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RISKS LINKED TO THE MACRO-FINANCIAL ENVIRONMENT

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Global economic activity has remained robust since the last *Financial Stability Report* (FSR), although some loss of momentum was detected during the summer months. The Spanish economy, in contrast to that of the euro area, has shown considerable strength, with both GDP estimates for previous years and growth forecasts being revised up. While the disinflation process has continued, the services inflation component has again exhibited a degree of downward stickiness in some economies, including the euro area and Spain.

Despite this relatively benign scenario, downside risks to global, European and Spanish economic growth persist. These risks primarily stem from geopolitical tensions and uncertainty regarding economic policy stances, which could lead to trade and financial fragmentation. Weakness in the Chinese economy or changes in global financial conditions could also shape the course of the global economy. Spain faces additional uncertainty associated with weak consumption and investment, the sectoral make-up of economic growth and the fiscal adjustment path that may be required to comply with European fiscal rules.

The world's main central banks, with a few exceptions such as the Japanese central bank, are starting to loosen their tight monetary policy stance. Meanwhile, financial markets have revised down their interest rate expectations. The scenario remains one of compressed risk premia and high equity prices, particularly in the technology sector. Such market valuations are consistent with a benign macroeconomic scenario and a very strong corporate earnings performance. However, a significant downward revision of earnings forecasts for certain firms or any adverse macroeconomic events that alter agents' expectations could trigger abrupt corrections, such as the very brief episode seen in early August. The role of some non-bank intermediaries could also exacerbate such declines.

Prices in the Spanish residential real estate market climbed at a faster pace, fuelled by strong demand, amid supply-side rigidity and a growing share of properties being used for holiday lets. Prices in the commercial real estate sector have recovered somewhat, supported by the commercial and industrial premises segments.

Both households and non-financial corporations continue to face high interest expenses. However, the lower interest rate outlook, coupled with resilient employment and growing incomes in both segments, continue to mitigate the financial risks. Public finances have improved somewhat, underpinned by GDP growth. However, government debt is high and remains an element of vulnerability, necessitating the strict implementation of the consolidation plan that was recently announced.

1.1 Macroeconomic environment

The global economy continued to follow a robust growth path in 2024 H1, a trend that is expected to persist in H2, despite some signs of weakness from the most recent indicators. Global economic activity proved more resilient than expected in 2024 H1, with some cross-region heterogeneity. However, weak domestic demand in China and sluggish global manufacturing suggest reduced momentum in H2, despite the stimulus measures announced in China (see Chart 1.1.a). Set against an improving inflationary outlook and easing monetary conditions, these signs of weakness have not substantially fed through to growth forecasts for 2024 and 2025 (see Chart 1.1.b).

Given the modest pace of economic growth in the euro area, the GDP recovery projected for 2025 is likely to be somewhat less robust than anticipated a few months ago. Net exports have been the main engine of growth to date. However, in the coming quarters a strong services sector is expected to take over as the primary driver of GDP growth, which will remain moderate. This would be underpinned by stronger private consumption, set against a robust labour market, a recovery in purchasing power and the impact of past interest rate hikes gradually fading, which would mean a progressive increase in real disposable income.

In Spain, conversely, the pace of GDP growth surprised on the upside in 2024 H1. The relative strength of Spain's economic activity compared with the euro area is likely due to a combination of various factors, such as the relative resilience of its manufacturing compared with other European countries and, above all, the large contribution made by net exports. This demand growth has not been stymied by productive capacity constraints thanks to robust migration inflows. Moreover, the upward revision of past GDP figures resulted in an earlier than anticipated return to pre-pandemic activity levels.

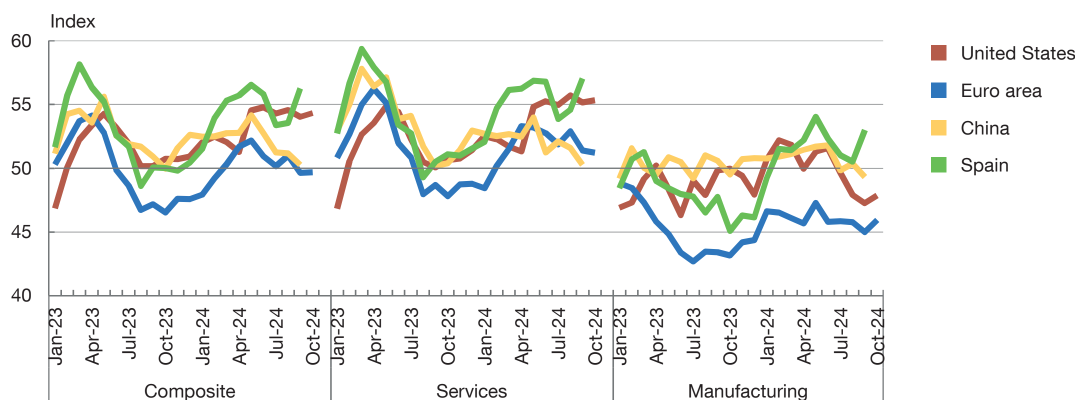
Economic growth is expected to remain high in Spain for the remainder of the year, albeit at somewhat more moderate levels. Looking ahead to the coming quarters, the (more gradual) economic growth will primarily be driven by domestic demand, underpinned by the same factors as identified for the euro area, in addition to the mobilisation of NextGenerationEU (NGEU) funds and resurgent export demand, particularly from Europe. Consequently, growth forecasts for Spain were revised up in September, compared with both those of the last FSR and the June projections[1] (see Chart 1.1.b).

Inflation rates have remained on a moderating path in the recent period. The disinflation process has continued in most regions, although services inflation continues to exhibit some downward rigidity. Short-term inflation expectations indicate that this moderating trend will continue in nearly all regions (see Chart 1.1.c). In the euro area, the inflation rate stood at 1.7% in September, while inflation in Spain (as measured by the harmonised index of consumer

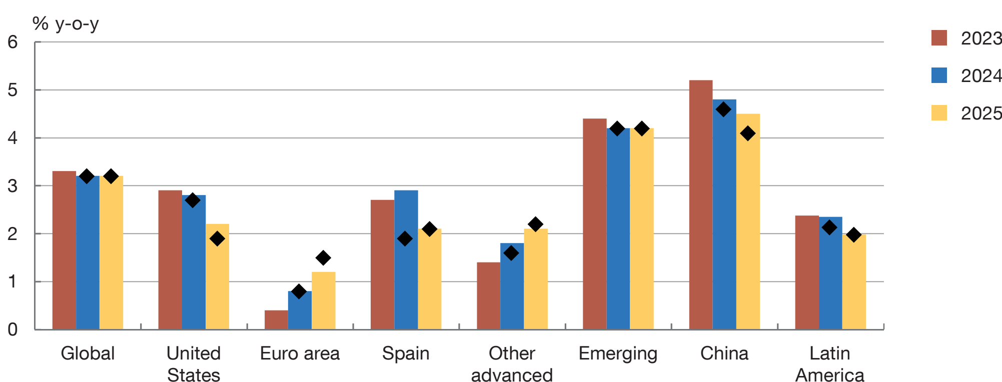
1 *Macroeconomic projections and quarterly report on the Spanish economy. September 2024.*

Chart 1.1
Global growth shows signs of stabilising, against a backdrop of global disinflation

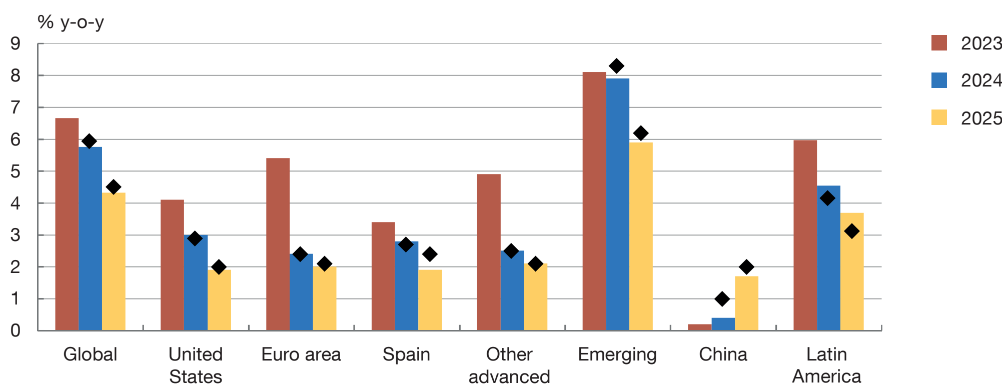
1.1.a Purchasing managers' indices (a)



1.1.b GDP growth forecasts (b) (c)



1.1.c Inflation forecasts (b) (c)



SOURCES: IMF and S&P Global.

a A reading above (below) 50 indicates economic expansion (contraction).
b The bars represent the WEO October 2024 forecasts. The diamonds represent the WEO April 2024 forecasts.
c WEO aggregates except Latin America (Brazil, Chile, Colombia, Mexico, Peru).

prices) fell to 1.7%, its lowest level since spring 2021. Underlying inflation rates also declined, but stand above headline rates, at 2.8% and 2.7%, respectively.

The recent sharper than expected drop in inflation is largely attributable to energy prices. This easing has been aided by the drop in oil prices (down by almost 14% since April, to $71 per

Brent barrel), amid lower demand for crude worldwide. Looking ahead, it is important to bear in mind that energy commodity prices are prone to bouts of volatility and spikes when geopolitical tensions flare. For instance, the escalation of the Middle East conflict pushed Brent oil prices to just over $80 per barrel in October, although this movement reversed rapidly and weak demand has been more important in its evolution afterwards.

Persistently high services inflation could slow the disinflationary process going forward and shape monetary policy decisions. In any event, wage growth shows signs of moderation, mitigating this risk.

The balance of risks to global economic activity remains on the downside, as a result of persistent geopolitical tensions and economic policy uncertainty. These factors could lead to global trade and financial fragmentation. An escalation of the Middle East conflict or of the war in Ukraine could lead to surging commodity prices or shipping costs, or to a return of global bottlenecks. The outcome of the US election adds a further layer of uncertainty, particularly considering the potential implications for trade relations with other regions, especially China, where a deterioration could lead to further fragmentation of the world economy (see Box 1.1). High US debt and uncertainty surrounding the fiscal policy path due to the presidential elections add another layer of risk to financial markets, and is currently reflected in higher real long-term interest rates, increasing the probability of further rises. The materialisation of these risks could raise inflation rates, tighten global financial conditions and harm the growth outlook.

The weakness of China's real estate market, which is in a pronounced downturn, continues to pose a downside risk to global activity and inflation. A more severe deterioration in the housing market or further distress at major real estate developers would adversely affect China's growth and feed through to the world's major economies via the trade and uncertainty channels. The recent measures announced by the Chinese authorities (monetary policy easing, mortgage loan renegotiation and an injection of funds to stimulate the stock market) helped to alleviate the risks somewhat and were welcomed by the markets, although there are still doubts over their effectiveness in reviving growth.

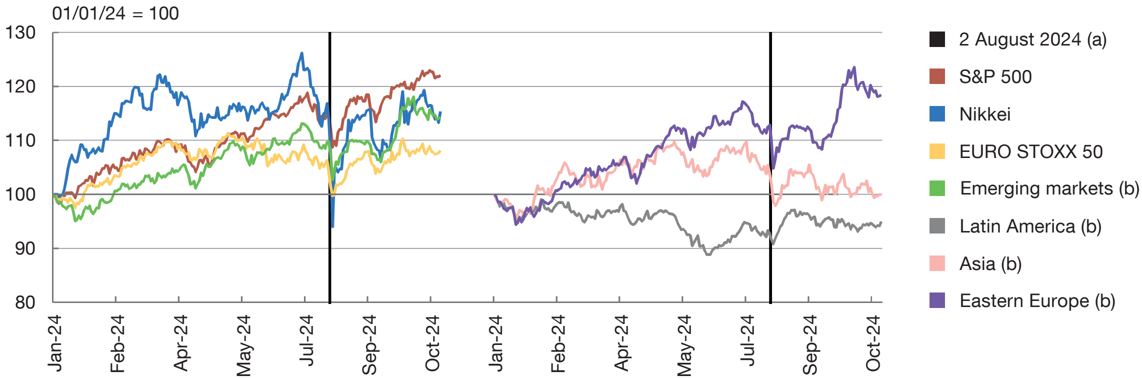
The potential for abrupt corrections in global financial markets adds further downside risks to global economic growth. The high valuations of risk-bearing assets, combined with the uncertainty surrounding the global economy and economic policies, increase the likelihood of sharp price corrections, such as the brief episode witnessed in global financial markets in August (see Section 1.2.1 and Chart 1.2.a). Should these corrections prove more persistent in the future, the tightening of financial conditions could act as a brake on economic activity. The financial markets of emerging countries have performed relatively well, despite the increased volatility over the summer, although they also experienced pronounced corrections during this episode.

The factors described above also pose risks to the future growth of the Spanish economy, which in addition is threatened by certain domestic factors. These notably include a slower recovery in household consumption and business investment, whose performance

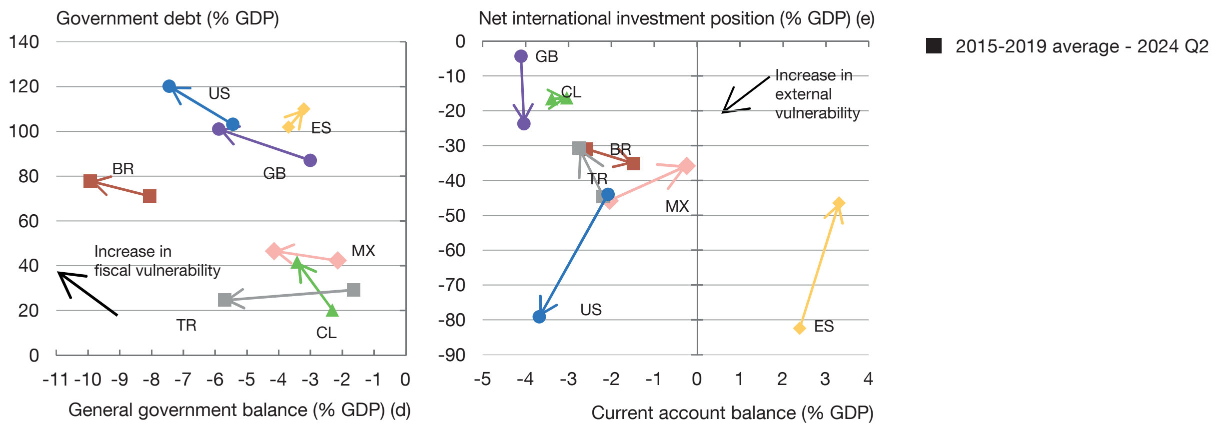
Chart 1.2

The episode of market volatility in August was reflected in large, albeit transitory, falls in stock markets in both advanced and emerging economies, in a context of mixed developments in financial vulnerabilities

1.2.a Global stock markets



1.2.b Vulnerability indicators (c)



SOURCES: Refinitiv and national statistics.

a Start of the August turbulence episode.
b MSCI Emerging Markets Index in local currency.
c The pairs of values for each variable are the average for the period 2015-2019 and the latest data available (2024 Q1).
d General government surplus (+) or deficit (-) as a percentage of GDP.
e External assets less external liabilities (stocks) as a percentage of GDP.

in the coming quarters will depend on developments in some of their key determinants. These include agents' confidence, financing conditions and the uncertainty surrounding economic policies, particularly fiscal policy, given the effects related to the make-up of a medium-term fiscal consolidation plan consistent with the new European fiscal rules, and the extent to which the plan is implemented. Similarly, the sectoral composition of growth (with low-productivity sectors, such as tourism, accounting for a large share) also poses further risks to its sustainability.

As regards the emerging economies that are material for the Spanish banking system, the main risks to financial stability would stem from a more adverse external environment or a heightening of their own vulnerabilities. US monetary policy decisions are a major determinant of financing conditions in these economies. First, a more restrictive policy than

expected could lead to capital outflows and tensions in foreign exchange markets.[2] Second, lower than expected growth in China would affect these countries through trade channels and lower commodity prices.[3] Lastly, on the domestic side, the main risks relate to the potential downward stickiness of inflation (which could hinder the monetary easing process), the mounting fiscal vulnerabilities in some countries such as Mexico and Brazil (see Chart 1.2.b), and the course of economic policy in Mexico following the formation of the new government. In Türkiye, the gradual correction of macro-financial imbalances continued, leading the rating agencies to upgrade their credit ratings.

1.2 Financial markets and the real estate sector

1.2.1 Financial markets

The interbank market

In recent months, euro area interbank market rates have decreased amid expectations of deeper policy rate cuts. A more favourable inflation outlook and the downward surprises in some macroeconomic indicators have prompted markets to revise their expectations. They now anticipate somewhat faster and steeper policy rate cuts in the euro area than a few months earlier. All this has led to declines in the interbank market rates that serve as benchmarks for bank loan agreements. Since the cut-off date for the last FSR, the 12-month EURIBOR has dropped by 108 basis points (bp), to stand at 2.6% at end-October (see Chart 1.3.a).[4]

Sovereign debt

Long-term yields on higher-rated sovereign debt have also declined in the euro area and in the United States. In the euro area, these developments in the period as a whole seem to have been largely influenced by expectations for a more accommodative monetary policy in the United States and the domestic macroeconomic weakness. At the cut-off date for this report, 10-year sovereign bond yields stood at 2.3% in Germany and 4.3% in the United States, following declines of 11 bp and 12 bp, respectively, since the cut-off date for the last FSR. Meanwhile, yields on Japanese and UK bonds increased slightly, by around 20 bp.

In most major euro area economies, sovereign bond spreads are somewhat narrower than they were in early April, except in France where they have widened. In early June, political uncertainty in France prompted the sovereign spread against the German Bund to

2 See page 18 of the *Report on the Latin American economy, First half of 2024,* Banco de España.

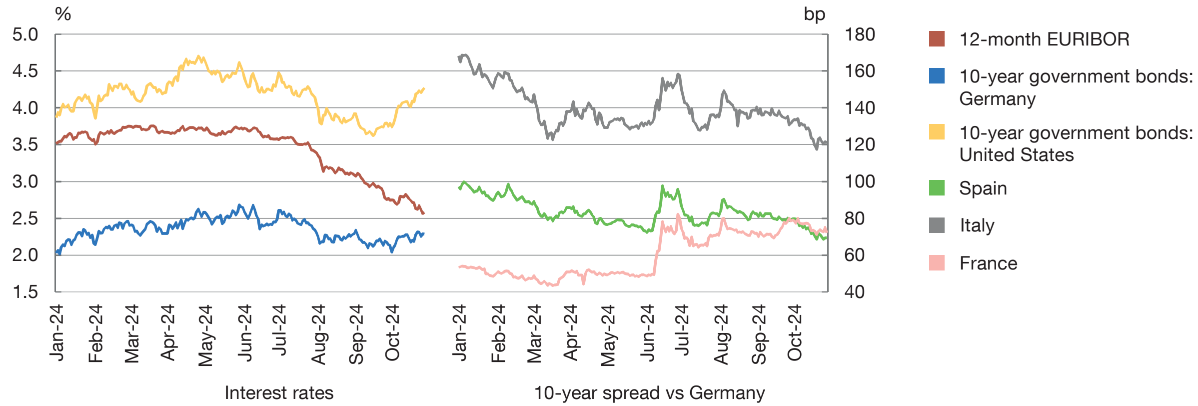
3 See page 19 of the *Report on the Latin American economy, First half of 2024,* Banco de España.

4 The data cut-off date for this report is 28 October 2024. The cut-off date for the last FSR was 5 April 2024.

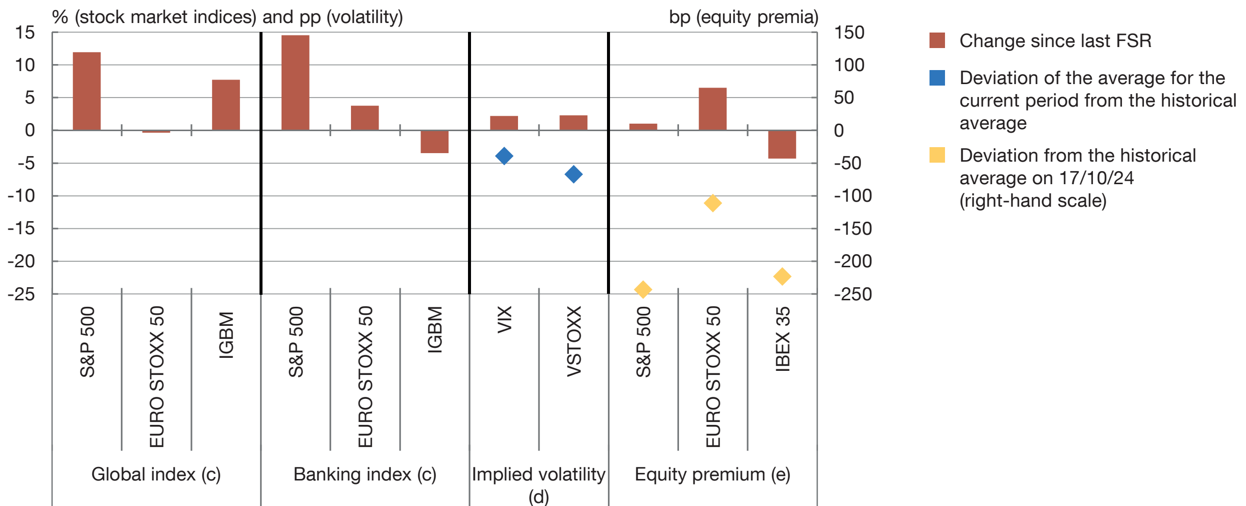
Chart 1.3

Declining sovereign debt yields in most euro area countries and in the United States and uneven equity market developments, against a backdrop of low equity risk premia

1.3.a EURIBOR, bond yields and sovereign spreads



1.3.b Stock market indices, volatility and equity risk premia (a) (b)



SOURCES: Banco de España and Refinitiv Datastream.

a The cut-off date for the last FSR was 05/04/24. The data cut-off date for this report is 28/10/24.
b The change in the equity risk premium is shown on the right-hand scale and uses weekly data.
c IGBM: Madrid Stock Exchange General Index.
d Difference between the average volatility for the period analysed in the previous FSR (24/10/23-05/04/24) and that of this report (06/04/24-28/10/24). The historical average, for the period 1999-2024, is 20.07% for the VIX and 23.41% for the VSTOXX.
e The equity risk premium is calculated based on a two-stage dividend discount model (Russel J. Fuller and Chi-Cheng Hsia. (1984). "A Simplified Common Stock Valuation Model". Financial Analysts Journal, 40(5), pp. 49-56). The historical average, for the period 2006-2024, is 500 bp for the S&P 500, 653 bp for EURO STOXX 50 and 774 bp for the IBEX 35.

expand. Despite a partial reversal in the following months, the spread subsequently widened again amid uncertainty over domestic fiscal developments.[5] At the cut-off date for this report, the 10-year spread stood at 72 bp, 21 bp wider than at the beginning of April. In Spain, the 10-year yield spread against the German Bund stands at 70 bp, down by 14 bp on early April.

5 In late May, S&P downgraded France's sovereign debt rating from AA to AA-. On 11 October, Fitch maintained its AA- rating for French sovereign debt but lowered the outlook from "stable" to "negative". Meanwhile, on 25 October Moody's reiterated its Aa2 rating for France and lowered its outlook from "stable" to "negative".

Exchange rates and equities

On the foreign exchange markets, the euro exchange rate against the US dollar stood at similar levels to those seen in April, having experienced significant appreciation and depreciation movements over recent months. The euro had appreciated against the dollar through to end-September amid expectations for a more accommodative US monetary policy stance. This movement completely reversed in October, influenced by the euro area's economic weakness and expectations for less monetary policy easing in the United States on the back of more favourable macroeconomic news. Meanwhile, the yen has depreciated over the period as a whole, reversing the appreciation witnessed in the summer, which was driven by the sharp narrowing of interest rate differentials between Japan and the other main advanced economies.

The main stock market indices have experienced episodes of pronounced corrections and volatility. This indicates that prices of risk-bearing assets are particularly sensitive to macroeconomic data, more so than in the past. Early August saw a spike in financial tensions, partly due to an overly pessimistic reading of US employment data. The initial corrections in asset prices were exacerbated by technical factors, such as the unwinding of yen carry trades[6] and the low trading volumes typical of August.

Equity markets have performed unevenly across regions. Since the April cut-off date for the last FSR, the S&P 500 Index has gained 11.9% (see Chart 1.3.b), fuelled by positive corporate earnings surprises. The Madrid Stock Exchange General Index has risen by 7.7%, while the EURO STOXX 50 remains close to its early April levels. Meanwhile, the Chinese stock market index recorded gains, buoyed by the robust economic stimulus measures in the country, while Japan's Nikkei 225 index posted a slight decline. By sector, defensive stocks[7] performed somewhat better in the euro area, while in the United States the gains were more broad-based, driven primarily by technology firms. The banking sector experienced spells of instability, with an uneven recovery across the regions.

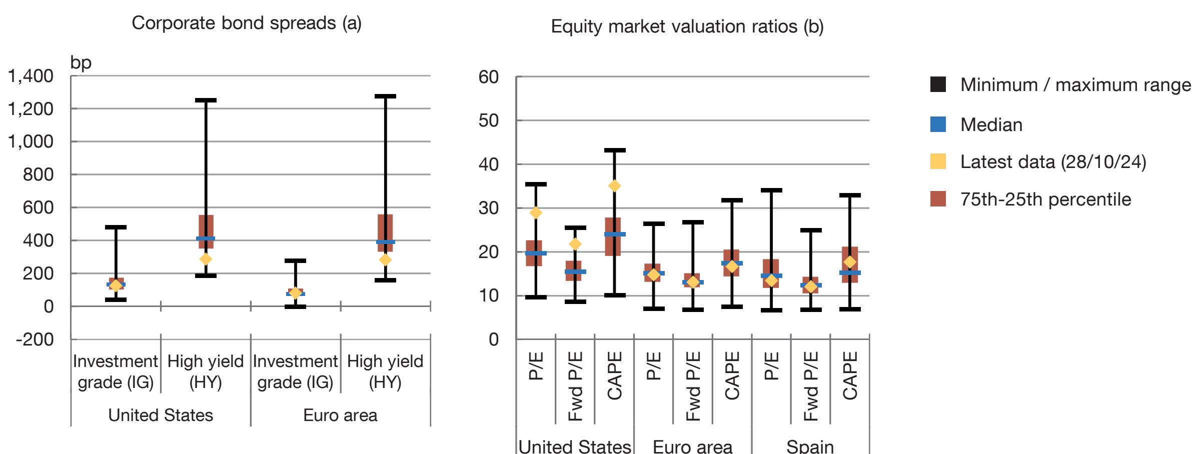
Stock market valuation indicators and corporate spreads continue to point to high prices of risk-bearing assets. Despite the uncertain environment and downside risks to economic activity, volatility in financial asset prices has remained subdued since the last FSR. Meantime, while corporate spreads in the high-yield segment have narrowed slightly compared with early April, those in the investment grade segment have widened a little. By historical standards, these spreads are very narrow in the high-yield segment, standing close to the 25th percentile of their distribution in both the euro area and the United States (see Chart 1.4.a). Similarly, equity risk premia in the euro area, Spain and the United States are well below the

6 In a carry trade strategy, investors borrow in a currency with low interest rates to invest in assets denominated in other currencies with higher interest rates. In early August, investors who had borrowed in yen unwound some of their carry trade positions in response to the narrowing of the interest rate differential between the United States and Japan.

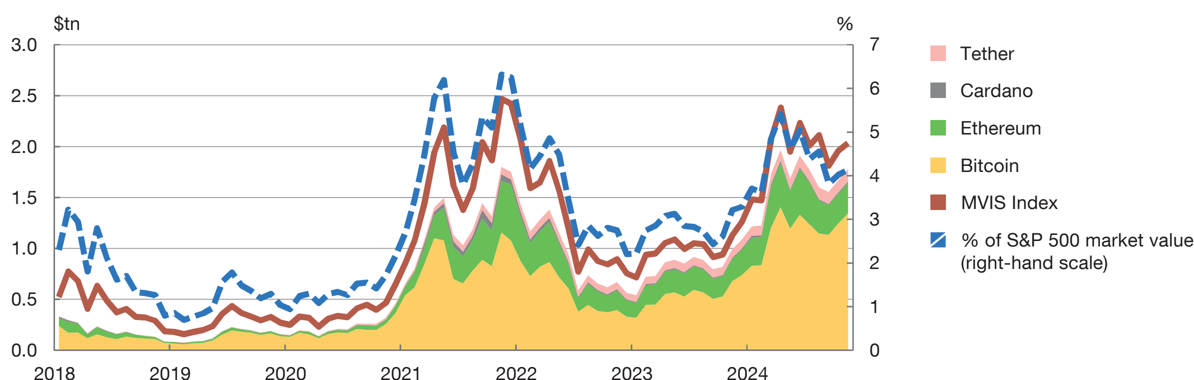
7 In the stock market, defensive sectors are those whose performance is less correlated with the business cycle, since their goods and services enjoy more stable demand irrespective of economic conditions.

Chart 1.4
High valuations persist in some segments of the fixed-income and equity markets, while the value of crypto-assets exhibits a level similar to April

1.4.a Corporate bond and equity market metrics



1.4 b Market value of the largest crypto-assets (c)



SOURCES: Refinitiv Datastream, MVIS, CoinMarketCap and Banco de España.

a Corporate spreads over the swap curve of the ICE Bank of America Merrill Lynch indices. Monthly series data since 1998.
b Drawing on monthly data from the stock market index series constructed by Datastream (since 1985 for the euro area and the United States and since 1987 for Spain). The sample is somewhat smaller for Spain's CAPE ratio and the euro area Fwd P/E ratio. Ratios provided by Datastream, except for the CAPE (cyclically adjusted price-to-earnings) ratio which is calculated as the value of the stock market index in real terms (adjusted for CPI) divided by a 10-year moving average of the index firms' earnings in real terms. The price-to-earnings (P/E) ratio and 1-year forward P/E (Fwd P/E) ratio capture the relationship between the stock price and earnings per share (observed or expected).
c The MVIS CryptoCompare Digital Assets 100 Index, which includes the largest 100 crypto-assets by market value. All of the cryptocurrencies shown are unbacked, except Tether.

historical average (see Chart 1.3.b). The price-to-earnings ratio remains above the 75th percentile of the historical distribution in the US market, but stands closer to the median in the euro area and Spain.

In the United States, the technology sectors have been key drivers of stock market valuation metrics. That said, they have not reached the heights observed in the early 2000s

(see Box 1.2). In any event, there is considerable uncertainty over the strong earnings projected for technology companies, whose investments take a long time to become profitable. Moreover, in the United States, the market capitalisation of the leading technology firms means they comprise a very large share of broad stock market indices,[8] which increases the likelihood of individual firms' idiosyncratic risks having a systemic impact.

High prices of risk-bearing assets and compressed risk premia raise the likelihood of abrupt corrections. The current market valuations are consistent with a benign macroeconomic scenario and a very strong corporate earnings performance. Against this backdrop, adverse macroeconomic events or a significant downward revision of projected earnings for key technology firms could trigger price corrections in risk-bearing assets.

Crypto-assets continue to pose limited risks to financial stability. The capitalisation of the MVIS index, which includes the top 100 crypto-assets, stands close to its April levels and continues to represent a small fraction of financial markets (see Chart 1.4.b). That said, a return to the rapid growth of the past, which looser monetary conditions might encourage, would raise crypto-assets' contribution to systemic risk, particularly in the case of those not backed by traditional financial assets.

Some factors could exacerbate financial asset price fluctuations in response to adverse events. In particular, in the event of liquidity tensions, some financial intermediaries, such as open-ended international investment funds with illiquid or highly leveraged positions, might engage in fire sales. Moreover, stress episodes could potentially be amplified by the rapid spread of information via the internet.

1.2.2 The Spanish real estate market

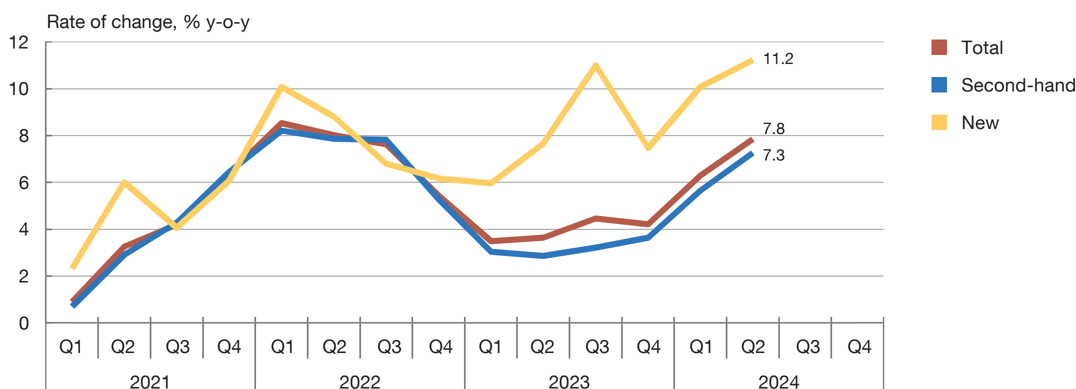
The pace of growth of house prices continued to accelerate in 2024 H1, against a backdrop of high demand, supply rigidities and a growing share of properties being used for holiday lets. By segment, both second-hand and new housing saw price rises (see Chart 1.5.a) across all regions. Specifically, during the first half of the year, prices rose on average by 6.5% year-on-year for second-hand housing and by 10.7% year-on-year for new housing, in both cases well ahead of inflation. In consequence, on average, house prices exceeded their previous peak (of 2007 Q3), although in real terms they are still 25% below that level.[9] Momentum is also strong in the rental segment. The main house price drivers continue to include strong net household formation, high levels of purchases by non-

8 At end-October 2024, the capitalisation of the top technology stocks (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) accounted for 33% of the S&P 500. See Box 1.2 of this report for more details.

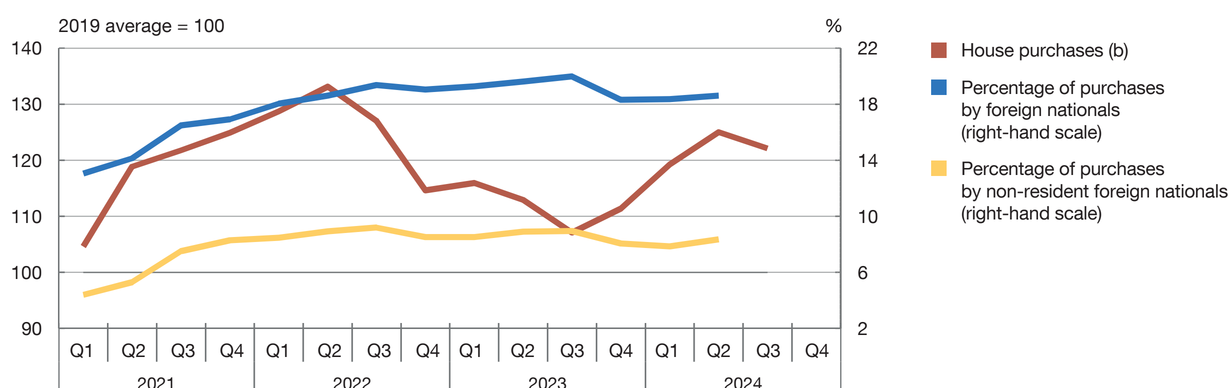
9 In 2024 Q2 house prices were 4.2% above this level: the price of new housing was 33.8% above its 2008 Q3 peak, while the price of second-hand housing was 8.9% below its peak. In real terms, house prices are below their all-time highs on all measures: total house prices are around 25% lower, new housing prices 1% lower and second-hand housing prices 35% lower.

Chart 1.5
The pace of growth of house prices continued to accelerate, against a backdrop of strong demand and rigid supply in the short term

1.5.a House prices (a)



1.5.b House purchases and share of purchases by foreign nationals



SOURCES: Banco de España, Centro de Información Estadística del Notariado, INE and Ministerio de Transportes y Movilidad Sostenible.

a The chart depicts the year-on-year rate of change of house prices in each segment in 2024 Q2.
b Seasonally adjusted series. The 2024 Q3 figure is the average for the months of July and August.

residents, the growing use of rented housing for holiday lets, the sharp past increases in housing construction costs[10] and rigid supply in the short term.[11]

House purchases increased in 2024 H1, although the pace of growth subsequently decelerated over the course of Q3. Purchases signed before notary between January and August were 8% higher than in the same period a year earlier. This is the second largest

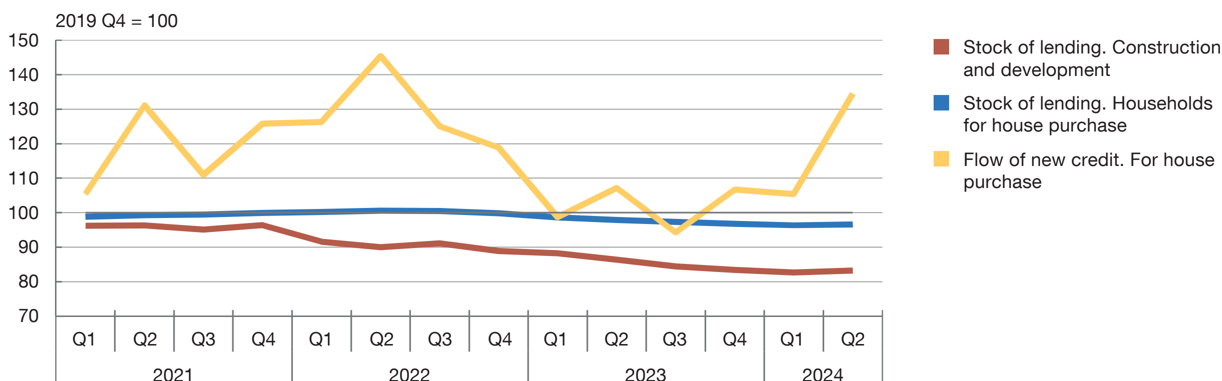
10 Changes in housing construction costs typically feed through to new housing prices with a lag of around two years, which is the average time required to complete construction. Housing construction costs surged between early 2022 and mid-2023, with year-on-year growth oscillating between 7% and 11%. They have since decelerated markedly, to year-on-year growth of just over 2% in 2024 Q2.

11 New residential building permits rose by 15% year-on-year between January and July, although the absolute number is small (119,000 in the last 12 months) compared with the housing demand linked to net household formation (272,000 on average in 2022 and 2023 and 153,000 according to the average year-on-year change in 2024 H1). Other house price drivers are associated with the growth in rental demand, especially in the big cities and tourist areas. For more details, see Dmitry Khametshin, David López Rodríguez and Luis Pérez García. (2024). "El mercado del alquiler de vivienda residencial en España: evolución reciente, determinantes e indicadores de esfuerzo". Documentos Ocasionales, 2432, Banco de España.

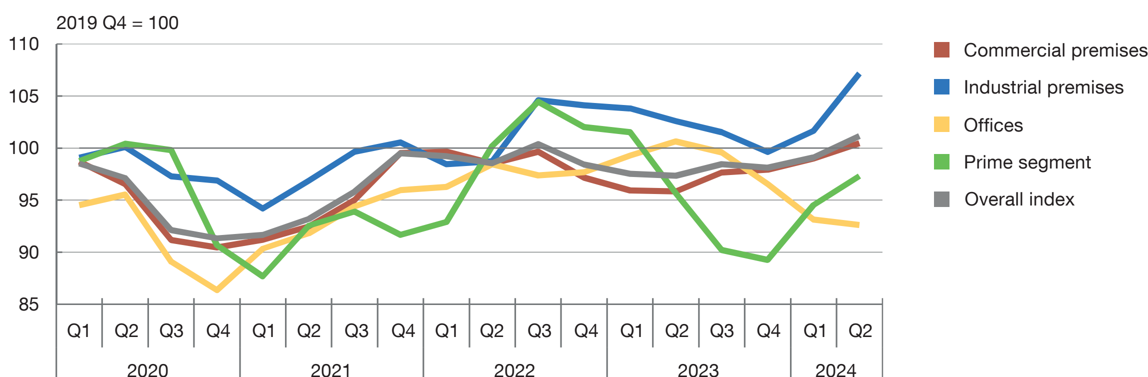
Chart 1.6

New mortgage lending rose sharply in 2024 Q2, while the stock of mortgage lending and lending for construction and real estate development was less contractionary

1.6.a Indicators of real estate sector financing (a)



1.6.b Commercial real estate sector price indices (b)



SOURCES: Colegio de Registradores and Banco de España.

a Lending for construction and development includes real estate activities. The flow of new credit refers to new lending originated in each quarter.
b Based on estimates using a hedonic regression model for each stratum. The aggregate index is the average weighted by the relative share of transactions made in each segment (4% for offices, 78% for commercial premises and 18% for industrial premises). In 2023 properties in prime locations, i.e. those located in central areas of the main large cities (Barcelona, Bilbao, Madrid, Malaga, Palma and Valencia), accounted for 4% of all commercial real estate transactions.

increase for this 8-month period since 2008 (the highest being recorded in 2022). In seasonally adjusted terms, albeit on incomplete information for Q3, momentum was lower than in 2024 H1 (see Chart 1.5.b). Purchases by foreign nationals remain high. In the first half of the year they accounted for 18.5% of the total, somewhat more than in 2019 H1 (17%) and at the upper end of the range of figures since records began.

The flow of new credit for house purchases rose sharply in 2024 H1 as borrowing costs declined. The volume of new credit grew by 25.6% year-on-year in 2024 Q2, after correcting in 2023 (-10.2% year-on-year in 2023 Q4). With this latest increase, the flow of new financing for house purchases has risen slightly above the levels recorded in 2021 H1 during the rebound that followed the health crisis and before the start of the monetary policy tightening cycle (see Chart 1.6.a).

Despite this growth in new credit, the high volume of repayments has meant that the stock of mortgage lending continues to shrink. However, the pace of decline in 2024 H1 was slower than in previous periods (1.4% year-on-year in 2024 Q2 compared with 3.1% in 2023 Q4) (see Chart 1.6.a).

Credit was also less contractionary in bank lending to construction and real estate development firms. In this case, the stock of lending decreased by 3.6% year-on-year at June 2024 (compared with a decline of 6.2% year-on-year at December 2023) (see Chart 1.6.a).

Commercial real estate prices recovered somewhat in 2024 H1. The overall price index rose by 3.9% year-on-year in 2024 Q2, compared with a correction of 0.3% at December 2023 (see Chart 1.6.b). This increase was driven by price rises in commercial and industrial premises, while office prices continued to fall. In the prime commercial real estate segment, prices rose moderately in Q2.

1.3 Non-financial sectors

1.3.1 Non-financial corporations and households

Non-financial corporations

Corporate profits performed favourably in 2024 H1, albeit unevenly across sectors. On the combined information of the Spanish tax authorities (AEAT) and the Central Balance Sheet Data Office Quarterly Survey (CBQ), the gross operating profit (GOP)[12] of the non-financial business sector increased in nominal terms by 6.5% year-on-year in 2024 Q1 and by 9.2% in Q2 (see Chart 1.7.a). The highest growth was in construction and real estate and in wholesale and retail trade and hospitality. By contrast, in the manufacturing sector profits fell slightly between April and June compared with the same period a year earlier.

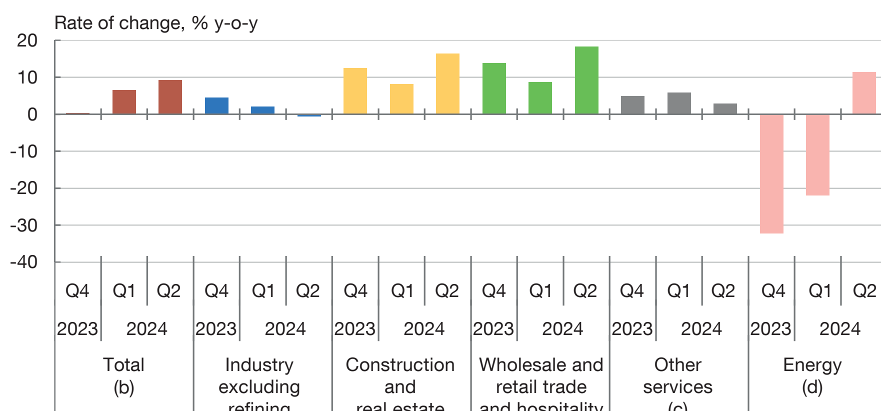
The most recent data from the Banco de España's Business Activity Survey (EBAE), corresponding to Q3, indicate that business activity remains on a positive path. Although firms perceive a decline in turnover in Q3 – consistent with the seasonal pattern – the outlook for Q4 is positive. In addition, a smaller proportion of firms now report constraints on their activity on account of difficulties accessing financing or interest expenses. Nevertheless, concerns remain over uncertainty about economic policies, labour shortages and possible increases in energy costs.

The volume of non-financial firms' debt rose in 2024 H1, interrupting the downward trend of the previous 18 months. However, assisted by GDP growth, the debt ratio continued

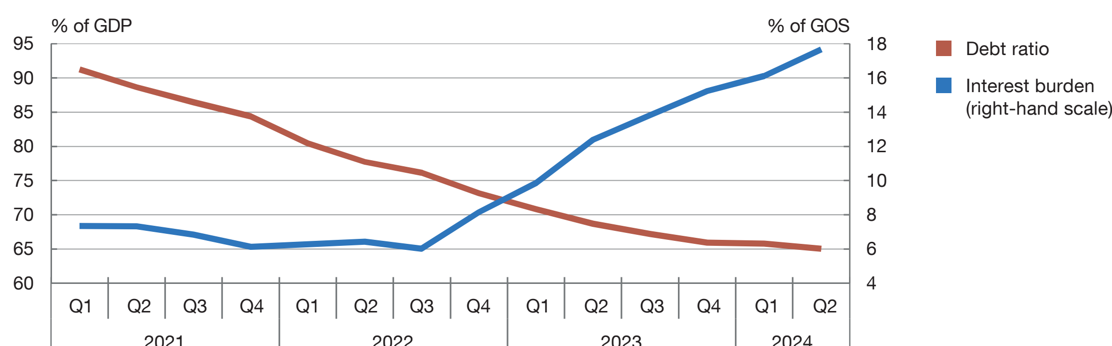
12 GOP is obtained by subtracting intermediate consumption (production costs and other operating expenses) and personnel costs from output (sales and other operating income).

Chart 1.7
Strong corporate profits and the declining debt ratio continue to contain the risks associated with the interest burden

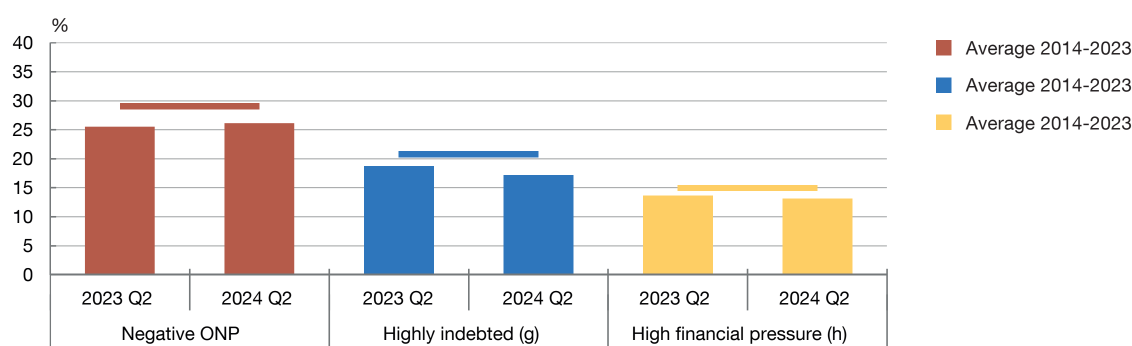
1.7.a GOP of Spanish NFCs (AEAT and CBQ) (a)



1.7.b Debt ratio and interest burden (e)



1.7.c Percentage of vulnerable firms (CBQ) (f)



SOURCES: AEAT, INE and Banco de España.

a GOP is obtained by subtracting intermediate consumption and personnel costs from output. Seasonally adjusted data.
b Excluding education, health, general government, recreation activities, financial and insurance institutions, and other services. The data source is the AEAT, except for electricity, gas, steam and air conditioning supply and manufacture of coke and refined petroleum products, for which the data source is the CBQ.
c Includes transportation and storage, information and communication, professional, scientific and technical activities, and administrative and support service activities.
d Includes energy, mining and quarrying, and electricity, gas and water supply.
e Interest payments are quarterly data, before allocation of financial intermediation services indirectly measured (FISIM). GOS is quarterly and seasonally adjusted.
f Excluding holding companies.
g Highly indebted firms are those whose net financial debt / (GOP + financial revenue) ratio is greater than 10 or which have positive net financial debt and zero or negative earnings. Positive net financial debt is defined as interest-bearing debt less cash and cash equivalents.
h Firms facing high financial pressure are proxied as those whose earnings are insufficient to cover their interest payments.

to decline (by 3.6 percentage points (pp) year-on-year), standing at 65% at June 2024 (see Chart 1.7.b), a level not seen since 2002 and 1.8 pp below the euro area average.

Non-financial firms' interest payments have continued to rise, but they could start to fall in the coming months. According to the institutional sector accounts in the National Accounts, interest payments in 2024 H1 were 13% higher than in 2023 H2. However, in the case of bank loans, interest payments have fallen slightly since May and this pattern will likely continue in the coming months if market interest rate expectations are met,[13] as short-term loans are rolled over and variable-rate loans are reset. For some firms interest payments could increase, if they roll over fixed-rate loans arranged before the last monetary policy tightening cycle, although according to Central Credit Register data, these loans account for a very small share of the total.

Overall, interest coverage ratios remain significantly above the levels observed before the last monetary tightening cycle. According to the National Accounts, the ratio of interest payments to gross operating surplus (GOS) stood at 17.7% in 2024 Q2, 5.3 pp higher than a year earlier (see Chart 1.7.b). This level is close to the historical quarterly average and median since 1999 (16% and 18%, respectively), but it is still well above the levels observed previous to the last monetary tightening cycle (around 7%).

Corporate vulnerability indicators show small variations and of different sign, although they remain, in any event, at historically low levels. According to data from the CBQ, which includes mostly medium-sized and large firms, the proportion of highly-indebted firms[14] and of firms facing high financial pressure (those whose ordinary earnings were insufficient to cover their interest payments)[15] decreased moderately in 2024 H1 (see Chart 1.7.c). By contrast, the proportion of firms whose ordinary earnings (proxied by ordinary net profit (ONP)[16]) were negative has grown slightly, by some 0.6%. In any event, vulnerability levels are below the average for the period 2014-2023. By sector, vulnerability levels have fallen most sharply in wholesale and retail trade and hospitality, while they have worsened somewhat (on all three indicators) in energy.

Households

Household income continued to grow in 2024 H1, underpinned by job creation, rising wages and property income. In the first half of the year employment grew by 2.3% and

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13 The methodology used for these calculations is explained in "Box 1. Monetary policy transmission to interest payments on the bank debt of households and firms". In Banco de España, *Report on the financial situation of households and firms,* Second half of 2023, pp. 25-28.

14 Highly indebted firms are those whose net financial debt / (GOP + financial revenue) ratio is greater than 10 or which have positive net financial debt (gross financial debt less liquid assets) and zero or negative earnings. The threshold of 10 is obtained assuming that firms can refinance their debts with loans with an approximate term of 10 years, in an amount that is 10 times their long-term expected earnings, at a market interest rate, and with annual instalments equal to their annual earnings. If firms take out larger loans, they would be unable to meet the annual instalments with their earnings.

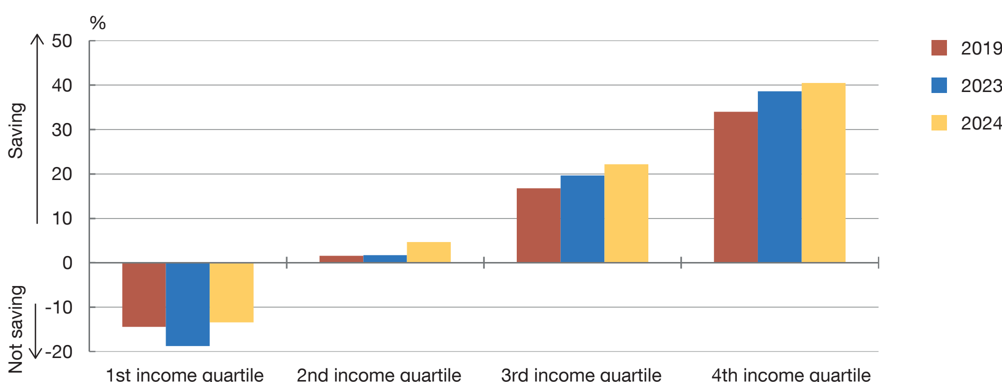
15 For the purposes of this indicator, ordinary earnings are calculated as the sum of GOP and financial revenue, excluding financial costs.

16 ONP is obtained by deducting financial costs and operating provisions and depreciation from GOP and adding financial revenue.

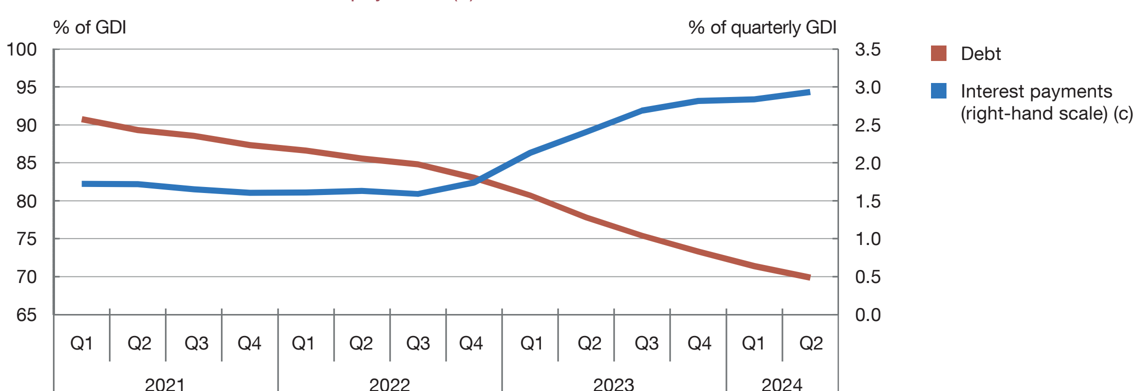
Chart 1.8

The ability to save has improved, although lower-income households are still unable to save. The debt-to-income ratio has risen slightly

1.8.a Households' ability to save, by level of income. Average January-September (a)



1.8.b Household debt and interest payments (b)



SOURCES: European Commission, INE and Banco de España.

a Households' ability to save is based on the following question: which of the following best describes your households' present financial situation? Indicator = weighted net percentage of positive replies less negative replies, i.e. percentage of households that reply "we are saving a lot" x 1 + percentage of households that reply "we are saving a little" x 1/2 - percentage of households that reply "we need to use our savings" x 1/2 - percentage of households that reply "we are getting into debt" x 1.

b Quarterly GDI, debt and interest payments are seasonally adjusted.

c Interest payments are quarterly data, before allocation of FISIM.

compensation per employee by 5.3%, in both cases in average year-on-year terms. These rates of growth were, in any event, more moderate than those seen in 2023 H2. Average real gross disposable income (GDI)[17] per household[18] rose by 3.8% year-on-year on average (compared with 4.4% in 2023 H2), and is 2.8% above its pre-pandemic level.[19]

Growing income, combined with a relative sluggishness in consumption, has led to higher savings. The saving rate rose to 13.1% of GDI in 2024 Q2, remaining above the

17 GDI includes compensation of employees, GOS and gross mixed income, property income and net taxes paid (which are deducted). Nominal GDI rose by 10%, in average year-on-year terms, in 2024 H1. Real income is calculated by adjusting nominal values using the private consumption deflator.

18 The number of households rose by 0.8% year-on-year at June 2024.

19 In seasonally adjusted terms.

historical average for the seventh consecutive quarter. The European Commission's consumer survey indicates that the increase in the ability to save has been widespread across income quartiles, albeit more marked in the higher income segments where it is most clearly above pre-pandemic levels (see Chart 1.8.a). Households in the lowest income quartile are still unable to save.

The volume of household debt rose in 2024 Q2, for the first time since summer 2022, while household gross wealth continued to increase. Income grew at a faster pace than debt levels, enabling the household debt ratio to ease – by 7.9 pp year-on-year – to 69.9% of GDI[20] in 2024 Q2, a level not seen since 2001 and 14.2 pp below the euro area average (see Chart 1.8.b). Consumer lending, while growing somewhat less robustly than nominal household consumption,[21] has continued to outpace other credit segments. Combined with the decline in the stock of mortgage lending, this has meant that, at June 2024, consumer credit amounted to nearly 15% of total household debt, almost 1 pp more than a year earlier. Gross household wealth grew by 6.5% year-on-year in 2024 Q2, driven mainly by rising house prices.

Households' debt burden has increased slightly, in terms of debt-to-income, but it could start to decline in the coming months. In 2024 H1 overall, households' interest payments were still above their 2023 H2 levels (9.8% higher), but the increase in nominal income has moderated the impact. The debt burden stood at 2.9% of GDI in 2024 Q2, 0.1 pp higher than six months earlier and 0.5 pp higher than in 2023 Q2 (see Chart 1.8.b). However, since May the average cost of households' outstanding debt has begun to ease, standing at 4.6% in August, barely 6 bp less than in April. Based on current market expectations – which point to a gradual decline in policy rates – it is estimated that, by end-2024, the cost of more than 40% of the stock of variable-rate mortgages (which in June accounted for 48.2% of the total stock of mortgages)[22] will have fallen by more than 50 bp (and the cost of almost three-quarters of those mortgages, by more than 100 bp).

1.3.2 General government in Spain

In recent months limited progress has been made in restoring Spanish public finances. The continued increase in public expenditure (5.3% year-on-year in 2024 H1) has dampened the positive impact of revenue growth (6.4% year-on-year). This will foreseeably result in failure to comply with the EU recommendation that the increase in net public expenditure[23] in Spain in 2024 be below 2.6%.

20 The amount of households' outstanding loans is seasonally adjusted.

21 At June 2024, year-on-year growth in final household consumption at current prices stood at 6.7%, compared with 5.25% for consumer credit stock provided by deposit institutions and specialised lending institutions.

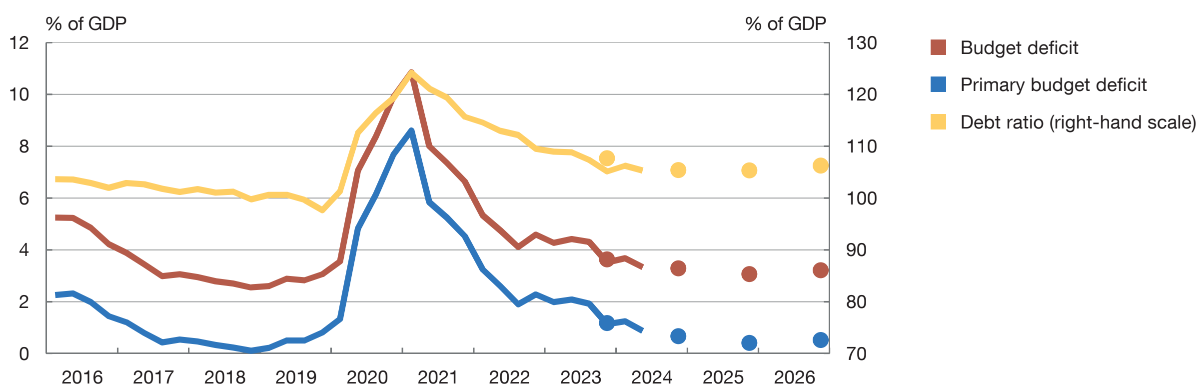
22 Also at that date, 16.4% of the stock of loans for house purchase were mixed-rate loans.

23 The recommendation is defined based on public expenditure, excluding interest payments, the cyclical component of unemployment, extraordinary expenditure and expenditure financed or co-financed with European funds. The change in revenue owing to discretionary measures applied by the authorities is subtracted from the resultant increase.

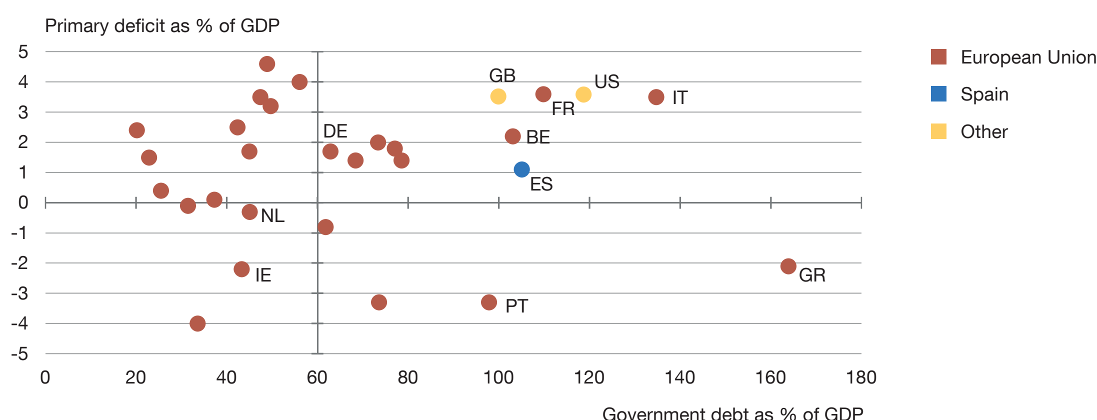
Chart 1.9

Spain's public finances are still a source of vulnerability

1.9.a General government financial position in Spain (a)



1.9.b International comparison (2023)



SOURCES: Eurostat, IMF, IGAE and Banco de España.

a The circles correspond to the Banco de España's projections published on 17 September, before the revision of the National Accounts series by the IGAE and INE. This revision altered the baseline data for 2023. The projections are made under the assumption that there are no economic policy changes, which means they do not include the Government's fiscal plan announced on 15 October.

However, improvements have been made in budget deficit and government debt levels as a percentage of GDP, underpinned by GDP growth and the upward revision of GDP growth estimates for previous years. During the first six months of the year, the budget deficit-to-GDP ratio fell by 0.2 pp, standing at 3.3% (see Chart 1.9.a). Meanwhile, the Spanish general government debt ratio stood at 105.3% of GDP at June, 3.5 pp below its June 2023 level, which in turn was revised down by 2.6 pp in the latest revision to the National Accounts.

In this setting, Spain remains in the group of developed countries with vulnerable public finances (see Chart 1.9.b). In the absence of fresh revenue and/or expenditure adjustment measures, the declines in the budget deficit and government debt ratios will tend to peter out in the coming years. This is on account of the strong structural component of the Spanish budget deficit and the impending upward pressures on expenditure linked to population

ageing, national defence and security and the energy and digital transitions. Following the pandemic-related health crisis and the energy crisis stemming from the Russian invasion of Ukraine, the Spanish economy has achieved a strong recovery that has significantly reduced the imbalance in public finances. However, the deficit remains close to its pre-pandemic levels, which means that, in structural terms, there has been little improvement since 2020. That said, the performance has been better than that of other European economies, which have seen their structural deficits increase over the same period.

Since publication of the last FSR, the average cost of new financing raised by the Spanish Treasury has fallen. The start of the policy rate-cutting cycle in the main economies, especially in the euro area, and the containment of the Spanish general government risk premium, have meant that sovereign bond yields at issue have fallen slightly. Thus, the actual cost of new financing at issue for the Spanish Treasury in 2024 Q3 was 3.08%, compared with 3.44% on average in 2023 and 3.30% in 2024 H1.

Nevertheless, the interest burden will continue to drive up public expenditure in the coming years. Markets expect to see further reductions in policy rates, but they will tend to steady at levels above those in place before the tightening cycle began. In consequence, when it comes to rolling over the debt issued when interest rates were very low (before 2022), prices will rise. Specifically, it is estimated that the average cost of outstanding general government debt will go from 2.3% in 2023 to 2.6% in 2026. The interest burden as a percentage of GDP will likewise increase from 2.5% to 2.7%. However, in a high debt environment, a more adverse (upward) performance by yields at issue would have a significant further impact on public finances.

Strict application of the new EU fiscal rules, from 2025, aims to place the government debt of the most indebted countries, such as Spain, on a clear downward path. Eventually, this would restore headroom in order for Spanish general government to address possible future shocks. It would also mean that public finances would be less sensitive to moves in market interest rates, and would thus reduce the vulnerabilities associated with the general government's financial position.

Against this backdrop, on 15 October the Government submitted its first medium-term fiscal-structural plan (MTFSP), which proposes a linear structural adjustment of 0.4 pp of GDP per year, over seven years. This plan must be validated by the European Commission during November. The proposed adjustment is similar to – albeit somewhat lower than – that deemed necessary by the Banco de España (0.5 pp) and would place Spanish government debt on a clearly downward path. However, the plan's timeline envisages stricter limits on net expenditure growth in the later stages, meaning that it will be easier to meet in the early years than in the subsequent ones. In consequence, the plan fails to take advantage of the current favourable economic situation to bring forward the fiscal effort in a countercyclical manner.

1.3.3 Financial flows vis-à-vis the rest of the world and the international investment position

During 2024 H1, the negative net international investment position (IIP)[24] continued to decline as a percentage of GDP. Specifically, it stood at 46.9% at June, 7.6 pp lower than a year earlier. This contraction was once again underpinned by the large current and capital account surplus[25] and by nominal GDP growth, combined with the net positive impact of changes in the value of financial instruments. The decline in Spain's gross external debt as a percentage of GDP was lower in the first half of the year. This was due to the increase in the outstanding amount of external debt (€59.5 billion), mainly as a result of the growth in non-residents' holdings of general government securities (€41.8 billion). By contrast, the external debt of the banking sector[26] has decreased slightly. The growth in nominal GDP led to a small decline in the external debt-to-GDP ratio, which stood at 162.6% in mid-2024.

24 The negative net IIP is defined as the negative difference between Spain's external financial assets and its external financial liabilities.

25 The current and capital account balance reflect the net lending (+) or net borrowing (–) of the economy vis-à-vis the rest of the world. A large surplus is associated with high net lending.

26 The gross external debt includes liabilities issued by the banking sector held by the rest of the world, excluding equity instruments and financial derivatives.