

Reactivating Credit

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Ana Rubio González

Head Economist of Financial Systems

1 Is credit reactivating?

Credit can be seen in terms of stocks or flows

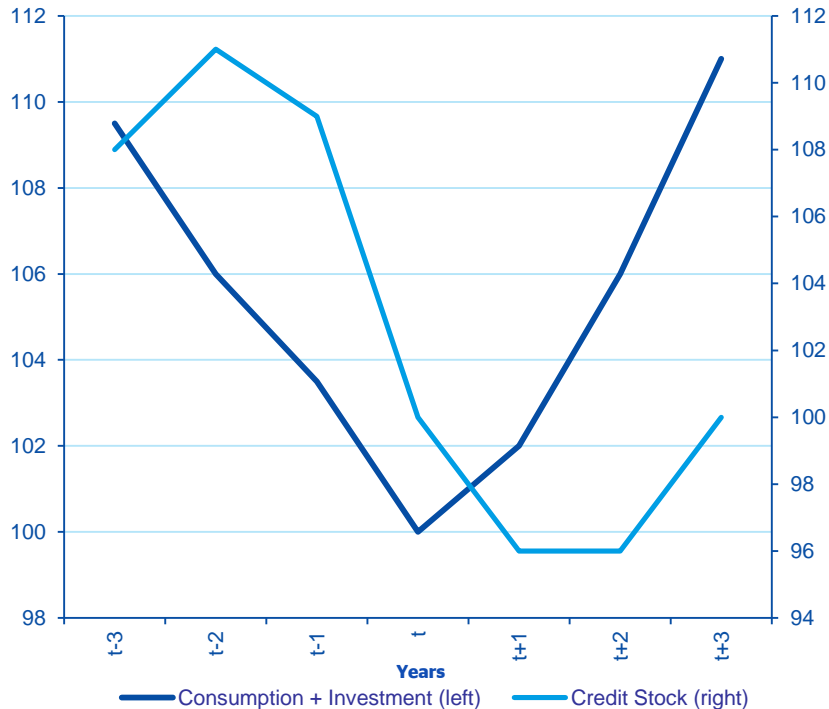


What is needed is the reactivation of flows, that are the ones linked to the economic recovery

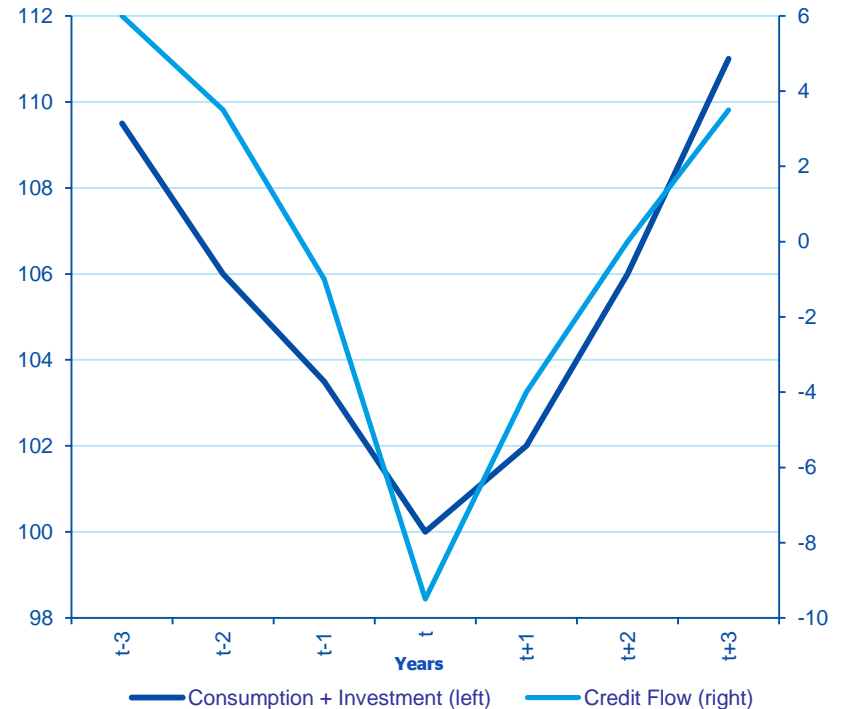
Deleveraging of the stock has to continue in over-indebted companies and sectors

In previous crises, the recovery of the flow of credit happened before that of the stock

Average evolution of consumption+investment and credit stock in a banking crisis
 (C+I=100 at the trough, average of crises in Finland, Japan, Norway, Spain and Sweden)
 Source: Biggs et al (2009)



Average evolution of consumption+investment and credit flow in a banking crisis
 (C+I=100 at the trough, average of crises in Finland, Japan, Norway, Spain and Sweden)
 Source: Biggs et al (2009)

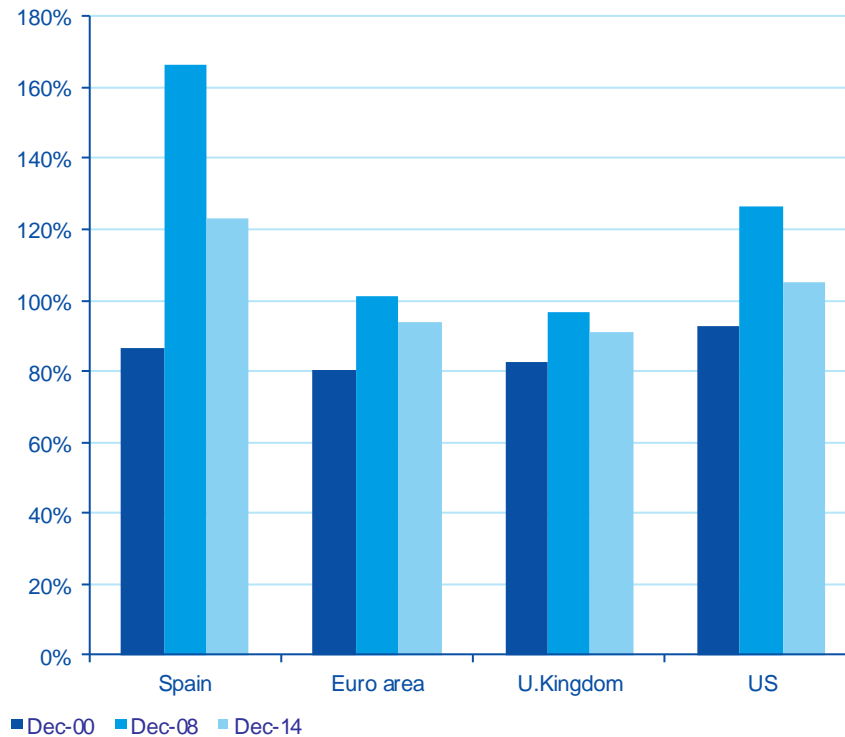


After a long period of credit growth, private-sector deleveraging is much needed

Bank credit to the private sector

(% GDP)

Source: ECB, Eurostat, Bank of England, FDIC and Haver



1. Amount

Private-sector leverage is excessive in countries like Spain

2. Composition

In Spain, credit to real estate firms still accounts for 14% of total (down from 25%) and 41% of defaulted loans

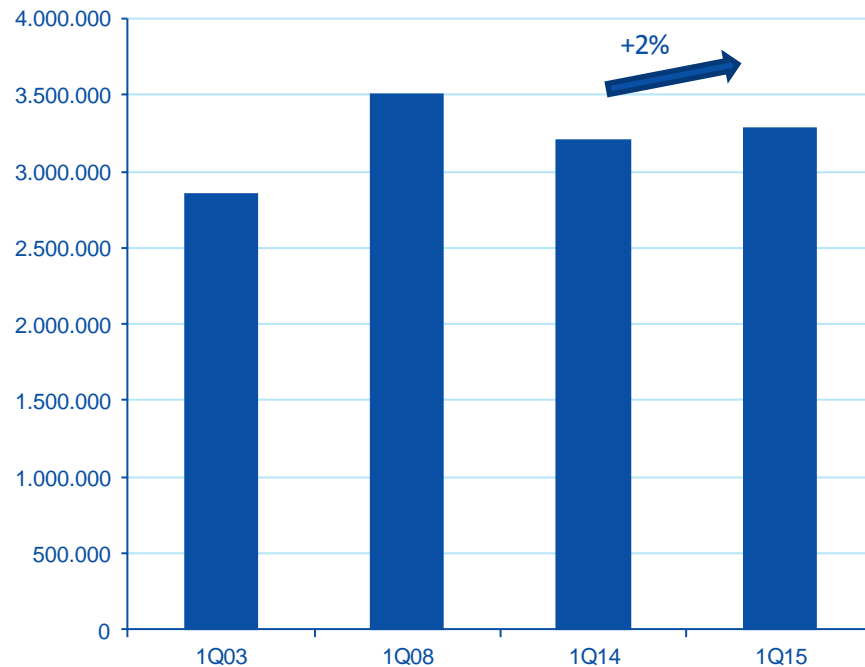
The weight of construction on the economy has come down from 12% to 6%, and it is expected to remain constant

Deleverage must be compatible with new credit to solvent demand

Euro Area, Private Sector: New Loans

(Quarterly figures, EUR mn)

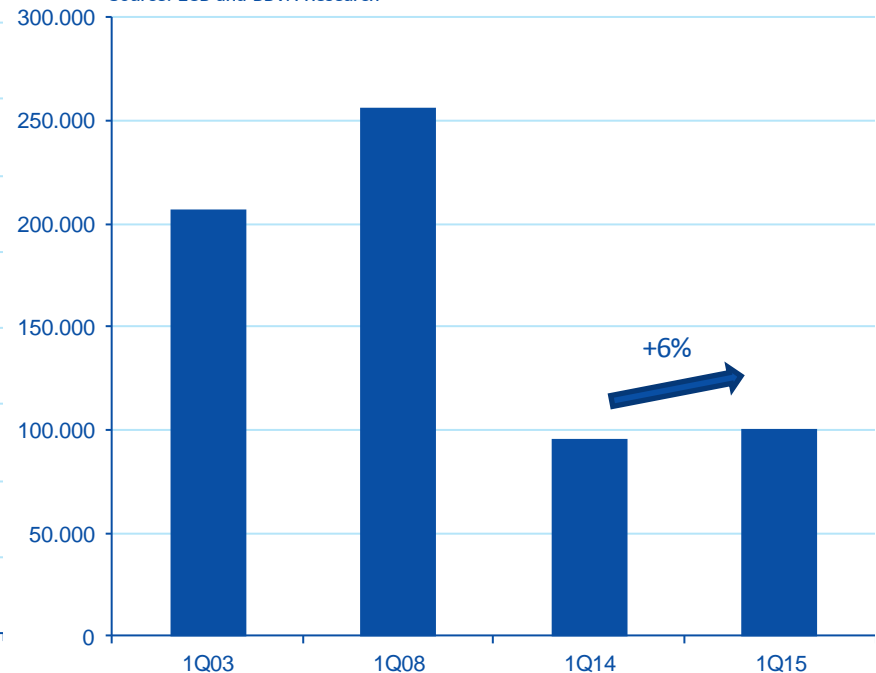
Source: ECB and BBVA Research



Spain, Private Sector: New Loans

(Quarterly figures, EUR mn)

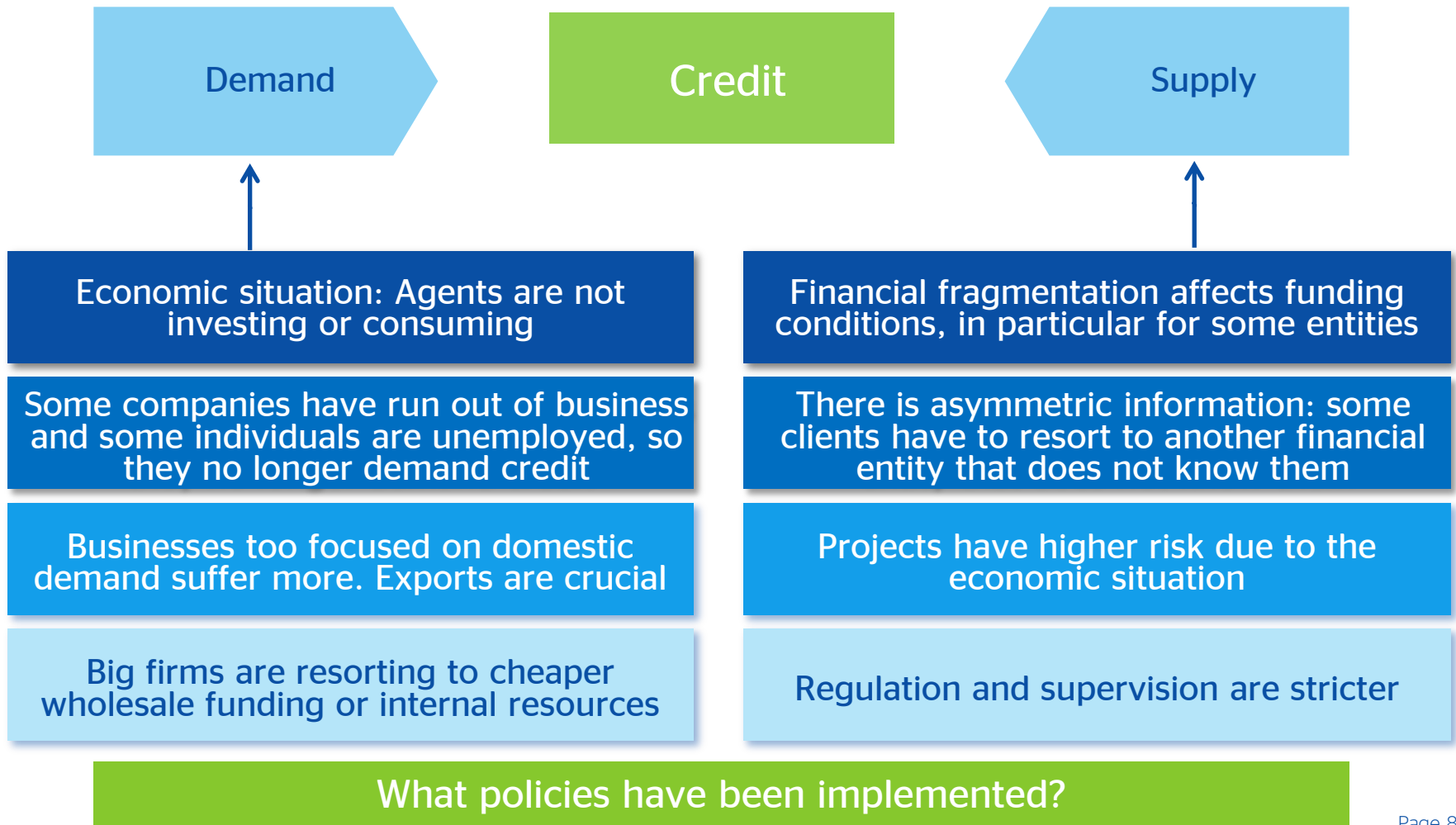
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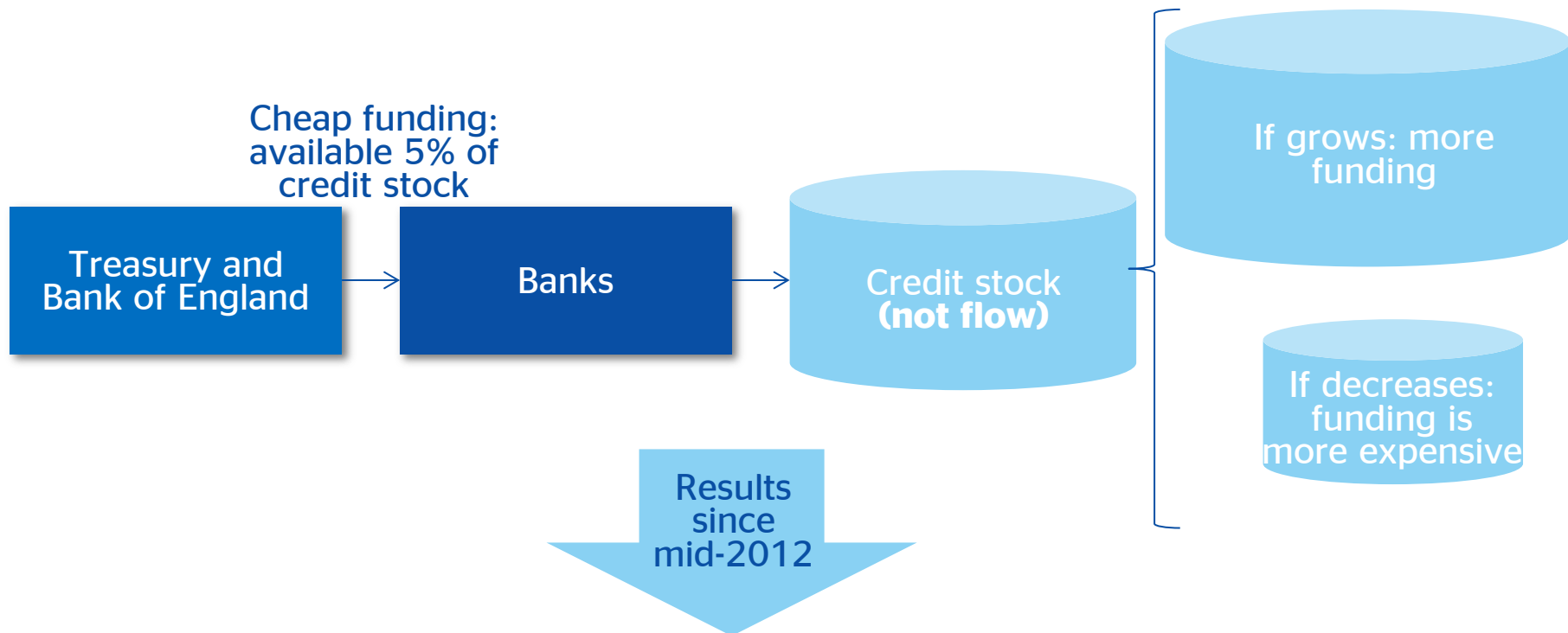
In Spain, new lending is in an upward trend, and outstanding credit will start growing by year-end

2 What policies have been implemented?

Policies should focus on the factors that are affecting credit



United Kingdom: Funding for Lending Scheme



- Outstanding FLS drawing: 3.5% of credit stock
- Credit stock: -0.5% (firms -11.6%, households +3.4%). **Risk not taken into account**
- Banks' funding cost: Senior unsecured bond spreads from 2% to 0.25%
- Lending rates: mortgage from 3.5% to 2%

Coincident with improvement in financial markets: there is **no counterfactual**

United States: Prompt reaction, stress test

List of stress test exercises

Source: BBVA Research

Year	US	Europe	Spain	U.Kingdom
2008				Financial Services Authority (FSA)
2009	Supervisory Capital Assessment Program (SCAP)	Committee of European Banking Supervisors (CEBS)		FSA
2010			CEBS	
2011	Comprehensive Capital Analysis and Review (CCAR)	European Banking Authority (EBA)		
2012	CCAR		Bank of Spain, Oliver Wyman	
2013	CCAR			
2014	CCAR		EBA	Bank of England
2015	CCAR			Bank of England

In the US solvency (and not only liquidity) problems were identified at the beginning of the crisis

The existence of an ex-ante \$350bn bailout fund was crucial for the success of the stress test

The supervisors assessed institution-specific potential losses and estimated resources to absorb them

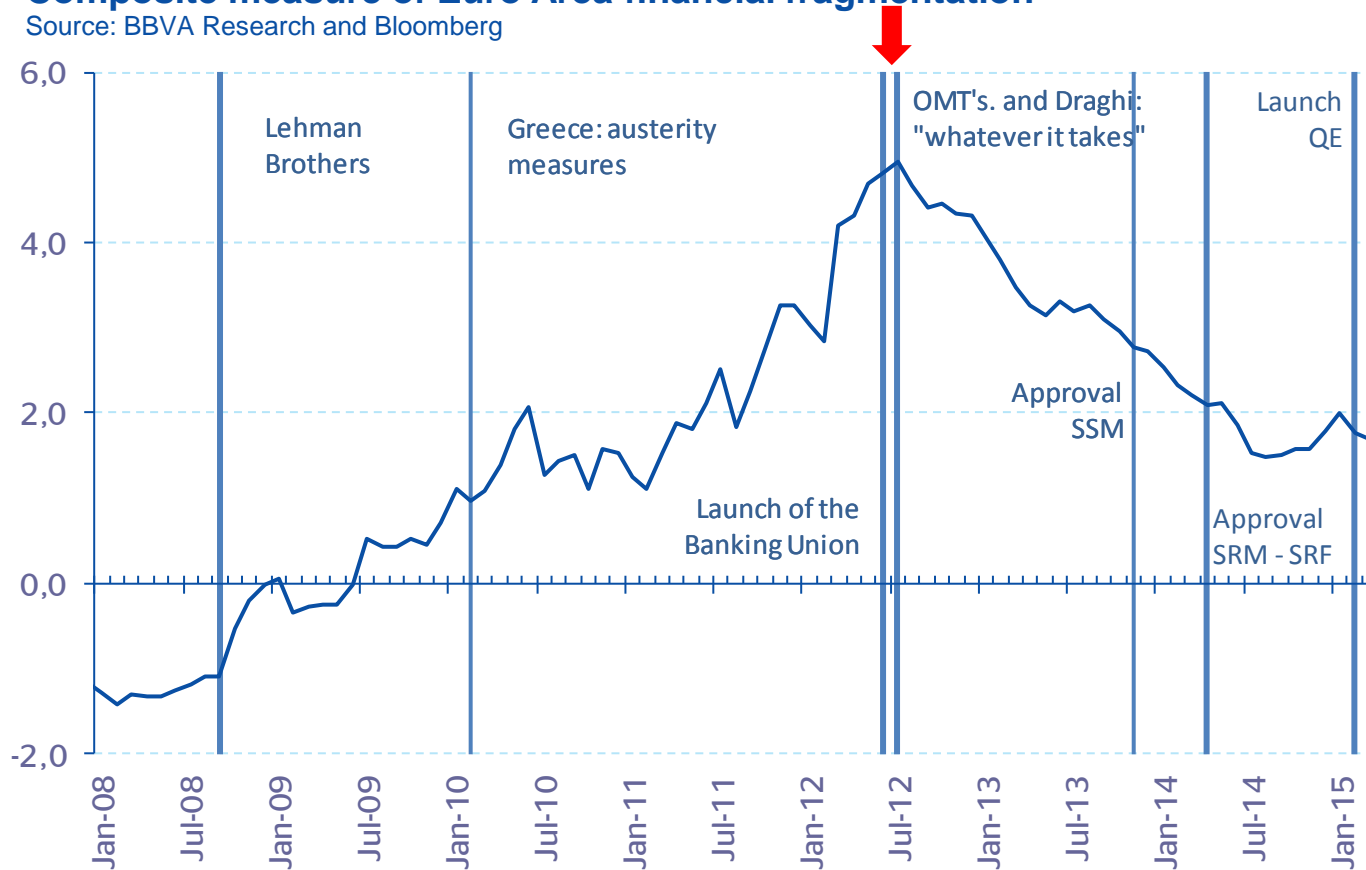
Results since 2009

- Credit stock +0.8% (corporates +10.7%, households -2.3%).

Euro Area: A successful coordinated reaction

Composite measure of Euro Area financial fragmentation

Source: BBVA Research and Bloomberg

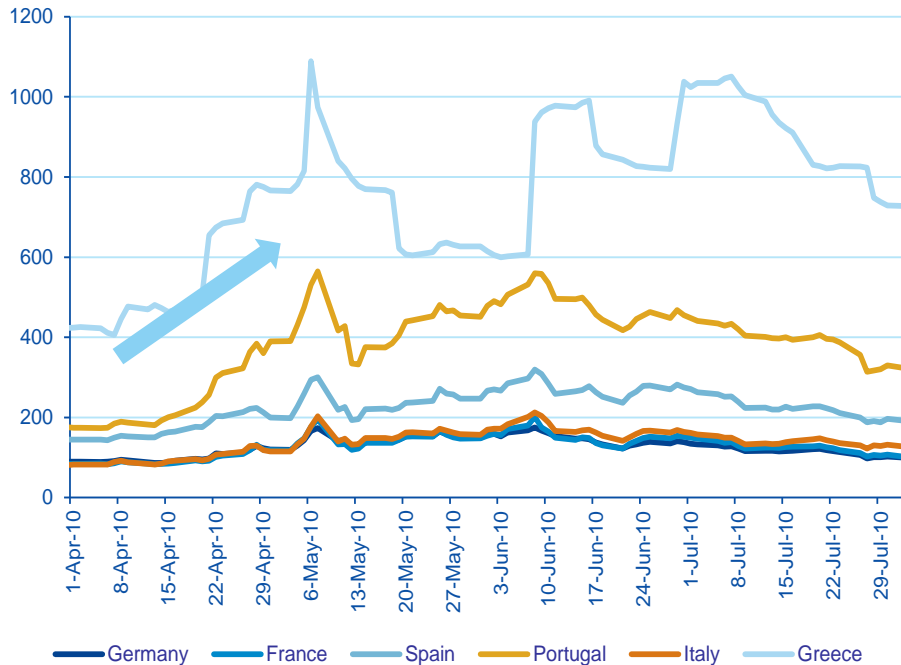


High fragmentation levels and sovereign-bank loop where incompatible with a monetary union

Euro Area: The banking union has helped eliminating the contagion of banking crises

Banks' CDS (weighted average, by assets)

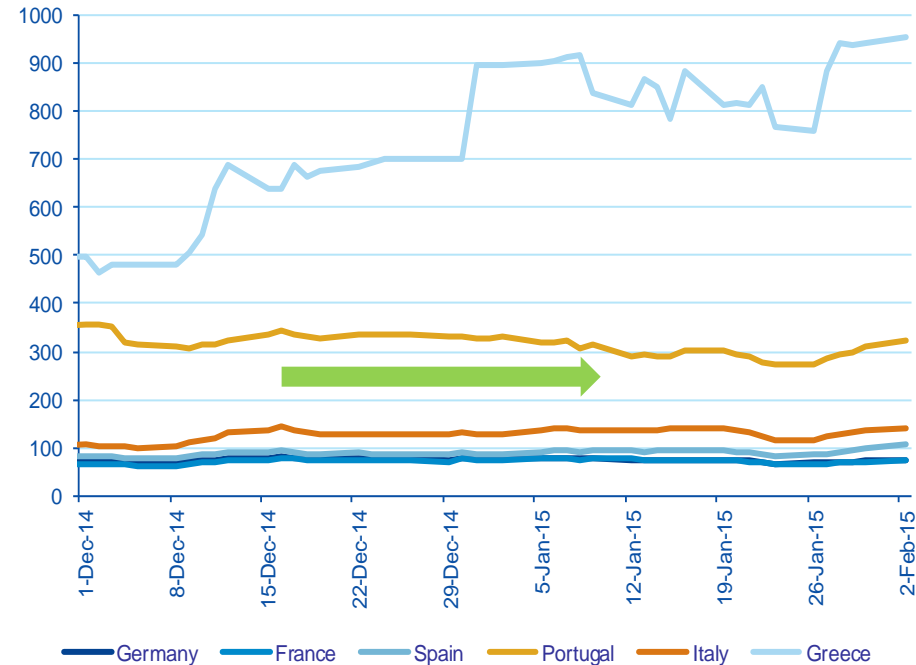
Source: BBVA Research and Bloomberg



**Greek first rescue:
May-10**

Banks' CDS (weighted average, by assets)

Source: BBVA Research and Bloomberg



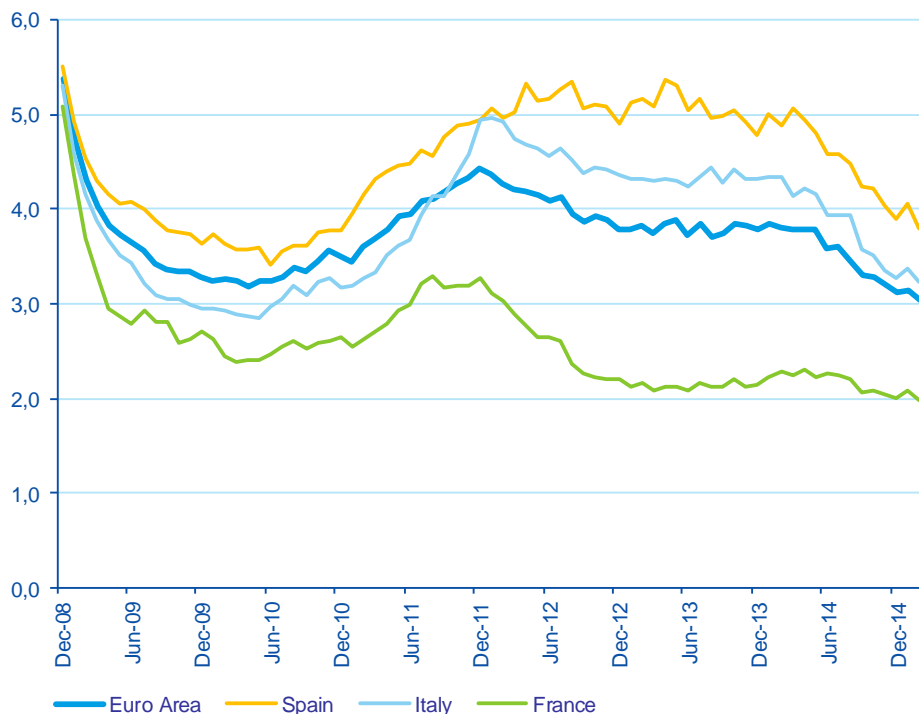
**Greek elections and
deposit run: Jan-15**

Euro Area: Credit conditions have not normalized completely in some countries

Interest rates on new bank lending (%)

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

Source: ECB



Determinants of interest rates on new bank lending

(to non-financial corporations, less than 1 million €)

Source: BBVA Research based on ECB and Bloomberg. Working Paper to be published

	France	Spain	Italy
Commercial policy	1,55	--	--
ECB official rate	0,79	1,37	1,26
Spread 12 months (12m-Euribor)	1,19	0,83	--
Spread EMU (10y-Euribor)	0,28	0,41	0,18
Spread sovereign (10y country-10y EMU)	--	0,70	0,69
Firms default rate	--	0,12	0,21

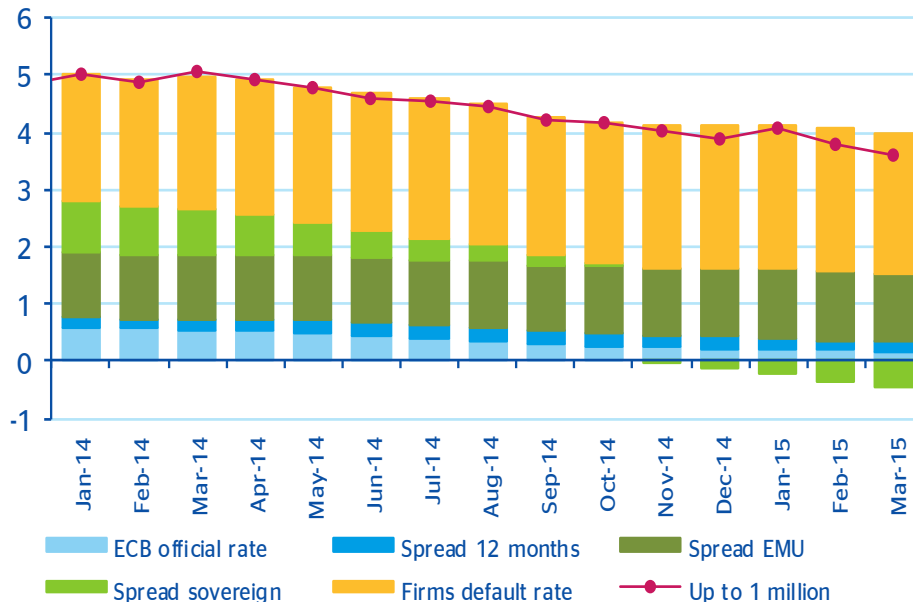
In peripheral countries, credit rates depend on sovereign spreads and credit risk (default rate)

Euro Area: The normalization of credit risk will help reducing interest rates, for firms...

Spain. Interest rates on new bank lending

(to non-financial corporations, less than 1 million €, %)

Source: BBVA Research based on ECB



The reduction in the Spanish risk premium and in the ECB official rate have explained most of the fall of credit rates

In the future, the ongoing reduction in firms' default rate (credit risk) will contribute to the contraction of credit rates

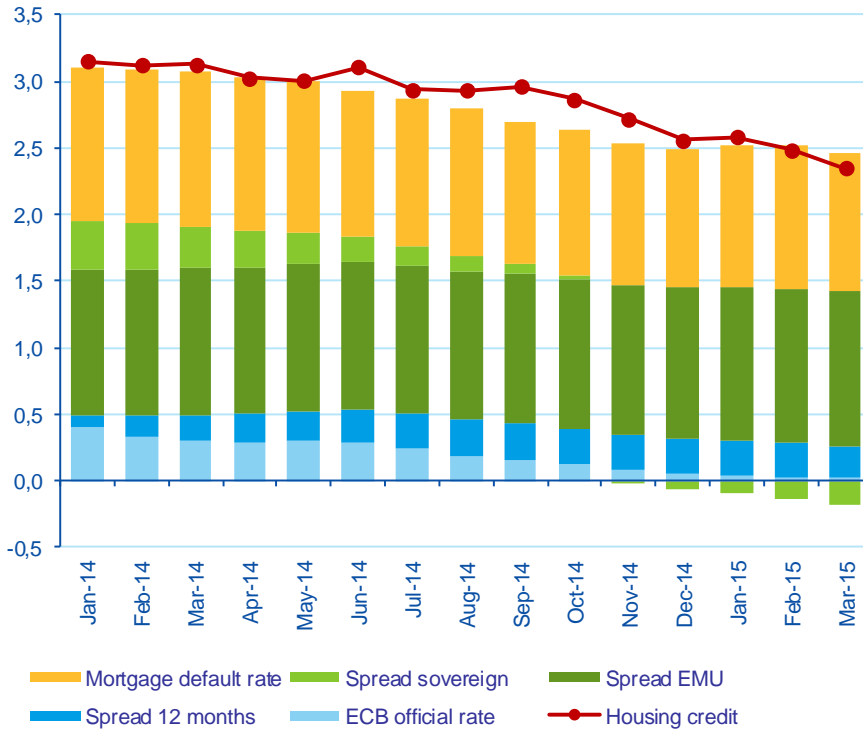
The reduction of credit prices should have a positive influence on solvent demand

... and for households

Spain. Interest rates on new bank lending (%)

(to households, housing credit, €)

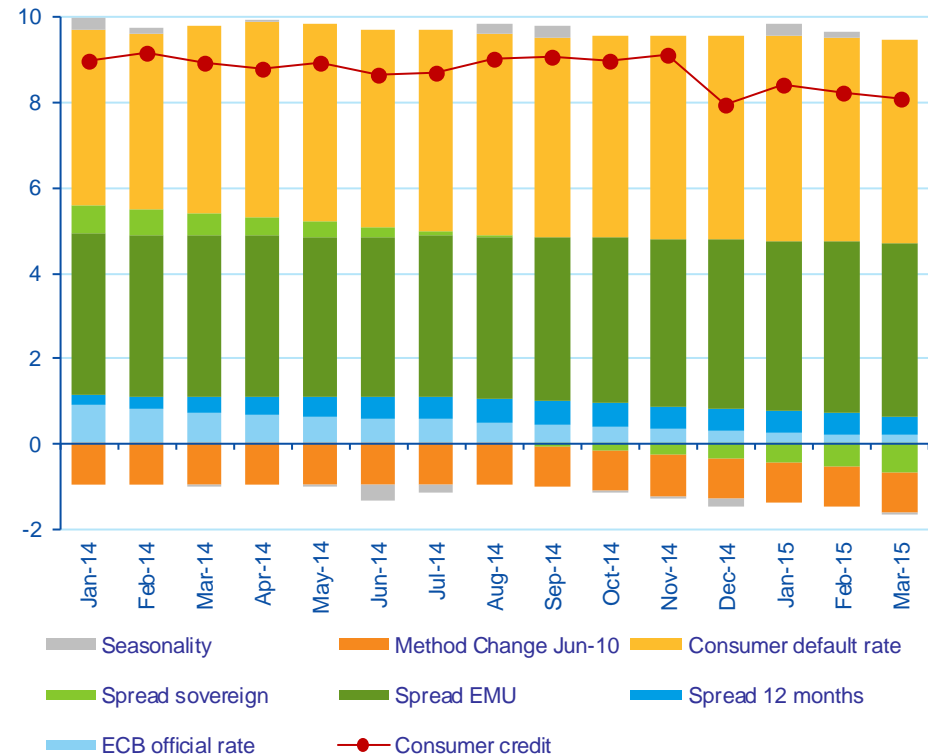
Source: BBVA Research based on ECB



Spain. Interest rates on new bank lending (%)

(to households, consumer credit, €)

Source: BBVA Research based on ECB



Spain: A deep restructuring of the financial system is bearing fruit

Phase 1

2008

Creation of FAAF and increased coverage of DGF

2009

Creation of FROB. Injection of 10bn € into savings banks

2010

Reform of legal framework of savings banks

2011

Minimum capital requirement of 8% (general) or 10%

Phase 2

Feb-May 2012

New regulation: 80bn € in provisions and capital buffers

June-Sep 2012

Financial assistance program, MOU and capital needs by bank

Post-MOU

Creation of Sareb and transfer of problem assets

Post-MOU

Liability management exercises (burden sharing)

Spain: Changes in the insolvency law can facilitate debt restructuring

Corporate Insolvency Law

- ✓ Strengthen in-court debt restructurings and out-of-court refinancing agreements
- ✓ Priority and secured creditors can be bound by majority acceptance of a restructuring plan
- ✓ Liquidation is made more conducive to going concern sales (no need of consent from creditors)

Personal Insolvency Law

- ✓ Debt discharge and a fresh start, after trying to reach an out-of-court settlement, the liquidation of the debtor's assets and the fulfillment of a payment plan for five years
- ✓ Good Practices Code can be applied to more clients
- ✓ The foreclosure moratoria is extended until 2017



Implemented changes facilitate restructuring processes, tackle debt overhang, promote a better allocation of available resources and foster entrepreneurship

Risk: Still recovering from crisis. Effect on payment culture?

Spain: Alternative finance is being promoted, but it is a long term process

Spain. Current size of alternative finance

Source: MARF, MAB, IEE, Crowdfunding Spanish Association

	Concept	EUR Million	% Private Sector New Credit, 2014
MARF	Issuance	565	0,14%
MAB	Market Cap	1.692	0,41%
Venture capital	New funds, 2013	872	0,21%
Business Angels	Investment 2013	63	0,02%
Crowdfunding	New funds, 2014	62	0,01%

The less regulated shadow banking can bring about risks (as part of the financial system did)

Alternative sources of funding should be under similar scrutiny than banks, ensuring a level playing field

The development of alternative funding will take time, so in the mean time we need a solid banking system to support the economic recovery

Alternative finance can be a complement to bank credit, for the first stages of a project or risky initiatives

3 The future

What are the plans in Europe?

Completing the Banking Union

Single Deposit Guarantee Scheme

Public backstop

Fiscal Union

Common Budget

Common Independent Fiscal Authority

Risk Sharing
(Eurobills, Debt redemption fund)

Reforming the Treaty

Bringing the instruments created during the crisis under the European architectural framework

Capital Markets Union

Deepening the Single Market

Eliminating barriers & harmonising rules

Promoting alternative sources of finance

Completing the reforms will be a lengthy process

What else could be done?

Information

European credit register (ECB end-2016)

Standard business reporting: simple (for SMEs) but not too much (for banks to have all the information)

Increase SMEs' size and foster exports

Avoid cliff effects: Fiscal and tax policies based on companies' size

Simplify administrative processes

Risk-sharing (liquidity is no longer an issue)

Public guarantees, co-financing: European Long-Term Investment Fund, Juncker Plan...

Basel III related reforms (review standard method)

It is key to analyze the combined effect of new regulation

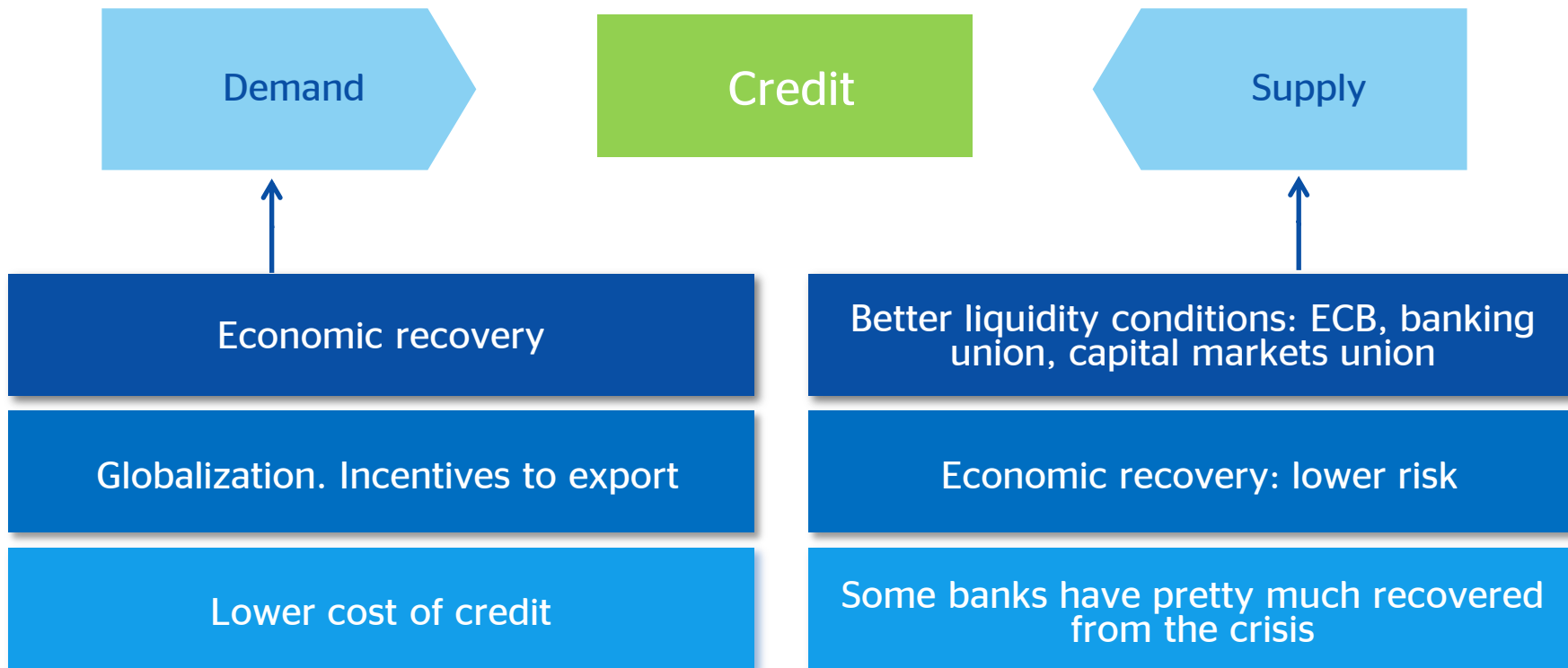
Alternative finance

Fiscal incentives for investors

SME-backed bonds eligible as ECB collateral

Alternative finance cannot replace bank lending in the short to medium term (size in Spain ~ 0.5% of GDP)

Measures taken and the ongoing economic recovery make us optimistic



After the crisis, credit should return to a more sustainable path of growth with a more balanced split by sectors