Foreword by the Governor Pablo Hernández de Cos

Two years after the pandemic first appeared in our lives, the world economy was hit by another extraordinary event: that derived from the invasion of Ukraine by the Russian army. As well as being an extraordinary human tragedy for the Ukrainian people, the consequences of this invasion, albeit difficult to predict, are expected to be global in nature and far-reaching, both geopolitically and in the economic and financial spheres.

This new shock hit the Spanish economy in the context of a gradual recovery, which remained incomplete and uneven by sector of activity, and which continued to be conditioned by the evolution of the pandemic and by continuous upward surprises in inflation. However, the invasion of Ukraine and reaction of Western authorities, resulting in the imposition of unprecedented economic sanctions on Moscow, have introduced enormous uncertainty, with adverse consequences in terms of worsening economic performance and rising inflationary pressures.

The Spanish financial sector is facing this new shock in a situation in which it had recovered the pre-pandemic profitability levels, and in which, as shown by the various exercises carried out by the micro- and macroprudential supervisory authorities described in this Report, its resilience remains generally high. In view of the new shock, although Spanish banks' direct financial exposures to Russia and Ukraine are very small, we will have to closely monitor the effects of the crisis on the institutions and their borrowers, focussing particularly on those business sectors and population groups in which the post-pandemic recovery was slowest or most delayed and, moreover, which are particularly exposed to the economic consequences of the invasion of Ukraine. In this context, institutions will need to remain highly prudent, with appropriate and early recognition of the associated risks, in order to preserve confidence in the sector and facilitate the continued flow of credit to the economy.

More generally, in such an extraordinarily uncertain scenario characterised by the interaction of two such major shocks occurring in succession, it is essential that economic policies respond decisively, provide targeted support to the most vulnerable households, companies and sectors affected, and provide certainty. In particular, the contribution of European supranational policies and their interaction with national policies are fundamental. And the current context is, once again, a crucial reminder of the importance of accumulating in normal times sufficient margin for manoeuvre in all economic policies so that they can be used to mitigate the effects of shocks.

Moreover, as was the case during the pandemic crisis, the war has made Europeans suddenly aware of the need to accelerate European integration if Europe is to be a major player on the global stage, capable of deciding its own future and defending its values. And a key element of this integration is in the financial sphere. Pan-European bond issues to finance the NGEU, together with the issues that may be launched as part of the response to the invasion of Ukraine, are an important step towards the creation of a European safe asset.

Also, a greater degree of integration of the euro area capital markets would promote more risk sharing in the face of asymmetric shocks. And this reinforcement of the eurozone's institutional architecture would be substantially bolstered by the creation of a European Deposit Insurance Scheme and by the establishment of a common framework for the resolution of systemic crises.

Beyond the new challenges that this context introduces to the financial sector, as highlighted in this Report with the description of the various actions taken by supervisors and institutions in the last year, we must continue to tackle decisively the sector's structural challenges, including most notably the growing competition of technology companies, the rise of crypto-assets, the increase in cyber risks and the financial risks associated with climate change.

Indeed, the digitalisation of finance and the emergence of crypto-assets are altering the competitive dynamics and the risks faced by financial intermediaries and their customers. In this environment, public authorities are obliged, on the one hand, to intensify the monitoring, regulation and supervision of the crypto-asset market, properly weighing up the benefits and costs of its use by institutions and citizens; and, on the other hand, as we have already done in a concerted manner at European level and across sectors, we must focus on warnings and on continuous information for users on the risks associated with crypto-asset investment. In addition, the increasing technological complexity of the digitalisation process is leading to both an increase in cyber risks and a greater dependence of institutions on third-party technology services, which means that they must strengthen processes and controls to ensure their operational resilience.

Effectiveness in addressing these challenges will demand, more than ever, a comprehensive and global view which, beyond the central role played by credit institutions, incorporates all intermediaries —including new market players— as further potential vehicles for the generation or transmission of shocks. This will allow for risks to be appropriately identified and mitigated and a balanced competitive environment to be maintained.

In the area of financial risks associated with climate change, it is crucial that these are adequately reflected in institutions' risk management practices and in the information they provide to the market, and that they are in turn taken into account in both regulations and supervisory practices. Central to this is improving our understanding of the nature and measurement of these risks, for which it is essential to further develop methodologies for scenario analysis and climate risk stress tests.

Along with the emergence of these new structural risks, the recent performance of the European economy has led to the re-emergence of more familiar risks to financial stability, such as those stemming from the performance of the real estate market. House prices are rising, for the euro area as a whole, at their fastest pace since 2005, and in some countries there are signs that they are above their long-term equilibrium value, while mortgage loan standards are deteriorating. In Spain, house prices rose significantly in 2021, and we have seen in recent years a reversal of the correction following the global financial crisis. However, they are close to their long-term equilibrium values, so there are still no clear signs of overvaluation. Nevertheless, we must keep a close watch on the performance of this market and the associated lending, in order to detect at an early stage significant imbalances in prices or relaxations in lending standards that require action before there is an excessive accumulation of risk. In short, we must remain vigilant about the evolution of the Spanish real estate market.

All this without forgetting the ongoing challenge for institutions to maintain customer confidence. A challenge that has proved particularly demanding for certain groups and which has required a rapid response by institutions to offer answers to those people who, with lesser digital skills or with difficulties in accessing new digital channels, require more support and accompaniment in this digital transition. This is a reminder of how phenomena that provide major benefits for society, such as digitalisation in banking, can also generate some transitory costs, which public authorities have to deal with.

The magnitude of the challenges faced by financial institutions highlights, more than ever before, the importance of sound governance. An institution's governing bodies, in the make-up of which independent members play a fundamental role, must be equipped with mechanisms, information circuits and capacities that enable them to monitor the institution's management in depth, issue opinions and take adequately informed decisions, and outline the strategic lines of future business.

In short, we are once again facing an uncertain and complex economic environment, which requires authorities to monitor risks closely and provide an adequate and timely response that, in the case of the financial sector, allows us to safeguard financial stability as a necessary element for economic growth and the improvement of citizens' well-being.

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