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Post-Programme Surveillance Report

Spain, Spring 2024

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European Commission
Directorate-General for Economic and Financial Affairs

Post-Programme Surveillance Report

Spain, Spring 2024

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The Post-Programme Surveillance assessment was prepared in liaison with staff from the European Central Bank (ECB) ⁽²⁾. The European Stability Mechanism (ESM) was consulted.

This report reflects information available and policy developments that have taken place up to 30 April 2024. The macroeconomic and budgetary projections, including those underlying the debt sustainability analysis are therefore in line with the Commission's 2024 spring forecast published on 15 May 2024 (with cut-off date 30 April 2024).

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⁽¹⁾ The executive summary of this report was adopted as Commission Communication C(2024)4002 on 18 June 2024. The rest of the report is the Staff Working Document SWD(2024)402 accompanying this Communication.

⁽²⁾ ECB staff participated in this mission, and in the drafting of this report, in line with the ECB's remit and therefore provided expertise on financial sector policies and macro-critical issues, such as headline fiscal targets and sustainability and financing needs.

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ABBREVIATIONS

DSA	Debt Sustainability Analysis
ECB	European Central Bank
EFSF	European Financial Stability Facility
ESM	European Stability Mechanism
Sareb	Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria S.A.

EXECUTIVE SUMMARY

The twenty-first Post-Programme Surveillance (PPS) mission to Spain took place on 18 and 19 March 2024. The meetings involved staff from the European Commission, in liaison with European Central Bank staff ⁽³⁾. The European Stability Mechanism (ESM) participated on aspects related to the ESM's Early Warning System.

The Spanish economy is projected to continue expanding in 2024, although at a slower pace than last year. According to the Commission's 2024 Spring Forecast, real GDP growth is projected to slow this year to 2.1% from 2.5% in 2023, mainly due to the weaker economic situation in Spain's main trading partners and to the lagged impact of previous years' interest rate hikes on aggregate demand. Overall, domestic demand is set to be the key driver of the economic expansion this year. The evolution of consumer spending is expected to be supported by still strong job creation and further real income gains. Meanwhile, investment growth is expected to rebound, underpinned by quicker implementation of the recovery and resilience plan (RRP) and the easing of financing conditions. Downside risks to the outlook relate to geopolitical uncertainty and growth in main trading partners being further weakened. Headline inflation is expected to continue to moderate in 2024 to 1.9%, following the strong deceleration experienced in 2023, when the decline in the overall price level was favoured by the sustained drop in energy prices throughout the year. Overall inflation is set to decline further in 2024 to 3.1% thanks to the expected gradual slowdown from core components, despite the upward pressure exerted by the phasing out of government measures rolled out to mitigate the impact of high energy prices.

The private sector debt-to-GDP ratio continued decreasing in 2023, as did the negative external net debt position ⁽⁴⁾. The debt ratio of the non-financial private sector fell to 111.6% of GDP in the fourth quarter of last year, down by 11.8 percentage points compared to the same period in 2022. This was mainly driven by strong nominal GDP growth, and also supported by the reduction of outstanding loans following tighter financial conditions. Despite the downward adjustment of sales from post-pandemic peaks, the housing market remained characterised by strong demand in 2023, particularly for new dwellings, with prices exceeding inflation in a context of supply constraints. Spain's negative net international investment position (NIIP) improved to -52.8% of GDP in the fourth quarter of last year from -60.0% of GDP in the same period in 2022, supported by the increasing surplus in the current and capital accounts.

While Spain's public finances keep improving, driven by favourable macroeconomic developments, the deficit and debt levels remain high, calling for further measures to consolidate the fiscal position and redress risks to debt sustainability. The general government deficit decreased to 3.6% of GDP in 2023, after having halved from 10.1% to 4.7% of GDP over the 2020-2022 period. The strong momentum of revenues from direct taxation keeps driving the deficit reduction. Revenues from personal income tax and corporate income tax grew in cash terms by 9.9% and 9.0%, respectively, reflecting the continued positive developments in the labour market and the good pace shown by corporate profits. On the other hand, VAT revenues decelerated (1.6%), due to a slower expansion of consumer spending, tax rebates adopted to mitigate energy prices and a narrowing inflation rate for imported energy products. Total expenditure decreased in terms of GDP, partly helped by more targeted energy support measures, whose budgetary impact narrowed by 0.6% of GDP. In the future, the government deficit is expected to continue reducing in 2024 as energy measures will be gradually phased out. The non-adoption of a 2024 budget with the extension of the 2023 budget may play a positive role in containing expenditure. On the revenue side, the government extended the solidarity wealth tax and the levy on financial institutions and energy companies. The Commission's 2024 Spring Forecast expects the headline deficit to narrow to 3.0% and the debt-to-

⁽³⁾ European Central Bank (ECB) Staff participated in this mission, and in the drafting of this report, in line with the ECB's remit and therefore provided expertise on financial sector policies and macro-critical issues, such as headline fiscal targets and sustainability and financing needs.

⁽⁴⁾ The evolution of the external and internal indebtedness position is also monitored as part of the In-Depth Review (IDR), which aims to identify and assess the severity of macroeconomic imbalances.

GDP ratio to decrease to 105.5%, driven by nominal GDP growth. Nonetheless, while the government deficit and debt have narrowed substantially in the 2021-2023 period, their levels in terms of GDP remain high and without new measures the structural deficit is expected to remain around 3% over the forecast period.

The banking sector has remained resilient, amidst continued geopolitical uncertainty and tighter financial conditions for borrowers, but the capital ratios of Spanish banks continue to be lower than EU peers. The contraction in lending activity that started in December 2022 started moderating in the last months of 2023. The Bank Lending Survey (BLS) of the first quarter of 2024 also indicated a broadly stable credit supply, while demand for loans has been declining for the fifth consecutive quarter across segments. In the second half of 2023, the asset quality of Spanish banks remained broadly stable, with some deterioration in loans provided to the construction sector and mortgage lending. The repricing of existing mortgage loans with variable interest rates progressed in 2023. In 2024, the anticipated reductions in interest rates may start mitigating these adverse effects. After repaying most of the funding provided under targeted longer-term refinancing operations (TLTRO), the liquidity position of banks continues to be reassuring. While, overall, the pass-through of higher interest rates to deposits was contained over the course of 2023, the cost of deposits is still increasing. Banking sector profitability increased significantly in 2023, driven by the favourable impact of rising interest rates on net interest income, which more than offset the adverse change in operating costs, the rise in impairment charges and the impact of the extraordinary levy on operations in Spain, which banks paid based on the 2022 and 2023 financial results. While remaining above the capital requirements and supervisory guidance, the capital ratios of Spanish banks continue to be lower than EU peers and, together with credit quality developments in the following quarters, warrant continued monitoring. Ongoing deliberations on the possibility of permanently implementing and reforming the extraordinary bank levy highlight the importance of thoroughly assessing its effects on banks' ability to provide credit. The State aims to maximise the recovery of public funds by divesting its CaixaBank stake, held by the Fondo de Reestructuración Ordenada Bancaria (FROB), by December 2025. It is actively assessing market conditions to optimise its divestment, particularly in light of CaixaBank's significant profit surge last year. The asset management company SAREB continues to reduce its balance sheet, having disposed of roughly 54% of assets and 41% of senior debt since its inception.

Spain retains the capacity to service its debt. Spain's economic activity is expected to continue to expand and its fiscal situation to further improve while its financial situation remains resilient amid still high inflation in the short run. Spain's government debt-to-GDP ratio is expected to continue declining gradually and based on unchanged policies to reach levels of around 105.5% of GDP in 2024. According to the debt sustainability analysis, Spain is deemed to face low risks in the short term, but medium-term fiscal sustainability risks appear high. To mitigate risks to the pension system, the 2023 reform includes a regular review that will be carried out from 2025 onwards. This will lead, if necessary, to corrective measures being adopted. Government gross financing needs are stable, below 20% of GDP level annually while the average maturity of the government debt remains at around 8 years. Spain made several voluntary repayments of the ESM loan in 2014-2018 and the first two scheduled repayments in 2022 and 2023. The next payment is due by the end of 2024, which would bring the total repayments to 69.1% of the total loan and – according to the agreed repayment schedule – the payments will continue annually until 2027. Financing conditions for Spain are considered to have improved recently to some extent, as investors have started to anticipate the change in the monetary policy stance. This is in tandem with the decline in interest rates at issuance and the narrowing of sovereign spreads.

1. INTRODUCTION

1. This report presents the main findings from the 21st post-programme surveillance (PPS) mission. Staff from the European Commission, in liaison with staff from the European Central Bank (ECB), participated in the mission to Spain. Staff from the European Stability Mechanism (ESM) also attended the meetings on aspects related to the ESM's Early Warning System. Under the PPS, the Commission carries out regular review missions to euro area Member States that had a financial assistance programme. The objective of the PPS mission is to assess the economic, fiscal and financial situation to ensure the Member State maintains its capacity to service its debt to the European Stability Mechanism (ESM) ⁽⁵⁾.

2. Spain received financial assistance to recapitalise its financial institutions in July 2012 and successfully exited the related programme in January 2014. The financial assistance programme was agreed by the Eurogroup on 9 July 2012 for a period of 18 months and provided financing from the euro area Member States of up to EUR 100 bn, to be lent by the European Stability Mechanism (ESM). Eventually, Spain used EUR 41.0 bn for bank recapitalisation, under restructuring and resolution plans approved by the European Commission in line with State aid rules, and around EUR 2.2 bn for capitalising SAREB, the Spanish asset management company.

3. This report reflects information available and policy developments that have taken place until 30 April 2024. The macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission's 2024 spring forecast published on 15 May 2024 (with a cut-off date 30 April 2024).

⁽⁵⁾ Under Regulation (EU) No 472/2013, PPS will continue until at least 75% of the financial assistance received under the programme has been repaid. Under the current repayment schedule, PPS will last until 2026.

2. MACROECONOMIC DEVELOPMENTS

4. The Spanish economy is estimated to have expanded by 2.5% in 2023. The strong growth outturn posted last year was underpinned by the positive labour market developments sustaining private consumption as well as the positive contribution from net exports and public consumption. On the other hand, overall investment growth, especially for equipment and machinery as well as residential construction, remained subdued. Employment growth increased in the first half of the year, before moderating in the second half. In annual terms, employment expanded by 3.0%, and the unemployment rate fell to 12.1% (from 12.9% in 2022).

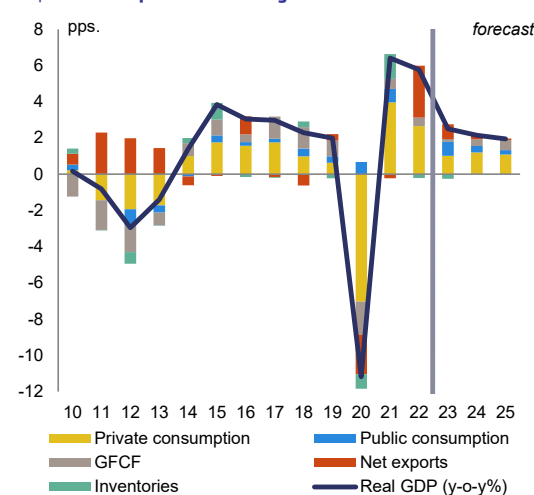
5. GDP growth is expected to reach 2.1% in 2024, according to the Commission's 2024 Spring forecast. Real GDP edged-up to 0.7% in the first quarter, largely driven by the contribution from external demand. Overall, domestic demand is set to represent the key driver steering the economic expansion this year, also benefitting from a strong carry-over from 2023. Private consumption is expected to be supported by still strong job creation and further real income gains for households as well as by the partial use of the still high level of household savings. Investment growth is expected to rebound underpinned by Spain's acceleration in implementing the recovery and resilience plan and the expected easing of financing conditions over the forecast period in the context of a healthy financial position of non-financial corporations. The unemployment rate will remain on a declining trend, set to reach 11.6% in 2024 although still at elevated levels and well above the euro area average.

6. Annual HICP inflation decelerated to 3.4% in 2023, favoured by the sustained decline in energy prices. Underlying price pressures eased more gradually last year as past high energy prices continued to be passed on to other items, especially food and services, in particular those related to hospitality, holidays packages and transport. Headline inflation is set to moderate further this year, reaching 3.1%, with the downward trend of underlying components expected to continue in the coming quarters. Against this backdrop, the expected phasing out of most government measures to mitigate the impact of high energy prices would exert upward pressure on inflation. Moreover, despite the limited second-round effects observed in 2023, a larger-than-expected increase in nominal wages this year could feed into higher inflation over the forecast period. Headline inflation is forecast to decrease further to 2.3% in 2025.

7. Downside risks to the outlook relate mainly to geopolitical uncertainty and the further weakening of growth in Spain's main trading partners. The materialisation of risks related to the uncertain unfolding of geopolitical events, including potential rebound in the levels of commodity prices, as well as pressure from core components might result in a more sluggish slowdown of inflation and would negatively weigh on the aggregate demand. Moreover, downside surprises in the evolution of economic activity in Spain's main trading partners could adversely impact the dynamism of activity. Furthermore, persisting low level of credit demand and lending to the private sector over the next quarters due to the still higher interest rates environment could further affect investment growth this year.

8. Housing activity moderated in 2023 although remained significant, while prices increased slightly above inflation. In the context of tighter financing conditions, house sales decreased last year by 12% after posting strong growth in 2022 (6.0%) and 2021 (39.3%). Despite the

Graph 2.1: Composition of GDP growth



GFCF: gross fixed capital formation

Source: INE, European Commission Economic Forecast, Spring 2024.

decline in 2023, which accelerated during the second half of the year (-15.2% year-on-year), the level of housing transactions remained well above pre-pandemic levels. The fall in house sales was more pronounced for the second-hand market in 2023 (-10.9% compared to -5.0% for new dwellings), which represents around 80% of transactions and for which sales had previously increased more significantly. An orderly slowdown in housing activity was supported by moderate credit growth financing the expansion of housing sales after the pandemic, limited increases in housing valuation gaps and the resilience of the labour market. House prices increased by 4.0% in 2023, posting a lower nominal growth than in 2022 (7.4%) but 0.4 percentage points (pps) above the headline CPI-inflation last year. The slowdown was restricted to second-hand market houses (3.3% in 2023), while prices of new dwellings kept increasing at a higher rate (8.0% compared to 7.8% in 2022) in the context of sustained strong demand and supply-side constraints.

9. The private sector debt-to-GDP ratio continued to decrease in 2023. The debt ratio of the non-financial private sector decreased to 111.6% of GDP in the fourth quarter of 2023, down by 11.8 pps compared to the same period of 2022 ⁽⁶⁾. The stock of debt accumulated by non-financial corporations (NFCs) accounted for 64.7% of GDP, while total household liabilities amounted to the remaining 46.9% of GDP. The decline of the debt ratio over the last year has been similar in relative terms for both segments and mainly driven by strong nominal GDP growth. In the context of economic slowdown and higher interest rates, the reduction of outstanding debt has increased the weight in the deleveraging process. The amount of loans to the non-financial private sector has continuously declined since mid-2022, decreasing by 3.3% year-on-year at the end of 2023. The contraction remains more intense for NFCs (-4.7% year-on-year) than for households (-2.5% year-on-year). According to the ECB bank lending survey, the outlook for loan demand has turned more neutral since the last quarter of 2023 once the transmission of monetary tightening to lending rates has been completed.

10. Spain's external net debtor position continued to improve in 2023. The net international investment position (NIIP) improved to -52.8% of GDP in the fourth quarter of 2023 from -60.0% of GDP in the same period of 2022. The change of the NIIP ratio over the last year has been mainly driven by strong nominal GDP growth, as well as supported by the increasing surplus in the current and capital account. The trade deficit has declined due to lower energy prices, while the service balance has kept its positive trend in both tourism and non-tourism revenues, exceeding 6.4% of GDP overall. In the future, the current account balance is expected to remain in surplus over the forecast period (2.8% of GDP in both 2024 and 2025), helping to further reduce the negative NIIP ratio.

⁽⁶⁾ Data are expressed in consolidated terms. Source: Bank of Spain.

3. PUBLIC FINANCE DEVELOPMENTS

3.1. FISCAL PERFORMANCE

11. Spain's public finances kept improving in 2023, benefiting from strong nominal GDP growth. The general government deficit was reduced last year by more than EUR 10 bn to 3.6% of GDP from 4.7% in 2022. Strong economic growth and positive labour market developments largely explained the sustained dynamism of revenues, particularly direct taxes, which was the main driver of the deficit reduction last year. In addition, the extension of measures to protect the income of firms' and households' income from high energy prices had a lower budgetary cost (0.9% of GDP) than in 2022 (1.6% of GDP). Since 2020, the general government deficit has narrowed by 6.4 pps (equivalent to EUR 60 billion) and the government gross debt has decreased by 17.6 pps, falling to 107.7% of GDP in 2023.

12. Revenues kept up momentum last year driven by direct taxation. The cumulated tax revenues recorded a growth of 7.2% in 2023 mainly helped by the expansion of revenues coming from direct taxation. Revenues from corporate income tax grew by 14.6%, reflecting the strong increase in corporate profits (more than 10.3% last year), with a notable increase in split payments, particularly in the last quarter. Revenues from personal income tax grew by 8.8% in 2023 supported by the 9.0% increase of household disposable income, which was supported by continued strong job creation, the decrease of undeclared work and higher salaries and pensions adjusting to inflation in the context of unrevised tax brackets. In turn, revenues linked to consumption taxes decelerated last year, particularly for VAT, recording a 1.9% growth rate compared to 13.9% in 2022. The main drivers for this were a lower expansion of consumer spending, rate cuts as part of the set of energy and food measures to mitigate price increases and the narrowing inflation of imported goods, most notably energy products, were the main drivers. Also, a new regulation on deferrals and extraordinary returns contributed to a VAT revenue shortfall of EUR 4.3 bn (or 0.3% of GDP). Some discretionary revenue measures approved over the course of the last two years had their first budgetary impact in 2023, helping to reduce the headline deficit. These measures include the solidarity tax, which brought around EUR 630 million in revenues in 2023 (although well below the government's initial estimation of EUR 1.5 billion) and the levy on energy companies and financial institutions, which added an extra EUR 2.9 billion (or 0.2% of GDP) to the general government balance. It remains unclear the extent to which the post-pandemic revenue strength has a structural nature but based on some analyses ⁽⁷⁾, a non-negligible part could be transitory, calling for a continued prudent expenditure strategy. Among the structural aspects of the revenue increase, there could be behavioural changes towards more use of electronic payments which may have helped the emergence of previously undeclared activities and could be further supported with the introduction of compulsory electronic invoicing.

13. Total expenditure decreased in terms of GDP in 2023, partly due to more targeted energy measures. The government extended most of the energy measures to fight inflation until the end of 2023. These included, among other things, the fuel rebate for targeted professional activities (transporters, farmers and ships), public transport subsidies, subsidies in the natural gas bill, and direct support for households and companies in the most affected economic sectors. In addition, other measures that were rolled out included the suspension of the tax on the value of electricity production, the VAT cuts on electricity and gas, the extension of the reduction of the special tax on electricity and a reduction of VAT on basic food was also granted. The estimated overall cost of the different measures decreased by 0.6 pps. in 2023. As for the main expenditure items, compensation of employees increased by 5.5%, reflecting the salary increase of 2.5% and the additional increases of 0.5% to compensate for the loss of purchasing power due to inflation (and another 0.5% due to the nominal GDP growth of 2023, affecting the expenditure of 2024). Intermediate consumption grew by 7.5%, social benefits in kind increased by 6.7%, mainly driven by higher expenditure on education and

(7) [Los ingresos públicos tras la pandemia. Residuos fiscales e inflación. BOLETÍN ECONÓMICO 2023/T1. Artículo 16 \(bde.es\)](#)

healthcare, interest payments expanded by 13.1% in the context of tighter financial conditions, and social benefits other than in kind grew by 10.1%, driven by the revaluation of pensions (8.5%) in line with high inflation recorded in 2023, consistent with the reformed legislation. Overall, the total expenditure-to-GDP ratio decreased by 1 percentage point in 2023.

3.2. FISCAL OUTLOOK

14. The government deficit is expected to keep decreasing throughout 2024 as most energy measures are phased out. According to the government's projections, the public deficit will reduce further this year to 3% of GDP. The Commission's Spring 2024 Economic Forecast also expects the public deficit to narrow to 3.0%, helped by the reduced cost of energy support measures (estimated at 0.2% of GDP) and the positive direct taxation developments underpinned by a favourable labour market and macroeconomic scenario. The non adoption of the 2024 budget is not expected to hinder the Recovery and Resilience Facility (RRF) absorption or substantially impact the budgetary position in 2024 as the main expenditure (pensions, public wages) and revenue (social security contributions) items were agreed before the start of the budgetary process. Some expenditure measures have been extended until the end of this year, most notably the public transport subsidies and the transfer to the electric system to cover costs, reducing the scope for additional measures if the expenditure rule is to be complied with. However, in 2024 the Autonomous Communities will receive higher funds from the regional funding system, which pose the risk of their expenditures increasing with permanent effects. On the revenue side, the government announced the extension of the solidarity wealth tax (until the reform of the regional financing system is carried out) and the levy on financial institutions and energy companies (with the intention of transforming it into a permanent tax). The VAT rebate for basic food, pellets and briquets was extended until June 2024 while the cuts on gas were phased out in March. Regarding electricity, as the main cut depends on energy prices, it is not currently in force. The special tax on electricity and the suspension of the tax on the value of electricity production will be gradually unwound until June.

15. The debt-to-GDP ratio is projected to keep reducing, but more moderately, remaining at high levels. The government expects the debt to decrease to 105.5% of GDP in 2024. This is in line with the Commission forecast that project a decline of the debt-to-GDP ratio to 105.5%, driven by strong nominal GDP growth. In the future, in the absence of new measures, the debt-to-GDP ratio is set to continue reducing, but less dynamically, to 104.8%.

4. FINANCIAL SECTOR DEVELOPMENTS

4.1. RECENT TRENDS

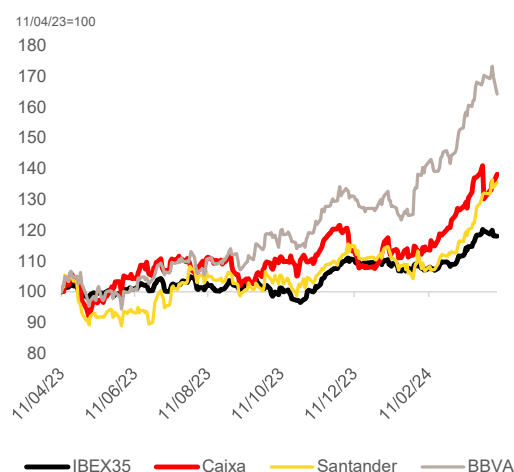
16. Amidst favourable financial results, the share prices of the largest Spanish banks have been on an upward path since late 2023. The share prices of Spanish banks faced increased volatility in 2022 and early 2023, after the onset of Russia's war of aggression against Ukraine, the energy supply crisis and the developments related to Silicon Valley Bank (SVB) and Credit Suisse. However, the share prices of all three large Spanish banks (Banco Santander, Banco Bilbao Vizcaya Argentaria and CaixaBank) started rebounding in November 2023 and in April 2024 stood markedly above the prices from a year earlier (Graph 4.1), as banks in Spain have benefitted from rising interest rates. In 2024, Banco Santander, Banco Bilbao Vizcaya Argentaria and CaixaBank have so far outperformed the main Spanish market index IBEX 35[®].

17. Despite the repayment of most of the targeted longer-term refinancing operations (TLTRO) funding, the liquidity position of banks has remained strong. The Spanish banks' borrowing from the ECB has been declining at a fast pace over the recent quarters, on the back of the gradual repayment of the TLTRO funding. The ECB funding went down to EUR 22.5 billion in February 2024, from EUR 289.7 billion in September 2022⁽⁸⁾. Total domestic bank deposits from households and non-financial corporations increased year-on-year (y-o-y) in February 2024, after continued declines in the second half of 2023.

The deposits of non-financial corporations were the main driver of the decline in total deposits in 2023, as they had been shrinking on an annual basis already since December 2022, due to the switch to higher-yield assets. In December 2023, the deposits of non-financial corporations started rebounding and increased by 5.5% year-on-year in February 2024 (Graph 4.2). The loan-to-deposit ratio slightly declined to 97% in the fourth quarter of 2023, compared to 98.8% a year earlier, driven both by lower lending and an increase in deposits⁽⁹⁾. So far, the cost of deposit funding has increased only moderately for Spanish banks. While the pass through of the increase in interest rates to deposits has been overall contained in the course of 2023, the cost of deposits is still increasing. The liquidity coverage ratio stood at 186% in December 2023, almost 8pps higher than in December 2022 (178%) and well above the regulatory minimum (at 100%).

18. Banks in Spain have continued to access the market with sustained issuances of debt securities. During 2023 and 2024, the Spanish credit institutions have continued tapping the markets by issuing MREL compliant debt securities⁽¹⁰⁾ in an environment of higher rates, despite the challenging macroeconomic environment in the euro area, continued geopolitical tensions, elevated inflation and tighter monetary policy. According to the Bank of Spain, the Spanish credit institutions issued MREL compliant debt instruments of almost EUR 49 billion in 2023 and already roughly EUR 13 billion in the first two months of 2024. However, the cost of debt issuances has increased in 2023.

Graph 4.1: IBEX35 and selected Spanish banks stocks



(1) Indexed at 03/10/2022=100.

Source: Madrid Stock Exchange, own calculations.

⁽⁸⁾ <https://www.bde.es/webbde/es/estadis/infoest/a0199.pdf>

⁽⁹⁾ Bank of Spain, *Nota de prensa estadística*, 19 April 2024. [El Banco de España publica las estadísticas supervisoras de las entidades de crédito correspondientes al cuarto trimestre de 2023.](#)

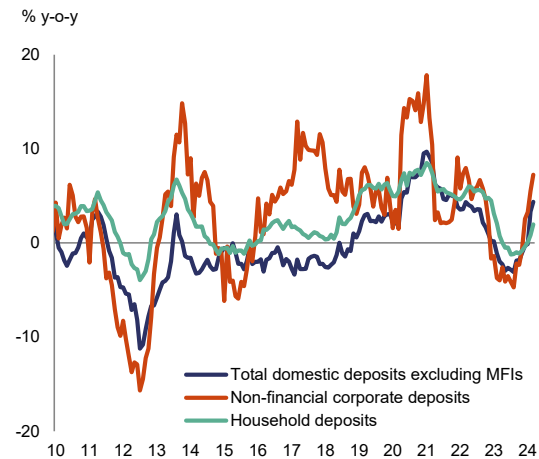
⁽¹⁰⁾ Minimum Requirement for own funds and Eligible Liabilities (MREL).

Based on the latest available data, Spanish banks do not have difficulties in complying with MREL targets.

19. The contraction in lending activity has started moderating.

Following strong declines, in particular during the first and third quarter of 2023, total lending to the private sector (excluding interbank lending) has been falling less strongly, by 3.3% year-on-year at the end of 2023 and by 2.8% year-on-year in February 2024 (Graph 4.3). This trend was notably observed as regards lending to non-financial corporations, which declined by 3.9% year-on-year in February 2024, after shrinking by 5.5% year-on-year in October 2023. The gradual increase in the average cost of corporate debt, as higher interest rates are passed through, in particular to the cost of bank loans, has likely exerted downward pressure on loan demand. This increase in average cost has only partially been mitigated by the existing long-term, fixed-rate debt that is unaffected by interest rate resets in the near term, in particular debt associated with the Instituto de Crédito Oficial (ICO) loan guarantee facility deployed early on during the COVID-19 pandemic. In the course of 2023, the stock of debt guaranteed by the ICO was being repaid at a rapid pace. Lending to households has been contracting since late 2022 and fell by 2.1% year-on-year in February 2024, a slight rebound from -2.7% in October 2023. The cost of lending has been gradually increasing since mid-2022. The one-year Euribor®, which is used as main reference to set the interest rate on mortgage loans granted by banks, peaked at 4.160% in October 2023, but stabilised at a slightly lower level (3.718%) in March 2024. Taking the last twelve months as reference, the one-year Euribor® increased by only 71 basis points (bps) compared to March 2023 ⁽¹¹⁾.

Graph 4.2: Bank deposits

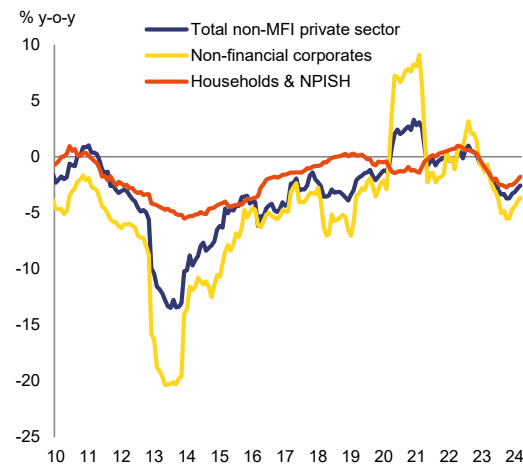


Source: BdE.

20. The Bank Lending Survey (BLS) for the first quarter of 2024 indicated a broadly stable credit supply.

Terms and conditions on new loans continued to tighten in the household consumer loan segment, albeit more moderately than in the previous quarter ⁽¹²⁾. The ongoing supply restrictions reflect the deterioration in the general economic outlook, lower risk tolerance by banks, the increase in risk perception and, to a lesser extent, the increase in financing costs and the more limited availability of funds. Overall tight credit conditions mainly translated into an increase in lending margins across segments although with a lower intensity than in the second half of 2023. The share of rejected loan applications increased for household consumer loans but remained stable both for corporate and mortgage loans.

Graph 4.3: Bank loans to the private sector



The decrease in the stock of loans in late 2012 and early 2013 was due to the transfer of assets to SAREB.

Source: BdE, own calculations.

21. For the fifth consecutive quarter, the BLS for Q1-2024 showed a decline in the demand for loans across segments.

The overall decrease in loan applications reflected mainly the rise in

⁽¹¹⁾ Source: Banco de España (BdE): <https://www.bde.es/webde/en/estadisticas/compartido/datos/pdf/a1901e.pdf>

⁽¹²⁾ For further details see Bank of Spain, [Nota de prensa estadística, 9 April 2024](#).

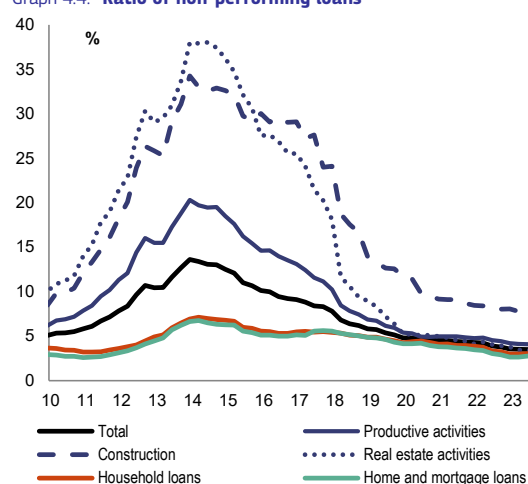
financing costs. In the corporate credit segment this effect was reinforced by lower needs to finance investments in fixed assets, inventories and working capital, fewer merger and corporate restructuring operations, and the use of internal financing. As regards households, the decline in loan demand could also be explained by lower consumer confidence, the greater use of accrued savings and the worsening outlook for the housing market. As for the second quarter of 2024, banks anticipated an increase in loan applications by households, while demand in the corporate credit segment is expected to remain broadly unchanged.

22. In the second half of 2023, the asset quality of Spanish banks remained broadly stable, with some deterioration in loans to the construction sector and mortgage lending. Supported by the decrease in the stock of impaired assets, due in particular to sales of NPLs by banks⁽¹³⁾, the system wide NPL ratio went down to 3.5% at the end of 2022 and remained broadly unchanged in 2023 (Graph 4.4). The construction sector continued to have the highest share of NPLs. Following declines in the past, the construction sector's NPL ratio stood at 8.2% at the end of 2023, 0.1 percentage points (pps) higher than a year earlier and slightly above the level in the first three quarters of 2023. Since the second quarter of 2022, the NPL ratios for real estate have declined steadily and stood at 3.0% at the end of 2023. The NPL ratio for productive activities fell to 4.1% in 2023, the lowest level since March 2009. Loans to households continue to have the lowest level of impairment, with the NPL ratio declining to 3.1% at end of 2023, but around 0.2 percentage points higher than in 2022. While the NPL ratio on mortgage loans had been on a declining path until the end of 2022, the level stagnated in the first quarter of 2023 and slightly increased thereafter, driven by the increases in the reference rate (the one-year Euribor®). The re-pricing of existing mortgage loans with variable interest rates has progressed in 2023. In 2024, the anticipated reductions in the monetary policy rate may start mitigating these adverse effects. After remaining broadly flat for almost a year, Stage 2 loans (according to IFRS 9⁽¹⁴⁾) at consolidated level increased in the final quarter of 2023. According to the latest data by the European Banking Authority (EBA), the share of Stage 2 loans as percentage of total loans and advances stood at 7.2% at the end of 2023, below the EU average of 9.6%, but 0.4 pps higher than in 2022.

23. Banking sector profitability increased significantly in 2023, driven by the favourable impact of rising interest rates on net interest income.

Banking sector profitability benefitted from the increase in net interest income and commissions, as the rise in interest rates has continued to drive up banks' revenue more than their financing costs (Graph 4.5). These positive developments in net interest income have more than offset the adverse change in operating costs, the rise in impairment charges and the impact of the extraordinary levy on operations in Spain, which banks paid on the basis of the 2022 and 2023 financial results⁽¹⁵⁾. Overall, Spanish banks are among the most efficient banks in the EU. The cost rationalisation in recent years (including from the recent banking mergers) has gradually fed into operational costs. According to ECB data, the cost-to-income ratio of Spanish credit institutions stood at 44.9% in the third quarter of 2023, down from 48.2% a year earlier and well below the EU average of 52.8%. The profitability of banking groups with an international footprint benefitted from the good results obtained by their subsidiaries outside the

Graph 4.4: Ratio of non-performing loans



(1) The scope of non-performing loans covered in these figures overlap with BdE's definition of doubtful loans.

(2) Home loans comprise also loans that are not mortgages

Source: BdE, own calculations.

⁽¹³⁾ Non-performing loan (NPL).

⁽¹⁴⁾ International Financial Reporting Standards (IFRS).

⁽¹⁵⁾ For further details on the bank levy, see Section 4.2 on reforms and policy.

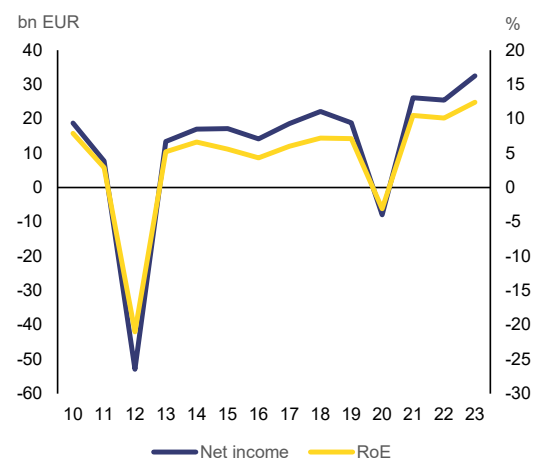
EU, particularly in Latin America. According to Bank of Spain data ⁽¹⁶⁾, the operating profit was just above EUR 33 billion in the fourth quarter of 2023 compared to just above EUR 29 billion a year earlier, while the return on equity (consolidated basis) stood at 12%. At the same time, the cost of risk increased in the fourth quarter of 2023 compared to the previous quarter and stood at 1.02% (also higher than a year earlier). Looking ahead, with interest rates remaining higher for longer, the cost of liabilities, which had been contained, is gradually rising and some deterioration in credit quality may be expected. As the materialisation of risks could give rise to the need to absorb losses, banks could use the current favourable profitability situation to build up their resilience.

24. Banking sector capitalisation only slightly improved in 2023, despite very strong profits. On the back of favourable profitability developments, banks in Spain opted for dividend pay-outs and share buy-backs. In line with EU peers, Spanish banks retained part of their 2023 profits, but the ensuing effect on capital was partially offset by the increase in risk-weighted assets. According to the latest data by Bank of Spain, the solvency ratio at banking system level in the fourth quarter of 2023 stood at 17.04%, by 0.5 pps higher than at the end of 2022. Less significant credit institutions (LSIs) continued to have higher capital ratios than significant credit institutions (SIs). The total capital of LSIs stood at 22.6% in the fourth quarter of 2023, while the total capital of SIs reached 16.72%, slightly below the system-wide solvency ratio. Meanwhile, the Common Equity Tier 1 (CET1) ratio at system level increased to 13.20% at the end of December 2023, from 13.04% at the end of 2022. Overall, the capitalisation of Spanish banks is aligned with their business model and stands above the capital requirements and supervisory guidance but remains much lower than for the EU peers. According to the 2023 EBA stress test ⁽¹⁷⁾, the participating Spanish institutions fared better than the EU aggregate, as they experienced a comparatively smaller negative impact under the adverse scenario and showed a greater capacity to generate capital revenue under the baseline scenario. Since the higher cost of living and interest rates are likely to put strain on the debt repayment capacity of some borrowers, the capitalisation of Spanish banks and their potential for organic capital generation continue to warrant close oversight.

4.2. REFORMS AND POLICY

25. The Bank of Spain has decided to maintain the countercyclical capital buffer (CCyB) rate for banks' credit exposures at 0% in the second quarter of 2024. Recent developments in Spain's credit and housing markets have not yet prompted a reassessment of the macro-prudential policy. Despite a 4.3% year-on-year increase in house prices at the end of 2023, overall housing market activity, including transactions and lending, continues to decline, albeit at a slower pace compared to previous months. House purchases decreased by 4.4% in the fourth quarter of 2023 in year-on-year terms, a smaller decline than in the previous quarter. Similarly, new mortgage loans continued to lose momentum in 2023, with the flow of new credit for house purchase decreasing by 10.5% at the end of 2023 compared to a year earlier, although significantly less than in the first three quarters of 2023. Another mitigating factor

Graph 4.5: **Bank sector profitability (consolidated basis)**



Since 2019, return on equity (RoE) is calculated dividing Net income by the average of total own funds, while before that year RoE was calculated according to the market standards, this means dividing the Income attributable to the controlling entity by the average of shareholders' equity.

Source: BdE, Financial Stability Report.

⁽¹⁶⁾ Bank of Spain, *Nota de prensa estadística*, 19 April 2024. [El Banco de España publica las estadísticas supervisoras de las entidades de crédito correspondientes al cuarto trimestre de 2023.](#)

⁽¹⁷⁾ See the results of the EBA's [2023 EU-wide stress test](#), July 2023. The exercise involved 70 EU credit institutions, accounting for 75% of EU bank's total assets, including 8 Spanish institutions (BBVA, Bankinter, CaixaBank, Kutxabank, ABANCA, Sabadell, Santander and Unicaja).

influencing the Bank of Spain's decision to keep the CCyB unchanged is the composition of variable and mixed-rate mortgages, which have traditionally made up over 70% of the total stock. However, in recent years, fixed-rate mortgages have become more prevalent, limiting the ability to set transmission of higher rates for mortgages and mitigating the impact of rising interest rates on household's financial situation. In addition, in December 2023, the Spanish government modified the relief measures for vulnerable households, lowering the threshold for households' disposable income in order to become eligible for benefits under the scheme. This reduces the risk for potential beneficiaries to default on their debts. Looking ahead, close monitoring of developments in the real estate sector remains crucial due to ongoing market dynamics. Moreover, the flow of new mortgages in Spain may pick up in the coming months as demand reacts favorably to the expected reduction in interest rates. Banks are therefore advised to use their temporarily increased earnings to strengthen their solvency, ensuring stability and resilience in the financial sector amid evolving market conditions.

26. The resolution planning process for credit institutions in Spain has continued to be effective and without any major hindrances. Currently, all ten significant institutions and all smaller entities have developed resolution plans that are updated annually. In particular, MREL decisions were communicated to relevant banks, including those with and without resolution colleges⁽¹⁸⁾ in the first half of 2023. Looking ahead to the ongoing 2023 cycle, banks with a resolution college are expected to receive their MREL decisions in the second quarter of 2024. Conversely, banks without a resolution college have already received some MREL decisions starting from December 2023, with the remainder expected to be communicated in early 2024. In addition, MREL decisions for less significant institutions were communicated to 31 such institutions in the first half of 2023, and a similar number of 49 such institutions were expected to receive their updated MREL decisions in the first half of 2024. Significant and less significant institutions in Spain have managed to meet their MREL targets without major challenges and have continued accessing the funding they need by issuing MREL instruments throughout 2023 and 2024, demonstrating their resilience in adapting to evolving financial conditions and regulatory demands.

27. In the first half of 2023, the government collected the temporary levy on banks. The Decree-Law 8/2023 of 27 December 2023 extended the bank levy over 2024, justified on the basis that the banking sector should continue contributing to fiscal justice and the sustainability of the welfare state. With the noticeable increase in interest rates during 2023 compared to the previous year, the market anticipates that the tax revenues from banks for 2024 will surpass those of 2023. Multiple banks and industry associations voiced concerns regarding the tax and took legal action by filing challenges before the National High Court. Despite this, as of September 2023, Spain's High Court denied appeals from specific credit institutions to suspend the obligation to make payments of the bank levy while the processing of the appeals presented continues.

28. In the debate about whether to make the bank levy permanent, it is important to consider how this change will impact banks' ability to lend money. Although a recent study by the Bank of Spain⁽¹⁹⁾ did not yield statistically significant findings regarding the evolution of interest margins in Spain compared to other countries, there are indications suggesting that it disproportionately penalises banks that focus on SME lending. Another proposal currently under public scrutiny involves offering lenders the option to bolster their reserve buffers rather than remitting the levy, mirroring recent changes in the legal design of the Italian bank levy.

29. The FROB's participation in CaixaBank's capital remains unchanged. The FROB⁽²⁰⁾ continues to evaluate potential opportunities and market conditions to optimise its divestment strategy for CaixaBank. Most notably, CaixaBank reported a significant profit increase of EUR 4.8 billion last year, marking a 53.9% surge compared to the previous year, while its share price has displayed a

⁽¹⁸⁾ Resolution colleges are the bodies that ensure cooperation of all parties at all stages of the resolution planning and resolution process of a failing bank.

⁽¹⁹⁾ Estrada, Á., & Pérez Montes, C. (March 2024). "Un análisis de la evolución de la actividad bancaria en España tras el establecimiento del gravamen".

⁽²⁰⁾ *Fondo de Reestructuración Ordenada Bancaria* (FROB) was created in 2009 to provide public support for the consolidation of the Spanish banking sector by, inter alia, strengthening the capital buffers of credit institutions.

strong performance in recent months. The State's deadline for divesting its CaixaBank stake, held by the FROB, has been extended until December 2025 (subject to further potential extension by a decision of the Council of Ministers), with the primary aim of maximising the recovery of public funds. While CaixaBank appears reasonably valued relative to its peers, recent market dynamics may still not fully reflect its anticipated earnings and strong track record.

30. The Management Company for Assets Arising from the Banking Sector Reorganisation (SAREB) has continued its asset disposal process ⁽²¹⁾. As of mid-2023, approximately 54% of assets and 41% of senior debt were sold or redeemed, respectively, reducing its balance sheet from an initial EUR 50.8 billion to EUR 25.3 billion. Over the past 11 years of its envisaged 15-year lifespan (until 2027), SAREB's asset composition has shifted towards real estate-owned assets (REOs), which now constitute 59% of its portfolio. The remaining portion consists of real estate developments (RED) loans, of which 96% are non-performing and secured with real estate. Around 80% of RED assets have a cost to value above 100%, with collateral repossession progressing slowly. As of mid-2023, approximately 41% of REO assets were published for sale, 16% were in preparation for sale, 21% were in development, and 22% were not for sale.

31. Despite its ongoing asset disposal efforts, SAREB has incurred significant losses, primarily due to negative valuation adjustments. Legal amendments have allowed SAREB to operate with negative equity by waiving general corporate law obligations related to compulsory winding up and capital reduction. Following losses of EUR 2.2 billion in 2023, SAREB's total own resources were EUR -4.7 billion by the year's end. Negative valuation adjustments, totalling EUR 9.9 billion from asset impairments, resulted in SAREB's negative equity exceeding EUR -14.6 billion by the end of 2023. However, SAREB managed to achieve a net margin in 2023 above its business plan, due to lower-than-planned asset sales with higher book losses and reduced operating expenses of EUR 107 million compared to initial budget projections.

32. SAREB continues to implement its business plan for 2023-2027, with a focus on the 'sustainability principle.' This involves increasing the transfer of assets to support social housing policies, alongside maximising the asset portfolio's value. As part of this initiative, SAREB has approved over 5,300 social rentals for vulnerable families and transferred 1,900 homes to public administrations for social purposes. In addition, it plans to transfer EUR 1 billion in land to regional and local administrations for social purposes, with its housing stock also available for sale to these administrations. Furthermore, the transfer of surface rights to private developers is pending approval for project launch.

33. The Government is making progress in establishing a Financial Client Defense Authority. Recently, the Government submitted to the Parliament the draft Law for creating the Financial Client Defense Authority, following the recent favorable opinion on the legislative bill from the Council of State. This law, a pivotal component of the Recovery and Resilience Plan, establishes an independent body for the extrajudicial resolution of conflicts between financial institutions and their clients. The Authority will consolidate the existing extrajudicial arbitration functions among banks and clients of the three supervisory bodies, enabling clients to submit their claims free of charge, with a maximum resolution period of 90 days. Resolutions by the Authority will be binding for claims under EUR 20 000.

⁽²¹⁾ SAREB (*Sociedad de gestión de Activos procedentes de la Reestructuración Bancaria*) is an asset management company that was created to divest the assets transferred from the old savings banks and help the economy.

5. SOVEREIGN FINANCING AND CAPACITY TO REPAY

34. In the short run, public debt in relation to GDP is forecast to decline, but this trend is expected to reverse in the medium term and the debt-to-GDP ratio is projected to reach around 113% in 2034 in the baseline scenario of the debt sustainability analysis (DSA) ⁽²²⁾.

Based on data validated by Eurostat, general government debt stood at 107.7% of GDP at the end of 2023. The debt ratio has decreased by 12.6 pps from the 2020 level but remains still nearly 10 pps above the level reached before the pandemic. The general government debt-to-GDP ratio is expected to decrease to 105.5% in 2024 and 104.8% in 2025 according to the Commission's Spring 2024 Economic Forecast. Based on the Commission's DSA baseline scenario, the debt ratio is projected to marginally decline to 104.4% in 2026 and the debt ratio is expected to rise gradually to 113.2% of GDP in 2034. Based on the debt sustainability analysis, Spain is considered to face low fiscal sustainability risks in the short term. The medium-term fiscal sustainability risks are assessed to be high while the long-run risks are considered to be medium (see Annex B for the debt sustainability analysis).

35. The structural features of the outstanding government debt in terms of average maturity and investor base remain favourable.

At the end of December 2023, according to the Bank of Spain, the central government debt-to-GDP ratio (net of financial assets vis-à-vis other general government sectors) was 76.1% while the ratio for the regional government sector (Autonomous Communities) was 22.2%. The local government sector's debt was 1.6% of GDP and the social security fund's debt was 7.9% of GDP. As regards central government debt, bonds that have maturities ranging from two years to up to 50 years accounted for 92% of the total outstanding central government debt according to the Treasury statistics. The outstanding stock of 10-year bonds represents about 42% of the total debt outstanding and it grew by 15% year-on-year during the first quarter of 2024, above the growth rate of the total debt stock (7.4%). The recent increasing trend in the share of outstanding bonds with at least 10-year maturity appears to continue. This has helped the average maturity of the debt stock to remain steady at around 7.9 years during the first quarter of 2024, a level where it has been since 2021. The share of short-term debt accounted for about 5% of the total central government outstanding debt in the first quarter of 2024. This share has gradually declined to its current level, which is around EUR 71 billion, as the Treasury has sought to issue less short-term debt. According to the Treasury's Funding Strategy for 2024, the target for the short-term debt portfolio is to keep its current size unchanged. As regards the holders of the central government outstanding debt (short- and long-term), non-resident investors' share accounted for 41.5% in January 2024. Their share started increasing in early 2023 and in January 2024 it was about 0.7 pps larger than 12 months earlier. Over the same period, the share of the outstanding debt stock held by the Bank of Spain declined by 3.3 pps to 28.2%, while the share of other resident holders increased by 2.6 pps to 30.3%. As part of the path to monetary policy normalisation, the ECB has decided to reduce the size of its balance sheet. While the reinvestments of maturing securities under the Asset Purchase Programme have already been discontinued, the monthly reinvestments under the Pandemic Emergency Purchase Programme will be reduced over the course of 2024 and discontinued at the end of 2024. ⁽²³⁾

⁽²²⁾ For a more detailed debt sustainability analysis, see Annex B.

⁽²³⁾ The reinvestments under the Asset Purchase Programme (APP) were discontinued as of July 2023. As regards the Pandemic Emergency Purchase Programme (PEPP) the ECB Governing Council stated on 11 April 2024 that "The Governing Council intends to continue to reinvest, in full, the principal payments from maturing securities purchased under the PEPP during the first half of 2024. Over the second half of the year, it intends to reduce the PEPP portfolio by €7.5 billion per month on average. The Governing Council intends to discontinue reinvestments under the PEPP at the end of 2024. The Governing Council will continue applying flexibility in reinvesting redemptions coming due in the PEPP portfolio, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic."

36. Spain has benefited from EU-financed instruments introduced during the pandemic.

Under the RRF, which provides financial support to the Spanish recovery and resilience plan (RRP) ⁽²⁴⁾, a total of EUR 38.1 billion (2.5% of GDP) in grants has been disbursed to Spain in the 2021-2024 period ⁽²⁵⁾. Following the approval of the revised RRP in October 2023, the maximum amount of RRF grants will be EUR 80 billion and Spain will also draw RRF loans worth EUR 83.2 billion by the end of 2026. In addition, under the Support to mitigate Unemployment Risks in an Emergency (SURE) to protect jobs during the pandemic, a loan which amounted to EUR 21.3 billion was disbursed to Spain in six tranches over 2020-2021.

37. While financing conditions for the government appear broadly favourable borrowing costs have increased.

The average yield at issuance has recently been on a declining trend and stood at 3.3 % in March 2024, down from the recent highs of 3.9% in October 2023 as the market has started to anticipate lower policy interest rates. For the benchmark 10-year bond, the average nominal interest rate at issuance was 3.05% in March 2024 (down by 0.53 pps from 12 months earlier and nearly 1 percentage point from October 2023, the recent peak). Lower interest rates at issuance also partly reflect the recent increase interest among investors towards Spanish debt. Despite some recent easing of market interest rates, the central government average interest rate on outstanding debt continued to increase in early 2024 reaching 2.12% in March, up by 0.3 pps from 12 months earlier reflecting the overall higher interest rate environment. The Treasury's funding strategy for 2024 estimates that the total net financing needs would be around EUR 55 billion, some EUR 10 billion less than the previous year. The gross issuance is projected at around EUR 257.6 billion (17% of GDP), around EUR 5.6 billion higher than in 2023. This indicates that the debt redemptions are increasing in 2024 from EUR 187 billion to EUR 202.6 billion (13% of GDP). As the short-term debt portfolio is projected to remain stable in 2024, the changes in net and gross issuances are driven by changes in the medium- and long-term debt portfolio. By 31 March 2024, the Treasury had already executed around 32% of the planned gross issuance, an indication of good market conditions.

38. Spain's sovereign spreads peaked in October 2023, but have declined significantly since then.

The expected slowdown in economic growth, the higher inflation and the less accommodative monetary policy stance led to an increase in spreads across the euro area in 2023. Spain's 10-year government spread with respect to German bonds reached at around 115 bps in late October last year. Since then, the situation has improved and in April 2024, the spread was at around 75 bps. This level is around 10 bps below the average spread since 2020, indicating increased confidence among investors. S&P Global, Moody's, Fitch and DBRS all rate Spain's long-term sovereign debt as investment grade. Moody's changed the outlook from stable to positive in March 2024 while other rating agencies consider the outlook as stable.

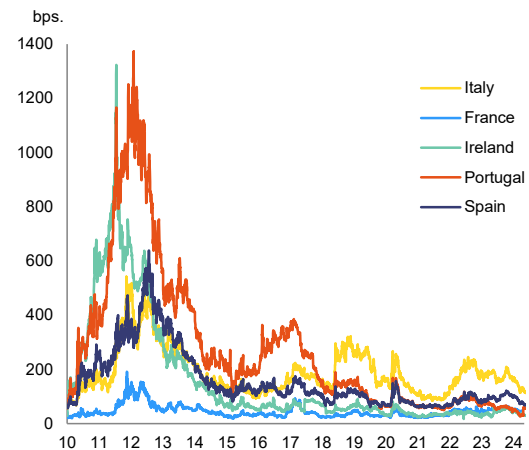
⁽²⁴⁾ See the Commission's proposal for the revised RRP: https://commission.europa.eu/publications/commission-proposal-council-implementing-decision-amending-council-implementing-decision-13-july_en

⁽²⁵⁾ Including pre-financing and three payment requests concerning grants. In addition, pre-financing related to loans, some EUR 340 million, has been disbursed in 2024. See the RRF scoreboard https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/disbursements.html?lang=en

39. The outstanding amount of the ESM loan stands at EUR 16.4 billion, which represents 39.7% of the total amount disbursed to Spain under the programme.

The Spanish Government started their repayment of the loan's principal with voluntary repayments in July 2014. Between July 2014 and October 2018, Spain made nine voluntary early repayments. In December 2022 – in line with the agreed repayment schedule – Spain made the first scheduled repayment worth EUR 3.6 billion. This was followed by the second scheduled payment in December 2023. At the end of 2023, Spain had repaid nearly EUR 25 billion of the ESM loan. The next scheduled payments are EUR 4.6 billion in 2024 and 2025. The last repayment is expected in 2027.

Graph 5.1: Sovereign spreads to the 10-year German bund



Source: IHS Markit, own calculations.

40. Spain retains the capacity to service its public debt.

The structure of outstanding government debt reduces the vulnerabilities arising from the elevated debt levels and rising market interest rates, and. Spain's public debt remains well above the pre-pandemic level. The gross financing needs are expected to remain large at around 18% of GDP in 2024-2025. Based on the ECB's policy decisions, the Eurosystem's holdings of Spanish debt are expected to continue to be on a decreasing trend, while the roles of non-resident and resident investors will gain in importance in the future. Against the high overall debt stock, relatively stable short-term financing needs and long average maturity, the increased market rates will only gradually result in an increase in actual interest expenditure, as some older higher-rate debt can be refinanced at still cheaper rates. On the positive side, the increases in the average costs of financing come from low levels and recently the cost at issuance has started to decline as a change in the monetary policy is expected. In addition, the spread in relation to German bonds has recently narrowed, which gives indications of increased market confidence towards Spain. In addition, the maturity has remained at a high level reflecting a policy choice of the Treasury and the consistent demand indicates that investors are not seeking less risky, shorter maturity bonds from this issuer. Owing to high average maturity, the Treasury is considered to have a buffer against possible shifts in investors' demand towards higher yield. As regards other government sector debt, the current situation is considered stable.

ANNEX A

Main macroeconomic and financial indicators

Table A.1: **Main macroeconomic and financial indicators**

	2000	2008	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
	-2007	-2013										(f)	(f)	(f)
Core indicators														
GDP growth rate	3.7	-1.3	1.4	3.8	3.0	3.0	2.3	2.0	-11.2	6.4	5.8	2.5	2.1	1.9
of which domestic demand incl. stocks	4.5	-3.1	1.9	3.9	2.0	3.1	2.9	1.6	-9.0	6.6	2.9	1.7	2.0	1.9
Private consumption (annual % change)	3.7	-2.1	1.7	2.9	2.7	3.0	1.7	1.1	-12.3	7.1	4.7	1.8	2.1	1.9
Public consumption (annual % change)	5.0	0.9	-0.6	2.0	1.0	1.0	2.3	1.9	3.6	3.4	-0.2	3.8	1.8	1.3
HICP (annual % change)	3.2	2.2	-0.2	-0.6	-0.3	2.0	1.7	0.8	-0.3	3.0	8.3	3.4	3.1	2.3
Unemployment rate (% of labour force)	10.6	20.2	24.5	22.1	19.6	17.2	15.3	14.1	15.5	14.9	13.0	12.2	11.6	11.1
Gross fixed capital formation (% of GDP)	27.7	21.4	17.8	18.0	18.0	18.7	19.4	20.0	20.4	20.1	20.1	19.3	19.2	19.3
Gross national saving (% of GDP)	22.3	18.8	19.6	21.0	21.9	22.2	22.3	22.9	21.1	22.4	22.1	22.8	23.0	23.1
General Government (% of GDP)														
Balance (g)	0.4	-9.0	-6.1	-5.3	-4.3	-3.1	-2.6	-3.1	-10.1	-6.7	-4.7	-3.6	-3.0	-2.8
Gross debt	46.7	69.0	105.1	103.3	102.7	101.8	100.4	98.2	120.3	116.8	111.6	107.7	105.5	104.8
Interest expenditure	2.2	2.4	3.5	3.0	2.8	2.5	2.4	2.3	2.2	2.1	2.4	2.5	2.5	2.6
Households														
Households saving rate	8.9	8.9	6.3	7.2	7.1	5.8	5.6	8.2	17.5	13.8	7.6	11.7	11.3	10.9
Rest of the world (% of GDP)														
Trade balance	-3.7	-0.1	3.1	3.0	4.0	3.6	2.7	2.9	1.4	1.0	1.2	4.1	4.3	4.4
Trade balance, goods	-6.8	-4.1	-2.1	-1.9	-1.3	-1.9	-2.4	-2.1	-0.8	-1.9	-4.4	-2.2	-2.1	-2.0
Trade balance, services	3.1	4.0	5.2	5.0	5.3	5.5	5.1	5.1	2.2	2.9	5.6	6.4	6.4	6.3
Current account balance	-5.9	-2.9	1.7	2.0	3.2	2.8	1.9	2.1	0.6	0.8	0.6	2.5	2.8	2.8
Net financial assets	-55.3	-91.5	-95.4	-88.3	-84.7	-85.2	-77.3	-73.3	-85.0	-71.6	-61.0	n.a.		
Net international investment position (h)	-56.5	-91.6	-95.9	-88.9	-85.4	-85.5	-79.1	-72.8	-84.9	-71.0	-60.0	-52.8		
Competitiveness (index, 2015=100)														
Real effective exchange rate relative to the rest of the euro area	104.6	107.9	100.4	100.0	98.3	98.1	97.8	99.8	103.7	104.6	101.8	102.0	102.0	102.2
Real effective exchange rate relative to the rest of the European Union	104.8	107.6	100.3	100.0	98.1	97.6	97.3	99.2	103.1	104.0	101.1	100.7	100.4	100.4
Real effective exchange rate relative to the rest of 37 industrialised countries	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Banking sector														
Assets (% of GDP)	214.9	325.0	287.9	262.4	244.8	234.3	219.7	214.9	258.5	245.7	220.9	206.3		
Private domestic credit (y-o-y %)	15.7	-3.0	-6.5	-4.2	-4.1	-2.0	-3.9	-1.5	3.3	-0.2	-0.6	-3.3		
Non-performing loans (NPLs), total (%) (i)	1.0	7.7	12.5	10.1	9.1	7.8	5.8	4.8	4.5	4.3	3.5	3.5		
NPLs, productive activities (%)	1.0	10.8	18.5	14.6	13.1	10.3	6.9	5.4	5.0	4.8	4.2	4.1		
* of which, construction, and (%)	0.9	17.3	32.6	30.0	29.1	24.1	14.0	11.7	9.2	8.5	8.1	8.2		
* real estate activities (%)	0.5	19.8	36.2	27.5	25.5	18.1	9.0	5.2	5.0	4.1	3.8	3.0		
NPLs, residential mortgages (%)	0.4	3.7	6.3	5.1	5.2	5.6	4.9	4.1	3.8	3.5	2.7	2.8		
ECB ratios (%) (j)														
NPL (domestic and controlled foreign branches and banks)	n.a.	n.a.	8.1	6.3	5.7	4.4	3.7	3.1	2.8	2.9	2.7	n.a.		
* of which non-financial corporations	n.a.	n.a.	16.4	12.8	10.9	7.9	5.9	4.7	4.6	4.8	4.0	n.a.		
* of which households	n.a.	n.a.	5.3	4.5	4.5	4.4	4.0	3.6	3.4	3.8	3.4	n.a.		
Coverage	n.a.	61.7	46.4	46.8	45.0	42.7	43.7	43.7	45.6	41.7	43.3	n.a.		
Return on equity (k)	n.a.	1.8	6.7	6.6	5.0	7.0	8.2	6.7	-3.5	10.2	9.9	n.a.		
Return on assets (k)	n.a.	0.1	0.5	0.5	0.4	0.5	0.6	0.5	-0.2	0.7	0.6	n.a.		
Total capital	n.a.	12.1	13.6	14.5	14.7	15.4	15.4	15.7	16.8	17.3	16.5	n.a.		
CET 1	n.a.	n.a.	11.8	12.7	12.8	12.6	12.2	12.5	13.2	13.3	13.0	n.a.		
Tier 1	n.a.	9.8	11.8	12.7	13.0	13.2	13.5	13.8	14.7	15.0	14.4	n.a.		
Loan-to-deposit	n.a.	n.a.	90.3	91.7	92.5	89.3	90.6	92.6	85.5	82.8	87.0	n.a.		
Interest rates														
10 year spread vis-à-vis the Bund (%)	0.1	2.1	1.5	1.2	1.3	1.2	1.0	0.9	0.9	0.6	0.9	0.9		
CDS 5 year (basis points)	n.a.	221.5	90.3	84.1	82.0	67.4	62.6	52.0	68.0	33.6	48.8	46.6		

Updated on 21 May 2024.

(f) forecast

(g) General government balances include capital transfers related to support of banks

(h) ESA2010 and BPM6, latest quarter divided by a 4 quarters rolling GDP

(i) NPLs: ratios, in % of total loans, end-of-period, source: BdE

(j) ECB ratios, end-of-period

(k) annualised

Source: Ameco, BdE, Boursorama, ECB, Eurostat, IHS Datainsight.

ANNEX B

Debt sustainability analysis

This annex assesses fiscal sustainability risks for Spain over the short, medium and long term. It follows the multi-dimensional approach of the European Commission's 2023 Debt Sustainability Monitor, updated based on the Commission 2024 spring forecast.

1 – Short-term risks to fiscal sustainability are low overall. The Commission's early-detection indicator (SO) does not signal major short-term fiscal risks (Table B.2) ⁽²⁶⁾. Government gross financing needs are expected to remain large, at around 18% of GDP over 2024-2025 (Table B.1, Table 1). Financial markets' perceptions of sovereign risk are investment grade, as confirmed by the main rating agencies.

2 – Medium-term fiscal sustainability risks are high.

Under the DSA baseline, debt is projected to decline slightly before increasing again over the medium term, reaching around 113% of GDP in 2034 (Graph 1 and Table 1) ⁽²⁷⁾. The increase in the government debt ratio is partially driven by the assumed structural primary deficit (excluding changes in cost of ageing) of 0.8% of GDP as of 2024. This level appears plausible compared with past fiscal performance, indicating that the country has room for corrective action (Table B.2) ⁽²⁸⁾. Moreover, ageing-related expenditure is projected to increase, weighing on public finances. At the same time, the baseline projection benefits from a still favourable (although declining) snowball effect up to 2034, notably thanks to the impact of Next Generation EU. Government gross financing needs are expected to remain large and to increase over the projection period, reaching 21.5% of GDP in 2034.

The baseline projection is stress-tested against four alternative deterministic scenarios to assess the impact of changes in key assumptions (Graph 1). All four scenarios lead to higher debt levels than the baseline. Under the *adverse interest-growth rate differential scenario* (in which the interest-growth rate differential deteriorates by 1.0 pp. compared with the baseline), the debt ratio would exceed the baseline level by around 9 pps. by 2034. Under both the *historical structural primary balance (SPB) scenario* (in which the SPB returns to its historical 15-year average of -1.4% of GDP) and the *lower SPB scenario* (in which the improvement in the SPB forecast for 2024 is halved), the debt ratio would be higher than in the baseline by around 4 pps. by 2034. Finally, under the *financial stress scenario* (in which interest rates temporarily increase by 2.1 pps. compared with the baseline), the government debt ratio would be higher by around 2 pps. by 2034.

The stochastic projections indicate high risk due to the high probability of debt increasing over the next five years ⁽²⁹⁾. These stochastic simulations indicate that the debt ratio will be higher in 2028 than in 2023 with a probability of 42%, pointing to high risk given the high initial debt level. Some uncertainty surrounds the baseline debt projection, as measured by the difference of around 31 pps. of GDP between the 10th and 90th debt distribution percentiles in five years' time (Graph 2).

⁽²⁶⁾ The SO is a composite indicator of short-term risk of fiscal stress. It is based on a wide range of fiscal and financial-competitiveness indicators that have proven to be a good predictor of emerging fiscal stress in the past.

⁽²⁷⁾ The assumptions underlying the Commission's 'no-fiscal policy change' baseline include in particular: (i) a structural primary deficit, before changes in ageing costs, of 0.8% of GDP from 2024 onwards; (ii) inflation converging linearly towards the 10-year forward inflation-linked swap rate 10 years ahead (which refers to the 10-year inflation expectations 10 years ahead); (iii) the nominal short- and long-term interest rates on new and rolled over debt converging linearly from current values to market-based forward nominal rates by T+10; (iv) real GDP growth rates from the Commission 2024 spring forecast, followed by the EPC/OGWG 'T+10 methodology' projections between T+3 and T+10 (average of 1.2%); (v) ageing costs in line with the 2024 Ageing Report (European Commission, Institutional Paper 279, April 2024). For information on the methodology, see the 2023 Debt Sustainability Monitor (European Commission, Institutional Paper 271, March 2024).

⁽²⁸⁾ This assessment is based on the fiscal consolidation space indicator, which measures the frequency with which a tighter fiscal position than assumed in a given scenario has been observed in the past. Technically, this consists in looking at the percentile rank of the projected SPB within the distribution of SPBs observed in the past in the country, taking into account all available data from 1980 to 2023.

⁽²⁹⁾ The stochastic projections show the joint impact on debt of 10,000 different shocks affecting the government's budgetary position, economic growth, interest rates and exchange rates. This covers 80% of all the simulated debt paths and therefore excludes tail events.

3 – Long-term fiscal sustainability risks are medium. This assessment is based on the combination of two fiscal gap indicators, capturing the required fiscal effort to stabilise debt (S2 indicator) and to bring it to 60% of GDP (S1 indicator) over the long term⁽³⁰⁾. This assessment is driven by the projected increase in ageing-related costs and by the unfavourable initial deficit and debt levels.

The S2 indicator points to medium risk. It signals that Spain would need to improve its structural primary balance by 5.6 pps. of GDP to ensure that debt stabilises over the long term (Table B.1, Table 2). This result is mainly driven by the projected increase in ageing costs, which contributes 4.0 pps. of GDP, of which 2.7 pps. stemming from pension expenditure and 1.8 pps. jointly from health care and long-term care expenditure, partially offset by a negative contribution from education. The remainder of the needed effort is due to the unfavourable budgetary position, contributing 1.6 pps. of GDP. The impact of the recently adopted pension reform under the RRP is included in this projection.⁽³¹⁾

The S1 indicator also points to medium risk. This indicator shows that a significant fiscal effort of 5.1 pps. of GDP would be needed for Spain to reduce its debt to 60% of GDP by 2070. This result is also mainly driven by the projected increase in ageing costs (contributing 3.2 pps. of GDP). The initial deficit and high debt level contribute an additional 1.0 pp. and 0.9 pp. of GDP, respectively (Table 2).

4 – Finally, several additional risk factors need to be considered in the assessment. On the one hand, risk-increasing factors relate to the context of higher interest rates given the elevated level of public debt. On the other hand, risk-mitigating factors include the lengthening of debt maturity in recent years, relatively stable financing sources featuring a well-diversified and large investor base, and the very large share of debt denominated in euro. In addition, the ‘closure clause’ introduced by the 2023 pension reform, if fully implemented, would contribute to addressing the emerging fiscal sustainability gaps related to public pension expenditure. Furthermore, while a number of investments and reforms in the RRP contribute to supporting the efficiency of the Spanish health system, measures may be required to further improve its efficiency and its fiscal sustainability.

⁽³⁰⁾ The S2 fiscal sustainability indicator measures the permanent SPB adjustment in 2025 that would be required to stabilise public debt over an infinite horizon. It is complemented by the S1 indicator, which measures the permanent SPB adjustment in 2025 needed to bring the debt ratio to 60% by 2070. The impact of the drivers of S1 and S2 may differ due to the infinite horizon component considered in the S2 indicator. For both the S1 and S2 indicators, the risk assessment depends on the amount of fiscal consolidation needed: ‘high risk’ if the required effort exceeds 6 % of GDP, ‘medium risk’ if it is between 2% and 6% of GDP, and ‘low risk’ if the effort is negative or below 2% of GDP. The overall long-term risk classification combines the risk categories derived from S1 and S2. S1 may notch up the risk category derived from S2 if it signals a higher risk than S2. See the 2023 Debt Sustainability Monitor for further details.

⁽³¹⁾ The pension reform includes measures aiming to preserve adequacy and intergenerational equity, including by increasing the effective retirement age and contributions to the pension system, while minimising the impact on the tax wedge on labour.

Table B.1: Debt sustainability analysis - Spain

Table 1. Baseline debt projections	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Gross debt ratio (% of GDP)	116.8	111.6	107.7	105.5	104.8	104.4	104.7	105.0	105.5	106.2	107.4	108.9	110.9	113.2
Changes in the ratio	-3.4	-5.2	-4.0	-2.1	-0.7	-0.5	0.3	0.4	0.4	0.8	1.1	1.6	2.0	2.3
of which														
Primary deficit	4.6	2.4	1.2	0.4	0.3	0.6	0.9	1.2	1.3	1.5	1.7	1.9	2.1	2.4
Snowball effect	-8.0	-8.4	-6.4	-3.0	-1.9	-1.0	-0.7	-0.8	-0.9	-0.7	-0.5	-0.3	-0.2	-0.1
Stock-flow adjustments	0.0	0.8	1.2	0.5	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs (% of GDP)	23.9	19.0	20.4	18.0	18.2	17.7	18.2	18.5	18.8	19.2	19.6	20.2	20.9	21.5

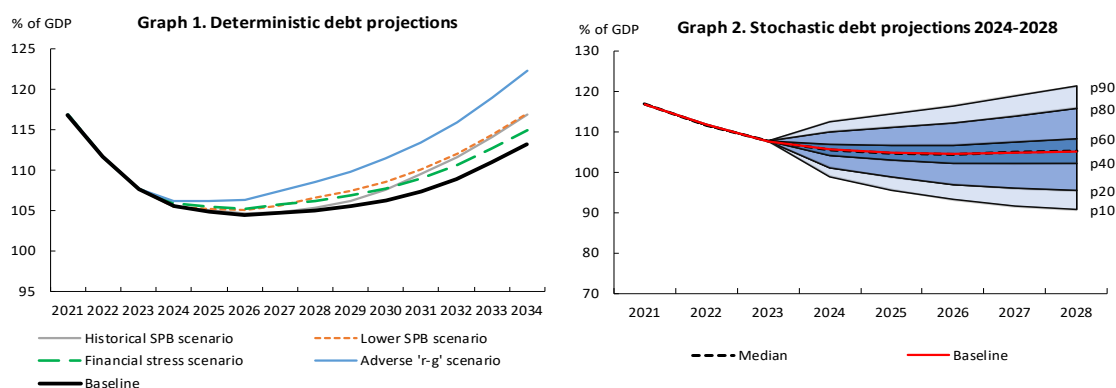


Table 2. Breakdown of the S1 and S2 sustainability gap indicators

	S1	S2
Overall index (pps. of GDP)	5.1	5.6
of which		
Initial budgetary position	1.0	1.6
Debt requirement	0.9	
Ageing costs	3.2	4.0
of which		
Pensions	2.4	2.7
Health care	0.9	1.1
Long-term care	0.5	0.7
Education	-0.5	-0.5

Source: Commission services

Table B.2: Heat map of fiscal sustainability risks - Spain

Short term	Medium term - Debt sustainability analysis (DSA)							Long term			
	Overall (S0)	Overall	Deterministic scenarios					Stochastic projections	S2	S1	Overall (S1 + S2)
			Baseline	Historical SPB	Lower SPB	Adverse 'r-g'	Financial stress				
LOW	HIGH	Overall	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MEDIUM	MEDIUM	MEDIUM
		Debt level (2034), % GDP	113.2	116.9	117.0	122.2	115.0				
		Debt peak year	2034	2034	2034	2034	2034				
		Fiscal consolidation space	71%	77%	76%	71%	71%				
		Probability of debt ratio exceeding in 2028 its 2023 level						42%			
							30.6				

(1) Debt level in 2034. Green: below 60% of GDP. Yellow: between 60% and 90%. Red: above 90%. (2) The debt peak year indicates whether debt is projected to increase overall over the next decade. Green: debt peaks early. Yellow: peak towards the middle of the projection period. Red: late peak. (3) Fiscal consolidation space measures the share of past fiscal positions in the country that were more stringent than the one assumed in the baseline. Green: high value, i.e. the assumed fiscal position is plausible by historical standards and leaves room for corrective measures if needed. Yellow: intermediate. Red: low. (4) Probability of debt ratio exceeding in 2028 its 2023 level. Green: low probability. Yellow: intermediate. Red: high (also reflecting the initial debt level). (5) The difference between the 90th and 10th percentiles measures uncertainty, based on the debt distribution under 10000 different shocks. Green, yellow and red cells indicate increasing uncertainty. (For further details on the Commission's multidimensional approach, see the 2023 Debt Sustainability Monitor)

Source: Commission services

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