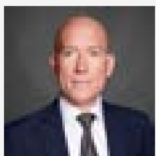
T. Rowe Price®
INVEST WITH CONFIDENCE

Analyst's Notebook - Your Partner For Insights

From Crisis to Confidence: Spanish Banks Ready to Shine



Rob Thomas
Global credit analyst,
Fixed Income Division
T. Rowe Price

If we thought turmoil in the financial sector, as well as troubled banks, was no longer a concern, then we were in for a rude awakening earlier this year. Regional banks in the US, along with the Swiss giant Credit Suisse, encountered difficulties. Thankfully, swift actions taken by central banks and politicians prevented these issues from spreading to major banks in the US and across Europe.

This can be partly attributed to the lessons learned from the Global Financial Crisis, which severely impacted banks in Europe. Presently, the banking sector is resilient, benefiting from two driving factors: regulation and market consolidation.

Regulatory reforms at the European level, notably Basel III, have played a crucial role in enhancing the financial stability of European banks. These reforms served to mitigate risks for the banking sector, otherwise prevalent in previous economic cycles.

One of the countries this is evident within, is Spain. When looking at Spanish banking sector under a microscope, we see the qualities of a more stable banking sector.

Consolidation as a key factor

Highly concentrated banking markets with strong market structures tend to exhibit greater stability and have more profitable institutions. Spain serves as an example of successful market consolidation following the Global Financial Crisis.

The Spanish banking sector underwent significant restructuring, transforming from a highly fragmented market to one in which five banks today control 67% of the retail lending market and over 80% of the deposit market.

Since 2008, the number of credit institutions in Spain has halved, indicating a substantial market consolidation, only being surpassed by the Netherlands and Cyprus which are two countries with the highest degree of consolidation in Europe.

Risk profile

The level of risk banks have on their balance sheets plays a pivotal role in determining their resilience during economic cycles. In Spain, the banking sector was greatly exposed to real estate lending and developers leading up to the Global Financial Crisis and leverage in Spain reached 170% of GDP. This was significantly higher than the Euro area average of a little over 100%.

Since then, Spain has reduced its debt. Currently, the level of debt in Spain is 93% of GDP and in line with the average for other European countries. Compared to Sweden, the United Kingdom, and France, we can see that Spain's current leverage level is significantly lower. In Sweden, leverage is 203% of GDP, while UK is leveraged 148% of GDP, and France is at 124% of GDP.

Improved financial flexibility

Financial flexibility is not solely determined by the risks a bank takes, but also by whether it receives fair compensation for those risks and possesses the earning power to withstand losses through credit cycles.

The financial flexibility of a banking sector can be measured through revenue strength, cost efficiency and absorption of credit risks. In this regard, Spain's banking sector demonstrate positive performance.

Spanish banks are highly geared towards the rising interest rates with 70% of the housing stock priced on a variable rate basis. This has improved Spanish bank revenues positively, as the interest rates have climbed upwards and will continue to do so. Another positive development is loan to deposit ratios, which are down from 120% in 2010, to current 94%, allowing for more flexibility on the pass through of funding costs.

Compared to core European countries, the cost structures of Spanish banks have remained stable, with an average efficiency ratio of 51% compared to 69% for French banks, 74% for German banks, and 48% for Sweden, which are leaders in this respect.

Strong cost efficiency and revenue strength enhance the capacity to absorb increased risks. Spanish banks also perform well compared to other core European countries in pre-provision capital generation which is currently 3.38%, compared to 2.4% in France and closely approaching Sweden's 3.5%.

Spain shows the path to financial stability

The recent challenges faced by regional banks in the US and Credit Suisse remind us of the importance of a stable financial sector. Fortunately, lessons from the Global Financial Crisis have left a stronger banking sector in Europe where Spain serves as a prime example.

The positive development in Spain is driven by consolidation and efforts to reduce debt levels and improved financial flexibility. This has positioned Spanish banks more favorably compared to their European counterparts. Spanish banks rightfully deserve recognition for their accomplishments.

Important Information

This material is being furnished for general informational and/or marketing purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance**. The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

Australia—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. For Wholesale Clients only.

Brunei—This material can only be delivered to certain specific institutional investors for informational purpose only. Any strategy and/or any products associated with the strategy discussed herein has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

Mainland China—This material is provided to qualified investors only. No invitation to offer, or offer for, or sale of, the shares will be made in the mainland of the People's Republic of China ("Mainland China", not including the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the Mainland China. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the Mainland China. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the Mainland China that are expressly authorized under the laws and regulations of the Mainland China to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the Mainland China. Potential investors who are resident in the Mainland China are responsible for obtaining the required approvals from all relevant government authorities in the Mainland China, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the Mainland China, or nationals with permanent residence in the Mainland China, or to any corporation, partnership, or other entity incorporated or established in the Mainland China

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd which is regulated by the Dubai Financial Services Authority as a Representative Office. For Professional Clients only.

EEA—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Hong Kong—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Indonesia—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

Korea—This material is intended only to Qualified Professional Investors. Not for further distribution.

Malaysia—This material can only be delivered to specific institutional investor. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

New Zealand—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

Philippines—ANY STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING DISCUSSED HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

Singapore—Issued by T. Rowe Price Singapore Private Ltd. (UEN: 201021137E), 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

South Africa—Issued in South Africa by T. Rowe Price International Ltd (TRPIL), 60 Queen Victoria Street, London, EC4N 4TZ, is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (Financial Services Provider (FSP) Licence Number 31935), authorised to provide "intermediary services" to South African Investors. TRPIL´s Complaint Handling Procedures are available to clients upon request. The Financial Advisory and Intermediary Services Act Ombud in South Africa deals with complaints from clients against FSPs in relation to the specific services rendered by FSPs. The contact details are noted below: Telephone: +27 12 762 5000, Web: www.faisombud.co.za, Email: info@faisombud.co.za

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

Taiwan—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

Thailand—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

UK—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

© 2023 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.

CCON0156058 | 202307-3009404

For more information on T. Rowe Price and our investment capabilities, please visit our website:

troweprice.com

T. Rowe Price®
INVEST WITH CONFIDENCE