Banking Outlook

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Closing date: **22 November 2017**

Summary

1. Trends and developments in the Spanish banking sector

The results of the system in the first half of the year were marked by the resolution and sale of Banco Popular. The losses of more than €12 billion posted by this bank in the half-year weighed down the accounts of the sector as a whole, which presented total losses of €6.18 billion for the first six months of the year. NPLs maintained the declining trend that started in January 2014. All categories of new lending showed positive rates of YoY growth in the first nine months of 2017, especially those of new lending to SMEs and households, although the deleveraging of the economy continues.

2. The Italian banking sector: Improving but from very low levels

The financial crisis impacted all European countries and, in particular the Italian financial system. Notwithstanding the sector restructuring effort and the actions taken by the Italian government, in the last quarter of 2016 Italian banks were still below EU-average in the main banking indicators. However, during the first half of 2017 the Italian banking system has been showing signs of recovery.

3. The likely pro-cyclicality of the IFRS 9 accounting rules: Spanish banks as an illustration

Following the financial crisis, accounting rules have been reformed with the aim of recognising losses earlier in the cycle. This seeks at enhancing transparency and the effectiveness of market discipline so that market concerns regarding capital adequacy in a crisis are reduced. However, the new accounting rules are not spared of shortcomings. In particular, some issues with respect to modelling (including data availability) may raise some concerns and the new rules can generate some pro-cyclical effects that are shown for the Spanish banking system.

4. European strategy on Non-Performing Loans

There are several ongoing European initiatives in order to tackle NPLs, like a new priority action in the Capital Markets Union or the Council Action Plan. Policy options are focused on three areas: enhanced supervision, the reform of the insolvency frameworks and the development of secondary markets for NPLs. For example, the ECB has recently issued a consultation on an Addendum to its NPLs Guidance (applicable to significant banks under the SSM) that sets the minimum provisions coverage required, and enables bank to decide whether to cover the deficit via provisions or a deduction from own funds. This proposal is being reconsidered by the ECB, due to the negative reaction it has originated. More recently, the European Commission issued a similar consultation that enables banks to apply a deduction on shareholders' equity or reduce the collateral assets' value.

5. Latin America: The high density of assets strengthens banks' solvency

Latin America's financial systems have a high density of risk-weighted assets (RWAs) as a proportion of total assets, as high as 80% in Argentina, Chile, Colombia and Peru. Despite Basel III's not yet having been adopted in several of these countries, the high asset density is a factor bolstering the capitalisation and solvency of these countries' banks and enabling them to face the introduction of the Basel III leverage ratio unperturbed.

1. Trends and developments in the Spanish banking sector

The tables and data are to be found in the appendices to this document. The majority of the data come from Chapter 4 of the Banco de España Statistical Bulletin. The analysis of the Spanish banking sector is confined to banking business in Spain (important: see footnote on page[1]).

Results of the sector

- The results of the Spanish banking sector in the first half of 2017 were heavily affected by the resolution and subsequent sale of Banco Popular to Banco Santander in June. According to data provided by Santander, Banco Popular posted losses of €12.13 billion in the half-year, due to several factors. The most important of these were: 1) €7.8 billion on cleaning up the real estate portfolio; 2) non-monetisable tax assets of €0.98 billion; 3) a €1.14 billion adjustment to goodwill; 4) an adjustment of €0.4 billion to held-to-maturity bonds of Popular. These non-recurring items directly affect the sector's accounts for the half-year, and are the main reason for the losses posted in the period.

- According to the foregoing (Table 2), the system posted losses of €6.18 billion after tax for the half-year (profit of €3.51 billion in the first quarter of the year).

- The first few lines of the P&L account continue to show signs of weakness as in previous quarters, due basically to the interest rate environment. Thus the financial margin fell by 3% for the half-year and net gains on financial transactions and other income were down by 24% relative to the first half of last year. These declines could not be offset by the 9% increase in fee income. The gross margin fell by 7% YoY for the half-year.

- Expenses increased slightly in the first six months of the year due to general expenses (+7% YoY), while personnel costs maintained the downward trend of the past few quarters (-3% YoY for the half-year). General expenses reflect the one-off effect of the restructuring costs of Banco Popular and its integration with Banco Santander. As a result of the lower revenues and increased expenditure, the cost/income ratio deteriorated to 55.5% and the net margin declined by 17% in the first six months of 2017 relative to the same period of 2016.

- The effects of the transaction referred to previously can be seen above all in the lower part of the P&L account, breaking the trend of the previous quarters in which normalisation of provisions and other value adjustments was starting to be habitual. In this regard, bad debt provisions increased by 53% in the half-year, and other results practically tripled due to the combined effect of the factors commented on previously.

1: Throughout the document, "€ billion" refers to thousands of millions of euros.

- The half-year closed with post-tax losses of €6.18 billion (€9.69 billion in 2Q17), as a result of the effects already commented on and the increase in tax paid by the sector in the second quarter, partly due to Banco Popular's non-monetisable tax assets.

Activity

- The deleveraging of the banking system continued (Table 1). The system's total balance sheet shrank by 2.1% to September 2017 and the weight of the banks' balance sheets in GDP stood at 233% at the same date. Furthermore there was a reduction in the number of offices and employees in the system, thus cutting the excess installed capacity (Table 3).

- The total volume of credit to the private sector continues to decline steadily (this is analysed in more detail later). On the liabilities side (Table 1) the volume of debt issued by banks continues to decline, in line with the funding gap (which is at an all-time low) and deposits are holding steady. Thus the more stable retail deposits fell by 1.8% in the twelve months to September (Table 6), although there has been a clear shift from term to sight deposits because of the interest rate environment and the meagre returns on term deposits (Table 8). Liquidity provided by the ECB showed an uptick in 2017 following the TLTRO auctions (up by 30% YoY to October), although remaining well below the peaks of 2012. We do not expect significant increases in this item in the future.

- Lastly, the capital in the balance sheet (Table 1) increases in 2017 (data to September) due to the recapitalisation transactions carried out in the system during the period. The increase is 30% since 2008 (€54 billion).

Spotlight on lending and NPLs

- With data to June 2017 all live lending portfolios continued their downward trend (Table 4), with the exception of non-mortgage lending to households, which was up by 2.7% YoY. The cumulative decline since 2008 in lending to the resident private sector ("Other Resident Sectors", ORS) is 34% or €626 billion, 55% of GDP). The declines continue to be sharper in lending to businesses, especially to those in the construction and real estate sectors (down by 8.4% and 68% respectively YoY since 2008).

- The NPL ratio in the system continues to decline. The total volume of NPLs in the sector stands at €104 billion, showing a 12% decline in the twelve months to September. The reduction from the high point of December 2013 is 46% or €94 billion. The reduction in NPLs is greater in lending to businesses (20% YoY) than in that to households, which shows a slight uptick due to lending to households not secured by mortgage. The unemployment rate stands at 8.33%.

- As for new lending transactions, with data to September 2017 all portfolios show positive variations relative to the YTD volumes for the first nine months of 2016. By portfolio, lending to SMEs and other lending to households show notable increases. At present the annualised volume of new lending is running at 35% of the average for the three years preceding the onset of the crisis.

Main ratios

- The deterioration in the cost/income ratio in the first half of 2017 reflects the effect of the absorption of Banco Popular, as already commented. As a result operating costs as a percentage of Average Total Assets rose above 1% for the first time since 2008 (Figure 6, Appendix 1). Profitability enters negative territory due to the losses of the second quarter of the year (Figure 5, Appendix 1).

- Solvency continues to strengthen. Total capital and reserves in the balance sheet reached 8.9% of total assets (Figure 3, Appendix 1), and the amount of equity in balance sheets more than doubled the amount of non-performing loans in the system, reaching 225% in September 2017 (Figure 2, Appendix 1).

- As regards liquidity, the ratio of ORS lending to ORS deposits fell to 108% as at August, 50 pp less than in 2008 (Figure 3, Appendix 1). The sector’s funding gap (ORS lending less ORS deposits) stood at less than 4% of the balance sheet, the minimum level of the series (Figure 4, Appendix 1).

- Provisions increased one-off in the second quarter due to the impact of Banco Popular. The “provisioning effort” (additions to provisions / net margin) and the “cost of risk” (net additions to provisions / average total lending), have increased significantly relative to previous quarters (Figure 1, Appendix 1).

International comparison

Comparing developments in the Spanish banking system with the average of EU banks (Appendix 2), the following are the main conclusions of the analysis of the data from the “Risk Dashboard” of the European Banking Authority (EBA), which show the average of 158 of the main EU banking institutions. The latest data available is from June 2017.

- The Spanish banks have more equity in their balance sheets and better cost/income ratios than their competitors from other European countries (Figure 1, Appendix 2), but their NPL ratio is clearly higher (Figure 2, Appendix 2) despite the continuing fall in the volume of NPLs. Moreover the negative profitability in thje half-year is due to non-recurring issues already commented upon (Figure 4, Appendix 2).

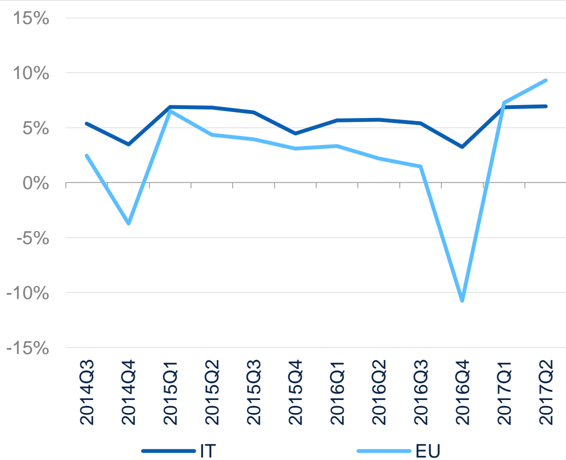
- As for the balance sheet clean-ups, the efforts made in 2012 and 2013 (Figure 3, Appendix 2) were necessary to show the fair value of their assets and to get into line with their European competitors. Thus NPL specific provision coverage has exceeded the European average since the beginning of 2014.

2. The Italian banking sector: Improving but from very low levels

The Italian banking sector was one of the most severely hit by the international economic crisis. Only recently is the system showing the first signs of recovery, but the starting point is so low that Italian banks remain well below the European average in some indicators.

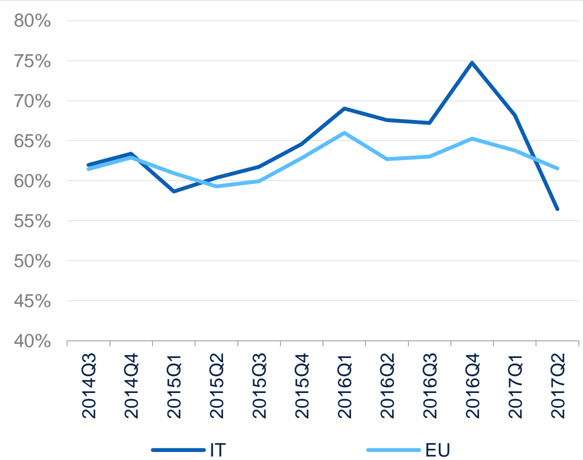
Regarding profitability, the levels registered in the first and second quarter of 2017 are back to positive territory after the negative results of December 2016. Last year a significant decline in income and an increase in operating costs related to the restructuring process led the Return on Equity to levels around -11%. The improvement in profitability is also reflected in the Italian cost-to-income ratio, which in the first quarter of 2017 narrowed the gap with the EU average reaching a 68% and in the second quarter reached an efficiency ratio of 56%, which is below the EU average.

Figure 1 Italian Banks ROE evolution, %



Note: The data of the Dashboard risk from the EBA is a selection of main banks.
Source: BBVA Research and EBA risk dashboard

Figure 2 Evolution of cost to income ratio, %



Note: The data of the Dashboard risk from the EBA is a selection of main banks data.
Source: BBVA Research and EBA risk dashboard

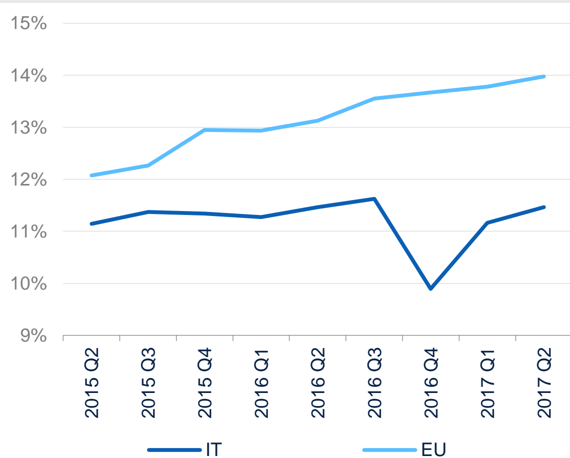
Solvency and prudential indicators recovered after the significant decline suffered at the end of 2016, in part due to the precautionary recapitalization of Monte dei Paschi, the Unicredit capital increase and the liquidation of two Veneto banks. Thus, CET1 *fully loaded* evolved positively, from 9.89% as of December 2016 to 11.47% as of June 2017, with a higher impact of the increase of CET1 than that of the reduction of the RWAs (the denominator). The improvement in solvency in the first quarter of 2017 is confirmed by the improval of the leverage ratio, which reached a 5.18% on June 2017, above EU-average (5.12%).

The system holds a liquidity surplus being the LCR ratio 195% as of June 2017, well-above the minimum requirements (80% for 2017) and the EU average (146%). The resort to the ECB liquidity is behind this number, and

therefore asset encumbrance (assets used as collateral) has increased significantly since 2015, reaching 29.6% as of June 2017. The Italian system is, after Greece, the country with the greatest share of central bank funding in credit institutions' liabilities.

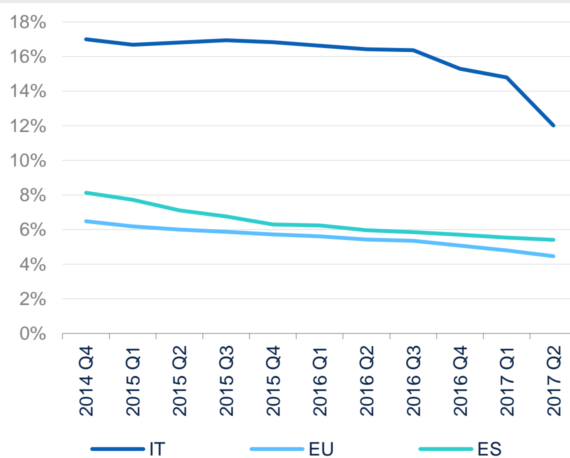
Asset quality issues are the main problem for the system, and have also evolved positively in the first half of 2017. Although the NPL ratio is still very high (12% as of June 2017, down from 16.4% as of June 2016), the coverage ratio is well above the EU average.

Figure 3 CET1 *fully loaded*, evolution, %



Source: EBA and BBVA Research

Figure 4 NPL Ratio, EU aggregated data, %



Source: EBA and BBVA Research

The improvement in asset quality has been partially caused by the insolvency reforms carried out both in 2015 and in 2016[2], which reduced the length of the proceedings and improved recovery rates. The The Law 132/2015 was introduced to enforce the protection to creditors in case of difficulties of the borrowers (foreclosure procedures are expected to become speedier and less costly) with forced sales improved by extra-judicial and more market-oriented mechanisms. Moreover, the law introduced an improvement in some of the available tools to provide solutions to a firm's crisis and to avoid irreversible insolvency[3]. On the other hand, Law 132/2016 and Law 119/2016 improved the process for recovering non-performing loans, reducing the length of proceedings, improving recovery rates and introducing new mechanisms to ensure a more effective protection to lenders.

2: See Plata, C; Rocamora, M; Rubio, A; (2017) *"Italian Banking Sector Improving, but from very low levels"* BBVA Research. Madrid
3: See Marcucci, M; Pischedda, A; Profeta, V;(2015) The changes of the Italian insolvency and foreclosure regulation adopted in 2015 in *Notes of Financial Stability and Supervision Nº 2* Banca d´Italia.

3. The likely pro-cyclicality of the IFRS 9 accounting rules: Spanish banks as an illustration

A lesson from the global financial crisis was that banks did not have enough provisions to confront a downturn of the unprecedented magnitude observed in the last global financial crisis, only comparable to the depression of the early 1930s. Following a G20 mandate, the new IFRS 9 rules incorporate a forward looking assessment by moving from an incurred credit loss (ICL) approach to an expected credit loss (ECL) approach for the measurement of impairment allowances with the goal of recognising existing credit losses earlier in the credit cycle.

This early loss recognition incorporated in IFRS 9 seeks at enhancing transparency and the effectiveness of market discipline so that market concerns regarding capital adequacy in a crisis are reduced. Financial statements will therefore reflect the weakness or strength of the reporting institution in a more timely and reliable way. Existing empirical work finds evidence pointing to the fact that the delayed recognition of expected losses has adverse effects on financial stability[4].

However, estimations of expected credit loss should be interpreted with caution and the benefits should be weighed against potential shortcomings. In particular, some issues with respect to modelling (including data availability) and some potential pro-cyclical effects could be highlighted.

The global financial crisis has cast doubt on the reliability of internal models. Under existing incurred loss models, the Basel Committee identified varied practices in accounting and regulatory provisions across jurisdictions and banks[5], which may contribute to level playing field concerns and highlighted substantial disparities in the calculations of RWA across banks for similar portfolios[6].

IFRS 9 establishes broad principles on how to model ECLs but it leaves many important details to the judgement of the reporting entities and their interaction with auditors and regulators. For instance, the shift of exposures from stage 1 to stage 2 (or vice versa) is critically dependent on the practical implementation of the concept of “significant deterioration in credit risk”.

The ECL as implemented through IFRS 9 may have pro-cyclical effects. These effects stem from two sources. On the one hand, from the transition from stage 1 to stage 2 of some loans, which require an increase of provisions corresponding to the expected loss over the life of the loan instead of the expected loss over 12 months. On the other hand, the expected losses parameters (i.e. PDs and LGDs) will follow a cyclical given pattern as ECL is based on a

4: See ESRB (2017): *Financial Stability implications of IFRS 9, July*.
5: See BCBS (2016): *Regulatory treatment of accounting provisions. Discussion Paper*.
6: See, for instance, BCBS (2016): *Reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches. March.*

point-in-time approach rather than an (average) through-the-cycle one. Moreover, these two effects can be magnified by the recency bias as the most recent events have a significant impact in forecasters even when they may have a low relevance.

We have estimated the impact of IFRS 9 for the Spanish banking system in the changeover phase and in a subsequent downturn. Although the impact of IFRS 9 seems limited for the system as a whole (a 21% increase in provisions equivalent to 67 bps of erosion of CET1 in the changeover), it is very heterogeneous across individual banks. According to our estimates, a downturn similar to the one simulated by the EBA Stress Test exercise of 2014 would lead, under IFRS 9, to an increase in provisions equivalent to more than 200 bps of CET1 capital in some Spanish banking groups that represent roughly 21% of the system measured in terms of RWAs (the CET1 capital ratio would drop below 9% in entities tha represent 6% of the system). Therefore, the early recognition of losses is expected to have a substantial impact on several entities. This effect may be even further exacerbated if a stress test were to be implemented during a downturn. Although the impact is not very large, it is still relevant and should be monitored, particularly by macroprudential authorities.

According to our simulations, the impact of provisions on banks using the standard approach for the calculation of capital requirements is more contained than on banks using IRB models. This is explained by a higher coverage with provisions. However, SA banks will incur in higher operational cost for the changeover to IFRS 9 because they will most probably have to build their models from scratch.

The potential unintended consequences of IFRS 9 and pro-cyclical effects warrant a series of remedial actions. They could include: a close monitoring by macroprudential authorities with the possibility of counterbalancing the effect through the various capital buffers; clear disclosures from the part of the entities to identify the effects on capital stemming from the implementation of the new rules and distinguish them from actual deterioration in capital levels; the implementation of dynamic transitional arrangement as proposed by the Basel Committee as they allow for ECL provisions to fluctuate over time, which is not the case for the static transitional arrangement.

4. European strategy on Non-Performing Loans

Currently, there is around €1 trillion of Non-Performing Loans (NPLs) in the EU. They constitute a problem because NPLs are expensive to maintain, imply a misallocation of capital, could exacerbate the bank-sovereign link, impair the monetary policy lending channel and could reduce new lending. Moreover, NPLs will become more costly after the entry into force of IFRS 9 and the new Bank of Spain regulation (*Anejo IX*) in Jan-2018.

There are several ongoing European initiatives in order to tackle NPLs. In particular, in the Capital Markets Union mid-term review NPLs were included as a new priority action. Additionaly, the Council Action Plan identifies future work streams, their deadlines and the European authority in charge of them. Currently, policy options are focused on three areas:

1. Enhanced supervision

The EBA has worked towards a common EU definition of NPLs and the ECB has published its “Guidance to banks on tackling non-performing loans”, which is applicable to all significant institutions under the Single Supervisory Mechanism (SSM).

The Council action plan invites the European Commission to interpret existing supervisory powers as regards banks’ provisioning policies (to ensure immediate action if necessary) and to consider introducing prudential backstops to new loans in the ongoing review of the CRR/CRD (possibly deductions from own funds). In that regard, the ECB has issued a consultation on an Addendum to its Guidance (applicable to significant banks under the SSM) that sets the minimum provisions coverage required, and enables bank to decide whether to cover the deficit via provisions or a deduction from own funds. More recently, the European Commission issued a similar consultation that enables banks to decide whether to covwer the deficit via a deduction on shareholders’ equity or reduce the collateral assets’ value.

Additionally, the ESRB has been mandated by the Council to develop macro-prudential approaches to prevent system-wide NPL problems by the end of 2018.

2. Reform of the insolvency frameworks

The Commission proposed in 2016 a directive on insolvency frameworks aiming at facilitating debt restructuring and that potential buyers of NPLs can have better information around insolvency outcomes (average recovery values, timing and cost of proceeding, etc..). The Council action plan invites the European Commission to publish the results of the benchmarking exercise on national loan enforcement, and Member States to consider carrying out peer-reviews on insolvency regimes in the EU.

On July 2017 the Commission launched a public consultation that considers the introduction of an ‘accelerated loan security’, which is a swift, out-of-court procedure so that the bank would have the right to acquire ownership of firms’ encumbered assets with a view to sell them.

3. Development of secondary markets for NPLs

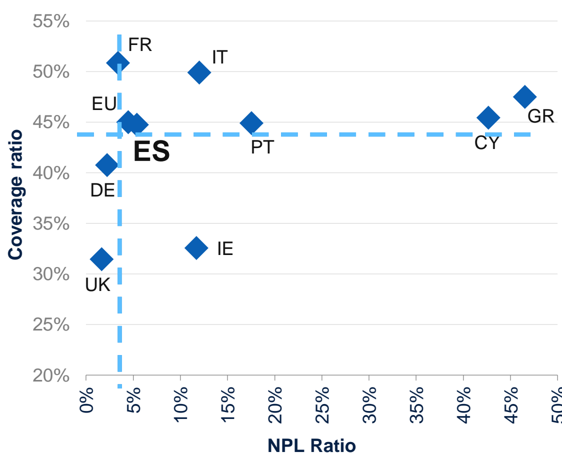
Direct sales of impaired assets to an outside investor can be a quick way to reduce the NPL stock. However, currently the bid-ask spread in the market is wide and there is a reduced number of transactions.

The Commission launched a consultation (closed on 20th October) which includes initiatives on this issue, aiming at fostering the transfer of loans, the functioning of third party servicers and on removing other constraints. On this regard, on January 2017 the EBA presented its proposal for an EU-wide asset management company (AMC or "bad bank"). Some of its disadvantages are the heterogeneity of national assets and procedures, the short term costs for banks and the mutualization of risks. More recently, the idea of a single European AMC seems to be discharged and the Council action plan invites the European Commission to develop a blueprint for national AMCs by the end of 2017.

Transparency could foster the development of the market. In the Council action plan EBA, ECB and European Commission are invited to propose initiatives on this, including the setting-up of NPL centralized data platforms, so that access to this information is easier, there is a single point of contact for potential investors and it is feasible to make packages of assets from different banks.

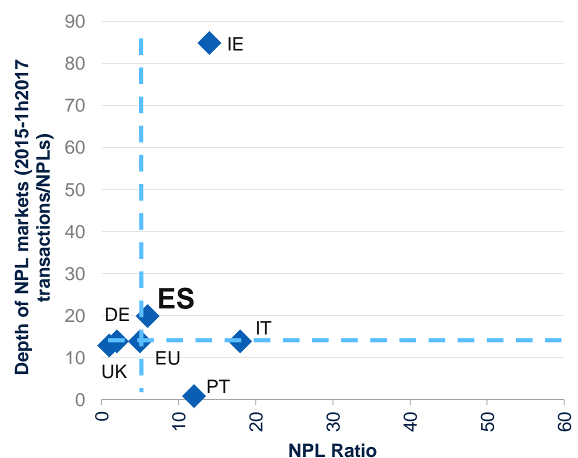
NPL securitisation and sale may additionally be an appropriate tool to remove more granular SME loans or unsecured loans (credit cards, consumer loans) from bank balance sheets. EBA has launched a Discussion Paper 'On the Significant Risk Transfer in Securitisation', which asks the industry on the best way to regulate NPL securitisations so as to foster the market. One of the main obstacles for a secondary market are the elevated transaction costs, which include taxes (like stamp duty) and registry costs. In any case, the introduction of a single European regulatory framework or the homogenization of rules among Member States (or even across regions in one country) will be crucial to eliminate regulatory uncertainty.

Figure 5 Non-Performing Loans ratio and coverage Jun-17 (%)



Source: EBA

Figure 6 Non-Performing Loans ratio and depth of NPL markets (%)



Source: KPMG and World Bank. Includes completed NPL portfolio transactions that are pooled with performing loans in the same loan deal.

5. Latin America: The high density of assets strengthens banks' solvency

Latin America's financial systems have demonstrated their strength in the past few years, maintaining high levels of profitability (ROE >10%), clean balance sheets with well-contained NPL ratios (<3% in most countries) and regulatory capital ratios comfortably in excess of the required minimums. Additionally, an analysis of other indicators of solvency, such as asset density or leverage ratios leads to the conclusion that these systems are well capitalised.

Latin American banks have a high density of RWAs to total assets - as high as 80% in Argentina, Chile, Colombia and Peru. In the case of Mexico the ratio was 66% as at December 2016. This is the combined result of several factors:

(i) **Heavy average weight of the loan portfolio in balance sheet totals**, representing 74% of total assets in Colombia, 71% in Chile and 66% in Peru. Argentina and Mexico, with greater exposure to public debt securities, financial investments and other liquid assets, had ratios of 50% and 48% respectively.

(ii) **Limited weight of the mortgage lending portfolio**, which with the exception of Chile (27%) accounts for less than 20% of the total portfolio in these countries. This differs from what we see in countries with higher per capita incomes and a more developed banking sector, where mortgage lending can account for as much as 50% of the total portfolio. In general terms mortgage lending is less risky, and for that reason its weighting for the calculation of RWAs is usually less than that of the other portfolios (Basel II establishes 35% for mortgage loans, as against 75% for consumer lending and 100% for businesses as a general rule).

(iii) **Limited or practically non-existent use of advanced models for calculating regulatory capital**. As at June 2017 only two Mexican banks (BBVA Bancomer and Santander México) used internal models to calculated risk-weighted assets. In the remaining countries, the banks continue to use standard models to calculate RWAs.

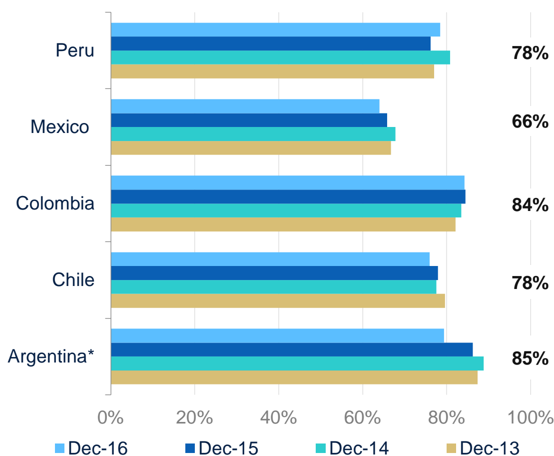
(iv) **Risk weightings under the standard model higher than those envisaged by Basel II.** With the exception of Argentina and Mexico, the countries have not adopted Basel III, but a comparison of national regulations leads to the conclusion that in general these countries adopt stricter risk weightings than those established by Basel.
We should highlight that one aspect that should reduce the density of RWAs in Colombia and Chile is the absence of requirements for operational risk - and in the case of Chile there is no requirement for market risk either. Nonetheless, the factors mentioned previously more than offset this effect. Once the requirements for these risks and others envisaged in Basel III have been adopted, *ceteris paribus* the density of RWAs will be even higher.

Leverage ratios in excess of 10% in nearly all countries

The high density of RWAs entails high minimum regulatory capital requirements, which translates into high leverage ratios (Figure 2). In all the countries analysed, accounting capital represents more than 10% of total assets in the balance sheet, with the exception of Chile which, with 8%, nevertheless maintains a very high ratio. In the countries that have yet to adopt Basel III, as is the case of Chile, Colombia and Peru, the quality and quantity of their banks' capital is frequently questioned. Although the Basel III framework is more demanding, (in that it requires deductions for intangible assets and better quality capital, among other things) the reality shows that the high density of assets leads to very high leverage ratios. This reflects a high degree of capitalisation for banks in general, which enables them to face the approach to more demanding international standards with relative equanimity.

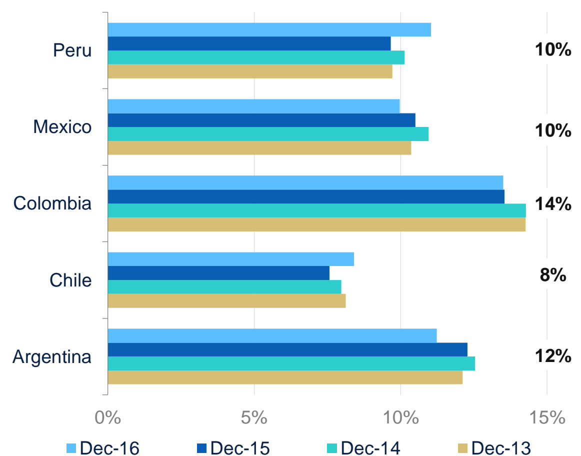
Therefore the introduction of the leverage ratio in Basel III, obliging banks with a low density of RWAs to improve their capital, will not be a problem for the financial systems of Latin America, where the high density of RWAs allows the introduction of a leverage indicator in the future to be fulfilled comfortably[7]. Thus it is not surprising that the differences among leverage ratios and regulatory capital are much smaller than for example in Europe, where many banks have Tier 1 capital ratios of double the leverage ratio.

Figure 7 Asset density (RWAs/Total assets)



Source: Central banks of Argentina (BCRA), Chile (SBIF), Colombia (SFC), Mexico (Banxico) and Peru (SBS)

Figure 8 Leverage ratio (Equity/Total assets)



Source: Central banks of Argentina (BCRA), Chile (SBIF), Colombia (SFC), Mexico (Banxico) and Peru (SBS)

7 At present only Argentina and Mexico have to comply with a minimum leverage ratio defined in Basel III as 3%.

Appendix 1: Main indicators for monitoring the Spanish banking system

Table 1 Summary Balance of the banking system. € bn and % variation

Assets	2011	2012	2013	2014	2015	2016	2017	Date	Growth rate 00-'08	08 - latest	y-on-y
Total lending	2,106	1,951	1,716	1,651	1,603	1,556	1,522	Sep-17	217%	-30.1%	-2.3%
Public corporations	*90*	*114*	*87*	*101*	*90*	*88*	*81*	*Sep-17*	*69%*	*53.6%*	*-12.2%*
Domestic resident sector	*1,783*	*1,605*	*1,448*	*1,380*	*1,327*	*1,276*	*1,249*	*Sep-17*	*234%*	*-33.2%*	*-2.3%*
Non residents	*234*	*232*	*180*	*169*	*186*	*191*	*191*	*Sep-17*	*164%*	*-24.5%*	*2.1%*
Fixed income securities and equity stakes	656	766	773	754	662	610	611	Sep-17	132%	22.8%	-4.6%
Fixed income securities	*406*	*509*	*493*	*492*	*415*	*366*	*354*	*Sep-17*	*135%*	*8.7%*	*-10.1%*
Of which: sovereign debt	*198*	*247*	*264*	*288*	*251*	*225*	*221*	*Sep-17*	*6%*	*120%*	*-10.0%*
Equity	*251*	*258*	*280*	*262*	*246*	*244*	*257*	*Sep-17*	*128%*	*49.7%*	*4.3%*
Interbank lending	251	279	211	155	164	163	209	Sep-17	81%	-20.7%	35.3%
Other assets (net of interbank lending/deposits)	387	426	326	354	331	319	301	Sep-17	230%	4.9%	-12.9%
Total assets	**3,400**	**3,423**	**3,026**	**2,913**	**2,760**	**2,647**	**2,642**	**Sep-17**	**184%**	**-18.0%**	**-2.1%**
Liabilities and Shareholders' Equity											
Customer deposits	1,934	1,725	1,684	1,686	1,637	1,578	1,557	Sep-17	169%	-22.7%	-2.2%
Public corporations	*70*	*69*	*63*	*76*	*77*	*54*	*65*	*Sep-17*	*263%*	*-15.2%*	*9.4%*
Domestic resident sector	*1,373*	*1,317*	*1,314*	*1,289*	*1,261*	*1,243*	*1,223*	*Sep-17*	*192%*	*-14.7%*	*-1.8%*
Non residents	*492*	*339*	*306*	*320*	*299*	*281*	*270*	*Sep-17*	*113%*	*-46.5%*	*-6.7%*
Interbank deposits	373	573	381	312	303	288	321	Sep-17	95%	1.8%	7.9%
Pro memoria: net interbank position	*122*	*294*	*171*	*157*	*139*	*125*	*112*	*Sep-17*	*215%*	*116%*	*-21.8%*
Debt issued	435	394	297	249	225	201	195	Sep-17	625%	-50.6%	-4.9%
Other liabilities	439	535	430	436	368	352	335	Sep-17	253%	4.9%	-9.6%
Shareholders' equity	220	195	233	230	227	227	234	Sep-17	134%	29.7%	1.1%
Pro memoria: ECB funding	*132*	*357*	*207*	*142*	*133*	*140*	*175*	*Oct-17*	*566%*	*89%*	*29.2%*
Total Liabilities and Shareholders' Equity	**3,400**	**3,423**	**3,026**	**2,913**	**2,760**	**2,647**	**2,642**	**Sep-17**	**184%**	**-18.0%**	**-2.1%**

Source: Banco de España Statistical Bulletin

Table 2 Summarized balance sheet of the banking system. Cumulative annual earnings € mn and % change

	2011	2012	2013	2014	2015	2016	2017	Date	Growth rate 00-'08	08-latest	y-on-y
Net interest revenue	29,565	32,739	26,816	27,118	26,410	24,296	11,809	Jun-17	92%	-32.8%	-3.0%
Net fees and commissions	11,750	11,275	10,931	11,257	11,237	11,059	5,989	Jun-17	79%	-8.0%	8.8%
Trading gains and other revenue	15,811	15,493	17,797	17,043	13,885	13,085	6,326	Jun-17	276%	-30.5%	-23.9%
Total revenue	**57,126**	**59,507**	**55,544**	**55,418**	**51,532**	**48,440**	**24,124**	**Jun-17**	**118%**	**-27.3%**	**-7.2%**
Operating expenses	-28,464	-26,951	-26,798	-26,116	-26,261	-26,388	-13,391	Jun-17	54%	-9.2%	2.0%
Personnel expenses	-16,889	-15,587	-15,108	-14,329	-14,182	-13,943	-6,818	Jun-17	54%	-23.8%	-2.6%
Other operating expenses	-11,574	-11,364	-11,690	-11,787	-12,079	-12,445	-6,572	Jun-17	54%	13.3%	7.3%
Pre-provision profit	**28,662**	**32,556**	**28,746**	**29,302**	**25,271**	**22,052**	**10,733**	**Jun-17**	**226%**	**-41.8%**	**-16.6%**
Loan-loss provisions	-22,668	-82,547	-21,800	-14,500	-10,699	-8,342	-5,651	Jun-17	620%	-25.9%	52.7%
Other income, net	-23,430	-37,142	-2,789	-1,739	-3,819	-6,993	-9,148	Jun-17	-299%	1375.1%	281.5%
Profit before taxes	-17,436	-87,133	4,156	13,063	10,753	6,717	-4,066	Jun-17	108%	-139.9%	-160.1%
Net attributable income	**-14,717**	**-73,706**	**8,790**	**11,343**	**9,312**	**6,078**	**-6,177**	**Jun-17**	**122%**	**-167.1%**	**-200.7%**

Source: Statistical Bulletin of the Bank of Spain

Table 3 Relative size and resources %, number and % variation of the banking system

	2011	2012	2013	2014	2015	2016	2017	Date	Growth rate 00-'08	08-latest	y-on-y
Lending to the private sector / GDP	166%	152%	139%	133%	123%	115%	110%	Sep-17	94%	-34.2%	-10.0%
Private sector deposits / GDP	128%	125%	126%	124%	117%	112%	108%	Sep-17	69%	-15.9%	-9.5%
Number of employees	248,093	236,504	217,878	208,291	202,954	194,283	n.d.	Dec-16	14%	-30.2%	-4.3%
Number of branches	40,202	38,237	33,786	32,073	31,155	28,959	28,123	Jun-17	17%	-39.1%	-7.4%

Source: Statistical Bulletin of the Bank of Spain

Table 4 ORS credit breakdown, defaults and non-performing asset ratios by portfolio. € bn and % variation

									Growth rate		
Lending volume	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Date**	**00-'08**	**08 - latest**	**y-on-y**
Loans to households	**793**	**756**	**715**	**690**	**663**	**652**	**656**	**Jun-17**	**236%**	**-20.0%**	**-1.4%**
Of which:											
Housing loans	627	605	581	558	531	517	510	Jun-17	270%	-18.6%	-2.5%
Other loans to households	167	151	134	132	132	136	146	Jun-17	159%	-24.5%	2.7%
Lending to corporates and SMEs	**971**	**830**	**719**	**674**	**644**	**605**	**592**	**Jun-17**	**237%**	**-41.8%**	**-3.6%**
Of which:											
Lending to real estate	397	300	237	200	179	161	152	Jun-17	517%	-67.6%	-8.4%
Other lending to corporates and SMEs	574	530	482	474	465	444	440	Jun-17	142%	-19.6%	-1.8%
Total lending to domestic private sector *	**1,783**	**1,605**	**1,448**	**1,380**	**1,327**	**1,276**	**1,249**	**Sep-17**	**234%**	**-33.2%**	**-2.3%**
Non-performing loans											
Loans to households	**28.7**	**37.0**	**49.4**	**46.8**	**37.0**	**35.7**	**35.7**	**Jun-17**	**1062%**	**46.7%**	**0.9%**
Of which:											
Housing loans	18.2	24.0	34.6	32.6	25.5	24.1	23.8	Jun-17	1878%	60.5%	-2.2%
Other loans to households	10.5	13.0	14.8	14.1	11.4	11.6	11.9	Jun-17	607%	25.2%	7.9%
Lending to corporates and SMEs	**109.9**	**128.4**	**146.1**	**124.6**	**94.2**	**79.2**	**68.6**	**Jun-17**	**818%**	**83.9%**	**-20.2%**
Of which:											
Lending to real estate	81.9	84.8	87.8	70.7	50.4	42.4	34.9	Jun-17	2790%	30.0%	-23.8%
Other lending to corporates and SMEs	28.0	43.6	58.2	53.9	43.7	36.8	33.6	Jun-17	232%	222.9%	-16.0%
Total lending to domestic private sector *	**139.8**	**167.5**	**197.2**	**172.6**	**134.3**	**116.3**	**104.0**	**Sep-17**	**808%**	**64.9%**	**-11.6%**
NPL ratio											
Loans to households	**3.6%**	**4.9%**	**6.9%**	**6.8%**	**5.6%**	**5.5%**	**5.4%**	**Jun-17**	**246%**	**83.4%**	**2.4%**
Of which:											
Housing loans	2.9%	4.0%	6.0%	5.9%	4.8%	4.7%	4.7%	Jun-17	434%	97.1%	0.3%
Other loans to households	6.3%	8.6%	11.1%	10.7%	8.7%	8.5%	8.2%	Jun-17	173%	65.9%	5.0%
Lending to corporates and SMEs	**11.3%**	**15.5%**	**20.3%**	**18.5%**	**14.6%**	**13.1%**	**11.6%**	**Jun-17**	**173%**	**215.8%**	**-17.2%**
Of which:											
Lending to real estate	20.6%	28.2%	37.1%	35.3%	28.2%	26.4%	22.9%	Jun-17	369%	300.7%	-16.8%
Other lending to corporates and SMEs	4.9%	8.2%	12.1%	11.4%	9.4%	8.3%	7.7%	Jun-17	37%	301.8%	-14.5%
Total lending to domestic private sector *	**7.8%**	**10.4%**	**13.6%**	**12.5%**	**10.1%**	**9.1%**	**8.3%**	**Sep-17**	**172%**	**146.9%**	**-9.6%**

(*) Total ORS credit incorporates total credit to households, total credit for productive activities, non-profit institutions serving households (NPISHs) and unclassified credit. From January 2014 it includes credit to Financial Institutions.
Source: Statistical Bulletin of the Bank of Spain

Table 5 Details of new lending transactions Cumulative annual earnings € bn and % change

Lending volume	2011	2012	2013	2014	2015	2016	2017	Date	Growth rate 03-'08	08-'16	y-on-y
Loans to households	**74.3**	**63.3**	**51.2**	**60.5**	**75.7**	**80.6**	**62.7**	**Sep-17**	**0.7%**	**-56.7%**	**5.3%**
Of which:											
Housing loans	37.5	32.3	21.9	26.8	35.7	37.5	28.3	Sep-17	-15.6%	-56.9%	0.6%
Other loans to households	36.8	31.0	29.4	33.7	40.0	43.1	34.3	Sep-17	21.3%	-56.4%	9.6%
Lending to corporates and SMEs	**527.5**	**484.8**	**392.6**	**357.2**	**392.6**	**323.6**	**250.5**	**Sep-17**	**29.2%**	**-65.2%**	**4.0%**
Of which:											
Less than €250,000	136.4	114.4	106.1	112.3	128.7	133.6	105.5	Sep-17	n.d.	-18.7%	7.3%
Between €250,000 and €1million)	37.7	31.6	28.3	34.0	36.8	36.3	29.2	Sep-17	n.d.	-21.0%	9.3%
Corporates (loans > €1mill.)	353.4	338.9	258.2	210.3	227.2	152.6	115.8	Sep-17	43.5%	-66.4%	0.8%
Total new lending flows	**601.8**	**548.1**	**443.9**	**417.7**	**468.3**	**404.1**	**313.1**	**Sep-17**	**23%**	**-58.0%**	**4.2%**

Source: Banco de España

Table 6 Detail of deposits of residents. € bn and % variation

	2011	2012	2013	2014	2015	2016	2017	Date	Growth rate 00-'08	08 - latest	y-on-y
Sight deposits	482	475	500	563	650	754	831	Sep-17	90%	88.5%	15.6%
Term deposits	706	693	677	597	509	404	320	Sep-17	272%	-56.9%	-26.6%
Total retail deposits	**1,188**	**1,168**	**1,177**	**1,160**	**1,159**	**1,157**	**1,151**	**Sep-17**	**163%**	**-2.7%**	**-0.4%**
Other deposits											
Repurchase agreements	60	60	64	60	42	32	24	Sep-17	-23%	-71.7%	-28.1%
Funds from financial asset transfers	54	43	37	32	25	23	22	Sep-17	14%	-76.2%	-8.0%
Hybrid financial liabilities	27	20	16	22	17	14	11	Sep-17	33%	-61.3%	-29.2%
Subordinated deposits	44	26	20	16	18	16	15	Sep-17	n.s.	-67.3%	-12.8%
Pro-memoria: Deposits in foreign currency	*28*	*30*	*30*	*27*	*29*	*28*	*26*	*Sep-17*	739%	-29.0%	-9.0%
Total deposits of domestic resident sector	**1,373**	**1,317**	**1,314**	**1,289**	**1,261**	**1,243**	**1,223**	**Sep-17**	**159%**	**-14.7%**	**-1.8%**

(*) Total ORS deposits does not match the data of Table 1 because it incorporates liabilities from asset transfer, subordinated deposits, CTAs and hybrid instruments.
Source: Statistical Bulletin of the Bank of Spain

Table 7 Interest rates on credit operations. Rates in % and variation in pbs

	2011	2012	2013	2014	2015	2016	2017	Date	Growth rate (bps) 03-'08	08 - latest	y-on-y
Loans. Stock (NDER)											
Loans to households											
Housing loans	3.12	2.61	2.11	1.89	1.53	1.30	1.22	Sep-17	178	-443	-11
Other loans to households	5.73	5.78	5.80	6.10	5.98	6.17	6.19	Sep-17	113	-88	10
Loans to corporates and SMEs	3.90	3.47	3.44	2.84	2.38	2.04	1.95	Sep-17	204	-360	-13
Loans. New lending transactions (APRC)											
Loans to households											
Housing loans	3.66	2.93	3.16	2.64	2.31	2.19	2.21	Sep-17	238	-362	-16
Consumer loans	9.11	8.32	9.52	8.98	8.43	8.14	8.83	Sep-17	237	-216	13
Other	6.29	6.23	5.92	4.91	4.28	4.26	4.41	Sep-17	224	-262	-37
Loans to corporates and SMEs (synthetic average)	4.03	3.66	3.57	2.73	2.58	2.30	2.35	Sep-17	112	-253	-15
Less than €250,000	5.57	5.67	5.54	4.56	3.61	3.29	3.07	Sep-17	n.a.	-148	-12
Between €250,000 and €1million)	4.79	4.27	4.03	2.91	2.20	1.91	1.83	Sep-17	n.a.	-206	-5
Corporates (loans > €1mill.)	3.53	3.00	2.83	2.10	2.07	1.63	1.76	Sep-17	n.a.	-95	-12

NDER: Narrowly Defined Effective Rate (APR less commissions).
APR: Equivalent Annual Rate. Narrowly Defined Effective Rate (APR less commissions).
Source: Statistical Bulletin of the Bank of Spain

Table 8 Deposit interest rate* Rates in % and variation in pbs

	2011	2012	2013	2014	2015	2016	2017	Date	Growth rate (bps) 03-'08	08 - latest	y-on-y
Deposits. Stock (NDER)											
Households deposits											
Sight deposits	0.28	0.21	0.22	0.17	0.12	0.06	0.04	Sep-17	6.5	-64	-3
Term deposits	2.76	2.72	2.08	1.39	0.75	0.30	0.17	Sep-17	232	-424	-23
Corporates and SMEs deposits											
Sight deposits	0.61	0.37	0.35	0.31	0.24	0.15	0.11	Sep-17	111	-167	-5
Term deposits	2.68	2.64	1.93	1.40	0.91	0.65	0.71	Sep-17	223	-367	0
Deposits. New transactions (NDER)											
Households deposits											
Sight deposits	0.28	0.21	0.22	0.17	0.12	0.06	0.04	Sep-17	30	-64	-3
Term deposits	2.79	2.83	1.50	0.66	0.39	0.11	0.10	Sep-17	225	-408	-5
Corporates and SMEs deposits											
Sight deposits	0.61	0.37	0.35	0.31	0.24	0.15	0.11	Sep-17	111	-167	-5
Term deposits	2.13	2.08	1.31	0.51	0.31	0.13	0.22	Sep-17	146	-326	4

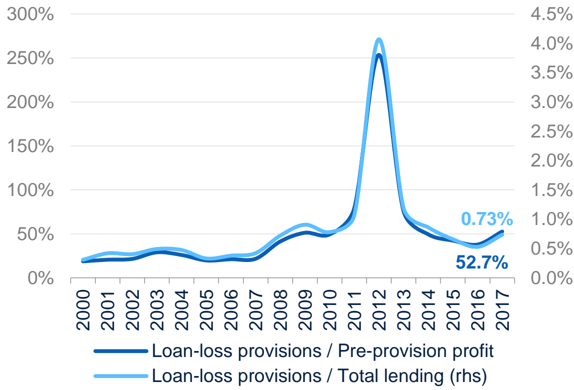
NDER: Narrowly Defined Effective Rate (APR less commissions).
APR: Equivalent Annual Rate. Narrowly Defined Effective Rate (APR less commissions).
Source: Statistical Bulletin of the Bank of Spain

Table 9 Main ratios

	2011	2012	2013	2014	2015	2016	2017	Date	Growth rate 00-'08	08-latest	y-on-y
Productivity											
Business volume* per branch (€'000)	78,494	76,409	81,761	83,229	83,085	86,975	85,350	Sep-17	168.2%	19.3%	2.7%
Profit before tax per branch (€'000)	-433.7	-2,279	123.0	407.3	345.2	231.9	-289.2	Jun-17	77.5%	-165.5%	-164.9%
Efficiency											
Cost-to-Income ratio (Oper. expenses / Total revenue)	49.8%	45.3%	48.2%	47.1%	51.0%	54.5%	55.5%	Jun-17	-29.3%	24.9%	9.9%
Operating expenses / ATA	0.86%	0.79%	0.83%	0.88%	0.93%	0.98%	1.01%	Jun-17	-43.4%	5.9%	10.4%
Profitability											
RoE	-7.4%	-35.5%	4.1%	4.9%	4.1%	2.7%	-5.4%	Jun-17	-3.4%	-151.6%	-199.8%
RoA	-0.52%	-2.55%	0.13%	0.44%	0.38%	0.25%	-0.31%	Jun-17	-23.6%	-146.5%	-162.7%
NIM (Net interest rev. / ATA)	0.89%	0.96%	0.83%	0.91%	0.93%	0.90%	0.89%	Jun-17	-29.6%	-21.6%	1.3%
Liquidity											
Loans-to-Deposits (resident sector)	150%	137%	123%	119%	115%	110%	108%	Sep-17	14.8%	-31.4%	-1.9%
Funding gap (Loans - Deposits, EUR bn)	594.4	436.8	270.9	220.1	168.3	118.9	97.7	Sep-17	349%	-85.8%	-20.1%
Funding gap / Total assets	17.5%	12.8%	9.0%	7.6%	6.1%	4.5%	3.7%	Sep-17	57.7%	-82.6%	-18.5%
Solvency and Asset Quality											
Leverage (Shareholders' equity / Total assets)	6.5%	5.7%	7.7%	7.9%	8.2%	8.6%	8.9%	Sep-17	-17.8%	58.3%	3.2%
Shareholders' equity / NPLs	158%	117%	118%	133%	169%	196%	225%	Sep-17	-74.3%	-21.3%	14.4%
Provisioning effort (Loan-loss prov. / Pre-provision profit)	79.1%	253.6%	75.8%	49.5%	42.3%	37.8%	52.7%	Jun-17	121%	27.4%	83.0%
Cost of Risk (Loan-loss provisions / total lending)	1.06%	4.07%	1.19%	0.86%	0.66%	0.53%	0.73%	Jun-17	134%	-26.7%	14.0%
NPL ratio (resident sector)	7.8%	10.4%	13.6%	12.5%	10.1%	9.1%	8.3%	Sep-17	172%	147%	-9.6%
NPL coverage ratio (total)	59.6%	73.8%	58.0%	58.1%	58.9%	58.9%	60.1%	Sep-17	-58.2%	-15.0%	1.4%
NPL coverage ratio (specific provisions)	37.1%	44.7%	46.9%	46.7%	47.0%	46.2%	43.7%	Jun-17	-39.0%	46.3%	-3.9%

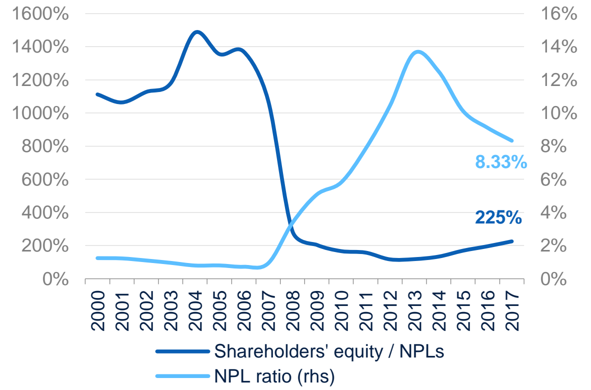
(*) ORS Credit plus ORS Deposits.
Source: Statistical Bulletin of the Bank of Spain

Figure A1.1 "Provisioning effort" (additions to provisions / net margin)



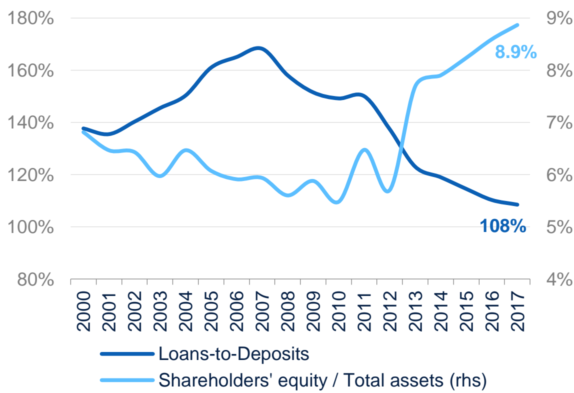
Source: BBVA Research

Figure A1.2 NPLs and Capital as % of NPLs



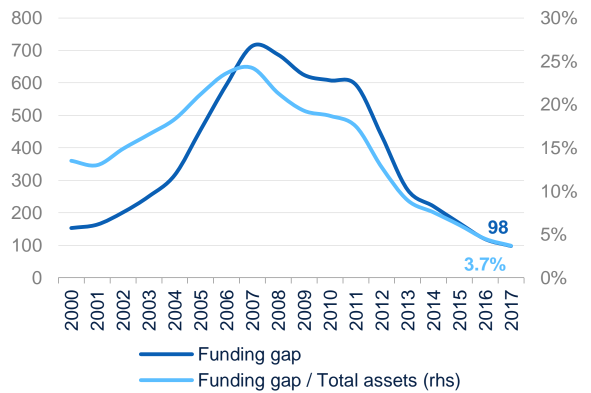
Source: BBVA Research

Figure A1.3 Liquidity and leverage



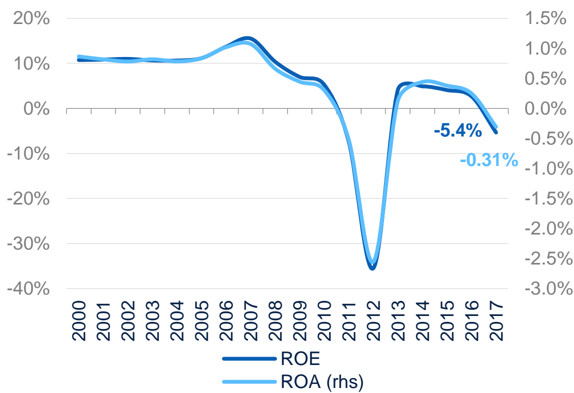
Source: BBVA Research

Figure A1.4 Funding gap (ORS lending – ORS deposits, € billions)



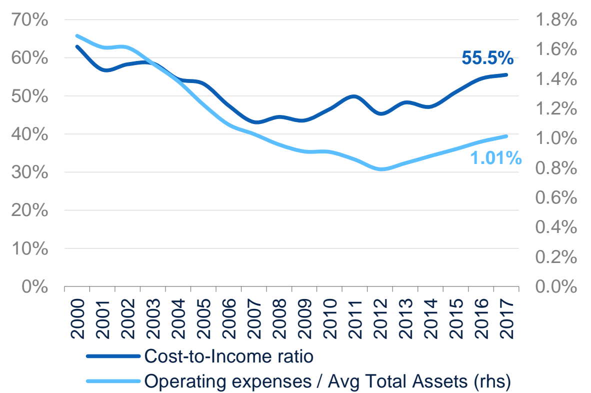
Source: BBVA Research

Figure A1.5 Profitability



Source: BBVA Research

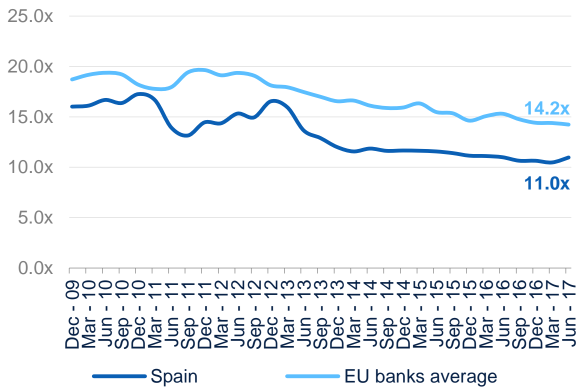
Figure A1.6 Cost/income ratio



Source: BBVA Research

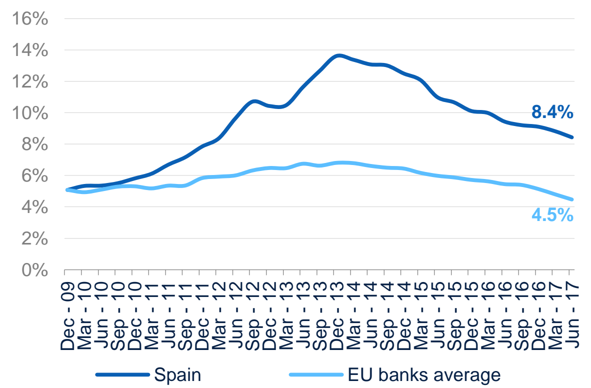
Appendix 2: Evolution of the Spanish banking sector

Figure A2.1 Total liabilities / Capital in balance sheet



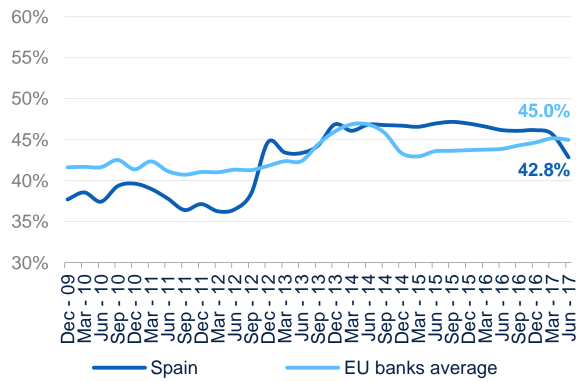
Source: EBA, Banco de España, BBVA Research

Figure A2.2 NPL ratio



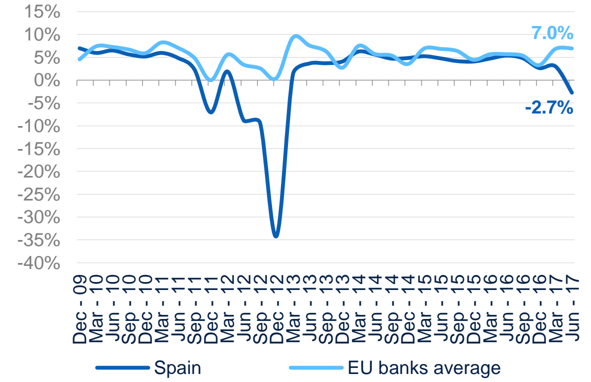
Source: EBA, Banco de España, BBVA Research

Figure A2.3 Coverage ratio (specific provisions only)



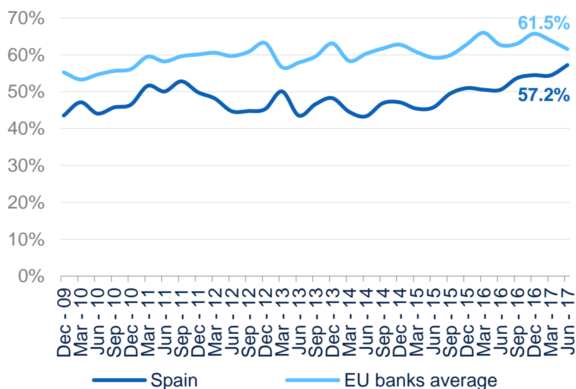
Source: EBA, Banco de España, BBVA Research

Figure A2.4 ROE



Source: EBA, Banco de España, BBVA Research

Figure A2.5 Cost/income ratio



Source: EBA, Banco de España, BBVA Research

Note: the data on averages of European banks come from the EBA's Risk Dashboard, composed of a panel of 158 major EU banks.

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