1 Evolution of the Spanish banking sector

The tables and data can 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 (important: see the footnote below 1).

Sector results

- The Spanish banking system incurred losses of €2,201 million in the fourth quarter of 2016 because of the significant increase in provisions caused by three non-recurring circumstances:
  1. The entry into force of Circular 4/2016 of the Bank of Spain, which partially adapts the Spanish accounting system to IFRS 9, whose main impact has been an increase in delinquencies. This forced a rise in provisions to maintain a stable level of coverage of 59%.
  2. The ruling of the Superior Court of Justice of the EU on the interest rate floor clauses that has forced entities to make provisions in their accounts for amounts which they previously had not provided for, which, according to the institutions themselves, amounted to €1.7tn.
  3. The restructuring of a domestic entity whose delinquencies rose sharply in 2016: € 5bn vs. € 3bn in 2015; and which has set aside nearly €6bn, of which €4.6bn were provided in the last quarter (non-recurring €4.4bn, according to the entity).
- The rest of the profit and loss account continues the trend of recent quarters: pressure on income and stable expenses. The gross margin was reduced by 6% in 2016, with falls in all components, especially net interest margin (-8% y-on-y) mainly because of the reduction in volumes and the interest rate environment. Interest rates of new credit operations fell further in 2016 (they rebounded slightly in January 2017), as well as the deposit rates, but in this case since there is virtually no headroom. Operating expenses increased by 0.5% in 2016, thus maintaining the efficiency ratio of 54%, excellent in comparison with international ratios. Net margin was reduced by 13% in the year.
- Finally, the increased provision already mentioned (Euro 15,838 million in the fourth quarter, including provisions for insolvencies, restructurings and foreclosures) made the income before tax fall by 38% and net attributable income fall by 35% to €6,086 million in 2016 (€8,288 million to September, with growth of 16% in the first nine months of the year).

Activity

- The total balance sheet of the system fell by 5.5% y/y in January 2017 (Table 1). Since its peak of December 2012, total assets decreased by €805bn (72% of GDP), which was accompanied by significant cuts in the number of employees and branches (Table 3).

1: Throughout the document, “€ billion” refers to thousands of millions of euros.
The credit volume maintained its downward trend, while the fixed income and equity portfolios increased their weight during the crisis, despite its decreasing in 2016 and January 2017 (Table 1). Progress in the sovereign debt portfolio, with growth of 121% since 2008, is especially noteworthy although during the 12 months to January 2017 it fell by 14%.

System deposits (current accounts and savings and term deposits, Table 6) are stable after deducting volatile items, showing no leakage of deposits. An important shift from time deposits to savings and sight deposits has taken place due to the former’s low profitability in the current interest rate environment.

The volume of debt issued by banks (bonds and notes, Table 1) has fallen by 52% since 2008 and fell 12% for the year to January 2017, in line with the contraction of the funding gap (credits minus deposits, Table 9) due the deleveraging of the system. ECB liquidity rebounded in early 2017 after the TLTRO auctions (+ 11% year to February), but remains well below the highs of 2012.

Shareholders’ equity (Table 1) remained stable in 2016, having increased by 26% since 2008 (+€ 52bn).

**Spotlight on lending and delinquency**

Table 4 shows that in 2016 the total credit to the private sector (Other Resident Sectors, ORS) was reduced by 4%, a cumulative decline of 32% from 2008 (€608bn, 55% of GDP). All credit portfolios fell for the year, especially real estate and construction loans (-10.3% in 2016). This item only represents 13% of the stock, although it accounts for 37% of non-performing loans.

The system default rate stood at 9.17% in January 2017, a slight increase from the close of 2016, but about one percentage point below the figure of 2015. NPLs declined by 13.3% y/y. With the exception of November 2016, NPLs have shown a continuous monthly decline since February 2014.

New credit operations (Table 5) fell by 13.7% in 2016 due to credit for large companies (loans over one million euros), but rebounded strongly in January 2017 compared to the same month of the previous year, particularly mortgage loans. The volume of new credit in 2016 was 35% of the average granted during the three years before the start of the crisis, so these growths are no cause for concern.

**Main ratios**

- The cost-to-income ratio was 54.5% thanks to cost control and improved system productivity (volume and profit before tax per office). Operating costs as a percentage of Average Total Assets (ATM) have been held below 1% since 2008 (Figure 6, Appendix 1).

- Solvency continues to improve. The volume of capital and reserves reached 8.6% of total assets (Figure 3, Annex 1), and the amount of equity on balance sheet almost doubled the amount of non-performing loans in the system, reaching 197% in January 2017 (figure 2, Annex 1).

- System liquidity, measured as the ratio of ORS credits and ORS deposits, further improved to 109% to January 2017, 49 percentage points (pp.) below the level of 2008 (Figure 3, Annex 1). The sector
funding gap (ORS credit less ORS deposits) fell to €105bn (4.0% of total assets), the historical minimum level (Figure 4, Annex 1).

- The system maintains satisfactory levels of provisions. The effort in provisions (provisions/net margin) and the cost of risk (provisions/average total loans), remain at pre-crisis levels despite endowments in the last quarter of 2016 (see Chart 1, Annex 1). Profitability remains positive, although weak, following losses in 2011 and 2012 (Figure 5, Annex 1). Data collected on closing 2016 show the impact of the additional provisions in the quarter, which we mentioned above.

International comparison

Comparing 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 show the average of 158 of the main EU banking institutions. The latest data available is from September 2016.

- Spanish banks are less leveraged and are more efficient than their European competitors (Figure 1, Annex 2). To be specific, figures to September 2016 show that Spanish banks hold 39% more equity on balance sheet than the European average (+17% in 2009). Efficiency levels are also 9.3% better than the average for European banks (see Figure 5, Annex 2).

- The write-off efforts made by Spanish banks (Figure 3, Annex 2) were necessary to show the fair value of assets and to approach their European competitors. The coverage of NPLs with specific provisions reached a similar level to the European average in mid-2014, and has remained slightly higher ever since.

- As for negative aspects, the default rate remains higher in Spain (Figure 2, Annex 2). Nonetheless, Spain's NPL rate has been falling since 2013. The system's profitability is slightly lower than the European average (Figure 4, Annex 2), which seems reasonable in a sector that still faces a high delinquency rate and has increased its capital stock more than their European competitors.
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