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The EU-wide stress tests confirm the soundness of the Spanish banking sector

The Banco de España has reinforced the transparency of the exercise by including all savings banks and listed banks, and by offering additional, detailed information on the situation of the sector

The results of the stress tests of the Spanish banking sector, published today as part of the common exercise coordinated by the Committee of European Banking Supervisors (CEBS) for all European banks, confirm its soundness. They also constitute an exercise of maximum transparency, since they cover all savings banks and listed Spanish banks (the commitment made at the European level was that the participating institutions in each country should represent at least 50% of the banking sector). The exercise further provides additional, detailed information on different portfolios, in particular that pertaining to credit for real estate activities, and on the public support committed before the stress tests were conducted.

The Banco de España had announced in June its intention to publish the results of the stress tests on Spanish banks. But it immediately signed up to the joint EU-wide exercise coordinated by CEBS, designed as it was to ensure greater transparency and comparability.

The results show that in the adverse macroeconomic scenario, with a cumulative decline of 2.6% in GDP in 2010-11 (a hypothesis far removed from current forecast ranges), the vast majority of the 27 Spanish institutions and groups analysed exceed the benchmark capital level set by CEBS (a Tier 1 capital ratio of 6%, which is 50% higher than the minimum level required under international regulations).

The exercise confirms that the Spanish banking system is sound, and in turn substantiates the savings bank restructuring and recapitalisation process pursued over the past twelve months by the Banco de España. This has entailed a commitment to inject resources totalling €14,358 million from the FROB and the Deposit Guarantee Fund. In this respect, to comply with the Ecofin resolution that no institution should remain below the Tier 1 capital ratio of 6% in the more adverse scenario, four savings bank groups will have a need for additional capital, for a total of €1,835 million.

The stress tests place the hypothetical asset impairment losses that would arise in the adverse scenario at €207,473 million, 7% of total assets for all the institutions considered (9.3% in the case of savings banks). That said, in the exercise Spanish institutions show a notable capacity to absorb these potential losses, owing primarily to the substantial write-downs made over the past two years, since the provisions they have set aside would allow 34% of this gross impairment to be absorbed.

Moreover, income generation could absorb a further 48% (even assuming a severe reduction in institutions' net operating income in relation to 2009), thanks to a business model that generates more stable and predictable income than other banking models. Finally, during 2008 and 2009 Spanish banks also strengthened their capital (issuing equity and capitalising profits) and savings banks have in recent months undergone substantial restructuring through integration processes, which also help ease their additional capital needs.

Since the stress tests have been conducted on the basis of simplified (e.g. a constant balance sheet during the period considered) and highly unlikely assumptions, the benchmark scenario variables are of use only for comparative purposes and in no case should they be construed as a forecast or reasonable estimate of developments in the economy or of institutions' results and capital.

Stress tests assess the extent to which institutions are capable of withstanding an extraordinarily adverse macroeconomic scenario over a specific period of time. The aim of the exercise conducted under the mandate of the EU Ecofin Council, and coordinated by the CEBS in cooperation with the European Central Bank (ECB), is to assess the overall resilience of the European banking sector and banks' capacity to absorb potential shocks related to their credit and market risks, including sovereign risk. This European exercise is of immeasurable value as it is the first time a joint effort to publish such information has been made, involving as it does various European supervisory and policymaking bodies.

Further, in Spain's case, and given their practically blanket coverage of its banking sector, the stress tests have been harnessed to make an additional effort in terms of transparency. The aim thereby is to provide better information to the markets, and this should continue into the future, as the Banco de España has urged institutions to convey more and better quality information to the market.

The restructuring and recapitalisation of savings banks has entailed contributions to the sector of approximately 1% of GDP in public funds by the FROB, amounts that will have to be returned within 5 years with the related interest. The approval of the reformed legislation on savings banks in Parliament last Wednesday means that in future it will be savings banks themselves that should raise capital on the markets without having to draw on public funds.

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