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# The Spanish banking system and the challenges it faces*

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To begin, I would first like to thank the organisers of “Diálogos para la democracia” for their invitation today. On this occasion I will focus my address on an analysis of the situation of the Spanish banking sector and the challenges it faces in an increasingly complex global setting.

**Introduction**

Spanish credit institutions play a very important part in our economy. They hold total assets of €4.2 trillion and make a direct contribution in terms of the value added of National Accounts of over 3%, more than in other large European economies. Spain’s ten significant institutions, that is, those under the direct supervision of the Single Supervisory Mechanism (SSM) account for 14.1% of the total assets, more than would be expected given Spain’s capital key.[1]

A total of 184 deposit institutions are registered in Spain, 108 of which are Spanish banks plus 76 foreign branches. According to the structural financial indicators of the European Central Bank (ECB),[2] the degree of concentration in the Spanish banking sector has increased significantly since 2007. Indeed, the five largest Spanish banks have gone from a market share of 40% in 2007 to around 70% in 2023. In consequence, at end-2023, Spain ranked second in terms of banking sector concentration among the main European countries, although according to various competition authorities’ guidelines, this is still below the levels associated with a moderately concentrated market. By comparison, over the same period, concentration levels held relatively stable in France, Germany and the Netherlands and were significantly lower than those recorded by Spain in 2023.

We must also recognise how well the banking sector has performed during the global economic shocks of recent years, from COVID-19 to the war in Ukraine and the subsequent energy crisis that caused an inflationary process that required a strong response from the ECB. Faced with these adverse scenarios, European banks, and Spanish banks in particular, have maintained good solvency, profitability, liquidity and credit quality ratios. Thanks to the extraordinary deployment of exceptional public sector measures and the soundness of the financial system, the economy outperformed the initial expectations.

Moving on now, and as I said earlier, I would like to begin by briefly reviewing the current situation of the banking sector.

**Bank lending volume**

First I wish to highlight that, after a period of sluggishness and even a decline in credit volumes, the banking sector has grown in recent quarters. In 2024 credit to households and firms rose by 0.6% (by some €7 billion), mainly owing to consumer credit and loans to large companies.

However, these figures mask a certain degree of heterogeneity, since while credit to households increased by 1.2%, mainly due to consumer credit (+6.7%), mortgage credit

[1] The capital key reflects a country’s relative share of EU gross domestic product and population and dictates its share of the capital of the European Central Bank.

[2] *ECB Structural Financial Indicators*.

saw a more moderate 0.7% rise. Meanwhile, credit to firms held steady, as the growth among large corporates (+2.4%) offset the continued decline among small and medium-sized enterprises (SMEs) (-2%).

By type of institution, business among the so-called less significant institutions, i.e. those that are directly supervised by the Banco de España, has been more dynamic than among the significant ones. Indeed, the volume of lending to firms by significant institutions continued to fall in 2024, although this decline was offset by the growth in the rest of the sector.

It remains to be seen whether this feeble credit growth in 2024 will consolidate in the coming quarters. In this respect, the latest Banco de España Business Activity Survey[3] indicates that 18.5% of firms increased their investment in the first quarter of 2025, 2 percentage points more than in the previous quarter. It also shows that firms expect investment to grow in the next quarter. If that is the case, the increased appetite for investment could boost credit stock growth, especially in the corporate sector.

Meanwhile, we will also have to closely monitor mortgages, which account for a very significant share in Spain (over 40% of the core credit stock). In 2024 we saw an increase of 18% in new mortgage loans, together with a fall in early repayments. This must be considered in context, as house prices rose sharply (by 11.3%) in 2024[4] and no significant changes in trend are expected in the short term. In this regard, however, nor have we seen a relaxation in lending standards, which remain prudent.

Accordingly, as we will see later, in terms of profitability it will be important that this growth in credit volumes consolidates. Spain's good economic situation, together with the new rate cutting cycle, is likely to further boost credit growth in 2025. But macroeconomic and particularly geopolitical uncertainties remain very high and could potentially impact exports, consumption or investment through the confidence channel. This means that, a priori, we do not expect to see significant growth in credit volumes this year.

**Credit quality**

The second point I wish to highlight is credit quality. The high inflation rates experienced in recent years, as well as the sharp rise in interest rates that was needed to combat this high inflation, impacted the income available to firms and households to meet their debts. But this has not translated into increases in the non-performing loan (NPL) ratio, which remains at historically low levels (3.24%)[5] and on a downward trend. Strong employment, reasonable corporate margins, wage growth and the savings built up during the pandemic have all helped mitigate the adverse impact of the rise in interest rates.

[3] https://www.bde.es/f/webbe/SES/Secciones/Publicaciones/InformesBoletinesRevistas/BoletinEconomico/25/T1/Files/be2501-art06e.pdf

[4] National Statistics Institute (INE) data. The annual rate of change in the Housing Price Index stood at 11.3% (12.3% in new housing and 11.1% in second-hand housing).

[5] https://www.bde.es/webbe/en/estadisticas/compartido/datos/pdf/a0453e.pdf

A further factor that must also be considered is the relatively low level of indebtedness of the Spanish private sector (firms and households), which has undergone large-scale deleveraging since the great global financial crisis. Indeed, corporate debt levels fell from 119.6% of GDP in June 2010 to 64.8% in September 2024 (the latest available data) while, during the same period, household debt went from 85% to 44.1%.

This year we expect that as inflation stabilises around 2.5%[6] and interest rates decline, the financial burden on households and firms will ease. Yet financial costs are expected to remain relatively high compared with the pre-pandemic period and this may have some impact on certain segments of households and firms with lower incomes or that are more financially vulnerable. In any event, we do not expect this impact to be significant, even though, as we all know, there is generally some lag between negative shocks and non-performance.

For this reason, it is useful to track developments in stage 2 loans, i.e. segments that are still performing but that face financial difficulties that may lead to problems with payments being met in the future.

In this respect also the developments are positive, as the stage 2 ratio for the core portfolio overall[7] fell from 8.37% to 7.07% in 2024, with an especially favourable trajectory in the last quarter of the year. By segment, the most significant reduction was among firms – especially SMEs – and mortgages. By volume, SMEs and consumer credit are the portfolios with the most stage 2 credit (11.66% and 9.18%, respectively).

As a result of these favourable credit quality developments, the cost of risk has also remained low, at 70 basis points (bp), compared with 83 bp in 2023. The total coverage ratio, that is, provisions held by banks, has been relatively stable at around 2.20% but with increases in NPL coverage, which stands at 49%, as although the denominator (the volume of non-performing loans) is decreasing, the numerator (the volume of provisions) remains steady.

**Profitability**

The third point I wish to analyse is profitability, which is another key factor for banks' viability. In 2024 the Spanish banking sector achieved outstanding profitability, with return on equity (ROE) of 14.7%, up from 12.7% in 2023 which was also a very good year. This increase was due to higher net interest income, which added 330 bp to ROE, and to higher fees and commissions, which added a further 130 bp. However structural costs were also higher in 2024, up 2.2% (mainly owing to staff costs, which climbed by 8.7%), as were credit provisions (albeit below expectations) and other provisions (as a result of conduct-related complaints).

The growth in interest income was driven by higher interest rates on asset transactions, although this effect may have come to an end with the ECB's recent interest rate cuts. Consequently, we expect profitability to stabilise this year, albeit at relatively high levels.

[6] See the Banco de España's latest projections.

[7] "Core portfolios" refers to loans to households (mortgages and consumer credit) and firms.

If this pattern of growing credit volumes continues, it could partly offset the reduction in net interest margin caused by lower interest rates. It should be borne in mind that, especially in the case of firms, the fixed rate portfolio subject to review will have to be renegotiated at lower prices, while lower interest rates are automatically transferred to the variable rate portfolio. As for household mortgages, although 72% of all new mortgages are fixed rate, 60.5% of the overall mortgage stock is still variable rate.

Moreover, all other items, including fee and commission income, operating costs and bank levy costs, are expected to stabilise this year. Provisioning charges may fall in the new lower interest rate setting, albeit subject in all cases to the current climate of heightened uncertainty. The geopolitical uncertainty, above all, especially impacts Spain's large banks that have an international presence, particularly in the United States and Latin America where macroeconomic variables could bear the brunt of new trade tariffs. At this stage it is extremely difficult to specify and analyse the impact this new scenario may have.

**Solvency**

Solvency is the fourth and last of the main points I wish to highlight. In this respect, the Spanish banking sector has also made progress, with capital ratios of 12.9% for the significant institutions in 2024, an increase of 25 bp. Although these ratios are lower than the SSM average (15.8%), it must be borne in mind that Spanish banks have lower Pillar 2 capital requirements and lower buffer requirements as a consequence of their lower risk profile, reflected in their better results in the regular stress testing exercises. In addition, the leverage ratio has also improved and stands at 5.5%, slightly below the SSM average of 5.9%.

As we have indicated on previous occasions, the solvency ratio must be placed in context and in relation to other variables such as profitability. Spanish banks' business models generate recurring income, which constitutes the first line of defence. However, these business models demand more Pillar 1 capital. In addition, in Spain the standardised approach is more commonly used, which is more burdensome in terms of Pillar 1 capital requirements than the advanced internal ratings-based (IRB) approach that is more common in other jurisdictions.

To conclude this overview, Spanish banks today enjoy a robust and solid financial situation. Following implementation of the regulatory reforms agreed in the wake of the great global financial crisis, and with banks' strengthened governance frameworks, prudent risk management and more effective supervision, the Spanish banking map is now quite different from that of a decade ago.

**Challenges**

This good starting point has to be placed in the current geopolitical setting, in which the shifting balance of power worldwide has called into question agreements and situations that until very recently were considered settled. Consequently, the banking sector is now facing a range of challenges.

**Digitalisation**

First and foremost, the banking sector must continue to enhance its digitalisation efforts, in tandem with the rest of the economy. In this new ecosystem, banks' own systems coexist with interactions and collaborations with other partners that provide services – often ones crucial for the banks. Banking is transforming its way of doing business to become more digital, offering more innovative products and services that are tailored to customer needs. In this sense, the path is clear. According to a recent study by Funcas, 80.8% of internet users in 2024 had used electronic banking in the last three months, up from 60.5% in 2019;[8] by 2030, this figure is expected to reach 95%. Indeed, if we break down the trends among digital banking users between 2019 and 2024, we can see that the greatest uptake is among lower-income households, the foreign population and the economically inactive. That said, this makes sense given that these groups had the most room for improvement. This digital transformation requires massive investments – more than €5 billion in 2023 and with more expected to follow.

From a technology perspective, artificial intelligence (AI) is a real disruptor that can give rise to synergies with other existing technologies. For example, it can contribute to more efficient risk management, earlier cyber threat detection and cost-cutting. However, its use also poses challenges from an ethical standpoint.

Employing these technologies entails new risks and amplifies existing ones. The operational risks, arising from the increase in interconnections and the surface exposed to system failures, mean that banks must be ever more aware of the implications of such failures or attacks for their business. The new DORA regulation is envisaged as a regulatory umbrella to boost banks' resilience in this new environment. Outsourcing is also a concern, given the risks posed by over-reliance on a small number of service providers capable of handling essential activities, leading to a loss of control over these areas and a loss of the relevant expertise.

Banks should be encouraged and helped to take advantage of their strong starting position to develop and invest in new technologies, following a clear and well-defined strategy while maintaining their commitment to financial inclusion.

**Sustainability**

Playing our part in the European economy's transition towards sustainable models is another challenge. Despite the recent noise surrounding this issue, Europe's commitment to this transformation remains unwavering. Energy dependency clearly weakens our economy. A green economy, free from reliance on fossil fuels that are polluting and scarce in Europe, is a stronger economy. It makes us more independent, less susceptible to unpredictable external factors and, therefore, less vulnerable.

Europe remains committed to this transformation and the banking sector must support firms on this journey. But it is certainly no easy task. It involves not only making the necessary

[8] https://www.funcas.es/documentos_trabajo/estudio-sobre-el-sector-bancario-espanol-estructura-operativa-cambio-tecnologico-y-transicion-verde/

investments and securing sufficient financing, but also establishing transition plans with achievable, measurable and assessable goals and milestones.

As we have said on other occasions, the lack of reliable data is a challenge for the economy as a whole and particularly for the banking sector, but so is accompanying firms along this journey. Banks are required to approve their transition plans in line with the guidelines recently published by the European Banking Authority. Naturally, these plans must be based on the plans of the firms they finance. The banking sector must engage with its counterparts throughout the entire process, as envisaged in the guidelines. This is no small ask in an economy as fragmented as ours.

**Adapting to the environment**

Lastly, in this unpredictable environment, banks must be able to adapt their strategies and decision-making systems to the shifting and uncertain geopolitical environment. Geopolitical risk gives rise to traditional risks, such as increased credit risk, reduced liquidity or higher market risk owing to greater volatility. Therefore, banks must incorporate this new dimension into all their risk management processes.

Banks must be adequately prepared to manage this new factor. This risk has been included among supervisory priorities, focusing on credit risk management capacity and, in particular, the early detection of a downturn in credit quality, to then be reflected in the appropriate levels of provisions and capital. Compliance with regulations relating to operational cyber resilience will also be closely monitored, given that cyber attacks are more likely in the current environment. Lastly, how to integrate this geopolitical dimension into risk management frameworks, capital and liquidity planning and internal stress testing will be analysed.

**Concluding remarks**

In short, Spanish banks are on a solid footing, but the challenges they face in the current setting are numerous and complex. Integrating AI and other emerging technologies, transitioning to sustainable economic models and adapting to an uncertain geopolitical environment demand a well-defined strategy, close collaboration with other stakeholders – including all authorities – and a robust commitment to ethics and financial inclusion. Only through proactive and prudent risk management, backed up by strategic investments and meticulously crafted adaptation strategies, will banks successfully navigate this constantly shifting landscape and contribute to the strengthening of the European economy.