Summary for non-specialists
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Financial Assistance Programme for the Recapitalisation of Financial Institutions in Spain. Second Review of the Programme – Spring 2013

The European Commission published the Second 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 28 January – 1 February 2013.

In general, the mission found that the policy conditionality of the programme has so far been met and the programme, and more widely the recapitalisation and reform of the financial sector, is on track. Furthermore, as financial markets have stabilised, funding and liquidity conditions of the Spanish financial sector have improved. In order to build on this momentum, it will be important to maintain the pace of reforms in order to overcome the still significant challenges and conclude successfully the programme.

Spain's access to financial markets has further improved. Favourable developments in global capital markets and effective initiatives at European level have improved the climate for foreign investors to return to Spanish markets. This has resulted in better market access by both the Spanish sovereign and private borrowers. Despite the significant progress achieved in recent months, a degree of uncertainty exists on whether these improvements would consolidate, as banks' profitability remains under pressure. On the domestic front, the good compliance with the conditions imposed in the Memorandum of Understanding has also contributed to the stabilisation of the banking sector and to the return of investor confidence.

As regards the bank-specific conditionality, significant progress in separating the impaired assets from banks has been achieved since the last review, with the start of operations by Sareb - the Spanish asset-management company. Against the background of a necessarily demanding timeline, the Spanish authorities have succeeded in designing, implementing and operationalizing this entity with the first, and largest, transfer of assets from banks to Sareb

[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.

occurring on time. Much work remains ahead in this regard, however, and the coming months will be devoted to making Sareb fully operational.

The implementation of the horizontal financial-sector conditionality has been further advanced and is close to completion in most areas. The reform of the governance of the savings banks, a review of supervisory procedures at Banco de España, reforms of the regulatory frameworks governing banks' credit concentration and provisioning, and the enhancement of the credit register are still on-going. In all these areas, the Spanish authorities have achieved or are very close to achieving compliance with the Memorandum of Understanding and have made very tangible progress towards major and lasting reforms in these areas.

The macroeconomic situation remains challenging, with very high and rising unemployment, GDP contraction and a need to reduce large stocks of internal and external debt. Notwithstanding the significant policy progress already made, further determined advances remain necessary in the consolidation of public finances - including reinforcing the institutional framework - and in the swift completion and implementation of the structural reform agenda, along the lines specified in last year's country–specific recommendations.

While credit contraction has been gaining speed, this seems mostly due to the necessary deleveraging of exposures toward the construction and real-estate developer sectors and to falling credit demand. Although it is difficult to draw clear-cut conclusions on the forces driving the decline in lending activity, it appears that the flow of new lending to the more dynamic sectors of the economy is less constrained than the shrinking stock of total credit would suggest.

The report concludes that currently there is no reason to foresee further programme disbursements. Two disbursements were made so far in a total amount of about EUR 41.4 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.