

Spanish financial system: the rescue is almost complete

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Progress in the restructuring of the financial system

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Credit: The road to recovery

The restructuring of the Spanish financial system is set in motion

Problem

Asset quality: real estate and others

Lack of differentiation between entities

Capital needs exceed the government's capacity

45 savings banks (*cajas*), with peculiar legal form

Late reaction, in part due to institutional problems

Solution

Higher provisions, sufficient capital (severe stress test), Independent audits and transfer to Sareb

Stress test (capital needs identified at entities managing only 30% of total system assets), additional transparency requirements

ESM credit line is a credible backstop. Total injections of 5% of GDP (like UK), manageable burden for public debt

11 now, and 9 have become banks. New regulation of *cajas* removes political influence

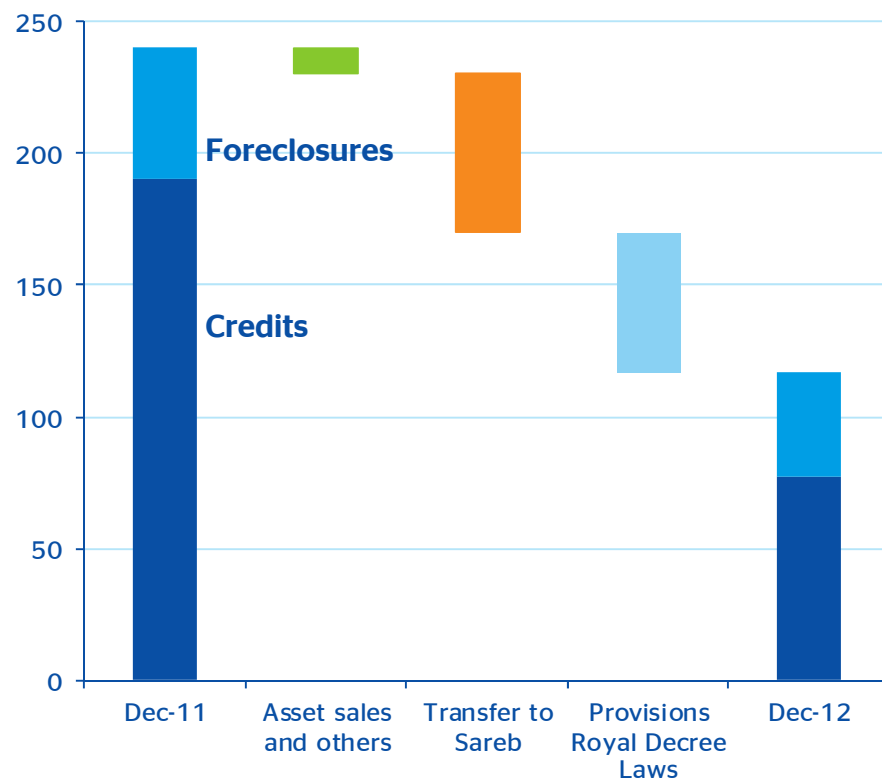
Clarification and reinforcement of FROB-Bank of Spain functions. Regulation on crisis management, restructuring and resolution frameworks

Balance-sheet clean-up has been focused on real estate assets

Real estate exposures net of provisions

(EUR bn)

Source: Bank of Spain



The bulk of the problems were in real estate assets

In 2012 real estate exposures halved, and exposure by end-2013 is estimated to be around EUR100bn

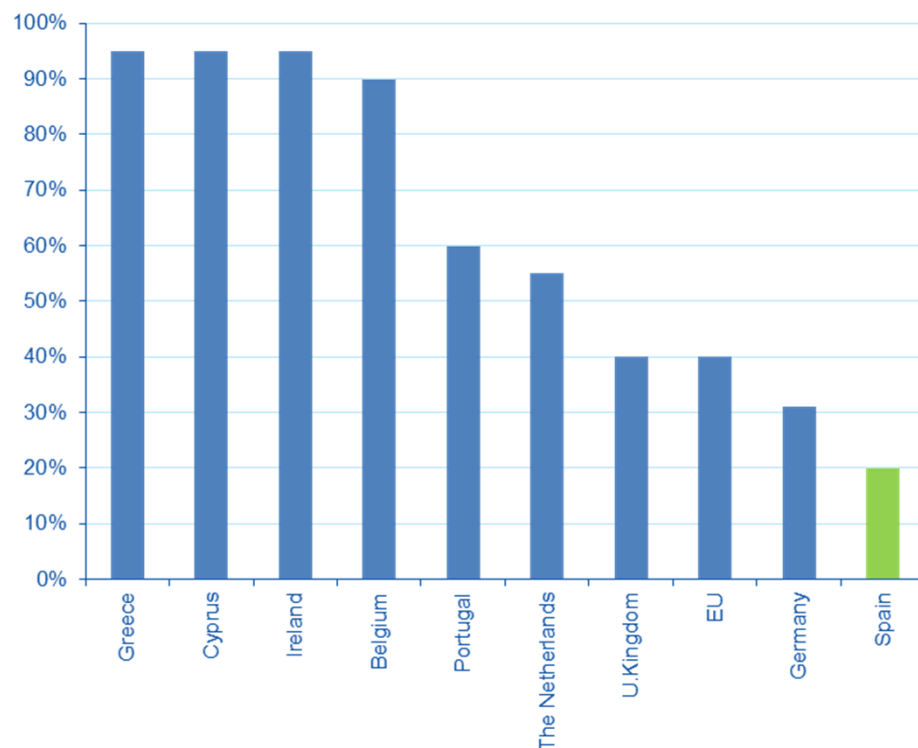
The worst-affected entities have transferred 90% of their assets to Sareb, and are subject to restructuring plans

The system has almost finished cleaning-up real estate exposures, in particular the sound entities

Only a limited part of the system is subject to restructuring

Percentage of assets in entities under public aid or restructuring programme (%)

Source: EU Commission



The stress test identified capital needs at entities that only represented 30% of the system's total assets

European regulation on public aid has made the process longer than in the US

The agreement regarding the end of the Spanish banking rescue is positive, and underlines that steps are being taken in the right direction

Spanish entities are ready for the ECB comprehensive assessment

Composed of 3 pillars

Supervisory Risk Assessment to review key risks, including liquidity, leverage and funding

Asset Quality Review (AQR) to analyze the quality of banks' assets, collateral valuation and provisions

Stress Test to examine the resilience of banks' balance sheet to stress scenarios

Valuation

In principle, details point to a balanced exercise with a wide enough scope

However, some issues require further clarification: bail-in, stress test procedures (end-January), publication of data so as to replicate the exercise...

The exercise is pivotal to eliminate all concerns about the solvency of the European banking sector

Spanish entities went through a similar exercise during the summer of 2012, so no major surprises are expected

However, there are some pending issues

The system does not need additional restructuring plans, but an efficient implementation of current plans is crucial

Problem

Complete the restructuring

Liquidate Sareb's assets

Restore liquidity conditions

Desirable solution

Quick resolution of intervened institutions, as international experience shows that public banks can be inefficient. Overcapacity is a concern

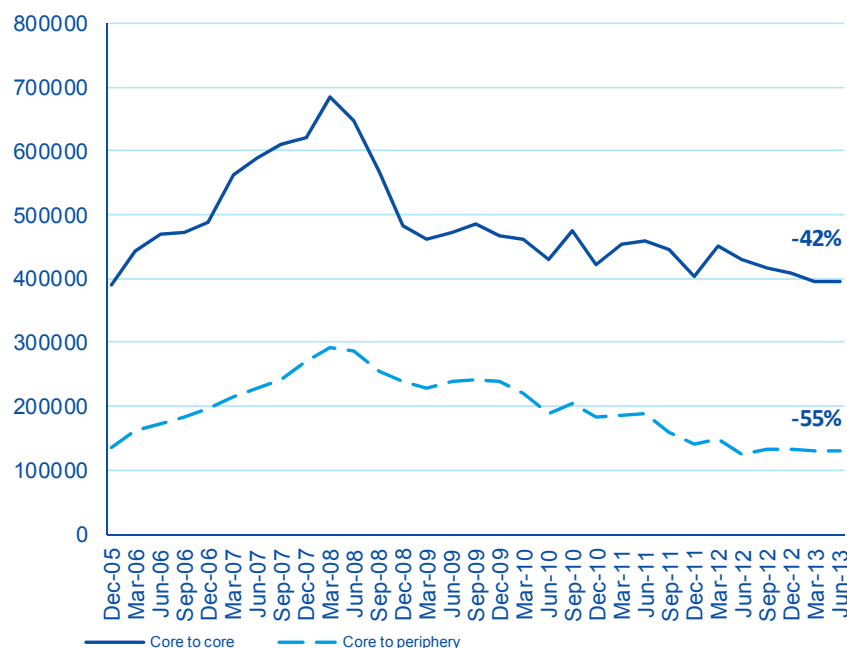
The sales should be gradual

Restoration of the interbank and wholesale markets, to break the vicious circle of banks and sovereigns. Banking union is the way forward

European problems persist: Financial fragmentation

European banks: Average exposure to EU members

Source: BIS
Fuente: BIS

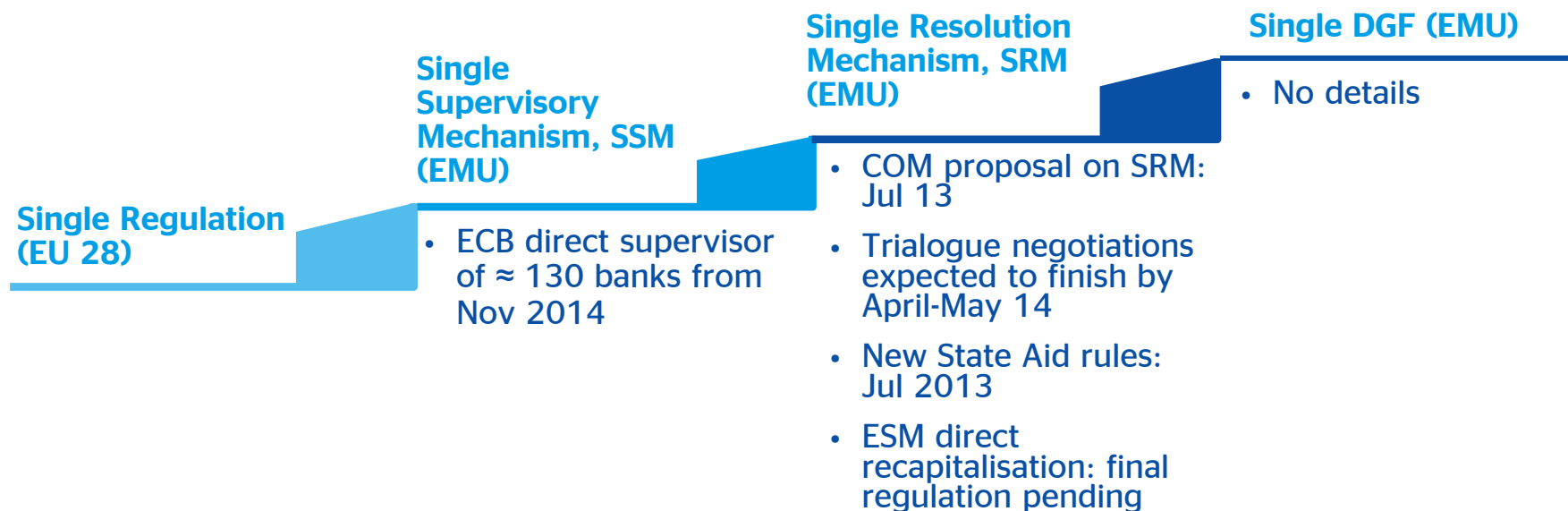


The crisis has caused a reversal of flows between EU member states, both core and peripheral

There is still a vicious circle between sovereign and banking risks

ECB liquidity has replaced the interbank market and the monetary policy transmission mechanism is broken

Banking union is much needed: the current fragmentation is incompatible with the euro



CHALLENGES

- 1 SRM is the necessary counterpart to SSM
- 2 Any delay in SRM must be avoided, Council and Parliament have to overcome differences
- 3 A credible SRM needs a single authority and a single resolution fund
- 4 The legacy assets problem should be dealt with at a national level before the SRM



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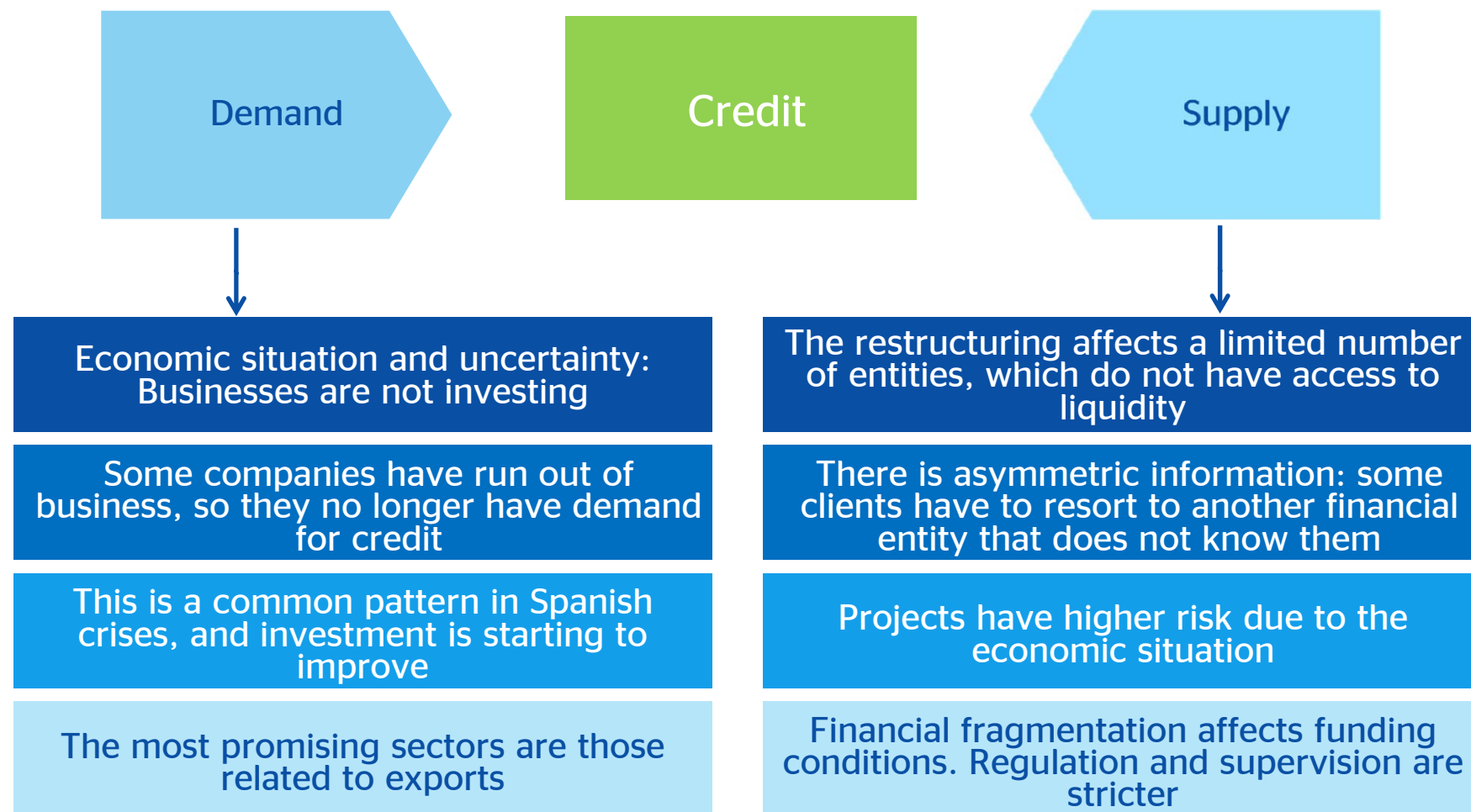
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Credit: The road to recovery

What factors are affecting credit?

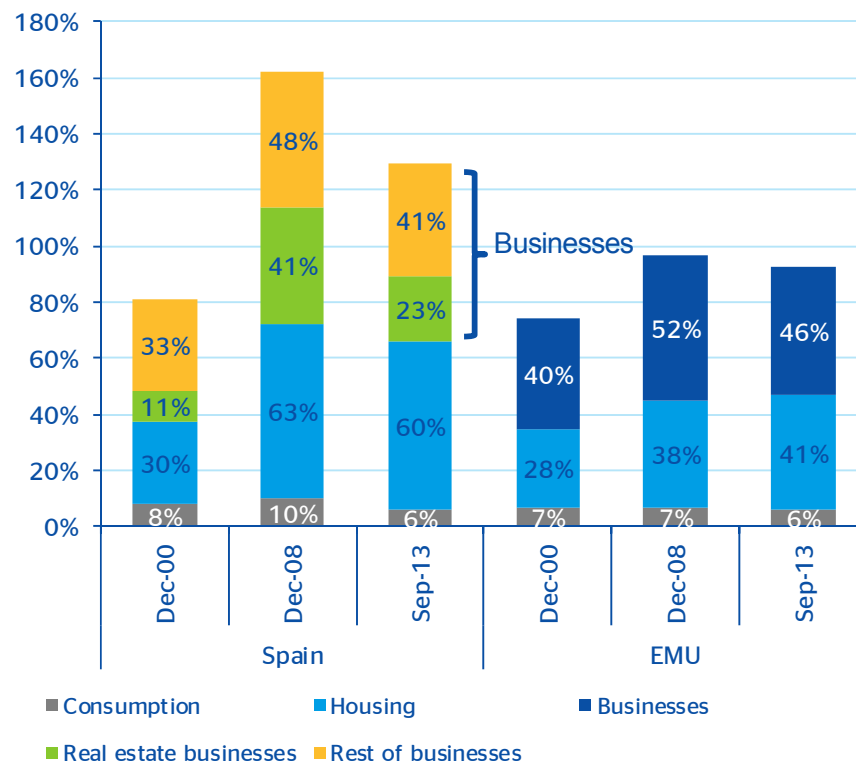


Private-sector deleveraging is much needed

Credit to the private sector

(% GDP)

Source: ECB and Bank of Spain



Private-sector leverage is excessive. Spanish levels are above those of EMU

Deleveraging will continue in terms of the stock of outstanding credit

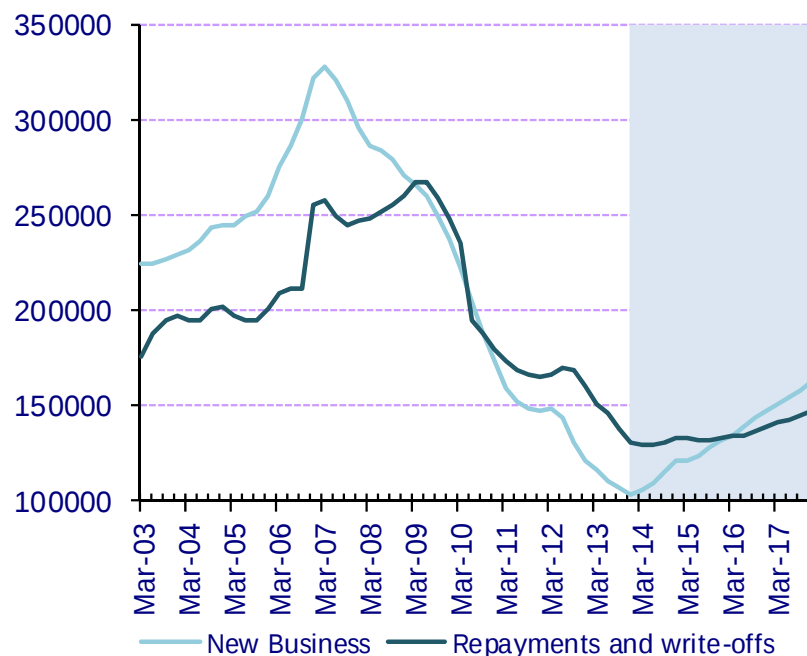
Compared to EMU, the most significant differences are in real estate businesses and mortgages

The deleverage of outstanding credit is compatible with a positive flow of new credit

Private-sector: new loans and repayments

(Quarterly figures, EUR mn)

Source: Bank of Spain and BBVA Research



Spanish statistics on new loans include 'novations' (change of terms and conditions), so refinanced operations are included

The forecast suggests that new lending may have bottomed-out in the first half of 2013. In the future refinancing will play a less important role

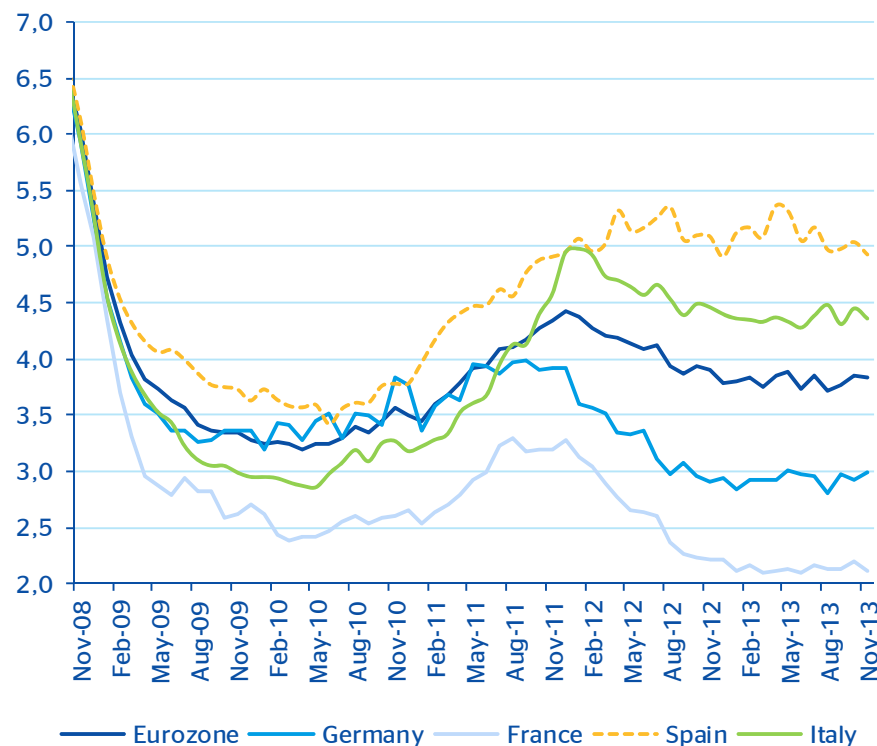
However, new lending will not exceed repayments until the end of 2015, so private-sector deleveraging has to continue

The price of credit for SMEs is still higher in peripheral countries

Interest rates on new bank lending (%)

(to non-financial corporations, less than EUR1mn, less than 1 year)

Source: ECB



Determinants of interest rates on new bank lending (to non-financial corporations)

Source: BBVA Research based on ECB and Bloomberg

	Germany	France	Spain	Italy
Commercial policy	1.66	--	--	--
ECB official rate	1.03	1.24	1.29	1.47
Spread 12 months (12m-Euribor)	0.59	1.21	1.6	-0.06*
Spread EMU (10y EMU-Euribor)	0.35	0.69	0.44	0.5
Spread sovereign (10y country-10y EMU)	0.17	0.46	1.22	1.05
CE Regulation 290/2009	0.15	0.54	-0.16	--

-- Does not differ significantly from zero

* Not significant at 20% confidence

The price of credit is affected by the sovereign spread. The solution is banking union

Main messages

- 1 The restructuring of the Spanish financial system has been set in motion. No major surprises are expected in the comprehensive ECB assessment
- 2 The deleverage of outstanding credit must continue, and this is compatible with the flow of new credit to solvent demand
- 3 Some measures to foster credit must come from Europe. Banking union is the key to reducing the current financial fragmentation in Europe