I Securities markets and their agents: Situation and outlook

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1 Executive Summary

– The most recent macroeconomic environment has been marked by the accelerating growth in GDP in most advanced and emerging economies, which is also taking place with a high level of synchrony. The economic cycle is still at a more advanced stage in the US, where the Federal Reserve maintains the process of raising interest rates[1], while the monetary policy stance in the euro area remains expansive although the ECB is reducing the volume of bond purchases in the market and is starting to show signs of a change in its strategy. In this context, it is likely that forces moving in opposite directions will condition the development of economic activity over the coming months. Factors such as the tax reform in the US might have a positive impact on activity in that economy, while growing tensions relating to a possible trade war would be harmful. In its latest forecasts, released in April, the IMF foresees a slight acceleration in global GDP growth this year, which it predicts will rise by almost 4%, but it highlights the presence of some risks.

– The most significant event in international financial markets in this period was the return of volatility to equity markets, which, influenced by the publication of certain data on the US labour market, an upward trend in energy prices and fears of a trade war, recorded, with few exceptions, falls. The falls in European indices ranged between 2% of the Euronext 100 and 8.2% of the UK's FTSE 100[2]. Japanese indices lost almost 6%, while US indices performed a little better and ranged between -2.5% of the Dow Jones and 2.3% of the NASDAQ. Despite the falls, market risk remains high in some companies.

– In international bond markets, short-term yields reflected the differences in monetary policies applied. Consequently, the US three-month yields rose by over 60 bp between January and March, while they remained virtually unchanged in the euro area. The yields on longer-term bonds rose in the first few weeks of the quarter and then fell; leaving cumulative balance to the end of March that varies depending on the country. Most noteworthy was the increase in the yield of the ten-year sovereign bond in the US (33 bp, up to 2.74%) and in the United Kingdom (16 bp, up to 1.35%) and the fall in several countries in the euro area, including Spain, Portugal and Italy, driven by the improvements in credit ratings published over recent months.

1 The closing date for this report is 31 March except for the IMF's forecasts for GDP growth and the information of the Financial Accounts corresponding to the fourth quarter of 2017, both of which were published in April.

2 Only the Italian index recorded growth (2.6%).

- The Spanish macroeconomic environment was favourable in 2017 as GDP continued growing at a good rate (3.1%), inflation gradually declined after the initial highs and the public deficit also narrowed, to 3.1% of GDP, favoured not only by the buoyancy of the economy, but also by the significant savings in the debt interest expense. Economic expansion allowed the number of employed people to grow by approximately 500,000, which meant that the unemployment rate, although still high, ended 2017 at 16.55% of the active population, two percentage points down on 2016. Since then, the political instability in Catalonia has remained a source of uncertainty, but at least for now its impact on economic activity is not significant. In April, the IMF confirmed the positive situation of the Spanish economy, releasing a forecast for the year of 2.8%, 0.4 percentage points up on its January forecast.

- Banks continue to operate in a complex scenario of low interest rates that pressures downward on their profitability. However, the buoyant economy remains a favourable factor for the financial sector in Spain. In fact, the appearance of attractive investment projects and healthy private consumption are favouring a recovery in lending. However, the volume of non-performing assets remains high and, as in other European economies, a certain overcapacity is noted, as well as a range of latent challenges, some of which are related to the development of new technologies applied to finance.

- The Spanish financial markets stress index, which remained at very low levels in 2017, rose at times to highs of 0.27 (the threshold separating low and medium stress levels), mainly as a result of volatility hikes in equity markets. Some episodes arose as a result of certain sudden changes in expectations regarding monetary policy in the US and to the perception of restrictions to global trade. The highest stress levels were recorded in the equity, derivatives and exchange rate segments. Since then, the index fell to values of around 0.2 at the end of March.

- More specifically, in Spanish equity markets, the Ibex 35 closed the first quarter of the year with a fall of 4.4%, in line with the performance of other benchmark European indices and in a context of higher volatility. European stock markets were dragged along by US markets at times in which the positive surprises in US employment data led to a change in expectations about interest rate hikes by the Federal Reserve. At the end of the quarter, the uncertainties generated with regard to a possible trade war led to new price falls, which were concentrated in large-cap companies. In this context, the trading of Spanish securities rose in the first three months of the year by 5.4%, to 234 billion euros, with growth in trading recorded in foreign markets and MTFs (of 32%) and a fall in the home market (of -6.6%), whose market share fell to 61.4% (68.3% in 2017).

- In fixed-income markets, expectations relating to the change in the ECB's monetary policy, in a context of strong growth, led to rises in medium-term and long-term interest rates in several European economies. In Spain, in contrast, the improvement in the rating of the ten-year sovereign bond had a greater impact and led to a substantial fall in the risk premium in the first quarter of the year, which dropped from 114 bp to 67 bp at the end of March. A total of 19.96 billion euros of gross fixed income issues were registered with the CNMV in the first quarter, 22% down on those registered in the same period of 2017. The volume of issues, which has remained at low levels, continues to be conditioned by financial institutions' lower financing requirements, competition from traditional bank financing - whose conditions have improved significantly - and maintenance of the international issuing activity of large companies (between January and February, fixed-income issues abroad amounted to almost 15 billion euros).

– Assets managed by mutual funds grew by over 11% in 2017 to 265 billion euros, mainly as a result of the high level of subscriptions by unit-holders, which in total exceeded 21 billion euros. Fund returns of 2.4% also had a positive effect on assets under management. It is worth noting that unit-holders are opting for higher-risk fund categories, such as global funds and equity funds in their search for higher returns in the current context of low interest rates. Against this backdrop, CIS management companies, which grew in number from 101 to 108, reversed the downward trend of recent years and recorded a 25.6% rise in their profit before tax to 755 million euros. The provisional data for January 2018 indicate that the sector's expansion continues as assets under management rose by 2.2% to over 270 billion euros.

– Broker-dealers and dealers operated in more favourable conditions in 2017 than in previous years, particular in the case of dealers. Even though these intermediaries only obtained 12% of the total revenue generated by investment services, in which credit institutions play a more prominent role, their profits grew by almost 10% in 2017. This increase is due to the gradual change in their business model, in which the traditional main source of income (order processing and execution) has been losing importance, while other business lines, such as CIS marketing, portfolio management and investment advisory services have taken on greater importance. The sector's solvency conditions remain satisfactory, although between 2016 and 2017 there was a fall in the surplus of regulatory capital over minimum requirements.

– The report includes two monographic exhibits:

  • The first describes the announcement of the ECB on publication of an unsecured overnight rate and creation of a working group on alternative benchmarks in the euro area.

  • The second lists the measures specified last year by the European Commission regarding its Action Plan on Building a Capital Markets Union in 2019.

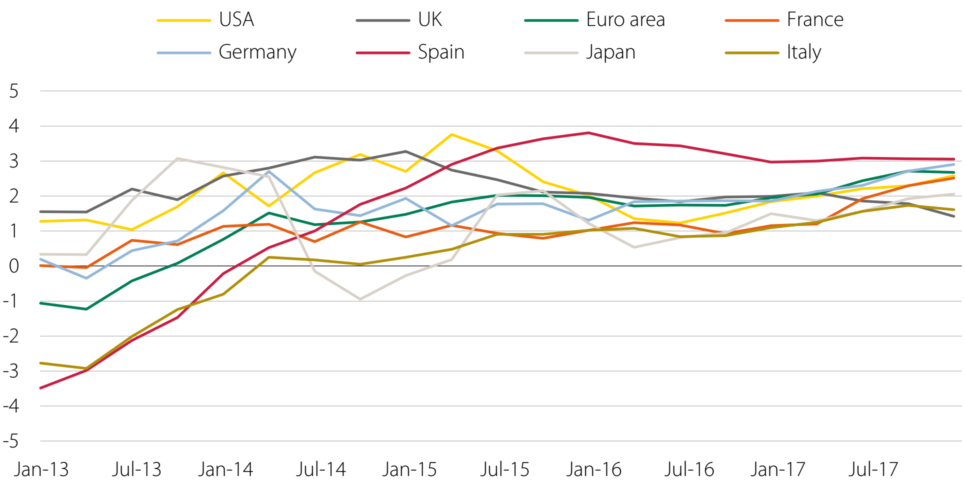
2 Macro-financial background

2.1 International economic and financial developments

The global economy continued growing at a good rate and across the board in 2017, with global GDP rising by 3.8%.

The global economy continued growing at a good rate across the board in the different countries in 2017, rising by 3.8%, over half a percentage point higher than the rate recorded in 2016. By region, US GDP grew by 2.3% over the year (1.5% in 2016), while growth in most euro area economies was greater than in 2016. Specifically, Germany and Spain recorded strong growth, with rates of 2.5% and 3.1%, respectively (1.9% and 3.3% in 2016). GDP growth in France accelerated significantly and reached 1.8% (1.2% in 2016), in contrast with the more moderate increase in Italy (1.5% compared with 0.9% in 2016). For its part, growth in the United Kingdom slowed to 1.8% (previously, 1.9%) due to the effect on inflation of the depreciation of the pound and, ultimately, on domestic demand. Lastly, Japan's GDP accelerated to 1.7%, 0.8% points above the figure recorded in the previous year.

Annual % change in GDP FIGURE 1



Source: Thomson Datastream.

In its last meeting, the Federal Reserve decided to raise its target range for the federal funds rate to 1.5%-1.75%…

At its last meeting, held on 20 and 21 March, the Federal Reserve decided to raise its target range for the federal funds rate to 1.5%-1.75% due to the progress recorded in the job market and the improved outlook for growth in the economy. The Federal Reserve expects to carry out two or three more rate hikes this year, although the speed of these rises will depend on the how economic conditions and inflation evolve relative to the objectives of the institution.

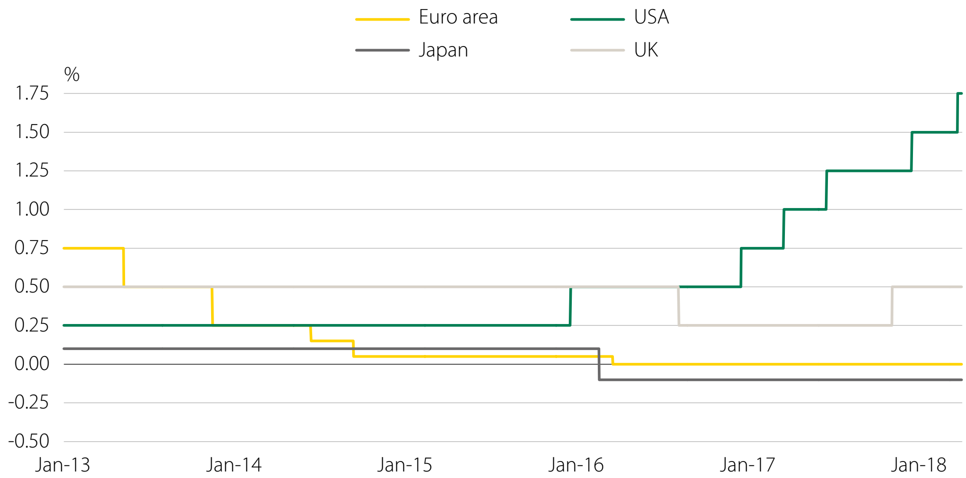
... while the ECB decided to maintain the official interest rate unchanged and confirmed that its asset purchase programme would continue until September.

For its part, the European Central Bank (ECB) announced in March its decision to maintain the main refinancing rate, the deposit facility rate and the marginal lending rate at 0%, -0.4% and 0.25%, respectively, and its expectation that these rates will remain low over a long period. Similarly, the ECB confirmed that the volume of its monthly asset purchases will be 30 billion euros until the end of September or beyond if necessary. It also stated that its monetary policy stance should be accommodative as, even though the euro area is growing at a good rate across the board, inflation measures, including core inflation, remain at low levels and still need to converge to rates lower than, but close to, 2%.

Lastly, the Bank of England decided to maintain its bank rate at 0.5% and continue with the same amounts in its asset purchase programme. The inflation rate, which fell from 3% in January to 2.7% in February, is expected to continue falling gradually although it will remain at levels above 2% in the short term. Similarly, the Bank of Japan maintained both its official interest rate, which remains at -0.1%, and the amount of its asset purchase programme, with the aim of controlling the interest rate curve.

For their part, both the Bank of England and the Bank of Japan decided not to make any changes to official rates or the amounts of their purchase programmes.

Central bank interest rates FIGURE 2



Source: Thomson Datastream. Data to 31 March.

Short-term interest rates followed the trend recorded in 2017 during the first quarter of the year and continued to diverge between regions as a result of the different monetary policies applied. Thus, three-month rates in the US, which had risen by 70 bp in 2017, recorded an increase of 62 bp in the first quarter of 2018 to stand at 2.31% at the end of March, discounting two additional rate rises by the Federal Reserve. In contrast, short-term interest rates in the euro area, which had fallen slightly in 2017 for the three-month benchmark rate (-1 bp) and for the twelve-month benchmark rate (-10 bp), remained unchanged in the first three months of 2018, which reflects the expectation that the ECB will not raise official interest rates in the short term.

Short-term interest rates continued diverging between regions in the first quarter of 2018, due to the different monetary policies applied.

Announcement of the ECB on publication of an unsecured overnight rate and creation of a working group on alternative benchmarks in the euro area EXHIBIT 1

Benchmarks, whose regulation in the European Union has been applicable since 1 January 2018 – Regulation (EU) 2016/1011 – play an essential role in the economy and in the financial sector because they are widely used for setting prices in numerous financial instruments and contracts and at the same time they have a significant influence on the implementation and monitoring of the transmission of monetary policy.

In their current format, the reduction in transactions and volume in the underlying markets that they represent call into question their medium and long-term sustainability. Therefore, in line with the FSB's recommendations, a transition is required towards improved benchmarks that are more representative of the economic reality that they aim to measure, as well as towards alternative benchmarks that reduce the excessive reliance on current benchmarks.

In this context, the European Central Bank has announced its intention to publish, prior to 2020, an unsecured overnight interest rate based totally on the actual transactions in euros that banks report daily to the ECB for the purpose of money market statistical reporting.

At the same time, the ECB, the European Commission, the European Securities and Markets Authority (ESMA) and the Belgian authority responsible for supervising the administrator of critical benchmarks in the euro area (FSMA, Financial Services and Markets Authority), have launched the creation of a working group to search for a risk-free rate to act as the basis for establishing an alternative to current benchmarks, basically Euribor and Eonia. The working group will be chaired by a private sector representative and with a secretariat provided by the ECB.

In order to fulfil its mission, three subgroups have been created that will report to the main group and whose lines of work will be as follows:

1. Identifying an alternative euro area risk-free rate consistent with IOSCO principles and Regulation (EU) 2016/1011 which may be used for new derivatives and other contracts, including mortgage contracts. With this aim, one or several subgroups will be set up, chaired by the private sector, which will analyse potential RFRs. Their conclusions and proposals will be announced at the end of 2018.

2. Study of robustness of contracts to a possible cessation of the benchmarks. This line of work will involve the participation of market representatives and end-users, as well as the International Swaps and Derivatives Association (ISDA), which will provide its experience in the ongoing work on derivatives. This work will be completed by 2019.

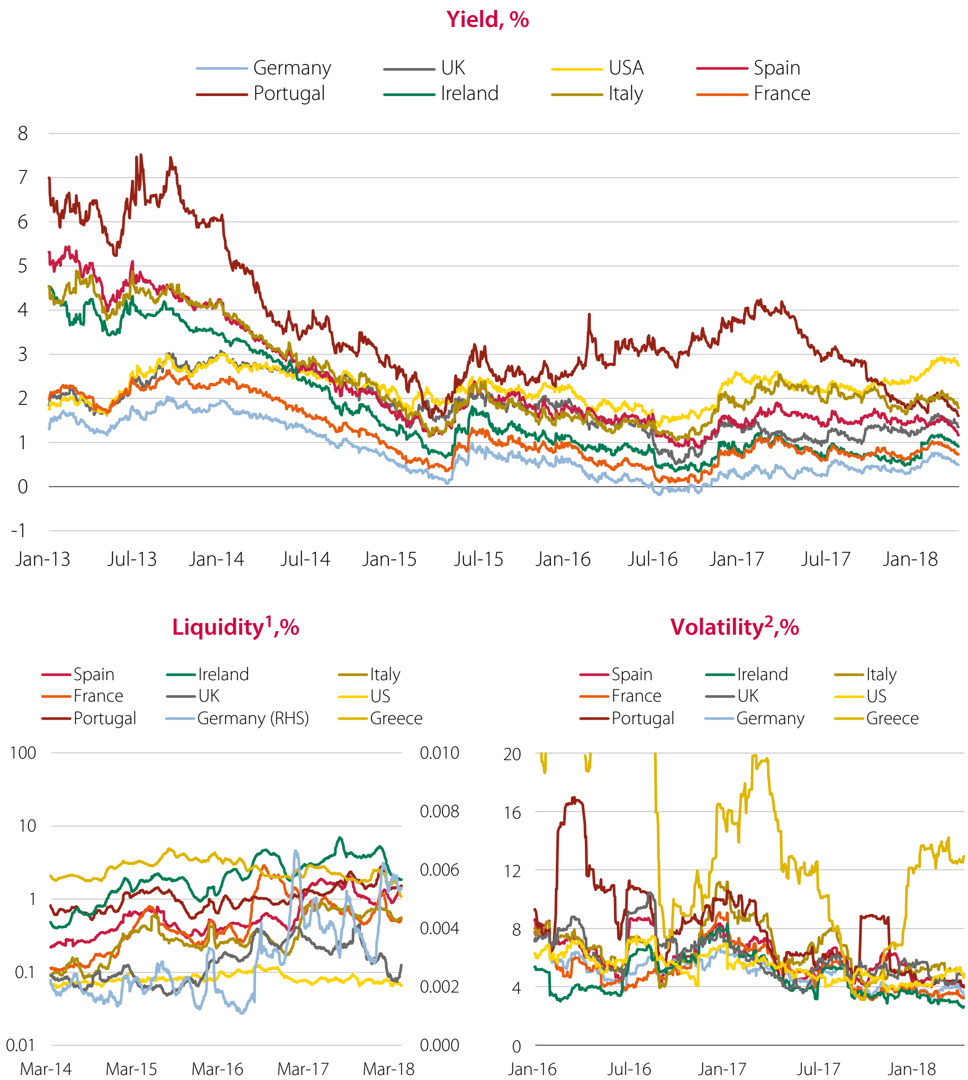
3. Development of an adoption plan for the new benchmarks and, if necessary, the creation of a transition plan for legacy contracts. Taking into account the existence of retail contracts and their implications from the perspective of consumer protection, ESMA will coordinate and act as secretary for a subgroup responsible for this line of work, which will also attempt to identify appropriate alternatives for the current term-structured benchmarks. This work will also be completed by the end of 2019.

These initiatives follow the recommendations of the FSB and the same line taken by other jurisdictions, such as the United Kingdom, the United States, Switzerland and Japan. This will establish the foundations for progress and the use of alternative benchmarks to those currently used, which will make it possible to reduce excessive exposure to these benchmarks and design a potential orderly transition without any disturbance for markets and end users, as well as for the financing of the economy and financial stability.

Yields on long-term government bonds performed unevenly in 2017. While in the US, the yield on the ten-year sovereign bond remained unchanged, in the euro area, yields rose by around 20 bp in most countries, partly as a result of strong economic growth in the region and the expectation that monetary policy would start to normalise in the medium term. Portugal and Greece did not follow this trend and the yields on their sovereign bonds fell by 183 bp and 301 bp, respectively, given the significant improvement in the perception of credit risk, confirmed by the improvement in their credit rating in the former case and, in the latter case, the approval of the disbursement of an additional tranche of the financial support offered by the European Stability Mechanism (ESM).

In 2017, yields on long-term government bonds remained unchanged in the US, while they rose in some euro area countries slightly, and in others fell significantly as a result of the improvement in the perception of their credit risk.

Ten-year sovereign bond market indicators FIGURE 3



Sources: Bloomberg, Thomson Datastream and CNMV. Data to 31 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.

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

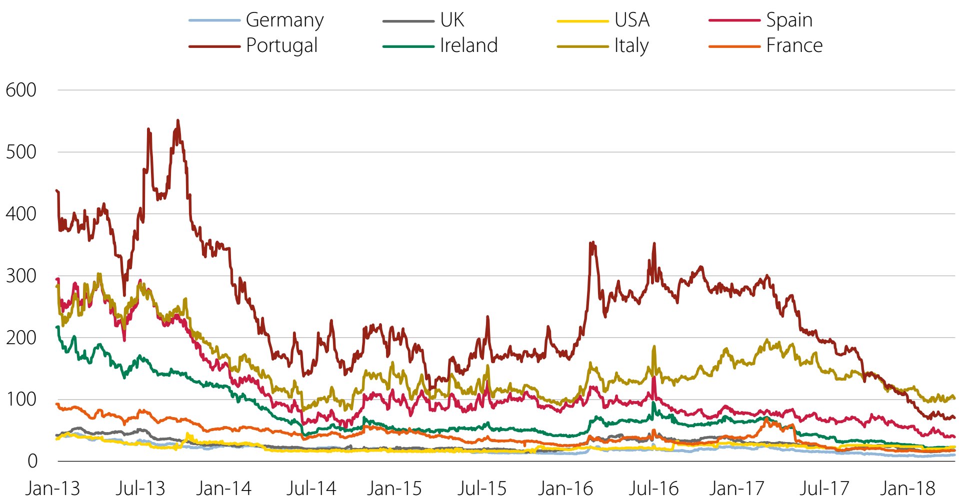
In the first quarter of 2018, sovereign bond yields rose across the board until the middle of February and then fell, leaving an uneven balance between countries.

In the first quarter of 2018, until mid-February, sovereign bond yields rose in most advanced economies, buoyed by the improved macroeconomic outlook, and subsequently fell leaving an uneven balance between countries at the end of March. No significant increase in the quarter was recorded in the US, where the ten-year bond yield rose by 33 bp to 2.74% as a result of the expected effects of the tax reform approved at the end of December, which is likely to have an upward impact on inflation. The performance of yields in the euro area was more uneven: yields rose in some countries as a result of the possibility of a normalisation of monetary policy in the medium term, while in others the downward impact of the improvement in their rating was more significant. Specifically, yields rose by 7 bp in Germany and 11 bp in Holland, to 49 bp and 64 bp, respectively. In contrast, falls were recorded in the yields of Portugal (-32 bp to 1.61%) and Spain (-40 bp to 1.16%), as a result of the aforementioned improvements in their credit ratings.

Sovereign risk premiums show little variation, as, even though the economy performed positively, they start from very low levels.

The sovereign credit risk premiums of most advanced economies (assessed through the five-year CDS of public debt instruments) are at very low levels. Therefore, despite the positive performance of the economy, they underwent few changes in the first quarter of the year. There were only significant falls in Greece (-45 bp, to 336 bp), Portugal (-24 bp, to 70 bp), Italy (-16 bp, to 101 bp) and Spain (-18 bp, to 39 bp), as a consequence of the improvements in their ratings in the last six months.

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



Source: Thomson Datastream. Data to 31 March.

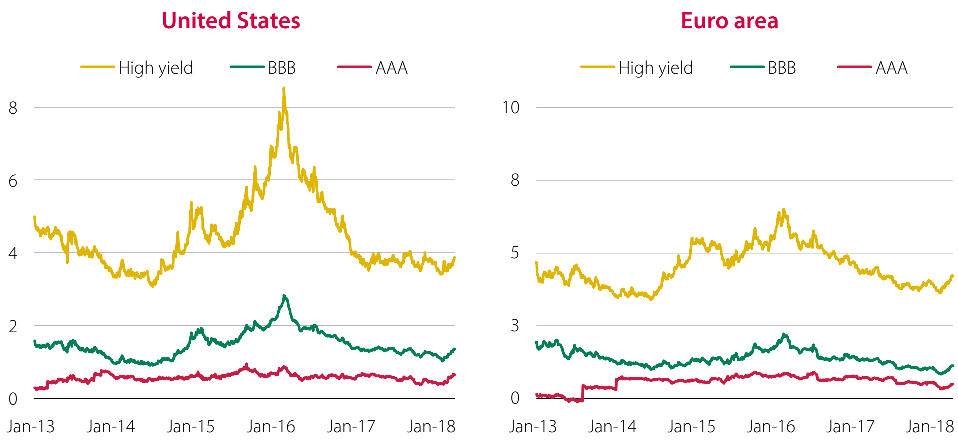
Corporate bond spreads in the US rose in all bond segments, while in the euro area, only high-yield bond spreads increased.

Corporate bond spreads in the US rose in all bond segments, though more sharply in those with a better credit rating. AAA grade spreads rose by 23 bp to 65 bp; BBB spreads by 16 bp to 136 bp; and high-yield spreads rose by 14 bp to 388 bp. In the euro area, where bond spreads fell across the board in 2017, the credit spread rose by 31 bp in the high-yield segment to 422 bp, while the other bonds recorded much greater stability. At the end of March, AAA and BBB bond spreads stood at 50 bp and 113 bp, respectively.

Corporate bond spreads

FIGURE 5

Spread vs. the ten-year government bond, percentage points[1]



Sources: Thomson Datastream and CNMV. Data to 31 March.

1 In the euro area versus German public debt.

Global debt issuance in the first quarter of 2018 fell compared with the same period of 2017, mainly as a result of the reduction in net sovereign issuance.

Net long-term issuance in global bond markets in the first three months of 2018 (semi-annualised data) fell significantly compared with the first half of 2017 and stood at 832 billion dollars (37% down on the same period of the previous year). This fall was mainly the result of a reduction in net sovereign issues, which are in negative territory. Net private sector issues, however, rose by 36% despite the 23% fall recorded in the non-financial sector.

In particular, the reduction in net sovereign issuance amounted to -134 billion dollars. By region, Europe recorded an increase, while the US and Japan recorded significant falls…

The reduction in the amount of net sovereign issues stood at -134 billion dollars. Although in Europe there was an increase of 69 billion dollars, up to a net volume of 278 billion dollars, the US and Japan recorded substantial falls, which in both countries led to net issuance being negative. In the former, net issuance stood at -211 billion dollars (50 billion dollars in the first half of 2017), while in the latter it fell to -469 billion dollars (112 billion in the first half of 2017). The falls in gross issuance explain to a great extent the falls recorded in net issuance, although in both regions the volume of maturities has increased. However, net issuance in the US is expected to increase this year as a result of the tax reform approved in December. In contrast, the reduction in issuance in Japan is the result of lower financing needs in a context in which the economic recovery is increasing tax income.

Net international debt issues

FIGURE 6

Source: Dealogic. Half-yearly data. Data for the second half of 2017 are up to 31 March, but their half-yearly equivalent is shown for comparative purposes.

… while net financial sector issues rose considerably, mainly as a result of the increase recorded in Europe, although issuance also grew in the US and Japan.

Total net financial sector issuance rose in the first half of 2018 to 585 billion dollars (compared with 220 million dollars issued in the same period of 2017). This increase is mainly the result of the net volume issued in Europe, which in the first half of 2017 had been negative and which rose by 274 billion to 212 billion in the first half of 2018 in a context of strong growth and an improved outlook for the European banking sector. For its part, issuance in the US rose to 196 billion dollars (compared with 162 million in the same period of the previous year) and in Japan rose by 14 billion to 21 billion dollars, as a result of the fall in maturities.

Finally, non-financial sector issuance fell across the board, except in Europe, although a large part of the falls may be attributed to the increase in maturities.

Finally, non-financial sector issuance fell by 111 billion dollars to 381 billion dollars. This fall was recorded across the board with the exception of Europe, although a large part of the falls may be attributed to the increase in maturities. Accordingly, gross issuance rose by 10 million dollars. By geographic area, the largest fall in net issuance was recorded in the US, where the amount stood at 171 billion (278 billion in the same period of the previous year). Meanwhile, issues in Europe rose by six billion dollars to 104 billion.

The leading equity indices, which in 2017 recorded substantial gains across the board, mostly recorded falls in the first three months of 2018. These falls took place despite the favourable global macroeconomic conditions partly as a result of the fears that normalisation of US monetary policy will take place faster than expected and the concern that protectionist policies might trigger a trade war.

The leading equity indices, which in 2017 had recorded substantial gains across the board, recorded falls in the first three months of 2018.

By region, US stock indices chalked up the most favourable relative performance, with slight falls in the Dow Jones (-2.5%) and in the S&P 500 (-1.2%), and a 2.3% gain in the NASDAQ Technology Sector Index. This performance is linked to the expectations that the tax reform approved in December will stimulate economic growth over the short and medium term. For their part, European stock markets recorded falls that range between -2% of the Euronext 100 and -8.2% of the British FTSE 100, which reflects the concerns about the progress of the Brexit negotiations. Italy's MIB 30 index is the exception to these generalised falls, with a gain of 2.6%.

By region, US stock indices chalked up the most favourable relative performance, while European stock markets recorded falls of between -2% and -8.2%.

Coinciding with the falls in the main stock market indices in the first half of February, the measures of global implied volatility reached their highest levels in two years, exceeding 35% in US markets and 25% in most other markets (see the right-hand panel of figure 7). In subsequent weeks, implied volatility levels fell once again and ended March at below 20%.

Coinciding with the falls in the main stock market indices in the first half of February, the measures of global implied volatility reached their highest levels in two years.

Emerging stock markets performed unevenly in the first half of 2018. The Argentine Merval index and the Brazilian Bovespa gained 3.5% and 11.7%, respectively, while the Mexican stock market fell by 6.5%. For its part, the Chinese Shanghai Composite index fell by 4.2%, which reflects the concerns relating to the protectionist measures imposed by the US administration, while the Russian RTS index gained 8.2%, buoyed by the improvement in the rating of sovereign Russian debt and the increase in the price of oil.

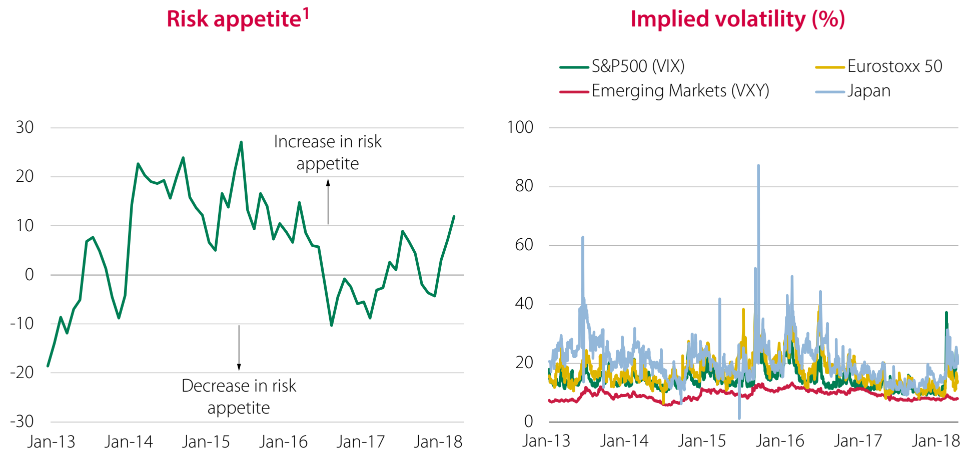
For their part, emerging stock markets performed unevenly in the first quarter of 2018.

Performance of main stock indices[1] TABLE 1

%	2014	2015	2016	2017	II17	III17	IV17	I18
World								
MSCI World	2.9	-2.7	5.3	20.1	3.4	4.4	5.1	-1.7
Euro area								
Eurostoxx 50	1.2	3.8	0.7	w6.5	-1.7	4.4	-2.5	-4.1
Euronext 100	3.6	8.0	3.0	10.6	0.0	5.1	-0.4	-2.0
Dax 30	2.7	9.6	6.9	12.5	0.1	4.1	0.7	-6.4
Cac 40	-0.5	8.5	4.9	9.3	0.0	4.1	-0.3	-2.7
Mib 30	0.2	12.7	-10.2	13.6	0.4	10.3	-3.7	2.6
Ibex 35	3.7	-7.2	-2.0	7.4	-0.2	-0.6	-3.3	-4.4
United Kingdom								
FTSE 100	-2.7	-4.9	14.4	7.6	-0.1	0.8	4.3	-8.2
United States								
Dow Jones	7.5	-2.2	13.4	25.1	3.3	4.9	10.3	-2.5
S&P 500	11.4	-0.7	9.5	19.4	2.6	4.0	6.1	-1.2
Nasdaq-Composite	13.4	5.7	7.5	28.2	3.9	5.8	6.3	2.3
Japan								
Nikkei 225	7.1	9.1	0.4	19.1	5.9	1.6	11.8	-5.8
Topix	8.1	9.9	-1.9	19.7	6.6	3.9	8.5	-5.6

Financial market indicators

FIGURE 7



Sources: Thomson Datastream and CNMV.

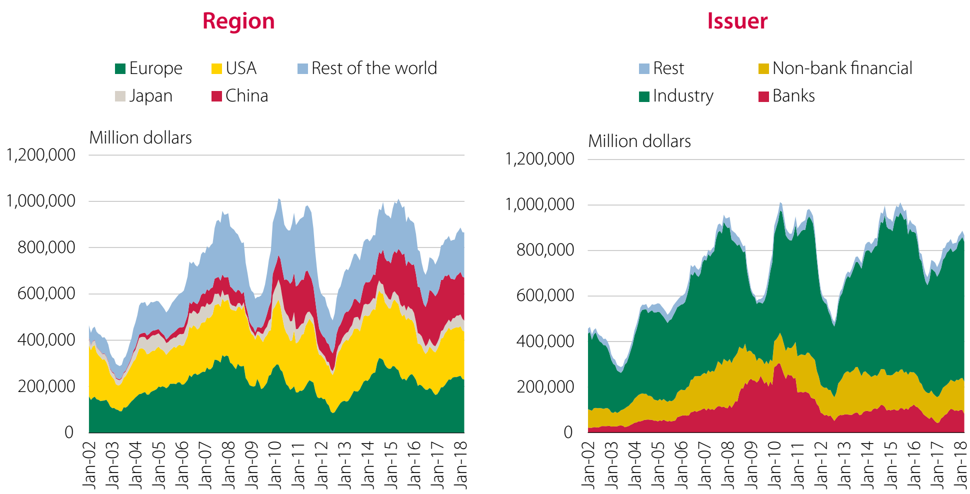
1 State Street indicator.

Equity issuance in the first quarter of 2018 was 3.4% down on the same period of 2017, with falls in the banking and financial sector and increases in utilities and industrial companies.

Equity issuance in the first quarter of 2018 was 3.4% down on the same period of the previous year and stood at 213 billion dollars. Falls were recorded in all the regions studied with the exception of China, where equity issuance amounted to 56 billion dollars, 39.3% up on the first quarter of 2017. The largest reductions were recorded in Europe and Japan (-23.2% and -38 2%, respectively), where stock market indices recorded worse performance, while the reduction in the US was 4.9%. The breakdown by sector reveals that the reductions were concentrated in the banking sector (-75.6%) and the non-banking financial sector (-7.2%), while utilities and industrial companies issued, respectively, 10.2% and 12.9% more than in the same period of 2017 (see figure 8).

Global equity issuance

FIGURE 8



Source: Dealogic. Cumulative twelve-month data to 31 March. For comparative purposes, the figure for this month is restated on a monthly basis.

2.2 National economic and financial developments

Spain's GDP grew by 3.1% in 2017, only 0.2 percentage points lower than the rate recorded in 2016, thus extending the expansion that began in 2014. The growth in the Spanish economy was greater than in the euro area (2.3%), but this difference fell compared with 2016 (from 1.5 pp to 0.8 pp) due to the strong recovery in European economies last year.

Spain's GDP grew by 3.1% in 2017, 0.6 percentage points more than the euro area.

The contribution of domestic demand to GDP growth rose progressively over 2017, increasing from 2.5 percentage points in 2016 to 2.8 points in 2017. In contrast, the contribution of the external sector to growth fell over the year, ending the last quarter in negative territory (annual average of 0.3 pp compared with 0.7 pp in 2016). The components of domestic demand showed that public consumption picked up speed between 2016 and 2017 (rising from 0.8% to 1.6%), as did gross fixed capital formation (from 3.3% to 5%), while private consumption slipped by 0.5 percentage points to 2.4%. With regard to the external sector, exports grew at a higher average annual rate than in 2016 (5% in 2017 compared with 4.8% in 2016), but the higher growth in imports (from 2.7% to 4.7%) meant that the contribution of the external sector to growth fell progressively to slightly negative figures.

The contribution of domestic demand to growth rose from 2.5 pp in 2016 to 2.8 pp in 2017, while the contribution of the external sector fell (from 0.7 pp to 0.3 pp).

Spain: Main macroeconomic variables (annual % change) TABLE 2

					EC[1]	
	2014	2015	2016	2017	2018	2019
GDP	**1.4**	**3.4**	**3.3**	**3.1**	**2.6**	**2.1**
Private consumption	1.5	3.0	2.9	2.4	2.2	1.6
Government consumption	-0.3	2.1	0.8	1.6	0.8	0.8
Gross fixed capital formation, of which:	4.7	6.5	3.3	5.0	4.0	3.7
Construction	4.2	3.8	2.4	4.6	n.d.	n.d.
Capital goods and other	6.0	11.5	5.1	6.2	4.5	4.1
Exports	4.3	4.2	4.8	5.0	4.8	4.5
Imports	6.6	5.9	2.7	4.7	4.3	4.0
Net exports (growth contribution, pp)	-0.5	-0.4	0.7	0.3	0.3	0.3
Employment[2]	**1.0**	**3.2**	**3.0**	**2.8**	**2.1**	**1.6**
Unemployment rate	**24.4**	**22.1**	**19.6**	**17.2**	**15.6**	**14.3**
Consumer price index[3]	**-0.1**	**-0.5**	**-0.2**	**2.0**	**1.6**	**1.5**
Current account balance (% GDP)	**1.1**	**1.1**	**1.9**	**1.9**	**1.9**	**1.9**
General government balance (% GDP)[4]	**-6.0**	**-5.3**	**-4.5**	**-3.1**	**-2.4**	**-1.7**
Public debt (% GDP)	**100.4**	**99.4**	**99.0**	**98.3**	**96.9**	**95.5**
Net international investment position (% GDP)	**-90.5**	**-79.1**	**-68.7**	**-63.4**	**n.a.**	**n.a.**

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

1 European Commission forecasts from the autumn of 2017, except for 2018 GDP and inflation, which were subsequently revised upwards (0.1 and 0.2 percentage points, respectively, compared with the previous forecast).

2 In full-time equivalent jobs.

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

4 Data for 2014, 2015, 2016 and 2017 include government aid to credit institutions amounting to 0.1%, 0.1%, 0.2% and 0.04% of GDP, respectively.

n.a.: [data] not available.

From the supply side, growth in value added accelerated in the construction sector and, to a lesser extent, in the industrial sector.

On the supply side of the economy, growth was recorded in the construction sector, whose value added grew by 4.9% in 2017, far above the growth in 2016 (1.9%) and, to a lesser extent, in the industrial sector, which recorded a slight acceleration (from 3.6% to 3.7%). In contrast, the services sector and the primary sectors recorded slower growth in 2017. In the case of services, value added rose by 2.6% (3% in 2016) and in the primary sectors, it rose by 3.7% (6.9% in 2016).

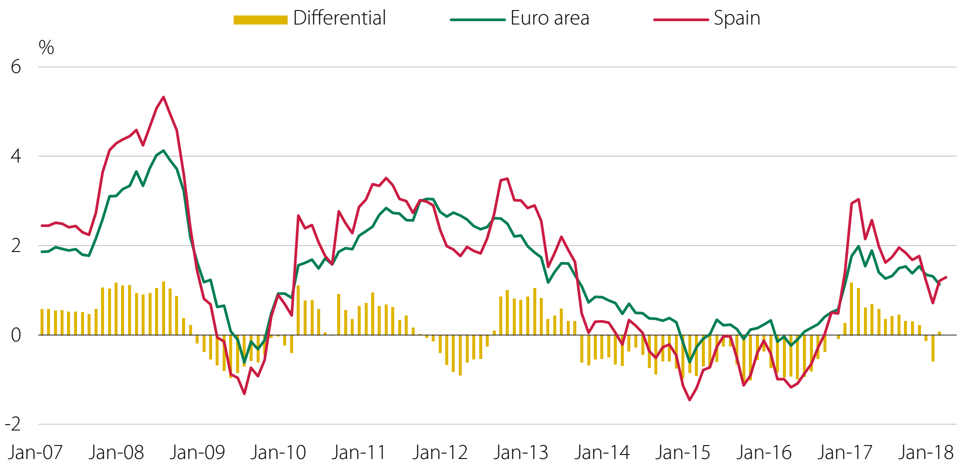
Following almost one year of sharp falls, the inflation rate rose slightly in the first three months of 2018 to 1.2% in March. The gap compared with the euro area fell to values very close to zero.

Inflation, which had fallen notably in 2017 as a result of energy inflation returning to normal[3], hit a low in January 2018 of 0.6%, to subsequently rise slightly to 1.2% in March. Core inflation, which excludes the more volatile elements in the index, such as energy and fresh food, fluctuated around 1% in 2017 and ended the year at 0.8%. In February, it recorded a small rise to 1.1%. The inflation gap versus the euro area, which began 2017 at over one percentage point fell significantly to temporarily hit negative territory at the end of the year. In February 2018, this gap stood at 0.1 pp.

Positive job creation data in 2017 (2.8%) helped to reduce the unemployment rate, which remains high.

In the job market, the buoyancy of the economy allowed employment to grow by 2.8% in 2017, only a few decimal percentage points below the growth recorded in the last two years (3.2% in 2015 and 3% in 2016). Information from the Labour Force Survey (EPA) indicates that last year the number of employed people rose by 490,000 (1.86 million over the last four years) and that the unemployment rate fell to 16.55% in the fourth quarter (18.6% at the end of 2016). Furthermore, year-on-year growth in unit labour costs remained negative in 2017, although a little less than in 2016, as the increase in apparent productivity (0.27% on average in the year) outstripped the growth in remuneration per employee (0.15%).

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



Source: Thomson Datastream. Data to March for Spain and February for the euro area.

3 Energy price inflation fell from 17.5% in January 2017 to 2.6% in December and 1.4% in February 2018.

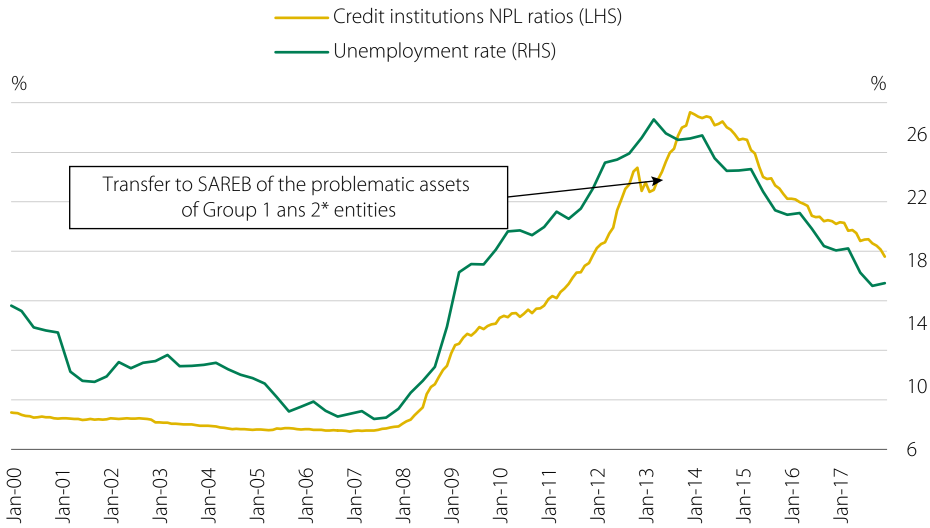
Public sector finances improved significantly in 2017 as a result of the recovery in the economy as well as the sharp fall in spending on debt interest. These factors allowed the public deficit to end the year at 3.11% of GDP[4], 1.22 percentage points lower than in 2016, in line with the target set by the Government. All levels of government that require financing reduced the amount borrowed. Particularly noteworthy was the fall in the deficit of the central government, which dropped from 2.6% in 2016 to 1.9% in 2017 and recorded a primary surplus for the first time in ten years, and that of the autonomous regions, which stood at 0.32% (0.84% in 2016). The deficit of the Social Security Funds also fell, although to a lesser extent, dropping from 1.59% to 1.48%. The surplus of the Local Authorities remained practically unchanged in 2017 at close to 0.6% of GDP. Government debt stood at 98.08% of GDP at the end of the year, recording very few changes since the middle of 2014.

Dynamic growth together with the fall in interest costs allowed the government deficit to fall to 3.1% of GDP in 2010, in line with the government's target.

Banks continue to operate in a complex context dominated by the low level of interest rates, which placed downward pressure on their profitability. The buoyancy of the economy remains a favourable factor for the financial sector in Spain. In fact, the appearance of attractive investment projects and strong private consumption are favouring a recovery in lending. However, the volume of non-performing assets remains high[5] and, as in other European economies, a certain overcapacity is noted, as well as a range of latent challenges, some of which are related to the development of new technologies applied to finance (fintech).

Low interest rates continue to apply downward pressure on bank profits, but a budding upturn in lending is noted in some segments.

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



Sources: Banco de España and National Statistics Office (INE). Data to December.

1 Percentage of active population.

* Group 1 transfers took place in December 2012 (36.7 billion euros) and Group 2 transfers in February 2013 (14.09 billion euros).

4 The government deficit figure stood at 3.07% of GDP if the amount of the support given to credit institutions is excluded.

5 The NPL ratio stood at 7.8% of total lending in December 2017 (9.1% in 2016).

The sector's aggregate income statement was significantly affected in 2017 by the losses of Banco Popular.

Bank income statements showed a combined loss of close to 4 billion euros in 2017 (compared with a profit of 6 billion euros in 2016), as a result of the losses of the Banco Popular, which stood at over 13.5 billion euros[6]. Excluding the losses of this bank, the sector's aggregate profit in 2017 stood at over 9.6 billion euros. In addition, bank profits are still restricted by the context of low interest rates (the net interest margin stood at 23.23 billion euros in 2017, compared with 24.3 billion euros in 2016) and by the volume of non-performing assets, which is falling but remains high.

In 2017, bank lending to companies grew slightly, while lending to households fell, although much less than in previous years.

Bank lending to the non-financial resident sector (households and companies) rose slightly in 2017 in the case of companies (0.4%) and fell in the case of households (-0.8%), although the fall in the latter was not as sharp as in previous years (-1.3% in 2016, -2.1% in 2015 and -3.6% in 2014). In the case of non-financial companies, although lending recorded positive annual growth rates throughout last year, the rate turned negative once again in February of this year (-0.5%). However, lending indicators picked up in some segments. The moderation in the fall in lending to households was related both to the smaller fall in home purchase loans (-2.7% in February 2018, -2.8% in 2017 and -3% in 2016) and to the intensification of consumer lending (7.8% in February 2018, 6.4% in 2017 and 4.2% in 2016). In the euro area, lending to companies climbed by 1.9% in December (2.2% in January 2018), while lending to households rose by 3.3% (3.2% in January 2018).

The size of the banking sector remained stable in 2017, thus breaking with the downward trend that began in 2013.

The size of the banking sector remained stable in 2017, at 2.65 trillion euros, thus breaking with the downward trend that had begun in 2013. Some of the most important sources of funding, such as debt or borrowing from the Eurosystem[7], grew, while others, such as deposits from resident households and companies recorded falls. Bank book value of equity remained stable at around 360 billion euros.

Aggregate profit of non-financial listed companies exceeded 30 billion euros in 2017, more than double the figure recorded in 2016, in line with the buoyancy of the economy.

Non-financial listed companies obtained an aggregate profit of 31.54 billion euros in 2017, more than double the figure recorded in 2016. With the exception of the industrial sector, every sector recorded growth in its profits, in line with the buoyancy of the domestic economy. Growth in profits was particularly strong in retail and services companies, rising from 63 million euros in 2016 to 14.63 billion euros in 2017[8]. Energy companies recorded a 10.5% increase in their profit to 9.76 billion euros, while construction and real estate companies recorded an even larger increase of 54%, to 5.27 billion euros. In general terms, industrial companies performed positively, but the contraction in the profits of some companies[9] led to the sector's aggregate profits falling from 2.34 billion euros in 2016 to 1.92 billion euros in 2017 (see table 3).

6 The SRB (Single Resolution Board) adopted the decision for its resolution in June.

7 Borrowing from the Eurosystem (deducting the amount of the debt purchase programmes) at the end of 2017 amounted to 164 billion euros (139 billion in 2016).

8 The increased profits of Abengoa and, to a lesser extent, Codere explain the bulk of the change in aggregate profits. Excluding the results of these two companies, aggregate profits in the retail and services sector rose from 8.84 billion euros in 2016 to 10.32 billion euros in 2017.

9 For example, Siemens, Duro Felguera and Almirall.

Profit by sector: Non-financial listed companies TABLE 3

Million euros	Operating profit		Profit before tax		(Consolidated) profit for the year	
	2016	2017	2016	2017	2016	2017
Energy	13,101	11,621	10,735	10,344	8,828	9,759
Industry	3,807	3,273	3,173	2,474	2,336	1,920
Retail and services	12,907	17,331	6,762	19,050	63	14,625
Construction and real estate	4,907	6,339	3,240	5,353	3,417	5,267
Adjustments	37	44	32	40	26	33
Aggregate total	**34,685**	**38,520**	**23,878**	**37,181**	**14,618**	**31,538**

Source: CNMV.

Debt levels remained broadly similar in 2017, although the composition shifted in favour of long-term debt (3%) to the detriment of short-term debt (-12.6%).

The aggregate debt of non-financial listed companies, at 252.61 billion euros, was barely 0.2% lower than the previous year. However, its composition changed significantly as the level of short-term debts fell by 12.6% to around 46 billion euros, while long-term debts grew by 3% to over 206 billion euros. The changes in debt were not even across sectors: while there was a rise in debt levels among energy companies (from 5.16 billion euros to 81.51 billion euros) and industrial companies (from 3.78 billion euros to close on 21 billion euros), companies in the retail and services sector and in the construction and real estate sector, which are on average the most leveraged companies, continued to reduce their debt levels (by 7.6% and 2.3%, respectively). As a consequence of these movements, the aggregate leverage ratio of non-financial listed companies, measured as the debt to equity ratio, fell slightly from 1.15 to 1.07. The leverage of energy companies rose slightly, while that of retail and services companies and, above all, construction and real estate companies, fell moderately. The debt coverage ratio, measured using the ratio of debt to operating profit, improved significantly (falling from 7.3 to 6.6) as the increase in profit was much sharper than the rise in debt.

The financial position of households (debt and wealth) continues to improve although the savings rate fell sharply to stand at 6% of disposable income in the first quarter of 2017.

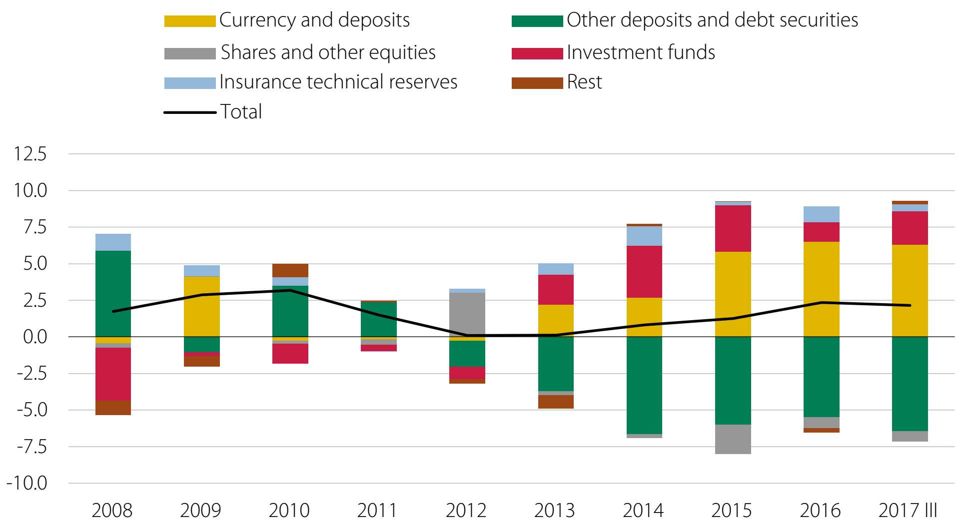
The latest data on the financial position of households reveal that both their savings rates and their debt-to-income and debt burden ratios continued to fall in 2017. The fall in the savings rate, which dropped from 7.7% of gross disposable income (GDI) at the end of 2016 to 5.7% in December 2017, is a result of buoyant aggregate consumption in a context of stagnated remuneration per employee. The debt-to-income ratio fell from 102.4% of GDI at year-end 2016 to 99.4% in 2017 as a result of both a reduction in the level of debt and an increase in the level of disposable income. The debt burden ratio fell slightly (from 11.7% of GDI to 11.6%) given the stability of the average cost of debt in the context of growing income[10]. Net household wealth rose in 2017 (from 529.5% of GDP to 541.6%) due to the increase in the value of real estate assets. Financial wealth remained relatively stable over the year.

10 The fact that income grew and remuneration per employee rose slightly is down to the fact that the former is calculated as the sum of the income of all employees, the number of which has grown significantly over recent years, while the latter corresponds to the changes in the remuneration per employee.

Investors are still showing a preference for more liquid assets and mutual funds, and within these, the higher-risk categories.

Households' net financial investments rose to 2.6% of GDP in 2017 (2.5% in 2016) while the major trends in place since 2013 continued: investors are reducing their investments in term deposits and bonds (5.7% of GDP) as a result of low returns, and they are investing in more liquid assets (5.3% of GDP) and in investment funds (2.6% of GDP). In the case of mutual funds, it is important to indicate that investors are showing a clear preference for higher-risk categories; in fact, figures for year-end 2017 show that the most conservative categories recorded net redemptions of over 7.2 billion euros, while higher-risk categories received a significant inflow of investment (over 30 billion euros in total). Among the latter category, there were significant investments in global funds (over 13 billion euros) and in absolute return, mixed equity and international equity funds, with amounts for each category ranging between 4.2 and 5.5 billion euros.

Households: Net financial asset acquisitions (% GDP) FIGURE 11



Source: Banco de España, Financial Accounts. Cumulative data from four quarters.

2.3 Outlook

According to the IMF, global GDP will grow by 3.9% this year and next year as a result of the impact of the tax reform in the US and the improvement in world trade, which will particularly have an impact on advanced economies.

The latest IMF forecasts (April 2018) indicate that global growth will accelerate even further in 2018 to 3.9%, maintaining the same rate in 2019. These forecasts are similar to those published in January of this year and 0.2 percentage points up on those of its report from October of last year. The forecast for the expected growth of advanced economies for the year was revised upwards by 0.2 percentage points to 2.5% (2.3% in 2017). A large part of this adjustment was the result of the significant tax reform adopted in the US, where the growth rate will be close to 3% this year. The euro area will grow by 2.4% in 2018 (2% in 2019), 0.2 percentage points up on the last forecast, as a result of the greater vitality of the most important economies, including the Spanish economy. Emerging and developing economies will grow by 4.9% this year and by 5.1% next year, figures that were revised slightly upwards.

A series of risks loom over this scenario. Some of these risks are financial, relating essentially to the possible build-up of imbalances between some investors, given the current context of low interest rates, and with the possibility of a repeat of episodes of turmoil in financial markets as a result of unexpected changes in monetary policy, which could particularly affect potentially overvalued assets. The other risks are basically political and include the shift towards more restrictive trade policies as a result of decisions taken by the US administration and the presence of some geopolitical conflicts.

The main elements of uncertainty in this scenario are financial and political...

Gross Domestic Product (annual % change)

TABLE 4

	2014	2015	2016	2017	IMF[1] 2018	IMF[1] 2019
World	3.6	3.4	3.2	3.8	3.9 (0.0)	3.9 (0.0)
United States	2.6	2.9	1.5	2.3	2.9 (0.2)	2.7 (0.2)
Euro area	1.3	2.1	1.8	2.3	2.4 (0.2)	2.0 (0.0)
Germany	1.9	1.5	1.9	2.5	2.5 (0.2)	2.0 (0.5)
France	0.9	1.1	1.2	1.8	2.1 (0.2)	2.0 (0.1)
Italy	0.1	1.0	0.9	1.5	1.5 (0.1)	1.1 (0.0)
Spain	1.4	3.4	3.3	3.1	2.8 (0.4)	2.2 (0.1)
United Kingdom	3.1	2.3	1.9	1.8	1.6 (0.1)	1.5 (0.0)
Japan	0.4	1.4	0.9	1.7	1.2 (0.0)	0.9 (0.0)
Emerging economies	4.7	4.3	4.4	4.8	4.9 (0.0)	5.1 (0.1)

Source: IMF.

1 In brackets, change compared with the previous published forecast (IMF, forecasts published in April 2018 compared with January 2018).

In Europe, in addition to the above, the following risks may be highlighted: (i) the difficulties faced by banks in obtaining profits in a context of extremely low interest rates; (ii) the high level of public and private sector debt in several economies in view of the possible increase in rates over the medium term; (iii) the effects of Brexit, especially in the event of a hard Brexit, and (iv) the effects of an appreciation of the euro on the region's exporters.

... some of which are also present in Europe, although this region also faces several specific risks, such as Brexit.

According to the IMF, the Spanish economy will grow by 2.8% this year and by 2.2% in 2019, which is an upward revision of 0.4 and 0.1 percentage points, respectively, with regard to the forecast published in January. The Spanish economy faces most of the aforementioned risks, particularly the European ones, although some of them are mitigated by the strength of domestic activity. The most significant national sources of uncertainty, in addition to the crisis in Catalonia, are the need to reduce the unemployment rate and extend the consolidation of the public accounts, together with the significant challenges posed by an ageing population.

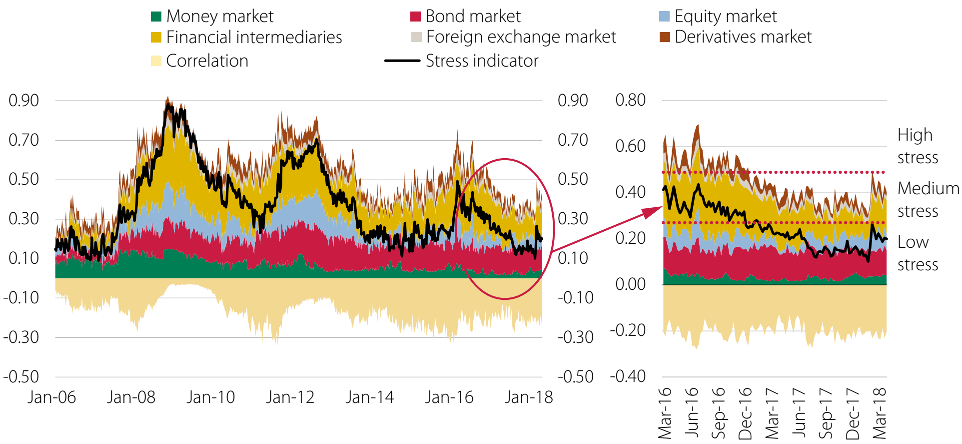
Spain's GDP will grow somewhat less this year, but its rate of growth will remain high against the backdrop of some ongoing sources of uncertainty, several of which are national.

3 Spanish markets

The Spanish financial markets stress index, which remained at very low levels in 2017, rose slightly in the first few months of 2018, in line with certain episodes of market volatility.

The Spanish financial markets stress index, which had remained at very low levels through practically all last year, rose slightly in the first few days of February to 0.27, the threshold that separates low stress from medium stress[11]. This increase needs to be understood in the context of the episode of turmoil recorded in those days in US equity markets following publication of data showing unexpectedly strong employment and rising salaries, which led to a change in inflation expectations in the US and, consequently, the expected speed of interest rate hikes. These events had an impact on European stock markets, which suffered sharp falls in prices and significant rises in volatility. By segment, there were upturns in stress in equity, derivatives and exchange rates. In the second half of the first quarter of the year, the index fell once again to values of around 0.2 (see figure 12).

Spanish financial market stress index FIGURE 12



Source: CNMV.

The most significant risks in financial markets remain market risk and liquidity risk, particularly in some corporate bond segments.

The most significant risks that continue to affect financial markets are market risk and liquidity risk, particularly in some corporate bond segments. In addition, in the context of prolonged low interest rates in Europe, it is important to bear in mind the possibility that some investors, in order to obtain higher returns, might be acquiring assets that entail too much risk for their profile. The spectrum of these assets is very wide and covers shares, high-yield debt and, more recently, much riskier assets, such as cryptocurrencies[12].

11 The stress index 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 of the financial system and aggregates them into a single figure bearing in mind the correlation between said segments. Econometric estimates 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 CNMV's quarterly Financial Stability Note and statistical series (market stress indicators) available at 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).

12 See the Joint press statement by the CNMV and the Banco de España on cryptocurrencies and initial coin offerings (ICOs) (https://www.cnmv.es/loultimo/NOTACONJUNTAcriptoEN%20final.pdf), CNMV considerations

3.1 Equity markets

Equity markets recorded significant losses in the first quarter due to the expectation of a change in monetary policy and contagion from the falls in US markets and fears of a trade war.

Spanish stock markets ended the first quarter of the year with significant falls adding to the losses recorded in the second half of 2016 as a result of the expectation that the first measures to normalise monetary policy in Europe would soon be adopted. Although the Ibex 35 began the year with gains, it started to record significant losses as from the start of February. This was also the case of the main European indices, which were dragged down by the falls in US indices in view of the expectation that the Federal Reserve would accelerate its rate hike schedule following the positive data on the US economy, the strength of its labour market and the upward trend in energy prices. In addition to this landscape of greater market volatility, uncertainties arose in March as a result of the protectionist measures announced by the Trump administration, the fears of a trade war and its possible effects on global trade and the income statements of the most important international companies.

The falls in share prices were concentrated in large companies in the electricity and gas sectors, while small-cap companies saw their share prices rise given their reduced exposure to international uncertainty.

The price falls were not spread evenly among all sectors and securities in the national market, but were concentrated in large companies, particularly companies in the electricity and gas sectors, whose regulated revenue might be affected in the event of a likely change in legislation, as well as companies in the textile sector and the construction sector. An increase in financial costs over the medium term is also expected, which should have a greater impact on companies with a high proportion of debt on their balance sheets. On the opposite side are the securities of small-cap companies, which recorded significant gains as they have lower international exposure and strong links to the economic cycle. These companies also enjoy the support of institutional investors, which applies upward pressure to their prices due to the limited supply of these types of shares. Similarly, the landscape of growth and the positive economic outlook remain in place in 2018, although in the short-term fears have grown in relation to a trade war triggered by the protectionist measures of the US administration.

The Ibex 35 fell by 4.4% in the first quarter of the year…

The Ibex 35, which in the previous two quarters had recorded losses of 0.6% and 3.3%, respectively, fell once again in March, by 4.4%, to stand at its lowest level since the first quarter of 2017. This fall follows the downward trend of the leading benchmark European indices[13], with the exception of the Italian index, given an environment of increased volatility and falls in trading, in contrast with the significant gains in the prices of small-cap companies (11.1%). The share price of medium-cap companies fell back slightly (-1.4%). Similarly, the indices representing Latin American shares that are listed in euros, FTSE Latibex All-Share and FTSE Latibex Top, recorded gains of 11.1% and 7.5%, respectively, in the first quarter of the year thanks to the improved outlook for growth in Latin

on cryptocurrencies and ICOs addressed to market professionals (https://www.cnmv.es/portal/verDoc.axd?t={62395018-40eb-49bb-a71c-4afb5c966374}) and the corresponding ESMA warning (https://www.esma.europa.eu/press-news/esma-news/esas-warn-consumers-risks-in-buying-virtual-currencies).

13 The main European indices also recorded losses: Eurostoxx 50 (-4.1%), Dax (-6.4%) and Cac (-2.7%). In contrast, the Italian Mib 30 grew by 2.6%.

American economies – especially Brazil[14] – as well as lower volatility in the exchange rate of their currencies against the Euro[15].

Performance of Spanish stock market indices and sectors

TABLE 5

Indices	2015	2016	2017	I-17[1]	II-17[1]	III-17[1]	IV-17[1]	I-18[1]
Ibex 35	-7.2	-2.0	7.4	11.9	-0.2	-0.6	-3.3	-4.4
Madrid	-7.4	-2.2	7.6	11.8	-0.2	-0.4	-3.2	-3.9
Ibex Medium Cap	13.7	-6.6	4.0	4.3	3.3	-3.3	-0.2	-1.4
Ibex Small Cap	6.4	8.9	31.4	15.1	2.2	2.8	15.1	11.1
FTSE Latibex All-Share	-39.2	71.0	9.0	10.0	-9.7	12.4	-2.4	11.1
FTSE Latibex Top	-34.6	67.8	7.3	12.4	-9.6	13.8	-7.2	7.5
Sectors[2]								
Financial and real estate services	**-24.2**	**-1.6**	**10.5**	**15.2**	**-0.5**	**2.6**	**-6.1**	**-3.7**
Banks	-26.0	-1.8	10.6	16.0	-0.9	3.0	-6.6	-4.5
Insurance	-5.0	15.5	0.1	9.7	-0.4	-7.8	-0.6	-0.9
Real estate and others	18.4	-2.3	17.6	8.0	8.1	0.0	0.8	-5.6
Oil and energy	**0.6**	**0.8**	**3.9**	**7.2**	**-0.4**	**-1.0**	**-1.7**	**-4.8**
Oil	-34.9	32.6	9.9	7.9	-7.4	16.3	-5.4	-2.2
Electricity and gas	9.6	-4.3	2.0	7.0	1.2	-5.2	-0.6	-6.1
Basic materials, industry and construction	**2.1**	**2.0**	**2.6**	**8.9**	**-0.9**	**-8.9**	**4.4**	**-1.8**
Construction	4.9	-7.9	9.9	9.0	3.6	-6.4	4.0	-7.3
Manufacture and assembly of capital goods	49.0	7.8	-19.3	11.4	-7.7	-23.5	2.7	8.1
Minerals, metals and metal processing	-30.8	48.8	14.2	6.8	-5.4	4.3	8.3	1.8
Engineering and others	-39.6	9.9	-9.9	-1.4	-6.5	-6.4	4.5	-2.0
Technology and telecommunications	**-5.2**	**-9.0**	**7.5**	**16.2**	**-6.1**	**2.7**	**-4.2**	**-0.2**
Telecommunications and others	-12.3	-14.2	-5.1	18.6	-12.3	1.6	-10.3	-0.1
Electronics and software	22.2	7.9	36.6	10.7	9.3	5.0	7.6	-0.3
Consumer goods	**30.9**	**0.2**	**-2.1**	**4.4**	**3.0**	**-3.9**	**-5.3**	**-8.4**
Textile, clothing and footwear	33.6	2.6	-10.4	1.9	1.6	-5.1	-8.9	-12.4
Food and drink	26.4	-5.4	5.2	0.4	4.9	-1.1	0.9	3.7
Pharmaceuticals and biotechnology	23.5	-6.4	14.6	15.5	4.4	-4.0	-1.0	-5.6
Consumer services	**10.4**	**-8.0**	**23.3**	**13.0**	**7.2**	**-3.8**	**5.8**	**-4.0**
Motorways and car parks	-7.9	-3.1	39.5	13.6	7.4	5.4	8.5	-1.8
Transport and distribution	29.6	-15.7	32.3	16.3	13.2	-7.3	8.3	-3.4

Sources: BME and Thomson Datastream.

1 Change on the previous quarter.

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

14 The main Brazilian stock market index gained 11.7%.

15 In the first quarter of the year, the Brazilian real depreciated by 2.1% against the euro.

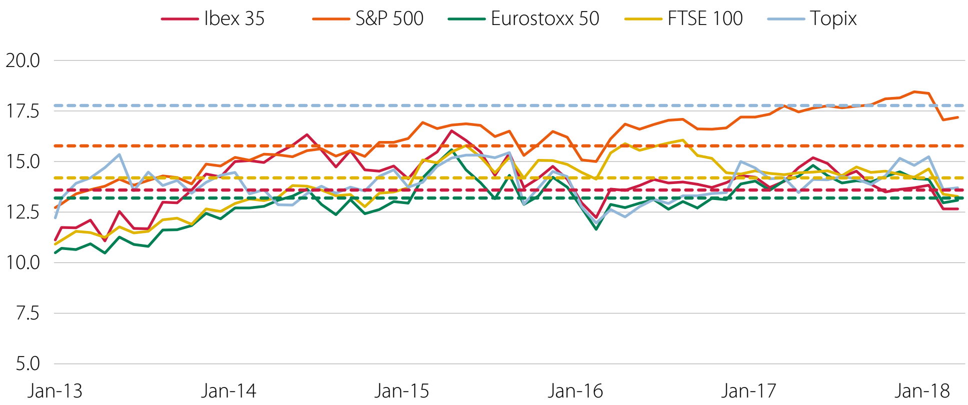
With the exception of some companies, every sector ended the quarter with falls, which were particularly significant in the consumer goods and the oil and energy sectors. Among the former, there was a noteworthy fall in the leading textile company, which suffered from the uncertainties relating to its digital transformation, which is necessary to face the strong competition from new business models orientated towards e-commerce. Companies in the oil and energy sector were affected by the potential impact on their income statements of regulatory changes reducing the remuneration from the regulated revenue of electricity and gas companies (see table 5). Furthermore, investors are starting to take into account the impact of a hike in interest rates in the medium term on corporate finance costs, particularly those with a high level of debt. In contrast, the most cyclical companies have benefited from the significant economic growth.

... with falls in most market sectors, which were sharper in the consumer goods sector and the oil and energy sector.

The fall in share prices in the quarter, together with the expected growth in corporate profits over the coming months, allowed the price-earnings (P/E) ratio of the Ibex 35 to fall from 13.7 in the middle of December to 12.7 in March, its lowest level since the first quarter of 2016. As shown in figure 13, the P/E ratios of the most significant stock market indices performed similarly over the quarter and incorporate the adjustments in their prices. With the exception of the US S&P 500 index, every ratio stands below its average value over the period between 2010 and 2017. At year-end 2017, they all had higher values except the Japanese Topix index.

The fall in share prices in the quarter, together with the expected growth in corporate profits, led to a fall in the price-earnings (P/E) ratio to its lowest level since the first quarter of 2016.

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



Source: Thomson Datastream. Data to 31 March.

1 Twelve-month forward earnings.

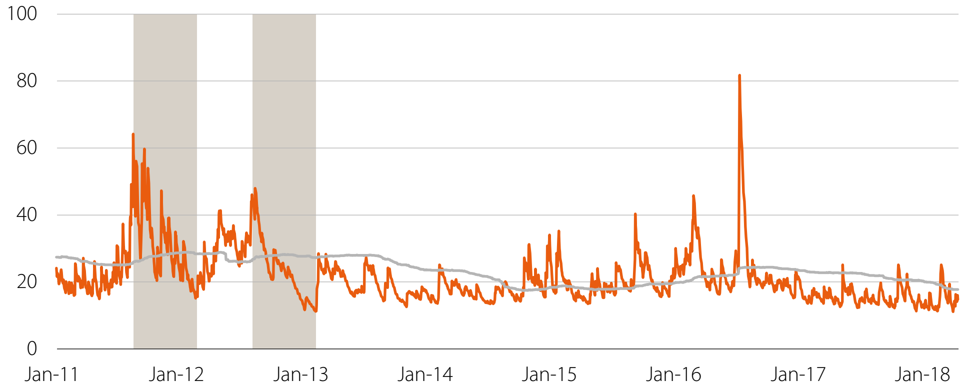
Ibex 35 volatility, which had remained at low levels over the previous year, when it reached its lowest level since 2015, began the quarter with significant gains, as did the leading international stock markets and in line with the sharp increase in volatility in US stock markets, where the VIX indicator exceeded 30%[16]. At the end of the first quarter, Ibex 35 volatility eased and stood at around 15%, slightly below the average value for the quarter (15.6%), although above the figure for the end of the last quarter of 2017 (13.4%). The performance of the Spanish market with regard to volatility was similar to that seen in other European indices, such as the

Volatility, which had been at very low levels, rose significantly, as in the major international markets.

16 At the end of 2017, the VIX index stood at below 10%.

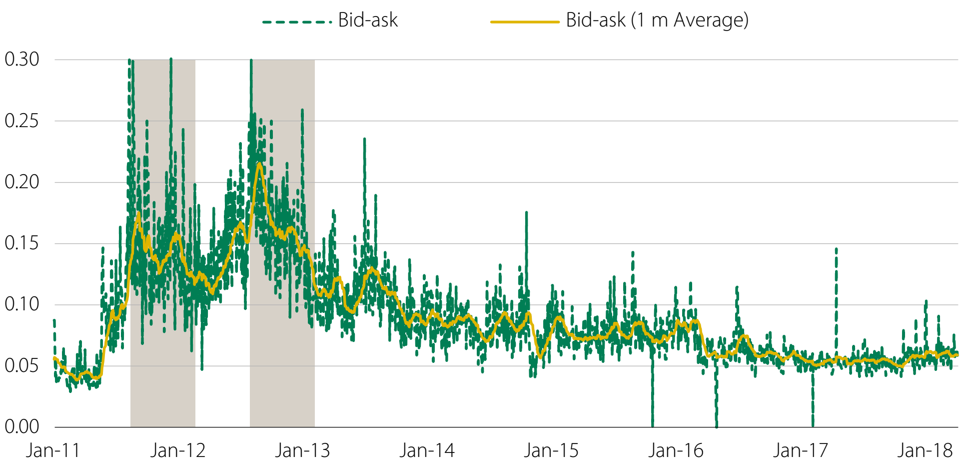
Eurostoxx 50 (13.4% at the end of the quarter), and at any event with shallower variations than those of the US indices (the VIX moved in a range of 22 percentage points over the quarter).

Historical volatility of the Ibex 35 FIGURE 14



Sources: Thomson Datastream and CNMV. The blue 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. The first ban affected financial institutions and the second ban applied to all listed companies.

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



Sources: Thomson Datastream and CNMV. 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. The first ban affected financial institutions and the second ban applied to all listed companies.

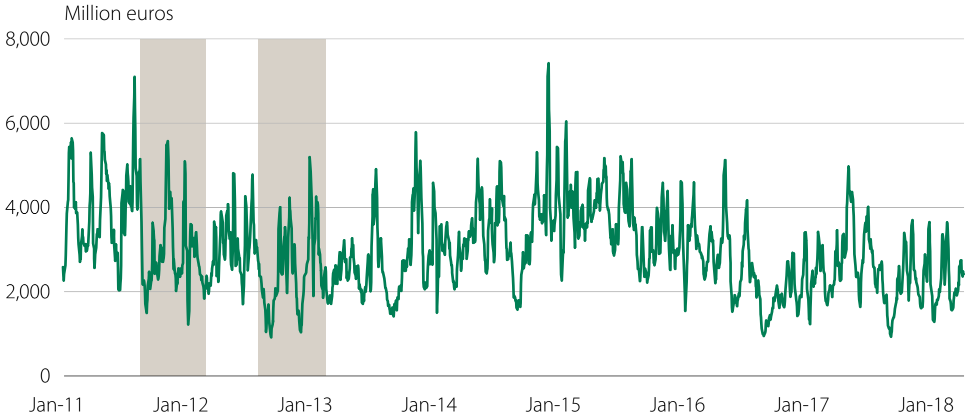
Liquidity remained at satisfactory levels, although it worsened slightly.

Ibex 35 liquidity, as measured by the bid-ask spread, worsened slightly in the first quarter of the year, with slight upturns during sessions with higher volatility. Nevertheless, the Ibex bid-ask spread stood at 0.06% in the first quarter of the year, slightly above the 2017 average (0.054%), but below the historic average of this indicator (0.095%).

Despite the falls in prices on stock markets, trading in Spanish equity improved in year-on-year terms in the first quarter thanks to the reduction in uncertainty about the Spanish economy and a possible increase in algorithmic trading in an increasingly volatile context, a large part of which is concentrated in multilateral trading facilities (MTFs). The volume of Spanish equity trading grew by 5.4% in the first quarter of the year to 234 billion euros, in line with the trend seen in most European stock markets, which also recorded increases in trading[17]. Average daily trading on the electronic market stood at 2.29 billion euros in the first quarter, a little under the average for 2017 (2.51 billion euros).

Despite the fall in prices, Spanish equity trading grew by 5.4% in year-on-year terms.

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



Source: CNMV. 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.

With regard to the distribution of the trading of Spanish securities, trading on other regulated markets and multilateral trading facilities stood at 91.42 billion euros in the first quarter of the year, the highest value in the entire historic series, a figure that is 32% up on the same period of 2017, while trading on Bolsas y Mercados Españoles (BME) fell by 6.6%. Consequently, trading in Spanish securities on foreign markets, whose share had fallen in the last year to around one third of the total amount traded, grew once again significantly in 2018, to around 40%, its historic high, above the 33.3% of the previous quarter and the 31.7% of 2017 as a whole. The regulated market Cboe Global Markets (Cboe), which operates through two different order books, BATS and Chi-X, with trading of over 73.5 billion euros, accounted for over two thirds of the total amount of Spanish securities traded abroad and 51% of the amount traded in the home market. In contrast, both Turquoise and the other operators, which had risen significantly in the previous year, saw their market shares fall to 11.9% and 7.6%, respectively.

The trading of Spanish securities abroad accounted for almost 40% of total trading of these securities in the quarter.

17 Source: Federation of European Securities Exchanges (FESE). Data to February 2018.

Trading in Spanish shares listed on Spanish exchanges[1]

TABLE 6

Million euros	2014	2015	2016	2017	III-17	IV-17	I-18
Total	**1,002,189.0**	**1,161,482.8**	**877,413.3**	**934,377.1**	**193,005.3**	**233,038.6**	**234,555.7**
Listed on SIBE	**1,002,095.9**	**1,161,222.9**	**877,402.7**	**934,368.3**	**193,004.8**	**233,036.3**	**234,554.7**
BME	849,934.6	925,978.7	631,107.2	634,990.9	125,110.5	154,495.8	143,131.5
Chi-X	95,973.0	150,139.9	117,419.4	117,899.2	27,142.3	29,128.9	26,830.1
Turquoise	28,497.5	35,680.5	51,051.8	44,720.1	9,601.2	10,880.6	10,900.3
BATS	18,671.0	35,857.6	44,839.8	75,411.6	19,378.6	23,075.6	46,765.7
Other[2]	9,019.8	13,566.2	32,984.5	61,346.5	11,772.2	15,455.3	6,927.0
Open outcry	**92.4**	**246.1**	**7.5**	**8.1**	**0.5**	**2.1**	**1.0**
Madrid	32.7	19.4	3.2	1.8	0.1	0.0	0.0
Bilbao	14.3	7.5	0.0	0.0	0.0	0.0	0.0
Barcelona	45.2	219.1	4.1	6.3	0.4	2.1	0.9
Valencia	0.3	0.1	0.0	0.0	0.0	0.0	0.0
Second market	**0.7**	**13.8**	**3.2**	**0.7**	**0.0**	**0.2**	**0.1**
Pro memoria							
Foreign shares traded on BME	14,508.9	12,417.7	6,033.0	6,908.0	1,318.6	1,143.0	1,153.0
Alternative stock market (MAB)	7,723.2	6,441.7	5,066.2	4,985.8	1,010.5	1,317.3	1,401.5
Latibex	373.1	258.7	156.7	130.8	12.3	16.1	43.8
ETFs	9,849.4	12,633.8	6,045.2	4,464.1	699.3	1,472.8	981.0
Total BME trading	882,482.3	957,990.5	648,418.9	651,488.5	128,151.5	158,447.5	146,711.9
% Spanish shares on BME vs. total Spanish shares	84.8	80.1	71.9	68.3	65.1	66.7	61.4

Sources: Bloomberg and CNMV.

1 Includes trading of Spanish shares subject to market or MTF rules (lit plus dark). Spanish shares on Spanish stock exchanges are those with a Spanish ISIN that are admitted to trading on the regulated market of Bolsas y Mercados Españoles (BME), i.e., not including the Alternative Stock Market MAB). Foreign shares are those which are admitted to trading on the regulated market of BME whose ISIN is not Spanish.

2 Difference between the turnover of the EU Composite calculated by Bloomberg for each share and the turnover of the markets and MTFs.

Application of MiFIR with regard to transparency obligations relating to trading orders at reference prices from another market...

On 8 March, the CNMV decided to suspend for six months the use of transparency obligations waivers of trading orders at reference prices of other markets[18] as they exceeded the trading threshold of 8% referred to in Article 5.1(b) of MiFIR with regard to the trading of thirteen shares[19]. MiFIR (Regulation (EU) 600/2014) establishes certain pre-trade transparency requirements applicable to shares and other financial instruments and recognises the possibility of trading venues requesting that competent authorities implement waivers relating to orders at reference prices and those on negotiated or pre-arranged transactions. However, in order to ensure that the use of these waivers does not hinder price discovery, MiFIR establishes a double volume cap rule on trading, such that in the event the rule is exceeded, the waivers will be suspended for six months.

18 Regulated pursuant to Article 4.1 of MiFIR, in stock markets.

19 See the communication www.cnmv.es/portal/verDoc.axd?t={d4ab4246-6ddb-41f4-b0d5-1d05866a4399}

In Spain, the CNMV has authorised a waiver on transaction matching, on shares or ETFs admitted to trading on the Spanish Stock Exchanges and MAB or LATIBEX, at the average price of the best current buying and selling position in a reference market. On 7 March, ESMA published for the first time the equity instruments that exceeded the trading volume caps, which included thirteen instruments admitted to trading in Spanish stock markets. This information led to the CNMV's decision to suspend the waiver of the transparency obligations for these shares until 12 September of this year.

... meant that in March, the CNMV decided to suspend for thirteen instruments the waivers to these transparency obligations for six months as they had exceeded certain trading thresholds.

Capital increases and public offerings[1]

TABLE 7

	2015	2016	2017	II-17	III-17	IV-17	I-18
NUMBER OF ISSUERS[2]							
Total	**50**	**45**	**46**	**16**	**17**	**17**	**15**
Capital increases	45	45	44	13	17	17	14
Primary offerings	0	3	3	1	1	1	0
Public offering of shares	6	2	4	3	0	1	1
NUMBER OF ISSUES[2]							
Total	**111**	**81**	**89**	**18**	**18**	**25**	**21**
Capital increases	99	79	82	14	18	24	20
Primary offerings	0	4	4	1	1	1	0
Public offering of shares[3]	12	2	7	4	0	1	1
CASH AMOUNT[2] (million euros)							
Total	**37,065.5**	**20,251.7**	**32,538.1**	**11,068**	**8,591**	**2,656.7**	**3,904.8**
Capital increases	28,733.9	19,745.1	29,593.6	10,049.8	8,590.6	2,089.5	3,259.2
Primary offerings	0.0	807.6	956.2	687.5	68.8	100.0	0.0
Bonus issues	9,627.8	5,898.3	3,807.3	850.3	1,152.5	720.1	1,362.8
Of which, scrip dividend[4]	9,627.8	5,898.3	3,807.3	850.3	1,152.5	720.1	1,362.8
Capital increases by debt conversion	1,868.7	2,343.9	1,648.8	23.6	0.0	125.5	1.6
Capital increases against non-monetary considerations[5]	365.2	1,791.7	8,469.3	8,122.6	238.8	49.9	1,179.1
With pre-emptive subscription right	7,932.6	6,513.3	7,831.4	11.7	7,102.9	531.6	574.7
Other increases (including accelerated book builds)	8,939.7	2,390.2	6,880.5	354.1	27.6	562.4	141.0
Public offering of shares	8,331.6	506.6	2,944.5	1,018.0	0.0	567.3	645.7
***Pro memoria*: MAB transactions[6]**							
Number of issuers	16	15	13	6	1	3	1
Number of issues	18	21	15	6	1	4	3
Cash amount (million euros)	177.8	219.7	129.9	84.2	10.9	26.2	13.2
Capital increases	177.8	219.7	129.9	84.2	10.9	26.2	13.2
Of which, primary offerings	21.6	9.7	17.1	14.1	0.0	3.0	0.0
Public offering of shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: BME and CNMV.

1 Primary offerings and Public offering of shares are usually known as IPO (Initial Ofering) in data vendors.

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

3 Transactions linked to the exercise of green shoe options are separately accounted for.

4 In scrip dividends, the issuer gives existing shareholders the option of receiving their dividend in cash or converting it into shares in a bonus issue.

5 Capital increases for non-monetary consideration have been stated at market value.

6 Transactions not registered with the CNMV.

The issuance of new shares was largely the result of capital increases under scrip dividends and for non-monetary consideration. There was also one public offering of shares by a real estate company.

In the first quarter of the year, equity issues made on Spanish markets amounted to 3.9 billion euros, less than half the sum issued in the same period of the previous year, when the financial restructuring of Abengoa took place. If we discount the amount issued by this company, equity issues in the first quarter of the year would have grown by 34.7% on the same period of 2017. On this occasion, there was one public offering of shares for an amount of 645 million euros, corresponding to a real estate company, as was the case in the last quarter of 2017. Capital increases consisted primarily of scrip dividends, which reached values greater than those recorded in the same period of 2017[20], and, to a lesser extent, capital increases for a non-monetary consideration, which have grown as a result of the issue of Bankia shares in the merger by absorption with Banco Mare Nostrum (BMN). Capital increases with pre-emptive subscription rights also rose and amounted 575 million euros.

Capital Markets Union EXHIBIT 2

Over 2017, the European Commission specified many of the measures of its Action Plan on Building a Capital Markets Union in 2019. The aim is to improve the access of savings to investment and to provide sources of non-bank financing. In January, the European Commission undertook a public consultation on the effectiveness of the measures that have already been adopted with the aim of reviewing the initial strategy, and in June it published a communication on the mid-term review. The main actions that have already been adopted are as follows:

– **Financing for innovation, start-ups and non-listed companies:** i) agreement of the co-legislators on a review of the EuVECA[1] and EuSEF[2] Regulations; ii) publication of a report on practices to apply tax incentives to venture capital and business angels; iii) publication of a FinTech action plan, and iv) publication of a proposal for a regulation on European crowdfunding service providers.

– **Making it easier for companies to enter and raise capital on capital markets:** i) publication of the Prospectus Regulation; ii) publication of a report by the expert group on corporate bond market liquidity; iii) publication of a report with the launch of the public consultation on barriers to SME admission on public markets and SME growth markets, and (iv) publication of a legislative proposal to improve the proportionality of prudential rules for investment firms.

– **Promoting long-term, infrastructure and sustainable investment:** i) in the context of the Capital Requirements Directive and Regulation, agreement on the calibration of investments in infrastructure; ii) publication of a public consultation on institutional investors and asset managers' duties regarding sustainability; iii) publication of an action plan on sustainable finance; and iv) legislative proposal on facilitating cross-border distribution of investment funds.

20 It is common in the first few days of January each year for several large companies – many from the electricity and gas sector – to distribute scrip dividends.

– **Fostering retail investment:** i) study on distribution systems of retail investment products, and ii) recurrent reporting by the European Supervisory Authorities on cost and performance of the principal categories of long-term retail investment and pension products.

– **Strengthening banking capacity to support the wider economy:** i) political agreement on legislative proposal for simple, transparent and standardised securitisation, and ii) legislative proposal for an EU framework on covered bonds.

– **Strengthening the capacity of EU capital markets:** i) publication of a proposed amendment to the European System of Financial Supervision, and ii) design of an EU strategy on local and regional capital market developments.

– **Facilitating cross-border investment:** i) publication of a report on barriers to the free movement of capital; ii) publication of an expert group report and launch of a public consultation on "Giovannini barriers" relating to post-trade; iii) publication of a code of conduct on withholding tax; iv) adoption of a regulation on the establishment of the structural reform support programme for the period 2017 to 2020; v) publication of a legislative proposal on the law applicable to cross-border transactions in claims and securities, and vi) publication of a communication clarifying conflict-of-law rules for securities.

1 Regulation (EU) 345/2013, of the European Parliament and of the Council, on European venture capital funds.
2 Regulation (EU) 346/2013, of the European Parliament and of the Council, on European social entrepreneurship funds.

3.2 Fixed-income markets

The expectation of a normalisation of monetary policy led to slight upturns in the yields of medium and long-term public and private debt in Europe…

Spanish fixed-income markets, like those of other European countries, remained broadly stable in the final months of 2017, although anticipating a toughening of the ECB's monetary policy, whose purchase programmes will likely be reduced to nothing over the year. The ECB's confirmation in January that it would extend its purchase programme until September[21], although with a reduced amount of 30 billion euros per month, as well as removal of the possibility of extending the amount of said programme, led to slight upturns in the yields on most medium and long-term public and private debt assets in Europe.

...offset in Spain by the fall in the risk premium as a result of the buoyant economy, the improvement in the credit rating and an easing of political uncertainties.

In Spain, the increases were more than offset by the fall in the sovereign credit spread, which took place following the upgrading of the sovereign rating set by Fitch and Standard & Poor's[22]. In this context, Spanish government debt yields, like

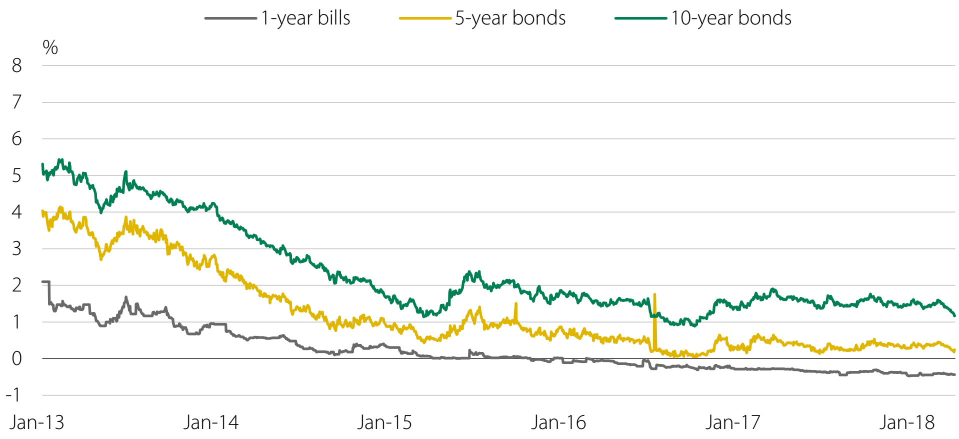
21 At the end of January, the ECB confirmed that the net asset purchases for a monthly amount of 30 billion euros would continue until the end of September, and in March it confirmed that it was dropping the possibility of increasing the volume of asset purchases.
22 In January, Fitch upgraded Spain's sovereign credit rating from BBB+ to A- with a stable outlook, while Standard & Poor's upgraded the rating in March from BBB + to A- with a positive outlook.

those in Portugal[23] and Italy, fell slightly, with sharp falls in long-term debt, favoured by the improvement in their credit risk. Corporate debt yields also fell slightly, as they are still supported by the ECB's corporate sector purchase programme[24]. The Spanish credit spread fell significantly to 67 bp, its lowest value since the start of the sovereign debt crisis in 2010. This fall is the result of the improvement in the economy, the upgrading of the sovereign credit rating and the easing of political uncertainties.

Despite the expectations of increasingly expensive financing over the long term, debt issues by Spanish issuers have fallen.

Despite the favourable context, debt issuance by Spanish issuers fell moderately in the first quarter of the year, although unevenly among the different asset types. In particular, there was year-on-year growth in issues of covered bonds and commercial paper, while issues of bonds (both those registered with the CNMV and those registered abroad) fell despite the expectations of increasingly expensive financing over the long term. Spanish issuers are likely to cover a large part of their financing needs in 2017, taking advantage of the positive market situation.

Spanish government debt yields FIGURE 17



Source: Thomson Datastream.

Yields on short-term government bonds remain at historic lows after over two years in negative figures.

Yields on short-term government bonds, which ended 2017 at historic lows, remained broadly unchanged in the first quarter of the year for the shortest terms, and performed rather unevenly for medium-term and long-term bonds. Despite expectations of a toughening of monetary policy in the euro area, the yields on short-term government bonds remained negative, as has been the case for over two years now. Their movements were conditioned by the accommodative monetary policy followed by the ECB, whose official rates have remained at historic lows. At the end of March, the secondary market yields on three-month, six-month and twelve-month Letras del Tesoro stood at -0.55%, -0.46% and -0.42%, respectively, similar to the levels of the previous quarter and slightly below the minimum annual yield of 0.4% established by the ECB in its debt purchase programmes (the deposit facility rate).

23 In September 2017, Standard & Poor's raised its rating on Portugal to BBB-, with its debt therefore becoming investment grade.

24 In the framework of its Public Sector Purchase Programme (PSPP), which had accumulated by mid-March public debt purchases in an amount of 1.94 trillion euros, with 235.74 billion euros corresponding to Spanish debt.

All Letras del Tesoro auctions were again settled at negative rates. The last ones carried out in March were settled at similar rates to the previous auction and even lower in some terms. Corporate debt traced a similar path, with insignificant changes over the quarter. Yields when issued stood at values ranging between 0.24% for the twelve-month benchmark and 0.29% for commercial paper at three months (see table 8).

Short-term interest rates[1]

TABLE 8

%	Dec-15	Dec-16	Dec-17	Jun-17	Sep-17	Dec-17	Mar-18
Letras del Tesoro							
3 months	-0.15	-0.47	-0.62	-0.41	-0.42	-0.62	-0.55
6 months	-0.01	-0.34	-0.45	-0.39	-0.39	-0.45	-0.46
12 months	-0.02	-0.25	-0.42	-0.36	-0.36	-0.42	-0.42
Commercial paper[2]							
3 months	0.31	0.18	0.39	0.18	0.28	0.39	0.29
6 months	0.42	0.20	0.26	0.42	0.04	0.26	0.22
12 months	0.53	0.15	0.19	0.10	-0.03	0.19	0.24

Sources: Thomson Datastream and CNMV.

1 Monthly average of daily data.

2 Interest rates at issue.

The long-term yield on government bonds fell thanks to the fall in the risk premium.

Yields on medium-term and long-term government bonds began the quarter with rises in Europe, but in Spain these rises were subsequently offset by the fall in the risk premium, which allowed the benchmark ten-year bond yields to remain at historic lows. The average yield on three-year, five-year and ten-year government bonds in the secondary market in March stood at -0.07, 0.3% and 1.35%, respectively (see table 9). The yields on the three-year and five-year benchmarks have hardly changed although it should be pointed out that the yield remains negative up to a term of four years. The ten-year yield fell by 9 bp.

Medium and long-term bond yields[1]

TABLE 9

%	Dec-15	Dec-16	Dec-17	Jun-17	Sep-17	Dec-17	Mar-18
Government bonds							
3 year	0.24	0.04	-0.09	-0.15	-0.07	-0.09	-0.07
5 year	0.72	0.35	0.31	0.22	0.31	0.31	0.30
10 year	1.72	1.44	1.46	1.46	1.57	1.46	1.35
Corporate bonds							
3 year	0.66	0.69	0.44	0.62	0.55	0.44	0.51
5 year	1.95	1.43	0.41	1.05	0.91	0.41	0.39
10 year	2.40	2.14	1.16	1.82	1.92	1.16	1.04

Sources: Thomson Datastream, Reuters and CNMV.

1 Monthly average of daily data.

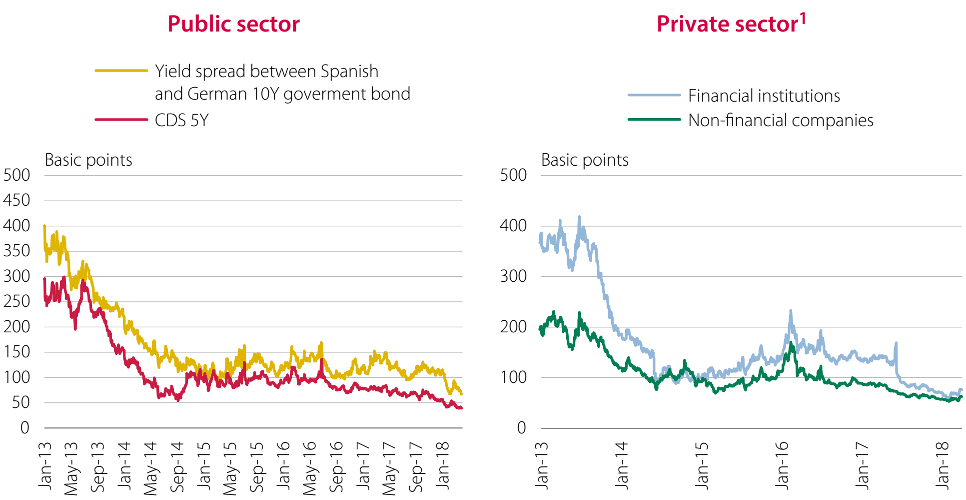
Corporate debt yields also fell as a result of uncertainties in equity markets and the positive impact of the ECB's debt purchase programme despite it becoming increasingly limited.

Corporate debt yields recorded a similar performance as, despite the expectations of a hardening of monetary policy, which favours an increase in yields, investors continue opting to buy corporate debt, which forces down yields. In this context, yields on three-year corporate bonds rose by 7 bp in the first quarter of the year to 0.51%, while the yields on five-year and ten-year bonds fell by 2 bp and 12 bp to 0.39% and 1.04%, respectively. They still benefited from the positive impact of the ECB's corporate sector purchase programme, some of which is carried out directly in the primary market[25] and is concentrated in issues with longer maturities.

The sovereign risk premium fell significantly (almost 50 bp to 67 bp), to stand at its lowest level since 2010.

The sovereign risk premium began the quarter with significant falls triggered by the positive performance of the Spanish economy, as reflected in the improvement in the sovereign debt rating, together with the easing of political uncertainties and, to a lesser extent, the positive impact of the ECB maintaining its public sector purchase programme. The risk premium, measured as the spread between the Spanish ten-year bond and the German benchmark stood at 67 bp at the end of March compared with 114 bp at the beginning of the year. The cumulative fall over the first quarter was therefore close to 50 bp, which places the risk premium at its lowest level since 2010, when the sovereign debt crisis in Europe began. The credit risk premium, assessed through the CDS of the Spanish sovereign bond, followed a similar path, although with more modest falls. It stood at 39 bp at the end of the quarter compared with 57 bp at the start of the year, the lowest level since 2008 (see left-hand panel of figure 18).

Risk premium paid by Spanish issuers FIGURE 18



Sources: Thomson Datastream and CNMV.

1 Simple average of the 5-year CDS of a sample of issuers.

The risk premiums of the private sectors of the economy have risen slightly, which might be due to the likely impact of a tightening of monetary policy on their finance costs.

The risk premiums of the private subsectors of the economy diverged from that of sovereign debt, with slight upturns, which may be explained by the outlook of a tightening of the ECB's monetary policy and the impact that the increase in the cost of financing would have on the most leveraged companies. Although, in theory, a

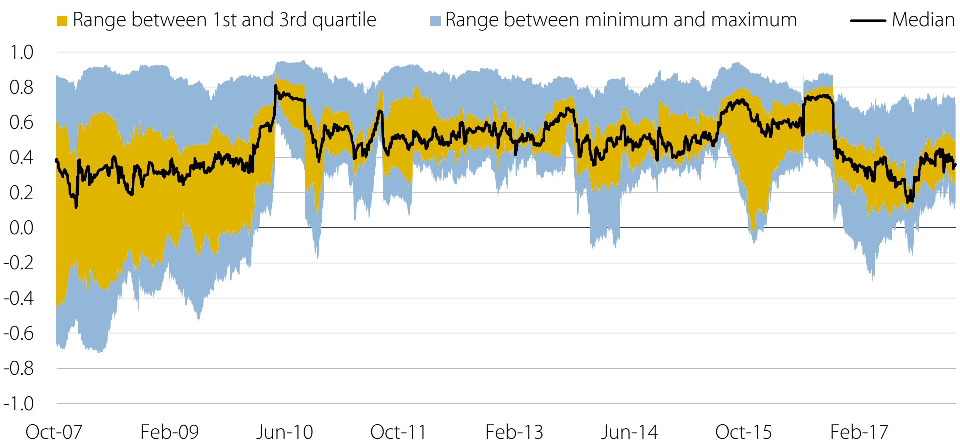
25 Purchases in the primary market in February accounted for 16.13% of total purchases performed under this programme.

scenario of a normalisation in monetary policy and rate hikes favours a widening of the margins of financial institutions, they might suffer from a scenario of greater market volatility as well as greater uncertainties in their business as a result of the increase in the finance costs of their clients. In addition, although there has been no specific purchase programme for their debt, financial institutions benefited from the positive effect of the covered bond purchase programme (CBPP3) and the asset-backed securities purchase programme (ABSPP)[26], whose purchases have also been reduced. The risk premiums of large non-financial companies would have also suffered both effects, i.e., both the effect of a possible increase in interest rates and the reduced impact of the corporate sector purchase programme[27]. As shown in the right-hand panel of figure 18, the average of the CDS of financial institutions stood at 76 bp at the end of the quarter, above the 70 bp at the end of 2017. Meanwhile, in non-financial companies, the average of the risk premiums on the same date was 62 bp, compared with 58 bp at the beginning of the year.

The level of correlation between the prices of the different financial asset classes rose significantly in the second half of 2017, coinciding with times of greatest tension in the Catalan institutional crisis. This value has remained relatively stable since then, with a temporary upturn at the start of the quarter to its highest value of the last year. Nevertheless, it remains below the average recorded over the last decade.

The correlation between asset prices, which had increased in the second half of 2017, has remained stable.

Indicator of correlation between asset classes[1] FIGURE 19



Sources: Thomson Datastream and CNMV.

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 companies, 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.

2 As from 7 June 2017, the calculation of the return on the asset class corresponding to financial fixed income excludes the CDS on the five-year senior debt of Banco Popular.

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26 Up to 16 March, the covered bond purchase programme (CBPP3) had accumulated covered bonds in an amount of 249.57 billion euros (35.6% of which were bought on the primary market), while the asset-backed securities purchase programme (ABSPP) held a balance of 26.27 billion euros (45.6% of which were bought on the primary market).

27 The ECB has purchased securities of 17 Spanish issuers under this programme.

Gross fixed-income issues

TABLE 10

Registered with the CNMV	2014	2015	2016	2017	2017 III	2017 IV	2018 I
NOMINAL AMOUNT (million euros)	**130,258**	**136,607**	**139,028**	**109,487**	**13,156**	**47,852**	**19,959**
Mortgage covered bonds	23,838	31,375	31,643	29,824	5,175	13,349	5,125
Territorial covered bonds	1,853	10,400	7,250	350	0	0	0
Non-convertible bonds and debentures	41,155	39,100	40,170	30,006	1,125	12,632	4,983
Convertible/exchangeable bonds and debentures	750	53	0	0	0	0	0
Asset-backed securities	29,008	28,370	35,505	29,415	2,969	16,328	5,431
Commercial paper[1]	33,654	27,310	22,960	17,911	2,906	5,544	3,170
Securitised	620	2,420	1,880	1,800	0	800	0
Other commercial paper	33,034	24,890	21,080	16,111	2,906	4,744	3,170
Other fixed-income issues	0	0	1,500	981	981	0	0
Preferred shares	0	0	0	1,000	0	0	1,250
Pro memoria:							
Subordinated issues	7,999	5,452	4,279	6,505	1,370	1,659	1,857
Underwritten issues	196	0	421	0	0	0	0

Abroad by Spanish issuers	2014	2015	2016	2017	2017 III	2017 IV	2018 I[2]
NOMINAL AMOUNT (million euros)	**56,736**	**66,347**	**58,587**	**84,771**	**22,701**	**18,379**	**14,866**
Long term	35,281	33,362	31,655	61,125	14,931	11,445	5,038
Preferred shares	5,602	2,250	1,200	5,844	1,750	2,094	0
Subordinated debt	3,000	2,918	2,333	5,399	1,050	0	0
Bonds and debentures	26,679	28,194	28,122	49,882	12,131	9,351	5,038
Asset-backed securities	0	0	0	0	0	0	0
Short term	21,455	32,984	26,932	23,646	7,770	6,934	9,828
Commercial paper	21,455	32,984	26,932	23,646	7,770	6,934	9,828
Securitised	0	0	0	0	0	0	0

Pro memoria: **Gross issues of subsidiaries of Spanish companies resident abroad**

	2014	2015	2016	2017	2017 III	2017 IV	2018 I[2]
NOMINAL AMOUNT (million euros)	**42,170**	**55,286**	**56,674**	**65,423**	**12,075**	**21,872**	**15,550**
Financial institutions	10,201	14,875	11,427	20,309	3,777	8,622	6,517
Non-financial companies	31,969	40,411	45,247	45,114	8,298	13,250	9,033

Sources: CNMV and Banco de España.

1 The figures for commercial paper issues correspond to the amounts placed.

2 Data to 28 February.

The CNMV registered 19.96 billion euros of bond issues in the first quarter of the year, 22% down on the same period of 2017. The issue volume, which remains at low levels, is again explained by the lower financing needs of financial institutions, competition from traditional bank financing - with improved conditions in terms of price and volume - and continuation of foreign issuance by large companies. In absolute terms, the largest falls were recorded in bonds and debentures, which fell to less than half to stand below 5 billion euros. In contrast, the greatest growth was recorded in issues of mortgage covered bonds, which were almost three times higher. It is possible that the growth in these issues is the result of financial institutions choosing to take advantage of the facilities offered by the ECB before they disappear or become more restrictive[28]. Also noteworthy was an issue by Caixabank of perpetual preferred securities contingently convertible in an amount of 1.25 billion euros, which was aimed at institutional investors.

The volume of fixed-income issues registered with the CNMV fell in the first quarter…

Fixed-income issuance abroad by Spanish issuers in the first two months of the year was slightly higher than the same period of 2017 and amounted to almost 15 billion euros. The largest increase corresponds to commercial paper issues, which were three times higher, while long-term assets fell by half. In relative terms, the proportion of these issues stood at 46% of the total amount issued by Spanish companies in 2017 and the preliminary data of this year seem to indicate that their proportion of total issues will remain significant.

… while those of Spanish issuers abroad grew once again, although largely concentrated in short-term debt.

Finally, issues by subsidiaries of Spanish companies in the rest of the world rose by 30% on 2017 to 15.55 billion euros. Almost 60% of this amount corresponds to non-financial companies, while the rest corresponds to banks. In general, Spanish companies have continued to issue debt in anticipation of this route of funding becoming more expensive once the ECB starts to normalise its monetary policy.

4 Market agents

4.1 Investment vehicles

Financial CIS[29]

Assets managed by mutual funds rose by 11.5% in 2017 to 265.2 billion euros, thus consolidating the expansion that began in 2013 (see table 12). Almost 80% of this growth was due to subscriptions by investors, which rose in net terms to a cumulative figure of 21.34 billion euros over the year, of which 5.65 billion euros corresponded to the last quarter (see table 11). However, this performance was not seen in all fund categories. On the one hand, global funds recorded the best performance, with net subscriptions of 12.98 billion euros followed, at some distance, by mixed equity and International equity funds, whose net subscriptions stood at 5.51 billion

The assets managed by mutual funds grew by over 11% in 2017, largely thanks to the high level of subscriptions by unit-holders, particularly in global funds and equity funds…

28 Although their volume is limited by the balance of outstanding mortgage loans, mortgage covered bonds benefit in their issue costs from the ECB's covered bond purchase programme (CBPP3).

29 Hedge funds and funds of hedge funds are financial CIS, but due to their specific features they are described in a separate sub-heading.

euros and 4.5 billion euros, respectively. Absolute return funds also recorded a high level of subscription, with a figure of 4.38 billion euros.

... and despite the disinvestment in the most conservative categories.

On the other hand, the largest net redemptions were recorded in passively-managed funds and fixed-income funds, with falls of 4.58 billion euros and 3 billion euros, respectively. In 2016, the assets under management in these two categories had recorded substantial growth thanks to a high level of subscriptions. Guaranteed fixed-income funds, following the downward trend of recent years, suffered net redemptions of 2.89 billion euros. It can therefore be inferred that investors once again took up the trend that began in 2013, and which was partially reversed in 2016, on choosing funds with a medium-high risk level to the detriment of more conservative funds, in the search for higher returns.

The return on fund portfolios also had a positive effect on the increase in assets under management, as it reached 2.4%, being particularly high in the first quarter.

The return on fund portfolios in 2017 also contributed to the growth in assets under management, as it rose to 2.42% compared with 0.98% in the previous year. In general terms, the first quarter saw the best performance, particularly in the case of mutual funds with a high proportion of equity in their portfolios thanks to the strong share price gains over said period. The funds with the highest returns were euro equity funds and international equity funds, with 11.16% and 8.75%, respectively. Only fixed-income funds ended the year with a negative return, in this case of -0.13%, with the lowest returns recorded in the last quarter (-0.08%).

Net mutual fund subscriptions TABLE 11

				2017			
Million euros	2015	2016	2017	I	II	III	IV
Total mutual funds	**23,466.6**	**13,782.4**	**21,338.4**	**6,266.4**	**5,968.3**	**3,458.6**	**5,645.1**
Fixed-income[1]	-5,351.4	7,613.8	-2,998.7	-1,952.6	-1,181.5	66.4	69.0
Mixed fixed-income[2]	21,167.5	-3,177.6	2,501.7	1,151.3	395.1	242.7	712.6
Mixed equity[3]	8,153.8	-3,030.2	5,509.6	1,529.4	1,679.7	810.2	1,490.3
Euro equity[4]	468.9	-542.9	2,544.9	397.9	957.7	646.3	543.0
International equity[5]	4,060.5	346.6	4,502.9	1,961.7	403.2	1,022.7	1,115.3
Guaranteed fixed-income	-6,807.4	-3,202.7	-2,890.0	-832.0	-778.5	-931.7	-347.8
Guaranteed equity[6]	-2,599.8	5,478.4	-588.4	844.6	-439.5	-454.4	-539.1
Global funds	5,805.3	3,579.9	12,984.3	3,350.4	4,353.3	1,641.8	3,638.8
Passively managed[7]	-6,264.2	5,790.0	-4,580.8	-1,181.4	-1,215.0	-734.2	-1,450.2
Absolute return[7]	4,811.4	946.4	4,378.9	997.0	1,793.8	1,148.9	439.2

Source: CNMV. Estimated data.

1 Includes: Euro fixed-income, international fixed-income and money market funds (from the third quarter of 2011, money market funds compass those engaging in money markets and short-term money market investments, Circular 3/2011).

2 Includes: Euro mixed fixed-income and International mixed fixed-income.

3 Includes: Euro mixed equity and International mixed equity.

4 Includes: Euro equity.

5 Includes: International equity.

6 Includes: Guaranteed equity and Partial guarantee.

7 New categories since II-09. All absolute return funds were previously classified under Global Funds.

The reduction in the supply of funds that began in 2013 due to the streamlining undertaken by management companies (the number of funds fell by 457 in four years) continued in 2017, although at a lower rate. The number of funds at the end of the year stood at 1,741, 64 down on year-end 2016. The largest fall, in line with the negative trend of recent years, was recorded in guaranteed fixed-income funds, with 43 fewer funds, followed by passively-managed and fixed-income funds, the number of which fell by 18 and 13, respectively. In contrast, the category that recorded the highest increase was that of global funds, with 22 more funds, thus extending the expansive trend of 2016, when the number of funds rose by 25. The number of international equity funds, mixed equity funds and mixed fixed-income funds rose by 10, 8 and 7, respectively.

The number of funds continued to fall in 2017, dropping to 1,741, thus extending the downward trend that began in 2013, although at a slower rate than in previous years.

In line with the trend in assets under management, the number of unit-holders in mutual funds rose by 24.6% to over 10.2 million at the end of the year. The largest increase was recorded in international equity funds, with 693,000 more unit-holders, followed by global funds and euro equity funds, with increases of 428,000 and 315,000, respectively. Guaranteed fixed-income funds, whose unit-holders have been falling gradually since 2013, when they numbered over 1 million, recorded the largest reduction in investors, with 118,000 fewer unit-holders, dropping to 190,000. Passively-managed funds also recorded a reduction in unit-holders, with 107,000 fewer, and, to a lesser extent, guaranteed equity funds, which recorded a reduction of 24,000.

The number of unit-holders moved in line with assets under management and recorded growth of 25% in 2017 to over 10 million.

With the provisional data from January this year, it seems that the upward trend in collective investment continues. The assets under management of mutual funds grew by 2.2% to over 270 billion euros in January, while the number of unit-holders increased to 10.5 million. The number of funds, however, remained fairly stable.

The expansion of the mutual fund industry continued in the first month of 2018.

Main mutual fund variables*

TABLE 12

Number	2015	2016	2017	2017 I	2017 II	2017 III	2017 IV
Total mutual funds	**1,804**	**1,805**	**1,741**	**1,815**	**1,804**	**1,795**	**1,741**
Fixed-income[1]	319	306	290	296	299	294	290
Mixed fixed-income[2]	132	148	155	154	154	158	155
Mixed equity[3]	142	168	176	172	173	177	176
Euro equity[4]	109	112	111	114	112	113	111
International Equity[5]	200	201	211	209	212	210	211
Guaranteed fixed-income	186	122	79	111	100	90	79
Guaranteed equity[6]	205	198	188	201	197	190	188
Global funds	178	203	225	208	217	223	225
Passively managed[7]	213	220	202	218	212	213	202
Absolute return[7]	97	106	104	111	107	106	104
Assets (million euros)							
Total mutual funds	**222,144.6**	**237,862.2**	**265,194.8**	**247,279.3**	**253,581.1**	**258,466.2**	**265,195**
Fixed-income[1]	65,583.8	74,226.4	70,563.9	72,038.9	71,124.9	70,297.1	70,563.9
Mixed fixed-income[2]	44,791.8	40,065.6	43,407.0	41,468.7	41,777.8	42,668.4	43,407.0
Mixed equity[3]	21,502.9	16,310.6	22,386.7	18,159.5	19,831.4	20,754.6	22,386.7
Euro equity[4]	9,092.9	8,665.9	12,203.2	9,874.5	10,996.5	11,753.3	12,203.2
International equity[5]	17,143.2	17,678.8	24,064.6	20,687.1	20,994.3	22,445.3	24,064.6
Guaranteed fixed-income	12,375.6	8,679.8	5,456.7	7,694.5	6,858.1	5,828.2	5,456.7
Guaranteed equity[6]	9,966.6	15,475.7	15,417.5	16,418.9	16,183.3	15,909.7	15,417.5
Global funds	12,683.3	20,916.8	35,511.5	24,735.0	29,044.8	31,439.9	35,511.5
Passively managed[7]	17,731.1	23,601.6	19,477.8	22,701.7	21,601.5	20,972.4	19,477.8
Absolute return[7]	11,228.1	12,215.2	16,705.9	13,474.6	15,142.6	16,371.3	16,705.9
Unit-holders							
Total mutual funds	**7,682,947**	**8,253,611**	**10,287,454**	**9,332,934**	**9,569,922**	**10,068,296**	**10,287,454**
Fixed-income[1]	2,203,847	2,347,984	2,627,547	2,554,194	2,656,675	2,660,197	2,627,547
Mixed fixed-income[2]	1,130,190	1,043,798	1,197,523	1,169,480	1,114,668	1,154,688	1,197,523
Mixed equity[3]	612,276	448,491	584,408	485,795	533,200	552,773	584,408
Euro equity[4]	422,469	395,697	710,928	429,147	515,999	663,541	710,928
International equity[5]	1,041,517	1,172,287	1,865,367	1,505,724	1,547,970	1,790,875	1,865,367
Guaranteed fixed-income	423,409	307,771	190,075	273,188	239,787	205,956	190,075
Guaranteed equity[6]	417,843	552,445	527,533	576,664	560,146	542,772	527,533
Global funds	381,590	658,722	1,086,937	857,135	903,273	985,627	1,086,937
Passively managed[7]	554,698	746,233	638,966	723,472	697,071	673,604	638,966
Absolute return[7]	479,182	565,325	858,170	743,411	786,472	823,971	858,170
Return[8] (%)							
Total mutual funds	**0.89**	**0.98**	**2.42**	**1.35**	**0.16**	**0.56**	**0.33**
Fixed-income[1]	0.10	0.52	-0.13	-0.07	-0.03	0.05	-0.08
Mixed fixed-income[2]	0.16	0.27	1.10	0.58	0.02	0.38	0.12
Mixed equity[3]	0.15	1.19	3.23	1.95	-0.12	0.80	0.57
Euro equity[4]	3.44	2.61	11.16	8.57	2.06	0.55	-0.23
International equity[5]	7.84	4.15	8.75	5.67	-0.46	2.09	1.27
Guaranteed fixed-income	0.27	-0.03	0.72	-0.35	0.48	0.29	0.30
Guaranteed equity[6]	1.07	0.19	1.61	0.41	0.68	0.48	0.03
Global funds	2.45	1.99	4.46	2.08	0.07	0.94	1.31
Passively managed[7]	0.53	1.16	2.13	1.30	0.52	0.50	-0.20
Absolute return[7]	0.12	0.38	1.44	0.50	0.27	0.43	0.23

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 fixed-income, international fixed-income and money market funds (from the third quarter of 2011, money market funds compass those engaging in money markets and short-term money market investments, Circular 3/2011).

2 Includes: Euro mixed fixed income and International mixed fixed income.

3 Includes: Euro mixed equity and International mixed equity.

4 Includes: Euro equity.

5 Includes: International equity.

6 Includes: Guaranteed equity and Partial guarantee.

7 New categories since II-09. All absolute return funds were previously classified under Global Funds.

8 Annual return for 2014, 2015 and 2016. Quarterly data comprise non-annualised quarterly returns.

The liquidity conditions of the fixed-income portfolio, which had improved significantly between 2010 and 2014 and had remained relatively stable in 2015 and 2016, worsened slightly over 2017. The percentage of less-liquid assets in mutual funds in the last quarter of the year stood at 1.5%, 0.3 percentage points up on year-end 2016, rising from 2.96 billion euros to 3.93 billion euros. Despite this increase, these figures are very far from those recorded in 2009, when less-liquid assets accounted for almost 9% of total fund assets. With regard to their composition, there was a gradual increase in low liquidity assets in the fixed-income portfolio of financial institutions with a rating below AA, with an increase of 755 million euros in 2017, rising from 5.2% of total assets in the portfolio to 7%. The proportion of less-liquid securitisations also grew in 2017, by over 20 percentage points, rising from 73% of total securitisations at year-end 2016 to 93.8% (see table 13).

The liquidity conditions of the fixed-income portfolio of mutual funds worsened slightly in 2017

Estimated liquidity of mutual fund assets TABLE 13

	Less-liquid investments					
	Million euros			% total portfolio		
Asset type	**Jun-17**	**Sep-17**	**Dec-17**	**Jun-17**	**Sep-17**	**Dec-17**
Financial fixed income rated AAA/AA	39	28	22	5.1	4.0	3.5
Financial fixed income rated below AAA/AA	1,644	1,795	1,929	6.2	6.5	7.0
Non-financial fixed income	898	999	925	5.6	5.9	5.2
Securitisations	963	964	1,058	92.5	92.8	93.8
AAA-rated securitisations	120	100	84	100.0	100.0	100.0
Other securitisations	843	863	974	91.5	92.1	93.3
Total	**3,544**	**3,785**	**3,934**	**8.0**	**8.2**	**8.4**
% of mutual fund assets	**1.4**	**1.5**	**1.5**			

Source: CNMV.

Real estate CIS

Despite the improvement in the construction and real estate sector since 2015, the key variables of real estate CIS worsened slightly in 2017.

Real estate CIS continued suffering setbacks in 2017.

Real estate funds, which were hit hardest by the effects of the crisis, shed 2.7% of their assets to end 2017 with 360 million euros. This contraction was caused by the negative returns suffered by real estate funds over the year, particularly in the second quarter, which in cumulative terms stood at -2.6%. Although these values are better than those recorded by these funds in the middle years of the crisis (a return of -11.3% in 2013), the recovery in the real estate sector has so far failed to work through to fund returns. The number of unit-holders fell significantly, specifically by 72%, with losses concentrated in the last quarter of the year. This fall was the result of the buyback of units by one fund owner from unit-holders that wished to sell. In December 2017, there was a total of 1,097 unit-holders, while the number of funds remained at three.

Real estate funds continued to record falls in assets managed as a result of their negative returns…

...while real estate investment companies recorded a fall in their assets as a result of de-registrations over the year.

The number of real estate investment companies, which had remained constant over the last two years, fell from six to four, after three de-registrations in 2017 (all of them in the last quarter) and one new registration. Assets managed by these companies fell by 10.7% to 631.5 million euros as a result of the aforementioned de-registrations. The number of shareholders fell by over 50%, dropping from 675 to 327.

Hedge funds

In 2017, hedge fund assets grew by 32%, while the number of funds rose by seven.

Hedge fund assets grew substantially over the first eleven months of 2017, rising by 31.7% to 2.73 billion euros. By the end of the year, the number of funds that had filed statements with the CNMV stood at 55, compared with 48 in 2016, following eight new registrations and one de-registration. The increase was recorded in hedge funds, which rose from 41 to 47 (six new registrations) and in funds of hedge funds, which rose from seven to eight (two new registrations and one de-registration). In the case of the latter, this increase was the first after they had fallen consistently since the start of the crisis, when a total of 41 vehicles of this type were registered.

Pure hedge fund assets rose by 26% and their return by 7%...

Pure hedge funds recorded an increase in assets of 26.3% to stand at 2.24 billion euros at the end of November (see table 14), mainly as a result of the increase in the value of their portfolio. The return of these funds stood at 7.01% between January and November 2017 and was particular high in the first quarter of the year (4.1%). Net subscriptions, in contrast, although still positive, were not particularly high (11.1 million euros), as they reflected the negative figure recorded in the second quarter. In the second half of the year, in contrast, net subscriptions amounted to 66.9 million euros, and the number of unit-holders rose by 22.2% to stand at 3,582.

Main hedge fund and fund of hedge fund variables

TABLE 14

				2017			
	2015	2016	2017[1]	I	II	III	IV[1]
FUNDS OF HEDGE FUNDS							
Number	11	7	8	8	9	9	8
Unit-holders	1,265	1,237	3,591	1,231	2,393	3,534	3,591
Assets (million euros)	319.8	293.7	482.7	293.2	327.0	472.0	482.7
Return (%)	6.16	0.90	-1.44	0.16	-2.04	0.36	0.09
HEDGE FUNDS							
Number	37	41	47	41	45	46	47
Unit-holders	3,089	2,930	3,582	3,080	3,308	3,444	3,582
Assets (million euros)	1,764.8	1,889.2	2,243.3	1,972.0	2,140.0	2,192.0	2,243.3
Return (%)	4.83	4.32	7.01	4.08	1.74	1.03	0.63

Source: CNMV.

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

In the segment of funds of hedge funds, which had recorded downturns in recent years, assets increased significantly (by 64.4%) to 482.7 million euros, as a consequence of the registration of two vehicles whose level of assets is high in relation to the others. For the same reason, the number of unit-holders almost trebled to 3,591 at the end of November. The return of these funds in the first eleven months of 2017 was negative (-1.44%), as they were dragged down by the poor performance in the second quarter (-2.04%), as in the other quarters the returns were all positive, although at very moderate levels.

… while the growth in funds of hedge funds was 64% even though their return was negative (-1.4%).

Foreign UCITS marketed in Spain

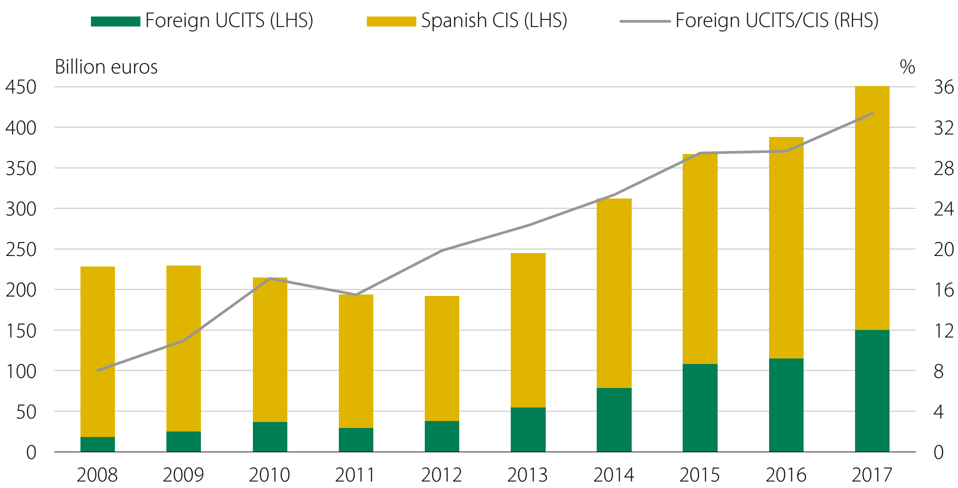
The expansion of the foreign UCITS segment in Spain that began in the middle of 2012, and which levelled off slightly in 2016, continued vigorously in 2017. The assets managed by these UCITS grew by 30.8% last year (6.1% in the last quarter) to over 150 billion euros, practically five times more than at the end of 2012 (see figure 20). This amount accounted for 33.4% of total assets managed by CIS marketed in Spain, four percentage points up on year-end 2016.

Expansion of foreign UCITS market in Spain, that began in 2012, continued vigorously in 2017: their investment volume amounted to 150 billion euros…

This increase in the investment in foreign UCITS was recorded both in funds and in companies, which are the entities with the highest level of assets. The assets managed by funds grew by 22.5% in the year as a whole, despite falling by 3.6% in the last quarter, to stand at 26.13 billion euros. The assets managed by companies grew by 32.7% over the year (8.3% between September and December) to 124.29 billion euros. In line with these results, the number of investors grew by 19.4% in the case of funds and by 29.5% of the case of companies, reaching a total of 2.23 million, 27.4% up on December 2016. The number of schemes grew in both cases, with 14 more funds and 58 more companies, with the year closing with a total of 1,013 vehicles (455 funds and 558 companies). As in previous years, most of the new registrations corresponded to undertakings from Luxembourg and Ireland. Five new funds were registered in the first quarter of the year, and hence at the end of February the total number of schemes stood at 1,018.

...and there are now over 1,000 vehicles, divided amongst funds (455) and companies (558).

Assets of foreign UCITS marketed in Spain FIGURE 20



Source: CNMV.

Outlook

Low interest rates and the growth in income favour the expansion of the collective investment industry. This sector, however, is not free from risks as it is particularly sensitive to moments of market turmoil.

The expansion of the collective investment industry in 2017 confirms the upward trend that began in 2012, with sharp growth in assets that has continued into the first months of this year. The current context of low interest rates that practically cancel the returns on bank deposits - the main competitors of the schemes - is likely to continue fuelling the resources of the collective investment industry over the short to medium term, particularly in the medium and high-risk categories. The increase in the income of investors also plays in favour of the sector. However, it is important to consider the fact that unit-holders are on average taking on higher risk than they traditionally assume and it is therefore essential that their decision-making is the result of appropriate knowledge about the products purchased. This factor will be particularly relevant in the event of turmoil in the markets as this may lead to high redemptions in some fund categories.

4.2 Investment firms

Broker-dealers and brokers

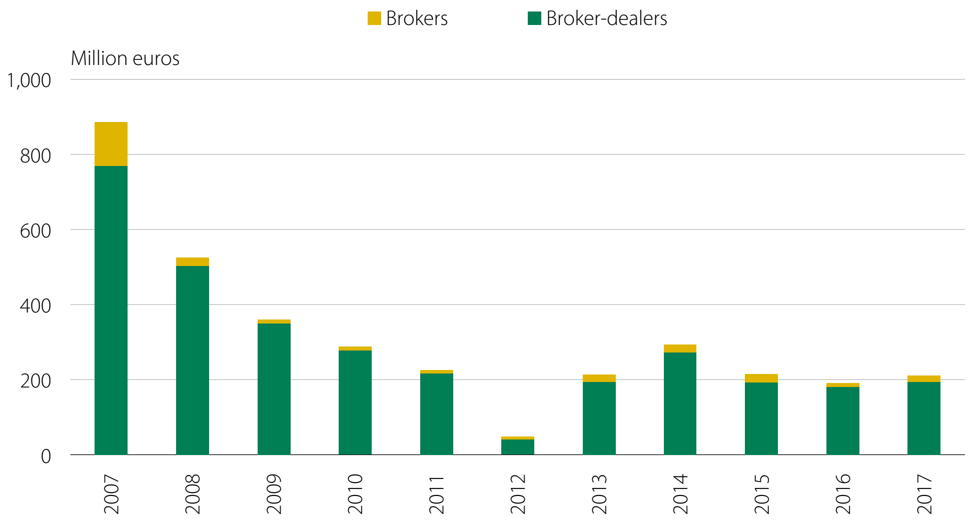
The profit of broker-dealers and brokers rose by almost 10% in 2017 thanks to a gradual change in their sources of income.

Broker dealers and brokers operated in more favourable conditions in 2017 than in previous years, particularly in the case of brokers. Even though these intermediaries only obtained 12% of the total income generated from the provision of investment services, in which credit institutions remain the most significant players, they were able to improve their profits by 9.8% in 2017. This was due to a gradual change in their business model, in which the traditional source of their main income (for order processing and execution) has been losing relative importance, while other lines of business, such as marketing CIS, portfolio management and investment advice, have been gaining importance.

A total of 89 entities were registered at the end of 2017, eight more than in 2016, thus reversing the contraction recorded in previous years.

At the end of 2017, the CNMV's register contained a total of 89 broker-dealers and brokers, eight more than at the end of 2016 (nine new registrations and one de-registration). This increase breaks the downward trend of recent years, which was related to the adjustments undertaken in the sector (in 2008 there was a total of 101 entities). As usual, most entities provide services in the European Union under the free provision of services (46) and only five entities maintain branches in other countries. For their part, the number of foreign entities that provide investment services in Spain continued to grow in 2017, both under the free provision of services (rising from 2,793 to 2,833) and by means of a branch (from 46 to 53).

Aggregate pre-tax profit of investment firms[1] FIGURE 21



Source: CNMV.

1 Except financial advisory firms and portfolio management companies.

The profit of broker-dealers rose by 7.1% in 2017 to 194 million euros as a result of the increase in most of the fee income…

Aggregate pre-tax profits of broker-dealers grew by 7.1% in 2017 to 194 million euros. The gross margin of broker-dealers fell slightly (by 0.3%) as the growth in net fee income (7.3%) was offset by the fall in net income from financial transactions (-61%). There was a gradual change in the importance of different types of financial services within fee income. Fees for order processing and execution, which remains the most important, fell by 11.4% in 2017, while fees from portfolio management, issue placement and underwriting and marketing CIS grew significantly (see table 15). The amount of income received for fees classified as "other" remained at similar levels to 2016 and accounted for 25% of total fees. This income is associated with ancillary services provided by broker-dealers.

… and the fall in operating expenses.

Finally, the slight fall in operating expenses (of 2.8%) and depreciation/amortisation (44.8%) led to operating profit growing by 6.3% to 180 million euros.

The distribution of profits was uneven amongst entities as just four of them concentrated over 76% of total profit and the number of loss-making entities remained stable at seven.

As has been the case in recent years, a small number of firms generated most of the profits in this sub-sector. In particular, four broker-dealers accounted for 76.2% of total profit, a higher level of concentration than in previous years. Furthermore, over half of the broker-dealers recorded an increase in profits in 2017. However, despite the general improvement in profits, seven entities incurred losses, the same number as in 2016, although the volume of such losses was higher (14.7 million euros compared with 8.9 million euros in 2016). In general, it seems that the larger entities are increasingly more profitable, while the smaller firms are suffering greater difficulties.

Aggregate income statement (December 2017)

TABLE 15

	Broker-dealers			Brokers		
Thousand euros	Dec-16	Dec-17	% change	Dec-16	Dec-17	% change
1. Net interest income	53,930	58,545	8.6	903	3,127	246.3
2. Net fee income	373,552	400,884	7.3	108,111	120,194	11.2
2.1. Fee income	538,586	547,776	1.7	129,682	142,323	9.7
2.1.1. Order processing and execution	245,700	217,667	-11.4	24,181	20,459	-15.4
2.1.2. Initial placement and underwriting	5,955	17,553	194.8	3,193	3,427	7.3
2.1.3. Securities administration and custody	47,843	38,175	-20.2	603	924	53.2
2.1.4. Portfolio management	23,738	50,467	112.6	11,054	12,492	13.0
2.1.5. Investment advisory services	2,547	5,551	117.9	8,614	11,572	34.3
2.1.6. Search and placement	2,155	1,500	-30.4	40	0	-100.0
2.1.7. Market trading	0	0	–	0	0	–
2.1.8. Marketing CIS	75,505	81,225	7.6	50,504	59,398	17.6
2.1.9. Other	135,143	135,640	0.4	31,494	34,052	8.1
2.2. Fee expense	165,034	146,892	-11.0	21,571	22,129	2.6
3. Profit from financial investments	104,292	40,996	-60.7	245	1,139	364.9
4. Net exchange differences	-29,731	4,290	–	154	-578	–
5. Other operating income and expense	28,554	24,160	-15.4	-1,184	-1,128	4.7
GROSS PROFIT MARGIN	**530,597**	**528,875**	**-0.3**	**108,229**	**122,754**	**13.4**
6. Operating expenses	351,951	341,944	-2.8	95,142	103,052	8.3
7. Depreciation, amortisation and other charges	10,451	5,764	-44.8	2,891	2,783	-3.7
8. Impairment losses on financial assets	-1,304	963	–	56	-10	–
OPERATING PROFIT (LOSS)	**169,499**	**180,204**	**6.3**	**10,140**	**16,929**	**67.0**
9. Other profit (loss)	11,695	13,808	18.1	682	-163	–
PROFIT (LOSS) BEFORE TAX	**181,194**	**194,012**	**7.1**	**10,822**	**16,766**	**54.9**
10. Corporate income tax	40,673	37,633	-7.5	3,840	4,876	27.0
PROFIT (LOSS) FROM CONTINUING OPERATIONS	**140,521**	**156,379**	**11.3**	**6,982**	**11,890**	**70.3**
11. Profit (loss) from discontinued operations	0	-407	–	0	0	–
NET PROFIT (LOSS) FOR THE YEAR	**140,521**	**155,972**	**11.0**	**6,982**	**11,890**	**70.3**

Source: CNMV.

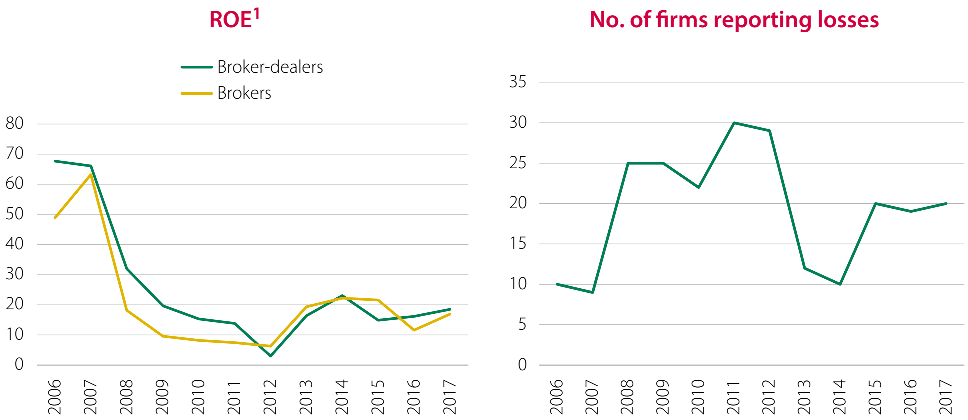
Brokers are more specialised than broker-dealers and include a much higher proportion of independent entities.

Brokers by definition may not invest on their own account and, therefore, their revenue almost exclusively comes from providing services to third parties. While some brokers obtain the bulk of their revenue from processing and executing orders, most tend to specialise in certain services, such as marketing CIS or portfolio management. In addition, unlike the case of broker-dealers, which are mostly controlled by a financial group, independent entities are much more important in this sector (27 out of 48).

Brokers' pre-tax profit rose by almost 55% in 2017 to 16.7 million euros as a result of the growth in most of the fees for providing financial services. The most significant growth was recorded in the headings of marketing CIS (17.6%), investment advisory services (34.3%) and portfolio management (13%). The only fees that fell were those for order processing and execution. These changes in fees, together with the 8.3% increase in operating expenses, led to an increase in operating profit of 67% to close to 17 million euros.

Their aggregate profit before tax rose by around 55% in 2017 to 16.7 million euros as a result of the growth in most fees…

Pre-tax ROE of investment firms and number of loss-making firms FIGURE 22



Source: CNMV.

1 ROE based on profit before tax.

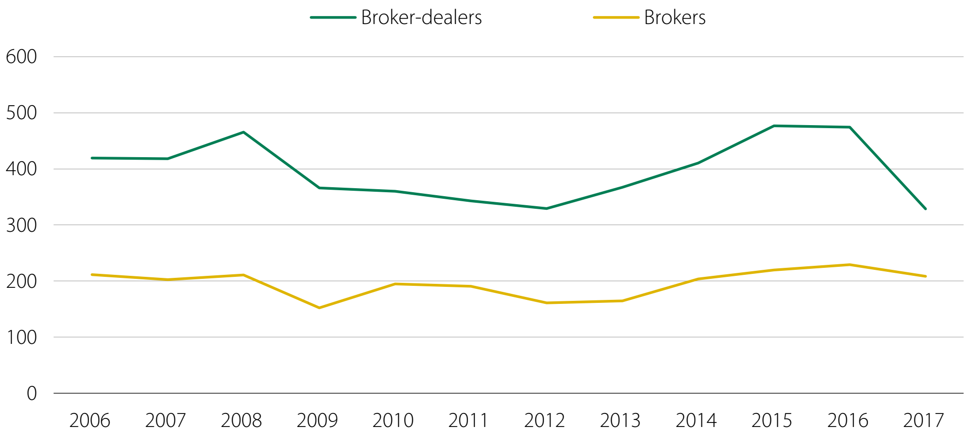
The increase in profits benefited a large number of brokers. Specifically, 67.5% of brokers recorded a growth in profits. However, the number of loss-making brokers increased from 11 in 2016 to 13 in 2017 and the volume of aggregate losses rose from 7.4 million euros to 7.95 million euros.

… but the number of loss-making brokers rose from 11 to 13, and the aggregate volume of said losses also grew.

The solvency levels of the sector remained high during 2017, although the values fell on the previous year. Accordingly, at the end of 2017, surplus capital was 3.2 times higher than the capital required compared with 4.5 times higher at the end of 2016. As usual, this margin was generally greater for broker-dealers than in brokers. While the capital adequacy ratio for broker-dealers was around 3.3, it remained at 2.1 for brokers. With regard to the distribution of this ratio, most broker-dealers continued to have surplus capital greater than 200%, while brokers recorded a wider range of figures. No broker-dealer or broker closed the year with a capital deficit, although, in the case of the latter, the gap provided by the equity capital was low as the amounts involved were not significant in absolute terms.

Sector solvency conditions remained high in 2017, although surplus capital fell on 2016.

Investment firm capital adequacy (Surplus of eligible capital over minimum capital requirements, %) FIGURE 23



Source: CNMV.

Financial advisory firms

The number of financial advisory firms rose in 2017 to 171, as did the assets under advice, which were 2% higher than in 2016.

The operations of the financial advisory firms continued to grow in 2017, albeit at a slower pace than in previous years. Assets under advice rose by 2% compared with the figures for year-end 2016 and stood at 30.8 billion euros, more than double the figure recorded in 2012. As shown in table 16, the distribution of assets amongst the different types of clients shifted in favour of retail and professional clients. The former grew from accounting for 25.1% of assets under management to 29.1%, while the latter rose from accounting for 18.7% to 21.1%. In contrast, the importance relating to eligible counterparties[30] (under the heading of "Others") fell by seven percentage points to 49.4%. The number of financial advisory firms also rose in 2017 from 160 at the end of 2016 to 171, following 16 new registrations and five de-registrations.

...which led to an increase in fee income from clients and also from other entities.

The management of a greater volume of assets meant that fee income rose by 22.4% in 2017 on the figure for 2016, to 63.7 million euros. Both fees received directly from clients and those corresponding to other entities rose in 2017, particularly the former, which grew by 25.1% to over 50 million euros. It is worth noting that 85% of the total amount of financial instruments included in the recommendations of financial advisory firms corresponded to CIS.

30 Eligible counterpart is the classification that MiFID typically gives banks, other financial institutions and governments, and is a category that requires a lower level of protection.

Main financial advisory firm variables TABLE 16

Thousand euros	2015	2016	2017	% change 17/16
NUMBER OF FIRMS	**154**	**160**	**171**	**6.9**
ASSETS UNDER ADVICE[1]	**25,084,882**	**30,174,877**	**30,790,535**	**2.0**
Retail clients	6,499,049	7,588,143	9,096,071	19.9
Professional clients	5,108,032	5,654,358	6,482,283	14.6
Others	13,477,801	16,932,376	15,212,181	-10.2
NUMBER OF CLIENTS[1,2]	**5,544**	**5,923**	**6,769**	**14.3**
Retail clients	5,156	5,510	6,320	14.7
Professional clients	319	327	355	8.6
Others	69	86	94	9.3
FEE INCOME[3]	**57,231**	**52,534**	**64,289**	**22.4**
Fee income	**56,227**	**51,687**	**63,683**	**23.2**
From clients	45,625	40,717	50,925	25.1
From other firms	10,602	10,970	12,758	16.3
Other income	**1,004**	**847**	**606**	**-28.5**
EQUITY	**25,021**	**24,119**	**33,595**	**39.3**
Share capital	5,881	6,834	7,796	14.1
Reserves and retained earnings	7,583	12,123	13,595	12.1
Profit (loss) for the year[2]	11,481	7,511	11,875	58.1
Other own funds	76	-2,349	329	–

1 Period-end data at market value.
2 Pre-2015 figures refer to number of contracts.
3 Cumulative data for the period.

Outlook

The medium-term outlook for financial intermediaries is positive as a whole, although they face significant challenges.

The outlook for non-bank financial intermediaries is generally positive despite the existence of several factors that entail challenges for the sector. One of the most important is related to the progressive contraction of the most important revenue traditionally received by these firms, i.e., that from trading on markets. This revenue is being affected by competition from credit institutions and by the shift from trading in Spanish securities to other markets and MTFs other than home markets. These trends have led to a shift in the business model of broker-dealers and brokers, which over recent years are building up business lines that were previously relatively unimportant. In this regard, CIS marketing, portfolio management services and investment advice are becoming increasingly important. A greater concern is the polarisation of the sector as it can be noted that entities with positive performance can continue improving over time, while those with worse results face greater difficulties in overcoming their situation.

4.3 CIS management companies

In 2017, CIS management companies managed assets of around 300 billion euros, 10% up on the previous year…

The assets under management by CIS management companies ended 2017 with an increase of 9.9% to stand at almost 300 billion euros. Following years of continuous falls, the growth trend that began in 2013 seems to have taken root (see figure 24). Almost all the growth was concentrated in mutual funds which, as stated, recorded growth in assets of over 11%. It is also important to highlight the level of concentration in the sector, which remained very high in 2017: at the end of the year, the three largest management companies had a joint share of 42% of total assets under management, a similar figure to year-end 2016.

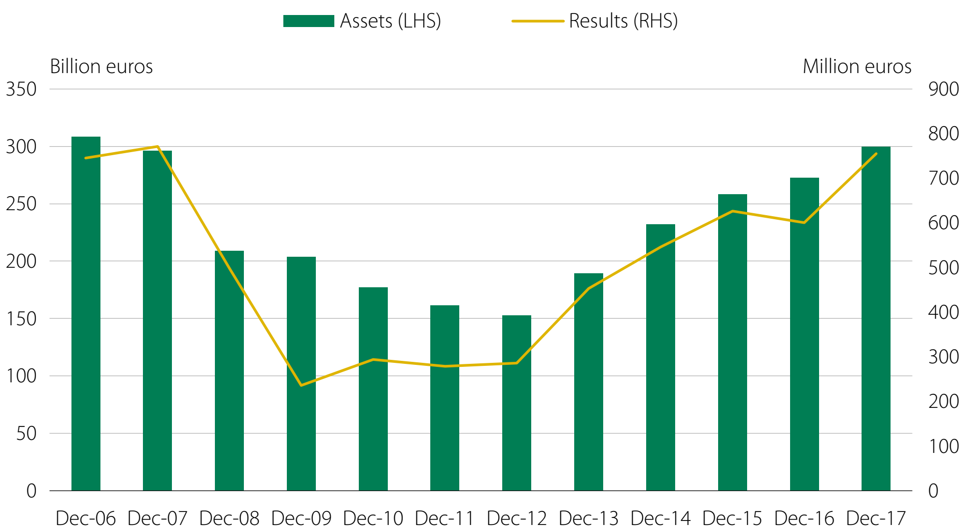
… a fact that was reflected in aggregate profits, which grew by 26%. CIS management fees, the main source of income, rose by 13% due to the increase in both assets and the average management fee.

In tandem with the growth in the sector's assets, aggregate profit before tax rose by 25.6% on 2016 to 754.6 million euros, mainly as a result of the increase in fee income, which stood at 2.98 billion euros. The largest increase was recorded in CIS management fees, which are by far the largest type of fees, with close to 300 million euros (a rise of 12.8%). This growth resulted from both the growth in assets managed by CIS management companies and a slight upturn in the average management fee, which stood at 0.89% of assets compared with 0.87% at the end of 2016 (see table 17). This increase was mainly the result of a shift of mutual fund assets to higher risk categories, which are generally associated with higher fees. In line with the improvement in the annual accounts, the return on equity (ROE) of CIS management companies as a whole rose from 55% at year-end 2016 to 73% in December 2017. The number of loss-making firms rose from 13 to 19. However, their aggregate loss fell by almost 1 million euros to 6.6 million euros.

The number of management companies, following several years in which bank restructuring led to some de-registrations, increased in 2017 from 101 to 109.

Over 2017, there were nine new registrations of CIS management companies and one de-registration, which places the number of companies registered with the CNMV at the end of December at 109. In the first two months of this year, two further management companies registered, bringing the total to 111. It may be concluded from this information that the sector's reorganisation process has come to an end.

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



Source: CNMV.

CIS management companies: Assets under management and CIS management fees and fee ratio

TABLE 17

Million euros	Assets under management	CIS management fee income	Average CIS management fee (%)	Fee ratio (%)[1]
2009	203,730	1,717	0.84	68.08
2010	177,055	1,639	0.93	67.24
2011	161,481	1,503	0.93	65.60
2012	152,959	1,416	0.93	64.62
2013	189,433	1,594	0.84	61.94
2014	232,232	2,004	0.85	61.80
2015	258,201	2,442	0.95	63.68
2016	272,906	2,347	0.86	61.67
2017	299,933	2,647	0.89	58.68

Source: CNMV.

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

4.4 Other intermediaries: Venture capital and crowdfunding platforms

Venture capital

Since entry into force of Law 22/2014, of 12 November, 33 of the new types of vehicle had been created at year-end 2016, while 16 vehicles of this type were created in 2017, while one was deregistered, bringing the total to 48. Specifically, one SME venture capital fund, three European venture capital funds, four SME venture capital companies, one closed-ended collective investment fund and seven closed-ended collective investment companies were registered.

25 of the new types of venture capital vehicles were created in 2017.

With regard to traditional vehicles, 2017 ended with 13 new registrations and six de-registrations of venture capital funds, thus giving a total of 173, and ten new registrations in venture capital companies and four de-registrations, leading to a total number of 105. As a result of these movements, the total number of venture capital entities at 31 December (excluding closed-ended entities) was 311, compared with 291 at the end of 2016. On the same date, there was a total of 15 closed-ended vehicles, 13 companies and two funds, as well as 89 closed-ended investment scheme management companies (a term that includes the old venture capital management companies) following 11 new registrations and three de-registrations.

The number of traditional vehicles also rose, resulting in the year ending with a total of 311 venture capital entities, 20 up on 2016.

The 2017 data provided by the Spanish Capital, Growth and Investment Association (ASCRI) indicate that the sector grew sharply in the first nine months of 2017. Over the period there was a noteworthy return of large deals with the completion of 11 megadeals (in excess of 100 million euros), with a volume of 2.86 billion euros, accounting for 60% of the total volume. In part thanks to these large deals, 2017 ended with an investment volume of 4.9 billion euros in 679 investments. Middle market deals (between 10 million and 100 million euros) reached historic highs with a volume of 1.47 billion euros in 55 investments.

The venture capital sector grew substantially in 2017, particularly thanks to megadeals, with total investment volume standing at 4.9 billion euros at the end of the year.

Movements in the venture capital entity register in 2017 TABLE 18

	Situation at 31/12/2016	New registrations	De-registrations	Situation at 31/12/2017
Companies				
Venture capital funds	166	13	6	173
SME venture capital funds	11	1	0	12
European venture capital funds	2	3	0	5
Venture capital companies	99	10	4	105
SME venture capital companies	13	4	1	16
Total venture capital entities	**291**	**31**	**11**	**311**
Closed-ended collective investment funds	1	1	0	2
Closed-ended collective investment companies	6	7	0	13
Total closed-ended collective investment entities	**7**	**8**	**0**	**15**
Closed-ended investment scheme management companies[1]	**81**	**11**	**3**	**89**

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.

Investments in seed and start-up phases accounted for most deals, although with a low volume. Private foreign investments accounted for over 70% of the total volume, with a record figure of 3.61 billion euros.

By investment stage, the bulk of the deals were in venture capital (seed and start-up) with a total of 519 investments, amounting to an investment volume of 494 million euros. The most important role was taken by private Spanish funds, with 345 investments. Particularly noteworthy was the positive performance of fundraising by private national operators, which amounted to 1.86 billion euros, a little under the figure for the previous year, which exceeded 2 billion euros. Investment by private international investors amounted to a record figure of 3.61 billion euros. The volume of disinvestments estimated for 2017 grew by 85% to 3.48 billion euros in 317 operations.

Public funds, through co-investment mechanisms, continue to be important for encouraging the raising of new funds.

Particularly noteworthy was the initiative of the ICO, through the FOND-ICO GLOBAL venture capital fund which remains extremely important in raising funds from the private sector through co-investment: 28% of the new investment vehicles registered in 2017 had some link with the fund.

Crowdfunding platforms

Nine applications for crowdfunding platforms were submitted in 2017, a much lower figure than in 2016 (24) and 2015 (21).

The number of applications from crowdfunding platforms over 2017 was considerably lower than in the previous two years, specifically a total of nine, compared with 24 and 21 in 2016 and 2015, respectively. This was due to the fact that, following publication of Law 5/2015, the bulk of the requests in 2015 and 2016 concerned platforms that were already operating as such and that had to adapt to the legislative requirements in order to be able to continue carrying on their business.

At the end of 2017, there were a total of 21 platforms registered in the CNMV Register, eight of which were registered that same year.

A total of eight platforms were registered in 2017, compared with 12 and one in 2016 and 2015, respectively. The CNMV Register contained a total of 21 platforms at the end of 2017. A total of four projects (one in 2016) were rejected and another four (seven in 2016) were withdrawn or deemed withdrawn in 2017. The key features of the registered platforms include:

- Eight are equity platforms, nine are lending platforms and four are mixed.

- Two are real estate platforms, one lending and the other mixed, and both were registered in 2017.

- 12 have their registered address in Madrid, five in Barcelona, two in Valencia, one in Soria and one in Santa Cruz in Tenerife.

- One lending crowdfunding platform and another equity crowdfunding platform, both registered in 2016, are controlled by foreign companies engaged in crowdfunding activities.

- Only one platform, registered in 2016, is a hybrid platform (it is authorised to act as a crowdfunding platform and as a payment institution).

The preliminary information received from the platforms on their activity over the first quarter of 2017 reveals that these entities raised 23.18 million euros, 13% more than all funding received in 2016, and that they obtained revenue of 816,000 euros, 25% up on the revenue of the previous year. The new platforms registered in that half-year accounted for 28% of the funds raised and 27% of the revenue. In addition, between January and June, the number of published projects amounted to 280 (487 in 2016 as a whole) and the number of investors stood at 7,494 (1,599 accredited investors and 5,895 non-accredited investors).

These platforms raised 23 million euros in the first half of the year, 13% up on the figure for the whole of 2016.

Number of registered crowdfunding platforms

TABLE 19

Platform Type	2015			2016			2017			Cumulative total		
		of which			of which[1]			of which[1]			of which[1]	
	Total	Madrid	Barcelona	Total	Madrid	Barcelona	Total	Madrid	Barcelona	Total	Madrid	Barcelona
Equity	**1**	1	0	**4**	3	1	**3**	0	2	**8**	4	3
Loans	**0**	0	0	**8**	4	2	**1**	1	0	**9**	5	2
Mixed	**0**	0	0	**0**	0	0	**4**	3	0	**4**	3	0
TOTAL	**1**	**1**	**0**	**12**	**7**	**3**	**8**	**4**	**2**	**21**	**12**	**5**

Source: CNMV.

1 In addition, one crowdfunding platform with registered address in Soria and another in Valencia were registered in 2016. In addition, one crowdfunding platform with registered address in Santa Cruz de Tenerife and another in Valencia were registered in 2017.