1. Trends and developments in the Spanish banking sector

The tables and data are to be found in the appendices to this document. The majority of the data come from Chapter 4 of the Bank of Spain's Statistical Bulletin. The analysis of the Spanish banking sector is confined to banking business in Spain. The following are the main conclusions on the current situation and recent trends and developments in the Spanish banking system (important: see footnote[1]):

Activity

- The size of the Spanish banking sector continues to shrink (see Table 1). The system's total assets fell by 4.9% over the twelve months to October 2016, and by 22% since their peak in December 2012. Since then, the size of the system has fallen by €759 billion (69% of GDP). This fall-off is reflected in the cut back to system capacity (see Table 3). The number of branches has been reduced by 36% since its high in December 2008. Figures from the close of 2015 show that the workforce has shrunk by 27% since then.

- The deleveraging of the private residential sector has continued since late 2008. However, despite the slow-down in 2016, fixed income and equity portfolios showed an upward trend since the beginning of the crisis, especially the sovereign bond portfolio, which has increased by 132% since 2008. Nevertheless, the latest figures as of October 2016 show that the fixed income portfolio has shrunk by 14% year-on-year (see Table 1).

- The total volume of system deposits (see Tables 1 and 6) has fallen by 22% since late 2008, although this drop-off has focused on volatile elements such as non-resident and subordinated deposits, repurchase agreements and hybrid instruments. More stable items (current accounts and savings and time deposits) have shown great steadiness, with an accumulated 3% fall since 2008. In any event, customer deposits remained flat over the past year, meaning that there was scarcely any sign of capital flight. Demand and savings deposits actually increased over the past year, due to the low profitability of other instruments in the current interest rate scenario (see Table 6).

- The debt issued by financial institutions is the liability item that has fallen the most, although increasingly slower (down 49% since late 2008, down 9% over the twelve months to October 2016. See Table 1). ECB liquidity has decreased by 68% since its high in August 2012. This is partly because institutions are taking advantage of the liquidity provided by the conditional auctions (TLTROs), as well as of that which they obtain in ordinary open market operations. Liquidity is no longer a problem for Spanish institutions.

- Finally, the percentage represented by on-balance-sheet equity capital continues to grow. With figures available to September, the volume of capital and reserves increased by 0.5% over the past year, up 27% (+€49 billion) since 2008 (See Table 1).

1: Throughout the document, "€ billion" refers to thousands of millions of euros.

Spotlight on lending and NPLs

- The reduction in private resident sector credit stock has continued (see Table 4). In the twelve months to October 2016, Other Resident Sector credit fell by 4.8%, with an accumulated decrease of 32% since 2008 (€599 billion, 55% of GDP). The rate of this fall has slowed down since late 2013, indicating that deleveraging might be coming to an end soon. All resident sector loan portfolios have decreased, especially credit to construction and real estate companies, which have registered significant drops, down 9.3% over the past year. This item only represents 13% of stock, although it accounts for 37% of non-performing loans.
- Deleveraging is compatible with the dynamic nature of new lending to households and SMEs (see Table 5). In the first ten months of 2016, all credit portfolios registered notable growth, except loans to large companies (credit operations of over a million euros), which have access to other sources of financing such as debt issuance and saving. The 33% fall in new lending to major corporations from January to October is also due to a strong base effect in 2015. This trend has meant that the total volume of new credit operations fell 13.8% in 2016. Elsewhere, new lending to SMEs picked up slightly, while new lending to households posted accumulated growth of 8%.
- Despite the deleveraging of the economy, the delinquency rate for the system was reduced to 9.27% in October 2016 (see Table 4). In October the volume of NPLs grew slightly, the first monthly increase after 34 consecutive months of reduction. The accumulated drop in NPLs was of €79 billion or 40% from its peak in December 2013.

Results of the sector

- Sector revenues remain under pressure. Total revenue in the first nine months of the year dropped by 7.3% compared with the same period of 2015, with declines in all revenue lines (Table 2).
- Net interest revenue fell by 9.3% year-on-year to September due to low business volume and low lending rates that keep the cost of borrowing low (Table 7). Data to October 2016 show interest rates on new lending transactions down in all lending portfolios in year-on-year terms. However, compared with year-end 2015, rates for new loans to households have shown a slight uptick, whereas those for new loans to businesses have fallen further, especially for loans of more than €250,000. These reductions cannot be offset by cheaper deposits (Table 8).
- Operating expenses increased 0.7% year-on-year. Cost control, one of the defining features of the Spanish banking system, helped maintain the cost-to-income ratio at 53.7%, slightly worse than last quarter (50.5%) but still the benchmark in Europe. As a result, pre-provision profit fell by 17% year-on-year in the first nine months of 2016 over the same period last year.
- The most remarkable aspect of the system’s results in January-September is the notable reduction in loan-loss provisions, which declined 35% year-on-year over the same period of 2015, in line with the improving NPL situation and the volume of balance sheet clean-up already carried out (€313 billion since 2008).

- Lower provisions resulted in flattish (-0.8%) pre-tax profit in the first nine months of 2016 over the same period last year, whereas net attributable income increased 16% year-on-year due to lower taxes in the second and third quarters of 2016.

- As regards the main ratios (Table 9):

  – As mentioned, cost-to-income remains slightly above 53% thanks to cost control and the improved levels of productivity (volumes and pre-tax profit per office). Operating expenses as a percentage of Average Total Assets have been held below 1% since 2008 (Figure 6, Appendix 1). This ratio's increase was due to the reduction in total assets.

  – Further improvement in the sector's solvency. The system's leverage ratio (capital and retained earnings over total assets) increased to 8.6% in October. Own funds on balance sheet almost double the volume of doubtful loans (Figure 2, Appendix 1), reaching 195% as of October 2016.

  – The loan-to-deposit ratio (the main indicator to monitor liquidity using public data) dropped further to 110% as of October 2016, 48 percentage points less than in 2008 (Figure 3, Appendix 1). The sector's funding gap (lending to, less deposits from, the domestic private sector) continues to narrow to all-time lows (€119 billion or 4.5% of total assets as of October) due to the deleveraging of the system and the stability of deposits.

  – System provisions remain at satisfactory levels. The provisioning "effort" (loan-loss provisions / pre-provision income) and cost of risk (loan-loss provisions / average total lending) indicators, are back at pre-crisis levels (Figure 1, Appendix 1), contributing to the consolidation of profitability following the losses of 2011 and 2012 (Figure 5, Appendix 1).

International comparison

If we compare developments in the Spanish banking system with the average of EU banks (Appendix 2), the following are the main conclusions of the analysis of the data from the "Risk Dashboard" of the European Banking Authority (EBA), which shows the average of 158 of the main EU banking institutions. The latest data available is from June 2016.

- Since late 2009 (when EBA figures became available) we can see that Spanish institutions are less leveraged than their European competitors (see Figure 1, Annex 2). To be specific, figures to June 2016 show a 39% increase in equity on the balance sheet, up from the 36% recorded in March.

- Efficiency levels are also 12.2% higher than the average for European banks (see Figure 5, Annex 2), an advantage that will last over time.

- The efforts that have been made to cleanse Spanish institutions were necessary (see Figure 3, Annex 2). Specific provisions to cover delinquent loans reached a similar level to the European average in mid-2014, and has remained above that level ever since.

- The delinquency rate continues to be higher in Spain, and grows faster than in other countries (see Figure 2, Annex 2). Nonetheless, the number of delinquent loans in Spain has fallen for 34 months consecutively. Trends regarding the rate are therefore related to their denominator, which is falling thanks to deleveraging.
- Finally, system yield is slightly lower than the European average (see Figure 4, Annex 2), something which would seem reasonable in an economy that has been hit so hard by the recession and in a sector which is still facing high levels of delinquency.

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This report has been produced by the Financial Systems Unit:

Chief Economist for Financial Systems and Regulation
Santiago Fernández de Lis
sfernandezdelis@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Jaime Zurita
jaime.zurita@bbva.com

Macarena Ruesta
esperanza.ruesta@bbva.com

José Félix Izquierdo
jfelix.izquierd@bbva.com

José María Álvarez
josemaria.alvarez.ines@bbva.com

Cristina Deblas
cristina.deblas@bbva.com

With the contribution of:

Regulation

María Abascal
maria.abascal@bbva.com

Matías Cabrera
matiasdaniel.cabrera@bbva.com

BBVA Research

Group Chief Economist
Jorge Sicilia Serrano

Macroeconomic Analysis
Rafael Doménech
r.domenech@bbva.com

Global Macroeconomic Scenarios
Miguel Jiménez
mjimenezg@bbva.com

Global Financial Markets
Sonsoles Castillo
s.castillo@bbva.com

Global Modelling & Long Term Analysis
Julián Cubero
juan.cubero@bbva.com

Innovation & Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

Financial Systems & Regulation
Santiago Fernández de Lis
sfernandezdelis@bbva.com

Countries Coordination
Olga Cerqueira
olga.gouveia@bbva.com

Digital Regulation
Álvaro Martín
alvaro.martin@bbva.com

Regulation
María Abascal
maria.abascal@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Spain & Portugal
Miguel Cardoso
miguel.cardoso@bbva.com

United States of America
Nathaniel Karp
Nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Turkey, China & Geopolitics
Álvaro Ortiz
alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

China
Le Xia
le.xia@bbva.com

South America
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

CONTACT DETAILS: BBVA Research: Azul Street, 4. La Vela Building - 4 and 5 floor. 28050 Madrid (Spain). Tel.:+34 91 374 60 00 y +34 91 537 70 00 / Fax:+34 91 374 30 25 - bbvaresearch@bbva.com www.bbvaresearch.com