I Securities markets and their agents: Situation and outlook

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1 Executive summary

– The global and national macroeconomic and financial environment remains highly complex, as there is no clear decline in the number of COVID-19 infections. In fact, a second wave has taken hold in several countries and there is no specific time horizon for the launch of a vaccine. Therefore, we find ourselves in a scenario in which new partial lockdown measures are being announced on almost a daily basis in different areas, adding even more uncertainty to the path of economic recovery.

– GDP data for the first and second quarters of the year were released after the publication of our last bulletin. These figures reflect the severity of this crisis, with declines in all major economies of a magnitude not seen since World War II. Second quarter declines in GDP were over 10% in most economies, even reaching 20% in the hardest hit, including Spain's. Governments, central banks and other institutions have adopted various measures that seek to alleviate and minimise the effects of the crisis, but despite these efforts the most relevant forecasts point to a drop in GDP of close to 6% in the advanced economies as a whole for this year and 3.3% in emerging economies. There is, however, some unevenness within these groups.

– The international equity markets, which had experienced substantial price falls in March, at the height of the crisis, recovered significantly in subsequent quarters.[1] In Europe we see considerable disparities, with year-to-date performance ranging from the slight 0.2% fall posted by Germany's Dax 30 index to the loss of close to 26% of Spain's Ibex 35. Performance is much more favourable in the case of the US benchmark indices, which are even showing gains this year (25% for the technology-heavy Nasdaq index). The upward trend in most quoted prices over the last two quarters has fuelled debate about the possible mismatch between stock markets and economic fundamentals.

– In the international fixed income markets, yields on long-term debt assets, which had risen significantly in March and April, showed a clear downward trend in subsequent months, placing them at them at levels lower than at the start of the year. Yields on 10-year government debt ended the third quarter with negative values or close to zero in most European economies. Risk premiums applied in both the public and private sectors have also tended to decline in recent months, after the strong uptick experienced in April, although in this case they were still higher at the end of the quarter than the figures seen at the beginning of the year, especially for companies with the lowest credit ratings.

– In Spain, the latest activity and employment indicators reflect the severity of the crisis, with a 21.5% drop in GDP in the second quarter (the sharpest fall of all major European economies) and a decrease of 1,360,000 in the number of persons employed between January and June. The outlook for this year as a whole is unfavourable, as GDP is expected to fall by more than 12% and forecasts are subject to a very high degree of uncertainty. This uncertainty, which

1 The closing date for this report is 30 September, except for certain specific information.

has led many institutions to provide forecasts for different scenarios without identifying any of them as the most probable, is related, among other factors, to the duration of the pandemic, the effectiveness of the measures adopted to address it and changes in agents' consumption and savings patterns. In this context, the most significant challenges facing the Spanish economy involve keeping unemployment figures as low as possible and ensuring the sustainability of public finances.

– The crisis triggered by COVID-19 led to the fastest increase in the Spanish financial market stress indicator in a period of just a few weeks. This indicator, which at the closing date of our previous report (31 March) stood at 0.56 (in the high stress zone) continued to increase in the following weeks to reach a third new historical high at close to 0.65 in May. All segments experienced significant increases in stress, especially in the indicators related to price falls and volatilities, and there was also a significant increase in the degree of correlation between them. The latest stress indicator value is below 0.50 (medium risk zone), with the financial intermediaries (banks) segment showing the highest values.

– The Spanish equity markets, which in the second quarter had barely recovered the heavy losses experienced in the first months of the year, suffered further setbacks in the third quarter. These setbacks intensified as the uncertainties facing the Spanish economy grew, driven by the potential effects of a second wave of the pandemic. The Ibex 35 closed the quarter with losses of 7.1%, bringing the year-to-date loss to 29.7%, the biggest fall of all the major international indices, in a context of more normal levels of volatility and liquidity and a notable fall in trading volumes.

– In the Spanish fixed income markets, the decline in asset returns observed in the second quarter continued in the third and most of these yields – on both public debt and private fixed income – were lower than those seen at the beginning of the year. This development was due to the asset purchases made by the European Central Bank (ECB), which reduce the risk premiums on debt assets. The decline in debt yields extended to all terms, although it was more intense in the longer-dated segments, which favours a flattening of the interest rate curve. Debt issues of Spanish issuers also decreased in the third quarter compared with the second, but are showing significant growth in the year to date (16%, to €144 billion, counting both the issues registered with the CNMV and those carried out abroad) as many companies brought their issues forward to the second quarter of this year and increased their amount, taking advantage of the favourable market conditions to refinance at longer terms and lower cost, with the intention of building up sufficient resources to deal with the current crisis.

– Investment fund assets decreased by 5.6% in the first half of the year, to stand at €263 billion, due to the combined effect of the net redemptions in March (€5.5 billion) following the lockdown announcement in Spain, and the decrease in the value of the portfolio. Net redemptions, which were handled by fund managers without problems, did not occur in all categories of funds, but were concentrated in fixed income funds. After this period of turmoil, the most representative figures for the collective investment sector once again showed some growth, although some uncertainty persists over the medium term. In this context, the work of the CNMV, as indicated in the last report of this series, focuses among other things on evaluating funds' exposure to relatively illiquid assets and assets with higher credit risk, as well as on ensuring that the management companies correctly value the assets of their portfolios. In this regard, the CNMV gave indications on the appropriateness in certain cases of valuing assets at the bid price or applying swing pricing schemes, techniques that have been adopted by a significant number of entities.

– Investment firms (IFs) posted substantial increases in pre-tax profit in the first half of the year, from €25 million in 2019 to €110 million in 2020. This performance, which was due to broker-dealers, can be explained by the inclusion of a large entity in the context of Brexit and by the better results reported by many companies, especially in terms of financial investments and net fees. The results reported by brokers were skewed by the liquidation of an entity with heavy losses. Stripping out data relative to this company, the segment would have posted a profit, albeit lower than that of 2019. The IF segment reported higher profits but also an increase in the number of loss-making entities, supporting the perception of sector polarisation. Lastly, the solvency of both broker-dealers and brokers remained satisfactory in relative terms.

– This report contains three monographic exhibits:

  • The first describes the most important characteristics of the recent partial reform of the Good Governance Code for listed companies, carried out to bring the corporate governance framework of Spanish companies into line with the highest international standards.

  • The second lists the five priority areas of work identified by the European Systemic Risk Board (ESRB), four of which are the subject of recommendations.

  • The third exhibit summarises a work carried out by the CNMV to assess the consequences that the recent ban on the creation or increase of net short positions adopted by the CNMV may have had on some key variables representing the shares of the companies concerned.

2 Macro-financial environment

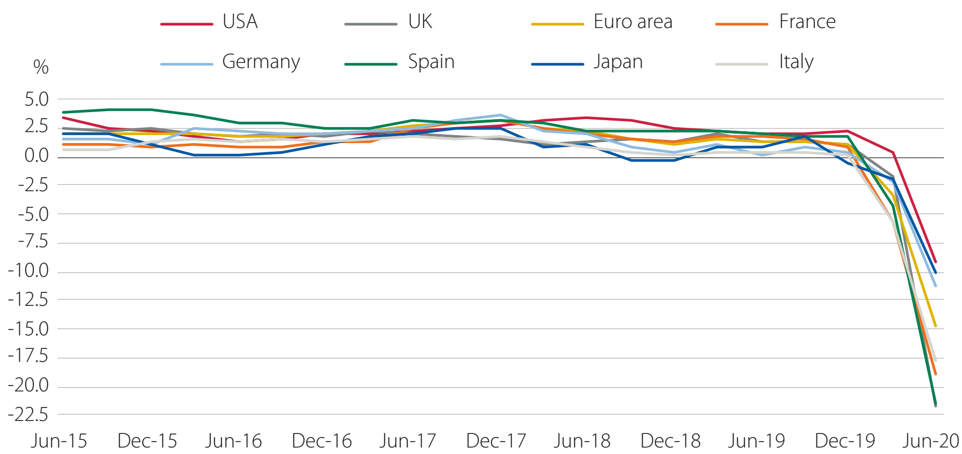
2.1 International economic and financial developments

The sharp falls in GDP in the first half of the year, which were sharper in European countries than in other regions, bear eloquent testimony to the economic impact of the spread of the coronavirus.

The sharp falls in the GDP of world economies in the first half of the year highlight the economic impact of the spread of the coronavirus. In this context of high uncertainty, most countries experienced slumps in economic growth, which were sharper in Europe. The GDP of the United States, one of the few countries in which a year-on-year increase was observed in the first quarter of the year (0.3%), fell by 9.1% in the second quarter compared with the same period of 2019.

However, the fall off in growth in the euro area stood out, with decreases in GDP of 3.2% and 14.7% in Q1 and Q2, respectively. The halt in activity during the months of lockdown caused by the health crisis – a measure that was generally implemented in the second half of the first quarter of the year – led to unprecedented declines in GDP in most economies, which were much sharper in the second quarter (see Figure 1).

Annual change in GDP FIGURE 1



Source: Thomson Datastream.

The falls in GDP in the second quarter of the year were over 10% in the major economies and even close to 20% in those hardest hit.

In the euro area economies, the year-on-year falls in GDP in the first quarter of the year ranged from 0.4% in the Netherlands to 5.7% in France, while in the second quarter these figures increased sharply to mark historical levels of 17.7% in Italy, 18.9% in France and 21.5% in Spain (the decrease in GDP in the Netherlands and Germany, while still considerable, at 9.2% and 11.3% respectively, was less than in these economies). In the United Kingdom, the impact of the coronavirus was compounded by the uncertainty surrounding Brexit, as no agreement for exiting the European Union has yet been reached. Thus, the year-on-year drop in GDP was 1.7% in the first quarter and 21.7% in the second, while in Japan it was 1.9% and 10.1% respectively. Since the health crisis started in China, the impact on China's GDP was greater in the first quarter, but the economy started to recover in the second quarter (year-on-year falls of 6.8% and 1.6%,[2] respectively).

In September, the Federal Reserve kept official interest rates unchanged in the range of 0.00-0.25%, following the announcement of the new lines of its monetary policy strategy.

The central banks of the major economies have adopted multiple measures in recent months to cope with the economic consequences of this crisis. These measures have translated into reductions in official interest rates and considerable increases in the amounts of asset purchase programmes, the types of instruments that can be acquired under which have also been expanded. Most of these measures were taken in March in response to the initial spread of the virus, although they remain in effect. At its last meeting in September, the US Federal Reserve kept its official rates in the range of 0-0.25% (after 2 rate cuts in March that placed them at the levels seen during the 2008-2015 financial crisis), indicating that it does not expect to make any

2 The information on China's GDP growth corresponds to year-to-date figures compared with the same period of the previous year.

changes until market conditions are aligned with its objectives of achieving maximum employment and inflation levels of over 2%. These statements are part of a new monetary policy strategy that has relaxed the inflation target in order to boost employment.[3] Following the meeting, the projections of the members of the Federal Open Market Committee were published. The majority of them expect these official rates to remain unchanged until 2024, suggesting that US interest rates will remain close to zero for more than three years. In addition, the Fed announced that it will increase its holdings of treasury bills and mortgage-backed securities at least at the current rate to keep the market running smoothly and support the flow of credit to households and businesses.

Along similar lines, at its September meeting the ECB did not make any monetary policy changes, but kept official interest rates unaltered (for main refinancing operations (MRO), the marginal lending facility and the deposit facility at 0%, 0.25% and -0.50% respectively), as well as the size of its asset purchase programmes.[4] The ECB did however announce at the end of September that from 1 January 2021 bonds with coupons linked to certain sustainability objectives will be eligible both as collateral for Eurosystem credit operations and for outright purchases for monetary policy purposes, provided they meet all other eligibility criteria.[5] The ECB stated that there is a great deal of uncertainty surrounding the strength of the recovery and that it depends directly on the evolution of the pandemic, defending its decision to maintain the measures implemented since March as these have contributed to economic recovery in the euro area and medium-term price stability.[6] However, the Governing Council has indicated that it is prepared to adjust these instruments if necessary to ensure that inflation moves towards the target of 2%.

The ECB also resolved to keep its official interest rate and the size of its asset purchase programmes unchanged.

The Bank of England also kept its official interest rate unchanged at 0.1% after the cuts carried out in March. It also made no changes to its asset purchase programme (£745 billion). The most striking development as regards the Bank's future steps is its acknowledgement that it has assessed the effects of implementing negative interest rates if necessary.

The Bank of England kept its official interest rate unchanged at 0.1%, although it said the effects of introducing negative rates were being studied.

3 In late August the Federal Reserve announced a new monetary policy strategy, in which it outlined a robust update to its tools. It will set average inflation targets, allowing inflation to rise moderately above 2% for some time to compensate for periods when it has been below that threshold. In addition, it will maintain an accommodative policy to prevent employment from falling below the established maximum levels. This policy flexibility with respect to inflation is motivated by an intention to drive employment.

4 The ECB will continue to make purchases under the Pandemic Emergency Purchasing Programme (PEPP) until at least the end of June 2021 and, in any case, until the end of the coronavirus crisis (with an allocation of €1.35 trillion). It will also maintain net purchases in the Asset Purchase Programme (APP), at a monthly rate of €20 billion, together with additional purchases of assets for the amount of €120 billion on a temporary basis until the end of the year.

5 Coupons must be linked to performance targets related to one or more of the environmental objectives established in the EU Taxonomy Regulation or to one or more of the United Nations Sustainable Development Goals relating to climate change or environmental degradation.

6 Another measure taken at the end of April, and which will run until September 2021, is the exemption from certain credit quality requirements for marketable assets. The ECB accepts that credit institutions may use "junk" or high-yield bonds as collateral in their liquidity transactions if they met the required quality requirements (at least BBB-) until 7 April and their current rating has since been downgraded by one of the credit rating agencies as a result of the crisis, and as long as the new rating remains above a certain level.

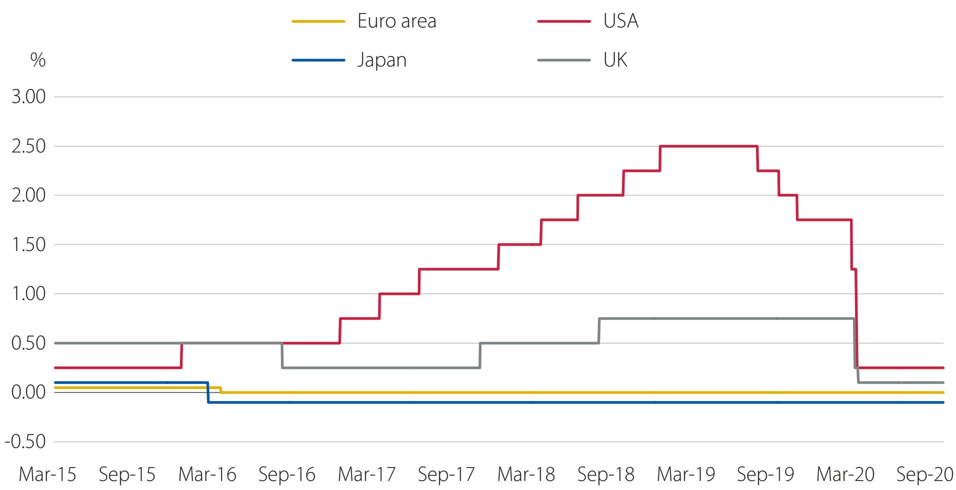
Lastly, the Bank of Japan has not changed its official interest rate, which has been the same since the beginning of 2016.

Lastly, at its most recent meeting, the Bank of Japan announced that it will keep its monetary policy unchanged, without altering the official interest rate of -0.10 in place since the beginning of 2016 or modifying its asset purchase programmes, considering for the time being, that no further stimulus measures are required to deal with the effects of the health crisis. The institution reported that although the Japanese economy is still in an unhealthy state, it has begun to gradually recover as business activity improves.

In the first three quarters of 2020 interest rates marked a downward trend in the main economies, with sharper falls in the second quarter, especially in the United States and the United Kingdom.

Short-term interest rate spreads between different advanced economies narrowed throughout the year as a result of the monetary policy measures adopted in response to the crisis caused by the coronavirus. Thus, in the first three quarters of 2020 interest rates followed a downward path in the main economies, especially in the United States and the United Kingdom, despite having tightened significantly at the start of the crisis. In the United States, where cuts in official rates have been more substantial, there was a cumulative fall of 168 bp in the 3-month interest rate compared with the beginning of the year, the decline being more marked in the second quarter (down by 115 bp compared with the first quarter) and less so in the third (8 bp). At the end of September this rate stood at 0.23%. Similarly in the United Kingdom short-term rates fell by 73 bp YTD, to 0.07% at the end of September, the sharpest drop being in the second quarter (45 bp). Meanwhile, in the euro area, although 3-month rates also saw cumulative falls in the year (11 bp), these were less significant than in the United States or the United Kingdom since they started out from a lower level and there were no changes in the official interest rate. In Japan, 3-month rates remained more stable than in the other economies, with a cumulative fall of 6 bp in the year to date.

Official interest rates FIGURE 2



Source: Thomson Datastream. Data to 30 September.

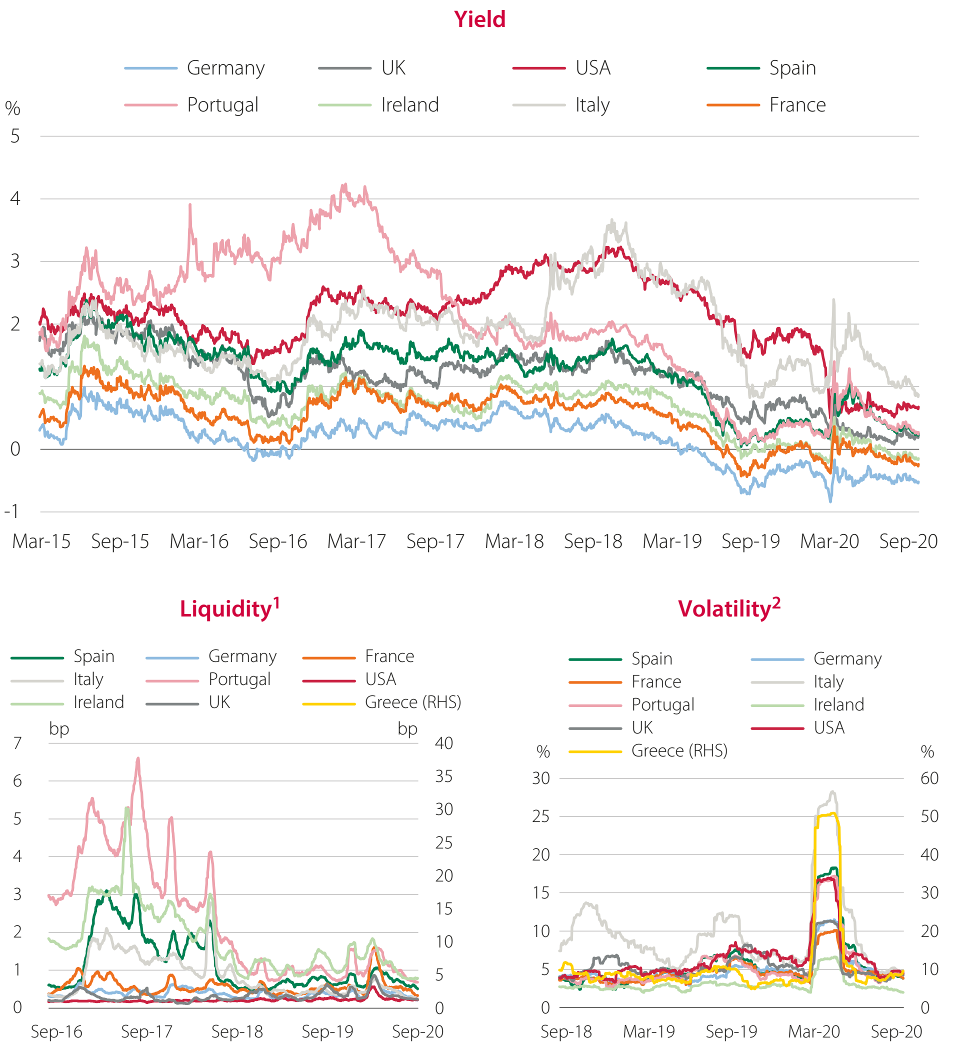
Sovereign bond yields declined slightly compared with the previous quarter in the euro area economies, while in the United States and United Kingdom they rose slightly…

Movements in interest rates on long-term public debt were relatively uniform in the third quarter of the year, decreasing slightly in most developed countries as a result of the downturn in world economic activity. In general, a fall in sovereign bond yields was observed over the first nine months of the year in most countries, as periods of falling yields offset the stress episodes in the debt markets seen in March and April. The only exceptions to this trend were the peripheral European countries in the first quarter, where this stress was more marked.

In the euro area, the decline in 10-year government bond yields in the third quarter ranged from 8 bp in the case of Germany to 46 bp in that of Italy (22 bp for Spain). In the year to date, the fall ranged from 18 bp for the Portuguese bond to 56 bp for the Italian bond (22 bp for the Spanish bond). The levels of debt yields thus remain very low, with the yield on 10-year government debt in negative territory at the end of September in Germany, France, Finland, Belgium, Austria, the Netherlands and Ireland; close to zero in Spain and Portugal, and close to 1% in Italy and Greece. The falls in sovereign bond yields in the United States and the United Kingdom were greater (123 bp compared with December 2019, to 0.68%, and 59 bp, to 0.23% respectively) (see Figure 3).

… which does not prevent the trend in long-term debt yields from being downward in the year to date, in many cases reaching new historical lows.

10-year sovereign bond market indicators FIGURE 3



Source: Bloomberg, Thomson Datastream and CNMV. Data to 30 September.

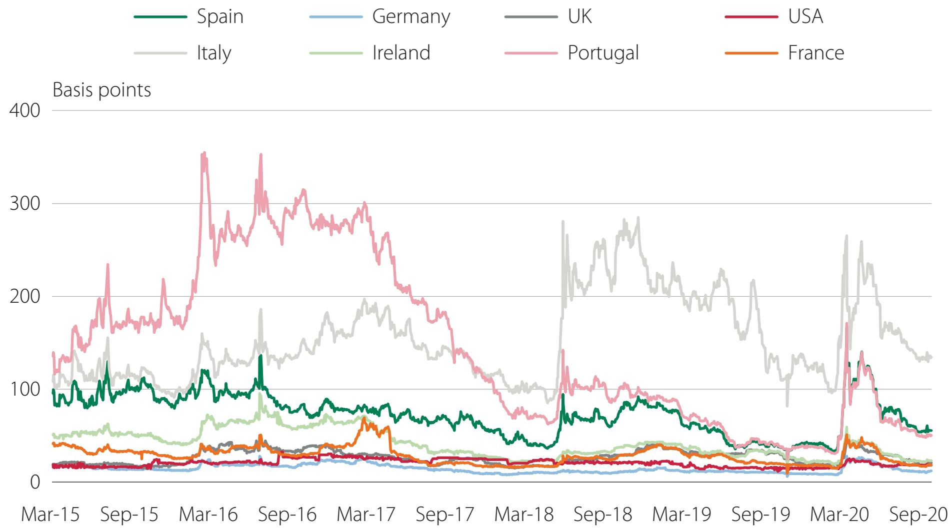
1 1-month average of the daily bid/ask spread of 10-year sovereign bond yields

2 Annualised standard deviation of daily changes in the prices of sovereign bonds over a 40-day period.

Sovereign credit risk premiums decreased during the third quarter of 2020, especially in the peripheral euro area countries…

Sovereign credit risk premiums in developed countries (measured through 5-year CDS) declined slightly during the third quarter, after increasing sharply in the first months of the year due to the spread of the coronavirus. The greatest reductions were seen in peripheral euro area countries, which had previously seen the largest rises as they were initially most affected by the pandemic. The sovereign credit risk premium decreased by 16 bp in Portugal, 24 bp in Spain and 36 bp in Italy. However, in general terms, the cumulative trend in the year to date in most regions is upward, as the decline in risk premiums in recent months has not been sufficient to return to pre-crisis levels (see Figure 4). Thus, increases in the peripheral euro area countries ranged between 12 bp in Portugal and 33 bp in Greece (in Spain the premium increased by 15 bp, to 56 bp), and were lower in countries such as Germany and the United States (3 bp and 5 bp respectively).

Credit risk premiums for sovereign debt (5-year CDS) FIGURE 4



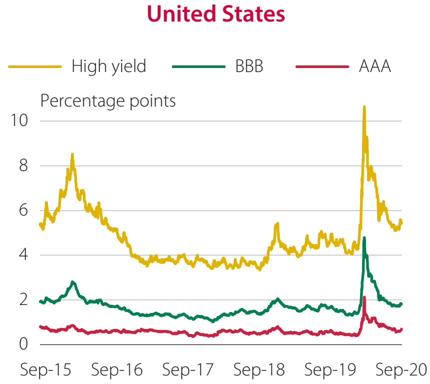
Source: Thomson Datastream. Data to 30 September.

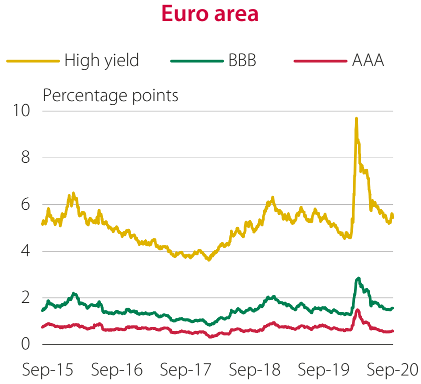
… as did credit risk premiums for all bond segments, most notably in the United States. However, for both types of debt the cumulative year-to-date trend is upward.

In the private fixed income markets, the credit risk premiums of advanced economies have shown a trend similar to that of public debt so far in 2020, spiking when the crisis broke in the first quarter – especially in the high-yield segment – and falling in the following two quarters. The decline in risk premiums in the third quarter was more marked in the United States than in the euro area. In the US economy, a 90 bp decrease was observed, to 543 bp, in the high-yield segment, while premiums in the BBB and AAA tranches fell by 25 bp and 17 bp, to 182 bp and 70 bp respectively. In the euro area, the decrease in credit risk premiums on corporate debt was 62 bp in the high-yield segment, 27 bp in the BBB tranche and 16 bp in the investment grade tranche (standing at 544 bp, 156 bp and 56 bp respectively at the end of September). However, the initial increases were more marked than the subsequent declines and, as in the case of sovereign debt, for the year to date, credit risk premiums have accumulated increases in most debt segments (except for higher credit quality assets in the euro area). The increase was greatest for US high-yield debt (130 bp versus 70 bp in the euro area).

Private debt risk premiums.
Spread compared with 10-year sovereign debt[1]

FIGURE 5





Source: Thomson Datastream and CNMV. Data to 30 September.

1 In the euro area in relation to German sovereign debt.

Gross long-term debt issues in the international markets in the second half of the year (semi-annualised data for the third quarter) increased by 11.5% compared with the second half of 2019, to stand at US$6.6 trillion. Increases in issue amounts were observed in the non-financial private sector (25.3%) and in the public sector (15%), while in the financial private sector there was a decrease of 12.3%. By region, the 61.6% drop in issues in Japan stands out, negatively affected by sovereign issues.

Gross debt issues in the international markets in the second half of the year increased by 11.5% year-on-year, with trends differing from one sector to another.

Gross sovereign issues increased to US$4.4 trillion (+15% compared with the second half of 2019), with trends differing among regions. Thus, the United States and Europe saw advances of 46.4% and 33.9% respectively, compared with the same period last year. In contrast, in Japan, gross sovereign issues fell dramatically, to US$91 billion (down by 83.2%).

Gross sovereign issues advanced by 15%, with upticks in the US and Europe and a sharp decline in Japan.

As regards private sector debt issues, the trend was uneven among sub-sectors, with increases in the non-financial sector and decreases in the financial sector. The rise in debt issues in the non-financial sector, with an aggregate half-yearly amount of US$1.2 trillion, was determined by the buoyancy of the United States and Japan (up by 44.4% and 36.9% respectively). The trend in these issues in the year to date is clearly upward, since in the first half of the year significant growth in issues was also observed (even in Europe) at a time when companies are taking advantage of low market rates to increase issues in anticipation of future needs and extend the terms of their debt. Gross debt issues by financial institutions went from US$1.1 trillion in the second half of 2019 to US$950 billion in 2020 (12.9% less); with the most notable declines seen in the United States and Europe (16.1% and 25% respectively). It should be noted that financial institutions have access to alternative sources of financing, most notably from central banks.

The trend in the private sector was uneven among sub-sectors, with increases in the non-financial sector and decreases in the financial sector.

International gross fixed income issues FIGURE 6

Source: Dealogic. Half-yearly data. The data for the second half of 2020 are until 30 September, but are shown in their half-yearly equivalences for comparative purposes.

Stock market performances were uneven in the third quarter among different regions and even within them, with the US and Japanese indices making gains…

In the equity markets, the main indices posted varying performances during the third quarter. US, Japanese and German indices made gains in the third quarter of the year, reflecting the slight improvement in expectations due to the progressive lifting of lockdown measures, although these gains were smaller than those of the second quarter, when they rebounded from the sharp falls seen in March. In contrast, the remaining European indices saw no gains in the third quarter, the declines in the UK's FTSE 100 and Spain's Ibex 35 indices being particularly notable (see Table 1).

Performance of the main stock market indices[1] TABLE 1

%

	2016	2017	2018	2019	I 20	II 20	III 20	% of Dec-19
World								
MSCI World	5.3	20.1	-10.4	25.2	-21.4	18.8	7.5	0.4
Euro area								
Eurostoxx 50	0.7	6.5	-14.3	24.8	-25.6	16.0	-1.3	-14.7
Euronext 100	3.0	10.6	-11.2	24.9	-25.0	13.8	-1.8	-16.2
Dax 30	6.9	12.5	-18.3	25.5	-25.0	23.9	3.7	-3.7
Cac 40	4.9	9.3	-11.0	26.4	-26.5	12.3	-2.7	-19.6
Mib 30	-10.2	13.6	-16.1	28.3	-27.5	13.6	-1.9	-19.1
Ibex 35	-2.0	7.4	-15.0	11.8	-28.9	6.6	-7.1	-29.7
United Kingdom								
FTSE 100	14.4	7.6	-12.5	12.1	-24.8	8.8	-4.9	-22.2
United States								
Dow Jones	13.4	25.1	-5.6	22.3	-23.2	17.8	7.6	-2.7
S&P 500	9.5	19.4	-6.2	28.9	-20.0	20.0	8.5	4.1
Nasdaq Composite	7.5	28.2	-3.9	35.2	-14.2	30.6	11.0	24.5
Japan								
Nikkei 225	0.4	19.1	-12.1	18.2	-20.0	17.8	4.0	-2.0
Topix	-1.9	19.7	-17.8	15.2	-18.5	11.1	4.3	-5.6

Source: Thomson Datastream.

1 In local currency. Data to 30 September.

… and decreases in the European indices, with the exception of Germany's Dax 30, which stands out from the rest with gains of close to 4%.

An analysis by region reveals that the US stock market indices made the largest gains in the third quarter of the year, with the 11% rise in the technology-heavy Nasdaq index standing out, followed by the S&P 500, with a gain of 8.5%, and the Dow Jones, with 7.6%. The first two indices have made significant cumulative gains so far this year, especially the Nasdaq (+24.5%). Most of the European stock markets registered falls, ranging from 1.9% for the Mib 30 to 7.1% for the Ibex 35, showing a negative cumulative trend in the year (29.7% for the Spanish market, the biggest fall in Europe). Germany's Dax 30 is an exception among the European stock market indices, gaining 3.7% during the quarter and posting the smallest loss in value so far in 2020 (-3.7%). The UK's FTSE 100 fell by 4.9% in the third quarter of the year, bringing the year-to-date decline to 22.2%. The Japanese stock market indices gained around 4.0%, although they could not compensate for the losses seen in previous months, and therefore the year-to-date trend is negative, especially that of the Topix (5.6%).

Emerging stock markets performed relatively well in the third quarter.

The emerging stock markets performed relatively well in the third quarter of 2020, reflected in a 7.5% increase for the MSCI Emerging Markets equity index compared with the end of June. In line with stock markets in the advanced economies, these gains, which were less than those seen in the second quarter, were not enough to offset the losses of the early part of the year, so that the cumulative trend for the year to date is negative, with a few exceptions. One such exception is China, where the first cases of the virus were recorded and therefore lockdown was lifted and activity resumed earlier than in other countries. The increase in quoted prices on China's equity markets in the second and third quarters (8.5% and 7.8% respectively) were sufficient to offset the initial fall (-9.8%). The other Asian indices strengthened in the third quarter (except for those of Indonesia, Hong Kong, Singapore, Thailand and the Philippines, which lost between 0.7% and 7.6%), with the gains made in South Korea, Taiwan and India standing out (10.4%, 7.7% and 9.4% respectively). In Latin America, Argentina's Merval index gained 58.7% in the second quarter and 6.7% in the third, although the cumulative trend for the year to date is negative (-1.0%). In Eastern Europe, performance in the third quarter was negative, with quoted prices falling in most countries (notably by 8.7% in Hungary).

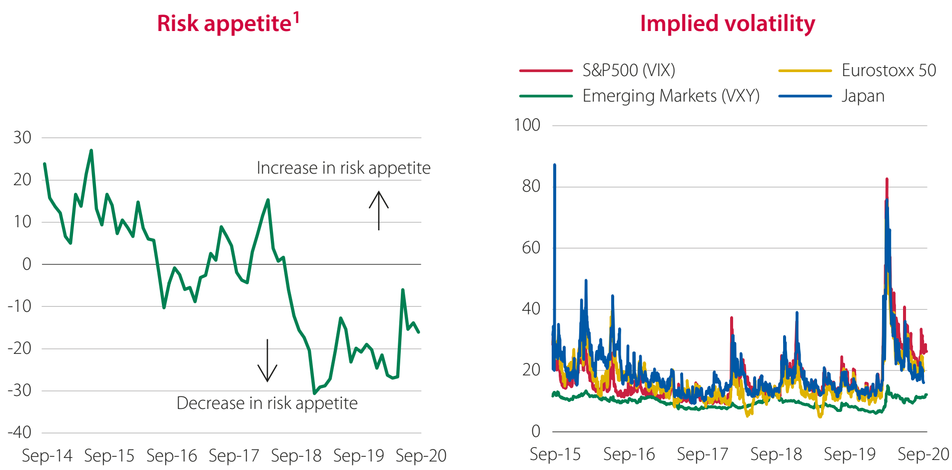
There may be some decoupling between share price performance and the real economy.

The share price increases seen in recent months have occurred in the context of a global recession of a scale not seen since World War II, the emergence of a second wave of coronavirus infections of varying intensity in different countries (and hence the implementation of partial lockdown measures) and several major sources of uncertainty, such as Brexit and the trade agreement between the United States and China. All these factors call into question the scale of the gains made by some indices, in what some analysts have identified as a decoupling between economic fundamentals and share prices. This perception is stronger in economies where stock markets have made gains in the year to date, but where at the same time GDP is expected to fall by close to 10% for the year.

Implied volatility metrics of the major stock market indices declined from April onwards and were more stable in the third quarter of the year.

Implied volatility metrics of the major stock market indices, which rose sharply in the first months of the year, decreased from April onwards and, in general, were more stable in the third quarter of 2020, marking slight increases in September (see right hand panel of Figure 7). The high degree of uncertainty in the current context means that volatility levels, even after falling significantly in recent months, remain on average at around 25%, above pre-crisis values, which were close to or below 15% in most indices.

Indicators relating to financial markets FIGURE 7



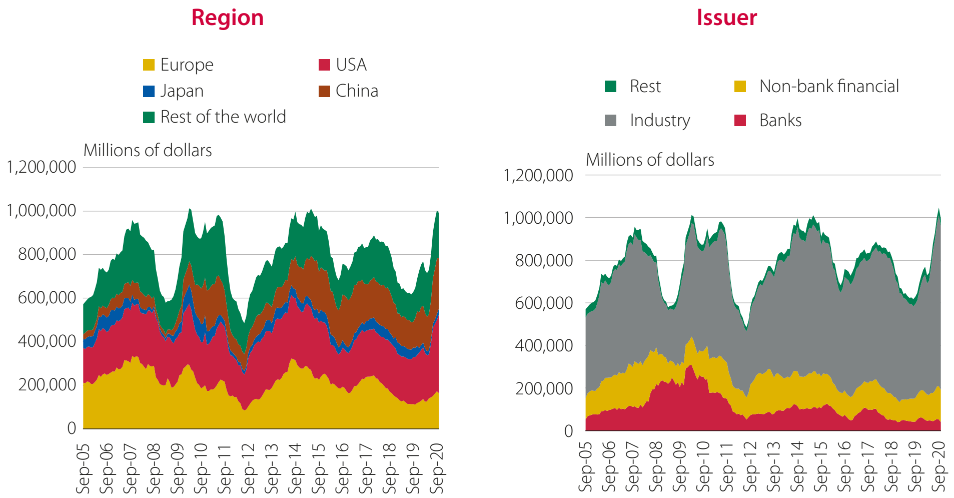
Source: Thomson Datastream and CNMV.

1 State Street indicator.

Equity issues on international financial markets increased significantly during the third quarter of 2020, reaching US$334 billion, nearly double the amount recorded in Q3 2019. Similarly, issues made in the last 12 months amounted to US$917.42 billion (well above the figure of US$628.39 billion for the 12 months to the end of September 2019). For the nine months to the end of September, increases were observed in all regions relative to the same period of the previous year, ranging between 31% in Japan and 78.4% in the United States. By sector, equity issues of industrial companies and the non-banking financial sector both increased (by 89.2% and 30.2% respectively). However, a 27.3% drop in issues of shares in the banking sector was observed.

The volume of equity issues increased significantly in the third quarter of 2020, with notable rises in most regions and sectors, except for banking.

International equity issues FIGURE 8



Source: Dealogic. Cumulative data for the 12 months to 30 September.

2.2 National economic and financial developments

In the second quarter of 2020, Spain's GDP saw its biggest ever year-on-year decline (-21.5%), due to the impact on activity of the lockdown measures, which were in place for practically the entire quarter. This fall was preceded by a milder decline in the previous quarter (-4.2%), as the measures affected only part of March. These figures were among the worst in the euro area, where GDP fell by 3.2% and 14.7% in the first and second quarters respectively, and the latter was also the worst figure in the historical series. The economic consequences of the spread of the coronavirus have been reflected in a slump in European growth, which has been more intense in countries such as Spain, where the economy is strongly linked to tourism and where the strict lockdown measures introduced to contain the spread of the virus, despite having been gradually lifted, started being reimposed in certain regions from the beginning of September.

Spain's GDP saw a year-on-year fall of 21.5% in the second quarter, much more than the 14.7% drop in the euro area as a whole.

Of the total drop in GDP in the second quarter (21.5%), 18.8 percentage points (pp) were due to the contribution of domestic demand and the remainder to the external sector. As regards the components of domestic demand, private consumption and gross fixed capital formation fell significantly (by 25.2% and 25.8%

The contribution of domestic demand to the fall in GDP was 18.8 pp, while that of the external sector was 2.7 pp.

respectively), on top of the falls seen in the first quarter (6.2% and 5.1% respectively, in contrast with the rises seen in 2019, which averaged 0.9% and 2.7% respectively). Public consumption grew by 3.1% in the second quarter, somewhat less than in the first (3.7%). The negative contribution of the external sector to growth was greater, moving from 0.3 pp to 2.7 pp In this sector, both exports and imports fell much more sharply in the second quarter of the year than in the first, the declines going from -5.6% to -38.1% in the case of exports and from -5.4% to -33.5% in that of imports.

Spain: Main macroeconomic variables TABLE 2

Annual % change

					EC[1]	
	2016	2017	2018	2019	2020	2021
GDP	**3.0**	**3.0**	**2.4**	**2.0**	**-10.9**	**7.1**
Private consumption	2.6	3.0	1.8	0.9	-10.7	8.9
Public consumption	1.0	1.0	2.6	2.3	5.8	-0.4
Gross fixed capital formation, of which:	2.4	6.8	6.1	2.7	-20.7	10.3
Construction	1.6	6.7	9.3	1.7	n/a	n/a
Capital goods and others	1.8	9.2	5.5	4.5	-23.0	12.0
Exports	5.4	5.5	2.3	2.3	-19.8	11.9
Imports	2.7	6.8	4.2	0.7	21.1	12.4
External sector (contribution to growth, pp)	1.0	-0.2	-0.5	0.6	-0.1	0.3
Employment[2]	**2.8**	**2.9**	**2.6**	**2.3**	**-8.7**	**6.1**
Unemployment rate	**19.6**	**17.2**	**15.3**	**14.1**	**18.9**	**17.0**
Consumer Price Index[3]	**-0.3**	**2.0**	**1.7**	**0.8**	**-0.1**	**0.9**
Current account balance (% of GDP)	**3.4**	**3.0**	**2.4**	**2.5**	**3.2**	**2.7**
Public administrations balance (% of GDP)	**-4.5**	**-3.1**	**-2.6**	**-2.0**	**-10.1**	**-6.7**
Public debt (% of GDP)	**99.2**	**98.6**	**97.4**	**95.5**	**115.6**	**113.7**
Net international investment position (% of GDP)	**71.0**	**68.0**	**79.2**	**58.7**	**n/a**	**n/a**

Source: Thomson Datastream, European Commission, Bank of Spain and INE (National Statistics Institute).

1 The European Commission forecasts correspond to spring 2020, with the exception of GDP and the CPI, which correspond to the summer forecasts.

2 In terms of full-time equivalent jobs.

3 The European Commission forecasts are for the harmonised consumer price index.

4 The public assistance to credit institutions in 2016, 2017, 2018 and 2019 is included for an amount of 0.2%, 0.04%, 0.01% and 0.00% of GDP respectively.

n/a: [data] not available.

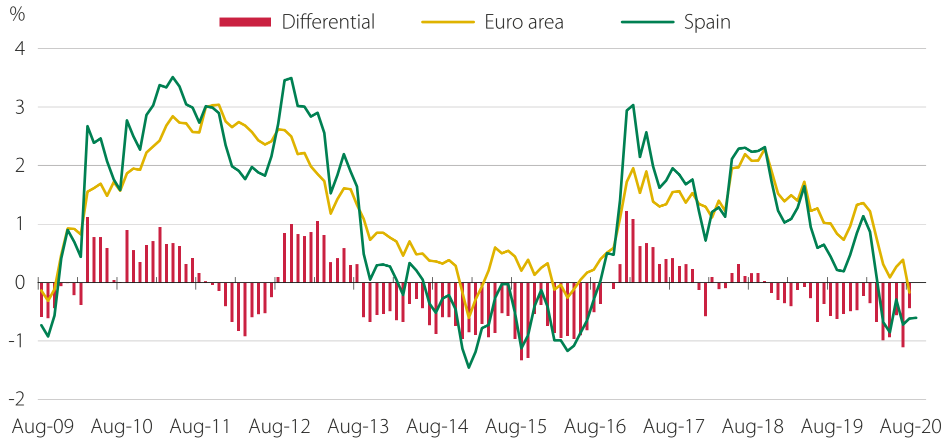
On the supply side, all sectors saw significant declines, except for the primary sector.

On the supply side, significant declines were observed in all sectors in the second quarter, except for the primary sector (agriculture, livestock, forestry and fisheries), the added value of which, having decreased by 0.2% in the first quarter, increased by 6.3% in the second. The construction sector marked the largest decline (27.5%), followed by industry (23.8%) and the services sector, with a fall of 21.3%. Within the services sector, the weak performance of the retail, transport and hospitality segments (-44.9%) stands out, these activities having been seriously affected by the restrictions imposed to contain the spread of the coronavirus.

While the inflation rate was positive at the start of the year (1.1% in January), it fell sharply in subsequent months to reach a low of -0.9% in May, from where, marking a somewhat erratic trend, it increased slightly (latest September figure: -0.4%). The downward performance in the first few months of the year was linked to the energy inflation rate, which has been in negative territory since February (hitting -18% in May). In subsequent months, this rate began to increase (although remaining negative) but contrasted with the decline in the core inflation rate (IPSEBENE), which excludes the most volatile elements of the index such as energy and fresh food and had remained stable at around 1.1% until June. During the summer months, this rate fell to 0.4% due to the effects of the crisis on the prices of some services. The inflation differential with the euro area decreased to -1 pp in April, but then increased slightly (to -0.4 pp).

The inflation rate has been in negative territory since March and hit a low of -0.9% in May, while the spread with respect to the euro area was -0.4 pp at the end of August

Harmonised CPI: Spain compared with the euro area as a whole (annual % change) FIGURE 9



Source: Thomson Datastream. Data to August for the euro area as a whole and to September for Spain

The present crisis and consequent slowdown in economic activity has led to a sharp drop in job creation, which grew on average by 2.3% in 2019, with a decline of 18.4% in the second quarter of 2020. According to the Active Population Survey (EPA), the number of persons in employment in the second quarter of the year fell by 1,360,000 from year-end 2019 and the unemployment rate, which at the end of last year was 13.8%, increased to 15.3%.[7] Unit labour costs increased significantly, at annual rates of 5.1% in the first quarter of the year and 7% in the second (2.5% on average in 2019), driven by decreases in apparent labour productivity (3.7% and 3.8% in Q1 and Q2 respectively), in addition to higher remuneration per employee (1.3% and 2.9% respectively).

The present crisis has triggered a sharp fall in employment, -18.4% in the second quarter.

7 The increase in the unemployment rate does not fully reflect the decrease in the number of persons in employment, since a substantial number of these have been considered as inactive for statistical reasons (between March and June the number of inactive workers increased by just over 1 million). Those affected by ERTE temporary layoff or furlough schemes are also not included in unemployment figures, since pursuant to Eurostat and International Labour Organization (ILO) methodology, they are considered to be employed. At the end of June, there were around 1.5 million workers in this situation.

The deficit of public administrations (excluding local authorities) increased to 6.54% of GDP between January and July, due to the impact of measures associated with the pandemic.

The deficit of public administrations (not including local authorities) to July stood at 6.54% of GDP, a figure that reflects the impact of the transactions carried out by these bodies as a whole in a context marked by the COVID-19 pandemic. Financing received from the government to ensure liquidity during the pandemic has allowed the autonomous regions to register a surplus of 0.27% of GDP. The deficit of the Social Security System eased to 0.35% of GDP on the back of transfers received from the government to cover the expense of benefits deriving from the crisis. Lastly, local authorities registered a deficit of 0.26% of GDP in the first half. Forecasts made by different institutions place this year's public deficit at over 10% of GDP and public debt at over 105%.

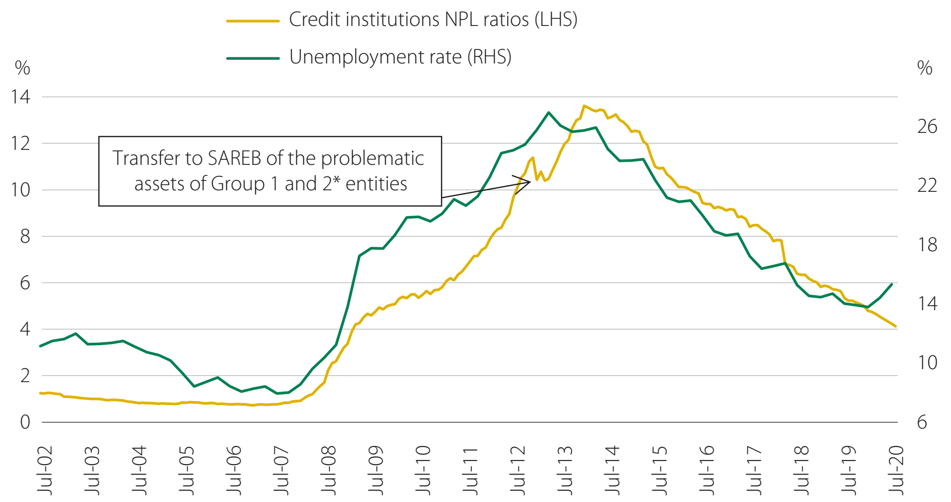
The NPL ratio remains at its lowest since 2009, although the trend is expected to reverse as the economic situation continues to deteriorate.

The banking sector, which has faced significant challenges in recent years, such as the extended period of low interest rates and the emergence of competitors in the provision of financial services in the form of Fintech and Bigtech companies, must now deal with the risks posed by the coronavirus crisis. While early on in the crisis there was a substantial increase in the flow of credit to companies, driven in part by the government secured loan programmes, in the medium term the severity of the economic crisis will determine the extent of the deterioration in these institutions' NPL ratio, which stood at 4.1% in July 2020 (compared with 4.8% in December 2019 and 5.2% in July of the previous year).

The aggregate profit and loss account of the banking sector reflected losses of €7.14 billion in the first half of the year.

In this context, Spanish credit institutions posted losses of €7.14 billion in the first half of the year, as against profits of €5.18 billion in the same period of 2019. Although the current environment of low interest rates continues to put downward pressure on net interest income (-2.9% in the first half), the losses reported in the first six months of the year were due mostly to the significant increase in impairment losses on financial and non-financial assets (from €1.64 billion to €5.86 billion, and from €261 million to €6.64 billion, respectively). Losses of this scale have not been observed in a six month period since June 2012.

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



Source: Bank of Spain and INE. Unemployment rate data up to June and delinquency ratio data up to July.

1 Of the active population.

* The transfers of Group 1 entities took place in December 2012 (€36.70 billion) and those of Group 2 in February 2013 (€14.09 billion).

Bank financing extended to businesses and households showed year-on-year growth of 2% in August (1.5% in August 2019), driven by the increase in financing granted to resident non-financial companies (4.2% in total), mainly through loans from credit institutions and off-balance sheet securitised loans. Financing extended to households fell steadily from March (-0.9% in August), mainly due to the decrease in loans for house purchases (-1.7%).

In August, bank financing extended to businesses and households increased by 2% year-on-year, driven by the increase in financing granted to non-financial companies.

The size of the banking sector, in terms of the aggregate volume of assets used in its activity in Spain, increased by 9.1% between December and July to €2.85 trillion (€2.61 trillion in 2019), largely due to the strong increase in lending. As regards sources of funding, the greatest increase was seen in loans from the Eurosystem, which between December and August grew by more than €120 billion. There was also a notable increase in deposit balances of the "OSR" (other resident sectors), which basically means businesses and households. The aggregate balance of these deposits increased by close to €65 million.

The size of the banking sector grew until July 2020, due to the sharp rise in loans extended.

Partial revision of the Good Governance Code for listed companies EXHIBIT 1

In February 2015, after most of the recommendations contained in the 2006 Unified Code of Good Governance for Listed Companies had been incorporated into the Corporate Enterprises Act, the CNMV Board, taking as a reference the contributions of an expert committee created for the purpose, approved the Good Governance Code for Listed Companies.

Since then, this new Code has been used to supplement the provisions of the Corporate Enterprises Act with good governance recommendations to serve as a reference for Spanish listed companies, which have been reporting their levels of compliance in their annual corporate governance reports.

Four years later, it became clear that some of the Code recommendations needed to be amended to reflect the legal changes that had occurred since 2015 or to provide them with greater precision or clarity. In particular, the regular review of corporate governance reports helped to identify problems of interpretation that needed to be clarified to encourage greater compliance.

The objective was not to substantially amend the Code, but to carry out a partial revision, keeping the corporate governance framework for Spanish companies aligned with the highest international standards. The level of acceptance of the Code by listed companies is high, the level of compliance with its recommendations in 2019 was 85.7% and it is expected that this revision, the scope of which turned out to be somewhat greater than initially planned, will lead to improvements in companies' corporate governance practices.

From 15 January to 14 February 2020, the draft revision, of limited scope, of the Good Governance Code for Listed Companies was submitted to public consultation. This consultation phase aroused a great deal of interest and more than 40 written submissions were received with comments and contributions that were taken into account in the formulation of the final version of the amendments.

After analysing and evaluating the comments received, and in accordance with the authorisation granted under ECC Order 461/2013,[1] of 20 March, on 26 June 2020, the CNMV Board approved the partial revision of the Good Governance Code for Listed Companies.

Main amendments

The revision has affected in varying degrees the wording of 20 of the Code's 64 recommendations. Specifically, recommendations 2, 4, 6, 7, 8, 14, 15, 22, 24, 37, 39, 41, 42, 45, 53, 54, 55, 59, 62 and 64 have been amended, which has also involved a revision of the wording of principles 2, 4, 10, 19, 20 and 24.

The main amendments are as follows:

Recommendation 2. Listing of companies belonging to groups

In its previous wording, recommendation 2 was limited to cases in which both the shares of the company and those of its parent were listed. However, the conflict of interest that may arise between the group and companies that form it, particularly in the context of intragroup transactions, is a separate matter from whether or not the parent is also listed (and if so where). Where the listed company has shareholders that are external to the group, maximising the interest of the parent group is not always in the corporate interest of the listed subsidiary.

Therefore, the new text addresses not only cases where both group companies are listed, but applies to all cases where the listed company is controlled by another entity.

Recommendation 4. General communication policy

Companies must have a general policy regarding the communication of economic-financial and corporate information through such channels as they may consider appropriate (the media, social networks or other channels) that helps to maximise the dissemination and quality of information available to the market, investors and other stakeholders. This new recommendation highlights the importance of companies' communication policy for the market and the advisability of this policy's being designed in accordance with proper guidelines and controls established with the involvement of the board of directors.

Recommendation 7. Remote voting and attendance

The situation caused by COVID-19, coupled with the objective of fostering the long-term engagement of shareholders, has led to the amendment of recommendation 7 of the Code, which now advises that entities should have systems in place to enable shareholders to exercise their right to vote by means of data transmission and, at least for large-cap entities, set up mechanisms to allow the remote attendance and participation in general shareholders' meetings, to the extent that this is proportionate. Until now, only the broadcasting of general shareholders' meetings was recommended.

Recommendation 8. Annual financial statements

The text of the recommendation has been amended to highlight the fact that the objective to be pursued by the board of directors in formulating the annual financial statements is the correct application to the best of their knowledge of the accounting principles and criteria.

Recommendations 14 and 15. Gender diversity

Recommendations on gender diversity have been strengthened to promote the presence of women on boards of directors. Recommendation 15 indicates that female directors should represent at least 40% of members of boards of directors before the end of 2022. Prior to that date, this percentage may not be less than 30%.

Recommendation 14 proposes that companies encourage increases in the number of female senior managers, given that this is one of the most effective measures to strengthen gender diversity on boards of directors in the long term.

Recommendations 22 and 24. Cessation of directors

Recommendation 22 is amended so that, among other aspects, the board must assess any situation in which a director is involved in circumstances that could damage the company's credit or reputation, and, where appropriate, take action without waiting for an official court decision (such as an indictment or the opening of oral proceedings).

The criteria of transparency are also reinforced in recommendation 24 with regard to the cessation of directors whether through resignation or by resolution of the general shareholders' meeting, both through the annual corporate governance report and at the time of cessation.

Recommendation 37. Composition of the executive committee

This recommendation is one of the least complied with by listed companies. In 2019, the level of compliance with this recommendation was 30 percentage points lower than the Code average and no significant improvement has been observed in recent years.

Most of the entities that do not comply with this recommendation consider the executive committee to be a purely executive board-delegated body, and consequently its composition tends to be based on criteria of efficiency and knowledge of the internal functioning of the entity, and to be dominated by executive directors.

The objective of the recommendation is to offset the risk of the executive committee's functions being exercised with a different perspective from that of the board. With a view to making this compatible with giving companies more flexibility in terms of its composition, the new text recommends that at least two non-executive directors sit on the committee, at least one of whom should be an independent director, as against the previous wording, which recommended that the composition of the committee in terms of the various categories of directors should be similar to that of the board itself.

Recommendations 39, 41, 42 and 45. Risks and non-financial information

Technical adjustments have been made to the wording to include the supervision of both financial and non-financial information, and control and management systems for financial and non-financial risk.

In recommendation 42, the scope of the channel for reporting irregularities (whistleblowing) has been expanded so that it can be used not only by employees but also by other persons related to the company, such as directors, shareholders, suppliers, contractors or subcontractors.

It is also recommended that this mechanism guarantee confidentiality and ensure that communications can be made anonymously.

Recommendations 53, 54 and 55. Sustainability

Some technical adjustments have been made and the term "corporate social responsibility" has been replaced by the broader and currently more commonly used term "sustainability" in relation to environmental, social and corporate governance (ESG) aspects.

Recommendation 59. Variable remuneration

The text has been changed to clarify that variable remuneration should only be paid to directors when it has been sufficiently verified that previously established performance or other conditions have been met. Companies that comply with this recommendation must disclose in their annual director remuneration reports the verification criteria that they apply.

Likewise, it is recommended that companies consider including reduction (*malus*) clauses deferring payment of a portion of variable remuneration and implying its total or partial loss if an event were to occur that would make this advisable.

Recommendation 62. Share-based remuneration

This recommendation is one of those that caused the greatest amount of uncertainty among listed companies when indicating whether they were compliant or not in their annual corporate governance reports. The new text clarifies the scope of the rule according to which, once shares or options or financial instruments arising from remuneration schemes have been allocated, executive directors are prohibited from transferring their ownership or exercising them as the case may be until a term of at least three years has elapsed.

The wording is also amended to clarify that it is not necessary to respect this requirement when the director has economic exposure to the variation in the price of the shares for a market value equivalent to at least twice the amount of his or her fixed annual remuneration.

Recommendation 64. Severance pay

For the purposes of this recommendation, some entities have understood that payments made for termination of the contract entered into between the company and the executive director should include only the severance pay received. However, there are other remuneration items that are not part of the severance pay but have been accrued on the termination of the contractual relationship between the director with the company.

The amendment specifies that payments made for contractual termination, which may not together exceed two years' remuneration, may include any payments accrued or where the payment obligation arises as a consequence of or due to the termination of the contractual relationship between the director and the company, including amounts not previously vested from long-term savings schemes and amounts deriving from post-contractual non-competition agreements.

1 Order ECC/461/2013, of 20 March, determining the content and structure of the Annual Corporate Governance Report, the annual report on remuneration and other information instruments of listed public limited companies, savings banks and other entities that issue securities admitted to trading on official securities markets.

Financial investment decisions made by households continued to focus on more liquid assets as against fixed income and equities.

The most recent data on the financial position of households indicate a strong increase in the rate of saving, which in June stood at 11.2% of gross disposable income (GDI), almost double the figure at the end of 2019 (6.3%) and very close to the highs seen in 2010, early on in the European sovereign debt crisis (11.5%). This increase is attributed to "precautionary saving", which usually occurs in periods of high uncertainty about future income, as is the case today. Both the gross wealth and indebtedness rates showed declines in the first quarter of the year. This decrease was sharper in the former case, due to the fall in the value of financial assets. Therefore, in net terms, household wealth fell from 917% of GDI to 906%.

Household's rate of saving increased significantly in the first half of the year due to precautionary saving, while net wealth decreased due to the loss of value of financial assets.

Households' net investments amounted to 3.5% of GDP in the first quarter of the year,[8] slightly above the figure of 3.2% observed in 2019, maintaining the trend seen in previous years. In the current context of low interest rates and given the stock market turbulence in the initial phase of the crisis, there was divestment of 2.3% in fixed income securities and term deposits (compared with 1.7% in 2019), and also in shares and other equity stakes of 0.5% (1.3% in 2019). As in previous years, the most significant investment was in means of payment (5.1% of GDP).

Investment in investment funds decreased significantly in the past year, due to the high volume of redemptions in March.

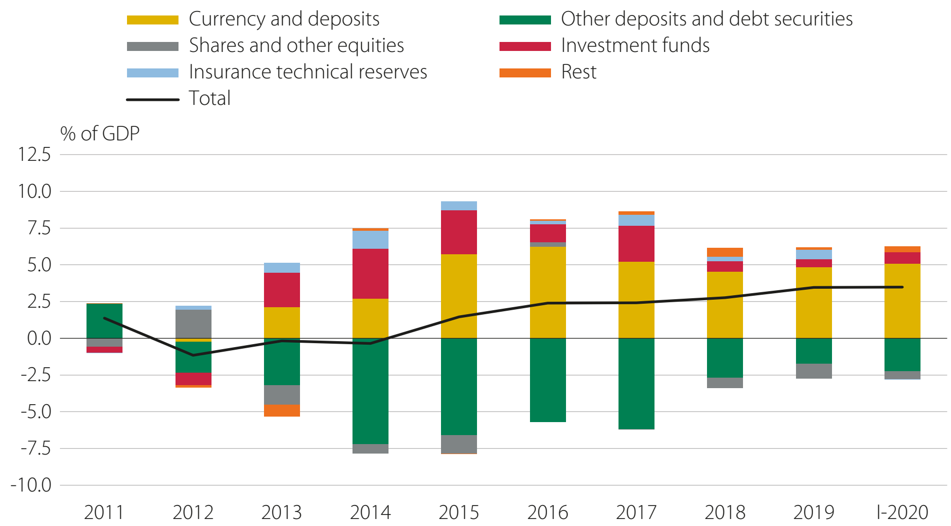
In terms of flows into investment funds, households invested 0.8% of GDP in the first quarter of 2020,[9] slightly above the 0.5% observed in 2019. However, this figure, which is significantly lower than the figure observed between 2013 and 2017 (around 2.5% of GDP), can be explained by the increase in

8 Cumulative data for four quarters, up to Q1 2020.

9 Cumulative data for four quarters, up to Q1 2020.

redemptions in the second half of March. As described in section 4.1, in the first quarter of this year investment funds saw redemptions of over €2 billion, concentrated mostly in the fixed income category, guaranteed equity funds and passive management funds. In the second quarter, a gradual recovery of investment in these products was observed, which resulted in aggregate net subscriptions of close to €150 million.

Households: net acquisitions of financial assets FIGURE 11



Source: Bank of Spain, *Financial statements*. Cumulative data for four quarters.

2.3 Outlook

The latest IMF forecasts predict a drop in world GDP of 4.4% for this year, 0.8 points less than in its previous forecast…

The latest forecasts published by the IMF in October, three months after its first assessment of the crisis, included an improvement in growth expectations for advanced economies this year (except for Spain, where the previous forecast was not improved) and a downward review of 0.2 pp for emerging markets. The IMF, which for the first time ever expects falls in GDP in all the regions it covers, has indicated that there is a great deal of uncertainty surrounding its forecasts, since they depend on the scale and duration of the pandemic, the effectiveness of the measures implemented to deal with it, and the consequences for consumer habits. It also warns of a sharp increase in social inequality due to the greater impact of the crisis on lower-income groups. Given the high degree of uncertainty, the IMF released, together with its base case forecasts, the results of two other scenarios: one more favourable, which posits a faster exit from the crisis, and the other more adverse, in which it takes longer and is more difficult to contain the virus.

… in which advanced economies would experience a decline in GDP of 5.8% and emerging economies of 3.3%. There is some disparity in both groups, as the crisis is not hitting all countries with the same intensity.

The published forecasts place the drop in world activity at 4.4% this year (0.8 pp less than in June) and growth of 5.2% in 2021. By economic area, the forecast for advanced economies is a decrease of 5.8% this year (an improvement of 2.3 pp compared with the June figure) and growth of 3.9% in 2021; for emerging markets, the expected fall this year is 3.3% (0.2 pp worse than in April) and growth of 6.0% in 2021. The IMF's adverse scenario would lead to a drop of 0.75 pp in GDP for this year and 3 pp for 2021 compared with the base case scenario. Figures also vary considerably within these areas. Among the advanced economies, the variations presented by the United States, Germany, Japan and Canada would be the least negative (although still significantly so), while several economies in the euro area would record GDP declines of more than 10%. Forecast figures for the emerging economies are even more disparate, ranging from small growth of close to 2% expected for China, given its earlier exit from the crisis, to a fall in activity of close to 8% in Latin America and 10% in India.

A significant increase in the deficit and aggregate public debt is also expected…

In addition to these activity forecasts, the IMF has indicated that it expects advanced economies to show an aggregate increase in public debt of close to 20 pp, to 124.1% of GDP this year (it was 10.5 pp in the global financial crisis) and of 14.2 pp in the public deficit (4.9 pp in the global financial crisis). This increase partly reflects the measures implemented by the governments of different countries to address the crisis, which have taken the form of extensions, guarantees and public loans.

… in a context of great uncertainty related to different factors: the evolution of the pandemic itself, consumer habits, trade agreements, Brexit…

The risks surrounding these forecasts are significant due to the high degree of uncertainty, as discussed above. Indeed, many institutions have pointed out the limited scope of traditional forecasting models and are developing complementary methodologies that include among other innovative features high-frequency data to enable forecasts to be adjusted more rapidly. The most significant – downside – risks identified in this scenario relate to: i) the possibility that a second wave of infections will lead to new lockdown measures and, consequently, further deterioration in economic activity ; ii) possible changes in the consumption-saving pattern of agents, which is already significantly affected by the decrease in aggregate income and wealth, and iii) other major sources of uncertainty related to the negotiations on the trade agreement between the United States and China and the final form of Brexit, for instance. In the medium term, one of the greatest identified risk factors relates to the sustainability of public finances in many economies after the budgetary effort made during the crisis.

Gross Domestic Product TABLE 3

Annual % change

					IMF[1]	
	2016	2017	2018	2019	2020	2021
Global	3.2	3.7	3.6	2.8	-4.4 (0.8)	5.2 (-0.2)
United States	1.5	2.2	2.9	2.2	-4.3 (3.7)	3.1 (-1.4)
Euro area	1.8	2.4	1.9	1.3	-8.3 (1.9)	5.2 (-0.8)
Germany	1.9	2.5	1.5	0.6	-6.0 (1.8)	4.2 (-1.2)
France	2.0	2.3	1.8	1.5	-9.8 (2.7)	6.0 (-1.3)
Italy	0.9	1.5	0.8	0.3	-10.6 (2.2)	5.2 (-1.1)
Spain	3.3	3.0	2.4	2.0	-12.8 (0.0)	7.2 (0.9)
United Kingdom	1.9	1.7	1.3	1.4	-9.8 (0.4)	5.9 (-0.4)
Japan	0.9	1.7	0.3	0.7	-5.3 (0.5)	2.3 (-0.1)
Emerging markets	4.4	4.7	4.5	3.7	-3.3 (-0.2)	6.0 (0.2)

Source: IMF.

1 In parentheses, the variation compared with the last published forecast (IMF, forecasts published in October 2020 with respect to June 2020).

According to the IMF, Spain's GDP will contract by almost 13% this year, unchanged from the June forecast, reflecting the greater impact of the crisis on the economy, as in other large European economies such as Italy or France.

For the Spanish economy, the IMF forecasts a drop in GDP of 12.8% for this year (keeping its June forecast unchanged), the largest fall among all euro area countries, followed by Italy and France (-10.6% and -9.8%, respectively). The expected recovery in 2021 is of 7.2% (almost 1 point above the June forecast and 3 points higher than in April), underpinned by funds received from the European Union's Recovery and Resilience Facility and the confidence generated by this. The Spanish economy is one of the most affected by the pandemic, as its productive model relies on services that have been hit particularly hard by the crisis. Based on these figures, the growth differential with the euro area as a whole would be negative this year (i.e. greater recession in Spain), but positive again next year.

The main risks for the Spanish economy are the same as those identified on an international scale, although the difficulty in recovering economic growth and the need to preserve the sustainability of public accounts stand out particularly.

The risks affecting the global economy also affect Spain. However, the country's greatest vulnerabilities are as follows: The first major challenge facing the Spanish economy is how to recover the economic growth rate that existed prior to the crisis and reduce the number of unemployed persons to a minimum. This problem is exacerbated by the second wave of coronavirus infection, which is leading to new partial lockdown measures in certain areas of the country. On a more positive note, Spain has been assigned funds of €140 billion from the "reconstruction fund", in the form of non-refundable grants and loans, which will be key to economic recovery. The second great challenge lies in the need to preserve the sustainability of public finances in a year in which public debt could rise above 120% of GDP and the deficit could be over 10%. This has led some rating agencies to address sovereign credit risk, putting their ratings of Spanish debt on "negative outlook" or in the case of some smaller agencies, lowering their ratings.

Recommendations of the European Systemic Risk Board in the context of the coronavirus crisis

EXHIBIT 2

The European Systemic Risk Board (ESRB), which was created 2010 to prevent and mitigate systemic risk, has been working intensively since the outbreak of the coronavirus crisis. While recognising that the financial system is more resilient today than it was prior to the global financial crisis, the severity of the current situation reveals a need to focus on certain factors that will be key for allowing this system to continue to function without disruption. The Board of the ESRB stated in April[1] the importance of measures being implemented in a coordinated and timely manner by the authorities, while also pursuing synergies between fiscal, monetary and regulatory policies. To this end, the institution decided to focus its attention on five priority areas:

i) Implications for the financial system of guarantee schemes and other fiscal measures to protect the real economy.

ii) Market illiquidity and implications for asset managers and insurers.

iii) Impact of large-scale downgrades of corporate bonds on markets and entities across the financial system.

iv) System-wide restraints on dividend payments, share buybacks and other pay-outs.

v) Liquidity risks arising from margin calls.

As a result of the work carried out at different levels of this institution on these five areas, the ESRB has approved four recommendations, which are set out below:

i) **Recommendation (ESRB/2020/4) on liquidity risks in investment funds.**[2] This recommendation was published on 6 May. In the first few weeks of the crisis, a substantial increase in redemptions was observed in some investment funds, while liquidity conditions in the markets deteriorated significantly. Although this situation subsequently stabilised, the ESRB considered it appropriate to strengthen liquidity risk management in the face of potential future adverse shocks. In the past, the ESRB has highlighted the vulnerabilities that may arise in investment funds that establish very short redemption periods while at the same time investing in illiquid assets (liquidity mismatch) and, specifically on this occasion it has identified two investment fund segments that require special scrutiny in terms of financial stability: i) funds with significant exposure to corporate debt assets and ii) funds with significant exposures to the real estate sector.

The ESRB therefore recommends that the European Securities and Markets Authority (ESMA) carry out, in collaboration with the national competent authorities, a supervisory exercise focused on these funds to determine their preparedness to respond to potential future adverse shocks, whether in the form of significant increases in redemptions or uncertainty – and value the assets in their portfolios. The analysis and its conclusions must be reported to the ESRB.

ii) **Recommendation (ESRB/2020/6) on liquidity risks arising from margin calls.**[3] This recommendation was published on 25 May and is motivated by the fact that market shocks, such as sharp drops in asset prices and high levels of market volatility, translate into increases in variation margins and may also lead to significant initial margin calls on positions in cash, securities, commodities or derivatives in the operations of central counterparties (CCPs). If these variations are significant and occur in a short period of time, they may have major implications for the liquidity management of market participants, for their funding needs, and possibly even for their solvency. In the context of the crisis, many clearing members have seen their initial margins increase and some clearing members may have experienced liquidity constraints. However, no defaults have occurred in any CCPs established in the European Union. Looking ahead, the ability of market participants to cover margin calls will depend on future levels of volatility and the continuing resilience of their liquidity management.

Therefore, the ESRB has issued four recommendations for CCPs to ensure that their risk management and resilience remain strong and continue to protect market participants from losses due to default. Recommendations A and D are intended to ensure that sudden changes and effects relating to initial margins and collateral are limited and proportionate. Liquidity planning should be predictable and manageable to the extent possible, limiting unexpected and significant margin calls. The objective of recommendation B is to ensure that CCPs capture comprehensively in their liquidity stress testing any events that could lead them to experience a liquidity shortfall, with a view to incentivising them to improve the management of their reliance on liquidity service providers. Recommendation C is aimed at ensuring that CCPs, while maintaining their financial resilience, limit the asymmetry in the payment of variation margins collected intraday – and that they design their margin frameworks and schedules so as to be predictable and avoid excessive liquidity constraints for clearing members that could lead to default events.

iii) **Recommendation (ESRB/2020/7) on restriction of distributions during the COVID-19 pandemic.**[4] This recommendation, which was published on 27 May, seeks to ensure that financial institutions maintain a sufficiently high amount of capital to mitigate systemic risk and contribute to economic recovery. To this end it is recommended that at least until 1 January 2021 relevant authorities request financial institutions under their supervisory remit to refrain from undertaking any of the following actions: i) making dividend distributions or giving an irrevocable commitment to make a dividend distribution, ii) buy-backs of ordinary shares and iii) creating an obligation to pay variable remuneration to a material risk taker, where any of these actions has the effect of reducing the quantity or quality of own funds at the EU group level. This recommendation extends to credit institutions, investment firms, insurance and reinsurance undertakings, and central counterparties.

The CNMV made the appropriate recommendation to the CCP under its supervision in July and notified the ESRB, while in the case of investment firms it was decided not to make the recommendation to them by virtue of the principle of proportionality and taking into account their low weight in the financial system as a whole.

iv) **Recommendation (ESRB/2020/8) on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic.**[5] This recommendation, published on 27 May, seeks to assess, from the point of view of financial stability, the effectiveness of the measures adopted by Member States to protect non-financial corporations and households from the effects of the pandemic. Given the high degree of integration of EU Member State economies and possible spillovers of the various measures implemented by one Member State on the others, this approach is necessary at a European level.

This general recommendation is broken down into two parts. Recommendation A recommends that national macroprudential authorities monitor and assess the financial stability implications of COVID-19 related measures taken by their Member States to protect the real economy. In particular, it is recommended that they monitor the design features and uptake of the measures (types of financial support, beneficiaries, duration and information on the use of the measure) and the implications for financial stability (flow of credit to the real economy, solvency and indebtedness of the non-financial sector, and the soundness of financial institutions, etc.).

Recommendation B recommends that national macroprudential authorities regularly report to the ESRB the information necessary for the ESRB to monitor and assess the implications of the national measures, including the cross-border and cross-sectoral implications. The Spanish macroprudential authority AMCESFI submitted its first report to the ESRB last July, which the board will assess, together with the contributions of the other authorities, on an ongoing basis.

Only one of the five priority areas established by the ESRB in April, that relating to the effects of the downgrade of credit ratings, has not been the subject of a recommendation but remains as a subject of analysis, on which an initial publication has been released in the form of a technical note.[6] This note contains a top-down analysis that attempts to quantify the impact of a mass bond downgrade scenario on the financial system. This hypothetical event could lead to significant price reductions in the affected assets and presumably could also lead to forced sales that would cause asset prices to fall further. The analysis focuses on corporate debt assets and considers two scenarios in which bonds are downgraded as well as three different behavioural scenarios regarding asset sales. The analysis shows that direct losses from downgrades could amount to between €150 billion and €200 billion, and that fire sale losses could add a further 20-30% to these. The latter would depend among other things on how much of their holdings institutions would have to sell and on market liquidity conditions at the time.

The CNMV has also embarked on a line of work seeking to assess the status of and trends in credit ratings of Spanish debt since March of this year, including a variety of assets and the financial and non-financial private and public sectors (see the article entitled "Credit ratings of Spanish debt assets since the beginning of the COVID-19 crisis" in this Bulletin).

1 https://www.esrb.europa.eu/news/pr/date/2020/html/esrb.pr200409~a26cc93c59.en.html
2 https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation200514_ESRB_on_liquidity_risks_in_investment_funds~4a3972a25d.en.pdf?9903de66f9dbd6783563ae3a4f76febb
3 https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation200608_on_liquidity_risks_arising_from_margin_calls~41c70f16b2.en.pdf?17da572cd7cae5ab20ae79f8786a19a7
4 https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation200608_on_restriction_of_distributions_during_the_COVID-19_pandemic_2~f4cdad4ec1.en.pdf?472c0a13909b423693bdaea41c32af6b
5 https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation200608_on_monitoring_financial_implications_of_fiscal_support_measures_in_response_to_the_COVID-19_pandemic_3~c745d54b59.en.pdf
6 https://www.esrb.europa.eu/pub/pdf/system_wide_scenario_analysis_large_scale_corporate_bond_downgrades.en.pdf

3 Domestic market performance

After the highs reached in the first half of May (close to 0.65), the Spanish financial market stress indicator has progressively decreased to levels below 0.49, the threshold that separates the high and medium stress levels.

The crisis triggered by COVID-19 led to the fastest increase in the Spanish financial market stress indicator[10] in a period of just a few weeks. This indicator, which at the closing date of our previous report (31 March) stood at 0.56, continued to increase in the following weeks to reach a third new historical high of close to 0.65 in the first half of May. The progressive increase in the indicator, which in February was

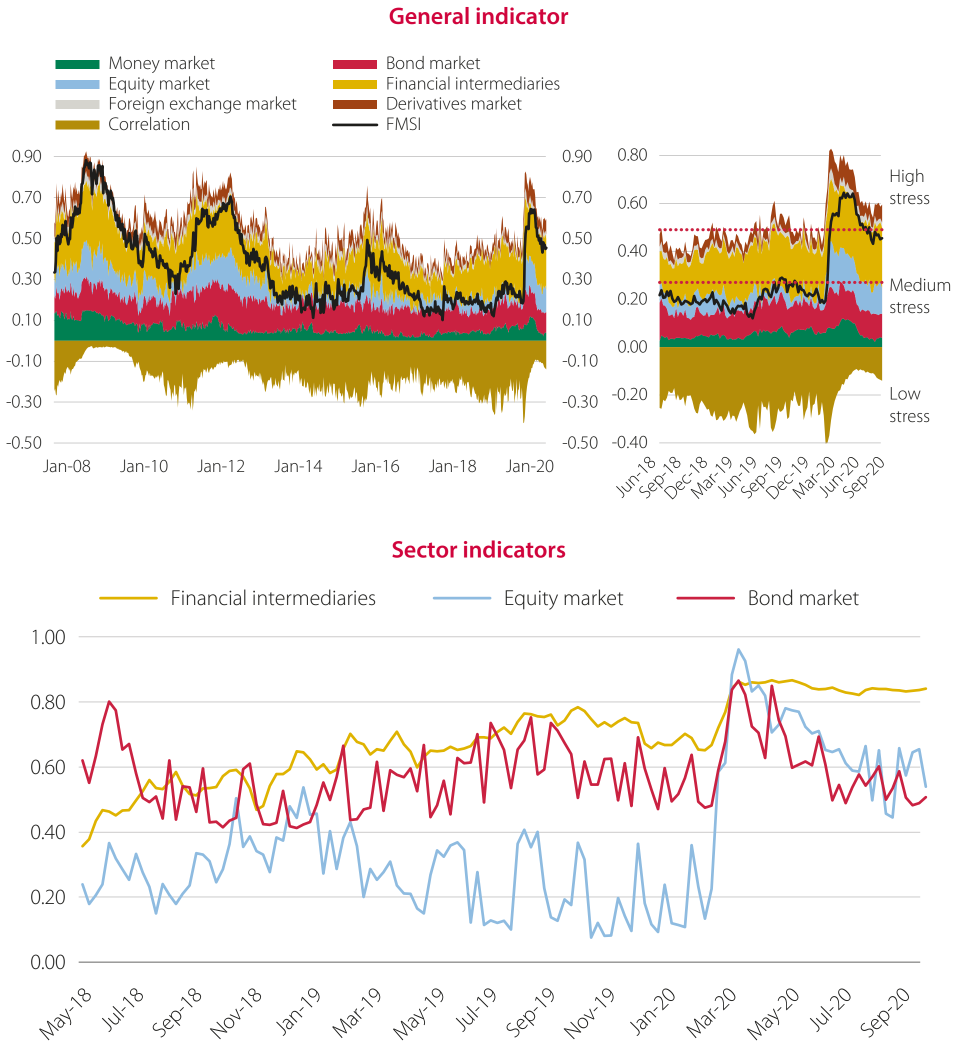
10 The stress indicator calculated by the CNMV provides a real-time measure of systemic risk in the Spanish financial system that ranges from zero to one. To do this, it evaluates stress in six segments of the financial system and makes an aggregate, obtaining a single figure that takes into account the correlation between these segments. Econometric estimates indicate that index values below 0.27 correspond to periods of low stress, while scores between 0.27 and 0.49 correspond to periods of medium stress, and values above 0.49 indicate periods of high stress. For further details on recent movements in this indicator and its components, see the quarterly publication of the *Financial Stability Note*, and the CNMV's statistical series (market stress indicators), available at http://www.cnmv.es/portal/Publicaciones/PublicacionesGN.aspx?id=51. For more information on the methodology of this indicator, see Cambón, M.I. and Estévez, L. (2016). "A Spanish Financial Market Stress Index (FMSI)". *Spanish Review of Financial Economics,* Vol. 14, No. 1, pp. 23-41 or as CNMV Working Paper No. 60 (http://www.cnmv.es/DocPortal/Publicaciones/MONOGRAFIAS/Monografia_60_en.pdf).

clearly below 0.20, was due to the rise in stress levels detected in the six segments assessed and the degree of correlation in the system (see Figure 12). The types of indicators that have suffered the greatest pressure in the context of the crisis relate to falls in asset prices and outbreaks of volatility, while the performance of the different risk premiums has been much more contained compared with other periods of stress. This relatively more favourable performance in the debt markets has prevented the general indicator from reaching the highs seen in the global financial crisis of 2008 or the sovereign debt crisis of 2012, when the risk premium applied to Spanish public debt peaked at 634 bp In this case, the measures implemented by the authorities, in particular the central bank, have prevented any substantial deterioration in risk premiums and liquidity conditions in the debt markets.

The stress levels of all individual indicators decreased except for financial intermediaries (banks), which were badly affected by the fall in their quoted prices. The correlation of the system remains high.

As shown in Figure 12, the individual indicators have marked a fluctuating but downward trend after the highs reached in May, with the general indicator declining gradually to levels just below 0.50, close to the threshold that separates the high and medium stress levels (0.49). At the date of this report (30 September), financial intermediaries (banks) were showing the greatest resistance to this fall, due to the sharp decline in their quoted prices and the increase in volatility indicators.

Spanish financial markets stress indicator FIGURE 12



Source: CNMV.

3.1 The stock markets

The Spanish equity markets, which had suffered sharp falls until April due to the coronavirus crisis, falls from which they had barely recovered in the second quarter, started the second half of the year with slight declines. These losses were consolidated as the third quarter progressed due to the poor outlook for the Spanish economy in a context of global economic uncertainty.[11] Added to the economic forecasts for Spain,[12] which are more unfavourable than for the rest of the large European economies, is the uncertainty as to how the second wave of the pandemic will spread over the next few months. This situation is forcing governments and local authorities to withdraw some of the measures implemented to reopen the economy adopted in recent months, which may negatively affect expectations of economic recovery and, consequently, the stock markets.

The Spanish equity markets began the second half with losses, which were consolidated in the third quarter due to the poor outlook and uncertainties for the country's economy, compounded by the effects of a second wave of the pandemic.

The main Spanish stock market index ended the third quarter with a decline of 7.1%, underperforming other benchmark indices[13] along with the UK's FTSE 100. The Ibex 35, which had lost 28.9% in the first quarter of the year, the worst quarter in its history, saw a small recovery of 6.6% in the second before falling again, by 7.1%, in the third. This new decline has increased the decline in the year to date, and places the index at its lowest level since May, with a cumulative YTD loss of 29.7%, the biggest among the major international indices.

In this context, the Ibex 35 lost 7.1% in the third quarter of the year, accumulating a year-to-date loss of 29.7%, the biggest of all the major international indices…

The drop in quoted prices put the Spanish indices back at their lowest levels since May and very close to the values reached in 2012 – at the time of the debt crisis in Europe – given that economic recovery in Spain is expected to be slow and that the outbreaks of infection will bring further harm to the sectors most affected so far this year, such as banking and tourism. These factors, and the fact that Spanish indices have a different composition compared with their European peers, as they have a greater weighting of companies in the financial and consumer services sectors (such as leisure, tourism and hospitality), in which recovery is expected to be slower, in addition to the significant presence of Spanish companies in Latin America, are the reasons why Spanish indices are showing the worst performance among the major international indices. The fall in quoted prices took place in a context of declining trading but in which some market liquidity indicators were also improving.

… a trend than can be explained by the greater relative weight in the index of the sectors most affected in Spain, banking and consumer services.

11 The markets are also anxiously awaiting the outcomes of Brexit, the upcoming elections in the US and the trade negotiations between the US and China.

12 The Bank of Spain has released projections for the Spanish economy for 2020-2022, indicating that the short and medium-term economic outlook remains subject to a very high level of uncertainty. Therefore, it presents two scenarios: one which reflects more moderate outbreaks of the virus and another in which there is a higher degree of contagion. In the first scenario, the economy would see an annual average decline of 10.5% in 2020, and in the second this figure would rise to 12.6%. Further, the economic recovery forecast for 2021 would be 7.3% in the first scenario and 4.1% in the second, so that by the end of 2022 GDP would stand at 2 pp and 6 pp respectively below the pre-crisis level.

13 The major international indices performed unevenly in the third quarter, with gains in the US, Japanese and German indices ranging from 3.7% for Germany's Dax 30 to 11% for the US technology-heavy Nasdaq index. The largest losses were seen among European indices, ranging from 1.3% for the Eurostoxx 50 to 7.1% for the Ibex 35 (see section 2.1).

The fall in the general index contrasts with the rises in quoted prices on small and mid-cap indices, which contain a larger number of technology and pharmaceutical companies, which are performing better in the crisis.

The falls in the main Spanish market indices contrast with the stability in the prices of mid-cap companies (0.5%) and increases in small caps (7.8%) thanks to the presence of some companies in the renewable energy and pharmaceutical sectors, which are posting better relative performances. Likewise, the indices that are representative of Latin American securities quoted in euros, the FTSE Latibex All-Share and FTSE Latibex Top, made further losses (-7.3% and -3.2%, respectively) as a consequence of the depreciation of their currencies against the euro.[14]

Most sectors ended the quarter with falls, although the sharpest were concentrated in the banking, consumer services and oil sectors.

The vast majority of sectors ended the third quarter with falls, although the sharpest falls were again concentrated in sectors on which the impact of the renewed outbreaks and the economic crisis is worst, such as banking, tourism and oil companies. The biggest falls (see Table 4) were observed in the oil sector, with the main oil company (Repsol) still feeling the effects of low crude prices.[15] Further, and despite the announcement of the merger[16] between Bankia and Caixabank, which temporarily boosted banks' share prices, the banking sector lost more than 20% in the quarter against a backdrop of falling commercial activity and tighter margins, in addition to higher delinquencies and rising risk, which reduces the value of this sector in Spain compared with other European countries.[17] The consumer services sector also continued to fall, standouts being the heavy losses of the main airline (IAG), which is badly affected by the slump in activity, as well as of companies in the tourism sector.[18] This was compounded by the removal of both BBVA and Telefónica from the Eurostoxx 50[19] index at the end of September, which has pushed down the quoted price of both stocks and their corresponding sector indices, since both companies were removed from the portfolios of many international investors, investment funds and ETFs that replicate the main market indices.

Other sectors such as telecommunications and construction also registered significant declines.

The negative performance of the telecommunications and construction sectors also stood out as did, to a lesser extent, that of insurance. In the telecommunications sector, the main company (Telefónica) continues to see reduced margins due to the effects of competition, and has also been affected by the uncertainties surrounding its subsidiaries in Latin America, in addition to its exclusion from the Eurostoxx 50. Construction companies have been affected by the decline in capital investment, while insurers, like banks, are feeling the effects of low interest rates.

Companies presenting a positive performance included most notably producers of industrial goods and raw materials and food, real estate and textile companies.

On the positive side, companies producing industrial goods and raw materials stood out due to the resumption of industrial activity and their more cyclical nature, which will allow them to benefit from the future recovery process. Food companies also showed slight gains due to their countercyclical nature, as did real estate and textile

14 In the third quarter of the year, the euro strengthened by 7% against the Brazilian real, and by 0.2% against the Mexican peso.

15 The price of oil remained around $41 a barrel in the third quarter and oil futures for the next few months do not anticipate any increases.

16 Bankia and Caixabank announced talks about a possible merger in early September, which was approved by the boards of both banks in the second half of the month.

17 The capitalisation of Spanish banks, which had traditionally been the largest in Europe, has fallen to third place, behind French and Italian banks.

18 The main companies linked to the airline and tourism sectors have seen sharp falls so far this year: IAG (85%), Meliá (60%), NH Hotel Group (45%) and Aena (30%).

19 Both companies left the index, to which they had belonged since it was created, on 18 September, along with Société Générale, Fresenius and Orange.

companies, among which Inditex, the leader, stood out for its ability to adapt to the new competitive and technological environment.

The effects of the crisis have significantly altered the capitalisation of companies and, consequently, the value of the country's productive structure.

The crisis has had a considerable impact on the capitalisation of Spanish companies and the value of the country's productive structure. The textile company Inditex remains the biggest Spanish company by capitalisation, but companies in the electricity sector have gained weight due to their defensive nature, due to the stability of their business and revenues, alongside technology firms such as Cellnex Telecom, to the detriment of banks, traditional telecommunications companies such as Telefónica and energy companies such as Repsol.

Performance of Spanish stock market indices and sectors TABLE 4

Indices	2017	2018	2019	IV 19[1]	I 20[1]	II 20[1]	III 20[1]	% vs Dec-19
Ibex 35	7.4	-15.0	11.8	3.3	-28.9	6.6	-7.1	-29.7
Madrid	7.6	-15.0	10.2	3.0	-29.4	6.4	-7.4	-30.4
Ibex Medium Cap	4.0	-13.7	8.4	11.1	-31.0	7.8	0.5	-25.3
Ibex Small Cap	31.4	-7.5	11.9	5.0	-24.6	17.5	7.8	-4.6
FTSE Latibex All-Share	9.0	10.3	16.3	7.8	-46.3	14.4	-7.3	-43.1
FTSE Latibex Top	7.3	14.8	15.3	8.4	-43.3	14.6	-3.2	-37.1
Sectors[2]								
Financial and real estate services	**10.5**	**-27.1**	**-27.1**	**4.3**	**-40.7**	**1.0**	**-19.8**	**-52.0**
Banking	10.6	-29.0	-29.0	3.8	-41.9	0.9	-20.6	-53.4
Insurance	0.1	-12.8	-12.8	-0.9	-36.4	4.8	-8.7	-39.1
Real estate and others	17.6	-26.1	-26.1	-1.3	-31.3	5.8	7.4	-22.0
Oil and energy	**3.9**	**6.1**	**6.1**	**-3.2**	**-13.9**	**10.6**	**-1.8**	**-6.5**
Oil	9.9	-4.5	-4.5	-2.9	-40.2	-6.6	-26.5	-58.9
Electricity and gas	2.0	8.9	8.9	-3.4	-7.7	12.9	1.0	5.3
Basic mats., industry & construction	**2.6**	**-8.6**	**-8.6**	**4.1**	**-30.5**	**11.5**	**-1.5**	**-23.7**
Construction	9.9	-3.4	-3.4	0.1	-29.2	11.3	-11.0	-29.9
Manufacture and assembly of capital goods	-19.3	-10.4	-10.4	15.9	-20.4	10.7	23.8	9.1
Minerals, metals and metal products processing	14.2	-25.3	-25.3	8.9	-38.7	13.8	3.5	-27.8
Engineering and others	-9.9	-21.3	-21.3	1.4	-44.3	-20.9	1.3	-31.9
Technology and telecommunications	**7.5**	**-5.5**	**-5.5**	**-0.3**	**-30.3**	**11.0**	**-9.7**	**-30.1**
Telecommunications and others	-5.1	-8.2	-8.2	-7.0	-23.8	13.3	-16.2	-27.7
Electronics and software	36.6	-0.1	-0.1	11.4	-40.1	6.6	1.9	-34.9
Consumer goods	**-2.1**	**-16.7**	**-16.7**	**11.3**	**-19.1**	**-0.3**	**-0.8**	**-20.0**
Textile, clothing and footwear	-10.4	-23.1	-23.1	10.7	-24.8	-0.4	0.9	-24.4
Food and drink	5.2	-8.4	-8.4	4.0	-2.1	9.8	1.6	9.2
Pharmaceutical products and biotechnology	14.6	-6.4	-6.4	13.9	-8.6	-3.6	-5.4	-16.0
Consumer services	**23.3**	**-19.7**	**-19.7**	**12.3**	**-50.2**	**8.8**	**-11.8**	**-52.2**
Motorways and car parks	-3.1	39.5	-34.7	2.4	-49.1	4.4	-17.7	-56.3
Transport and distribution	-15.7	32.3	-11.5	15.6	-52.5	12.5	-12.4	-53.2

Source: BME and Thomson Datastream.

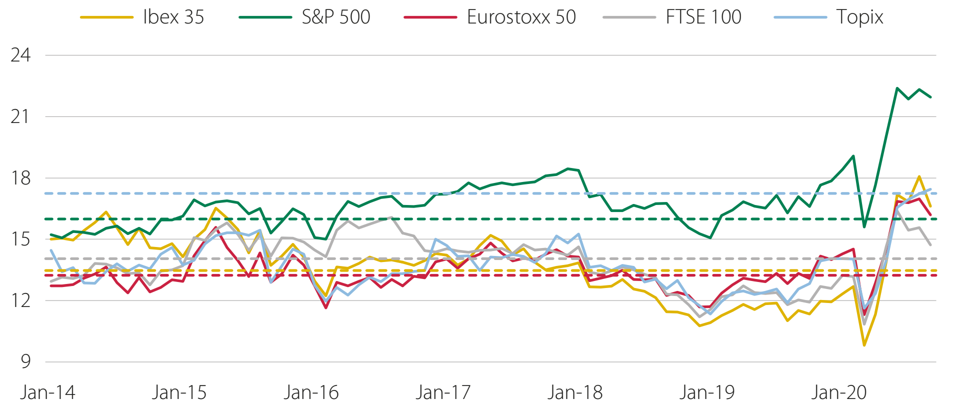
1 Variation compared with the previous quarter.

2 Sectors belonging to the IGBM (Madrid Stock Exchange General Index). The information corresponding to the most representative sub-sectors is displayed within each sector.

The fresh decline in quoted prices led to a fall in the forward PER, from 17.2 in June to 16.6 in September, remaining at high values above its historical average.

The fresh decline in prices, together with lower volatility in corporate profits expected for the coming months, led to a fall in forward price-earnings ratios in the third quarter. This ratio is expected to adjust further in the coming months as profit forecasts start to reflect the impact of the pandemic more accurately. The forward price-earnings ratio for the Ibex 35 fell from 17.2 in mid-June to 16.6 in September, although it peaked at 18.1 in August, its highest level since 2002. Figure 13 shows how the PERs of the major stock market indices around the world showed a similar performance in the quarter, albeit of varying intensity, placing the Spanish indicator higher than the values marked by other European indices. With the exception of the Japanese TOPIX index, the PERs of all the leading indices rose again above their average values in 2010-2020.

Price-earnings ratio[1] (PER) FIGURE 13



Source: Thomson Datastream. Data to 15 September.

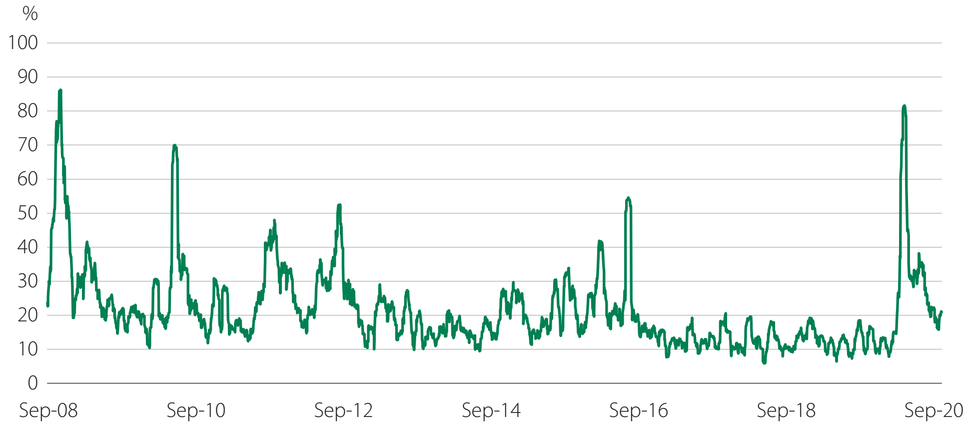
1 With forecast profits for 12 months.

Volatility, which reached its highest level since the 2008 financial crisis in the first quarter, has progressively eased, to normalise in the third quarter.

The volatility of the Ibex 35, which had reached its highest level since the 2008 financial crisis in the first quarter, gradually eased off throughout the second quarter to normalise in the third, marking moderate average levels (22.18%),[20] which were still higher than the values registered before the crisis (see Figure 14). This downward performance tracked the trends marked by other international indices such as the Eurostoxx 50 (20.3% average in the quarter), although the declines were more pronounced for US indices.

20 Values were similar to those seen throughout 2016 (23.7%), although far above the historic low of close to 10% reached at year-end 2019.

Historical volatility of the Ibex 35 FIGURE 14

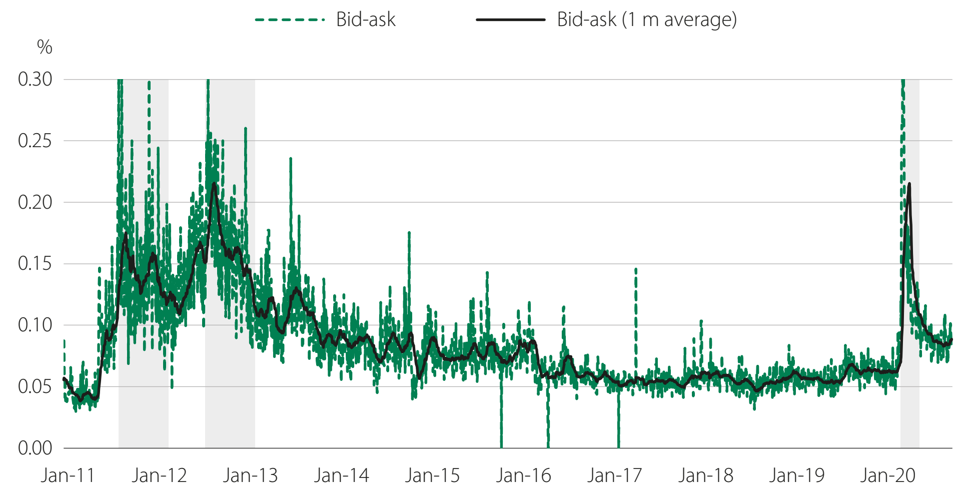


Source: Thomson Datastream and CNMV. The indicator is calculated as the annualised standard deviation of the daily price variations of the Ibex 35 over 21 days.

The liquidity conditions measured using the bid-ask spread progressively improved to reach values slightly above pre-crisis levels (and below the historical average of 0.091% for the indicator).

The liquidity conditions of the Ibex 35, measured through the bid-ask spread, which had deteriorated significantly in the first part of the year, reflecting the high market volatility and to a lesser extent the CNMV's restrictions on short-selling on a large number of securities, progressively improved from the latter part of the second quarter, moving slightly above pre-crisis values. The indicator marked an average of 0.086% in the third quarter of the year, below the figures of 0.107% and 0.111% seen in the first and second quarters, respectively, and below its historical average (0.091%). However, these values are still above the figures observed in recent years, close to 0.06% (see Figure 15).

Ibex 35 liquidity. Bid-ask spread FIGURE 15

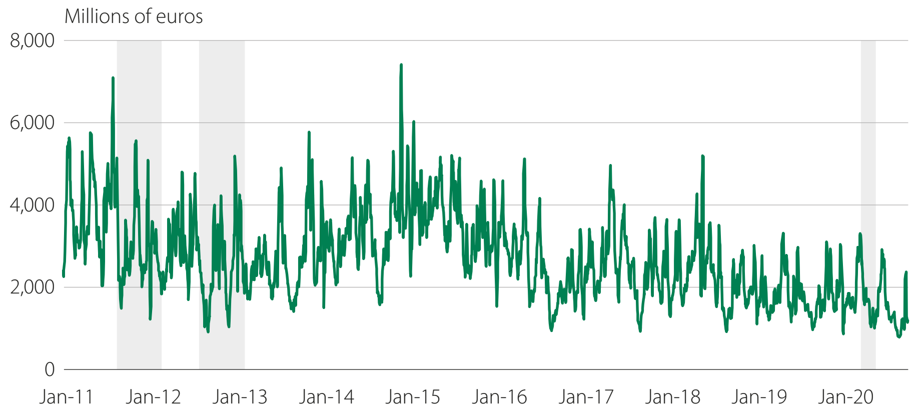


Source: Thomson Datastream and CNMV. Information on the bid-ask spread of the Ibex 35 and the average of the previous month is presented here. The vertical lines of the graph refer to the introduction of the precautionary prohibition on short-selling dated 11 August 2011, its subsequent lifting on 16 February 2012 (for financial institutions), the new prohibition of 23 July 2012 and its lifting on 1 February 2013, as well as the two most recent bans: the first for one day (13 March), which affected 69 entities, and the second, adopted a few days later and lifted on 18 May, which affected all entities.

In this context of further falls in prices, trading in Spanish securities reached its lowest level seen in one quarter in recent years, down 16.2% year-on-year.

In this environment of falling share prices, trading in Spanish equities fell significantly, to stand at just over €152 billion in the third quarter of the year, 16.2% less than in the same period of the previous year and the lowest volume in one quarter observed in the last five years. Thus, despite the temporary improvement in the first quarter, a downward trend in trading volumes can be observed, which does not occur in other European markets,[21] where trading remains buoyant and volumes are growing and where some trading models such as algorithmic and high-frequency trading[22] are becoming less popular due to the lower volatility levels. Cumulative trading in Spanish securities in the year to date stood at €583.4 billion, 2.2% less than in 2019. Average daily trading on the continuous market in the third quarter reached €1.25 billion (-18% year-on-year, the lowest in the past few years), below the figures seen in previous quarters (€1.20 billion in the first quarter and €1.75 billion in the second) and the €1.82 billion of the previous year.

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



Source: CNMV. The shaded areas of the graph refer to the introduction of the precautionary prohibition on short-selling dated 11 August 2011, its subsequent lifting on 16 February 2012 (for financial institutions), the new prohibition of 23 July 2012 and its lifting on 1 February 2013, as well as the two most recent bans: the first for one day (13 March), which affected 69 entities, and the second, adopted a few days later and lifted on 18 May, which affected all entities.

1 Moving average of five trading sessions.

The proportion of trading carried out through systematic internalisers remained at 15%…

Trading through systematic internalisers, which is not subject to market rules, accounted for a proportion of close to 15% of total trading of Spanish securities in the third quarter (total trading is defined as the sum of trading subject to market rules and trading carried out through systematic internalisers). This proportion has remained relatively stable in the range of 15-18% for almost two years.

… putting trading carried out through venues and competing markets other than the home market at 48.1% of the total, its highest value in the entire historical series.

Regarding the distribution of Spanish securities trading in the year, €312.25 billion corresponded to the Spanish regulated market and the rest were traded through other trading venues and competing markets. The amount traded through BME fell by 6.7% year-on-year in the first three quarters of the year, and its market share

21 According to data from the World Federation of Exchanges, trading up until August increased significantly on the main European and international stock markets: 33.9% on Euronext, 8.8% on the London Stock Exchange Group (London and Italy) and 38.5% on Deutsche Börse, 104.1% on the NYSE, 48.6% on the Nasdaq and 19.5% on the Japan Exchange Group.

22 High-frequency trading (HFT)

decreased further to reach a new historical low of 52.1%, one tenth of a point below the previous low seen in the first quarter. Therefore, despite the recovery observed in the second quarter, the relative importance of trading on the regulated market is showing a (fluctuating) downward trend while at the same time trading through other venues and competing markets is consolidating, with fluctuations comfortably above 40%. Further, the latter tend to take on more significance in periods of high volatility, which favour algorithmic and high-frequency trading, which is usually conducted to a greater extent through competing venues.

The absolute value of Spanish shares traded through competing venues also fell in the quarter and in the year to date, although to a lesser extent than shares traded through BME. The standout was once again Cboe Global Markets (Cboe), which operates through two different order books, BATS and Chi-X, and which continued to gain weight. Trading was close to €59 billion in the quarter, which represents 80% of trades made abroad and nearly three quarters of trades carried out through BME. In addition, in contrast with previous quarters, when distribution shifted between the two books in favour of BATS, part of the trading was recovered by Chi-X. Among BME's other competing venues, the market share of Turquoise and all other operators remained largely unchanged at 6.3% and 13.7%, respectively, with declines in volumes similar to those in total trading in the quarter (see Table 5).

Cboe Global Markets continued to lead the trading of Spanish stocks abroad, with 80% of the total volume traded, and is gaining weight compared with BME.

Trading in Spanish shares listed on Spanish stock exchanges[1] TABLE 5

Millions of euros

	2016	2017	2018	2019	I 20	II 20	III 20
Total	**877,413.3**	**932,771.9**	**930,616.1**	**805,833.0**	**244,429.7**	**186,968.4**	**152,027.8**
Admitted to SIBE (electronic trading platform)	**877,402.7**	**932,763.1**	**930,607.1**	**805,826.6**	**244,428.6**	**186,967.8**	**152,027.6**
BME	631,107.2	633,385.7	579,810.4	460,267.4	126,698.3	106,928.9	78,626.0
Chi-X	117,419.4	117,899.2	106,869.7	80,678.9	22,954.9	13,130.9	13,529.9
Turquoise	51,051.8	44,720.1	42,833.4	30,550.6	7,954.3	5,019.6	4,607.6
BATS	44,839.8	75,411.6	171,491.3	176,093.6	62,025.5	51,263.8	45,202.7
Other	32,984.5	61,346.5	29,552.2	58,236.1	24,795.5	10,624.5	10,061.4
Open outcry	**7.5**	**8.1**	**8.2**	**6.2**	**1.1**	**0.6**	**0.2**
Madrid	3.2	1.8	0.8	0.8	0.1	0.0	0.0
Bilbao	0.0	0.0	0.0	2.1	0.0	0.0	0.0
Barcelona	4.1	6.3	7.4	3.2	1.0	0.6	0.2
Valencia	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Secondary market	**3.2**	**0.7**	**0.8**	**0.1**	**0.0**	**0.0**	**0.0**
Pro memoria							
Trading in foreign equities through BME	6,033.0	6,908.0	3,517.1	3,480.5	987.7	1,265.4	1,041.4
MAB	5,066.2	4,987.9	4,216.3	4,007.7	1,145.3	809.5	629.9
Latibex	156.7	130.8	151.6	136.6	29.2	24.5	16.4
ETFs	6,045.2	4,464.1	3,027.6	1,718.0	819.0	671.4	431.3
Total trading through BME	648,418.9	649,885.3	590,732.0	469,616.6	129,680.6	109,700.3	80,745.2
% total Spanish equities traded through BME	71.9	68.3	62.6	57.4	52.2	57.5	52.1

Source: Bloomberg and CNMV.

1 This includes the trading of Spanish equities 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 equities are those admitted to trading in the regulated BME market with an ISIN that is not Spanish.

Capital increases with fund raising reached their highest levels since the third quarter of 2019, doubling the amount issued in the first half of the year. Capital increases under the scrip dividend format for the payment of dividends also grew.

Equity issues made in Spanish markets stood at €5,108.5 million in the third quarter, of which €4,024.6 million corresponded to capital increases to raise funds, the highest amount since the same quarter of 2019 and double the amount issued in the first half of the year (see Table 6). Capital increases were largely carried out with pre-emptive rights, and the remainder almost entirely under the scrip dividend method. The first option totalled €4 billion, the highest amount since the third quarter of 2017,[23] corresponding to a single capital increase carried out by Cellnex Telecom, while the second accounted for €1.08 billion, similar to the amount in the same quarter of 2019, which corresponded to the dividend payments made in July under this format by the main Spanish energy, telecommunications and construction companies. As was to be expected, the payment of dividends under the scrip dividend method has regained its appeal for companies because it allows them to partially uphold their dividend policies vis-à-vis shareholders and investors and, at the same time, shore up their balance sheets to deal with the impact of the pandemic.

As in 2019, there have been no IPOs so far this year.

Capital increases totalled around €7.3 billion in the first nine months of the year, compared with €5.67 billion in the same period of the previous year. Of this amount, 78% corresponded to increases with fund raising. In line with the first half of the year and in 2019, there were no initial public offerings in the quarter and the prolongation of uncertainty over the comings years makes it unlikely that there will be any transactions of this type in the near future.[24] MásMóvil Ibercom was the subject of a successful takeover bid, and the buyer announced that it intended to delist the company from the stock markets in the next few months.

Financial institutions, unable to pay dividends in the coming months on the recommendation of their financial supervisors, have announced their intention of resuming these payments in 2021.

The main banks have announced that they intend to restore dividend payments in cash next year, for which they will need the approval of the financial supervisor, which, together with the European Systemic Risk Board, has encouraged financial institutions and insurance companies to suspend dividend payments until January 2021.

23 In the third quarter of 2017, Banco de Santander carried out a capital increase of more than €7.1 billion.

24 There was, however, an increase in IPOs in the international markets, mostly related to technology companies. The Spanish market does not appear to be unaffected by this trend as, in early October, a company in the renewable energies sector indicated that it was preparing its flotation on the continuous market through a share offering aimed at qualified investors. If this transaction materialises, it would be the first IPO since December 2018, when Solarpack started trading.

Capital increases and public offerings

TABLE 6

	2017	2018	2019	IV 19	I 20	II 20	III 20
NUMBER OF ISSUERS[1]							
Total	**47**	**46**	**47**	**12**	**8**	**8**	**8**
Capital increases	45	45	47	12	8	8	8
Public offerings (for subscription of securities)	3	2	1	0	0	0	0
Initial public offerings (IPOs)	4	1	0	0	0	0	0
NUMBER OF ISSUES[1]							
Total	**91**	**81**	**52**	**15**	**8**	**8**	**8**
Capital increases	84	80	52	15	8	8	8
Public offerings (for subscription of securities)	4	2	1	0	0	0	0
Initial public offerings[2] (IPOs)	7	1	0	0	0	0	0
CASH AMOUNT[1] (millions of euros)							
Capital increases with fund raising	**25,787.7**	**7,389.9**	**8,240.6**	**4,132.9**	**174.9**	**1,518.4**	**4,024.6**
With pre-emptive rights	7,831.4	888.4	4,729.8	3,132.8	0.0	50.0	3,999.5
Without pre-emptive rights	956.2	200.1	10.0	0.0	0.0	0.0	0.0
Of which, increases	68.8	0.0	30.0	0.0	0.0	0.0	0.0
Accelerated book builds	821.8	1,999.1	500.0	500.0	0.0	750.0	0.0
Capital increases with non-monetary consideration[3]	8,469.3	2,999.7	2,034.2	0.0	12.5	0.0	0.0
Capital increases via debt conversion	1,648.8	388.7	354.9	341.1	162.4	0.0	0.0
Other	6,060.2	913.9	611.8	159.0	0.0	718.4	25.1
Scrip issues[4]	**3,807.3**	**3,939.7**	**1,565.4**	**2.6**	**396.4**	**93.5**	**1,083.9**
Of which, scrip dividends	3,807.3	3,915.2	1,564.1	1.3	396.4	93.5	1,083.9
Total capital increases	**29,595.0**	**11,329.6**	**9,806.0**	**4,135.5**	**571.3**	**1,611.9**	**5,108.5**
Public offerings	**2,944.5**	**733.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
***Pro memoria*: Transactions on MAB[5]**							
Number of issuers	13	8	12	4	5	3	1
Number of issues	15	12	17	4	6	3	1
Cash amount (millions of euros)	129.9	164.5	298.3	200.5	18.3	9.9	35.0
Capital increases	129.9	164.5	298.3	200.5	18.3	9.9	35.0
Of which, IPOs	17.1	0.0	229.4	196.3	0.1	0.0	0.0
Public share offerings	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: BME and CNMV.

1 Trades registered with the CNMV. Does not include data from MAB, ETF or Latibex.
2 Transactions linked to the exercise of green shoe options are separately accounted for.
3 Capital increases for non-monetary consideration have been stated at market value.
4 In scrip dividends, the issuer gives existing shareholders the option of receiving their dividends in cash or converting them into shares in a bonus issue.
5 Trades not registered with the CNMV.

Analysis of the effect of restrictions on short selling of Spanish shares between March and May 2020

EXHIBIT 3

The performance of international equity prices in recent months has been marked by the spread of COVID-19. The rapid development of the pandemic forced many countries to impose lockdown measures on their populations, which significantly disrupted their productive activity. In this context, the main stock market indices registered sharp declines in the first quarter of the year, especially during the month of March.

Specifically, on 12 March 2020, the European stock market indices experienced extraordinarily sharp falls. The Ibex 35 lost 14%, the highest loss in a single day in its 28-year history. In light of the situation, the CNMV resolved to prohibit short-selling during the day of 13 March of all liquid shares admitted to trading on the Spanish stock exchanges whose price had fallen by more than 10% in the previous session (12 March) and of all illiquid,[1] shares when this fall was greater than 20%. The ban affected 69 securities in total and was carried out pursuant to the provisions of Article 23 of Regulation (EU) No. 236/2012 of the European Parliament and of the Council, of 14 March.

After another session of sharp falls on 16 March, in accordance with Article 20 of the aforementioned Regulation, the CNMV prohibited, for one month, which was extended to two,[2] the creation or increase of net short positions on shares admitted to listing on Spanish trading venues for which the CNMV is the competent authority. On that date, the Ibex 35 lost a further 7.9%. The ban was carried out in response to the exceptional nature of the situation and the uncertainty in the market, which could have been boosting sales and encouraging a downward spiral. On the following day, the supervisory authorities equivalent to the CNMV in France, Italy, Belgium, Austria and Greece adopted similar measures.

The rule allows this measure to be adopted to preserve financial stability and investor confidence at times when there are turbulences that could result in disorderly price movements. However, it also affects the efficiency of the markets, in other words, a ban of this type can reduce the speed at which prices adjust to the available information and reduce the reliability of some liquidity measures such as the bid-ask spread or trading volumes. Therefore, the CNMV resolved to carry out a study[3] to determine the impact, in terms of market efficiency, of the restrictions on short-selling described above. Specifically, the impact on some liquidity measures (such as the bid-ask spread, trading volume and the Amihud ratio)[4] was analysed, as well as the impact on price performance and intraday volatility. The study also assessed whether the ban could have influenced the credit risk of financial and non-financial issuers whose securities are listed on equity markets. To do so, it tried to establish the relationship between the bans and the price of the 5-year CDS of various Spanish issuers.

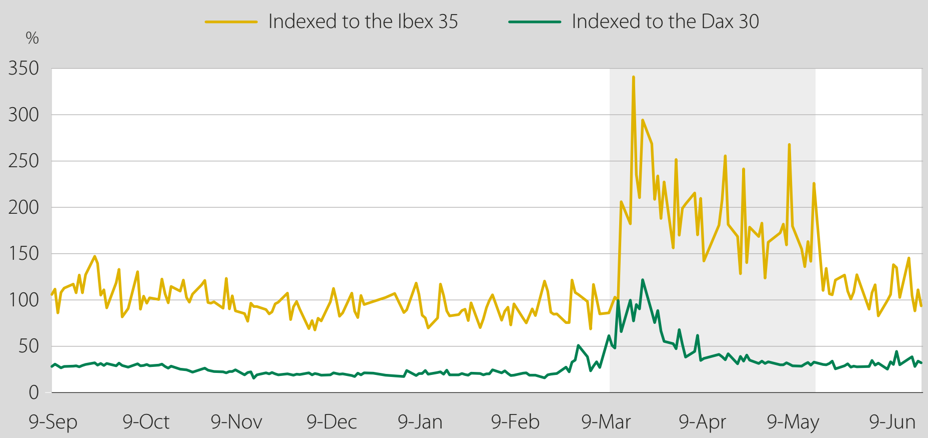
The first part of the analysis was based on establishing a comparison between the performance of Ibex 35 components and components from another index in a market where no restrictions were introduced, in this case Germany's Dax 30.

A study was made of variables related to the returns, volatilities and liquidity measures of the listed shares that made up the Ibex 35 and the Dax 30 between 9 September 2019 and 19 June 2020. This enabled sufficient data to be collected from sessions before and after the CNMV's adoption of the ban on creating or increasing net short positions. In a second part of the analysis, and for the same period, it was observed how these restrictions could influence the credit risk of issuers whose securities are subject to these restrictions, compared with the securities in the market in which they were not.

From the descriptive and econometric analyses carried out as part of the study, the following conclusions were obtained:

– The bid-ask spreads increased for shares listed on the Ibex 35 and Dax 30 alike in the first few days after the ban and then tended to narrow. In relative terms, the initial increase was sharper for Spanish securities and therefore, despite the subsequent decrease, pre-crisis values were only reached once the ban had been lifted. The recovery of the German securities was faster. The econometric analysis revealed that the securities included in the ban experienced a drop in liquidity compared with the unrestricted scenario, an impact which persisted when the ban was lifted, albeit to a lesser degree.

Daily bid-ask spread for the Spanish and German markets (index = 100 corresponds to 12/03/2020) FIGURE E3.1



Source: Thomson Datastream and own compilation by the authors. The shaded area indicates the period during which the CNMV prohibited the creation or the increase of short positions on shares admitted to listing on Spanish trading venues.

– Trading in Ibex 35 shares fell when the restrictions were imposed, standing at levels that were lower than in the pre-crisis period. However, it bounced back when the ban was lifted. Trading in components of the Dax 30 index during the ban decreased significantly after it was announced, and the trend was similar to that of the Ibex 35. Once the restrictions had been lifted, trading patterns were similar in both markets. The econometric analysis therefore concludes that the ban did not have a significant impact on trading of the securities to which it applied.

– The average Amihud measure increased during the period of the ban for securities traded on the Ibex 35 and the Dax 30. This suggests that both markets lost depth during that time, which could be attributed to the generalised turbulence. Based on the evolution over time during the ban, it can be observed that the components of the Ibex 35 lost more depth than those of the Dax 30. However, once it had been lifted, both markets gained depth, reaching levels similar to those seen before the restrictions were imposed. Further, the econometric analysis found no evidence that the ban had a negative effect on the Amihud measure of the securities it affected. The greater loss of depth recorded by the Spanish securities could be more a result of the higher country risk of these securities than the ban itself.

– For both equity indices, it was observed that volatility was higher during the prohibition than in the period immediately preceding it. Only in the last sessions, when the restrictions were no longer in force, did levels of volatility return to pre-crisis values. Volatility was not observed to have behaved differently under the ban than it would have behaved otherwise.

– There was also no evidence to suggest that it had any notable effect on the price performance of the shares listed on the Ibex 35 with respect to share prices on the Dax 30 index, or with respect to the situation before the ban.

– Lastly, credit spreads widened significantly in the days prior to the implementation of the ban. These spreads narrowed as the pandemic in Europe eased, although they were still greater than their pre-crisis levels. In this sense, German securities recovered to a greater extent than Spanish securities. The econometric analysis offered no evidence that the ban had any influence on the credit risk spreads of Spanish equity issuers either during the application period or after it was lifted.

In short, the analysis found no notable evidence of effects attributable to the ban on key variables, such as trading volumes, price trends, volatility or credit risk of the issuers concerned, identifying only a larger increase in bid-ask spreads (i.e. a certain loss of liquidity), which has since persisted to some extent.

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1 According to Commission Delegated Regulation (EU) No. 918/2012, of 5 July 2012.

2 The ban was initially implemented until 17 April, extendible for additional periods of no more than three months if necessary. In practice, extensions are made every month. In this case, the ban was in effect until 18 May, after the extension that began on 18 April.

3 The full study is available at: http://www.cnmv.es/DocPortal/Publicaciones/OTROS/Informe_ventas_en_corto_23072020.pdf

4 The Amihud illiquidity ratio is defined for each of the values considered as:

$\frac{1}{T}\sum_{t=1}^{T}\frac{|r_t|}{€V_t}$, where $|r_t|$ is daily returns in absolute value and $€V_t$ daily trading in euros. The ratio was calculated taking into account 5 sessions, therefore *t* is equal to 5. As a ratio measuring illiquidity, the higher its value, the less liquidity there is for that security. When the ratio has been calculated for an entire market, it is calculated as the simple average of the individual ratio of the securities listed on that market.

3.2 Fixed income markets

The debt markets, which had seen temporary tensions in risk premiums of public and private debt of the most vulnerable states and companies in March, saw how the falling yields on these assets observed in the second quarter continued into the third, with the majority ending the quarter at lower levels than at the start of the year. This development was due to the extraordinary measures adopted by central banks, which were ratified in subsequent months. As mentioned in Section 2.1, these measures include abundant purchases of both public and private debt and financing for banks on favourable terms,[25] in addition to maintaining official interest rates at low levels for a prolonged period.

The tensions seen in the debt markets at the start of crisis subsequently dissipated as a result of the measures implemented by the ECB, which included a specific plan to alleviate the effects of the pandemic (Pandemic Emergency Purchase Programme, or PEPP).

In this context, as in other large European countries, interest rates on Spanish debt, both public and corporate, fell slightly during the third quarter. These declines were somewhat greater in southern European countries, where the impact of the ECB purchases is larger. Thus the Spanish sovereign bond yield fell by 22 bp in the quarter while the risk premium was reduced by 16 bp, to 77 bp, which is still higher than the figure of 65 bp seen at the start of the year. The positive effect of the economic reactivation funds set up by the European Union also contributed to this performance.

In this context, interest rates on public and private debt, in addition to risk premiums, generally decreased in the third quarter of the year.

Despite the abundant liquidity and greater ease of placing debt thanks to the ECB purchases, fixed income issues made by Spanish issuers registered with the CNMV decreased in the third quarter compared with the second, but continued to increase significantly in year-on-year terms (+40% in the year to date). Many companies had already built up sufficient funds in the second quarter to deal with the uncertainty and the economic crisis, taking advantage of market conditions to refinance their debt at longer terms and at a lower cost.

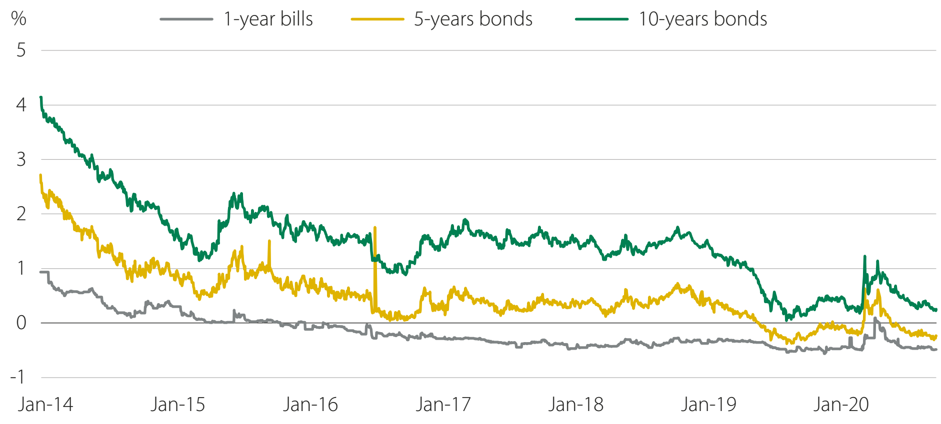
Despite the abundant liquidity, fixed income issues fell in the third quarter compared with the previous quarter, as companies had already built up sufficient funds in previous months.

The yields on short-term private fixed income and public debt saw different performances in the third quarter, with small declines and increases, respectively. Short-term government debt rates are approaching their historical lows and heading towards a sixth consecutive year of negative values for the entire length of the curve, under the ECB's ultra-expansive monetary policy, which includes purchases of securities with a minimum residual maturity of 70 days. At the end of September, the secondary market yield on 3, 6 and 12 month treasury bills was -0.51%, -0.46% and -0.49%, respectively, the lowest level in the year so far, and in line with 2019 closing values. These rates were close to the rate set by the ECB for its marginal deposit facility (-0.50%), with which they are usually aligned and from which they had moved away for much of the first half of the year. Additionally, all treasury auctions on the primary market were still awarded at negative rates and the last one in September saw values of -0.50% for all terms of the curve, in line with the previous auction.

The yield on treasury bills decreased slightly, once again approaching a historical low…

25 The ECB awarded €174.46 billion to 388 entities in the 3-year liquidity auction in September, which is 86% less than the record amount awarded at the June auction (€1.31 billion).

Interest rates on Spanish public debt FIGURE 17



Source: Thomson Datastream.

… while issues of short-term private fixed income increased slightly.

In the case of short-term private fixed income, the behaviour was different, with values that were higher than those of the previous quarter, as occurred in the second quarter. Thus while short-term commercial paper may benefit from the guarantees of the Official Credit Institute (ICO), which would contribute to reducing their issue interest rates, and from the ECB purchases in the primary market, in practice only a small number of issuers meet the conditions to benefit from the guarantee programme[26] of the former or fall within the range of eligible issuers[27] for the asset purchases of the latter. Spanish market data show that in September the issue yields on commercial paper in the primary market ranged from 0.39% for the 3-month instrument to 1.02% for 12-month paper (see Table 7).

The ECB's different asset purchase programmes have caused declines in the long-term returns on government debt assets…

Interest rates on public and private medium- and long-term debt showed a similar trend throughout the quarter, falling slightly on the back of the Pandemic Emergency Purchase Programme (PEPP), under which assets of public and private issuers[28] may be acquired, in addition to the previous Asset Purchase Programme (APP), which is still in force.[29] In the area of public debt, these purchases, which account

26 Beneficiaries of issues of commercial paper on the MARF guaranteed by the ICO guarantee programme included: El Corte Inglés, Sacyr, Hotusa, Pryconsa, Vocento, Amper, Tubacex, Aedas Homes and Grupo Pikolin. The maximum amount of the guarantees will cover 70% of the commercial paper issue, which will have a maximum maturity of 24 months and be available until 30 September, with the following conditions for awarding them: having registered a commercial paper issue programme on the MARF before 23 April, the company's registered office being located in Spain and the funds obtained not being available for paying dividends.

27 The ECB can acquire short-term debt under its PEPP programme and this debt may include commercial paper issued by some Spanish companies such as Endesa, Iberdrola, Repsol, Telefónica, Red Eléctrica, Ferrovial, Naturgy, Abertis, Aena, ACS, Amadeus, Cellnex, Colonial, ACS and Viesgo. To be eligible, these assets must have a minimum credit rating of BBB- from Standard & Poor's, Fitch or DBRS, or Baa3 from Moody's.

28 The emergency programme, which started in March, accumulated purchases amounting to €571.31 billion up until 2 October. These corresponded mostly to public debt, followed by corporate commercial paper and bonds. Commercial paper was mostly acquired in the primary market (85%), as was around 45% of corporate debt. Purchases of Spanish public debt under this programme totalled €61.03 billion at the end of September, around 12% of total purchases of public assets.

29 Up until August, the ECB had acquired public debt for a net amount of €2.38 trillion, of which €280.70 billion corresponded to Spanish instruments.

for around 30% of Spanish debt, put downward pressure on rates and tended to offset the unfavourable news relating to its credit ratings.[30] Thus the yields on 3, 5 and 10 year Spanish government debt stood at -0.43%, -0.24% and 0.25%, respectively, at the end of September (see Table 8), and negative values up to 7 year terms were observed for the first time in the year, while the 10 year rate was at its lowest since March.

Short-term interest rates[1] TABLE 7

%

	Dec-17	Dec-18	Dec-19	Dec-19	Mar-20	Jun-20	Sep-20
Treasury bills							
3 months	-0.62	-0.50	-0.58	-0.58	-0.28	-0.48	-0.51
6 months	-0.45	-0.41	-0.47	-0.47	-0.24	-0.45	-0.46
12 months	-0.42	-0.33	-0.48	-0.48	-0.28	-0.45	-0.49
Corporate commercial paper[2]							
3 months	0.39	0.24	0.20	0.19	0.19	0.36	0.39
6 months	0.26	0.19	0.52	0.52	0.23	0.52	0.69
12 months	0.19	0.07	0.71	0.71	0.58	0.71	1.02

Source: Thomson Datastream and CNMV.

1 Monthly average of daily data.

2 Issue interest rates.

… and also on private fixed income assets, although returns are more varied in the second group, as not all issues are eligible.

Private fixed income saw a similar performance, with small decreases in all terms of the curve, putting yields at historical lows. Most of the large corporate debt issuers have benefited from the ECB debt purchase measure, which includes a specific corporate debt purchase programme,[31] which was recently expanded to include purchases of this type of debt through the new PEPP programme.[32] However, it should be noted that this shows more varied returns,[33] because not all issuers have issues that are included in the range of eligible assets.[34] At the end of September, yields on 3, 5 and 10 year private debt stood at 0.12%, 0.06% and 0.64% respectively, implying a risk premium of between 30 and 55 bp compared with public debt assets. Further, companies continue to see downgrades in their credit ratings[35] or downward revisions of their outlook as a result of the risks facing their activities.[36]

30 For example, at the end of September, when Standard & Poor's announced it was changing its rating outlook for Spain to negative as a result of the pandemic.

31 Up until 18 September, the Corporate Sector Purchase Programme (CSPP) accumulated a volume of purchases amounting to €233.07 billion, of which more than 21% was acquired in the primary market.

32 At the end of July, the ECB had accumulated corporate bonds for the amount of €17.62 billion and commercial paper for a value of €34.85 billion acquired under this programme.

33 The sample used to estimate interest rates is based on a wide range of assets with different levels of risk that includes covered bonds, investment grade rated bonds, high-yield bonds and even debt with no credit rating.

34 The ECB requires a minimum investment grade rating for its purchases.

35 These notably include companies such as Amadeus, IAG, NH Hoteles, Gestamp, Codere, DIA and Madrileña Red de Gas.

36 According to the analysis published in this Bulletin about trends in credit ratings of Spanish companies between March and June this year, there has been a notable increase in the amount of debt in the lowest

Medium- and long-term bond yields

TABLE 8

%

	Dec-17	Dec-18	Dec-19	Dec-19	Mar-20	Jun-19	Sep-20
Public fixed income							
3 years	-0.09	-0.04	-0.29	-0.29	0.02	-0.28	-0.43
5 years	0.31	0.43	-0.06	-0.06	0.26	-0.11	-0.24
10 years	1.46	1.43	0.45	0.45	0.68	0.47	0.25
Private fixed income							
3 years	0.44	0.67	0.20	0.20	0.48	0.19	0.12
5 years	0.41	0.55	0.23	0.23	0.65	0.40	0.06
10 years	1.16	1.52	0.79	0.79	1.49	0.77	0.64

Source: Thomson Datastream, Reuters and CNMV.

The sovereign risk premium continued to decline in the third quarter, approaching the levels seen at the start of the year thanks to the ECB debt purchase programmes…

The sovereign risk premium – measured as the difference in yield between the Spanish and the German 10-year sovereign bonds – started the quarter at 93 bp, and subsequently decreased progressively to close the period at around 77 bp As with yields on debt assets, the ECB's purchases of public debt and the announcement of economic reactivation funds for the European Union further eased the pressure on risk premiums and they returned to levels seen at the start of the year. Further, the risk premium estimated using the CDS of the Spanish sovereign bond (the market for which is less liquid than that of its underlying, the Spanish bond) closed the quarter at around 55 bp, implying a sharper reduction than for the risk premium assessed as the difference in returns. In the short term, the performance of the sovereign risk premium – like that of the risk premiums applied for large Spanish issuers – will continue to be shaped by the support provided by the ECB through its purchase programmes, although in the medium term it could be conditioned by economic trends and the budgetary and fiscal policy measures adopted.

… which also favoured the risk premiums of private sector companies…

The risk premiums of the private sub-sectors of the economy followed a similar path to public debt, although the reductions were somewhat more moderate for both financial institutions and non-financial companies. The right hand panel of Figure 18 shows how the average CDS of financial institutions stood at 93 bp at the end of September, 12 bp lower than at the beginning of the quarter, but well above the 65 bp seen at the start of the year; while for non-financial companies, the average risk premium was 68 bp on the same date, compared with 52 bp at the end of 2019.

… both financial…

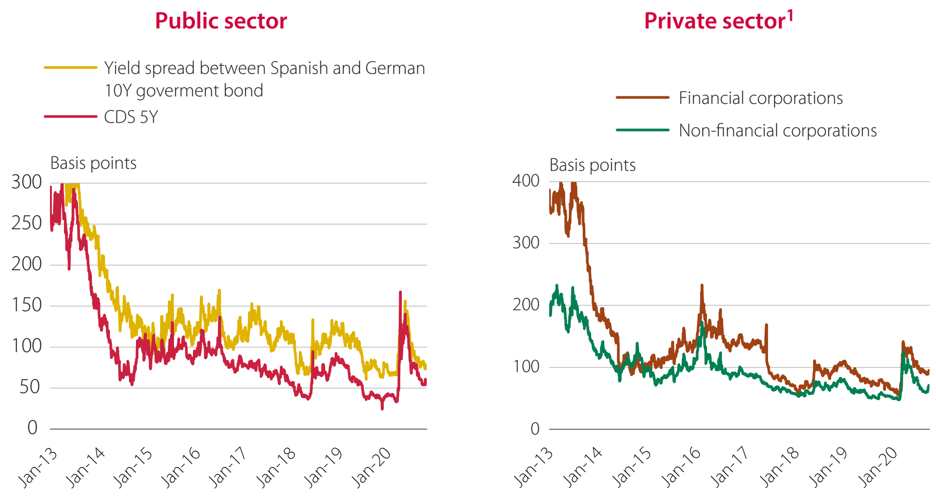
For financial institutions, the decrease in risk premiums was due, as for sovereign debt, to the scale of the ECB's asset purchases, which, in addition to the PEPP programme,[37] includes specific programmes for securities issued by banks, such as

investment grade categories (BBB and BBB-). According to this report, the balance of BBB debt among all Spanish issuers, including the public administration service, rose from €149 billion to €165 billion, and the balance of BBB- debt increased from €55 billion to €79 billion.

37 At the end of July, the ECB had accumulated covered bonds amounting to €3.13 billion acquired under this programme.

covered bonds and securitisation bonds or asset-backed securities[38] (CBPP3 and ABSPP, respectively). In the coming months, financial institutions face a scenario of increasing uncertainty and risk caused by the sharp drop in economic activity, which may affect the risk premiums of these issuers. This scenario puts even more downward pressure on banks' net interest income and could lead to a spike in NPLs, although the latter trend could be mitigated by the low interest rates.

Risk premium of Spanish issuers FIGURE 18



Source: Thomson Datastream and CNMV.

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

… and non-financial companies.

In the case of non-financial companies, the decline in risk premiums was similar, although they remain well above the levels observed at the started of the year. Thus although these companies also benefit from the positive effects of the ECB's corporate debt purchases and increased facilities for obtaining financing at low cost, the risk premiums applied reflect the deterioration of their businesses and the uncertainties surrounding their future performance, as well as the foreseeable increase in their finance costs due to higher credit risk.

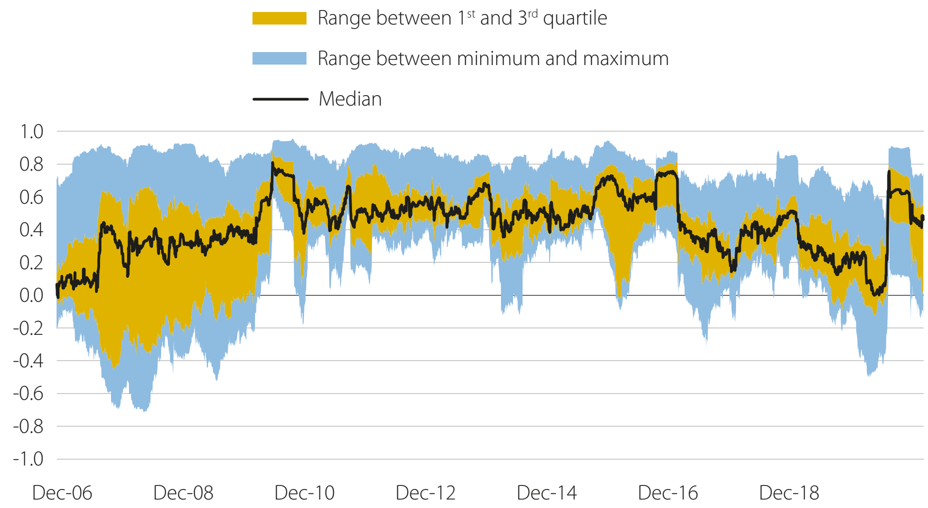
The correlation between asset prices, which had increased sharply in the first quarter of the year, subsequently declined due to the different performance of share prices (downward) and debt prices (upward).

The correlation between prices of the different classes of financial assets (which due to the crisis had risen sharply in the first quarter of the year, to reach their highest values since the second half of 2016) eased further in the third quarter, following on from the second (see Figure 19). The decrease was caused by the different performance of debt and credit asset prices compared with shares, resulting from the ECB support programmes. Thus the uncertainties and risks arising from the crisis, which translated into generalised price falls, continue to affect equity assets, while other asset prices are rising due to the support measures provided by the monetary authority.

38 To 25 September, the covered bond purchase programme had accumulated purchases totalling €287.74 billion, of which more than 37% were acquired in the primary market. Further, the asset-backed securities programme had accumulated on the same date purchases for a total of €29.26 billion, of which more than 52% were acquired in the primary market.

Indicator of correlation between asset classes[1, 2]

FIGURE 19



Source: Thomson Datastream and CNMV.

1 The correlation indicator between asset classes includes pairs of correlations calculated using daily data in three-month windows. The asset classes are sovereign debt, private fixed income of financial and non-financial companies and securities traded on the Ibex 35 of financial institutions, utilities and companies from other sectors. A high correlation between the different classes of Spanish assets would indicate the possible existence of herding behaviour by investors. This situation could cause high volatility during stress periods. However, diversification would offer fewer advantages given that in this context it would be more difficult to avoid exposure to sources of systemic risk.

2 Since 7 June 2017 the CDS of the 5-year senior debt of Banco Popular has been excluded from the calculation of ROI on the asset class corresponding to financial fixed income.

After rising strongly in the second quarter, debt issues stagnated in the third quarter.

Fixed income issues registered with the CNMV in the third quarter of 2020 amounted to €20.73 billion, almost half of the figure registered in the previous quarter and 3.8% more than in the same period of 2019. In the year as a whole, these issues totalled €77.37 billion (well above the €55.15 billion in 2019) thanks to the buoyancy observed in the first half of the year. During this period, there was a substantial rise in corporate issues, which grew by 61% compared with the same period in 2019, with the aim of increasing their funds and refinancing debt at longer terms, on concerns that financial conditions could be harsher in the future. In the first half, issues carried out abroad also increased, although to a lesser extent (by 7.1%, to €58.12 billion), leading to a substantial reduction in the difference between the volume of issues made abroad and those registered with the CNMV.

The largest increases were in issues of asset-backed securities.

With regard to the composition of issues made in the third quarter, the largest rise was observed in issues of regional covered bonds, asset-backed securities, and, to a much lesser extent, commercial paper. Issues of other assets dropped off significantly, particularly covered bonds and internationalisation bonds. The trend in covered bonds was conditioned by the balance of outstanding mortgage loans, which has declined to its lowest level in recent years;[39] while internationalisation bonds are very specific types of assets that are issued on a one-off basis. A volume of €4.4 billion was registered in regional covered bonds, which together with the €4.75 billion of the

39 Based on data from the Bank of Spain, until July the balance of mortgage loans to households fell by 1.7% year-on-year, to stand at €512.59 billion.

previous quarter, place issues of these assets at their highest level since 2015. Issues of asset-backed securities, which can be used as collateral to obtain financing in the ECB's liquidity auctions, totalled close to €8.2 billion. One of these corresponded to the FADE (Fund for the Amortisation of the Electricity Deficit) and the remainder to three securitisation programmes run by two financial institutions, of which barely €80 million were STS (single, transparent and standardised) securitisations.

Gross fixed income issues registered with the CNMV

TABLE 9

					2020		
	2016	2017	2018	2019	I	II	III[1]
NOMINAL AMOUNT (millions of euros)	**139,028**	**109,487**	**101,296**	**90,161**	**20,203**	**35,840**	**20,731**
Covered bonds	31,643	29,824	26,575	22,933	6,250	10,100	1,160
Regional covered bonds	7,250	350	2,800	1,300	0	4,750	4,400
Non-convertible medium- and long-term bonds	40,170	30,006	35,836	29,602	6,159	1,885	373
Convertible/exchangeable medium- and long-term bonds	0	0	0	0	0	0	0
Asset-backed securities	35,505	29,415	18,145	18,741	3,066	5,060	8,193
Corporate commercial paper[2]	22,960	17,911	15,089	15,085	4,728	7,780	5,605
Asset-backed	1,880	1,800	240	0	0	0	0
Other commercial paper	21,080	16,111	14,849	15,085	4,728	7,780	5,605
Other fixed income issues	1,500	981	0	1,500	0	6,266	0
Preference shares	0	1,000	2,850	1,000	0	0	1,000
***Pro memoria*:**							
Subordinated issues	4,279	6,505	4,923	3,214	861	516	2,020
Guaranteed issues	421	0	0	0	0	0	0

					2020		
Issues carried out abroad by Spanish issuers	2016	2017	2018	2019	I	II	III[1]
NOMINAL AMOUNT (millions of euros)	**58,587**	**84,760**	**89,358**	**100,321**	**26,098**	**30,377**	**8,915**
Long term	31,655	61,095	38,425	53,234	14,384	16,579	3,733
Preference shares	1,200	5,844	2,000	3,070	1,500	0	350
Subordinated bonds	2,333	5,399	2,250	1,755	0	0	0
Medium- and long-term bonds	28,122	49,852	34,175	48,409	12,884	16,579	3,383
Asset-backed securities	0	0	0	0	0	0	0
Short term	26,932	23,665	50,933	47,087	11,714	13,798	5,182
Commercial paper	26,932	23,665	50,933	47,087	11,714	13,798	5,182
Asset-backed securities	0	0	0	0	0	0	0

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

					2020		
	2016	2017	2018	2019	I	II	III[3]
NOMINAL AMOUNT (millions of euros)	**56,674**	**66,790**	**91,446**	**92,284**	**18,315**	**20,216**	**6,582**
Financial institutions	11,427	19,742	43,234	57,391	14,152	10,757	4,141
Non-financial companies	45,247	47,585	48,212	34,893	4,163	9,459	2,442

Source: CNMV and Bank of Spain.

1 Data until 30 September.

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

3 Data up to 31August.

Issues made on the MARF have fallen 11% so far this year, to €6.57 billion.

Issues made on the Alternative Fixed Income Market (MARF) stood at €1.93 billion in the third quarter, bringing the accumulated figure for the year to €6.57 trillion, 11% lower than between January and September 2019. Most of the issues in the third quarter corresponded to commercial paper issues (96% of the total amount) made by more than 30 companies, including El Corte Inglés, Sacyr and Gestamp.

Growth in issues made abroad slowed, and activity was concentrated in long-term issues.

Debt issues carried out by Spanish issuers abroad, which had increased by more than 7% during the first half, subsequently slowed, putting the aggregate amount up until August at €67.03 billion, 3.5% less than in the same period of the previous year. This decrease was based on the lower issues of medium- and long-term bonds, which went from €38 billion in 2019 to €35 billion in 2020. Issues of commercial paper rose by around 2% compared with the previous year, to over €32 billion. Debt issues made by subsidiaries of Spanish companies in the rest of the world fell by 24%, to €51 billion, of which just over one third corresponded to non-financial companies and the remainder to banks.

Trading in Spanish venues in the first nine months of the year decreased in SEND, but increased in the OTFs.

In regard to Spanish trading venues, trading on the Electronic Debt Negotiation System (SEND) dropped 6% in the first 9 months of the year, to €126.6 billion. 79.3% of this amount corresponded to Spanish public debt and 20.6% to foreign debt. Trading through the two organised trading facilities (OTFs) authorised by the CNMV at the beginning of 2018 – CAPI and CIMD – totalled €154.47 billion in the third quarter, of which almost €132 billion (more than 85%) corresponded to Spanish public debt. For the year to date, trading in these systems was €481.21 billion, almost 25% more than in the same period of 2019.

4 Market agents

4.1 Investment vehicles

Financial CIS

Investment funds

Investment fund assets decreased by 5.6% in the first half of 2020 due to the large redemptions in March (€5.5 billion), following the lockdown announcement in Spain and the decrease in the value of the portfolio.

The assets of the investment funds decreased by 5.6% during the first half of 2020, to €263.62 billion due to the difficulties experienced by the sector following the lockdown announcement in Spain in mid-March. The drop in fund assets was due both to the increase in net redemptions made by unitholders, in a context of great uncertainty, and the fall in value of the portfolio assets due to the instability of the financial markets. In regard to subscriptions and redemptions, it should be noted that the rise in net redemptions occurred only in the first quarter, particularly in the month of March, when they totalled around €5.5 billion (between January and February there had been positive net subscriptions of €3.5 billion). Approximately half of these net redemptions affected fixed income funds.[40] The weighted average return of the funds was -4.26% throughout the six-month period, showing a different performance in the two quarters, in line with the performance of the financial markets. Thus in the first quarter of 2020, the return on investment funds was -9.3%, compared with 5.6% in the second.

Net investment funds subscriptions

TABLE 10

Millions of euros

					2019		2020	
	2017	2018	2019	1H2020	III	IV	I	II
Total investment funds	**21,325.0**	**7,841.8**	**2,467.5**	**-1,958.3**	**295.6**	**2,247.9**	**-2,103.9**	**145.6**
Fixed income[1]	-3,638.0	-2,766.0	10,732.6	-1,792.8	4,352.6	914.1	-3,186.6	1,393.8
Mixed fixed income[2]	2,890.5	-1,063.7	-1,506.1	3,388.8	-949.3	1,618.4	3,742.5	-353.7
Mixed equity[3]	5,498.6	2,485.9	3,288.8	418.0	-0.8	693.1	411.2	6.8
Euro equity[4]	2,549.7	1,848.7	-3,588.2	-1,202.8	-518.3	-466.0	-836.8	-366.0
International equity[5]	4,514.0	3,864.1	4,113.8	1,380.2	2,843.5	1,492.7	1,735.7	-355.5
Guaranteed fixed income	-3,262.6	-575.8	-282.6	-305.1	-126.2	-278.9	-261.3	-43.8
Guaranteed equity[6]	-309.5	-667.2	-1,857.0	-1,526.7	-745.2	-1,078.6	-1,313.7	-213.0
Global funds	13,405.9	9,448.9	-2,553.9	-828.1	-3,325.4	495.4	-574.7	-253.4
Passive management[7]	-4,585.0	-2,790.4	-3,026.8	-362.2	-780.1	-1,295.8	-1,099.7	737.5
Absolute return	4,287.3	-1,899.6	-2,852.9	-1,127.6	-454.9	153.5	-720.6	-407.0

Source: CNMV.

1 Until I-19 it includes the following categories (CNMV Circular 3/2011): euro fixed income, global fixed income, money market and short-term money market. From II-19 onwards it includes the following categories (Circular 1/2019): short-term public debt constant net asset value MMF, short-term low volatility net asset value MMF, short-term variable net asset value MMF, standard variable net asset value MMF, euro fixed income and short-term euro fixed income.

2 It includes euro mixed fixed income and international mixed fixed income.

3 It includes euro mixed equity and international mixed equity.

4 It includes euro equity.

5 It includes international equity.

6 It includes: guaranteed equity and partial guarantee.

7 Until I-19 it includes passively managed CIS (CNMV Circular 3/2011). From II-19 onwards it includes the following categories (Circular 1/2019): passively managed CIS, CIS that replicate an index and CIS with a specific non-guaranteed target return.

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40 In this context, the main tasks undertaken by the CNMV related to the liquidity conditions of the assets in the funds' portfolios and the trends in redemptions in each entity, while remaining in constant contact with management companies to monitor the situation and remind them both of their obligations and of the liquidity management tools available. In this regard, the CNMV issued indications on the advisability in certain cases of valuing assets at the bid price or applying swing pricing schemes. As regards the macroprudential tools available, it is worth noting the inclusion, by virtue of Royal Decree-Law 11/2020, of 31 March, adopting urgent complementary measures in the social and economic area to deal with COVID-19, of a new tool consisting of the possibility of establishing prior notice periods for redemptions without these being subject to the requirements that are normally applicable regarding term, minimum amount and being provided for in the management regulations. These terms can be established by the manager or by the CNMV itself. For more details on the measures implemented by the CNMV for CIS during the crisis, see exhibit "Actions undertaken by the CNMV to address the COVID-19 crisis" published in the *CNMV Bulletin* for the first quarter of this year.

The categories with the highest redemptions were fixed income funds and guaranteed equity funds, while the highest subscriptions were in mixed fixed income funds and international equity funds.

A breakdown by category shows that fixed income funds saw the highest level of net redemptions in the six-month period (€1.79 billion), which were concentrated in the second half of March, as mentioned above. Table 10 shows how these funds attracted net subscriptions of almost €1.4 billion in the following months (April-June). Net redemptions were also relatively high in guaranteed equity funds in the six-month period, at €1.53 billion, but this trend was not a new trend as it had been observed for several years. Euro equity funds and global funds experienced net redemptions of €1.20 billion and €1.13 billion in the six-month period, with fund outflows in both quarters. In contrast, mixed fixed income funds recorded the highest net subscriptions (€3.39 billion in the six month period), following inflows of funds in this category of over €3.7 billion between January and March. International equity funds saw net subscriptions of €1.38 billion, due at least in part to the additions to this category (see Tables 10 and 11).

The fund portfolio posted negative returns in the first quarter and positive returns in the second for all categories. Categories with a higher equity component showed the worst performance.

The return on the fund portfolio in the first half of 2020 was negative in all categories except for guaranteed fixed income, with a return of 0.25%. Returns were negative in all categories in the first quarter and positive in the second. The pure equity categories registered the worst performance in the six-month period due to the falls in quoted prices experienced during the period: -19.94% in the euro equity category and -10.47% in global equities (-28.48% and -23.11% in the first quarter). Mixed fund categories marked a slightly less negative performance: -5.24% for mixed equity and -6.59% for global funds.

The number of funds declined further between January and June of this year to stand at 1,692, driven by the losses in guaranteed equity funds, passive management and global funds. In contrast, the number of international equity funds increased.

The number of funds continued to decline in the first half of the year, with 18 fewer institutions, to stand at 1,692. This marks the continuation of a trend that began in 2013, although the rate of decrease is currently slower. Guaranteed equity funds saw the largest fall, in line with the trend marked in recent years, with 10 fewer vehicles, followed by the passive management and global fund categories, which lost eight funds each. In contrast, the large numbers of subscriptions to international equity funds in recent years took place alongside an increase in the number of vehicles, with 12 new institutions.

Investment funds. Key figures*

TABLE 11

	2017	2018	2019	1H2020	2019 III	2019 IV	2020 I	2020 II
Total investment funds (number)	**1,741**	**1,725**	**1,710**	**1,692**	**1,723**	**1,710**	**1,697**	**1,692**
Fixed income[1]	290	279	281	283	283	281	283	283
Mixed fixed income[2]	155	168	173	175	171	173	173	175
Mixed equity[3]	176	184	185	186	186	185	187	186
Euro equity[4]	111	113	113	110	113	113	112	110
International equity[5]	211	236	263	275	257	263	272	275
Guaranteed fixed income	79	67	66	63	66	66	66	63
Guaranteed equity[6]	188	163	155	145	159	155	147	145
Global funds	225	242	255	247	252	255	254	247
Passive management[7]	202	172	133	125	148	133	119	125
Absolute return	104	99	84	81	86	84	82	81
Assets (millions of euros)								
Total investment funds	**265,194.8**	**259,095.0**	**279,377.4**	**263,619.4**	**273,100.7**	**279,377.4**	**250,126.3**	**263,619.4**
Fixed income[1]	70,563.9	66,889.3	78,583.2	76,179.4	77,871.1	78,583.2	73,475.8	76,179.4
Mixed fixed income[2]	43,407.0	40,471.0	40,819.9	42,581.8	38,959.2	40,819.9	41,312.7	42,581.8
Mixed equity[3]	22,386.7	23,256.0	28,775.8	27,511.7	27,613.4	28,775.8	25,829.7	27,511.7
Euro equity[4]	12,203.2	12,177.7	10,145.1	7,027.7	10,034.3	10,145.1	6,618.2	7,027.7
International equity[5]	24,064.6	24,404.9	34,078.9	31,757.0	30,447.0	34,078.9	27,636.0	31,757.0
Guaranteed fixed income	5,456.7	4,887.4	4,809.3	4,517.4	5,143.1	4,809.3	4,505.2	4,517.4
Guaranteed equity[6]	15,417.5	14,556.0	13,229.1	11,626.5	14,395.0	13,229.1	11,684.0	11,626.5
Global funds	35,511.5	42,137.2	43,041.9	39,071.8	41,702.5	43,041.9	37,120.7	39,071.8
Passive management[7]	19,477.8	16,138.6	14,073.8	13,054.6	15,355.0	14,073.8	11,708.7	13,054.6
Absolute return	16,705.9	14,172.5	11,818.3	10,289.6	11,577.6	11,818.3	10,233.0	10,289.6
Unitholders								
Total investment funds	**10,287,454**	**11,217,569**	**11,739,183**	**11,944,057**	**11,227,036**	**11,739,183**	**11,751,437**	**11,944,057**
Fixed income[1]	2,627,547	2,709,547	3,668,324	3,793,867	3,376,056	3,668,324	3,660,775	3,793,867
Mixed fixed income[2]	1,197,523	1,188,157	1,087,881	1,204,871	1,044,836	1,087,881	1,203,900	1,204,871
Mixed equity[3]	584,408	624,290	707,159	715,404	695,444	707,159	707,919	715,404
Euro equity[4]	710,928	831,115	598,901	500,778	553,832	598,901	532,060	500,778
International equity[5]	1,865,367	2,225,366	2,655,123	2,775,877	2,512,222	2,655,123	2,732,902	2,775,877
Guaranteed fixed income	190,075	165,913	154,980	145,787	161,392	154,980	148,317	145,787
Guaranteed equity[6]	527,533	494,660	428,470	383,372	461,897	428,470	391,235	383,372
Global funds	1,086,937	1,501,730	1,359,915	1,376,316	1,291,172	1,359,915	1,355,885	1,376,316
Passive management[7]	638,966	543,192	429,428	435,035	474,947	429,428	396,398	435,035
Absolute return	858,170	930,641	646,042	609,793	652,278	646,042	619,085	609,793
Return[8] (%)								
Total investment funds	**2.42**	**-4.89**	**7.12**	**-4.26**	**0.71**	**1.57**	**-9.30**	**5.56**
Fixed income[1]	-0.13	-1.44	1.38	-0.65	0.42	-0.26	-2.43	1.82
Mixed fixed income[2]	1.10	-4.27	4.75	-3.29	0.69	0.59	-6.97	3.96
Mixed equity[3]	3.23	-6.45	9.25	-5.24	0.97	1.68	-11.06	6.54
Euro equity[4]	11.16	-13.01	14.27	-19.94	-1.13	5.95	-28.48	11.94
International equity[5]	8.75	-12.34	22.18	-10.48	1.37	6.91	-23.11	16.43
Guaranteed fixed income	0.72	0.09	3.98	0.25	1.39	-1.07	-0.94	1.20
Guaranteed equity[6]	1.61	-1.33	3.62	-0.54	1.42	-0.63	-1.86	1.35
Global funds	4.46	-5.69	8.45	-6.59	0.77	2.04	-12.00	6.15
Passive management[7]	2.13	-3.16	7.45	-4.26	0.96	1.28	-9.29	5.54
Absolute return	1.44	-4.81	3.94	-3.19	0.35	0.75	-7.50	4.66

Source: CNMV. * Information on funds that have submitted confidential statements (does not therefore include funds in the process of dissolution or liquidation).

1 Until I-19 it includes the following categories (CNMV Circular 3/2011): euro fixed income, global fixed income, money market and short-term money market. From II-19 onwards it includes the following categories (Circular 1/2019): short-term public debt constant net asset value MMF, short-term low volatility net asset value MMF, short-term variable net asset value MMF, standard variable net asset value MMF, euro fixed income and short-term euro fixed income.

2 It includes euro mixed fixed income and global mixed fixed income.

3 It includes euro mixed equity and global mixed equity.

4 It includes: euro equity.

5 It includes: global equities.

6 It includes: guaranteed equity and partial guarantee.

7 Until I-19 it includes passively managed CIS (CNMV Circular 3/2011). From II-19 onwards it includes the following categories (Circular 1/2019): passively managed CIS, CIS that replicate an index and CIS with a specific non-guaranteed target return.

8 Annual return for 2017, 2018 and 2019. Quarterly return not annualised for quarterly data.

The number of unitholders exceeded 11.9 million at the end of the six-month period, increasing particularly in the categories in which the number of funds increased.

Unlike the trend in assets and the number of funds, the number of unitholders grew by 1.7% between January and June, making a total of 11.9 million at the end of the six-month period. It should be noted that the same unitholder is counted for each contract held in different funds, so that the registered increase could be partially explained by diversification into a greater number of funds. The fixed income and international equity fund categories saw the largest increases in unitholders (125,000 and 121,000, respectively), followed by mixed fixed income funds, with 117,000 more unitholders, in all cases in line with the increase in the number of funds. In contrast, the number of unitholders in the euro equity, absolute return and guaranteed equity fund categories decreased (by 98,000, 36,000 and 54,000, respectively).

In July 2020, assets and the number of unitholders both increased, while the number of funds decreased by 24.

According to provisional data for July, the main figures for investment funds are slightly positive, continuing the recovery observed in the second quarter. Investment fund assets grew by 0.58% to over €265 billion at the end of July and the number of unitholders rose by 2.24%, to stand at 12.21 million. Meanwhile, the number of funds fell substantially, with 24 fewer vehicles.

The percentage of assets with reduced liquidity in the private fixed income portfolios of investment funds fell significantly during the first half of 2020, reaching their lowest levels of recent years…

In terms of liquidity conditions, the weight of assets with reduced liquidity, which had fluctuated between 7% and 9% of the private fixed income portfolio of investment funds for several years, decreased in June to 5.1% of the portfolio. At the end of the first half of the year, the total volume of assets considered to be of reduced liquidity was €2.79 billion, representing 1.1% of total assets under management.

… with decreases in all fixed income asset categories.

Looking at the different categories of fixed income assets, a slight decrease in the weight of assets with reduced liquidity can be observed across the board in the whole six-month period (see Table 12). The largest decline in the weight of assets with reduced liquidity took place in the category of fixed income assets rated below AA, in absolute terms (€666 million from December 2019 to June 2020), falling from 6.7% of the portfolio of these assets to 4.3%. The securitisation category continued to account for the largest share of assets with reduced liquidity, although it also declined to 63.9%. These assets, however, have very little weight in fund portfolios.

Estimated liquidity of IF assets

TABLE 12

	Reduced liquidity investments[1]					
	Millions of euros			% of total volume of asset type		
Asset type	**Dec-19**	**Mar-20**	**Jun-20**	**Dec-19**	**Mar-20**	**Jun-20**
Financial fixed income with AAA/AA rating	72	11	6	5.6	1.2	0.6
Financial fixed income with a rating below AA	1,844	1,395	1,178	6.7	5.3	4.3
Non-financial fixed income	1,339	1,115	1,146	6.2	5.1	4.5
Securitisations (asset-backed securities)	630	483	455	75.1	66.0	63.6
AAA securitisations	14	13	140	35.6	34.3	83.9
Other securitisations	616	470	315	77.0	67.7	57.4
Total	**3,885**	**3,003**	**2,785**	**7.6**	**6.0**	**5.1**
% of IF assets	**1.39**	**1.20**	**1.06**	**–**	**–**	**–**

Source: CNMV.

1 Reduced liquidity assets are considered to be private sector fixed income assets with a maturity greater than one year for which there is no representative number of intermediaries willing to buy and sell them with a normal market spread.

Open-ended collective investment schemes (SICAV)

As in the last four years, the number of SICAVs registered with the CNMV decreased in the first half of 2020, with 52 deregistrations in the six month period and only one registration. Thus at the end of June there were a total of 2,518 registered SICAVs compared with 2,569 in December 2019 and 3,368 in 2016. Most of the deregistrations (37) were the result of liquidation processes, six were absorbed in merger processes, one was withdrawn and eight were transformed into other types of entities, six into S.Ls (private limited liability companies) and two into S.As (public limited companies). The decrease in the number of entities was also reflected in the number of shareholders, which dropped by 3.3% to 385,359. Virtually all SICAVs (over 99% of the total), were listed on the Alternative Stock Market (MAB).

The number of SICAVs registered with the CNMV declined further between January and June 2020, with 52 deregistrations and only one registration, to stand at 2,518…

The assets of these CIS reduced by 8.9%, from €28.79 billion at year-end 2019 to €26.23 billion at the end of June 2020. 2.7 pp of the decrease was due to share buybacks made by SICAVs themselves and by the SICAVs that had been deregistered, while most of it, the remaining 6.2 pp, was due to the negative performance of the vehicles, which tracked the performance of the financial markets. Average assets per SICAV decreased from €11.2 million in 2019 to €10.4 million in the first half of 2020.

… which, together with their weaker performance, led to a decrease in assets of 8.9%.

Hedge funds

Hedge funds continue to have a very low weight in collective investment in Spain as they account for less than 1% of total assets. This collective investment segment consists of two types of vehicles, depending on whether they invest in assets directly (hedge funds) or through other hedge funds (funds of hedge funds). In both cases, the vehicles can be set up as funds or as companies.

Hedge funds, which continue to have a very low weight in collective investment in Spain…

Aggregate assets of these institutions declined by 4.1% during the first five months of the year, to stand at €3.26 billion at the end of May. Hedge funds saw a decrease of 4.7%, to €2.7 billion, while funds of hedge funds marked a much smaller decline, with assets down by just over €7 million to stand at €460 million.

… saw a 4.1% decrease in assets between January and May, mainly in the pure hedge fund segment.

Trends in portfolio returns were in line with the performance of the markets, especially the equity markets, and were positive for all categories: while hedge funds posted a return of -8.2% to May, funds of hedge funds showed a return of -1.1%. As in investment funds, the better performance in the second quarter of the year (April and May in this case) did not offset the larger losses seen in the first 3 months.

Trends in portfolio returns were negative, in line with the fall in the prices of equity assets.

The total number of these vehicles registered with the CNMV in June 2020 was 72, three more than at the end of 2019. Table 13 reflects how this increase occurred in hedge funds (from 62 to 65, with five registrations and two deregistrations – all hedge funds), while funds of hedge funds remained unchanged at seven (constant since 2018). Of the latter, six have the legal form of a fund (three of which have been in liquidation for more than four years), and one is set up as a corporate enterprise. In May, this company had equity of €271.1 million, an amount similar to that of all six funds of hedge funds.

The number of entities at the end of June was 72, three more than in December 2019, with five registrations and two deregistrations of pure hedge funds. There were no movements in the other entities.

The number of unitholders and shareholders increased by 4.8% (due to registrations in the pure hedge funds category).

Despite the decrease in assets, the total number of unitholders and shareholders of these institutions increased by 4.8% in the first five months of 2020, with a total of 10,910 at the end of May. This increase was seen entirely in the hedge funds sub-segment, which marked a rise of 6.7%, to 8,053, since in the funds of hedge funds segment there was virtually no movement, ending May with 2,857 unitholders (2 fewer than in December). These movements are almost completely due to the three registrations (net) in the hedge funds segment.

Key figures of hedge funds and funds of hedge funds TABLE 13

					2019		2020	
	2017	2018	2019	1H2020	III	IV	I	II[1]
FUNDS OF HEDGE FUNDS								
Number	8	7	7	7	7	7	7	7
Unitholders	3,596	2,804	2,859	2,857	2,861	2,859	2,855	2,857
Assets (millions of euros)	468.7	468.8	565.9	559.9	562.4	566.7	546.8	559.9
Return (%)	-1.66	-1.28	5.07	-1.10	1.10	0.83	-3.49	2.48
HEDGE FUNDS								
Number	47	49	62	65	58	62	62	65
Unitholders	3,656	4,444	7,548	8,053	6,451	7,548	8,025	8,053
Assets (millions of euros)	2,298.2	2,262.2	2,832.4	2,700.1	2,467.1	2,832.4	2,523.3	2,700.1
Return (%)	7.84	-6.47	10.35	-8.23	0.22	3.94	-13.75	6.40

Source: CNMV.

1 Data until May, except the number of entities which is until June.

Real estate CIS

Despite the improvement of the construction and real estate sector, the figures for real estate CIS continued to decline due to the transfer of business to SOCIMIs.

The construction and real estate sectors were two of the most affected by the financial crisis that began in 2008, which caused real estate collective investment schemes to decline steadily and significantly. However, despite the improvement seen in this sector since 2015, the key figures for real estate CIS continued to perform negatively. One of the main reasons is that real estate investment in Spain is being channelled mainly through SOCIMIs[41] (listed real estate investment companies, similar to REITs). These entities are listed in a specific segment of the BME Growth market (formerly MAB), which has been extremely buoyant throughout the last three or four years, and appears to be stabilising: at the end of June there were a total of 77 registered SOCIMIs, the same figure as at the end of 2019.

Real estate investment funds have marked the worst performance, with only two left since 2018, both of which are in the process of liquidation.

In contrast, real estate investment funds have seen large numbers of redemptions in recent years, leading them to start liquidation processes, with their consequent deregistration in most cases. Thus, from a high of ten real estate investment funds in mid-2007, with assets of around €9 billion, these had declined to just two (both in the process of liquidation) at the end of 2018, which were still registered in the

41 SOCIMIs are listed public companies whose corporate object, like that of real estate funds and companies, is either investment in real estate for subsequent lease or indirect investment through the purchase of shares or equity stakes in other SOCIMIs or similar foreign entities (REITs).

CNMV in mid-2020, with figures remaining very stable since then. At 30 June 2020, these two funds had assets of €310 million and 483 unitholders.

Unlike real estate investment funds, real estate investment companies saw a rise in assets in the first six months of 2020, as they had in previous years, of 17.3%, to €897.2 million, although this volume is not significant for Spanish CIS a whole. Around two thirds of this increase was due to the positive returns obtained during the period,[42] while the remaining third was due to net subscriptions made by unitholders. There were still three real estate investment companies in the first half of this year, one of which was in the process of liquidation.

However, real estate investment companies also saw a significant rise in assets (17.3%), although this volume is not significant for Spanish CIS a whole.

Foreign CIS marketed in Spain

The volume of foreign CIS marketed in Spain dropped slightly between January and June this year, for the first time since these vehicles were first registered with the CNMV. Between 2008 and 2019 they increased tenfold, from €18 billion to nearly €180 billion. However, falls took place only in the first quarter of the year, when assets decreased by 6.2%, and part of this loss was recovered in the second quarter, with a rise 2.4%, to stand at €171.88 billion. This decline in the first 3 months was partly the consequence of the poor performance of the financial markets, especially the equity markets.

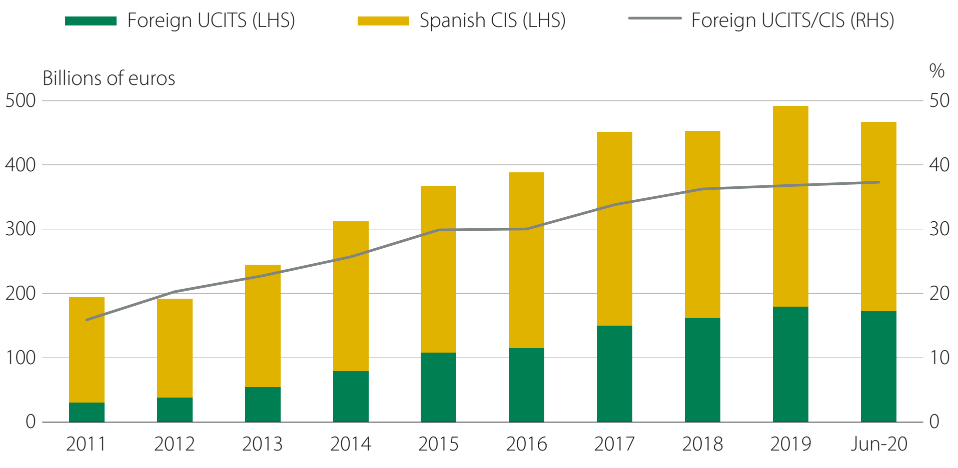
Assets of foreign CIS fell by 3.9% in the first half of the year, after several years of uninterrupted growth…

As shown in Figure 20, the strong growth rate marked in recent years led to a sharp increase in the weight of foreign CIS in total CIS marketed in Spain, moving from around 10% at the beginning of the financial crisis to over 36% in 2019. In the early months of 2020, despite the drop in investment volumes, this percentage increased slightly to 36.9%, as the drop in the assets of Spanish CIS was larger than in those of foreign CIS.

… although in percentage terms there was a slight increase in the weight of these institutions as a portion of total assets of CIS marketed in Spain, to 36.9%.

Assets of foreign CIS marketed in Spain[1]

FIGURE 20



Source: CNMV.

1 With the entry into force of CNMV Circular 2/2017, of 25 October, the number of entities required to submit statistical information has increased and therefore the data may not be comparable with the information published up to December 2017.

42 More than half of the gains on the portfolios of real estate investment companies was due the returns of a single entity, which were obtained mainly from the share premium in a capital increase.

The number of foreign CIS registered with the CNMV increased by nine in January-June 2020, to a total of 1,042 vehicles (402 funds and 633 companies).

In line with the trend of recent years, the number of foreign CIS registered with the CNMV grew by nine in the first half of 2020, to close the period with a total of 1,042 undertakings of this type (402 funds and 633 companies). This increase occurred both in investment companies, with six more institutions, and funds, with three more, after the latter had fallen significantly in 2019 (30 fewer). By country of origin, as in previous years, most of the registrations corresponded to vehicles from Luxembourg, with seven more, up to 469, while in other jurisdictions there was hardly any movement.

Outlook

Although figures for CIS have stabilised and are even showing some growth, after the tensions in March, the medium-term outlook is uncertain.

Although most recent available data appear to indicate that the collective investment industry has stabilised since the turbulence experienced in March, and some of its key figures show growth, it is reasonable to assume that the short- and medium-term outlook will be somewhat uncertain. This is due to not knowing how the pandemic will develop, whether the continuously changing measures being implemented will work, and ultimately its impact on the real economy. Further economic slowdown could translate into a need for liquidity among the more financially vulnerable households, with the consequent divestment of assets, including investment funds. Precautionary saving among households is also increasing: in the second quarter of the year the rate of saving stood at 31.1% of gross disposable income and at 11.2% on an annualised basis, which could prompt further acquisitions of financial assets. The net balance of the two effects is difficult to forecast at this time.

4.2 Provision of investment services

The provision of investment services can be carried out by various types of entities, mainly credit institutions, which receive almost 90% of the income generated by this business.

Credit institutions are the main providers of investment services and they are where most of the income generated by this activity is concentrated. Based on data from year-end 2019, credit institutions receive around 90% of their total fees from the provision of investment services. This percentage has increased in recent years partly as a result of the absorption by several banking entities of broker-dealers and brokers that belonged to the same banking group.

Broker-dealers and brokers are second in the ranking, followed by financial advisory firms and portfolio management companies, that perform specific services.

Broker-dealers and brokers still account for a fairly substantial weight, especially in the transmission and execution of orders, which, as described later in this section, represent more than 90% of their fee income, even though they offer a wide range of services. In addition to these entities, financial advisory firms and portfolio management companies (EAF and SGC in the respective Spanish abbreviations) provide specific investment services.

The CNMV supervises broker-dealers and brokers, financial advisory firms and portfolio management companies. For credit institutions authorised to provide investment services, the CNMV only supervises their compliance with the rules of conduct.

Entities in this sector, the prudential and regulatory supervision of which is carried out by the CNMV, are broker-dealers and brokers, portfolio management companies and financial advisory firms. For credit institutions that are authorised to provide investment services, the CNMV also performs supervisory work regarding compliance with the rules of conduct in the market and in relation to clients. In this section we look closely at the performance of the activity in the sector and the economic and financial situation of the entities. As different entities report information to the CNMV at different times, in the reports for the first quarter of the year, which contain data from the end of the previous year, an analysis of all institutions is made,[43] while reports for the third quarter assess the performance of broker-dealers and brokers in the first half of the year. Therefore, this document presents the results of broker-dealers and brokers for January-June 2020.

In 2019, credit institutions authorised by the CNMV received fees of €3.81 billion for the provision of securities services and the marketing of CIS, 2.1% less than in 2018.

It should be noted that in 2019, there were 112 credit institutions registered with the CNMV to provide investment services. Likewise, the aggregate fees received for the provision of securities services and marketing of CIS stood at €3.81 billion (2.1% less than in 2018), of which €1.58 billion corresponded to the provision of investment services, a rise of 4.8% compared with the previous year. The financial advisory firms sector saw a contraction in 2019, due to the decrease in the number of companies, which went from 158 to 140 in one year, and to the 32.4% fall in the volume of assets under advisory services, to stand at €21.39 billion. This asset management service resulted in fee income of €56 million.

An analysis of the entities that provide investment services according to their business model reveals that 70% of the income related to this activity is received by traditional commercial banks or their group companies.

As explained in the report published in the first half, the information usually submitted on the provision of investment services in Spain will vary according to the type of entity providing the service. However, from a less formal point of view (according to the business model), based on 2019 figures it is estimated that just over 70% of the business relating to the provision of investment services in Spain (including the management of CIS and measured through fee income) is performed by traditional commercial banks or their group companies, while the remainder is performed by financial institutions specialising in the provision of investment services and with no links to the commercial banks.

Broker-dealers and brokers

In the first half of 2020, broker-dealers and brokers saw an increase in activity: aggregate profit before tax came to €110 million, four times the figure obtained in the same period of 2019.

In the first half of 2020, the activity of broker-dealers and brokers increased significantly, apparently bucking the downward trend seen in recent years which was due both to increasing competition from credit institutions in the provision of financial services and to the loss of part of the trading of Spanish stock exchanges to other trading venues abroad. Aggregate profit before tax came to around €110 million in the first six months of 2020 compared with just over €24.6 million in the same period of the previous year. However, two factors must be taken into account in assessing this significant increase. Firstly, these are profits for the first half of the year only, so it would be necessary to wait for full year figures to confirm whether there is a change in trend, or whether on the contrary the results are due to one-off factors associated, for instance, with the pandemic. Secondly, the results are influenced by the strong performance of one broker-dealer which transferred part of its business (mainly processing and execution of customer orders) to Spain because of Brexit.

Performance was uneven among entities, with broker-dealers seeing increased profits, while brokers reported falls.

Profit increased only in broker-dealers, while brokers went from reporting an aggregate profit in the first half of 2019 to losses in the same period of 2020. More than half of this loss was due to a single entity, Esfera Capital, Agencia de Valores, S.A., which the CNMV decided to place in administration ("intervención") in March, after the entity itself reported an equity mismatch deriving from an incident related to

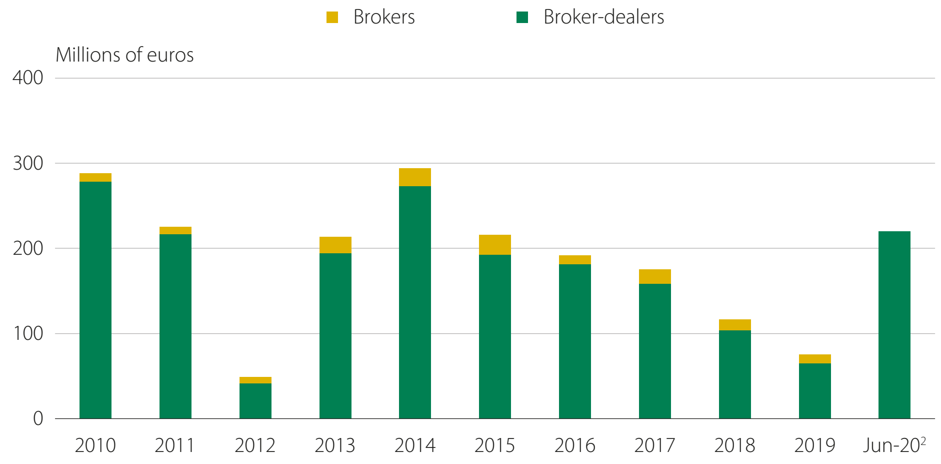
43 There is no sub-heading for portfolio companies, a sub-sector that currently has only one registered, as this segment is insignificant compared with the others.

the management of the derivatives positions of a small number of clients. The entity is currently in the process of liquidation.

At the end of June, a total of 93 broker-dealers and brokers were registered with the CNMV, two fewer than at the end of 2019.

At the end of June 2020, a total of 93 broker-dealers and brokers were registered with the CNMV, two fewer than at the end of 2019, following four registrations and six deregistrations. Two of the registrations corresponded to the creation of new entities (a broker-dealer and a broker), and the other two were entities created following the transformation of another type of vehicle.[44] Four of the six deregistrations were due to absorption by a bank that was already the sole shareholder of the entity (in all cases). After the lengthy and far-reaching adjustment process that began with the financial crisis was interrupted in 2019, another adjustment process deriving from the current crisis cannot be ruled out.

Aggregate profit (loss) of investment firms before tax[1] FIGURE 21



Source: CNMV.

1 Except financial advisory firms and portfolio management companies.

2 Annualised data.

Most Spanish entities that provide services in the rest of the European Union do so under the freedom to provide services regime (50) and only 6 operate through branches.

As in previous years, the number of foreign entities that provide investment services in Spain grew in the first six months of 2020, both under the freedom to provide services regime, which increased from 3,020 to 3,036, and through branches, from 65 to 66 (about half of these were based in the United Kingdom). Further, and as usual, most Spanish entities that provided services in the rest of the European Union did so under the freedom to provide services regime, specifically 50, and only 6 maintained branches in other countries, in both cases the same figure as at year-end 2019.

Broker-dealers reported a significant increase in profits to €110 million driven in particular by income from financial investments and fees received.

As seen in Table 14, broker-dealers saw an increase in aggregate profit before tax of nearly €97 million, to €110 million, in the first half of the year. As mentioned above, this was largely due to the contribution of one single entity, although several companies reported strong profit growth. In fact, around 60% of the entities belonging to this sector reported an increase in profits. In aggregate terms, all items contributed to this performance, but more particularly financial investments, which grew by more

44 Specifically, one entity that had previously been a financial advisory firm was registered as a broker and one broker changed its legal status to that of broker-dealer.

than 300% to over €70 million, and net fees, which amounted to over €140 million, €22 million more than in January-June 2019. The rise in net fees was due to the greater increase in fees received (€62 million) than in fees paid (€40 million; see Table 14).

Within revenues from the provision of services to third parties, fees for processing and executing orders accounted for most of the increase, growing by 83.2% compared with the first half of 2019, to over €120 million. Most of this increase was due to the contribution of the company referred to above which transferred part of its activity to Spain because of Brexit. Without the contribution of this company, fees would also have increased, albeit much more moderately (18.3%). Fees received from all other activities registered decreases, of varying degrees, with the drop in fees for investment advisory services standing out (down by 63%, after posting strong growth in 2019, when they doubled). Fees paid increased substantially, specifically by 60.9%, to €106 million.

Fees for processing and executing orders drove the overall increase, growing by 83.2% to €120 million.

Aggregate profit and loss account (Jun-20)

TABLE 14

Thousands of euros

	Broker-dealers			Brokers		
	Jun-19	Jun-20	% change	Jun-19	Jun-20	% change
1. Net interest income	12,446	12,589	1.1	609	551	-9.5
2. Net fees	118,404	140,318	18.5	58,008	65,697	13.3
2.1. Fees received	184,559	246,775	33.7	66,889	75,912	13.5
2.1.1. Processing and execution of orders	65,962	120,852	83.2	11,788	14,004	18.8
2.1.2. Issue placement and underwriting	2,153	1,270	-41.0	208	1,172	463.5
2.1.3. Deposit and book-entry of securities	22,946	21,646	-5.7	421	417	-1.0
2.1.4. Portfolio management	6,163	5,513	-10.5	6,462	6,648	2.9
2.1.5. Investment advice	7,599	2,809	-63.0	6,738	10,948	62.5
2.1.6. Search and placement of packages	16	358	2,137.5	0	0	-
2.1.7. Market credit transactions	0	0	-	0	0	-
2.1.8. Marketing of CIS	27,276	24,390	-10.6	29,171	29,299	0.4
2.1.9. Other	52,444	69,936	33.4	12,102	13,423	10.9
2.2. Fees paid	66,155	106,457	60.9	8,881	10,215	15.0
3. Gains/(losses) on financial investments	17,277	70,866	310.2	738	-6,788	-
4. Net exchange differences	-79	8,055	-	25	-13	-
5. Other operating income and expense	15,570	43,893	181.9	266	-403	-
GROSS MARGIN	**163,618**	**275,721**	**68.5**	**59,646**	**59,044**	**-1.0**
6. Operating expenses	144,913	163,336	12.7	52,294	61,153	16.9
7. Depreciation, amortisation and other charges	2,239	5,116	128.5	309	1,490	382.2
8. Net losses due to impairment of financial assets	248	-468	-	-28	4	-
OPERATING PROFIT/(LOSS)	**16,219**	**107,737**	**564.3**	**7,071**	**-3,604**	**-**
9. Other gains and losses	1,038	2,315	123.0	343	3,467	910.8
PROFIT/(LOSS) BEFORE TAX	**17,257**	**110,052**	**537.7**	**7,414**	**-137**	**-**
10. Income tax	-922	13,523	-	1,010	1,410	39.6
PROFIT/(LOSS) FROM CONTINUING OPERATIONS	**18,179**	**96,529**	**431.0**	**6,404**	**-1,547**	**-**
11. Profit/(loss) from discontinued operations	0	0	-	0	0	-
NET PROFIT/(LOSS) FOR THE YEAR	**18,179**	**96,529**	**431.0**	**6,404**	**-1,547**	**-**

Source: CNMV.

As in previous years, a small number of companies generated most of the profits in this sector.

On the other hand, broker-dealers' operating expenses increased by 12.7%, with the two sub-headings of this item both growing, particularly personnel expenses, which increased by 15.3%. The lower increase in expenses compared with revenues led to a significant rise in operating income, which grew fivefold from €16.2 million in the first half of 2019 to €107.7 million in the same period of 2020. Profit before tax rose by a similar percentage to €110 million due to "other income" of €2.3 million. As in recent years, a small number of companies generated most of the profits in this sub-sector, a trend that has also been increasing. Specifically, only two broker-dealers accounted for 43.5% of the total profits of companies reporting a profit, while four accounted for 68.5%.

Brokers, which cannot carry out investment activities on their own account, and which in recent years have tended to specialise in investment services other than processing and executing orders…

Broker-dealers receive income mainly from the provision of services to third parties, since they cannot carry out investment activities on their own account. Some brokers derive the bulk of their income from order processing and execution, a percentage that has reduced over the years, but most of them have tended to specialise in certain services such as marketing CIS or portfolio management. Independent entities predominate in this sub-sector (52 out of a total of 55, two more than in December 2019).

… posted profit before tax of €5.9 million, 21% less than in the first half of 2019 (excluding one entity in the process of liquidation).

Brokers' aggregate pre-tax profits fell into negative territory, to a total of €0.13 million. The deterioration was almost entirely due to one broker, Esfera Capital, Agencia de Valores, SA., which recorded losses of €6 million and which, as already mentioned, is in the process of liquidation. Excluding this entity, profit would still have decreased by 21.0%, but there would have been a profit before tax of €5.9 million. This decline of around €1.5 million was due to the rise in costs exceeding the increase in income.

Fee income increased as a whole by 14.2%, to €75 million.

Due to the potential distortion caused by the entity in the process of liquidation, its figures have been excluded in the analysis of the profit and loss account. Under fee income, which grew by 14.2% overall to more than €75 million, the most notable increases were in income from the processing and execution of orders (23.6%) and from fees for investment advice (62.5%), although admittedly the latter had fallen significantly in 2019. The remaining fee categories did not show large variations: fees from the marketing of CIS, for example, the largest category, hardly grew at all (0.4%).

The higher increase in operating expenses compared with fee income brought the net operating profit down to €2.5 million.

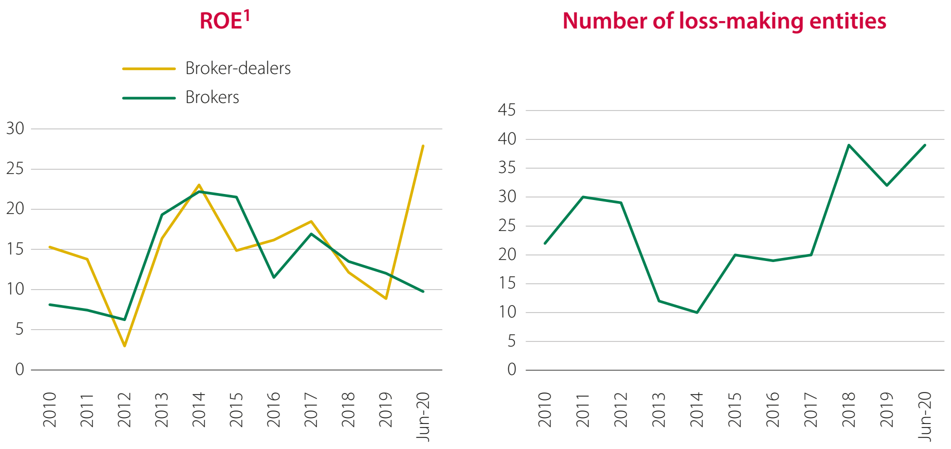
The increase in brokers' fee income occurred in parallel with the rise in fees paid to third parties, which grew by 15.3%. As a consequence of the performance of fee income, the aggregate gross margin increased by 9.6% to €64.8 million. Meanwhile, operating expenses increased by 17.3% compared with the same period in 2019, with personnel expenses up by 20.3%. The combination of lower income growth compared with the increase in operating expenses brought net operating profit to €2.5 million, a decrease of almost €4.5 million compared with January-June 2019.

The higher profits reported by investment firms led to a notable rise in ROE.

The pre-tax return on equity (ROE) of the sector marked a substantial increase during the first half of the year, from 9.2% to 25.5%, driven by the strong earnings trend. As occurred with profits, the increase in ROE applied only to broker-dealers (up almost 20 pp, to 27.9%). Brokers saw a decline in ROE from 12.1% to 9.8%[45] (see left hand panel of Figure 22).

45 Excluding the entity in the process of liquidation.

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



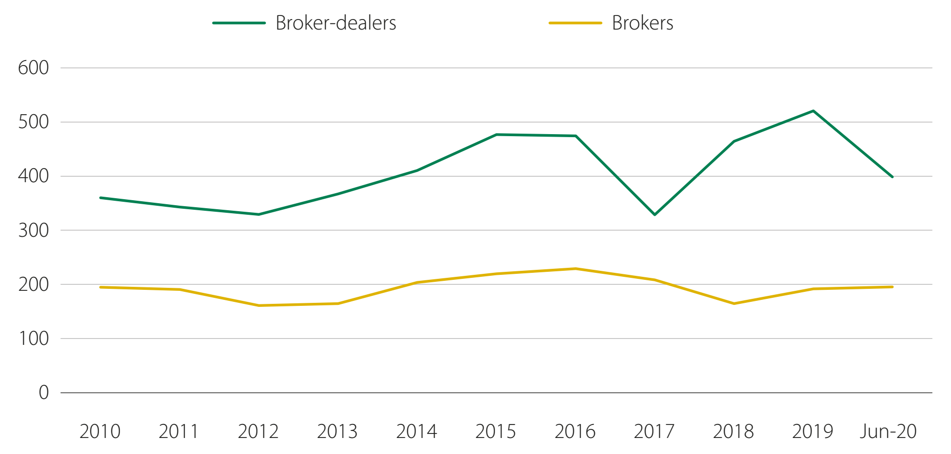
Source: CNMV.

1 ROE calculated using profit before tax.

The increase in the sector's profits did not prevent a decrease in the number of loss-making entities. In June 2020, 15 broker-dealers and 24 brokers reported negative pre-tax earnings, two and five more, respectively, than at the end of 2019. Accumulated losses practically halved for broker-dealers, to €12.8 million, and tripled for brokers, to €14.2 million. As a reminder, one single broker posted losses of €6 million.

The increase in sector profits was accompanied by a rise in the number of loss-making entities, although the volume of losses reported by broker-dealers was halved.

Capital adequacy of investment firms (capital surplus vs requirements) FIGURE 23



Source: CNMV.

The sector as a whole continued to exhibit high relative solvency levels in the first half of 2020, despite the substantial fall seen from the end of the previous year: at the end of June the capital surplus was 3.8 times higher than the capital requirement compared with 4.9 at the end of 2019. In absolute terms, this buffer is too small to be significant. This margin was higher in broker-dealers than in brokers, as for the former the aggregate capital surplus was around 4.0 (5.2 in 2019), while for the latter it remained at 1.9, a value similar to the figure seen six months earlier (see Figure 23).

Solvency levels in the sector remained high in the first half of 2020 and higher for broker-dealers than brokers.

Outlook

The medium-term outlook for financial intermediaries is more uncertain in the context of the crisis triggered by the coronavirus, which could lead to a new restructuring process in the sector.

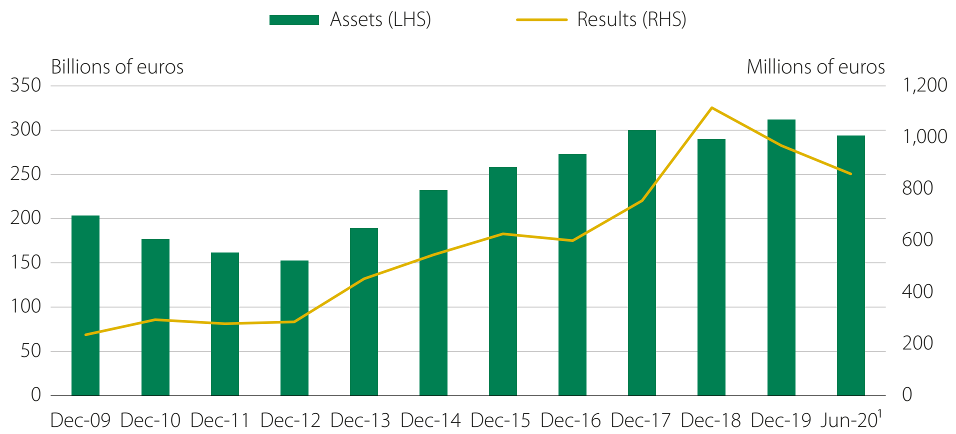
The outlook for non-bank financial intermediaries has been uncertain for several years due to two main factors. Firstly, there has been an increase in competition in the provision of investment services, which has led to a change in the business model of dealer-brokers and brokers, in that their main traditional business, intermediation in the securities markets, tends to have less and less weight, while marketing and management activities, and advisory services to third parties, are increasingly important. Secondly, the shift of some of the trading in Spanish securities to non-traditional trading venues has also influenced this reduction in fees from processing and executing orders. In addition to these factors, the crisis triggered by the coronavirus has raised even greater uncertainty for the sector in recent months. For the time being, based on first-half earnings, it would not appear that the situation of these entities has worsened, and in some cases and business segments it could even have had a favourable impact. However, it remains to be seen whether the crisis will lead to a restructuring process as occurred after the previous financial crisis, which resulted in a notable decrease in the number of entities.

4.3 CIS management companies

The number of CIS management companies remained largely unchanged in the first six months of the year, with one registration, while assets under management fell by 5.9%, to €294 billion.

At the end of the first half of 2020, there were a total of 124 CIS management companies registered with the CNMV, one more than at the end of 2019, after one registration and no deregistrations during the period. This 3-year upward trend has enabled the sector to return to figures seen prior to the restructuring process which lasted several years. The assets managed by these companies closed June with a decrease of 5.9%, to stand slightly below €294 billion, after a year of substantial growth (see Figure 24). Around 85% of this decrease originated in the transferable securities investment fund segment, where assets, as we have already seen, were negatively affected by the redemptions made in March and impairment of the investment portfolio.

CIS management companies: assets under management and profit before tax FIGURE 24



Source: CNMV.

1 Annualised data.

In line with the decrease in assets managed by these institutions, their aggregate profit before tax fell by 7.2% in the first half of the year compared with the same period in 2019, to €434.9 million (see Figure 24). This decline was due mainly to the fall in the main source of income of CIS management companies, namely CIS management fees, which in June accounted for 87% of total fees received by these entities. Income from these fees fell from €2.55 billion in the first half of 2019 to €2.44 billion in the same period of 2020 (in annualised terms), mainly due to the reduction in assets under management as the average CIS management fee was virtually unchanged (moving from 0.84% to 0.83%, see Table 15).

Profit of these entities fell by 7.2% in the first half of 2020 compared with the same period of the previous year, with CIS management fees – the main component – dropping to €2.44 billion.

Discretionary portfolio management and venture capital firm management are the next most important activities in generating revenue for CISMCs. In both cases, the fees received from these activities grew strongly, although they remain largely insignificant in relation to total fees received by these entities (6.9% and 2.2%, respectively). In the first half of 2020, portfolio management fees increased by 7.4%, to €97.8 million, while management fees received from venture capital entities were up by 29.5%, to €32.2 million.

Portfolio management and venture capital firms, which are the next most important activities in generating revenue for CIS management companies, grew strongly.

As shown in Table 15, the ratio between fee expenses for marketing funds and fee income from CIS management activities has remained stable in the last two years, after falling slightly for several years until 2017, and dropping very sharply in 2018. The drop in 2018 was the result of the entry into force of the MiFID II regulation, which imposes strict conditions on kickbacks of fees from the manager to the marketer, which are also subject to strict transparency requirements. The percentage of fees rebated to marketers fell from 64.6% of CIS management fees in 2012 to 50.9% in June 2020.

The percentage of CIS management fees rebated to marketers remained stable in the first half of the year, following a significant reduction in recent years, a trend that was accentuated after the entry into force of MiFID II.

The decline in aggregate profits was reflected in the aggregate return on equity (ROE), which fell from 88.0% in June 2019 to 79.4% in the same month of 2020. The number of loss-making companies increased from 26 to 37 and the volume of these losses went from €4.4 million to €5.6 million.

In line with the reduction in profits, return on equity (ROE) decreased to 79.4% and the number of loss-making entities increased to 37.

CIS management companies: assets under management, CIS management fees and average fee ratio

TABLE 15

Millions of euros

	Assets under management	Revenue from CIS management fees	Average CIS management fee (%)	Fee ratio (%)[1]
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	299,974	2,647	0.88	58.68
2018	290,364	2,649	0.91	51.24
2019	312,235	2,638	0.84	49.75
Jun-20[2]	293,968	2,441	0.83	50.95

Source: CNMV.

1 Ratio of fees paid for the marketing of funds to revenue from CIS management fees.

2 The data on fee income and the average management fee are annualised.

4.4 Other intermediaries: venture capital

The venture capital sector grew strongly in 2019…

In the first eight months of 2020, the expansion taking place in the venture capital sector in recent years continued, with large numbers of new vehicles registered with the CNMV. The number of registrations increased by 63 (55 investment vehicles and 8 management companies), with 80 registrations and 17 deregistrations.

… particularly affecting traditional venture capital undertakings, both funds and companies.

Traditional venture capital firms,[46] which still account for the largest number by far, saw 50 registrations and nine deregistrations, making for a total of 226 venture capital funds and 173 venture capital companies at the end of August. SME venture capital firms registered few movements between January and August, with only one registration and one deregistration, so there were still the same number of vehicles as at 31 December 2019: 10 funds and 19 companies . Five European venture capital funds (EuVECA) were registered, bringing the total to 25, and two of the five European social entrepreneurship funds (EuSEF) existing in 2019 were deregistered (the first was registered in 2018).[47]

Closed-ended collective investment entities, which enjoy high flexibility in their investment policy, also experienced a significant increase in the number of registered vehicles.

As in the previous two years, closed-ended collective investment schemes were also buoyant in the first eight months of 2020, with 13 registrations and only two deregistrations in the period. At 31 August, there were a total of 57 vehicles of this type, of which 29 were funds and 28 were companies. It should be mentioned that this type of collective investment scheme enjoys high flexibility both in its investment policy and in terms of compliance with investment ratios, which are more restrictive in the case of venture capital firms.

In 2019, the assets of the venture capital firms increased by 24.2%, to €13 billion (66% for funds and 34% for companies).

Throughout 2019, the assets of venture capital firms increased by 24.2%, reaching €13 billion. This growth was seen both in venture capital funds, with an increase in assets of 27.4% to €8.63 billion, and venture capital companies, with an increase in assets of 18.6% to €4.41 billion (see Table 16).

Investment in venture capital funds increased, particularly investment by public administrations and non-financial companies.

Venture capital funds (including traditional and newly created funds, in this case SME, European funds and European social enterprise funds) saw a slight change in the relative importance of investors in 2019 in favour of natural persons, in line with the trend observed in 2018. However, investors with the largest holdings were still foreign entities and the public administrations, with €1.30 billion and €1.29 billion respectively. These were followed by natural persons, who, as mentioned above, increased their investment to €1.13 billion (31.9% more than in 2018). Despite this increase, natural persons still have a minority holding in the assets of venture capital funds: 13.1% compared with 86.9% for legal persons. The investment made by non-financial companies also stands out (up by 44.2% to €1.09 billion).

46 Traditional firms are understood as being types of firms existing prior to the entry into force of Law 22/2014 of 12 November governing venture capital firms, other closed-ended collective investment schemes and closed-ended investment scheme management companies, amending Law 35/2003 of 4 November on Collective Investment Schemes.

47 EuVECA and EuSEF (FCRE and FESE respectively in Spanish) are entities governed by Regulations (EU) Nos. 345/2013 and 346/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds and European social entrepreneurship funds respectively.

Movements in the venture capital firm register in 2020 TABLE 16

	Situation at 31/12/2019	Registrations	Deregistrations	Situation at 31/08/2020
Entities				
Venture capital funds	210	21	5	226
SME venture capital funds	10	1	1	10
European venture capital funds (EuVECA)	20	5	0	25
European social entrepreneurship funds	5	0	2	3
Venture capital companies	148	29	4	173
SME venture capital companies	19	0	0	19
Total venture capital firms	**412**	**56**	**12**	**456**
Closed-ended collective investment funds	20	10	1	29
Closed-ended collective investment companies	26	3	1	28
Total closed-ended collective investment entities	**46**	**13**	**2**	**57**
Closed-ended investment scheme management companies (SGEIC)[1]	**106**	**11**	**3**	**114**

Source: CNMV.

1 This term now applies both to the old venture capital firm management companies (SGECR) and to the new closed-ended investment scheme management companies.

Venture capital companies specialising in SMEs also saw an increase in the relative importance of natural persons (66.5%, to €744 million), although they continued to hold a minority share of the capital, as for funds: 16.9% compared with 83.1% for legal persons. Non-financial companies and other financial companies remained the two largest types of investors, with a joint holding of 65.3% of the total capital of venture capital companies (58.7% in 2018), after increasing their investment by 26.1% and 38.6%, respectively.

Non-financial companies and other financial companies remained the two main types of investors in venture capital companies.

Preliminary data for the first half of 2020 provided by the Spanish Venture Capital & Private Equity Association (ASCRI) reflect a slowdown in investment volumes of 67%, to €1.43 billion. However, activity remained buoyant despite the current situation (344 transactions took place, a figure similar to the first half of 2019). The sharp drop in investment volumes was therefore due to the absence of megadeals (transactions of over €100 million). Most of the transactions (309) corresponded to investments of less than €5 million.

According to preliminary data from ASCRI, investment in the venture capital sector contracted by 67% in the first half of the year, due to the absence of megadeals. However, the number of transactions remained at figures similar to 2019.

International funds continued to show great interest in the Spanish market and accounted for 79 transactions for an amount of €993.4 million, representing 69.3% of the total investment volume. Private Spanish investors carried out 208 transactions, while Spanish public funds accounted for the remaining 57. In terms of the project development phase, investment in buy-outs should be highlighted,[48] accounting for just over 26% of the total volume invested (€375.4 million in 13 transactions).

By type of investor, the buoyant activity of international funds stood out, with 69.3% of the total volume invested, and by project development phase, venture capital accounted for 297 of the 344 transactions carried out in the period.

48 Leveraged transactions (investments in mature companies in which external debt is used, in addition to equity, to acquire stakes) whose investors belong to the company itself.

Venture capital (the seed and start-up phases), for its part, remained very active throughout the first six months of the year, accounting for 297 transactions, with an investment volume of €307.2 million. The volume of fundraising by private Spanish operators increased by 36.4%, to €990 million, compared with the same period of 2019, in most cases completing processes that had already started in that year.

Venture capital firms: assets by investor type TABLE 17

Millions of euros

	VC funds		VC companies	
	2018[1]	**2019[1]**	**2018[2]**	**2019[2]**
Natural persons				
Residents	813.26	1,074.54	399.51	738.79
Non-residents	41.81	53.56	47.57	5.45
Legal persons				
Banks	174.82	175.55	136.35	112.35
Savings banks	35.18	90.48	13.88	11.56
Pension funds	588.07	729.17	20.18	11.69
Insurance companies	437.11	613.43	87.20	85.15
Broker-dealers and brokers	7.34	0.63	0.06	0.00
Collective investment schemes	431.79	484.18	5.46	7.77
Spanish venture capital firms	289.58	301.20	29.81	42.45
Foreign venture capital firms	338.26	406.98	161.61	165.09
Public administration service	989.64	1,290.91	412.98	176.99
Sovereign wealth funds	12.47	3.42	6.08	4.90
Other financial companies	414.36	770.17	1,030.57	1,428.52
Non-financial companies	757.05	1,091.52	1,149.79	1,450.13
Foreign firms	1,138.30	1,302.00	62.41	56.08
Other	306.64	245.01	154.12	110.34
TOTAL	**6,777.93**	**8,632.75**	**3,717.58**	**4,407.26**

Source: CNMV.

1 Includes SME VC funds, EuVECA and EuSEF.

2 Includes SME VCFs.