

FINANCIAL STABILITY REPORT Spring 2022

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Director General

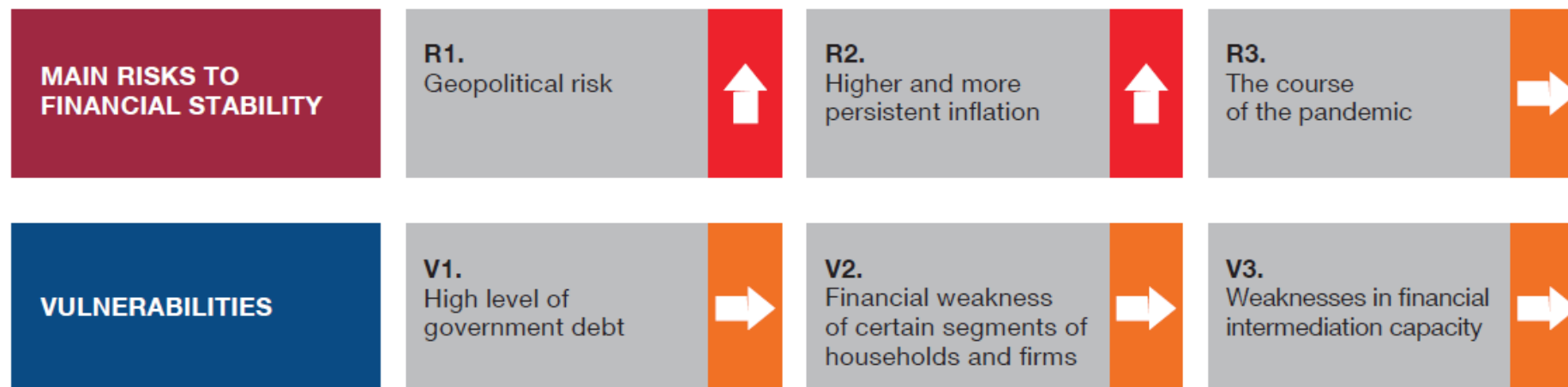
Presentation to the press
27-04-2022

DIRECTORATE GENERAL FINANCIAL STABILITY, REGULATION AND RESOLUTION



THE MACRO-FINANCIAL SITUATION OF THE SPANISH ECONOMY HAS CONTINUED TO IMPROVE SINCE THE LAST FSR...

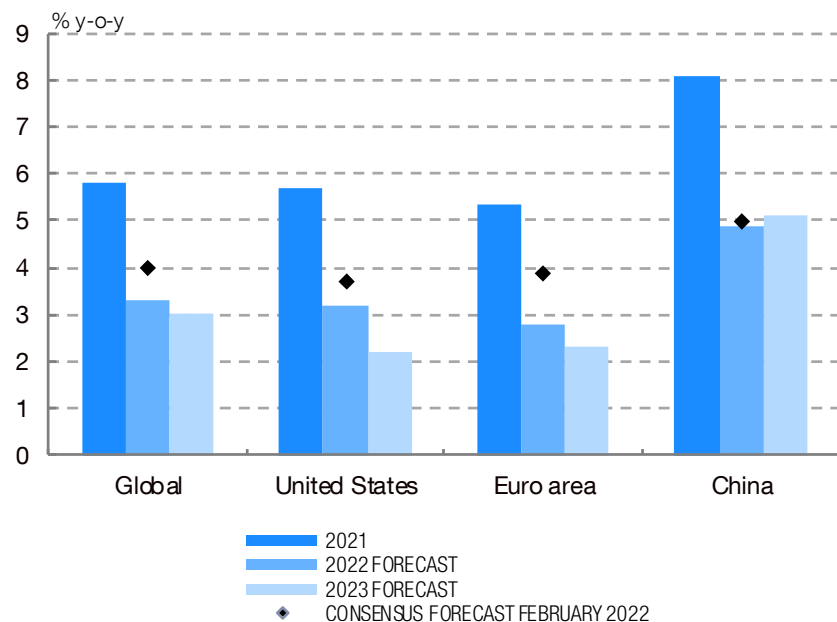
- ... but new risks have emerged, including most notably the Russian invasion of Ukraine, that may increase financial instability, not only in Spain but also worldwide



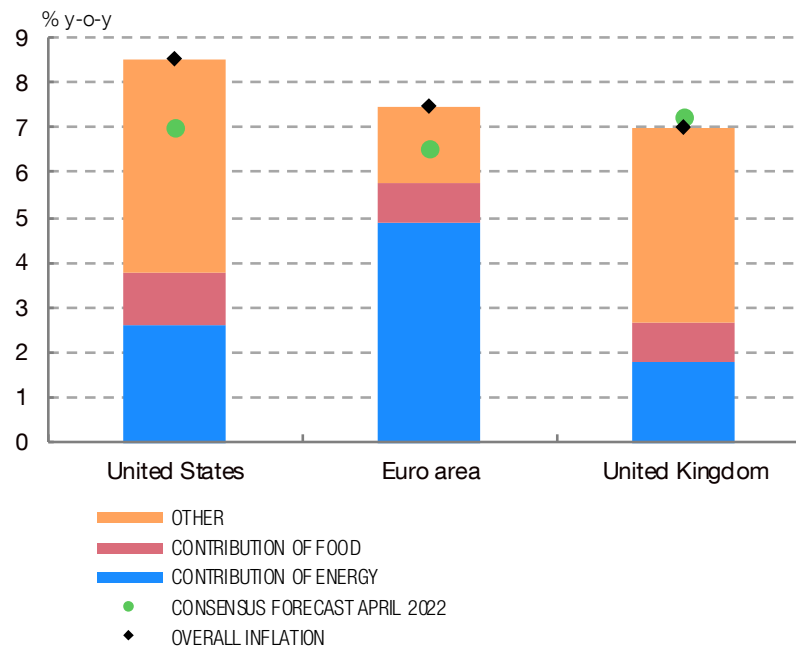
THE RECOVERY IN ECONOMIC ACTIVITY HAS SLOWED AND INFLATION HAS CONTINUED TO RISE

- The moderation in global economic growth is attributable to the new wave of COVID-19 infections, the persistence of bottlenecks and the slowdown of the Chinese economy
- Demand pressures, bottlenecks and higher commodity prices are behind the stronger pressures on prices

1 GDP GROWTH FORECASTS (2021-2023)
Consensus Forecast April 2022



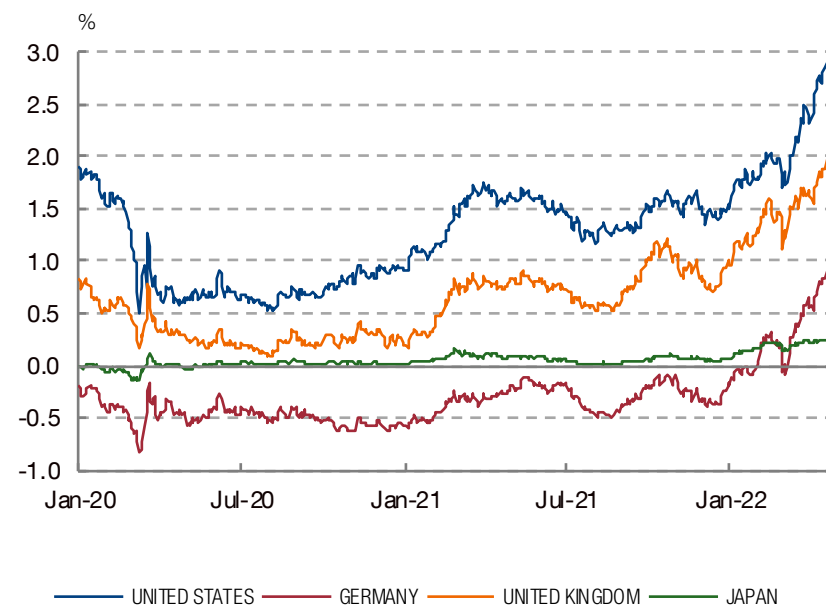
3 CONTRIBUTION OF ENERGY AND FOOD TO HEADLINE INFLATION:
MARCH 2022



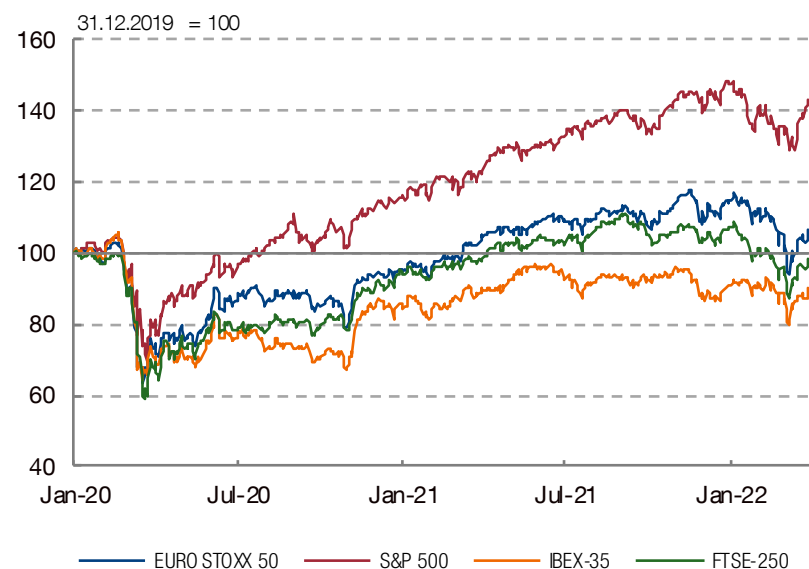
FINANCING CONDITIONS ARE TIGHTENING OWING TO HEIGHTENED GEOPOLITICAL TENSIONS AND THE EXPECTATION OF MONETARY POLICY NORMALISATION

- Euro area sovereign yield spreads and corporate credit risk premia have also risen
- The outbreak of the war between Russia and Ukraine prompted a decline in stock market indices worldwide, which have, however, recovered in recent weeks

1 10-YEAR SOVEREIGN DEBT YIELD



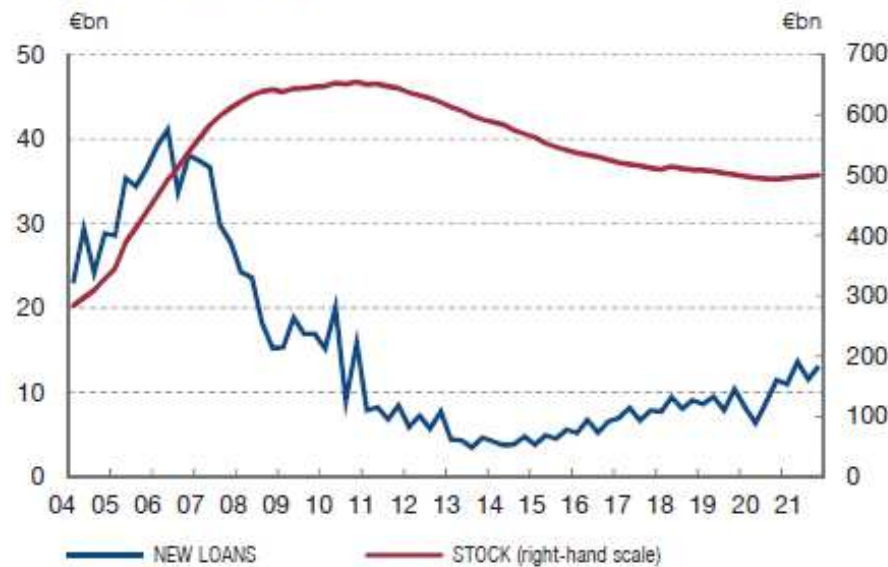
4 STOCK MARKET INDICES



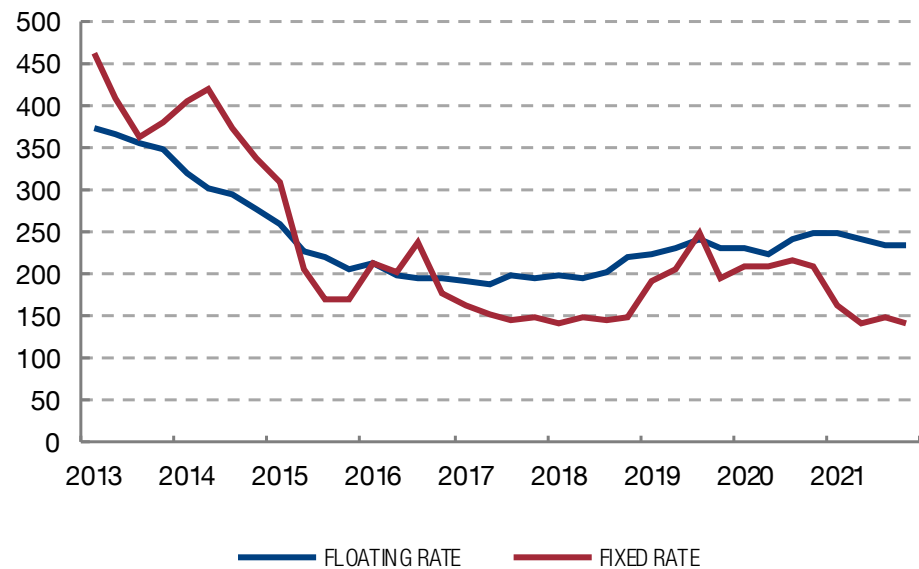
HOUSE PRICES HAVE CONTINUED TO ACCELERATE, BUT MORTGAGE STANDARDS HAVE NOT EASED OVERALL

- In 2021 H2 the volume of new residential mortgage lending remained around H1 levels, which are significantly higher than in 2019
- As regards mortgage lending conditions, a notable development was the narrowing of the average interest rate spread for fixed-rate mortgages to its lowest level in recent years

1 NEW LOANS FOR HOUSE PURCHASE AND STOCK OF MORTGAGE LOANS (a)



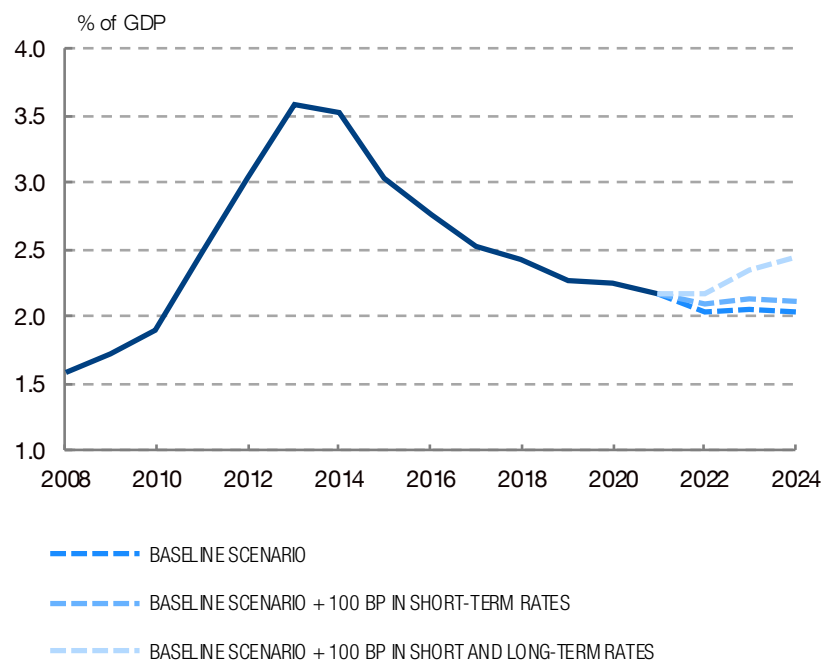
3 SPREADS OVER RISK-FREE RATES (c)



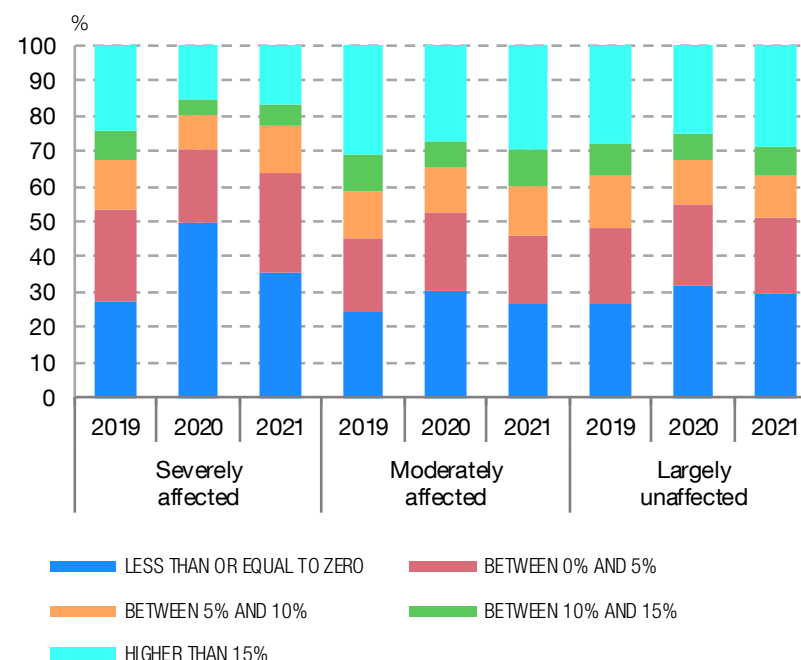
BUDGET DEFICIT DECREASED IN 2021, BUT REMAINS HIGH, AS DOES GOVERNMENT DEBT

- **High debt increases the sensitivity of financing costs to interest rate rises**
- **Despite the across-the-board improvement in firms' profitability in 2021, the proportion of more vulnerable firms remains higher than in 2019, especially in the sectors hardest hit by the pandemic**
 - This is expected to affect households with members employed in those sectors

2 SENSITIVITY OF INTEREST PAYMENTS (b)



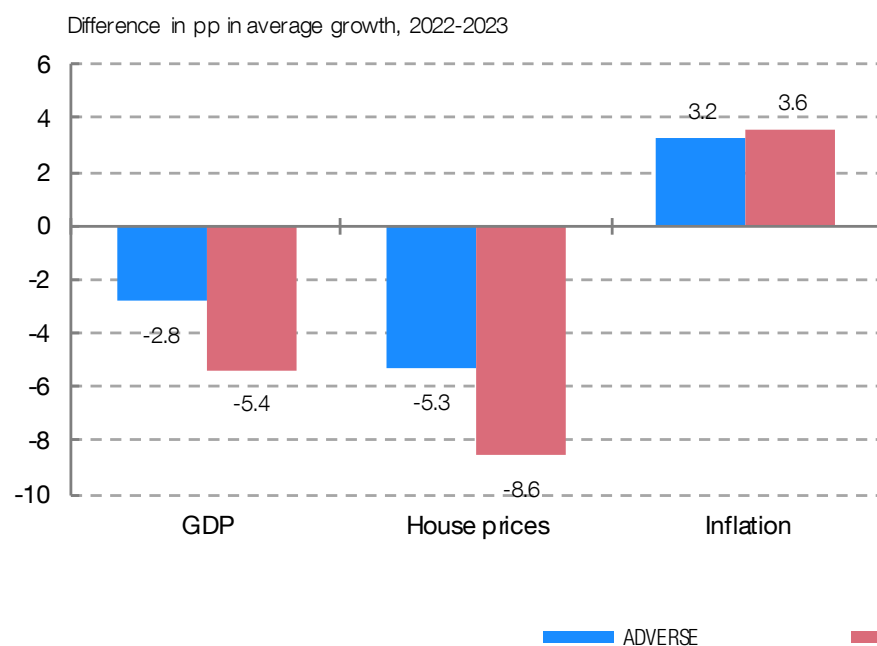
1 PERCENTAGE OF FIRMS BY RANGE OF RETURN ON ASSETS. BREAKDOWN BY SECTOR (a) (b) (c)



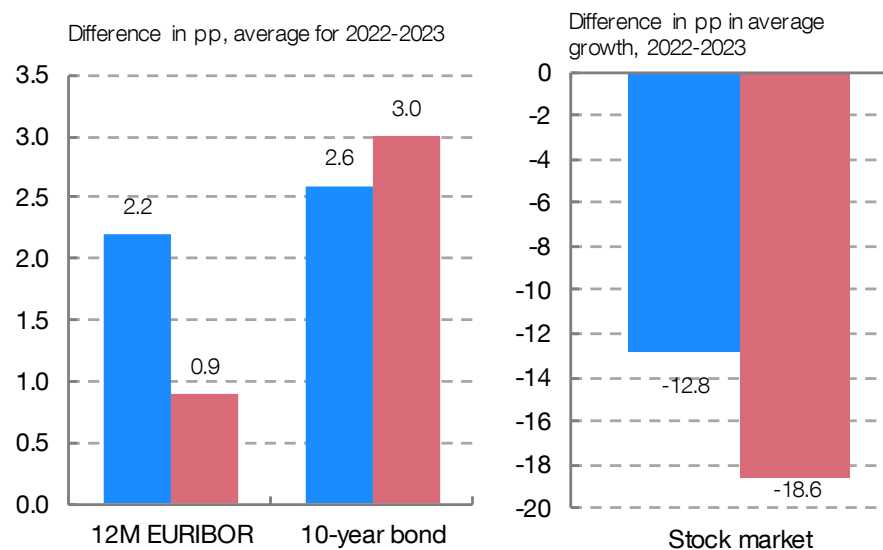
TWO SCENARIOS RELATED TO THE RUSSIAN INVASION OF UKRAINE ARE CONSIDERED IN THE STRESS TESTS CONDUCTED ON SPANISH BANKS

- **Adverse: Rising risk premia, larger increases in energy commodity prices and bottlenecks drive up inflation and force a monetary policy response**
- **Severe: Adverse scenario + erosion of agents' confidence, entailing a less aggressive monetary policy response**

ADVERSE AND SEVERE SCENARIOS FOR SPAIN. MACROECONOMIC IMPACT (a)



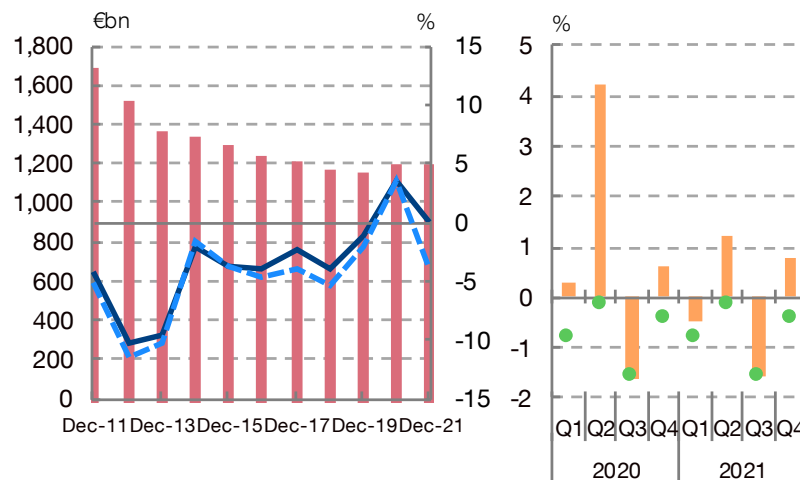
ADVERSE AND SEVERE SCENARIOS FOR SPAIN. IMPACT ON THE FINANCIAL ENVIRONMENT (a)



BANK LENDING TO THE PRIVATE SECTOR DECLINED SLIGHTLY IN 2021, WITH FIRMS AND HOUSEHOLDS PERFORMING DIFFERENTLY

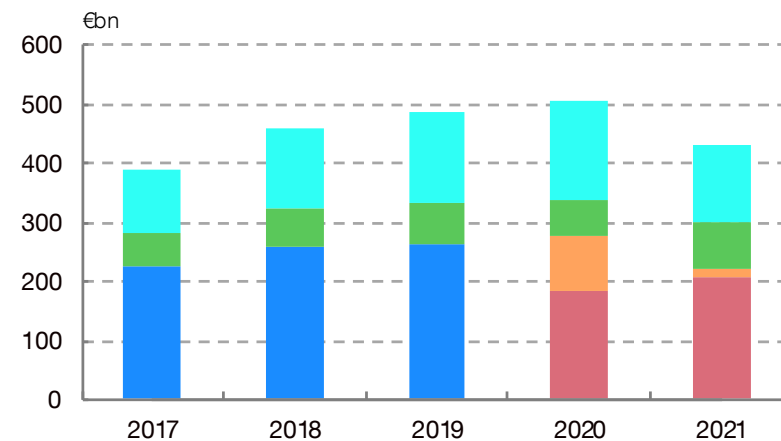
- While new loans granted to productive activities fell (with the decline concentrated almost entirely in those guaranteed by the public sector)...
- ...new loans extended to households increased
 - Driven by strong growth in new lending for house purchase

1 VOLUME OF LENDING AND YEAR-ON-YEAR RATE OF CHANGE
Business in Spain, ID



■ LENDING TO THE RESIDENT PRIVATE SECTOR
— LENDING, Y-O-Y RATE OF CHANGE (right-hand scale)
- - - LENDING, REAL-TERMS Y-O-Y RATE OF CHANGE (a) (right-hand scale)
■ Q-O-Q RATE
● AVERAGE Q-O-Q RATE 2014-2019

2 VOLUME OF NEW LENDING IN THE YEAR.
HOUSEHOLDS, NFCs AND SOLE PROPRIETORS
Business in Spain, ID

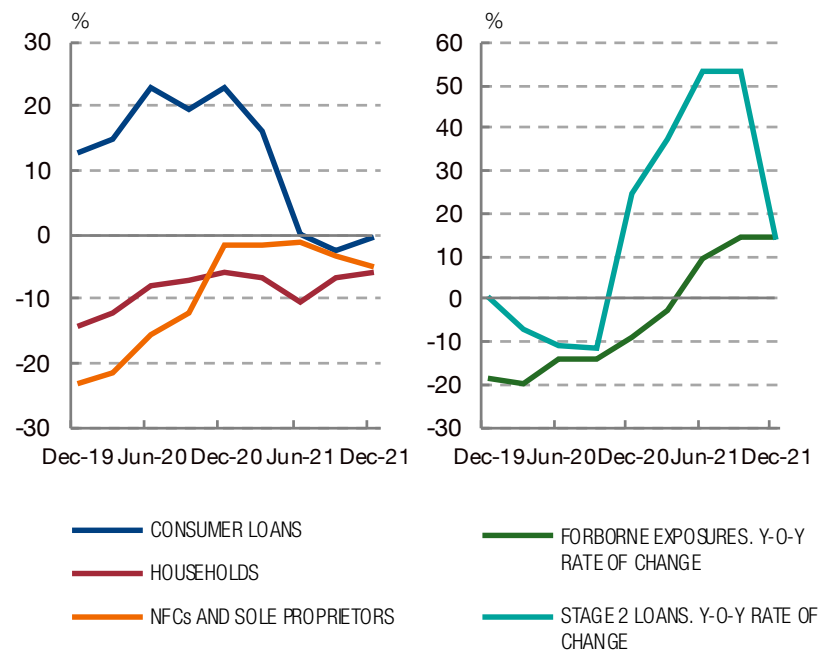


■ INCREASE IN PRINCIPAL DRAWN
■ NEW LENDING. HOUSEHOLDS
■ NEW LENDING. NFCs AND SOLE PROPRIETORS WITH ICO GUARANTEES
■ NEW LENDING. NFCs AND SOLE PROPRIETORS WITHOUT ICO GUARANTEES
■ NEW LENDING. NFCs AND SOLE PROPRIETORS

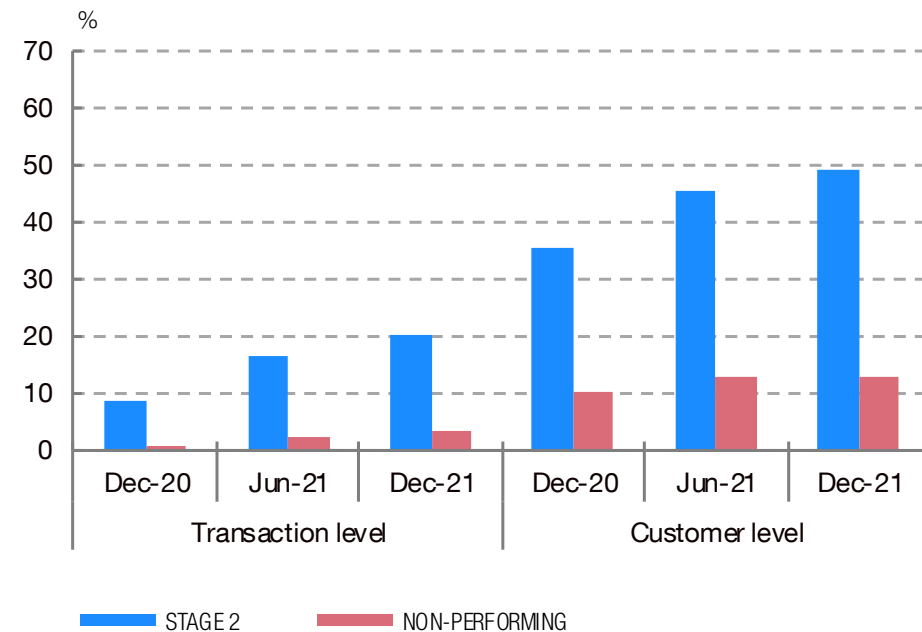
NON-PERFORMING ASSETS CONTINUED TO DECLINE IN 2021, BUT LATENT SIGNS OF IMPAIRMENT PERSIST, PARTICULARLY IN THE SECTORS MOST AFFECTED BY THE PANDEMIC

- **The credit quality of ICO-guaranteed loans continued to worsen, albeit at a slower pace**
 - Most of the deterioration in these loans remains concentrated in Stage 2 loans

2 YEAR-ON-YEAR RATES OF CHANGE IN NPLs (L-H PANEL) AND SIGNS OF EARLY IMPAIRMENT IN LENDING TO THE RESIDENT PRIVATE SECTOR (R-H PANEL)
Business in Spain, ID



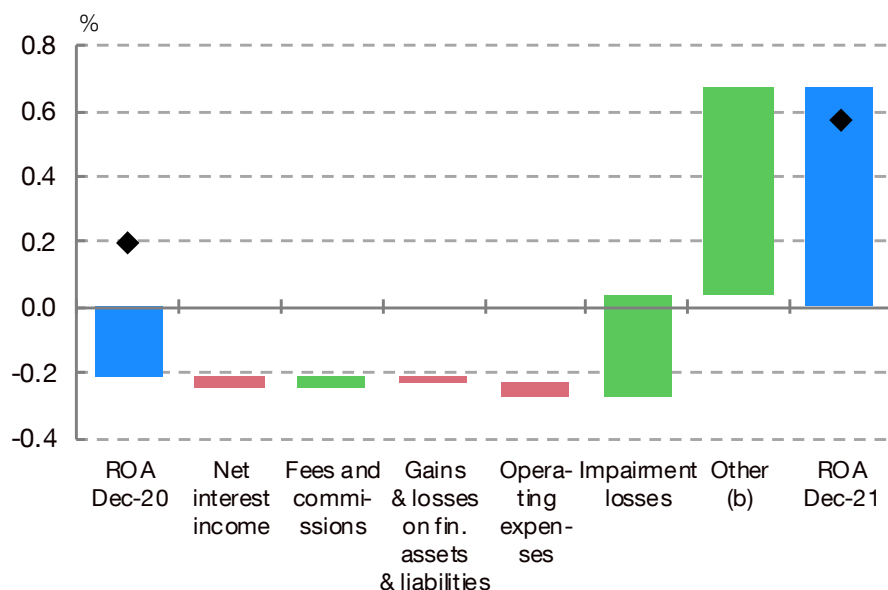
1 CREDIT QUALITY OF THE STOCK OF ICO-BACKED LOANS (a)



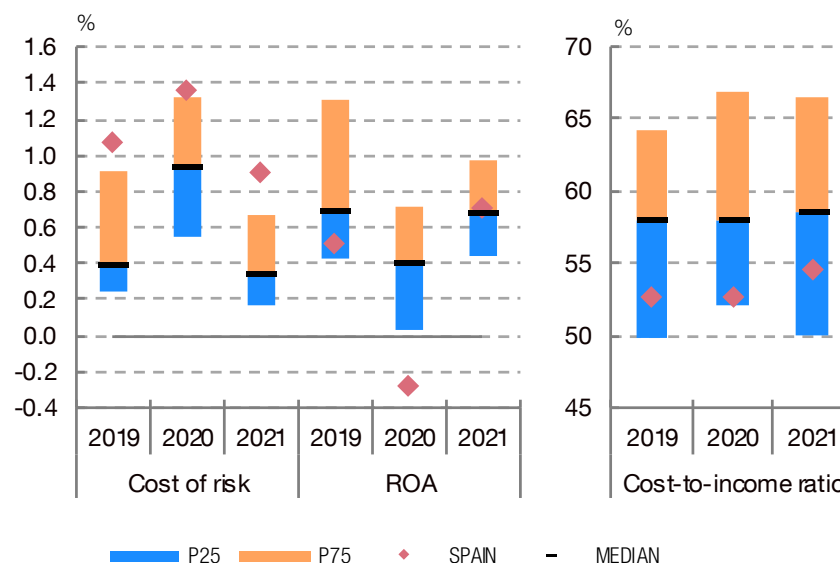
THE BANKING SECTOR'S PROFITABILITY IMPROVED SUBSTANTIALLY FOLLOWING THE LOSSES RECORDED IN 2020 AND IS NOW ABOVE THE EUROPEAN MEDIAN

- The improvement was mainly attributable to the extraordinary results (positive in 2021 and notably negative in 2020) and to lower impairment losses

1 BREAKDOWN OF THE CHANGE IN PROFIT
Consolidated net income as a % of ATA (a)



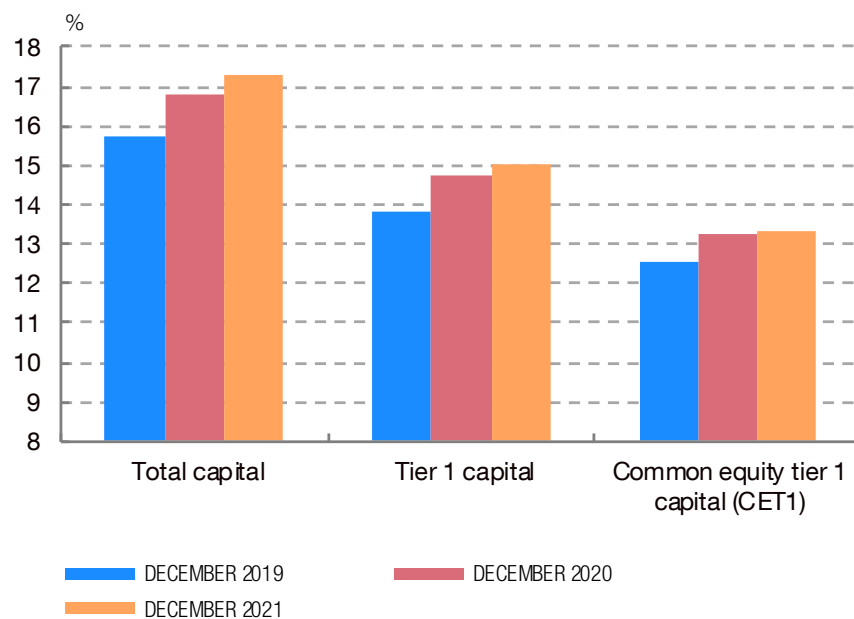
2 THE MAIN PROFITABILITY VARIABLES: A EUROPEAN COMPARISON (d)



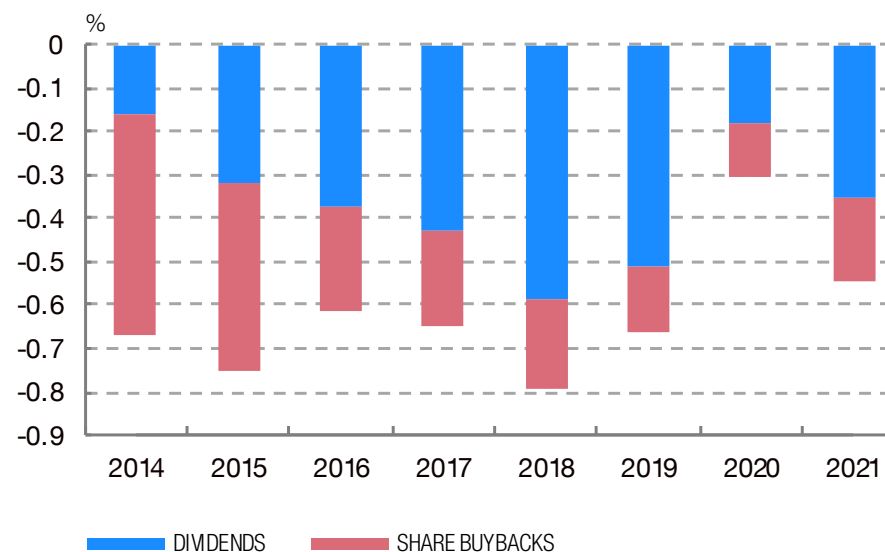
THE CET1 RATIO REMAINED STABLE IN 2021, AS IN THE REST OF EUROPE; THE DIFFERENCES HAVE THEREFORE STABILISED AFTER CONVERGING SLIGHTLY IN 2020

- The decreases in CET1 capital and RWAs were of a similar scale
- The distribution of profits to shareholders resumed in 2021, although it remains below the levels observed before the pandemic

1 CAPITAL RATIOS
Consolidated data



2 DIVIDENDS AND SHARE BUYBACKS AS A PERCENTAGE OF RWAs
Consolidated data



THE STRESS TESTS OF THE ADVERSE AND SEVERE SCENARIOS PRESENTED PREVIOUSLY SHOW THE BANKING SECTOR'S AGGREGATE RESILIENCE

- The impact on the CET1 ratio was 1.8 pp and 3 pp in the adverse and severe scenarios, respectively
- However, there is cross-bank heterogeneity attributable to differences in: (i) the composition of their credit to the private sector and sovereign exposures, (ii) international presence, (iii) coverage of the ICO programme, etc.

Chart 1
IMPACT OF THE RISK MATERIALISATION SCENARIOS ON BANK SOLVENCY (a)
CONSOLIDATED BUSINESS

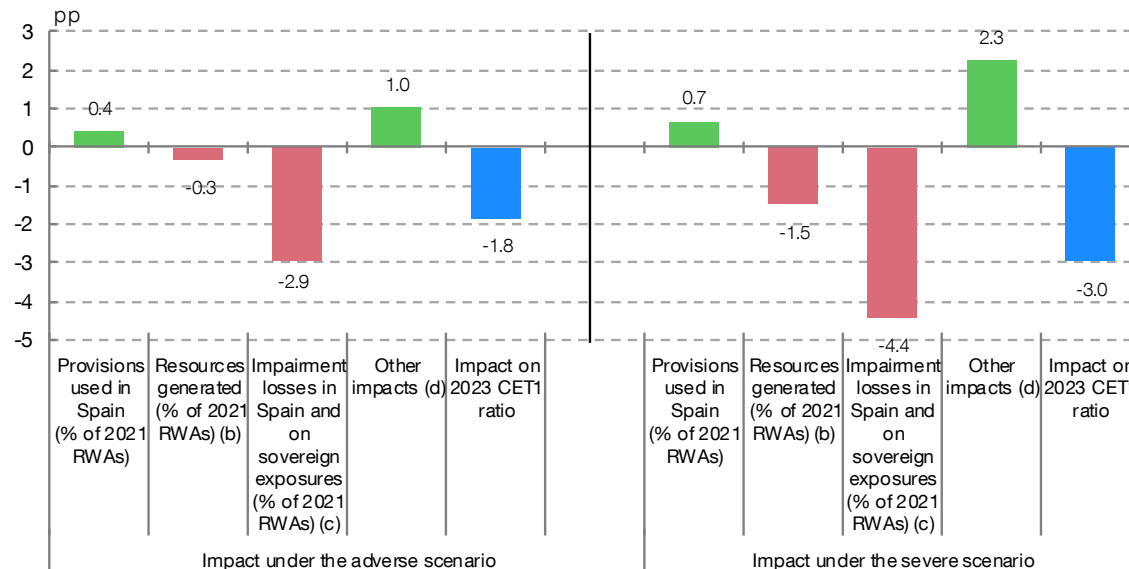
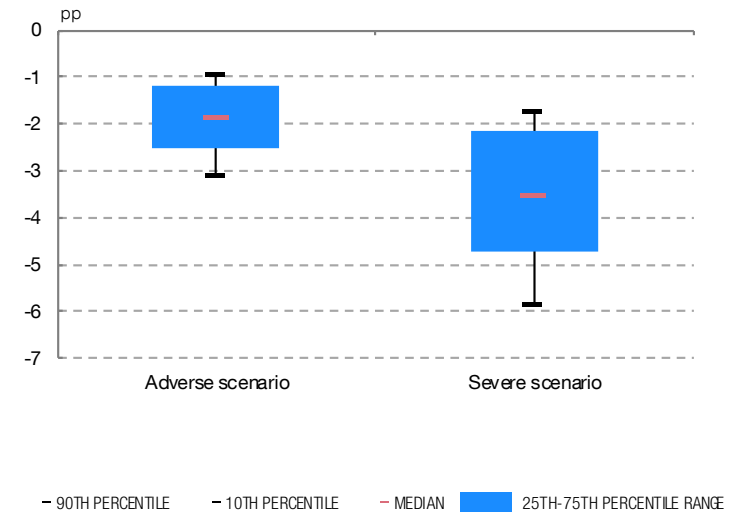


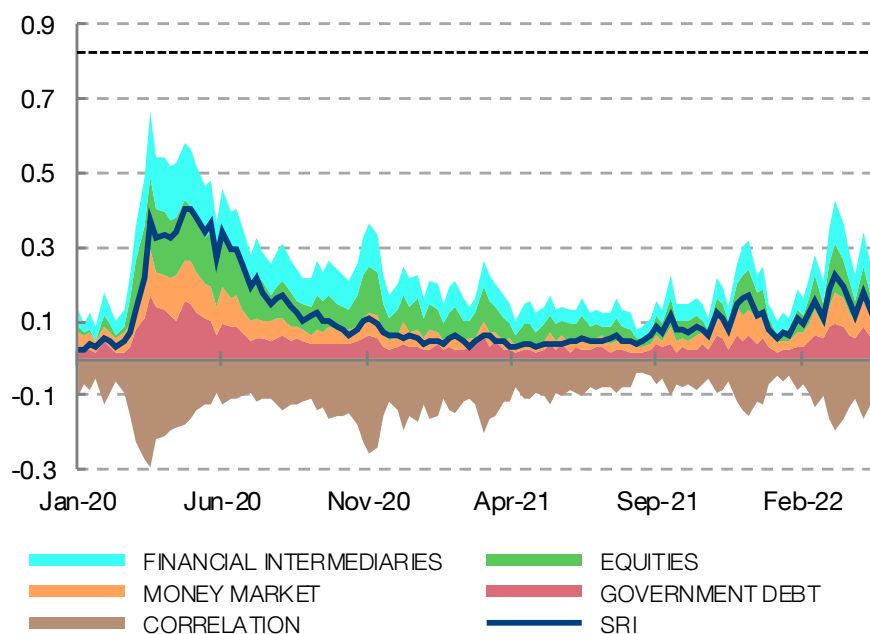
Chart 3
DISTRIBUTION AMONG BANKS OF IMPACTS ON LOAN IMPAIRMENT PROVISIONS RELATIVE TO 2021 RWAs (b). OPERATIONS IN SPAIN



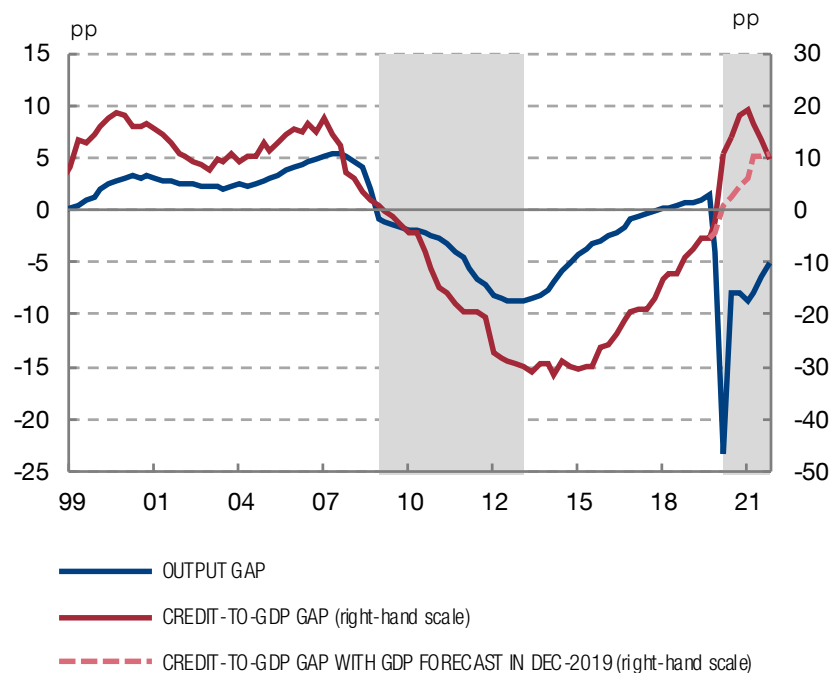
THE SYSTEMIC RISK FOR THE SPANISH ECONOMY REMAINS CONTAINED, AND THEREFORE IT DOES NOT SEEM THAT ANY MACROPRUDENTIAL INSTRUMENTS NEED TO BE ACTIVATED

- **Rising uncertainty on financial markets since mid-2021 has brought with it episodes of heightened systemic stress...**
 - ...that were further exacerbated by the Russian invasion of Ukraine, although they have eased in recent weeks
- **While the credit-to-GDP gap has continued to correct following the rise recorded at the onset of the pandemic, it remains very wide**

1 SYSTEMIC RISK INDICATOR (a)



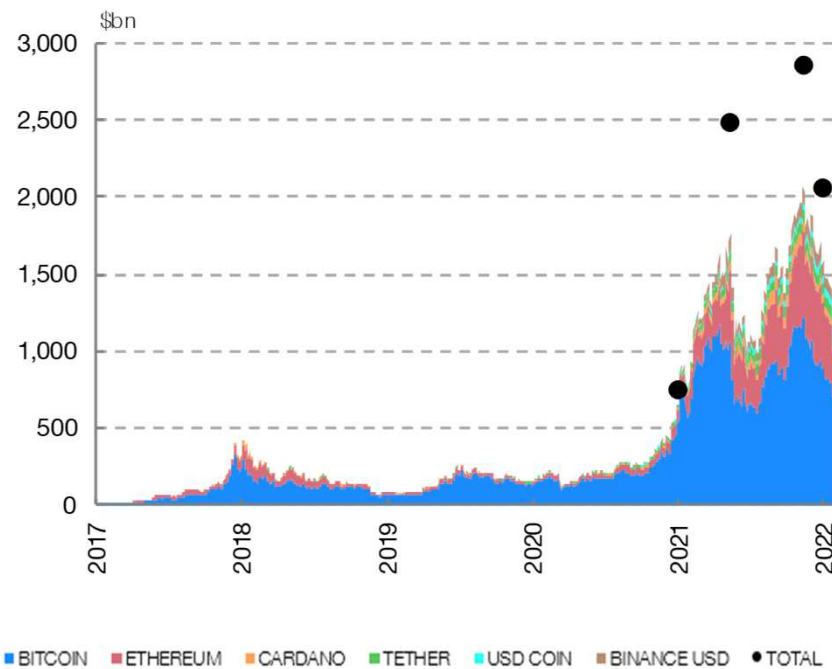
1 CREDIT-TO-GDP GAP AND OUTPUT GAP (a) (b)



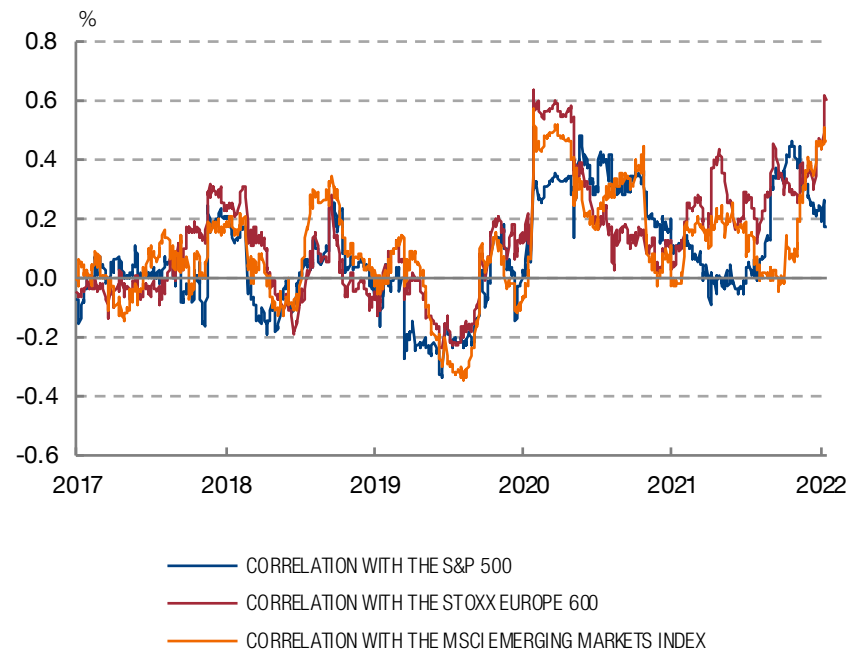
THE INCREASE IN TRADING VOLUMES OF CRYPTO-ASSETS AND IN INTERCONNECTIONS WITH TRADITIONAL FINANCIAL MARKETS COULD POSE RISKS TO FINANCIAL STABILITY

- **The global market value of crypto-assets is still limited, but it has risen exponentially**
 - Unbacked crypto-assets are predominant (accounting for 84% of the market value), contributing to their high volatility
- **Crypto-asset market returns are more volatile than equity market returns, with which there has been a growing correlation since 2020**

1 MARKET VALUE OF MAIN CRYPTO-ASSETS (a)



2 CORRELATION BETWEEN DAILY RETURNS ON A CRYPTO-ASSET INDEX AND EQUITY MARKET INDICES (EUROPE, UNITED STATES AND EMERGING ECONOMIES) (a)



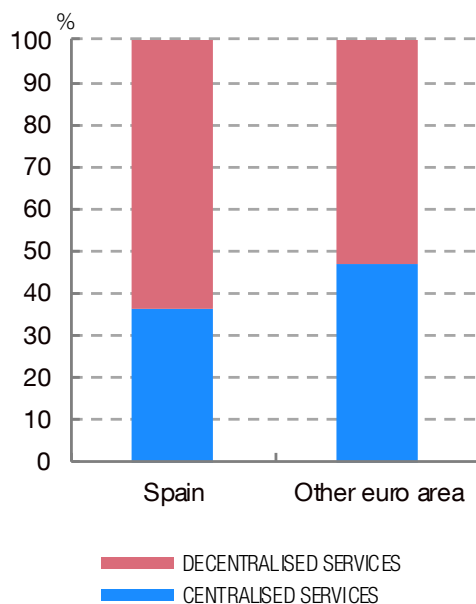
SPAIN DOES NOT HAVE SPECIFIC REGULATIONS ON CRYPTO-ASSETS AND THE BANCO DE ESPAÑA DOES NOT HAVE SUPERVISORY OR REGULATORY POWERS OVER THESE MARKETS

- Only recently has a CNMV circular been approved on the advertising of crypto-assets that are marketed as an investment
- The Banco de España is only responsible for managing the register of providers engaged in exchange services between virtual currency and fiat currencies and custodian wallet providers
 - It includes any such firms that comply with anti money laundering and terrorist financing requirements
- Various supranational initiatives are under way for the regulation and supervision of crypto-assets
 - EU: **MiCA** (Markets in Crypto-Assets) Regulation
 - In the international sphere, initiatives at the FSB, CPMI-IOSCO, BCBS and FATF (in particular, on **prudential requirements** for operating with crypto-assets)
- **MiCA:**
 - Focus on providing crypto-asset users with **legal certainty**, applicable to both crypto-asset issuers and service providers
 - Distinction between **stablecoins** (electronic money tokens and asset-referenced tokens, which may be “significant” depending on their client base, number of transactions, etc.) and **other crypto-assets**
 - “White paper” required from issuers/providers on **organisation, governance and supervision**

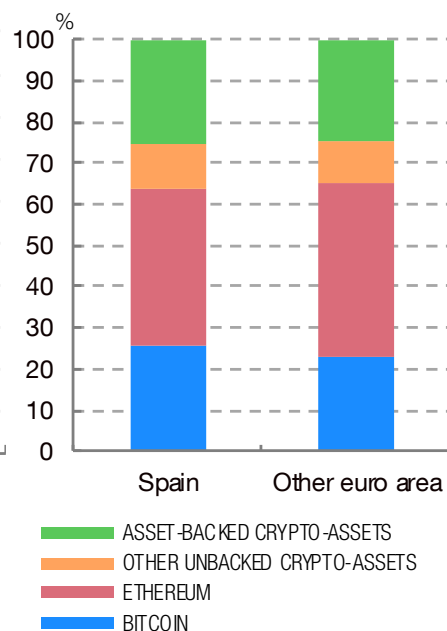
GROSS CRYPTO-ASSET PURCHASES IN SPAIN AMOUNTED TO 4.8% OF GDP IN 2021 AND 12% OF THE POPULATION HAS HAD CONTACT WITH CRYPTO-ASSETS

- Transactions in unbacked crypto-assets account for the bulk of the total, and non-intermediated trading is predominant, in both Spain and Europe
- A certain proportion of cryptocurrency transactions are for illicit activities (1% in the case of Spain)
 - Scams (58%) and stolen funds (32%) account for the bulk of illicit transactions detected in Europe

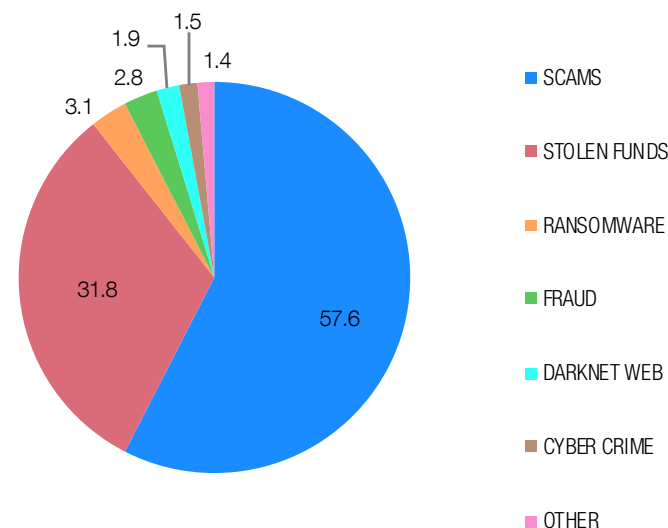
3 TRADING IN CRYPTO-ASSETS BY SERVICE TYPE (d)



2 TRADING IN DIFFERENT CRYPTO-ASSETS (c)



4 BREAKDOWN OF ILLICIT ACTIVITIES ASSOCIATED WITH CRYPTO-ASSET TRANSACTIONS IN EUROPE (AS %) (b) (e)



THANK YOU FOR YOUR ATTENTION



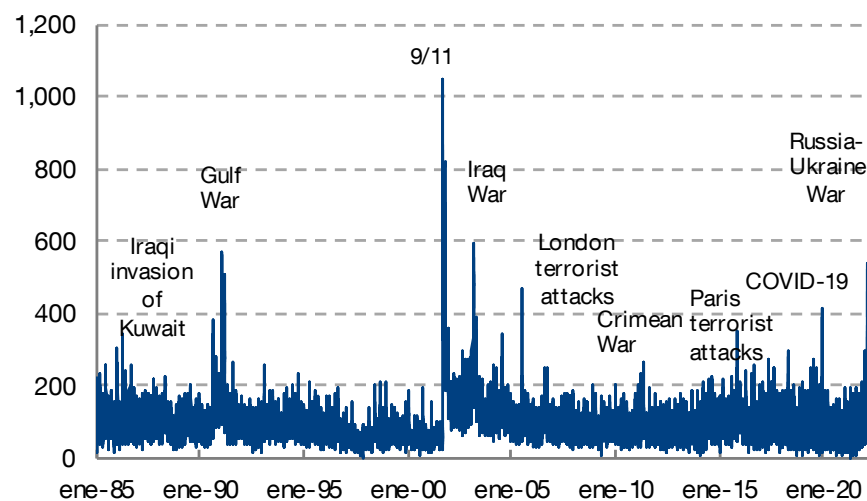


ADDITIONAL INFORMATION

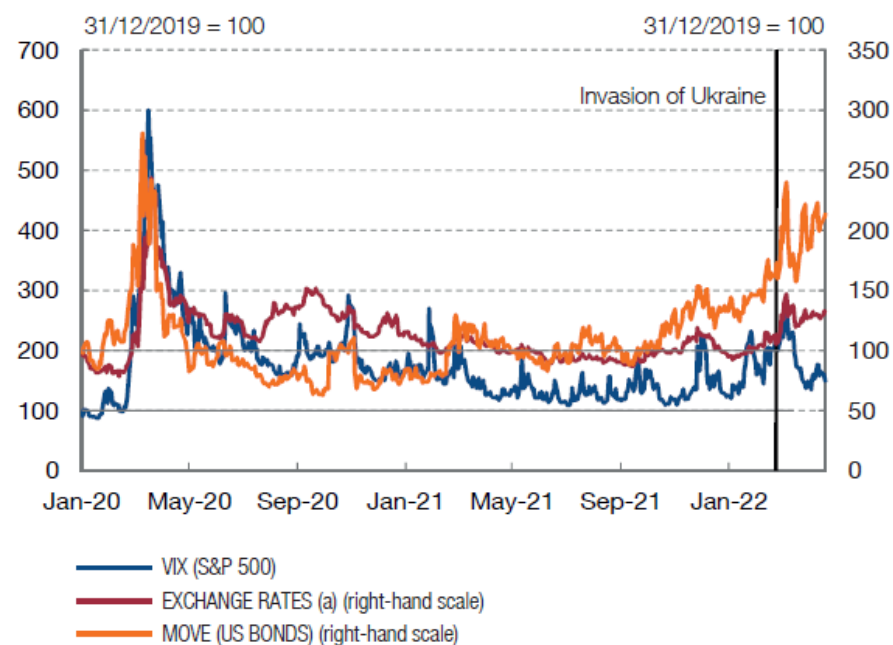
THE STABILITY OF THE SPANISH FINANCIAL SYSTEM: MAIN VULNERABILITIES AND RISKS (I)

- The war between Russia and Ukraine has **further strained global geopolitical tensions**
 - The sanctions imposed on Russia and its potential response create a situation of global confrontation of uncertain severity and duration
- This is leading to **greater volatility in the financial markets** and making investors more risk averse, thus driving up premia associated with risky assets

1 GEOPOLITICAL RISK



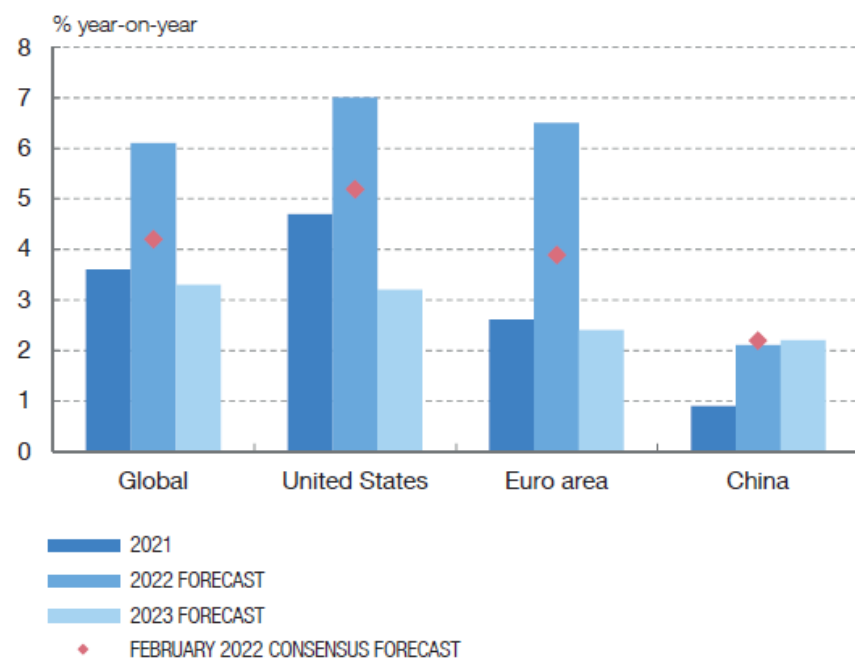
3 VOLATILITY



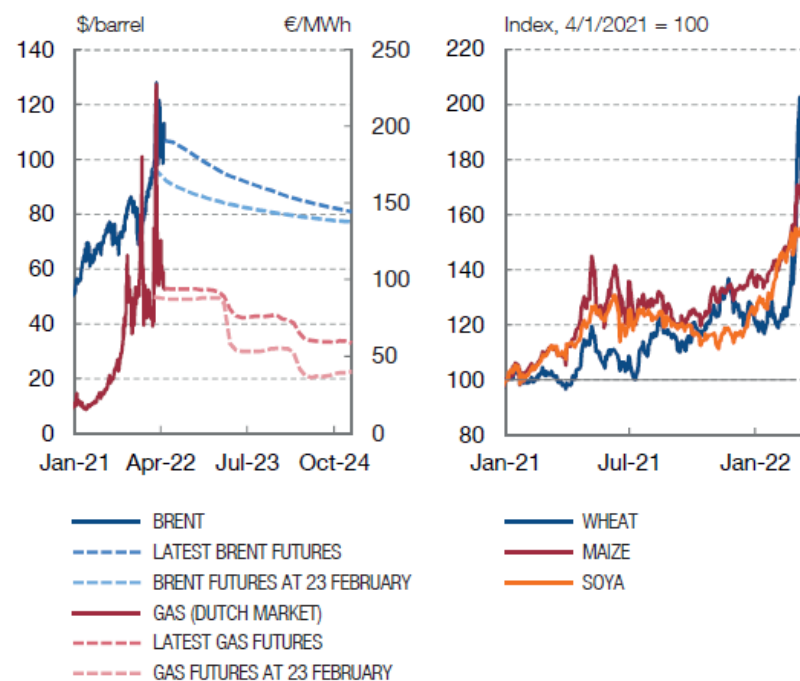
THE STABILITY OF THE SPANISH FINANCIAL SYSTEM: MAIN VULNERABILITIES AND RISKS (II)

- **Risks concerning the course of the pandemic persist**
 - Past experience suggests that the economy is more resilient
- Inflation has been higher and more persistent than expected, **driving up risks to economic activity**
- In the euro area, inflation is less associated with demand pressures. The **normalisation of monetary policy** could therefore take place over a somewhat **longer time horizon** than in the United States
 - The Russia-Ukraine conflict could make monetary policy decision-making more complex

5 INFLATION FORECASTS (2021-2023)
April 2022 Consensus Forecast



4 PRICE OF OIL, NATURAL GAS (L-H PANEL) AND AGRICULTURAL COMMODITIES (R-H PANEL)

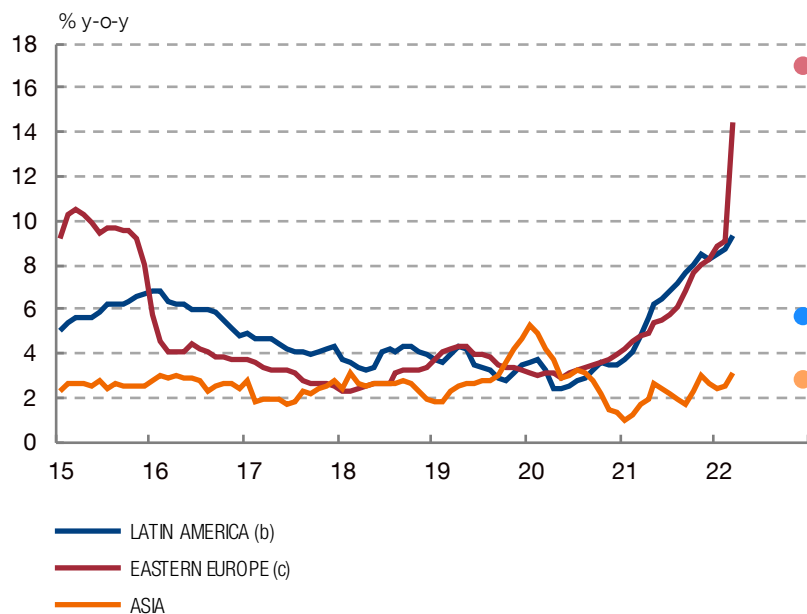


CHAPTER 1

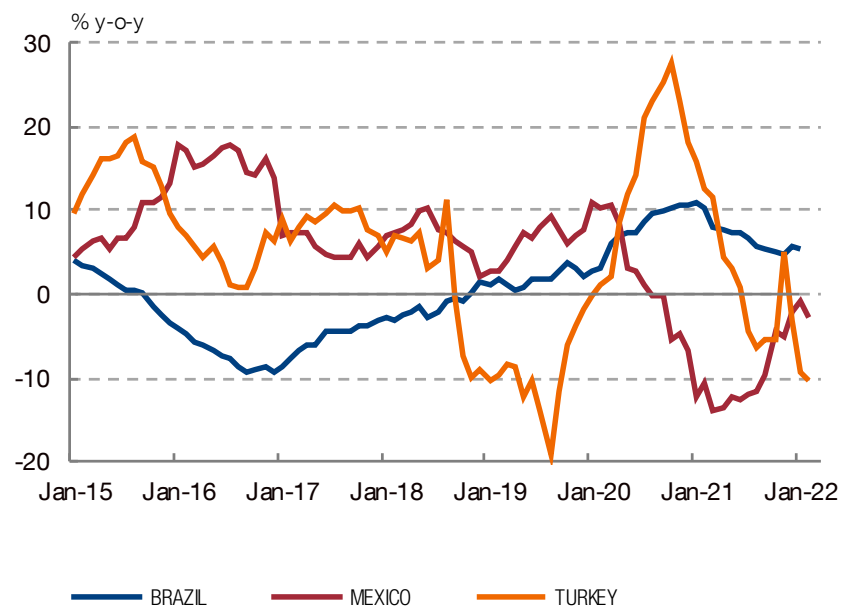
Emerging economies

- **Inflation in the emerging economies rose** more than expected...
 - ...prompting a further tightening of monetary policy
- **Credit growth also moderated** as public support plans in most of these economies were partially or fully withdrawn

1 INFLATION (a)



3 RATE OF CHANGE OF CREDIT TO THE PRIVATE SECTOR



BOX 1.1

Economic and financial sanctions against Russia

- **Sanctions have a very heterogeneous effect on international trade flows**
 - Trade flows decrease by an average of 4.5%, with the reduction approaching 80% in the case of extreme sanctions (e.g. Cuba and North Korea)
- The effect of the sanctions against **Russia** is simulated using a standard general equilibrium model for world trade, which estimates that **exports would decrease by 28% and imports by 40%**...
- ...while **the euro area's total imports and exports would fall by 1%**

Chart 1
EFFECT OF PREVIOUS SANCTIONS ON INTERNATIONAL TRADE FLOWS (a)

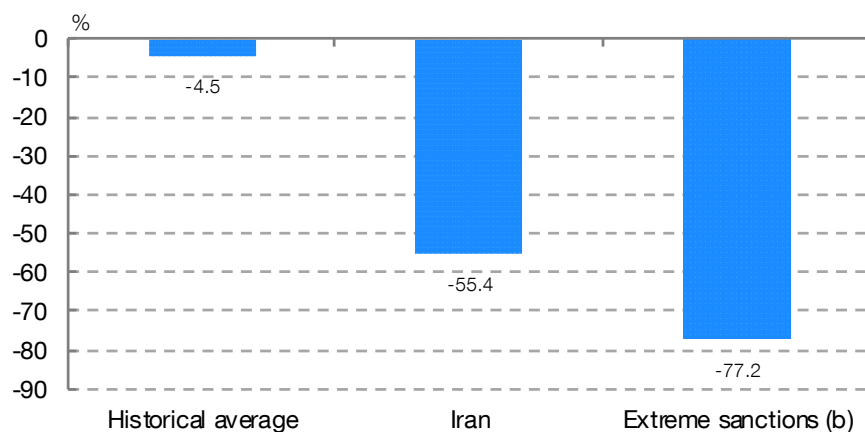
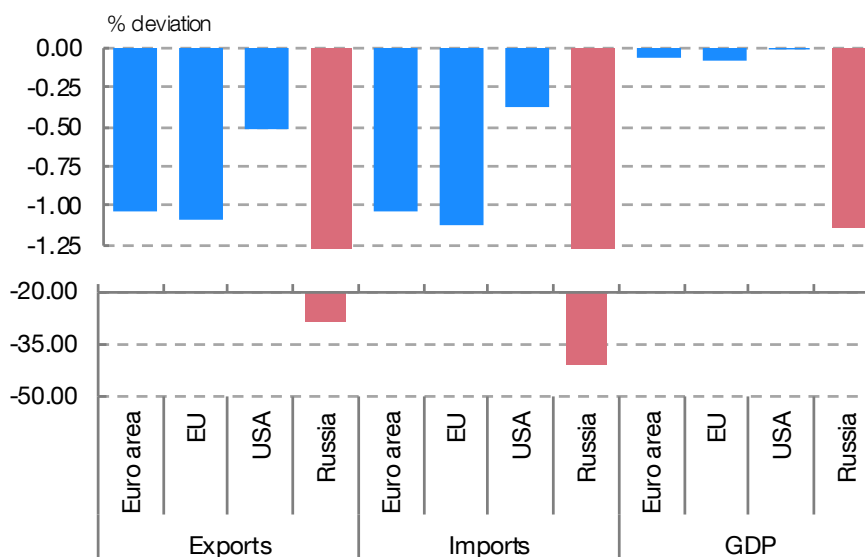


Chart 2
IMPACT OF TRADE SANCTIONS ON EXPORTS, IMPORTS AND GDP



BOX 1.2

Impact on the emerging economies of tighter financial conditions and rising commodity prices

- A potentially faster and stronger than expected **withdrawal of monetary stimuli** in the advanced economies could **severely affect emerging economies' financial conditions**, exacerbating the impact of the greater risk aversion
 - During the taper tantrum, markets discriminated between countries on the basis of their vulnerabilities
- In Latin American economies, the effects could be partially offset by the increase in commodity prices

Chart 5
IMPACT ON PORTFOLIO CAPITAL FLOWS (c)

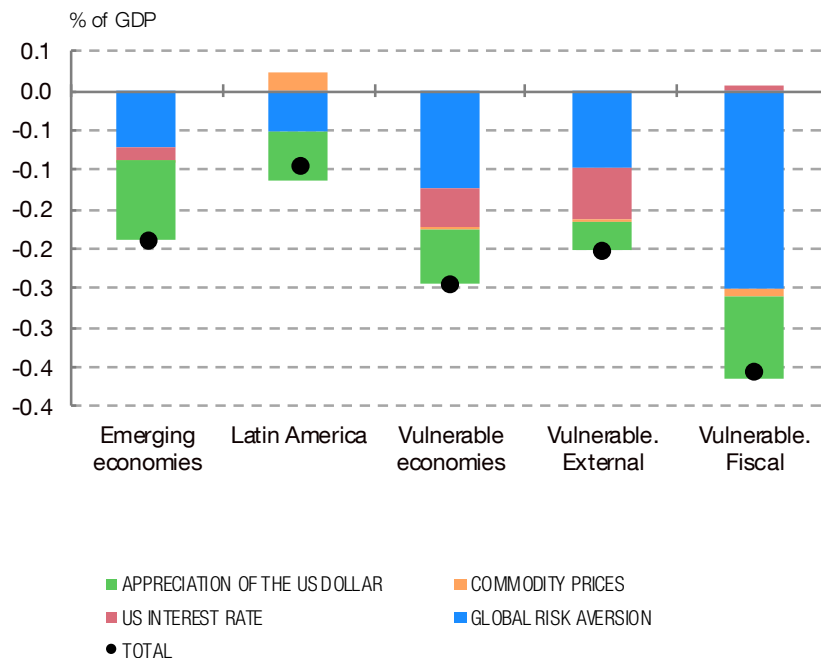
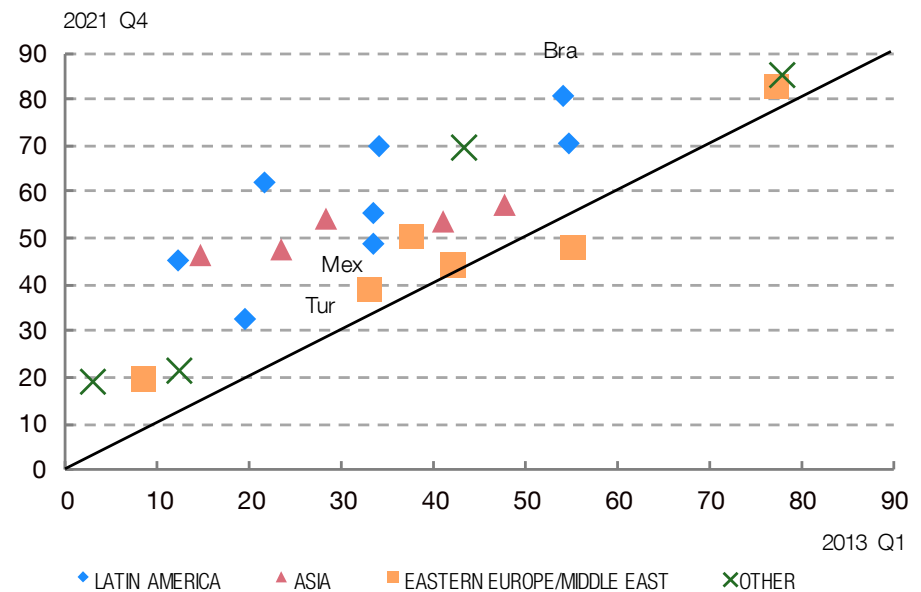


Chart 3
GOVERNMENT DEBT (% OF GDP)

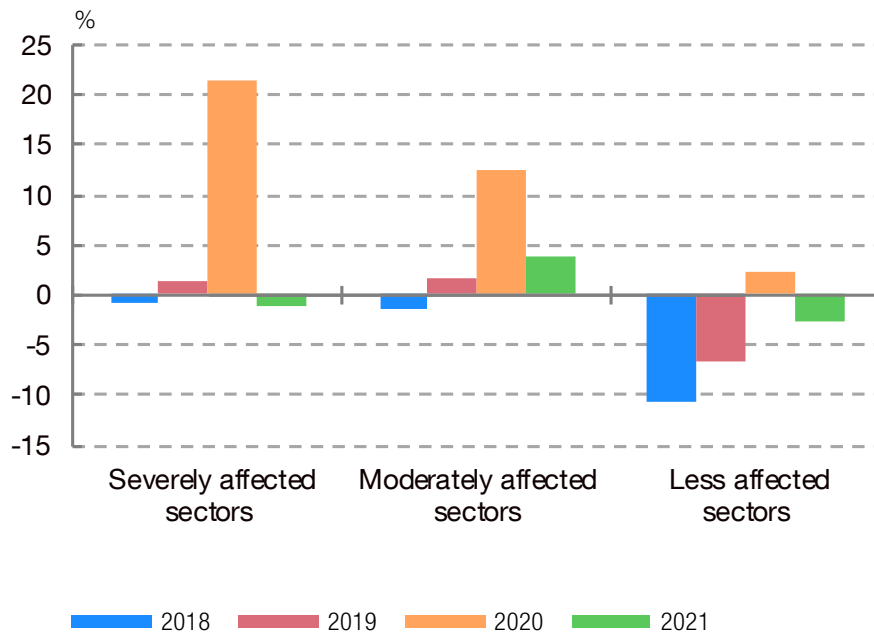


CHAPTER 2

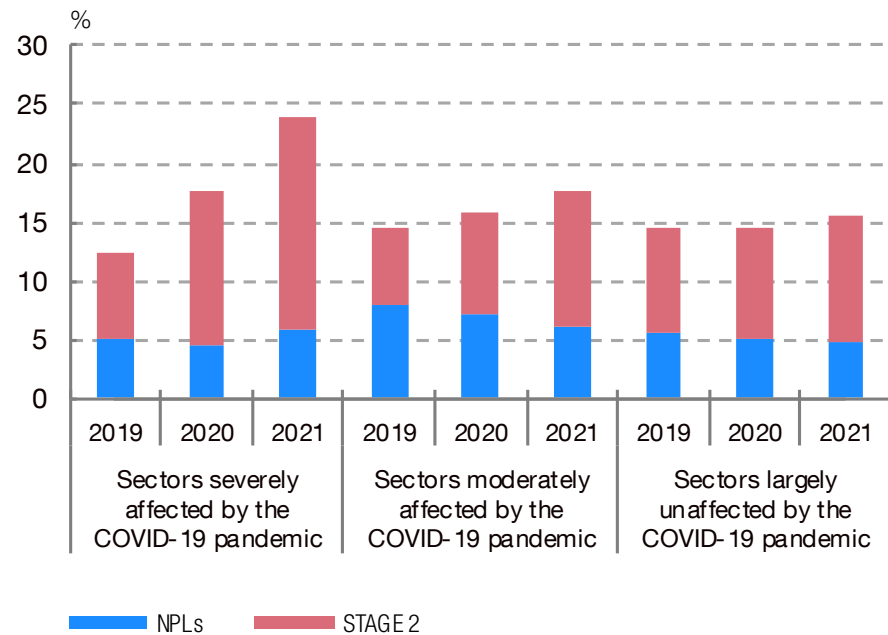
Lending and NPLs to non-financial corporations and sole proprietors

- **Lending** to non-financial corporations held **steady** over the past year, **growing only in the sectors moderately affected** by the pandemic and declining in the other sectors
- In terms of credit quality, the **sectors severely affected** by the COVID-19 crisis continue to show the **largest signs of deterioration**, particularly in **Stage 2 loans**

2 YEAR-ON-YEAR RATE OF CHANGE IN THE STOCK OF LOANS.
NFCs AND SOLE PROPRIETORS
Business in Spain, ID (a)



3 SHARE OF NON-PERFORMING AND STAGE 2 LOANS.
NFCs AND SOLE PROPRIETORS
Business in Spain, ID (a)

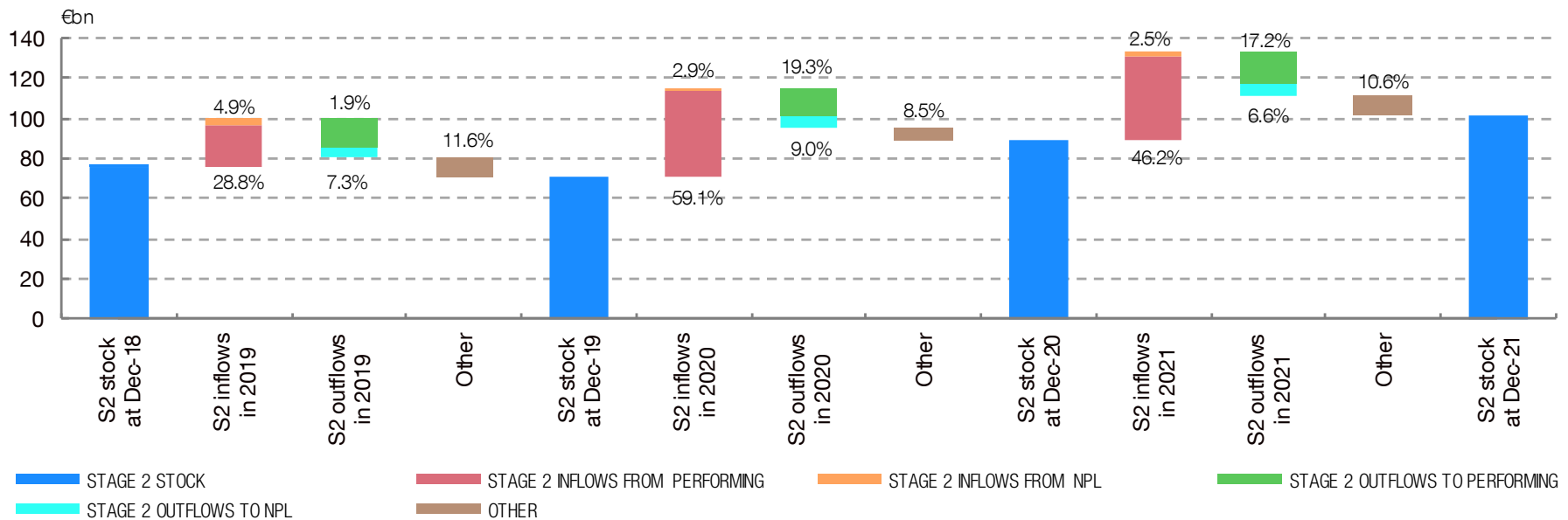


CHAPTER 2

Stage 2 loans

- **Stage 2 loans have increased significantly** over the last two years
- This increase owes to the rise in **reclassifications from performing status...**
 - ...while reclassifications from non-performing status are far lower and declined during the crisis

1 INFLOWS AND OUTFLOWS OF STAGE 2 LOANS AND ADVANCES (a)
Business in Spain. ID



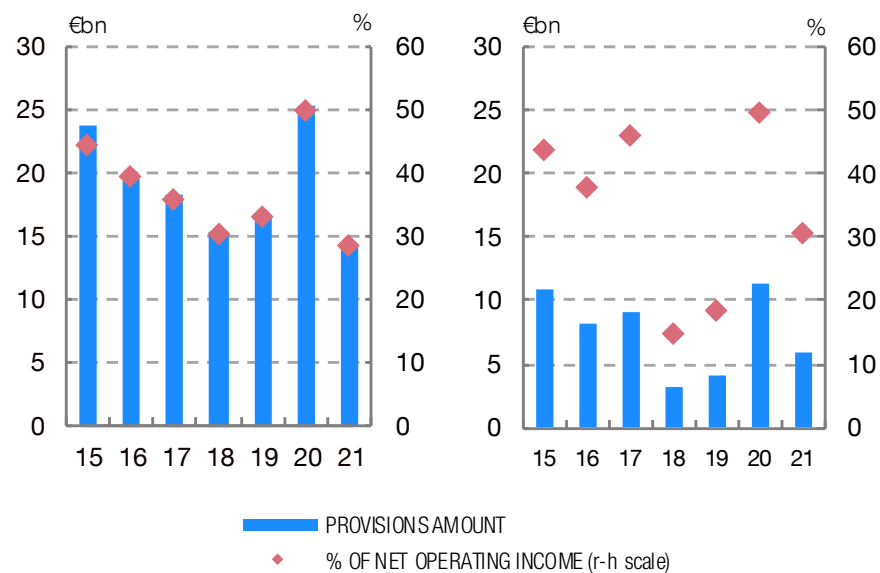
CHAPTER 2

Impairment losses and fees and commissions

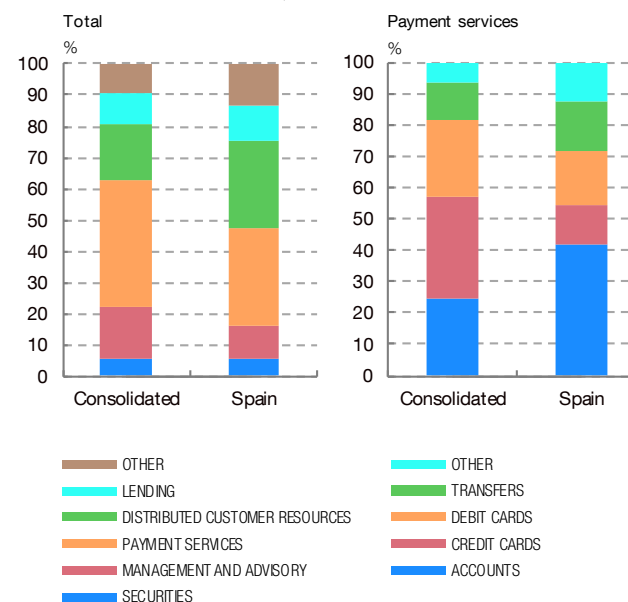
- **Impairment losses fell by 44%** in 2021 (€11 billion) and were the main driver of the improvement in ordinary profit
 - They stood slightly below the figure for the two years prior to the pandemic, signalling a certain stabilisation compared with the progressive decline that began in 2012
- **Revenue from payment services** is the main source of fee and commission income for Spanish institutions
 - Net fee and commission income is converging towards the values of other European countries

2 IMPAIRMENT LOSSES

Global consolidated data (l-h panel) and individual business in Spain (r-h panel)



1 DISTRIBUTION OF GROSS FEES AND COMMISSIONS, BY TYPE (a)
Consolidated and individual data, December 2021

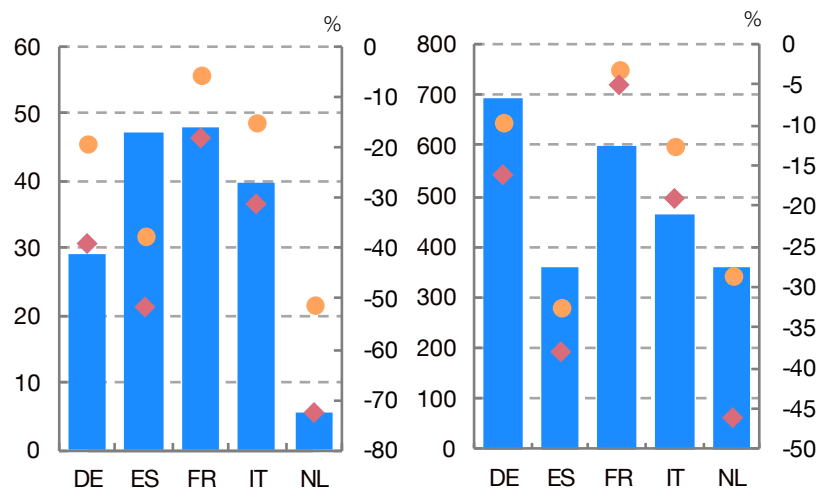


CHAPTER 2

Bank branches: European comparison and developments by size of municipality

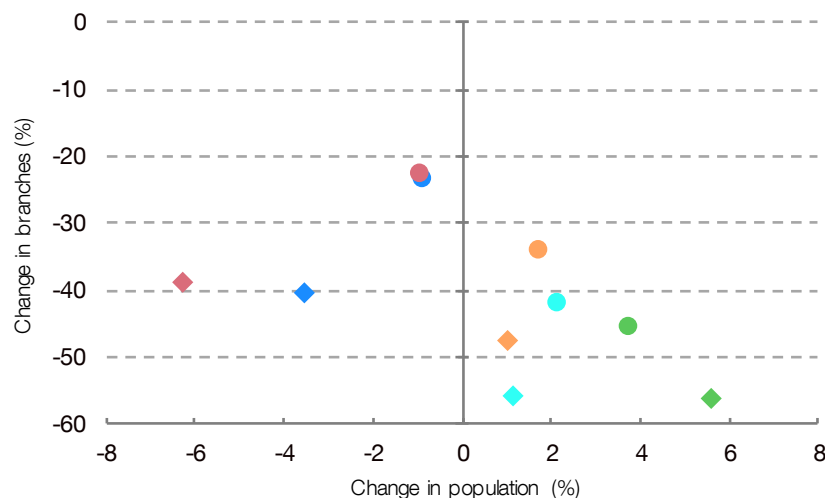
- The **number of branches in Spain fell** by more than 50% between 2008 and 2020, bringing the ratio of branches per inhabitant closer to the **levels of the main European countries**
 - The staff adjustment has been smaller than the reduction in the number of branches, although also significant
- The reduction in the number of branches has been **widespread across municipalities of different sizes** and more pronounced in larger cities

1 BRANCHES (L-H PANEL) AND EMPLOYEES (R-H PANEL)
December 2020



■ BRANCHES/EMPLOYEES PER 100,000 INHABITANTS
 ● 2008-2016 CHANGE (right-hand scale) (a)
 ◆ 2008-2020 CHANGE (right-hand scale) (a)

2 CHANGES IN POPULATION AND NUMBER OF BRANCHES, BY MUNICIPALITY
SIZE. 2008-2016 (CIRCLE) 2008-2020 (DIAMOND)



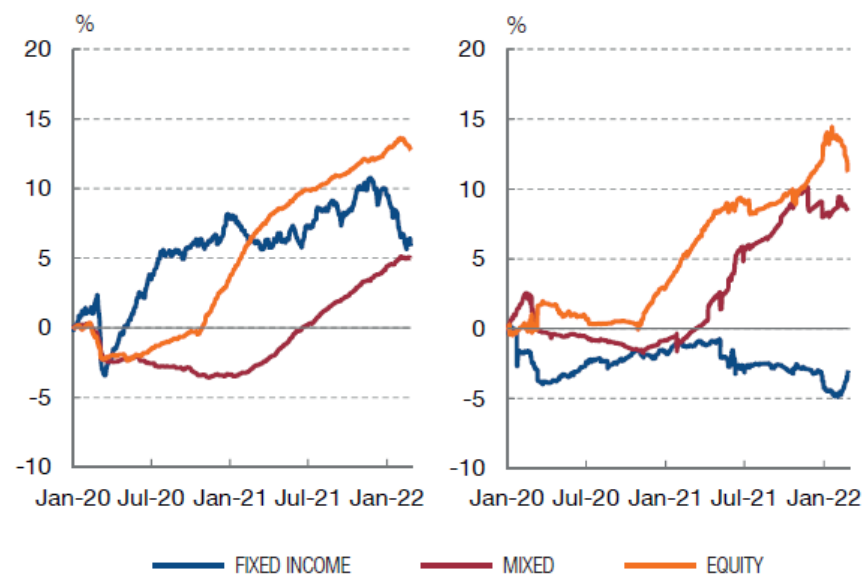
● LESS THAN 1,000 ● 1,000 TO 5,000 ● 5,000 TO 50,000
 ● 50,000 TO 100,000 ● MORE THAN 100,000

CHAPTER 2

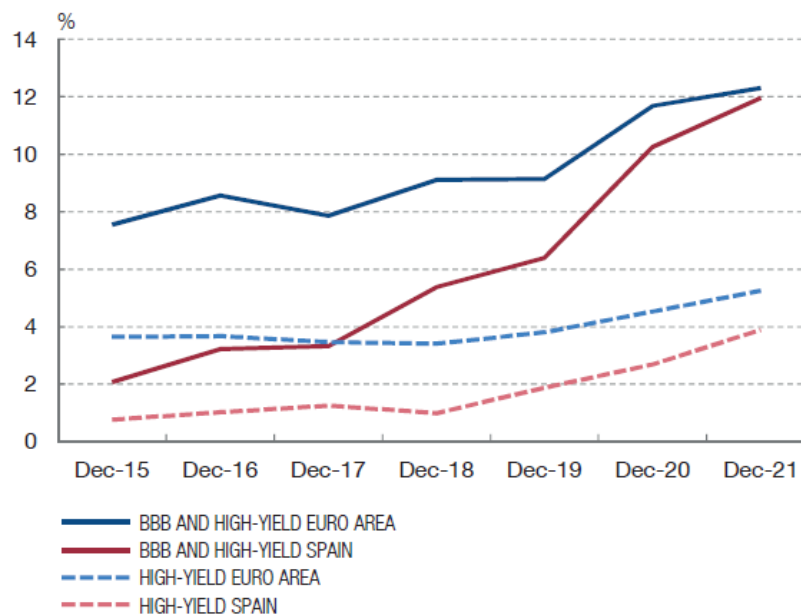
Investment funds

- In general, euro area **investment funds** recorded **capital inflows** during 2021 H2, although there are differences across countries and fund categories
 - Inflows into the equity segment continued to see the strongest growth, both in the euro area overall and in Spain
- **High-yield bond holdings increased**, but remain relatively low compared with the fixed-income portfolio
 - Spanish funds have a lower risk profile than euro area funds

2 INVESTMENT FUND FLOWS IN THE EURO AREA (EXC. SPAIN) (L-H PANEL) AND IN SPAIN (R-H PANEL) (a) (b)



2 PROPORTION OF BONDS ISSUED BY NFCs AND RATED HIGH-YIELD AND ON THE CUSP OF INVESTMENT GRADE IN THE FIXED-INCOME PORTFOLIO (b)

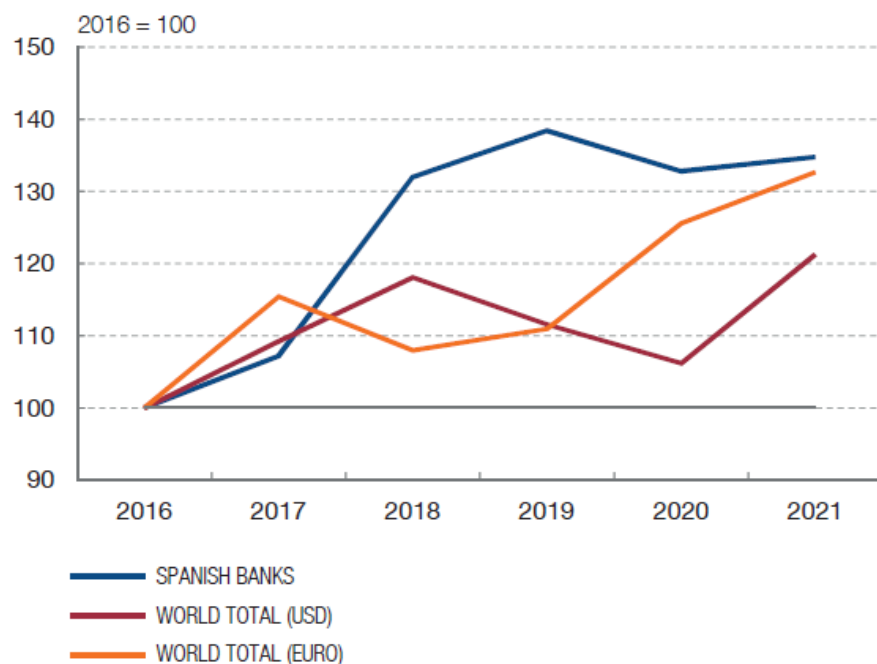


CHAPTER 2

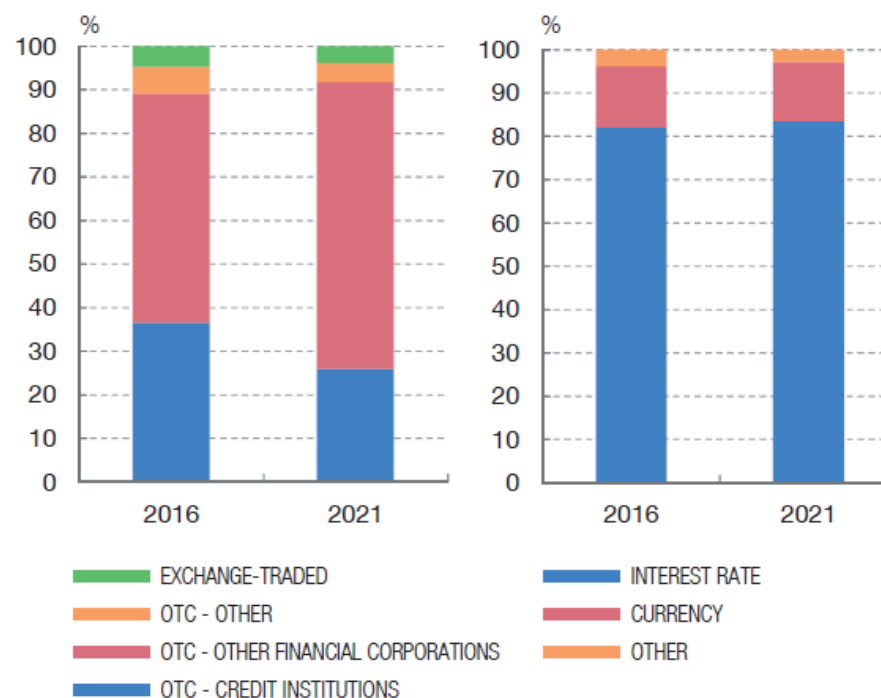
Interest rate derivatives

- The overall notional value of **interest rate derivatives in Spain has increased** in recent years
 - This increase is in line with the trend observed in other jurisdictions, with certain fluctuations
- **Non-bank financial institutions are the main counterparties**

1 INTEREST RATE DERIVATIVES. NOTIONAL (a)



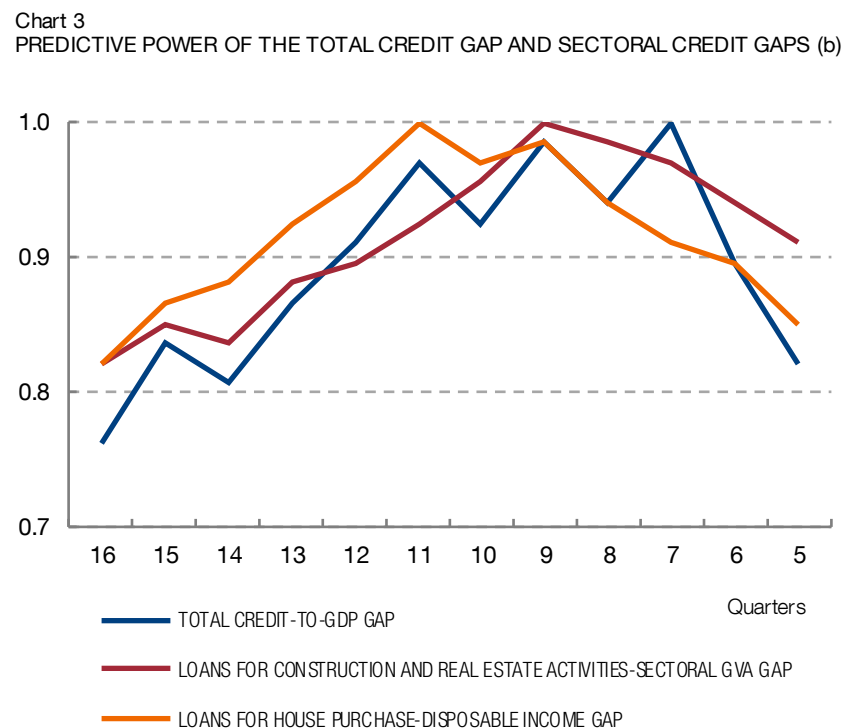
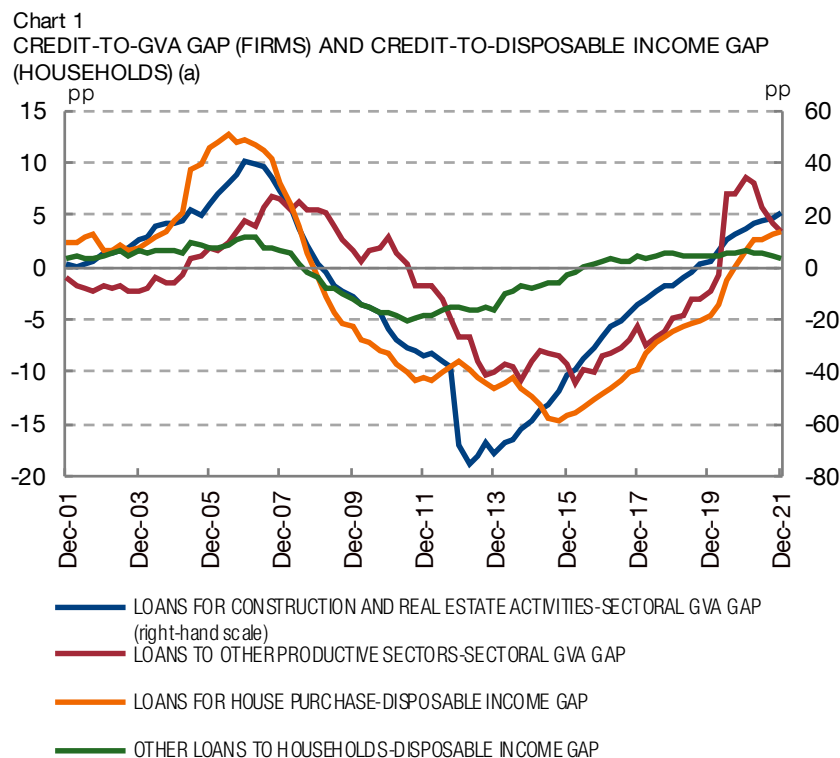
2 BREAKDOWN BY COUNTERPARTY (L-H PANEL) AND UNDERLYING ASSET (R-H PANEL). NOTIONAL (b)



BOX 3.1

Sectoral indicators for applying the new macroprudential tools

- **Sectoral credit gaps have widened significantly** since the outbreak of the COVID-19 health crisis, mainly due to the decline in their denominators...
 - ...and developments in these gaps should therefore not be construed as an early warning, as no excessively large credit build-ups can be seen in any of the sectors
- **Sectoral gaps have a greater power to predict crises** than the general gap (particularly in the case of the global financial crisis that started in 2009 Q1) over much of the projection horizon



BOX 3.2

Imbalance indicators in Spain and euro area housing markets

- Despite the sharp economic contraction triggered by the pandemic, euro area **house prices continued to grow** in 2020, doing so **even more vigorously in 2021**
- The countries showing signs of risk (which do not include Spain) have a high credit-to-GDP intensity...
 - ...but they have adopted a series of measures to reduce real estate imbalances, although their effectiveness is not yet apparent

Chart 1
HOUSE PRICES. YEAR-ON-YEAR RATE OF CHANGE (a)

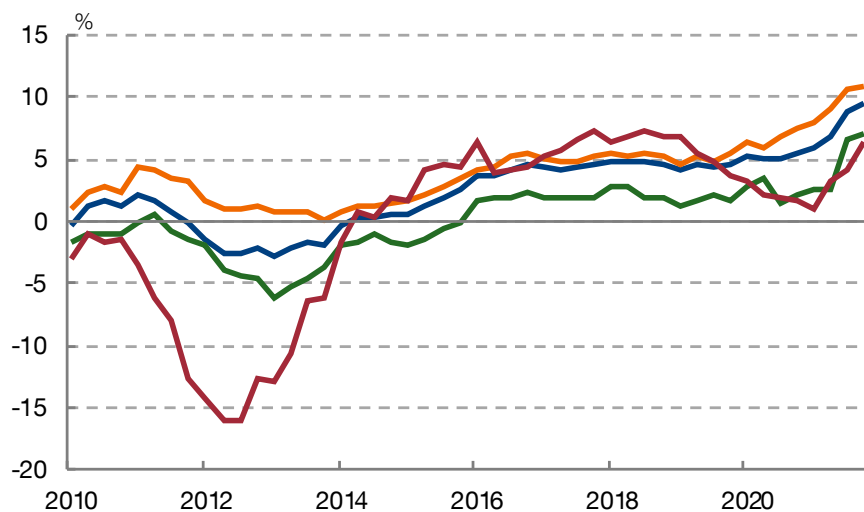
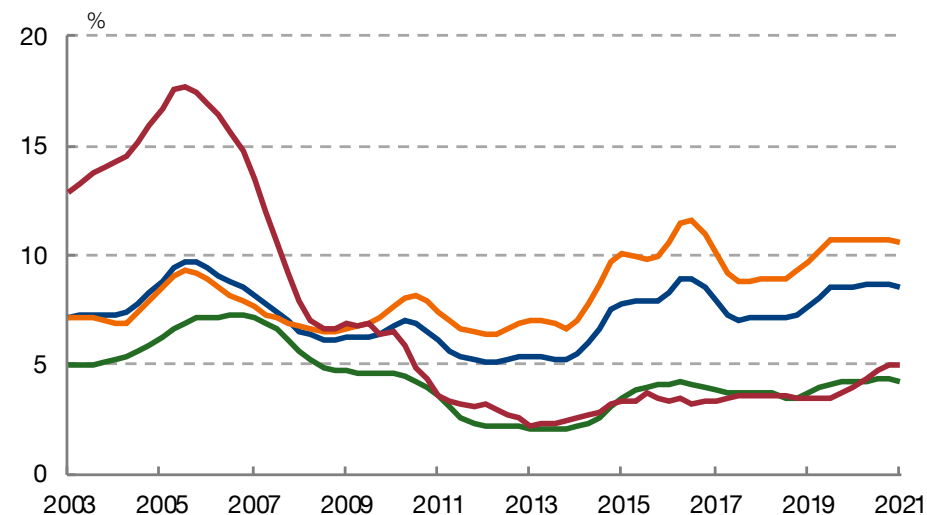


Chart 2
NEW MORTGAGE LENDING/GDP (a) (b)



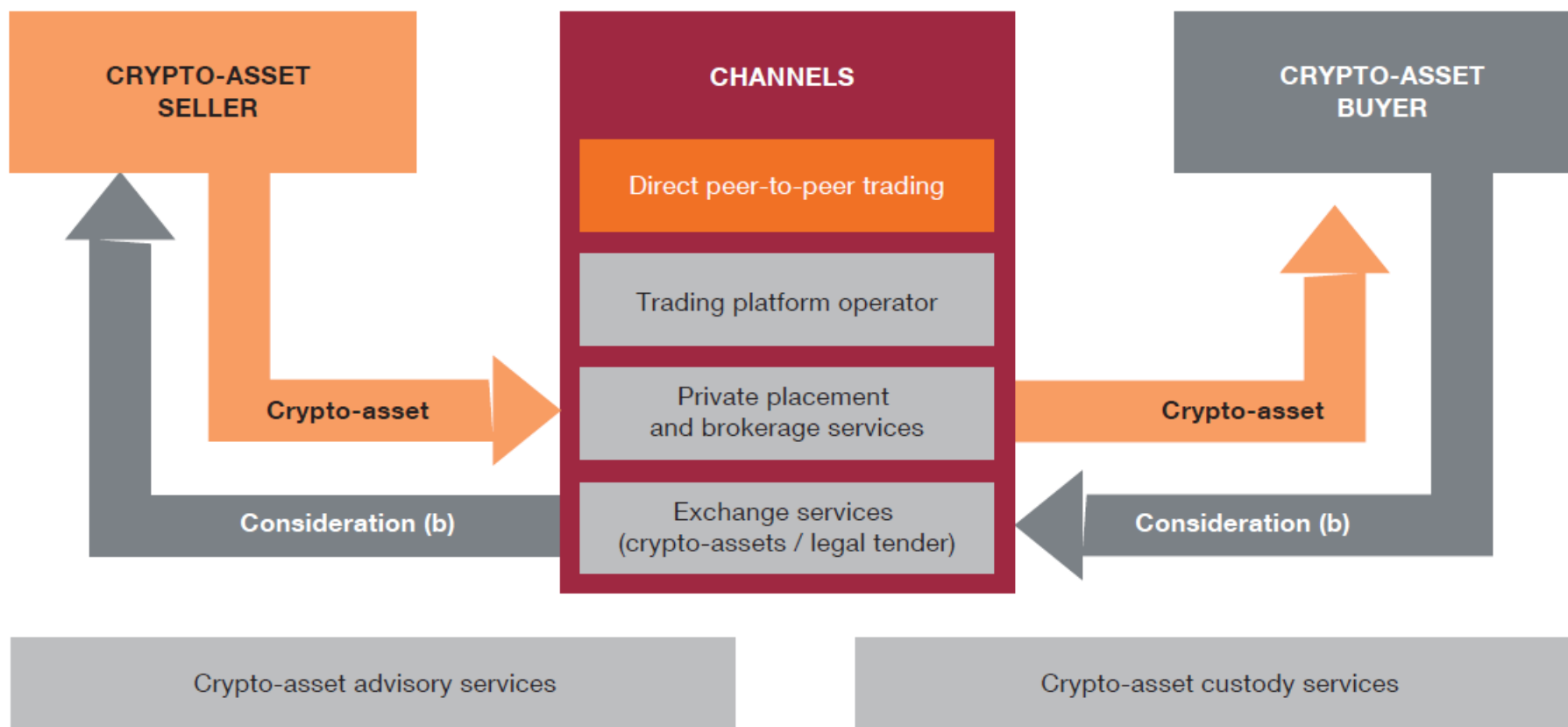
— TOTAL EURO AREA — COUNTRIES WITH WARNINGS — OTHER (EXCL. SPAIN) — SPAIN

SPECIAL CHAPTER ON CRYPTO-ASSETS

Participating agents

- Although crypto-assets do not require traditional financial intermediaries in basic transactions, their expansion has led to the appearance of a series of agents, in addition to the issuers, that provide financial services related to these instruments

AGENTS PARTICIPATING IN CRYPTO-ASSET MARKETS



SPECIAL CHAPTER ON CRYPTO-ASSETS

Interconnectedness

- Growth in the supply of stablecoins entails larger holdings of the safe underlying assets, thus increasing interconnectedness with other segments of the financial market

INTERCONNECTIONS GENERATED THROUGH STABLECOIN HOLDINGS

