EUROPEAN COMMISSION

MEMO

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# Statement by the EC and the ECB following the conclusion of the fifth review of the financial assistance programme for Spain

A delegation from the European Commission, in liaison with the European Central Bank, carried out the fifth and final review of the financial sector assistance programme for Spain from 2 December to 13 December 2013. The International Monetary Fund also participated in the review, fulfilling its role as an independent monitor. Meetings were also attended by the European Stability Mechanism and the European Banking Authority. The positive assessment of steadfast programme implementation that formed the basis of the Eurogroup statement of 14 November has been maintained through the final review. Spain has pulled back from severe problems in some parts of its banking sector, thanks to its reform and policy actions, with the support of the euro area and broader European initiatives.

Spanish financial markets have further stabilised. Following the drop in sovereign bond yields, and the rise in share prices, financing conditions for large parts of the economy have improved, even if financing conditions for SMEs remain more challenging. The liquidity situation and the financing structure of the Spanish banking sector have further improved as bank deposits have been rising and Spanish banks are gradually benefiting from access to funding markets. The solvency position of banks has remained comfortable after the recapitalisation of parts of the banking sector, the transfer of assets to SAREB (the Spanish asset management company) and overall positive earnings results over 2013 so far. The recent legislative measures on deferred tax assets should support the solvency of the banking sector under the new EU rules on capital requirements.

The process of restructuring of banks having received State aid is well underway, guided by the restructuring plans as adopted by the European Commission. Efforts to implement the agreed measures need to continue as envisaged.

Compliance with the horizontal policy requirements in the Memorandum of Understanding is complete. This contributed to a thorough overhaul of the governance, regulatory and supervisory framework of the Spanish banking sector. Continuing on this path of close monitoring, pro-active supervision, advancing reform in the broader governance of the banking sector and fostering non-bank financial intermediation will help securing these achievements and contribute to a more resilient financial sector in Spain.

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Nevertheless, the broader economic environment has continued to weigh on the banking sector, even if that impact has recently been receding. The private sector needs to reduce its debt stocks going forward, as heavy debt burdens continue to weigh on lending to the private economy.  Lending to the economy, and in particular to the corporate sector, is still declining substantially, even if some bottoming out of that contraction process might be in sight. The profitability of the banking sector is therefore over the coming years affected by still contracting volumes of intermediation and continued pressure on asset quality, also due to further falling housing prices, as the adjustment in the real estate market has slowed down but is not yet completed. Therefore, supervisors and policy makers have to continue to monitor closely the operation and stability of the banking sector. Continued in-depth diagnostics of the shock resilience and solvency of the Spanish banking sector remain vital. This is also important in order to ensure a proper preparation of the pending assessment of banks' balance sheets by the ECB and EBA in the run up to the start of the Single Supervisory Mechanism.  Policy makers and supervisors in particular will need to continue devoting close attention to the banks currently owned by FROB, in order to ensure proper governance and business models for these banks going forward.  Furthermore, SAREB will have to continue with its efforts to meet the challenge of divesting its significant asset portfolio with the view of maximising its financial results and contributing to the proper functioning of real estate markets in Spain at large.

The recent encouraging macroeconomic developments bear witness of advancement in the process of adjustment of the Spanish economy and corroborate the expectation of a gradual recovery in activity and of an approaching end to employment destruction.  The economic situation remains however subject to risks as imbalances continue to be worked out.  Respecting fully the agreed fiscal consolidation targets - so as to reverse the rise in government debt - and completing the reform agenda remain imperative to return the economy on a sustainable growth path. Following progress during 2013, the policy momentum needs to be maintained to finalise ongoing and planned reforms - amongst which are the delayed law on professional services and associations, reforms of public administration, further strengthening of labour market policies, eliminating the electricity tariff deficit and the forthcoming review of the tax system - and to ensure effective implementation of all reforms.

With the programme coming to an end on 23 January 2014, the European Commission, in liaison with the ECB where indicated, will continue monitoring Spain´s financial sector and the broader economy under all relevant EU surveillance processes.