

The macrofinancial outlook, both for the global and for the Spanish economies, has improved since the last edition of this report was published, which was before the announcement of the effectiveness of several vaccines against the SARS-CoV-2 coronavirus. Despite this, vulnerabilities, such as the weak financial situation of some household and business segments, the increasing public indebtedness and low profitability of deposit institutions, have become more pronounced. In addition, significant risks to financial stability remain. The most relevant of these are lower-than-expected growth, an abrupt correction in the valuation of certain assets on specific financial markets and also a reduction in the supply of credit.

During this period of economic crisis as a result of the pandemic, credit institutions have continued to provide financing to the non-financial private sector. In fact, the volume of bank credit to this sector has increased again in Spain for the first time since the global financial crisis, supported by the various public programmes to mitigate the impact of the restrictions on activity that were adopted to curb infections. Credit standards have generally been marked by risk considerations. In this respect, both public guarantees and loan moratoria have been key to the flow of credit reaching the firms and households that are most affected by the pandemic and most vulnerable.

Despite the sharp fall in GDP in 2020, the NPL ratio in Spain has fallen, in stark contrast to historical regularities. In this connection, the evidence shows that the measures implemented by the authorities are delaying (and also reducing) the emergence of delinquencies in bank balance sheets. It is therefore essential to analyse any evidence of latent credit impairment, in particular by monitoring loans in Stage 2, which have increased significantly, and studying the credit situation in the banking system as a whole of firms that have had access to guarantee schemes, which show signs of weakness. The monitoring of loans subject to expired moratoria also shows that they have a high NPL ratio. All of this suggests that credit impairment will materialise to a greater degree in the coming quarters.

Deposit institutions recorded negative returns last year. However, this is largely due to extraordinary factors, such as the impairment of goodwill at larger institutions. When these factors are excluded, returns are positive, but significantly lower than in 2019. The increase in provisions in anticipation of credit risk materialisation appears to be the main explanatory factor behind this reduction. According to the analysis carried out, this provisioning effort has been significant in relation to the credit impairment expected by the end of 2022, although there is heterogeneity across institutions. Therefore, institutions should persevere with their efforts and be prepared to step them up if the macroeconomic situation turns out to be worse than expected.

Although institutions recorded accounting losses in 2020, their prudential solvency ratios increased. This is due, in part, to the extraordinary factors noted above, which apply to balance sheet items with no impact on prudential solvency (e.g. goodwill). In addition, the authorities implemented a number of measures that strengthened institutions' CET1 ratio. These include the rapid regulatory reform undertaken by the European Union («Quick Fix»), the public guarantee scheme and the recommendation not to pay dividends.

In any case, even though vaccination progress is boosting expectations of a return to normal economic activity, considerable uncertainty remains, both regarding the health situation and, above all, the total extent of the damage the crisis has inflicted on the economy and the financial system. Against this background, it seems clear that macroeconomic policies must remain sufficiently expansionary until the recovery has taken hold. These policies should focus on supporting firms that are viable but with financial weaknesses as a result of the pandemic, and also on the most severely affected households. In this regard, the implementation of a sufficiently ambitious structural reform plan and a fiscal consolidation programme that can be progressively implemented once the economy has recovered would increase the growth capacity of the Spanish economy and reduce its vulnerabilities.

In this setting, continued close monitoring of the financial system is essential to identify, and to react well in advance to mitigate, any risks that may materialise. Banks must sustain their provisioning efforts and also recognise any actual impairment in a timely fashion. To face this challenge, banks have capital and liquidity buffers to duly cushion its impact and to continue to fulfil their role of providing financing to the economy. The subsequent rebuilding of these buffers will be gradual and will not be required by the prudential authorities before the main effects of this crisis have dissipated.