Banking & Finance 2018

Last Updated September 11, 2017

Spain

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Trends and Developments

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Basic trends

The recovery and improvement of the Spanish economy has not just been confirmed in economic bulletins and reports published by the Bank of Spain, but is also clearly reflected in the banking and finance trends of 2016.

Indeed, the prevailing banking and finance trend in 2016 – building on the 2015 trend – is the granting of new loans and credits.

The amendments to the quantitative easing (QE) monetary policy used by the European Central Bank to stimulate the economy have played a remarkable role in the growth of these trends. More specifically, the application of a 0% interest rate and an increase in the established monthly limits – from 60,000 to 80,000 – have caused a dramatic increase in liquidity. The Spanish banks are the main beneficiaries of this increase.

On the one hand, looking at the kind of work we have been involved in and the information provided by financial institutions over the last few years, the global financial crisis did not appear to affect the number of banking and finance transactions that were taking place. However, what was indeed affected by the economic recession was the kind of transaction that was being carried out. Hence, during the years of the recession – from 2008 to 2013 – refinancing and re-structuring of debt were the main transactions, whereas different trends started to emerge in 2014. These trends have gone on to dominate the Spanish banking and finance sector in 2016. Notably, the bulk of banking and finance transactions carried out in 2016 were primarily focused on the industrial, healthcare, real estate and service sectors.

On the other hand, the political uncertainty arising from the implications of Brexit, the US elections, and especially the current Spanish political impasse which has led to a period of almost a year of successive general elections, has affected the number of new lending transactions being carried out since the first quarter of 2016. The number of larger deals has decreased since the first general election in December 2015: in the first seven months of 2016 the total volume of new lending fell by 13% compared with the same period in 2015 due to a decline in new lending to large corporates. However, this recession has not affected the number of mid-market transactions, as the mid-market has maintained a high level of liquidity and is still growing in terms of volume. In this regard, it should be noted that although the first quarter of 2016 witnessed a higher number of buyout transactions, the volume of these transactions has decreased relative to the same period in 2015.

Furthermore, in keeping with 2015 trends, traditional lenders are the prevailing debt source for Spanish transactions and the domestic banks are the leaders among these traditional lenders due to their considerable liquidity.

Regarding transaction trends in relation to traditional lenders, it should be pointed out that subordinated debt transactions take preference over the so-called “club deals”.

In addition, increased competition between banks to handle the highest number of transactions possibly translates to a greater bargaining power for borrowers and sponsors. This circumstance allows for more flexibility regarding the covenants in some transactions. Ultimately, it helps reduce margins and provides for longer-term repayment structures which are considerably more convenient for the borrower, with gradual repayment calendars and a “balloon” component.

As regards new agents making an appearance in the banking and finance market, the main newcomers are debt funds, which are increasing their exposure in the Spanish mid-market. The increasing role of debt funds in the Spanish market can be attributed to several factors, from allowing a wider range of solutions to facilitating covenant-lite structures.

However, although the increasing appearance of new agents is a relatively new phenomenon, as is the case for disintermediation and lending diversification, the increase has been gradual and not of the magnitude predicted during the recession. In fact, the rising number of credit and loan transactions due to the aforementioned QE monetary policy applied by the European Central Bank, as well as the improvement of the Spanish economy, have raised the liquidity levels of the market. Currently, Spanish banks are lending under markedly low prices which makes them very competitive compared to alternative lending options.

Notwithstanding this previous statement, there are some circumstances which in the medium term may help consolidate direct lending options.

Firstly, the introduction of measures to implement the Basel III regulatory framework has direct implications for the financial indebtedness of financial institutions. The amendments that were introduced were designed to improve regulation, supervision and risk management within the banking sector. As a result of these regulations, financial institutions are required to maintain proper leverage ratios and meet certain minimum capital requirements. The regulation provides for a transition period until 2019, during which financial entities will be bound to reinforce their equity. In particular, financial institutions will have to comply with minimum solvency requirements which will restrict the number of loans and credits granted by such institutions to small and medium-sized companies.

Secondly, as a consequence of the implementation of Basel III, long-term loans and credits will be detrimentally affected, which will eventually lead to increased competition with alternative debt sources such as direct lending funds, which are provided with a more flexible financing structure for these kinds of transactions.

Finally, a change in the expansionary policies that have been applied recently by the European Central Bank – within the framework of the QE policy – may constrain the increase in liquidity in the market, and consequently limit the number of loans and credits granted by traditional lenders. Therefore, alternative debt sources such as debt funds will be the main beneficiaries of these measures.

Developments

Banking business in Spain has been subject to several developments and is following the same trend as in 2015.

Firstly, the deleveraging of the system initiated in 2013 continues while the volume of private sector loans has decreased significantly. This reduction has been notable in business lending, which has experienced a cumulative reduction of 40% since 2008, and particularly in the portfolio of loans to real estate and construction companies. Lending for construction and property development has decreased by an even greater amount, and is down by 65%.

Secondly, the amount of total assets belonging to the banking sector has diminished by approximately 13% during the recession, while the total volume of deposits has suffered a reduction since 2008. Moreover, the capital adequacy of the banking sector has been strengthened, as well as the volume of doubtful loans.

Additionally, as stated in the “Press statement following the fifth post-programme surveillance visit to Spain” on 11-13 April 2016, issued by members of the European Commission together with members of the European Central Bank, new bank lending in the tradable sector as well as to small and medium-sized enterprises continues to grow.

Analysing developments in the Spanish banking system in comparison with the average EU banks, the following conclusions can be reached: Spanish banks have more capital on their balance sheets than the average for EU banks and consequently, the profitability of the Spanish system is slightly below average.

Overall, it can be stated that the system has become stronger and more stable during the recession, as there has been a notable increase in the equity of financial entities since the beginning of the crisis. Nevertheless, significant challenges remain in order to further rebalance the banking sector.

Finally, new agents are starting to gain ground in the banking and finance sector: financial technology (FinTech) companies which focus on developing technology to make financial services more efficient. These companies contribute to the modernisation of the sector by creating innovative banking services for every transaction, including payments, lending and investments. These non-traditional agents are catching up with traditional agents and targeting profitable banking businesses.

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