BBVA Research

Banking Outlook

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Financial Systems Unit

Creando Oportunidades

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Contents

Summary 3

1 Developments in the Spanish banking industry 4

2 Situation of European banking with regard to MREL 7

3 Private debt trends in the eurozone 9

4 Banking Union: little progress at the euro summit 11

5 Entry into force of the Fifth Anti-Money Laundering Directive (5AMLD) 13

Appendix 1: Main indicators for supervision of the Spanish banking system 16

Appendix 2: Trends and developments in the Spanish banking sector 23

Closing date: **2 August 2018**

Summary

1. Trends and developments in the Spanish banking sector

The Spanish banking industry made profits of 3.106 billion euros in the first quarter of 2018 compared to the losses posted in 2017, which were prompted by the sale of Banco Popular. Cleaning of bank balance sheets is gathering pace, while deleveraging of the private sector is ongoing. The efficiency and profitability of the system have improved in the first quarter of the year relative to levels last year.

2. Situation of European banking with regard to MREL

MREL requirements have been calculated under three subordination scenarios. The subordination requirement specifies the proportion of liabilities with loss-absorbing capacity in the event of resolution. For financial systems traditionally funded using senior debt, a broader subordination requirement means a greater shortfall of instruments eligible for MREL. Thus, based on information from the close of 2017, the requirements for the applicable sample range from €195bn under the subordination recommended by the EBA, €301bn under the subordination requirement recently approved by the Council (8% of *total liabilities and own funds*) and €526bn under a total subordination scenario.

3. Private debt trends in the eurozone

Since 2012, private debt in Europe has declined relative to GDP in the overwhelming majority of countries, except in those such as France. Households and non-financial corporations (NFCs) have scaled down their debt and Spain stands out as one of the countries experiencing one of the most pronounced decreases. There are signs that corporate bonds are becoming more prominent in the eurozone, although issuance of these is small compared to corporate credit, which has decreased in recent years. Spain has exhibited a good performance, although its private debt levels are still above average.

4. Banking Union: little progress at the euro summit

The June euro summit made scant headway regarding the aspects outstanding for culmination of the banking union. The only substantial decision regarding reform of the eurozone where there was consensus, and which affects the banking union was that the European Stability Mechanism (ESM) will become a backstop for the Single Resolution Fund, although the technical details will be discussed in the second half of the year, the aim being to approve this matter in December, together with reform of the mechanism itself. As regards the European Deposit Insurance Scheme (EDIS), there was reference to commencing policy negotiations, but this was without any definitive time-table.

5. Entry into force of the Fifth Anti-Money Laundering Directive (5AMLD)

The Fifth Anti-Money Laundering Directive seeks to improve on the previous norm of 2015, which was intended to stop the EU financial system being used to launder money and finance terrorism. The reform strives for adaptation to forms of unlawful acts that ensue from using new technologies and global interconnection of the financial system.

1 Developments in the Spanish banking industry

Tables and data can be found in the appendices to this document. Most of the data is taken from Chapter 4 of the Banco de España Statistical Bulletin. Analysis of the Spanish banking industry **is confined to banking business in Spain**[1].

Industry results

- In 2018 industry results are no longer affected by the resolution and the sale of Banco Popular. This undertaking produced losses of 13.56 billion euros in the second quarter of last year, which was a burden on industry results for the remainder of the year. The system achieved a profit after tax of 3.11 billion euros in the first three months of 2018 (table 2). This quarterly profit has only been higher five times since 2009.

- As in previous quarters, revenues remain weak. Net interest income fell 3% with respect to the first quarter of 2017, basically on the interest rate environment and the continued drop in credit volume, while net trading income and other income were down 22% YoY in the quarter. Net fees and commissions were up 3%, although they failed to make up for previous falls, which has meant that overall industry revenues in 1Q18 have contracted by 7.5% YoY. On the other hand, costs remain under control (+0.8% in the first quarter).

- As a result of developments in revenues and expenses the industry's efficiency ratio deteriorated to 54.8% in the first three months and operating income dropped 15.9% relative to the levels reached in the first quarter of 2017.

- In the lower portion of the income statement provisioning fell substantially in 1Q18 relative to the first quarter of last year (-54%) and the "other gains/losses" item shows a negative balance of 750 million euros, which compares very favourably with the losses of 11.586 billion euros for 2017 as a whole, which included several effects from the resolution of Banco Popular.

Activity

- Total assets in the system continue to shrink (table 1). Based on data as of May 2018, the industry balance sheet fell below €2.6trn for the first time since 2007 (221% of GDP). Similarly, the number of employees and bank branches in the system continues to decline (-31% and -41% as of December 2017 and March 2018 respectively, from the 2008 high, see table 3).

- The system balance sheet assets exhibit practically the same trend as in previous quarters. Lending to private sector residents is still shrinking (this is examined greater detail later on) and the volume of fixed income portfolios fell in terms of YoY change up to May 2018. On the other hand, there were increases in lending to non-residents, equity holdings and especially inter-bank lending, including positions open with the ECB (+38% in the past 12 months, though unchanged in 2018).

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

- Turning to liabilities (table 1), customer deposits fell slightly, while the volume of outstanding bank debt rose 15.8% YoY as of May 2018 (virtually stable since the close of 2017), partly due to the need to satisfy MREL requirements. Meanwhile sight and term deposits as of the same date were stable since May 2017 (table 6). Once again we are seeing a shift from term deposits to sight due to their low return. Recourse to ECB liquidity marks a departure from the upward trend of previous quarters and shows a slight fall of 2% YoY as of June this year. As for the cumulative volume of equity on the balance sheet (capital plus reserves) this is 26% more than at the onset of the crisis.

Spotlight on lending and NPLs

- The figures for lending and NPLs can be seen in Table 4. The stock of private sector credit remains on a downward path and had dropped 3.2% YoY as of May 2018. The volume of credit in the system represents 104% of GDP, as against 171% at the end of 2010 (table 3).

- The first quarter of 2018 saw recognition of the sale of Banco Popular loan portfolios and assets allocated to Blackstone for a gross book value of €30bn. This transaction was announced by Banco Santander in September last year but was concluded in the first quarter of 2018. This transaction evidently affects trends for the stock of credit in 2018, as will those transactions already announced by BBVA, Caixabank and Banco Sabadell. The selling of these loan portfolios will prolong the deleveraging process, yet they will give rise to a considerable improvement in the quality of system assets.

- By portfolios, based on data as of March 2018 the volume of lending to households remains at practically the same level of March 2017, with a YoY decrease in mortgage lending and a 7.5% rise in consumer credit. As for corporate lending, the total amount declined by 5.7% owing to the almost 16% contraction in lending to real estate activities on account of the aforementioned transaction involving the sale of assets by Banco Santander, while the rest of business lending (not relating to construction and real estate activities) dipped a shade as of March 2018.

- With respect to the system's NPL ratio, in May 2018 it fell to 6.7%, which is 23.5% (205 basis points) lower than in May 2017. The downward trend in NPLs witnessed since December 2013 became more acute in 2018 due to the sale of the Banco Popular loan portfolios, falling 26% YoY as of May (-€28.6bn since May 2017). Since the NPL peaks reached in December 2013, the volume of doubtful debts has fallen by 59% (-€116bn).

- Cumulative data as of June 2018 indicates that new lending is still considerably strong (+12.9% YoY), with growth in all portfolios. The volume of new lending for 2017 as a whole also rose, doing so by 5.8%.

Key ratios

- In the first quarter of 2018 system efficiency and profitability no longer show signs of the impact of the transaction involving the resolution and sale of Banco Popular and regained their previous levels. The efficiency ratio has thus improved from 57.1% for 2017 as a whole to 54.8%, while the volume of operating expenses is back at under 1% of Average Total Assets (Figure 6, Appendix 1).

- The system's profitability has returned to positive territory in 2018 (Figure 5, Appendix 1). ROE stands at 5.4% and ROA is at 0.57%, the highest level since 2008. The indicators for "provisioning effort" (provision allowances / operating income) and the "cost of risk" (provision allowances / average total lending) dropped away substantially in 1Q18 (Figure 1, Appendix 1).

- The system's solvency remains at comfortable levels. The volume of capital on the balance sheet reached 8.7% of total assets as of May 2018 (Figure 3, Appendix 1), and own funds on the balance sheet almost tripled the system's NPL volume (Figure 2, Appendix 1).
- Liquidity still does not represent a problem. The funding gap (Figure 4, Appendix 1) is at an all-time low, at 3.0% of total assets, far removed from its 2007 peak for the series historically (24% of the balance sheet, marking a decline of more than €600 billion).

International comparison

Comparing developments in the Spanish banking system with the average for EU banks (Appendix 2), the following were the main conclusions of the analysis of the data from the European Banking Authority (EBA) “Risk Dashboard”, which includes an average of 158 of the main EU banking institutions at consolidated level. The latest data available are from March 2018.

- The Spanish banks had more own funds on their balance sheet and were more efficient than their European competitors (Figures 1 and 5, Appendix 2).
- Even so, the system’s NPL ratio is clearly higher (Figure 2, Appendix 2) despite the fall-off in the volume of NPLs, this being accelerated in the first quarter of the year by the aforementioned transaction involving the sale of Banco Popular assets.
- Profitability has returned to positive territory after the impact of the losses arising from the resolution of Banco Popular in 2017 (Figure 4, Appendix 2).
- With respect to putting the balance sheet on a sound footing, the deterioration of the coverage ratio in 2017, which was caused by increased recognition of concealed NPLs within Banco Popular, was an isolated event and the system has returned to previous levels (Figure 3, Appendix 2).

2 Situation of European banking with regard to MREL

The European banking industry is in the process of adjusting its liabilities to the new requirements of MREL (*Minimum Requirement for Own Funds and Eligible Liabilities*), while some of its parameters are still pending specific determination. This study estimates the MREL shortfall for a substantial sample of European banks under three subordination scenarios, including that recently approved by the Council in May 2018.

MREL deficit: The subordination requirement, the larger gap in peripheral banks and the gap of subordinated debt in core countries' banks

Based on information as of December 2017, the MREL requirement for the sample of banks[2] range from **€195 billion under the subordination definition recommended by the EBA[3] to €301 billion under the Council's subordination scenario[4] and €526 billion under a total subordination scenario[5]**. Similarly, the gap for subordinated instruments[6] under these scenarios ranges from **€24 billion euros under EBA subordination to €167 billion under Council subordination and €526 billion under total subordination**.

The results are highly mixed for the various different subordination requirements (scenarios in the analysis) because some European financial systems have more wholesale funding in the form of senior debt, while others have a greater weight of subordinated funding. The subordination requirement is key to calculating both the shortfall of eligible instruments and the cost of complying with MREL given that subordinated instruments are the kind of issue that involves most risk and entails the most cost. Thus, the fall in profitability suffered for the sake of compliance with MREL is largely due to the shortfall of subordinated instruments.

By groups of countries, the shortfall of instruments eligible for MREL is highest in percentage points of RWAs for the peripheral countries[7] because their liabilities structure has a lower proportion of debt instruments. Nonetheless, the subordinated debt instruments deficit is lower than the European average[8] since their liabilities have a greater proportion of capital.

2: The sample in the study encompasses 63 European banks, including all the global systemically important banks (G-SIBs), as well as a large portion of Europe's other systemically important institutions (O-SIIs). The sample has additionally been rounded off with 13 banks that are neither G-SIBs nor O-SIIs, called "other banks".

3: Subordination recommended by the EBA in its "Final Report on MREL" of 14 December 2016: 13.5% of RWAs + CBR for O-SIIs and 14.5% of RWAs + CBR for G-SIBs (CBR: combined buffer requirements.

4: Council subordination: 8% TLOF (total liabilities and own funds) with exceptions that allow a portion of non-subordinated senior debt to be counted.

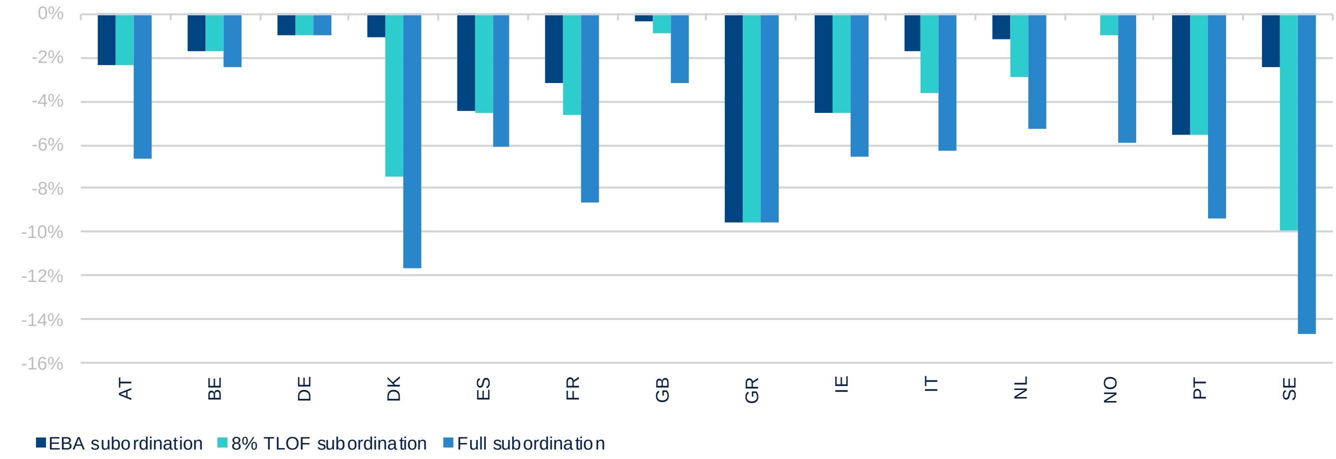
5: Total subordination: compliance with MREL via the full amount of subordinated instruments.

6: Subordinated to "preferred" or traditional senior debt statutorily (as in Germany), contractually (as in France or Spain) or structurally (those banks which issue senior debt from a holding company).

7: 3.7% under the EBA scenario, 4.4% under the Council scenario and 6.4% under the total subordination scenario (on average, European countries would have a gap of 2.2% under EBA subordination, 3.5% under Council subordination and 6% under total subordination).

8: 0.3% under EBA subordination and 1.3% under Council subordination (on average, European countries would have a gap of 0.3% under EBA subordination and 4.3% under Council subordination).

Figure 1 Gap for instruments eligible for MREL under three subordination scenarios, percentage of RWAs



Source: BBVA Research

The debt market in the EU and holders of “bailinable” debt

Analysis has been made of both the balances of debt issued as of December 2017 and issues by 16 European countries which are part of Additional Tier 1 capital (AT1), Tier 2 capital, senior debt and eligible senior debt for bail-in[9].

The core countries (Germany, Austria, Belgium, France and the Netherlands) plus the UK account for 73% of the balance of debt issued (77% of issues for the period[10]), while the peripheral countries (Spain, Italy, Portugal and Greece) represent 9% of the balance issued (16% of issues). The lower level of participation by the peripheral countries could be due to their business model, their funding structure being more reliant on deposits and capital, their greater RWA density which obliges them to have a higher percentage of capital and subordinated debt on their balance sheet, and the higher average cost they bear when issuing senior debt (representing 7% of the balance of senior debt issued) and subordinated debt, which is the first to absorb losses and the kind that entails most risk. The eurozone’s core countries, on the other hand, bear a lower cost than on average in Europe, in both subordinated[11] and senior debt issues, where they dominate the market since they account for over 70% of the total balance.

In summary, the periphery banks will suffer an increase in issuance costs of over the European average when they cover their gap (since this mainly comprises senior debt), whereas the gap for core countries, which mainly consists of subordinated debt, can be covered at a lower-than-average cost. On the other hand, the foremost investors in this kind of debt are financial institutions, which in most countries come to account for more than 30% of total debt in circulation in markets and even in some cases as much as 50%[12], which betrays a lack of diversification among holders of debt that has been issued that might lead to spillover in the event of resolution of some or other institution.

9: The latter is a new category created by Bloomberg and includes both Senior non Preferred debt and Senior preferred or traditional debt issued from a holding company.

10: Period under review: 2017 and the first quarter of 2018.

11: Issue cost, in weighted average terms, for subordinated debt issues in 2017-Q1 of 2018: 3.5%.

12: Cyprus, Germany, Spain, Finland, Greece and Portugal have over 50% of debt issued by their banks in the hands of the banking industry.

3 Private debt trends in the eurozone

From 2012 onwards and contemporary with the sovereign debt crisis in Europe, private debt in the eurozone peaked. From early 2008 up to 2012, private debt levels[13] (families and non-financial corporations, or NFCs) relative to GDP grew in most eurozone countries[14]. Yet from 2012 private debt continued to rise in absolute terms, though at a pace below the clip for GDP, meaning that private debt to GDP fell off, reaching 133% in 2017, which is 7 percentage points (pp) lower than in 2012.

A further key aspect is the increased preference of non-financial corporations for bond issuance on account of the drop in credit, low interest rates, copious liquidity and quantitative easing. At a time when the banks had to face stricter regulatory changes and others had to recapitalise, as well as due to QE on the part of the ECB, it was cheaper for NFCs to issue debt. Although eurozone corporate debt issuance still represents only a small portion of the debt of NFCs, the ratio of corporate bonds to GDP has practically doubled since 2008, reaching 12% in 2017.

NFCs in the eurozone have deleveraged in recent years and have swapped funding sources since 2012: bank credit to GDP has declined by 4 pp (especially in Slovenia: -34 pp, Spain15: -30 pp, and Portugal: -23 pp), while bonds have gained traction and, save for one or two exceptions, countries have raised their exposure to debt markets. The net result is that eurozone NFCs have deleveraged by 2 pp since 2012 (see table 1) and that their debt currently stands at 76.7% of GDP. Non-financial corporations in Slovenia, Spain and Portugal are those which have brought down their debt to GDP levels to the greatest extent. Despite this falling trend, countries such as Luxembourg, France, Slovakia, Germany and Cyprus have seen their corporate debt levels rise[16].

Household deleveraging has been more pronounced than that of NFCs. Eurozone families have deleveraged 5 pp since 2012 to 56% of GDP in 2017. The largest fall has been in Ireland, where 2017 household debt was 47% of GDP, 47 pp below the level of 2012. As with the NFCs, there are countries where household debt has risen. In Slovakia household debt to GDP has climbed 12 pp, albeit from low initial levels. This has also increased in Luxembourg (+7 pp), Belgium (+5 pp) and France (+3 pp).

Spain is one of the countries exhibiting the biggest drop in private debt relative to GDP, only behind that for Ireland and very similar to that shown by Portugal. Spanish private debt has dipped both in real and in absolute terms, and stands at 139% of GDP, which is 49 pp less than in 2012 and 62 pp less than in 2010. The most notable decrease has been among businesses (-30 pp since 2012 and -40 pp since 2010), yet Spanish households have recorded one of the most considerable contractions in the eurozone (-19 pp since 2012 and -22 pp since 2010). On the other hand, the rise in corporate debt issuance in Spain has been relatively modest. In 2017, corporate bonds were 3%[17] of GDP, showing an exposure level below that reached in the past few years by other European countries (for example, corporate bonds in Belgium jumped from 4% of GDP in 2012 to 15% in 2017). This said, diversification in sources of funding is something positive and could be considered as a first step toward a lower reliance by NFCs on bank lending.

Recently private debt levels in Europe have garnered greater attention due to the decision by France's central bank to require that banks should keep more capital in their counter-cyclical buffers[18]. This decision was prompted by the

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13 The definition of debt used is in consolidated terms and embraces families (credit) and non-financial corporations (corporate credit and bonds). Therefore, flows between participants in the same category are not taken into account (companies or families). In practice this has a substantial effect on corporate credit, as it cuts out trade credit and any other form of inter-company funding. The source of data used is the Quarterly Sector Accounts prepared jointly by the ECB and Eurostat.
14 Although the high for private debt in the eurozone was in 2012, the peak in Spain was recorded in 2010 (200% of GDP).
15 The fall since 2010 has been 40 pp.
16 In the case of Germany and Cyprus, NFCs have deleveraged but not households.
17 According to the Banco de España, debt issued was around 9% of GDP in April 2018.
18 Banque de France raised counter-cyclical buffer reserves from 0 to 0.25 percent of risk-weighted assets for banks. It also placed a limit on the exposure of systemic banks to highly indebted companies (5% of their capital).

rise in French private sector debt. We are not of the view that this might represent a problem for Spain, given that private debt levels have been steadily waning since 2012, even in absolute terms. Nevertheless, the Spanish private sector still faces debt levels that are marginally higher than on average in the eurozone (6 pp), particularly in the case of households (4 pp), for which reason there is still some scope for deleveraging.

Table 1 Private sector indebtedness, 2017

	Households	Securities	Corporate Loans	Total	Household debt/GDP 2017Q4 vs 2012Q4 pp change	Corporate debt/GDP 2017Q4 vs 2012Q4 pp change
Luxembourg	66.7%	36%	245%	347.6%	7	38
Cyprus	108.7%		211%	319.5%	-16	9
Ireland	46.9%	5%	173%	225.3%	-47	-9
Netherlands	104.3%	13%	95%	212.0%	-12	1
Belgium	60.0%	15%	105%	179.9%	5	-12
Portugal	68.1%	18%	76%	162.3%	-21	-26
France	57.7%	29%	62%	148.4%	3	7
Finland	66.2%	14%	65%	145.5%	4	-6
Spain	60.8%	3%	75%	139.3%	-19	-29
Euro Area	56.5%	12%	65%	133.2%	-5	-2
Austria	49.2%	11%	60%	120.2%	-3	-6
Malta	49.9%	6%	63%	119.5%	-10	-23
Greece	56.6%		61%	118.4%	-8	-5
Italy	40.8%	9%	60%	110.2%	-3	-12
Estonia	39.0%	6%	61%	106.3%	-1	-10
Germany	52.4%	6%	41%	99.8%	-3	2
Slovakia	39.8%	7%	46%	92.9%	12	5
Latvia	22.1%		61%	84.0%	-11	-2
Lithuania	32.2%	2%	47%	80.9%	9	11
Slovenia	26.8%	2%	46%	74.7%	-4	-34

Source: BBVA Research

4 Banking Union: little progress at the euro summit

The June euro summit made scant headway regarding the aspects outstanding for culmination of the banking union. The only substantial decision regarding reform of the eurozone where there was consensus, and which affects the banking union was that the European Stability Mechanism (ESM) will become a backstop for the Single Resolution Fund, although the technical details will be discussed in the second half of the year, the aim being to approve this matter in December, together with reform of the mechanism itself. As regards the European Deposit Insurance Scheme (EDIS), there was reference to commencing policy negotiations, but this was without any definitive time-table.

Outstanding elements: EDIS and the backstop mechanism for the SRF

Since 2014 the EU has been working on the construction of a genuine Banking Union. In this regard substantial progress has been achieved in record time in shaping a European system for regulation (known as the Single Rulebook), supervision (Single Supervisory Mechanism) and resolution (Single Resolution Mechanism) for banking institutions. Yet the framework is still to be finalised because depositor protection remains under national sovereignty and full banking union will not be achieved until a completely pooled EDIS and the backstop for the Single Resolution Funds (SRF) have been developed.

The European summit could have represented a milestone in adopting decisions in the right direction and making progress in piecing together the outstanding components. Yet the outcome was more modest than expected because the EU leaders only adopted an initial set of minimal decisions and failed to reach a “genuine agreement" on the next steps to take to move forward in concluding banking union and the framing of the future role of the European Stability Mechanism (ESM). They thus put off the decision-making side, which means that there is still a lot of work to do over the next few months in the run-up to the December summit.

Among the most discussed aspects is the need to reduce risks rather than share them, which is the chief concern of the northern European countries given the build-up of imbalances on the part of the banks in the southern countries during the crisis. In this respect, most of the northern member states prefer a gradual approach whereby measures to reduce risk are adopted before they are pooled (EDIS), while they suggest that more work is needed on cutting down NPLs on bank balance sheets even more. On the other hand, the periphery countries give greater priority to concluding banking union with a backstop for the SRF and the creation of an EDIS. This last point is essential for European savers to be able to enjoy the same level of security regardless of the country where they hold their bank account and this pillar would represent the final piece to add to those already in existence of supervision and resolution.

As a result of this deep divergence of views, and despite the fact that the European Commission, the ECB and the Single Resolution Board have all said that there has been sufficient progress in reducing risks among banks in the eurozone to make a start on designing risk-sharing measures such as the EDIS, at the euro summit the only decision reached was that work would begin on a road map for future policy negotiations without any clear commitment on the date when such talks should commence and without clarification on whether pooling would go as far as being total.

It was however decided to reform the ESM for it to take on the role of backstop for the Bank Resolution Fund with a maximum provision of 60 billion euros. If necessary, in any bank resolution the ESM will provide the necessary funds, which will subsequently be reimbursed by the Resolution Fund via apportioning contributions among the banks. The Eurogroup will prepare the terms of reference for the backstop and agree a time-table for work on subsequent of the ESM for December 2018. The negotiations on the backstop will be combined with those to reform the ESM. The ESM is expected to take on these new duties before the deadline envisaged for this, which is set for 2024, provided that risk reduction in the system continues. Finally, the ESM's new role will imply the disappearance of the direct bank recapitalisation instrument.

Given the summit's limited progress due to a lack of policy agreements, there is still a lot of work to do to finalise banking union. Specifically, progress must be made in technical definition of an EDIS to avert market fragmentation and a reversal of the progress already made. To this end it is key for there to be recognition of the big strides forward that have been achieved as regards risk reduction measures, even if we continue to make progress with these (particularly where NPLs are concerned) in parallel with steps aimed at pooling them. For banking union to be a truly successful project, there must be no loss of momentum in reforms and Europe should work on specific measures for the summit in December 2018.

5 Entry into force of the Fifth Anti-Money Laundering and Terrorism Financing Directive (5AMLD)

The draft for the Fifth Directive was tabled in July 5, 2016 as part of the EU Commission Action Plan against Terrorism Financing, which was announced on February 2016 in response to the string of terrorist attacks in Europe and the Panama papers leaks. According to the European Commission, it is reckoned that some 110 billion euros a year are generated from criminal activities in the EU, which is equal to 1% of the EU's GDP. The new Directive addresses five main topics:

- Increase transparency of financial transactions originated in high-risk countries.
- Strengthen the EU Financial Intelligence Units, as well as the cooperation between them.
- Establish centralized registries for bank accounts and domestic payments, and general systems for data recovery in all Member States.
- Address the risks derived from the use of virtual currencies for money laundering and terrorism financing.
- Tackle the risks linked to anonymous pre-payment instruments.

Greater control over virtual currencies

The Directive includes an amendment that seeks to prevent the risk implied by the use of virtual currencies to launder money and finance terrorism through the inclusion of providers of e-money custody services and virtual money exchange platforms as persons obliged to comply with the Directive. Such entities will have to apply due diligence controls with respect to their customers in exchanging virtual currencies for fiat currencies, thereby putting an end to the anonymity associated with them.

Control over the use of anonymous pre-paid cards

In order to control anonymity in the use of e-money (including anonymous pre-paid cards) due diligence measures must be applied to identify bank customers that carry out transactions that: i) exceed 150 euros made with electronic money; ii) use e-money instruments whose balance is in excess of 150 euros; and iii) use e-money instruments that allow for the withdrawal or reimbursement of cash in excess of 50 euros.

Moreover, European banks and financial institutions are only permitted to accept payments made with anonymous pre-paid cards issued in third countries if these cards are compliant with requirements that are equivalent to those established for the use of electronic money.

Electronic identification of customers

Customers' identity may be verified using electronic identification mechanisms (as long as they are available), reliable or trustworthy methods, or any other remote or electronic identification mechanism that has been regulated, recognised, approved or accepted by the national competent authorities.

Enhanced due diligence measures with respect to high-risk third countries

The Directive establishes in its Art. 18 bis, the adoption of enhanced due diligence measures with regard to customers and clients who reside in countries held to be high-risk jurisdictions or transactions that are carried out with such countries as the source or destination. These measures include:

- Obtain additional information about the client and/or the beneficiaries.
- Obtain additional information about the intended nature of the commercial transaction.
- Obtain information about the source of funds and the client's and the beneficiaries' wealth.
- Obtain information about the motives expressed by the client in previous transactions, actual or expected.
- Obtain authorization to initiate or continue the commercial transactions.
- Strengthen the supervision of the commercial relationship.

Improving access to information on the owner of companies, trusts and other legal structures

The previous Directive (4AMLD) already regulated the gathering, storage and access of information on the real owners of companies, trusts and other types of legal structures by member states, which have to keep such information on a Central Register. The 5th Directive (5AMLD) states that, in addition to the aforementioned dispositions, all information included in the Central Register of each member state should be accessible to the general public and all obliged entities. Furthermore, member states must ensure that national Central Registers are interconnected through the European Central Platform.

Financial Intelligence Units

The reform means that so-called national financial information units (SEPBLAC in Spain) will play a more substantial role and have access to the information on centralised registers of bank accounts and payment accounts so they can identify who holds them. Access can also be performed via automated and centralised means, such as, for example, a register or data querying system. Registers will likewise be inter-connected to facilitate information among EU countries.

Supervision and transposition

The supervisory Authority of the member state where the parent company of the consolidated Group is incorporated will be responsible of the proper application of this Directive and all related internal policies and procedures in the Group subsidiaries that operate in any other member state.

The Directive became effective on 9 July 2018, although member states have until 10 January 2020 to transpose it. In Spain, transposition of the Fourth Directive is still pending (4AMLD) and there is already a draft of the bill and the royal decree implementing this, which were published under a public hearing procedure in December 2017.

Appendix 1: Main indicators for supervision of the Spanish banking system

Table A.1 Summary of the banking system balance sheet. Billion euros and percentage change

Assets	2012	2013	2014	2015	2016	2017	2018	Date	Growth rate 00-'08	Growth rate 08 - latest	Growth rate y-on-y
Total lending	1,951	1,716	1,651	1,603	1,556	1,532	1,505	May-18	217%	-30.8%	-1.6%
Public corporations	*114*	*87*	*101*	*90*	*88*	*78*	*78*	*May-18*	*69%*	*46.5%*	*-9.0%*
Domestic resident sector	*1,605*	*1,448*	*1,380*	*1,327*	*1,276*	*1,254*	*1,219*	*May-18*	*234%*	*-34.8%*	*-3.2%*
Non residents	*232*	*180*	*169*	*186*	*191*	*200*	*208*	*May-18*	*164%*	*-17.8%*	*12.6%*
Fixed income securities and equity stakes	766	773	754	662	610	589	581	May-18	132%	16.8%	-2.9%
Fixed income securities	*509*	*493*	*492*	*415*	*366*	*330*	*334*	*May-18*	*135%*	*2.7%*	*-6.0%*
Of which: sovereign debt	*247*	*264*	*288*	*251*	*225*	*206*	*209*	*May-18*	*6%*	*109%*	*-3.2%*
Equity	*258*	*280*	*262*	*246*	*244*	*260*	*247*	*May-18*	*128%*	*43.5%*	*1.6%*
Interbank lending	279	211	155	164	163	235	236	May-18	81%	-10.3%	38.0%
Other assets (net of interbank lending/deposits)	426	326	354	331	319	297	297	May-18	230%	3.5%	-2.3%
Total assets	**3,423**	**3,026**	**2,913**	**2,760**	**2,647**	**2,653**	**2,619**	**May-18**	**184%**	**-18.7%**	**0.6%**
Liabilities and Shareholders' Equity											
Customer deposits	1,725	1,684	1,686	1,637	1,578	1,539	1,524	May-18	169%	-24.3%	-1.0%
Public corporations	*69*	*63*	*76*	*77*	*54*	*62*	*62*	*May-18*	*263%*	*-18.3%*	*14.6%*
Domestic resident sector	*1,317*	*1,314*	*1,289*	*1,261*	*1,243*	*1,203*	*1,196*	*May-18*	*192%*	*-16.5%*	*-1.9%*
Non residents	*339*	*306*	*320*	*299*	*281*	*275*	*265*	*May-18*	*113%*	*-47.4%*	*-0.4%*
Interbank deposits	573	381	312	303	288	327	330	May-18	95%	4.8%	5.0%
Pro memoria: net interbank position	*294*	*171*	*157*	*139*	*125*	*93*	*94*	*May-18*	*215%*	*81.4%*	*-34.3%*
Debt issued	394	297	249	225	201	222	223	May-18	625%	-43.5%	15.8%
Other liabilities	535	430	436	368	352	331	315	May-18	253%	-1.4%	-4.1%
Shareholders' equity	195	233	230	227	227	232	227	May-18	134%	25.9%	-0.6%
Pro memoria: ECB funding	*357*	*207*	*142*	*133*	*140*	*169*	*169*	*Jun-18*	*566%*	*82.6%*	*-2.0%*
Total Liabilities and Shareholders' Equity	**3,423**	**3,026**	**2,913**	**2,760**	**2,647**	**2,653**	**2,619**	**May-18**	**184%**	**-18.7%**	**0.6%**

Source: Banco de España Statistical Bulletin

Table A.2 Summarised banking system balance sheet. Cumulative annual results and percentage change

	2011	2012	2013	2014	2015	2016	2017	2018	Date	Growth rate 00-'08	latest	y-on-y
Net interest revenue	29,565	32,739	26,816	27,118	26,410	24,297	23,225	5,728	Mar-18	92%	-34.8%	-3.0%
Net fees and commissions	11,750	11,275	10,931	11,257	11,237	11,062	11,751	3,001	Mar-18	79%	-7.9%	3.0%
Trading gains and other revenue	15,811	15,493	17,797	17,043	13,885	13,070	11,758	3,102	Mar-18	276%	-31.8%	-21.8%
Total revenue	**57,126**	**59,507**	**55,544**	**55,418**	**51,532**	**48,429**	**46,734**	**11,831**	**Mar-18**	**118%**	**-28.7%**	**-7.5%**
Operating expenses	-28,464	-26,951	-26,798	-26,116	-26,261	-26,388	-26,667	-6,479	Mar-18	54%	-12.2%	0.8%
Personnel expenses	-16,889	-15,587	-15,108	-14,329	-14,182	-13,943	-13,935	-3,437	Mar-18	54%	-23.2%	1.1%
Other operating expenses	-11,574	-11,364	-11,690	-11,787	-12,079	-12,445	-12,733	-3,042	Mar-18	54%	4.8%	0.5%
Pre-provision profit	**28,662**	**32,556**	**28,746**	**29,302**	**25,271**	**22,041**	**20,067**	**5,351**	**Mar-18**	**226%**	**-42.0%**	**-15.9%**
Loan-loss provisions	-22,668	-82,547	-21,800	-14,500	-10,699	-8,344	-9,127	-867	Mar-18	620%	-77.2%	-54.1%
Other income, net	-23,430	-37,142	-2,789	-1,739	-3,819	-7,006	-11,586	-750	Mar-18	-299%	141.8%	14.9%
Profit before taxes	-17,436	-87,133	4,156	13,063	10,753	6,691	-647	3,734	Mar-18	108%	-26.7%	-2.3%
Net attributable income	**-14,717**	**-73,706**	**8,790**	**11,343**	**9,312**	**6,003**	**-3,920**	**3,106**	**Mar-18**	**122%**	**-32.6%**	**-11.6%**

Source: Banco de España Statistical Bulletin

Table A.3 Relative size and resources of the system. Percentage of GDP, number and percentage change

	2012	2012	2013	2014	2015	2016	2017	2018	Date	Growth rate 00-'08	08-latest	y-on-y
Lending to the private sector / GDP	152%	152%	139%	133%	123%	114%	108%	104%	May-18	94%	-38.0%	-7.8%
Private sector deposits / GDP	125%	125%	126%	124%	117%	111%	103%	102%	May-18	69%	-20.6%	-6.5%
Number of employees	236,504	236,504	217,878	208,291	202,961	194,283	192,626	n.d.	Dec-17	14%	-30.8%	-0.9%
Number of branches	38,237	38,237	33,786	32,073	31,155	28,959	27,623	27,228	Mar-18	17%	-41.0%	-4.6%

Source: Banco de España Statistical Bulletin

Table A.4 Breakdown of ORS (other resident sector) lending, NPLs and NPL ratios by portfolio. Billion euros and percentage change

Lending volume	2012	2012	2013	2014	2015	2016	2017	Date	Growth rate 00-'08	08 - latest	y-on-y
Loans to households	**756**	**715**	**690**	**663**	**652**	**647**	**646**	**Mar-18**	**236%**	**-21.2%**	**-0.3%**
Of which:											
Housing loans	605	581	558	531	517	503	500	Mar-18	270%	-20.2%	-2.4%
Other loans to households	151	134	132	132	136	144	146	Mar-18	159%	-24.4%	7.5%
Lending to corporates and SMEs	**830**	**719**	**674**	**644**	**605**	**592**	**564**	**Mar-18**	**237%**	**-44.5%**	**-5.7%**
Of which:											
Lending to real estate	300	237	200	179	161	145	133	Mar-18	517%	-71.8%	-15.8%
Other lending to corporates and SMEs	530	482	474	465	444	447	431	Mar-18	142%	-21.2%	-2.1%
Total lending to domestic private sector *	**1,605**	**1,448**	**1,380**	**1,327**	**1,276**	**1,254**	**1,219**	**May-18**	**234%**	**-34.8%**	**-3.2%**
Non-performing loans											
Loans to households	**37.0**	**49.4**	**46.8**	**37.0**	**35.7**	**35.0**	**34.7**	**Mar-18**	**1062%**	**42.7%**	**-3.4%**
Of which:											
Housing loans	24.0	34.6	32.6	25.5	24.1	23.6	22.7	Mar-18	1878%	52.7%	-6.5%
Other loans to households	13.0	14.8	14.1	11.4	11.6	11.4	12.1	Mar-18	607%	27.1%	2.8%
Lending to corporates and SMEs	**128.4**	**146.1**	**124.6**	**94.2**	**79.2**	**60.7**	**47.4**	**Mar-18**	**818%**	**27.0%**	**-36.3%**
Of which:											
Lending to real estate	84.8	87.8	70.7	50.4	42.4	28.2	18.5	Mar-18	2790%	-31.1%	-52.8%
Other lending to corporates and SMEs	43.6	58.2	53.9	43.7	36.8	32.4	28.8	Mar-18	232%	177.0%	-17.8%
Total lending to domestic private sector *	**167.5**	**197.2**	**172.6**	**134.3**	**116.3**	**97.7**	**81.6**	**May-18**	**808%**	**29.3%**	**-26.0%**
NPL ratio											
Loans to households	**4.9%**	**6.9%**	**6.8%**	**5.6%**	**5.5%**	**5.4%**	**5.4%**	**Mar-18**	**246%**	**81.0%**	**-3.1%**
Of which:											
Housing loans	4.0%	6.0%	5.9%	4.8%	4.7%	4.7%	4.5%	Mar-18	434%	91.3%	-4.1%
Other loans to households	8.6%	11.1%	10.7%	8.7%	8.5%	7.9%	8.3%	Mar-18	173%	68.1%	-4.4%
Lending to corporates and SMEs	**15.5%**	**20.3%**	**18.5%**	**14.6%**	**13.1%**	**10.3%**	**8.4%**	**Mar-18**	**173%**	**129.0%**	**-32.4%**
Of which:											
Lending to real estate	28.2%	37.1%	35.3%	28.2%	26.4%	19.5%	14.0%	Mar-18	369%	143.9%	-43.9%
Other lending to corporates and SMEs	8.2%	12.1%	11.4%	9.4%	8.3%	7.3%	6.7%	Mar-18	37%	251.3%	-16.1%
Total lending to domestic private sector *	**10.4%**	**13.6%**	**12.5%**	**10.1%**	**9.1%**	**7.8%**	**6.7%**	**May-18**	**172%**	**98.3%**	**-23.5%**

(*) Total ORS lending includes total lending to households, total lending for productive activities, non-profit institutions serving households (NPISHs) and unclassified lending. From January 2014 it includes lending to banking institutions.
Source: Banco de España Statistical Bulletin

Table A.5 New lending transactions. Cumulative annual volume in billion euros and percentage change

									Growth rate		
Lending volume	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**Date**	**03-'08**	**08-'17**	**y-on-y**
Loans to households	**63.3**	**51.2**	**60.5**	**75.7**	**80.6**	**87.6**	**52.4**	**Jun-18**	**0.7%**	**-52.9%**	**23.7%**
Of which:											
Housing loans	32.3	21.9	26.8	35.7	37.5	38.9	23.3	Jun-18	-15.6%	-55.4%	21.4%
Other loans to households	31.0	29.4	33.7	40.0	43.1	48.8	29.1	Jun-18	21.3%	-50.7%	25.6%
Lending to corporates and SMEs	**484.8**	**392.6**	**357.2**	**392.6**	**323.6**	**339.0**	**186.9**	**Jun-18**	**29.2%**	**-63.5%**	**10.2%**
Of which:											
Less than €250,000	114.4	106.1	112.3	128.7	133.6	143.4	73.7	Jun-18	n.d.	-12.7%	4.3%
Between €250,000 and €1million)	31.6	28.3	34.0	36.8	36.3	40.6	21.8	Jun-18	n.d.	-11.8%	9.9%
Corporates (loans > €1mill.)	338.9	258.2	210.3	227.2	152.6	155.1	91.5	Jun-18	43.5%	-65.9%	15.6%
Total new lending flows	**548**	**444**	**418**	**468**	**404**	**427**	**239.3**	**Jun-18**	**23%**	**-63.8%**	**12.9%**

Source: Banco de España

Table A.6 Information on ORS deposits. Billion euros and percentage change

									Growth rate		
	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**Date**	**00-'08**	**08 - latest**	**y-on-y**
Sight deposits	475	500	563	650	754	857	884	May-18	90%	100.7%	10.7%
Term deposits	693	677	597	509	404	286	256	May-18	272%	-65.5%	-25.1%
Total retail deposits	**1,168**	**1,177**	**1,160**	**1,159**	**1,157**	**1,143**	**1,141**	**May-18**	**163%**	**-3.6%**	**0.0%**
Other deposits											
Repurchase agreements	60	64	60	42	32	28	26	May-18	-23%	-69.6%	-9.5%
Funds from financial asset transfers	43	37	32	25	23	21	21	May-18	14%	-76.8%	-2.4%
Hybrid financial liabilities	20	16	22	17	14	10	8	May-18	33%	-70.9%	-36.0%
Subordinated deposits	26	20	16	18	16	1	0	May-18	n.m.	-99.1%	-97.2%
Pro-memoria: Deposits in foreign currency	*30*	*30*	*27*	*29*	*28*	*17*	*16*	*May-18*	*739%*	*-57.2%*	*-39.7%*
Total deposits of domestic resident sector	**1,317**	**1,314**	**1,289**	**1,261**	**1,243**	**1,203**	**1,196**	**May-18**	**159%**	**-16.5%**	**-1.9%**

Source: Banco de España Statistical Bulletin

Table A.7 Interest rates on lending transactions. Rates in percentage terms and change in basis points

	2012	2013	2014	2015	2016	2017	2018	Date	Growth rate (bps) 03-'08	08 - latest	y-on-y
Loans. Stock (NDER)											
Loans to households											
Housing loans	2.61	2.11	1.89	1.53	1.30	1.21	1.19	May-18	178	-446	-6
Other loans to households	5.78	5.80	6.10	5.98	6.17	6.24	6.21	May-18	113	-86	3
Loans to corporates and SMEs	3.47	3.44	2.84	2.38	2.04	1.89	1.90	May-18	204	-365	-6
Loans. New lending transactions (EAR)											
Loans to households											
Housing loans	2.93	3.16	2.64	2.31	2.19	2.05	2.18	May-18	238	-366	1
Consumer loans	8.32	9.52	8.98	8.43	8.14	8.30	8.85	May-18	237	-214	8
Other	6.23	5.92	4.91	4.28	4.26	4.02	3.91	May-18	224	-313	-86
Loans to corporates and SMEs (synthetic average)	3.66	3.57	2.73	2.58	2.30	2.12	2.07	May-18	112	-280	-31
Less than €250,000	5.67	5.54	4.56	3.61	3.29	2.93	2.80	May-18	n.a.	-175	-36
Between €250,000 and €1 million)	4.27	4.03	2.91	2.20	1.91	1.79	1.72	May-18	n.a.	-217	-14
Corporates (loans > €1 mill.)	3.00	2.83	2.10	2.07	1.63	1.55	1.97	May-18	n.a.	-74	25

NDER: Narrowly Defined Effective Rate (APR ex commissions).
APR: Annual Percentage Rate.
Source: Banco de España Statistical Bulletin

Table A.8 Interest rate on deposits. Rates in percentage terms and change in basis points

	2012	2013	2014	2015	2016	2017	2018	Date	Growth rate (bps) 03-'08	08 - latest	y-on-y
Deposits. Stock (NDER)											
Households deposits											
Sight deposits	0.21	0.22	0.17	0.12	0.06	0.04	0.04	May-18	6.5	-65	-1
Term deposits	2.72	2.08	1.39	0.75	0.30	0.16	0.15	May-18	232	-426	-6
Corporates and SMEs deposits											
Sight deposits	0.37	0.35	0.31	0.24	0.15	0.10	0.09	May-18	111	-168	-2
Term deposits	2.64	1.93	1.40	0.91	0.65	0.77	0.71	May-18	223	-367	3
Deposits. New transactions (NDER)											
Households deposits											
Sight deposits	0.21	0.22	0.17	0.12	0.06	0.04	0.04	May-18	30	-65	-1
Term deposits	2.83	1.50	0.66	0.39	0.11	0.08	0.07	May-18	225	-412	-4
Corporates and SMEs deposits											
Sight deposits	0.37	0.35	0.31	0.24	0.15	0.10	0.09	May-18	111	-168	-2
Term deposits	2.08	1.31	0.51	0.31	0.13	0.16	0.18	May-18	146	-329	-2

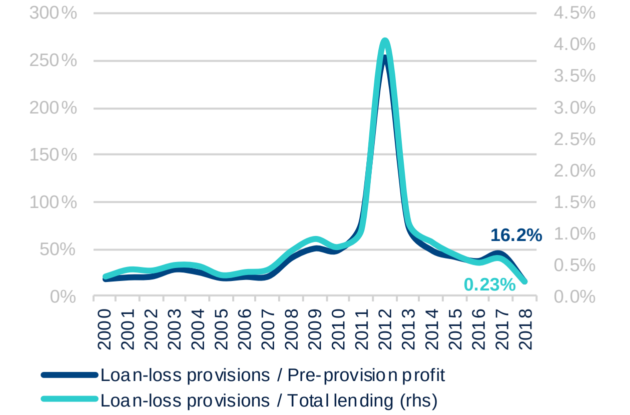
NDER: Narrowly Defined Effective Rate (APR ex commissions).
APR: Annual Percentage Rate.
Source: Banco de España Statistical Bulletin

Table A.9 Key ratios

	2011	2012	2013	2014	2015	2016	2017	2018	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	88,942	88,712	May-18	168.2%	24.0%	2.2%
Profit before tax per branch (€000)	-433.7	-2,279	123.0	407.3	345.2	231	-23.4	548.6	Mar-18	77.5%	24.2%	2.5%
Efficiency												
Cost-to-Income ratio (Oper. expenses / Total revenue)	49.8%	45.3%	48.2%	47.1%	51.0%	54.5%	57.1%	54.8%	Mar-18	-29.3%	23.2%	9.0%
Operating expenses / ATA	0.86%	0.79%	0.83%	0.88%	0.93%	0.98%	1.01%	0.98%	Mar-18	-43.4%	2.8%	7.7%
Profitability												
RoE	-7.4%	-35.5%	4.1%	4.9%	4.1%	2.6%	-1.7%	5.4%	Mar-18	-3.4%	-47.9%	-12.3%
RoA	-0.52%	-2.55%	0.13%	0.44%	0.38%	0.25%	-0.02%	0.57%	Mar-18	-23.6%	-14.3%	-0.2%
NIM (Net interest rev. / ATA)	0.89%	0.96%	0.83%	0.91%	0.93%	0.90%	0.88%	0.87%	Mar-18	-29.6%	-23.7%	-1.0%
Liquidity												
Loans-to-Deposits (resident sector)	150%	137%	123%	119%	115%	110%	110%	107%	May-18	14.8%	-32.3%	-3.2%
Funding gap (Loans - Deposits, EUR bn)	594.4	436.8	270.9	220.1	168.3	118.9	110.4	78.9	May-18	349%	-88.5%	-33.8%
Funding gap / Total assets	17.5%	12.8%	9.0%	7.6%	6.1%	4.5%	4.2%	3.0%	May-18	57.7%	-85.9%	-34.2%
Solvency and Asset Quality												
Leverage (Shareholders' equity / Total assets)	6.5%	5.7%	7.7%	7.9%	8.2%	8.6%	8.8%	8.7%	May-18	-17.8%	55.0%	-1.2%
Shareholders' equity / NPLs	158%	117%	118%	133%	169%	196%	238%	279%	May-18	-74.3%	-2.6%	34.3%
Provisioning effort (Loan-loss prov. / Pre-provision profit)	79.1%	253.6%	75.8%	49.5%	42.3%	37.9%	45.5%	16.2%	Mar-18	121%	-60.8%	-45.4%
Cost of Risk (Loan-loss provisions / total lending)	1.06%	4.07%	1.19%	0.86%	0.66%	0.53%	0.59%	0.23%	Mar-18	134%	-68.3%	23.6%
NPL ratio (resident sector)	7.8%	10.4%	13.6%	12.5%	10.1%	9.1%	7.8%	6.7%	May-18	172%	98%	-23.5%
NPL coverage ratio (total)	59.6%	73.8%	58.0%	58.1%	58.9%	58.9%	60.0%	62.6%	May-18	-58.2%	-11.6%	5.5%
NPL coverage ratio (specific provisions)	37.1%	44.7%	46.9%	46.7%	47.0%	46.2%	42.1%	45.6%	Mar-18	-39.0%	52.6%	3.8%

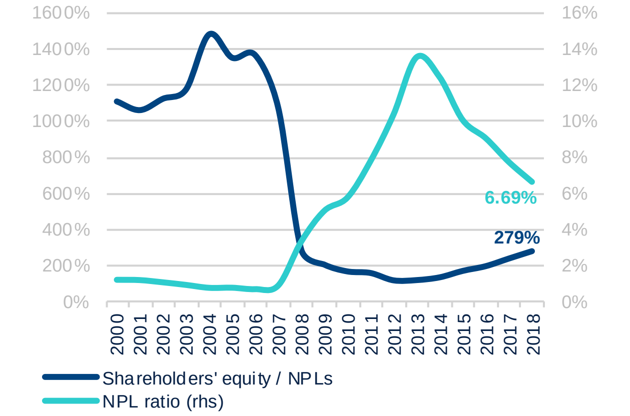
(*) ORS Credit plus ORS Deposits.
Source: Banco de España Statistical Bulletin

Figure A1.1 Provisioning burden



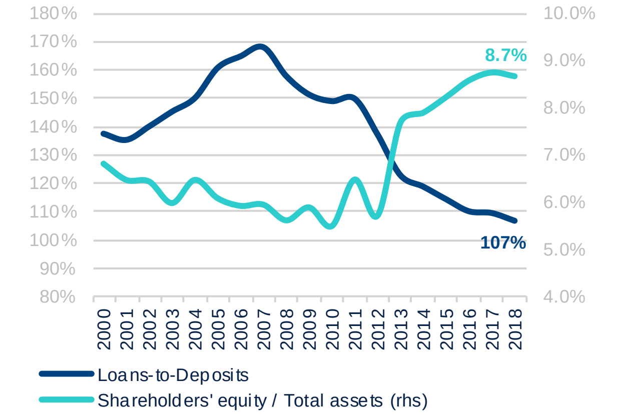
Source: BBVA Research

Figure A1.2 NPLs and Capital as a percentage of NPLs



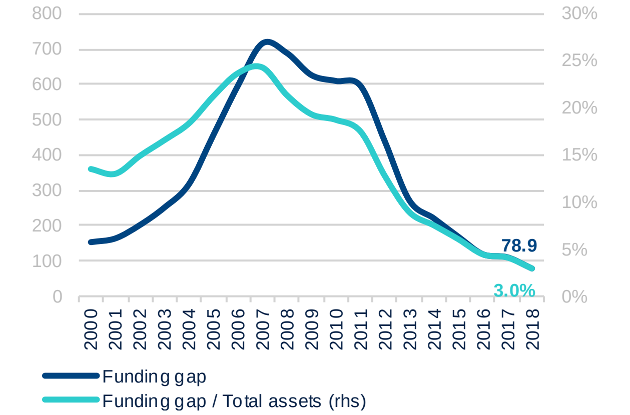
Source: BBVA Research

Figure A1.3 Liquidity and leverage



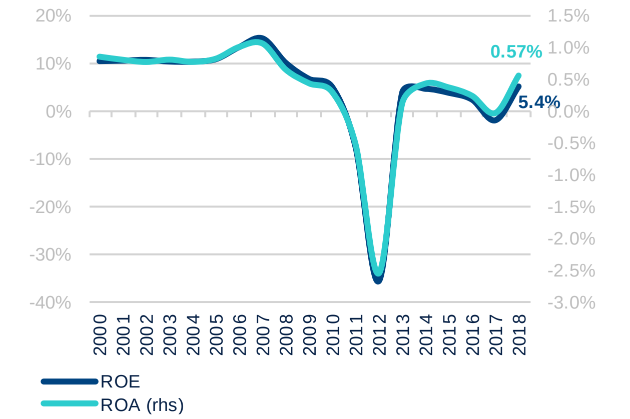
Source: BBVA Research

Figure A1.4 Funding gap



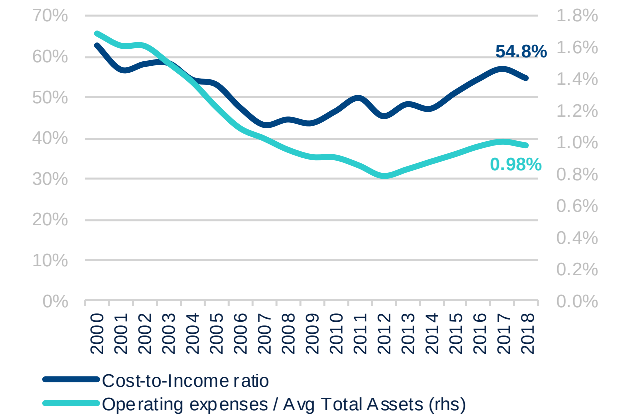
Source: BBVA Research

Figure A1.5 Profitability



Source: BBVA Research

Figure A1.6 Efficiency



Source: BBVA Research

Appendix 2: Trends and developments in the Spanish banking sector
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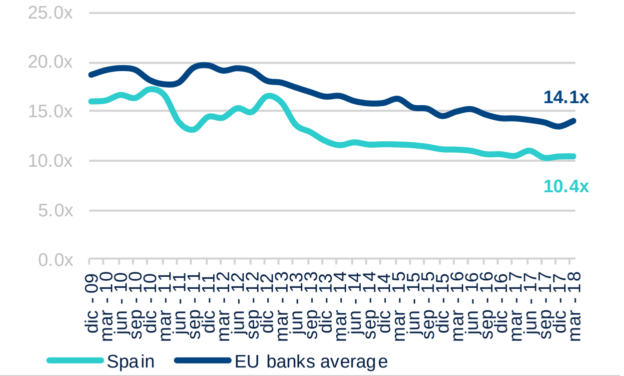
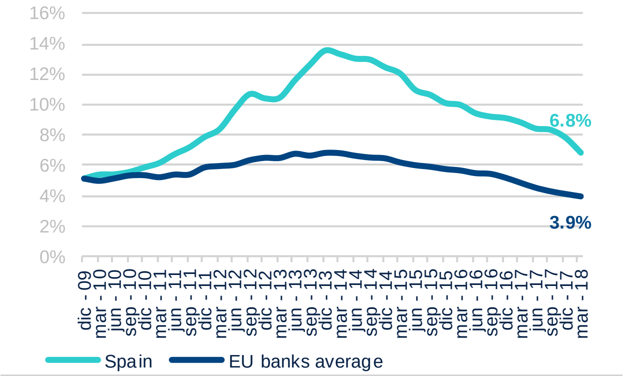
Figure A2.1 Total liabilities / Balance sheet capital



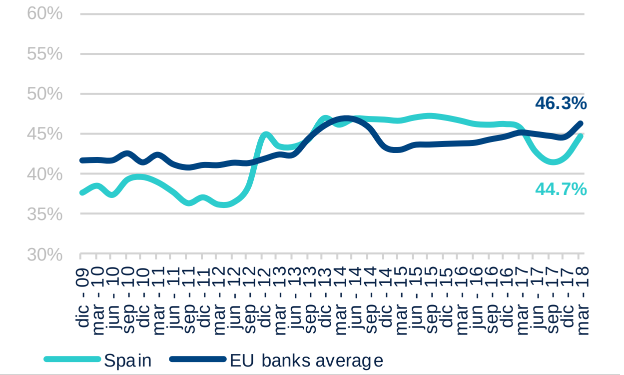
Source: EBA, Banco de España, BBVA Research

Figure A2.2 NPL ratio



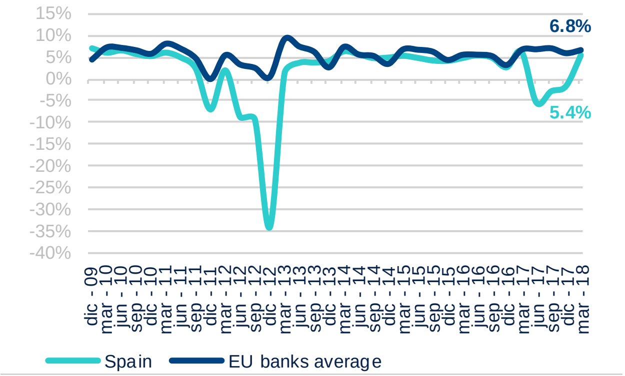
Source: EBA, Banco de España, BBVA Research

Figure A2.3 Coverage ratio (specific provisions only)



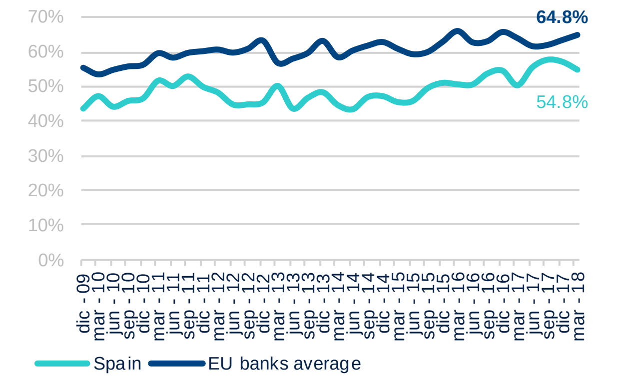
Source: EBA, Banco de España, BBVA Research

Figure A2.4 ROE



Source: EBA, Banco de España, BBVA Research

Figure A2.5 Efficiency ratio



Source: EBA, Banco de España, BBVA Research

Note: the data for European banks on average comes from the EBA's Risk Dashboard, which comprises a panel of 158 major EU banks.

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