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THE SPANISH ECONOMY AND THE COVID-19 CRISIS: CURRENT SITUATION, OUTLOOK AND CHALLENGES

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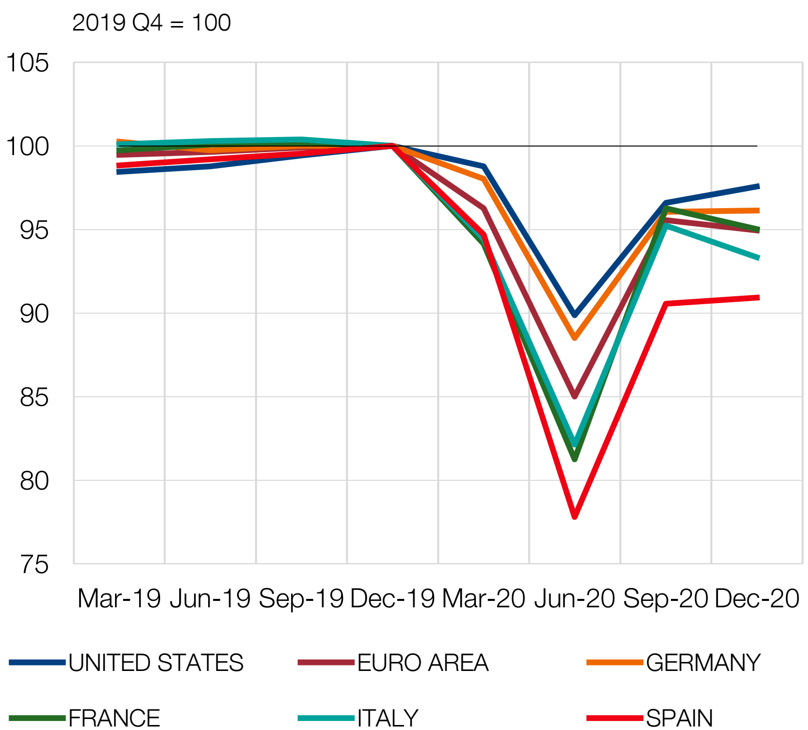
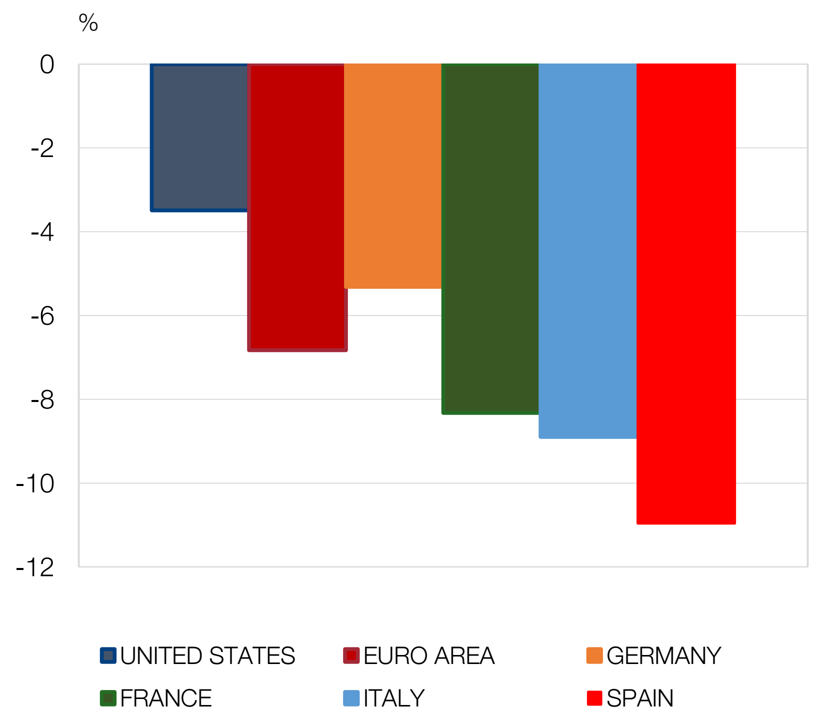
AN UNPRECEDENTED ECONOMIC IMPACT

- **On the latest IMF forecasts, global economic activity is estimated to have fallen by 3.5% in 2020 (-4.9% in the advanced economies and -2.4% in the emerging ones).**
- **The impact of Covid-19 was very marked in the euro area (-6.8%) and, in particular, in Spain (-11%).**

REAL GDP



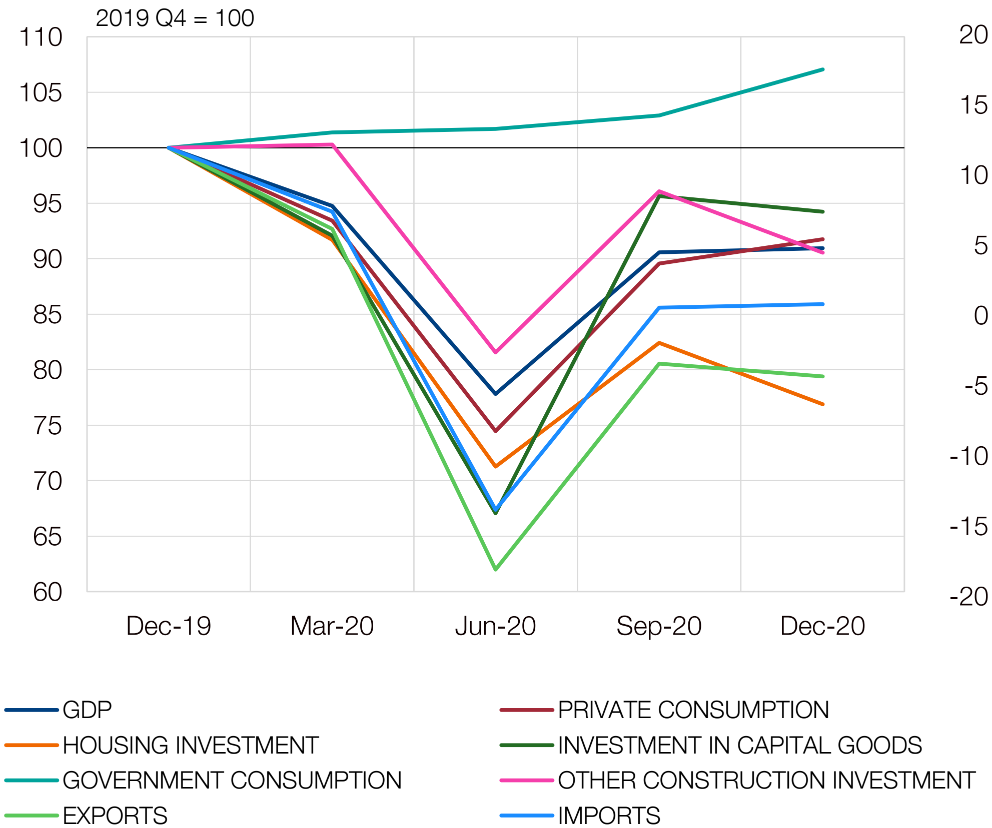
FALL IN REAL GDP IN 2020



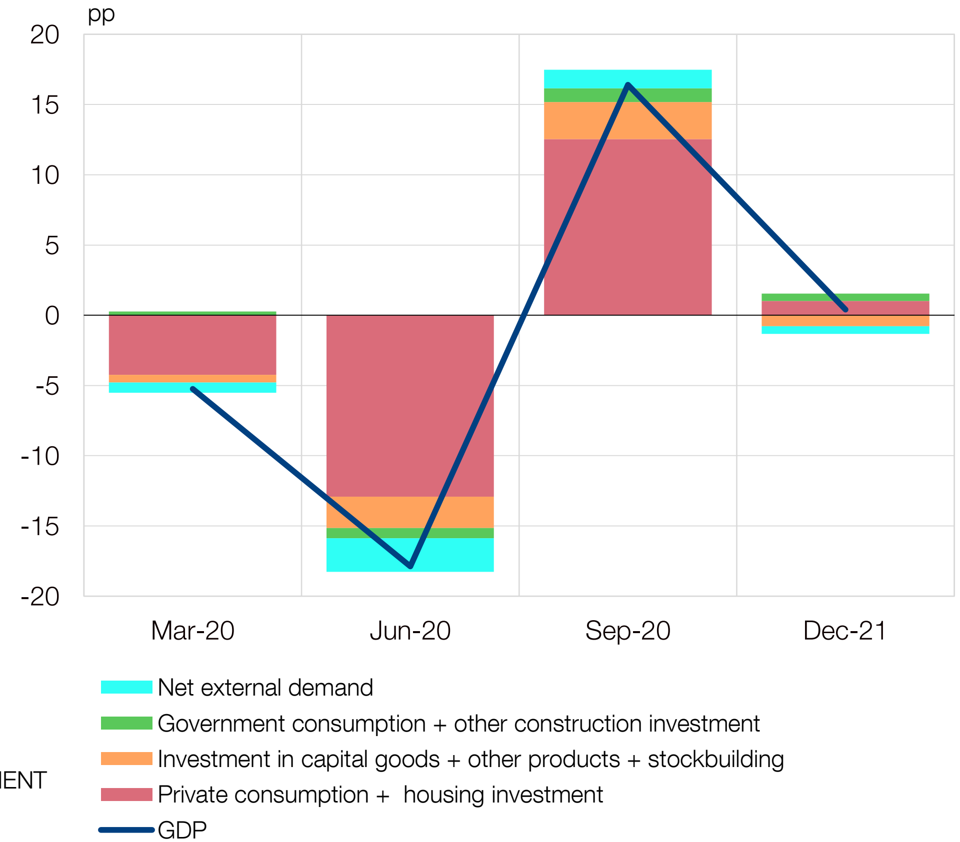
Source: Eurostat. Latest observation: 2020 Q4.

THE CRISIS HAS HIT CROSS-BORDER FLOWS HARDER, IN PARTICULAR TOURIST AND HOUSING INVESTMENT FLOWS

REAL GDP AND COMPONENTS



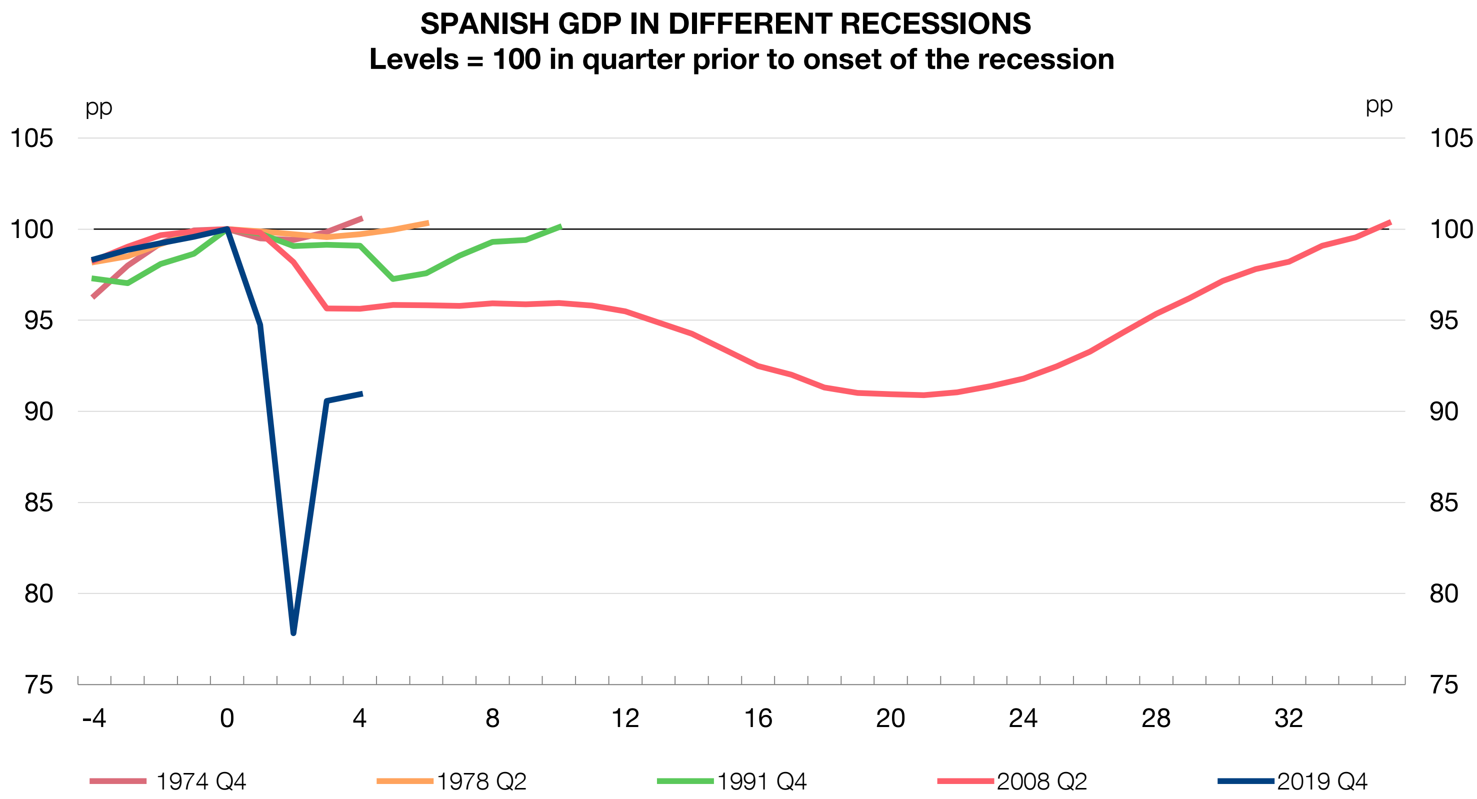
CONTRIBUTIONS TO REAL GDP QUARTERLY GROWTH



Source: INE. Latest observation: 2020 Q4.

THE RECOVERY IS STILL INCOMPLETE

- **Spanish GDP at end-2020 was down 9.1% on 2019 Q4 (5.1% in the euro area)**
- **The 2020 Q4 performance was somewhat better than forecast, but early 2021 developments were worse than anticipated**

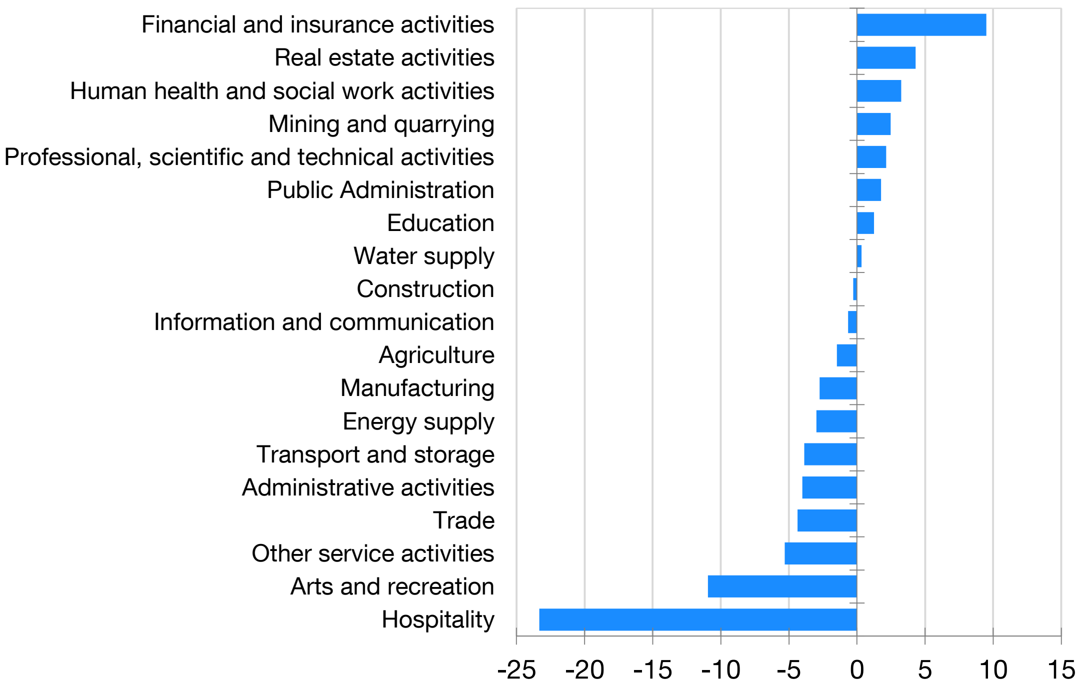


Source: INE. Latest observation: 2020 Q4.

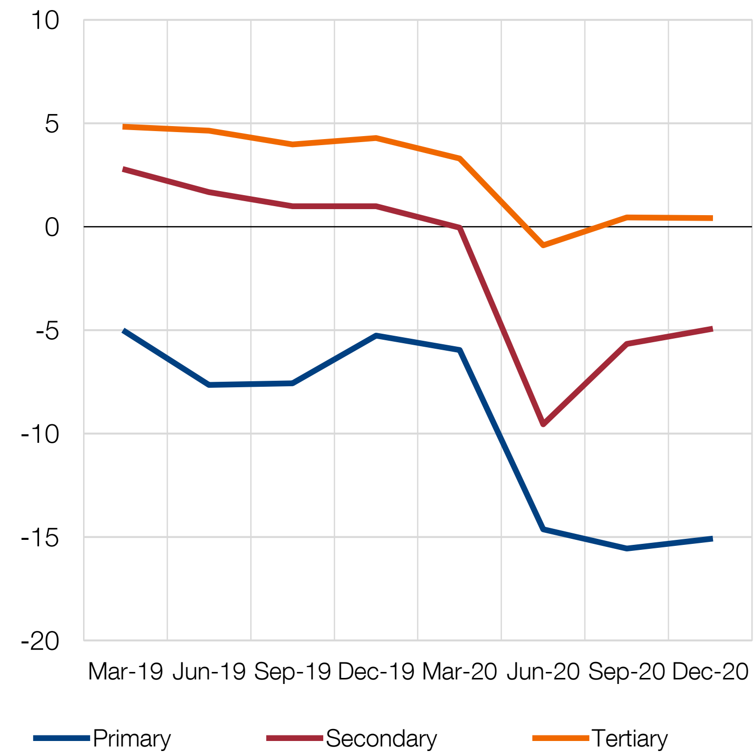
THE IMPACT OF THE CRISIS AND THE RECOVERY IS UNEVEN

- **Employment developments across the different sectors have been very uneven throughout the crisis. As a result, set against the recovery in some sectors, the declines in the services most dependent on social interaction remain very heavy.**
- **The least-skilled groups are those in which the employment adjustment has been concentrated.**

PERSONS IN EMPLOYMENT BY SECTOR
(Year-on-year rate of change, 2020 Q4, %)



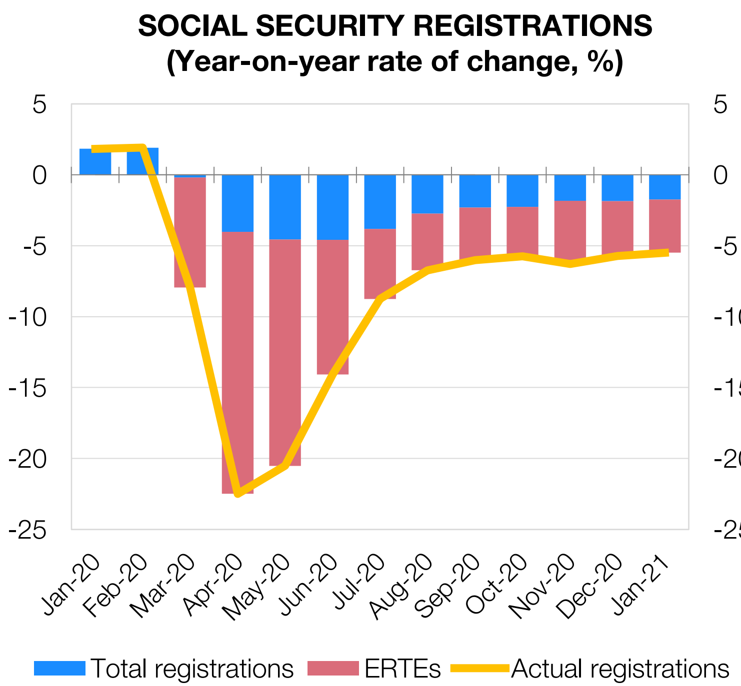
PERSONS IN EMPLOYMENT BY EDUCATION ATTAINMENT LEVEL
(Year-on-year rate of change, %)

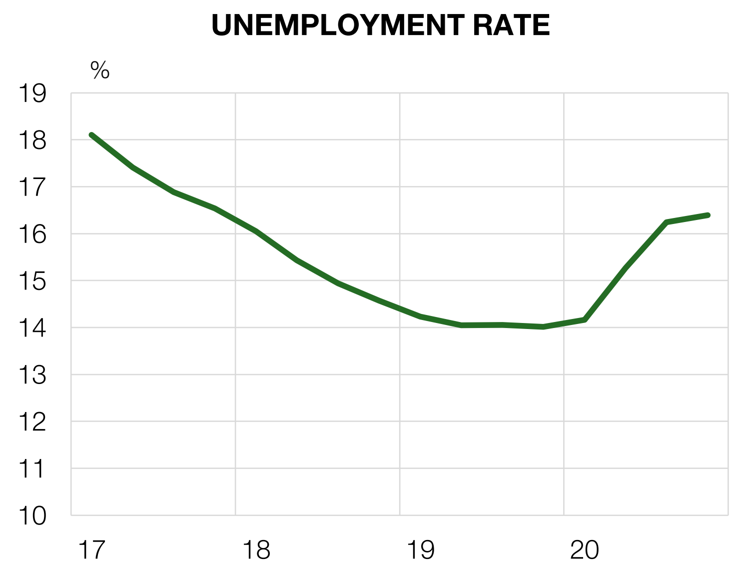


Source: INE. Latest observation: 2020 Q4.

THE RECOVERY IS SUBJECT TO HIGH UNCERTAINTY

- **Actual Social Security registrations [after stripping out furlough schemes (ERTEs)] picked up swiftly, following lockdown easing, from their initial heavy fall.**
- **But hardly any further improvements have been observed since August, reflecting the reintroduction of restrictions in response to fresh outbreaks.**
- **The use of ERTEs has eased the rise in the unemployment rate.**



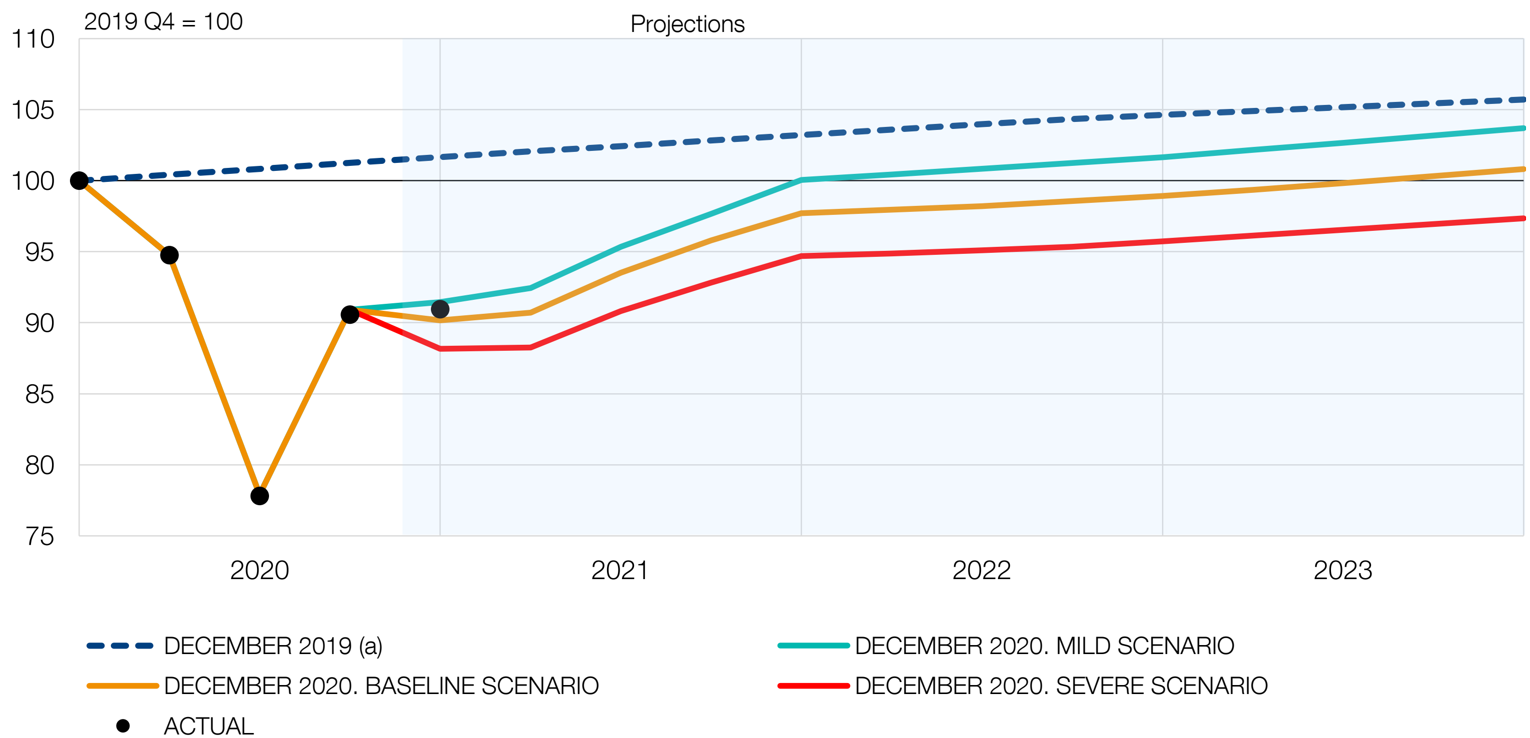


Sources: Ministerio de Inclusión, Seguridad Social y Migraciones, INE and Banco de España. Latest observation: January 2021 (left-hand chart) and 2020 Q4 (right-hand chart).

A RELATIVELY TEMPORARY SHOCK, BUT ONE WITH PERSISTENT EFFECTS

- **The economic outlook continues to hinge crucially on resolving the health crisis**

GDP
(Chained volume index)



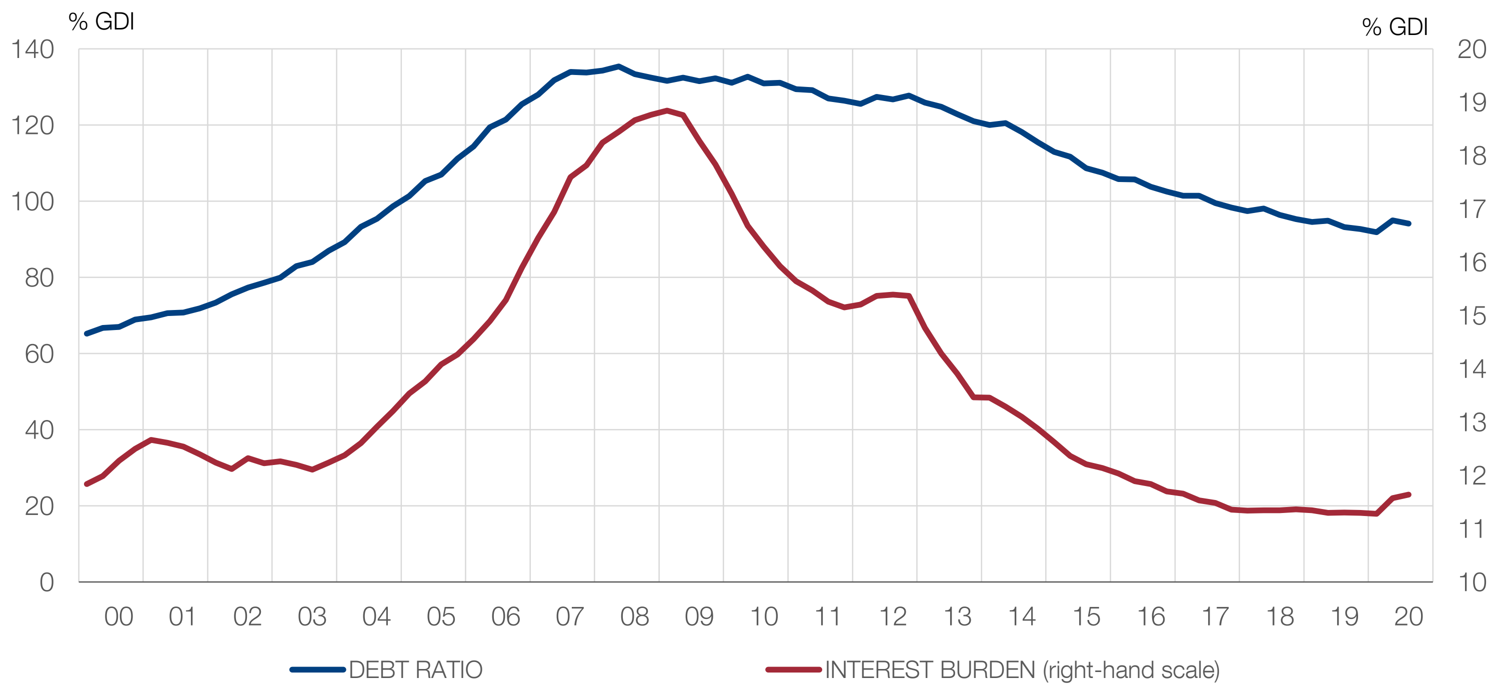
Sources: Banco de España and INE. The chart presents the scenarios envisaged in the Banco de España's December 2020 projections.
(a) For 2023, trend projection of the path.

1. THE ECONOMIC IMPACT OF THE CRISIS
2. **THE EFFECT ON AGENTS’ FINANCIAL SITUATION**
3. ECONOMIC POLICIES

AT THE AGGREGATE LEVEL, THE RISE IN THE HOUSEHOLD DEBT RATIO AND INTEREST BURDEN HAS BEEN RELATIVELY MODEST

- **The arrangements involving public support for incomes and credit moratoria have meant that the rise in household debt (and, therefore, in their interest burden) has been contained.**
- **But some groups of households have been more acutely affected by the crisis.**

HOUSEHOLD DEBT RATIO AND INTEREST BURDEN

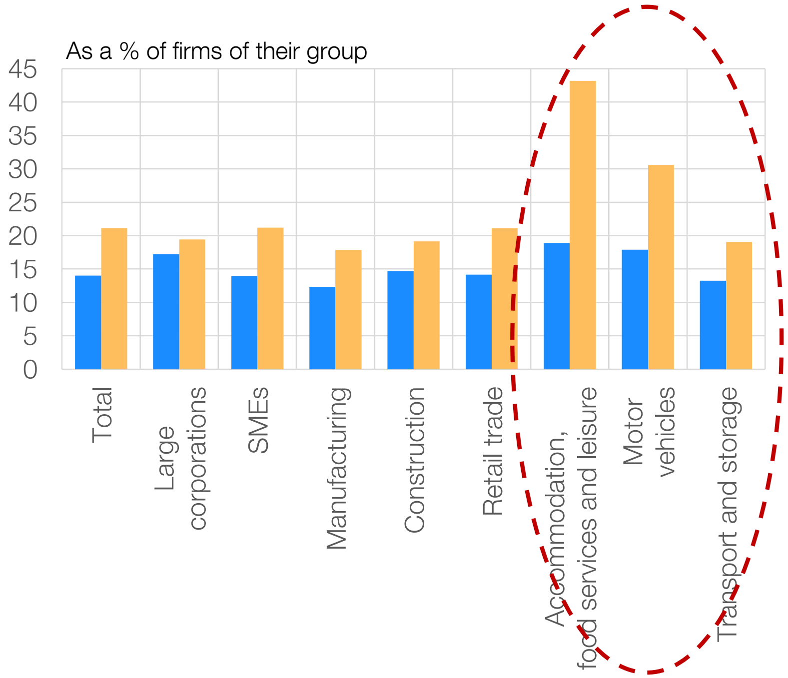


Source: Banco de España. Latest observation: 2020 Q3.

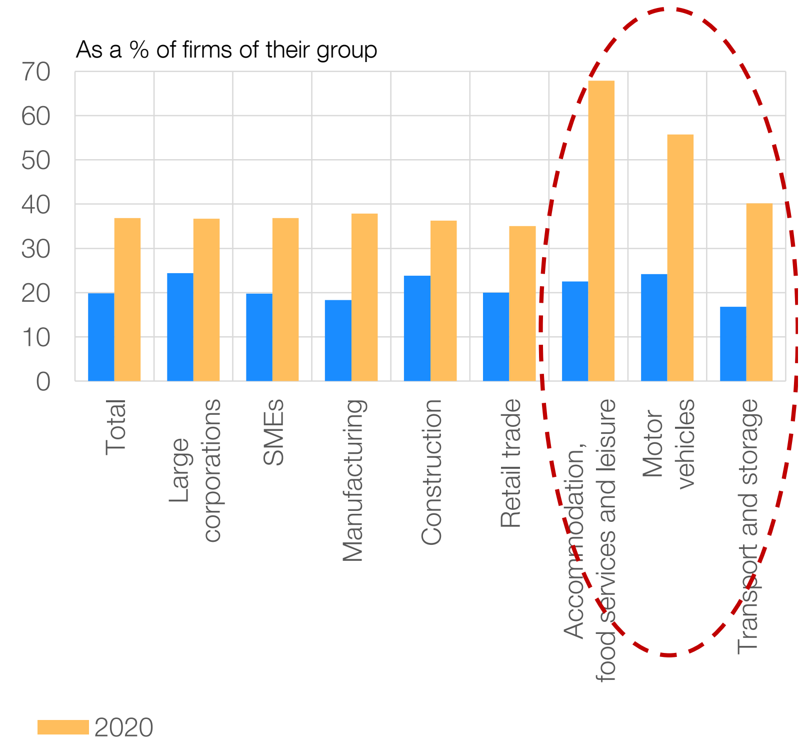
THE WORSENING IN THE FINANCIAL SITUATION OF FIRMS AS A WHOLE IS SOMEWHAT MORE MARKED

- **Firms operating in the most affected sectors have seen their financial position worsen more sharply.**

SHARE OF VULNERABLE FIRMS ACCORDING TO NET DEBT TO NET ASSETS RATIO (a)



SHARE OF VULNERABLE FIRMS ACCORDING TO NET DEBT TO EARNINGS RATIO (b)



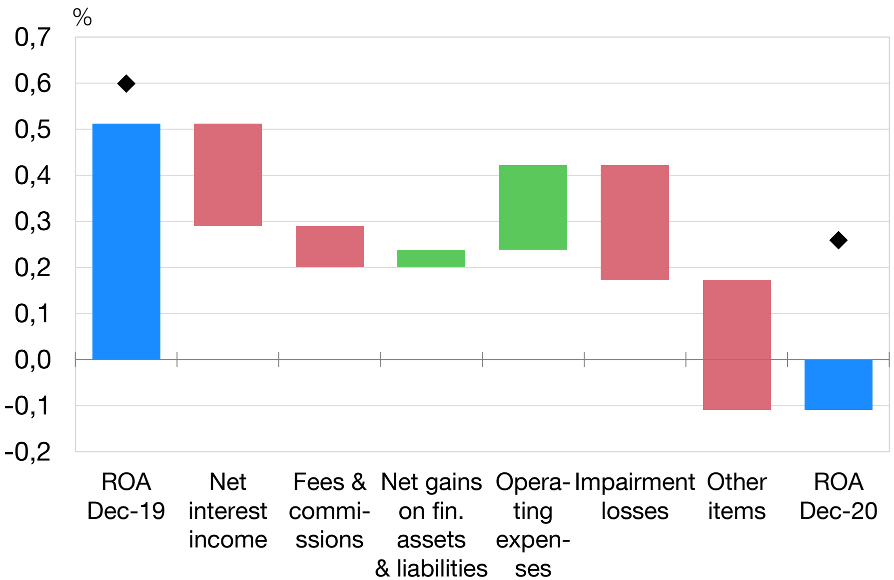
Source: Banco de España.

(a) Vulnerable firm: those with a debt ratio higher than or equal to 0.75. Net assets: total assets net of non-interest-bearing borrowing.
(b) Vulnerable firm: those with a debt ratio higher than or equal to 10 or with positive net debt and negative or no earnings. Earnings: Gross Operating Profit + Financial Revenue.

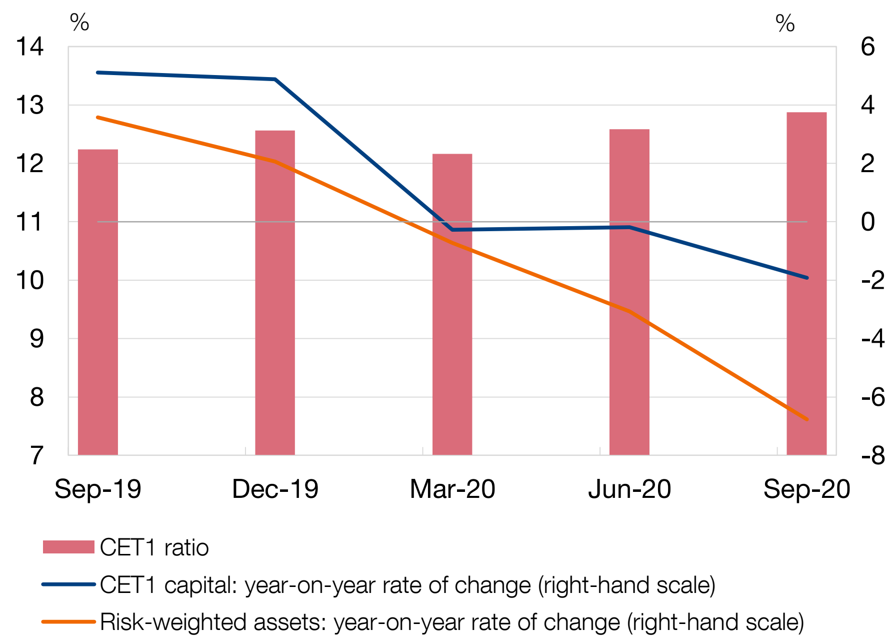
FINANCIAL INSTITUTIONS HAVE ALSO BEGUN TO FEEL THE CONSEQUENCES OF THE CRISIS

- **The downturn in banks' earnings in 2020 was due above all to credit impairment provisions, in anticipation of the expected increase in NPLs.**
- **There was a rise in the capital ratio owing, above all, to the decline in risk-weighted assets.**

BREAKDOWN OF THE CHANGE IN THE EARNINGS OF SPANISH LISTED BANKS (a)



TREND IN THE CET1 RATIO, NUMERATOR AND DENOMINATOR

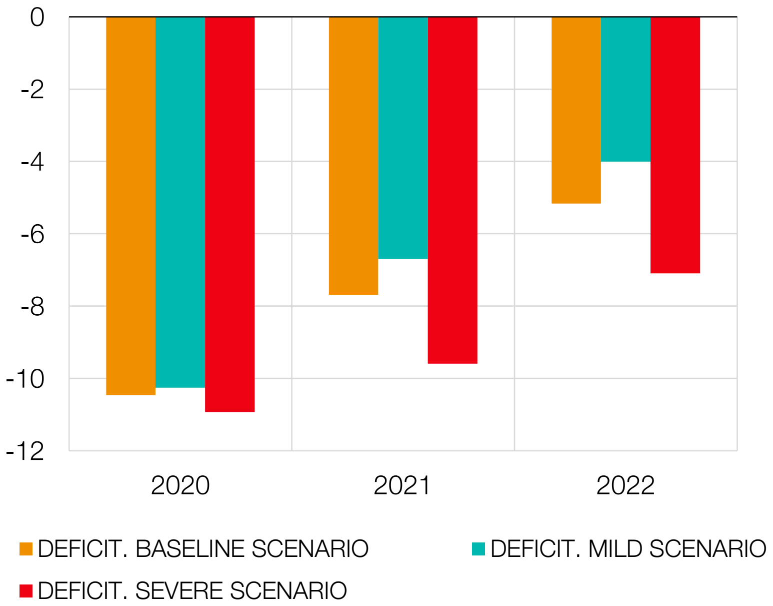


Source: Banco de España.
(a) The red (green) colour of the bars indicates a negative (positive) contribution of the item concerned to the change in the consolidated annual earnings of the eight Spanish listed banks in December 2020 with respect to December 2019. The black diamonds show ROA if the goodwill adjustments recorded in 2019 (-€2.8 billion) and 2020 (-€12.2 billion) are not taken into account

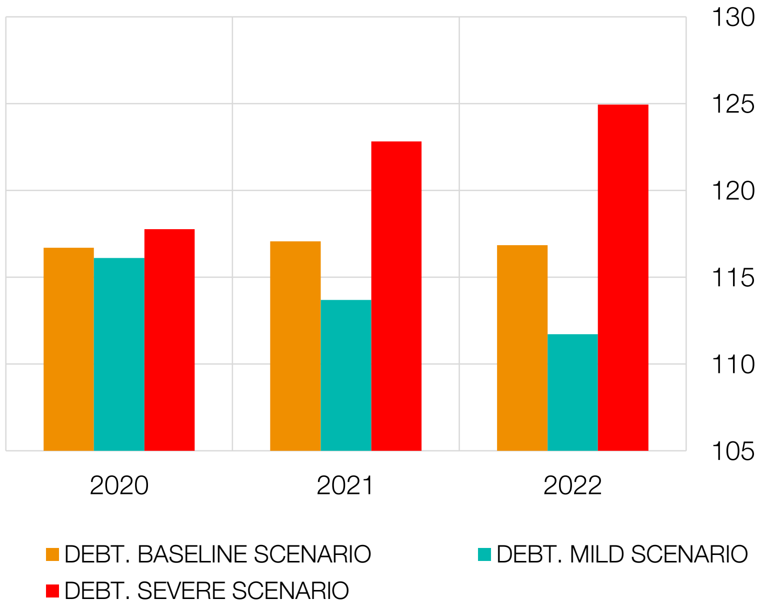
IN TERMS OF FINANCIAL SITUATION, GENERAL GOVERNMENT HAS BORNE THE BRUNT OF THE IMPACT

- **The budget deficit is expected to have exceeded 10% of GDP in 2020, with debt at around 120%.**

BUDGET DEFICIT (% of GDP)



PUBLIC DEBT (% of GDP)



Source: Banco de España. The scenarios envisaged in the Banco de España's December 2020 projections are presented.

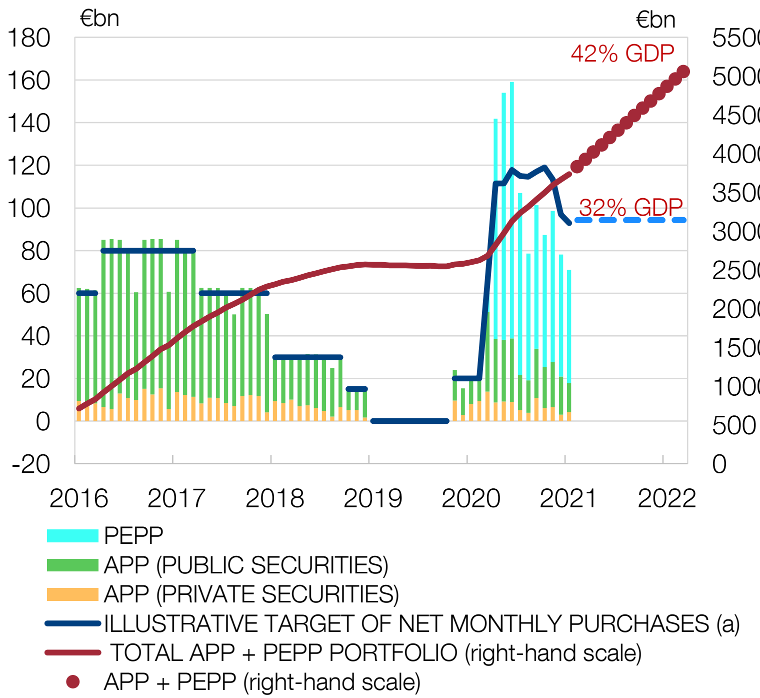
BROAD-BASED, FORCEFUL AND COORDINATED ECONOMIC POLICY RESPONSE IN THE FIRST PHASE OF THE CRISIS

- **Monetary policy:**
  - Eurosystem financing for banks under more favourable conditions and easing of the collateral framework, to promote the extension of credit to the real economy.
  - Significant increase in Eurosystem asset purchases (PEPP), to ease aggregate financial conditions and prevent fragmentation in the euro area.
- **Financial policies:**
  - More flexible liquidity and capital regulations.
  - Changes in the calculation of regulatory capital ("quick fix"). Adaptation of accounting standards to avoid mechanistic application.
  - Loan moratoria (especially for households) and insolvency moratoria.
- **EU policies:**
  - SURE, ESM facilities, EIB,…
  - Next Generation EU Fund: on an unprecedented scale, funded via joint debt issues and with a significant percentage of (non-repayable) direct aid.
- **Fiscal policy** comprises the first line of defence against the consequences of the pandemic. In particular:
  - ERTEs are enabling a high proportion of employment relationships to be maintained.
  - The granting of credit guarantees is proving effective, along with ERTEs themselves, in tackling firms' liquidity problems.

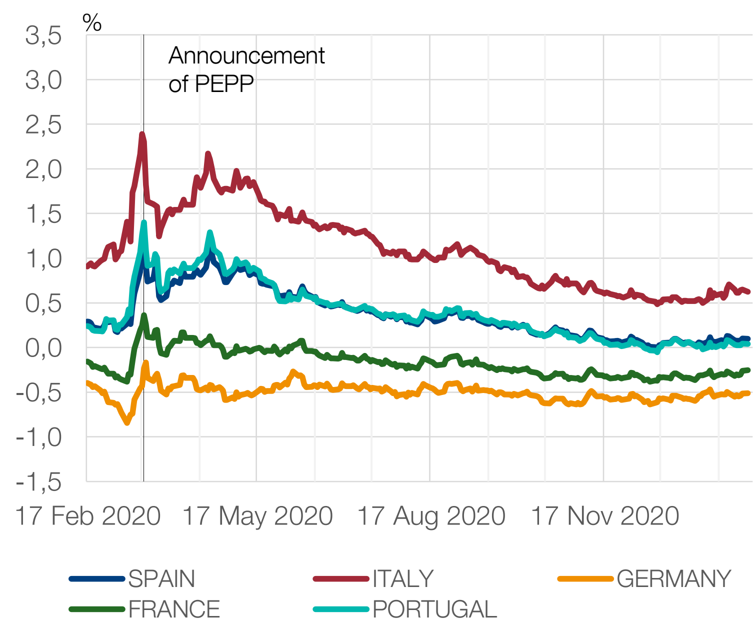
MONETARY POLICY HAS ACTED FORCEFULLY…

- **The increase, by an unprecedented amount, in the volume of asset purchases has contributed to stabilising financial markets, easing financing conditions and preventing the fragmentation of euro area capital markets**

ASSET PURCHASE PROGRAMMES (APP+PEPP)



INTEREST RATES ON TEN-YEAR SOVEREIGN BONDS



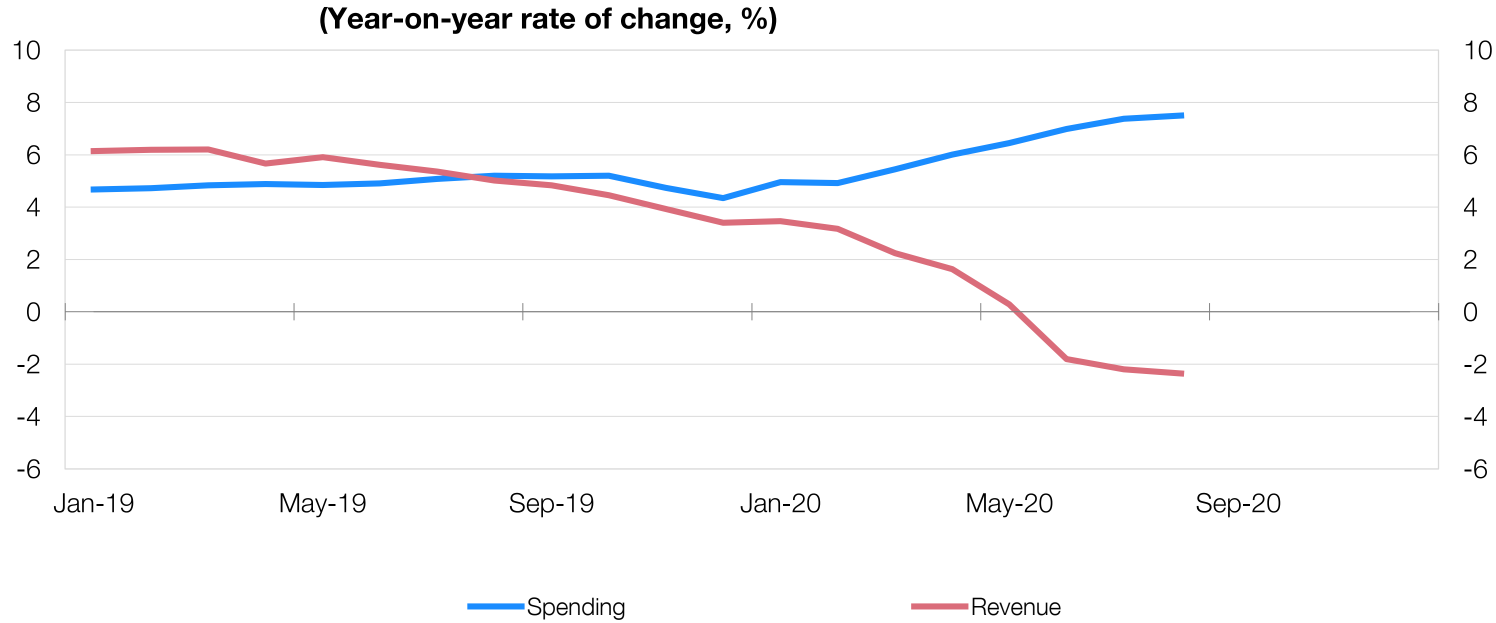
Sources: ECB and Thomson Reuters Datastream. Latest observation: left-hand panel, January 2021; right-hand panel, 01/02/2021.

(a) The monthly net purchase target as from February 2021 (broken blue line) includes, in addition to the €20 billion per month approved last year and ratified at the Governing Council in December 2020, the unused portion of the maximum amount of €1,850 billion under the new Pandemic Emergency Purchase Programme (PEPP, approved on 18 March and extended and increased on 4 June and 10 December), assuming, for illustrative purposes, that the purchases will be distributed uniformly until March 2022 (in practice they may be distributed flexibly over time) and that full use will be made of said maximum amount (in practice, this maximum amount cannot be used in full).

...WHICH HAS PAVED THE WAY FOR AN UNPRECEDENTED FISCAL POLICY RESPONSE

- **Monetary policy action has been crucial in giving the fiscal authorities leeway to deploy the support measures needed for households and firms.**
- **In Spain, public spending has increased significantly owing to greater healthcare expenditure and to the measures approved to contain the decline in households' and firms' income.**

GENERAL GOVERNMENT REVENUE AND SPENDING (a) (b)
12-MONTH CUMULATIVE DATA



Sources: IGAE and Banco de España. Latest observation: November 2020.
(a) The National Audit Office (IGAE) only provides quarterly data for general government as a whole. Monthly data are estimated drawing on information on the aggregate excluding local government.
(b) Data adjusted by distributing over the entire year each month's extraordinary revenue and spending.

LOOKING AHEAD, MONETARY POLICY MUST RETAIN A SUBSTANTIALLY ACCOMMODATIVE STANCE FOR AS LONG AS NEEDED

- **The pick-up in euro area activity is fragile and subject to downside risks given the uncertainty over how the pandemic will evolve, following its recent intensification in many countries. Only an acceleration in the vaccination process might counter it.**

- **Against this background, and regarding the ECB's monetary policy:**
  - **An extensive monetary stimulus remains vital to retain favourable financing conditions in all sectors of the economy, supporting economic activity and safeguarding price stability in the medium term.**
  - **We stand ready to adjust all our instruments accordingly, so as to ensure inflation moves towards our objective in a sustained fashion, in keeping with our commitment to symmetry.**
  - **As regards the PEPP, our purchases will be flexible to prevent a tightening of financing conditions and financial fragmentation within the area, both of which are incompatible with the aim of countering the downward impact of the pandemic on the inflation path.**

THE BANKING SECTOR'S RESILIENCE DURING THE CRISIS MUST BE RETAINED

- No increase in NPLs has been observed yet, which is largely on account of the extensive range of measures adopted by the various authorities.
- The final impact of the crisis will depend on its scale and duration, and on the effectiveness of the measures to mitigate its effects on households and firms. In any event, the projections suggest that a significant increase in the NPL ratio will take place in the coming quarters, even under the most benign scenario.
- Against this background:
    - Banks must persist in factoring in the recognition of credit impairments, assessing provisioning needs in accordance with plausible and conservative scenarios for the coming years.
    - As to the use of capital buffers, banks will have sufficient time to meet capital requirements once more, and the process will not start before the main effects of the pandemic have abated.
    - We have recommended that banks should act with extreme prudence and that they consider abstaining from dividend pay-outs and share buy-backs or that they restrict such pay-outs until 30 September 2021. We expect dividends and share buy-backs to hold below 15% of cumulative earnings for 2019 and 2020 and not to exceed the CET1 ratio by more than 20 basis points, if the latter amount were the lower of these two percentages.
    - The sector must tackle low profitability by seeking further gains in efficiency, cutting costs and using new technologies more intensively.

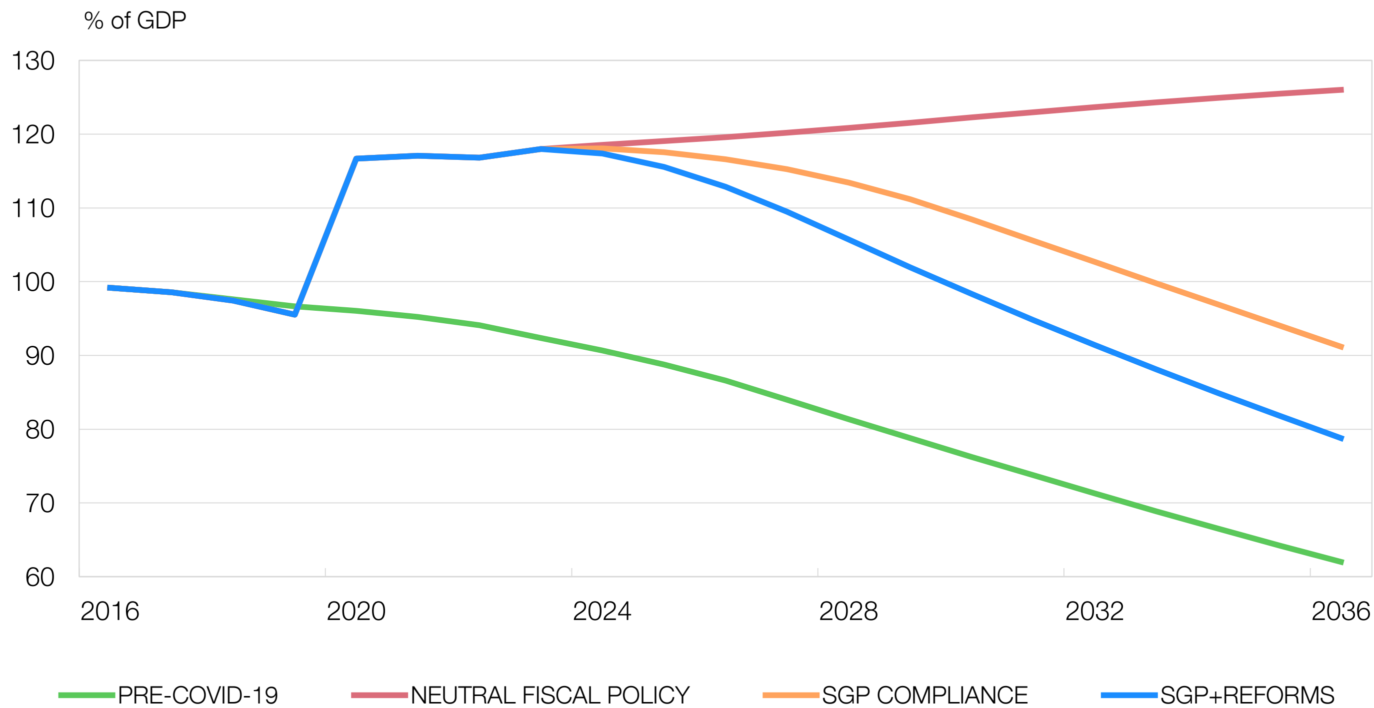
THE SUPPORT OF FISCAL POLICY, NOW MORE TARGETED AND ADAPTING ITS INSTRUMENTS, MUST BE MAINTAINED

- **With the horizon afforded by vaccine availability, it is essential to maintain the support measures. Their withdrawal would entail greater costs than those arising from maintaining them until activity shows signs of robustness.**
- **They will need to be targeted on the sectors and firms most affected.**
- **Moreover, identifying potential structural changes and damages will be crucial. Economic policy should not sustain indefinitely a sector whose level of activity is going to diminish, but rather ease its adaptation to the new reality and the efficient reallocation of resources.**
- **To consider the need to re-design instruments and/or complement them with other, new ones:**
    - ***Placing the emphasis on improving active labour market policies is crucial for preventing the decapitalisation of human capital.***
    - ***In the business sector, the focus is shifting from liquidity problems to potential solvency problems, which suggests the advisability of using capital-reinforcement instruments (recapitalisation, debt restructuring) and direct aid.***
    - ***Complement policy with smoother, swifter legal and out-of-court insolvency procedures that allow a greater number of viable firms to be able to pursue their activity and provide an exit for those that are inviable.***
    - ***It would also be advisable to simultaneously make use of the various flexibility instruments firms have at hand under the current labour market framework.***

STIMULI TO BE ACCOMPANIED BY DESIGN OF A FISCAL CONSOLIDATION PROGRAMME TO BE IMPLEMENTED IN THE WAKE OF CRISES

- **Once the pandemic is behind us, it will be necessary to re-build fiscal room and reduce public debt by means of a gradual, multi-year strategy.**
- **The design of this plan should be set out in advance:**
  - The composition of public spending and revenue needs reviewing with a view to i) ensuring fiscal-financial sufficiency and ii) promoting sustainable growth

PUBLIC DEBT UNDER DIFFERENT ASSUMPTIONS (a)

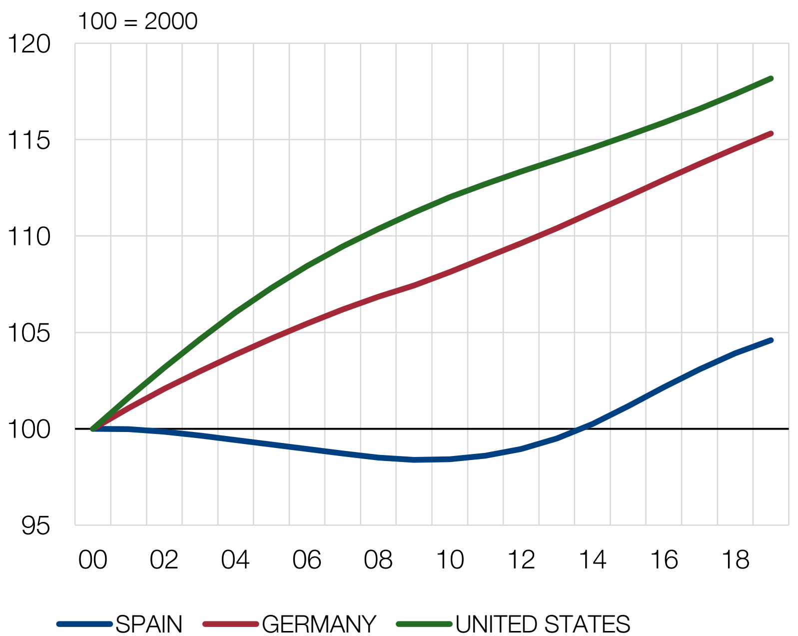


Sources: INE and Banco de España.
(a) Macroeconomic assumptions based on the baseline scenario of the Banco de España's December 2020 projections.

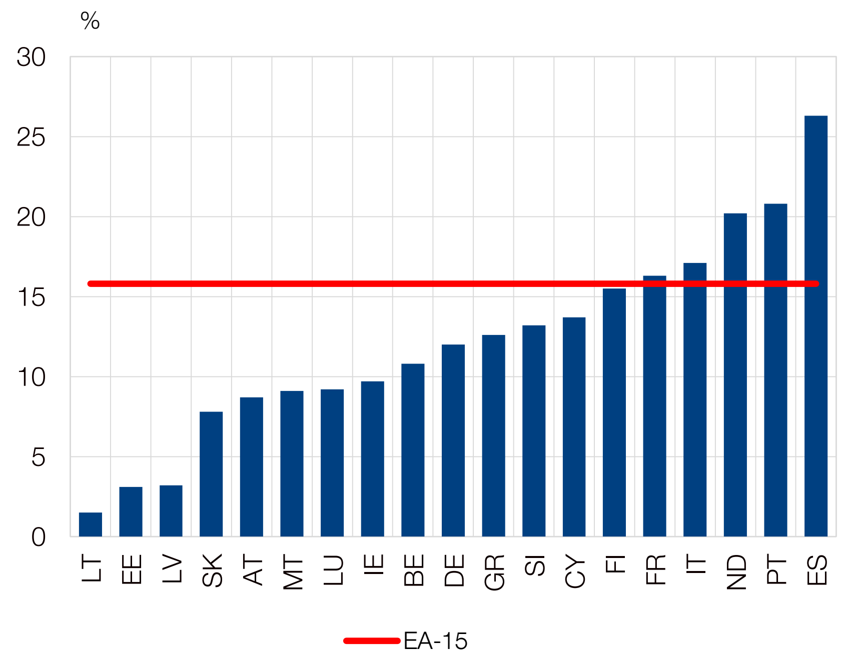
AN AMBITIOUS STRUCTURAL REFORM AGENDA MUST ALSO BE DESIGNED AND URGENTLY APPLIED

- **These reforms should, inter alia, be geared to enhancing productivity dynamics in Spain and to correcting labour market dysfunctions.**

TOTAL FACTOR PRODUCTIVITY IN SPAIN COMPARED WITH THE UNITED STATES AND GERMANY



PERCENTAGE OF EMPLOYED AGED 15-64 WITH A TEMPORARY CONTRACT (2019)

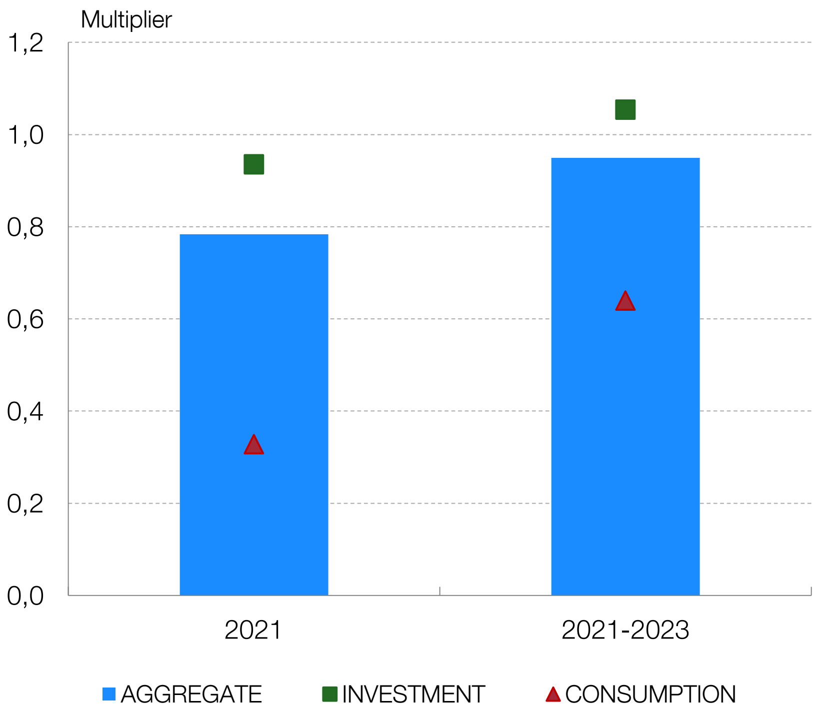


Source: European Commission. Latest observation: 2019 (left-hand chart) and 2018 (right-hand chart).

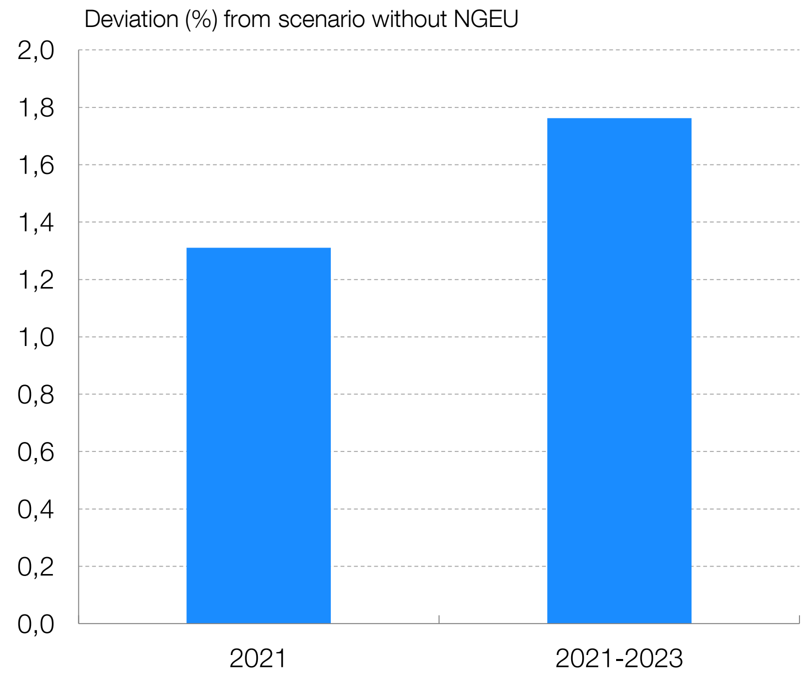
PROPER USE OF THE EUROPEAN FUNDS MAY PROVE PIVOTAL IN SUPPORTING THE RECOVERY AND INCREASING POTENTIAL GROWTH

- **Depending on the speed at which the funds are executed, on their nature (loans or transfers from the Community budget) and, above all, on the extent to which they are earmarked for shoring up growth (including the financing of structural reforms), the impact of these funds on economic activity in the coming years may vary most significantly.**

ASSUMPTIONS ON THE MULTIPLIERS OF THE NGEU FUNDS



IMPACT OF NGEU ON GDP



Source: Banco de España.

THE EUROPEAN RESPONSE TO THE CRISIS MUST BE PERSEVERANT

- **The response of the monetary, prudential and fiscal authorities – national and European alike – has so far allowed the initial impact of the pandemic shock to be absorbed and has headed off the materialisation of a systemic risk that would further amplify the crisis and make it more persistent.**

- **However, some of the shortcomings still in place have been highlighted. We must, then:**
  - **Complete the Banking Union, with the approval of a fully pooled European deposit guarantee scheme. This would be a decisive contribution to ensuring financial stability in the euro area, both in the coming months and over a medium-term horizon.**
  - **Deepen the Capital Markets Union Project. This would likewise be crucial.**
  - **A permanent European macroeconomic stabilisation mechanism must also be created. The NGEU fund should be a precursor of this mechanism.**

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THANK YOU FOR YOUR ATTENTION