FINANCIAL STABILITY: MAIN VULNERABILITIES AND RISKS

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Since the Russian army invaded Ukraine in February the growth outlook for the world economy has deteriorated against a background of high inflation and tightening financing conditions. In these circumstances, the risks to financial stability have increased since the last Financial Stability Report (FSR) was published. The risks mainly stem from geopolitical tensions, particularly as regards how the war in Ukraine might unfold, generating extraordinary uncertainty over growth in real activity and the persistence of the current inflationary episode (see Figure 1). In any event, while predicting the economic and geopolitical fallout from the war in Ukraine remains difficult, everything suggests that it will be global in scope and have long-term implications, as witnessed by the trade tensions between geographical areas.

In Spain, the lifting of almost all of the health-related restrictions over recent months gave a very significant boost to activity in 2022 Q2, particularly in the sectors most dependent on social contact. However, the persistence of high inflation, the tightening of financial conditions, ongoing supply-side distortions and bottlenecks, falling

Figure 1
FINANCIAL STABILITY: MAIN VULNERABILITIES AND RISKS (a) (b) (c)

SOURCE: Banco de España.

a In this report, the vulnerabilities are defined as economic and financial conditions that increase the impact or probability of materialisation of risks to financial stability, which in turn are identified as adverse changes in economic and financial conditions, or in the physical or geopolitical environment, with an uncertain probability of occurrence, which hamper or impede financial intermediation, with negative consequences for real economic activity.
b The risks and vulnerabilities in this figure are measured using three colours: yellow (low level), orange (medium level) and red (high level). The arrows denote the change in the risks and vulnerabilities since the last FSR.
c The risk of unfavourable pandemic developments indicated in the Spring 2022 FSR has become less important for assessing financial stability and is included in a group of factors that may adversely affect inflation and activity dynamics.

confidence on the part of agents and high uncertainty all contributed to a weakening of activity in 2022 Q3. These factors are likely to continue exerting downward pressure on the outlook for economic activity in Spain in the coming quarters.

Spanish banks face this new scenario with higher levels of solvency than before the pandemic, and lower NPL ratios. Meanwhile, profits have returned to pre-pandemic levels and now exceed the cost of capital. That said, the current scenario of economic slowdown, high inflation and extraordinary uncertainty increases the risks of a deterioration in credit quality and a further tightening of financing conditions. As a result, a policy of prudent provisioning and capital planning is advisable, to enable higher profits over the short term to be used to make the sector more resilient. This would leave it better placed to deal with any losses over the medium term as a result of worsening economic growth.

The main risks[1,2] to the stability of the Spanish financial system are analysed in greater detail below:

R1. Heightened geopolitical risks.

The uncertainty surrounding the duration and possible escalation of the war between Russia and Ukraine continues to be the main risk factor.

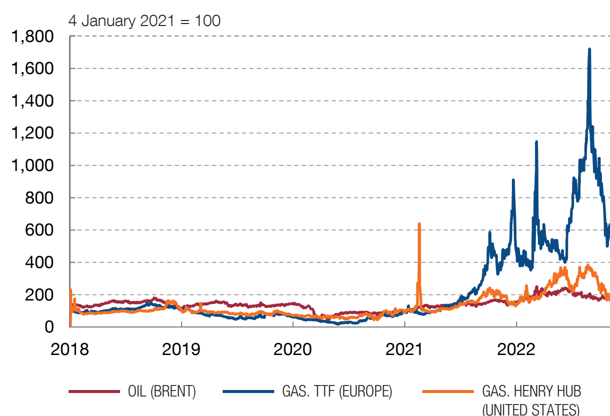
The greatest economic impact of the conflict to date has arisen from the importance of Russia and Ukraine as producers of commodities (essentially energy and metals in the case of Russia and agricultural commodities in the case of Ukraine). The war has led to a very significant increase in energy prices, with a greater impact in Europe, where some countries are particularly dependent on Russian gas and oil (see Chart 1). These developments have led to significant inflationary tensions and have compounded the downside risks to growth. Indeed, the still uncertain consequences of the drastic reduction in Russian gas supplies to Europe during the winter remain the largest short-term risk to economic growth in the European Union (EU).

Also, US-China tensions over the political status of Taiwan and certain trade disputes have heightened in the last six months. This increases the risk of a divided world order becoming entrenched that would, at least partly, reverse the efficiency gains from globalisation.

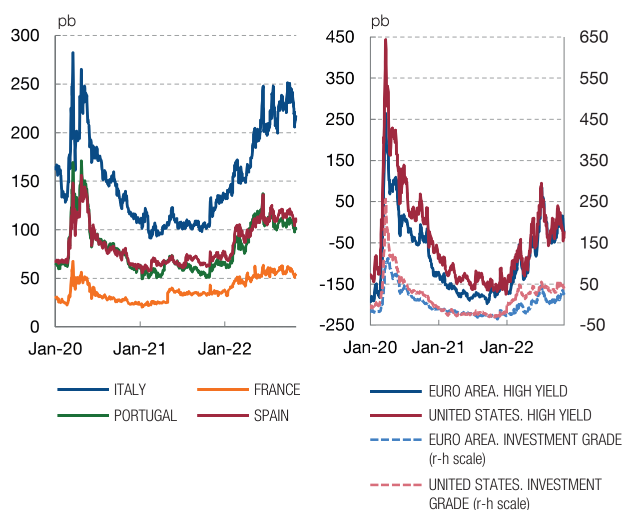
1 Risks to financial stability are defined as adverse changes in economic and financial conditions, or in the physical or geopolitical environment, with an uncertain probability of occurrence, which hamper or impede financial intermediation, with negative consequences for real economic activity.

2 The risk of unfavourable pandemic developments indicated in the Spring 2022 FSR has become less important for assessing financial stability and is included in a group of factors that may adversely affect inflation and activity dynamics.

1 NATURAL GAS AND OIL PRICES (a)



2 TEN-YEAR SOVEREIGN YIELD SPREAD AGAINST GERMANY (L-H PANEL) AND DEVIATIONS FROM THE HISTORICAL AVERAGE OF THE SPREADS OF NFCs' BONDS AGAINST THE SWAP CURVE (R-H PANEL) (b)



SOURCES: Refinitiv Datastream and Banco de España.

a The spot prices of the three markets are expressed in euro for ease of comparison.

b Deviations calculated with respect to the historical average between 1998 and 2022. High yield: ICE Bank of America Merrill Lynch Non-Financial High Yield Index. Investment grade: ICE Bank of America Merrill Lynch Non-Financial Index.

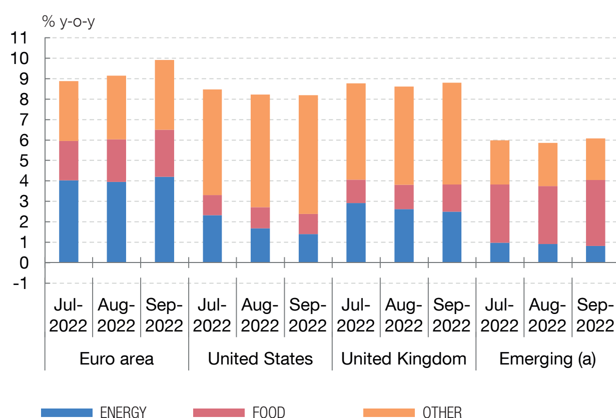
Despite the geopolitical situation, financial markets have not seen high levels of stress, although the risk premia of certain asset categories have risen since the start of the invasion (see Chart 2), and volatility has also increased. More sudden financial market corrections cannot be ruled out if geopolitical tensions continue or intensify.

R2. Higher and more persistent inflation.

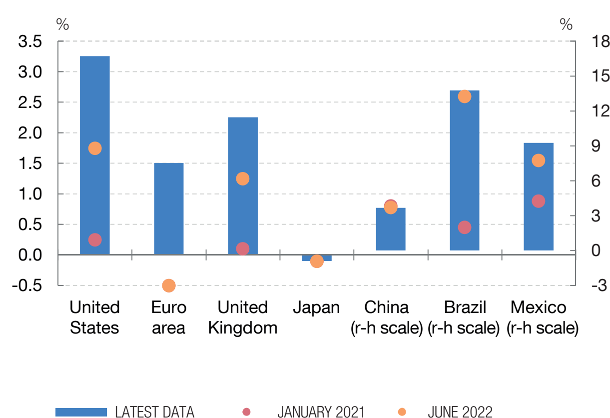
The inflation surge has been global in scope and its scale and persistence have exceeded expectations in many different geographical areas. Different supply and demand factors, with varying weight across countries, have contributed to the acceleration in price growth (see Chart 3). Supply-side factors include most notably the pressures on commodity prices, and on energy goods in particular, the bottlenecks in the production of certain goods and strains in shipping. On the demand side, notable were the fiscal impulse implemented in some areas, particularly in the United States, and the effect of the lifting of the health-related restrictions on the demand for certain services (for example, entertainment, food service activities and tourism).

Against this backdrop, most central banks have responded by tightening their monetary policies (see Chart 4). Given its major influence on global financial conditions, the path being followed by the US Federal Reserve is especially relevant. US inflation is also high, with demand factors playing a greater role. Among the

3 RECENT INFLATION DEVELOPMENTS



4 MAIN POLICY INTEREST RATES



SOURCES: National statistics and national central banks.

a The aggregate includes four geographical areas: China, Asia excluding China, LATAM-5 and Eastern Europe.

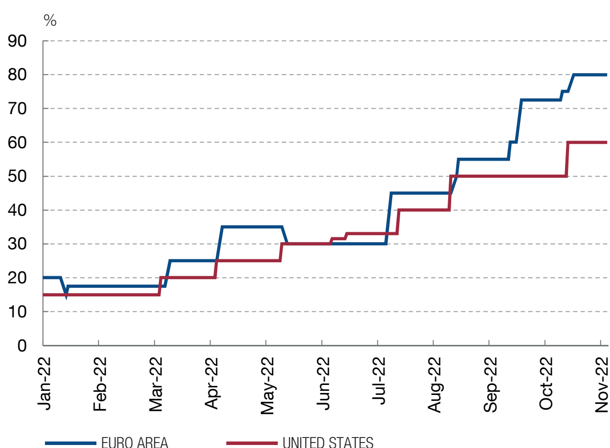
economies in which Spanish banks are active, the Latin American ones are currently increasing their interest rates to a lesser extent, since they are ahead of other central banks in the rate-rise cycle, while in the case of Turkey, soaring inflation and mounting financial imbalances are of particular concern.

In the case of the euro area and the Spanish economy, the role of supply-side factors and, in particular, of the energy component and food prices stands out. Nonetheless, owing to its duration and scale, the increase in energy and other commodity prices is proving difficult for firms to absorb and they appear to be passing these cost increases through to their prices. Thus, rising inflation has spread to an ever larger number of goods and services in the consumer basket.

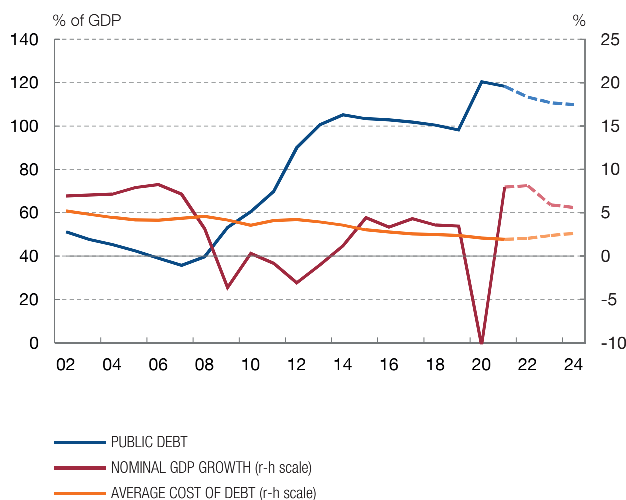
With this in mind, in December 2021 the European Central Bank (ECB) embarked on a process of monetary policy normalisation, which, following the rate hikes at its last three meetings, has already made considerable headway in reversing the accommodative stance from which it started, as borne out by the notable rise in market interest rates across all maturities.

Looking ahead, the heightened uncertainty makes it difficult to predict future developments in the demand and supply-side factors that have been driving up inflation, which may vary across geographical areas. Thus, the degree of monetary tightness the different central banks should apply to meet their price stability targets is hard to predict, adding yet another element of uncertainty. In any event, the main central banks and, in particular, the ECB, have indicated that further interest rate hikes will be required if their price stability targets are to be met.

5 PROBABILITY OF RECESSION ONE YEAR AHEAD. EURO AREA AND UNITED STATES (a)



6 GENERAL GOVERNMENT DEBT IN SPAIN (b)



SOURCES: Bloomberg, Intervención General de la Administración del Estado and Banco de España.

a These indicators are based on the responses to surveys conducted by Bloomberg on the probability of a recession one year ahead. The indices used are: US Recession Probability Forecast Index and Eurozone Recession Probability Forecast Index.
b The Banco de España's "Macroeconomic projections for the Spanish economy (2022-2024)" (published on 5 October 2022) are depicted with dashed lines.

R3. Risk of a contraction in real activity.

Growth forecasts for the second half of 2022 and for 2023 have been revised downwards in almost all areas and especially in the advanced economies. Despite some easing of global value chain bottlenecks since 2021, geopolitical uncertainty, the increase in inflation and consequent deterioration in real disposable income and the tightening of financing conditions have increased the probability of recession in the main developed economies (see Chart 5).

Uncertainty over the future course of supply-side factors also increases the downside risks to growth. The possible disruption to transport and to the supply of certain materials and energy goods, as well as the maintenance of health restrictions in Asia-Pacific, may aggravate global value chain bottlenecks, hampering manufacturing activity. The drastic reduction in Russian gas supplies to Europe may have a severe negative impact on the industrial activity of the EU member countries most directly dependent on such supplies, which would be unevenly transmitted to growth in other EU countries, essentially through trade channels. The uncertainty regarding inflation developments, along with the associated economic policy reaction, may itself discourage and delay investment decisions, leading to more persistent negative effects on supply-side conditions.

The possible contraction in demand, as a result of factors such as higher uncertainty, lower real incomes and poorer financial conditions, may have a beneficial effect in terms of reducing inflationary pressures, but it would boost risk of a decline in

economic activity. Fiscal policy is thus faced with a certain trade-off, since expansionary measures to sustain activity, especially if they are not selective, may help to sustain price growth.

In view of these risks, the main vulnerabilities[3] of the Spanish economy and financial system include:

V1. High level of government debt.

The general government deficit in Spain has declined in 2022 to date to 4.6% of GDP in June 2022, 2.3 percentage points (pp) lower than at end-2021. This reduction has been faster than was anticipated in the previous macroeconomic projections. The public debt-to-GDP ratio is expected to remain stable in 2022 with respect to the value observed at end-2021 (118.4% of GDP). It will then decline slightly, driven by growth in nominal GDP, to 109.9% of GDP in 2024.

However, the existing high level of public debt entails vulnerability for the Spanish economy, particularly in a setting in which the monetary normalisation process has raised the cost of public debt.

The 1-year and 10-year interest rates on new issues of Spanish public debt increased by 258 basis points (bp) and 284 bp, respectively, between December 2021 and October 2022. The average cost of debt (1.69% in October 2022) has risen only slightly in recent months and stands slightly above the rate at end-2021 (1.64%). The repayment of debt that was issued at comparatively higher interest rates during the global financial crisis and the fact that Spanish sovereign debt maturities are still relatively long are helping to contain the average cost of debt. However, these beneficial effects are expected to gradually fade if the current period of tighter monetary conditions persists over time.

Moreover, the current highly uncertain environment could lead to greater risk aversion in financial markets. Indeed, international financial markets have become increasingly sensitive to adverse economic news. A clear recent example was the negative reaction of sovereign debt markets in the UK to the announcement by the former UK Government of measures that could significantly drive up the deficit and the level of public debt. The subsequent rectification of this announcement and the Bank of England's intervention seem to have contained the initial adverse effects.

In Europe, sovereign debt spreads have seen only a minor increase since the end of 2021 (by approximately 38 bp in the case of Spain). The approval in July of the

3 In this report, vulnerabilities are defined as economic and financial conditions that increase the impact or probability of materialisation of risks to financial stability.

Transmission Protection Instrument (TPI) by the ECB is an important factor for mitigating this vulnerability.

Overall, Spanish government indebtedness is expected to continue at high levels in the coming years (see Chart 6) and to remain a vulnerability to the potential deterioration of financing conditions, as there would be little fiscal space to react to the materialisation of new risks.

In the current setting of high inflation and public indebtedness fiscal policy measures should be targeted and focus on lower-income households, which bear the brunt of inflation, and on the firms most vulnerable to this shock. Moreover, the measures should be temporary to avoid a further increase in the structural budget deficit.

In parallel, a fiscal consolidation process needs to be launched that will help progressively reduce the current fiscal imbalances and gain fiscal space to respond to future shocks. In this regard, it should be borne in mind that the roll-out of investment projects under the European Next Generation EU (NGEU) programme already represents an appreciable fiscal stimulus (even if their implementation is experiencing some delays). Thus, the combination of the large-scale use of the European funds – which does not directly affect the budget deficit but does have a positive impact on economic activity – and the commencement of a fiscal consolidation process would make it possible to continue providing some support to economic activity (which may be necessary in a setting in which pre-pandemic GDP levels have not yet been recovered), while gradually reducing the high structural budget deficit of public finances in Spain.

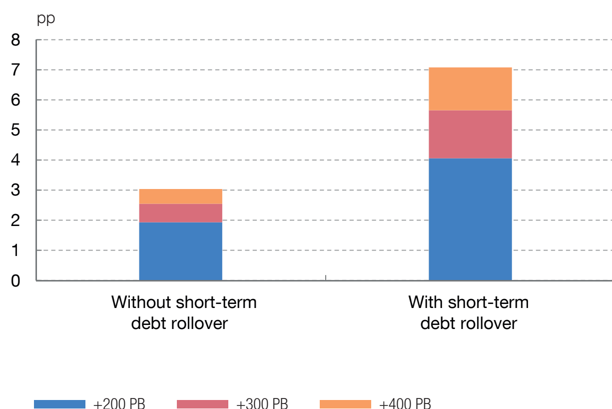
In any event, it should be noted that offsetting the adverse effects of the current supply-side shock also calls for ambitious policies to boost productivity growth and potential GDP. The role of the NGEU funds could also be particularly important to accompany and finance the necessary structural reforms.

V2. The financial weakness of households and firms.

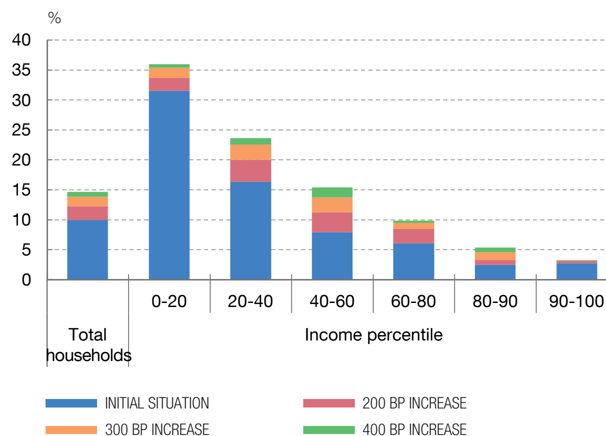
The recovery in business turnover and profits continued in the first half of 2022, particularly in the sectors most affected by the pandemic, which are now benefiting most from the lifting of the health-related restrictions. Based on the most recent data, the first six months of the year saw only some signs of financial deterioration in sectors sensitive to energy costs and in those least affected by the health situation (e.g. manufacture of chemicals, manufacture of plastics, the wood industry and the basic metals sector).

However, mounting inflationary pressures and tighter financing conditions have spread financial vulnerabilities beyond the corporate sectors most affected by the

7 ESTIMATED INCREASE IN NFCs' MEDIAN DEBT BURDEN DUE TO AN INTEREST RATE RISE (a) (b)



8 IMPACT OF AN INTEREST RATE RISE ON THE PERCENTAGE OF HOUSEHOLDS WITH A HIGH NET DEBT BURDEN. BREAKDOWN BY INCOME PERCENTILE (c) (d)



SOURCES: Banco de España and EFF (2017).

a The debt burden is defined as Financial costs / (Gross operating profit + Financial revenue). Firms with no financial costs are excluded from this calculation.
b In the case where no short-term debt rollover is assumed, the interest rate rise is fully passed through to long-term floating-rate debt and loans. The case with short-term rollover differs from the foregoing case in that the interest rate rise is passed through also to short-term debt and loans.
c The increase in debt service expenses is calculated for households with floating-rate debt. It is assumed that short-term interest rate rises are passed through in full to the interest rate on floating-rate debt.
d The net interest burden is considered to be high when the ratio of (Debt service expenses - Interest income from deposits) / Household income is higher than 40%. Households without debt are excluded from this calculation.

pandemic or more dependent on energy inputs. The rising cost of energy and other inputs will lead to a more widespread reduction in real business income, thereby eroding these agents' ability to pay. Risks to activity growth may also limit firm's ability to offset higher costs through turnover growth.

Firms' bank financing costs have been gradually rising up to August 2022, as the rise in market interest rates was only passed through partially – and by less than in the past. A more marked increase was seen in the cost of corporate financing on wholesale markets, partly because of higher corporate risk premia.

Liquidity risks and financial pressure on firms are expected to increase further insofar as interest rate rises continue and gather pace and it becomes necessary to roll over corporate debt at shorter maturities (see Chart 7). However, these rises are being mitigated by the medium and long-term financing obtained in recent years via State-backed loans, a high proportion of which are at fixed rates.

Meanwhile, households have experienced sustained improvements in their gross income in recent quarters, mainly due to the sound performance of the labour market. In 2022 Q2 their gross disposable income was 3.2% higher than before the health crisis, in nominal terms. They have also accumulated savings and financial assets in recent years, albeit unevenly across households, according to their income levels.

Despite this, it appears that high inflation and rising interest rates are already increasing the financial pressure borne by households, particularly those with lower incomes. In particular, the surge in energy prices appears to be leading better-off households to save less and forcing lower-income households to reduce their spending on non-energy goods. The pass-through of market interest rate rises to the cost of bank financing to households is still moderate. However, the cost of loans is expected to pick up particularly over the coming quarters, as mortgage rate revisions incorporate EURIBOR hikes, thereby adding to the financial pressure on households (see Chart 8). This would be somewhat mitigated by the increase in recent years in the share of fixed-rate mortgages, which accounted for 27.1% of the stock in August 2022. Moreover, risks to economic growth could lead to higher unemployment, further straining households' income and ability to pay.

Although the financial pressure on households and firms is increasing more generally, the heterogeneity in these developments still needs to be monitored to detect the most vulnerable segments and measure the impact on financial stability.

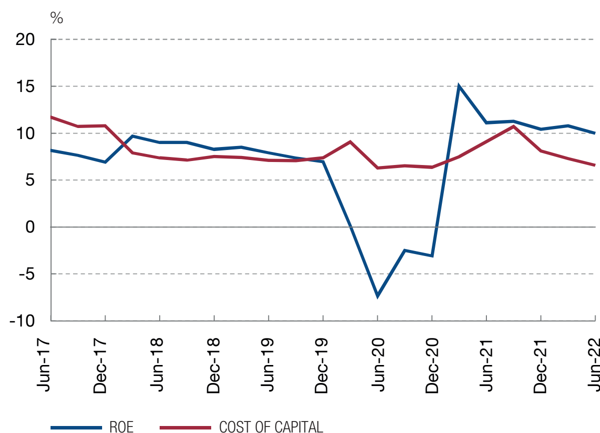
V3. Weaknesses in the financial intermediation capacity of the financial sector.

On the data available for 2022 Q2, the profitability of the Spanish banking sector remained at the level reached in 2021, after the adverse effects of the health crisis had been overcome. Thus, unlike in previous periods, in the first half of the year ROE (10%) stood comfortably above the estimated average cost of capital (7%), (see Chart 9), sending positive signs about the ability to generate capital. In the same vein, the Q3 results for listed banks confirm the favourable trend in bank profitability observed in the first half of the year. At the same time, institutions' capital levels are higher than before the pandemic and NPL ratios have continued to decline.

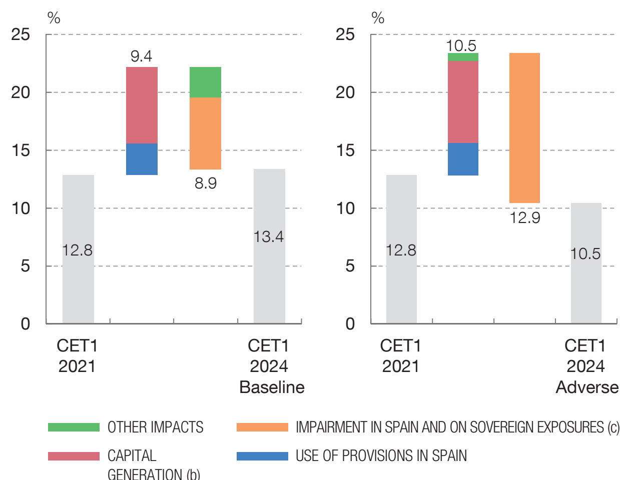
Although this current favourable situation in the banking sector, the global macro-financial environment may have a significant negative impact on banks' income statement. Higher interest rates will boost banks' income, but will also put upward pressure on their financing costs. Factors such as the banking sector's current ample liquidity and the negative interest rate level at the outset of the present rate-rise cycle have contributed to bank deposit rates not yet reflecting the market interest rate rise. However, the pass-through of interest rate hikes to the cost of deposits is expected to increase in the future and to be higher in more adverse macro-financial scenarios. Moreover, the increase in households' and firms' financing costs and the slowdown in their income will reduce their ability to pay, which could drive up banking costs through impairment charges.

Against this backdrop, a legislative proposal is being discussed in Parliament to impose a temporary levy (in 2023 and 2024) on banks whose 2019 fee and interest income exceeded a certain level (€800 million). A 4.8% tax rate would be applied

9 ROE AND COST OF CAPITAL IN THE BANKING SECTOR



10 FLESB STRESS TESTS. IMPACT ON THE CET1 RATIO IN THE BASELINE SCENARIO (L-H CHART) AND ADVERSE SCENARIO (R-H CHART) (a)



SOURCE: Banco de España.

a The net effect of positive (negative) flows is indicated by the figure above (below) the bar in question. The initial and final CET1 ratios are presented as "fully-loaded". Other impacts include, among other effects, the change in RWAs between 2021 and 2024 and the effect of ICO guarantees. Aggregate results, including institutions directly supervised by both the SSM and the Banco de España.

b This variable includes net operating income in Spain and net income attributable to business abroad. Thus, the funds that the banking group as a whole may generate are compared with the impairment losses in Spain and on the sovereign portfolio (the focus of these tests).

c This variable shows the projection over the three years of the exercise of gross losses due to credit portfolio impairment for exposures in Spain and other types of losses (associated with the fixed-income portfolio, the management of foreclosures and the sovereign portfolio).

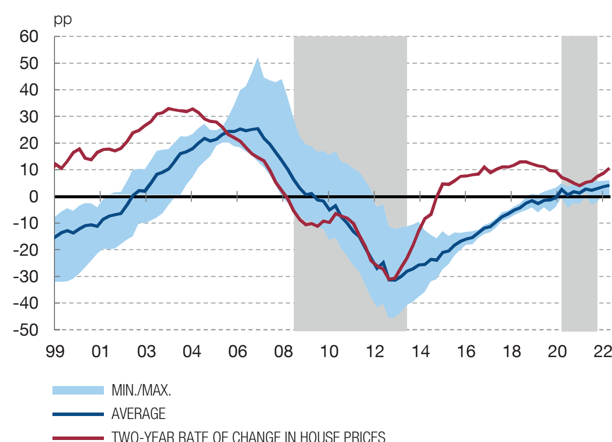
to the 2022 and 2023 net interest income and net fee and commission income. This levy is expected to raise €1.5 billion in each year, which would reduce the sector's profits.

In relation to the non-bank financial sector there is also some concern worldwide about certain open-ended investment funds that have accumulated risk exposures in recent years and have very tight liquidity positions.[4] In Spain, investment funds have better liquidity positions. However, like other financial intermediaries and the banking sector, they are susceptible, particularly as regards the value of their holdings of financial instruments and their financing conditions, to global financial market corrections prompted by the potential stress that could arise in these segments of non-bank financial intermediation, which have seen a greater build-up of risks.

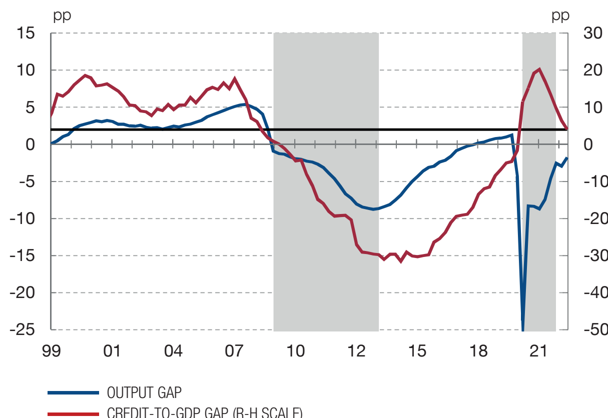
As already noted in this year's Spring FSR, amid the current extraordinary uncertainty banks must maintain a prudent stance, with adequate and early recognition of risks, to preserve confidence in the sector and the ability to sustain the flow of financing to the economy. In particular, it is essential that they continue to exercise a high degree of prudence in their provisioning and capital planning policies.

4 The International Monetary Fund analyses this global risk in detail in Chapter 3 of its latest Global Financial Stability Report.

11 INDICATORS OF HOUSE PRICE IMBALANCES (a) (b)



12 CREDIT-TO-GDP GAP AND OUTPUT GAP (c)



SOURCES: INE and Banco de España.

a The areas shaded in grey represent the periods of the two financial crises in Spain since 2009: the last systemic banking crisis (2009 Q1-2013 Q4) and the crisis triggered by the COVID-19 pandemic (2020 Q1-2021 Q4). Data updated as at June 2022.

b The shaded area represents the minimum and maximum values of the four indicators of imbalances in house prices. The indicators are: (i) the real house price gap; (ii) the house price-to-household disposable income ratio gap; (iii) the ordinary least squares (OLS) model which estimates house prices based on long-term trends in household disposable income and mortgage interest rates; and (iv) the error correctionmodel which estimates house prices based on household disposable income, mortgage interest rates and fiscal effects. The long-term trends are calculated for all indicators (i) to (iv) using a statistical one-sided Hodrick-Prescott filter with a smoothing parameter equal to 400,000. Indicators (i) to (iv) and the two-year rate of change in house prices have an equilibrium value of 0.

c The output gap is the percentage difference between observed GDP and potential quarterly GDP. Values calculated at constant 2010 prices. See P. Cuadrado and E. Moral-Benito (2016), "Potential growth of the Spanish economy", *Occasional Paper* No 1603, Banco de España. The credit-to-GDP gap is calculated as the difference, in percentage points, between the observed ratio and the long-term trend calculated using a statistical one-sided Hodrick-Prescott filter with a smoothing parameter equal to 25,000. This parameter is calibrated to the financial cycles historically observed in Spain. See J. E. Galán (2019), "Measuring credit-to-GDP gaps. The Hodrick-Prescott filter revisited", *Occasional Paper* No 1906, Banco de España. Data available up to June 2022. The areas shaded in grey represent the periods of the two financial crises in Spain since 2009: the last systemic banking crisis (2009 Q1-2013 Q4) and the crisis triggered by the onset of the COVID-19 pandemic (2020 Q1-2021 Q4). The horizontal black line represents the 2pp CCyB activation threshold for the credit-to-GDP gap.

The stress tests conducted by the Banco de España, based on a potential adverse scenario stemming from the materialisation of the current risks to growth, inflation and financing conditions, show that the sector's aggregate solvency remains at adequate levels (see Chart 10), albeit unevenly across institutions. These exercises point to a conflicting impact of interest rate rises: on one hand they would improve the capacity to generate net interest income, but on the other they would considerably worsen provisioning. In any event, should the rises occur in an adverse scenario of contracting GDP and tightening risk premia, the results indicate a negative impact on the sector's profitability and capital.

V4. Incipient signs of real estate market imbalances.

The Banco de España continues to closely monitor the situation in the real estate market. The house price growth rate remained high in 2022 Q2, with a year-on-year rate of change of 8%, slightly down from 8.5% in the previous quarter. In this regard, indicators of price imbalances in this market continue to show signs of overvaluation, which have been evident since mid-2021 (see Chart 11). These signs remain contained for the time being.

As for the indicators of activity, house purchases continued to grow strongly in 2022 Q2 (by 19.7% year-on-year), mainly due to second-hand home purchases. However, the July and August year-on-year growth figures of 8% and 14.9%, respectively, suggest a slowdown that will only be confirmed in the coming months. In line with the growth in transactions, the flow of new lending for house purchase increased by 10.9% in 2022 Q2. However, the stock of mortgage credit grew by just 1.3% year-on-year in June 2022, given the sizeable volume of repayments and the relatively small share of new loans as a proportion this stock. Lending for construction activities and real estate development continued to contract to June 2022, with the year-on-year rate of change standing at -6.7%, in keeping with the negative developments in the supply of new housing.

Credit standards in relation to collateral values for new residential mortgages did not change significantly in 2022. In particular, despite the strong growth in the volume of transactions since 2021, the share of mortgages with high loan-to-value (LTV) or loan-to-price (LTP) ratios has not increased. However, the ratios of house price and average amount of new mortgages to average household disposable income have been rising steadily since 2014 and deserve particular attention. In addition, high loan-to-income (LTI) ratios are concentrated to a larger extent among low-income households, which could be more vulnerable to the materialisation of macroeconomic risks.

As mentioned above, the rise in benchmark rates was passed through only moderately to interest rates on new mortgages up to the end of 2022 Q2. Moreover, the spreads between these rates and the benchmark continued to narrow, particularly in fixed-rate loans, which poses certain risks to their profitability in the face of potential increases in the cost of bank borrowing.

Against this backdrop, tighter monetary conditions and the heightened uncertainty would help limit the build-up of real estate risks in the short term, particularly by reversing the downward trend in interest rate spreads over the coming quarters. However, it cannot be ruled out that, should macroeconomic risks to growth and headline inflation materialise, the incipient signs of imbalance could contribute to slightly amplifying the adverse effects on economic activity and banking sector solvency.

Macroprudential policy stance

The Spring 2022 FSR argued that heightened uncertainty and the absence of any indications of systemic financial imbalances building up in Spain made it advisable to maintain a loose macroeconomic stance. Since then, the degree of uncertainty has increased and short-term risks linked to a larger pick-up in inflation and a slowdown in economic growth have risen in particular. Moreover, there appear to be no signs of a widespread rise in financial imbalances (see Chart 12).

These developments strengthen the case for not activating macroprudential measures, such as capital requirements or limits on credit standards in Spain. In particular, the assessment of the available indicators is consistent with holding the countercyclical capital buffer (CCyB) rate at 0%. Activating these measures now could prove pro-cyclical and ultimately curb new lending in a period of materialising risks linked to real activity and, in particular, to supply strains in energy goods markets. In any event, the indicators of a build-up of systemic risks (e.g. the debt servicing ratio, which will probably be driven up in coming quarters by higher interest rates) need to be closely monitored, paying special attention to the residential real estate sector and credit standards.

Warning issued by the European Systemic Risk Board

On 22 September 2022 the European Systemic Risk Board (ESRB) issued a warning on vulnerabilities in the EU financial system (see Chapter 3.1). The ESRB's assessment of the risks to financial stability at European level is consistent with that of the Banco de España included in this report. As noted in the ESRB warning and in a statement by the ECB's Governing Council, in this highly uncertain environment it is necessary and desirable for the national macroprudential policy response to be tailored to each country's specific, structural and cyclical conditions and, especially, the intensity of the imbalances detected. Against this backdrop, the decision to maintain the CCyB rate at 0% and not activate other macroprudential measures is founded on the analysis of Spain's specific conditions, which differ significantly from those in other European countries, where there are greater signs of imbalance, particularly in the real estate sector.