

The Russian invasion of Ukraine has increased the risks to global financial stability notably. This new shock to the Spanish economy arrives in the context of a gradual recovery, that remains incomplete and is uneven across sectors, while risks associated with the pandemic persist, and after upward surprises to inflation in the second half of 2021.

The direct exposure of the Spanish economy and financial system to Russia is very low, owing to the moderate size of financial and trade links. However, the risks associated with indirect channels are very relevant, with those arising from the increase in the prices of energy and other commodities, and the possible associated macroeconomic deterioration being notable. Thus, the outbreak of the war in Ukraine has increased short-term inflationary pressures and the probability that these will become more persistent. Also, there is a risk of a further tightening of financing conditions, owing to the possible monetary policy reaction to contain the inflationary pressures and the possible increase in risk premia in an environment of uncertainty. The potential impact of the sanctions is another factor that needs to be taken into account. In this context, certain vulnerabilities of the Spanish economy, including its high levels of public debt and the financial weakness of certain household and firm segments, are particularly important.

In 2021, lending to the private sector in Spain declined slightly. The growth of lending to firms was very low, offsetting the greater buoyancy of lending to households, which was driven by the sharp growth of new lending for house purchase. Mortgage lending conditions (loan-to-value, loan-to-price, etc.) did not change appreciably last year, while the costs of this type of lending decreased, with a fall in interest rates and a narrowing of the spreads over risk-free rates in the case of fixed-rate mortgages. The inflation developments in 2022 and risks identified in the context of the war in Ukraine appear to entail a change of trend in mortgage costs.

In 2021, non-performing loans continued to decline in Spain, at a higher rate than in the previous year. Notwithstanding this, there was a further increase in Stage 2 loans, explained by the reclassification of performing loans. In addition, there are other signs that could anticipate a greater decline in the quality of credit, such as the increase in forborne loans, or the larger increase in non-performing and Stage 2 loans in certain segments, especially in those sectors hit hardest by the pandemic. Moreover, ICO-backed loans recorded additional impairment in the second half of 2021. The risks in these more vulnerable segments may worsen in the new macro-financial environment stemming from the invasion of Ukraine, and as a result of the end of the principal payment grace periods enjoyed by a significant proportion of ICO-backed

loans. However, the new public support measures to alleviate the economic effect of the war in Ukraine may to some extent mitigate the materialisation of these risks.

The profitability of Spanish banks recovered significantly in 2021, bolstered by a positive change in extraordinary items and lower provisioning. This improvement was seen across the main countries in which they operate. Against this background, the banking sector's CET1 capital ratio held relatively stable in 2021, after increasing in 2020. The results of the stress tests show that the average CET1 ratio would decline if the macro-financial risks identified materialise strongly. However, the aggregate resilience in terms of solvency would be satisfactory, with some heterogeneity across institutions.

In this environment, the financial system needs to be closely monitored so that any potential materialisation of the identified risks can be rapidly verified and action taken to mitigate them. Banks must be very prudent and continue to make adequate provisions, while fully recognising any actual impairment that may arise in a timely fashion.

In the second half of 2021, thanks largely to the upturn in economic activity, the high levels reached in 2020 by the systemic risk indicators that inform decisions on the countercyclical capital buffer (CCyB) continued to abate. Nonetheless, some indicators, such as the credit-to-GDP gap, still diverge significantly from their pre-COVID-19 levels, making it crucial to track developments in the coming quarters in order to assess any potential warning signs.

In other euro area countries, cyclical imbalances are already being observed, especially in the real estate sector, which have led to the activation of some countercyclical capital buffers and sectoral tools that act directly on real estate imbalances. Owing to the presence of certain common factors, such as accommodative financing conditions in recent years, which partly explain the developments in European real estate markets, close monitoring is appropriate, given the risk that the imbalances identified in other countries could also arise in Spain.

The growth of crypto-assets, their potential use as a means of payment and the almost complete absence of regulation of these financial instruments pose increasing risks to financial stability. The Banco de España lacks regulatory and supervisory powers over crypto-asset issuers and the providers of crypto-asset services, although it analyses this market due to its potential impact on the financial system as a whole. Given the global dimension of crypto-asset activities, the development of regulatory initiatives at international level is urgent to establish uniform rules to provide legal certainty in operations with these instruments and allow the currently existing shortcomings in the information on them to be remedied.