

# The Spanish Financial System

## October 2011

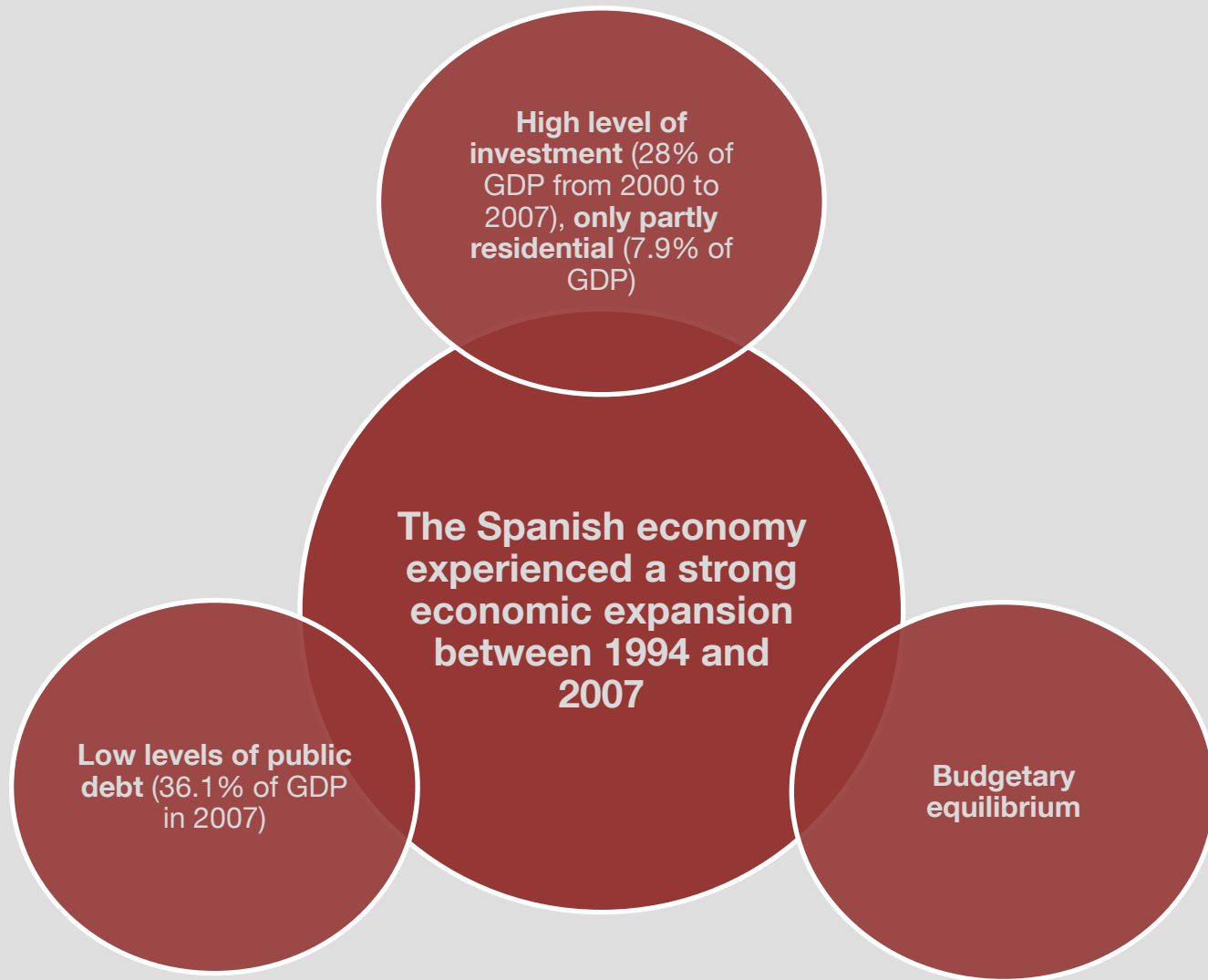
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19 October 2011  
Madrid

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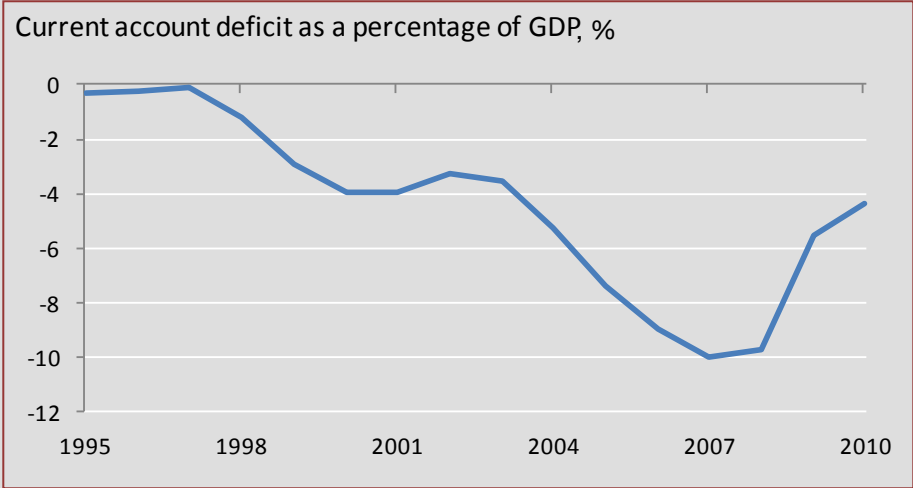
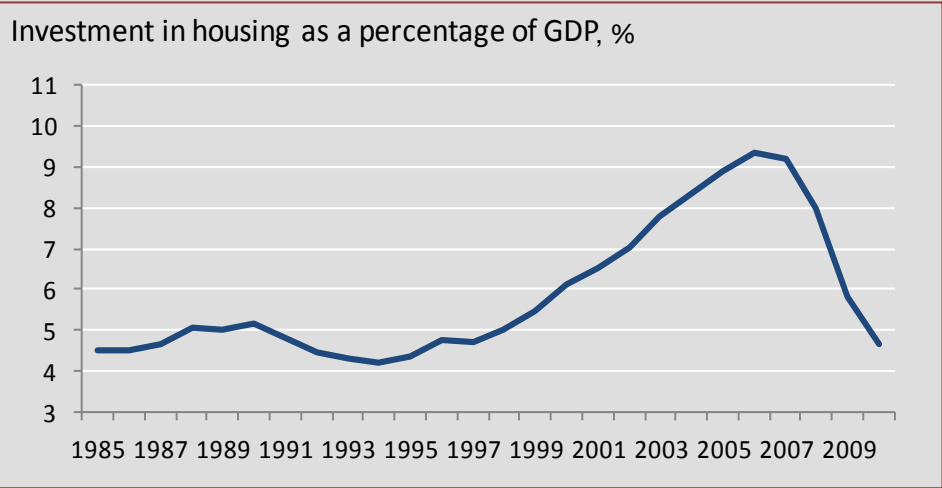


... But it also accumulated imbalances:



Housing sector

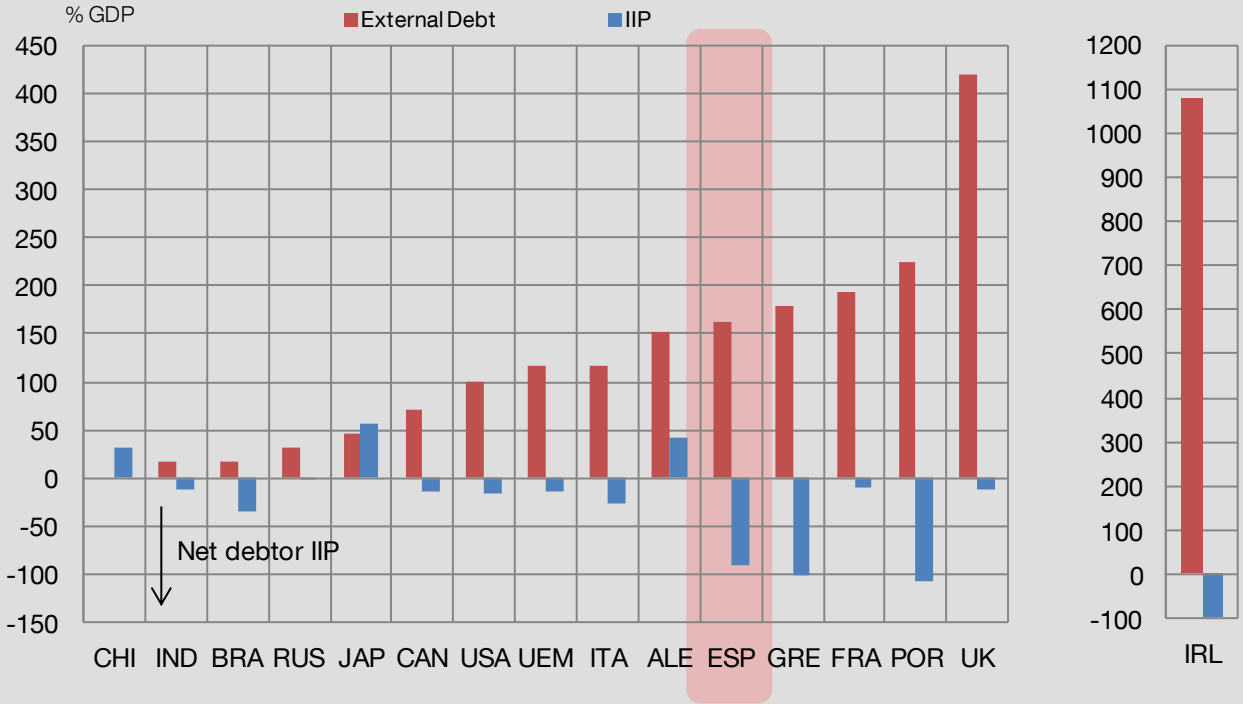
Current account deficit





- External debt as percentage of GDP is higher for European countries ...

EXTERNAL DEBT AND INTERNATIONAL NET INVESTMENT POSITION. 2011 Q1 (a)



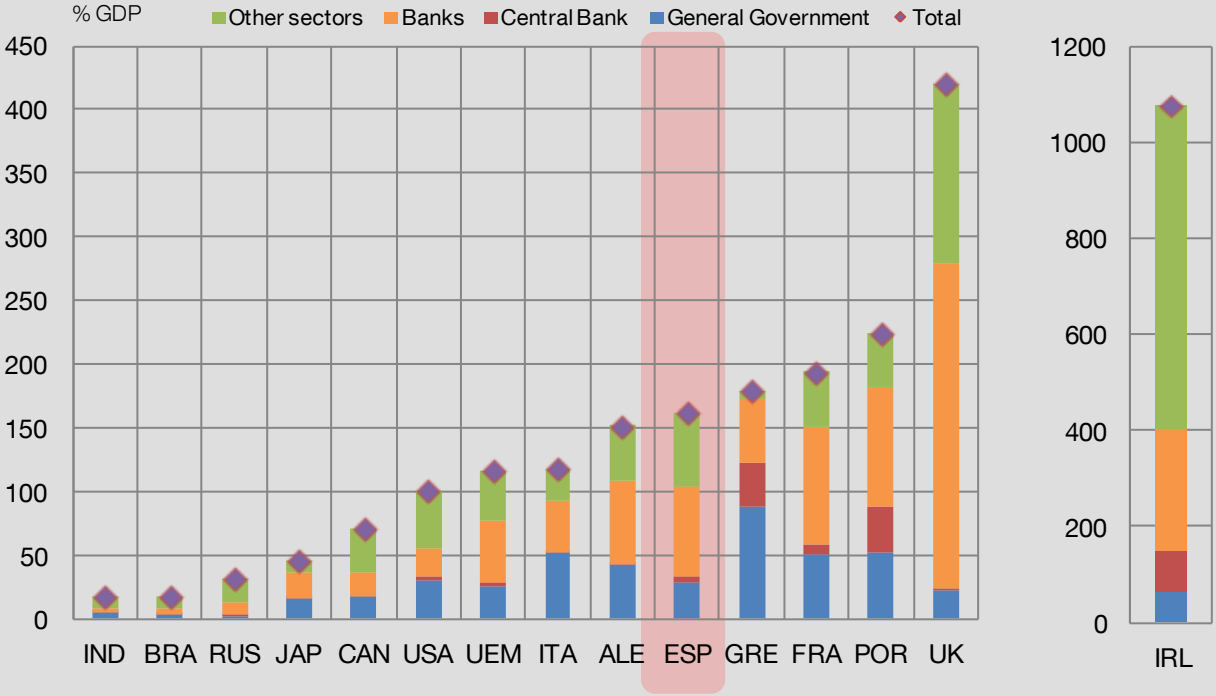
Source: DataStream, IFS and Joint External Debt Hub

a. External debt: 2011 Q1 except UK (2010 Q2) and India (2010 Q4); data for China not available. Net IIP: 2011 Q1 except for France, India, Ireland, Portugal and US (2010 Q4). BRICs and Canada in US dollar, other countries in local currency



- ... In the majority of European countries this external debt is channelled by the banking sector

**EXTERNAL DEBT BY SECTOR. 2011 Q1 (a)**

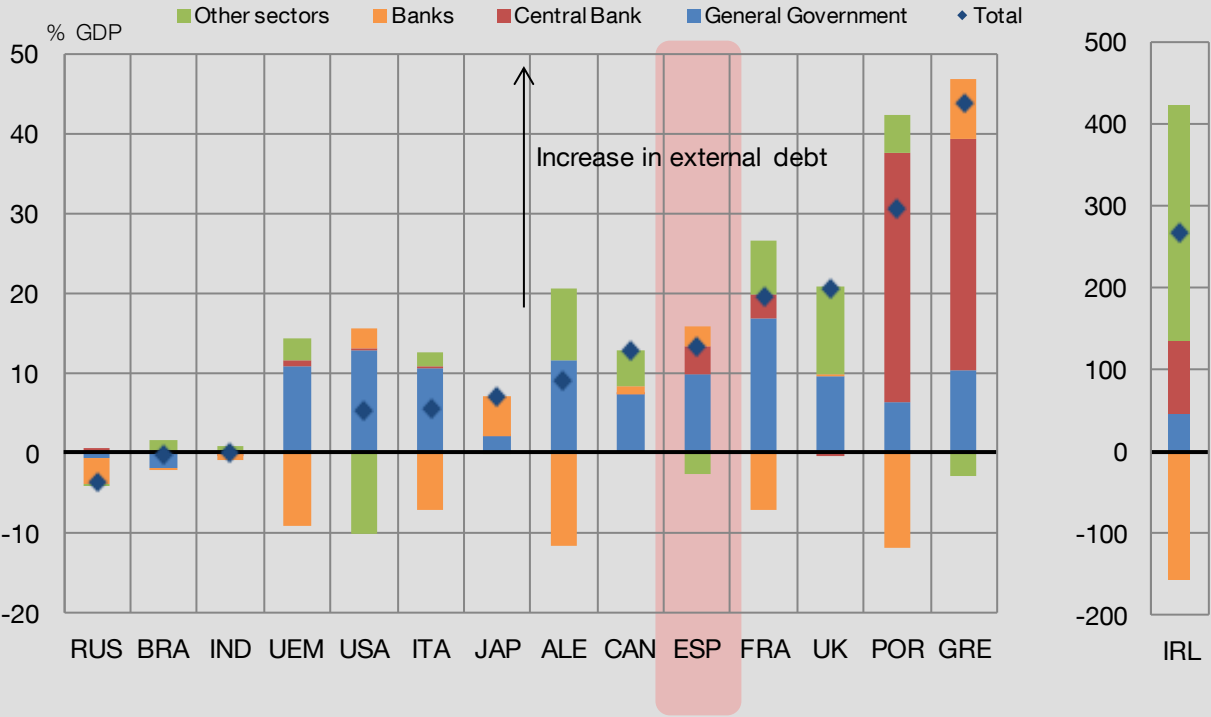


Source: DataStream and Joint External Debt Hub  
 a. External debt: 2011 Q1 except UK (2010 Q2) and India (2010 Q4). BRICs and Canada in US dollar, other countries in local currency.  
 b. Other sectors includes non-banking private sector, financial intermediaries other from banks (i.e. pension and investment funds) and public sector companies.



- Since the beginning of the crisis external debt has generally increased, and in most countries due to the public sector

**EXTERNAL DEBT BY SECTORS, CHANGE SINCE THE BEGINNING OF THE FINANCIAL CRISIS (a)**



Source: DataStream and Joint External Debt Hub

a. Change from 2007 Q4 to the most recent data: 2011 Q1 except UK (2010 Q2) and India (2010 Q4). BRICs and Canada in US dollar, other countries in local currency.



## Good starting position before 2007

- In terms of its **financials** (profitability, efficiency and solvency) and its **business model** (traditional retail banking)

## Accumulation of weaknesses, particularly in a group of savings banks

- Fast growing business with **weak corporate governance** and **no market discipline through equity investors** and **poor risk selection and monitoring**

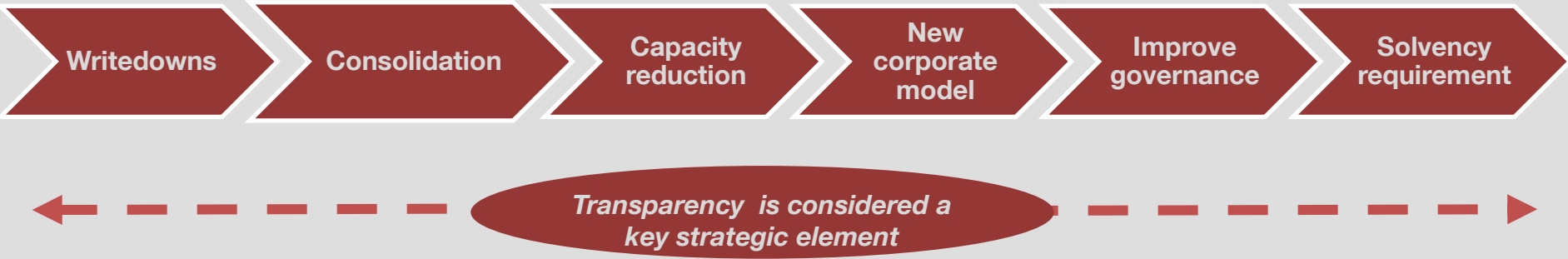
## Diagnosis of the situation in year 2009

- **Excessive credit growth**, particularly intense related with real estate developers
- **Overcapacity** in the sector
- **Fragmentation**: excessive number of relatively small institutions (45 savings banks)
- **Lack of clear ownership of savings banks**

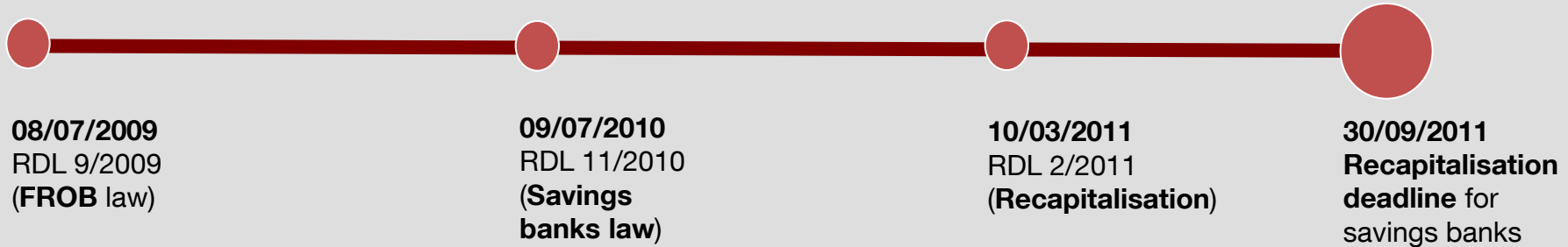




## Strategy:



## Key milestones of this strategy:





## As a result of the implementation of this strategy:

- ➔ **Balance sheet write-downs:** from Jan. 2008 to mid-2011 overall write-downs by the Spanish banking sector stands at 10% of GDP
- ➔ **Increase in core capital:** core capital has increased +1.3 pp from Dec. 2008 until Jun. 2011\* (+0.3 pp from Dec. 2010 to Jun. 2011)
- ➔ **Consolidation:** from 45 savings banks to 15
- ➔ **New corporate model for savings banks:** transformation into commercial banks
- ➔ **Improved governance for savings banks:** more professional management

\* Solvency data for June 2011 are provisional



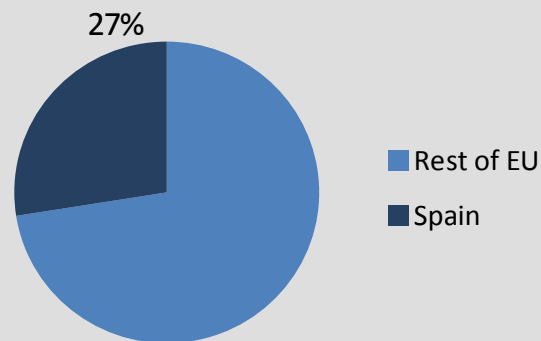
- **Transparency: communication policy by the BE**
  - **Regular publications** (Statistical Bulletin and Financial Stability Report), including monthly information on doubtful loans, credit, deposits, etc.
  - Numerous and very frequent **meetings with investors (at their request) at the Bank of Spain**
  - **Public presentations** by Bank of Spain top management
  - **Specific information on the web site regarding the restructuring process** of the savings banks sector (more than 10 documents year-to-date)



▪ **Transparency:** EU wide stress test exercises reported around 3,200 data points per institution vs. around 100 data per institution the US SCAP

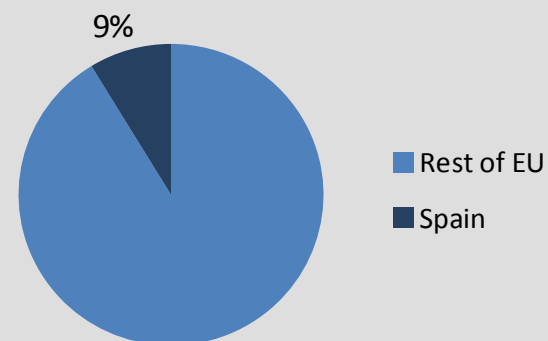
- *Basically all the Spanish banking sector is subject to the ST, meaning that 25 out of 91 EU institutions considered in the exercise are Spanish.*
- *More detailed information, particularly regarding exposures and losses by portfolios*

**Number of institutions considered in the EBA stress test**



Source : EBA Stress Test Results

**Total consolidated assets**



Source : ECB Statistics on Consolidated Banking Data



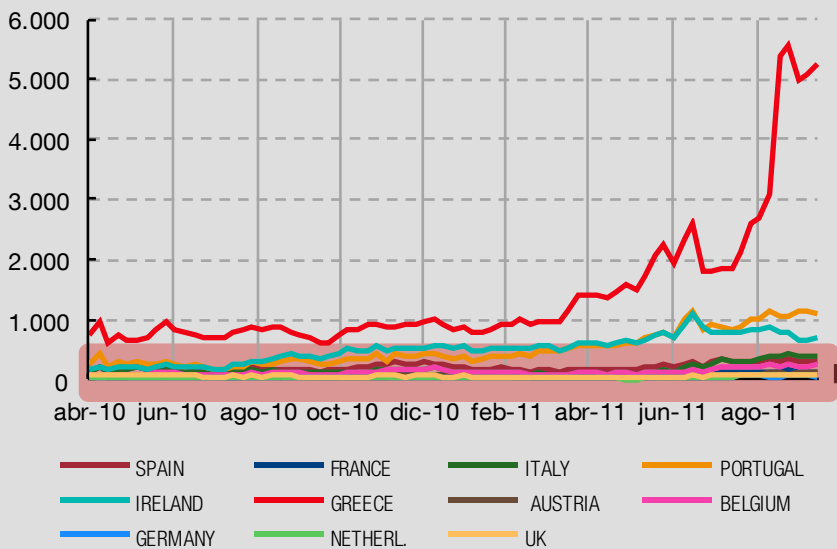
- **Transparency:** requiring institutions to regularly disclose to the markets relevant information
  - **Very granular information regarding real state exposures;** also included in the annual accounts and thus subject to the supervision of external auditors
  - **Very granular information regarding mortgages in Spain**
    - Special **registry** for mortgages (RD 716/2009)
    - According to Circular BE 7/2010 institutions must publish very **detailed information for banks that issue covered bonds** (cédulas)
      - *Information about the asset side (mortgage volume, average residual maturity of mortgage portfolio, breakdown by eligibility, asset quality, type of collateral, currency, LTV, ...)*
      - *Information about the liability side (amount of securitized assets, average residual maturity of securitized bonds,...)*

# SPANISH BANKING SECTOR

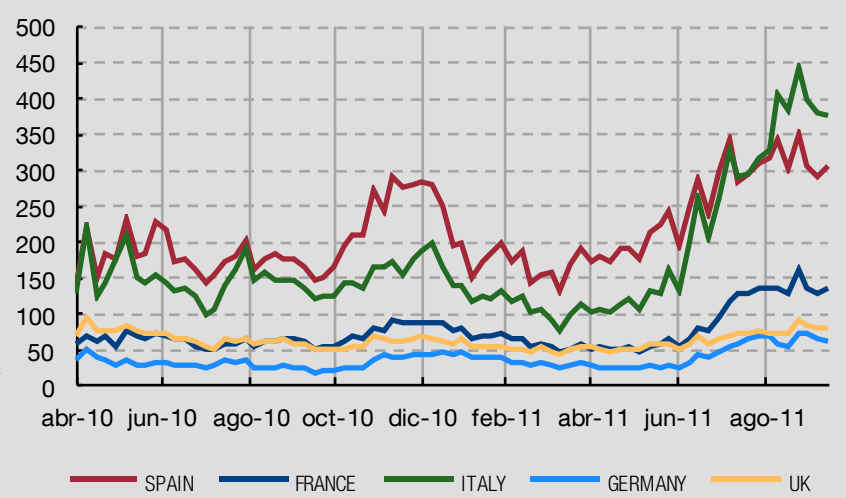


- At present the situation in financial markets in Europe is **characterised by sovereign debt strains**
  - CDS recent trends points to the spread of the tensions from the three countries under EU/IMF programmes to larger countries

SOVEREIGN DEBT CDS. Latest data: 14-Oct.  
bp



SOVEREIGN DEBT CDS. Latest data: 14-Oct.  
bp



Source: Datastream. FSR, forthcoming

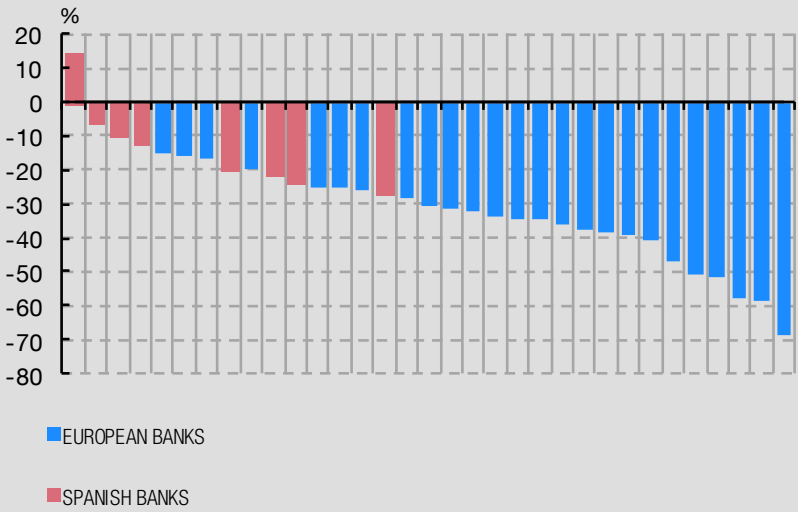
# SPANISH BANKING SECTOR



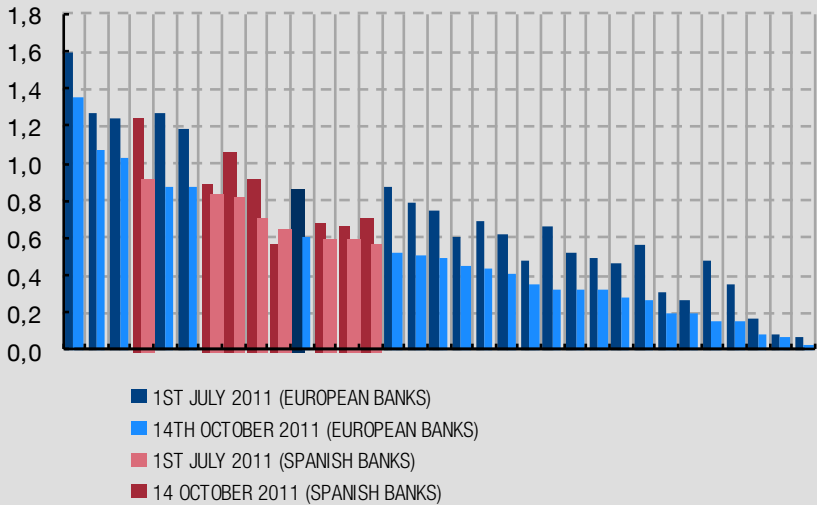
- Banking sector **stock prices** have been declining with intensity since sovereign crisis started

- Price to book values** show historically low levels

CHANGE IN EQUITY PRICES: FROM 1ST JULY 2011 TO 14TH OCTOBER 2011



RATIO PRICE-TO-BOOK VALUE. MAJOR EUROPEAN INSTITUTIONS



Source: Datastream. FSR, forthcoming



- The **exposure of the Spanish banking sector to the sovereign debt is not a major issue** for the Spanish institutions

Banking institutions' exposures to sovereign debt (% of total assets of the banking sector)

	Sovereign from:										
	BE	DE	ES	FR	GB	GR	IE	IT	NL	PT	SE
BE	<b>3,59%</b>	1,66%	0,35%	0,46%	0,02%	0,47%	0,03%	2,59%	0,04%	0,25%	0,08%
DE	0,13%	<b>6,47%</b>	0,38%	0,28%	0,15%	0,16%	0,02%	0,76%	0,09%	0,07%	0,02%
ES	0,02%	0,06%	<b>6,91%</b>	0,11%	0,13%	0,01%	0,00%	0,22%	0,01%	0,16%	0,00%
FR	0,60%	0,82%	0,26%	<b>2,13%</b>	0,16%	0,18%	0,04%	0,95%	0,25%	0,09%	0,00%
GB	0,12%	0,69%	0,24%	0,89%	<b>2,35%</b>	0,05%	0,02%	0,51%	0,24%	0,05%	0,07%
GR	0,00%	0,11%	0,00%	0,04%	0,00%	<b>14,43%</b>	0,00%	0,03%	0,00%	0,00%	0,00%
IE	0,06%	0,18%	0,10%	0,36%	0,94%	0,01%	<b>3,72%</b>	0,25%	0,16%	0,07%	0,01%
IT	0,02%	1,01%	0,16%	0,04%	0,01%	0,07%	0,01%	<b>8,11%</b>	0,01%	0,02%	0,00%
NL	0,61%	1,32%	0,11%	1,18%	0,07%	0,06%	0,02%	0,51%	<b>2,26%</b>	0,04%	0,00%
PT	0,00%	0,00%	0,07%	0,16%	0,00%	0,40%	0,15%	0,29%	0,00%	<b>5,61%</b>	0,00%
SE	0,02%	1,98%	0,01%	0,16%	0,00%	0,01%	0,00%	0,03%	0,03%	0,01%	<b>2,90%</b>

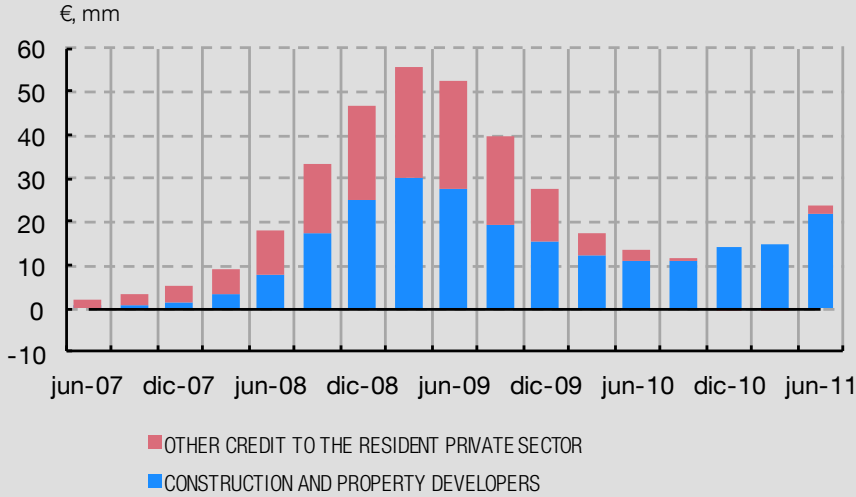
Source: EBA stress test results



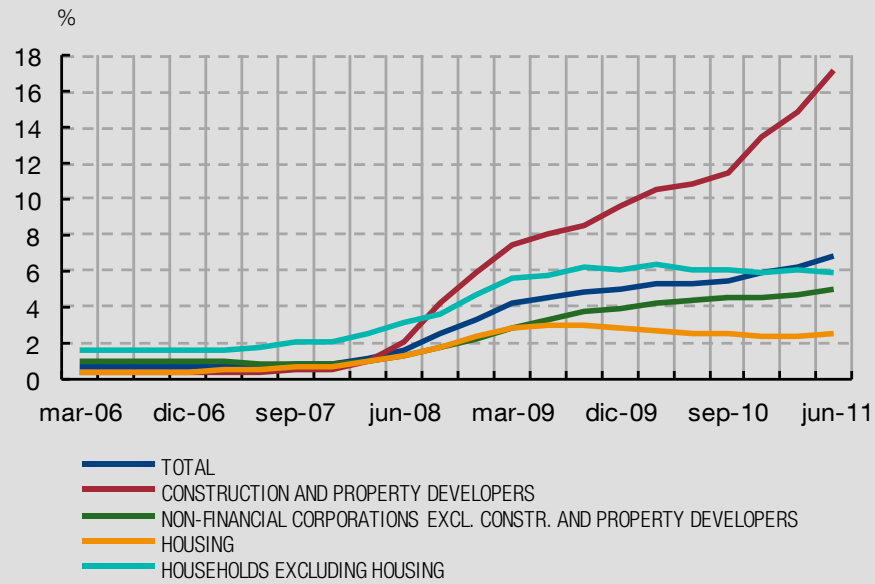


- **Doubtful loans ratios are increasing**, particularly in the credit to construction and property developers

YEAR ON YEAR CHANGE IN DOUBTFUL CREDIT TO THE RESIDENT PRIVATE



DOUBTFUL ASSETS RATIO. RESIDENT PRIVATE SECTOR

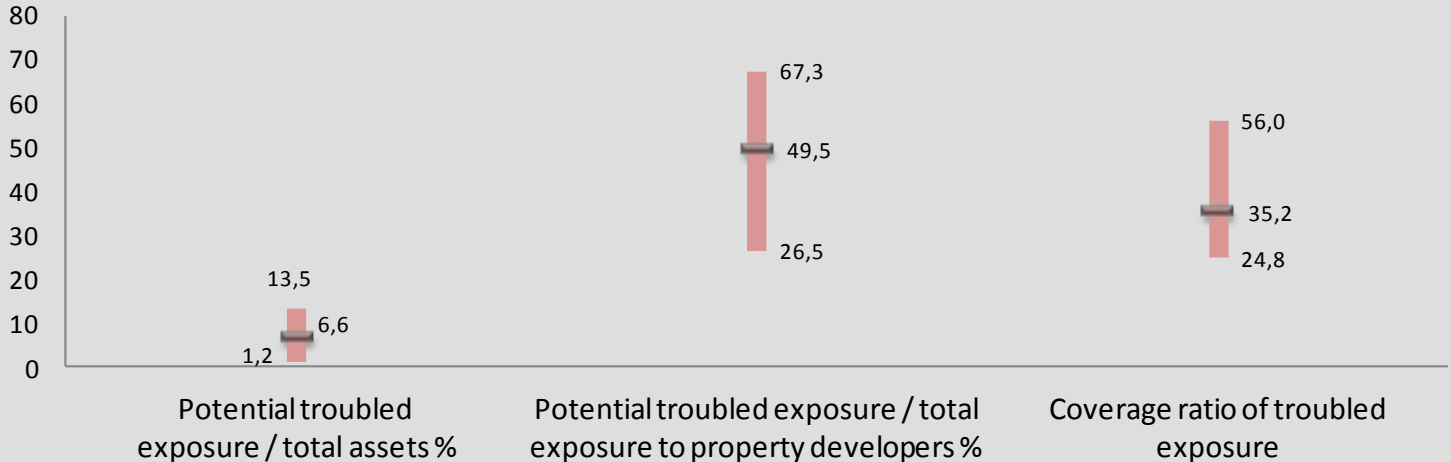


Source: FSR, forthcoming



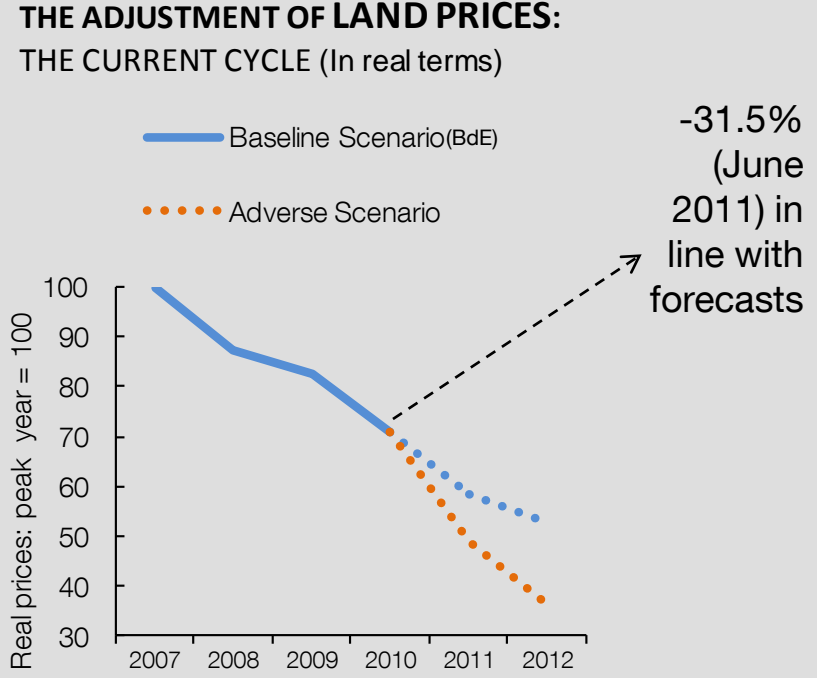
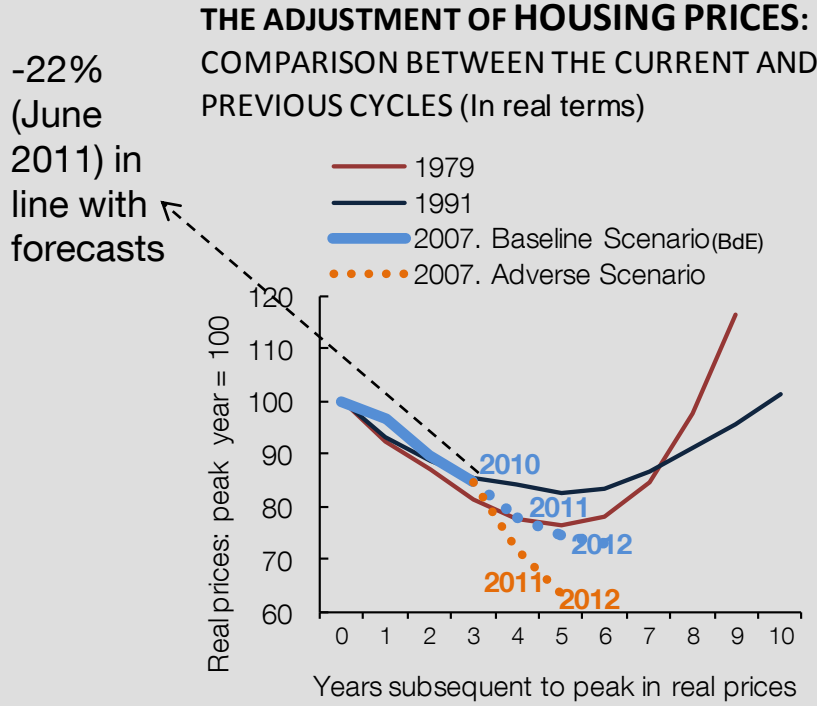
- The **difficulties** for some Spanish banking institutions **remain basically in their exposures to property developers**
- In any case, **institutions need time to digest these exposures**
- **Transparency is a key element as this process evolves**

Exposure to property developers, Minimum, Median and Maximum. June 2011  
Information institution by institution based on their publicly reported data





- There has already been a significant correction in house and land prices. In both cases we expect further corrections in the year to come

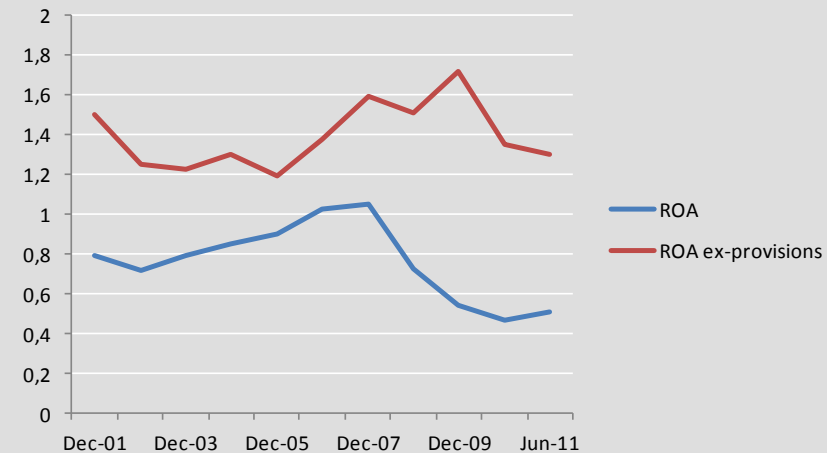




## ■ P&L accounts are still under pressure:

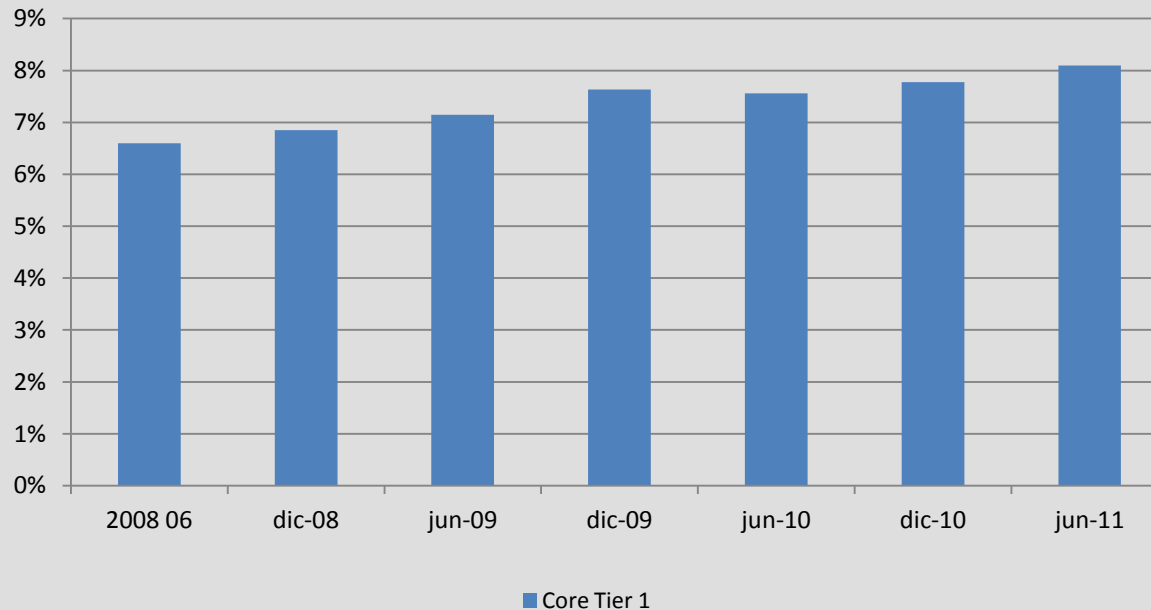
- Low levels of new banking activity
- Pressure on funding costs
- Provisions still high
- However, banking business is viable
- Restructuring and concentration alleviates expenses

Deposit institutions. Last data: June-2011, %





- Spanish deposit institutions have reinforced their core capital

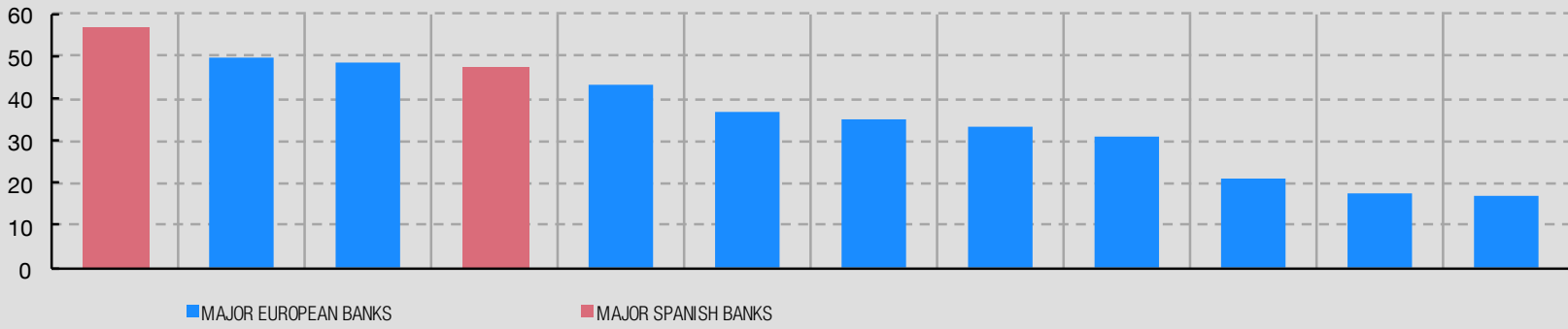


Note. For consistency purposes over time, the Core Tier 1 figure is calculated as the sum of eligible capital and reserves minus intangible assets. This definition does not fully comply with that of EBA used for the 2011 EU-wide stress test exercise, although mostly identical.

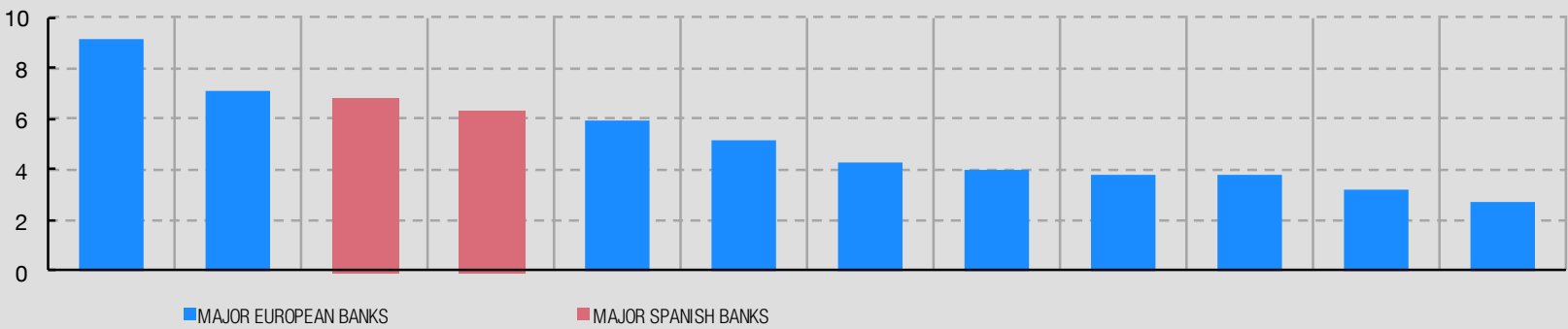


■ **In moments of uncertainty, (core) capital ratio is not the only relevant issue, but also leverage**

RISK WEIGHTED ASSETS / TOTAL ASSETS. %, JUNE 2011



SHAREHOLDER EQUITY / TOTAL ASSETS, % June 2011



Source: DataStream. FSR, forthcoming



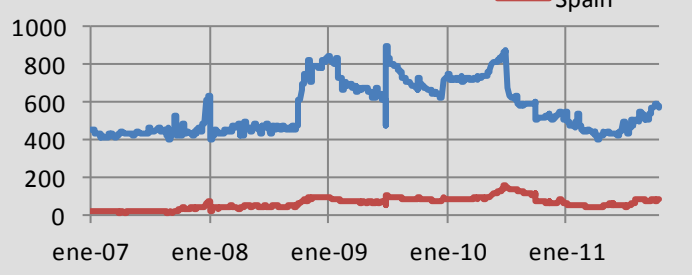
## Short term funding topics

- Wholesale markets are closed
- ECB full allotment policy reduces the risks arising from short-term liquidity pressures
- Spanish deposit institutions have **enough collateral to obtain funds from the ECB**

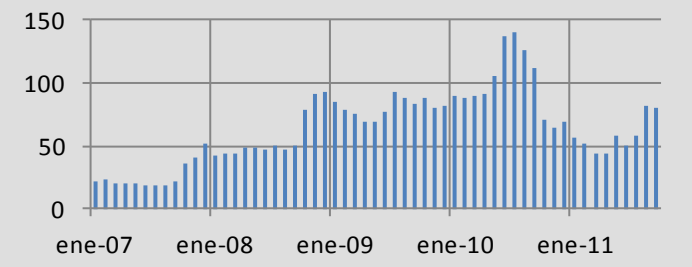
**On the medium term,** ensuring wholesale markets re-opening requires both

- Regaining market confidence for Europe
- and national authorities and institutions solving potential domestic weaknesses

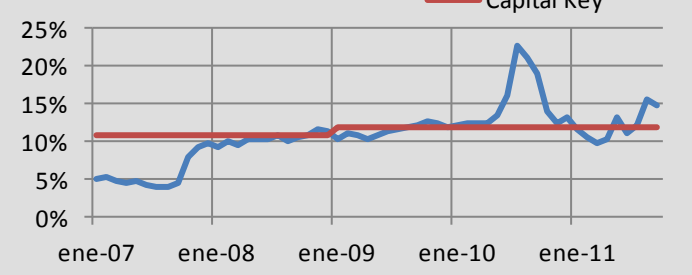
Outstanding amounts of Eurosystem tenders, €bn. Latest data: 14 Oct.



Eurosystem gross lending to Spanish banking sector, €bn



Eurosystem gross lending to Spanish banking sector, %



Source: FSR, forthcoming

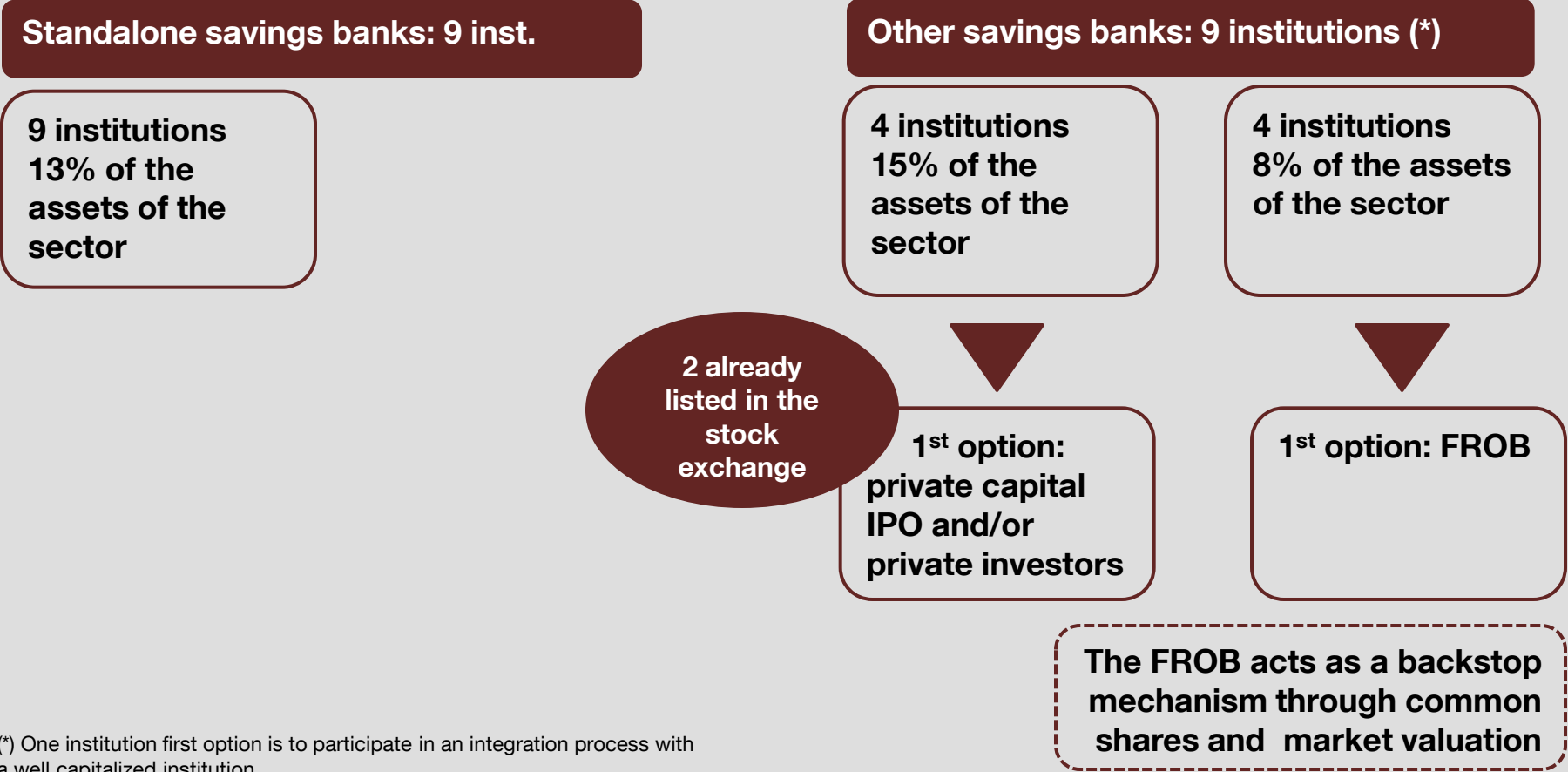


- In difficult, uncertain and volatile times such as the current ones **it is key having a strategy. Thus, we stick to our master plan**
- The **Royal Decree-Law 2/2011**, approved by the Parliament on 10 March, required **higher levels (8%-10%) of Principal Core capital for Spanish institutions**
- **On 10 March the BE published the list of the institutions that needed more capital** (as well as the amount of capital) to comply with the new regulation
  - **Two possibilities to obtain the additional capital:** private funds from the markets/private investors; and/or the **FROB** acting as a backstop
  - **An unique timeline: 30/09 is the recapitalisation deadline for all institutions**



# RESTRUCTURING OF THE SPANISH BANKING SECTOR

- On 30<sup>th</sup> of September BE published detailed information on the financial system recapitalisation process envisaged under Royal Decree-Law 2/2011



(\*) One institution first option is to participate in an integration process with a well capitalized institution



- **In a very difficult market environment characterised by increasing uncertainty and risk aversion having a clear strategy is key**
  
- **We have a strategy in place**
  - Capital injections that are conditioned on the restructuring of the institutions
  - Transparency a key element
  - Enough flexibility to cope with a very rapid changing external environment
  
- **And so far we stick to the master plan**