I Securities markets and their agents: Situation and outlook

Contents

List of exhibits

1 Executive summary

- The outcome of the US elections and resurgent inflation have largely set the tone for global macroeconomic and financial developments in recent months. The new US administration is expected to significantly impact the country's economic policy, foreseeably pushing it towards greater protectionism, looser fiscal policy and higher interest rates. In fact, the Federal Reserve has raised rates twice since the last issue of this report, and two more hikes seem likely to follow before the year is out. The ECB, meantime, has kept its monetary policy on a fixed course, on the grounds that the recent inflation uptick owes to transitory factors, while committing to the upkeep of its purchase programme.

- Long-term bond yields were quick to pick up on this changed macro-financial landscape with rises lasting through the opening months of 2017. The climb was steepest in the United States, where ten-year treasury yields jumped by almost 70 bp to 2.5% between November and mid-March[1]. Equity markets, meantime, kept up the bull run initiated in the latter half of 2016 after shaking off post-Brexit losses. Index gains ran from 2.5% to 6.7% in Europe, and from 6% to 9.6% in the United States, bolstered in the latter case by the administration's new policies. It seems likely that markets have profited from a sentiment of greater growth solidity despite the persistence of uncertainty factors: some political, potentially threatening episodes of market turmoil, and others related, for instance, to the challenges facing Europe's banks.

- In Spain, the latest activity figures confirm that growth last year was 3.2%, significantly ahead of the rest of the euro area, accompanied by a 3% increase in employment. This allowed further inroads into the jobless rate, which closed at 18.6% of the active population against the 22.1% average of 2015. As in other advanced economies, headline inflation has been accelerating of late under the pull effect of energy prices, while core rates have held below 1%. This upturn promises to be transitory, and should unwind as the months advance, albeit with rates moving consistently ahead of the levels of 2015.

- Banks are still struggling to grow their net interest income in a context of ultra-low rates compounded by mounting competition from shadow banking and fintech operators. In Spain, robust domestic activity has provided a buffer to the sector, lessening the damage from asset impairment while bringing

1 The closing date for this report is 15 March.

down NPL ratios. Also, the efficiency and rationalisation drives under way at most entities will deliver future advances in profitability.

- Non-financial listed companies posted combined 2016 profits of 17.08 billion euros, 3.5 less than in 2015. The decline was almost solely due to heavy losses at one retail and service sector operator (Abengoa), without which aggregate earnings would have climbed 30% on the continued vigour of domestic activity[2].

- The stress indicator for Spanish financial markets held below 0.30 in the year's first months, a low-key reading that contrasts with the uncertainty-driven spikes of 2016. Levels were highest in the bond market, reflecting the heightened volatility and thinner liquidity that has prevailed in these past months.

- The rally in Spanish equity prices of last year's closing months allowed them to recoup most of their earlier losses and close with a restrained fall of 2%. This positive run has lasted into the first quarter of 2017, when a strengthening economy and corporate earnings growth helped lift the Ibex 35 by 6.7%, outperforming other European indices. The advance took in most sectors, with small cap firms faring particularly well (up 10.8%) on their close tie-in with the domestic business cycle. Although overall trading in Spanish shares sank further in the first quarter (-19% year on year), it seems a turning point has been reached, with the first two IPOs launched since the second quarter of 2016, and others in the pipeline.

- Spanish fixed-income markets, like most of their peers, closed last year with a jump in yields reflecting both the shift in US monetary policy and the prospect that the ECB will shortly transition to a new stance, tapering its monetary stimulus as inflation settles at higher levels. Although the advance in yields has slowed year to date, it has been accompanied by an uptick in the sovereign risk premium reflecting political uncertainty in Europe. Domestic debt issuance, meantime, faltered in the first quarter with asset-backed securities and covered instruments leading the decline. The exception were bonds, whose issuance spurt (in terms of both CNMV-registered and foreign volumes) was partly due to issuer expectations of a run-up in debt financing costs.

- Assets under management in mutual funds climbed 7.1% to 237.86 billion euros in full-year 2016, prolonging the expansion begun in 2013. The pace of advance was, however, slower than in earlier years, due to a spate of redemptions in the uncertain climate of the opening months that was offset as the year progressed. Uncertainty was likewise behind investors' growing preference for products perceived as carrying less risk. Foreign UCITS marketed in Spain also grew their assets in the year; by 6.4% to 114.99 billion euros or around 30% of the sum of assets marketed in Spain. Industry growth failed

2 Sector debt levels barely varied, facilitating a small drop in leverage from 1.15 in 2015 to 1.11 in 2016.

to translate as an increase in fund manager earnings, due to the cut taken in average management fees.

- Investment firms registered with the CNMV had another tough year characterised by renewed downward pressure on trading fees, their main source of income. The result was a 10.8% slump in sector pre-tax profits to 195.2 million euros, though the number of loss-making firms and the scale of their losses were lower than in 2015. Investment advisory business continued to expand, with assets under advice up by 11% to 28.2 billion euros. Investment firm solvency, finally, remained within acceptable bounds.

- This report includes four monographic exhibits:

  – The first summarises the main findings of the latest Survey of Household Finances (Encuesta Financiera de las Familias, EFF), with particular attention to the mix of financial assets held by households. Results are also compared with those of the cross-Europe Household Finances and Consumption Survey (HFCS).

  – The second expands on the content of the CNMV's end-February communication on the requirement for firms to exchange collateral in respect of OTC derivative products, which came into force on 1 March this year.

  – Exhibit three presents the results of the latest evaluation conducted in the frame of the Financial Education Plan, a joint initiative of Banco de España and CNMV implemented since 2008 among pupils in the third year of compulsory secondary education.

  – Finally, our fourth exhibit describes the steps taken by the CNMV to strengthen the protection of Spanish retail investors acquiring CFDs, forex products or binary options.

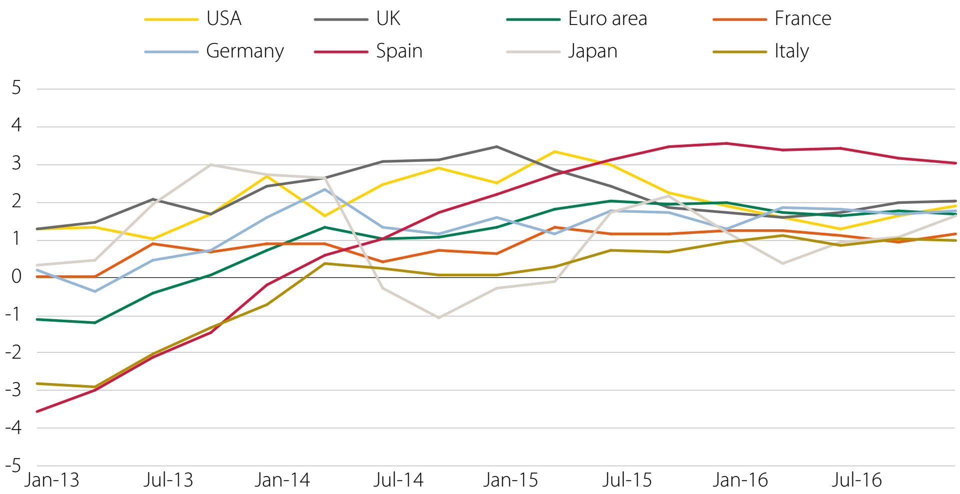
2 Macro-financial background

2.1 International economic and financial developments

Global output climbs by 3.1% in 2016 (3.2% in 2015), with emerging market economies contributing a notable 4.1%.

The global economy grew by 3.1% in 2016, just a little short of the 2015 rate (3.2%), on a combination of 1.6% growth for the advanced economies and 4.1% across the emerging market group. In the United States and United Kingdom, activity picked up pace after a weak first half to close with full-year rates of 1.6% and 1.8% respectively. In the euro area, GDP growth of 1.7% drew on a mixed set of outcomes, with Germany (1.8%) and, above all, Spain (3.2%) advancing strongly against the more restrained pace of France and Italy (1.1% and 1% respectively). Among the emerging market economies, growth was led by Asia (6.3%), with China (6.7%) and India (6.6%) to the fore. Latin America, finally, saw GDP contract 0.7% due to the still beleaguered Brazilian economy (-3.5%).

Annual % change in GDP (%) FIGURE 1



Source: Thomson Datastream.

Monetary policies hold to a divergent course in the US and euro area. The ECB sticks to its accommodative stance…

Monetary policies in the euro area and United States pursued their divergent paths. The ECB stuck with its accommodative stance on the grounds that the recent inflation upturn was a product of transitory factors, with no clear sign of core rates trending higher. The bank opted consequently to keep its main refinancing rate and its deposit and lending facility rates at 0%, -0.4% and 0.25% respectively, and pledged to press on with its asset purchase programme, specifying monthly volumes of 60 billion euros from April to December 2017, or longer if warranted.

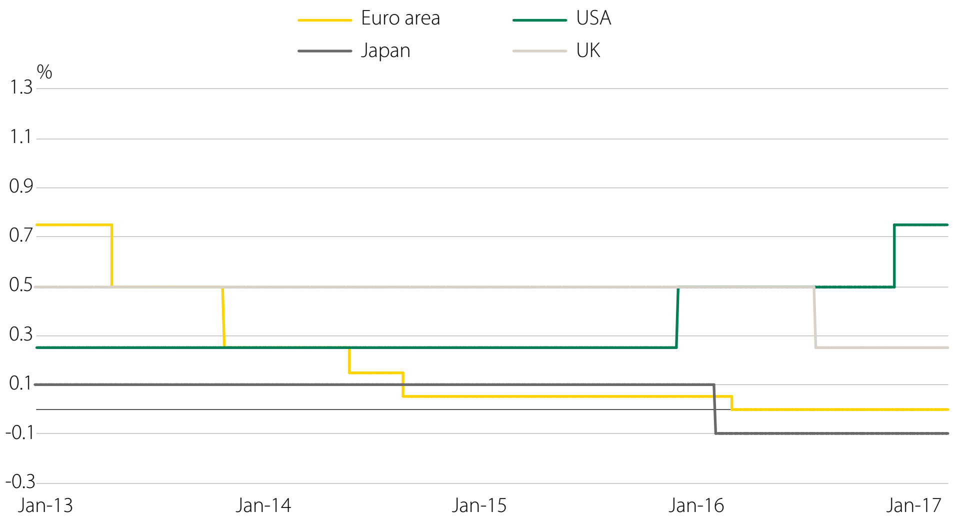
… while the Fed raises official rates to the range of 0.75%-1%.

In the US, conversely, the Federal Reserve followed its December 2016 hike with a new rise in March to the range of 0.75%-1%. The Fed based its decision on the better labour market figures coming through and the ongoing expansion of economic activity, despite some deceleration. This monetary policy, it judged, would help steer inflation toward its mid-term target of 2%, while economic developments should prove supportive of a gradual rates upcycle, with the timing of hikes dependent on the strength of activity and advances in employment and prices.

No change in the monetary stance of either the Bank of England or the Bank of Japan.

The Bank of England left its rates unchanged after last August's cut to 25 bp while maintaining its bond-buying programme, and is ready to cope with what it expects will be a temporary inflation overshoot due to sterling pound depreciation. The Bank of Japan, finally, has decided to press on with its ultra-expansionary monetary policy, and will continue to raise the monetary base until inflation is anchored above its 2% target and the yield curve is under tight control.

Official interest rates FIGURE 2



Source: Thomson Datastream. Data to 15 March

Short-term rates move higher in the US and stay negative in the euro area, reflecting the contrasts in monetary policy.

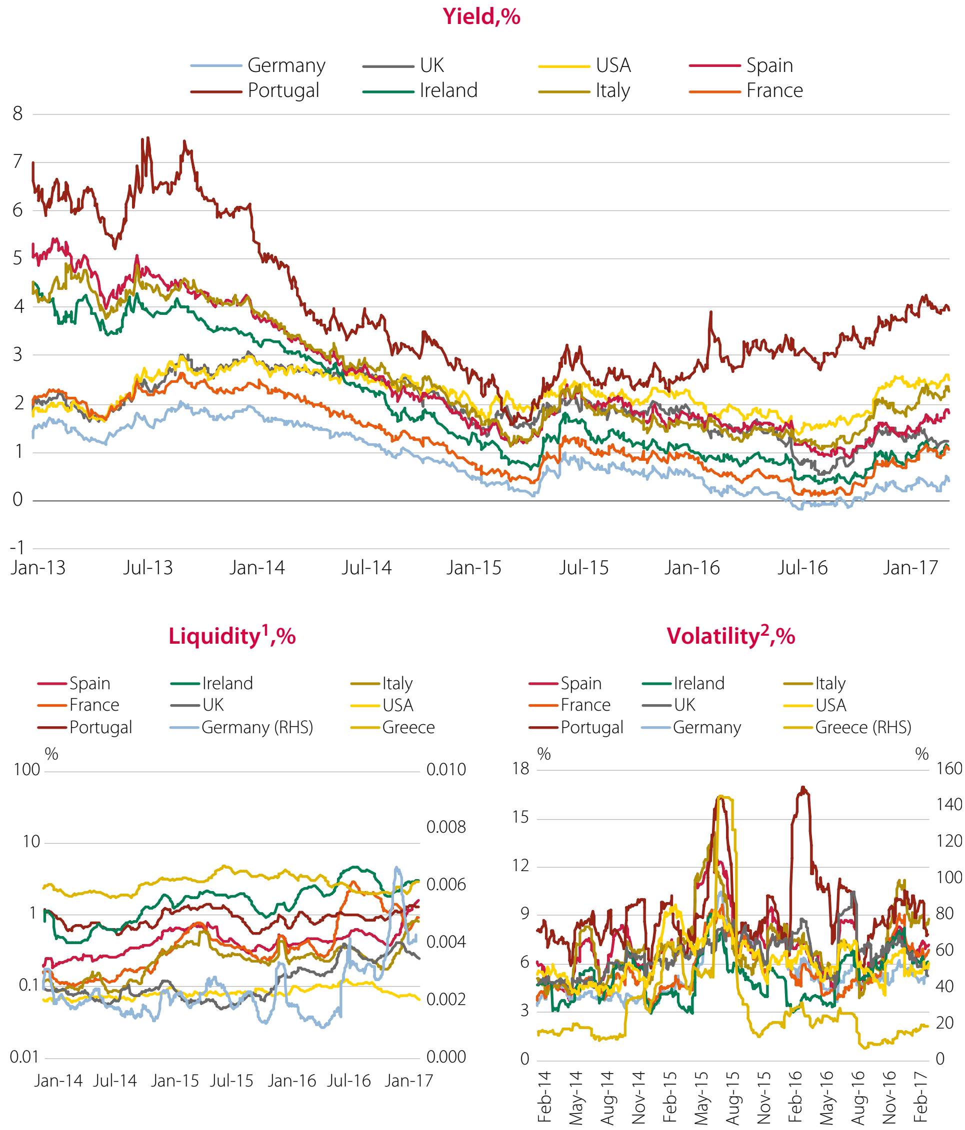
Short-term rates showed considerable dispersal across the advanced economies, in tune with their respective monetary paths. In the United States, three- and twelve-month interbank rates followed up the 39 bp and 51 bp rises of 2016 with an additional 14 bp increase to mid-March levels of 1.14% and 1.83% respectively. In the euro area, by contrast, three- and twelve-month rates slipped further into negative terrain and by mid-March were down to -0.33% and -0.11% (-0.32% and -0.08% respectively at year-end 2016).

Long-term government yields fall in the first half and rebound thereafter, with greater force after the US's November elections…

In international bond markets, ten-year yields on advanced economy government bonds reversed their first-half decline in response to the changed macro-financial scenario introduced by the new US administration. Despite a late spurt, ten-year government yields in Europe stopped short of the levels of the 2015 close, except in Italy and Portugal where they continued higher on concerns over the health of their banking sectors. In the United States, the upturn in yields came sooner and faster than in Europe, such that the full-year increase stretched to 25 bp.

Ten-year sovereign debt market indicators

FIGURE 3



Source: Bloomberg, Thomson Datastream and CNMV. Data to 15 March.

1 One month average of daily bid-ask spread for yields on ten-year sovereign bonds (logarithmic scale). In the case of the German bond, the one month average of the bid-ask spread is represented without dividing by the yield average, to avoid the distortion introduced by its proximity to zero. A rise in this indicator represents a loss of liquidity.

2 Annualised standard deviation of daily changes in 40-day sovereign debt prices.

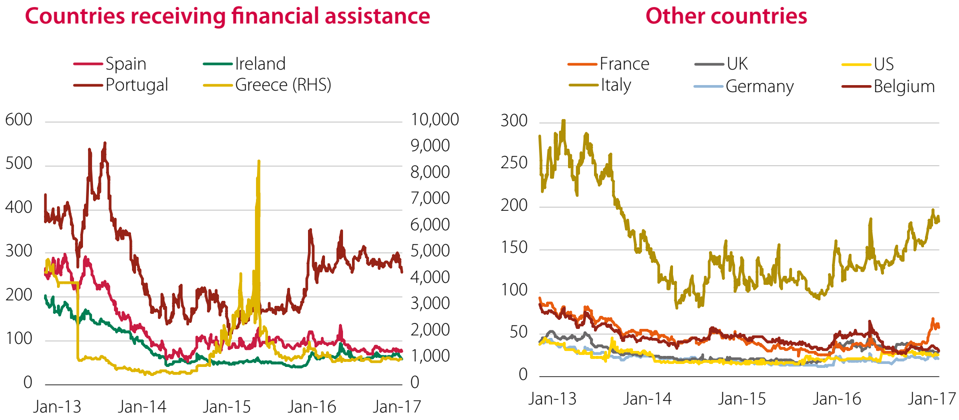
… a trend persisting through the first months of 2017.

Rising yields remained a feature of the advanced economies through the first months of 2017. By mid-March, ten-year US bonds were trading at 2.5% (68 bp up vs. last November). This was substantially more than the rates paid by the euro area's most solid economies, reflecting expectations of faster monetary policy normalisation by the Federal Reserve. Within Europe, German and Spanish ten-year bonds reached mid-March yields of 0.41% and 1.81% (up by 24 bp and 52 bp vs. November 2016), while those of Italy and France stood at 2.3% and 1% respectively. The slightly steeper run-up in these last two economies (55 bp) was due in part to elevated political uncertainties plus, in the case of Italy, the purported weakness of its banking sector. Without, of course, forgetting that these values still mark historical lows.

Sovereign risk premiums, as gleaned from the five-year CDS of government bonds, saw little change in either the US or core euro-area economies (see figure 4). Peripherals experienced more mixed fortunes, with a 6 bp fall in Spain contrasting with the 66 bp and 102 bp increases of Italy and Portugal respectively. In March this year, spreads were running at 26 bp in the US, 21 bp in Germany, 29 bp in the United Kingdom, 77 bp in Spain, 184 bp in Italy and 275 bp in Portugal, on a par with the 2016 close. Only in France did spreads rise a little more steeply (21 bp), as far as a March average of 59 bp.

Credit risk premiums based on CDS hold flat across most economies, with rises confined to those facing added uncertainties (banks or elections), i.e., Italy, Portugal and, more recently, France.

Credit risk premiums on public debt (five-year CDS, bp) FIGURE 4

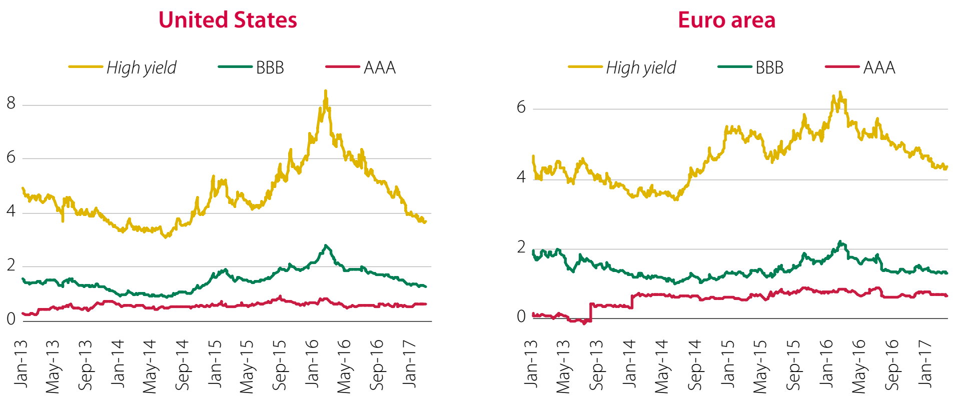


Source: Thomson Datastream. Data to 15 March.

Corporate bond spreads narrowed throughout the year across all US ratings grades and in the two lowest rated categories of euro-area debt (with AAA spreads unaltered). As figure 5 shows, high-yield spreads declined fastest in both regions, by a hefty 246 bp in the US and a more moderate 73 bp in the euro area. The downtrend, moreover, has continued into 2017, due presumably to the growing popularity of search for yield strategies in today's ultra-low interest rate environment. By mid-March, spreads on these higher-risk instruments were down to 366 bp in the United States and 433 bp in the euro area.

High-yield corporate spreads continue to narrow as strategies prioritise the search for yield.

Corporate bond yields
Spread vs. ten-year governments, p.p.[1] FIGURE 5



Source: Thomson Datastream and CNMV. Data to 15 March.

1 In the euro area versus the German benchmark.

Global debt issuance swells by 5.2% in 2016.

Net long-term issuance in global bond markets summed 2.72 trillion dollars, a 5.2% increase with respect to 2015. Growth extended to both sovereign and corporate paper, whose volumes rose by 91 and 45 billion respectively to 1.43 and 1.29 trillion dollars.

Sovereign issuance contracts in 2016 in both Europe and the United States

In Europe, net sovereign issuance was again curtailed by ongoing fiscal consolidation efforts. Issues volumes dropped in consequence from 110 billion dollars in 2015 to 70 billion in 2016, most notably in the second half when the figure turned negative in net terms (-178 billion dollars; see upper right-hand panel of figure 6). Net sovereign issuance also contracted in the United States, although the cause in this case was a redemptions bill 16.5% higher than in 2015.

… while financial sector issuance advances in the US and recedes in Europe, where banks must negotiate a challenging environment.

Net financial sector issuance in the United States came to 220 billion dollars, 14 billion more than in 2015 due to lower redemption volumes. In Europe, meantime, net issuance turned more steeply negative in the year (a further -24.9% to -97 billion dollars). This outcome reflects the deleveraging under way at European banks, as they confront the challenges posed by excess capacity, elevated operating costs and growing competition in certain financial services.

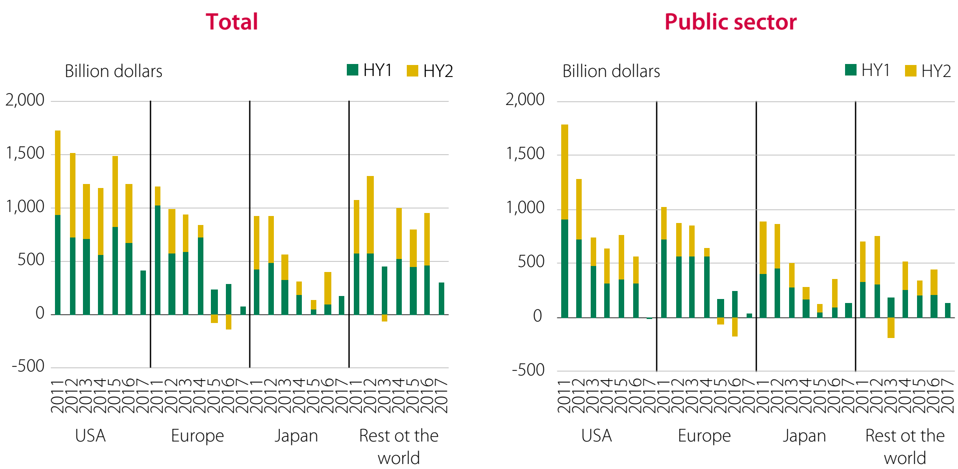
Corporate bond issuance rises everywhere but in the US, encouraged by central bank purchases and the prospect of the coming upcycle in rates.

Corporate bond issuance rose in 2016 in all regions except the United States. Net volumes, specifically, climbed by 29% in Europe to 165 billion dollars, and reached 10 billion dollars in Japan, after running a negative balance over 2015 and the first half of 2016. These advances were likely motivated in part by the asset purchase programmes of the ECB and Bank of Japan, and by companies bringing forward placements to lock in lower costs ahead of the expected upcycle in rates. In the case of the US, the 15.4% fall is partly a comparative effect vs. the issuance spurt of first-half 2015, when companies stepped up their primary market activity in anticipation of a Fed rate hike.

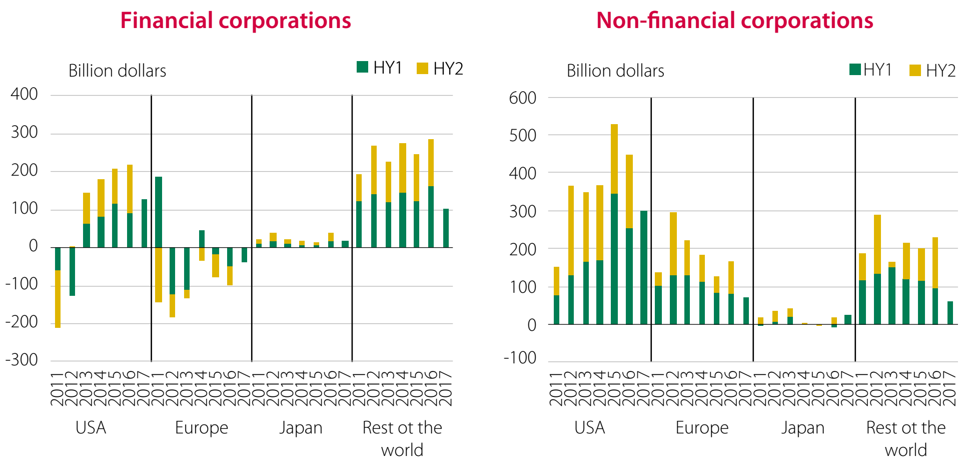
Issuance falls off sharply from the sovereign side in the opening months of 2017.

Net bond issuance on international markets receded 40% year on year in the first months of 2017[3], due mainly to falling sovereign debt sales in both the US and Europe.

Net international debt issuance FIGURE 6



3 Data to 15 March 2017.



Source: Dealogic. Half-year data. Data for first-half 2017 are to 15 March, restated on a semiannual basis to facilitate comparison.

After a poor first half in which sundry uncertainties[4] weighed on market performance, leading stock indices rallied strongly and in most cases closed the year in positive territory. US indices chalked up the largest advances (13.4% for the Dow Jones, 9.5% for the S&P 500 and 7.5% for the Nasdaq tech composite), in contrast to the slimmer pickings recorded in Japan (0.4% for the Nikkei and -1.9% for the Topix). Leading the field among European indices were the UK's FTSE 100 (14.4%) and the German Dax 30 (6.9%), contrasting with the 10.2% losses of Italy's Mib 30, penalised for the country's troubled banking sector, and the 2% fall of Spain's Ibex 35.

Most equity indices shake off first-half losses to close the year with gains,

Stock market gains have by and large carried over to the opening months of 2017, ranging from the 2.8% of the Mib 30 and 2.5% of the Cac 40 to the 6% of the Dow Jones or the Nasdaq's 9.6%. US indices benefitted from expectations of a more expansionary fiscal policy and the deregulation of key industries, while, in Europe, some indices were held back by uncertainties of a political nature. Finally, the implied volatility of leading world exchanges has remained low key (between 10% and 20%) since the start of the year (see right-hand panel of figure 7).

… continuing into the first months of 2017 against a backdrop of muted volatility.

In emerging stock markets, the MSCI index rose 5.3% in 2016, with second-half gains wiping out the small losses of the first six months. Leading the advance were Latin American and Eastern European indices, particularly the Argentine Merval and Brazil's Bovespa (up 44.9% and 38.9% respectively) and the Russian index (up by a hefty 52.2%). Asian markets, meantime, experienced more mixed fortunes, with the Shanghai Composite bringing up the rear (-12.3%) as concerns grew over renminbi depreciation, possible capital outflows and the country's heavily indebted corporate sector. Since the start of this year, all emerging indices have posted further rises, the exception being Russia with losses to date of -7.8%.

Emerging market indices also perform strongly in 2016, above all in Latin America and Eastern Europe.

4 Concerns at the year's outset focused on the performance of emerging market economies, particularly China, then shifted at mid-year to the repercussions of the UK's referendum vote to leave the European Union (Brexit).

Performance of main stock indices[1]

TABLE 1

%	2013	2014	2015	2016	1Q 16	2Q 16	3Q 16	4Q 16	1Q 17 (to 15 March) %/prior quarter	1Q 17 (to 15 March) % y/y[2]
World										
MSCI World	24.1	2.9	-2.7	5.3	-0.9	0.3	4.4	1.5	5.9	14.5
Euro area										
Eurostoxx 50	17.9	1.2	3.8	0.7	-8.0	-4.7	4.8	9.6	3.6	11.2
Euronext 100	19.0	3.6	8.0	3.0	-4.6	-2.1	4.1	5.9	3.1	10.4
Dax 30	25.5	2.7	9.6	6.9	-7.2	-2.9	8.6	9.2	4.6	20.9
Cac 40	18.0	-0.5	8.5	4.9	-5.4	-3.4	5.0	9.3	2.5	11.5
Mib 30	16.6	0.2	12.7	-10.2	-15.4	-10.6	1.3	17.3	2.8	5.4
Ibex 35	21.4	3.7	-7.2	-2.0	-8.6	-6.4	7.5	6.5	6.7	11.1
United Kingdom										
FTSE 100	14.4	-2.7	-4.9	14.4	-1.1	5.3	6.1	3.5	3.2	20.0
United States										
Dow Jones	26.5	7.5	-2.2	13.4	1.5	1.4	2.1	7.9	6.0	21.4
S&P 500	29.6	11.4	-0.7	9.5	0.8	1.9	3.3	3.3	6.5	18.3
Nasdaq-Composite	38.3	13.4	5.7	7.5	-2.7	-0.6	9.7	1.3	9.6	24.8
Japan										
Nikkei 225	56.7	7.1	9.1	0.4	-12.0	-7.1	5.6	16.2	2.4	14.4
Topix	51.5	8.1	9.9	-1.9	-12.9	-7.5	6.2	14.8	3.5	14.5

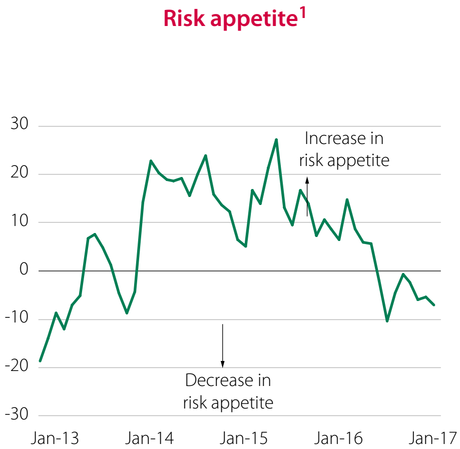
Source: Datastream.

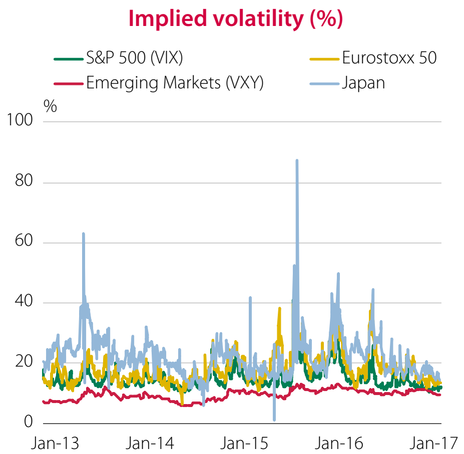
1 In local currency.

2 Year-on-year change to the reference date.

Financial market indicators

FIGURE 7





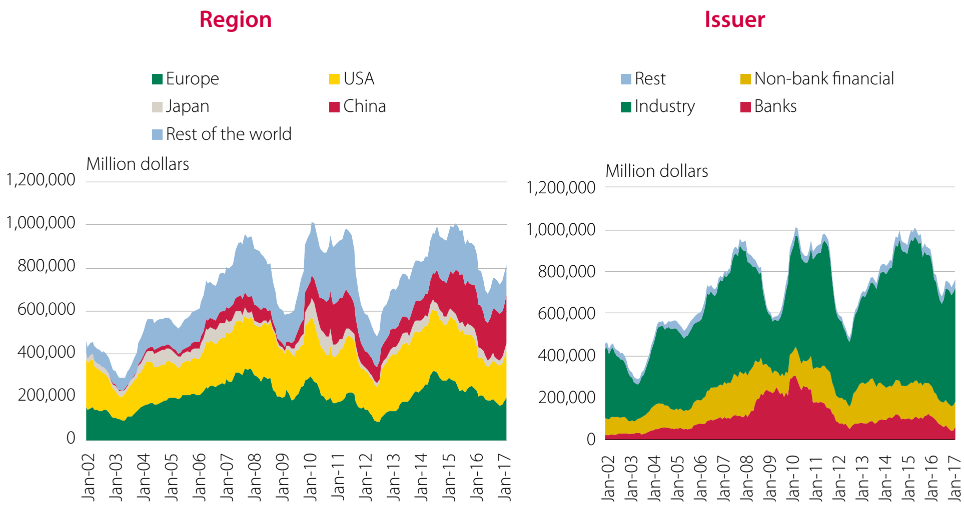
Source: Thomson Datastream and CNMV.

1 State Street indicator.

The volumes raised on global equity markets in the twelve months to March 2017 show some recovery with respect to the year before.

Equity issuance on global markets dropped by 21% to a year-end total of 725 billion dollars. However momentum is gathering to judge by the 818 billion dollars raised in the twelve months to March 2017, improving slightly on the figure for the year before (see figure 8). Regionally, the pattern varied, with declines in Japan (-17.3%) and Europe (-3.3%), and increases in China (12.5%) and, most dramatically, the United States (20.3%), where fast rising equity prices proved a strong inducement. All sectors raised their issue volumes in the period (financials: 7.3%; industrial companies: 5.4%, and utilities: 52.6%), with the exception of the banks (-25.7%). Although this last register represents some advance compared to second-half 2016 (-66% in December), it is also indicative of the challenges facing Europe's banking sector, as it struggles to squeeze out more profits in a context of ultra-low interest rates and mounting competition.

Global equity issuance FIGURE 8



Source: Dealogic. Cumulative twelve-month data to 15 March. For comparative purposes, the figure for this month is restated on a monthly basis.

2.2 National economic and financial developments

Spain's economy expanded at the same rate as in 2015 while conserving a clear lead over the remainder of the euro area. GDP growth was finally 3.2% (0.7% in the closing quarter), against the euro area's 1.7% (0.4% in the closing quarter).

Spain grows its GDP by 3.2% on average, substantially ahead of the euro-area rate (1.7%).

Domestic demand input 2.8 points to GDP growth, 0.5 points less than in 2015, with net exports taking up the slack. Of domestic demand components, only private consumption picked up speed (from 2.8 to 3.2%), while gross fixed capital formation slowed from 6 to 3.1% and government consumption from 2 to 0.8%. Meantime, imports decelerated faster than exports (5.6 to 3.3% against 4.9 to 4.4%), lifting the external sector contribution into positive terrain (up from -0.1 to 0.4 points).

A lesser growth contribution from domestic demand is offset from the net exports side.

On the supply side of the economy, all branches quickened their advance, except the industrial sector whose growth dropped from 5.5 to 2.4%. Specifically, the gross value added of primary sectors rose by 3.4% in 2016 (-2.8 the previous year), against the 2.5% of construction (0.2) and the 3.4% of the service sector (2.6).

All supply side sectors, with the exception of industry, pick up speed in 2016.

Spain: Main macroeconomic variables (annual % change)

TABLE 2

	2013	2014	2015	2016	EC[1] 2017F	EC[1] 2018F
GDP	**-1.7**	**1.4**	**3.2**	**3.2**	**2.3**	**2.1**
Private consumption	-3.2	1.6	2.8	3.2	2.1	1.8
Public consumption	-2.1	-0.3	2.0	0.8	0.9	0.8
Gross fixed capital formation, of which:	-3.4	3.8	6.0	3.1	3.4	3.8
Construction	-8.6	1.2	4.9	1.9	n. d.	n. d.
Equipment	5.3	8.4	8.9	5.1	4.0	3.8
Exports	4.3	4.2	4.9	4.4	4.0	4.3
Imports	-0.5	6.5	5.6	3.3	3.5	4.3
Net exports (growth contribution, p. p.)	1.4	-0.5	-0.1	0.4	0.2	0.1
Employment[2]	**-3.4**	**1.1**	**3.0**	**2.9**	**2.0**	**1.7**
Unemployment rate	**26.1**	**24.4**	**22.1**	**19.6**	**17.7**	**16.0**
Consumer price index[3]	**1.4**	**-0.1**	**-0.5**	**-0.2**	**1.9**	**1.7**
Current account balance (% GDP)	**1.5**	**1.1**	**1.4**	**2.0**	**1.7**	**1.6**
General government balance (% GDP)[4]	**-7.0**	**-6.0**	**-5.1**	**-4.7**	**-3.5**	**-2.9**
Public debt (% GDP)[5]	**95.4**	**100.4**	**99.8**	**99.7**	**100.0**	**99.7**
Net international investment position (% GDP)[6]	**-83.7**	**-90.1**	**-79.3**	**-76.3**	**n. a.**	**n. a.**

Source: Thomson Datastream, European Commission, Banco de España and National Statistics Office (INE).

1 European Commission forecasts of February 2017.

2 In full-time equivalent jobs.

3 European Commission forecasts refer to the harmonised index of consumer prices.

4 Data for 2012, 2013, 2014 and 2015 include government aid to credit institutions amounting to 3.8%, 0.5%, 0.1% and 0.1% of GDP respectively. The percentage for 2016 is as forecast by the European Commission.

5 The 2016 rate is as forecast by the European Commission.

6 Ex. Banco de España. The net international investment position corresponds to the third quarter of 2016.

n. a.: [data] not available.

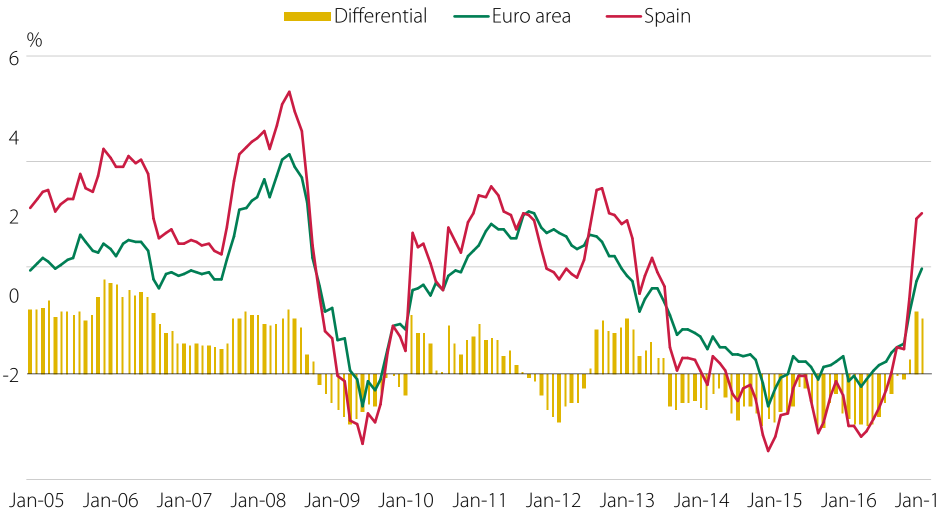
Inflation accelerates in the closing months with the bottoming out of energy prices, while core rates hold to a notably more stable course.

Inflation recovered sharply after a first half in negative terrain, due chiefly to the bottoming out of energy prices. The headline rate closed at 1.6%, almost a full point higher than in November, and by February 2017 had reached 3%. Meantime, the items making up core inflation – excluding volatile energy and fresh food constituents – traced a notably more stable course, with February's year-on-year rate of 0.9% a repeat of November 2016. Finally, Spain's inflation gap versus the euro area widened from -0.1 points in November 2016 to 1.1 points in February (see figure 9).

Employment growth consistently near 3% helps steer jobless rates down to 19%.

In the labour market, employment growth of 2.9% was on par with the previous year (3%). The 462,000 jobs created lifted the employed population to 17.51 million. The unemployment rate dropped to 18.6% in the fourth quarter for a yearly average of 19.6%, comparing favourably with the 22.1% average of 2015. Year-on-year growth in unit labour costs stayed negative throughout, with apparent productivity (up by an annual average of 0.37%) sizeably outstripping compensation per worker (up by a bare 0.01%).

Harmonised ICP: Spain v. the euro area (annual % change) FIGURE 9



Source: Thomson Datastream. Data to February.

The general government deficit closed last year at 4.5% of GDP (4.3% if we strip out aid to the financial sector), a little below the government's target level of 4.6% and over 0.5 points lower than in 2015. A breakdown by account shows a small reduction in the central government deficit (from 2.59 to 2.52% of GDP) and a larger one for the autonomous regions (practically halving their deficit from 1.74 to 0.82%[5]). Improvement too from local authorities, with an 0.64% surplus up from 0.47% in 2015. Only the deficit registered by the social security was higher than in 2015 (up from 1.22 to 1.62%). According to the excessive deficit procedure (EDP), general government debt edged down to 100.3% in the third quarter from its mid-year peak of 101% (99.8 at end-2015). The latest updated Budget Plan sets deficit targets of 3.1% in 2017, followed by 2.2% in 2018 and 1.3% in 2019.

Spain's public deficit drops to 4.5% of GDP in 2016, a little below the 4.6% targeted and over 0.5 points lower than in 2015.

Banks again had to negotiate a complex business landscape characterised by ultra-reduced interest rates and the encroachment of new competitive forces (shadow banking, fintech...), which has driven profitability ratios well below the historical average. Although all Europe's banks are feeling the pressure, Spain's have suffered less than most because robust domestic activity has helped bring down non-performing loan ratios. As well as fending off competitors, it is important for banks to press on with cost rationalisation and efficiency gains.

Spain's banking sector, though affected by the low interest rates environment, has the advantage of a strong economy at home…

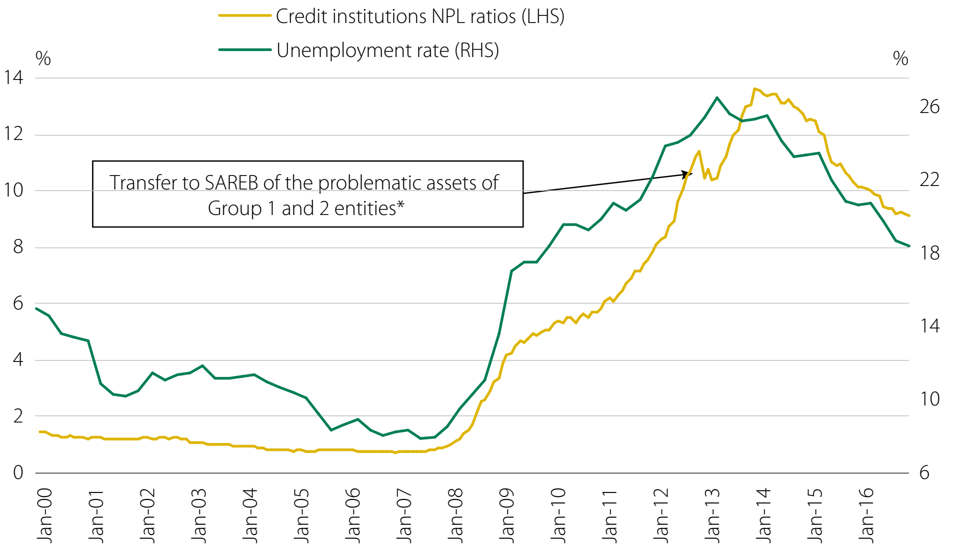
Non-performing loans to other resident borrowers (households and non-financial companies) amounted to 9.1% of the total outstanding in December 2016, one point below the equivalent ratio for December 2015. Contributing to the improvement were factors like the pickup in economic activity and reduced interest rates, which mean cheaper finance for borrowers. Against this backdrop, bank income statements showed a combined 8.29 billion euros profit in the first nine months of 2016 (7.15 billion in the same period in 2015). A look at key income captions reveals: (i) a

… which is driving improvement in sector NPL ratios and income statements.

5 The fiscal outcome of Spain's regions (Comunidades Autónomas) is influenced by the higher revenues transferred to them under the current financing system; an additional 8.20 billion euros in 2016. Eleven regions met the deficit target.

decline in gross income mainly reflecting the erosion of net interest margin; (ii) flat operating expenses, and (iii) lower impairment losses (on both financial and non-financial assets). Year-on-year net profit growth was mainly sourced from this last item plus a lower corporate income tax charge.

Credit institution NPL ratios and the unemployment rate[1] FIGURE 10



Source: Banco de España and National Statistics Office (INE). NPL and unemployment data to December 2016.

1 Percentage of the active population.

* Group 1 transfers took place in December 2012 (36.70 billion euros) and Group 2 transfers in February 2013 (14.09 billion euros).

Bank lending to the non-financial sector (households and businesses) contracts in 2016, though less so than in previous years.

Bank lending to the non-financial resident sector (households and companies) reduced at a slower rate in 2016. In the case of non-financial corporations. year-on-year growth in the flow of finance stood at -0.2% in December (-0.4% one year before). The positive impact of loans from abroad and securities other than shares was not enough to offset the contraction in resident credit institution lending. The picture with lending to households was broadly similar, with last December's year-on-year rate of -1.4% improving on the -2.1% of December 2015. Negative growth in this case was due to home purchase loans, which detracted 2.3%. In the euro area, conversely, the stock of outstanding loans to non-financial corporations and households climbed by 1.8% and 2.1% year on year to November 2016.

The bank sector balance sheet experiences further shrinkage, despite an upturn in Eurosystem borrowings.

Bank sector balance sheets shrank further in 2016 prolonging the downtrend of previous years. By the month of December, the sector-wide balance sheet was down to 2.65 trillion euros, equivalent to 113 billion less in assets compared to year-end 2015. All main funding sources contracted in the period: deposits by 74 billion euros, outstanding debt by 24 billion and equity by 8 billion. Meantime, banks increased their net Eurosystem borrowings to 139 billion in December 2016, up from the 133 billion of December 2015, after the initial reduction was wiped out by heavier borrowing in the second half.

Profits of non-financial listed companies climb 30% in 2016, if we strip out the heavy losses of one retail and services firm.

Non-financial listed companies obtained 17.08 billion euros profits in 2016, 3.5% less than in the previous year. All sectors secured major advances in EBITDA and pre-tax profits on the back of vigorous domestic activity (see table 3). Growth at the pre-tax line was strongest among energy companies (upwards of 5 billion euros) and in retail and services (almost 2.80 billion). Finally, consolidated profits rose 75% among energy companies to 8.83 billion euros and 8.8% in the industrial sector to 4.91 billion, against the slippage experienced by construction and real estate (-4.3%). The retail and services sector closed the year in red numbers, affected by heavy losses at one leading company[6]. Stripping out the figures for this one firm, the (consolidated) profits of retail and services operators would have grown by 23.8% and those of all non-financial listed firms by 29.7%.

Earnings by sector: Non-financial listed companies TABLE 3

	EBITDA[1]		Profit before taxes		(Consolidated) profit for the year	
Million euros	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**
Energy	7,692	13,167	5,818	10,841	5,030	8,829
Industry	6,713	7,280	6.085	6,667	4,514	4,913
Retail and services	9,649	12,808	3,824	6,621	4,716	-114
Construction and real estate	5,186	5,623	2,908	3,886	3,398	3,253
Adjustments	-60	83	46	192	39	197
TOTAL	**29,180**	**38,961**	**18,681**	**28,207**	**17,697**	**17,078**

Source: CNMV.

1 Earnings before interest, taxes, depreciation and amortisation.

Stable debt levels facilitate a reduction in leverage in 2016, from 1.15 to 1.11.

The aggregate debt of non-financial listed companies, at 253.87 billion euros, was a bare 0.5% higher than in full-year 2015. There was no set trend, with debt levels rising among energy sector and retail and services firms and falling across the industrial sector and, most markedly, in construction and real estate (a pay-down of over 2.80 billion euros). The average leverage (debt to equity) of non-financial listed companies dropped from 1.15 in 2015 to 1.11 in 2016 (see table 4). Improvement was strongest among construction operators in line with the reduction in their debt levels. Finally, the debt coverage ratio (debt to EBITDA) for this set of firms strengthened from 8.7 to 6.5, with energy companies managing to push the ratio even lower, to 5.8 (9.6 in 2015).

Gross debt by sector: Listed companies TABLE 4

	Debt		Debt/equity		Debt/ EBITDA	
Million euros	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**
Energy	74,010	76,205	0.72	0.72	9.6	5.8
Industry	16,971	16,574	0.53	0.47	2.5	2.3
Retail and services	107,766	109,361	1.98	2.00	11.2	8.5
Construction and real estate	55,209	52,370	1.86	1.58	10.6	9.3
Adjustments	-1,461	-642				
TOTAL	**252,495**	**253,867**	**1.15**	**1.11**	**8.7**	**6.5**

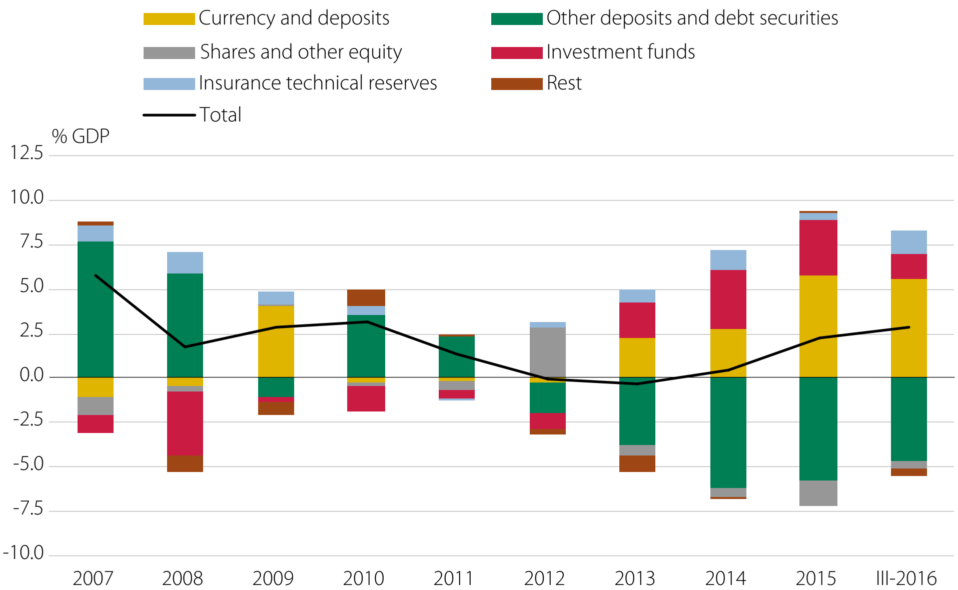
Source: CNMV.

6 Abengoa.

Lower debt-to-income and debt burden ratios deliver further improvement in the financial position of Spanish households, whose financial investments amount to nearly 3% of GDP, surpassing the registers of prior years.

Indicators for the financial position of Spanish households reveal that saving rates held broadly flat at around 8% of gross disposable income (GDI) in the third quarter of 2016. Both debt-to-income and debt burden ratios prolonged the downtrend in place since the financial crisis: the former from 106.08% of GDI at the 2015 close to 103.2% in September last year, on a combination of lower debt and higher income, and the latter by 0.4 points to 11.7%, due partly to the lower average cost of borrowed funds. Household financial investments amounted to 2.9% of GDP in the third quarter (cumulative four-quarter data), up from 2.2% in 2015, 0.4% in 2014 and -0.3% in 2013. As in previous years, households opted to move out of long-term deposits and debt securities (4.7% of GDP), due to the poor returns on offer, exchanging them for cash and transferable deposits (5.6% of GDP), insurance products (1.3% of GDP) and mutual funds (1.4% of GDP).

Household: Financial asset acquisitions (% GDP) FIGURE 11



Source: Banco de España, *Cuentas financieras*. Cumulative four-quarter data.

Financial assets of Spanish households: Recent developments and comparison vs. other euro-area countries EXHIBIT 1

Banco de España's Survey of Household Finances (EFF in its Spanish initials) provides comprehensive data on the income, assets, debt and spending of family units. The survey is run every three years on an extensive sample of households, over six thousand in its latest edition. The five waves available to date – corresponding to 2002, 2005, 2008, 2011 and 2014 – cover a period of more than ten years that is particularly illuminating for the study of household behaviour patterns, including as it does a full cycle of the Spanish economy with expansionary and recession phases of unusual intensity and duration. The longitudinal nature of a part of the sample (the recalling of families interviewed in earlier editions) provides added depth and contrast by enabling analysis of different variables throughout the life cycle of households. The detailed results of the latest round are not yet available, but the Banco de España has published a summary of its main findings[1].

The European Central Bank sponsors a similar initiative in the euro area known as the Household Finances and Consumption Survey (HFCS). Two editions have been run to date, providing standard information on households in fifteen countries in the first wave and twenty in the second[2] that ensures the comparability of results. In most cases, the data for this second wave correspond to the year 2014.

Both surveys are particularly rich in information on securities market matters, since both inquire into the make-up of households' financial asset portfolios, broken down into three large categories of investment products: shares, fixed income and investment funds. The methodology employed involves oversampling of the wealthiest households, thus ensuring a sufficient number of households in the sample to reliably study their investment patterns[3].

In this exhibit, we present the main results of the latest EFF edition, focusing on households' financial asset mix. Results are then compared with those of the countries taking part in the HFCS.

The average 2014 income of Spanish households was 30,400 euros while their median income[4] stood at 22,700 euros, 12.1% and 9.6% less respectively than in the 2011 edition. Average net wealth fell by 7.7% to 245,600 euros in the 2011-2014 period, while median net wealth sank by 22.1% to 119,400 euros. Extending our comparison back to the 2008 and 2011 survey waves, we find that Spanish households suffered an 18.1% drop in median income and a 37.3% drop in median wealth over the length of the financial crisis. In the latter case, the scale of the decline owes mainly to the falling price of housing, for most Spanish families the single most important outlet for their wealth[5].

Both the EFF and the ECB survey confirm that Spanish and European households hold a large proportion of their gross wealth in real assets. A salient development in Spain's case is the rise in the relative weight of financial assets, from 15.4% of the total value of household assets in 2011 to 19.8% in 2014. This upswing has two main causes: the aforementioned fall in house prices and the decline in home ownership among younger families. In Europe, meantime, HFCS results show a similar weight for financial assets, specifically 17.8%.

1 *Encuesta Financiera de las Familias (EFF) 2014: métodos, resultados y cambios desde 2011*, February 2017. Available from http://www.bde.es/f/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/ArticulosAnaliticos/2017/T1/fich/beaa1701-art2.pdf

2 The fifteen countries in the first edition, all belonging to the euro area (Belgium, Germany, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland), were joined in the second by all remaining members except Lithuania, along with Hungary and Poland.

3 Some asset classes are held only by a small fraction of households, normally the wealthiest. So in order to obtain a significant sample of investors, such households must be overrepresented in the survey.

4 Median income is the value of income such that 50% of households earn less and the other 50% more.

5 The index of real estate prices contracted 30.2% between mid-2008 and the end of 2014.

Households' main residence again figured strongly among real assets held, with an average weight that differed little between the two surveys (57.4% in Spain and 60.2% in the area covered by the European study, with percentages ranging from the 40% of Cyprus to the 80.1% of the Netherlands). Percentages of home ownership throw up greater differences, with an especially wide gap among lower net wealth households. So while in Spain 45.6% of households below the 25th percentile[6] of net wealth and 92% of those falling between the 25th percentile and the median declare themselves owners of their main residence, among households in the HFCS survey below the 20th percentile and between percentile 20 and 40, the proportion drops to just 8.1% and 31% respectively.

Turning to financial assets, the most widely reported in the 2014 EFF were bank accounts that cannot be used to make payments, followed, in order of importance, by unlisted shares and other equity securities, and accounts and deposits usable for payments. The former made up 17.9% of the value of households' financial assets, at some distance from the peak levels of the 2008 wave (26.4%). Unlisted shares, conversely, raised their weight to 17.8% of Spanish households' financial portfolios, finding special favour in the first years of the crisis. That said, the number of households owning such assets remained a fairly negligible 1.9%. Finally, accounts and deposits usable for payments weighed in at 16.8%, having receded steadily from the 26.6% high of the 2005 wave.

The pension schemes and life insurance that occupied second place in the 2011 EFF, dropped by over three full points to 15.1% of households' financial holdings. This adds to the existing gap versus HFCS countries, which reported an average 24.5% weight for this asset group albeit with a wide dispersal between the 40% of the Netherlands and France and the less than 10% of Greece and Italy.

Investment assets (listed shares, investment funds and fixed-income securities) raised their relative weight between 2011 and 2014, but continued to command a much smaller share than the aforementioned assets in both the EFF and HFCS. Listed shares advanced from 9% of Spanish households' financial assets in 2011 to 12.6% in 2014, exceeding the HFCS average of 7.1%, with a median invested value of 11,200 euros compared to 7,000 euros in Europe. The percentage of Spanish households directly owning listed shares, up by one point since the start of the crisis to 11.4%, was on a par with countries such as France or Belgium (11.7% and 11%) and ahead of others like Germany or the Netherlands (9.6% and 8%). Note that both the portfolio weight and percentage ownership of this kind of asset is increasing with households' net wealth.

After a major dip in the first years of the crisis, investment funds worked their way back as a percentage of Spanish households' financial assets from 5.6% in 2011 to 9% in 2014. According to CNMV figures, this recovery dates from around 2012 and was fuelled by the poor returns of competing products, deposits especially, in a low interest rate environment. The upswing is patent in the sums in-

6 The 25th percentile is the level of wealth such that 25% have a lower net wealth and the other 75% a higher net wealth.

vested by owner households (median value up from 10,000 to 39,300 euros) but less so in percentage ownership, which rose by a small margin only (from 5.6% to 6%). In fact, the proportion of Spanish households holding funds stands in stark contrast to other countries like Finland or the Netherlands, where percentage ownership stands at 27% and 21%, although median investment (4,200 and 8,900 euros respectively) is significantly lower.

Spanish households have little tradition of investing in fixed-income instruments. Hence the 2014 EFF puts their percentage ownership at just 0.6% (1.5% in 2011), compared to over 5% across the whole HFCS sample and upwards of 10% in countries like Italy or Malta. Spanish households' median investment in fixed-income securities stands at 24,600 euros, against the HFCS median of less than 20,000 euros.

In sum, the EFF shows that the income and net wealth of Spanish households, particularly the latter, contracted sharply over the crisis years, partly as a result of the fall-off in real estate values. Although the squeeze extended to the other European countries in the ECB survey, the overall decline was significantly less. The EFF also finds that Spain stands out from the rest of the HFCS sample in the large percentage of households of below median income that are home owners; a major impediment to their investing in other types of assets. As regards investment assets, it bears mention that the percentage of Spanish households investing in equity markets exceeds that of many European countries, while their ownership of fixed-income securities lags considerably behind. They also trail European peers in investment fund holdings, despite the expansion of the 2011-2014 period.

2.3 Outlook

Global growth is projected to quicken from last year's 3.1% to 3.4% in 2017.

The IMF, in its January forecasts, estimates global growth of 3.4% in 2017 and 3.6% in 2018. These rates improve on the 3.1% of 2016, but are viewed as particularly uncertain in light of potential changes in the policy stance of the United States under the incoming administration. Advanced economies are projected to grow by 1.9% in 2017 and 2% in 2018, compared to the 1.6% of 2016, while the emerging market economies are expected to accelerate to 4.5% in 2017 and 4.8% in 2018 (4.1% in 2016).

Internationally, the biggest risks for the macro-financial scenario have to do with incognitos over the policy stance of the new US administration....

The new US administration brings a series of risks to the global growth outlook. Specifically, restrictions on trade and immigration could disrupt the world economy in the medium to long run, while expectations of fiscal easing are already pushing up bond yields in the medium and long curve segments, and could yet trigger fresh corrections in financial asset prices and stoke volatility on global markets

… plus, in Europe, political fragmentation and the squeeze on bank sector profitability.

In Europe, increased uncertainty and, in some countries, political division are still the main risk factors dominating the economic and financial landscape, with the potential to slow down the structural reforms under way and reignite doubts about the sustainability of the debt load of some euro-area economies. Much will hinge on the progress of the Brexit negotiations initiated at the end of March, when the United Kingdom formally began its process of separation from the European Union, as well as on this year's general elections in France and Germany. Another risk focus is the banking sector, as banks struggle to coax out more profitability in the face of reduced interest rates, excessive non-performing exposure in certain countries, high operating costs and growing competition from fintech and shadow banking operators.

Gross domestic product (annual % change) TABLE 5

	2013	2014	2015	2016	IMF[1] 2017P	2018P
World	3.3	3.4	3.2	3.1	3.4 (0.0)	3.6 (0.0)
United States	1.7	2.4	2.6	1.6	2.3 (0.1)	2.5 (0.4)
Euro area	-0.3	1.1	2.0	1.7	1.6 (0.1)	1.6 (0.0)
Germany	0.6	1.6	1.5	1.7	1.5 (0.1)	1.5 (0.1)
France	0.6	0.6	1.3	1.3	1.3 (0.0)	1.6 (0.0)
Italy	-1.7	-0.3	0.7	0.9	0.7 (-0.2)	0.8 (-0.3)
Spain	-1.7	1.4	3.2	3.2	2.3 (0.1)	2.1 (0.2)
United Kingdom	1.9	3.1	2.2	2.0	1.5 (0.4)	1.4 (-0.3)
Japan[2]	2.0	0.3	1.2	0.9	0.8 (0.2)	0.5 (0.0)
Emerging economies	5.0	4.6	4.1	4.1	4.5 (-0.1)	4.8 (0.0)

Source: IMF.

1 In brackets, change vs. the previous forecast. IMF, forecasts published January 2017 vs. October 2016.

2 Japan's historical national accounts were revised in December 2016 in line with changes in the country's GDP methodology.

The Spanish economy will continue to outperform the euro area, while it seeks to face off the challenges of high unemployment and fiscal consolidation.

In the case of the Spanish economy, the IMF projects some moderation of the growth pace to 2.3% in 2017 and 2.1% in 2018, a mark-up of 0.1 and 0.2 points respectively on its previous forecast. Despite this mild slowdown, which assumes a more modest advance in private consumption, growth of the Spanish economy will easily outpace that of the euro area (an augured 1.6% in both years). The main challenges for Spain are still high unemployment and fiscal consolidation, although strong domestic activity has delivered recent progress on both fronts. Other risks have to do with the resilience of the banking sector in the face of threats shared with other European economies, and the outlook for firms most exposed to the UK and Latin America in the light of the progress of Brexit and the policies of the US government.

3 Spanish markets

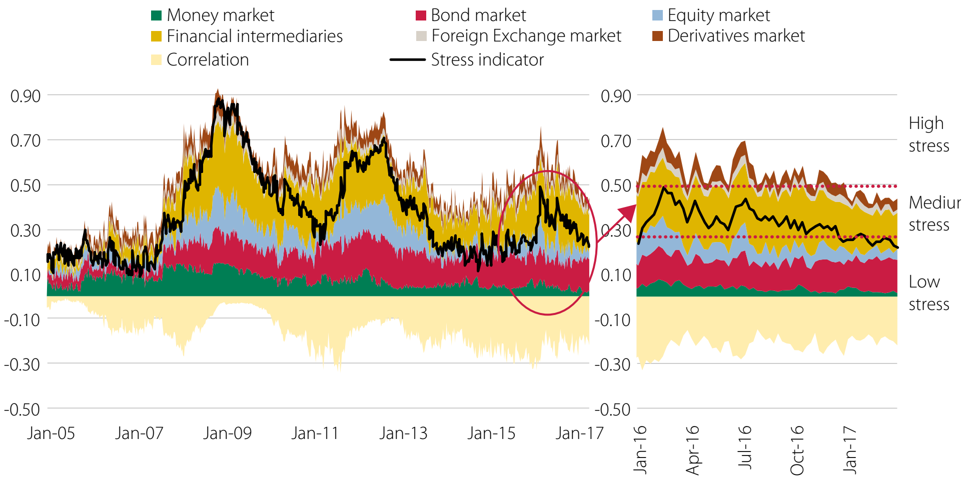
The stress indicator for Spanish financial markets has dropped to 0.23 in recent weeks, placing it firmly within the low stress band.

The stress indicator for Spanish financial markets has moved steadily lower in recent months to a mid-March reading of 0.23, corresponding to the low stress bracket[7] (0.27 marks the threshold separating low from medium stress). Note, however,

7 The stress indicator developed by the CNMV provides a real-time measurement of systemic risk in the Spanish financial system in the range of zero to one. To do so, it assesses stress in six segments (equity, bonds, financial intermediaries, the money market, derivatives and the forex market) and aggregates them into a single figure bearing in mind the correlation between them. Econometric estimations consider that market stress is low when the indicator stands below 0.27, intermediate in the interval of 0.27 to 0.49, and high when readings exceed 0.49. For more detailed information on the recent progress of this indicator and its components, see the quarterly Financial Stability Note and statistical series (market stress indicators) available from www.cnmv.es/portal/Menu/Publicaciones-Estadisticas-Investigacion. For further information on the indicator's methodology, see M. I. Cambón and L. Estévez (2016), "A Spanish Financial Market Stress Index (FMSI)", Spanish Review of Financial Economics 14 (January (1)), 23-41 or CNMV Working Paper No. 60 (www.cnmv.es/portal/Publicaciones/monografias).

that this is a real-time measurement with no predictive power, such that we cannot rule out uncertainty-driven upswings, for instance, as elections draw near in some European countries. For the moment, stress levels are highest in the bond market, given the heightened volatility and thinner liquidity of these last weeks, and, to a lesser extent, the financial intermediaries segment.

Spanish financial market stress indicator FIGURE 12



Source: CNMV.

The most pressing risk in financial markets is currently market risk, referring chiefly to the extremely high prices of fixed-income assets**.** However, this risk is gradually attenuating in the new macro-financial scenario ushered in by the foreseeably more aggressive tone of US monetary policy, which is already bearing down on long-term bond prices (and pushing up yields). Other emerging risks for the Spanish financial system relate to the thinning of liquidity, most notably in some segments of the fixed-income market, and market fragmentation.

3.1 Equity markets

Equity markets rally in 4Q 2016 on the upkeep of ECB monetary policy and, at home, the strength of the economy and greater political stability.

Spanish stock markets ended the year with a price spurt that made up some of the ground lost in the first half-year. This late rally was helped along by confirmation of the expansionary tone of ECB monetary policy, and a sturdy growth pace at home as the new Government settled in. The Ibex 35 closed the year just 2% down, underperforming other major European indices, Italy's excepted, against a backdrop of increased volatility and thinner trading. Price recovery did not extend equally to all sectors and shares, but was strongest among large corporations and among financials, which had taken a heavy punishment in the first six months. Small cap stocks also performed strongly thanks to a buoyant domestic economy and their low exposure to the external sector with its attendant uncertainties. The bull run has continued into 2017 in a spirit of optimism about the domestic growth outlook, and partly influenced by rising US markets.

The advance has lasted through the first months of 2017 (Ibex 35 up 6.7%) against a backdrop of subdued volatility and thinner trading volumes.

The Ibex 35 moved up 6.7% to mid-March adding to the 7.5% and 6.5% gains of the two previous quarters. Small cap stocks were at the forefront of the advance (10.8%), which outpaced that of other European markets[8], with medium cap stocks bringing up the rear (0.8%). The indices grouping Latin American securities traded in euros posted fresh gains in the opening stretch building on the strong price rally of last year's second half. Specifically, the FTSE Latibex All-Share and FTSE Latibex Top climbed by 8.6% and 11.2% respectively, bolstered by the improved performance of Latin American economies like Brazil, and the strength of their currencies against the euro[9].

Performance of Spanish stock market indices and sectors (%) TABLE 6

%							1Q 17 (to 15 March)	
Index	**2014**	**2015**	**2016**	**2Q 16[1]**	**3Q 16[1]**	**4Q 16[1]**	**%/prior quarter**	**%/Dec 2016**
Ibex 35	3.7	-7.2	-2.0	-6.4	7.5	6.5	6.7	6.7
Madrid	3.0	-7.4	-2.2	-6.7	7.7	6.7	6.6	6.6
Ibex Medium Cap	-1.8	13.7	-6.6	-7.6	7.8	3.5	0.8	0.8
Ibex Small Cap	-11.6	6.4	8.9	-8.1	11.6	6.3	10.8	10.8
FTSE Latibex All-Share	-16.1	-39.2	71.0	-2.6	24.4	14.3	8.6	8.6
FTSE Latibex Top	-11.1	-34.6	67.8	-5.6	29.3	17.0	11.2	11.2
Sector[2]								
Financial and real estate services	**1.4**	**-24.2**	**-1.6**	**-14.0**	**10.4**	**21.0**	**5.7**	**5.7**
Banks	1.6	-26.0	-1.8	-15.0	10.3	22.5	5.8	5.8
Insurance	-9.2	-5.0	15.5	1.8	20.5	16.8	3.5	3.5
Real estate and others	36.3	18.4	-2.3	-3.4	0.1	0.9	5.7	5.7
Oil and energy	**11.8**	**0.6**	**0.8**	**5.3**	**0.8**	**1.7**	**1.8**	**1.8**
Oil	-15.1	-34.9	32.6	15.0	5.8	11.1	6.5	6.5
Electricity and gas	21.7	9.6	-4.3	3.7	-0.1	-0.2	0.7	0.7
Basic materials, industry and construction	**-1.8**	**2.1**	**2.0**	**-5.7**	**12.6**	**-0.4**	**6.3**	**6.3**
Construction	8.9	4.9	-7.9	-8.2	9.5	-1.9	4.6	4.6
Manufacture and assembly of capital goods	-18.3	49.0	7.8	-4.0	16.2	-6.1	5.7	5.7
Minerals, metals and metal processing	4.5	-30.8	48.8	-1.2	21.7	11.6	11.8	11.8
Engineering and others	-17.0	-39.6	9.9	3.4	14.3	6.5	4.4	4.4
Technology and telecommunications	**2.5**	**-5.2**	**-9.0**	**-9.7**	**9.0**	**2.8**	**10.2**	**10.2**
Telecommunications and others	2.6	-12.3	-14.2	-13.6	7.0	-2.7	12.9	12.9
Electronics and software	2.3	22.2	7.9	3.4	14.4	-3.0	4.0	4.0
Consumer goods	**-1.5**	**30.9**	**0.2**	**0.9**	**7.0**	**-0.9**	**-1.9**	**-1.9**
Textiles, clothing and footwear	-1.1	33.6	2.6	1.2	10.4	-1.5	-5.5	-5.5
Food and drink	-5.2	26.4	-5.4	-1.0	-1.2	-2.2	0.6	0.6
Pharmaceuticals and biotechnology	-1.0	23.5	-6.4	2.5	-1.3	1.3	9.6	9.6
Consumer services	**10.0**	**10.4**	**-8.0**	**-10.2**	**7.3**	**0.9**	**8.4**	**8.4**

8 Leading European indices all recorded gains: Dax (4.6%), Cac (2.5%), Eurostoxx50 (3.6%), Mib30 (2.8%).

9 The Brazilian real has appreciated 2.9% against the euro year to date.

%							1Q 17 (to 15 March)	
Index	2014	2015	2016	2Q 16[1]	3Q 16[1]	4Q 16[1]	%/prior quarter	%/Dec 2016
Motorways and car parks	6.8	-7.9	-3.1	-4.1	5.0	-4.1	6.2	6.2
Transport and distribution	27.9	29.6	-15.7	-19.5	7.9	4.3	11.9	11.9

Source: BME and Thomson Datastream.

1 Change vs. the previous quarter.

2 IGBM sectors. Under each sector, data are provided for the most representative sub-sectors.

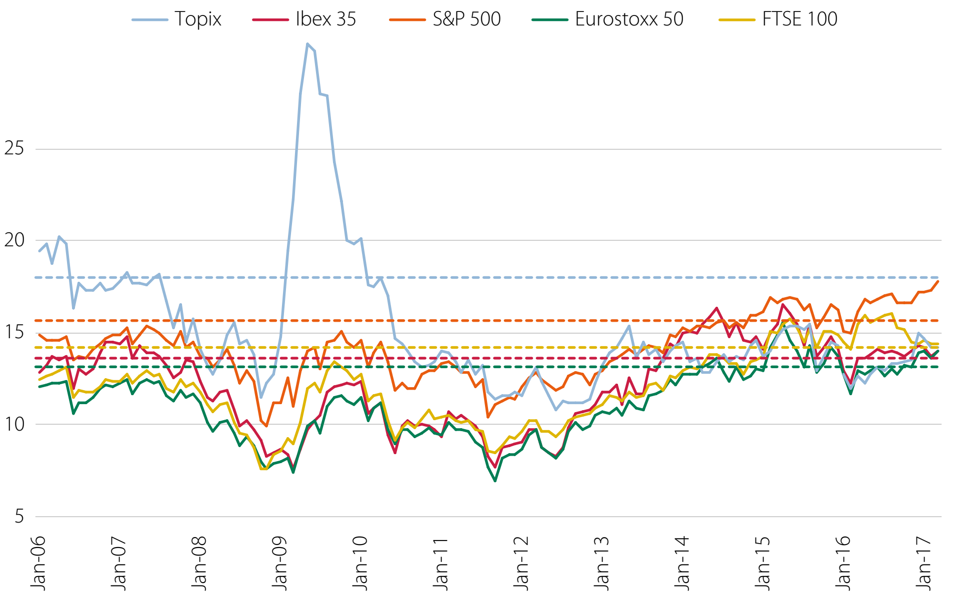
A positive evolution from most sectors, including financials, which are finding growing favour with investors.

With the exception of textiles, all sectors have kept in positive territory to varying degrees. At the head of the field was telecommunications and its leading operator, after struggling for most of 2016, followed by the consumer services sector. Financials too kept up their recovery though a little less strongly than before. The outlook for this sector has brightened significantly in the eyes of investors, on the grounds that most of its restructuring is now safely behind it and its business should benefit from the upcycle in rates. Finally, the oil sector and minerals and metals continued buoyant on the bottoming out of commodity prices (see table 6).

The Ibex 35 P/E falls despite first-quarter price rises due to an increase in forward earnings expectations.

Despite the price rises of the quarter, higher corporate earnings and the prospect of further growth in coming months lowered the price-earnings ratio (P/E) of the Ibex 35 from 14.3 in mid-December to 14 in mid-March. As figure 13 shows, the P/Es of major stock indices moved in different directions while generally staying ahead of the average levels of 2000-2017 period[10]. Hence the P/E of Japan's Topix index fell on the improved outlook for corporate earnings, while that of the US S&P 500 rose on the back of the index's strong advance. The multiples of the Eurostoxx 50 and the UK's FTSE 100 barely varied in the period.

Price-earnings ratio[1] (P/E) FIGURE 13



Source: Thomson Datastream. Data to 15 March.

1 Twelve-month forward earnings.

10 Except Japan's Topix.

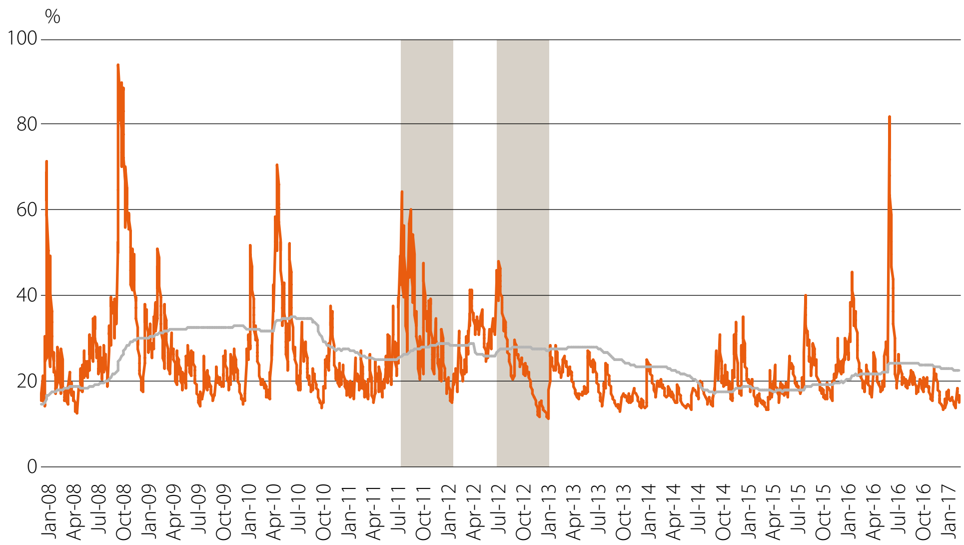
Ibex 35 volatility die down further, in line with other equity indices, to mid-March levels below 16%.

Ibex 35 volatility eased further in the opening months of 2017 prolonging the downtrend of last year's closing quarter. By mid-March it was down to just under 16%, a little below the 18.8% average of 4Q 2016, and improving significantly on the full-year average of 24%. This squared with the progress of volatility readings on other European indices, like the Eurostoxx 50 (10% at the end of the first quarter) or the US's VIX (upwards of 12%).

Liquidity holds within acceptable bounds during the first months of 2017.

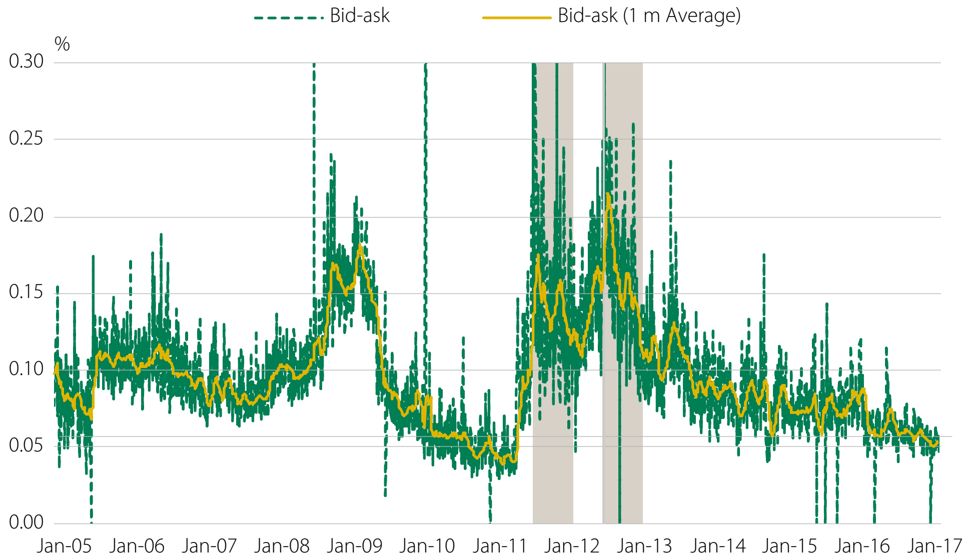
Ibex 35 liquidity, as measured by the bid-ask spread, traced a smooth progression in the first quarter of 2017, with signs of improvement in the form of a slight mid-March narrowing of the spread. Similarly to the movements in volatility, the Ibex 35 bid-ask fell from 0.06% at end-2016 to around 0.05% in March, a good way below its historical average (0.098%) and the average for full-year 2016 (0.064%).

Historical volatility of the Ibex 35 FIGURE 14



Source: Thomson Datastream and CNMV. Data to 15 March. The black line tracks conditional volatility and the red line unconditional volatility. The grey shaded areas refer to the introduction and lifting of the short selling ban running from 11 August 2011 to 16 February 2012, and the later ban starting on 23 July 2012 and ending on 1 February 2013.

Ibex 35 liquidity. Bid-ask spread (%) FIGURE 15



Source: Thomson Datastream and CNMV. Data to 15 March. The curve represents the bid-ask spread of the Ibex 35 along with the average of the last month. The grey shaded areas refer to the introduction and lifting of the short-selling ban running from 11 August 2011 to 16 February 2012, and the later ban starting on 23 July 2012 and ending on 1 February 2013.

Communication on the requirement to exchange collateral on OTC derivatives as of 1 March 2017

EXHIBIT 2

On 27 Febuary, the CNMV issued a communication directed at all those entities required to exchange margin on OTC derivatives as of 1 March, 2017. According to article 11.3 of the EMIR[1], financial and non-financial entities whose trading in OTC derivatives exceeds a certain threshold should have procedures in place to arrange for the exchange of collateral with respect to bilateral derivative contracts not cleared through a central counterparty (CCP). This requirement is elaborated on in a regulatory technical standard published in the Official Journal of the European Union on 15 December 2016[2], which stipulates that entities must exchange variation margins with their counterparties starting 1 March 2017.

Some entities have experienced difficulties implementing this requirement within deadline because of the changes entailed in their support documenta-

1 Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories: http://eur-lex.europa.eu/legal-content/ES/TXT/PDF/?uri=CELEX:32012R0648&from=EN

2 Commission Delegated Regulation supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty: http://eur-lex.europa.eu/legal-content/ES/TXT/PDF/?uri=CELEX-:32016R2251&from=EN

tion. This situation was acknowledged by the European Supervisory Authorities[3] and the IOSCO[4] in their respective statements of 23 February 2017.

Taking its cue from their content, the CNMV will bear these difficulties in mind and consider each industry member's size and circumstances when assessing the degree and timing of compliance.

In any case, the CNMV expects those counterparties unable to satisfactorily meet their margin exchange requirements as of 1 March 2017 to make every effort to achieve full compliance as soon as possible in accordance with a realistic and effective plan. The CNMV trusts that such compliance will be forthcoming in the space of weeks or a few months at most, and will launch specific supervisory actions to verify that this is so.

3 https://esas-joint-committee.europa.eu/Publications/Statements/Statement%20-%20Variation%20margin%20exchange%20under%20the%20EMIR%20RTS%20on%20OTC%20derivatives.pdf
4 https://www.iosco.org/library/pubdocs/pdf/IOSCOPD556.pdf

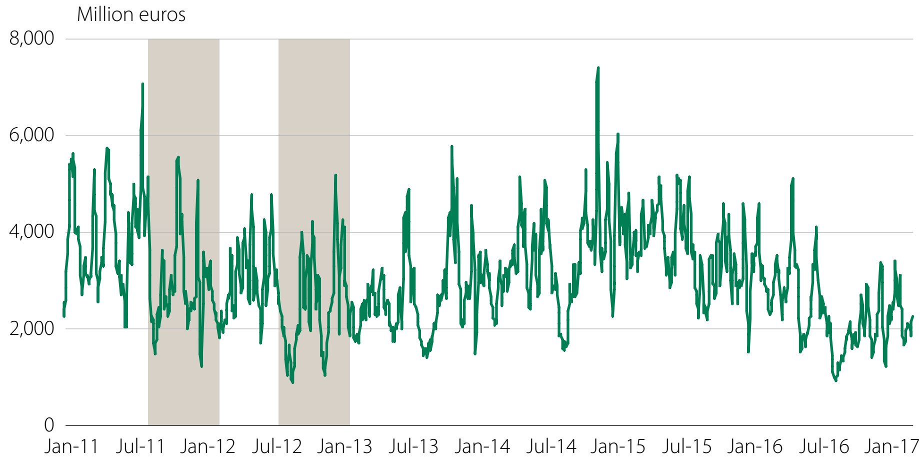
First-quarter turnover in Spanish equities is down 19% year on year within a protracted decline…

The bullish mood failed to stem the decline in trading in Spanish equities, which only picked up slightly in the third quarter of 2016. Reasons were the continuing expansion of OTC trading, concerns over the outcome of electoral processes in Europe, and the prospect of an imminent switch in the ECB's monetary stance. The result was that turnover in Spanish equities shrank by 19% year on year in 1Q 2017 to 176 billion euro, a steeper fall than at other major European exchanges. Average daily trading in the electronic market stood at 2.32 billion euros, ahead of the 1.78 and 2.13 billion of the third and fourth quarter, but a little short of last year's average of 2.48 billion (see figure 16).

… at odds with their popularity on external markets, which now account for 30% of total volumes.

Turnover in Spanish equities on other regulated markets and multilateral trading facilities (MTFs) amounted to 54.60 billion euros in the opening quarter, 4.5% higher

Daily trading on the Spanish stock market[1] FIGURE 16



Source: CNMV. Data to 15 March. The grey shaded areas refer to the introduction and lifting of the short-selling ban running from 11 August 2011 to 16 February 2012, and the later ban starting on 23 July 2012 and ending on 1 February 2013.

1 Moving average of five trading days.

than in the same period last year. This equates to rather more than 30% of overall trading in Spanish shares, a similar proportion to 2H 2016, and suggests some stabilisation after the recent reform of the securities clearing, settlement and registration system. Finally, external markets channelled 28.1% of trading in the last year. The Chi-X platform was again strongly to the fore, with 22.50 billion euros year to date giving it a 41% share of foreign business, though it continues to lose ground to competing platforms: new operators are coming up fast and already command a combined 23% of volumes transacted outside Spain.

Trading in Spanish shares listed on Spanish exchanges[1] TABLE 7

Million euros	2013	2014	2015	2016	3Q 16	4Q 16	1Q 17[2]
Total	**764,986.6**	**1,002,189.0**	**1,161,482.8**	**877,413.3**	**172,742.7**	**198,336.0**	**176,005.5**
BME[3]	687,580.7	850,027.7	926,238.6	631,117.8	116,217.3	134,687.5	121,387.4
Chi-X	53,396.7	95,973.0	150,139.9	117,419.4	25,332.5	29,055.3	22,503.2
Turquoise	11,707.9	28,497.5	35,680.5	51,051.8	13,288.1	12,243.4	9,552.9
BATS	10,632.1	18,671.0	35,857.6	44,839.8	8,814.8	10,845.4	9,999.1
Others[4]	1,669.2	9,019.8	13,566.2	32,984.5	9,089.9	11,504.4	12,562.8
Pro memoria							
BME trading of foreign shares[3]	5,640.0	14,508.9	12,417.7	6,033.0	1,539.1	1,632.3	1,819.6
MAB	5,896.3	7,723.2	6,441.7	5,066.2	1,021.7	1,845.9	1,148.8
Latibex	367.3	373.1	258.7	156.7	26.5	58.9	61.9
ETF	4,283.9	9,849.4	12,633.8	6,045.2	1,014.3	1,288.9	768.1
Total BME trading	703,768.7	882,482.3	957,990.5	648,418.9	119,818.9	139,513.5	125,185.8
% Spanish shares on BME vs. total Spanish shares	89.9	84.8	80.1	71.9	67.7	68.4	69.3

Source: Bloomberg and CNMV.

1 Spanish shares listed on Spanish exchanges are those with a Spanish ISIN that are admitted to trading in the regulated market of Bolsas y Mercados Españoles, i.e., not including alternative investment market MAB. Foreign shares are those admitted to trading in the regulated market of Bolsas y Mercados Españoles whose ISIN is not Spanish.

2 Data to 15 March.

3 Including turnover on the electronic market (SIBE), open outcry and the second market.

4 Difference between the turnover of the EU Composite estimated by Bloomberg for each share and the turnover of the markets and MTFs listed in the table, i.e., including trading on other regulated markets, MTFs and OTC systems.

Even after the first IPOs since 2Q 2016, equity issuance slumps in the opening quarter on the smaller amount of capital increases.

Equity issuance on domestic markets sagged to 2.15 billion euros in 1Q 2017[11], less than half (-55.6%) the total for the year-ago period. The highlights of the quarter were its two initial public offerings, the first since 2Q 2016: one 750 million euro float corresponding to a security and cash management firm, and the other of a real estate operator, for an amount of 431 million. Similar transactions are in the pipeline for coming months. Capital increases, meantime, consisted primarily (77%) of scrip dividends[12], which overtook the total for the same period last year. Finally, capital increases with preferential subscription rights summed a bare 150 million euros.

11 Data to 15 March.

12 Several large corporations traditionally pay dividends in the first days of January.

Capital increases and public offerings

TABLE 8

	2014	2015	2016	2Q 16	3Q 16	4Q 16	1Q 17
NUMBER OF ISSUERS[1]							
Total	**49**	**52**	**44**	**20**	**13**	**18**	**13**
Capital increases	47	47	44	20	13	18	12
Public offers for subscription	6	0	3	3	0	0	0
IPOs	4	6	2	2	0	0	1
NUMBER OF ISSUES[1]							
Total	**147**	**115**	**84**	**24**	**15**	**24**	**14**
Capital increases	140	103	82	22	15	24	13
Public offers for subscription	8	0	4	4	0	0	0
IPOs[2]	7	12	2	2	0	0	1
CASH AMOUNT[1] (Million euros)							
Total	**32,762.4**	**37,067.4**	**20,031.7**	**9,247.2**	**1,907.8**	**3,985.2**	**2,151.2**
Capital increases	27,875.5	28,735.8	19,525.0	8,740.6	1,907.8	3,985.2	1,401.2
Public offers for subscription	2,951.5	0.0	807.6	807.6	0.0	0.0	0.0
Paid-in capital increases	12,650.8	9,627.8	5,729.2	1,233.3	1,146.3	2,383.0	1,084.4
Of which, scrip dividend[3]	12,573.8	9,627.8	5,729.2	1,233.3	1,146.3	2,383.0	1,084.4
Capital increases by debt conversion[4]	3,757.9	2,162.5	3,660.5	230.7	342.6	78.6	0.0
Capital increases against non-monetary consideration[5]	2,814.5	367.0	1,791.8	0.0	238.3	1,502.6	58.0
With preferential subscription rights	2,790.8	7,932.6	6,513.3	5,534.0	174.8	4.6	147.2
Without trading rights	2,909.9	8,645.9	1,022.5	935.0	5.8	16.3	111.5
IPOs	4,886.9	8,331.6	506.6	506.6	0.0	0.0	750.0
Pro memoria: MAB transactions[6]							
Number of issuers	9	16	16	3	8	7	2
Number of issues	15	18	21	4	8	7	2
Cash amount (million euros)	130.1	177.8	219.7	4.2	178.2	30.1	2.2
Capital increases	130.1	177.8	219.7	4.2	178.2	30.1	2.2
Of which, through public offers for subscription	5.0	21.6	9.7	0.0	7.3	2.4	0.0
Public offerings of shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IPOs	0,0	0,0	0,0	0,0	0,0	0,0	0,0

Source: BME and CNMV. Data to 15 March.

1 Transactions registered with the CNMV. Not including figures for MAB, ETFs or Latibex.

2 Greenshoe-related transactions are accounted for separately in this item.

3 In scrip dividends, the issuer gives existing shareholders the option of receiving their dividend in cash or converting it into shares in a paid-in capital increase.

4 Includes capital increases to allow conversion of bonds and other debt into shares by the exercise of employee stock options or execution of warrants.

5 Capital increases for non-cash consideration have been measured at their market value.

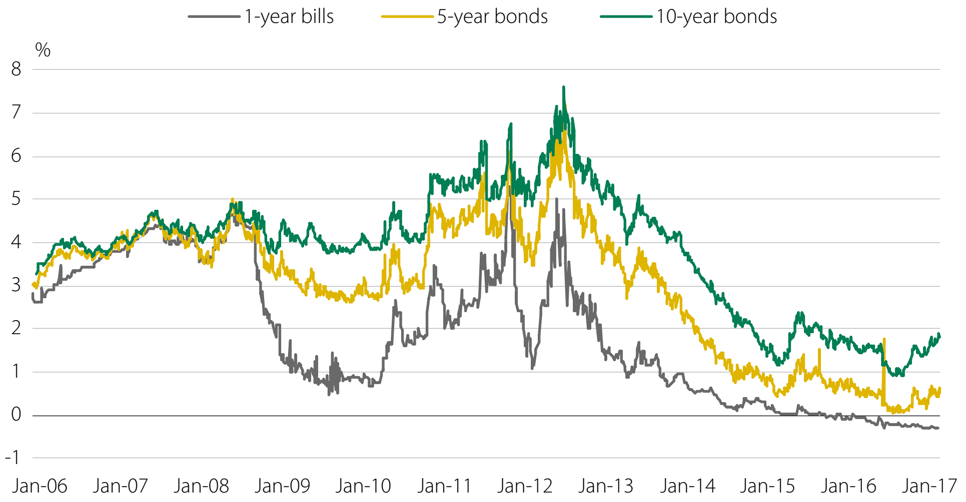
6 Transactions not registered with the CNMV.

3.2 Fixed-income markets

The global macro and financial ramifications of the new US government, and sundry uncertainties in Europe, have set long bond yields and sovereign spreads on a sharply rising course.

Spanish fixed-income markets, like those of other major advanced economies, closed 2016 with significant rises in medium and long-term yields, in response to the new political scenario in the United States, particularly the prospect that fiscal policy will turn more expansionary and that the Fed will complete the monetary shift already signalled by two official rate hikes[13]. The run-up in yields, which has continued with some levelling-off through the first months of 2017, takes place in a context of higher inflation and, in Europe's case, mounting uncertainty around forthcoming electoral processes and doubts about a possible switch in the ECB's monetary tack[14]. These more European than domestic factors have ratcheted up the sovereign credit spread (by 40 bp) in the last six months, along with those of other euro-area countries. Against this backdrop, Spanish issuers reduced their issuance in the opening quarter, with asset-backed securities and covered bonds leading the decline. The concurrent advance in bond sales (registered both abroad and with the CNMV) was due in part to expectations of progressively costlier debt financing.

Spanish government debt yields FIGURE 17



Source: Thomson Datastream. Data to 15 March.

Yields on short-term governments hold at record lows, while commercial paper rates edge higher.

Interest rates on short-dated government bonds moved sideways in the opening quarter, in contrast to the run-up in longer tenors, after the record lows reached in primary and secondary markets in the second half of 2016. The ECB's accommodative stance, with rates held low, and its suite of bond-purchase programmes[15] con-

13 The rise in both cases was 25 bp. The first increase, to the 0.50%-0.75% range, was on 14 December 2016, and the second, to 0.75%-1%, in mid-March 2017.

14 The ECB announced last December that it would extend its purchases of corporate and government debt from March to December 2017, although it would taper the monthly amount from 80 to 60 billion euros.

15 At the start of March 2017, the ECB had bought 1,404 billion euros of debt, including 167.49 billion euros of Spanish paper.

tinued to dominate movements at the short end of the yield curve. By mid-March, secondary market yields on three-month, six-month and twelve-month Letras del Tesoro stood at -0.43%, -0.35% and -0.28% after shedding between 1 and 4 bp, very close to the minimum annual return of -0.4% set by the ECB for its marginal deposit facility[16]. All Tesoro Público auctions were again settled at negative rates. Short-term corporate debt was a rather different case. Although rates stayed reduced, there was some upward movement (between 7 and 12 bp) in three- and six-month tenors, which pulled them away from the lows of the previous quarter as far as mid-March rates at issuance of 0.3%, 0.27% and 0.12% at three, six and twelve months respectively (see table 9).

Short-term interest rates[1] TABLE 9

%	Dec 14	Dec 15	Dec 16	Jun 16	Sep 16	Dec 16	Mar 17[2]
Letras del Tesoro							
3 month	0.12	-0.15	-0.47	-0.22	-0.42	-0.47	-0.43
6 month	0.25	-0.01	-0.34	-0.18	-0.27	-0.34	-0.35
12 month	0.34	-0.02	-0.25	-0.14	-0.23	-0.25	-0.28
Commercial paper[3]							
3 month	0.55	0.31	0.18	0.25	0.25	0.18	0.30
6 month	0.91	0.42	0.20	0.49	0.35	0.20	0.27
12 month	0.91	0.53	0.15	0.34	0.33	0.15	0.12

Source: Thomson Datastream and CNMV.

1 Monthly average of daily data.

2 Data to 15 March.

3 Interest rates at issuance.

Political uncertainty drives long-term government yields significantly higher in the past six months…

Yields on long-term government bonds moved higher in the opening quarter, on top of the sizeable advances of the fourth quarter last year. Driving the uptrend were political uncertainties associated with forthcoming elections in a number of European countries, in a context of gathering inflation. Rises were in any case rather more modest (between 16 and 34 bp) and confined to medium- and long-dated instruments, while three-year yields even headed lower. By mid-March, specifically, three-, five- and ten-year governments were yielding 0.02%, 0.51% and 1.78% (see table 10). The three-year note has held relatively stable in the last six months, but the ten-year bond, the most liquid, is paying 79 bp more than at the start of the period, zeroing in on the levels of the 2015 close.

… in contrast to more gently rising corporate debt yields.

Corporate debt traced a similar path to governments in the last part of 2016, but has since pulled apart. Yields rose by between 16 and 50 bp in the closing quarter, on concerns that the ECB might bring the end of its asset purchase programme forward to the month of March. But the chairman's December pledge to maintain purchases through 2017 (though tapering monthly amounts from 80 to 60 billion

16 At its 9 March meet, the ECB confirmed its main refinancing rate, marginal credit rate and marginal deposit rate at 0%, 0.25% and -0.4% respectively, while pledging to prolong its debt purchase programme to the end of this year, or longer if needed.

euros) eased the pressure on yields and set them on a moderately downwards course. This trend has been bolstered by the ratings upgrades granted to certain large corporations for their policies of paying down debt. The fall in yields was steepest (around 31 bp) in shorter-dated notes, the curve segment subject to most tension as the first to discount any change in the interest rate cycle. At the closing date for this report (15 March), yields on three-, five- and ten-year corporate notes were 0.38%, 1.45% and 1.97% respectively.

Medium and long term interest rates[1] TABLE 10

%	Dec 14	Dec 15	Dec 16	Jun 16	Sep 16	Dec 16	Mar 17[2]
Government bonds							
3 year	0,65	0,24	0,04	0,10	-0,05	0,04	0,02
5 year	0,96	0,72	0,35	0,46	0,12	0,35	0,51
10 year	1,77	1,72	1,44	1,47	0,99	1,44	1,78
Corporate bonds							
3 year	0,84	0,66	0,69	0,81	0,53	0,69	0,38
5 year	1,88	1,95	1,43	1,51	1,09	1,43	1,45
10 year	2,32	2,40	2,14	2,04	1,54	2,14	1,97

Source: Thomson Datastream, Reuters and CNMV.

1 Monthly average of daily data.

2 Data to 15 March.

Sovereign risk premiums felt some fallout from the change of government in the US and the uncertainty engendered by forthcoming elections in Europe. The ten-year yield spread versus the German benchmark has widened in the last six months, a trend Spain has in common with other major European economies. Specifically, the 18 bp rise of the fourth quarter left the premium based on this spread a bare 3 bp higher, at 118 bp, than at the start of 2016. But this was followed by a 22 bp increase in 2017 that stretched the mid-March spread to 140 bp. On the CDS market, the premium traded on the Spanish sovereign CDS barely varied in the period, and by the close of the quarter was even slightly down on its start-out level (see left-hand panel of figure 18).

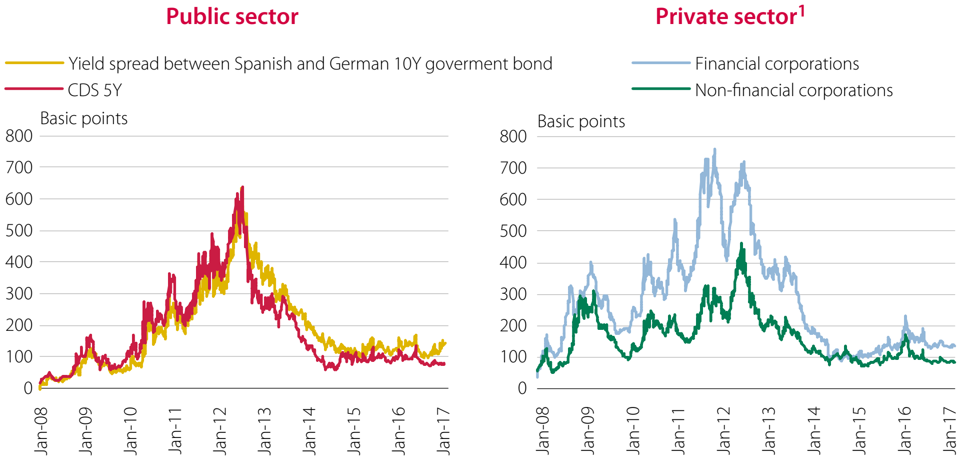
Spain's sovereign risk premium, like that of other European economies, has strained higher in the last six months (by 40 bp to 140 bp) in a climate of greater political uncertainty.

By way of contrast, credit risk premiums on corporate bonds held to a stable course with occasional downticks, presumably due in part to the boost effect of the ECB's corporate bond-buying programme. Although there has never been a specific programme to buy financial sector paper (excluded from the corporate debt purchase programme), issuers certainly benefited from programmes to purchase mortgage covered bonds and, to a lesser extent, asset-backed securities. Otherwise the small drop in financials' risk premiums in the last six months may reflect the positive impact of a higher interest rates scenario on the sector's business margins. As we can see from the right-hand panel of figure 18, the mid-March CDS spread of Spanish financial entities averaged 139 bp, close to the levels of the 2016 close (136 bp) and below the 145 bp of the third quarter. For non-financial corporations, average risk premiums were 85 bp at the same date, improving slightly on the 89 bp of the third and fourth quarters of 2016.

Notably stabler corporate spreads reflect the benefits of the ECB's bond-buying programme, and, in the case of financial issuers, the prospect of rising interest rates.

Risk premium paid by Spanish issuers

FIGURE 18



Source: Thomson Datastream and CNMV. Data to 15 March.

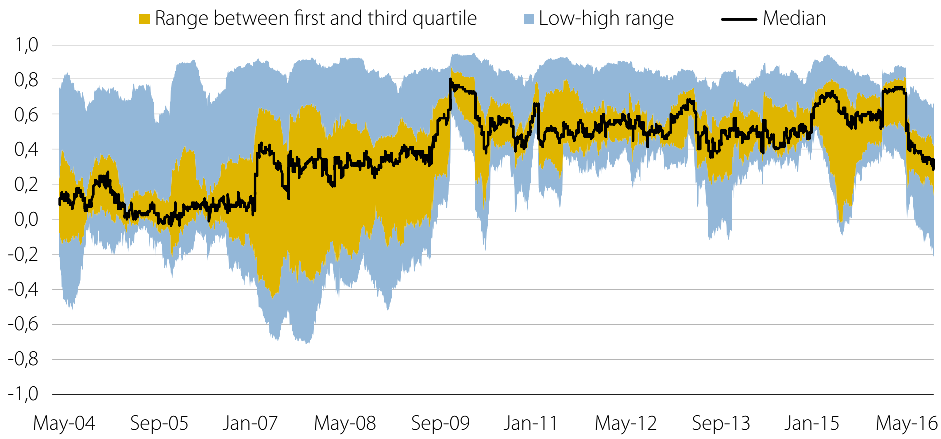
1 Simple average of five-year CDSs from a sample of issuers.

Correlations between the price of Spain's financial assets weaken further in the opening quarter to the lowest median values since 2010.

Correlation between the prices of different Spanish equity and fixed-income assets weakened significantly in the last quarter of 2016, once clear of the immediate effects of Brexit. And the trend has lasted into 2017. As figure 19 shows, the median correlation between the diverse sets of asset pairs dwindled to its lowest point since 2010. Also, the range of correlations between assets widened, due mainly to the lower correlation between financial sector equities, trending higher in the period, and the Spanish ten-year benchmark, whose prices have dropped in line with the rally in sovereign yields.

Correlations between classes of Spanish financial assets[1]

FIGURE 19



Source: Thomson Datastream and CNMV. Data to 15 March.

1. The indicator of correlation between asset classes is based on pairs of correlations calculated using daily data in three-month windows. The asset classes are sovereign debt, corporate fixed income of financial and non-financial firms and Ibex 35 stocks of financial corporations, utilities and the other sectors. A high correlation between Spanish asset classes points to gregarious investor behaviour, possibly due to the heightened volatility typical at times of stress. Also, diversification would hold out fewer advantages, since it would be harder to avoid exposure to sources of systemic risk.

The volume of fixed-income issues registered with the CNMV sums 17.41 billion euros to mid-March, less than half the figure of one year before.

The CNMV registered 17.43 billion euros of gross bond issuance in the first quarter of 2017 (to 15 March), half the figure for the same period last year and just a third of the total recorded in fourth quarter 2016. These restrained issue volumes are again symptomatic of increased competition and the cheaper finance available through the traditional banking channel, as well as the upkeep of a busy schedule of foreign issuance by large corporations. Securitisation issues fell off most sharply, decreasing by almost 16 billion euros in the first quarter to 1.13 billion, ahead of mortgage covered bonds, down by 4.39 billion vs. the year-ago period, and commercial paper, down by 2.14 billion. Although the issue costs of mortgage covered bonds again benefitted from ECB purchases of covered bonds under its CBPP3 programme[17], issue volumes rely heavily on the outstanding stock of mortgage loans, which continues in decline. Conversely, issuance of non-convertible bonds and debentures expanded 55% to just short of 12 billion euros, accounting for over two thirds of quarterly volumes. These instruments' newfound popularity is based partly on the conviction that interest rates will rise in the coming months.

Fixed-income issuance abroad rises sharply in the year's first weeks, with longer-dated instruments leading the advance.

Fixed-income issuance abroad exceeded 9.30 billion in the first weeks of this year, more than double the figure for the same weeks in 2016. Leading the increase were longer-dated assets, while commercial paper sales contracted slightly. Foreign issuance now account for 35% of the total raised by Spanish issuers (up from 30% in full-year 2016). Issuance by Spanish subsidiaries abroad was also higher at 6.67 billion euros, 26% more than in 2016, with over two thirds raised by non-financial corporations and the rest by the banks. In general, Spanish firms have stuck to debt financing ahead of what they see as the likely rise in the cost of these borrowings once the ECB changes monetary tack.

Gross fixed-income issues TABLE 11

					2016		2017
Registered with the CNMV[1]	**2013**	**2014**	**2015**	**2016**	**3Q**	**4Q**	**1Q[2]**
NOMINAL AMOUNT (million euros)	**138,839**	**130,258**	**136,607**	**139,026**	**13,529**	**55,524**	**17,429**
Mortgage covered bonds	24,800	23,838	31,375	31,643	0	11,500	2,250
Territorial covered bonds	8,115	1,853	10,400	7,250	2,500	2,000	0
Non-convertible bonds and debentures	32,537	41,155	39,100	40,168	1,411	26,358	11,942
Convertible/exchangeable bonds and debentures	803	750	53	0	0	0	0
Asset-backed securities	28,593	29,008	28,370	35,505	4,186	9,625	1,130
Domestic tranche	24,980	26,972	25,147	32,229	3,865	8,541	718
International tranche	3,613	2,036	3,222	3,276	321	1,084	412
Commercial paper[3]	43,991	33,654	27,310	22,960	3,931	6,040	2,108
Securitised	1,410	620	2,420	1,880	0	740	0
Other commercial paper	42,581	33,034	24,890	21,080	3,931	5,300	2,108
Other fixed-income issues	0	0	0	1,500	1,500	0	0
Preference shares	0	0	0	0	0	0	0
Pro memoria:							
Subordinated issues	4,776	7,999	5,452	4,279	733	1,435	0
Other issues	193	196	0	421	0	0	0

17 Purchases under this programme summed over 213 billion euros to 3 March, 31.5% in the primary market.

						2016	2017
Abroad by Spanish issuers	2013	2014	2015	2016	3Q	4Q	1Q[4]
NOMINAL AMOUNT (million euros)	**47,852**	**56,736**	**65,602**	**58,387**	**9,796**	**16,237**	**9,377**
Long term	34,452	35,281	32,362	31,455	4,234	9,740	6,645
Preference shares	1,653	5,602	2,250	1,200	0	0	0
Subordinated debt	750	3,000	2,918	2,333	170	620	0
Bonds and debentures	32,049	26,679	27,194	27,922	4,064	9,120	6,645
Asset-backed securities	0	0	0	0	0	0	0
Short term	13,400	21,455	33,240	26,932	5,562	6,497	2,732
Commercial paper	13,400	21,455	33,240	26,932	5,562	6,497	2,732
Securitised	0	0	0	0	0	0	0

Pro memoria: Gross issuance by subsidiaries of Spanish companies resident in the rest of the world

						2016	2017
	2013	2014	2015	2016	3Q	4Q	1Q[4]
NOMINAL AMOUNT (million euros)	**48,271**	**41,682**	**55,835**	**57,388**	**16,199**	**13,228**	**6,670**
Financial corporations	8,071	9,990	15,424	12,171	4,484	2,226	2,026
Non-financial corporations	40,200	31,691	40,411	45,217	11,715	11,002	4,643

Source: CNMV and Banco de España.

1 Incorporating issues admitted to trading without a prospectus being filed.

2 Data to 15 March.

3 Figures for commercial paper issuance correspond to the amount placed.

4 Data to 31 January

4 Market agents

4.1 Investment vehicles

Financial CIS[18]

Mutual fund assets grow by over 7% in 2016 after a first-quarter dip. The advance owes to unit-holder subscriptions…

Assets under management in mutual funds expanded 7.1% in 2016 to 237.86 billion euros, prolonging the growth trend in place since 2013 (see table 13) despite some degree of slowdown. After a shaky first quarter in which assets shrank by 1.7%, business was brisk enough to more than make up the initial fall. The advance in assets owed almost entirely to investor subscriptions, a total of 13.78 billion euros in the year, offsetting the 492.4 million in redemptions of the opening quarter (see table 12). Performance varied widely by category, as investor preferences shifted with respect to prior years. In contrast to the appetite for riskier products (balanced, absolute return and global funds) evident in the reduced rates environment of 2015, last year saw a gathering move into more conservative options (fixed-income or guaranteed equity funds), as markets were again gripped by bouts of uncertainty.

18 Although this classification includes hedge funds and funds of hedge funds, we make no separate reference to them here, since they are the subject of their own subsection further ahead.

As we can see from table 12, fixed-income funds received the highest net subscriptions, at 7.61 billion euros, followed by passively managed and guaranteed equity funds, with net inflows of 5.79 and 5.48 billion respectively. Global funds too fared well in the year, taking in 3.58 billion net. This contrasted with the 3.2 billion in net outflows from guaranteed fixed-income funds, followed closely by balanced funds in both fixed-income and equity variants (-3.18 billion and -3.03 billion respectively).

… as investors seek refuge from market turmoil in more conservative fund products.

Portfolio returns were on a par with the previous year at just under 1%. Leading the field were equity funds with 4.2% and 2.6% respectively in international and euro categories. In both cases, second-half gains more than countered earlier losses in line with the broader performance of equity prices. Finally, guaranteed fixed income was the only category to close the year in negative terrain (-0.03%), with returns lowest of all in the closing quarter.

Initial losses in riskier fund categories keep a lid on fund returns, which close at just under 1%.

Net mutual fund subscriptions

TABLE 12

				2016			
Million euros	2014	2015	2016	1Q	2Q	3Q	4Q
Total mutual funds	**35,972.7**	**23,466.6**	**13,782.4**	**-492.4**	**2,014.2**	**5,898.7**	**6,361.9**
Fixed income[1]	13,492.7	-5,351.4	7,613.8	2,078.5	1,836.1	2,400.8	1,298.4
Balanced fixed income[2]	15,712.0	21,167.5	-3,177.6	-1,604.4	-562.3	-1,200.0	189.1
Balanced equity[3]	6,567.7	8,153.8	-3,030.2	-712.8	-383.0	-2,312.2	377.8
Euro equity [4]	2,184.9	468.9	-542.9	-251.6	-410.1	-172.6	291.4
International equity[5]	531.8	4,060.5	346.6	-324.4	-99.6	237.2	533.4
Guaranteed fixed-income	-10,453.6	-6,807.4	-3,202.7	-1,268.2	-964.9	-813.1	-156.5
Guaranteed equity[6]	-909.5	-2,599.8	5,478.4	1,752.9	1,520.5	770.1	1,434.9
Global funds	2,182.3	5,805.3	3,579.9	-78.0	-283.2	3,537.5	403.6
Passively managed[7]	4,970.9	-6,264.2	5,790.0	-152.4	1,328.1	2,983.2	1,631.1
Absolute return[7]	1,693.9	4,811.4	946.4	77.4	42.5	467.8	358.7

Source: CNMV. Estimates only.

1 Includes: Euro and international fixed income and money market funds (as of 3Q 2011, money market funds encompass those engaging in money market and short-term money market investments, Circular 3/2011).

2 Includes: Euro and international balanced fixed income.

3 Includes: Euro and international balanced equity.

4 Includes: Euro equity.

5 Includes: International equity.

6 Includes: Guaranteed and partial protection equity funds.

7 New categories as of 2Q 09. Absolute return funds were previously classed as global funds.

The rationalisation drive launched by CIS management companies that slashed fund numbers by 381 in just three years appears to have concluded. The number of funds in operation was 1,805 at the December close, one more than at end-2015. The biggest additions, of 26 and 25 respectively, were in balanced equity and global funds, contrasting with the 64 funds wound up in the guaranteed fixed-income category, in tune with recent movements in industry assets. Fixed-income and guaranteed equity funds also reduced in number by 13 and 7 respectively.

Fund numbers stabilise at just over 1,800 after the weeding-out of recent years...

… while unit-holder numbers parallel asset growth, climbing 7.4% in 2016 to just over 8.2 million.

Paralleling the growth in industry assets, unit-holder numbers rose by 7.4% to upwards of 8.2 million. Global funds took the lead here, attracting 277,000 new investors, ahead of passively managed and fixed-income funds, with an additional 192,000 and 144,000 respectively. The biggest outflows were in balanced equity funds, where investor numbers dropped by 164,000 to 448,000 after tripling in the two previous years. There was shrinkage too in guaranteed and balanced fixed-income funds, whose unit-holder numbers dropped by 164,000 and 86,000 in the year. Note that while the trend has been decreasing in the former category since 2014, for balanced fixed-income funds this was the first reduction in the last three years.

Main mutual fund variables*

TABLE 13

	2014	2015	2016	2016			
Number				1Q	2Q	3Q	4Q
Total mutual funds	**1,951**	**1,804**	**1,805**	**1,799**	**1,809**	**1,810**	**1,805**
Fixed income[1]	359	319	306	309	312	308	306
Balanced fixed income[2]	123	132	148	135	138	146	148
Balanced equity[3]	131	142	168	147	156	166	168
Euro equity[4]	103	109	112	111	111	112	112
International equity[5]	191	200	201	201	197	201	201
Guaranteed fixed-income	280	186	122	171	155	135	122
Guaranteed equity[6]	273	205	198	204	201	196	198
Global funds	162	178	203	185	198	200	203
Passively managed[7]	227	213	220	221	222	221	220
Absolute return[7]	102	97	106	92	98	104	106
Assets (million euros)							
Total mutual funds	**198,718.8**	**222,144.6**	**237,862.2**	**218,339.2**	**220,296.0**	**229,117.4**	**237,862.2**
Fixed income[1]	70,330.9	65,583.8	74,226.4	67,765.4	70,308.6	73,001.3	74,226.4
Balanced fixed income[2]	24,314.3	44,791.8	40,065.6	42,585.9	40,541.2	39,644.2	40,065.6
Balanced equity[3]	13,570.4	21,502.9	16,310.6	20,170.2	17,595.1	15,601.3	16,310.6
Euro equity[4]	8,401.5	9,092.9	8,665.9	8,160.0	7,410.3	7,795.7	8,665.9
International equity[5]	12,266.4	17,143.2	17,678.8	16,162.8	15,424.4	16,274.4	17,678.8
Guaranteed fixed-income	20,417.0	12,375.6	8,679.8	10,818.8	9,854.5	9,066.1	8,679.8
Guaranteed equity[6]	12,196.4	9,966.6	15,475.7	11,862.3	13,277.3	14,064.6	15,475.7
Global funds	6,886.3	12,683.3	20,916.8	12,300.8	16,190.4	20,067.8	20,916.8
Passively managed[7]	23,837.5	17,731.1	23,601.6	17,403.6	18,534.2	21,872.0	23,601.6
Absolute return[7]	6,498.1	11,228.1	12,215.2	11,073.7	11,134.1	11,704.0	12,215.2
Unit-holders							
Total mutual funds	**6,409,806**	**7,682,947**	**8,253,611**	**7,699,646**	**7,800,091**	**8,022,685**	**8,253,611**
Fixed income[1]	1,941,567	2,203,847	2,347,984	2,222,005	2,274,700	2,315,533	2,347,984
Balanced fixed income[2]	603,099	1,130,190	1,043,798	1,113,180	1,075,219	1,033,454	1,043,798
Balanced equity[3]	377,265	612,276	448,491	596,136	556,818	451,040	448,491
Euro equity[4]	381,822	422,469	395,697	412,495	392,465	387,786	395,697
International equity[5]	705,055	1,041,517	1,172,287	1,052,810	1,052,225	1,138,697	1,172,287
Guaranteed fixed-income	669,448	423,409	307,771	378,017	355,577	325,955	307,771
Guaranteed equity[6]	557,030	417,843	552,445	463,423	497,543	515,563	552,445
Global funds	223,670	381,590	658,722	383,066	456,609	625,931	658,722
Passively managed[7]	686,526	554,698	746,233	557,262	609,995	681,545	746,233
Absolute return[7]	264,324	479,182	565,325	505,442	513,724	532,151	565,325
Return[8] (%)							
Total mutual funds	**3.67**	**0.89**	**0.98**	**-1.36**	**-0.03**	**1.34**	**1.05**
Fixed income[1]	2.41	0.10	0.52	0.16	0.23	0.34	-0.21
Balanced fixed income[2]	3.67	0.16	0.27	-1.27	0.30	0.69	0.56
Balanced equity[3]	4.70	0.15	1.19	-2.84	0.00	1.75	2.35
Euro equity[4]	2.09	3.44	2.61	-6.99	-4.49	7.89	7.06
International equity[5]	6.61	7.84	4.15	-4.62	-0.44	4.00	5.46
Guaranteed fixed-income	2.54	0.27	-0.03	0.09	0.19	0.27	-0.58
Guaranteed equity[6]	2.64	1.07	0.19	-0.87	0.37	0.97	-0.27

	2014	2015	2016	2016			
				1Q	2Q	3Q	4Q
Global funds	4.63	2.45	1.99	-2.21	0.02	2.10	2.13
Passively managed[7]	7.74	0.53	1.16	-1.13	-0.03	1.63	0.71
Absolute return[7]	1.98	0.12	0.38	-0.51	0.12	0.65	0.12

Source: CNMV.

* Data for funds that have filed financial statements (i.e., not including those in the process of winding-up or liquidation).

1 Includes: Euro and international fixed income and money market funds (as of 3Q 2011, money-market funds encompass those engaging in money market and short-term money market investments, Circular 3/2011).

2 Includes: Euro and international balanced fixed income.

3 Includes: Euro and international balanced equity.

4 Includes: Euro equity.

5 Includes: International equity.

6 Includes: Guaranteed equity and partial protection equity funds.

7 New categories as of 2Q 2009. All absolute return funds were previously classed as Global funds.

8 Annual return for 2013, 2014 and 2015. Quarterly data comprise non-annualised quarterly returns.

Fund industry expansion carries over into 2017.

Provisional figures for January this year suggest the mutual fund industry remains in expansion. Assets under management are reckoned to have grown by a modest 0.5% to 239 billion euros, with unit-holder numbers up by 150,000 to 8.4 million. The number of funds remains substantially unchanged.

The proportion of less-liquid assets in mutual fund portfolios settles at a reduced 1.2%.

After years of solid improvement, the proportion of less-liquid assets in industry fixed-income portfolios levelled off over 2015 and 2016. In effect, less-liquid assets have moved in the range of 1.2%-1.4% in recent quarters, far from 2009's peak levels bordering on 9%. At the 2016 close, the sum of less-liquid assets was 2.96 billion euros or 1.24% of the total, the same percentage as in September that year and improving slightly on the 1.4% of the 2015 close. The stand-out development was the steady second-half decline in less-liquid assets in financial entities' fixed-income portfolios, which dropped by 471 million euros (-27.9%) between June and December. By contrast, the volume of asset-backed securities defined as less liquid rose by 45 million; not that high a sum, perhaps, but a large jump in relative terms from 59% to 73% of the securitisation portfolio.

Estimated liquidity of mutual fund assets

TABLE 14

	Less-liquid investments					
	Million euros			% total portfolio		
Type of asset	Jun 16	Sep 16	Dec 16	Jun 16	Sep 16	Dec 16
Financial fixed income rated AAA/AA	77	43	43	7%	4%	4%
Financial fixed income rated below AAA/AA	1,611	1,266	1,174	8%	6%	5%
Non-financial fixed income	463	627	760	4%	5%	6%
Securitisations	939	917	984	59%	62%	73%
AAA-rated securitisations	23	20	116	87%	87%	100%
Other securitisations	915	897	869	58%	61%	71%
Total	**3,089**	**2,852**	**2,960**	**8.6%**	**7.6%**	**7.7%**
% of mutual fund assets	**1.4**	**1.2**	**1.2**			

Source: CNMV.

Latest evaluation of the Financial Education Programme for students in secondary education EXHIBIT 3

This programme is a cornerstone of the Financial Education Plan led since 2008 by Banco de España and the CNMV. It numbers among its priorities the promotion of financial education in schools, in line with the recommendations of the Organisation for Economic Cooperation and Development (OECD).

To this end, a programme was launched in 2010 aimed at students in compulsory secondary education (Educación Secundaria Obligatoria, ESO) to which schools can sign up on a voluntary basis. Lessons take place within normal teaching hours. Participating centres are provided with a teacher's manual and textbook for students, available from the Gepeese portal http://www.finanzasparatodos.es/gepeese/es/index.html. Textbook contents are organised into ten topics adapted to the financial literacy learning framework envisioned in the OECD's Programme for International Student Assessment (better known by the acronym PISA). These materials focus basically on savings, means of payment, dealing with banks and responsible consumption.

A series of evaluations have been run to measure the impact of the programme. The latest was conducted in the 2014-2015 academic year with pupils aged 14-15 in state and private secondary schools. The study design specified control and treatment groups, enabling comparisons to be drawn between students receiving financial instruction and the rest. The variables compared included financial knowledge, attitudes to money and saving or spending choices.

Some of the conclusions reached are described below:

- Students who had received the financial education course outperformed the others in financial knowledge tests.

- The programme was especially effective in improving students' understanding of "dealing with banks" (for instance, opening or cancelling a bank account, the consequences of being overdrawn or interpreting bank charges), but its influence was less evident in matters like savings, means of payment or responsible consumption.

- The financial education course delivered a significant increase in the proportion of students who discussed financial matters with their parents, lending weight to the idea that the programme can benefit not just the pupils taking it but also their families.

- The course changed students' attitudes with regard to time preferences for consumption, making them more "patient" when faced with hypothetical spending choices (i.e., with a higher proportion of students choosing future over present consumption).

- After taking the course, a higher percentage of students had taken on some paid work, suggesting that the programme may encourage students to get more involved in their families' financial lives.

Real estate schemes

Despite the improved climate for the construction industry and real estate business since 2015, the key variables of Spanish real estate schemes worsened slightly in the year.

Real estate schemes suffer a degree of setback in 2016…

Real estate funds, hit hardest by the crisis, shed 5.3% of their assets to close the year at 370.1 million euros. Behind the contraction were portfolio losses of 5.4% in full-year terms (-1.8% in the fourth quarter). Although this improves somewhat on the worst years of the crisis, it seems that the real estate upturn has so far failed to work through to fund returns. Investor numbers, finally, were essentially unchanged at the three funds remaining in the market.

… with funds in particular posting negative portfolio returns.

The number of real estate investment companies was likewise unchanged, with a total of six in operation at year-end 2016. Assets in this sub-sector grew by a bare 0.7% to 707.3 million euros, but the number of shareholders jumped from 583 to 682. The reason for this increase was that the last company joining the register, in 2015, recruited in large numbers between the months of April and September.

Despite virtually no change in assets, real estate investment companies see a leap in shareholder numbers.

Hedge funds

Hedge fund assets contracted 1.2% to end the month of November at 2.06 billion euros. By the 2016 close, 48 schemes had filed financial statements with the CNMV. This was the same total as one year before, but with hedge funds up from 37 to 41 and funds of hedge funds down from 11 to 7. This last sub-sector has been shrinking steadily since the start of the crisis, when there were 41 schemes in operation.

Assets in Spanish hedge funds fall by 1.2% in 2016 to somewhere over two billion euros.

Key variables of pure hedge funds varied little in the year. Assets under management summed 1.77 billion euros at end-November, just two million higher than at the 2015 close (see table 15), with a small net outflow (32 million euros) made up by a full-year portfolio gain of 1.75%. Unit-holder numbers, finally, were down by 5.3% to 2,925.

Pure hedge funds offset investment outflows via small portfolio gains.

Main hedge fund and fund of hedge fund variables

TABLE 15

				2016			
	2014	2015	2016	1Q	2Q	3Q	4Q[1]
HEDGE FUNDS							
Number	37	37	41	37	39	40	41
Unit-holders	2,819	3,089	2,925	3,011	2,928	2,916	2,925
Assets (million euros)	1,369.5	1,764.8	1,766.1	1,652.2	1,690.2	1,793.0	1,766.1
Return (%)	5.30	4.83	1.75	-1.30	-0.50	3.62	-0.01
FUNDS OF HEDGE FUNDS							
Number	18	11	7	11	10	10	7
Unit-holders	2,734	1,265	1,242	1,262	1,255	1,244	1,242
Assets (million euros)	345.4	319.8	292.8	306.3	290.7	286.7	292.8
Return (%)	8.48	6.16	0.00	-2.89	0.56	0.48	2.14

Source: CNMV.

1 Data to November 2016, except number of schemes, which are shown to December.

All fund of hedge fund variables continue in retreat (assets, and fund and unit-holder numbers).

Fund of hedge fund assets fell by 8.4% to 292.8 million euros, prolonging the downtrend of recent years. Despite the four funds of funds deregistering in 2016, the number of investors dropped by a lesser 1.8% to 1,242. Portfolio returns were negligible, finally, with late gains (2.1% between September and November) failing to make up the 2.9% losses of the first six months.

Foreign UCITS marketed in Spain

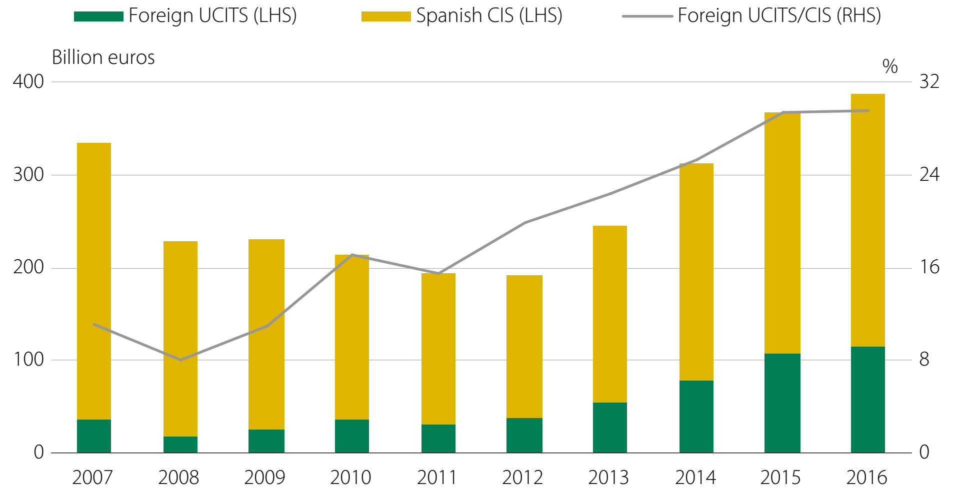
Foreign UCITS keep up the expansion begun in 2012 albeit with some levelling off.

The expansion enjoyed by foreign UCITS since mid 2012[19] continued in 2016 at an appreciably slower pace, with assets up by 6.4% (2.2% in the closing quarter) to 114.99 billion euros. As we can see from figure 20, this was 29.6% of all assets held in collective investment schemes marketed in Spain, on a par with the percentage of the 2015 close.

Mutual funds lead the advance with asset growth of 40%.

The advance was led by fund products, which grew their assets by 9.4% in the last quarter and 39.4% in the full-year period. Meantime, assets under management in companies, accounting for the bulk of investment, rose by a bare 0.9% to 93.65 billion euros. Investor numbers echoed this two-speed growth, with an increase of 24.8% in funds and 2.3% in the companies segment (5.3% and 0.4% from September to December), as far as a combined 1.75 million, 6.3% more than in December 2015. The number of schemes increased in both cases, with the 16 funds and 45 companies joining the CNMV registers in 2016 lifting the year-end total to 441 and 500 respectively. Most new entrants, as in previous years, came from Luxembourg or Ireland. This trend has continued into 2017, with nine new entrants so far giving an end-February total of 958.

Assets of foreign UCITS marketed in Spain FIGURE 20



Source: CNMV.

19 Investment by these schemes tripled between mid-2012 and end-2015.

Outlook

The collective investment industry has come back strongly since 2013 after a run of troubled years, but incremental growth is now noticeably slowing. And while it is true that collective investment should benefit for some time from the low interest rates in the economy, bond market turbulence and equity market volatility are risks to be reckoned with. These two factors have successively boosted products riskier than those normally favoured by Spanish investors, in the initial years of recovery, and then lured them back to supposedly safer funds in segments like fixed income.

Industry expansion can be expected to continue if interest rates stay at current lows, though financial market turbulence could undermine growth.

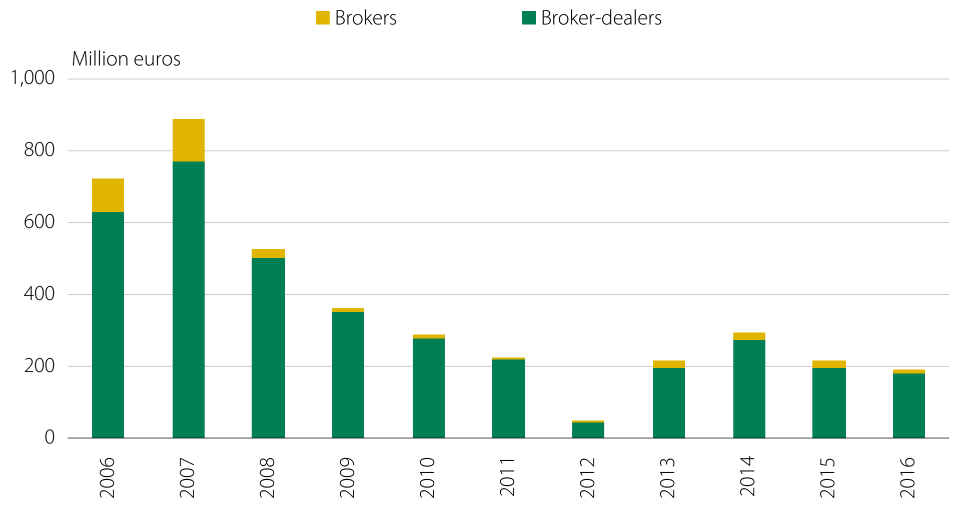
4.2 Investment firms

Broker-dealers and brokers

Spain's investment firms had to contend throughout the year with uncertain, unstable financial markets. This adverse climate made a large dent in sector earnings, which contracted 10.8% to a closing total of 195.2 million euros (see figure 21). This was the second consecutive fall after the solid advances of 2013 and 2014. The number of firms registered with the CNMV closed at 83[20], two more than at end-2015 as a result of eleven new entries and nine deregistrations. Of this total, 45 are passported to operate in other EU countries: six through a branch (the same number as in 2015); and 39 under the free provision of services (40 in 2015).

Investment firm earnings take a new hit in 2016 as markets experience fresh bouts of instability.

Investment firm pre-tax profits[1] FIGURE 21



Source: CNMV.

1 Except investment advisory firms and portfolio managers.

Broker-dealers, who contribute around 90% of sector earnings, experienced a year-long fall in business, with aggregate pre-tax profits dropping by 6% to 181.2 million euros (see table 16). The decline was mainly localised in fee income and results from

Broker-dealer profits, at 181 million euros, are 6% lower than in 2015 on falling fee income…

20 Not including investment advisory firms, which have their own section further ahead.

financial operations. Fee income, specifically, was down 12.4% versus 2015 to 538.6 million euros. Fees from order processing and execution fell most steeply in absolute terms to 245.7 million at the 2016 close, 23.9% less than one year before. These fees remain by a distance the biggest earners for broker-dealers but now make up just 50% of the total compared to the 70% peak of 2010, due to the cut taken in brokerage fees. By contrast, fee income from CIS marketing, the second biggest item under this income statement caption, inched up 2.2% to 75.5 million euros (on top of the 17.4% growth of 2015). We should also highlight the 90% jump in fees for securities depositary and registration services to nearly 50 million euros, double the amount of 2015.

… and a slump in results from financial investments.

The other stand-out development above the net operating income line was the 51.7% slump in results from financial investments to 104.3 million euros. However, help was forthcoming in the shape of a 14.1% decrease in fee expense and a 79.1% increase in net exchange rate differences, which contained the gross income slide at 6.2%, for a year-end figure of 530.6 million euros. With operating expenses falling much more slowly than income (by 5% to 351.9 million euros), this gave a net operating income figure of 169.5 million euros, 9.2% less than in 2015.

Brokers' profits sink by over half, the main culprits being lower fee income and, to a lesser extent, a small increase in operating expenses.

Brokers felt the effects of market instability more acutely in the form of a 52.5% slump in pre-tax profits to 10.1 million euros. In the main, this was for the same reason as broker-dealers, a fall in fee income, exacerbated by a slight increase in operating expenses. Underlying the decline in fees was a drop-off in brokers' two biggest sources of fee income – CIS marketing and order processing and execution – which together make up over 60% of the total. Specifically, fund fee volumes dropped by 5% to 50.5 million euros while order processing and execution fees receded by a steeper 24.1%, similar to the fall experienced by broker-dealers. Meantime portfolio management fees, which had faded in importance in recent years, came back with a 3.2% advance to 11.1 million euros. The result was a gross margin figure 7.2% lower than in 2015 at 108.2 million euros, while the abovementioned rise in operating expenses left net operating income down by 54.2% to 10.1 million euros.

Aggregate income statement (Dec 16) TABLE 16

	Broker dealers			Brokers		
Thousand euros	Dec 15	Dec 16	% change	Dec 15	Dec 16	% change
1. Net interest income	55,570	53,930	-3.0	884	903	2.1
2. Net fee income	422,542	373,552	-11.6	113,904	108,111	-5.1
2.1. Fee income	614,705	538,586	-12.4	135,320	129,682	-4.2
2.1.1. Order processing and execution	322,857	245,700	-23.9	31,845	24,181	-24.1
2.1.2. Issue placement and underwriting	11,556	5,955	-48.5	3,829	3,193	-16.6
2.1.3. Securities administration and custody	24,358	47,843	96.4	521	603	15.7
2.1.4. Portfolio management	22,541	23,738	5.3	10,711	11,054	3.2
2.1.5. Investment advising	2,930	2,547	-13.1	7,636	8,614	12.8
2.1.6. Search and placement	1,497	2,155	44.0	216	40	-81.5
2.1.7. Margin trading	0	0	-	0	0	-
2.1.8. CIS marketing	73,889	75,505	2.2	53,169	50,504	-5.0
2.1.9. Others	155,077	135,143	-12.9	27,393	31,494	15.0
2.2. Fee expense	192,163	165,034	-14.1	21,416	21,571	0.7

Thousand euros	Broker dealers Dec 15	Dec 16	% change	Brokers Dec 15	Dec 16	% change
3. Results of financial investments	215,861	104,292	-51.7	592	245	-58.6
4. Net exchange differences	-142,545	-29,731	79.1	730	154	-78.9
5. Other operating income and expense	14,345	28,554	99.1	467	-1,184	-
GROSS INCOME	**565,773**	**530,597**	**-6.2**	**116,577**	**108,229**	**-7.2**
6. Operating expenses	370,419	351,951	-5.0	93,222	95,142	2.1
7. Depreciation and other charges	12,222	10,451	-14.5	1,180	2,891	145.0
8. Impairment losses	-3,643	-1,304	64.2	27	56	107.4
NET OPERATING INCOME	**186,771**	**169,499**	**-9.2**	**22,148**	**10,140**	**-54.2**
9. Other profit and loss	6,005	11,695	94.8	633	682	7.7
PROFITS BEFORE TAXES	**192,776**	**181,194**	**-6.0**	**22,781**	**10,822**	**-52.5**
10. Corporate income tax	51,485	40,673	-21.0	5,515	3,840	-30.4
PROFITS FROM ONGOING ACTIVITIES	**141,291**	**140,521**	**-0.5**	**17,266**	**6,982**	**-59.6**
11. Profits from discontinued activities	0	0	-	0	0	-
NET PROFIT FOR THE YEAR	**141,291**	**140,521**	**-0.5**	**17,266**	**6,982**	**-59.6**

Source: CNMV.

Profitability ratios edge ahead despite falling sector earnings.

The return on equity (ROE) of investment firms edged up from 15.3% at the 2015 close to 16% in 2016 despite the drop in sector earnings. The advance owed entirely to broker-dealers who grew their ROE more than one percentage point to 16.2%. Brokers, meantime, suffered a heavy dent in profitability, with ROE deteriorating from 21.5% to 11.5% (see left-hand panel of figure 22).

Improved statistics for loss-making firms (two fewer) and the volume of their losses (-11%).

The number of loss-making entities closed at 18, compared to 20 at end-2015. Specifically, 7 broker-dealers and 11 brokers reported losses in the year, one fewer in both cases than at the 2015 close (see right-hand panel of figure 22). The cumulative losses of these firms totalled 16.4 million euros, 11.4% less than in the previous year.

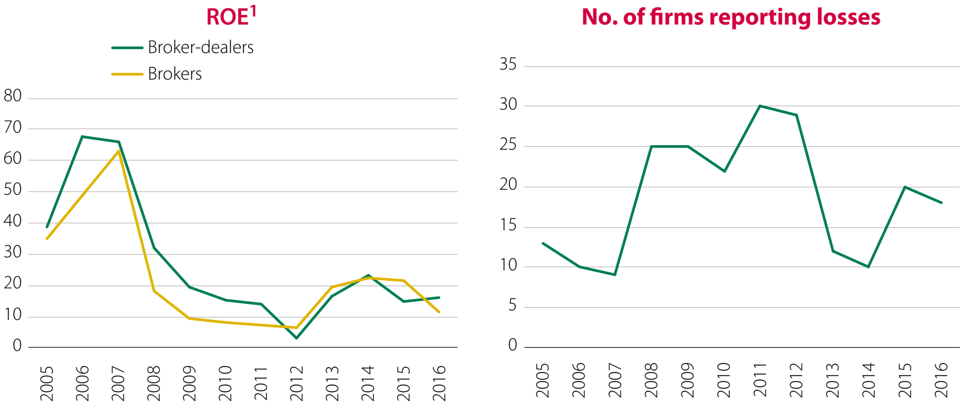
Sector solvency conditions remain acceptable through 2016.

Investment firms' solvency conditions remained acceptable throughout the year. The capital adequacy ratio at firms that have to file solvency statements[21], calculated as regulatory capital over the minimum capital requirement, held more or less flat between December 2015 and December 2016 at 4.7 for broker dealers (4.8 last year) and 2.3 for brokers (up from 2.2%) (see figure 23). It should be said, however, that these comfortable margins are calculated on the basis of relatively small quantities of own funds, especially in the broker segment.

21 As of 1 January 2014, CNMV Circular 2/2014, of 23 June, on the exercise of various regulatory options regarding the solvency of investment firms and their consolidable groups exempts some firms from the obligation to report on their compliance with solvency standards, an exemption that in September extended to 12 of the 83 firms registered with the CNMV.

Pre-tax ROE of investment firms and loss-making entities

FIGURE 22

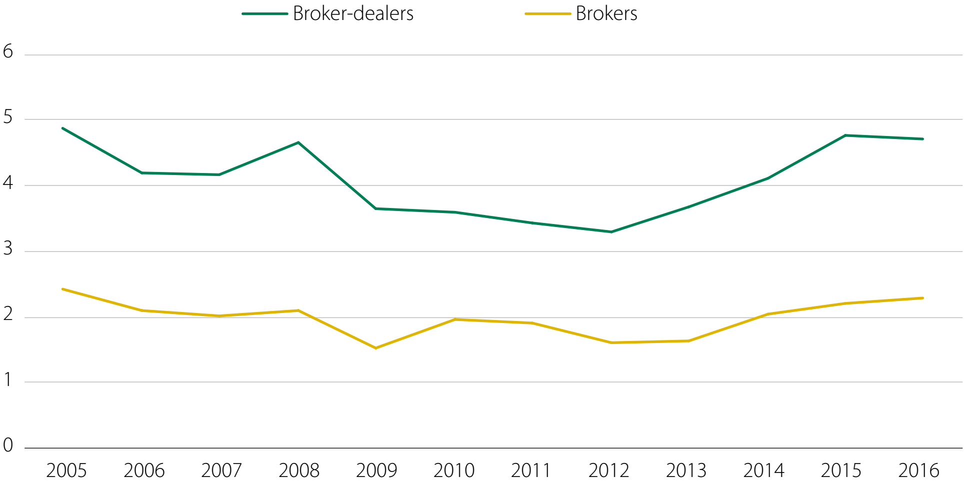


Source: CNMV.

1 ROE based on pre-tax earnings.

Investment firm capital adequacy (surplus of regulatory capital over minimum requirement,%)

FIGURE 23



Source: CNMV.

Investment advisory firms

Investment advisory firms forge ahead with an 11% increase in assets under advice.

Investment advisory firms continued to grow their business throughout 2016. Assets under advice, at 28.2 billion euros, were up by 11% with respect to the 2015 close, practically doubling the figure for 2012. As we can see from table 17, the sector's customer mix was broadly as before, with retail investors' assets accounting for 26.4% (26.7% in 2015), professionals for 19.2% (20.1% in 2015) and eligible counterparties[22] for 54.4% ("others" heading).

Fee income, however, contracts by 8.2% in the year.

Despite the higher asset volumes under advice, fee income decreased by 8.2% in the year to 52.1 million euros, with fees charged directly to clients leading the decline (down 10.4% against the 2.3% increase in fees from other segments). Finally, six more firms entered the business in 2016 for a year-end total of 160.

22 Eligible counterparty is the definition the MiFID traditionally reserves for banks, other financial institutions and governments as investors in need of less protection.

Main investment advisory firm variables*

TABLE 17

Thousand euros	2014	2015	2016	% change 16/15
NUMBER OF FIRMS	**143**	**154**	**160**	**3.9**
ASSETS UNDER ADVICE[1]	**21,379,858**	**25,366,197**	**28,154,829**	**11.0**
Retail customers	5,707,640	6,777,181	7,435,241	9.7
Professional customers	4,828,459	5,109,979	5,413,702	5.9
Others	10,843,759	13,479,037	15,305,886	13.6
NUMBER OF CUSTOMERS[1,2]	**4,635**	**5,544**	**5,895**	**6.3**
Retail customers	4,319	5,156	5,476	6.2
Professional customers	276	319	326	2.2
Others	40	69	93	34.8
FEE INCOME[3]	**47,616**	**56,726**	**52,050**	**-8.2**
Fees received	**47,037**	**55,781**	**51,314**	**-8.0**
From customers	37,940	45,180	40,464	-10.4
From other entities	9,098	10,602	10,850	2.3
Other income	**579**	**945**	**736**	**-22.1**
EQUITY	**26,454**	**25,107**	**40,255**	**60.3**
Share capital	5,576	5,881	6,834	16.2
Reserves and retained earnings	8,993	7,585	27,127	257.6
Profit/loss for the year	11,885	11,531	7,988	-30.7
Other own funds	–	76	-1,694	–

* Provisional data (except number of entities) based on data from 94% of IAFs registered with the CNMV.
1 Period-end data at market value.
2 Pre-2015 figures refer to number of contracts.
3 Cumulative figures for the period

Outlook

Two main factors are weighing on investment firm business after several years of growth. Equity market instability is one, since firms' main business lines rely heavily on trading activity. Another is the growing penetration of domestic banks in traditional investment firm activities, which is eating into fee income from order processing and execution. It bears mention, finally, that the restructuring of Spain's financial system has had little real impact on the sector: only one of the nine deregistrations recorded in 2016 was the result of a takeover (the remainder resulting from a change in corporate form or else dissolution), compared to two in 2015.

The main risks for investment service providers have to do with unstable equity markets and growing encroachment from the banks.

Measures regarding the marketing to retail clients of CFDs and other speculative products

EXHIBIT 4

In Spain and other European countries, we see more and more cases of financial intermediaries marketing increasingly complex and risky products to retail clients. These include contracts for difference (CFDs), rolling spot foreign exchange ("forex products" for the purposes of this exhibit) and binary options.

The sale of such products to retail customers has long been a cause of concern for the CNMV. In October 2014, it issued a warning about the risk or, indeed, the likelihood of customers suffering losses on CFDs[1], and in July 2016, coinciding with an ESMA communication on transacting in CFDs, binary options and other speculative instruments, it issued a further warning about the risks attached to trading in these products.

CFDs, forex products and binary options, and their attendant risks, are hard to grasp for most retail investors. According to studies carried out by the CNMV and other securities supervisors, the vast majority of retail clients dealing in them systematically lose money. The latest CNMV study, run from 1 January 2015 to 30 September 2016, found that losses extended to 82% of customers trading in CFDs. The combined losses of 30,656 customers, including transaction costs and fees, summed 142 million euros (an overall 52 million in straight losses and a further 90 million in fees and other costs).

This being so, some European Union countries have proposed, and in some cases implemented initiatives to, for example, limit the level of leverage available to clients trading in this kind of product or restrict their sale by imposing constraints on their advertising or their distance selling through call centres.

Without ruling out future actions along these lines, the CNMV has just launched a series of measures to strengthen the protection of retail investors in Spain acquiring CFDs, forex products or binary options:

- The CNMV has imposed the following requirements on providers offering CFDs or forex products with a leverage ratio higher than 10:1 or offering binary options to retail clients established in Spain, when such offers are not within the scope of an investment advisory service:

  – They must warn clients expressly that the CNMV considers such products to be inappropriate for retail investors in view of their complexity and risk.

  – Also, they must inform clients about the costs they will incur if they decide to close their position shortly after taking out the product. In the case of CFDs and forex products, clients should be advised that the leverage effect can cause losses steeper than their initial outlay on acquiring the product.

  – They should procure from their clients either a written or recorded verbal statement which proves they are aware that the product they are about to acquire is particularly complex and that the CNMV considers it inappropriate for retail investors.

  – The advertising materials used by intermediaries to promote CFDs, forex products or binary options should always carry a warning about the difficulty of understanding these products and the fact that the CNMV considers that their complexity and risk makes them inappropriate for retail investors.

  The providers bound by these requirements must adapt their procedures and systems so they can issue the above warnings and procure the written or verbal statements as soon as possible, and certainly within one month of receiving the corresponding notification.

- The CNMV intends to approach securities supervisors in other countries so they impose the same warnings and requirements on intermediaries registered in their jurisdictions who market this kind of product to Spanish clients under the free provision of services.

Through ESMA, the CNMV will actively champion the coordinated adoption of measures at European level in order to strengthen investor protection in this domain.

1 A warning also reproduced in the CNMV Bulletin for the third quarter of 2014, and the CNMV annual report for the same year.

4.3 CIS management companies

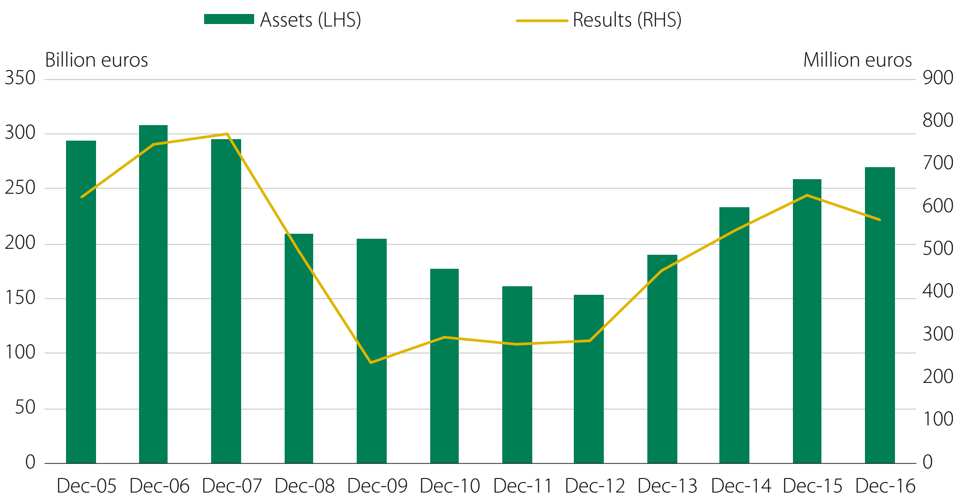
After a slow first half, CIS management companies fight back with asset growth bordering on 5%...

Management companies shook off the business slowdown of the first six months to close with over 272 billion euros in assets under management, 4.8% more than in 2015. The sector thus prolongs the recovery begun in 2013 after several years' decline (see figure 24). Over 90% of this advance traced to securities investment funds which, as stated elsewhere, grew their assets by more than 7%. It is also important to remember that this is a heavily concentrated sector: the three biggest managers commanded a combined 43% of total managed assets at mid-2016, little changed from the level recorded at end-2015.

… but lower average management fees prevent this feeding through to profits.

Aggregate pre-tax profits, at 600.8 million euros, were nonetheless 4.1% lower than in 2015, reflecting the combined effect of increased operating expenses (up 10.8%) and falling fee income (-2.3%). Income from CIS management fees, companies largest-earning item, fell 3.9% due to a drop in the average management fee from 0.95 to 0.87% of assets (see table 18). The difference here is mainly explained by the shift in the fund mix to less risky categories which tend to carry lower fees. Management company ROE, at 55%, was on a par with the levels of the 2015 close. Finally, the number in losses rose from 11 to 13 in the year, while the volume of their combined losses more than doubled to 7.4 million euros.

CIS management companies: Assets under management and pre-tax profits FIGURE 24



Source: CNMV.

With sector reorganisation laid to rest, the number of CIS managers starts to recover.

Sector reorganisation, begun in the wake of the restructuring of the Spanish financial system, now seems to be nearing its end. In 2016, only one closure was attributable to this process. Meantime six new companies entered the register, for a year-end total of 101, joined by three more in January and February this year.

CIS management companies: Assets under management, Management fees and fee ratio TABLE 18

Million euros	Assets under management	CIS management fee income	Average CIS management fee (%)	Fee ratio (%)[1]
2009	203,730	1,717	0.84	68.1
2010	177,055	1,639	0.93	67.2
2011	161,481	1,503	0.93	65.6
2012	152,959	1,416	0.93	64.6
2013	189,433	1,588	0.84	62.0
2014	232,232	2,004	0.85	61.8
2015	258,201	2,442	0.95	63.7
2016	272,782	2,347	0.87	61.7

Source: CNMV.

1 Ratio of fee expenses for fund marketing to fee income from CIS management.

4.4 Other intermediaries: Venture capital

The year sees the advent of more closed-ended investment vehicles created under Law 22/2014 to promote venture capital as an alternative financing route.

Law 22/2014 of 12 November allowed the creation of new types of vehicle to promote venture capital as an alternative financing route. The first fifteen of these vehicles appeared in 2015, comprising eight SME venture capital funds, six SME venture capital companies and one closed-ended collective investment company, joined in 2016 by a further three, eight and five respectively. The year also saw the first deregistration of a new-generation vehicle, concretely an SME venture capital company, and the creation of the first two European venture capital funds and the first closed-ended collective investment fund (see table 19).

The number of traditional vehicles also rises, lifting the total of venture capital schemes in operation to 291, 26 more than at end-2015.

Among "traditional" vehicles, the year ended with 166 venture capital funds in operation after 23 entries and five closures, while the number of venture capital companies dropped to 99 after 10 entries and 14 deregistrations. The total number of venture capital schemes (not including closed-ended vehicles) was accordingly 291 at 31 December 2016, compared to 265 at end-2015. At the same date there were seven closed-ended vehicles, six companies and a fund, as well as 81 closed-ended investment scheme management companies (a term that includes the old venture capital management companies), after ten entries and six closures.

Sector expansion continues into 2017.

The first two months of 2017 brought further movements in the list of venture capital schemes, producing an end-February total of 294 in operation (180 funds and 114 companies), alongside 84 closed-ended investment scheme management companies and the same seven closed-ended vehicles. Finally, the addition of one new SME venture capital fund lifted their number to 13 at the February close.

Movements in the venture capital entity register in 2016 TABLE 19

	Situation at 31/12/2015	Entries	Retirals	Situation at 31/12/2016
Entities				
Venture capital funds	148	23	5	166
SME venture capital funds	8	3	0	11
European venture capital funds	0	2	0	2
Venture capital companies	103	10	14	99
SME venture capital companies	6	8	1	13
Total venture capital entities	**265**	**19**	**10**	**291**
Closed-ended collective investment funds	0	1	0	1
Closed-ended collective investment companies	1	5	0	6
Total closed-ended collective investment entities	**1**	**6**	**0**	**7**
Closed-ended investment scheme management companies[1]	**77**	**10**	**6**	**81**

Source: CNMV.

1 A name that now applies to both the old venture capital scheme management companies and the management companies of the new closed-ended investment schemes.

Investment in the venture capital industry amounts to 2.99 billion euros in 2016, 3% more than in 2015, after a run of major deals in the closing months.

Preliminary data from the Spanish Venture Capital Entity Association (ASCRI) for the second half of 2016 suggest that the industry has come back strongly after a nine-month lull marked by political uncertainty and a dearth of major operations. In effect, the closing months brought a run of seven large-scale deals (in excess of 100 million euros), all closed by international operators, which helped carry annual investment volumes to 2.99 billion euros, 3% more than in 2015. In the meantime, midmarket transactions (between 10 and 100 million euros) sank 30.9% in volume terms, leaving small-scale deals as once more the market norm, accounting for 88.4% of all transactions.

A successful fundraising effort led by public funds Innvierte and FOND-ICO Global.

By phase, the bulk of deals (75%) were in venture capital (seed and start-up), with a total of 436 in the year, though their share of total investment volume was a meagre 13%. One welcome development was the successful fundraising drive by Spanish private operators, which brought in over two billion euros, 52% more than in 2015. Much of this advance can be laid at the door of public funds Innvierte and FOND-ICO Global.