Spain
Macroeconomic & Financial Outlook

CaixaBank Research

September 2023

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Key messages

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Activity

- **The ECB raised rates by 25bp at its July meeting (depo at 3.75%, refi at 4.25%).** Officials kept a hawkish bias as they reiterated their concern about inflation being “too high for too long”, and Lagarde signaled that the ECB’s next movement would be either “a skip” or “a hike”. Nevertheless, deteriorating euro area sentiment indicators have shifted the ECB towards a still-hawkish-but-more-balanced stance. We expect the ECB will hike rates one more time in September and leave rates flat at that level until mid-2024.
- **Brent oil prices reach 90$/bbl**. A number of factors, such as supply cuts from OPEC+ countries, low US oil inventories and diminished concerns regarding US and China growth outlook have pushed oil prices up. The extension of supply cuts by Saudi Arabia and Russia until the end of this year means that oil prices are likely to trade above $80/bbl in the following quarters.
- **We forecast GDP growth of 2.3% in 2023.** GDP data has been stronger than expected in the first half of 2023 which leads us to revise GDP growth for 2023 upwards by 0.3pp. Bear in mind that the upward revision is largely driven by factors that have already happened. Looking into the second half of 2023, we expect growth will be more subdued due to weaker demand from our main trading partners and the squeeze on domestic demand driven by the tightening of macro-financial conditions.
- **Growth slows down in Q3 according to early indicators.** The composite PMI dropped in August to 48.6 points, down from 51.7 points in July and below the 50-point mark that indicates expansion. Social security affiliation, instead, rose by around 18k people in August on a seasonally adjusted basis, but that is lower than the average monthly increase of around 52k people in Q2. We forecast growth of 0.3% qoq in Q3 2023 but the latest indicators pose slight downside risks to our Q3 GDP growth forecast.
- **Headline inflation increased in August, reaching 2.6% (2.3% in July), due to the recent increase in oil prices.** Underlying inflation, which excludes energy and non-processed food, decreased 0.1pp to 6.1%. We have revised headline inflation in 2024 upwards to 3.4% as we incorporate the withdrawal of price moderation policies in January 2024.
- **We revise the 2023 house price growth forecast up from 0.8% to 2.9%,** following the better-than-expected data of Q1-23 (2.2% qoq growth). Going forward, we still expect a notable slowdown due to increase in interest rates, but a strong labor market, significant immigration flows plus the absence of glaring imbalances mean that it is unlikely to witness sharp price corrections as was seen in 2008-2013.
- **Negotiations to form a government following the 23rd of June elections are underway.** The conservative People’s Party (PP) will submit his candidacy to parliament on the 26th and 27th of September. If his candidacy fails, the Socialist Party (PSOE) will have two months to submit his own candidacy. Were PSOE’s candidacy to fail as well, new elections would be held on the 14th of January 2024. While political uncertainty is expected to have a limited economic impact, it could delay the implementation of the Next Generation EU funds.

Banking Sector

- **The banking system remains strong with robust capital and liquidity positions.** The deposit base is dominated by household deposits (71% in 1Q23, 6 pp above EU levels) with a high proportion of all deposits covered by guarantees schemes (c.66%). Liquidity ratios remain high after the repayment of nearly 80% of TLTROs, with LCRs of top 5 banks ranging from 142% to 298%. Regarding credit risk, domestic NPL ratio stood at 3.50% in Jun, 132 bps below pre-covid level of February 2020.

Main economic forecasts

%, 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	2.3	1.7
Private Consumption	1.7	2.9	2.6	3.0	1.8	0.9	-12.4	6.0	4.5	0.0	1.9
Public Consumption	-0.6	2.0	1.0	1.0	2.3	1.9	3.5	2.9	-0.7	1.2	1.0
Gross Fixed Capital Formation (GFCF)	4.1	4.9	2.4	6.8	6.3	4.5	-9.7	0.9	4.6	0.7	2.7
GFCF - equipment	5.6	9.1	1.8	9.2	4.7	2.0	-13.3	6.3	4.0	0.7	5.2
GFCF - construction	3.0	1.5	1.6	6.7	9.5	7.2	-10.2	-3.7	4.7	0.6	1.2
Exports	4.5	4.3	5.4	5.5	1.7	2.2	-19.9	14.4	14.4	6.2	1.2
Imports	6.8	5.1	2.6	6.8	3.9	1.3	-14.9	13.9	7.9	2.0	1.8
Unemployment rate	24.4	22.1	19.6	17.2	15.3	14.1	15.5	14.8	12.9	12.3	11.8
CPI (average)	-0.2	-0.5	-0.2	2.0	1.7	0.7	-0.3	3.1	8.4	3.4	3.4
External current account balance (% GDP)	1.7	2.0	3.2	2.8	1.9	2.1	0.6	1.0	0.6	1.0	0.7
General Government Balance (% GDP)[1]	-6.1	-5.3	-4.3	-3.1	-2.6	-3.1	-10.1	-6.9	-4.8	-4.3	-3.5
General government debt (% GDP)[2]	105.1	103.3	102.7	101.8	100.4	98.2	120.4	118.3	113.2	111.8	110.4
Housing prices	-2.4	1.1	1.9	2.4	3.4	3.2	-1.1	2.1	5.0	2.9	1.1
Risk premium (vs. 10Y Bund, bps, Dec.)	149	120	124	120	97	88	86	67	104	104	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	-2.7

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

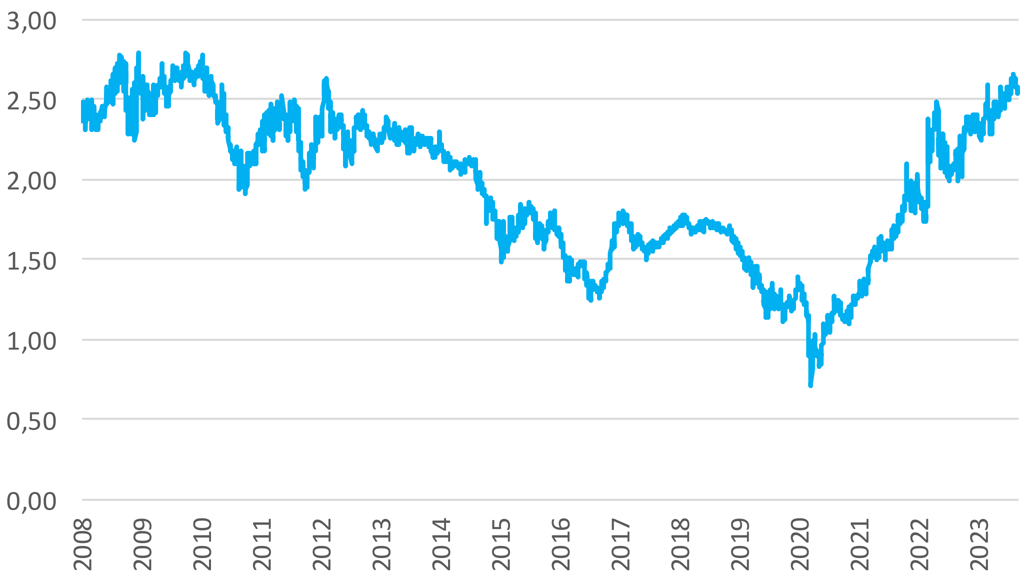
1/ The general government deficit excludes one-off bank restructuring costs of 3.7% of GDP in 2012, 0.3% of GDP in 2013, 0.1% in 2014, 0.05% in 2015, 0.2% in 2016, 0.04% in 2017 and 0.01% in 2018.
2/ General government debt includes ESM/FROB related borrowings equivalent to 3.9% of GDP in 2012.

Source: *CaixaBank Research.*

Monetary policy sets a "high for long" course

Eurozone: market-based 5Y5Y inflation expectations

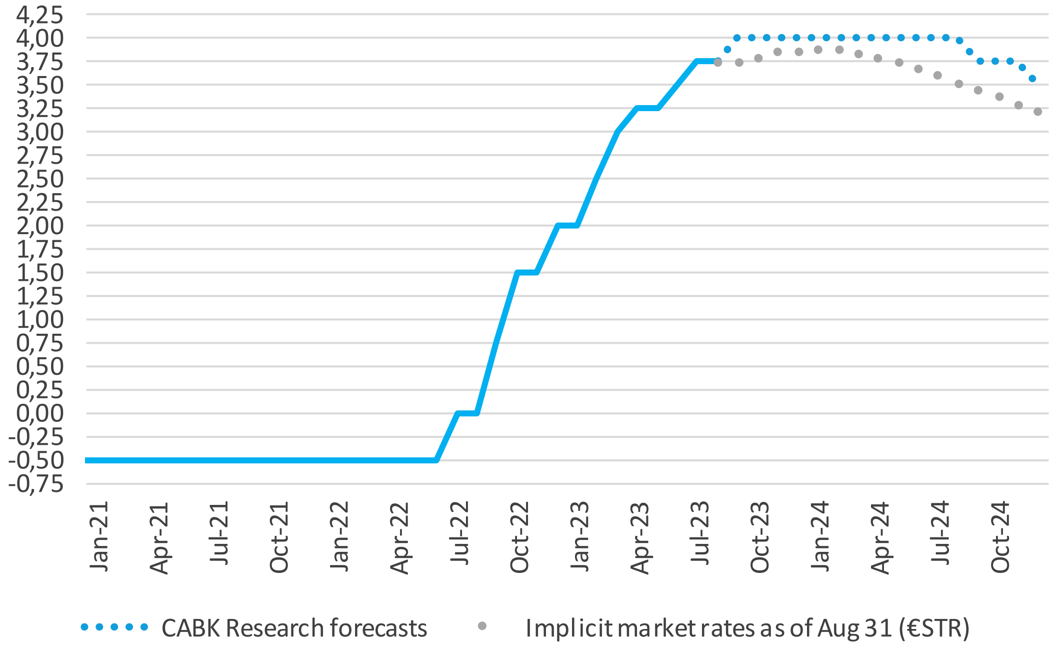
(%)



ECB deposit rate

(%)

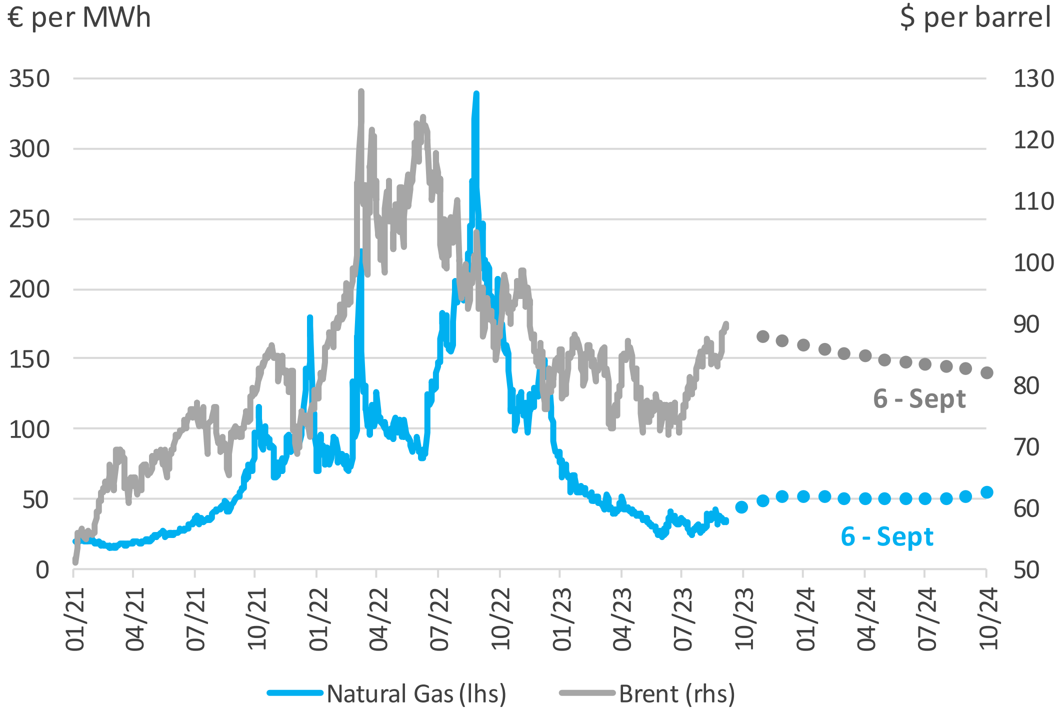
31-August-2023



- **The ECB raised rates by 25bp at its July meeting** (depo at 3.75%, refi at 4.25%). Officials kept a hawkish bias as they reiterated their concern about inflation being "too high for too long", and Lagarde signaled that the ECB's next movement would be either "a skip" or "a hike". The ECB also set the remuneration of its minimum reserve requirements at 0% (prev.: depo rate). Since late August, deteriorating euro area sentiment indicators have shifted ECB speak towards a still-hawkish-but-more-balanced stance.
- As it strikes a balance between high-but-declining inflation and weakening activity, **the ECB is seen to be close to peak rates** (depo at 4.0%; odds of reaching it in September at 25% and by year-end at 60%, according to markets) **and is shifting to a high-for-long guidance**. Rate cuts are not expected before Q3 2024, and policy is likely to remain restrictive for a significant period of time (e.g., the "neutral" depo rate is estimated to lie in the 1.50%-2.50% range).

Focus turns on the oil market

Gas and oil prices (and futures)



Commodity prices

	Metric	Price	Change (%) Last Month	Year to Date	2021	2022
Commodities	**index**	**106,4**	**0,5**	**-5,7**	**27,8**	**13,8**
Energy	**index**	**37,0**	**2,7**	**-10,4**	**54,5**	**-4,4**
Brent	$/barrel	89,3	3,6	4,0	51,5	33,5
Natural Gas (Europe)	€/MWh	33,7	16,6	-55,9	270,2	-0,3
Precious Metals	**index**	**215,0**	**-1,4**	**0,0**	**-6,2**	**25,3**
Gold	$/ounce	1923,0	-0,7	5,4	-3,4	44,8
Industrial Metals	**index**	**143,5**	**-1,6**	**-13,2**	**29,0**	**6,1**
Aluminum	$/Tm	2193,0	-1,8	-7,8	40,4	16,7
Copper	$/Tm	8487,0	-1,0	1,4	23,9	12,4
Agricultural	**index**	**67,3**	**0,7**	**-2,3**	**28,0**	**-1,9**
Wheat	$/bushel	572,5	-9,6	-27,7	20,3	7,5

- **European natural gas prices remain stable**. Despite some volatility related with possible strike action at some LNG plants in Austrialia, gras prices have remained broadly stable throughout the summer. In August, European natural prices (TTf Dutch reference) traded between 30-40 €/MWh range, while Europe's gas storage levels have exceeded the 90% capacity three months ahead of the November target of 100%. We forecast natural gas prices to average 51 €/MWh in 2023 and 55 €/MWh in 2024, as we expect LNG supply will remain elevated while European gas demand will remain below prewar levels.
- **Investors foresee tightness in oil market**. Brent oil prices have recovered since mid-July and have hit 10-month highs, up to $90/bbl, in September because of various factors, such as supply cuts from OPEC+ countries, the decrease of oil inventories (strategic and commercial) in the US, a global oil demand increase, and the diminished concerns about US and China growth. The extension of supply cuts by Saudi Arabia and Russia until the end of this year sets a floor in oil prices above $80/bbl for the next quarters.

Upward revision of GDP due to strong growth in first half of 2023

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New macroeconomic scenario

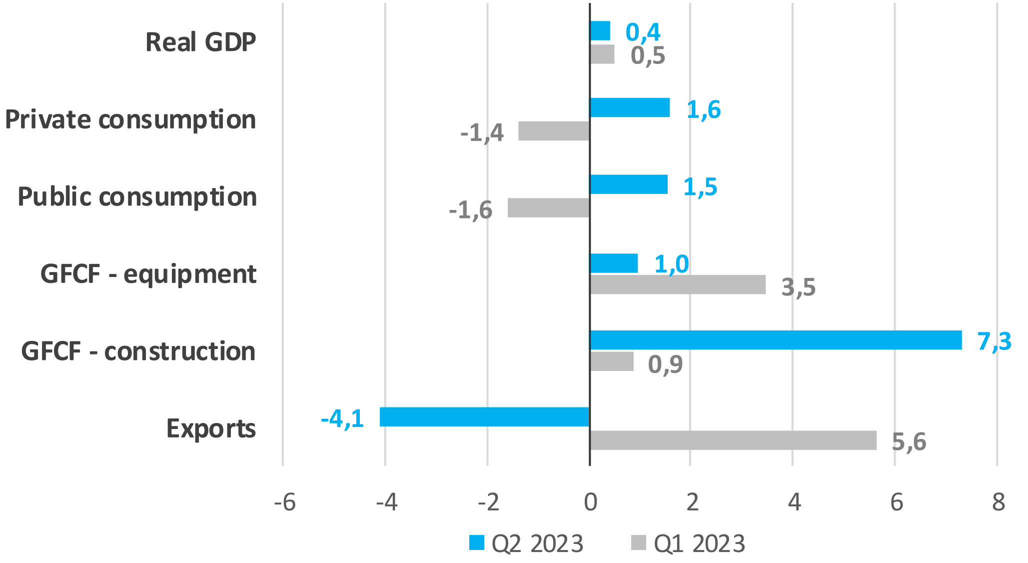
Annual variation (%), unless otherwise stated

	2022	2023	2024	2025	Cum. 23-25
GDP	5.5	2.3 *(2.0)*	1.7 *(1.8)*	2.2 *(2.3)*	**6.4** ***(6.2)***
Unemployment rate (% labor force)[2]	12.9	12.3 *(12.6)*	11.8 *(12.2)*	11.3 *(11.7)*	**-1.7** ***(-1.2)***
Inflation rate (average of period, %)	8.4	3.4 *(3.9)*	3.4 *(2.8)*	2.2 *(2.0)*	**9.2** ***(8.9)***
House prices	5.0	2.9 *(0.8)*	1.1 *(1.2)*	2.4 *(2.4)*	**6.5** ***(4.5)***

Note: (1) old scenario in parenthesis. (2) Cumulative is difference between 2025 and 2022.

GDP components

Quarter-on-quarter change (%)



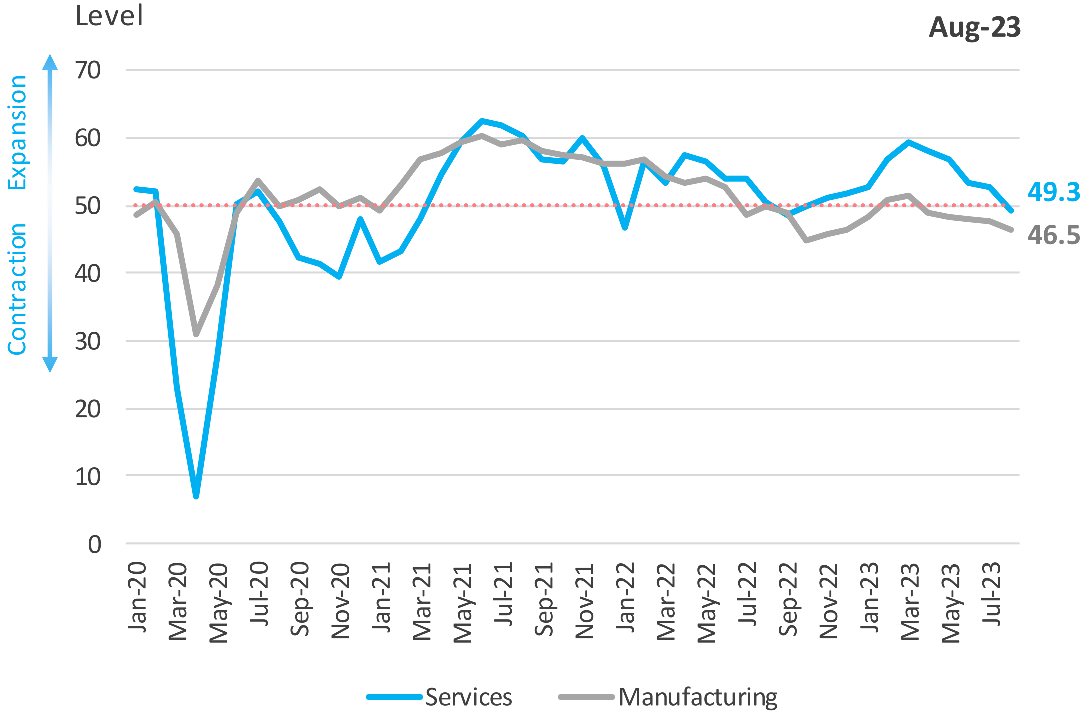
Source: CaixaBank Research, based on INE data.

- **GDP grew 0.4% qoq (1.8% yoy) in Q2 2023.** Private consumption broke a streak of two quarters in a row of declines and grew 1.6% qoq, possibly helped by the decline of inflation, and private investment grew 4.6% qoq, mostly due to investment in transport equipment and non-residential construction. The external sector made a negative contribution, as exports declined more than imports. Goods exports explain the decline in exports, as tourist exports grew 1.5% qoq.
- **We forecast GDP growth of 2.3% in 2023.** The swift decrease in energy prices and the robustness of the external sector (primarily tourism), provided more support to the economy in the first half of 2023 than we initially anticipated (GDP grew 0.5% qoq in Q1-23 and 0.4% in Q2). However, a note of caution is in order: the upward revision is largely driven by factors that have already happened. Looking into the second half of 2023, we expect growth will be more subdued, with qoq growth rates around 0.3%, as the economy will be buffeted by several headwinds. We highlight weaker demand from our main trading partners which will take a toll on our exports as well as the squeeze on domestic demand driven by the tightening of macro-financial conditions.

Growth in Q3 is set to moderate

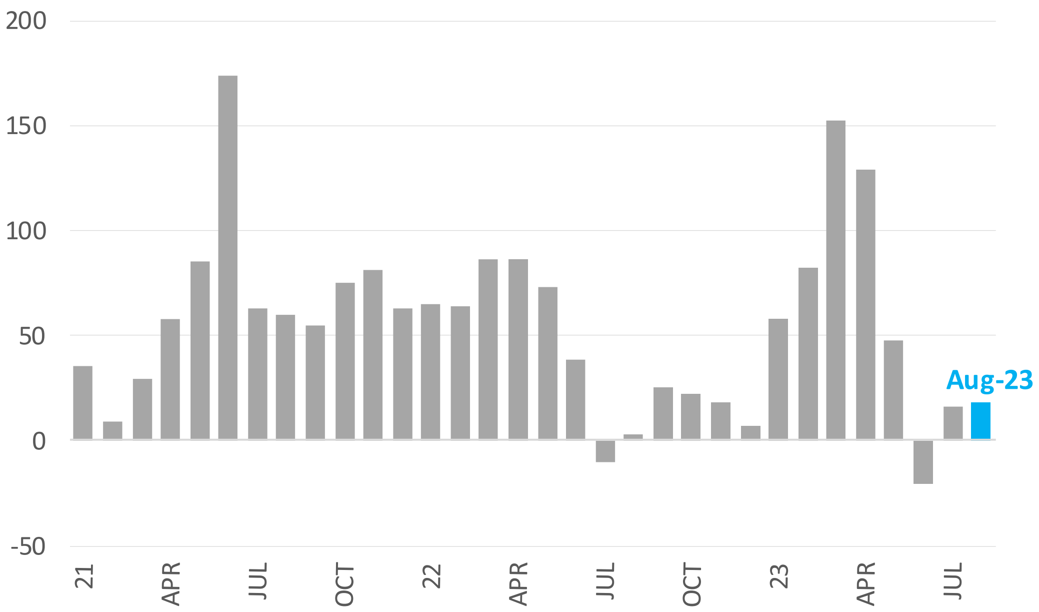
PMI indices

Level



Social Security registered members*

Month-on-month change (thousand)



Note: (*) Seasonally adjustment.

- **Growth slows down in Q3 according to early indicators.** The manufacturing sector's PMI index dropped in August to 46.5 points, 1.3 points lower than July and well below the 50-point mark that indicates expansion. This shows that industrial activity contracted faster than in previous months. The services sector's PMI index also declined by 3.5 points to 49.3 points, signaling a contraction in the sector as well. Social security affiliation, instead, rose by around 18,000 people in August on a seasonally adjusted basis, however, that is lower than the average monthly increase of around 52,000 people in Q2. Based on July and August data, social security affiliation grew by just 0.1% qoq in Q3, compared to a 1.4% qoq growth rate in Q2.
- **We forecast growth of 0.3% quarter-on-quarter in both Q3 and Q4 2023**, below the 0.5% and 0.4% rates witnessed in Q1 and Q2 2023. However, the latest indicators pose slight downside risks to our Q3 GDP growth forecast.

Strong summer season for the tourist sector

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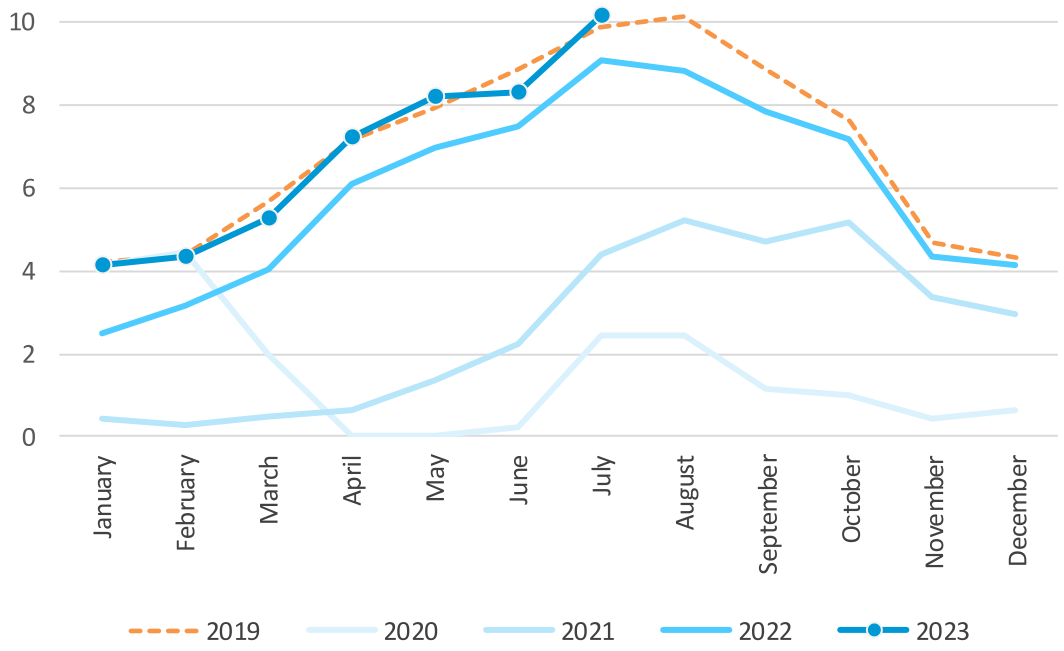
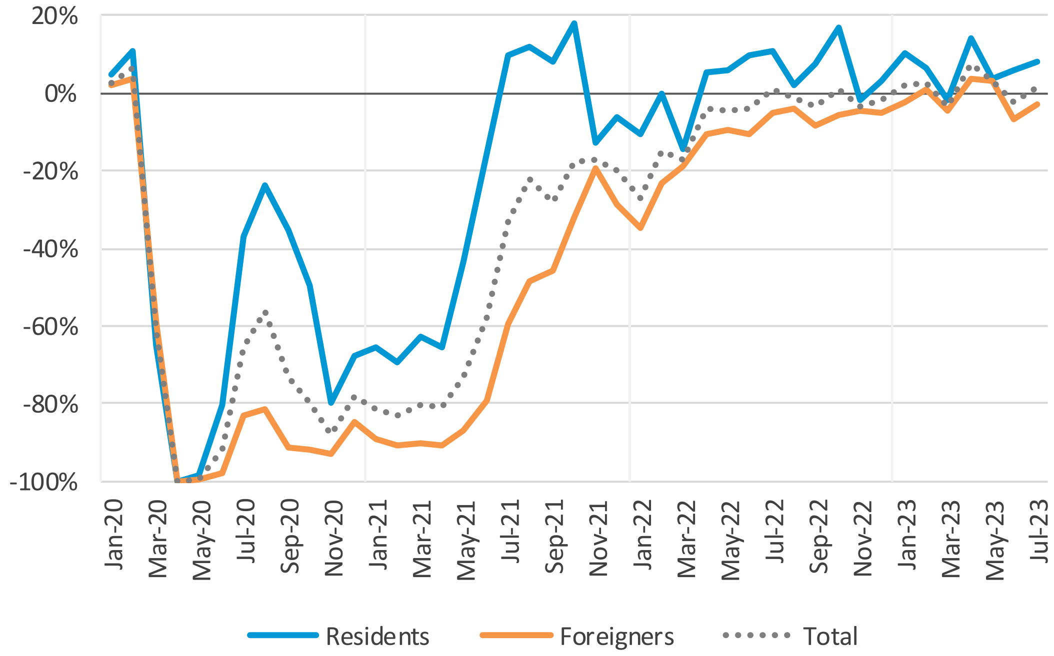
International tourists that visit Spain

Millions of people



Overnight stays in touristic accommodation

Gap with respect to 2019



- **Tourism demand remains strong.** International arrivals in July were 2.6% above the same month of 2019, while international tourist expenditure attained a level 16.0% above. Demand for tourist services is holding up despite the strong increase in tourism related prices: CPI hotel prices in July increased by 8.9% year-on-year, attaining a level 27.3% above the same month of 2019. Tourist arrival figures in July were boosted by stronger tourist flows from the Americas (+24% w.r.t. July 2019) and by tourism from the EU (+6.4% w.r.t. May 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 fell by a modest -2.4% year-on-year in July, landing at a level 8.0% above July 2019. Looking ahead, we expect a modest rate of growth but activity remaining at high levels.

Inflation revised upwards in 2024 due to unwinding of fiscal measures

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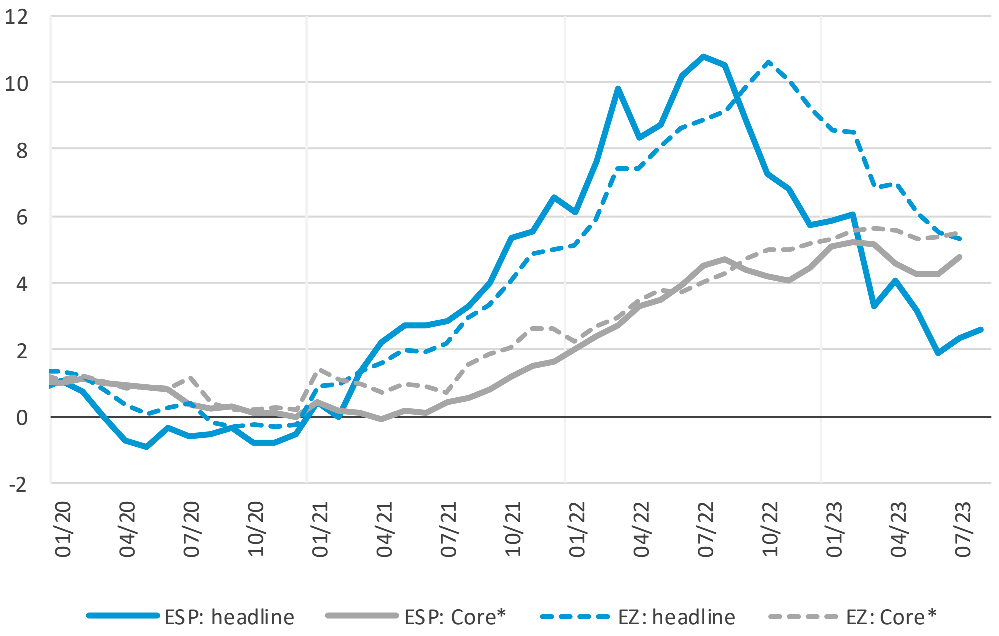
CPI in Spain and the Eurozone

Year-on-year change (%)



Note: * Core inflation excludes energy and all food products.

Inflation forecast by component

Annual change (%)

	2022	2023 (Forecast)	2024 (Forecast)	2025 (Forecast)
Headline inflation	8.4	3.4	3.4	2.2
Underlying inflation (excl. energy and non processed food)	5.2	6.0	3.1	2.3
Core inflation (excluding energy and food)	3.7	4.4	2.9	2.3
• Industrial goods	4.2	4.3	2.3	2.0
• Services	3.3	4.3	3.2	2.5
Food. beverages & tobacco	10.7	10.7	4.2	2.6
Energy	27.9	-16.9	5.1	0.1
• Electricity	26.8	-36.0	13.1	0.2
• Fuels	25.6	-6.5	0.5	0.1

- **Headline inflation increased in August, reaching 2.6% (2.3% in July),** due to the recent increase in oil prices. Underlying inflation, which excludes energy and non-processed food, decreased 0.1pp to 6.1%, although it remains at elevated levels. Despite the recent uptick, Spain's headline and core (the latter as per July data) inflation remain below that of the Euro Area.
- **We have revised headline inflation in 2024 upwards to 3.4%** (from 2.8%), as we incorporate the withdrawal of price moderation policies (decrease in VAT for electricity, gas and food, and public transport subsidies) in January 2024. We estimate that this will have an impact of +1.0pp on headline inflation for 2024: +0.7pp due to energy, +0.2pp due to food, and +0.1 due to transport.

Housing market: slower-than-expected deceleration pushes forecasts slightly up

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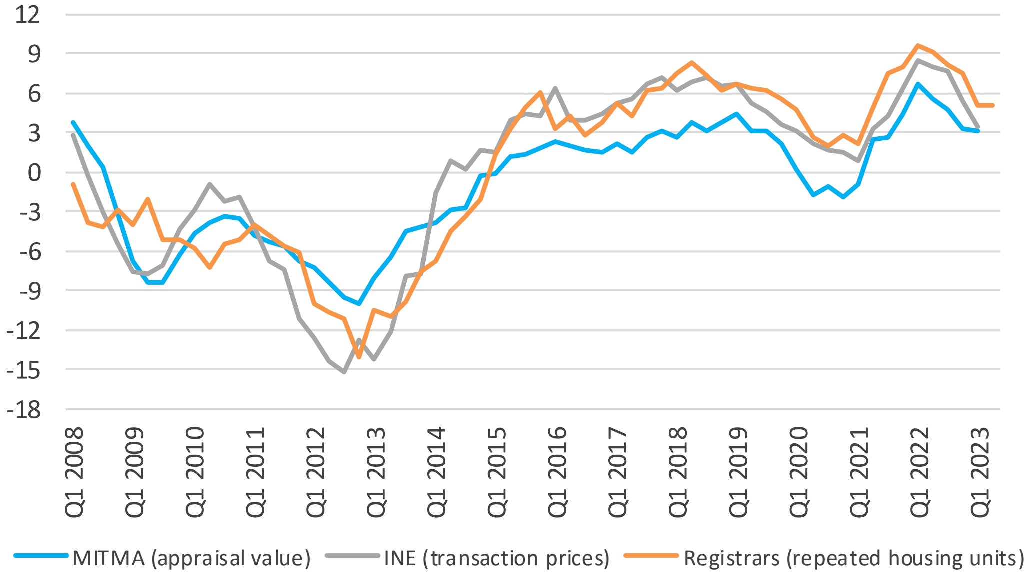
Housing prices

Year-on-year (%)



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

Updated forecasts for the real estate market

	2021	2022	2023	2024	2025
Housing sales *(thousand)*	566	649	500 *(480)*	510 *(500)*	511 *(510)*
New building permits *(thousand)*	108	109	90	105	110
House price (appraisal, Mitma) *Year-on-year (%)*	2.1	5,0	2.9 *(0.8)*	1.1 *(1.2)*	2.4
House price (transaction, INE) *Year-on-year (%)*	3.7	7.4	2.1 *(1.0)*	1.1 *(1.2)*	2.4

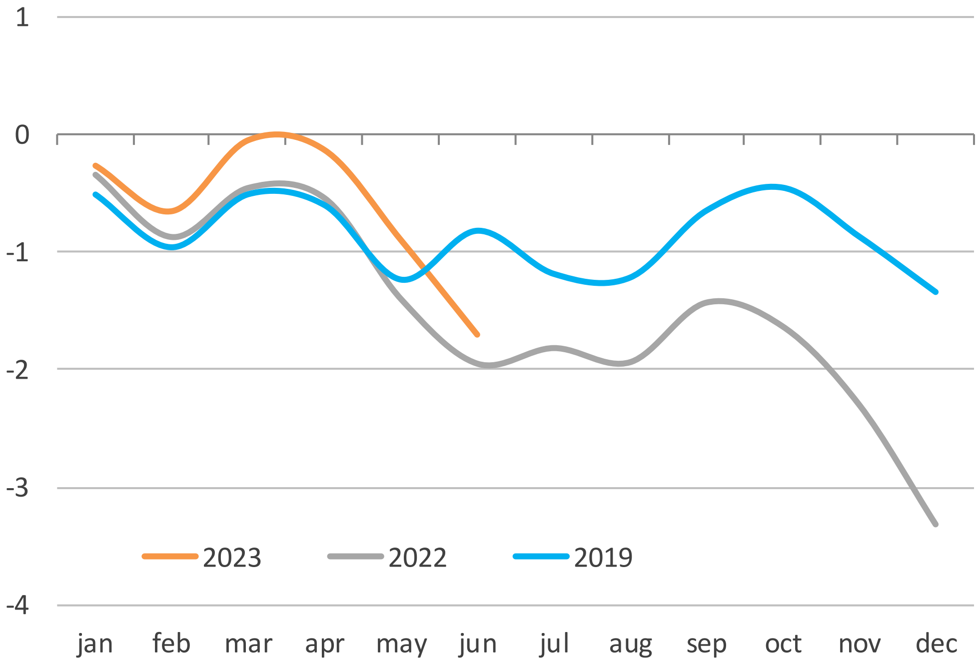
Note*: Previous forecast* in parenthesis.

- The Spanish housing market is slowing down but at a more moderate pace than expected in our scenario. The better-than-anticipated Q1 data leads us to **revise upwards house prices and sales forecasts**. New building permits in Q2 (April-May) have picked up (+23% YoY) which may lead us to improve our annual forecast if this positive trend consolidates in the following months.
- **Housing prices (appraisal value, Mitma) surprised on the upside and increased by 2.2% QoQ in Q1 2023** (forecast 0.1%), which leads us to revise the annual projection for 2023 upwards, from 0.8% to 2.9%. The positive surprise in the INE index was more modest (0.6% QoQ vs. forecast of 0.1%) and therefore the upward revision is more contained, from 1.0% to 2.1% (transaction price, INE). Bear in mind that the upward revisions are due to past overperformance and price stickiness in the short term. Going forward, we still expect a notable slowdown, as it is reflected in our forecast for 2024 (1.1% in both indices). A strong labor market, significant immigration flows plus better fundamentals mean that it is unlikely to witness sharp price corrections as was seen in 2008-2013.
- As expected, **housing sales have started to decline** (-4.5% cumulative January to June 2023) from the very high levels achieved in 2022 (650,000 units, the highest since 2008). Although housing sales have declined at a moderate pace so far, we expect them to decline sharply in the following months (-23% in 2023 to 500k, a slightly better forecast than previously) as the impact of the increase in interest rates feeds into the economy.

Fiscal revenues grow at a notable pace, albeit slower than in 2022

Central government budget balance

(% GDP)



General Government Budget Execution Consolidated*

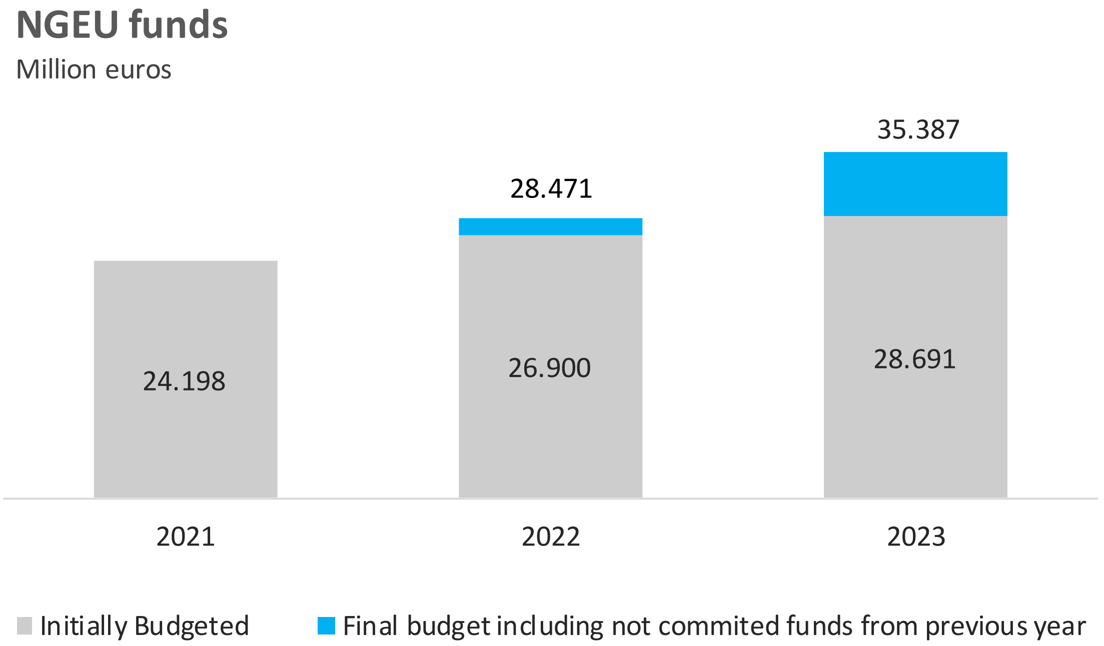
Year-to-date until May

	Million euros			Change (%)	
	2019	2022	2023	2023-2022	2023-2019
Revenues	**168.854**	**196.777**	**215.896**	**9.7%**	**27.9%**
Tax revenues	84.685	103.310	109.992	6.5%	29.9%
Social contributions	63.003	70.631	77.577	9.8%	23.1%
Expenditures	**185.766**	**217.953**	**233.310**	**7.0%**	**25.6%**
Public employee wages	40.608	46.679	49.657	6.4%	22.3%
Social transfers	71.943	84.954	92.889	9.3%	29.1%
Gross capital formation	7.595	10.494	10.223	-2.6%	34.6%
Interest	11.550	12.209	12.333	1.0%	6.8%

Note: Excluding local governments.

- **Consolidated fiscal revenues (taxes and social contributions) excl. Local Corporations up to May grew by 7.8% year-on-year,** below 12.0% in the first 5 months of 2022 (cumulative average up to May 2015-2019: 3.5%). Direct taxes and social contributions are advancing at a good pace due to the increase in employment, but indirect taxes (on production) are slowing down due to VAT fiscal discounts and the moderation of inflation.
- The extension until the end of 2023 of a large part of the measures to mitigate the impact of inflation (VAT food discounts, generalized public transport discounts, direct aid and diesel transport bonuses...) will have a budgetary cost of c. 0.2pp and it has already been incorporated into the public deficit forecast of 4.3% in 2023.
- **Negotiations to form a government following the 23rd of June elections are underway.** The conservative People's Party (PP) will submit his candidacy to parliament on the 26th and 27th of September. If his candidacy fails, the Socialist Party (PSOE) will have two months to submit his own candidacy. Were PSOE's candidacy to fail as well, new elections would be held on the 14th of January 2024. While political uncertainty is expected to have a limited economic impact, it could delay the implementation of the Next Generation EU funds.

NGEU: many projects are in the pipeline



Source: CaixaBank Research, with data from IGAE and Mineco.

	2021	2022	2023*
Initially budgeted	24.198	26.900	28.691
Final budget	24.198	28.471	35.387
Authorised (activated projects)	22.128	25.143	16.849
Commited (projects allocated to firms&sub-state public administrations)	20.976	21.647	11.957
Disbursed	11.003	11.271	3.739

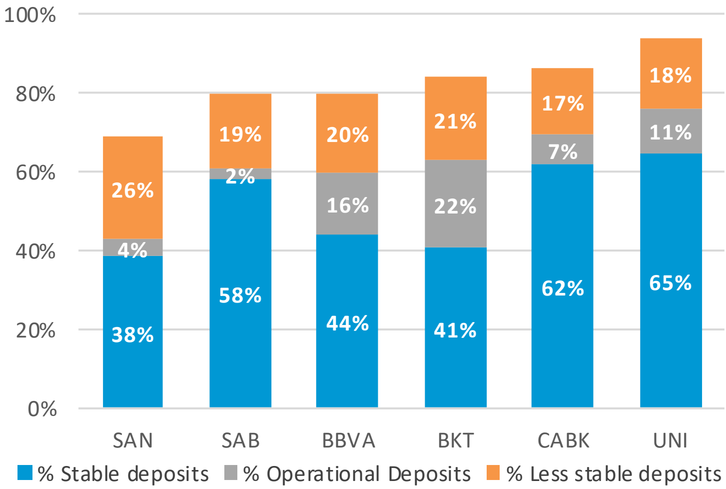
Notes *Until June 2023.
Source: IGAE.

- The NGEU **budget** in 2021-22 was €51bn, of which €28b.4n corresponded to 2022. The final budget for 2023, including the non-committed funds in 2022, is **€35.4bn.**
- **Addenda:** The Government requested in June access to €84bn in loans and then 3 months can pass until approval (2 for the EC assessment and 1 for the Council). Of these, €17.9bn will reinforce the PERTES and the remaining €66.3bn will have other uses (such as €20bn for sustainable investments by CCAA with support of European Bank of Investment, €15.5bn for an ICO green line and €7bn for an ICO line for companies and entrepreneurs).
- Of the €35.4bn budgeted for 2023, projects worth €16.9bn have been launched up to June and calls for a value of €12bn have been assigned. However, disbursements have been €3.7 billion, a rate clearly lower than that of the second half of 2022.
- Although NGEU investments will continue to be executed, going several months without a fully functioning government could delay the implementation of NGEU funds. For example, it could delay reforms such as the tax reform, and the application of projects that are in an initial phase like in some PERTEs.
- In July, the 2nd call for the PERTE VEC was launched. It will have two tranches: one for battery development with a budget of €850 M (€550 M in grants and €287 M in loans) and a second for the electric vehicle value chain (€344 M in grants and €215 M € in loans).

Banking system: strong liquidity position

Banks' deposit breakdown

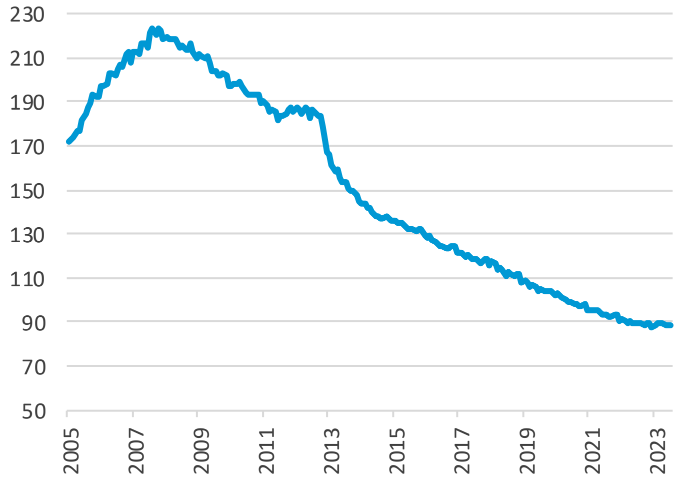
% of total deposits excluding unsecured debt



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 2Q23 (except for BBVA, BKT, SAB and UNI 1Q23).

HHs & NFCs loan to deposit ratio

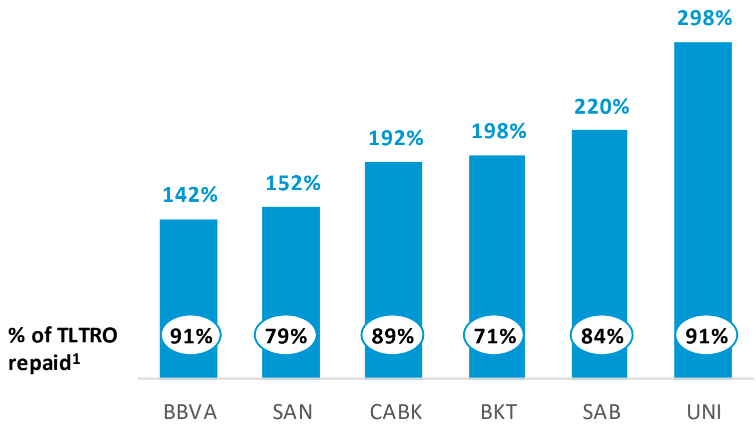
Percentage (%)



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

Banks' LCR

Q2 23 published ratio



Note: (1) TLTRO repaid between the beginning of Nov'22 and the end of Jun'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 06.30.2023, TLTRO sector funds: €590 bn.
Source: Banks' financial statements.

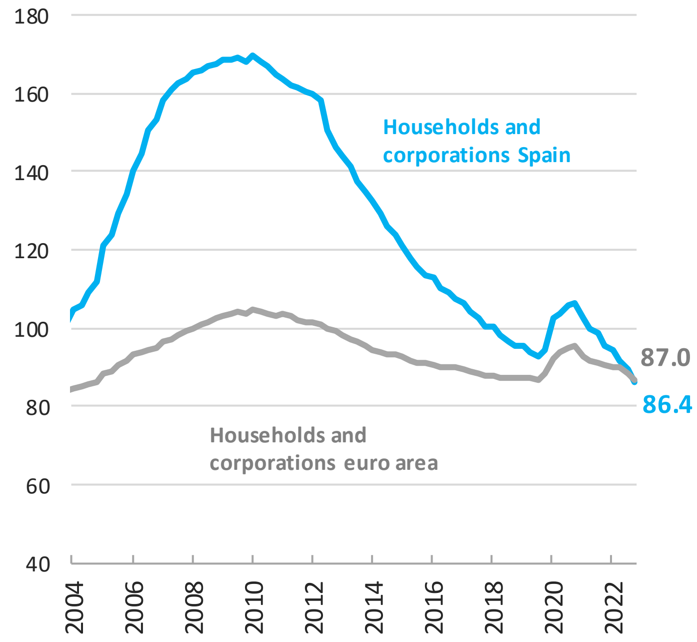
- **Spanish banks are strongly focused on the retail segment, which provides a more stable source of funding in the long-term.** Stable deposits and operational deposits (those that have proven to be harder to withdraw) account for over 60% of total deposits for nearly all Spanish banks. This has contributed 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.** Jul'23 data show a 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%)
- **With data available up to Jul'23, Spanish banks had repaid around 78% of TLTROs outstanding at Oct'22.** This figure compares to a 72% for the Euro Zone banks in aggregate.
- **Although full repayment of TLTROs may have uneven impacts on banks' LCR, the Spanish banking sector faced the pending TLTRO maturities of Jun'23 from high liquidity ratios in aggregate.** EBA data for 1Q23 points to an LCR ratio of 166% and a NSFR of 129% for Spanish banks (vs. an EU average of 164% and 126%, respectively).

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

CaixaBank

Bank credit to the private sector

% GDP



Note: latest data available as of Mar-23.
Source: ECB, Eurostat.

Private domestic credit

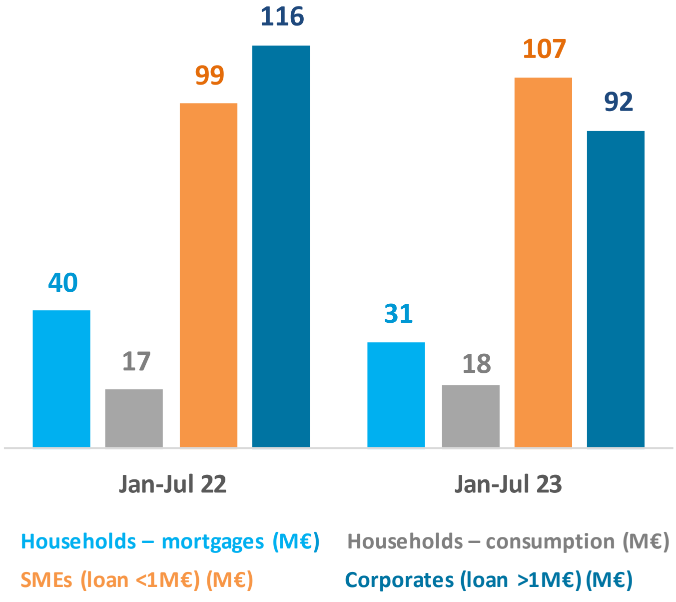
Year-on-year (%)

	Dec-22	Jul-23 (latest)	2023 (forecast)
	% yoy	% yoy	% yoy
Total credit	-0.4%	-3.0%	-2.7%
Households	-0.2%	-2.4%	-2.3%
Housing mortgages	-0.2%	-3.3%	-3.2%
Other purposes	0.0%	0.1%	0.2%
Of which consumption	1.1%	2.2%	2.8%
Businesses	-0.7%	-3.9%	-3.3%
Non-real estate developers[1]	1.3%	0.1%	-
Real estate developers[1]	-8.8%	-4.1%	-

Note: (1) latest data available Mar-23.
Source: Bank of Spain.

New lending activity by sector

YTD, €Bn

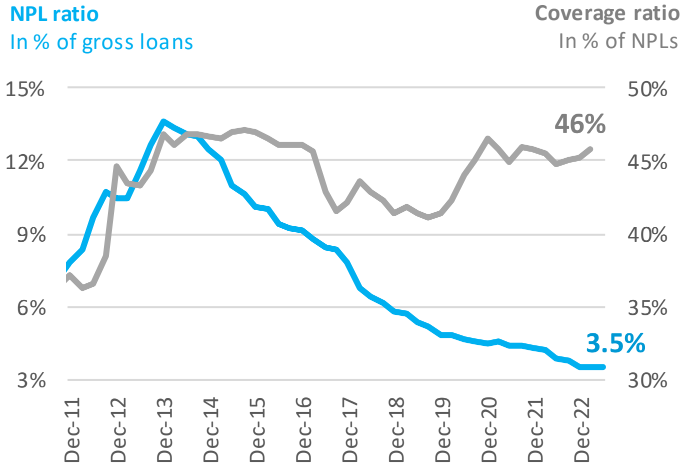


Source: Bank of Spain.

- **Households and corporate debt levels** (including debt securities) remain below euro area averages in 1Q23. Both sectors have deleveraged in terms of GDP, reaching levels below of pre-pandemic. 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. Loans under 1M€ continue 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]



Cost of risk[2]
0.4% in Q1 2023
0.4% in Q2 2023

Note: (1) latest available data Jun-23. (2) 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

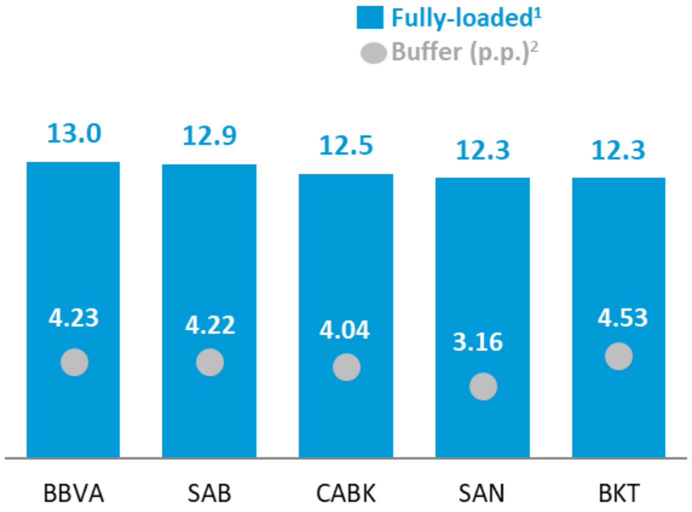
% of avge. total assets (Q2 23; trailing 12M)

	CABK	BBVA	SAN	SAB	BKT
Net interest income	**1.3%**	**1.0%**	**1.2%**	**1.6%**	**1.8%**
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	**2.0%**	**1.5%**	**1.9%**	**2.1%**	**2.2%**
Operating expenses	-0.9%	-0.7%	-0.8%	-1.0%	-0.9%
Impairment losses, tax and others	-0.5%	-0.4%	-0.6%	-0.7%	1.1%
Profit	**0.6%**	**0.5%**	**0.4%**	**0.4%**	**0.7%**
ROTE (%)[1]	12.0	8.3	12.4	8.6	14.7

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: 16.9 and 14.5, respectively.
Source: Bank's financial statements.

Banks' solvency position

In % (Q2 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. The share of stage 2 loans on a group level increased slightly to 6.9% in 1Q23, remaining below EU level. Additionally, at the end of 2022 the Government and the banks agreed to expand 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 11.4% in 1Q23 and 10.4% in 4Q22 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.** In the adverse scenario considered (more severe than in the previous exercise), the EBA stress test for 2023 shows that the CET1 ratio for the Spanish banks as a whole would fall by 2.4 p.p. as of end-2025 (vs. -4,6pp for the European average) and would stand at 10%.

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