Summary for non-specialists
Occasional Papers No. 163 / November 2013
Occasional Papers index

Financial Assistance Programme for the Recapitalisation of Financial Institutions in Spain. Fourth Review – Autumn 2013

The European Commission published the Fourth Review report of Spain's compliance with the Financial Assistance Programme for the Recapitalisation of Financial Institutions. The report is based on the findings of a joint European Commission (EC)/European Central Bank[1] (ECB) mission to Madrid during 16 – 27 September 2013.

The mission found that the stabilisation and repair of the financial sector have advanced further amid tentative signs of economic recovery. The timely and adequate implementation of the policy conditionality of the programme, together with visible progress with growth-enhancing structural reforms, contributed to a return of investor confidence.

Spanish financial markets have extended their significant trend of stabilisation, which had started in the summer 2012. Following the drop in sovereign bond yields and lower volatility, financing conditions for large parts of the economy have improved considerably. The liquidity situation of the Spanish banking sector has further improved, as deposits have been over the rise and Spanish banks are regaining access to funding markets, although the situation has not normalized for some segments of the inter-bank market.

After significant losses in 2012 due to a massive build-up of provisions, bank profitability turned positive in the first half of 2013, partly due to one-off gains. In this context, the recent initiatives by the Banco de España (BdE) to harmonise treatment of restructured loans and to carry out a forward-looking exercise of the banking sector, as a useful supervisory tool, are welcome.

The solvency position of Spanish banks has remained comfortable after the recapitalisation of parts of the banking sector, the transfer of assets to Sareb (the Spanish asset management company) and overall positive earnings results of Spanish banks over 2013 so far. Consequently, all banks (except one in the process of being taken over) are reporting solvency rates above regulatory minimum requirements.

[1] The mission also involved expert teams from the European Stability Mechanism and the European Banking Authority. The International Monetary Fund participated in the meetings as part of its independent monitoring.

The process of restructuring of banks having received State aid is well underway, guided by the restructuring plans, as adopted by the European Commission. The foreseen burden-sharing exercises with banks´ shareholders and junior bond holders are virtually completed.

Despite recent improvements, the economic environment continues to weigh on the banking sector and constitutes the main risk factor going forward. Lending to the real economy is still contracting at a rapid pace against the backdrop of weak solvent demand for new lending and a large increase in the banks' holdings of government securities. While there are early signs of a general economic stabilisation, supported in particular by net exports, the central scenario going forward remains one of a mild recovery in activity. Both the private and public sector need to reduce much further their debt stocks, and the adjustment in real estate prices is not yet completed.

Compliance with the horizontal policy requirements in the MoU has been completed, although full implementation is still required in a few areas. Thereby, the governance, regulatory and supervisory framework of the Spanish banking sector has been strengthened. This, in turn, translates into higher future shock resilience of the banking sector. However, the adoption, in particular in the area of the reform of the governance of the savings banks, and implementation of the agreed measures need to continue as envisaged. Steps have already been taken aiming at improving non-banking financial intermediation, which should help smoothen the contraction in lending.

The economic and budgetary situation remains challenging. This calls for a continuation of recent advances with structural reforms and full adherence to budgetary commitments. Notable ongoing measures include reforms to stabilise the pension system, unify the Spanish internal market for goods and services, liberalise professional services, deliver more effective local and public administration and address the electricity tariff deficit. Fiscal consolidation advanced further in the first half of the year but there are risks to the attainment of the 2013 deficit target.

In sum, the programme remains on track and the resilience of the financial sector has increased, so that there is no reason to foresee further programme disbursements at this stage. Two disbursements were made so far in a total amount of about EUR 41.3 billion for the recapitalisation of State aided banks and the capital injection into Sareb. The rest of the Spanish banks either were not diagnosed with a capital shortfall in the stress test or were able to cover it by private means.