Presentation by the Governor Pablo Hernández de Cos

Supervisory activity in 2023 was influenced by exogenous shocks, in particular those stemming from geopolitical tensions, by monetary policy tightening, which materialised in sharp interest rate hikes in several monetary areas, and by the global banking turmoil experienced in March.

After more than a decade in which interest rates were very low (and even negative), the monetary policy shift following the surge in inflation, combined with the energy crisis, had a significant impact on economic activity across Europe. However, the Spanish economy – and especially the labour market – retained considerable momentum.

In consequence, Spanish banks were able to achieve strong profit growth which, albeit unevenly across banks, allowed the sector as a whole to exceed its cost of capital. However, this has only led to a modest boost to solvency.

From a medium-term perspective, a call for prudent behaviour from banks is needed, especially in a setting in which, although the economic growth outlook continues favourable, significant risks remain, in particular from global geopolitical tensions.

To begin with, the net interest income growth observed in recent years cannot be considered permanent. Following the rapid pass-through to income of the interest rate rises, the cost of deposits is expected to increase, in a setting in which, so far, there has been only a partial pass-through to deposits owing to high levels of liquidity. Moreover, banks should be prepared for a possible deterioration of credit portfolios as creditors face higher debt servicing costs. This deterioration generally appears with a certain time lag compared with the immediacy of the repricing of floating rate loans.

Against this backdrop, banks should make careful provisioning and capital planning and take advantage of rising profits to increase their solvency levels and fund their strategies to respond to structural banking sector challenges, such as the digital transformation, growing competition from fintechs and the shift towards more sustainable business models.

Moreover, in the field of bank conduct and transparency with customers, and in the setting described, marked by rising inflation and interest rates, in 2023 the Banco de España's supervisory activities focused, in particular, on operations with the most vulnerable customers and on the control measures adopted by banks to address the risks of card fraud and digital payment fraud. These actions allowed us to identify certain weaknesses, along with various trends and best market practices. By correcting these weaknesses and extending best market practices, banks should be able to improve their customer relationships.

Looking ahead, we will continue to foster a preventive supervisory approach, based on early risk identification, and we will continue to take steps to provide greater transparency on supervisory priorities and expectations. This process will be underpinned by the findings of the ongoing external evaluation of our supervisory approach in this area and the corresponding action plan, which we will publish in the coming months.

From a global perspective, in March 2023 the international banking system experienced the most significant stress episode since the global financial crisis. The turmoil affected a number of banks from different countries, mainly the United States and Switzerland.

Stability was returned to the banking system thanks to a combination of public support measures – such as central bank liquidity facilities for banks, public guarantees or even the broadening of deposit guarantee schemes – in the jurisdictions involved. Meanwhile, the greater resilience provided by the regulatory reforms of the last decade, and in particular by the implementation of Basel III, reduced the risks of contagion to the rest of the global banking sector.

On the Financial Stability Committee and the Basel Committee on Banking Supervision (BCBS) we analysed this situation to try to understand its scope and implications and draw conclusions. One of the main lessons learned, and on which there is broad consensus, is the importance of banks' sound risk management practices and governance arrangements as the first and most important source of financial and operational resilience. In addition, this first safeguard, which necessarily falls on banks themselves, must be accompanied by robust regulation and strong and effective supervision on a global scale. In this respect, supervision should be sufficiently flexible and geared towards the principal risks at any point in time.

In the regulatory field, fully implementing Basel III (including the last package of reforms endorsed in 2017) across jurisdictions and as soon as possible remains a key priority. This has been my main objective throughout my years as Chair of the BCBS and I want to reiterate it once again in the final stretch of my term. Robust common minimum regulatory and supervisory standards are crucial to safeguard financial stability worldwide.

In the European Union (EU), the transposition of Basel III began just over ten years ago with Regulation (EU) No 575/2013 and Directive 2013/36/EU on prudential requirements for credit institutions. These rules also provided for more harmonised prudential regulations within the EU, laying the foundations for the European Single Rulebook applicable to all EU banks.

As this process of building the banking union continues, in November 2024 we will celebrate the 10th anniversary of the entry into operation of the Single Supervisory Mechanism (SSM). The launch of the SSM posed a major challenge and the Banco de España made a decisive contribution. The new supervisor drew on best practice from the European Central Bank (ECB) and the participating national authorities. This involved significant cultural changes in many aspects and has resulted in a robust, credible, flexible and globally influential supervisory body.

In this regard, further deepening of the banking union is needed, to ease the vulnerabilities and fragmentation of the European financial system. The next big step should be the creation of a fully mutualised European deposit guarantee scheme, boosting public and market confidence.

Staying with European concerns, in 2023 the ECB agreed to continue the work on the digital euro project, ushering in a new phase that aims to lay the foundations for its potential use. Moreover, the European Commission adopted a legislative proposal to grant the project an appropriate regulatory framework. However, none of the work completed or agreed so far involves a decision to issue the digital euro. Should the ECB eventually decide to do so, the digital currency would be distributed by regulated payment providers. Although European – and especially Spanish – payment systems are currently highly efficient, the speed at which digitalisation is advancing clearly justifies the efforts and resources dedicated to this project.

To conclude, the progress made in this decade means that, from the supervisory perspective, we face the future with confidence in the robustness of the system, but without growing complacent. The European banking system is now stronger and more resilient to shocks. It also has a more integrated supervisory framework, equipped with new tools, and a robust and unified regulatory framework. This places the financial sector and the supervisory bodies in a better position to address the important challenges facing the European economy in general and the banking sector in particular.

Pablo Hernández de Cos

Governor of the Banco de España