

Spanish banking - Earnings scenarios

JULY 2021

The scenarios defined

Given the **high level of uncertainty** hanging over the economy today, shaped largely by the speed of vaccination, the path and fate of the Delta variant of COVID-19 and the economic recovery, we have devised **three forecasting scenarios: a baseline scenario, an optimistic scenario and an adverse scenario**, to which we have ascribed probabilities of occurrence of 50%, 30% and 20%, respectively.



Baseline Scenario

- Articulated around the base case macroeconomic scenario modelled by Afi's Economic Research Department.
- This scenario assumes a relatively intense economic recovery.
- It assumes the gradual normalisation of interest rates, particularly from 2023.



Optimistic Scenario

- This scenario assumes that the vaccination process accelerates and the pandemic is brought under full control in 2021.
- Which translates into a more favourable macroeconomic climate than in our baseline scenario.
- Interest rates normalise sooner than in the baseline scenario.



Adverse Scenario

- Based on the assumption that there will be successive new outbreaks and the COVID-19 pandemic will stay with us until 2022.
- As a result, we assume the reintroduction of fiscal support (state loan guarantees) and no change in monetary policy.
- The macroeconomic situation deteriorates and rates remain in negative territory throughout the projection period.

New lending activity and gross credit

Our forecasts for **corporate lending (excl. the construction sector)** considered the following factors:



Baseline scenario

- ❖ A significant base effect as a result of the sharp growth sustained in 2020, fuelled by the state guarantees, is the reason for the contraction forecast in 2021 (coupled with the fact that the NGEU effect this year is nil). As for 2022, we are projecting very moderate growth as a result of the adverse effect of the end of the guarantees and payment moratoria, which largely offset the positive effect of the economic recovery. In addition, the NGEU effect is not expected to be decisive in 2022 as the role of the banking system in channelling those funds will not be as prominent as initially expected. We are forecasting modest growth in 2023 driven by the economic recovery and NGEU funds (growth partially mitigated by the gradual rise in rates).



Optimistic scenario

- ❖ The strong economic recovery, accompanied by the creation of new businesses and growth at existing businesses, is expected to mitigate the contraction in new lending forecast in 2021 under the baseline scenario. In other areas, we are forecasting growth in new loans, as would be expected in an optimistic economic scenario.



Adverse scenario

- ❖ The extension of the mitigating measures we assume in this scenario would cushion the contraction in new lending and gross credit forecast for 2021. Indeed, the contraction forecast is less than in the baseline scenario as the effect of the mitigating measures is expected to more than offset the downturn in macroeconomic conditions.

New lending activity and gross credit

Corporate lending (excl. construction) (€ bn, YoY change)

Scenarios	Optimistic	Baseline	Adverse
2020		286 5,2%	
2021 (P)	272 -4,9%	232 -19,0%	273 -4,5%
2022 (P)	286 5,2%	267 15,3%	265 -3,2%
2023 (P)	292 2,0%	272 1,7%	266 0,5%

Gross outstanding credit - corporate (excl. construction) (€ bn, YoY change)

Scenarios	Optimistic	Baseline	Adverse
2020		446 11,4%	
2021 (P)	440 -1,5%	438 -2,0%	441 -1,2%
2022 (P)	447 1,7%	441 0,7%	439 -0,5%
2023 (P)	451 0,9%	443 0,5%	439 0,1%

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Source: Afi, Bank of Spain

New lending activity and gross credit

With respect to **corporate lending - construction**



Baseline scenario

We have factored in, in addition to the generic considerations outlined on the previous page (corporate lending excl. construction), the growth in demand for housing in dormitory town close to the major Spanish cities. In addition, in 2023 we are forecasting slow yet positive growth (in line with the stabilisation trend observed in the run-up to the pandemic), which dovetails with the house price growth forecast and the macroeconomic scenario.



Optimistic scenario

- ❖ New lending and gross credit are expected to gradually pick up as a result of the real estate market dynamics contemplated in this scenario.



Adverse scenario

- ❖ New lending and gross credit are expected to contract by more in 2021 than in the baseline and optimistic scenarios due to the downturn in macroeconomic conditions (in this segment, the impact of the state guarantees was relatively small in 2020 and we expect that to continue to be the case in 2021 and 2022).

Corporate lending (construction) (€ bn, YoY change)

Scenarios	Optimistic	Baseline	Adverse
2020		71	
		-6,9%	
2021 (P)	73	71	70
	2,4%	-0,5%	-1,1%
2022 (P)	76	73	70
	4,8%	3,2%	0,1%
2023 (P)	78	73	70
	2,7%	0,4%	0,2%

Gross outstanding credit - corporate (construction) (€ bn, YoY change)

Scenarios	Optimistic	Baseline	Adverse
2020		108	
		-3,5%	
2021 (P)	104	104	104
	-3,4%	-3,4%	-3,7%
2022 (P)	102	102	101
	-2,2%	-2,2%	-2,6%
2023 (P)	101	101	100
	-0,5%	-0,5%	-1,1%

New lending activity and gross credit

Turning to **mortgage credit**:



Baseline scenario

- ❖ We are forecasting growth in credit due to:
 - I. The savings pent up during the pandemic, some of which will be set aside for home purchases;
 - II. The drop in housing prices sustained during the economic crisis;
 - III. The drop in mortgage rates facilitated by the lax monetary policy rolled out by the ECB to offset the effects of the crisis, coupled with heightened competition between the entities;
 - IV. The role of the NGEU funds (in 2022) in funding green housing and other buildings that fit with the strategic uses for the proceeds from those funds.



Optimistic scenario

- ❖ The growth projected in the baseline scenario is higher in this scenario due to the improved macroeconomic conditions (growth in household income) and a greater propensity to lend by the banks in such circumstances.



Adverse scenario

- ❖ The growth projected in the baseline scenario is lower in this scenario due to the adverse macroeconomic conditions (drop in household income) and a reduced propensity to lend by the banks in such circumstances.

New lending activity and gross credit

Mortgage lending
(€ bn, YoY change)

Scenarios	Optimistic	Baseline	Adverse
2020		44 0,9%	
2021 (P)	51 16,3%	50 14,4%	46 5,2%
2022 (P)	54 5,8%	53 5,2%	47 2,1%
2023 (P)	54 0,1%	53 0,0%	46 -2,2%

Gross outstanding credit - mortgage
(€ bn, YoY change)

Scenarios	Optimistic	Baseline	Adverse
2020		494 -1,3%	
2021 (P)	512 3,7%	494 0,1%	494 0,0%
2022 (P)	525 2,4%	500 1,2%	498 0,7%
2023 (P)	532 1,5%	500 0,0%	490 -1,5%

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Source: Afi, Bank of Spain

New lending activity and gross credit

As for **consumer credit**:



Baseline scenario

- ❖ Here our forecasts take account of the regional government guarantee lines included under this category (contraction in 2021); in contrast we assume that the economic recovery and definitive restriction-free reopening of the economy will underpin growth in consumer lending in 2022. In 2023, this category is expected to contract due to the base effect.



Optimistic scenario

- ❖ Here we forecast strong growth due, in addition to the greater intensity of the economic recovery, the rapid reopening of the economy and return to 'normality'.



Adverse scenario

- ❖ In the adverse scenario we forecast a sharp contraction (particularly in 2021) as a result of *i)* the weaker macroeconomic scenario, and *ii)* the imposition of new business and mobility restrictions.

Consumer lending (€ bn, YoY change)

Scenarios	Optimistic	Baseline	Adverse
2020		45 -16,1%	
2021 (P)	44 -3,0%	40 -11,1%	39 -14,5%
2022 (P)	56 28,4%	53 30,7%	42 8,8%
2023 (P)	60 5,5%	53 0,0%	40 -6,1%

Gross outstanding credit - consumer (€ bn, YoY change)

Scenarios	Optimistic	Baseline	Adverse
2020		115 3,1%	
2021 (P)	116 0,1%	113 -1,7%	112 -3,3%
2022 (P)	121 4,3%	118 4,2%	112 0,3%
2023 (P)	121 0,5%	119 0,3%	112 0,0%

Non-performance

The analysis with respect to **impaired credit** is as follows:



Baseline scenario

- ❖ We estimate that non-performance will peak between the second quarter of 2022 and the first half of 2023, going on to recover slightly in 2023, in keeping with the macroeconomic forecasts. In addition, we expect the consumer lending segment to be the hardest hit, with the mortgage sector the least affected, despite an increase in non-performance following the withdrawal of the furlough scheme. Non-performance in business lending will be shaped by huge differences by sector and region: it is expected to increase significantly in the sectors more exposed to the pandemic (hospitality, leisure, transport, etc.), with only small increases, or even declines, in non-performance in the more resilient sectors (primary sector, etc.).



Optimistic scenario

- ❖ We are forecasting a slight decline in 2021, which we view as feasible in light of the trend in non-performance in the first half of the year and the bright macroeconomic forecasts defined for this scenario. In the optimistic scenario, non-performance is expected to peak towards year-end 2022 at around €70 billion (up €16 billion from year-end 2019), implying an NPL ratio of 5.8% (1pp higher than at year-end 2019). Non-performance is forecast to trend lower in 2023.



Adverse scenario

- ❖ We expect the assumed rollout of support measures to delay the rise in non-performance, as was the case in 2020, which is why we are forecasting a similar level of non-performance at year-end 2021 as in the baseline scenario (i.e., despite the downturn in the macroeconomic context). In the adverse scenario, non-performance is expected to peak towards year-end 2023 at around €118 billion (up €64 billion from year-end 2019), implying an NPL ratio of 10.3% (5.5pp higher than at year-end 2019).

Non-performance

Forecasts for non-performing loans

(€ bn, YoY change)

Scenarios	Corporate (excl. Construction)			Corporate (Construction)			Mortgage			Consumer		
	Optimistic	Baseline	Adverse	Optimistic	Baseline	Adverse	Optimistic	Baseline	Adverse	Optimistic	Baseline	Adverse
2020		22			6			15			9	
		3,5%			-13,9%			-9,7%			0,6%	
2021 (P)	22	24	24	6	7	7	15	16	16	9	10	10
	0,3%	12,3%	9,5%	0,0%	3,4%	5,9%	0,2%	11,2%	7,2%	0,1%	10,5%	13,9%
2022 (P)	32	45	30	7	8	8	18	24	19	12	17	13
	45,9%	85,7%	25,6%	10,8%	18,4%	21,1%	24,5%	43,2%	20,6%	37,5%	71,8%	22,5%
2023 (P)	28	36	56	7	7	12	17	21	29	11	14	21
	-11,7%	-19,2%	89,0%	-3,7%	-5,3%	43,0%	-6,1%	-9,8%	52,0%	-9,3%	-16,9%	68,0%

Scenarios	Non-performing loans		
	Optimistic	Baseline	Adverse
2020		52	
		-3,4%	
2021 (P)	52	57	57
	0,2%	10,6%	9,2%
2022 (P)	70	93	70
	34,0%	63,3%	23,1%
2023 (P)	63	79	118
	-9,0%	-15,2%	69,6%

Source: Afi, Bank of Spain



Non-performance

Forecasts for NPL ratio

Scenarios	Corporate (excl. Construction)			Corporate (Construction)			Mortgage			Consumer		
	Optimistic	Baseline	Adverse	Optimistic	Baseline	Adverse	Optimistic	Baseline	Adverse	Optimistic	Baseline	Adverse
2020		4,8%			6,0%			3,0%			7,8%	
2021 (P)	4,9%	5,5%	5,4%	6,0%	6,4%	6,6%	2,9%	3,3%	3,2%	7,8%	8,8%	9,2%
2022 (P)	7,1%	10,2%	6,8%	6,6%	7,7%	8,2%	3,5%	4,7%	3,8%	10,3%	14,5%	11,2%
2023 (P)	6,2%	8,2%	12,8%	6,3%	7,4%	11,8%	3,3%	4,2%	5,9%	9,3%	12,0%	18,9%

	Total		
	Optimistic	Baseline	Adverse
2020		4,5%	
2021 (P)	4,4%	5,0%	4,9%
2022 (P)	5,8%	8,1%	6,1%
2023 (P)	5,2%	6,8%	10,3%

Source: Afí, Bank of Spain

Customer funds

Turning to **deposits**, it is worth first pointing out that they continued to increase throughout the first half of 2021 as a result of the restrictions and the base effect (sharp increase in 2020). Against that backdrop, the scenario forecasts look as follows:



Baseline scenario

- ❖ We are forecasting an improvement in the health situation in the second half of the year (easing of restrictions), permitting households to spend some of the savings pent up during the months of lockdown/restrictions. In short, the two effects (first half, second half) set each other off such that we are forecasting very slight growth in 2021. In 2022 and 2023, we are forecasting a down-trend in deposits as consumption picks up and money gets shifted into off-balance sheet products (especially investment funds, the more cyclical product).



Optimistic scenario

- ❖ Here we are forecasting growth despite the extraordinary increase sustained in 2020, as both the growth in GDP (lifting agents' income) and interest rates should translate into growth in deposits that more than offsets the decline attributable to the growth in spending on goods and services.



Adverse scenario

- ❖ In our adverse scenario, we are forecasting growth in 2021 due to the imposition of fresh restrictions ('forced' savings) and the heightened uncertainty faced by Spain's households ('precautionary' savings). However, deposits are expected to decline in 2022 and 2023: the duration of the crisis and the downturn in macroeconomic conditions are forecast to prompt households (the agents suffering the drop in income) to start to eat into their savings.

Customer funds

Lastly, in terms of **investment funds**:



Baseline scenario

- ❖ We are forecasting significant growth in 2021, 2022 and 2023, underpinned by the economic recovery, reduced market volatility and surplus liquidity (the latter two factors of reduced relevance by 2023), so that deposits are not remunerated, prompting the agents to seek returns by shifting some of their savings into investment funds.



Optimistic scenario

- ❖ Stronger economic and stock market performances are expected to accelerate flows into this type of product relative to the baseline scenario. Note that the difference (at least from 2023) with respect to the baseline scenario is not as big as might be expected because the gradual rise in interest rates anticipated in the optimistic scenario means that deposits would start to be remunerated, mitigating the flows of savings into alternative investment products.



Adverse scenario

- ❖ Weaker economic and stock market performances are expected to reduce flows into this type of product relative to the baseline scenario (triggering a drop in 2022).

Customer funds

Forecast year-end balance of customer funds (€ bn, YoY change)

Scenarios	Deposits			Investment Funds		
	Optimistic	Baseline	Adverse	Optimistic	Baseline	Adverse
2020		1.179 8,5%			274 -0,8%	
2021 (P)	1.192 1,1%	1.189 0,8%	1.198 1,6%	294 7,2%	288 5,1%	275 0,3%
2022 (P)	1.199 0,6%	1.152 -3,1%	1.136 -5,2%	306 4,1%	297 3,0%	269 -2,2%
2023 (P)	1.223 2,0%	1.124 -2,4%	1.132 -0,3%	314 2,6%	305 2,8%	273 1,5%

Source: Afi, Bank of Spain



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