Foreign banks' exposure to Spain and Spanish banks' foreign exposure

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Economic recovery has brought back foreign banks' appetite for Spanish debt, while at the same time supporting growth in Spanish banks' outward investments. Fortunately, Spain´s exposure to countries that currently face heightened geopolitical/default risk remains low.

The Spanish economy's return to GDP growth, which began in mid-2013, has had a positive impact in terms of restoring confidence among foreign banks, which have increased their exposure to both Spanish bank and public sector debt, with France and Germany being the principle holders of Spanish debt. Although exposure to corporate debt has declined, the drop should not be interpreted as a loss of confidence, as it has taken place in a context of intensive deleveraging. Over the same period, Spanish banks have increased the value of their outward investments, concentrating their exposure in the United Kingdom, the U.S, Brazil, Mexico, and Italy. Meanwhile, Spanish banks´ exposure to countries currently experiencing increased geopolitical/default risks (Greece and Russia) is marginal.

The emergence of the Euro Area debt crisis in May 2010 caused capital flight from various EMU countries, in particular from the periphery. The resulting financial instability, coupled with soaring risk premiums, put the Eurozone on the brink of collapse. The strains were so intense that overcoming them required joint commitment by the European Commission, European Parliament and the ECB to support the euro. In particular, as a result of the actions of the ECB, since mid-2012, risk premiums have declined and investor confidence has returned.

In the specific case of the Spanish economy, foreign investors' initial mistrust gave way in 2013 and 2014 to a period of recovery in both FDI and portfolio investment. Confidence among foreign banks has also returned, and since mid-2012, they have increased their exposure to Spanish public debt.

When interpreting the results of the changing exposures of foreign banks to a given country, it is extremely important to bear in mind whether they are taking place in a context of debt growth or

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deleveraging. In the case of the former, if foreign banks increase their exposure, it is a good sign that they have confidence in an economy. However, if foreign banks reduce their exposure in a context of debt reduction, it does not necessarily mean a loss of confidence, as this would be a logical process associated with debt repayment. This point needs to be taken very much into account in the Spanish case, as in the last few years, private sector deleveraging has coexisted with an increase in public sector debt. It is therefore important to analyse foreign banks' exposure on a disaggregated basis, distinguishing exposure to public debt from exposure to private debt (both bank and non-financial corporation debt).

Against this background, this article aims to analyse in disaggregated form the changes that have taken place in the exposure of foreign banks to Spain prior to and since the summer of 2012, distinguishing between public and private debt and across countries. It also examines whether the recovery in GDP since the second half of 2013 is strengthening the recovery of confidence among foreign banks. Additionally, the exposure of Spanish banks abroad is discussed, looking at the countries and the types of debt they hold.

Finally, this article analyses the exposure of international banks to the Greek economy, given the relevance of recent events in Greece following the change of government and the heightened risk of proposed debt restructuring. To this end, this article examines the way foreign (including Spanish) banks' exposure to Greece has changed between December 2010 and September 2014 (the most recent data available from the BIS), as well as provides the most recent snapshot of this exposure.

The return of foreign banks' confidence in Spain

As Table 1 shows, the most severe period of the sovereign-debt crisis, which lasted until mid-2012, led to a reduction of 12.4% (122.2 billion dollars) in foreign banks' total exposure to Spain, with a drop of 25.7% in direct exposure, while other potential exposures (credit commitments, guarantees extended and derivative contracts) rose by 20.9%. By type of debt, the exposure to debt issued by banks fell most sharply (41.7%), and the reduction in exposure to the public sector was also intense (31.6%).

In contrast with capital flight during the sovereign debt crisis, since mid-2012, foreign banks' confidence in Spain has returned. Although total exposure has dropped by almost 15.9%, this is due to the reduction in other potential exposures.

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Conversely, foreign banks have increased their holdings of Spanish public debt considerably (by 30.9%) and also bought more debt issued by banks (13.7%). Holdings of debt issued by the non-financial private sector have dropped, but it is important to bear in mind when interpreting this drop that Spanish companies have been deleveraging intensely, which was necessary to reduce their high levels of debt. Thus, from June 2012 to September 2014, Spanish non-financial corporations reduced their debt by 17.2%, making it logical that foreign banks have reduced their holdings of this type of debt.

The information published by the BIS broken down by countries indicates that in the case of public debt, German and U.S. banks have increased their holdings of Spanish public debt most (5.4 and 4.5 billion dollars, respectively), while British banks have cut their holdings by 3.5 billion dollars. In the case of debt issued by Spanish banks, French banks have increased their exposure to Spain most, with an increase in debt holdings of 20 billion dollars.

Table 1

Change in foreign banks´exposure to Spain

Jun 12 - Sep 14	Belgium	France	Germany	Italy	Japan	Switzerland	Turkey	United Kingdom	United States	Other countries	Total
						Millions of dollar					
Total	**-1,386**	**12,010**	**-17,524**	**-1,737**	**1,621**	**4,638**	**160**	**-379**	**-121,127**	**-14,115**	**-137,839**
Foreign Claims	**-1,361**	**16,108**	**-13,405**	**-741**	**-180**	**117**	**142**	**-20,446**	**639**	**-16,625**	**-35,752**
Banks	-159	19,990	-881	3,951	-293	-3,969	107	5,768	-1,398	-5,244	17,872
Public Sector	927	3,899	5,403	600	2,459	1,581	0	-3,548	4,539	5,756	21,616
Non-bank private sector	-2,131	-6,759	-17,927	-5,298	-2,346	2,654	35	-22,666	-2,502	-16,887	-73,827
Other potential exposures	**-25**	**-4,098**	**-4,119**	**-996**	**1,801**	**4,521**	**18**	**20,067**	**-121,766**	**2,510**	**-102,087**
						Variation (%)					
Total	**-12.7**	**8.3**	**-10.9**	**-4.9**	**6.7**	**18.1**	**842.1**	**-0.3**	**-52.4**	**-12.9**	**-15.9**
Foreign Claims	**-13.8**	**14.1**	**-10.9**	**-3.3**	**-0.8**	**0.7**	**1,092.3**	**-26.3**	**1.5**	**-17.5**	**-6.8**
Banks	-4.6	87.6	-2.3	83.7	-10.3	-44.5	1,783.3	47.0	-9.1	-24.5	13.7
Public Sector	124.6	24.3	22.4	11.4	30.3	123.7	0.0	-78.6	75.0	148.2	30.9
Non-bank private sector	-37.7	-9.1	-29.9	-43.2	-21.7	35.3	500.0	-37.2	-11.6	-24.2	-22.9
Other potential exposures	**-2.4**	**-13.2**	**-10.9**	**-7.6**	**78.7**	**58.8**	**300.0**	**43.6**	**-64.7**	**17.2**	**-29.9**

Dec 10 - Jun 12	Belgium	France	Germany	Italy	Japan	Switzerland	Turkey	United Kingdom	United States	Other countries	Total
						Millions of dollar					
Total	**-11,493**	**-30,024**	**-63,765**	**-7,273**	**-3,082**	**-30**	**-431**	**-18,606**	**55,453**	**-42,961**	**-122,212**
Foreign Claims	**-11,625**	**-26,174**	**-59,367**	**-7,402**	**-1,687**	**-131**	**-427**	**-29,450**	**-1,736**	**-43,364**	**-181,363**
Banks	-7,037	-15,992	-36,955	-3,618	-1,943	1,025	-433	-8,840	-1,693	-17,734	-93,220
Public Sector	-2,658	-14,245	-4,439	21	-726	-1,229	0	-5,075	2,285	-6,246	-32,312
Non-bank private sector	-1,928	2,980	-17,973	-3,586	982	28	6	-15,536	-2,328	-19,567	-56,922
Other potential exposures	**132**	**-3,850**	**-4,398**	**129**	**-1,395**	**101**	**-4**	**10,844**	**57,189**	**403**	**59,151**
						Variation (%)					
Total	**-51.2**	**-17.1**	**-28.5**	**-17.1**	**-11.4**	**-0.1**	**-95.8**	**-13.1**	**31.5**	**-28.1**	**-12.4**
Foreign Claims	**-54.0**	**-18.6**	**-32.6**	**-25.0**	**-7.2**	**-0.7**	**-97.0**	**-27.5**	**-3.9**	**-31.3**	**-25.7**
Banks	-66.9	-41.2	-49.0	-43.4	-40.5	13.0	-98.6	-41.9	-9.9	-45.3	-41.7
Public Sector	-78.1	-47.0	-15.5	0.4	-8.2	-49.0		-52.9	60.7	-61.7	-31.6
Non-bank private sector	-25.4	4.2	-23.1	-22.6	10.0	0.4	600.0	-20.3	-9.7	-21.9	-15.0
Other potential exposures	**14.4**	**-11.0**	**-10.4**	**1.0**	**-37.9**	**1.3**	**-40.0**	**30.8**	**43.6**	**2.8**	**20.9**

Source: BIS.

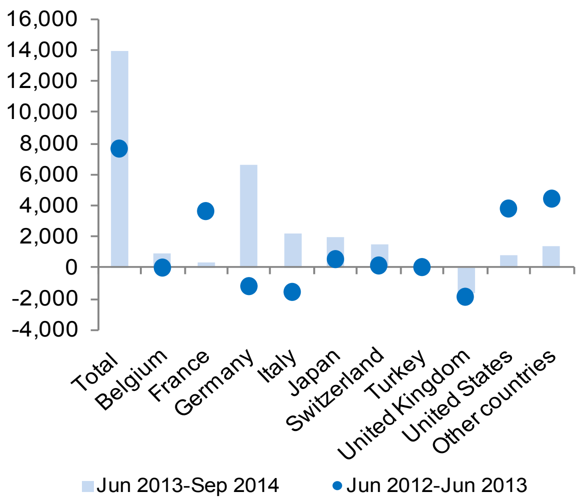
Private deleveraging *vs.* public indebtedness

Turning our attention to how foreign banks' exposures to Spain have changed since the ECB gave its support to the euro in mid-2012, it is worth analysing whether confidence in Spanish banks has consolidated with the recovery in the Spanish economy since mid-2013 (the GDP growth rate has been positive since the third quarter of 2013). To do so, we have compared the change in foreign banks' exposures from June 2012 to June 2013 with that taking place between June 2013 and September 2014.

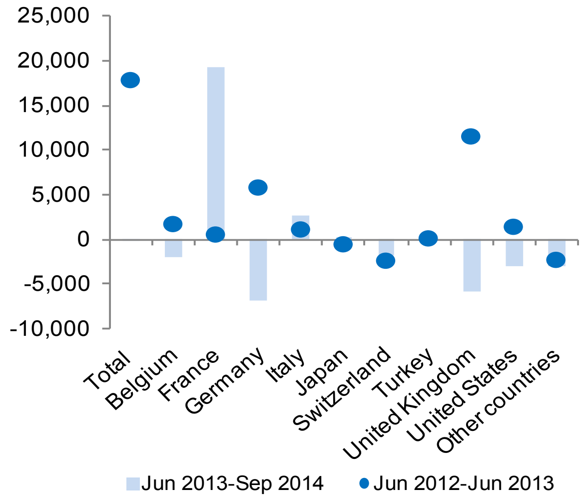
Exhibit 1

Variation in foreign banks' exposure to Spain: Direct exposure
(millions of dollars)

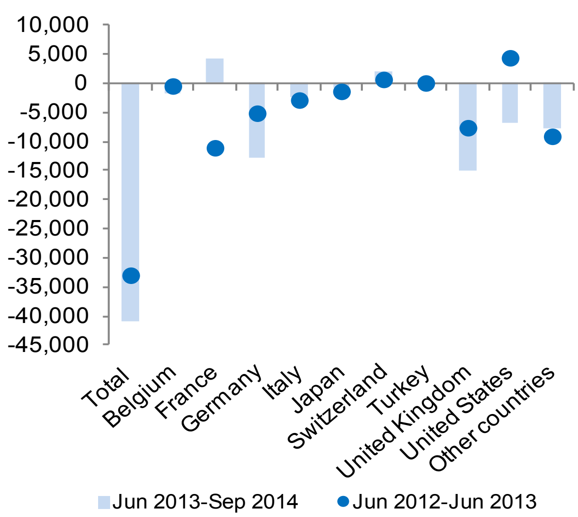
a) Public sector



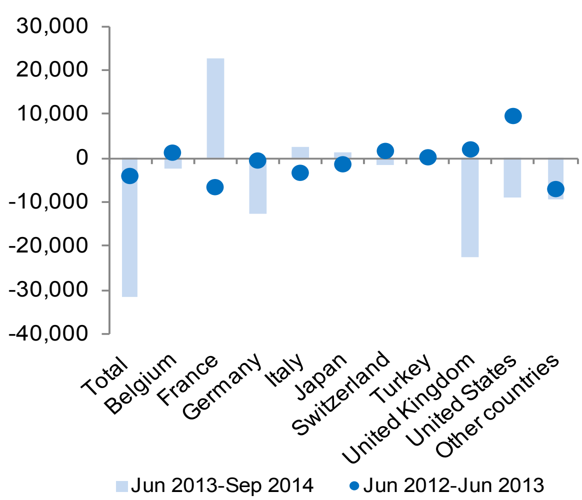
b) Banks



c) Non-bank private sector



d) Foreign claims



Source: BIS.

As Exhibit 1 shows, in the case of direct exposures in the form of debt purchases, the strong deleveraging undertaken by the Spanish economy's private sector (both companies and households) explains why foreign banks' holdings of Spanish debt have shrunk, a process that has been more intense since June 2013. Specifically, there was a drop of 31.8 billion dollars between June 2013 and September 2014. German and UK banks reduced their exposures to Spain most. By contrast, French banks have substantially increased their exposure to Spain (22.7 billion dollars), and there has been a much smaller increase in the purchase of Spanish debt by Italian banks (2.6 billion dollars).

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This aggregate behaviour conceals significant differences between types of debt as a result of private sector deleveraging and growing public-sector debt. In the case of the former, debt reduction explains why foreign banks have reduced their holdings of Spanish businesses' debts by almost 74 billion dollars since mid-2012, with the decline being continuous since then. German and British banks reduced their exposures to Spanish companies most, while France has increased its debt holdings.

By contrast, foreign banks have increased their exposure to Spanish public debt, with an increase since June 2012 of 21.6 billion dollars, the biggest increase being concentrated in the period of GDP growth that began in June 2013. Thus, during this period of economic growth, foreign banks added 14 billion dollars of Spanish public debt to their balance sheets. German banks increased their exposures to Spanish public debt most since June 2013, by a wide margin, in contrast to the situation one year earlier, when they reduced their exposures. The UK's banks are the only ones to have gotten rid of Spanish public debt.

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In the case of debt issued by Spanish banks, the amount of debt held by foreign banks has increased since June 2012 but is unchanged since June 2013. French banks have shown strongest confidence in Spain's banks, having increased their exposure by almost 20 billion dollars since June 2013. By contrast, German and British banks have reduced their exposures.

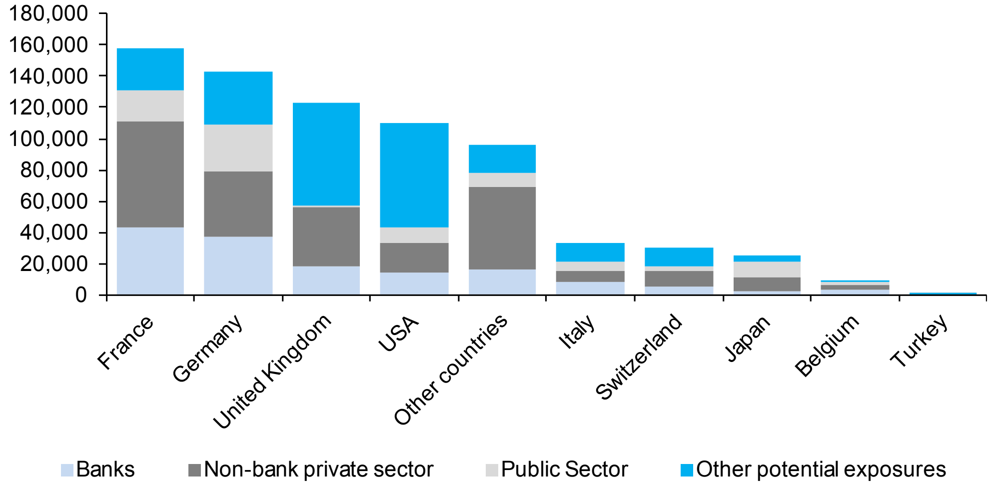
Foreign banks' exposure to Spain: September 2014

The most recent information available, referring to September 2014, shows French banks to have the greatest exposure to Spain: 22% in terms of total exposure and 27% in terms of direct exposure. In this latter case, French banks hold Spanish debt worth 130.5 billion dollars on their balance sheets. The second largest holder of Spanish debt is Germany, whose banks hold 109.1 billion dollars of Spanish debt. Therefore, between them, French and German banks hold almost 50% of Spanish debt.

Turning to the case of public debt, Germany's banks have the biggest exposure to Spain, with 29.5 billion dollars. French banks come second, with 20 billion dollars. These two banking sectors

Exhibit 2

Foreign banks´exposures to Spain. September 2014
(millions of dollars)



Source: BIS.

hold slightly more than half (54%) of all Spanish public debt held by foreign banks, which in September 2014 totalled 91.7 billion dollars. Therefore, Spanish public debt held by foreign banks was 7.3% of the total.

Debt issued by Spanish banks held by foreign banks came to 148 billion dollars, with France and Germany holding 54%. Foreign banks hold 249 billion dollars worth of debt issued by Spanish businesses, 59% concentrated in France, Germany and the United Kingdom. Half of all Spanish debt held by foreign banks is business debt.

Spanish banks' foreign exposure

Where have Spanish banks focused their outward investments? To answer this question, Table 2 shows the breakdown of outward investments in September 2014 for total direct exposure resulting from the purchase of debt, and its breakdown by debt type. This recent snapshot of Spanish banks' direct foreign exposure (at the level of consolidated groups, therefore including the operations of Spanish banks' foreign subsidiaries) shows that, by a wide margin, the United Kingdom is the main destination for investment, with an exposure of 379 billion dollars, representing 24.8% of total outward investment. Exposure to the United States comes second in importance (236 billion dollars or 15.5% of the total).

Spanish banks' exposures to countries that are currently the focus of attention due to their geopolitical/default risks is marginal: just over a billion dollars to Russia and 399 million dollars to Greece, with most investments being in the non-financial business sector.

In Latin America, Brazil and Mexico together concentrate 22.6% of foreign exposure, with a similar volume of investment in each country. Other countries with investments of more than 1% of the total are Portugal (4.8%), Germany (3.5%), Italy (3.2%), Poland (2.6%), France (2.4%) and Turkey (1.5%). Spanish banks' exposures to countries that are currently the focus of attention

Table 2

Spanish banks' exposures to other countries. Direct exposure. September 2014

Public sector			Banks			Non bank private sector			Total Foreign claims		
	Millions $	%		Millions $	%		Millions $	%		Millions $	%
Mexico	68,832	20.4	France	22,941	18.1	United Kingdom	324,407	30.6	United Kingdom	378,568	24.8
Brazil	61,010	18.1	United Kingdom	18,795	14.8	United States	167,353	15.8	United States	236,202	15.5
United States	52,887	15.7	United States	15,962	12.6	Brazil	101,883	9.6	Brazil	175,915	11.5
United Kingdom	35,367	10.5	Brazil	13,023	10.3	Mexico	89,582	8.4	Mexico	168,984	11.1
Italy	29,973	8.9	Mexico	10,570	8.3	Portugal	52,198	4.9	Portugal	73,100	4.8
Portugal	16,583	4.9	China	7,030	5.5	Germany	45,990	4.3	Germany	53,596	3.5
Poland	9,290	2.8	Italy	5,346	4.2	Poland	28,212	2.7	Italy	49,027	3.2
Turkey	6,501	1.9	Portugal	4,320	3.4	Turkey	15,169	1.4	Poland	39,038	2.6
Japan	6,173	1.8	Switzerland	2,956	2.3	Netherlands	13,767	1.3	France	36,463	2.4
France	4,855	1.4	Germany	2,915	2.3	Italy	13,708	1.3	Turkey	22,391	1.5
Germany	4,691	1.4	Hong Kong SAR	2,550	2.0	France	8,667	0.8	Netherlands	16,576	1.1
Switzerland	1,812	0.5	Poland	1,536	1.2	Norway	7,052	0.7	Switzerland	9,306	0.6
Netherlands	1,383	0.4	Austria	1,433	1.1	Luxembourg	5,610	0.5	Norway	8,133	0.5
Belgium	1,164	0.3	Luxembourg	1,428	1.1	Switzerland	4,538	0.4	China	8,099	0.5
Denmark	939	0.3	Netherlands	1,426	1.1	Ireland	4,318	0.4	Luxembourg	7,042	0.5
Sweden	652	0.2	Ireland	1,400	1.1	Hong Kong SAR	3,568	0.3	Japan	6,667	0.4
Austria	475	0.1	Belgium	1,210	1.0	Denmark	2,350	0.2	Hong Kong SAR	6,570	0.4
Hong Kong SAR	452	0.1	Norway	853	0.7	Austria	2,330	0.2	Ireland	5,989	0.4
Ireland	271	0.1	Australia	746	0.6	Finland	2,216	0.2	Austria	4,238	0.3
Norway	228	0.1	Turkey	720	0.6	Cayman Islands	1,619	0.2	Belgium	3,929	0.3
Chinese Taipei	104	0.0	Denmark	510	0.4	Belgium	1,555	0.1	Denmark	3,799	0.2
Finland	60	0.0	Canada	510	0.4	Australia	1,431	0.1	Finland	2,760	0.2
Greece	47	0.0	Sweden	468	0.4	Canada	1,289	0.1	Australia	2,419	0.2
South Korea	29	0.0	Japan	201	0.2	China	1,069	0.1	Canada	2,177	0.1
Canada	12	0.0	South Korea	190	0.1	Russia	935	0.1	Cayman Islands	1,811	0.1
Singapore	11	0.0	New Zealand	149	0.1	Singapore	785	0.1	Sweden	1,668	0.1
Russia	9	0.0	Finland	143	0.1	South Korea	487	0.0	Russia	1,023	0.1
Luxembourg	4	0.0	Singapore	112	0.1	Greece	342	0.0	Singapore	907	0.1
New Zealand	0	0.0	Russia	79	0.1	Japan	293	0.0	South Korea	707	0.0
India	0	0.0	Cayman Islands	49	0.0	Sweden	136	0.0	Greece	399	0.0
Czech Republic	0	0.0	India	47	0.0	India	128	0.0	New Zealand	212	0.0
China	0	0.0	Czech Republic	33	0.0	Czech Republic	99	0.0	India	176	0.0
Cayman Islands	0	0.0	Greece	9	0.0	New Zealand	63	0.0	Czech Republic	132	0.0
Australia	0	0.0	Chinese Taipei	1	0.0	Chinese Taipei	4	0.0	Chinese Taipei	109	0.0
Other countries	33,878	10.0	Other countries	7,101	5.6	Other countries	157,414	14.8	Other countries	196,893	12.9
All countries	**337,692**	**100.0**	**All countries**	**126,762**	**100.0**	**All countries**	**1,060,567**	**100.0**	**All countries**	**1,525,025**	**100.0**

Source: BIS.

due to their geopolitical/default risks is marginal: just over a billion dollars to Russia and 399 million dollars to Greece, with most investments being in the non-financial business sector.

Exposure to corporate debt is the most significant, as it accounts for 71% of Spanish banks' total outward investments (1.1 trillion dollars). The United Kingdom is again the main destination for corporate debt purchases, as the country accounts for 30.6% of the total debt of this type. The United States is second in importance, with an exposure to corporate debt of 167 billion dollars. Together with Brazil, Mexico and Portugal, these five countries account for almost 80% of the foreign business debt held by Spanish banks.

In the case of public debt issued by third countries, Spanish banks' exposure comes to 337.7 billion dollars, with Mexico, Brazil and the U.S. being the main destinations for this investment. In the case of bank debt, Spanish banks hold debt of almost 126.8 billion dollars, with France, the United Kingdom, the United States, Brazil, and Mexico accounting for 60% of the total.

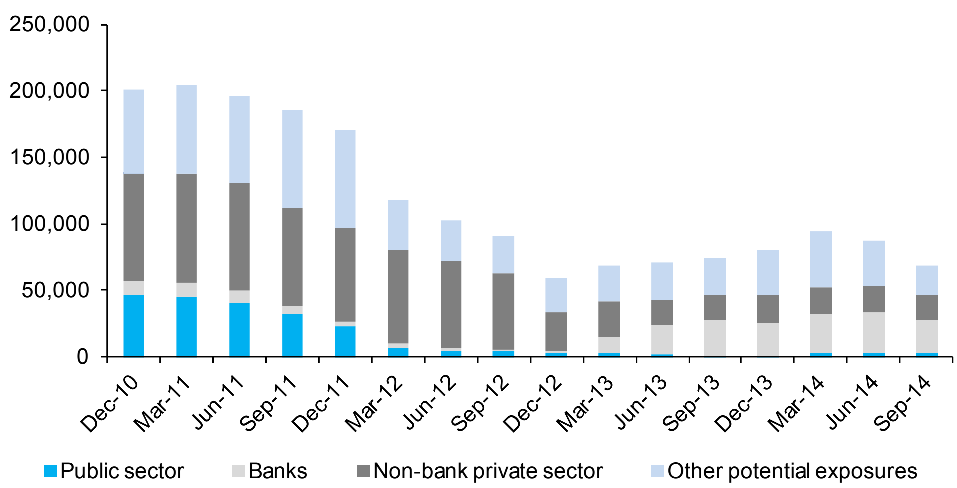
Banks' exposure to Greece

Of particular interest is the analysis of the banks' exposure to Greece, as a consequence of the two bail-outs the country has undergone so far, and the current tension following the formation of the new government, which proposes a restructuring of the debt.

As Exhibit 3 shows, foreign banks' exposure to Greece fell by a third between late 2010 and September 2014, from 201 to 69 billion dollars. The sharpest drop has been in public debt, which in September 2014 was just 5% of foreign banks' 2010 holdings. Thus, the most recent information available indicates that just 2.4 billion dollars of Greek public debt is held by foreign banks.

Capital flight has also been intense in the case of debt issued by non-financial corporations, with holdings having shrunk to a fifth. By contrast, after the capital flight in the wake of the first bail-out, since 2012, foreign banks have increased their exposure to debt issued by Greek banks, although since the third quarter of 2014, exposures have again contracted.

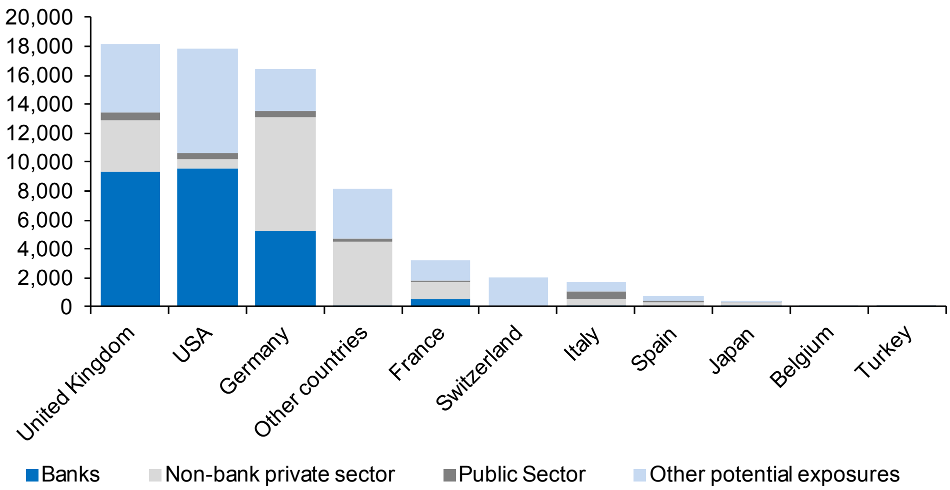
Exhibit 3
Foreign banks' exposure to Greece. All countries
(millions of dollars)



Source: BIS.

Exhibit 4

Foreign banks' exposure to Greece. September 2014
(millions of dollars)



Source: BIS.

Table 3

Foreign banks' exposure to Greece. September 2014
(millions of dollars)

	Banks	Non-bank private sector	Public Sector	Total direct exposure	Other potential exposures	Total
United Kingdom	9,362	3,521	588	13,472	4,658	18,130
USA	9,608	543	489	10,640	7,181	17,821
Germany	5,255	7,826	434	13,515	2,938	16,453
Other countries	120	4,343	278	4,742	3,418	8,160
France	580	1,179	52	1,812	1,371	3,183
Switzerland	0	0	0	0	2,037	2,037
Italy	108	441	511	1,060	678	1,738
Spain	9	342	47	399	358	757
Japan	134	155	11	300	101	401
Turkey	4	8	22	54	2	56
Belgium	0	38	0	39	9	48

Source: BIS.

Which banking sectors currently have the biggest exposures to Greece? U.S., British and German banks hold, in more or less equal shares, slightly more than three quarters (76%) of Greek debt, with a total exposure of 52.4 billion dollars. They are followed, at some distance, by France (3.2 billion dollars), while Spanish banks' exposure to Greece is marginal (0.8 billion dollars).

In the case of public debt exposures, British banks are the most exposed to Greece, although the figures are small (588 million dollars), followed by Italian banks (511 million dollars), U.S. banks (489 million dollars) and German banks (434 million dollars). Spanish banks have only 47 million dollars of Greek public debt on their balance sheets.

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Foreign banks' exposure to debt issued by Greek banks and businesses is larger. In the former case, of the 25.2 billion dollars of debt, British and U.S. banks are the most exposed, holding 75% of the total. German banks have the third biggest exposure to Greek banks, with 5.2 billion dollars of debt on their balance sheets. Spanish banks' exposure to Greek banks is marginal, at just 9 million dollars. And in the case of the latter, the high exposure of German banks to Greek businesses stands out, as they hold 7.8 billion dollars of debt, or 42.5% of the total held by foreign banks. Spanish banks hold 342 million dollars of debt issued by Greek businesses.

Concluding remarks

From this analysis, we can conclude that the economic recovery has brought back foreign banks' appetite for Spanish public and bank debt, while the reduction in their exposure to private debt issued by non-financial corporations should not be interpreted as capital flight, but is rather the product of the process of intense corporate deleveraging. Additionally, over this same period of growth that began in mid-2013, the value of Spanish banks' outward investments has risen by 4.2% (61 billion dollars), with the growth in investments in the U.S. (29 billion dollars), Brazil (11.3 billion dollars), Mexico (19.4 billion dollars) and Italy (18.8 billion dollars) standing out. Fortunately, Spanish banks' exposures to countries that currently face heightened geopolitical/default risk is marginal, as the presence of Greek and Russian debt on Spanish banks' balances is minimal.