. In 2018, Spain continued growing above the euro area average.** Despite continued slowdown since the 2015 peak, real GDP grew by a robust 2.4% in 2018. Private consumption slowed down sharply, allowing for an increase in the savings rate, whereas investment, especially in equipment, surprised by its strength. By contrast, net exports negatively contributed to economic growth.

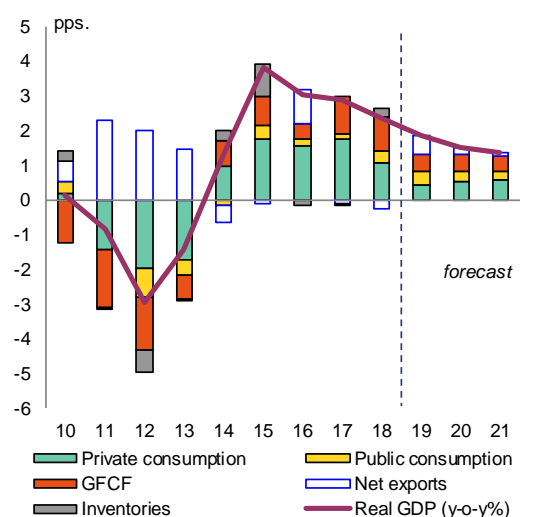
**5. Economic growth is set on a moderating though still expansionary path.** In the first half of 2019, real GDP grew by about 2.1 % y-o-y, less than expected in the European Commission 2019 summer forecast, mainly as a result of lower domestic demand. Data for the third quarter<sup>(12)</sup> point to a more moderate slowdown than in the first half of 2019. Growth is however expected to continue easing until 2021, amid high uncertainty arising from both external and domestic factors. Investment in equipment decelerated sharply in the first half of this year, reflecting weakness in the manufacturing sector, and is set to grow only moderately over the forecast horizon, while activity in the construction sector is expected to decelerate. Following very weak growth in recent quarters, consumption is set to slightly rebound, as employment continues to expand and wages grow above inflation, also pushed by the increase in the minimum wage in 2019. Still, consumption is expected to grow less than disposable income, resulting in a continued gradual recovery in the household savings rate.

**6. The contribution of the external sector to growth is expected to be positive over the projection horizon.** Exports are forecast to continue growing only moderately, amid trade tensions and weak global growth. Import growth has been unusually low in recent quarters, partly reflecting weak demand for durable and investment goods. This should result in a large positive contribution of net exports to growth in 2019. As the import intensity of final demand is expected to gradually recover, the contribution of net exports to growth is expected to diminish but remain positive in 2020 and 2021. After worsening in 2018, the terms of trade are set to stabilise over the forecast horizon. These factors should result in the current account surplus gradually increasing to

2.6% of GDP by 2021. By the second quarter of 2019, the net international investment position had improved by 16 pps of GDP from 2014 and net external debt had declined up to 79.6%.

**7. Risks to the outlook are mainly on the downside.** Risks are related to external developments such as further trade restrictive measures, a more protracted slowdown in world GDP growth than anticipated, geopolitical tensions which could push oil prices up and more adverse Brexit developments than assumed. On the upside, trade tensions could be resolved faster than assumed, giving rise to a stronger rebound of foreign trade.

Graph 2.1: Composition of GDP growth



GFCF: gross fixed capital formation

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

**8. Core inflation is expected to gradually increase.** The European Commission 2019 autumn forecast projects HICP inflation to decline from 1.7% in 2018 to 0.9% in 2019, due to base effects from energy prices, and to rebound thereafter, reaching 1.4% in 2021, as core inflation gradually increases.

**9. Unemployment is set to continue falling, despite a lower pace of job creation.** The pace of employment growth is expected to continue moderating over the forecast horizon, reflecting slower growth of final demand. National accounts

<sup>(12)</sup> Flash GDP estimate released after the cut-off date of the Commission forecast (24 October).

data for the third quarter <sup>(13)</sup> also point to a faster-than-anticipated slowdown in job creation. Still, the unemployment rate is set to continue falling, to 13% in 2021, the lowest rate since 2008. Wage growth is expected to peak in 2019, and moderate afterwards but still grow at a rate above inflation in 2020. Combined with moderate growth of labour productivity over the forecast horizon, this will lead to an acceleration in nominal unit labour cost growth in 2019 and a further, smaller increase in 2020 and 2021.

**10. The housing market keeps recovering though activity has moderated in 2019.** By 2018, the number of transactions on dwellings had increased by about 60% since they bottomed out in 2013. The increase mainly concerned secondary dwellings, while transactions on new dwellings remained very low, only slightly above the minimum recorded during the crisis. In both cases the number of transactions has slowed down in 2019, likely affected to some extent by changes in new mortgage market legislation enacted in the first months of the year. The supply of new housing has been increasing over the last three years (by about 9% y-o-y on average between 2015 and 2018), but the growth pace started to slowdown in mid-2018 and it grew by 4% in the second quarter of 2019. However, the steady growth of new building permits at a high rate over the latest quarters suggests housing supply still growing in the near future. Unsubsidised house prices increased by 5.3% year-on-year in the second quarter of 2019 <sup>(14)</sup>. Prices of new dwellings went up by 7.2% and those of used dwellings by 5.0%, signalling a deceleration in both cases relative to their previous accelerating path. House price developments vary greatly across regions, with larger increases in the major cities and the coastal areas. In big cities, the increased propensity to rent after the crisis and improved 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 over recent years, which might have started to moderate in 2019.

**11. The general government deficit reduction is expected to slow further.** After decreasing by 0.5 pps. to 2.5% of GDP in 2018, the general

government deficit is expected to continue declining over the forecast horizon, but at a slower pace. Despite the moderation in economic growth, revenues are expected to grow at a relatively rapid pace in 2019, helped by buoyant social contributions, and personal income taxes. This rise in revenues should more than offset significant increases in expenditure related to compensation of employees and social transfers, in particular pensions, leading the general government deficit to narrow to 2.3% of GDP for the full year. In the absence of a 2020 budget bill, the deficit is projected to decline further to 2.1% of GDP in 2020. This forecast includes the wage increase for public employees stipulated in the 2018-20 agreement with the unions and an annual pension revaluation in line with inflation. At the same time, it incorporates only some of the potential savings identified in the spending reviews published by AIReF which, if fully implemented, could help lowering the deficit from 2020 onwards. Assuming no change in policy, the deficit is expected to narrow to 2.0% of GDP in 2021.

**12. The public debt ratio is set to continue decreasing slowly but to remain high over the forecast horizon.** According to the Commission 2019 autumn forecast, gross general government debt will decrease from 97.6% in 2018 to 96.0% of GDP in 2021. The decline is expected to be driven by nominal GDP growth and falling interest expenditure, while the primary balance is likely to remain broadly unchanged around zero. The strong increase in the average life of debt outstanding observed during the 2015-18 period has levelled off somewhat so far in 2019. As of early September 2019, it amounted to around 7.6 years, compared to the low point of 6.2 years in 2013. The cost at issuance reached an all-time low in early September 2019 at 0.4% and remains significantly below the cost of debt outstanding, which stood at 2.4% at that time. In 2011, both stood at around 4.0%. The average cost of debt will continue falling as long as the cost of issuance remains below the cost of debt falling due. Over the last four years, Spanish residents have reduced their holdings of Spanish state debt instruments from just over half of their total amount to around three tenths. This has been fully offset by a corresponding increase in the holdings of the Bank of Spain, which now holds slightly over one fifth of debt instruments of the state, mainly in the context of the implementation of the ECB

<sup>(13)</sup> See footnote 12.

<sup>(14)</sup> Source: INE.

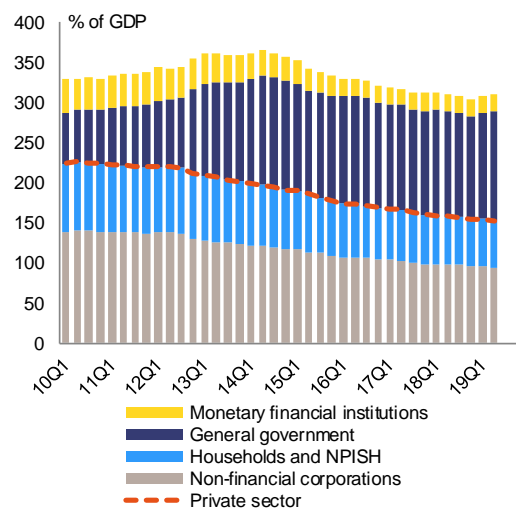
monetary policy decisions. The share of non-resident investors has been rather stable at slightly below half, showing only a slight tendency to increase in the course of 2019.

**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 153.2% of GDP in non-consolidated terms at the end of the second quarter of 2019 (58.6% of GDP held by households and 94.5% of GDP by non-financial corporations (NFCs)) (see Graph 2.2). This is 73 pps. lower than its peak in the second quarter of 2010. Consolidated private sector debt decreased by 5.0 pps to around 130% of GDP in 2019, in line with the MIP threshold for the first time since 2003. However, the stock of private debt has remained above prudential levels and fundamental-based benchmarks for both households and NFCs. In the first half of 2019, the stock of debt in nominal terms fell only slightly compared to the same period in 2018 for households, but increased for NFC. GDP growth was thus the main driver of private sector deleveraging in the first two quarters of 2019. Most of the debt reduction since 2010 has been made by non-financial corporations<sup>(15)</sup>, but progress in households' deleveraging was also significant over the period. Over recent years, the

<sup>(15)</sup> In consolidated terms, the NFC debt decreased from 119.9% of GDP in Q2-2010, to 73.4% in Q2-2019. Financial derivatives are not included in these figures.

decline in the volume of mortgages has been offset by significant growth in loans to finance durable consumer spending. The growth in consumer credit has supported private consumption, but its increase may make households, especially the over-indebted ones, more vulnerable to adverse shocks<sup>(16)</sup>. Since the start of 2019, the growth of this type of debt has slowed down.

Graph 2.2: Indebtedness by sector



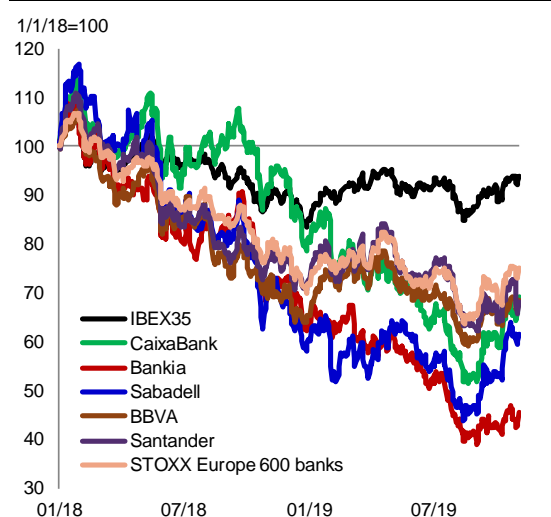
NPISH: Non-profit institutions serving households  
Source: BdE, own calculations.

<sup>(16)</sup> Financial Stability Report by Bank of Spain, Autumn 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 remained resilient in the first three quarters of 2019.** Financial markets and the financial sector in Spain have remained rather stable, despite uncertainties in the domestic and international environment. However, the share prices of Spanish banks continued decreasing and underperforming the national stock index (IBEX 35) and moved rather in synchrony with the European sectoral index STOXX Europe 600 Banks (see Graph 3.1).

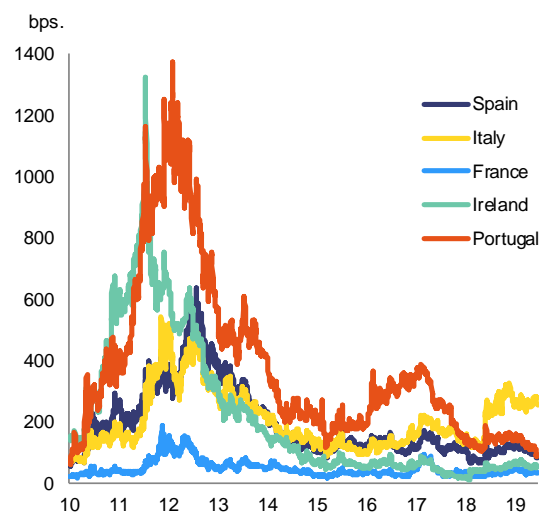
Graph 3.1: IBEX35, STOXX 600 Banks and selected Spanish banks stocks



Source: Madrid Stock Exchange via Macrobond, own calculations.

**15. Spanish government bond yields and spreads have declined over the first three quarters of 2019 (see Graph 3.2).** The spread between Spain's benchmark 10-year government bond and the 10-year German bund declined from around 120 bps in January 2019 to around 65 bps at the end of October 2019. Likewise, the 5-year Spanish CDS spread decreased from 65 basis points at end 2018 to 36 basis points at the end of October 2019, with a yield at 0.23%. In September 2019, S&P upgraded Spain's sovereign rating from A- to A.

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

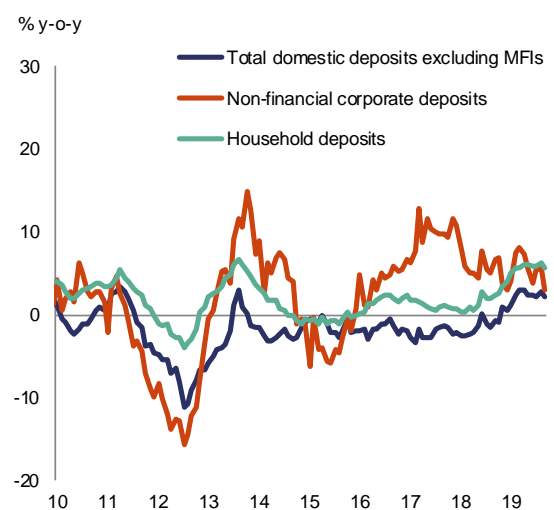


Source: IHS Markit, Macrobond, own calculations.

**16. Spanish banks maintained good liquidity and reduced further their Eurosystem borrowing.** Total domestic bank deposits excluding monetary financial institutions (MFIs) continued to increase, by 2.2% y-o-y in September 2019, although with variations across sectors: whilst bank deposits by private non-financial sector maintained a strong growth pace, with +5.7% for households and +3.1% for non-financial corporations y-o-y (see Graph 3.3), bank deposits of non-MFIs (e.g.: asset securitisation funds, central counterparties), insurance corporations and pension funds decreased by 10%. Bank deposits of MFIs decreased by 13%. As banks prepare for the upcoming MREL requirements<sup>(17)</sup>, securities other than shares issued by credit institutions grew fast, by 8.5% y-o-y in August 2019, reaching 8.4% of total assets. Finally, Spanish banks' total net borrowing from the Eurosystem declined fast over the summer, by 13.2% y-o-y, to EUR 145.9 billion, in September 2019.

<sup>(17)</sup> MREL: Minimum Requirement for own funds and Eligible Liabilities.

Graph 3.3: Bank deposits

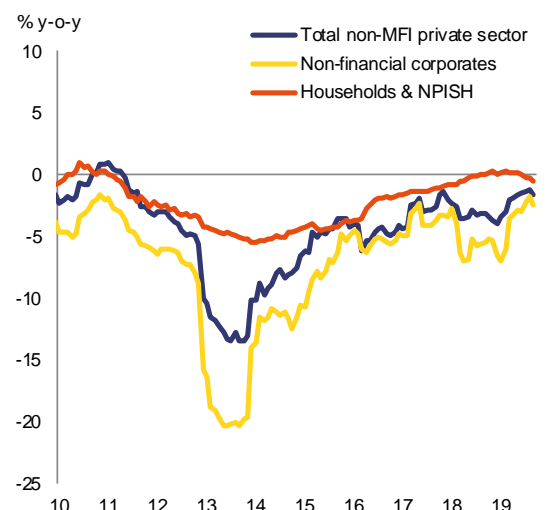


Source: BdE.

**17. Banks domestic assets continued decreasing.** Between September 2018 and September 2019, banks' domestic assets<sup>(18)</sup> decreased by 3.5%, to EUR 1.88 trillion, whereas banks' total assets increased by 1.5% to EUR 2.69 trillion in the same period. The stock of debt securities decreased, while the loan portfolio remained largely unchanged. The stock of domestic private credit decreased (by -1.16% y-o-y). This was mainly driven by the decline in credit to NFCs (-2.5% y-o-y) (see Graph 3.4), as a result of negative new lending to NFCs, led by the strong reduction of credit lines (-15% y-o-y), and other new lending to SMEs (-1.6% in the first nine months of 2019 y-o-y, proxied by loans under EUR 1 million). At the same time, new loans to large corporates (proxied by loans above EUR 1 million) grew by 2.3% in the first nine months of 2019 y-o-y. Finally, the stock of domestic credit to households remained flat over the first nine months of 2019. While the stock of mortgage loans continued to decline, by 1.4% y-o-y, the stock of consumer credit continued to increase (+8.3% y-o-y). Though the share of consumer credit in total credit remains low, this credit category has typically a higher potential for losses than other types.

<sup>(18)</sup> Source: BdE, <https://www.bde.es/webbde/es/estadis/infoest/a0802e.pdf>

Graph 3.4: Bank loans to the private sector



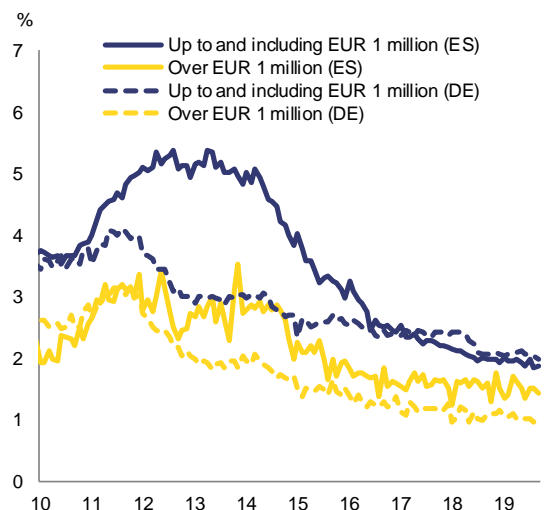
The decrease in the stock of loans in late 2012 and early 2013 was due to the transfer of assets to SAREB.

Source: BdE, own calculations.

**18. In the third quarter of 2019, credit standards for approving loans remained unchanged<sup>(19)</sup>.** For enterprise and housing loans, credit standards did not change. For consumer loans, they tightened, reflecting increased risk perceptions and aversion by banks. Net demand for all loan types (enterprises, housing and consumer) declined in Spain. Demand for loans by enterprises was mainly supported by the low level of interest rates, while consumers' more subdued assessment of economic and financial trends weighed on demand for consumer loans.

<sup>(19)</sup> According to the Eurosystem Bank Lending Survey of October 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)

Graph 3.5: Cost of borrowing for NFCs



Source: ECB.

**19. On aggregate, Spanish banks continued to reduce their non-performing loans during 2018 and the first half of 2019.** Against the background of continued positive economic developments over the past year, the total stock of NPLs as reported by BdE<sup>(20)</sup> in both the corporate and household segment decreased by EUR 14 billion (-17.3%) y-o-y down to EUR 65 billion by June 2019. The share of NPLs in total loans (NPL ratio) went down by one percentage point to 5.35% over the same period, in a context of still flat volumes of credit. By sector, the latest data show that in June 2019 especially construction and real estate NPLs fell strongly (and were almost halved y-o-y), down to 12.6% and 7.7%, respectively. The household NPL ratio also decreased, but at a lower pace, down to 4.7% in June 2019 compared to 5.17% a year earlier (see Graph 3.6). At consolidated level, data from the European Central Bank (ECB) show that the NPL ratio for Spanish banks decreased y-o-y from 4.1% to 3.4% in June 2019, and remains above the EU average of 2.9%. As regards provisioning levels, ECB data for Spain show a decrease in the coverage ratio (43.9% at the end of June 2019 vs. 44.7% a year earlier), which remains below the EU average of 46.2%.

**20. Over the first half of 2019, banks continued to reduce their forborne exposures.** Forborne loans continued to decrease over the past year, to stand at 5.4% of total credit to the resident private

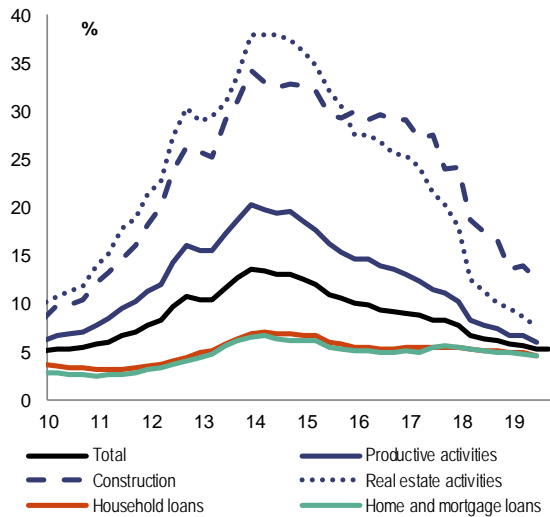
sector in June 2019. This is 20.2% lower than a year earlier. This decline was across the board in NFCs and households, but was overall smaller than a year earlier<sup>(21)</sup>. Nevertheless, according to European Banking Authority (EBA) data, the forbearance ratio for Spanish banks, after experiencing a significant reduction from 10.2% in September 2014 to 3.4% in June 2019, remained almost double the ratio of the EU average (1.9%). This suggests that there is still room for further reduction. Furthermore, after falling by more than EUR 20 billion in 2018, the volume of foreclosed assets decreased by another EUR 3.3 billion in the first half of 2019. This brings the rate of decline of foreclosed assets from the high in 2011 to 50%.

**21. 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. Between end-2012 and mid-2019, the number of credit institutions and CFIs declined by one third (to 237 in total) and stagnated in 2019. During the same period, the branch network shrank by more than 30% (to 25,759 in total, including rep offices), whilst the number of employees fell by 20% (to 187,182) between end-2012 and end-2018. According to ECB data, Spanish banks have higher cost efficiency than the EU average, with an average cost-to-income ratio of 54.3% vs. 64.7% at EU level (June 2019).

<sup>(21)</sup> Financial Stability Report, Autumn 2019, BdE [https://www.bde.es/f/webbde/INF/MenuHorizontal/Publicaciones/Boletines%20y%20revistas/InformedeEstabilidadFinanciera/IEF\\_Autumn2019.pdf](https://www.bde.es/f/webbde/INF/MenuHorizontal/Publicaciones/Boletines%20y%20revistas/InformedeEstabilidadFinanciera/IEF_Autumn2019.pdf)

<sup>(20)</sup> The BdE reports the stock of doubtful debtors, to which this report refer as NPLs.

Graph 3.6: Ratio of non-performing loans

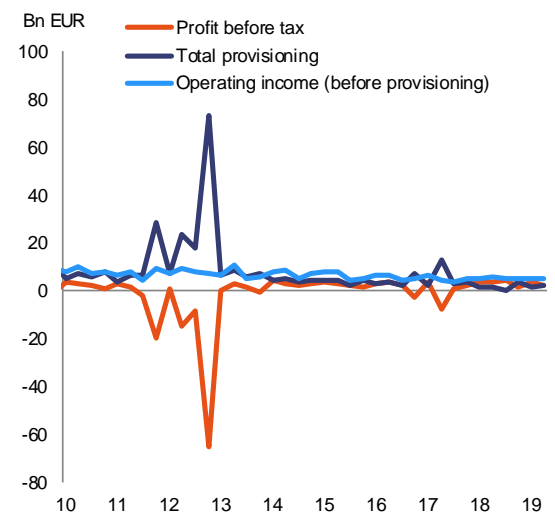


(1) The scope of non-performing loans covered in these figures overlap with BdE's definition of doubtful loans.  
(2) Home loans comprise also loans that are not mortgages  
Source: BdE, own calculations.

**22. The profitability of the Spanish banking sector remained under pressure in the first half of 2019, as in other European countries.** Deposit taking institutions registered a net profit of EUR 5.7 billion in the first half of 2019. The consolidated profit attributed to the parent entity of the Spanish banking system were 11.5% lower than a year earlier <sup>(22)</sup>, which translated into a decline in the return on assets (ROA) by 8 bp, to 0.49%. The return on equity (ROE) also fell slightly (by +1 pps y-o-y, down to 6.6%) for Spanish banks.

<sup>(22)</sup> Financial Stability Report, Autumn 2019, BdE; [https://www.bde.es/f/webbde/INF/MenuHorizontal/Publicaciones/Boletines%20y%20revistas/InformedeEstabilidadFinanciera/IEF\\_Autumn2019.pdf](https://www.bde.es/f/webbde/INF/MenuHorizontal/Publicaciones/Boletines%20y%20revistas/InformedeEstabilidadFinanciera/IEF_Autumn2019.pdf)

Graph 3.7: Bank sector profitability for domestic operations



Source: BdE, own calculations.

**23. Spanish banks' capital position remained stable.** The common equity tier 1 (CET 1) ratio of Spanish banks according to ECB data, increased from 11.8% at H1-2018 to 12.2% at H1-2019 and remained below the EU average (15.0%) but higher than required levels for all credit institutions. As regards the fully loaded CET1 ratio, based on EBA data <sup>(23)</sup>, the gap with the EU average was 2.8 percentage points (11.6% vs 14.4%). The total capital ratio also increased by 30 bps to 15.3% by end June 2019. Finally, the capital position of Spanish banks shows a better picture on a non-risk weighted base, as their leverage ratio <sup>(24)</sup> ranked similarly to the EU average (5.6% vs. 5.4% as of end June 2019 according to EBA data).

<sup>(23)</sup> EBA data only takes into consideration the most significant banks in each jurisdiction.

<sup>(24)</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

**24. SAREB's<sup>(25)</sup> asset recovery is progressing but at a slower pace.** After 43% of SAREB's expected lifetime, 34% of assets have been sold and 30% of senior debt has been repaid. From its inception in 2013 until mid-2019, SAREB managed to reduce its loan portfolio from EUR 39.4 billion to EUR 20.8 billion, of which 96% is NPL. The stock of the real estate portfolio slightly rose from EUR 11.3 billion to EUR 11.7 billion. This was due to the fact that there was a similar amount of sales of real estate properties as there were loans converted into new foreclosed properties. The senior debt of SAREB, which enjoys state guarantee and is held by banks that had received state aid, was reduced from EUR 50.8 billion to EUR 35.8 billion by 30 June 2019. SAREB has time until 2027 to liquidate the remaining portfolio, but sales have recently slowed down, partly due to the moderating real estate market activity but also the new strategy of SAREB.

**25. SAREB's new strategy aims to deliver higher recoveries but might entail higher costs, more risks and may need more time.** As NPL sales last year became slower and more expensive (larger discounts), SAREB's Board decided to move away from NPL sales and rather recover real estate collaterals with in-house capacity. On the one hand, this strategy might entail higher costs, such as one-off investment to build in-house capacity as well as operational costs for managing, maintaining and improving foreclosed real estates. On the other hand, it will allow SAREB to directly control and monitor its assets and decrease servicing fees. However, the remaining real estate seem to be of lower quality and less liquid than those already sold. They are scattered geographically, in many cases in non-prime locations. A considerable part of them is on undeveloped land, which needs fresh investment

<sup>(25)</sup> SAREB (Sociedad de gestión de Activos procedentes de la Reestructuración Bancaria) is an asset management company that was created to divest the assets transferred from the old savings banks and help the economy recover. 54% of its share capital is owned by private shareholders, but the main shareholder (46%) is the public Fund for Orderly Bank Restructuring (FROB).

and administrative work. The foreclosure procedures also take time (in the corporate insolvency cases up to 6 years). Furthermore, whereas the strategy was initially supported by the recovering real estate market in 2018, the upswing moderated in the first half of 2019, and price increases have slowed down. Overall, this poses risks to the materialisation of the planned recoveries within SAREB's lifespan, i.e. by end 2027. Consequently, the implementation of this strategy requires close and regular monitoring, with, if needed, appropriate adjustments.

**26. SAREB managed to sell 75% of its stake in Témpace Properties as part of its divestment strategy.** This vehicle was created at the end of 2017 to manage SAREB's residential rental portfolio. It is listed on the alternative stock exchange and SAREB used to own 98.4% of the entity. By October 2019 SAREB had sold 75% of its stake as part of its more general divestment strategy.

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

**27. Macro-financial stabilisation has continued, yet emerging risks need to be closely monitored.** The Spanish economy continued to grow, yields have decreased and Spain's sovereign rating has been raised. The financial sector reform and stabilisation policies have been maintained. However, economic growth is weakening, real estate market activity has moderated, and banks' profitability remains affected by the very low interest rate environment. The banking sector's legacy assets (NPL ratio) are still higher than the EU average (3.4% H1 2019 versus 2.9% by ECB). Furthermore the loss-absorbency capacity of credit institutions in terms of profit is more limited due to the currently narrow margins. Although the sector's high-quality capital ratio is comfortably higher than required levels for all credit institutions, it is the lowest in the euro area (CET1: 11.9% versus 14.6 at H1 2019 by EBA). Credit standards and the performance of post-crisis production of credit needs to be closely monitored, especially as regards riskier portfolios.

**28. There are legal risks of some relevance for certain credit institutions.** The economic

consequences of litigation had been sizeable for many credit institutions in the aftermath of the financial crisis, mainly due to compensation that had to be paid to consumers for the use of unfair terms in consumer contracts. Although the economic consequences of litigation concerning IPOs and preferred shares have already been paid or provisioned, other risks especially regarding the applied interest rates on some mortgages (i.e. IRPH) could emerge depending on the final ruling by the European Court of Justice (ECJ).

**29. The BdE continued keeping the countercyclical capital buffer (CCyB) at 0%.** On 30 September BdE decided to maintain the countercyclical capital macro-prudential buffer unchanged at 0% for the fourth quarter of 2019, in light of the evolution and subsequent analysis of credit indicators. The latest available data of March 2019 shows that the credit-to-GDP gap was negative (-7.8 pps.) and BdE expects it to be positive only in 2021.

**30. The MREL targets set based on the bank recovery and resolution directive (BRRD) may pose some challenge for some smaller Spanish banks.** Resolution plans have been drafted or approved for all Spanish banks, including significant, less significant and small institutions. MREL requirements for significant institutions (SIs) with resolution colleges will be updated in Q4 2019, while SIs without resolution colleges already received them earlier in 2019. Priority institutions and less significant institutions (LSIs) will receive their MREL requirements in 2020. According to BdE, LSIs may face some challenges when raising the required funds.

**31. FROB remained cautious with its Bankia privatisation approach.** FROB management's strategy continues to focus on trying to balance between the government's objective of disposing of its controlling stake in Bankia and that of maximising the recovery of public money.

## ANNEX A

### Main macroeconomic and financial indicators

Table A.1: Main macroeconomic and financial indicators

	2000 -2007	2008 -2013	2014	2015	2016	2017	2018	2019 (f)	2020 (f)	2021 (f)
<b>Core indicators</b>										
GDP growth rate	3.7	-1.3	1.4	3.8	3.0	2.9	2.4	1.9	1.5	1.4
of which domestic demand incl. stocks	4.5	-3.1	1.9	3.9	2.0	3.0	2.6	1.3	1.3	1.3
Private consumption (annual % change)	3.7	-2.1	1.7	2.9	2.7	3.0	1.8	0.8	1.0	1.0
Public consumption (annual % change)	5.0	0.9	-0.7	2.0	1.0	1.0	1.9	2.0	1.5	1.4
HICP (annual % change)	3.2	2.2	-0.2	-0.6	-0.3	2.0	1.7	0.9	1.1	1.4
Unemployment rate (% of labour force)	10.3	20.2	24.5	22.1	19.6	17.2	15.3	13.9	13.3	12.8
Gross fixed capital formation (% of GDP)	27.7	21.4	17.8	18.0	18.0	18.7	19.4	19.8	20.1	20.3
Gross national saving (% of GDP)	22.3	18.8	19.6	21.0	21.9	22.1	22.3	23.1	23.5	23.7
<b>General Government (% of GDP)</b>										
Balance (g)	0.4	-8.8	-5.9	-5.2	-4.3	-3.0	-2.5	-2.3	-2.2	-2.1
Gross debt	46.7	67.6	100.7	99.3	99.2	98.6	97.6	96.7	96.6	96.0
Interest expenditure	2.2	2.4	3.4	3.0	2.8	2.5	2.4	2.3	2.1	2.0
<b>Households</b>										
Households saving rate	8.9	8.9	6.3	7.2	7.1	5.5	5.9	7.8	8.6	8.9
<b>Rest of the world (% of GDP)</b>										
Trade balance	-3.7	-0.1	3.1	3.0	4.0	3.6	2.7	3.2	3.3	3.3
Trade balance, goods	-6.8	-4.1	-2.1	-1.9	-1.3	-1.9	-2.4	-1.9	-1.7	-1.7
Trade balance, services	3.1	4.0	5.2	5.0	5.3	5.5	5.2	5.0	5.0	5.0
Current account balance	-5.9	-2.9	1.7	2.0	3.2	2.7	1.9	2.4	2.5	2.6
Net financial assets	-55.3	-90.4	-95.1	-88.2	-84.7	-84.8	-79.8			
Net international investment position (h)	-56.5	-91.6	-95.9	-88.9	-85.5	-85.5	-80.4			
<b>Competitiveness (index, 2010=100)</b>										
Real effective exchange rate relative to the rest of the euro area	94.8	97.9	91.1	90.8	89.3	89.2	88.5	89.3	89.5	89.6
Real effective exchange rate relative to the rest of the European Union	92.8	97.7	90.7	89.4	88.9	89.0	88.4	89.0	89.0	88.8
Real effective exchange rate relative to the rest of 37 industrialised countries	91.9	98.3	91.7	88.1	87.2	88.0	88.6	88.2	87.7	n.a.
<b>Banking sector</b>										
Assets (% of GDP)	214.9	325.0	288.0	262.5	244.9	234.4	220.0			
Private domestic credit (y-o-y %)	17.8	-3.0	-6.5	-4.2	-4.1	-2.0	-3.9			
Non-performing loans (NPLs), total (%) (i)	1.0	7.7	12.5	10.1	9.1	7.8	5.8			
NPLs, productive activities (%)	1.8	14.7	25.6	20.9	19.2	16.5	12.8			
" of which, construction, and (%)	0.9	17.3	32.6	30.0	29.1	24.1	13.7			
" real estate activities (%)	0.5	19.8	36.2	27.5	25.5	18.1	9.6			
NPLs, residential mortgages (%)	0.5	3.5	6.1	5.0	4.8	4.9	4.3			
Tier 1 ratio (%)	n.a.	9.8	11.7	12.6	12.9	13.2	13.5			
<b>Interest rates</b>										
10 year spread vis-à-vis the Bund (%)	0.1	2.1	1.5	1.2	1.3	1.2	0.9			
CDS 5 year (basis points)	n.a.	221.5	90.5	84.1	82.1	67.4	62.6			

Updated on 07 Nov 2019

(f) Commission 2019 autumn forecasts

(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, Boursorama, Eurostat, Macrobond.



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