Spain

Macroeconomic & Financial Outlook

CaixaBank Research

May 2023

Prepared with information available as of May 9th, 2023

CaixaBank

Key messages

Activity	▶ **The ECB raised rates by 25bp in May and signaled more ground to cover.** The combination of (i) the remarkable tightening implemented since summer 2022 (+375bp) and (ii) growing evidence that the transmission of monetary policy is working have allowed the ECB to slow down the pace of interest-rate tightening. Still, inflation data led officials to signal higher rates in the coming months. We expect the ECB to hike by +25pb in June and see it close to reaching a peak rate. The ECB could start to normalize rates towards neutral levels by 2024, when inflation dynamics should have provided comfort that second-round effects are limited, and that inflation is heading back towards 2% in a sustainable way. ▶ **GDP grew 0.5% qoq in Q1 2023 (3.8% in yoy terms)**, a very positive figure that introduces upside risks on our 2023 GDP growth forecast (currently at 1.3%). GDP grew on the back of investment and exports. However, private consumption fell and so did public consumption. GDP now stands just 0.2% below the pre-pandemic level of Q4 2019. We will revise our macroeconomic scenario in the upcoming month. ▶ **Early Q2 2023 indicators show a positive trend.** In April employment growth continued to accelerate and the composite PMI index sat comfortably at 56.3 points, well above the no-change threshold (50 points), indicating expansion in the economy. ▶ **Headline inflation increased to 4.1% in April** (3.3% in March) due upward base effects generated by the energy price drop in April 2022 (the price adjustment that followed the surge of March 2022). Underlying inflation (excluding all energy and unprocessed food), on the other hand, declined sharply to 6.6% (7.5% in March). The deviation of the underlying month-on-month growth rate with respect to its own historical average was negative in April (the first time since August 2021), which suggests that pressures on underlying inflation could begin to abate in the coming months. ▶ **We expect house prices to grow 0.2% in 2023.** High inflation and the increase in interest rates will weigh on demand. The impact will be more acute in housing transactions, which we expect will decline by c. 25% relative to the high levels registered in 2022, than in prices, which we expect will nearly stagnate. The likelihood of a severe price correction is low as prices have remained broadly in line with fundamentals. ▶ **The Stability Plan presented by the Government proposes a gradual adjustment of the public deficit, driven by the economic recovery.** It expects the deficit to decline from 4.8% in 2022 to 2.5% in 2026. Public spending is forecast to decrease in % of GDP due to the large increase in nominal GDP and some restraint in primary spending excl. pensions, while public revenues are forecast to increase as a % of GDP because of higher revenues from direct taxes and social contributions.
Banking Sector	▶ **The banking system remains strong with robust capital and liquidity positions.** Regarding liquidity, the deposit base is dominated by household deposits (70% in 4Q22, 6 pp above EU levels) with a high proportion of deposits covered by guarantees schemes (c.66% on average). Liquidity ratios remain high, both the short-term LCR (171.1% in 4Q22 vs 164.7% EU average) and the longer-term stable funding (NSFR was 129.8% in 4Q22 vs. 125.6% EU average). Regarding credit risk, domestic NPL ratio stood at 3.55% in February, 127 bps below pre-covid level of February 2020.

Main economic forecasts

UNDER REVIEW

%, YoY, unless otherwise specified	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 (Forecast)	2024 (Forecast)
GDP	1.4	3.8	3.0	3.0	2.3	2.0	-11.3	5.5	5.5	1.3	1.9
Private Consumption	1.7	2.9	2.6	3.0	1.8	0.9	-12.4	6.0	4.5	0.7	2.3
Public Consumption	-0.6	2.0	1.0	1.0	2.3	1.9	3.5	2.9	-0.7	2.2	0.5
Gross Fixed Capital Formation (GFCF)	4.1	4.9	2.4	6.8	6.3	4.5	-9.7	0.9	4.6	-1.7	2.6
GFCF - equipment	5.6	9.1	1.8	9.2	4.7	2.0	-13.3	6.3	4.0	-4.5	3.4
GFCF - construction	3.0	1.5	1.6	6.7	9.5	7.2	-10.2	-3.7	4.7	-0.3	2.2
Exports	4.5	4.3	5.4	5.5	1.7	2.2	-19.9	14.4	14.4	1.0	2.0
Imports	6.8	5.1	2.6	6.8	3.9	1.3	-14.9	13.9	7.9	-0.5	2.0
Unemployment rate	24.4	22.1	19.6	17.2	15.3	14.1	15.5	14.8	12.9	12.8	12.4
CPI (average)	-0.2	-0.5	-0.2	2.0	1.7	0.7	-0.3	3.1	8.4	4.2	2.6
External current account balance (% GDP)	1.7	2.0	3.2	2.8	1.9	2.1	0.6	1.0	0.9	0.3	1.0
General Government Balance (% GDP)[1]	-6.1	-5.3	-4.3	-3.1	-2.6	-3.1	-10.3	-6.9	-4.8	-4.0	-3.3
General government debt (% GDP)[2]	100.4	99.3	99.0	98.1	97.6	95.5	120.4	118.3	113.2	110.4	108.3
Housing prices	-2.4	1.1	1.9	2.4	3.4	3.2	-1.1	2.1	5.0	0.2	1.5
Risk premium (vs. 10Y Bund, bps, Dec.)	149	120	124	120	97	88	86	67	104	108	105
Bank credit (to the private domestic sector)	-9.4	-7.1	-4.3	-2.9	-1.9	-2.6	-1.2	2.5	0.5	-0.4	-0.7

Notes: *All GDP figures are based on ESA-2010 methodology.*

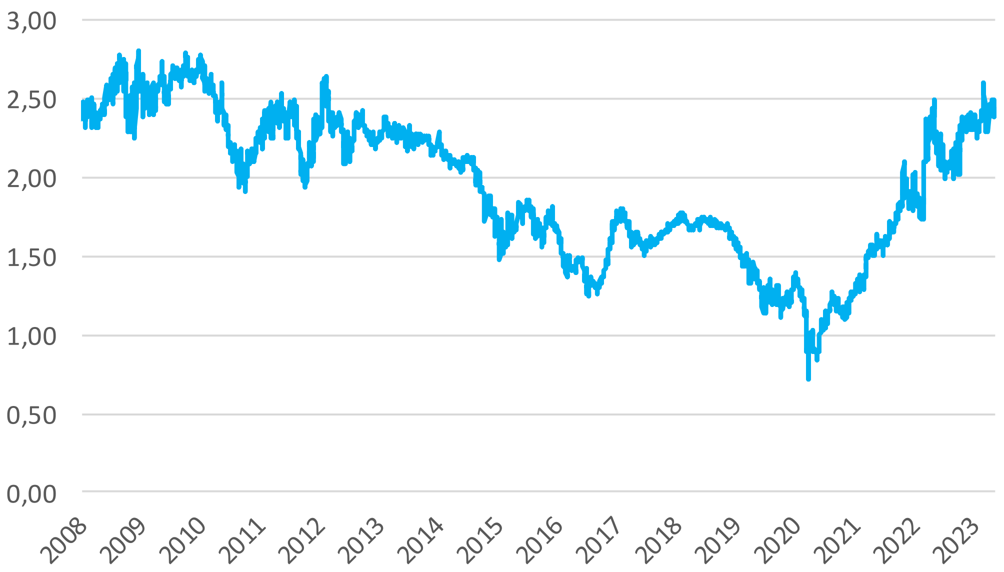
1/ The general government deficit excludes one-off bank restructuring costs of 3.7% of GDP in 2012, 0.3% of GDP in 2013, 0.1% in 2014, 0.05% in 2015, 0.2% in 2016, 0.04% in 2017 and 0.01% in 2018.
2/ General government debt includes ESM/FROB related borrowings equivalent to 3.9% of GDP in 2012.

Source: *CaixaBank Research.*

Tightening cycle not over yet

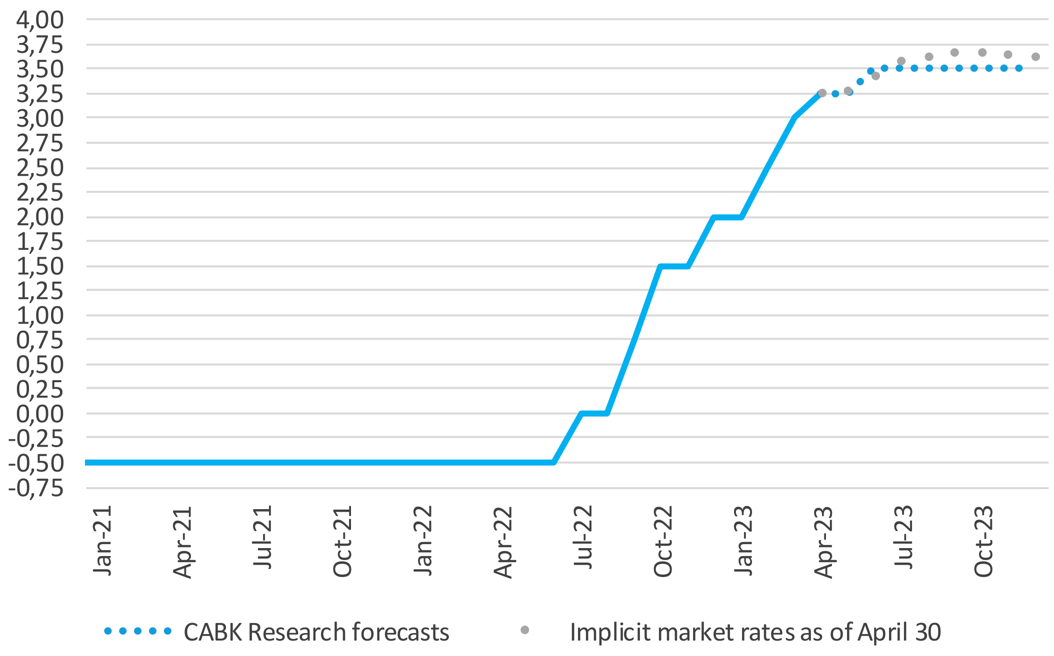
Eurozone: market-based 5Y5Y inflation expectations

(%)



ECB deposit rate

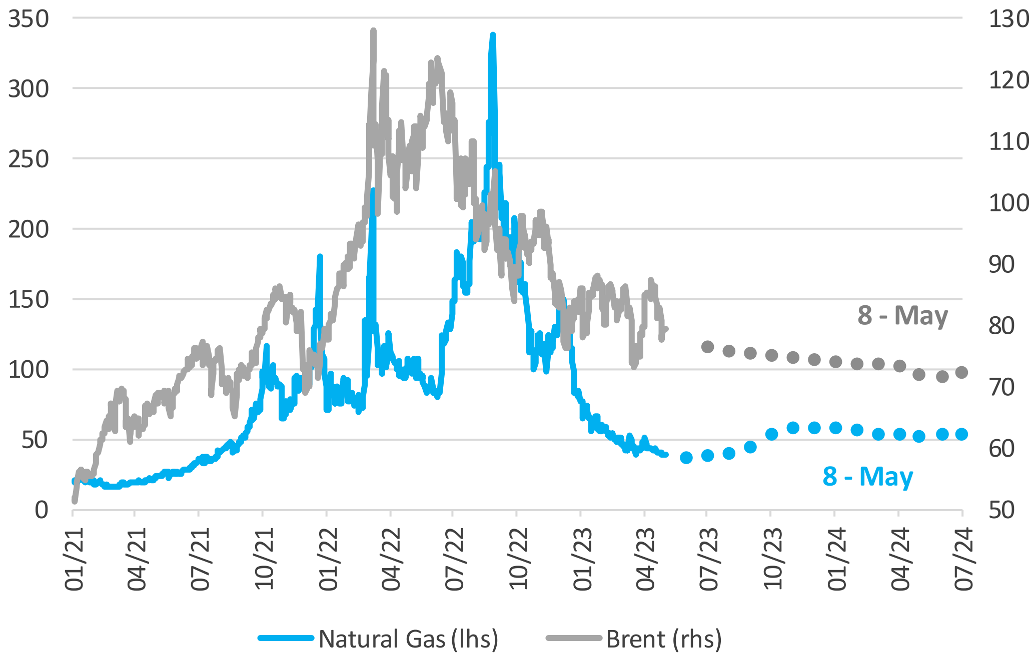
(%)



- **The ECB raised rates by 25bp in May and signaled more ground to cover**. The combination of (i) the remarkable tightening implemented since summer 2022 (+375bp) and (ii) growing evidence that the transmission of monetary policy is working (e.g., Q1 2023's Bank Lending Survey showed a sustained tightening in credit standards and a broad-based weakness in credit demand) have allowed the ECB to slow down the pace of interest-rate tightening. Still, inflation data led officials to signal higher rates in the coming months. Regarding QT, the ECB will discontinue APP reinvestments starting in July 2023 while keeping full PEPP reinvestments (we see a modest impact on sovereign yields, reflecting a gradual ECB withdrawal and strong investor appetite).
- **Financial turbulences in a context of solid macroeconomic data give the upper hand to the 'dovish hikers'**. An inflation outlook that remains too high for too long continues to push ECB officials towards higher rates. Yet, evidence of tighter financial conditions, together with the spring 2023 episode of financial turbulences in the U.S. (which is likely to lead to tighter credit conditions, particularly so among regional banks), favors a more cautious approach going forward, possibly opting for keeping rates at restrictive levels for longer (instead of continuing to hike aggressively).
- **We expect the ECB to hike by +25pb in June and see it close to reaching a peak rate**. The ECB could start to normalize rates towards neutral levels by 2024, when inflation dynamics should have provided comfort that second-round effects are limited, and that inflation is heading back towards 2% in a sustainable way.

Gas prices plummet following mild weather conditions

Gas and oil prices (and futures)



Commodity prices

	Metric	Price	*Change (%)* Last Month	Year to Date	2021	2022
Commodities	**index**	**103,8**	**-2,3**	**-8,0**	**27,8**	**13,8**
Energy	**index**	**31,4**	**-7,6**	**-23,8**	**54,5**	**-4,4**
Brent	$/barrel	76,8	-9,8	-10,7	51,5	33,5
Natural Gas (Europe)	€/MWh	36,2	-16,1	-52,6	270,2	-0,3
Precious Metals	**index**	**232,8**	**0,6**	**8,3**	**-6,2**	**25,3**
Gold	$/ounce	2023,4	1,6	10,9	-3,4	44,8
Industrial Metals	**index**	**154,2**	**-0,5**	**-6,8**	**29,0**	**6,1**
Aluminum	$/Tm	2318,5	-0,6	-2,5	40,4	16,7
Copper	$/Tm	8581,5	-2,3	2,5	23,9	12,4
Agricultural	**index**	**68,0**	**0,0**	**-1,2**	**28,0**	**-1,9**
Wheat	$/bushel	647,3	-4,2	-18,3	20,3	7,5

- **European natural gas prices fell to the lowest level since summer 2021.** In April, gas prices traded between the 35-45 €/MWh range, as the EU came out of winter with plenty of gas reserves (61% well above the 10-year average of 33%) and a positive outlook for next winter. However, current prices still double the historical average as potential supply risks (possibility of further cuts in Russia's supplies or rebounding appetite from China) increase the risk premium. Looking ahead, we may have to revise down our forecast for 2023 (113 €/MWh average price) although not by as much as what future markets prices suggest, as we expect gas demand from Asia to accelerate in the 2H 2023.
- **Oil prices plunge below 80$ per barrel in April.** Brent oil prices have retreated by about 10% this year, as futures have been subjected to fluctuations due to the Federal Reserve's tightening cycle, concerns of a potential recession in the US economy, and expectations for a rebound in Chinese demand. The decline in prices has come despite a surprise production cut by the OPEP+, that will last, at least, until the end of this year. We forecast an average oil price for 2023 of 86$ per barrel, as the market could face supply side tensions as demand recovers in 2H 2023.

GDP growth surprises on the upside in Q1 2023

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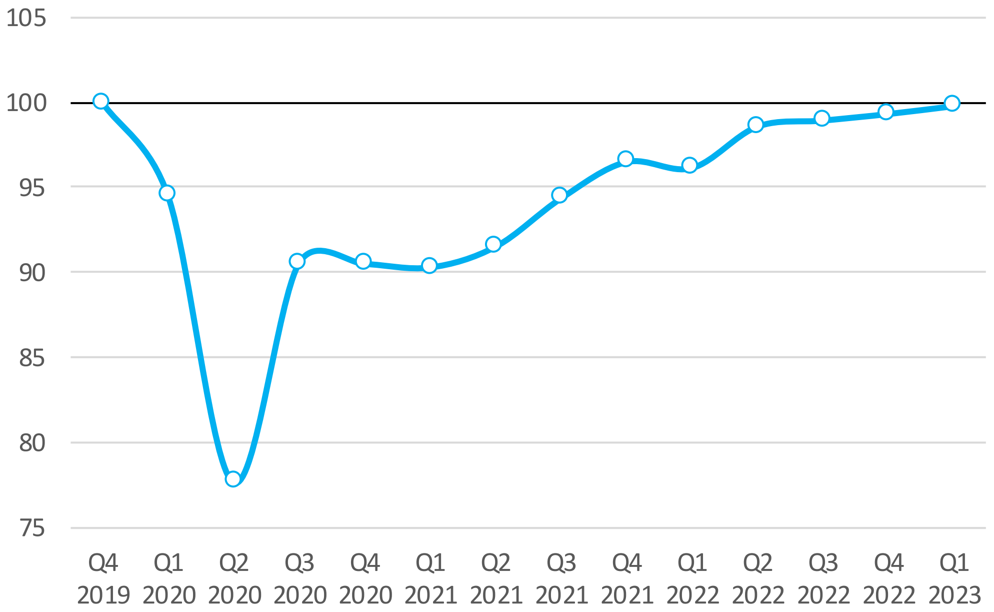
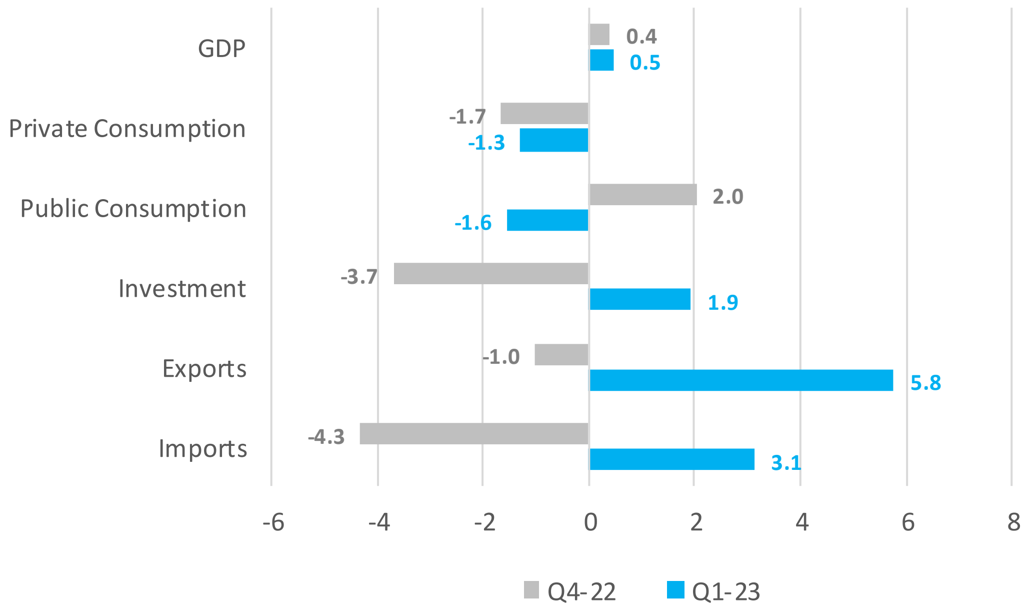
GDP

Index (Q4 2019 = 100)



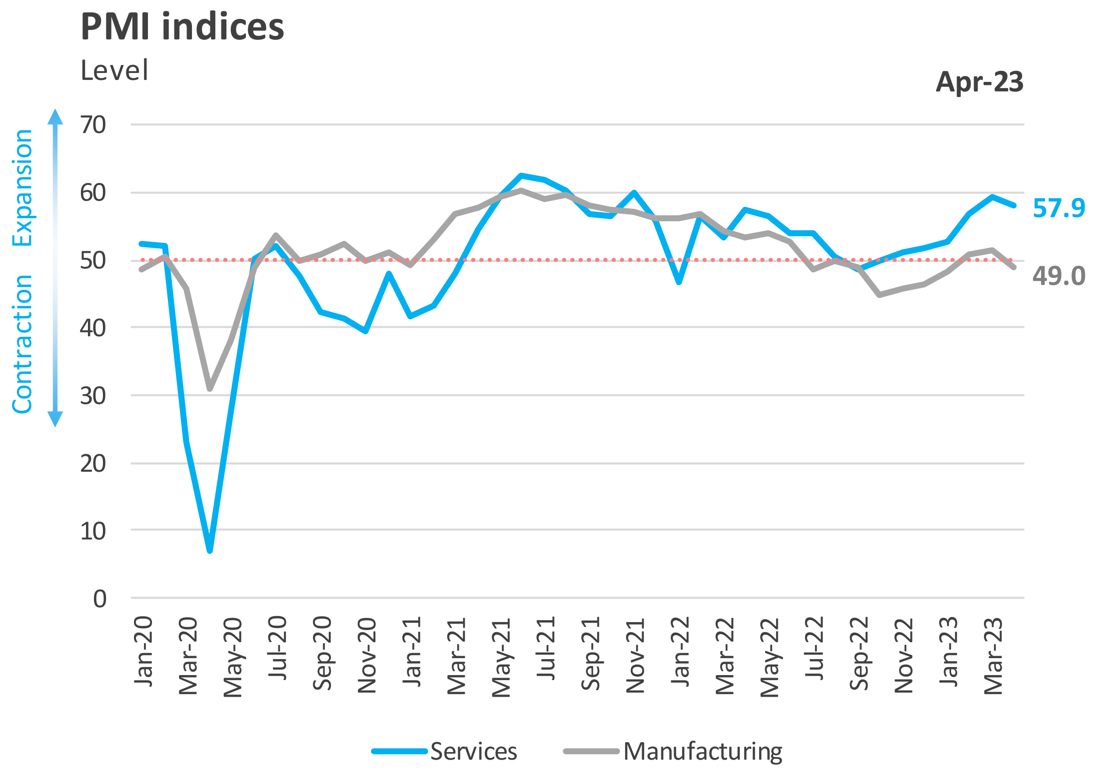
GDP breakdown

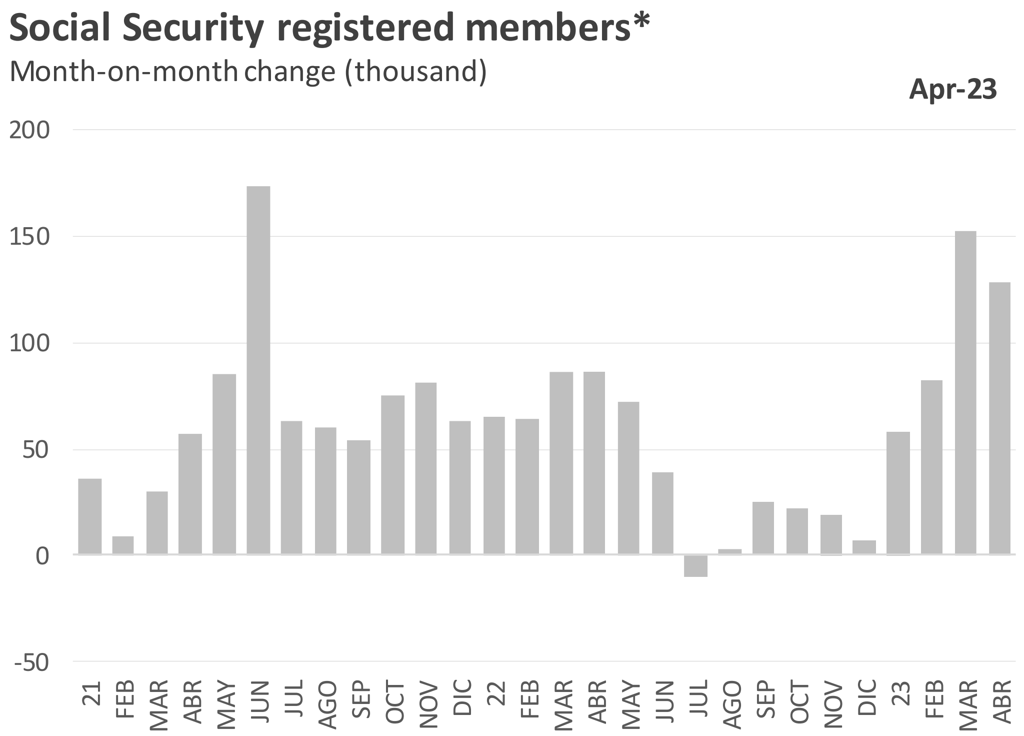
Quarter-on-quarter change (%)



- **GDP grew 0.5% qoq in the first quarter of the year** (0.4% in Q4 2022). This figure is above what was penciled in our scenario (0.1% qoq), although the latest indicators already suggested there were upside risks around our forecast. In yoy terms, GDP grew 3.8% (2.9% in Q4 2022). The National Statistical office also revised the data for 2022, leading to a -0.4pp downward revision of qoq GDP growth in Q1 2022 but an upward revision of +0.3pp in Q2 2022 and +0.2pp in both Q3 and Q4 2022. Following the data release, GDP now stands just 0.2% below the pre-pandemic level of Q4 2019.
- **GDP grew on the back of investment and exports.** GDP growth in Q1 2023 was driven by investment (+1.9% qoq), particularly in equipment (+3.9%) and non-residential construction (+2.0%), and exports (+5.8% qoq), particularly in the service sector (+21.4% qoq) due to tourism exports. However, private consumption fell 1.3% qoq, due to the impact of sustained elevated inflation and rising interest rates, and so did public consumption (-1.6% qoq), resulting in a negative contribution of domestic demand to quarterly GDP growth of -0.8 pp. External demand, instead, made a positive contribution (+1.3pp), as exports grew significantly more than imports.
- **We will revise our scenario in the upcoming month.** The new GDP figures pose upside risks on our 2023 GDP growth forecast (currently at 1.3%). Most likely, the revised figure will be around 2.0%.

Early Q2 2023 indicators show a positive trend





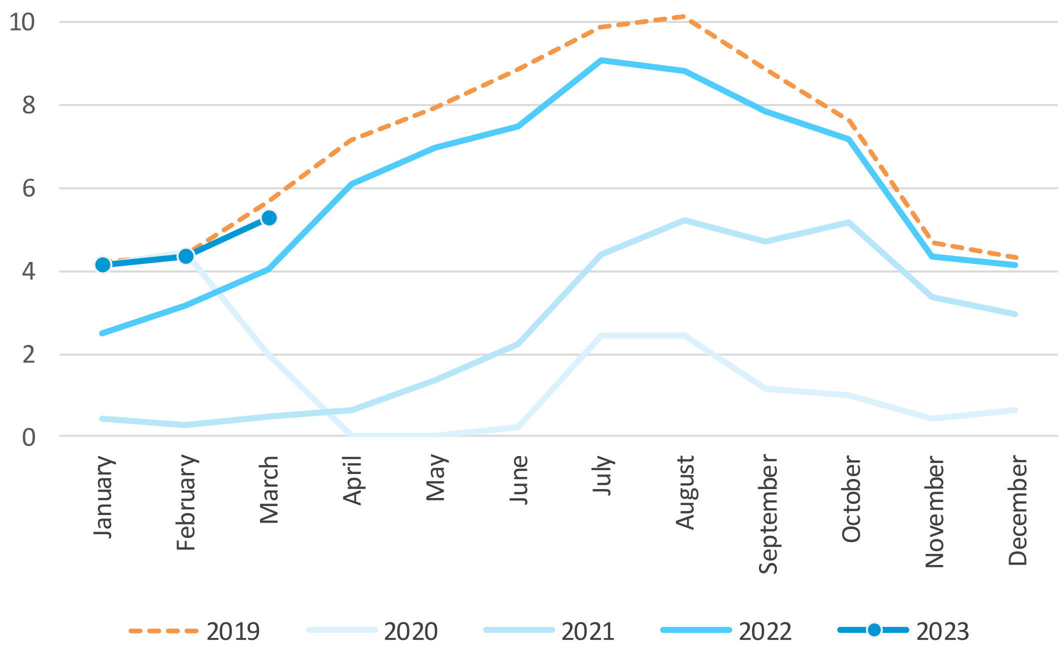
Note: (*) Seasonally adjustment.

- **Although limited data is available for Q2 2023, the indicators show a positive trend**. In April, employment added c. 130k workers (seasonally adjusted). In year-on-year terms growth accelerated from 2.7% in March to 3.0% in April. The services PMI in April sat comfortably at 57.9 points, well above the no-change threshold (50 points) and indicating expansion in the sector. On a more negative note, the manufacturing PMI dipped slightly below 50, pointing to a mild contraction in the sector during April.
- From the consumer side, **CaixaBank's domestic consumption indicator (based on Bank's data on card expenditure) grew by 4% yoy in April**, below the growth rate in March (10%), possibly affected by seasonal effects driven by the Easter holiday.

Strong tourism demand during the low season

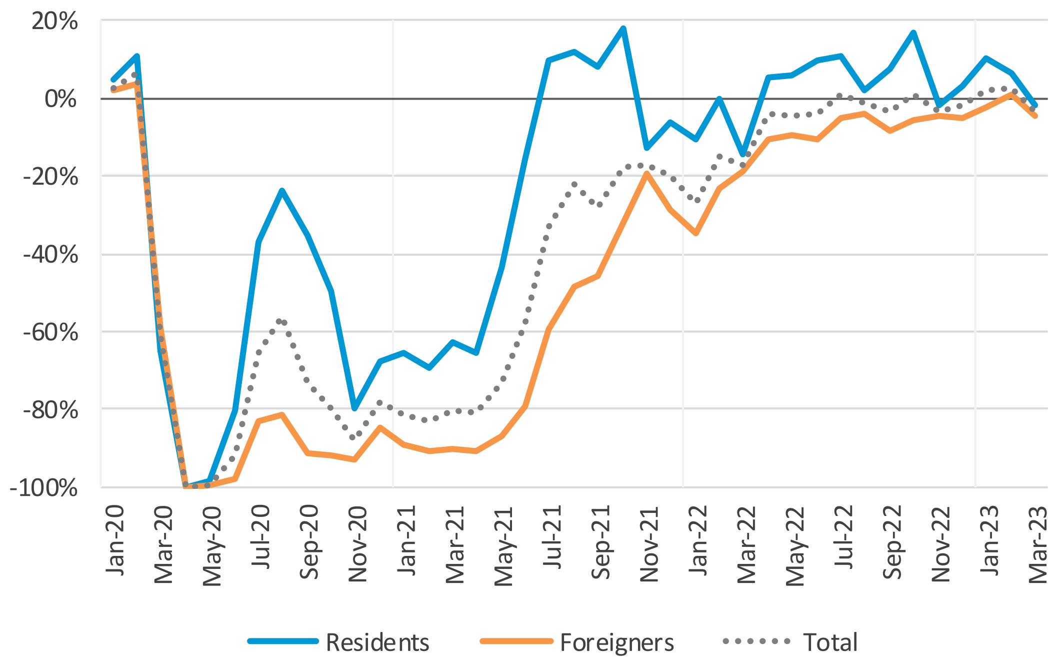
International tourists that visit Spain

Millions of people



Overnight stays in touristic accommodation

Gap with respect to 2019



- **Tourism demand remained strong at the beginning of 2023.** International arrivals in March were 6.9% below the same month of 2019, while international tourist expenditure attained a level 10.3% above. Demand for tourist services is holding up despite the strong increase in tourism related prices: CPI hotel prices in March increased by 18.2% year-on-year, attaining a level 24.1% above the same month of 2019. Tourist arrival figures in March were boosted by stronger US tourist flows (+6.6% w.r.t. March 2019) and by the recovery of tourism arrivals from the UK (only -3.6% w.r.t. March 2019).
- **The inflationary shock has barely taken a dent on domestic tourism demand**. After achieving remarkable figures last summer (well above 2019 level), domestic tourism performance remains positive. Overnight stays by residents in touristic accommodations grew by 14.7% year-on-year in March, attaining a level only 1.8% below March 2019. Looking ahead, we expect a moderation of the rate of growth but activity remaining at high levels.

Base effects drive headline inflation dynamics

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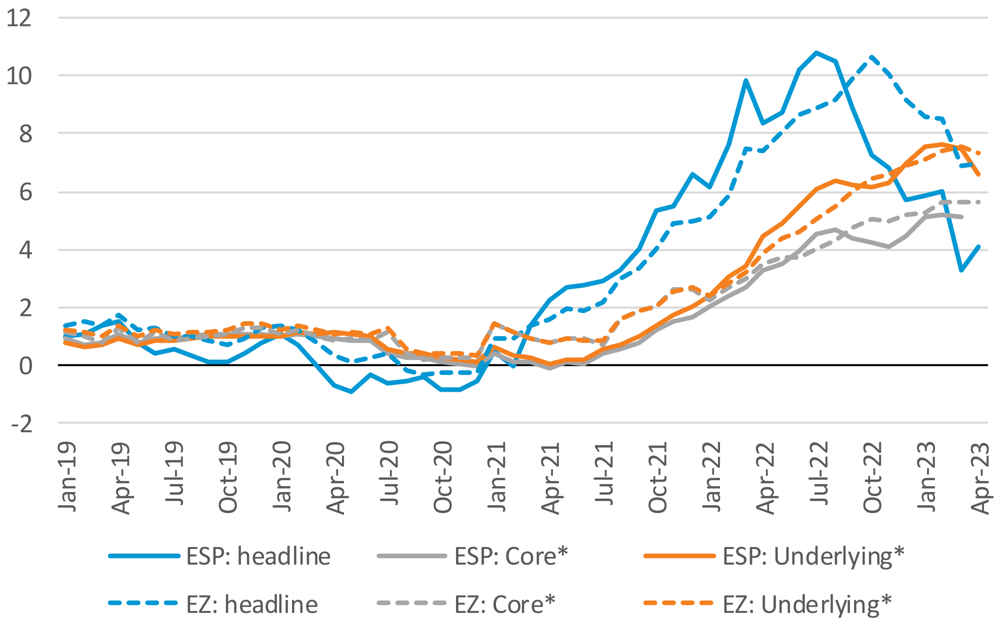
CPI inflation in Spain (ESP) and the Eurozone (EZ)

Year-on-year change (%)



Note: * Core excludes energy and all food products. Underlying excludes energy and non processed food.

CPI forecasts by component

Annual change (%) and contributions to headline inflation (p.p.)

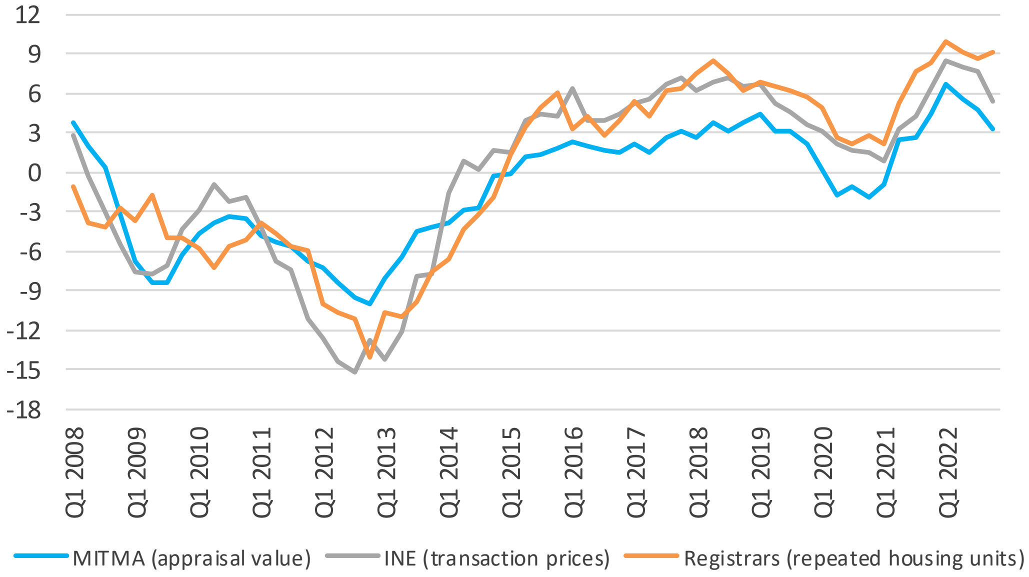
	2022	contrib.	2023 (f)	contrib.	2024 (f)	contrib.
Headline inflation	8.4		4.2		2.6	
Underlying inflation (excl. unprocessed food and energy)	5.2	4.5 pp.	5.8	4.2 pp.	2.7	2.1 pp.
Core inflation (excl. food and energy)	3.7	2.6 pp.	4.5	2.6 pp.	2.8	1.7 pp.
Industrial goods	4.2	1.1 pp.	5.0	1.1 pp.	2.3	0.5 pp.
Services	3.3	1.5 pp.	4.2	1.5 pp.	3.0	1.2 pp.
Food	10.7	3.0 pp.	9.0	2.2 pp.	3.0	0.8 pp.
Energy	27.9	2.8 pp.	-6.0	-0.6 pp.	1.0	0.1 pp.

- **Headline inflation increased to 4.1% in April** (3.3% in March) due upward base effects generated by the energy price drop in April 2022 (the price adjustment that followed the surge of March 2022). Underlying inflation (excluding all energy and unprocessed food), on the other hand, declined sharply to 6.6% (7.5% in March). Furthermore, the deviation of the underlying month-on-month growth rate with respect to its own historical average was negative in April (the first time since August 2021), which suggests that pressures on underlying inflation could begin to abate in the coming months.
- **We forecast that headline inflation will be 4.2% in 2023, and will drop to 2.6% in 2024,** thanks to the consolidation of lower energy prices. Regarding core components and food prices, we expect more persistent dynamics in 2023, as there is room for further pass-through of high energy prices to final goods prices (currently, the main driver of inflation). Thus, we forecast core inflation in 2023 to reach 4.5%, and food price inflation 9.0%. After the April flash CPI release, risks to our 2023 headline inflation forecast are balanced (downward due to energy prices and upward due to food inflation).

Housing market is slowing down, but a sharp correction seems unlikely

Housing prices

Year-on-year (%)



***Source**: CaixaBank Research, based on data from INE, Resistrars and Mitma.*

Better fundamentals of the market

	Latest figure	Last bubble
No oversupply *(number of new building permits compared to net household formation)*	109K new homes *(50% of households created)*	865k new homes *(x2 households created)*
Low weight of residential investment *(% of GDP)*	5.2	11.6
Mortgage credit standards have not been relaxed *(% of loans with LTV>80%)*	8.3	18.0
Higher percentage of fixed-rate mortgages *(% of fixed rate mortgage by lending amount)*	64.0	4.0
Lower household indebtedness *(household debt as % of GDP)*	53.0	85.6

- **Housing sales remain elevated** (650,000 units cum. 12 months in Feb.-23, the highest since 2008) but there are emerging signs of **deceleration of housing demand**: in February housing sales declined by 6.6% year-on-year and new credit for house purchases declined by 17.8% year-over-year in Jan.-Feb. 23. We expect housing sales to decline sharply in 2023 (-26% to 480k) mainly due to the impact of the increase in interest rates and the impact of higher inflation on households' real incomes.
- **House price growth has begun to moderate after peaking in Q1 2022.** We expect a sharp deceleration in housing prices, but a hard landing scenario in nominal terms is deemed unlikely as there is no evidence of a housing bubble in the Spanish housing market (as opposed to what may be the case in other advanced economies). On the one hand, prices are broadly in line with fundamentals, and the boom in housing purchases in 2022 can be explained by several factors that fueled demand (excess savings, favorable financial conditions, change in preferences) with a limited role of expectations on housing value appreciation (a key ingredient in housing bubbles). On the other hand, there has been no excessive growth in credit, no loosening of credit standards and banks are not excessively exposed to the sector (see the table above). For the MITMA index (appraisal value) we expect a deceleration from 5% growth in 2022 to close to stagnation in 2023 (0.2%).
- **Housing supply will remain very limited**: new building permits (109,000 units cum. 12 months in feb-23) are about half the figure of net household creation (241,000 in a year up to Q1 2023). Lower economic growth, elevated construction costs and weaker housing demand will not favor the recovery of supply in 2023.

Public deficit to decline gradually in 23-26 thanks to economic growth

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Government macroeconomic outlook

Year-on-Year change, unless otherwise stated	2022	2023	2024	2025	2026
Real GDP growth	5.5	2.1	2.4	1.8	1.7
Nominal GDP growth	10.0	6.1	5.9	3.9	3.6
Unemployment rate	12.9	12.2	10.9	10.3	9.8
Compensation per employee	2.0	4.7	3.3	2.4	1.7
Private consumption deflator	6.8	3.9	3.2	2.0	1.9
Euribor 3-month	0.3	3.3	3.0	2.5	-
Natural gas Price (€/MWh)	100	59	50	50	50
Spanish 10-Year bond rate	2.2	3.5	3.6	3.8	-

Stability plan 23-26

Key elements	% GDP 2022	% GDP 2023	% GDP 2024	% GDP 2026
Public revenues	**43.0**	**43.4**	**43.3**	**43.8**
Indirect taxes (VAT…)	12.1	11.9	12.0	11.8
Direct taxes	12.4	13.2	13.5	14.3
Capital taxes	0.4	0.4	0.3	0.3
Social contributions	13.6	13.9	14.0	14.0
Other revenues*	4.6	4.0	3.5	3.4
Public spending	**47.8**	**47.3**	**46.3**	**46.3**
Worker salaries	11.6	11.3	11.2	11.2
Social transfers (excl. in-kind)	17.2	17.7	17.6	17.7
Public investment	2.8	2.7	2.6	2.4
Interest payments	2.4	2.4	2.6	2.9
Subsidies	2.0	1.8	1.3	1.4
Public balance	**-4.8**	**-3.9**	**-3.0**	**-2.5**
Primary balance	**-2.4**	**-1.5**	**-0.4**	**0.4**
Cyclical balance	**-1.0**	**-0.5**	**-0.1**	**0.1**
Structural balance	**-3.6**	**-3.4**	**-2.9**	**-2.5**

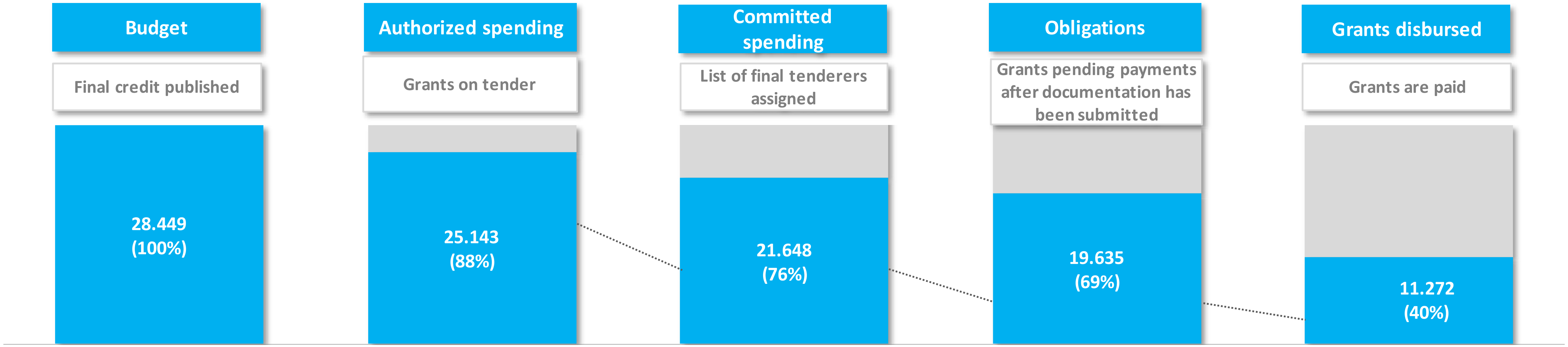
Note*: *It includes revenues linked to property income and EU transfers excluding NGEU.*

- **The Stability Plan presented by the Government proposes a gradual adjustment of the public deficit, driven by the economic recovery** (reduction from 4.8% in 2022 to 3.0% in 2024 and 2.5 % in 2026).
- **Public spending projections:** it will decrease in % of GDP due to the large increase in nominal GDP and some restraint in primary spending excl. pensions.
- **Public revenues projections:** it incorporates no new measures and expects revenues to increase as a % of GDP thanks to direct taxes and social contributions.
- **The public debt** decreased to 113.2% of GDP in 2022 (120.0% at the end of 2020). The government forecasts public debt to drop to 111.9% of GDP in 2023 and reach 106.8% in 2026.

NGEU: many projects are on the pipeline

2022 NGEU funds: execution

Million euros



Note: Obligations and disbursed grants data are only available until November. Instead, figures on authorized spending and committed spending include December**Source:** CaixaBank Research, with data from IGAE and Mineco.

- The NGEU **budget** in 2021-22 was €51bn, of which €28bn corresponded to 2022. The budget for 2023 is **€28.7bn and calls scheduled in S1 2023 will amount to €11.6bn**
- The Government will request access to €84bn in loans before the summer. Of these, 18,7bn will reinforce the PERTES and the remaining 65,3bn will have other uses (such as 10bn for an ICO green line).
- The EC has disbursed €6bn after a positive assessment of 23 milestones and 6 objectives corresponding to S1 2022, such as the commitment of €0.9bn for the Digital Kit, the workplace pensions plans and a new social contributions model for the self-employed. The second part of the pension reform, approved at the end of March which incorporates an increase of social contributions which will eventually amount to 1 p. p, of GDP in 2050, will be evaluated for the next payment in mid-2023 (€10bn).

NGEU projects have been **launched** in 2021-22 for €47.2bn (€22.1bn in 2021 and €25.1 bn in 2022). However, only **11.3 bn have actually been disbursed in 2022**.

- The most advanced PERTE is that of renewables and green hydrogen, with c. €5bn in launched calls.
- For the 3 calls of the Digital Kit (SMEs between 11 and 49 employees, between 3 and 9 and between 0 and 2) around 50.000 vouchers have been granted, corresponding to circa € 0,37bn, a 23% of the total budget of the currently opened calls (€ 1.6bn)

2023 has kicked off with good speed: of the €28.7bn budgeted, projects worth almost €11bn have been launched as of March 8, much more than last year (with a very similar total budget).

Banking system: strong liquidity position

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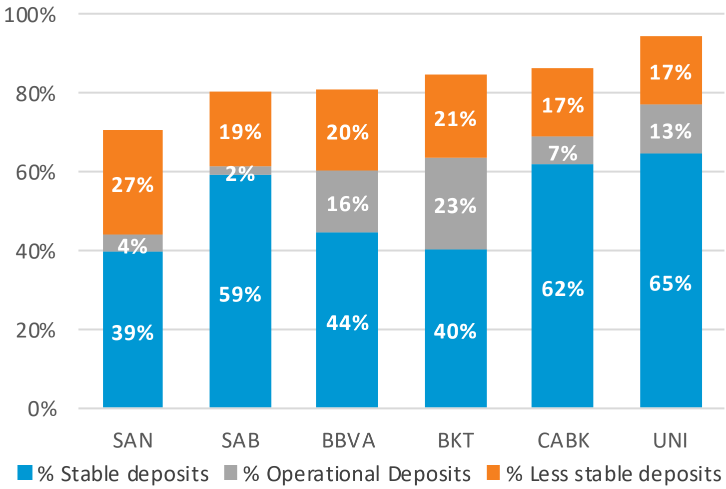
Banks' deposit breakdown

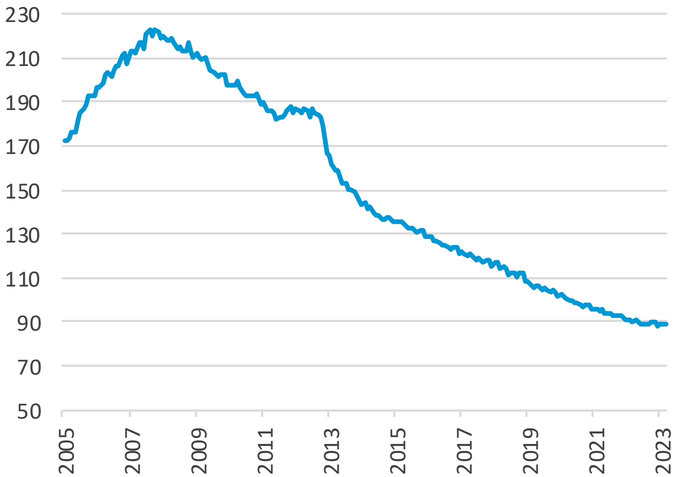
% of total deposits excluding unsecured debt



Note: Stable deposits and less stable deposits correspond to retail deposits and deposits from small business customers. Operational deposits (all counterparties and deposits in networks of cooperative banks) correspond to unsecured wholesale funding. Rest are non-operational deposits (all counterparties). Unsecured debt not included.
Source: Banks' consolidated Pillar 3 public report 4Q22.

HHs & NFCs loan to deposit ratio

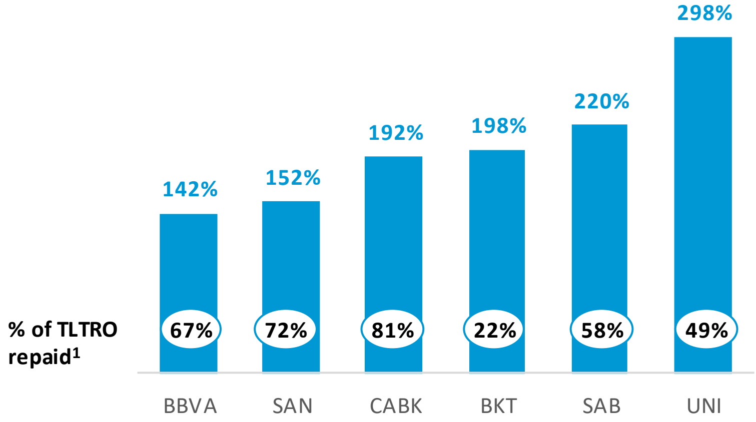
Percentage (%)



Note: loans and deposits to residents in Spain, on a non-consolidated basis. Latest data available Mar-23.
Source: CaixaBank Research, based on Bank of Spain data.

Banks' LCR

Q1 23 published ratio



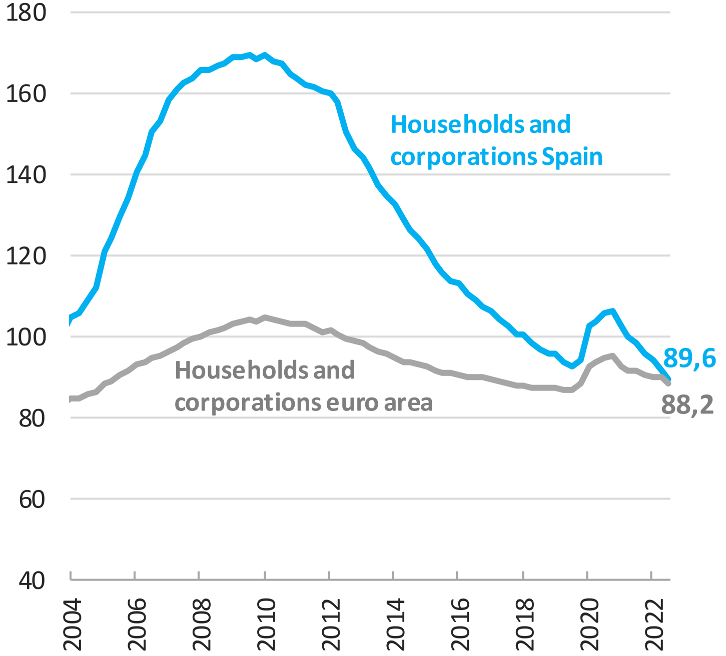
Note: (1) TLTRO repaid between the beginning of Nov'22 and the end of Mar'23 as % of total TLTROs. This includes TLTRO returned at maturity and extraordinary returns. At the beginning of Nov'22, TLTRO sector funds: €2,113 bn. As of 03.31.2023, TLTRO sector funds: €1,098 bn.
Source: Banks' financial statements.

- **Spanish banks are strongly focused on the retail segment, which provides a more stable source of funding in the long-term.** Stable deposits and operational deposits (those that have proven to be harder to withdraw) account for over 60% of total deposits for nearly all Spanish banks. This has contributed both to a positive evolution of profitability in a context of rising interest rates, as well as to a favorable liquidity position and to the stability and diversification of their funding sources.
- **Households and non-financial corporation (NFCs) deposits peaked in August 2022.** Mar'23 data show a modest 2,1% decline since then, but a large part is due to the repayment of COVID-related precautionary loans and increased early-repayments in mortgages. Loan to deposit ratio remains stable at very comfortable levels (c. 90%)
- **The Spanish banking sector maintains high liquidity ratios, far above the regulatory requirements.** EBA data for 4Q22 points to an LCR ratio of 171% and a NSFR of 130% for Spanish banks (vs. an EU average of 165% and 126%, respectively).
- **Spanish banks have started to partially return TLTROs**. Until end of Mar'23, the 6 leading banks had repaid on average 50% of TLTROs outstanding at Nov'22. Full repayment of TLTROs may have uneven impacts on banks' LCR.

Banking system: higher interest rates start to weight on credit growth

Bank credit to the private sector

% GDP



Note: latest euro area data available as of Dec-22.
Source: ECB, Eurostat.

Private domestic credit

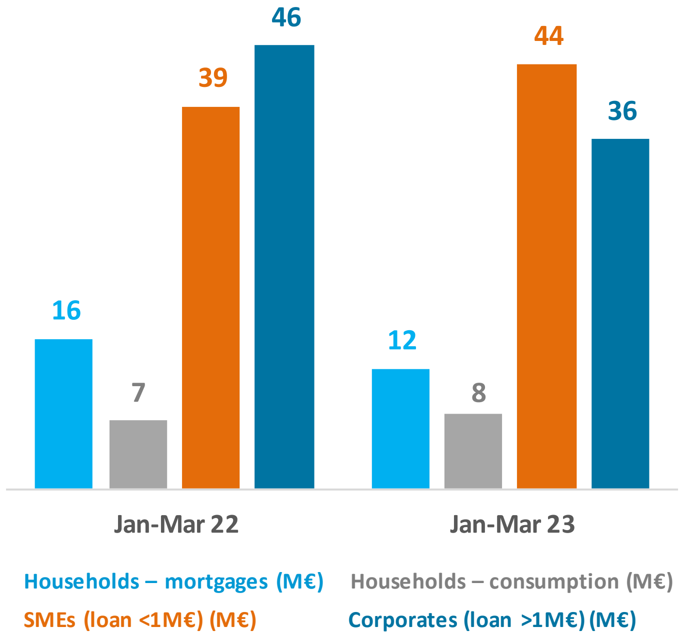
Year-on-year (%)

	Dec-22	Mar-23 (latest)	2023 (forecast)
	% yoy	% yoy	% yoy
Total credit	-0.4%	-1.1%	-0.7%
Households	-0.2%	-1.3%	-1.7%
Housing mortgages	-0.2%	-1.7%	-2.1%
Other purposes	-0.1%	-0.2%	-0.6%
Of which consumption	1.1%	3.2%	0.4%
Businesses	-0.7%	-0.8%	0.7%
Non-real estate developers[1]	1.3%	1.3%	-
Real estate developers[1]	-8.8%	-8.8%	-

Note: (1) latest data available Dec-22.
Source: Bank of Spain.

New lending activity by sector

YTD, €Bn

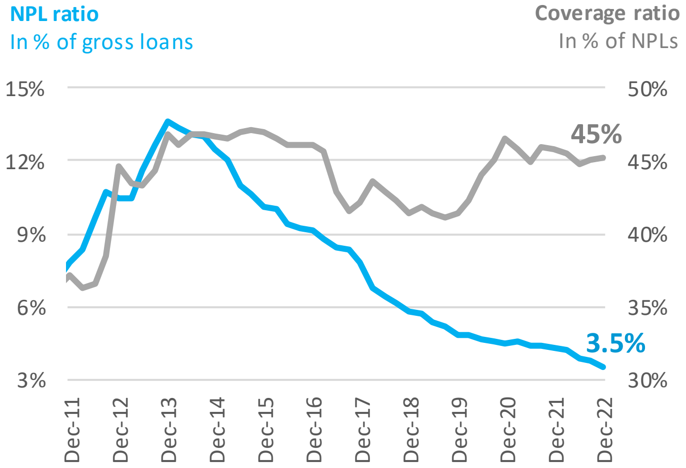


Source: Bank of Spain.

- **Households and corporate debt levels** (including debt securities) remain below euro area averages in 4Q22 despite the strong pick-up in credit in 2020. Both sectors have deleveraged in terms of GDP but while households have attained the pre-pandemic level, corporates are still above the December 2019 level. We expect this gradual deleveraging to continue in the coming months.
- **New mortgage production** declines in the recent months due to the rise in interest rates and its impact on home purchases.
- **New lending for consumption** increases favored by improvements of consumer confidence, although it is still below pre-COVID-19 levels.
- **New lending to corporates** decreases but only for larger loans and after an extraordinary 2022. The smaller loans continues to grow favored by the increase in the demand for working capital.
- Increased early repayments of mortgages, and the repayment of business credit lines granted on dec'21 to meet TLTRO benchmarks, will weight on credit growth in the coming months.

Banking system: sound profitability and capital position

NPLs and coverage ratios[1]



Expired moratoria[2]
c.8.7% of loans to households
2.5% of loans to NFC

Cost of risk[3]
0.4% in Q4 2022
0.4% in Q1 2023

Note: (1) latest available data Feb-22. (2) Based on EBA data as of Dec-22. (3) Spanish business. Accumulated 12 months based on the average of the 6 largest institutions.
Source: Bank of Spain and Bank's financial statements.

Banks' profitability

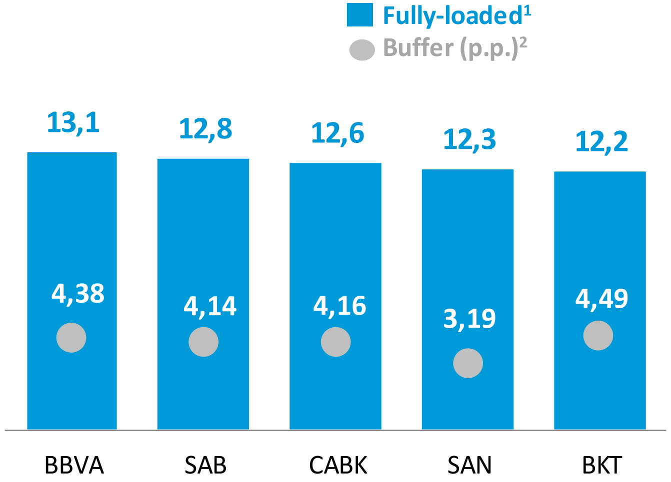
% of avge. total assets (Q1 23; trailing 12M)

	CABK	BBVA	SAN	SAB	BKT
Net interest income	**1.1%**	**0.9%**	**1.0%**	**1.4%**	**1.6%**
Net fees	0.6%	0.5%	0.6%	0.7%	0.6%
Gains on financial assets/liab. and others	0.0%	0.1%	0.1%	0.0%	0.1%
Other operating income	0.0%	-0.1%	0.0%	-0.1%	-0.2%
Gross income	**1.8%**	**1.4%**	**1.7%**	**2.0%**	**2.0%**
Operating expenses	-0.9%	-0.7%	-0.8%	-1.0%	-0.9%
Impairment losses, tax and others	-0.4%	-0.4%	-0.6%	-0.6%	0.9%
Profit	**0.5%**	**0.4%**	**0.3%**	**0.4%**	**0.5%**
ROTE (%)[1]	10.5	6.4	9.2	7.0	12.4

Note: Domestic businesses. ROTE based on internal calculations. (1) BBVA includes Corporate Centre (only proportion applicable to business in Spain). SAN also includes Corporate Center + Portugal. ROTEs published by the BBVA and SAN groups: 16.3 and 14.4, respectively.
Source: Bank's financial statements.

Banks' solvency position

In % (Q1 23)



Note: (1) CET1 FL transitional IFRS9, except for BKT.
Source: Bank's financial statements.

- **NPLs remain below 4%,** despite the fact that both debt moratoria and the grace period for ICO loans expired in 2Q22. As for the asset quality of loans benefiting from support measures, the NPL ratio on a group level for loans with expired moratoria declined slightly in 4Q22 (to 8.3%) while it increased for loans with ICO guarantees (to 6,6%, above the EU average, partly due to the decline of the total amount outstanding). The share of stage 2 loans on a group level decreased in the last quarter, remaining below EU levels in both categories. Additionally, the Government and the banks have agreed expanding the scope of the Code of Good Practice (CGP) to protect households under financial strain due to surging Euribor.
- **Profitability stabilized at levels higher than in the pre-pandemic period (ROE stood at 10.4% in 4Q22 and 10.6% in 3Q22 at the consolidated level).** Net interest margin is widening, helped by the very moderate increase in the cost of deposits. However, the Spanish government has introduced an extraordinary and temporary banking tax (4.8% on domestic net interest and fee income, where such income exceeds €800 million) that will be a headwind to profitability.
- **The capital position of Spanish banks provides buffers against the risks that could arise due to the worsening macrofinancial conditions.** Under the adverse scenario considered, the Bank of Spain's stress test[1] shows that the CET1 ratio as a whole would fall 2.4 percentage points but would remain above the regulatory minimum.

Note: (1) Forward-Looking Exercise on Spanish Banks (FLESB). Financial Stability Report Autumn, 2022. Bank of Spain.