

# **Financial Stability Report**

**November 2016**

## **Banking System Risks and Situation**

## MAIN FEATURES



- In the first half of 2016 Spanish deposit institutions' activity increased modestly. On a consolidated basis, their volume of total assets grew slightly (0.4%), driven fundamentally by business abroad.
- With respect to asset quality, the reduction of the total volume of non-performing loans, although still at high levels, continues (accumulated fall of 38% from December 2013). The stock of foreclosed assets remains significant, but in 2015 the flow of sales exceeded, for the first time, the flow of new entries. Forborne assets also continued on a downward trend (an accumulated fall of over 25% from 2014).
- In terms of solvency, the CET1 ratio stands at levels above 12%, exceeding the regulatory minimum. A forward-looking analysis conducted by the Banco de España shows the resilience of Spanish banks, even under a severely adverse scenario, harsher than that used by the EBA in the 2016 ST exercise.
- Institutions' profitability continues to be weighed down by the pressure exerted by low interest rates on margins. Together with a still-declining volume of domestic banking activity, and a still-high level of non-productive assets, this has resulted in low profitability levels (ROE of 6.1%).
- Against the backdrop of the current environment of low rates and low level of activity it is expected that institutions will: (a) persevere in their efforts to increase efficiency through the reduction of costs; (b) explore alternative income sources; (c) and, in certain cases, consider possible corporate transactions.

## MAIN RISK FACTORS



- 1. Low profitability of domestic banking business** in an environment of very low interest rates, a still-declining volume of banking activity and a still-high though continuously diminishing level of non-productive assets.
- 2. Deterioration in the growth outlook for the domestic and international economies**, affecting those in which Spanish banks are significantly exposed.
- 3. Downward correction in the prices of financial assets**, both fixed-income and variable-yield securities, as a result of a rise in risk premia.

# BANKING RISKS

## Credit Risk. International Exposures



- On a consolidated level, Spanish deposit institutions' **total assets increased by 0.4%** annually. This is the consequence of greater international activity (15.5% growth) compensating for the decrease in domestic business (-2.2%).
- International activity is concentrated in **United Kingdom (29%)**, **USA (16%)**, **Brazil (9%)**, **Mexico (8%)** and **Turkey (6%)**, although with different exposure profiles. UK exposures are for financing households, whereas in other countries financing is for both households and firms.

INTERNATIONAL EXPOSURE. FINANCIAL ASSETS  
Deposit institutions

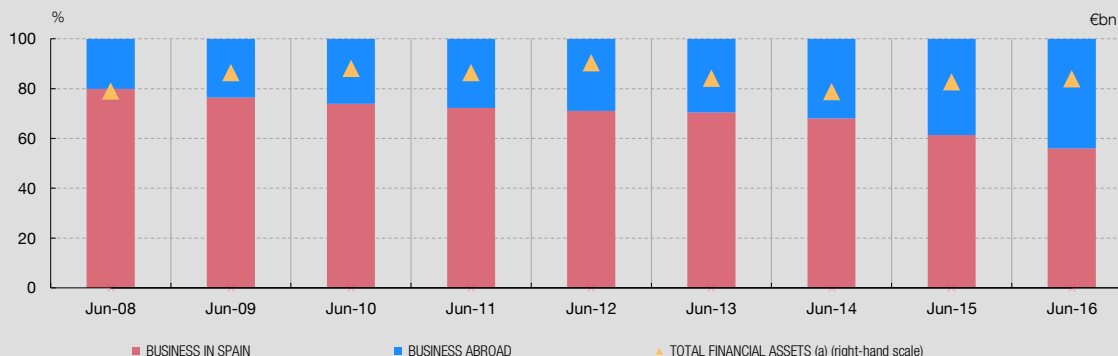
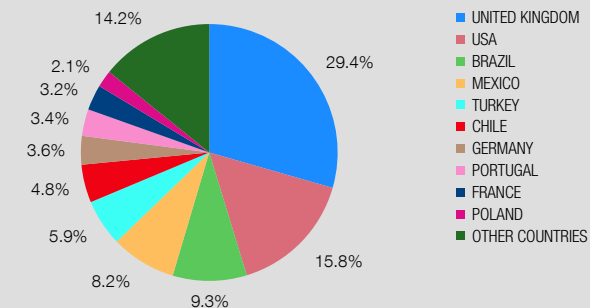


CHART 2.1

CHART 2.2

A GEOGRAPHICAL BREAKDOWN OF LOANS



SOURCE: Banco de España.

a. Total financial assets include derivatives, equity instruments, debt securities, and loans and advances, and the distribution between business in Spain and business abroad is based on this magnitude.

# BANKING RISKS

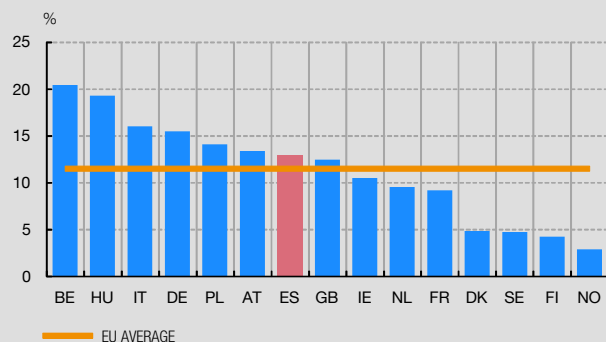
## Credit Risk. Sovereign Exposures and Non-Performing Assets



- Spanish banks' **sovereign exposures** expressed as a proportion of total exposures are similar to the European average (13% versus 11.5% EU average). The proportion of sovereign domestic exposures (57%) is higher than that of the average European banks (48%) but similar to that of Germany, France or Italy (source: EBA).
- As of June 2016, **non-performing assets** on a **consolidated** basis **decreased by 13.7%** annually resulting in a **non-performing loans ratio of 5%**.

CHART 2.4

A SOVEREIGN EXPOSURES AS A PROPORTION OF TOTAL EXPOSURES.  
EU COMPARISON (a)  
December 2015



SOURCE: EBA.

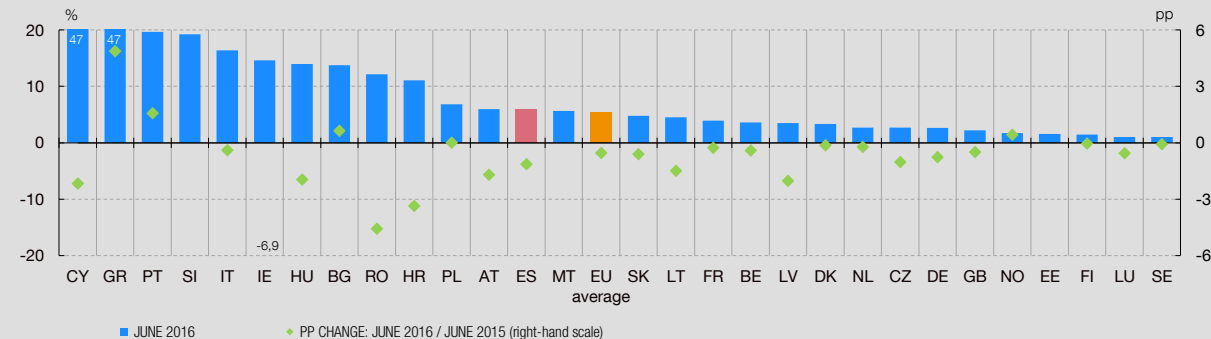
a. The comparison is made for the 51 institutions which participate in EBA 2016 stress test.

b. NPL ratio in Cyprus and Greece is 47.4% and 46.9%, respectively. NPL ratio change in Ireland is -6.9 pp.

c. June 2015 data not available for the following countries: Slovenia, Malta and Estonia.

CHART 2.5

C EU NPL RATIOS (a) (b) (c)  
June 2016



# BANKING RISKS

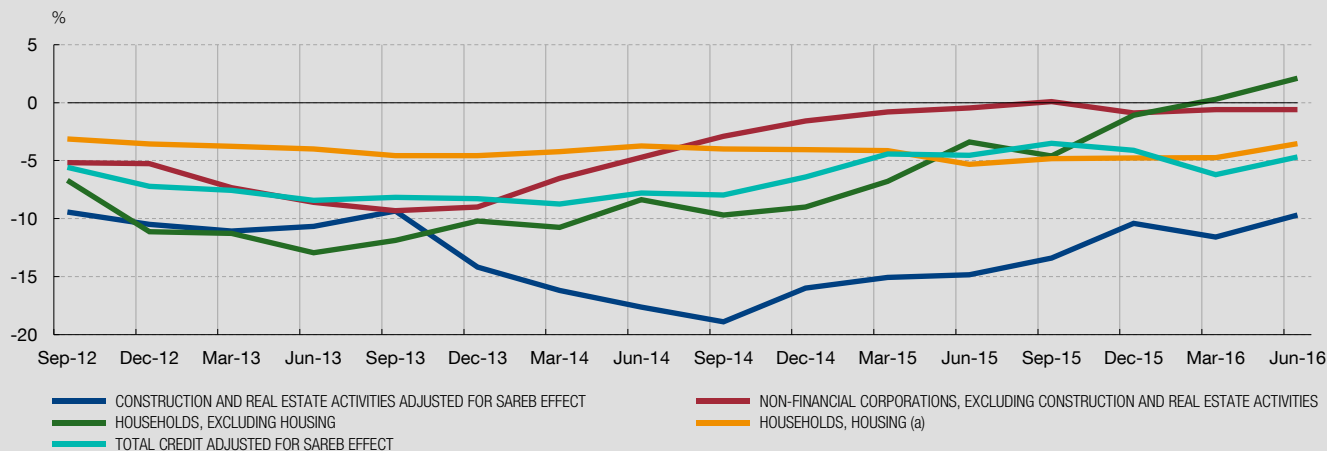
## Credit Risk. Domestic Exposures



- **Credit to the domestic sector** continued on a declining trend, down by 4.7% with respect to June 2015.
- **Credit to non-financial firms fell by 3.6%.** Credit to real estate and construction activities decreased by 9.7% versus 14.9% one year before. Credit granted to other firms only decreased by 0.5%, although unevenly distributed among sectors.
- The **decline in credit to households slowed** (-2.7%). Mortgages decreased by 3.5% whereas consumer lending increased by 2.1% for the first time since the beginning of the crisis.

CHART 2.6

A YEAR-ON-YEAR RATE OF CHANGE IN CREDIT TO THE RESIDENT PRIVATE SECTOR BY SECTOR OF ACTIVITY



SOURCE: Banco de España.

a. Includes securitisations.



- **NPLs at the domestic level decreased by 18.2%** on a year-on-year basis accumulating a **reduction of 38% since December 2013**. Overall, the **NPL ratio** for the domestic sector **stood at 9.7%** as of June 2016.
- NPL ratio for households stood at 5.2% (4.5% for mortgage loans and 8.7% for consumer lending), and fell to 15.7% for credit to non-financial corporations.

# BANKING RISKS

## Credit Risk. Domestic Exposures. Non-Performing Loans



CHART 2.8

A NON-PERFORMING LOANS (a)

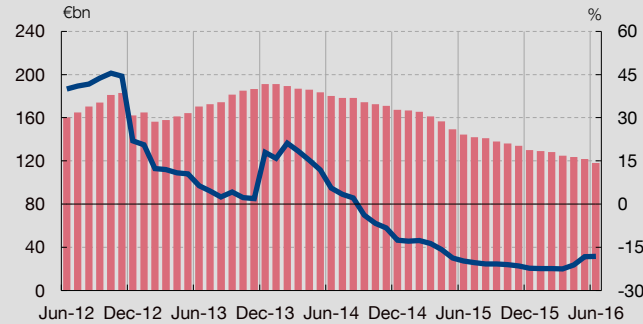
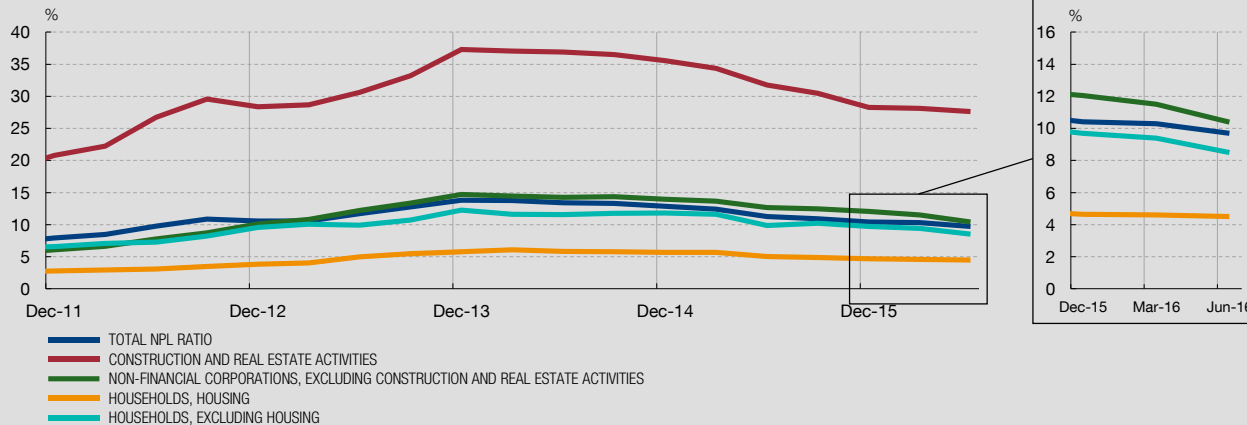


CHART 2.11

LEVELS (red bar)      YEAR-ON-YEAR RATE OF CHANGE (right-hand scale) (blue line)

C NPL RATIO, BY SECTOR OF ACTIVITY



SOURCE: Banco de España.

a. The transfers to Sareb by Group 1 and Group 2 banks in December 2012 and February 2013 affect the rates of change in those periods.





- **Foreclosed assets** amounted to a total of €81 billion as of June 2016, falling 1.4% y-o-y and reaffirming the moderate downward trend over recent years.
- Between 2011 and 2013 foreclosed assets decreased as a result of their transfer to **Sareb**, whereas the reduction observed in 2015 was due to the **sale of those assets**.
- Overall, **non-productive assets** (NPLs and foreclosed assets) have decreased by 12% and amount to €199 billion as of June 2016.
- **Forborne loans** decreased by 12.1% in June 2016, accumulating a total decline of 26% since March 2014.



CHART 2.12

A FORECLOSED ASSETS BETWEEN DECEMBER 2011 AND DECEMBER 2015 (a)

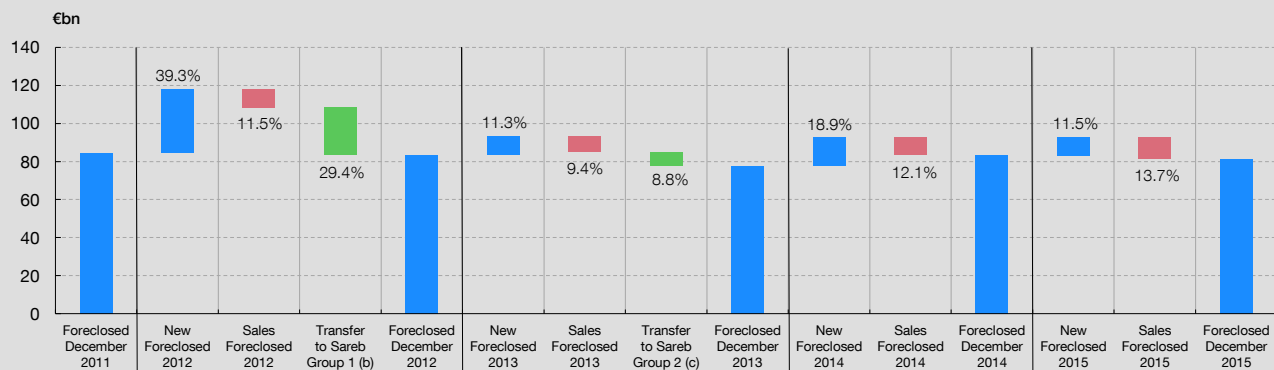
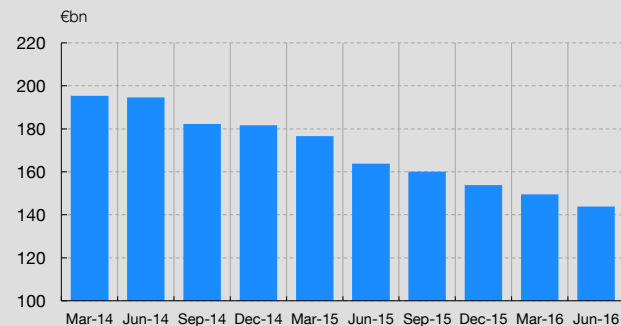


CHART 2.13

A VOLUME OF FORBORNE LOANS



SOURCE: Banco de España.

a Shown beside each bar is the percentage each item represents of the total foreclosed assets at the beginning of the year.

b Group 1 institutions were Banco Financiero y de Ahorros, NCG Banco, Catalunya Banc (currently integrated in BBVA) y Banco de Valencia (currently integrated in La Caixa).

c Group 2 institutions were BMN, Liberbank, Caja3 (currently integrated in Ibercaja) and CEISS (currently integrated in Unicaja).

# BANKING RISKS

## Funding Risk



- **Deposits from the private sector on a consolidated basis** increased by 1.9% as of June 2016 due basically to those from abroad (10.7%). **In Spain, retail deposits** increased by 2.8% despite the low interest rate environment, maintaining the upward trend initiated in 2015.
- The volume of **issuance of senior debt and covered bonds** by Spanish banks in 2016 decreased slightly with respect to the previous year, and the issuance of subordinated debt was also more limited.
- In any event, it may be said that **Spanish banks are not facing funding problems.**

CHART 2.15  
D MAIN ISSUES OF SPANISH INSTITUTIONS IN MEDIUM- AND LONG-TERM WHOLESALE MARKETS

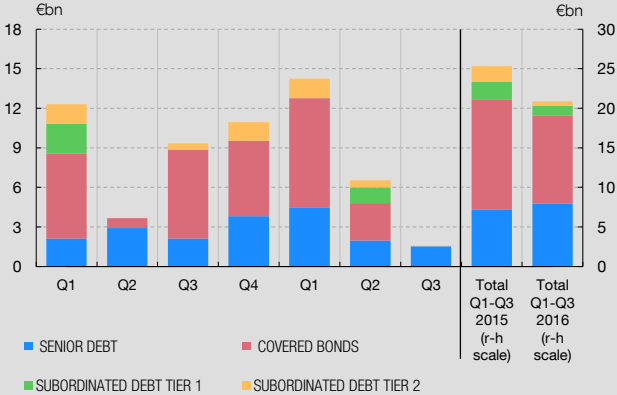
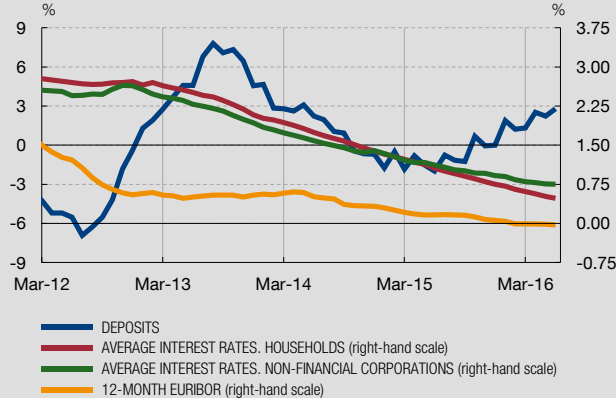


CHART 2.18  
A DEPOSITS FROM HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS, AND AVERAGE INTEREST RATES



SOURCES: Bloomberg, Dealogic and Banco de España.

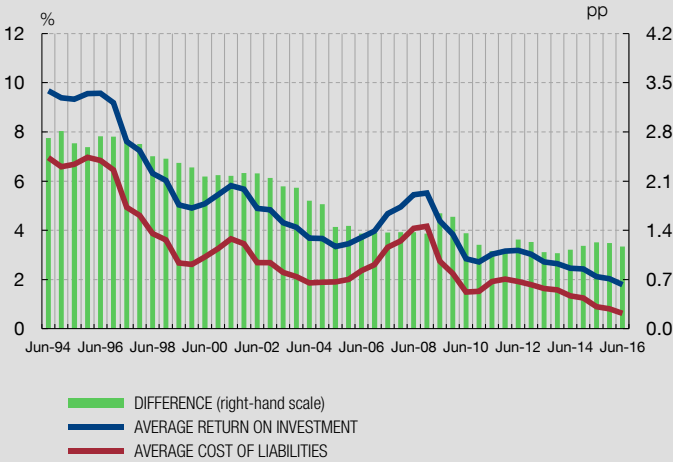
- **The interest margin** is close to historical lows. The reduction in lending rates has been in combination with a reduction in funding rates, but pressure on margins increases as the latter draws closer to the zero bound.
- **Non-productive assets** are still significant on banks' balance sheets and put pressure on the P&L account, although better macroeconomic conditions and the lower debt service burden due to lower interest rates contribute to reducing the volume of NPLs.
- Against this backdrop of depressed margins which, foreseeably will be protracted, **it is expected that banks:**
  - (a) persevere in their efforts to increase efficiency through further cost-cutting;**
  - (b) explore alternative income sources;**
  - (c) and, in specific cases, consider possible corporate operations.**

# BANKING RISKS

## Profitability

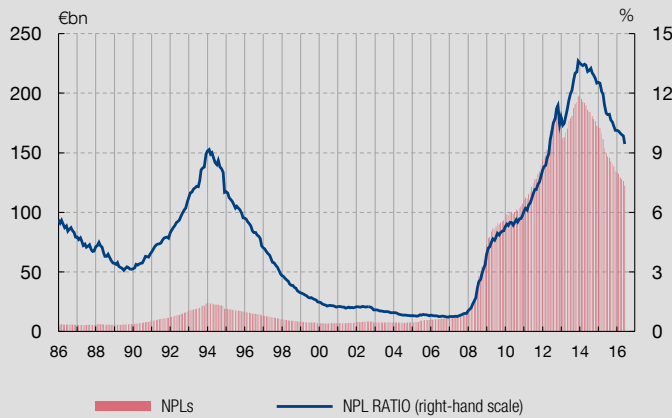


**A DIFFERENCE BETWEEN AVERAGE RETURN ON INVESTMENT AND AVERAGE COST OF LIABILITIES**  
Business in Spain, ID



SOURCE: Banco de España.

**B RESIDENT PRIVATE SECTOR NPLs AND NPL RATIO**  
Business in Spain, ID



# BANKING RISKS

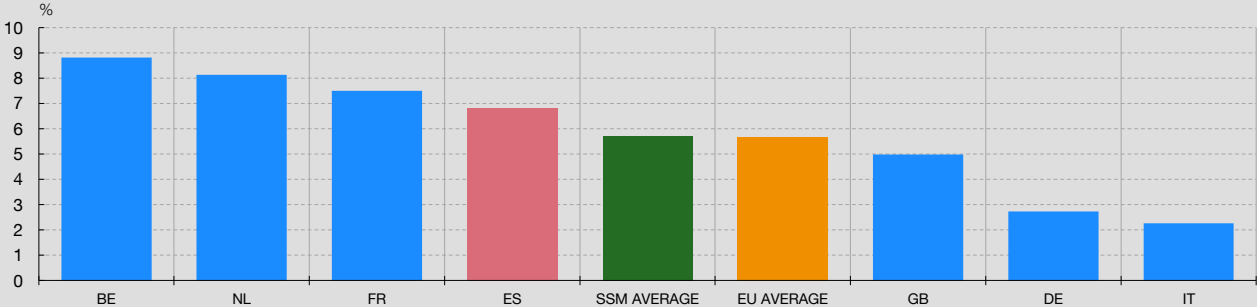
## Profitability



- Over the first half of 2016, the **income attributable to the controlling entity decreased by 30%** with respect to 2015. **ROA** fell to 0.42% and **ROE diminished** by more than 2.5 pp to 6.1%, slightly above the European union ROE average.

ROE. EUROPEAN COMPARISON. JUNE 2016 (a)

CHART 2.20



SOURCE: EBA.

a. The data refer to the sample of 198 banks included in the Risk Dashboard.



- Capital ratios for Spanish banks are above the regulatory minimums. The **CET1 ratio** stood at **12.4%** as of June 2016, retaining last year's level. **Risk Weighted Assets (RWAs)** increased slightly by **0.2%**.

CAPITAL RATIOS  
Deposit institutions

CHART 2.27



SOURCE: Banco de España.

# BANKING RISKS

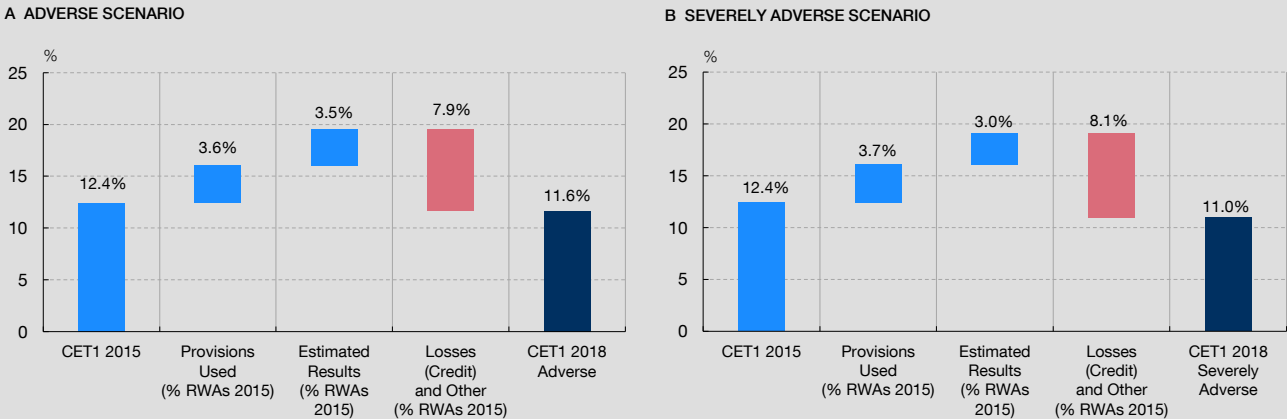
## Solvency. Forward-Looking Analysis



- The **Banco de España** has developed its own forward-looking solvency analysis (**FLESB**) for practically the entire Spanish banking system. The methodology used differs from that designed and applied by the EBA. Consequently, the results of both ST exercises are not directly comparable.
- Notwithstanding, the **FLESB results are qualitatively similar** to those of the EBA: Spanish banks' **CET1 ratio decreases significantly but stands at a level above the regulatory minimum**, even under a severely adverse macroeconomic scenario (more adverse than that used in the EBA ST exercise).

IMPACT ON TRANSITIONAL CET1 RATIO.  
INSTITUTIONS WITH SIGNIFICANT INTERNATIONAL ACTIVITY

CHART 2.32



SOURCE: Banco de España.