Spain
Macroeconomic & Financial Outlook
CaixaBank Research
November 2023
**Key messages**

**Activity**

- **The ECB left policy rates unchanged in October (depo at 4.00%, refi at 4.50%), reinforcing the view that rates have reached their summit.** While not closing the door to further hikes, the ECB considers current rate levels to be consistent with achieving its inflation target—provided they are maintained for a sufficiently long period of time. We do not expect rate cuts before Q3 2024.

- **Energy prices have reacted in a muted way following the crisis in the Middle East.** This may reflect the assessment that the conflict will not escalate drawing in other countries such as Iran. We maintain our forecast where oil prices close the year at $85/b.

- **GDP grew 0.3% qoq in Q3 2023 (1.8% yoy),** slightly above what we expected (0.2% qoq), driven by domestic demand. Private consumption grew a notable 1.4% qoq while investment declined 0.4% qoq. Both exports and imports declined, but exports more so, leading to a negative contribution to growth of net trade in quarterly terms. Despite the deceleration, GDP growth was higher than that of the eurozone (-0.1% qoq). GDP is now 2.1% above the pre-pandemic level of Q4 2019.

- **Early Q4 indicators suggest growth will remain subdued in Q4 2023.** The composite PMI index remained, in October, barely unchanged with respect to the previous month (50 points in Oct. vs 50.1 points in Sept.) while affiliation to the social security system added c.5k workers in October, a rate below the c.16k new monthly workers posted on average in the previous three months. We expect growth of 0.3% qoq in Q4 2023, but considering the limited amount of information available, the degree of uncertainty is elevated.

- **Headline inflation remains flat in October at 3.5%.** This stabilization can be attributed to lower oil prices and slower growth in food prices. Underlying inflation (excluding energy and non-processed food) decreased to 5.2% (5.8% in September), the largest decrease in the past 10 months.

- **Housing prices surprised on the upside in Q2 2023 and increased by 2.1% QoQ (transaction price, INE) and by 0.3% QoQ (appraisal value, Mitma).**

  Going forward, we still expect some slowdown (2024 forecast is 1.4% in both indices), but a strong labor market, significant immigration flows, relative scarcity of new housing supply plus better real estate market fundamentals will continue to support the market.

- **Negotiations to form a government following the 23rd of June elections are underway.** The Socialist Party (PSOE) has up to the 27th of November to submit his own candidacy. Were PSOE’s candidacy to fail, new elections would be held on the 14th of January 2024. While lags in the formation of a new government should have limited economic impact, the implementation of some NGEU funds could be delayed.

**Banking Sector**

- **The banking system remains strong with robust capital and liquidity positions.** The deposit base is dominated by household deposits (71% in 2Q23, 6 pp above EU levels) and a high proportion of all deposits are either stable or operational (>60%). Liquidity ratios remain high after the repayment of nearly 90% of TLTROs, with LCRs of top 5 banks ranging from 143% to 259%. Regarding credit risk, domestic NPL ratio stood at 3.56% in August, 126 bps below pre-covid level of February 2020.
## Main economic forecasts

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<td>Gross Fixed Capital Formation (GFCF)</td>
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<td>2,5</td>
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<tr>
<td>GFCF - equipment</td>
<td>5,6</td>
<td>9,1</td>
<td>1,8</td>
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<td>4,7</td>
<td>2,0</td>
<td>-12,6</td>
<td>4,4</td>
<td>1,9</td>
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<td>3,7</td>
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<td>GFCF - construction</td>
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<td>1,5</td>
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<td>Exports</td>
<td>4,5</td>
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<td>Unemployment rate</td>
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<td>14,8</td>
<td>12,9</td>
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<td>11,8</td>
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<td>CPI (average)</td>
<td>-0,2</td>
<td>-0,5</td>
<td>-0,2</td>
<td>2,0</td>
<td>1,7</td>
<td>0,7</td>
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<td>3,1</td>
<td>8,4</td>
<td>3,7</td>
<td>3,6</td>
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<td>External current account balance (% GDP)</td>
<td>1,7</td>
<td>2,0</td>
<td>3,2</td>
<td>2,8</td>
<td>1,9</td>
<td>2,1</td>
<td>0,6</td>
<td>0,8</td>
<td>0,6</td>
<td>1,8</td>
<td>1,7</td>
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<td>General Government Balance (% GDP)</td>
<td>-6,2</td>
<td>-5,4</td>
<td>-4,3</td>
<td>-3,1</td>
<td>-2,6</td>
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<td>-10,1</td>
<td>-6,8</td>
<td>-4,7</td>
<td>-4,2</td>
<td>-3,6</td>
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<tr>
<td>General government debt (% GDP)²</td>
<td>105,1</td>
<td>103,3</td>
<td>102,7</td>
<td>101,8</td>
<td>100,4</td>
<td>98,2</td>
<td>120,3</td>
<td>116,8</td>
<td>111,6</td>
<td>108,2</td>
<td>107,0</td>
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<td>Housing prices</td>
<td>-2,4</td>
<td>1,1</td>
<td>1,9</td>
<td>2,4</td>
<td>3,4</td>
<td>3,2</td>
<td>-1,1</td>
<td>2,1</td>
<td>5,0</td>
<td>3,7</td>
<td>1,4</td>
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<td>Risk premium (vs. 10Y Bund, bps, Dec.)</td>
<td>149</td>
<td>120</td>
<td>124</td>
<td>120</td>
<td>97</td>
<td>88</td>
<td>86</td>
<td>67</td>
<td>104</td>
<td>104</td>
<td>105</td>
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<td>Bank credit (to the private domestic sector)</td>
<td>-15,8</td>
<td>-4,3</td>
<td>-2,9</td>
<td>-1,9</td>
<td>-2,6</td>
<td>-1,2</td>
<td>2,5</td>
<td>0,5</td>
<td>-0,4</td>
<td>-3,3</td>
<td>-1,5</td>
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</tbody>
</table>

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

ECB September macroeconomic projections

<table>
<thead>
<tr>
<th></th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
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<tr>
<td>GDP growth</td>
<td>3.5</td>
<td>0.7 (0.9)</td>
<td>1.0 (1.5)</td>
<td>1.5 (1.6)</td>
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<tr>
<td>Headline inflation</td>
<td>8.4</td>
<td>5.6 (5.4)</td>
<td>3.2 (3.0)</td>
<td>2.1 (2.2)</td>
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<tr>
<td>Core inflation</td>
<td>3.9</td>
<td>5.1 (5.1)</td>
<td>2.9 (3.0)</td>
<td>2.2 (2.3)</td>
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<td>Unit labor costs</td>
<td>3.2</td>
<td>5.8 (5.6)</td>
<td>3.5 (3.4)</td>
<td>2.4 (2.6)</td>
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<tr>
<td>Compensation per employee</td>
<td>4.3</td>
<td>5.3 (5.3)</td>
<td>4.3 (4.5)</td>
<td>3.8 (3.9)</td>
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Note: Previous forecasts (June) in brackets.

The ECB left policy unchanged in October (depo at 4.00%, refi at 4.50%), reinforcing the view that rates have reached their summit. While not closing the door to further hikes, the ECB considers current rate levels to be consistent with achieving its inflation target –provided they are maintained for a sufficiently long period of time. There were no discussions about possible adjustments to other instruments (rundown of APP holdings, PEPP reinvestments, MRR, etc.). Formally, the ECB remains on a data-dependent mode, but we think forthcoming data releases will set a high bar for further rate hikes (given weakness in current activity indicators and the observed cliff-effect in inflation once summer distortions disappeared).

As it strikes a balance between high-but-declining inflation and weakening activity, the ECB is seen to be at peak rates, and it has embraced a high-for-long guidance. We do not expect rate cuts 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).
Commodities bear the pressure of the war

Commodity prices, especially energy, have moved little following the crisis in the Middle East. This can be attributed, partly, to the fact that none of the countries involved in the conflict are reference producers of basic resources, and the international monetary context (with high interest rates for longer) helps cushion a price boom, via lower demand. However, energy prices remain volatile as the environment is highly uncertain. The most important risk is that of an extension of the conflict to more countries, which would have greater repercussions on the production and commercial transit of some energy materials (Iran’s involvement could lead to obstacles in oil and gas trade through the Strait of Hormuz).

Crude oil price will remain high. The extension of oil supply cuts by Saudi Arabia and Russia, at least until the end of the year, will fuel imbalances in the oil market, while global demand keeps strong thanks to China. We maintain our forecast for Brent prices in 2023 (avg price 83,2 $/b; dec-23 85 $/b) and 2024 (avg price 81,3 $/b; dec-24 79 $/b).

Commodity prices

<table>
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<tr>
<th>Metric</th>
<th>Price</th>
<th>Change (%)</th>
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<td></td>
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<td>Israel/ Hamas*</td>
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<tr>
<td>Commodities</td>
<td>index</td>
<td>105,5</td>
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<td>Energy</td>
<td>index</td>
<td>36,7</td>
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<tr>
<td>Brent</td>
<td>$/barrel</td>
<td>86,1</td>
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<td>Natural Gas (Europe)</td>
<td>€/MWh</td>
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<td>Precious Metals</td>
<td>index</td>
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<td>Gold</td>
<td>$/ounce</td>
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<td>Industrial Metals</td>
<td>index</td>
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<tr>
<td>Aluminum</td>
<td>$/Tm</td>
<td>2254,0</td>
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<tr>
<td>Copper</td>
<td>$/Tm</td>
<td>8175,5</td>
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<tr>
<td>Agricultural</td>
<td>index</td>
<td>65,9</td>
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<tr>
<td>Wheat</td>
<td>$/bushel</td>
<td>570,5</td>
</tr>
</tbody>
</table>

* It takes October 6 closing prices as reference
GDP growth slows down in Q3, but remains above euro area average

- **GDP** grew **0.3% qoq** in Q3 **2023** (**1.8% yoy**), slightly above what we expected (**0.2% qoq**), driven by domestic demand. Private consumption took a leap and grew **1.4% qoq**, powered by the recovery of gross disposable income and the moderation of inflation. As a result, private consumption now stands **0.3% above** the pre-pandemic level of Q4-19 (GDP is now **2.1% above** that level). Instead, private investment retreated a little (**-0.4% qoq**), as the decline in investment in construction outweighed growth in investment in equipment. Net trade deducted from growth, as exports declined more than imports. Both goods and services exports declined, reflecting weak external demand and the normalization of the rates of growth of the tourist sector. Despite the slowdown, GDP growth remains above that of the euro area (**0.3% qoq vs -0.1%**).

- **We expect GDP growth of 2.4% for 2023 and 1.4% in 2024.** Growth in 2024 is forecast to slow down as the economy feels the brunt of the impact of the increase in interest rates in the twelve months raging from Q3-23 to Q2-24. Topping it up, the economy will also be dragged down by weaker growth from the Euro Area and China, and higher oil prices. That said, the strength of the labor market as well as ongoing NGEU-related investments will continue to support activity.

- **Risks on both sides of our forecast.** After our revision of the scenario, INE revised the household saving rates for recent quarters, indicating that it was higher than previously thought–this poses some upside risks to our projections as there is some additional room for increases in private consumption. On the downside, were the Israel-Hamas conflict to escalate, this could trigger a further surge in oil prices and undermine sentiment.
Indicators point to moderate growth in Q4

Early Q4 indicators suggest growth will remain subdued in Q4 2023. The PMI index for the manufacturing sector declined in October and reached 45.5 points, well below the 50-point mark that indicates expansion and the lowest reading since October 2022. Offsetting the weakness in the industrial sector, the services PMI index bounced back and increased 0.6 points until reaching 51.1 points. As a result, the composite PMI index remained barely unchanged with respect to the previous month (50 points in Oct. vs 50.1 points in Sept.). Following the trend of previous months, employment growth slowed down in October. Affiliation to the social security system added c.5k workers in Oct. vs c.16k new monthly workers posted on average in the previous three months. Tying everything together, the economy appears to be growing at a rate similar to that of the previous quarter (0.3% qoq in Q3).

We expect growth of 0.3% qoq in Q4 2023. Considering the limited amount of information available so far, there is still an elevated degree of uncertainty regarding this forecast.
Tourism demand remains strong. International arrivals in September were 1.0% below the same month of 2019, while international tourist expenditure attained a level 15.6% above September 2019. Demand for tourism services is holding up despite the strong increase in tourism related prices: CPI hotel prices in September increased by 11.0% year-on-year, attaining a level 26.6% above the same month of 2019. Tourist arrival figures in August were boosted by stronger tourist flows from the Americas (+13.8% w.r.t. September 2019) and by tourism from the EU (+4.3% w.r.t. September 2019). On the domestic side, following remarkable figures last summer, overnight stays by residents in touristic accommodations fell by a modest -1.2% year-on-year in September, landing at a level 6.2% above September 2019. Looking ahead, we expect modest rates of growth but activity remaining at high levels.

The current account surplus keeps improving. The current account registered a 2.4% of GDP surplus in the twelve months to August 2023, the largest surplus since the outbreak of the pandemic. The decline in energy prices is an important driver: the deficit on the energy balance took 4.2% of GDP in 2022, while in the twelve months to August the bill declined to 3.0% of GDP. Another important driver are services. The surplus on the tourist balance reached 4.0% of GDP in August 2023, slightly above that of 2019 (3.7%), and the surplus on non-tourist services reached 3.0% of GDP, far exceeding the figure of 2019 (1.8%).
Spanish headline inflation stabilizes in October

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**Headline inflation remains flat in October at 3.5%**. This stabilization can be attributed to lower oil prices (Brent oil prices decreased 4% MoM in October) and to slower growth in food prices. Underlying inflation (excluding energy and non-processed food) decreased to 5.2% (5.8% in September), the largest decrease in the past 10 months. The three months average MoM rate, seasonally adjusted and annualized, declined from 4.8% to 2.8%, which suggests that, looking ahead, there is further room for declines in underlying inflation.

**Inflation in 2024 is forecast to remain elevated, at 3.6%, because of the removal of food and energy subsidies due in January 2024**, which we estimate will add c. 1pp to inflation. However, considering the lack of evidence of meaningful second round effects, once the fiscal impact falls out of the calculations, headline inflation is forecast converge to close to 2% in 2025.

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**Inflation forecast by component**

**Annual change (%)**

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<thead>
<tr>
<th>Forecast</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
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<tbody>
<tr>
<td>Headline inflation</td>
<td>8.4</td>
<td>3.7</td>
<td>3.6</td>
<td>2.2</td>
</tr>
<tr>
<td>Underlying inflation (excl. energy and non-processed food)</td>
<td>5.2</td>
<td>6.1</td>
<td>3.1</td>
<td>2.3</td>
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<tr>
<td>Core inflation (excluding energy and food)</td>
<td>3.7</td>
<td>4.5</td>
<td>2.9</td>
<td>2.3</td>
</tr>
<tr>
<td>- Industrial goods</td>
<td>4.2</td>
<td>4.6</td>
<td>2.4</td>
<td>2.0</td>
</tr>
<tr>
<td>- Services</td>
<td>3.3</td>
<td>4.3</td>
<td>3.2</td>
<td>2.5</td>
</tr>
<tr>
<td>Food, beverages &amp; tobacco</td>
<td>10.7</td>
<td>11.1</td>
<td>4.4</td>
<td>2.6</td>
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<td>Energy</td>
<td>27.9</td>
<td>-15.8</td>
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<td>-0.2</td>
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<tr>
<td>- Electricity</td>
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<tr>
<td>- Fuel</td>
<td>25.6</td>
<td>-4.1</td>
<td>2.8</td>
<td>-0.4</td>
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**Note:** Core inflation excludes energy and all food products.

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**CPI in Spain and the Eurozone**

Year-on-year change (%)
The Spanish housing market is slowing down but the better-than-anticipated data lead us to revise upwards our forecasts last month. Incoming data is in line with the new scenario.

Housing prices surprised on the upside in Q2 2023 and increased by 2.1% QoQ (transaction price, INE) and by 0.3% QoQ (appraisal value, Mitma). Last month we improved our price forecast due to this positive data, but it reflects past overperformance and price stickiness in the short term. Going forward, we still expect some slowdown (2024 forecast is 1.4% in both indices). A strong labor market, significant immigration flows and a relative scarcity of new housing supply plus better real estate market fundamentals mean that it is unlikely to witness sharp price corrections as was seen in 2008-2013.

Housing sales are declining at a moderate pace (-6.5% YoY, cum. Jan. to Aug.), but the number of mortgages has declined more sharply so far (-15.4% YoY, cum. Jan. to Aug.), which has led to a notable decrease in the ratio of number of housing sales to mortgages from 71.3% in 2022 to 57.5% in Aug. 2023.

New housing construction remains very limited, but the latest data is quite positive (+8.4% YoY, cum. Jan. to Aug.). We expect new building permits to reach 105k in 2023, a figure in line with 2022.
Spain: Government budget plan aims at a deficit of 3.0% in 2024

Macro and fiscal scenario
- Dynamic real GDP growth in 2024 (2.0% vs. 1.4% in our forecasts).
- Inertial scenario: no new measures and Ukraine-related policy measures come to an end in January 2024.
- This budget plan can suffer modifications due to the formation of a new government. Even though Ukraine-related fiscal measures are expected to be phased out in January, every month of extension would add ≈ 0.1 pp to public deficit.

Public revenues
- Revenues reach 42.0% of GDP in 2024 (41.9% in 2023) due to the rise of indirect taxes after the end of tax cuts and the dynamism of direct taxes and social contributions.
- Growth of 5.8% with respect to 2023, in line with nominal growth forecasts (5.6%).

Spending (excluding NGEU)
- Expenditure reach 45.0% of GDP in 2024 (45.8% in 2023).
- Net primary spending growth of 2.5% < 2.6% recommended by the European Commission.
- Structural spending increase with respect to 2023: social transfers grow +5.1% (with pensions’ revaluation of ≈4.0%) and employees’ total remuneration grow +4.6% (with an increase of public salaries of 2-2.5%).

Main takeaways
- The government projects a deficit of 3.9% of GDP in 2023 and 3.0% in 2024. Our deficit forecast for 2023 is similar, but we expect a more muted fiscal adjustment in 2024 (CBK deficit forecast: 4.2% in 2023 and 3.6% in 2024) due to smaller nominal GDP growth forecast.
- This plan would comply with the new fiscal rules: The structural deficit declines by more than the 0.5% of GDP that should be implemented when public deficit surpasses 3% of GDP.

Government’s budgetary plan 2024 (excluding NGEU)

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<thead>
<tr>
<th>%GDP</th>
<th>2019</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
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<td>Total public revenue</td>
<td>39.2</td>
<td>41.8</td>
<td>41.9</td>
<td>42.0</td>
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<td>Indirect taxes (VAT…)</td>
<td>11.5</td>
<td>11.9</td>
<td>11.3</td>
<td>11.4</td>
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<td>Taxes on income and wealth</td>
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<td>12.2</td>
<td>12.7</td>
<td>13.1</td>
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<td>Social contributions</td>
<td>12.9</td>
<td>13.4</td>
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<tr>
<td>Other revenues</td>
<td>4.0</td>
<td>3.9</td>
<td>4.1</td>
<td>3.6</td>
</tr>
<tr>
<td>Total public spending</td>
<td>42.1</td>
<td>46.5</td>
<td>45.8</td>
<td>45.0</td>
</tr>
<tr>
<td>Worker salaries</td>
<td>10.8</td>
<td>11.4</td>
<td>11.1</td>
<td>11.0</td>
</tr>
<tr>
<td>Intermediate consumption</td>
<td>5.1</td>
<td>5.8</td>
<td>5.7</td>
<td>5.7</td>
</tr>
<tr>
<td>Social transfers</td>
<td>18.4</td>
<td>19.8</td>
<td>19.8</td>
<td>19.7</td>
</tr>
<tr>
<td>Interest payments</td>
<td>2.3</td>
<td>2.4</td>
<td>2.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Subsidies</td>
<td>1.0</td>
<td>2.0</td>
<td>1.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Capital spending (excl. NGEU)</td>
<td>2.8</td>
<td>3.2</td>
<td>3.3</td>
<td>3.3</td>
</tr>
<tr>
<td>Other expenditures</td>
<td>1.7</td>
<td>1.9</td>
<td>1.8</td>
<td>1.6</td>
</tr>
<tr>
<td>Public Balance</td>
<td>-2.9</td>
<td>-4.7</td>
<td>-3.9</td>
<td>-3.0</td>
</tr>
<tr>
<td>Public Debt</td>
<td>98.2</td>
<td>111.6</td>
<td>108.1</td>
<td>106.3</td>
</tr>
<tr>
<td>Nominal GDP (€Bn)</td>
<td>1245.5</td>
<td>1346</td>
<td>1461</td>
<td>1543</td>
</tr>
</tbody>
</table>

Note: Projections incorporating the macroeconomic impact of the NGEU plan. 2019 balance without Sareb.
The NGEU budget in 2021-22 was €51bn, of which €28.4bn corresponded to 2022. The final budget for 2023, including the non-committed funds in 2022, is **€35.9bn**.

The European Commission has already approved the NGEU Addenda. It involves 83 billion euros via loans, 7.7bn via non-refundable additional transfers and 2.6bn via transfers from RePowerEU between 2024 and 2026. Adding these funds to the 69.5bn already approved (from which Spain has already received 37bn), Spain will receive 163bn between 2021 and 2026. The European Council should approve the Addenda in the upcoming weeks.

Some of the funds from the Addenda will be channeled through the banking system, which will have access to liquidity from ICO at favorable terms to on-lend to the private sector. 22bn will be for an “ICO green line” and 8bn for other ICO lines for businesses and entrepreneurs.

Calls or tenders have been launched in 2021–September 2023 for a value of 66.3bn. 58.6bn have been allocated, but these include funds channeled towards other public administrations.

2023: From the amount budgeted for 2023, projects with a value of 20.0bn have been launched until September, and calls have been allocated for 15.9bn. However, only **6.5bn have been disbursed**.
Banking system: strong liquidity position

### Banks’ deposit breakdown

<table>
<thead>
<tr>
<th>Bank</th>
<th>% Stable deposits</th>
<th>% Operational Deposits</th>
<th>% Less stable deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAN</td>
<td>26%</td>
<td>19%</td>
<td>20%</td>
</tr>
<tr>
<td>SAB</td>
<td>4%</td>
<td>58%</td>
<td>44%</td>
</tr>
<tr>
<td>BBVA</td>
<td>16%</td>
<td>20%</td>
<td>62%</td>
</tr>
<tr>
<td>BKT</td>
<td>7%</td>
<td>21%</td>
<td>17%</td>
</tr>
<tr>
<td>CABK</td>
<td>9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UNI</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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 Q2Q3.

### HHs & NFCs loan to deposit ratio

Note: loans and deposits to residents in Spain, on a non-consolidated basis. Latest data available Sep’23.

Source: CaixaBank Research, based on Bank of Spain data.

### Banks’ LCR

Q3 23 published ratio

Note: (1) TLTRO repaid between the beginning of Nov’22 and the end of Sep’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 09.31.2023, TLTRO sector funds: €590 bn.

Source: Banks’ financial statements.

- Spanish banks are strongly focused on the retail segment, which provides a 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. Ago’23 data show a 1.4% decline yoy but with a clear slowdown in the last months. A large part of the decline 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 Ago’23, Spanish banks had repaid around 87% of TLTROs outstanding at Oct’22. This figure compares to a 76% for the Euro Zone banks in aggregate.

- The Spanish banking sector faced the pending TLTRO maturities of Jun’23 from high liquidity ratios. EBA data for 2Q23 points to an LCR ratio of 170% and a NSFR of 130% for Spanish banks (vs. an EU average of 160% and 126%, respectively).

- The liquidity position of Spanish banks is fairly sound even in the adverse scenario. All entities exceed the minimum LCR requirements set for 2023 in the Bank of Spain’s stress test.

Banking system: higher interest rates depress credit demand

Bank credit to the private sector

% GDP

Private domestic credit

Year-on-year (%)

<table>
<thead>
<tr>
<th></th>
<th>Dec-22</th>
<th>Sep-23 (latest)</th>
<th>2023 (forecast)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% yoy</td>
<td>% yoy</td>
<td>% yoy</td>
</tr>
<tr>
<td>Total credit</td>
<td>-0.4%</td>
<td>-3.4%</td>
<td>-3.3%</td>
</tr>
<tr>
<td>Households</td>
<td>-0.2%</td>
<td>-2.5%</td>
<td>-2.4%</td>
</tr>
<tr>
<td>Housing mortgages</td>
<td>-0.2%</td>
<td>-3.4%</td>
<td>-3.5%</td>
</tr>
<tr>
<td>Other purposes</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Of which consumption</td>
<td>1.1%</td>
<td>2.2%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Businesses</td>
<td>-0.7%</td>
<td>-4.7%</td>
<td>-4.7%</td>
</tr>
<tr>
<td>Non-real estate developers</td>
<td>1.3%</td>
<td>-2.9%</td>
<td>-</td>
</tr>
<tr>
<td>Real estate developers</td>
<td>-8.8%</td>
<td>-4.4%</td>
<td>-</td>
</tr>
</tbody>
</table>

New lending activity by sector

YTD, €Bn

- Households and corporate debt levels (including debt securities) remain below euro area averages in 2Q23. 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 but at a slower pace.
- Early repayments of mortgages and soft demand for new corporate lending combined with the repayment of covid-related borrowing will weigh on credit growth in the coming months.
Banking system: sound profitability and capital position

**NPLs and coverage ratios**

- **NPL ratio** (% of gross loans)
  - Dec-11: 15%
  - Dec-12: 12%
  - Dec-13: 9%
  - Dec-14: 6%
  - Dec-15: 3%
  - Dec-16: 3.6%
  - Dec-17: 3%
  - Dec-18: 3%
  - Dec-19: 3%
  - Dec-20: 3%
  - Dec-21: 3%
  - Dec-22: 3%

- **Coverage ratio** (% of NPLs)
  - Dec-11: 50%
  - Dec-12: 46%
  - Dec-13: 45%
  - Dec-14: 50%
  - Dec-15: 45%
  - Dec-16: 45%
  - Dec-17: 45%
  - Dec-18: 45%
  - Dec-19: 45%
  - Dec-20: 45%
  - Dec-21: 45%
  - Dec-22: 45%

**Cost of risk**
- 0.4% in Q2 2023
- 0.4% in Q3 2023

**Banks’ profitability**

- **% of avge. total assets (Q3 23; trailing 12M)**
  - CABK: 15%
  - BBVA: 12%
  - SAN: 13%
  - SAB: 17%
  - BKT: 20%

  - **Net interest income**
    - CABK: 1.5%
    - BBVA: 1.2%
    - SAN: 1.3%
    - SAB: 1.7%
    - BKT: 2.0%

  - **Net fees**
    - CABK: 0.6%
    - BBVA: 0.5%
    - SAN: 0.6%
    - SAB: 0.7%
    - BKT: 0.6%

  - **Gains on financial assets/liab. and others**
    - CABK: 0.0%
    - BBVA: 0.1%
    - SAN: 0.2%
    - SAB: 0.0%
    - BKT: 0.1%

  - **Other operating income**
    - CABK: 0.0%
    - BBVA: -0.1%
    - SAN: 0.0%
    - SAB: -0.1%
    - BKT: -0.2%

  - **Gross income**
    - CABK: 2.2%
    - BBVA: 1.7%
    - SAN: 2.0%
    - SAB: 2.3%
    - BKT: 2.4%

  - **Operating expenses**
    - CABK: -0.9%
    - BBVA: -0.7%
    - SAN: -0.9%
    - SAB: -1.0%
    - BKT: -0.9%

  - **Impairment losses, tax and others**
    - CABK: -0.5%
    - BBVA: -0.4%
    - SAN: -0.7%
    - SAB: -0.7%
    - BKT: 1.2%

  - **Profit**
    - CABK: 0.7%
    - BBVA: 0.6%
    - SAN: 0.5%
    - SAB: 0.5%
    - BKT: 0.8%

  - **ROTE (%)**
    - CABK: 14.1
    - BBVA: 10.5
    - SAN: 15.2
    - SAB: 9.8
    - BKT: 16.6

**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: 17% and 14.8%, respectively. Source: Bank’s financial statements.

**Banks’ solvency position**

- **In % (Q3 23)**
  - CABK: 13.1
  - BBVA: 12.7
  - SAN: 12.5
  - SAB: 12.3
  - BKT: 12.3

**Fully-loaded**
- CABK: 4.28
- BBVA: 3.97
- SAN: 4.76
- SAB: 3.73
- BKT: 3.06

**Buffer (p.p.)**
- CABK: 8.82
- BBVA: 8.73
- SAN: 8.74
- SAB: 8.74
- BKT: 8.74

**Note:** (1) CET1 FL, with IFRS9 transitional adjustments if applicable. Source: Bank’s financial statements.

**Key Points**

- **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 decreased to 6.8% in 2Q23, remaining below EU level. 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 (in the first seven months of 2023, the number of applications for measures under the CGPs was low relative to the total number of existing mortgage loans, less than 0.4%).

- **Profitability is recovering (ROE stood at 12.3% in 2Q23)** thanks to the widening of the net interest margin and despite inflationary pressures and the extraordinary and temporary banking tax (4.8% on domestic net interest and fee income, where such income exceeds €800 million).

- **The capital position of Spanish banks remains comfortable with a 12.8% CET1 ratio**. Under the adverse scenario considered, the Bank of Spain’s stress test¹ for 2023-2025 shows that the CET1 ratio for the Spanish banks as a whole would fall by 3.3 p.p but would remain above the regulatory minimum.

**Notes:**