Box 2.1

EFFECTS OF THE PANDEMIC ON THE INTERNATIONAL BANKING SYSTEMS MOST RELEVANT TO SPAIN

In the 1990s, the major Spanish banking groups embarked on an extensive internationalisation drive. This has seen them establish a significant presence in the United Kingdom, the United States, Latin America (in particular Mexico and Brazil), Turkey and the rest of the European Union. Overall, almost 50% of these Spanish deposit institutions' consolidated financial assets are outside Spain (see Chart 2.4 in the main body of the text). The expansion model broadly pursued is characterised by financial and operating autonomy using subsidiaries, in contrast to the model based on branches, which lack a legal personality separate from that of their parent.[1]

From the standpoint of financial stability, this model restricts certain channels of risk contagion to the parent institution in Spain in the event of potential financial turmoil in the subsidiary's country.[2] And that is of particular relevance in the case of more volatile economies such as the emerging countries. This box aims to analyse the developments in recent months in banking systems in which Spanish banks' foreign business is concentrated. It considers the potential adverse consequences of the health crisis on the sector and the effect of the extensive support measures implemented by the respective authorities. Finally, it describes some of the risks already materialising.

Chart 1
SITUATION OF THE PANDEMIC AS AT SEPTEMBER 2020

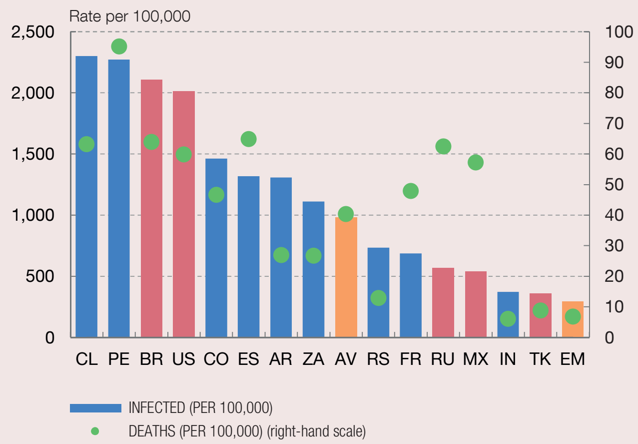


Chart 2
THE OXFORD LOCKDOWN STRINGENCY INDEX

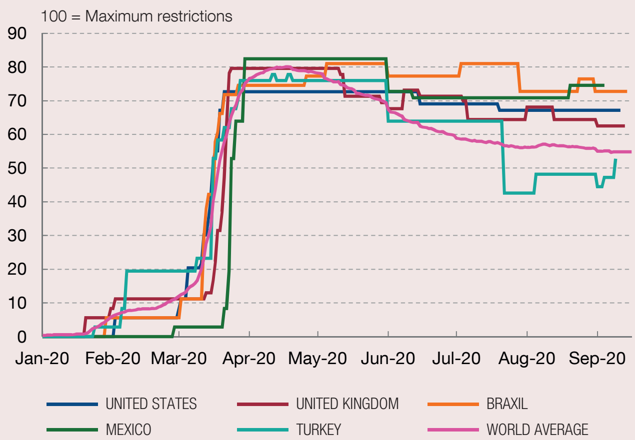


Chart 3
GDP CHANGES IN 2020 Q2

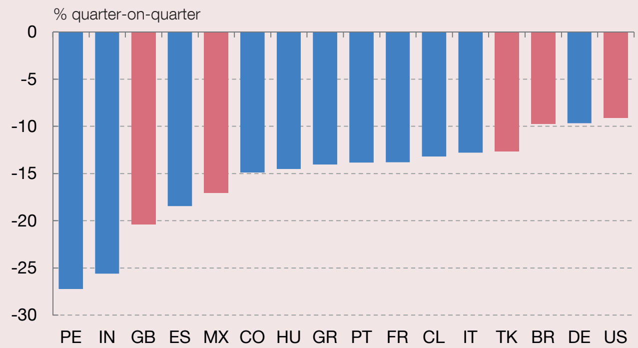
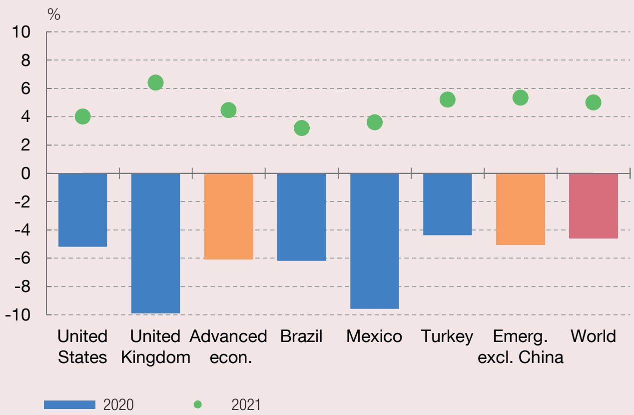


Chart 4
PROJECTED CHANGES TO GDP



SOURCES: Johns Hopkins, Consensus, national statistics and Oxford.

1 See Argimón, I. (2019), "Spanish banks' internationalisation strategy: characteristics and comparison", Economic Bulletin 1/2019.

2 See chapter 3 of the Report "Macroprudential policy implications of foreign branches relevant for financial stability", European Systemic Risk Board, December 2019.

The five countries most relevant to the Spanish banking system are among those most affected by the COVID-19 pandemic (see Chart 1). Specifically, in September 2020, the United States was the world's most affected country in absolute terms of numbers infected and deaths, and ranked ninth in infections per 1,000,000 inhabitants. Brazil stood third in numbers infected, seventh in infections per 1,000,000 inhabitants, and second in deaths. In Europe, the United Kingdom was the second-ranked country most affected in absolute terms and ninth in relative terms. Mexico stood fifth in absolute terms in numbers infected, close to the United Kingdom in per capita terms, and it had a higher mortality rate than all the other countries. Only in Turkey were the pandemic-contagion figures not so high. On the statistics available, Turkey also had a low mortality rate.

In an attempt to check the spread of the virus, all these countries adopted measures restricting individual movements and the normal functioning of economic activity. The measures were broadly similar to those applied in other countries worldwide (see Chart 2). Along with the effects of the pandemic on agents' behaviour and, in the case of the emerging economies, the financial turmoil in March and April, these measures prompted strong contractions in activity and higher unemployment rates (see Chart 3). The consensus among analysts regarding the latest GDP growth forecasts would suggest a significant decline in GDP this year, which would not be fully reversed in any of the jurisdictions in 2021 (see Chart 4). In 2020, the United Kingdom, Mexico and, to a lesser extent, Brazil are expected to post bigger contractions than the advanced and emerging economies as a whole, respectively, while the United States and Turkey will fall somewhat less on average than the economies referred to. In 2021, it is estimated that only the United Kingdom will grow above the average of the reference countries in each case (see Chart 1.4).

Like the other main economies, all these countries have launched wide-ranging economic policy measures to address the consequences of the pandemic.[3] Fiscal and monetary policy actions seek to support the economy as a whole, which exerts beneficial effects on all sectors, including the finance industry. Some measures have been more directly geared to upholding the financial system, such as the credit support programmes, the moratoria on payments, State guarantees and other action relating to the oversight of banks. The main characteristics of these measures are detailed in Table 1. Albeit with some differences, the measures are fairly similar in all countries, and pursue a threefold objective: a) to promote the granting of credit; b) to provide the system with liquidity; c) to mitigate the adverse impact of the crisis on institutions' capital.

Against this background, lending in these banking systems has continued growing in the first half of 2020 (see Chart 5). Such growth has come about essentially via lending to firms. This has been due, initially, to the drawdown of previously extended credit lines and, subsequently, to the public support programmes set in place by different governments to promote the extension of credit. Further, and as has also occurred in other countries, lending to households has slowed. In Mexico, where aid programmes of this type have not been approved, the behaviour of lending has been much more moderate and its year-on-year growth rate has fallen. Also, in those countries in which the weight of public banks is greater, such as Brazil and Turkey, whose respective market shares exceed 45% and 40%, there has been a notable increase in public financing during the first half of the year compared with previous periods.

Despite the unfavourable economic situation, the NPL ratio has not increased significantly to June this year (see Chart 6) as a consequence of the increase in lending activity (an increase in the ratio's denominator) and in light of the 90-day period that must elapse as from the first default arising until a loan is recognised as non-performing. Indeed, in Turkey the ratio has improved significantly in the first half of the year following an uptrend in 2018. This can be explained by a regulatory change which has extended the default period for recognising a loan as non-performing from 90 to 180 days, until end-2020.

In addition, generally all countries have launched widespread public programmes involving moratoria. Brazil has been an exception. There, each bank applies discretionary measures under the flexibility temporarily allowed by the central bank to classify loans as non-performing. The expiry dates of these moratoria are concentrated in the second half of 2020. Thus, it will

3 Details of the main measures adopted by the US and UK governments and central banks can be found in Cuadro-Sáez, L., López-Vicente, F. S., Párraga Rodríguez, S., and F. Viani (2020), Fiscal policy measures in response to the health crisis in the main euro area economies, the United States and the United Kingdom", Occasional Papers, No. 2019, August 2020, Banco de España. For the main measures adopted initially in Brazil and Mexico, see Banco de España (2020), Report on the Latin American economy. First half of 2020", 29 April, Analytical Articles, Economic Bulletin 2/2020.

Table 1
MEASURES ADOPTED TO ADDRESS THE CONSEQUENCES OF THE PANDEMIC ON THE BANKING SECTOR

Country	Moratoria	Credit-promoting measures	Supervisory measures
Mexico	Moratoria for mortgage loans, consumer loans, credit cards, loans to SMEs and to companies (from 26 March to 31 July 2020) Deferral of principal and/or interest payment of between 4-6 months For all customers whose source of income is affected by the pandemic	None set	Recommendation not to pay out dividends Possibility of using the capital conservation buffer for the extension of credit Delay in the entry into force of certain international standards, such as IFRS 9 or TLAC Easing of local liquidity requirements for 6 months
Brazil	No general public moratoria established. Credit institutions have defined private deferral measures with different charactreristics Suspension of up to 6 months of repayment of indirect loans from BNDES (April to September 2020)	Support from public banks and the BNDES PESE (Emergency Job Support Programme): financing of payrolls for firms with turnover of up to 10 million BRL in the first phase (to June 2020) and up to 50 million BRL in the second (to October 2020). 85% guarantee. 3-year term PRONAMPE (SME support programme): for firms with turnover up to 4.8 million BRL (to November 2020). 85% guarantee. 3-year term PEAC (emergency credit access programme): for firms with turnover up to 300 million BRL (to December 2020). 80% guarantee. Term up to 5 years	Temporary restriction on the distribution of income above the legal minimum in 2020 Reduction of the capital conservation buffer from 2.5% to 1.25% and further measures to reduce requirements such as the change in weighting for SMEs from 100% to 85% in operations between April and December Exemption for reclassification and increase in provisioning for loans subject to restructuring on account of COVID-19 from March to September
United Kingdom	Legislative moratoria for mortgage loans (19 March to 31 October), personal loans, credit cards and car finance (9 April to 31 October) Deferral of principal and interest payments for a period of 3-6 months Various private measures	State-backed programmes: – CBILS *(Coronavirus Business Interruption Loan Scheme)*: financing to companies with annual turnover of up to 45 million GBP (to 30 September). 3-6 year term. 80% guarantee – CLBILS *(Coronavirus Large Business Interruption Loan Scheme)*: financing to companies with annual turnover of over 45 million GBP (to 30 September). Term up to 3 years. 80% guarantee – BBLS *(Bounce Back Loan Scheme)*: financing for all types of companies (to 4 November). 6-year term. 100% guarantee. Bank of England programme for purchase of short-term debt issued by large companies	Recommendation not to pay out dividends until January 2021 Reduction in countercyclical buffer to 0% for 12 months Maintenance of Pillar 2A requirements for 2020 and 2021 More flexible reclassification arrangements and increased provisioning for loans subject to restructuring on account of COVID-19 from March to October

SOURCES: National Central Banks and Banco de España.

foreseeably be as from 2020 Q4 and in early 2021 that the impairment of credit quality becomes more evident, with an increase in NPLs and forbearance expected.

The profitability of the different banking systems began already to worsen in the first half of the year (see Chart 7).

Broadly, banks' income statements have begun to reflect the initial impacts of the pandemic. This has essentially been the result of lower revenue, owing to the lower fees arising on diminished commercial activity, and, above all, to higher provisioning by banks to withstand the new

Box 2.1
EFFECTS OF THE PANDEMIC ON THE INTERNATIONAL BANKING SYSTEMS MOST RELEVANT TO SPAIN (cont'd)

Table 2
MEASURES ADOPTED TO TACKLE THE CONSEQUENCES OF THE PANDEMIC ON THE BANKING SECTOR (cont'd)

Country	Moratoria	Credit-promoting measures	Supervisory measures
United States	Deferral of principal and/or interest payments, with a recommendation this should not exceed 6 months Applicable to all products, except certain mortgage loans To be concluded when the first of these two dates should fall due: (a) 60 days after the end of the state of alert, or (b) 31 December 2020 For loans not more than 30 days past-due on 31 December 2019	PPP *(Paycheck Protection Program)*: intended for SMEs with fewer than 500 employees (discontinued in August, but could be extended if a new package of fiscal stimuli is approved). 2-year term. 100% guarantee. Main Street Program*:* intended for firms with fewer than 15,000 employees or annual income below 5 million dollars. 5-year term. 95% guarantee. Can be requested until December 2020.	Restrictions on dividend payouts in 2020 for the country's biggest banks Easing of TLAC and leveraging requirements Incentives to use buffers for extension of credit
Turkey	Applicable to all types of loans Deferral of 3 months for retail customers and of 6 months for wholesale customers, with the possibility of an extension until the end of the year in both cases if the customer so requests it Deferral of principal and/or interest payment	Increase in the ceiling on the Credit Guarantee Fund (State programme for SMEs) of TRY 25 - 50 million. No discontinuation date. 80% guarantee Asset ratio: new requirement defined as loans and securities divided by deposits, which must be higher than 95%, penalising foreign exchange activity Capitalisation of the three public banks through the "weal*th fund*" ($2.97 billion)	Restrictions on dividend payouts in 2020 for the country's biggest banks Easing of TLAC and leveraging requirements Incentives to use buffers for extension of credit

SOURCES: National Central Banks and Banco de España.

macroeconomic scenario. In Turkey, which is an exception to this pattern, the slight improvement in the banking system's profitability has been underpinned exclusively by public banks (a 28 bp rise in ROA to 0.76%), since the profitability in the private banking sector has behaved similarly to the other countries analysed.

As regards liquidity, the situation has remained relaxed in most countries. Liquidity ratios have held above the regulatory minimum (standing even higher at the start of the crisis), thanks to central bank liquidity injection programmes. These enabled banks to stockpile liquidity in anticipation of possiblel future needs, which have so far not materialised. As an exception, some small retail-oriented Mexican banks experienced some liquidity tensions in March and April, but these have now been overcome.

Lastly, as regards bank solvency, there has been no discernibly significant impact on capital ratios, which remain relatively stable and above the minimum required level in all the countries (see Chart 8). Several provisions adopted by the authorities have contributed to this stability of solvency ratios. They include most notably the across-the-board recommendation not to pay out dividends (see Table 1). In addition, as in the European Union, a further series of measures have been taken focusing on minimising the impact stemming from market developments and reducing requirements in a transitory manner.

In short, despite the adverse effects of the COVID-19 pandemic, the main indicators of the banking systems most relevant to Spanish banks have not worsened substantially so far. This is largely owing to the swift adoption of support measures by the authorities of these countries. However, the outlook for these banking systems is subject to significant downside risks. Factors here include the pandemic potentially taking a turn for the worse, and its macroeconomic influence and the likely associated credit impairment, as the manifold downgrades in corporate credit ratings anticipate (see Charts 9 and 10). Such factors have been exacerbated in the case of certain emerging economies owing to their greater macrofinancial vulnerability. Finally, some of the measures taken by the authorities also entail certain risks that should be taken into account. These include possible market segmentation resulting from the actions of public banks, and the public sector having to burden itself with sizeable fiscal costs.

Box 2.1

EFFECTS OF THE PANDEMIC ON THE INTERNATIONAL BANKING SYSTEMS MOST RELEVANT TO SPAIN (cont'd)

Chart 5
LENDING TO THE PRIVATE SECTOR (a)

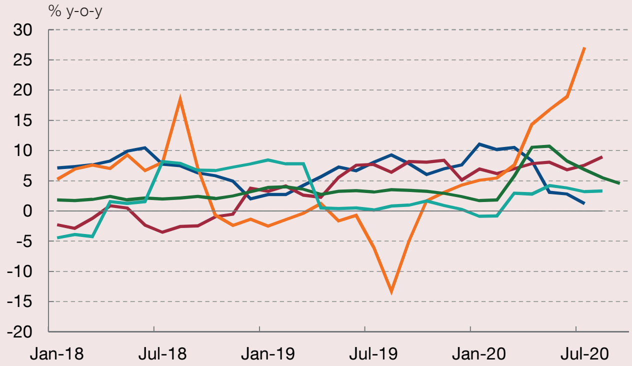


Chart 6
NON-PERFORMING LOANS

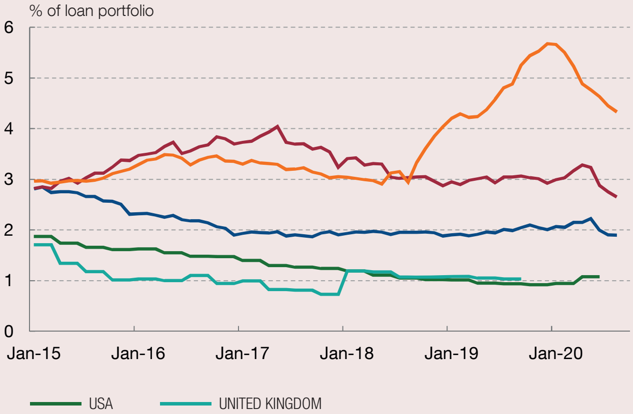


Chart 7
PROFITABILITY (b)

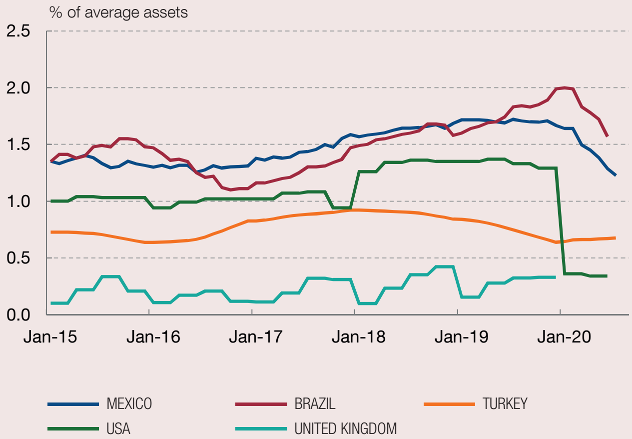


Chart 8
REGULATORY CAPITAL

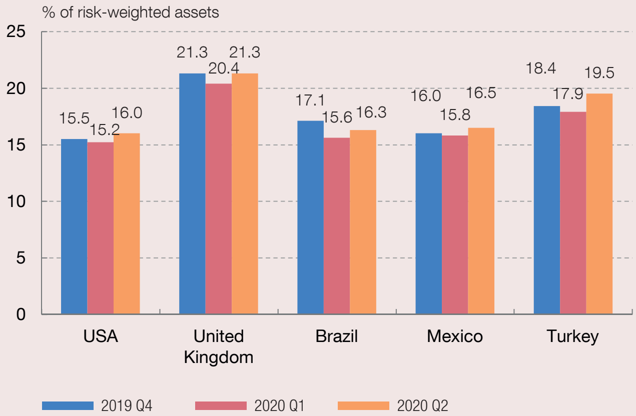


Chart 9
CORPORATE CREDIT RATINGS: EMERGING ECONOMIES

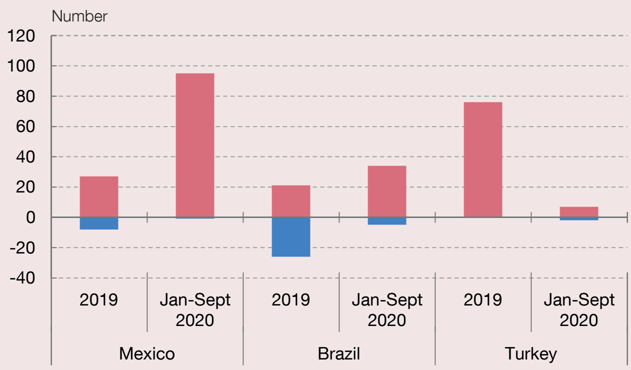
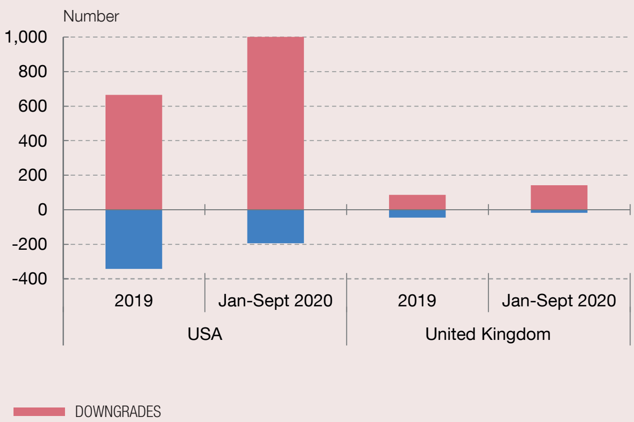


Chart 10
CORPORATE CREDIT RATINGS: ADVANCED ECONOMIES



SOURCES: National statistics, Refinitiv and IMF.

a In real terms.
b Return on assets (ROA).