# 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 Statistical Bulletin of Banco de España. The analysis of the Spanish banking sector is confined to banking business in Spain (important: see footnote on page[1]).

## Results of the sector

- The system obtained post-tax net attributable income of €3,514 million in the first quarter of 2017 (up 31% YoY), the highest quarterly result since the end of 2009 (Table 2).

- However, this improvement came from below-the-line items. Revenues continued on their slightly downward trend. Total revenues fell by 1% relative to the first quarter of 2016. Net fees and commissions (up 7% YoY) was the only revenue item to grow, but this was not enough to offset the 3% decline in net interest revenue and the weak trading gains and other operating income. Net interest revenue slowed its decline relative to the past few quarters, despite the contraction in lending volumes and fixed income portfolios over the past twelve months. The reduction in deposit rates was slightly greater than the decline in the average lending rate, where we are already seeing an uptick in consumer credit prices.

- Costs remain under control, especially personnel expenses, which contracted by 3% in the quarter relative to the first three months of 2016. This reduction in costs led to an improvement in the cost/income ratio to 50.3% with the pre-provision profit being held practically stable.

- Loan-loss provisions increased by 2% relative to the first quarter of last year, but moderated relative to the fourth quarter of 2016, which saw a significant uptick due to three non-recurring factors: 1) the entry into force of Banco de España Circular 4/2016 partially adapting Spanish accounting to IFRS 9; 2) the ruling of the Court of Justice of the European Union on interest rate floor clauses in Spanish mortgage loan agreements; and 3) the restating of year-end accounts by a domestic credit institution.

- Net profits grew by 31%, basically due to: 1) lower provisioning and restructuring-related expenses in the first quarter of the year; and 2) the effective tax rate of 8% in the quarter, below the system's "normal" level (15% on average in the period 2000-2007), probably as a result of deferred tax assets being applied.

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

## Activity

- The banking system's total balance sheet continues to contract in 2017 (Table 1). With data to March, the reduction since the high of December 2012 is €800 billion (71% of current GDP). The weight of the banking balance sheet on GDP has fallen from 324% in 2012 to 233% in the first quarter of 2017. In the past twelve months the decline in total assets has been 4.2%. Additionally, the number of employees and branch offices in the system has also fallen, reducing over-capacity (Table 3).

- Despite the contraction in total lending (analysed later in more detail), the system's asset structure has changed during the crisis. The weight of credit has fallen from 70% in 2008 to 59% in 2017, while that of fixed income and equity portfolios has increased from 15% to 23% in the same period, despite falling in 2016 and the first quarter of 2017 (Table 1). The evolution of the sovereign debt portfolio, with growth of 123% since 2008, is especially noteworthy although during the 12 months to March 2017 it declined by 14.6%. In the absence of profitable investment alternatives, the banking system substantially increased its holdings of public debt in the crisis.

- The system's liabilities remained more stable. Deposits (current accounts, savings accounts and term deposits, Table 6) held steady at practically the same level as in March last year once the most volatile items are deducted. Nevertheless, we see a significant shift from term deposits to savings and sight deposits due to the low returns on the former and households' preference for liquidity. As shown in Table 8, interest rate on term deposits are at practically the same level as those on sight deposits.

- Spanish banks' debt continue to decline (Table 1). Since 2008 bonds and notes have fallen by 52% (and by 13% from March 2016 to March 2017), in line with the contraction of the funding gap (loans minus deposits, Table 9) due to the deleveraging of the system. Liquidity provided by the ECB showed an uptick in the first few months of 2017 following the TLTRO auctions (up 36% YoY to May), although remaining well below the peak of 2012. Since the last TLTRO auction has now taken place, no further significant increases in this item are expected.

- Capital on-balance sheet (Table 1) remains stable since 2013, having increased by 27% or €48 billion since 2008.

## Spotlight on lending and NPLs

- With data to March 2017 all lending portfolios continued their downward trend (Table 4), with the exception of non-mortgage lending to households, which was up by 2.7% YoY. Total lending to the private sector ("Other Resident Sectors" in Banco de España's classification, hereinafter "ORS") was down by 2% relative to March 2016, with a cumulative decline of 32% since 2008 (€604 billion, 54% of GDP). The moderation in the declines could be an indication that we are nearing the end of deleveraging. The portfolio with the sharpest fall is lending to real estate, with a YoY decline of 8% (down by 66% from its 2008 high). This item now represents just 12% of total loans outstanding, but still accounts for 35% of non-performing loans.

- NPL volumes in the system continue to decline significantly. Total NPLs have come down by 13.5% in the past twelve months, with a cumulative decline of €85 billion or 43% since the highs of 2013, making 40 consecutive months of reduction with the sole exception of November 2016. The reduction in NPL volumes is greater (18% YoY) in lending to businesses than in lending to households (-0.6% YoY), where the reduction in mortgage NPLs (-3.7%) is offset by the 6.4% increase in NPLs in other lending to households. The NPL rate fell below 9% for the first time since mid-2012.

- The cumulative volume of new lending transactions YTD May 2017 (Table 5) is slightly up on the first five months of last year. By portfolios, lending to SMEs and other (non-mortgage) lending to households were both up, while mortgage lending and lending to large corporates were down in the first five months of 2017. In the case of mortgage lending, this is because renegotiations of loans with interest rate floor clauses gave rise to a large volume of new transactions in the same period of last year. At present the annualized volume of new lending is running at 34% of the average for the three years preceding the onset of the crisis.

## Main ratios

- The cost/income ratio improved to 50.3% in the first quarter of 2017, thanks to cost control and to a notable increase in the system's productivity (business volumes and pre-tax profit per branch, Table 9). Operating costs as a percentage of Average Total Assets (ATM) have been held below 1% since 2008 (Figure 6, Appendix 1).

- The system continues to strengthen its solvency position. The volume of capital and reserves reached 8.7% of total assets (Figure 3, Appendix 1), and the amount of equity on balance sheet doubled the amount of NPLs in the system, reaching 205% in March 2017 (Figure 2, Appendix 1).

- Liquidity does not currently pose a problem for the Spanish banking system. The ratio of ORS lending to ORS deposits was steady at 110% as at March 2017, 48 pp less than in 2008 (Figure 3, Appendix 1). The sector's funding gap (ORS lending less ORS deposits) stood at €114 billion (4.0% of the balance sheet), the minimum level of the series (Figure 4, Appendix 1).

- The system maintains satisfactory levels of provisions. The "provisioning effort" (loan-loss provisions / pre-provision profit) and the "cost of risk" (loan-loss provisions / average total lending), have held steady at pre-crisis levels (Figure 1, Appendix 1). Profitability remains positive, although weak (Figure 5, Appendix 1).

## 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 are from December 2016.

- Spanish banks have better cost/income ratios and have more capital on balance sheet than their European competitors (Figure 1, Appendix 2). Specifically, they have 35% more capital (+17% in December 2009, the first EBA data available) and a cost/income ratio 11 pp better than the average for European banks (Figure 5, Appendix 2).
- The balance sheet clean-up efforts made by Spanish banks in 2012 and 2013 (Figure 3, Appendix 2) were necessary to show the fair value of their assets and to get into line with their European competitors. Thus NPL specific provision coverage has exceeded the European average since the beginning of 2014.
- On the other hand the NPL ratio remains higher in Spain than in other countries (Figure 2, Appendix 2), although the volume of NPLs has fallen continuously since December 2013. The system's profitability is slightly below the European average (Figure 4, Appendix 2).

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