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THE BANCO DE ESPAÑA HAS SET IN MOTION THE PROCESSES TO REVISE THE FRAMEWORK FOR SETTING THE COUNTERCYCLICAL CAPITAL BUFFER (CCyB) AND TO ESTABLISH THE CCyB RATE FROM 2024 Q4

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THE CCyB IS A MACROPRUDENTIAL TOOL DESIGNED TO MITIGATE THE TIME/CYCLICAL DIMENSION OF SYSTEMIC RISKS

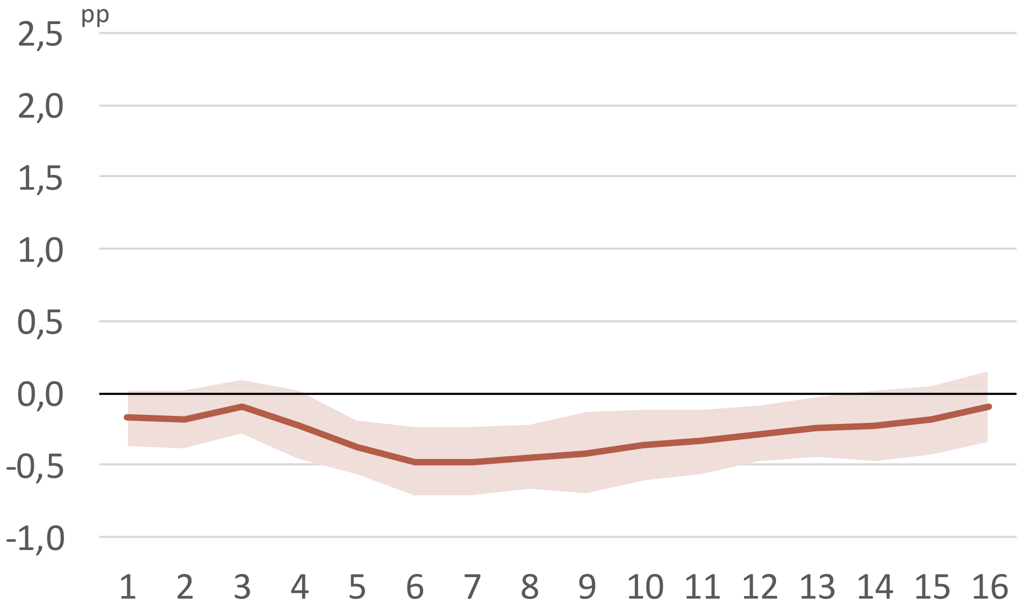
- **The CCyB has two distinctive characteristics: it may be released and it is governed by a guided discretion principle**
  - The CCyB is activated in the event of build-up of cyclical systemic risk, strengthening the solvency of the banking sector, and is deactivated when such risks materialise, releasing funds to absorb the losses incurred
  - The authorities must notify their courses of action with the buffer, although they have a degree of discretion to adapt to unforeseen circumstances

- **In consequence, the three essential elements of the functioning of the CCyB are:**
  - Determination of the level of cyclical systemic risk (prior to this revision, based on the credit-to-GDP gap and other complementary indicators, notably including the output gap)
  - Setting of the CCyB rate for each level of cyclical systemic risk
  - Decision as to the optimal time for activation and deactivation of the buffer
    - *So as to minimise the cost of activation (prior to this revision, in the event of high cyclical systemic risk) and maximise the benefits of deactivation*
- <u>**The European Systemic Risk Board (ESRB) recommendation envisages periodic revisions of the operational framework of the CCyB in the light of experience of use (over almost a decade)**</u>

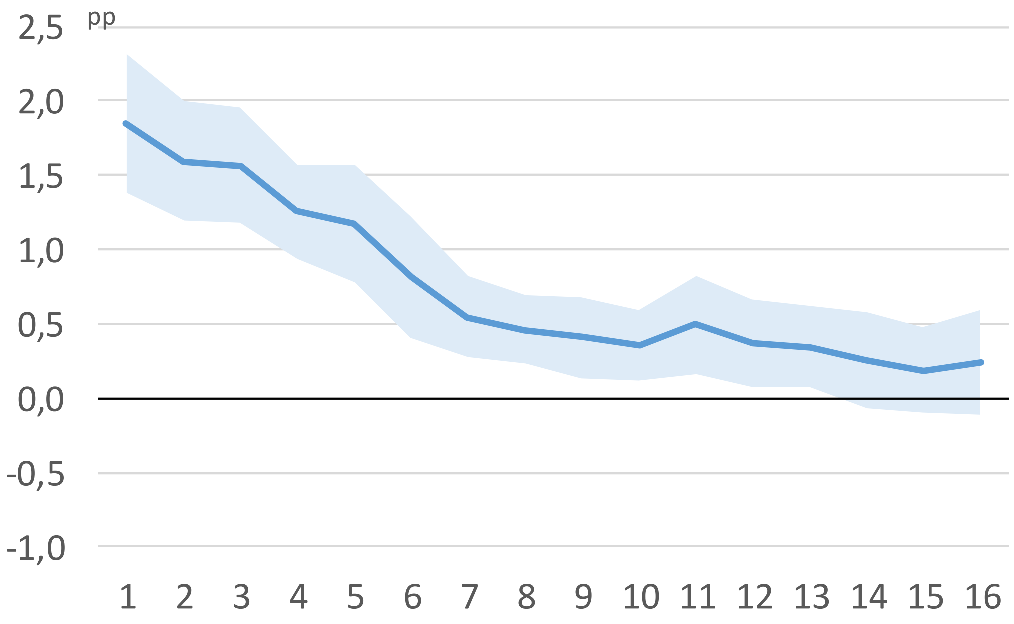
THE EXPERIENCE GAINED REVEALS (I) THE NEED FOR AN INTEGRATED FRAMEWORK TO DETERMINE THE LEVEL OF THESE RISKS AND (II) THE ADVANTAGES OF EARLY ACTIVATION OF THE BUFFER

- **The benchmark established in the regulations – the credit-to-GDP gap – has some shortcomings**
  - Accordingly, in recent years, we have added other variables and made methodological changes
- **The cost-benefit ratio of the CCyB remains positive when the cyclical systemic risk level is neither very high nor very low (standard risk level)**

Build-up of 1 pp of the CCyB in s standard risk scenario. Impact on GDP growth in the following quarters



Release of 1 pp of the CCyB in a macro-financial crisis scenario. Impact on GDP growth in the following quarters

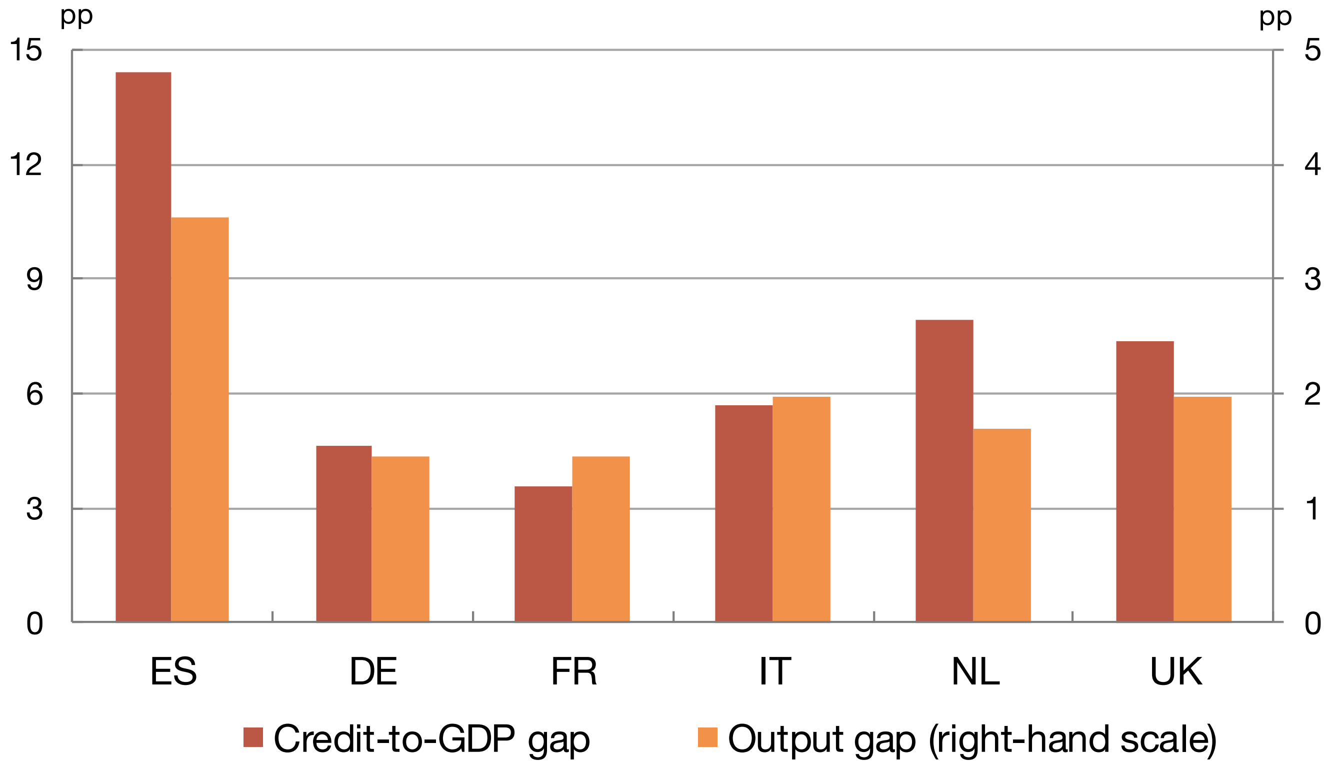


- <u>**The CCyB can help reduce the volatility of the macro-financial cycle and the economic cycle**</u>

IN SPAIN, THE VOLATILITY OF BOTH THE CREDIT-TO-GDP RATIO AND THE OUTPUT GAP IS HIGHER THAN IN THE OTHER LARGE EUROPEAN ECONOMIES

- **Moreover, these cycles tend to move in tandem in Spain, Italy and the United Kingdom, as suggested by the positive correlation between the two gaps in these countries**

Volatility of credit-to-GDP and output gaps in Spain and other European countries

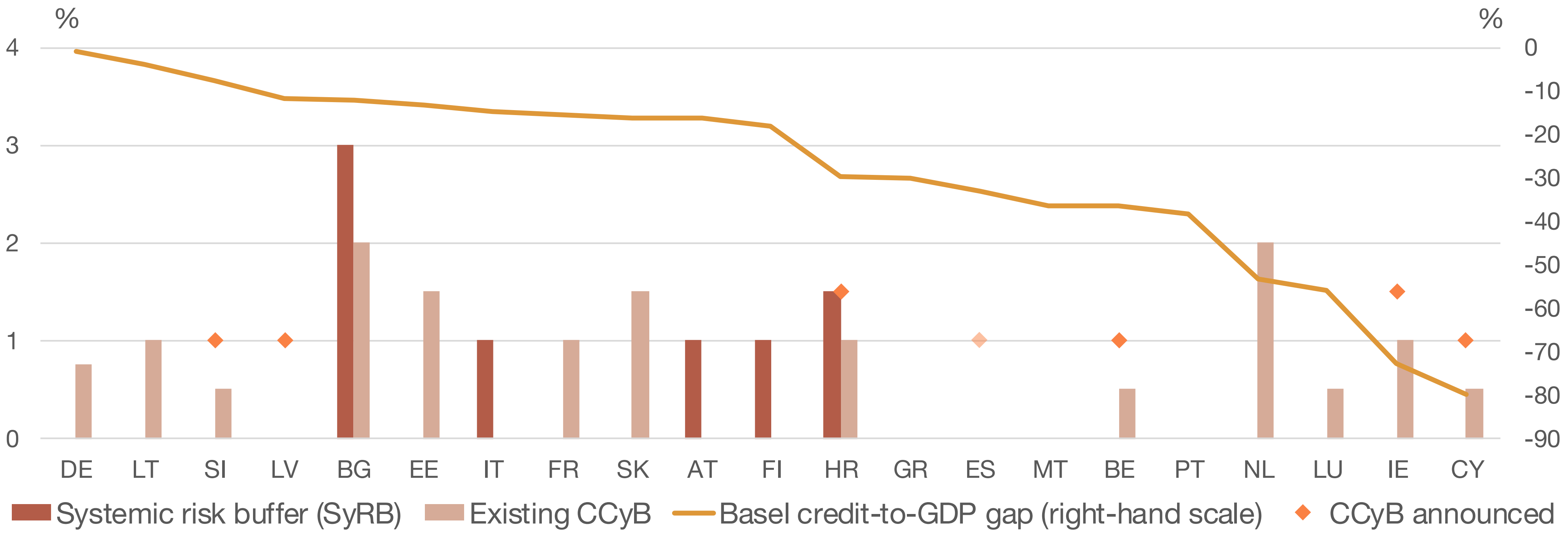


- **<u>The CCyB may be particularly useful in Spain to complement monetary and fiscal policy with regard to their macroeconomic stability objective</u>**

VARIOUS ORGANISATIONS SUPPORT A MORE PROACTIVE USE OF THE CCyB, AND IMF STAFF HAVE MADE A SPECIFIC RECOMMENDATION FOR SPAIN IN THIS RESPECT (2024 ARTICLE IV MISSION)

- **A growing number of European macroprudential authorities have begun to make more proactive use of the CCyB in a standard risk environment**

Macroprudential capital buffers in Europe



- **<u>If the CCyB is not activated, Spain has no national macroprudential space and, therefore, no buffer to release to mitigate the impact of a potential shock</u>**

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THE CYCLICAL SYSTEMIC RISK MONITORING FRAMEWORK IS DESIGNED TO BE COMPREHENSIVE, INCLUDING DIFFERENT EVALUATION ELEMENTS

- **The procedure consists of two stages: 1) analysis of indicators; and 2) complementary analysis**
  - In the first stage, 16 indicators, whose position in the cycle depends on their historical distribution, are considered, while the second stage uses other quantitative and qualitative contextual information

		Latest data observed	Previous observation	1-year projection
Macroeconomic indicators	**Output gap**	0.20	-0.02	0.27
	Annual change in real GDP	2.02	1.93	1.74
	Unemployment rate	11.76	11.84	
Macro-financial indicators	**Adjusted credit-to-GDP gap**	-9.13	-8.82	-3.62
	Credit intensity	-4.41	-5.96	2.02
	Debt service ratio	18.16	18.26	16.59
	Rate of change, credit to households and firms	-3.32	-4.34	1.65
	Econometric models of credit imbalance	[-9.7 -2.8]	[-8.7 -2.3]	[-10.9 -4.1]
	Rate of change, house prices	4.14	4.36	2.68
	Indicators of price imbalances, real estate sector	3.77	3.53	0.19
Market indicators	**Systemic risk indicator (SRI)**	0.04	0.11	
Banking system indicators	ROE	12.44	12.59	
	NPL ratio	3.54	3.56	
	Net interest income to total assets	2.33	2.32	
	Price-to-book value	0.71	0.69	
	ROE Spain	11.30	11.39	
Memorandum items	CET1 ratio	13.21	13.07	
	LCR	186.28	179.19	
	Cost-to-income ratio	0.43	0.44	
	Cost of bank liabilities	2.07	1.83	

COLOUR CODES

One-tail risk indicators

Standard level	High risk
Value < 75th percentile	Value > 75th percentile

Two-tail risk indicators

Materialisation of risks	Standard level	High risk
Value < 25th percentile	25th percentile < Value < 75th percentile	Value > 75th percentile

BANKING SYSTEM COLOUR CODES

One-tail risk indicators

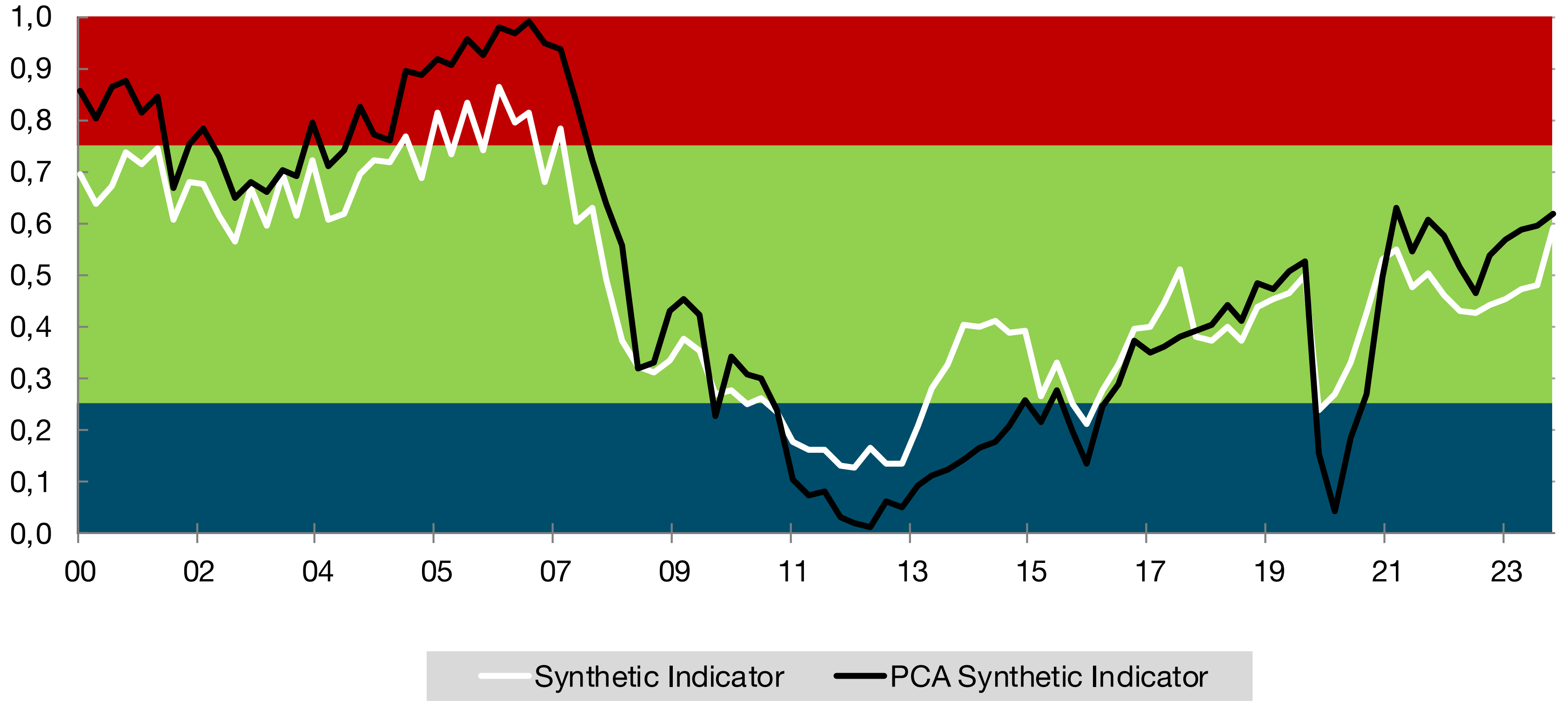
Standard capacity to generate capital	Low capacity to generate capital
Value < 75th percentile	Value > 75th percentile

Two-tail risk indicators

Low capacity to generate capital	Standard capacity to generate capital	High capacity to generate capital
Value < 25th percentile	25th percentile < Value < 75th percentile	Value > 75th percentile

THESE INDICATORS ARE AGGREGATED IN FOUR KEY DIMENSIONS AND AN AGGREGATE SYNTHETIC INDICATOR IS THEN CONSTRUCTED

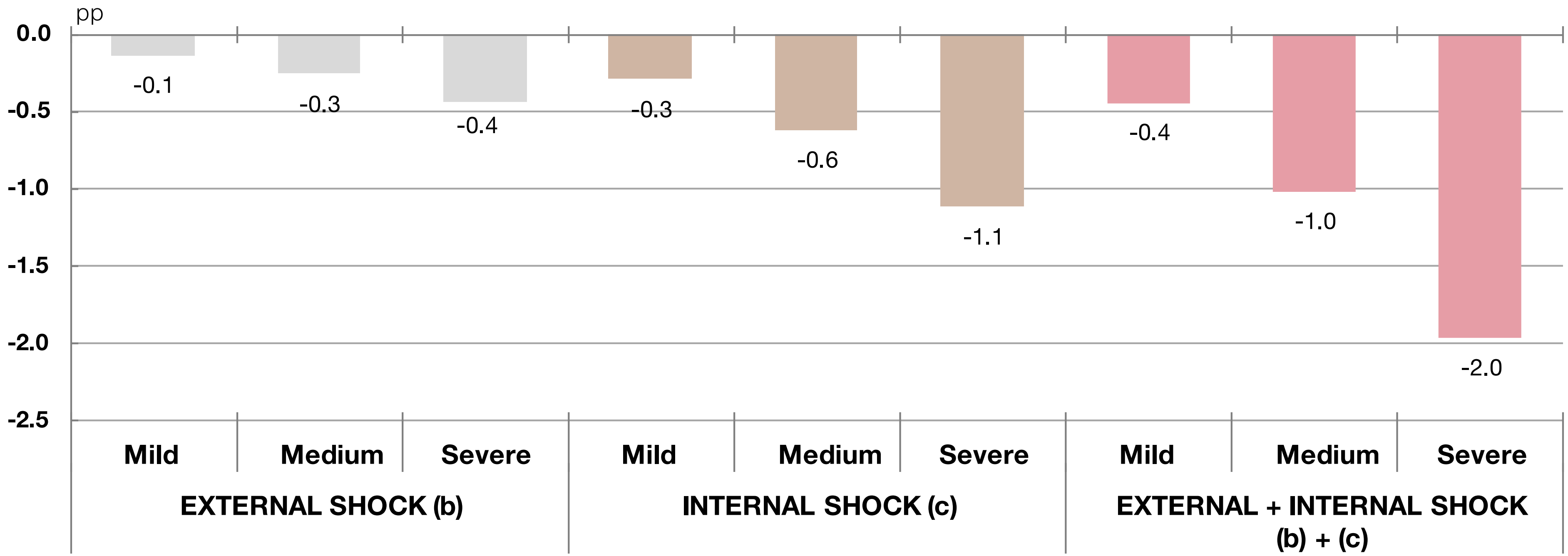
- **When the aggregate synthetic indicator and at least two of the category indicators are in standard risk territory, and in addition the banking indicator is not in risk materialisation territory, this may be considered an appropriate time to build up the CCyB**



CALIBRATING THE CCyB FOR STANDARD RISK ENVIRONMENTS HAS BEEN BASED ON CAPITAL CHARGES IN VARIOUS STRESS TESTS

- **External and internal shocks with a mild, medium and severe impact on GDP have been considered**
- **The CCyB rate of 1% for standard risk is calibrated in line with a combination of mild shocks**
  - A national CCyB rate of 1% entails a buffer rate of approximately 0.5 pp at consolidated level

AGGREGATED IMPACT OF SIMULATED SCENARIOS ON CET1 RATIO (a)



Source: Banco de España.
a The impacts are defined as the differences in the foreseeable CET1 ratio at the end of each scenario compared with the baseline scenario (projection horizon 2023-2025).
b. External shock resulting from a fall in global markets and an increase in international oil and natural gas prices.
c. Internal shock, combining (1) financial elements: interest rate rises (in short-term reference rates, long-term government debt and bank rates), and declines in credit, stock prices and house prices; and (2) real elements: negative consumption, housing investment and capital investment shocks.

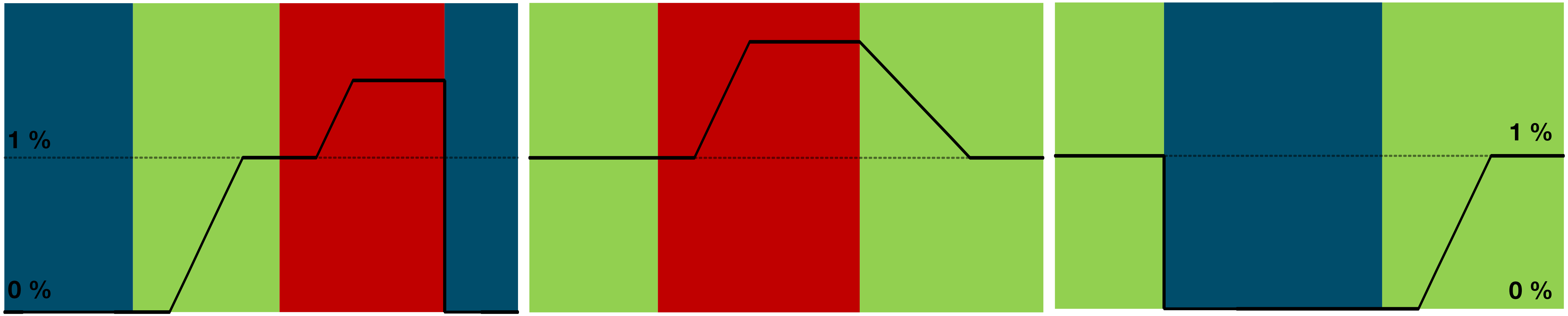
THE NEW FRAMEWORK WILL OPERATE SIMILARLY TO THE PREVIOUS ONE, BUT WITH THE DIFFERENCE OF EARLIER ACTIVATION OF THE CCyB

- **Under the new framework, the CCyB rate will be positive when cyclical systemic risk is at an intermediate or standard level, neither very high nor very low**
  - A higher risk level would push the CCyB rate higher
  - Materialisation of risks would lead to, generally full, release of the buffer
  - Mitigation of high risks would lead to gradual release, down to the buffer rate for a standard cyclical systemic risk environment

% CCyB Scenario 1: Complete cycle

% CCyB Scenario 2: Mitigated vulnerabilities

% CCyB Scenario 3: Exogenous shock



Phase of standard cyclical systemic risk

Phase of elevated cyclical systemic risk

Phase of materialisation of cyclical systemic risk

Source: Banco de España.

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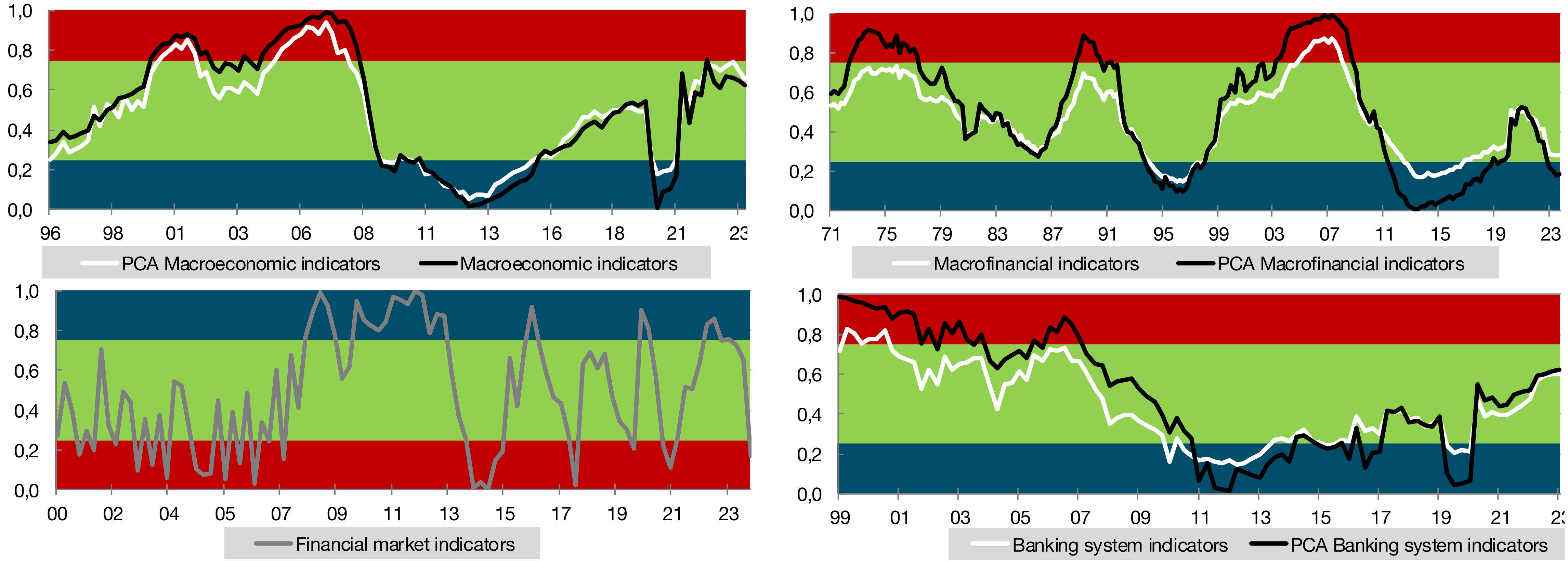
THE FIRST STAGE OF THE CYCLICAL SYSTEMIC RISK MONITORING FRAMEWORK SUGGESTS THAT THIS RISK REMAINS AT A STANDARD LEVEL

- **Among the macroeconomic indicators analysed, the output gap was particularly noteworthy – it stands at 0.2 pp and is projected to widen further**
- **Macro-financial credit indicators are the lowest, although projections point to an increase; real estate sector indicators are at a standard level**
- **Banking sector indicators point to a significant capital generation capacity**

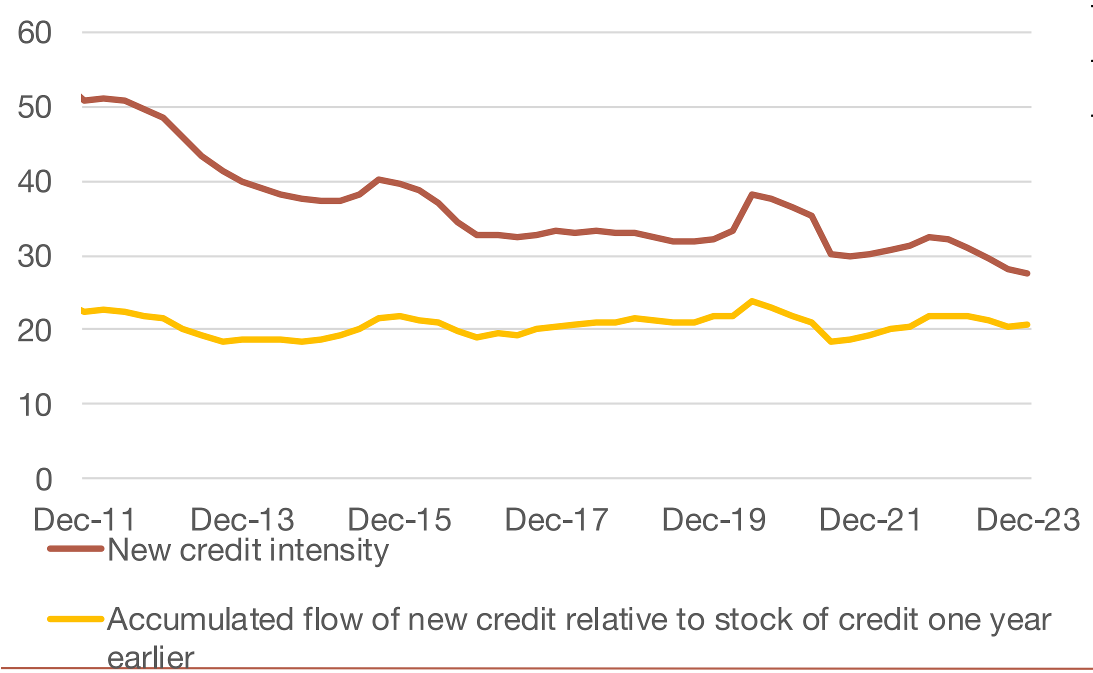
Synthetic cyclical systemic risk indicators by category



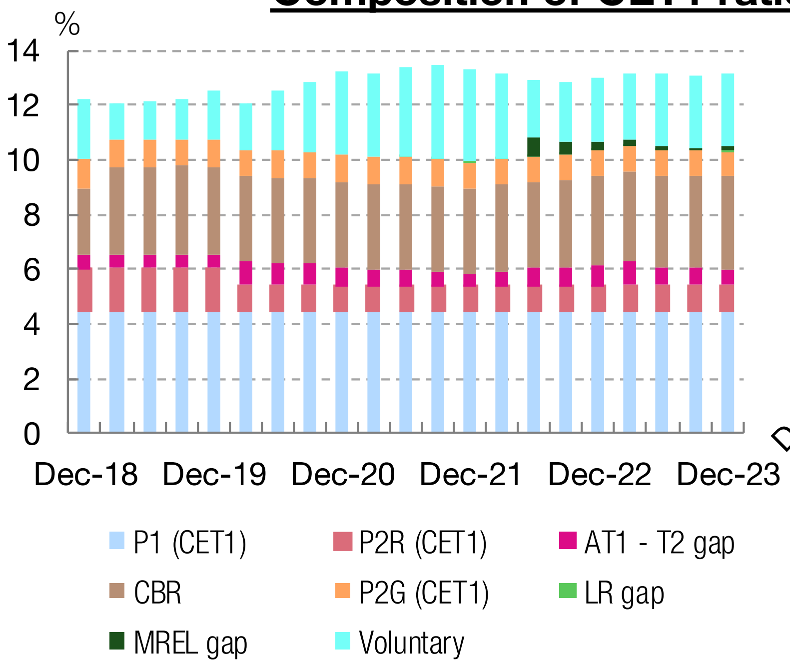
THE SECOND STAGE OF THE CYCLICAL SYSTEMIC RISK MONITORING FRAMEWORK CONFIRMS THAT THE TIME IS RIGHT TO ACTIVATE THE CCyB

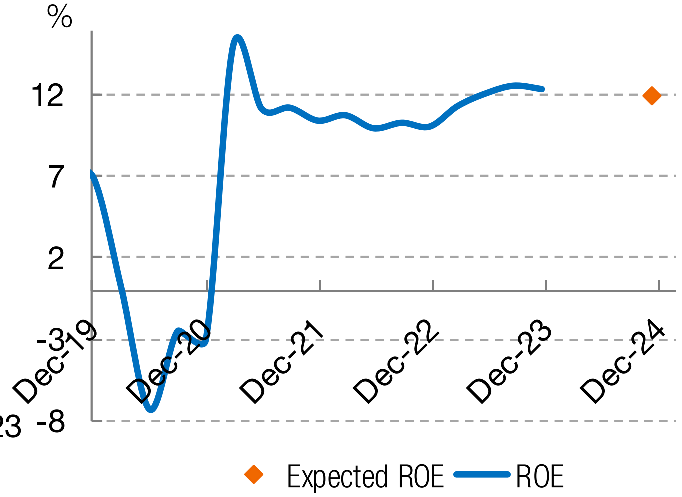
- **New credit intensity to GDP and the accumulated flow of new credit in the year relative to the stock of credit in the previous year remain relatively stable**
- **Banks have sufficient voluntary buffers and profitability is expected to fall somewhat, albeit remaining high**
- **Other objects of analysis (the classification of risks to financial stability and the current account balance, among others) also support activation of the CCyB**

New credit indicators



Composition of CET1 ratio and profitability





SINCE IT IS ESTIMATED THAT WE ARE CURRENTLY SEEING A STANDARD LEVEL OF CYCLICAL SYSTEMIC RISK, IT IS PROPOSED THAT THE CCyB BE ACTIVATED AT A RATE OF 1.0% IN TWO STAGES

- **A CCyB rate of 1.0% results in 0.4 pp to 0.5 pp of CET1 as a percentage of total RWAs**
  - Each bank's CCyB rate is calculated as a weighted average of the CCyB rates in all the jurisdictions in which it operates, weighted by the relative RWAs in each one

- **The CCyB will be gradually activated to give banks some room to adjust, thereby minimising the potential associated costs**
  - The process of public disclosure begins now, to set the buffer rate at 0.5% from 2024 Q4 …
    - *… to be applicable in 2025 Q4*
  - The process would be repeated in a year's time, to raise it by 0.5 pp to 1.0% from 2025 Q4 …
    - *… to be applicable in 2026 Q4*

- **The Banco de España may change or even reverse these planned actions if the circumstances or the data justify such a decision**

- **In the event of deactivation, the Banco de España will announce its expectations for a future reactivation, which will, in any case, take place gradually once cyclical systemic risks have returned to a standard level and be required after one year, in line with the regulations**

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THANK YOU