Summary for non-specialists
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Occasional Papers index

Financial Assistance Programme for the Recapitalisation of Financial Institutions in Spain

Fifth Review – Winter 2014

The European Commission published the Fifth Review report of Spain's compliance with the Financial Assistance Programme for the Recapitalisation of Financial Institutions. The report is based on the findings of a joint European Commission (EC)/European Central Bank[1] (ECB) mission to Madrid during 2-13 December 2013.

The mission considered that the positive assessment of steadfast programme implementation has been maintained through the final review. Spain has forcefully addressed severe problems in some parts of its banking sector, thanks to its reform and policy actions and benefitting from the support of the euro area and broader European initiatives. The programme has contributed to restoring financial stability and investor confidence in Spain. As a result, the financial sector programme was completed on 22 January 2014, as initially foreseen.

The stabilisation of Spanish financial markets continued, also bolstered by positive economic news. The drop in sovereign bond yields reached new lows and the financing conditions for large parts of the economy, including banks, have improved. Financing conditions for SMEs remain onerous, but expectations are slightly improving in this sector as well. The liquidity situation and the financing structure of the Spanish banking sector have further strengthened and the liquidity generated by the drop in the loan-to-deposit ratio is being used by banks to reduce their reliance on the Eurosystem and on the wholesale market.

The solvency position of banks has remained broadly comfortable after the recapitalisation of parts of the banking sector, the transfer of assets to Sareb[2] and overall positive earnings results over 2013. The recent legislative measures on deferred tax assets should support the solvency of the banking sector under the new EU rules on capital requirements. Spain needs to continue monitoring closely the operation and stability of the banking sector.

The process of restructuring of banks having received State aid continued with the double objective of reaching a balanced and viable asset/liability structure and providing credit to the real economy. Unicaja launched an offer to acquire Banco CEISS and the return of NCG Banco, S.A. (NCG) to private ownership will soon be effective, reinforcing the stability of Spanish banking sector. The monitoring of restructuring plans as adopted by the European Commission will continue in the coming years.

[1] The mission also involved expert teams from the European Stability Mechanism and the European Banking Authority. The International Monetary Fund participated in the meetings as part of its independent monitoring.

[2] ***S**ociedad de Gestión de **A**ctivos Procedentes de la **Re**estructuración **B**ancaria* S.A., the Spanish asset management company.

The broader economic environment has continued to weigh on the banking sector, even if that impact has recently been receding. Recent evidence suggests a deceleration in the significant contraction of domestic private credit, and a bottoming-out is in sight. Nevertheless, the profitability of the banking sector over the coming years will be affected by the lower volumes of intermediation and continued pressure on asset quality.

Compliance with the horizontal policy requirements in the Memorandum of Understanding (MoU) is complete. This contributed to a thorough overhaul of the governance, regulatory and supervisory framework of the Spanish banking sector. The reform agenda of the financial sector needs to continue beyond the finalisation of the programme in order to consolidate the progress in stabilisation. The report highlights the remaining key issues where the Spanish authorities need to focus their efforts in order to accomplish reforms in the financial sector.

The recent macroeconomic news are encouraging, stoking expectations of a gradual recovery in activity and of an approaching end to employment destruction. GDP growth returned positive in the third quarter of 2013, and economic indicators for the fourth quarter have generally been favourable. The economic recovery however remains fragile as imbalances continue to be worked out, and subject to external risks.

Fiscal consolidation and structural reforms need to advance further. Respecting fully the agreed fiscal consolidation targets and completing the reform agenda remain imperative to return the economy on a sustainable growth path and consolidate the recovery in confidence.

In conclusion, the programme was successfully finalised in January 2014. The EC, in liaison with the ECB, where indicated, will continue monitoring Spain´s financial sector and the broader economy. This monitoring will be performed under all relevant EU surveillance processes. As regards the financial sector, this monitoring should allow the review of further progress with the stabilisation of all parts of the banking sector and the further effects of the horizontal policy measures taken under the terms of the programme.