



The Spanish financial-sector programme over 2012-13 - Key features and achievements -

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Outline

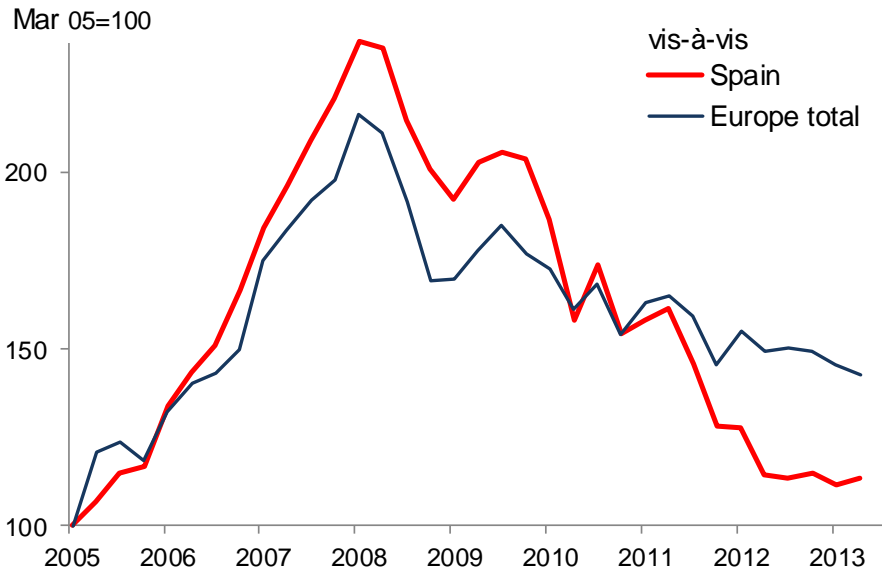
- 1. Crisis origin**
- 2. Programme design**
- 3. Programme implementation**
- 4. Programme achievements**
- 5. Challenges ahead**
- 6. Concluding remarks**

1. Crisis origin

***Burst of a real-estate driven
bubble and large accumulated
macroeconomic imbalances***

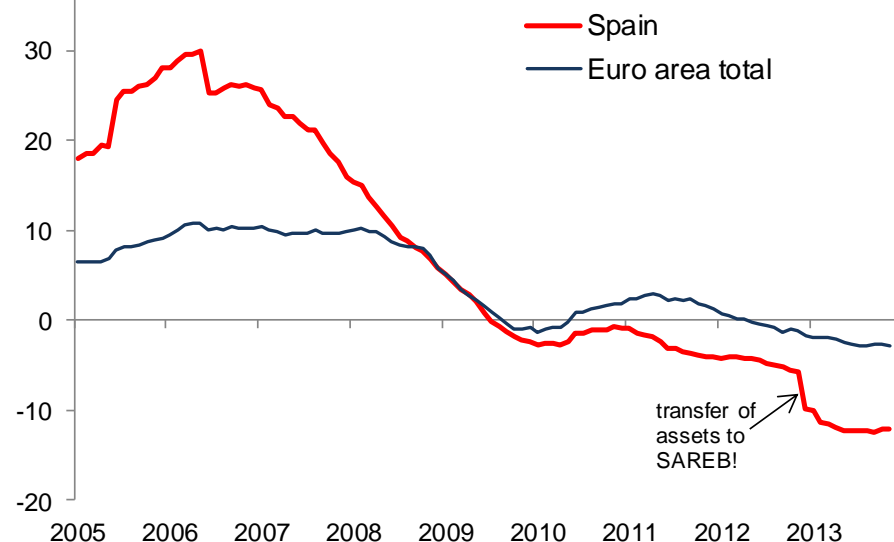
Large capital inflows and strong credit growth prior to the financial crisis of 2008....

Consolidated foreign claims of BIS reporting banks



Source: BIS - ultimate risk basis (USD basis, Mar 2005=100)

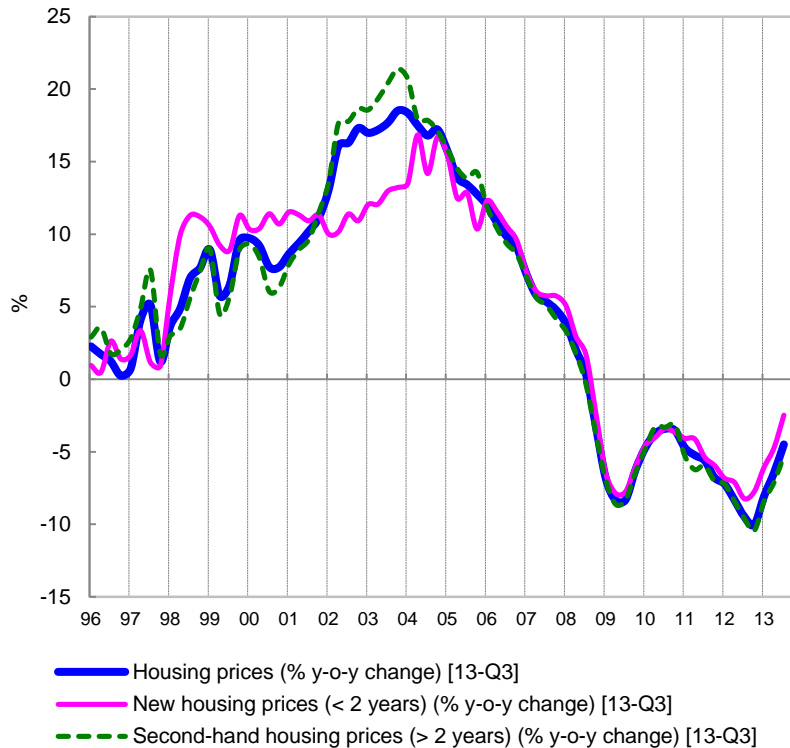
Bank lending to the private non-financial sector
(annual growth rates in %)



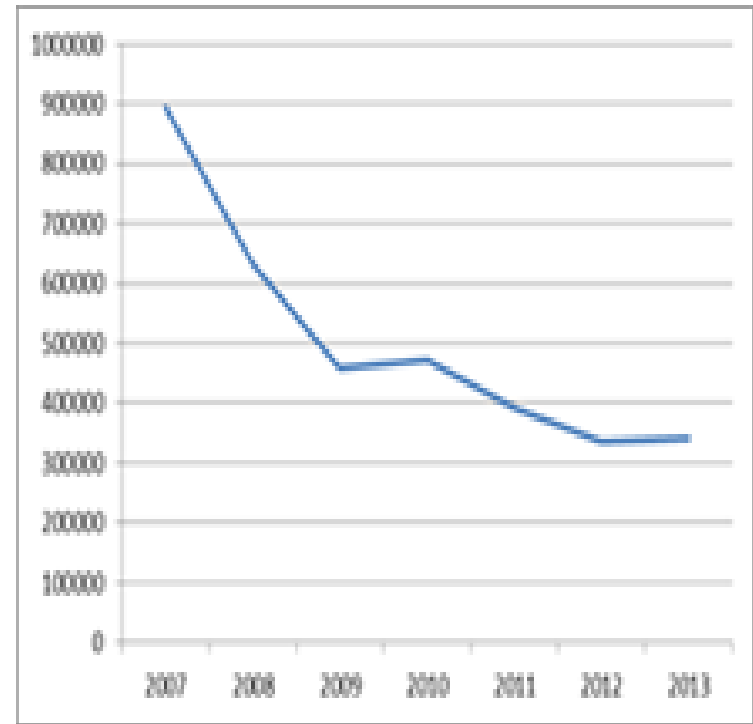
Source: ECB

... fuelling the property boom until 2007/08 ...

House prices (y-o-y growth rate)



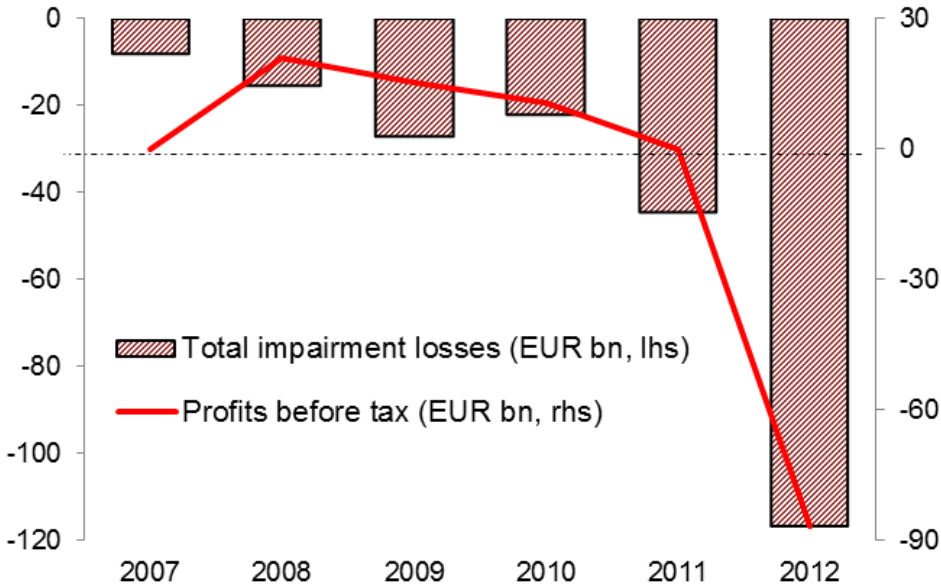
Residential transactions (last 4 quarters)



Source: Ministry of Public Works.

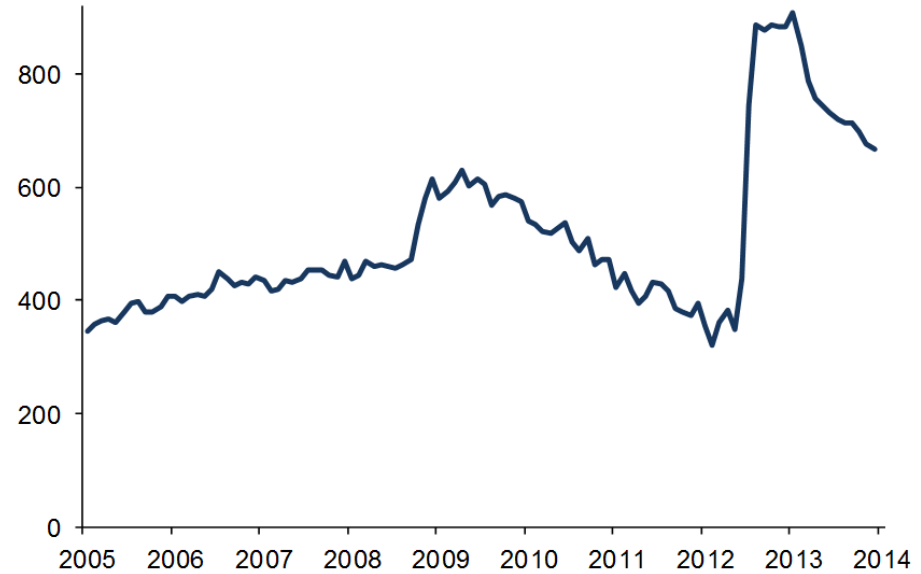
... leading to massive losses and liquidity strains of banks

Spanish credit institutions: profit and loss account (EUR bn)



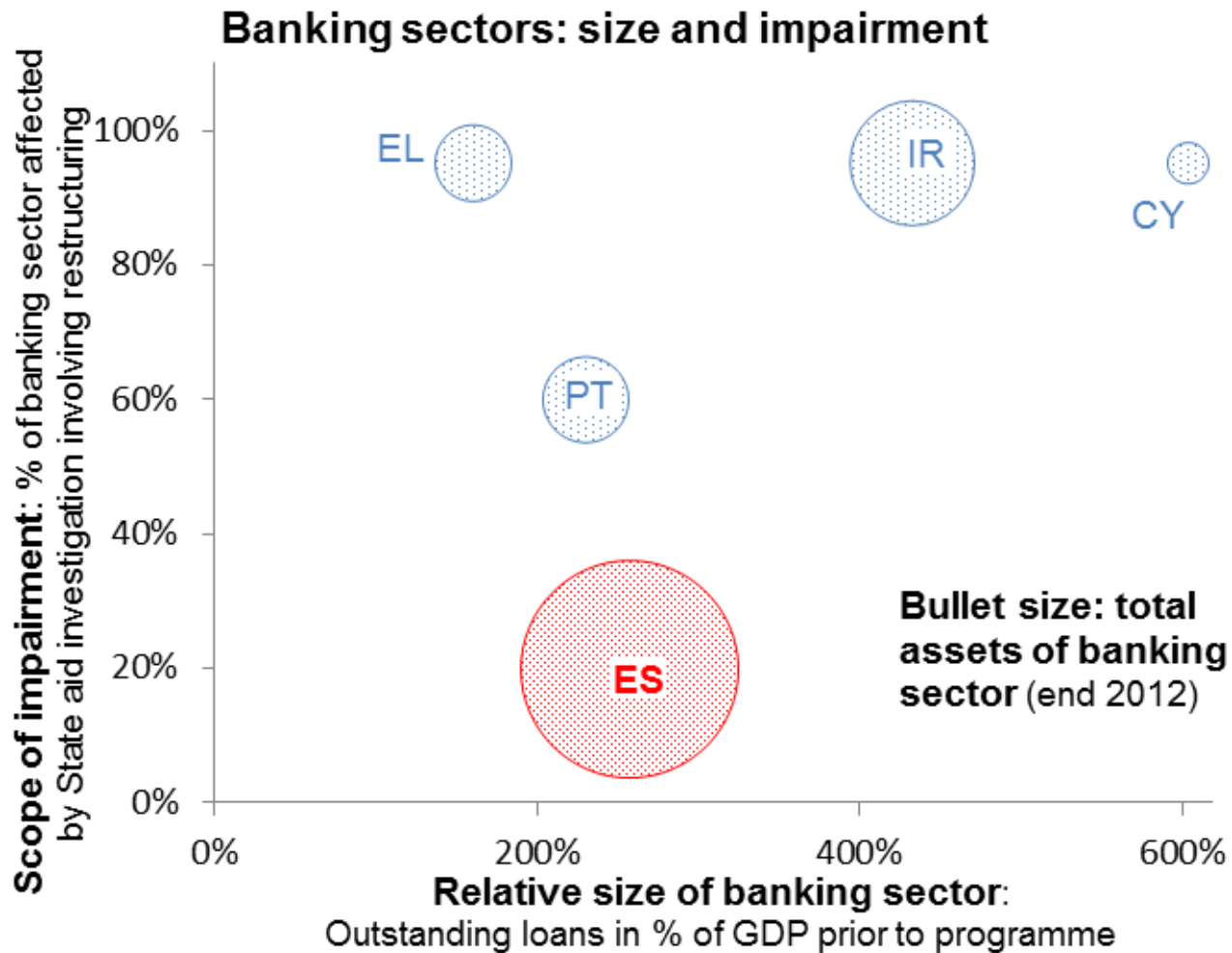
Source: BdE, own estimates

Spanish credit institutions: balance with the Eurosystem (EUR bn)



Source: BdE

Large banking market, deep problems, but only in parts of sector



2. Programme design

Focus on quickly re-establishing solvent banks and strengthening governance in the sector at large

Programme focus on the banking sector, with limited size and duration

- **Objective: Stabilisation of the Spanish banking sector**
 - Conditionality limited to financial sector, linked with state aid procedures, while monitoring fiscal policies and structural reforms in parallel
 - Ultimate beneficiaries of disbursements: banks
 - Restore solvency and thereby, indirectly foster market access and liquidity
 - Support fiscal burden on the state stemming from the bank bailout
 - Building confidence

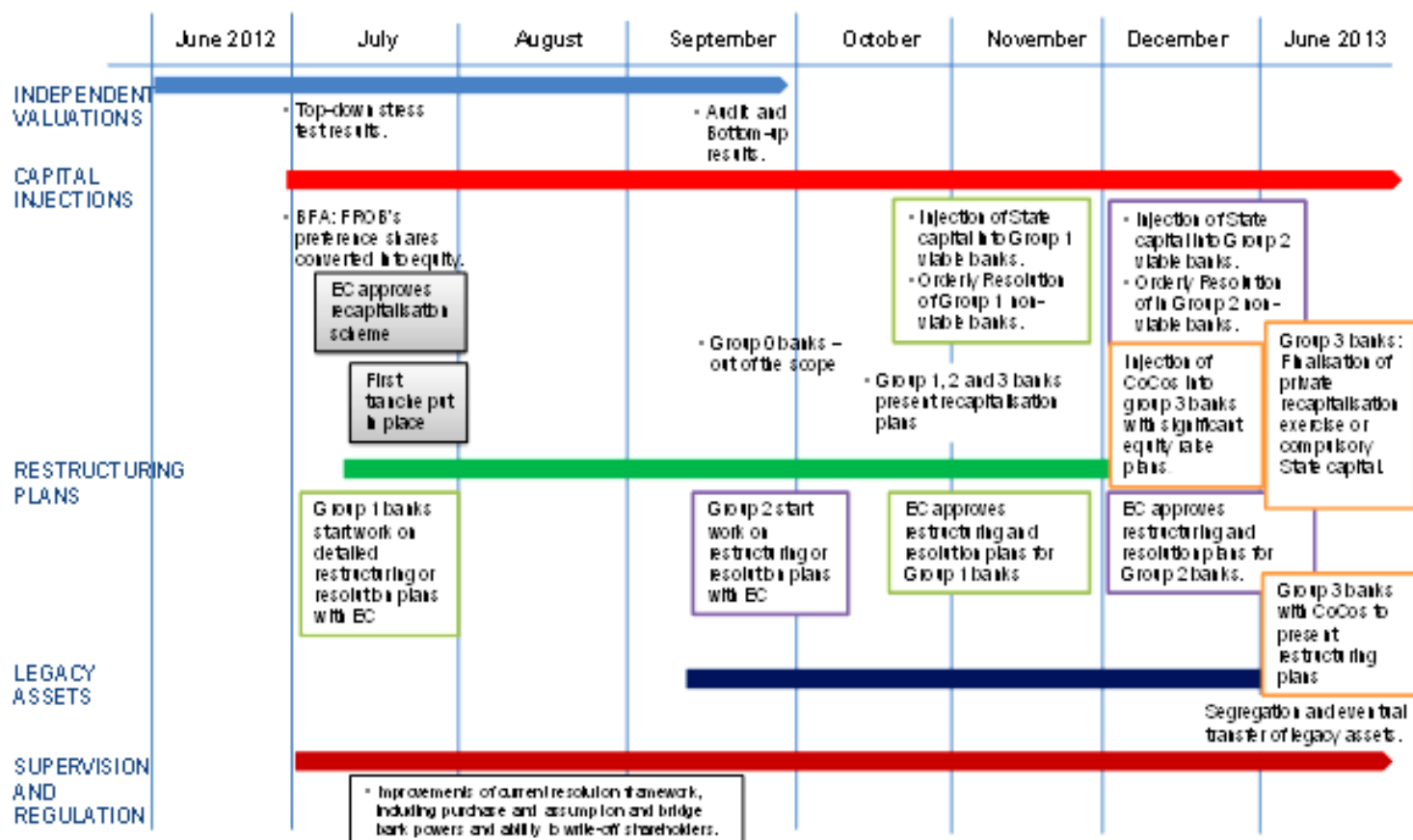
- **Length: 18 months** (23 July 2012 – 22 January 2014)

- **Size: Limited compared to initial estimates and to GDP**
 - Upfront maximum by Eurogroup: EUR 100 billion
 - Disbursements: ~ EUR 40 billion (~ 4% of GDP)

- **Funding pattern: Front-loaded, no regular disbursements**

Clear and ambitious timeline

Restructuring of the Spanish Banking Sector: Timeline



Group of banks:

- Group 0: Banks with no capital shortfall are out of the scope;
- Group 1: FROB banks (BFA/Bankia, CatalunyaCaixa, NovaCaixaGalida, Banco de Valencia); banks for which State aid needs are – largely – known before the Stress Test and which will need to be validated on this basis;
- Group 2: Banks with capital shortfall identified by the Stress Test, with no possibility to raise privately capital, and thus which will need to recourse to State aid.
- Group 3: Banks with capital shortfall identified by the Stress Test, doing so raising this privately.

EC: European Commission

Addressing specific banks as well as the sector as a whole

Bank-specific approach	System-wide approach	
	Instruments	Framework
<ul style="list-style-type: none"> ○ Stress test of major banks by independent consultants ○ Restructuring plans for banks in need of state aid ○ Transfer of assets to AMC (SAREB) ○ Burden sharing ○ Recapitalisation of these banks 	<ul style="list-style-type: none"> ○ Setting up an AMC ("bad bank"): SAREB ○ Higher capital requirements for all banks ○ Improved credit register ○ Developing non-bank intermediation 	<ul style="list-style-type: none"> ○ Establishing a resolution framework ○ Revamping savings banks' governance ○ Strengthening financial regulation/supervision (roles of government vs. BdE, supervisory procedures, concentration risk, provisioning regime, transparency of balance sheets, mis-selling...)

3. Programme implementation

Expedient and successful

Implementation has been continuously well on track

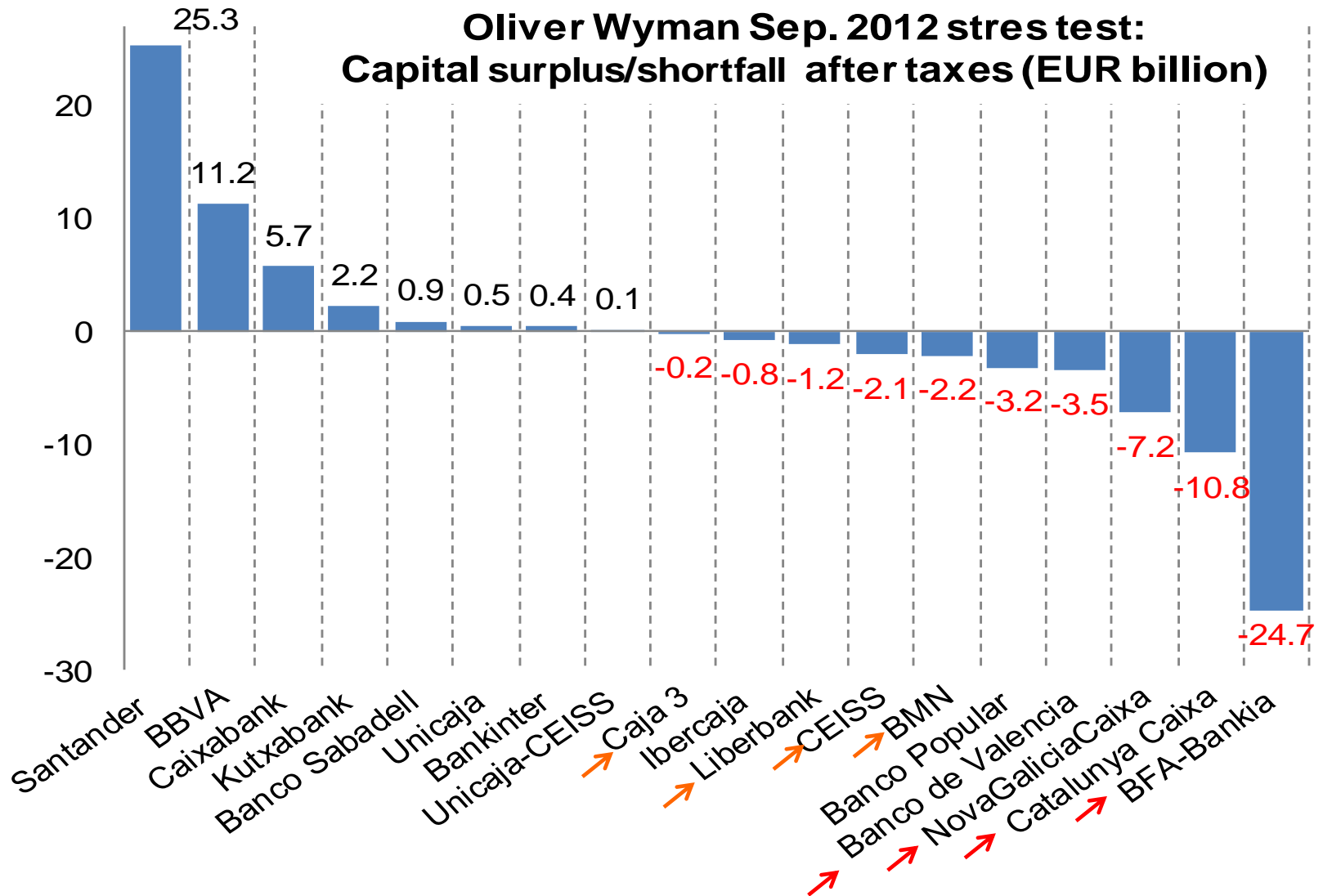
➤ **Asset quality review and Stress tests**

- **Problems concentrated in a few banks, with Bankia standing out**
- **Problems essentially with real-estate lending**

➤ **Strategy**

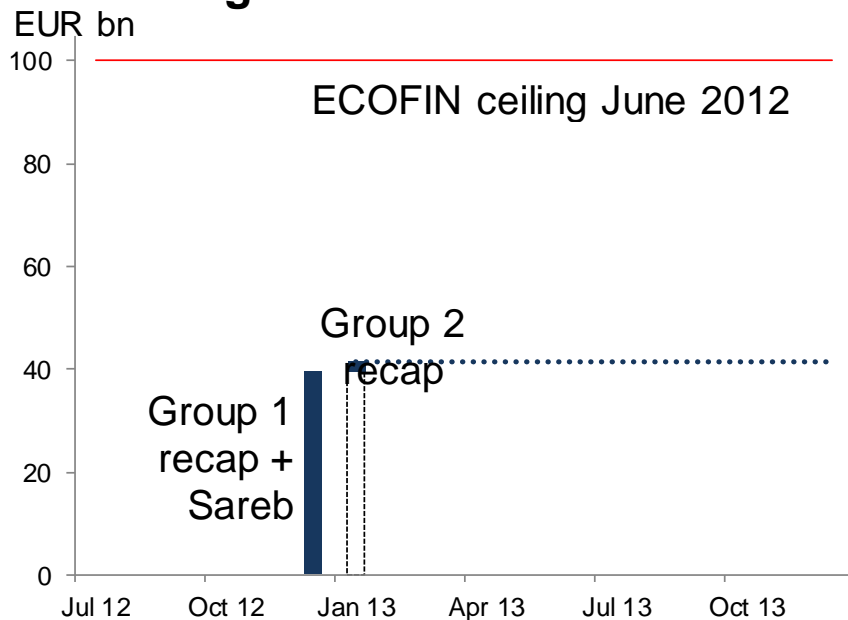
- **Rapid restructuring and recapitalisation of these banks**
- **Burden sharing: sub-ordinated liabilities exercise**
- **Segregation of impaired assets**
- **Setting-up of Asset Management Company (SAREB) to deal with legacy assets**

Very diverse banking landscape

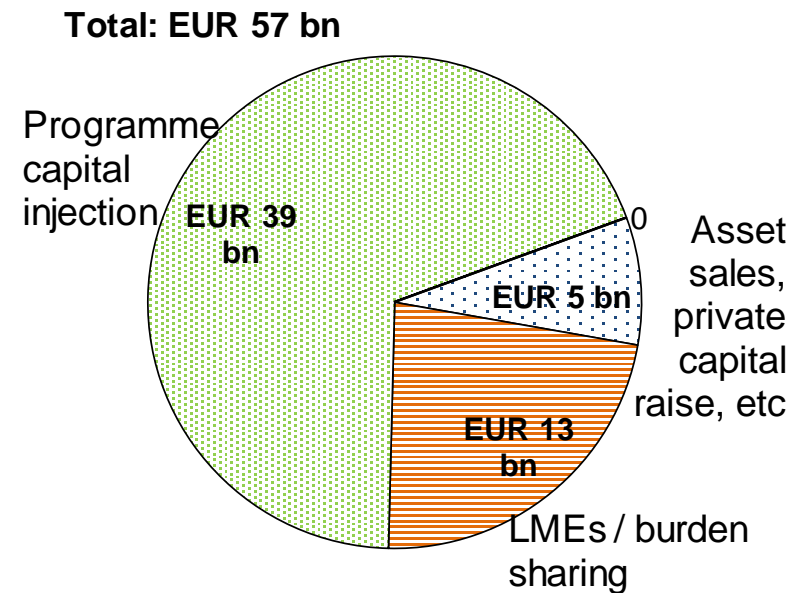


Burden of bank recapitalisation shared by taxpayers as well as banks' junior bondholders and shareholders

Programme disbursements



Capital needs and sources



SAREB: The new Asset Management Company

- **Objective:** Manage and disinvest the assets transferred by state-aided banks, optimise levels of recovery and value preservation, minimise cost for taxpayers and market distortions;
- **Maximum timeframe:** 15 years.
- **Size:** Transfers of real-estate related assets from Group 1 and Group 2 of total of EUR 50.6bn. Total number of assets: around 198 000.
- **Haircut:** Average of 52.7% relative to gross book value.
- **Capital:** EUR 4.8bn. 25% equity, rest: subordinated convertible debt. 55% of equity capital held by private shareholders, of which, over 95% are credit institutions.
- **Corporate governance:** Board of Directors with 15 members (president, CEO, 8 representatives of SAREB shareholders, 5 independent directors. By-laws rule out conflict of interest.
- **Supervision:** BdE is supervisor of SAREB. Also Monitoring Committee (Ministry of Economic Affairs and Competitiveness, Ministry of Financial Affairs and Public Administration, BdE and CNMV)

Political and public support of the programme

- **The interested public has been supportive of the programme from the outset**
 - Support by financial industry and academia of the programme has been strong
 - Programme seen as unavoidable, helpful and well-designed.
- **Authorities have been fully supportive of the programme throughout its implementation and increasingly acknowledged its merits.**
- **But, of course, some issues had been controversial, including:**
 - Burden sharing
 - Governance of savings banks
 - Governance and business model of SAREB
 - Strengthening of bank supervision
 - Pace of credit contraction and deleveraging

4. Programme achievements

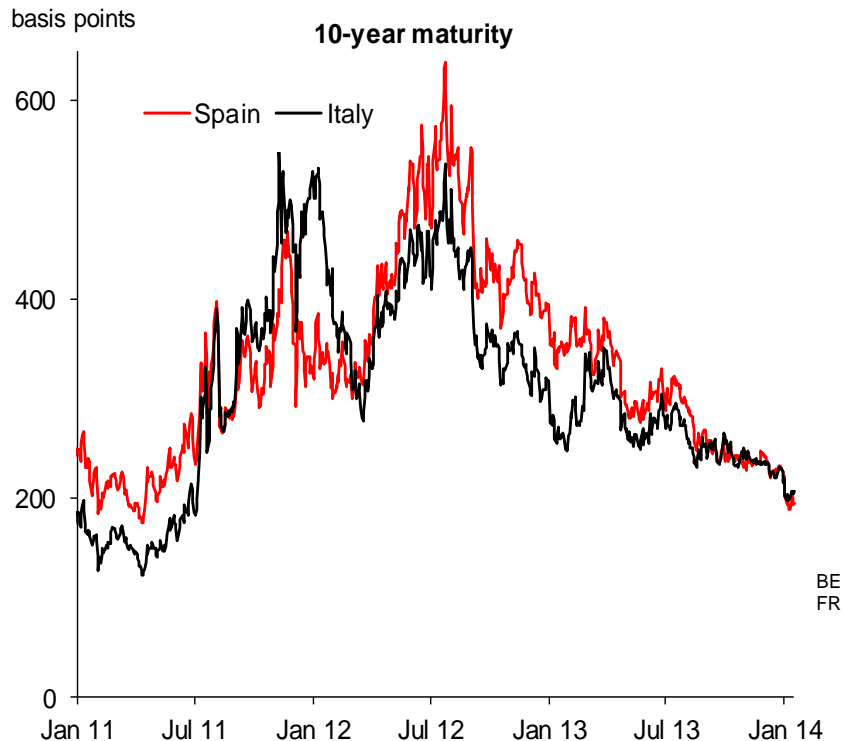
***Banking sector is stabilised, money
is flowing back to Spain***

Market confidence has returned

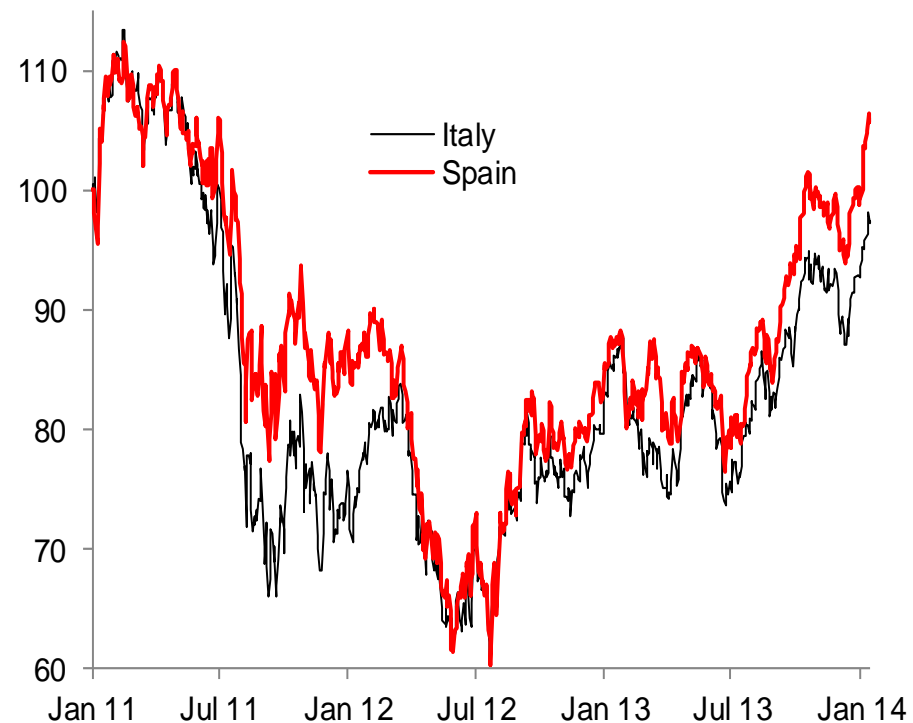
- ◆ Bank deposits on the rise again
- ◆ Interest rates have been falling

- ◆ Foreign capital returning
- ◆ And share prices rising

Sovereign bond spreads to German bund



Main share price indices (Jan 2011=100)



The still fragile economic situation continues to weigh on financial stability

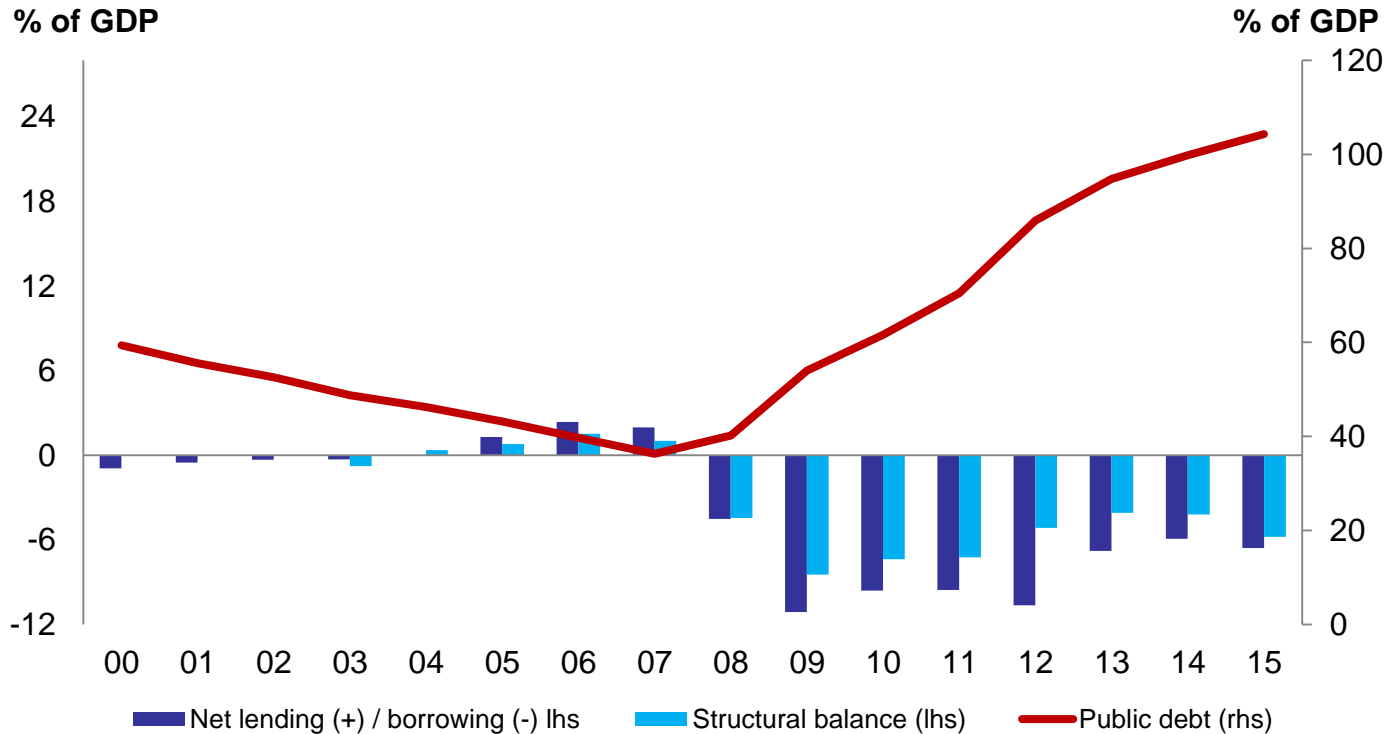
- **Asset quality of banks is still deteriorating**
 - **Economy remains weak (rise of NPLs, ...)**
 - **Real estate markets have not yet fully recovered**

- **Demand for lending remains low; business volumes of banks are shrinking**

- **Both elements keep pressure on profits and stability of financial sector**

Significant consolidation achieved, though public deficit and debt remain high

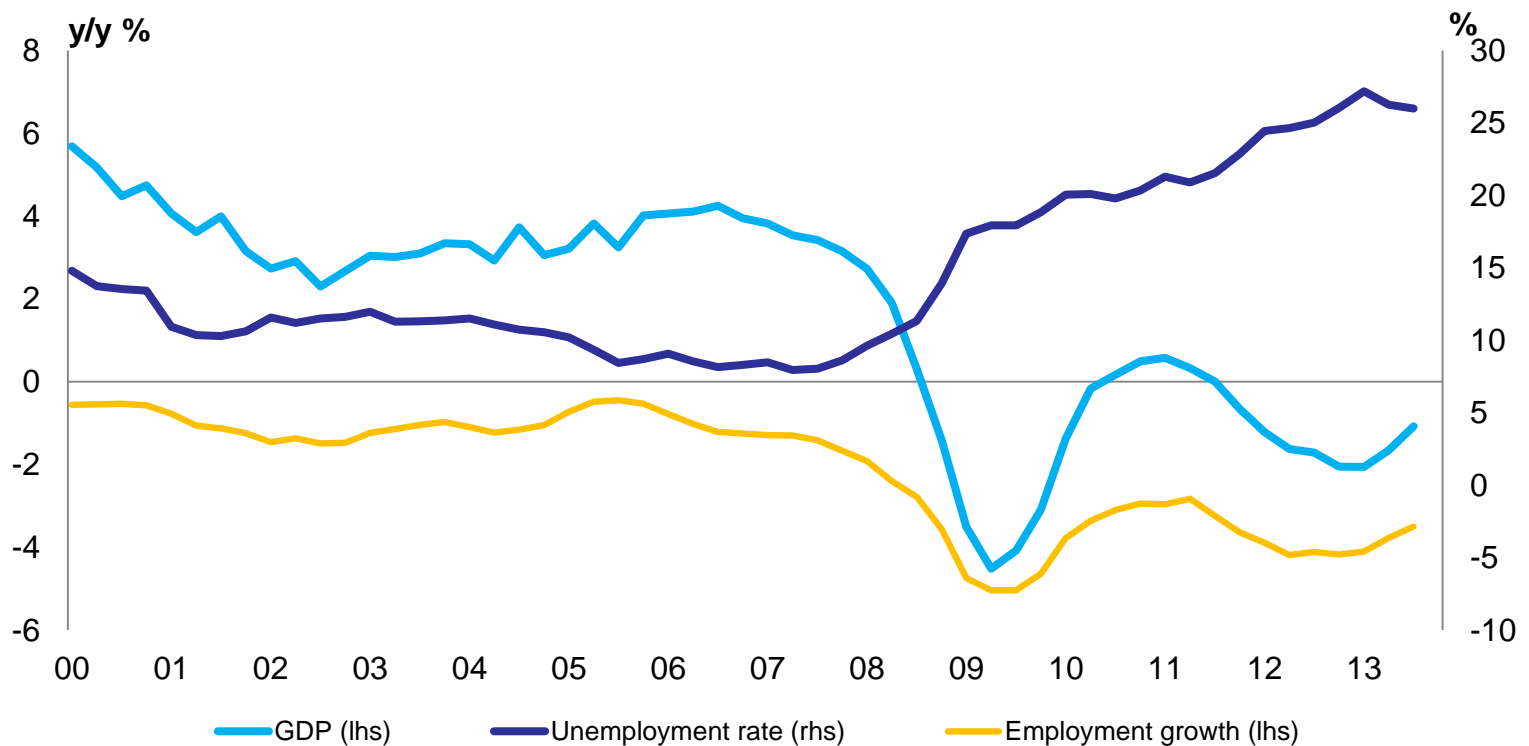
General government deficit and debt



Source: Commission services (AMECO)

Employment loss is bottoming out; still very high unemployment is beginning to decline

Real GDP, Employment, Unemployment



Source: Eurostat, INE

Ongoing progress on a comprehensive structural reform agenda

- **Public finance management:** Stronger fiscal discipline; independent fiscal council; public sector arrears; pensions; public administration reform; de-indexation of administered prices and public sector contracts.
- **Labour market:** Strengthening internal flexibility of firms; better collective bargaining; improving active labour market policies; incentives for youth employment. Education and training.
- **Product and services markets:** Curbing regulatory fragmentation and increasing competition; professional services; electricity tariff deficit.

5. Challenges ahead

Despite progress, several challenges remain (1)

Financial sector

- Measures initiated under the MoU have to be carried through, where not yet done.
- Financial sector stability and bank balance sheet repair, also in the light of the ECB comprehensive assessment, and the pending Single Supervisory Mechanism (SSM).
- SAREB's activity, in particular asset sales.
- Restructuring (and privatising) of state-owned banks in order to accelerate their full recovery.

Despite progress, several challenges remain (2)

Growth

- Deleveraging has to continue, given the still high private, public and external debt levels.
 - Flexible labour and product markets needed to reduce high levels of unemployment.
-

Fiscal policy

- Correct excessive deficit by 2016 and bring public debt back on a declining path.
 - Pursue disciplined public finance management and efficiency gains in the administration.
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Structural reforms

- Complete adoption of pending reforms in the 2013 National Reform Programme (e.g. professional services, tax reform).
- Fully implement ongoing reforms (e.g. public administration, labour market, energy sector, market unity, etc.) and further improve the business environment.

6. Concluding remarks

Concluding remarks

1. **Origin:** bursting property bubble, triggering a major banking crisis, affecting the entire economy and threatening to spill over into other countries.
2. **Novel design and strategy**
 - i. A "first" targeted financial sector programme
 - ii. Simple, smart and ambitious design.
3. **Steadfast implementation**
 - i. Timely and full compliance with MoU
 - ii. Strong ownership, effective administration and widespread public support
4. **Highly successful**
 - i. Banks are now solvent and liquid
 - ii. The entire sector has been profoundly restructured
 - iii. Supervisory and regulatory framework has been thoroughly overhauled
 - iv. Radical reversal in market sentiment
 - v. Parallel progress with fiscal consolidation and structural reforms
5. **Important challenges remain:** reforming and strengthening the financial sector is a continuous task and is tied to the stabilisation and adjustment of the economy²⁸

More info

- **European Commission:**
http://ec.europa.eu/economy_finance/assistance_eu_ms/spain/index_en.htm
- **Spanish government:**
<http://www.thespanisheconomy.com/portal/site/tse/menuitem.efbc5feeac2b3957b88f9b10026041a0/?vgnnextoid=c89e7e7b61b7f310VgnVCM1000002006140aRCRD>
- **Banco de España:**
<http://www.bde.es/bde/en/secciones/prensa/infointeres/reestructuracion/>
- **ESM:** <http://www.esm.europa.eu/>
- **IMF:** <http://www.imf.org/external/country/esp/index.htm>